

Trade and globalization

Canadian Engagement in the Global Economy

Michael Hart

Comments:

"Constructing Constructive Engagement"
Jonathan T. Fried

"Engage the United States, Forget the Rest?"
Keith Head

EXECUTIVE SUMMARY

In analyzing Canada's policy challenges with respect to trade and globalization, Michael Hart argues, "Canada's most basic economic interests have become inextricably bound up with those of the United States and can no longer be addressed multilaterally in the WTO." By securing and deepening North American integration, Canadian firms will gain access to global supply chains and be better able to meet the challenge of the rapidly growing Asian economies, making productive engagement with the US the "indispensable anchor of Canadian security and prosperity."

To reap the full benefits of deepening cross-border economic integration, Hart proposes that Canada and the United States engage in three fundamental and interrelated policy challenges: streamlining border administration; accelerating the pace of regulatory convergence; and building the necessary institutional capacity to implement the results of the first two undertakings.

Commentators Jonathan Fried and Keith Head questioned the wisdom of "putting all of our eggs in one basket" and maintained that high priority should also be assigned to non-US bilateral agreements and multilateral trade liberalization.

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SCOPE OF THE CHALLENGE

Canada faces a globalized market served by global supply chains in goods and services, within which an increasingly integrated North American economy has to compete.

Modern trade is “integrative” in the sense that countries no longer primarily trade finished goods. Supply chains have become fragmented across countries, with components coming from around the world. Thus the importance of trade to the economy can no longer be measured in terms of whether a country runs a trade surplus or deficit — it is more a function of the productivity gains that accrue with increased specialization. Specialization, in turn, increases as trade agreements expand access to markets.

The rapid rise in trade in the 1990s was in large part the result of this value-chain fragmentation — imported components replaced domestic components and finished products are exported to a broader market base. In a global economy, firms are less constrained in their choice of geographic location and seek to increase profitability by dispersing their value-adding activities across national boundaries. Governments now must compete for this increasingly mobile production capacity by removing barriers to foreign investment and enhancing the competitive environment.

Nowhere has the process of integration been more pronounced than between Canada and the US. Proximity, history, technology, opportunity and policy have combined to create deep and irreversible ties between Canadian and American production and consumption patterns. Bilateral Canada-US agreements have served to deepen the integration of the Canadian and US markets by accelerating the process of cross-border fragmentation and agglomeration.

High levels of both trade and foreign direct investment indicate continued integration of production between Canada and the US as well as a deepening interdependence between manufacturing and service industries. Hart shows that almost three-quarters of Canada's total trade is with the United

States, as well as half of its foreign investment. In an era of global supply chains, many of these trade and investment flows ultimately reach non-North American markets.

OPTIONS FOR ADDRESSING THE CHALLENGE

Against this backdrop, Hart presents three broad directions for strengthening Canadian engagement in the global economy and ensuring greater benefits from that engagement.

First, existing barriers to trade and investment flows should be reduced so that the Canadian economy is open to broad international competition and participation. Restrictions on foreign ownership and control in sectors such as telecommunications, financial services and transportation; subsidies to favoured sectors; tax policies that coddle selected industries; and competition policies that limit mergers and acquisitions and growth are “reminders of an earlier era of regulatory zeal and nationalist foolishness.” In the long run, if Canadians are to see greater benefits from their engagement in the global economy, governments must avoid the substitution of political for market judgment.

Second, Hart suggests that the federal government should reduce Canada's activities in global trade negotiations such as WTO-sponsored liberalization (Doha Round), free trade agreements (FTAs) and Team Canada trade missions. These activities, he argues, “will have at best a marginal impact on the productivity and well-being of Canadians.” Instead, “the best trade and economic policy for Canada in its relations with the rest of the world is one of benign neglect at the macro level and assistance to individual firms as needed.”

Reducing resources and programs devoted to marginal activities and redeploying them to areas of greater potential leads Hart to his third option: strengthening the policy framework that governs cross-border trade and investment with the United States. He argues that the ability of Canadian firms to benefit from the global economy depends on how well they

are integrated into US-anchored value chains, rather than on policies based upon the outdated premise of national markets. Specifically, Canada and the US must do more to address the dated, dysfunctional and intrusive nature of border administration, the haphazard process leading to deepening regulatory convergence and the frail institutional capacity to govern accelerating integration.

Both commentators, while acknowledging the importance of Canada-US trade, cautioned against a solely US-focused policy of engagement. According to Head, Canada is “missing the boat” by failing to expand its business presence in the fast-growing markets of Asia, noting that there are substantial gains to be realized from trade with other countries where Canada has comparatively little market access, such as South Korea. Both Head and Fried argued that Canada could advance the goal of closer integration with the US by seeking FTAs with countries that already have FTAs with the US.

The commentators also took issue with Hart’s view on multilateral trade negotiations, noting that active multilateral engagement is a matter of national pride and is the only means for Canada to address important non-US trade issues.

PREFERRED POLICIES

Given the primordial importance that Hart ascribes to Canada’s economic and trade links with the United States, he focuses his three proposals on actions that would improve this relationship to Canada’s benefit.

Border administration

Hart writes that, ultimately, the objective should be to create a border that is considerably more open and less bureaucratic without compromising security. Much of what is done at the border has little to do with security, and could be done elsewhere or dispensed with altogether. The security issue can be resolved through more cooperation and information exchange, greater investment in intelligence gathering, better infrastructure and technology investments and more targeted enforcement. Both commentators question the political feasibility of this option, given the core security concerns in the US that have driven a number of measures that run counter to border-

**THREE POLICY PROPOSALS
TO ADDRESS THE
TRADE AND GLOBALIZATION CHALLENGE**

- Streamline Canada-US border administration.** Inspection strategies should be based more on risk assessment and random inspections; in Hart’s view there is little payoff to increasing the number and intensity of inspections. In addition, activities unrelated to security should be moved away from the border and in some cases dispensed with altogether.
- Enhance regulatory cooperation.** There is much informal cooperation at the state/provincial and federal level, but Hart argues it is time for a treaty-based process to eliminate immaterial differences in regulatory standards.
- Build institutional capacity to implement these policies.** While there already exist a number of institutions devoted to enhancing Canada-US economic cooperation, Hart concludes that some issues — most notably regulatory cooperation — require the creation of new institutions to enhance continental economic efficiency.

crossing facilitation. Head suggested one policy that could eliminate border impediments without setting off alarm bells over Canadian sovereignty and US security: a common external tariff with the US, which would eliminate the need for NAFTA’s cumbersome rules of origin and enhance market access.

Regulatory cooperation

Regulations on either side of the border suffer from what Hart calls the “tyranny of small differences,” in which marginal divergences in regulatory standards impose large costs in terms of verification and compliance. Canada needs a strong political commitment to regulatory cooperation and a plan to put it into effect. Hart calls on the two governments to

develop, through a treaty-based process, an enforceable agreement to reduce duplication and overlap. Fried asked whether common regulation is in fact the right response: "Mutual recognition has proven efficient and effective in many areas...and such frameworks can often be negotiated more quickly than full regulatory reform." As Head noted, the case for harmonizing regulation depends in large part on establishing that regulatory divergence truly imposes significant costs on exporters; however, there is a lack of direct evidence to support this claim.

Institutional capacity

Hart proposes the creation of a bilateral commission to supervise efforts to establish a more coordinated and convergent set of regulations, as well as an independent Canada-US secretariat with a mandate to report annually to the president and prime minister on progress. The governments of Canada and the US must "focus upon the functions that must be performed for the efficient governance of deepening integration and create new institutions only where current arrangements are unsuitable."



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CONCLUSION

Hart's fundamental conclusion is that Canada's success in prospering in the global economy and meeting the challenge of the rising economic power of Asia hinges on its bilateral relationship with the US. There was agreement among all parties that because of the size and proximity of the US economy, a small reduction in the cost of trading with the US is worth much more than an equivalent reduction in the cost of trading with any other partner. The critics questioned the magnitude of incremental gains from further efforts and worried that they would distract from the three-quarters of the world economy that lies outside the United States.

THE CANADIAN PRIORITIES AGENDA

The IRPP's Canadian Priorities Agenda project is designed to initiate a broad-based and informed public debate on policy choices and priorities for Canada over the medium term. Research papers by some of Canada's foremost scholars examine the most effective ways to address the following eight broad policy challenges:

- Human capital
- Climate change
- Natural capital
- Population aging
- Economic security
- Health outcomes
- Productivity
- Trade and globalization

Based on the results of this research, six judges, among Canada's top policy thinkers, each crafted from the eight papers a policy package of the specific recommendations that in his or her view will best enhance the economic and social well-being of Canadians.