About this chapter

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Redesigning Canadian Trade Policies for New Global Realities, edited by Stephen Tapp, Ari Van Assche and Robert Wolfe, will be the sixth volume of The Art of the State. Thirty leading academics, government researchers, practitioners and stakeholders, from Canada and abroad, analyze how changes in global commerce, technology, and economic and geopolitical power are affecting Canada and its policy.

COMMENTARY

Is More Trade Liberalization the Remedy for Canada's Trade Woes?

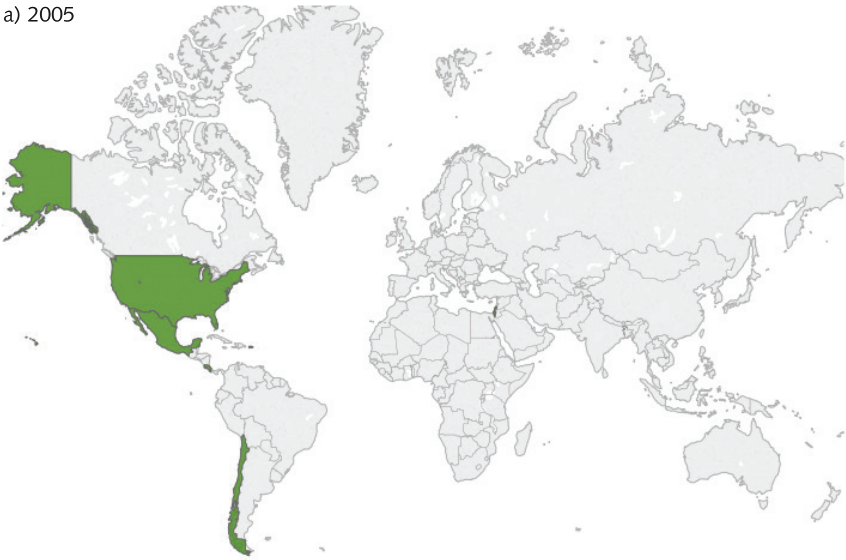
Jim Stanford

A sustained deterioration in Canada's international trade performance has contributed significantly to its generalized macroeconomic weakness over much of the past decade. Growth in Canada's exports of goods and services has been among the weakest of any industrial country, while the composition of Canadian exports has shifted to unprocessed, resource-based products and away from more sophisticated, higher-value goods and services. As the growth of imports has outpaced that of exports, Canada's trade balance has deteriorated, and sizable current account deficits are now a chronic feature of its economic record.

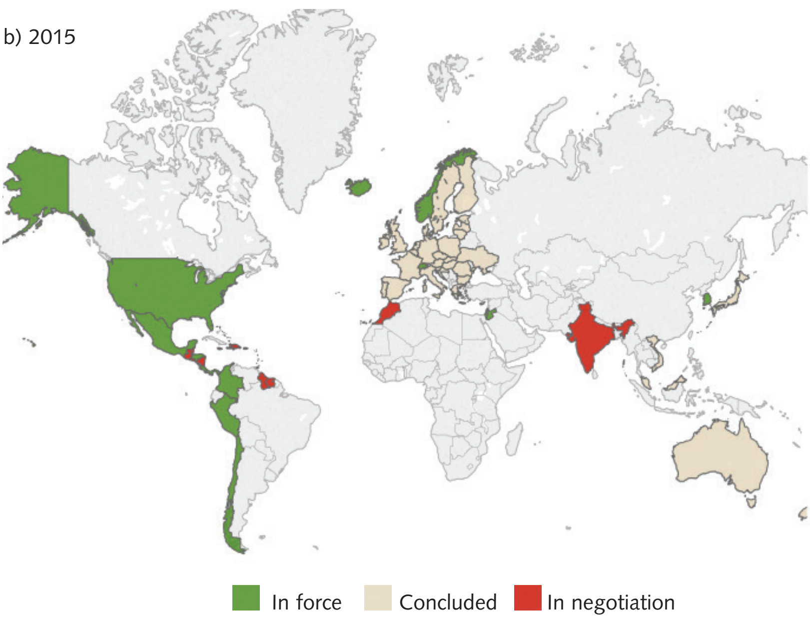
Interestingly, some trade commentators have not interpreted these discouraging results as suggesting that Canada's current trade strategy is not working. Instead, they effectively recommend that Canada do more of the same — in particular, continue to negotiate more liberalized trade through new free trade agreements (FTAs), which are generally assumed to boost both the quantity and quality of trade (see, for instance, Manley and Kingston, in this volume). Indeed, the previous federal Conservative government followed this strategy from 2006 to 2015, with Canada finalizing new FTAs with 10 countries — more than any other government in Canadian history (figure 1). As well, two mega-regional trade deals — the Comprehensive Economic and Trade Agreement (CETA) with the European Union, and the Trans-Pacific Partnership (TPP) — have been concluded, which, if implemented, will add 35 more countries to Canada's free trade relationships.[1] During the same time, the Conservative government also reached foreign investment promotion and protection agreements with 25 countries, notably including China (figure 2). These agreements are supposed to improve Canada's trade performance by attracting more foreign direct investment (FDI), including into export-oriented sectors, and facilitating the global business development of Canadian-based firms.

Figure 1
Canada's free trade agreements in force, concluded and in negotiation, 2005 and 2015

a) 2005



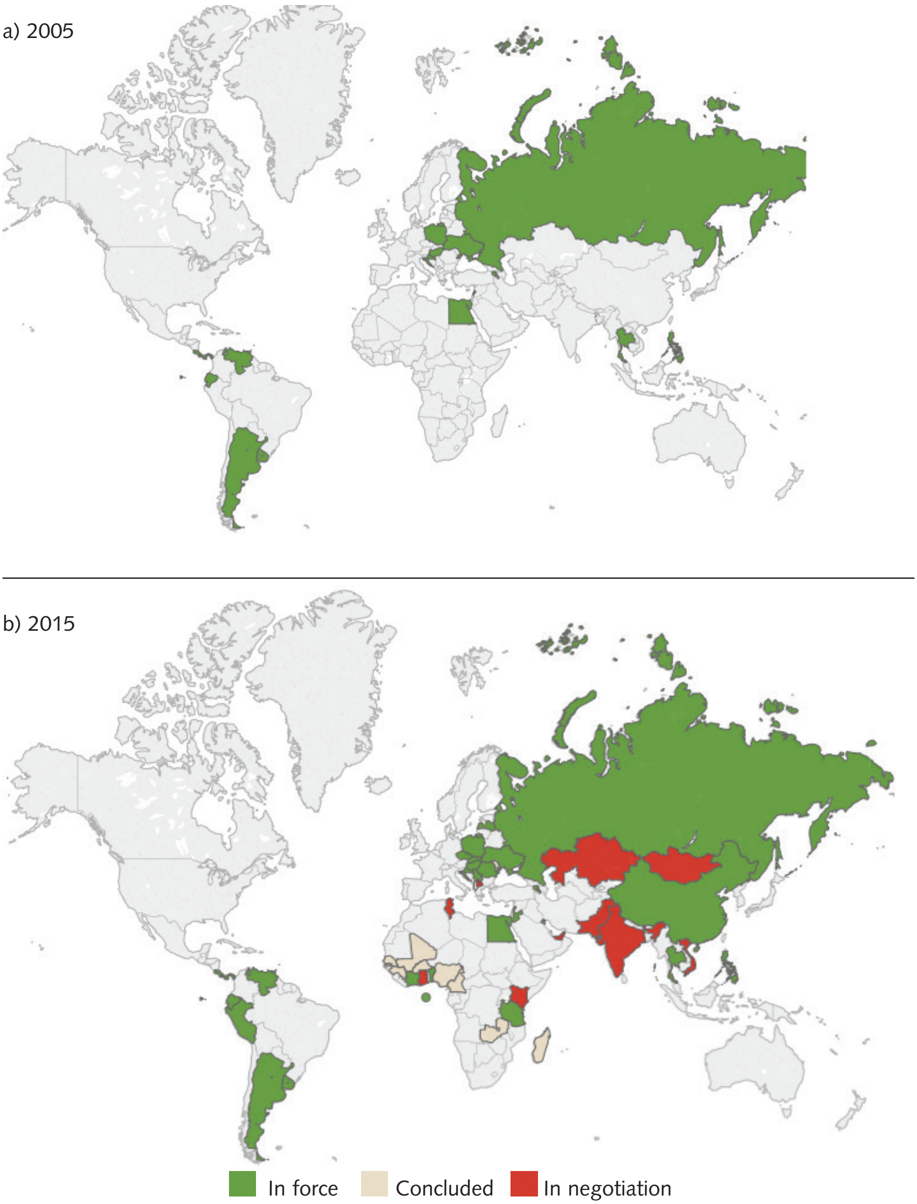
b) 2015



Source: Global Affairs Canada (2016a).

Figure 2

Canada's foreign investment promotion and protection agreements in force, concluded and in negotiation, 2005 and 2015



Source: Global Affairs Canada (2016b).

In short, Canada has pursued trade liberalization more aggressively, on more fronts, than ever before,[2] yet its trade performance has continued to deteriorate. Moreover, this deterioration has been more marked in bilateral trade flows between Canada and its FTA partners than with its trade with the rest of the world. Such results raise a critical question: Is signing more FTAs really the best way to address Canada's trade woes, or has it actually been part of the problem?

In my view, Canada's overarching policy focus should not be on signing yet another blockbuster trade deal, but rather on something else: supporting the development and growth of globally oriented, innovative, technologically intensive firms in Canada — firms that produce goods and services the rest of the world demands. Canada's abysmal performance in business innovation stands at the centre of this challenge, and I expect it to continue to lose global market share if Canada does not move closer to global best practices of innovation, business development and export promotion.

Canada's Trade Failures

The story of Canada's export performance since 1981, shown in table 1, indicates that, in the last two decades of the previous century, exports of both goods and services grew robustly, both in real terms and as a share of gross domestic product (GDP). Over that period, total exports grew by an average of

Table 1
Measures of export performance 1981-2015 (percent)

	Goods	Services	Total
Real: export growth (chained 2007 dollars)			
1981-2001	6.6	5.3	6.5
2001-2015	1.0	1.7	1.1
Nominal: exports as share of GDP			
1981	23.5	3.0	26.4
2001	36.7	5.3	42.0
2015	26.4	5.0	31.4
Change: 1981-2001	13.3	2.3	15.6
Change: 2001-2015	– 10.4	– 0.3	– 10.7

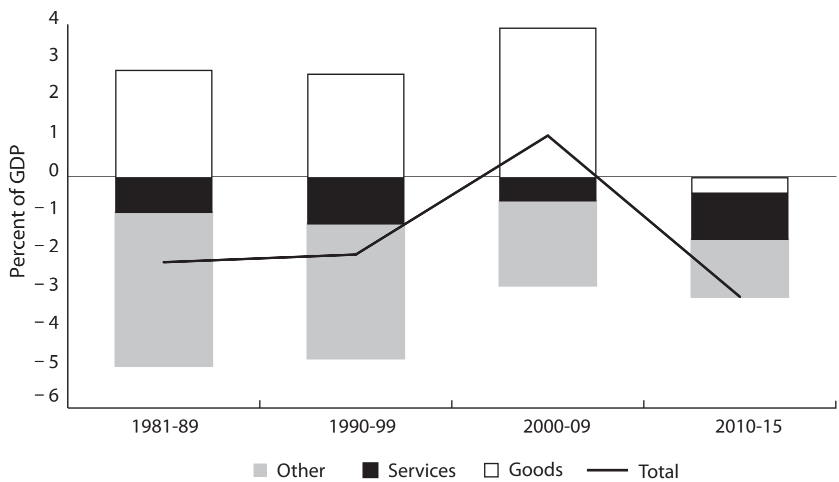
Source: Author's calculations based on data from Statistics Canada, CANSIM table 380-0064.

6.5 percent per year, providing a consistent stimulus to total output growth and job creation. Goods exports grew slightly faster than services, but both grew much faster than overall GDP and, as a result, total gross exports grew dramatically, from 26.4 percent of GDP in 1981 to a peak of 42.0 percent in 2001. Adjusting to the new North American free trade zone was clearly one driver of this growing trade intensity, but Canada's exports to other jurisdictions also grew strongly.

After that point, however, the export engine that powered Canada's economic growth stalled. Since 2001, exports of goods have grown by only 1 percent per year — the slowest annual growth in Canada's postwar history. Exports of services have been a bit better, growing almost twice as fast as goods, but less than one-third their pace between 1981 and 2001, and slower than the growth of GDP. As a share of GDP, goods and services exports have shrunk since 2001. By 2015, the share of exports had fallen to 31.4 percent of GDP, in the process undoing most of the increase in trade intensity that occurred between 1981 and 2001. Curiously, by this measure, Canada's economy has "deglobalized" since the turn of the century.

With imports growing faster than sluggish exports, trade balances and current account balances have deteriorated significantly (figure 3). In the 1980s and 1990s, Canada recorded consistent trade surpluses in goods of close to 3 percent

Figure 3
Components of Canada's current account balance, 1981-2015



Source: Author's calculations based on data from Statistics Canada, CANSIM table 376-0103.

of GDP. These surpluses were more than offset by other current account flows — notably, net outflows of investment income — together with services trade deficits. As a result, overall current account deficits averaged around 2 percent of GDP, financed through net capital inflows, largely associated with rising public debt. Then, in the first decade of the twenty-first century, merchandise surpluses widened, driven largely by higher nominal values for resource exports, and Canada generated modest current account surpluses for a while. But the decline in nonresource exports combined with the eventual collapse in resource prices then created a dramatic deterioration in merchandise trade balances, pushing Canada into merchandise trade deficits — unusual in its history. Current account deficits have been even larger, exceeding 3 percent of GDP on average since 2010 and spurring a sustained increase in Canada's net foreign indebtedness.

Canada's export performance since 2001 has also been weak relative to that of other industrial countries, suggesting that its recent trade failures cannot be blamed solely on global macroeconomic conditions. This is confirmed by De Backer and Miroudot (in this volume), who analyze data on countries' growing participation in global value chains — Canada has not kept pace with developments in the rest of the world over the past 15 years, and this contributes to poor export performance. de Munnik, Jacob and Size (2012) also find that Canada's export performance since the turn of the century has been among the worst of any industrial country. As table 2 shows, the average annual real growth of Canada's goods and services exports between 2001 and 2015 was only one-fifth of the average pace for the Organisation for Economic Co-operation and Development (OECD) as a whole, with Canada

Table 2
Canada's trade performance relative to the OECD average

	Canada (percent)	**OECD average (percent)**	**Canada's rank (out of 34 countries)**
Real growth in exports of goods and services (compound annual average), 2001-15	0.7	3.6	33
Current account balance (average share of GDP), 2010-15	– 3.0	– 0.2	29
Foreign balance contribution to GDP growth (average share of GDP), 2002-15	– 0.8	0.1	32

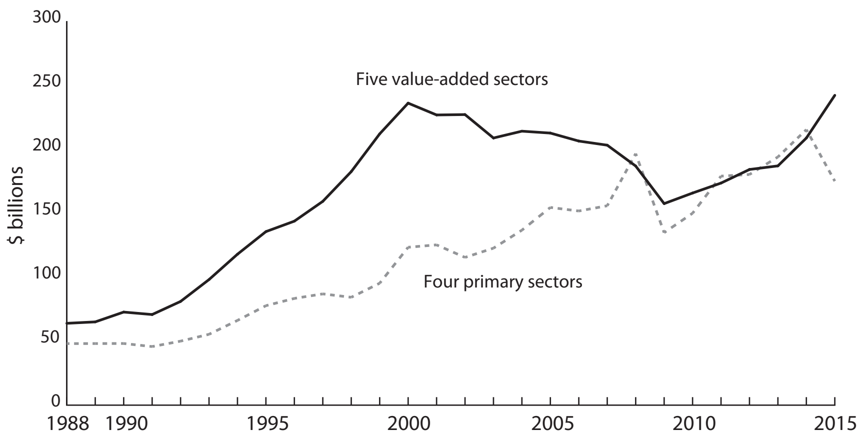
Source: Author's calculations based on from OECD (2015), annex tables 9, 39 and 52, and OECD.stat database.
Note: The data for Canada reported in this table differ slightly from those reported in table 1 and figure 3, which are from Statistics Canada, because of different definitions or methodologies.

ranking 33rd out of 34 countries on this indicator. Canada's average current account deficits since 2010 are also among the worst of any OECD country, and the ongoing drag on total output caused by deteriorating trade balances has been the third worst of any OECD country.

But it is not just the *quantity* of Canada's net exports that has been disappointing; there has also been an important and, in my view, troubling deterioration in the overall *quality* of Canada's exports. Through the 1990s, exports of sophisticated manufactured products expanded steadily, driven by several factors: the high quality and cost competitiveness of Canada's production, incoming foreign investment in manufacturing, and strong growth in the US market — the destination for most of Canada's exports. By 1999, the five high-value-added sectors (automotive, aerospace and other transportation equipment, machinery, electronics, and consumer products) together accounted for almost 60 percent of Canada's goods exports, while the primary sectors (agriculture, energy, mining and forestry) accounted for just one-quarter.[3] Thus, Canada had largely escaped its legacy as a supplier of unprocessed "staples" to the rest of the world (figure 4).

After the turn of the century, however, the global commodities boom shifted capital and policy attention toward extractive industries, a reallocation

Figure 4
Value of exports by Canada's higher-value-added and primary sectors, 1988-2015



Source: Source: Author's calculations based on data from Statistics Canada, CANSIM table 228-8059.
Notes: Primary sectors include agriculture, energy, mining and forestry. Higher-value-added sectors include automotive, aerospace and other transportation equipment; machinery; electronics; and consumer products.

reflected in the rapid change in the composition of Canada's exports. By the onset of the global financial crisis in 2008, higher prices and growing real quantities of resource exports made primary products the most important component of total exports. Renewed growth in resource exports (especially oil) continued even as the global and Canadian economies recovered from the 2008-09 recession. By 2014, the four primary sectors accounted for 40 percent of total exports, eclipsing the importance of the higher-value-added sectors.[4]

Other indicators also suggest that Canada's economy has been "deindustrializing" — moving down, rather than up, the economic value chain. For example, Canadian innovation activity has fallen steadily since 2001, with business research and development (R&D) spending as a share of GDP falling by over one-third to just 0.8 percent in 2015 — the lowest share ever recorded.[5] Other research confirms the failure of Canadian firms to innovate, increase productivity and implement technology (Expert Panel on the State of Industrial R&D in Canada 2013). Both Canada's absolute score and its relative ranking by the Observatory of Economic Complexity — which quantifies the level of complexity and development of different national economies based on a composite measure of exports, imports, production and technology — have plummeted. From being one of the most technically complex economies in the world, ranking 6th in 1980, Canada had become one of the least technically complex of any OECD country by 2013, ranking 33rd, a decline in relative complexity that was the most rapid of any industrial country (Observatory of Economic Complexity, n.d.). Canada's growing focus on primary extraction and exports is not the only factor in this worrisome trend, but it is clear that renewed dependence on raw resource extraction has reshaped Canada's entire economy and reduced its stature in the world as a source of knowledge, innovation and productivity.

Several factors have contributed to these disappointing outcomes in Canada's external commerce, some tied directly to the temporary boom in global resource prices and resulting reallocation of economic activity. The Canadian dollar soared along with commodity prices[6] to levels far above purchasing power parity (PPP),[7] which reinforced the erosion of Canadian manufacturing, tourism and tradable services, and accelerated the concentration of exports in resource sectors. The overvalued currency also encouraged a reallocation of resources to nontradable sectors, which were less affected by the loss of competitiveness from the stronger dollar, and this contributed to the decline in trade intensity experienced across the economy. Other factors include the rise of formidable new competitors — especially China, which has undermined Canada's share of key export markets — the severe recession and slow recovery experienced in the United States, still the destination for over three-quarters of Canadian exports, and Canada's relatively small export presence in the fastest-growing regions of the global economy, particularly east Asia.

Domestic factors have also contributed to the weak growth in Canadian exports, the concentration of exports in a few resource sectors and Canada's subsequent vulnerability to the inevitable downturn in global commodity prices. Poor business innovation has undermined the competitive position of Canadian firms in innovation-intensive manufactures and services. Unfavourable patterns of business formation and firm growth have hollowed out the private sector, eroding the role of mid-sized firms, the population of which has actually declined (Business Development Bank of Canada 2013). Compared with other industrial economies, Canada relies more on very small firms (including self-employment) that typically demonstrate weak innovation activity, propensity to export and productivity. Successful Canadian start-ups in globally oriented sectors are often sold to larger foreign companies, rather than continuing to grow organically. As well, numerous foreign takeovers of larger Canadian firms also might have undermined the capacity of Canadian business to project itself successfully onto the global stage.[8]

Trade Liberalization and Canada's Trade Failures

Interestingly, this unprecedented and damaging deterioration in Canada's international trade performance occurred precisely coincident with the most far-reaching agenda of trade and investment liberalization Canada has ever pursued. Yet when policy-makers and political leaders are confronted with these discouraging trade results, they often propose doubling down with further trade liberalization. But what if lack of access to foreign markets has not been the key factor behind Canada's flagging exports and widening trade imbalance? And what if, given underlying structural weaknesses in Canada's international engagement, further trade liberalization only makes matters worse?

What are FTAs meant to do? Trade deals in the tradition of the North American Free Trade Agreement (NAFTA) — including those Canada has recently negotiated — contain a wide range of provisions that affect trade and investment. First, they mutually reduce tariffs and nontariff barriers. This, the most straightforward feature of an FTA, will stimulate more trade in both directions — but not necessarily in equal measure. Various trade flows are affected differently by mutual liberalization, depending on the initial size and balance of trade flows, the initial level of tariffs and the speed of their reduction, demand elasticities, macroeconomic and exchange rate effects and other factors. Increases in mutual, balanced trade are believed to facilitate mutual gains in efficiency arising from the reallocation of factors of production. But larger gains in GDP and employment occur if the trade deal results in larger net exports (with exports growing faster than imports), and vice versa when imports are stimulated more than exports.

Second, FTAs, by enhancing mutual awareness of markets, spurring FDI in both directions, encouraging "gravity effects" (which reinforce the growth of trade through closeness and familiarity) and other indirect effects, can spur structural, nonlinear change in trade patterns above and beyond the normal effects of tariff elimination.

Third, most FTAs include extensive provisions liberalizing the international movement of direct investment and finance. This might facilitate both inflows and outflows of capital spending. As with trade flows, the net benefit for Canada might depend on whether more investment enters or leaves the country because of a trade deal.

Fourth, FTAs contain far-reaching provisions curtailing government regulatory powers in wide parts of the economy, including in less easily traded sectors such as services. The goal of these provisions is to cement a generally market-oriented, business-friendly environment throughout the trading area. This effect is reinforced through provisions such as the investor-state dispute settlement mechanisms pioneered in NAFTA and replicated in recent FTAs — and which have become controversial recently, particularly in Europe (see Newcombe, in this volume).

The coincidence of the sharp deterioration of Canadian trade performance and the aggressive expansion of free trade ties should cast some doubt on the value of trade liberalization for Canadian exports and trade balances. Of course, whether the former was "caused" by the latter depends on a more complex analysis of the causes of Canada's trade failures and a judgment on what would have occurred in the absence of new trade agreements. Nonetheless, some insight into this relationship can be gleaned by looking at the average

Table 3
Canada's trade performance by trading partner, 2001-14 (percent)

	Average annual change	
	Exports	**Imports**
All products		
United States	1.1	1.9
Non-US FTA partners	1.2	2.4
Non-FTA partners	6.8	4.7
World	2.0	3.1
Manufactured goods		
United States	– 0.5	1.3
Non-US FTA partners	– 0.3	1.8
Non-FTA partners	4.2	5.0
World	0.3	2.8

Source: Author's calculations based on data from Industry Canada, Strategis Database; includes merchandise only.
Notes: Non-US FTA partners are Mexico, Honduras, Panama, Colombia, Peru, Chile, Israel, Jordan, South Korea and the four countries of the European Free Trade Association (Norway, Iceland, Switzerland and Liechtenstein). I include current FTA partner countries for the entire period (2001-14) even if they only became free trade partners sometime during that period. This methodology does not significantly alter the relative growth rates reported. An alternative approach would be to adjust the composition of the three categories during the period, but this would create misleading changes in the end-of-period growth rates for each category.

annual change in trade flows between Canada and its free trade partners on one hand, and between Canada and the rest of the world on the other (table 3). It should be noted that about two-thirds of Canada's total trade, including three-quarters of exports and 55 percent of imports, occurs with the United States, about 5 percent of bilateral trade occurs with other FTA partners — Mexico being the most important — and close to 30 percent of bilateral trade occurs with non-free-trade partners.

Considering all products, Canada's exports to FTA partners grew slowly after 2001: by just over 1 percent annually to the United States and only marginally faster to the other FTA partners. Canada's exports to South Korea, its most recent FTA partner, have actually declined under free trade (see box 1). In contrast, exports to countries with which Canada does not have a free trade deal grew over six times faster. This is certainly an inconvenient result for those who claim that Canadian exports have been held back by a lack of access to foreign markets — access that signing more FTAs is assumed to improve significantly.

Box 1
The Canada-South Korea Free Trade Agreement

The most recent free trade agreement Canada has implemented is with South Korea, effective January 1, 2015. This is perhaps the most important new agreement to come into effect since the NAFTA in 1994. The brief experience of the Canada-South Korea trade deal demonstrates the potentially negative effect of trade liberalization on trade performance. The fact that South Korea shares many structural features with East Asian economies like Japan, Malaysia, Taiwan and Singapore also suggests that this experience will be important in judging the effect of the TPP, which includes several of those economies. Unfortunately, Canada's experience so far under the bilateral deal is not encouraging, as the table below indicates.

Canada-South Korea trade trends, 2015

	Canada's exports to South Korea	Canada's imports from South Korea	Balance[1]
All products ($ billions)	4.0	7.9	– 3.9
(year-over-year, % change)	(– 3.9)	(+8.7)	(+ 25.9)
Manufactures ($ billions)	1.9	7.7	– 5.8
(year-over-year, % change)	(+ 0.3)	(+ 8.7)	(+ 11.7)

Source: Author's calculations based on Industry Canada, Strategis database.
[1] A positive sign on change in the deficit indicates a larger negative trade balance.

During the FTA's first year, exports to South Korea declined by about 4 percent, while imports grew by around 9 percent. Canada's trade with Korea was worse under the South Korea FTA than was its trade with the rest of the world (exports shrank faster, while imports grew faster), casting major doubt on the value of this deal's "special access." One factor in Canada's falling exports was the South Korean ban on imports of Canadian beef after there was a single episode of "mad cow" disease in Alberta; the ban was not lifted until the end of the year. The extreme nature of South Korea's reaction — almost all other countries continued to accept Canadian beef — and Canada's inability to have the ban lifted quickly is testimony to the limited value of an FTA in ensuring market access. But the export problem was not confined to beef; nonbeef exports also declined during 2015, and manufactured exports were stagnant. It is difficult to argue that the Canada-South Korea FTA has stimulated Canadian exports, though it likely has spurred imports. Sadly, the South Korean experience has not been atypical of Canada's unbalanced trade performance with other FTA partners.

Also striking are the results for imports, which grew about twice as fast from Canada's FTA partners as did exports to them, and were the key driver of Canada's deteriorating overall trade balance. Imports grew somewhat faster from non-US FTA partners than from the United States, mostly reflecting the rapid growth of imports from Mexico over the 2001-14 period. Imports from non-FTA partners, however, grew twice as fast, while only with non-FTA partners did Canada's exports grow faster than its imports — again challenging the implicit assumption held by many in the trade policy community that FTAs are necessary to expand trade.[9] The difference in Canada's trade performance between FTA partners and non-FTA countries is even starker for manufactured goods, exports of which to FTA partners actually declined over the period, while imports of manufactured goods from those partners grew by between 1 and 2 percent. In contrast, exports of manufactured goods to non-FTA partners grew respectably, by 4.2 percent per year — almost as quickly as Canada's imports of manufactured goods from those countries.

Conclusion

In traditional comparative advantage economic theory, trade liberalization stimulates an expansion of two-way trade flows that reflect each trading partner's relative cost advantages. Efficiency gains from the resulting mutual specialization create the basis for net welfare gains; overall employment is assumed not to change, and output is assumed to be limited only by supply (not aggregate demand).[10] Importantly, "competitiveness" is not a relevant variable in this theoretical approach, because every jurisdiction holds a *relative* cost advantage producing something — and market forces generating full employment of resources (including labour) are assumed to push every jurisdiction in a liberalized context toward specialization in those relatively advantageous goods and services.

In the real world, however, idle resources are a normal state of affairs, reflecting aggregate demand constraints. Shifts in demand, therefore — including those arising from international trade imbalances or net investment flows — can cause gains or losses in output that typically swamp the efficiency gains expected from comparative advantage specialization. One of the factors that can affect demand is international trade, experienced through trade imbalances and international net investment flows. In this case, a country's "competitiveness" is not automatic and will affect a country's experience under trade liberalization. Overall competitiveness determines a country's ability to sell exports into world markets, generate trade surpluses that enhance, rather than subtract from, aggregate demand, and attract FDI in a world where business capital spending is scarce and highly mobile. In this context, trade liberalization might help or hurt a country, depending on whether it stimulates more exports than imports, and more inflows of capital expenditure than outflows.

If we relax the traditional, unrealistic assumptions of neoclassical trade theory, it becomes possible to reconcile Canada's deteriorating trade performance since the turn of the century with the aggressive trade liberalization policies the federal government pursued over the same period. It seems clear to me that Canada's exports were simply not broadly competitive during this period, partly because of underlying structural weaknesses — including a lack of innovation and the growing concentration of exports in unprocessed resources — and partly because of a rapidly appreciating currency. Similarly, apart from short-lived periods of major capital inflows targeted at resource industries, Canada has not been a particularly appealing site for FDI. In fact, despite resource takeovers, more FDI left Canada than arrived over the 2001-14 period, and weak business investment generally — again, apart from temporary surges in resource projects, especially oil — has been a chronic restraint on Canada's GDP and employment growth.

For an economy that is not adequately competitive in trade and investment on either cost or noncost grounds (the latter include innovation and quality), NAFTA-style trade liberalization, by stimulating export and investment opportunities in both directions without a guarantee of balance in those impacts, can cause more harm than good. Widening trade deficits as new imports overwhelm export growth, and failure to attract sufficient investment spending, might undermine growth and employment through demand-side effects that are more immediate and substantial than the incremental productivity gains projected to be the main benefit of increased two-way trade. Indeed, these reactions have contributed to the unprecedented deterioration in Canada's trade performance and its weak macroeconomic performance since 2001.

The policy implications of this alternative understanding of the working of trade liberalization are important. The typical approach of signing more free trade agreements with more and larger trading partners must be interrogated critically. So must be the widely held belief — informed in part by trade models that are not applicable to a demand-constrained world — that trade liberalization is mutually and universally efficiency enhancing and welfare improving. Repeated (and rather repetitive) debates in Canada about whether to sign the next trade agreement have been largely beside the point in improving our understanding of the causes of and remedies for Canada's global underachievement. Lack of access to foreign markets is not the main thing holding back Canada's exports. We need measures other than the signing of FTAs to effectively boost exports, investment and innovation. As for evaluating the likely effects of new trade deals, we need a more pragmatic and empirically based approach, rather than taking it for granted that trade liberalization is always mutually beneficial thanks to the working of market-driven comparative advantage processes. Here are some of the main conclusions I take from the preceding analysis:

> Canada's highest priority should be to support the development of globally oriented, innovative, technology-intensive domestic firms that can develop, produce and sell the high-value goods and services foreign purchasers demand.[11] Simply signing trade deals is unlikely to promote this goal. And if such deals expose Canadian production to more intense foreign competition, then more FTAs likely will undermine, rather than strengthen, Canada's productive capacity if Canadian firms are incapable of meeting that challenge.

> The failure of Canadian business innovation — measured by R&D spending, among other indicators — is an especially important challenge. Canada will continue to lose global trade share until it positions itself closer to the frontier of product and process innovation. Similarly, measures to support the growth of Canadian-based firms are a crucial dimension of strengthening Canada's business sector. We should encourage such firms to become sufficiently large and outward-looking to penetrate global trade, instead of the current approach of subsidizing very small companies with perverse incentives that encourage them to stay small.

> Other economic levers, such as macroeconomic, fiscal and exchange-rate policies, should be employed with an eye to their impact on the international competitiveness of Canadian products and investment opportunities. Measures that harm competitiveness can exact a huge toll on exports, investment and overall demand. For example, the destructive and inevitably temporary detour of the Canadian dollar to unjustified heights during the 2000s was a key factor in the erosion of Canada's trade performance. Although the dollar has since come back to earth, the lasting effects of its overvaluation are still with us in the form of an atrophied industrial base that may never be repaired. Worse yet, the willingness of companies to take advantage of Canada's renewed cost competitiveness with new investments will be inhibited by their expectation that the dollar might once again shoot up far beyond PPP benchmarks in the event of a renewed surge in oil prices.

> Trade policy can play a role in enhancing exports and investment in tradable industries, but it needs to be approached on an empirical,

> case-by-case basis, rather than from an almost religious assumption that FTAs are always beneficial for all signatory countries. Each trade initiative should be examined on its own terms to see if it will stimulate Canadian trade and investment. In making such evaluations, the interests of the Canadian economy should be considered as distinct from those of Canadian-based corporations, whose primary goal is to enhance the wealth of their shareholders, whether or not that is associated with higher production and employment here in Canada.

At the very least, we should be open to the possibility that FTAs are not a magic bullet for Canada's trade ailments. Their effects can be positive or negative, depending on their provisions, the trading partners involved and the readiness of Canadian industries to grow exports and attract mobile investment. In my view, in the past 15 years FTAs have probably done more harm than good to Canada's trade and foreign investment record. Developing Canadian-based firms that produce goods and services the rest of the world demands, and helping them to upgrade their activities and project themselves more effectively onto the global stage would do far more for Canada's trade performance than carrying on the quest for yet another blockbuster trade deal.

Notes and References

The author thanks Stephen Tapp and two reviewers for very useful suggestions.

1 CETA includes the 28 members of the European Union; TPP consists of 12 countries, 4 of which already have free trade ties with Canada.

2 The economic impact of liberalization achieved in the original Canada-US FTA was certainly greater than that of the 10 deals implemented since 2006. Nevertheless, the breadth of liberalization efforts Canada has pursued with unique ambition over the past decade is unprecedented in its history. For a catalogue of FTAs and foreign investment promotion and protection agreements, see Global Affairs Canada (2016a, b).

3 In addition to the five value-added and four primary sectors identified in figure 4, there are other categories of merchandise exports that are not pictured on the graph, including two intermediate sectors (semi-processed basic materials) and special transactions trade.

4 Interestingly, this pattern is once again being disrupted, this time by the sharp decline in global commodity prices that occurred beginning in mid-2014. Low prices have depressed the value of primary exports, but value-added exports are growing strongly once again, thanks to various factors, including the lower Canadian dollar and strong US growth.

5 Statistics Canada, CANSIM table 358-0024.

6 The precise transmission mechanism linking high commodity prices — particularly oil prices — with the Canadian dollar is unclear. The relationship is not experienced through trade balance effects: as noted, Canada's trade and current account balances deteriorated significantly during this period, yet the dollar strengthened — consistent with findings in the literature that exchange rates are driven, not by real trade flows, but by adjustments in asset markets. The effect of commodity prices on the valuation of corporate assets in resource industries — and, consequently, on inflows of foreign direct and portfolio investment — was likely important. In any event, the empirical link between the value of the Canadian dollar and world commodity prices is strong.

7 OECD (2015a) estimates the PPP benchmark for the Canadian dollar at about US$0.81. From 2004 through 2014, therefore, the Canadian dollar traded far above its PPP value, with the effect that Canadian costs and prices seemed disproportionately high in international comparisons. Since late 2015, in contrast, the dollar traded well below PPP levels, causing Canadian costs and prices to seem disproportionately low.

8 The peak of this takeover wave occurred in 2006 and 2007, at the crux of the commodities price cycle, when FDI in Canada expanded by $112 billion, and several iconic Canadian resource corporations were taken over by foreign purchasers. During this period of strong capital inflow, the Canadian dollar also reached its highest point.

9 Despite this, trade balances deteriorated with non-FTA trading partners as well as with FTA partners, because Canada's initial balance of trade with non-FTA partners was in deficit. That deficit grew in absolute terms, even though exports were growing relatively faster than imports.

10 In quantitative economic models of trade, employment is generally held constant by assumption. See Stanford (2003) for a discussion of the assumptions used in these models and their implications.

Notes and References

11 I am largely agnostic as to whether those firms should be Canadian owned, so long as they are present in Canada and undertaking high-value investments and activities here. Many of Canada's greatest high-value exporters are foreign owned, while some Canadian-owned companies (even ones with a global presence) have been less successful in growing exports, focusing instead on expanding their own foreign production activities.

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