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Adjustment challenges for Canadian producers

by Wendy Dobson, based on remarks to CCBC, August 2007

Canada's trade relationship with China is largely complementary, exchanging our natural resources for their consumer goods. To sustain our standard of living we must move beyond complementary trade and understand how we can become suppliers to the many global production networks that stretch to China.

Thinking about these networks suggests some interesting issues. Alan Blinder at Princeton University has observed that everything that can be packed in a box, if it can be produced cheaply somewhere else, will be; and any service that can be digitized and delivered electronically without a decline in value, will be. The implication of his thinking is that we should think about doing well what foreigners can't do more cheaply and computers can't do faster. Activities that cannot be offshored are knowledge-based personalized services like adding novel processes to customize our services exports.

Others think about it differently. Suzanne Berger's 2006 study *How we compete* published by Doubleday argues that no country has a comparative advantage in everything. China's leadership seems to agree in their current goals about more equitable and cleaner economic growth. Even so, the dash for growth is unlikely to slow any time soon but they do suggest a new opportunity for foreign producers. We should focus on China's comparative *disadvantages*. For example:

- Capital market inefficiencies provide opportunities for capital intensive firms;
- Labor abundance means opportunities for flexible knowledge based firms;
- Environmental problems mean opportunities for waste management techniques and resource efficient product and processes;
- Legal weaknesses imply advantages for services by firms from countries with strong regulatory regimes.

We should also identify activities in which we have comparative advantage -- that we can do more efficiently than others. Berger's research examines "sunset" industries in the OECD countries that have mostly migrated offshore to lower their costs. What she found is that a firm's capabilities and strategies are what really matter. Some firms manage successfully by offshoring all their manufacturing. Others are profitable keeping many functions at home, even tee shirts made in the US. Still others leverage their proximity to the customer, their design expertise, and supplies of highly skilled labor, even in the shoe industry. She found that the only lasting sources of competitive advantage are the strengths that allow a company to detect new opportunities and develop its capabilities in a constant forward march toward novel products and processes. And innovation and productivity growth are not a story of individual prowess alone, but of individuals combining their talents with societal capital – the stock of infrastructure, financial institutions, legal system, business practices, bureaucracy, research institutions and public culture.

This thinking suggests at least three implications. First, we should be implacable in our determination to improve the skills of our people. It is not the quantity and quality of education that matters, but focusing the education system more on the likely jobs in ten or twenty years. People skills, not just computer skills, will matter.

Second, we should also be implacable in helping people to become more flexible in the face of rapid economic change by re-evaluating our systems that facilitate changing skills and jobs. We need to evaluate trade adjustment assistance: the UI system, reskilling institutions, and pension portability should facilitate more frequent job changes.

Third, we should rethink North America. Chinese competition should be the catalyst for a new thrust to remove border barriers that remain post-NAFTA. The North American market should become a seamless common economic space with three sovereign political systems. Much of our technology comes from the US market, and many of our knowledge industry opportunities are there. NAFTA introduced cumbersome rules of origin and ignored obstacles to the free flow of people, capital and ideas. We need new arrangements that eliminate those obstacles.

In conclusion, we have to adjust our thinking and our strategies to stay ahead of China, not protect against it. We don't know all the answers, but we must find them by asking new questions, ones that are appropriate to a knowledge-based, networked world, rather than ones that reflect our mass production past.