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Raising our Game: Canada among Nations

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The Room to Maneuver theme prompts the question, “to do what?” To the economist the answer is a straightforward one. The central economic goal in any market economy is to ensure sustained growth in living standards – a goal that many Canadians take for granted. Canada’s real GDP per capita relative to the United States has hovered around 80 percent since the early 1990s, recovering slightly in recent years, but since 2000, the efficiency with which we use labor to produce that output has deteriorated -- both in relation to US productivity performance, and more troubling, in relation to our own performance in the late 1990s.[1] Correcting GDP for other indicators of wellbeing does not change the rankings that much. Yet Canada is extraordinarily well endowed and well situated in the world. Indeed, a bright future is ours to lose. We have lots of room to maneuver if we are focused and imaginative, anticipate change, and prepare to seek new sources of growth if old ones flag.

Taking advantage of our room to maneuver requires raising the level of our game. In this short article, I suggest five priorities for Canada’s international economic policy that anticipate and respond to the turbulent and rapidly changing international economic environment. A transformation of historic proportions is underway in the world economy. Hungry new competitors have appeared in world markets, new technologies are being created and new industries and jobs as a result, requiring new thinking and institutions to address future opportunities.

Yet Canada currently lacks an international economic strategy beyond Advantage Canada’s blueprint for what we should do at home. This lack may matter little in the short term. Canadians are net beneficiaries of economic openness as measured by the dramatic growth in demand for and prices of our natural resources and by strongly-positive terms of trade which reflects healthy prices for our exports relative to the declining prices of imports. Canadian growth and employment has largely escaped the US slowdown as job losses in manufacturing due to technological change and import competition are offset by job gains in natural resource sectors and construction. Wage and salary shares of national income have declined somewhat but corporate profits have recovered from lows in the late 1990s.

Benign short-term prospects may help to explain the sense of complacency. It may also result from the reluctance of a minority government to define Canadian interests in a strategic framework. But it could also be that we suffer the complacency of the “lucky” country, perceiving the global transformation as merely opening windows of opportunity for us.

When the time frame is extended to 2020, a lot can change. A strategy is required that anticipates and mitigates risks in the long-term outlook and that positions Canadians for challenges as well as opportunities. At least three sources of change could bring challenges. One factor in the long term outlook is slower growth in China.

[1] Jean-Philippe Cotis (2006).

The Chinese government is determined to slow economic growth in the next five years, to 7.5 percent from recent unsustainable 10 percent rates. Policy is being refocused on rebalancing the economy – away from export dependence to domestic demand.[2] A second factor is changes in political perceptions in the United States of its role in the world. The attacks in 2001 and failure in Iraq have left it wounded, its people fearful and inward looking, and its administration with marginalized legitimacy both at home and abroad. Access to US markets is not assured despite NAFTA and the fact that the US market takes more than 80 percent of our exports. Rising congressional concerns about "porous borders" are raising the cost of bilateral trade, just like a tariff would do. Another terrorist attack or catastrophic health event in either country would undoubtedly result in border closure. A third factor is the changing ways in which business is being done. The information and communications technology (ICT) revolution is making the world economy increasingly networked and disaggregated; competitive advantage is driven by knowledge and talent embodied in people. The rapid evolution of cross-border services trade through increasingly tightly integrated networks and flows of technical people and ideas make this change apparent. Yet we persist with industrial-era thinking, hierarchies and policies.

What should we be doing?

The first priority is the bilateral relationship with the United States. Canada's place in the world is influenced, but not entirely, by our proximity to the world's richest and most innovative economy. Our top priority should be to improve the management of the bilateral political and economic relationship while preserving our political independence and distinctiveness. NAFTA was concluded in the industrial era when goods trade was the priority, and indeed the unfinished business of NAFTA includes burdensome rules of origin that raise transactions costs for goods flows. But border and regulatory barriers increasingly interfere with business networks and the movement of low-risk technical people. Governments are addressing some of these issues, but in a slow incremental fashion that lacks concerted attention at the top. Thus simple but more radical approaches to improving North American efficiency are not considered, such as eliminating border barriers and negotiating a common external tariff (CET).[3]

Another deficiency in the bilateral relationship is our own failure to manage it in a sustained professional manner. Public displays of recrimination hurt no one but ourselves; they merely confirm our failure or inability to manage. Instead, we should be doing just the opposite: being smart about leveraging our unique proximity to the US market to make a difference:[4] to promote domestic growth and productivity and to increase our competitiveness in third countries. Indeed, the second priority, discussed next, should be the catalyst for a major effort to create a barrier-free common economic space in North America.[5]

The second priority is our relationships with China and India, the world's two most populous countries whose economic emergence is shifting the center of global

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[2] The rebalancing of performance criteria for Communist Party cadres –away from growth and towards health, education and environment criteria – are further evidence of determination to implement changes going forward.

[3] But not a common commercial policy

[4] Mintz (2001).

[5] Among the recommendations of a three-country independent task force published in Council on Foreign Relations (2005).

economic gravity. I have spent much of the past fifteen years teaching about and studying the economic integration of the East Asian economies in collaboration with partners throughout the region. For thirty years, China's economy has been doubling in size roughly every eight years; India is now on a more modest growth trajectory, but the size of its economy is likely to double between 2003 and 2012. China's decisions to negotiate a free-trade agreement with the Association of South East Asian Nations (ASEAN) and to discuss one with India are powerful signals of another new era. An East Asian community is unlikely by 2020 but a regional consciousness is developing in which the United States and Europe are "over the horizon". It is possible to spend weeks in the region with news of North America being crowded out by dynamic regional developments and trends. Deeper integration among the main Asian economies will require much adjustment in the region but this will be facilitated by growth rates that range from 5 percent a year in most of the smaller economies to 10 percent in China. East Asians outside of Japan are shifting their angle of vision in a dramatic way and Beijing, not Tokyo, is becoming Asia's economic leader.

There was a time when Canada had a unique standing with the Chinese because of our own leadership initiatives. Those days are gone but not forgotten as Canada's international interests and institutional capabilities fade in relevance. We have done little to maintain our unique standing, choosing rather to spread our resources thinly throughout the region. Yet it is in our long-term interest to participate in both China's and India's re-emergence onto the world stage. Both will play expanding regional roles; both are already affecting global economic performance and will have eventual impacts on global institutions and world order.

We should adjust to the emergence of China and India by refocusing our resources.[6] There is a tendency to think of these countries mainly in terms of large potential market sizes, or in terms of labor-cost arbitrage. Indeed we are living through a major labor supply shock as nearly 250 million people of labor force ages from these countries alone enter the world economy between 2000 and 2010 (one of the main reasons for declines in labor's share of national income). But this shock will pass by 2020, largely because of accelerating aging of the Chinese population. What we should be focusing on is their potential talent. Large numbers of people with technical and science backgrounds are being trained in both countries but few currently have marketable skills.

As both countries continue to invest heavily in building their human and other technical capabilities, we will see competitive challenges in our knowledge based industries, not just in manufacturing. This means our priority should be the development of our own talent by reshaping skills and productive structures to produce what both countries want to buy and what they cannot (yet) produce themselves. Their demand for our natural resources has temporarily improved our terms of trade; but it is quite possible that this robust demand, particularly for fossil fuels, will not continue. For example, compulsory targets in China's 11th five year plan (2006-10) are to increase energy efficiency by 20 percent and reduce pollutants by 10 percent. Raising R&D intensity to 2 percent by 2010, measured by R&D expenditures as a share of GDP, is another plan target.[7]

[6] See Dobson (2004) and (2006).
[7] The R&D intensity target is indicative. Zhang (2006).

The third priority is to focus on the world's poorest who are not yet even part of this networked world. Our official development institutions have strayed from their original mandates of development, poverty reduction and capacity building, to transferring resources to Canadian academics, consultants and businesses, and more recently, to areas of conflict. Canadian aid should be focused on the provision of public goods -- basic health and education programs -- primarily in the poorest countries that are prepared to reform themselves and integrate into the world economy.

The fourth imperative is to invest in selected international institutions that reflect this changing world. Most of these institutions exist; some are in need of reform and updating, but Canada's participation has not kept pace. As our relative economic clout declines, our value added lies in focusing on the issues and providing quality ideas and proposals. A more effective high-level inter-governmental mechanism for managing the Canada-US relationship tops the list. But raising our game in evolving Asian cooperative forums comes a close second. We should also invest in regime maintenance at the global institutions governing trade, capital and environmental protection. Efficient functioning of the interdependent world economy depends heavily on agreed and enforced rules of the road. The Bank of Canada has been one of the respected voices in IMF reform as that institution struggles with its future in a world dominated by private capital flows, but our voice has faded at the WTO.

The final priority is to invest in our stock of expertise in international economics and international relations. Public resources should be re-focused and increased to enable Canada's educational and research institutions to invest in building deeper international relationships and expertise. A systematic competitive and peer-reviewed funding program, such as exists in both Australia and the United States, structured along the lines of the centers of excellence program in the natural sciences is need to replace heavy reliance on the aid program and ad hoc public investments, fired like grapeshot into a variety of institutions and foundations to serve passing political fancies.

In conclusion, Canada has much Room to Maneuver in international economic policy, particularly if we raise the level of our game, beginning with a focused strategic framework.

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