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Canada's Catch-22: The State of Canada-US Relations in 2014

by Alexander Moens
and Alex Bartos

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Executive summary

Economic and political relations between Canada and the United States, our most important foreign relationship, have worsened since the Fraser Institute's previous report on the state of Canada-US relations, *Skating on Thin Ice* (Moens, 2010). The recovery of the US economy after the financial crash in 2008 has been slow. The long-term uncertainty in US budget politics and public debt resolution remains, and the concomitant policy instability—as we first noted in *US Election 2012: Implications for Canada* (Moens and Clemens, 2013)—continues to put a drag on economic growth. The across-the-board budget cuts that took effect on January 1, 2013, better known as sequestration, offer a ray of light in the present context, as they have imposed cuts on spending of \$84 billion in both 2013 and 2014.

Canadian merchandise exports to the United States have weakened in relative terms. At the same time, there is not enough Canadian export diversification to other destinations to make up this relative loss. The natural resources component of Canadian exports is the only major growing segment of overall trade. In both merchandise and services trade, the post-2007 period shows Canada is losing in trade competitiveness in relation to the United States. The negative trend in trade competitiveness in services is even bigger than in merchandise trade. The relative loss of trade competitiveness in our relationship may be a surprise to many Canadians who believe Canada is simply doing better than the United States.

Canada's weakening competitiveness vis-à-vis the United States is occurring at the same time as political relations at the top are in a slump. The main sector in US-bound trade showing growth in the last decade, crude oil products, is also the one facing most political interference from US decision makers. The six-year delay in the international permit for KXL to cross the Canada-USA border is without precedent in our bilateral relations. At the same time, the US mandatory country-of-origin labeling rule, which took effect in 2009, has severely damaged the decades-old and deeply integrated supply chain in beef and pork, costing Canadian producers some \$1 billion per year. "Buy American" in the public procurement sector remains a latent threat to bilateral relations. While American trade barriers have risen,

Canada has removed some from its side: intellectual property rights have been strengthened, and the Canadian Wheat Board dissolved.

Because of the Beyond the Border Vision, set in motion in 2011, American and Canadian regulators are talking about rationalization, mutual recognition, and harmonization regarding certain policy areas, manufacturing product standards, and border security regulations. Incremental progress is being made, mainly by pilot projects, and it appears that border costs have plateaued. As we called for in *Measuring the Costs of the Canada-US Border* (Moens and Gabler, 2012), governments on both sides need to provide cost metrics in addition to identifying individual projects, so that the public can assess whether common perimeter agreements are delivering cost savings to travelers and traders. Capping costs is good, but the goal remains to reduce border costs. Border crossing data, though incomplete, suggests that Americans are travelling far less to Canada *and* that the commercial costs of crossing the border remain too high.

While Canadians are selling relatively less to the US than they buy from the US, they are also not selling substantially more to the rest of the world. In other words, Canada's record for diversifying its trade from the US is modest over the last five years. The conclusion of the Comprehensive Economic and Trade Agreement (CETA) with the European Union offers a small trade effect for Canada: about \$12 billion in an overall trade figure of nearly \$700 billion. Nevertheless, the deal presents a confidence boost for Canadian free traders who are not getting much help from their southern neighbour. CETA also promises an important advance in lowering certain regulatory barriers to trade.

The Ryan-Murray budget accord will offer another two years of modest budget cuts in the USA, and will likely improve policy stability and thus foster GDP growth. Canada's opportunities to benefit from a stronger US economy in 2014/15 exist, but Canadians cannot count on any policy governance from the bilateral relationship to facilitate such market growth. The Catch-22 of Canada's ongoing trade dependency with the USA and its modest success in diversification can only be lessened by strategic and systematic attention from the US Executive branch. In such a strategy, a two-pronged approach would emerge. It involves both lowering North American barriers to trade and negotiating freer trade with the rest of the world as a North American economic actor.

Bilateral trade relations

Merchandise trade

There is a significant decline in both exports and imports from 2008 to 2009 as a result of the US recession ([table 1](#)). The sharpest decline is in Canadian merchandise exports to the US, which decreased by 27 percent in 2009 and still have not recovered to the 2008 level in 2012. Canadian merchandise imports from the US, on the other hand, did not fall as sharply—16 percent in 2009—and in 2012 are only slightly below the 2008 number. Thus on balance, Canadian exports to the US have suffered significantly more from the recession than American exports to Canada ([figures 1, 2](#)). Given this re-balancing, Canada's merchandise trade balance surplus with the USA has been virtually cut in half (46 percent) from \$77 billion in 2008 to \$35 billion in 2012.¹

The traditionally large gap between merchandise exports and imports between Canada and its largest trading partner have shrunk substantially. As a result, Canada's trade balance with the world has declined from \$41 billion in 2008 to a deficit of \$10 billion in 2012. The monthly import and export numbers in 2013 show a continuation of this trend.

A noticeable trend in Canada in the last 7 years reveals that less GDP is derived from trade (and thus more from Canada's domestic market), while in the United States the trade versus domestic market share of GDP is on a rising trend ([table 2](#)). When we examine the US share of Canada's total exports and imports over a longer period (1993–2012) we notice the overall downward trend ([figures 3, 4](#)). The main causal factors are the higher value of the Canadian dollar, the post-2008 slump in US demand, and a certain amount of diversification in Canada's trade, as well as stronger relative growth in Canada's domestic market.

1. All figures are in real Canadian dollars unless otherwise noted.

A breakdown of the top export and import sectors in Canada-US trade shows that the traditionally strong machinery and automotive sectors are holding well in terms of US exports to Canada, but the same sector is weaker on the Canadian side. The gains on our side are in minerals and energy products ([tables 3, 4](#)). The slow decline in Canadian exports of manufactured products suggests a weakening on Canada's side in the integrated supply-chain in this sector. Lower productivity and border costs may well play a role.

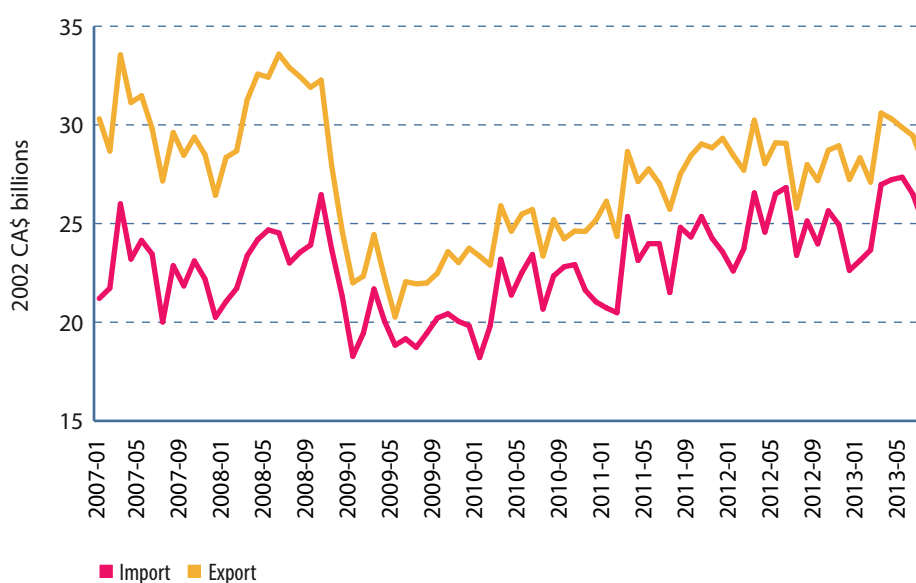
Table 1: Canadian merchandise trade, 2007–2012 (2002 CA\$ billions)

	2007	2008	2009	2010	2011	2012
Total exports	413.80	427.05	320.99	346.75	380.99	380.06
Exports to US	317.95	323.31	236.10	253.32	275.17	278.09
Total imports	372.91	388.77	326.91	355.08	380.36	389.93
Imports from US	242.15	246.66	206.41	223.12	234.75	243.60
Total balance	40.89	38.27	-5.92	-8.33	0.63	-9.87
Balance with US	75.79	76.66	29.69	30.20	40.42	34.50

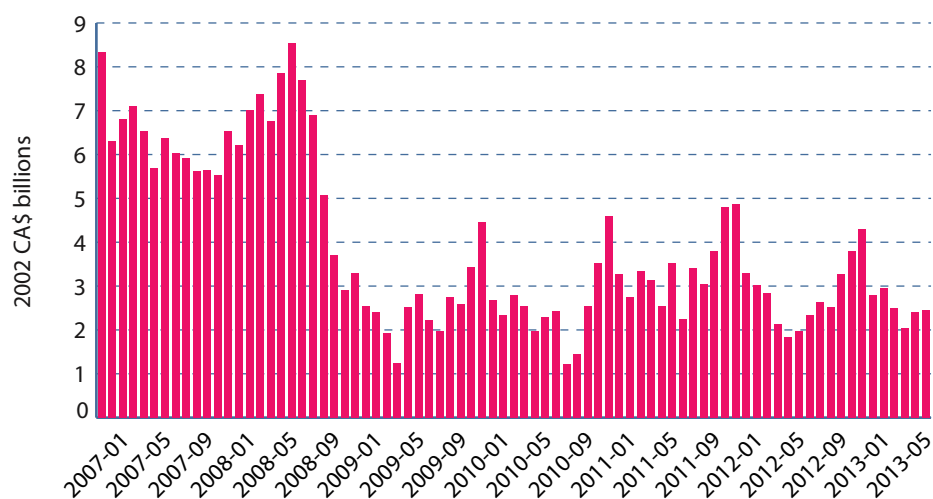
Note: On a balance of payments basis.

Source: Statistics Canada (2013d).

Figure 1: Canada's merchandise trade (monthly), 2007–2013



Source: Statistics Canada (2013c); calculations by authors.

Figure 2: Canada-US net merchandise trade (monthly), 2007–2013

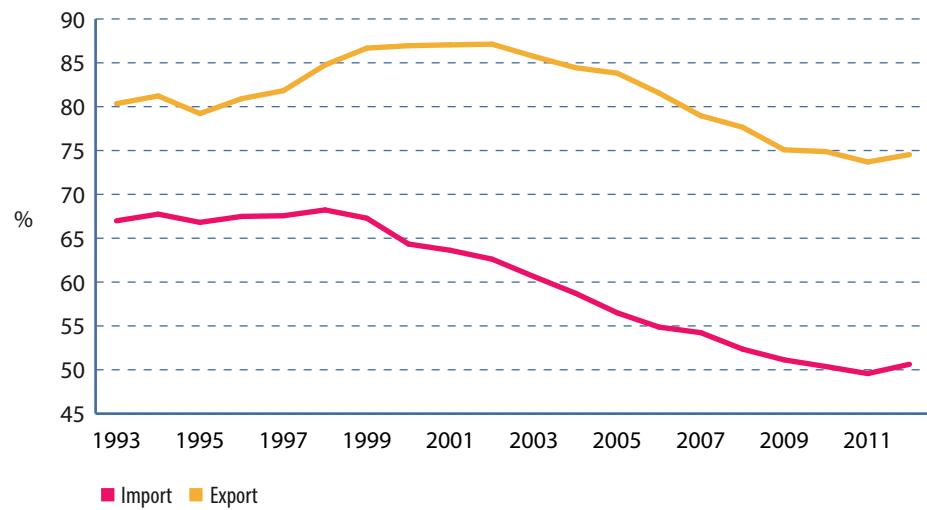
Source: Statistics Canada (2013c); calculations by authors.

Table 2: Merchandise trade as a % of GDP, 2005–2012 (current US\$)

	2005	2006	2007	2008	2009	2010	2011	2012
Canada	60.2%	58.4%	56.9%	58.3%	48.3%	50.1%	51.5%	51.0%
% Growth	0.2%	-3.0%	-2.6%	2.5%	-17.2%	3.7%	2.8%	-1.0%
US	21.0%	22.1%	22.7%	24.3%	19.1%	22.5%	25.0%	24.8%
% Growth	6.1%	5.2%	2.7%	7.0%	-21.4%	17.8%	11.1%	-0.8%

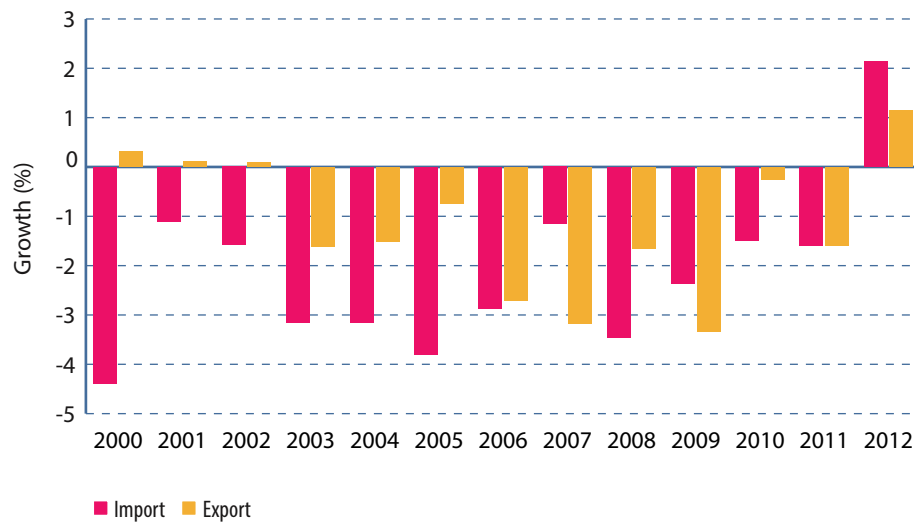
Source: The World Bank (2013a).

Figure 3: US share of Canada's annual merchandise trade (%), 1993–2012



Source: Industry Canada (2013b).

Figure 4: Growth—US share of Canada's annual merchandise trade (%), 2000–2012



Source: Industry Canada (2013b); calculations by authors.

Table 3: Top sectors for Canadian merchandise exports to the US, 2012

Industry	Exports	
	<i>2002 CA\$ billions</i>	<i>Percentage</i>
Mineral products	88.6	31.8%
Products of chemical or allied industries	16.3	5.9%
Plastics and related articles	11.8	4.3%
Base metals and articles of base metals	20.0	7.2%
Machinery, mechanical appliances, electrical equipment, and related articles	27.6	9.9%
Vehicles, aircraft, vessels, and associated transport equipment	53.0	19.1%

Note: On a customs basis.

Source: Statistics Canada (2013a).

Table 4: Top industries for Canadian merchandise imports from the US, 2012

Industry	Imports	
	<i>2002 CA\$ billions</i>	<i>Percentage</i>
Mineral products	16.3	8.5%
Products of chemical or allied industries	17.1	8.9%
Plastics and related articles	12.7	6.6%
Base metals and articles of base metals	15.8	8.2%
Machinery, mechanical appliances, electrical equipment, and related articles	41.3	21.5%
Vehicles, aircraft, vessels, and associated transport equipment	41.3	21.5%

Note: On a customs basis.

Source: Statistics Canada (2013a).

Trade in services

As a share of overall bilateral trade, trade in services is growing gradually. Total bilateral services trade in 2010 amounted to 18 percent of bilateral merchandise trade. It was 15 percent in 2007.² The United States is by far the largest trading partner in Canada's international trade in services. Trade with the US is nearly ten times the amount with the next largest partner, the United Kingdom. But unlike merchandise trade, the value of non-US services trade is nearly half (44 percent in 2010) of that with the USA (**table 5**). In other words, there is more diversification from the US market in services than in merchandise.³

The trend reveals rising competitiveness on the US side (and non-USA), as Canadian imports are growing considerably while Canadian exports are stagnant, resulting in a growing services trade deficit (**figure 5**).

Bilateral trade in services was not impacted by the US recession as merchandise trade was. Total volume of trade is slightly up in the three years after 2007 (**figure 6**). Most of this gain is from growth in Canadian imports from the US (and from non-US), while Canadian exports to the USA are slightly down.

Given that there is no growth in Americans traveling to Canada during this time period (as we will show later), the relative strength of US exports vis-à-vis Canadian exports appears to lie in the commercial sector (**tables 6, 7**).

In conclusion, in both merchandise and services trade, the post 2007 period shows that Canada is relatively losing in trade competitiveness in relation to the United States. The relative loss of trade competitiveness in our relationship may be a surprise to many Canadians who believe Canada has simply been doing better than the US since 2008. The 'doing better' part may apply to domestic economic activity but not to external trade.

2. Data on trade in services is not as recent as merchandise trade.

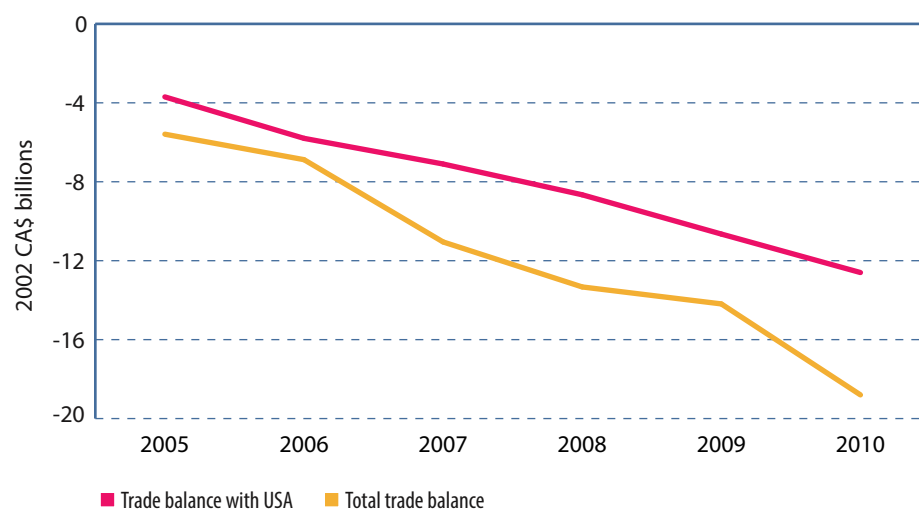
3. Top export destinations in 2010 after the USA are the UK, France, and Germany. Top importers to Canada in 2010 after the USA include UK, Hong Kong (China), France, Germany, and Mexico. The case with importers to Canada is similar to that with exporting countries. Imports from the UK make up roughly 10 percent that of imports from the US. Imports from Hong Kong are 51 percent that from the UK with France at 42 percent and both Germany and Mexico rest at roughly 38 percent each.

Table 5: Services trade between Canada and the US, 2005–2010 (2002 CA\$ billions)

	2005	2006	2007	2008	2009	2010
Exports to USA	39.88	38.15	38.34	39.66	37.18	37.00
Imports from USA	43.58	43.95	45.44	48.33	47.83	49.60
Trade balance with USA	-3.70	-5.80	-7.10	-8.66	-10.65	-12.60
Trade balance with USA %	-4.43%	-7.07%	-8.47%	-9.85%	-12.40%	-14.55%
Exports to non-USA	28.32	30.80	29.85	30.52	31.42	31.02
Imports from non-USA	30.22	31.87	33.80	35.18	34.96	37.22
Trade balance with non-USA	-1.89	-1.08	-3.95	-4.66	-3.54	-6.20
Trade balance with non-USA %	-3.23%	-1.72%	-6.21%	-7.10%	-5.40%	-9.09%
Total services exports	68.20	68.94	68.19	70.18	68.60	68.02
Total services imports	73.79	75.82	79.24	83.50	82.79	86.82
Total trade balance	-5.59	-6.88	-11.05	-13.33	-14.19	-18.80
Total trade balance %	-3.94%	-4.75%	-7.50%	-8.67%	-9.37%	-12.14%
Bilateral (X+I) USA	83.46	82.10	83.78	87.99	85.89	86.60
Bilateral (X+I) non-USA	58.54	62.67	63.65	65.69	65.51	68.24
Bilateral (X+I) total	142.00	144.77	147.42	153.68	151.40	154.84

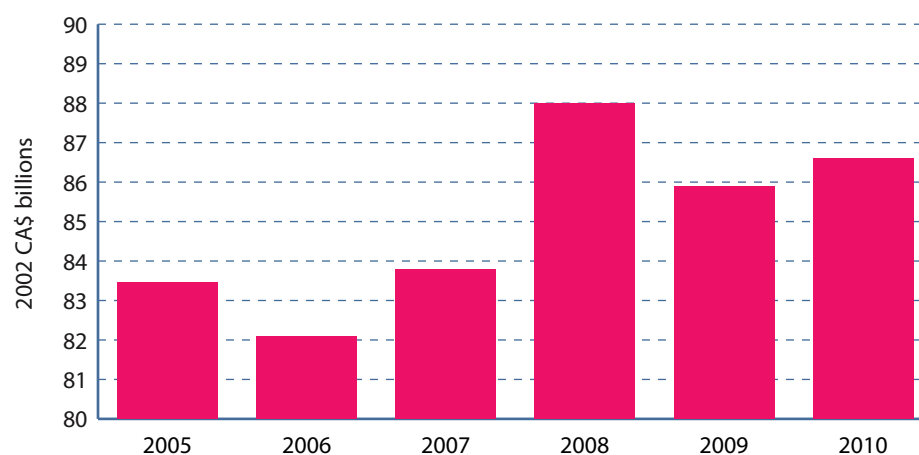
Source: Foreign Affairs, Trade and Development Canada (2013a).

Figure 5: Canada's trade deficit with US and the world, 2005–2010



Source: Foreign Affairs, Trade and Development Canada (2013a).

Figure 6: Canada-US net services trade, 2005–2010



Source: Foreign Affairs, Trade and Development Canada (2013a).

Table 6: Top categories for service trade exports, Canada-World, 2012

Category	Subcategory	Exports	
		2002 CA\$ billions	Percentage
Government services		1.3	1.9%
Travel services		14.3	20.7%
	Personal travel	11.9	17.2%
Transportation services		11.1	16.1%
	Air transport	5.2	7.6%
Commercial services		42.4	61.4%
	Financial services	5.7	8.2%
	Computer and information services	6.4	9.3%
	Intellectual property use	3.1	4.4%
	Management services	9.0	13.0%
	Research and development	3.3	4.7%
	Architectural, engineering	3.9	5.7%

Source: Foreign Affairs, Trade and Development Canada (2013a).

Table 7: Top categories for service trade imports, Canada-World, 2012

Category	Subcategory	Imports	
		2002 CA\$ billions	Percentage
Government services		1.1	1.2%
Travel services		28.8	32.3%
	Personal travel	25.3	28.4%
Transportation services		19.5	21.9%
	Water transport	8.2	9.2%
	Air transport	8.4	9.5%
Commercial services		39.6	44.6%
	Insurance services	4.4	5.0%
	Financial services	4.4	5.0%
	Intellectual property use	8.9	10.0%
	Management services	7.5	8.4%

Source: Foreign Affairs, Trade and Development Canada (2013a).

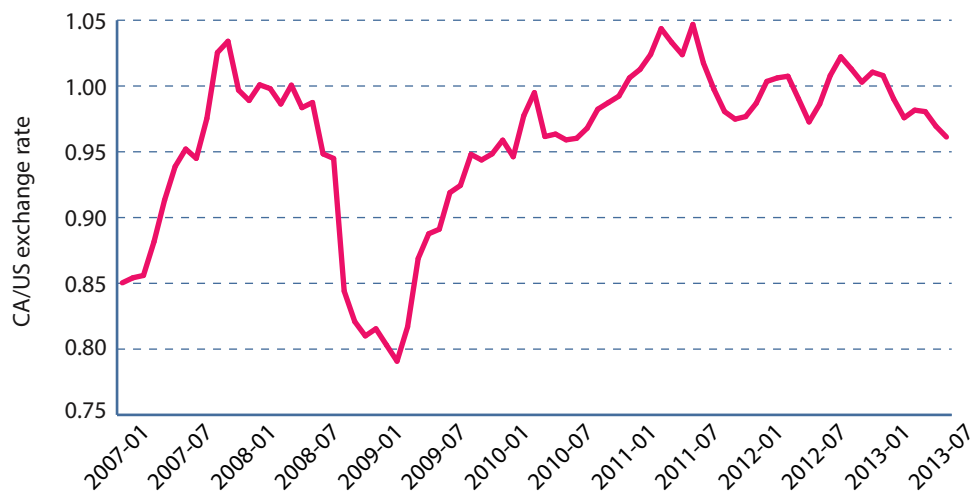
Dollar value and productivity trends

The first factor to consider regarding Canada's trade competitiveness vis-à-vis the United States is the value of the Canadian dollar. The substantial appreciation of the Canadian dollar against the US dollar that began in the early 2000s has stabilized at a much higher average value of the loonie (**figure 7**). As is well documented, such exchange rate appreciation tends to have a strong effect on current account balances as exports decline (Kappler et al., 2011). A growing account deficit will likely push the value of the Canadian dollar downward in the longer term, and thus offer some remedy.

Productivity

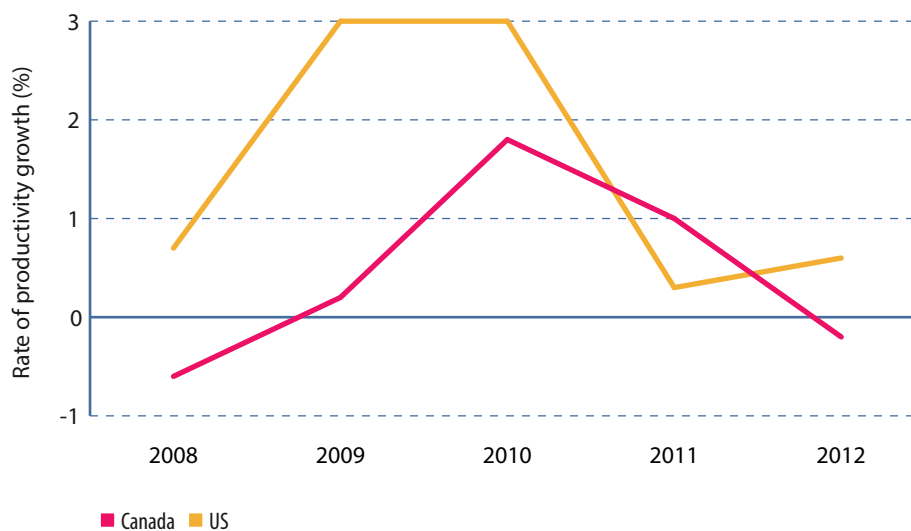
Of more concern to Canadians should be the data indicating that Canadian labour productivity rates are lagging those in the United States (**figures 8, 9**). One would expect that Canada's higher dollar has provided industry in recent years with an opportunity to improve productivity, as imported machinery and technology would be available at a lower price. However, Canada's productivity rate of growth is modest and, in 2012, dips into negative territory again.

Figure 7: Canada/US dollar exchange rate, 2007–2013



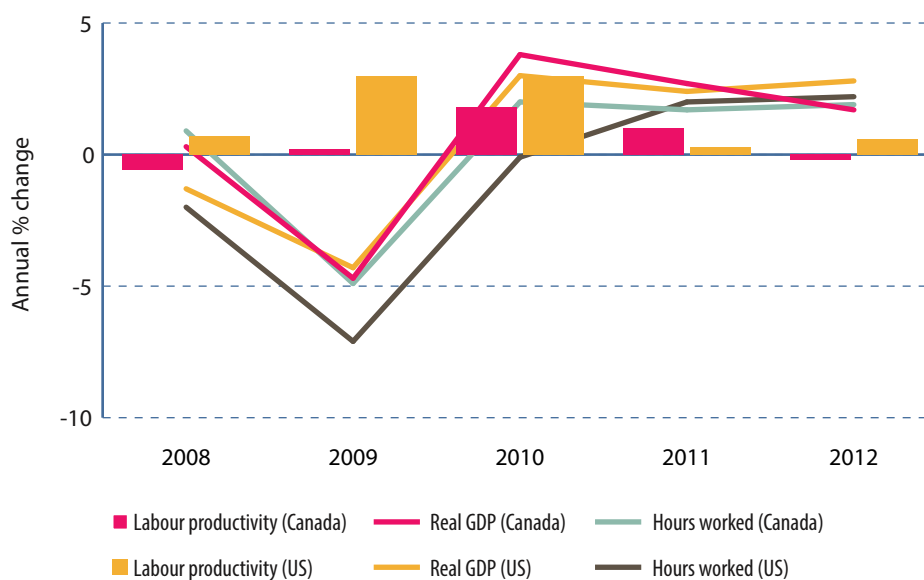
Source: Bank of Canada (2013b).

Figure 8: Canada and US rates of output productivity growth (%), 2008–2012



Source: Statistics Canada (2013g).

Figure 9: Real US-Canadian output and hours worked (%), 2008–2012



Source: Statistics Canada (2013g).

Trade and regulatory barriers/disputes

Table 8 provides a synopsis of the major trade disputes/barriers that have played a role in bilateral relations in the last five years and that are pertinent for the 2014 period (pages 16-17). The two large disputes—Keystone XL and Mandatory Country-of-Origin Labeling (MCOOL) on red meat—are more ominous than they may seem. First, both in crude oil products and in cattle and hogs, the United States is unilaterally disrupting or dismantling a well-established, integrated sector. Canada has started attempts to diversify its oil transportation structure, including more rail and new pipeline routes. But, as all proposed alternative pipelines have shown, the alternatives are controversial and at best years away from making a difference. Meanwhile, there is considerable risk in putting too much crude oil on rail, as its accident rates are higher than pipe.

Canadian threats to counter US MCOOL action with tariffs on food products are not going to have much impact in the near future. Moreover, an escalating tariff war on food products cannot be won by Canada and will ultimately harm consumers on both sides of the border. US defiance of two WTO rulings also means more uncertainty for Canadian traders.

Keystone XL pipeline

Proposed in 2008, the Keystone XL (KXL) extension is part of a pipeline system connecting Alberta oil sands and US mid-West and Gulf region refineries. KXL is a 1,897 km crude oil pipeline with a capacity of 465,000 barrels per day (Hussain, 2013). It is a substantial private infrastructure proposal that will create employment and guarantee a secure energy source for the United States (Millington and Murillo, 2013). It is by no means a new feature in Canada-US energy relations, as a dense network of oil and electricity carriers cross the border at multiple points.

What is unprecedented is that the permit process is now in its sixth year and the final resolution remains uncertain (by US law a cross-border line requires Department of State approval). If not resolved in 2014, the question may well be handed over to the next president after 2016. The policy uncertainty associated with KXL approval has by far the largest impact on Canada-US trade

relations. The dragged-out procedure has chilled relations. The southern leg of KXL has been completed and the original route objection by Nebraska has been resolved. What remains ostensibly the problem is that the US administration has identified this heavy oil as a component of its policy objective of curbing the emission of greenhouses gasses to reduce global warming.

The impact of this pipeline delay in the 2.7 million barrels per day (bpd) export of Canadian oil products to the USA reverberates at various levels. Across Canada, investment in mining, oil, and gas extraction for 2013 is predicted to decrease by 2.7 percent—the largest decline since the 2008 recession (Statistics Canada, 2013f). In Alberta, investment is predicted to increase by only 0.1 percent (Statistics Canada, 2013f). Capital investment in oil and gas extraction has not recovered to pre-2008 levels (Industry Canada, 2013a).

While the industry has become increasingly dependent on rail transport to move product, it is a costly alternative. It can cost up to three times as much as pipeline transport (Millington and Murillo, 2013), and its limitations are self-evident, because rail movement of oil is constrained by the limited availability of rail cars. In 2012, 130,000 bpd of heavy crude was being transported by rail. This is expected to rise to 425,000 bpd by the end of 2014, falling short of the 465,000 bpd which could have been moved through KXL (Hussain, 2013). The forced increase in rail transport has resulted in unintended costs for the industry: a total of US\$1 billion must be invested for new rail terminals, and another US\$4–5 billion for new rail cars (Lewis, 2013).

Rail transport is both more costly and more dangerous. A recent study concluded that “pipeline transportation is safer than transportation by road, rail, or barge, as measured by incidents, injuries, and fatalities” (Green & Furchtgott-Roth, 2013). It is not inconceivable that another major oil accident either in Canada or the USA—such as took place in Quebec in July 2013, killing 47 people—would result in a moratorium on oil transport by rail, with grave consequences for Canadian producers.

2002 Mandatory Country-of-Origin Labeling

Mandatory Country-of-Origin Labeling (MCOOL) is a provision mandated by Congressional law and first implemented in 2008. The measure imposes strict segregation rules on American, Canadian, and Mexican cattle and hogs, and the subsequent slaughtering and processing of these animals to produce beef and pork products for retail sale. The stated purpose is to create labels that indicate the origin in part or in whole of the product. In effect, it is a veiled trade barrier because it gives US animals and products a competitive advantage due to higher labeling, inventory, and processing costs for equivalent Canadian products.

Table 8: Synopsis of trade disputes in Canadian-American relations in 2013

Dispute	Impact and cost	Prospect for resolution
<i>Keystone XL Pipeline</i>	<i>Very serious</i>	<i>Poor</i>
2008 proposal for a 1,897 km 465,000 bpd crude oil pipeline spanning from Alberta down to Nebraska.	<p>Downward pressure on investment.</p> <p>Lost wages: January 2012 postponement is costing US \$4.7 million a day in lost wages (Consumer Energy Alliance, 2013).</p> <p>Continuation of crude oil price discounts due to lack of infrastructure.</p> <p>Costly alternative: rail has emerged as a transportation alternative, but can cost up to three times as much as pipeline travel (Millington and Murillo, 2013).</p>	<p>Permit postponed twice.</p> <p>Resolution is not transparent.</p> <p>Rising risk of decision deferral past 2016.</p>
<i>Mandatory Country-of-Origin Labelling (MCOOL)</i>	<i>Serious</i>	<i>Poor</i>
2008 Congressional Law mandating rules for segregated livestock processing and packaging, and a labeling structure in order to have food labels indicate origin of product.	<p>Annual cost to Canadian beef and pork sector of \$1 billion.</p> <p>Deconstruction of a highly integrated trilateral supply chain industry.</p> <p>MCOOL adds no animal health or food safety benefits.</p>	<p>US has defied both WTO complaint and the core part of the WTO Appeal ruling.</p> <p>2013 US reaction has been to strengthen the discriminatory provision banning co-mingling of meats altogether.</p> <p>Canada plans to retaliate with tariffs, but this is a costly gambit with low chance of success.</p>
<i>Softwood Lumber Agreement</i>	<i>Moderate</i>	<i>Good</i>
In 2011, American softwood companies took their Canadian counterparts to the London Court of International Arbitration, accusing them of circumventing the SLA (Foreign Affairs, Trade and Development Canada, 2012a).	If in violation, Canadian industry would face \$380 million in penalties (The Canadian Press, 2012).	<p>The London Court of International Arbitration in 2012 ruled in favor of Canada (Foreign Affairs, Trade and Development Canada, 2012a).</p> <p>SLA was to expire in 2013 but Canada and the USA extended it until 2015 (CBC News, 2012).</p> <p>Long-term free trade in lumber needs to replace SLA.</p>
<i>Buy American Provision</i>	<i>Serious</i>	<i>Partial resolution but high risk of recurring Buy American legislation</i>
2009 American Recovery and Reinvestment Act.	Exclusion of Canadian products and production sharing in US public works procurement.	<p>Canada-US Procurement Agreement in 2010 which allowed for the purchase of Canadian goods on seven U.S. infrastructure projects valued at more than \$7,777,000.</p> <p>Canada needs to seek a comprehensive agreement in order to escape future American protectionism with all provinces on board and compliant with the WTO provision.</p>

Table 8, continued

Dispute	Impact and cost	Prospect for resolution
<i>Canadian Wheat Board</i>	<i>Long-term benefit</i>	<i>Completed</i>
Canada's mandatory wheat marketing board; monopsony ended in 2011.	Frequent US action against CWB in the past will now end as wheat marketing in Canada turns fully market based.	
<i>Intellectual Property Rights</i>	<i>Moderate potential cost</i>	<i>Partially resolved</i>
Canada has been on the Special 301 Priority Watch List by the United States Trade Representative since 1995.	Ongoing threat of US Trade Action and legal action.	<p>Canadian domestic compliance, including:</p> <p>Strengthening data protection.</p> <p>Participation in Anti-counterfeiting Trade Agreement (ACTA in 2013).</p> <p>Enacted the Combating Counterfeit Products Act (2013).</p> <p>Started the process of strengthening the Copyright Act and implementing World Intellectual Property Organization Internet Treaties.</p> <p>In recognition of which Canada has been removed from the Special 301 Priority Watch List.</p>
<i>Prescription drugs</i>	<i>Serious potential for trade action</i>	<i>Indirect progress</i>
<p>The US complaint against Canada:</p> <p>Imposing price ceilings that shifts the cost burden of R&D to US firms.</p> <p>Weak protection of intellectual property rights re: third party sales.</p> <p>Slow prescription drug approval process causing reduced market access.</p>	US firms experience lost revenues and trade action is a risk.	<p>In 2013 CETA agreement with the European Union, Canada agrees to give full patent protection to new drugs for two years.</p> <p>Two-year rule may be transferable to future Canada-US resolution.</p>

Canada and the United States have had a deeply integrated market in this sector since the early 1990s. Animal health and food safety standards have been largely harmonized. As a result, highly efficient supply-chain production methods have made this industry quite efficient. However, the imposition of MCOOL has changed all that (Moens & Leon, 2012). The cost differential has widened and Canadian exports have dropped dramatically. Since 2008, the cattle sector has lost \$640 million per year and the hog sector has lost \$500 million a year (The Canadian Press, 2013a).

In 2012, the World Trade Organization (WTO) ruled in Canada's favor by concluding that MCOOL is discriminatory. The WTO gave the US until May 23, 2013 to act, but on that same day, the USDA imposed regulatory changes that

actually strengthened the provisions of MCOOL. In retaliation, the Canadian government released a list of US exports to Canada that would be subjected to tariffs, and it is preparing to seek a compliance panel at the WTO. Until this situation is resolved, the Canadian government predicts a continuing annual loss of \$1 billion for the Canadian red meat sector (The Canadian Press, 2013a).

Softwood lumber

In 2011, several American softwood companies took their Canadian counterparts to the Court of International Arbitration in London, accusing them of circumventing the Softwood Lumber Agreement of 2006 (Foreign Affairs, Trade and Development Canada, 2012a). The dispute centered on the accelerating pace of lumber harvests resulting from the pine beetle infestation. The stakes were high: \$380 million in penalties should Canada lose (The Canadian Press, 2012).

In 2012, the Court of International Arbitration ruled in Canada's favor (Foreign Affairs, Trade and Development Canada, 2012a). In addition, while the Softwood Lumber Agreement was set to expire in 2013, the Canadian and American governments successfully negotiated an extension of the Agreement until 2015 (CBC News, 2012). The fact remains that as long as a large part of Canada's softwood lumber is managed in terms of quotas and the stumpage fee system, US trade action is very likely.

'Buy American' provision

The 2009 American Recovery and Reinvestment Act (ARRA, which expired on September 30, 2011) and the more recent 2011 American Jobs Act, stipulated that steel, iron, and other goods used in the repair and construction of infrastructure projects in the US (highways, bridges, mass transit, and federal buildings) must be manufactured in the United States (Matthiesen, 2011).

In response to ARRA, Canada and the US signed the Canada-US Procurement Agreement in 2010, which allowed for the purchase of Canadian goods on seven U.S. infrastructure projects valued at more than \$7,777,000 or within the 37 states subject to the WTO GPA (Government of Canada, 2013a). The 2011 American Jobs Act did not pass in Senate and is thus moot.

While the ARRA dispute was partially resolved, 'Buy American' and a counter position of 'Buy Canadian' can flare up on either side of the border. Canadian industry is most vulnerable in this uncertainty. The Canadian government ought to seek a comprehensive Buy American exemption to escape future American protectionism. In so doing, all provincial governments need to be on board in order to make the WTO and NAFTA rules function optimally.

Canadian Wheat Board (CWB)

In 2011, the Canadian government removed the monopsony held by the Canadian Wheat Board. This unilateral action offers a successful reduction in bilateral trade distortion. Today, the CWB continues to operate as a marketing group.

Intellectual Property Rights (IPR)

From 1995 through 2013, Canada was on the Special 301 Priority Watch List by the United States Trade Representative. The US complaint was that protection and enforcement of IPR in Canada were weak. The Special 301 Priority Watch List is designed to identify US trading partners that are the worst offenders in IPR protection (Embassy of the United States, Ottawa, Canada, 2013).

Although the issue is not completely resolved, Canada has made significant progress in recent years. The federal government has strengthened data protection regulations, criminalized the use of camcorders in theaters, and participates in the Anti-Counterfeiting Trade Agreement (ACTA) negotiations (2013). Most recently, Canada enacted the Combatting Counterfeit Products Act (Embassy of the United States, Ottawa, Canada, 2013). The Canadian Government is in the process of strengthening the Copyright Act and implementing World Intellectual Property Organization Internet Treaties (Embassy of the United States, Ottawa, Canada, 2013).

As a result of these steps, Canada was removed from the Special 301 Priority Watch List in 2013.

Prescription drugs

Prescription drug prices in Canada are relatively low due to a price ceiling mandated by Canada's healthcare system. In addition, Health Canada approval times for prescription drugs significantly lag behind their counterparts in the United States and the European Union (Barua and Esmail, 2013). US lawmakers have repeatedly expressed their concerns over cheap prescription drugs re-entering the US from Canada (Moens and Gabler, 2011). The EU also asked Canada to strengthen IPR protections for prescription drugs (Lexchin and Gagnon, 2013). Since the signing of the CETA agreement in principle on October 18, 2013, the issue between Canada and the EU is now resolved (Waldie, 2013). Canada has agreed to "EU demands for patent protection for up to two years on brand-name drugs" (Blanchfield, 2013).

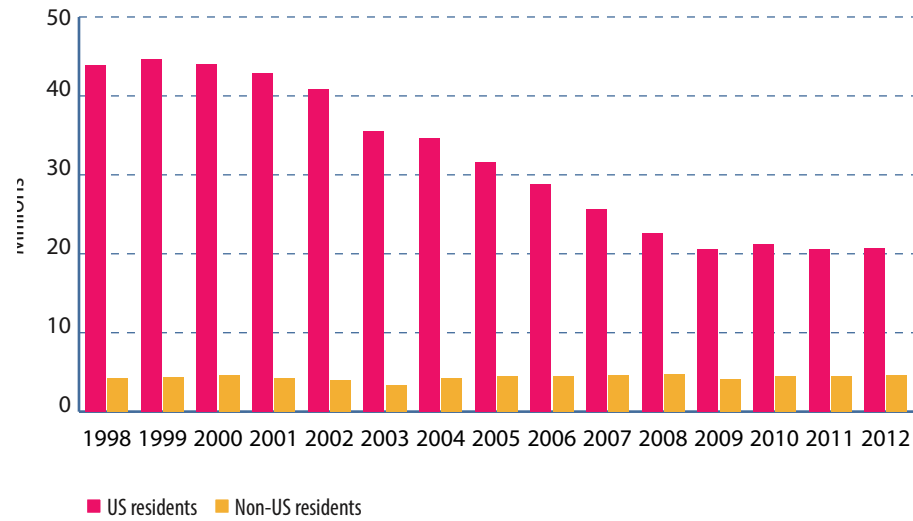
State of the border and regulatory cooperation

The decline in Americans traveling to Canada corresponds with the US Greenback losing value against the Canadian dollar (**figures 10, 11**). However, when we consider the extent of the decline in total numbers it appears disproportionate. The change in American travel suggests instead a bigger problem following the 9-11 shock. The imposition of new border transit requirements such as passports, as well as longer wait times and more security screening, has likely dampened US travel across this international boundary. Given the modest economic recovery in the USA from the beginning of 2010 onward, one would expect disposable income, including for travel, to trend back up. Instead the numbers remain stagnant at around 20 million, less than half the number of 2002.

While an overall national average for border wait times is not available, data on major border crossings in both Central Canada and British Columbia indicate that no reductions in wait times have been achieved between 2006 and 2011 (**figure 12**). The problem of inefficiency as presented by the Canada-US border goes well beyond wait times. It includes inefficient activity away from the border such as extra warehousing, and costs of complying with various facilitated traveler and goods programs such as FAST for trucks, loads, and drivers.

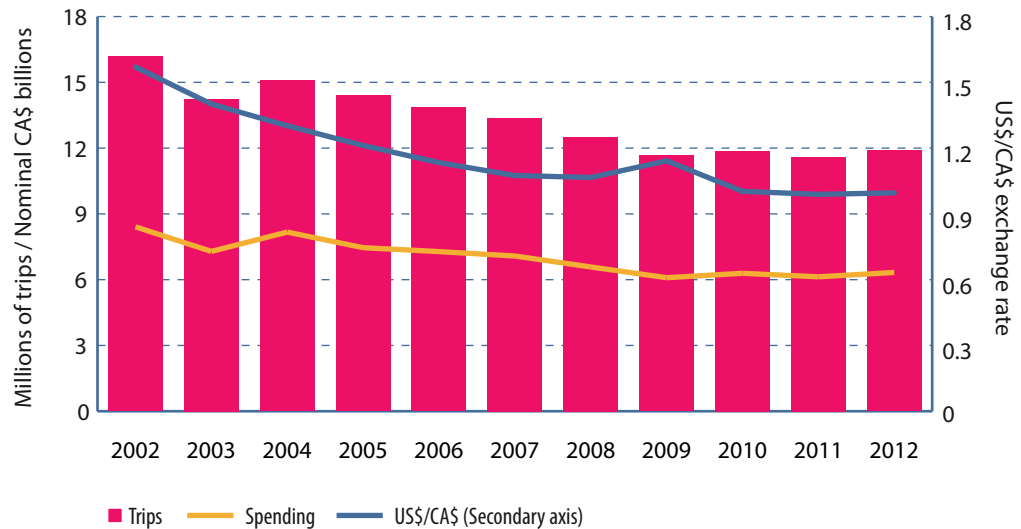
There are consistent cost differences between domestic and cross-border truck-borne trade which point to significant border costs. “For exports to the US, these costs added 0.9 percent to the delivered price of goods in 2004. This figure fell to 0.4 percent in 2009 ... Higher fixed costs per shipment accounted for most of the additional cost of transporting goods to the US” (Brown and Anderson, 2012). When we consider that, in the manufacturing sector, parts cross the border several times in various stages of assembly, we realize how this cost accumulates and defeats the efficiency gains otherwise generated by integrated supply chain manufacturing. Border costs are typically passed on to the consumer as fixed costs per shipment.

Figure 10: Travellers entering Canada, 1998–2012



Source: Statistics Canada (2013e).

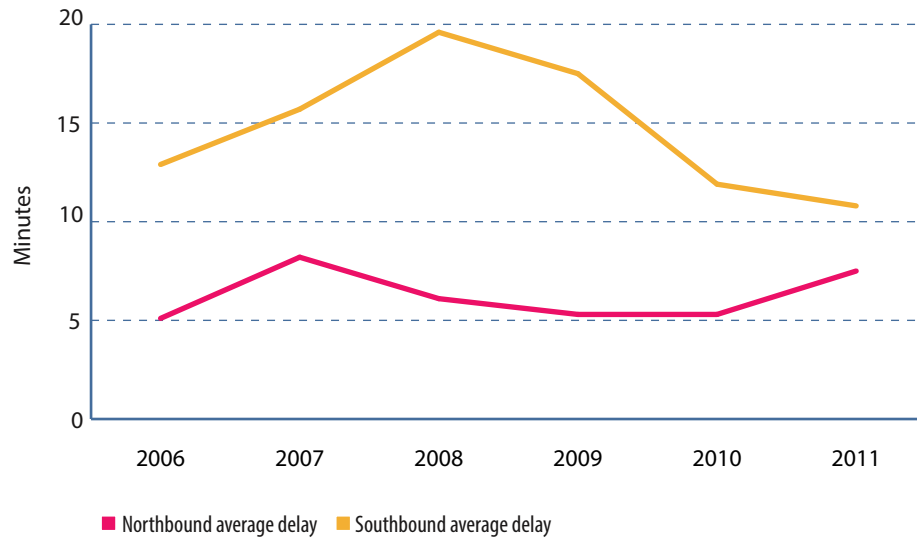
Figure 11: US overnight travel to Canada, 2002–2012



Source: Statistics Canada (2011); Bank of Canada (2013b).

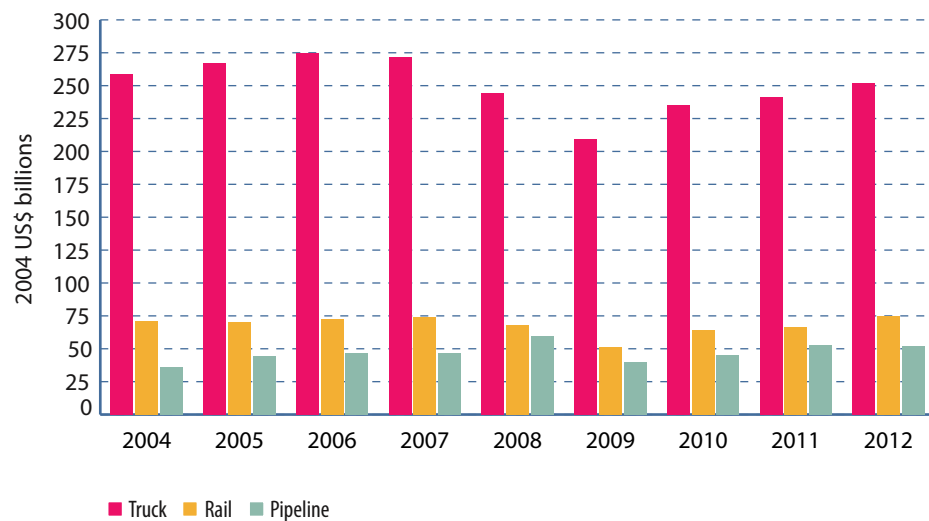
An unprecedented border problem has arisen in the current US Administration's lengthy (six years) review of the permitting of a pipeline border crossing as proposed in the Keystone XL project. As a result, oil-by-rail transport has recently increased, while the pipeline mode of Canada-US trade has seen a drop in growth in the 2011/12 period (**figures 13, 14**).

Figure 12: Peace Arch average border wait time, 2006–2011

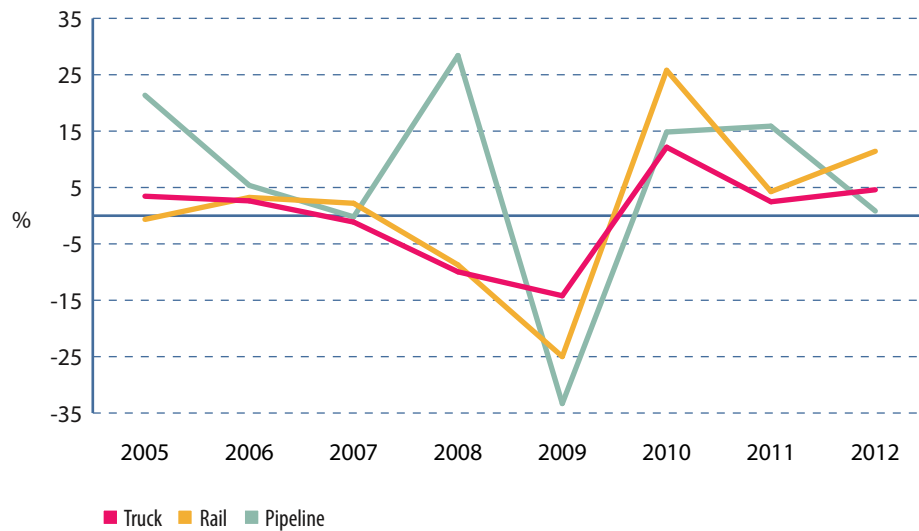


Source: Cascade Gateway Data (2013).

Figure 13: All surface modes of freight flow data based on value of goods, 2004–2012



Source: Bureau of Transportation Statistics (2013).

Figure 14: Growth rate of all surface modes of freight flows (%), 2005–2012

Source: Bureau of Transportation Statistics (2013); calculations by authors.

‘Beyond the Border’ and Regulatory Cooperation

In 2011, Canada and the United States announced an ambitious agreement to reduce border costs by means of deeper bilateral regulatory and security cooperation. The accord seeks to streamline various border procedures—some already in existence, and some new—to improve intelligence-sharing between law enforcement agencies, mutual recognition of passenger baggage screening, improved frameworks for trusted trade programs, harmonization of NEXUS protocols, streamlined supply chains, enhanced trade competitiveness, collaboration in border infrastructure investment, and deeper cooperation in national security investigations. The agreement is known as *Beyond the Border: A Shared Vision for Perimeter Security and Economic Competitiveness* (February 4, 2011).

The *Beyond the Border* Vision accord also set up a Regulatory Cooperation Council. In it, Canadian and American officials seek to reduce red tape and harmonize regulations in certain key sectors. To date, the Council has announced various plans affecting agriculture and food, transportation, health, personal care products, workplace chemicals, environment, nano materials, and small business loans. We summarize the key points of progress made since 2011 in [table 9](#).

Table 9: Key elements of Beyond the Border and Regulatory Cooperation

Beyond the Border Program	
Integrated Cargo Security Strategy (ICSS), December 2011	Reduces administrative duplication between Canada and the US by addressing security risks in advance within the shipment supply chain and at the border (Canada Border Services Agency, 2013).
Prince Rupert Pilot, October 2012	Offshore cargo heading to the US via marine transport and then forwarded from port of entry via rail is examined by Canadian officials on behalf of the US (Government of Canada, 2013c).
Montreal Pilot, January 2013	Offshore cargo heading to the US via marine transport and then forwarded from port of entry to the US via truck is examined by Canadian officials on behalf of the US (Government of Canada, 2013c).
Pre-load Air Cargo Targeting (PACT)	Joint pilot by CBSA and Transport Canada to screen cargo pre-flight on Canada-bound airplanes at foreign airports (Canada Border Services Agency, 2013).
Tamper Evident Technology Pilot, October 2012	Pilot collaboration between CBSA and US CBP to ensure containers remain sealed upon arrival at the U.S. border (Canada Border Services Agency, 2013).
Truck Cargo Pre-Inspection Pilot, March 2013	Pilot program between the CBSA and the US CBP for pre-inspection of southbound traffic into US (Canada Border Services Agency, 2013).
Free and Secure Trade (FAST) Pilot, Sarnia, Ontario	Pilot program for usage of FAST lanes without Partners in Protection and Customs Self Assessment programs (Government of Canada, 2013c).
Canada-U.S. Shiprider, June 2013	Removal of jurisdictional barriers to improve law enforcement personnel in Windsor-Detroit and Vancouver-Blaine waterways (Government of Canada, 2013c).
Entry/Exit Initiative Phase II, June 2013	Exchange entry/exit data between the CBSA and US DHS on individuals at Canada-U.S. land border crossings (Government of Canada, 2013c).
Regulatory Cooperation Program	
Memorandum of Understanding between Transport Canada and the Railway Association of Canada, September 2013	Framework for Canadian rail emissions between 2011 to 2015 (Government of Canada, 2013d).
Canada-United States Perimeter Approach to Plant Protection, September 2013	Draft framework for increased cooperation and reduction in administrative duplication between the Canadian Food Inspection Agency (CFIA) and United States Animal and Plant Health Inspection Service (APHIS) on trade in plants and plant products (Government of Canada, 2013d).
Common Electronic Submission Gateway Pilot (CESG), August 2013	FDA and Health Canada will allow pharmaceutical firms to electronically submit drug applications (Government of Canada, 2013d).
Initiative to Align Veterinary Drug Approvals, December 2012	Joint reviews between US FDA and Health Canada on veterinary drug products (Government of Canada, 2013d).
Stricter Air Pollutant Emissions	Environment Canada aligns car emissions beginning in 2017 with the US Environmental Protection Agency's "Tier 3" (Government of Canada, 2013d).

On September 4, 2013, \$46.6 million in investment was allocated to the Border Action plan by the Government of Canada in order to expand two marine container examination facilities (Government of Canada, 2013c). \$3.3 million was invested by the Government of Canada in the Asia Pacific Gateway and Trade Corridor Initiative (Government of Canada, 2013c). The Plan includes an additional 29 harmonization initiatives that will enhance trade activity between Canada and the US.

Neither Beyond the Border nor the Regulatory Cooperation Council offer further investment or cost estimates on the initiatives described in table 9. Moens and Gabler (2012) pointed to the need for both the Canadian and American governments to provide data on border costs so that a cost-benefit analysis can ensue. Nonetheless, the small steps of progress towards integrating and harmonizing US and Canadian border practices remains a very important (long-term) part of reducing the profile of the border.

Canadian and American public perceptions

Three observations are noteworthy in recent assessments of public perceptions between Americans and Canadians. First, Americans consistently have a very high favourability rating of Canadians, typically in the 90% plus range (**table 10, figure 15**). Both as a friend and a strategic ally, Americans hold Canadians in the most favourable light possible (**table 11**). Disagreements over policy between the two countries, whether in defence and foreign affairs or over border and trade issues, do not move this fundamental asset Canadians enjoy in dealing with their neighbour.

Second, Canadians do not have high expectations of either the American or Canadian government regarding progress in bilateral relations. As **table 12** shows, Canadians hold Obama in high regard (63 percent), but only 54 percent expect progress from him in trade relations. Prime Minister Harper is rated slightly ahead of President Obama in terms of working hard towards improving Canada-US relations (**table 13**).

Third, and most significant in light of Canada's Catch-22 situation: both Canadians and Americans are more supportive of closer cooperation and integration policies than is the case for political representatives in either the United States or Canada. In two recent studies we showed how US Senators and House Representatives are quite critical of Canada with regard to NAFTA issues and border security (Moens and Gabler, 2011). Similarly, we found that among the three major political parties in Canada's parliament, only one consistently expressed itself in favour of closer ties with the United States (Moens and Gabler, 2011).

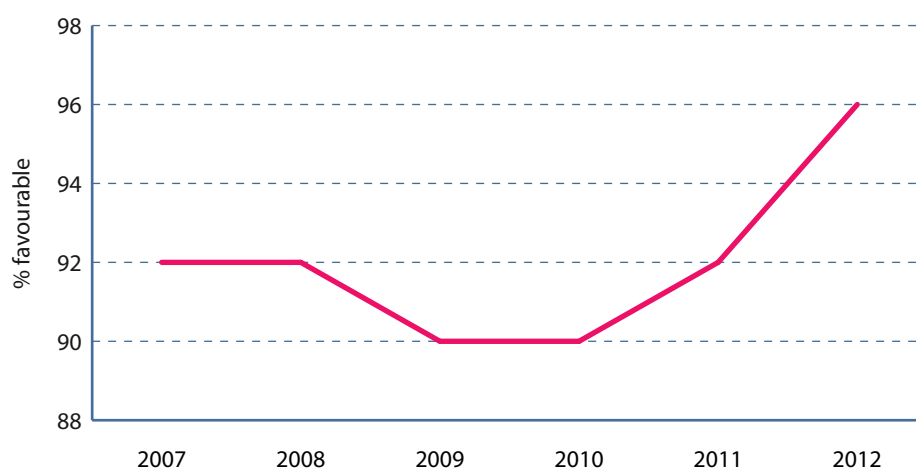
A recent survey of American and Canadian (and Mexican) attitudes towards free trade and NAFTA show surprisingly strong data for more trade integration. In response to the statement "There should be more free trade between the US, Canada and Mexico," 80 percent of Canadians approved, as did 74 percent of Americans. Even on border security, Canadians and Americans are more pro-cooperation and integration than their governmental policies suggest. In the US, 41 percent support a common perimeter while 20 percent are opposed. In Canada, 43 percent support it and 30 percent are opposed (Graves, Pastor, and Basáñez, 2013). Therefore, in terms of public mandate, both governments would have a case to work towards broader bilateral (or trilateral) cooperation to lower trade barriers.

Table 10: Canadian favourability rating among Americans (February 2012)

Very favourable	Mostly favourable	Mostly unfavourable	Very unfavourable	Not sure	Total favourable	Total unfavourable
53%	38%	3%	2%	3%	91%	5%

Note: n=1015.

Source: Gallup Poll (2012).

Figure 15: Canadian favourability among Americans (%), 2007–2012

Source: Gallup Poll (2012).

Table 11: Ally or enemy for Americans? (June 2013)

Country	Ally	Friendly	Unfriendly	Enemy	Total Ally and Friendly
Great Britain	66%	25%	2%	1%	91%
Canada	61%	33%	2%	1%	94%
China	11%	44%	26%	14%	55%

Note: n=1529.

Source: Gallup Poll (2013).

Table 12: What effect will Obama have on Canada-US relations? (November 2012)

	<i>Canadians</i>			<i>Americans</i>		
	Positive	Negative	None	Positive	Negative	None
Relationship	62%	5%	34%	48%	12%	40%
Trade	54%	10%	35%	48%	12%	39%
Harmonizing	53%	8%	40%	47%	14%	39%

Note: n=1066.

Source: Abacus Data (2012).

Table 13: Has each leader worked hard to improve Canada-US relations? (July 2012)

Country	Agree	Disagree	Not sure
Stephen Harper	58%	32%	10%
Barack Obama	53%	32%	15%

Note: Sample of Canadians.

Source: Harris/Decima (2012).

US policy uncertainty

Canadian economic prospects face their most important challenge in the United States. The US economic recovery has been modest, and real GDP growth so far has remained below the post-World War II average of post-recession periods (**figure 16**). As we noted above, the less-than-stellar US recovery is made even more challenging for Canadian traders in that productivity gains in Canada are lagging while the Canadian dollar remains high. On top of that, several American-imposed regulatory obstacles to free trade are depressing trade prospects in crude oil, red meat, and public works procurement. These impediments reduce Canadian competitive access to the US market.

A high level of public spending until the January 2013 sequester, and ongoing monetary stimulation, have not produced notable US GDP growth. The seven post-recession periods below show the current average to be well below the historical average (Young, 2013).

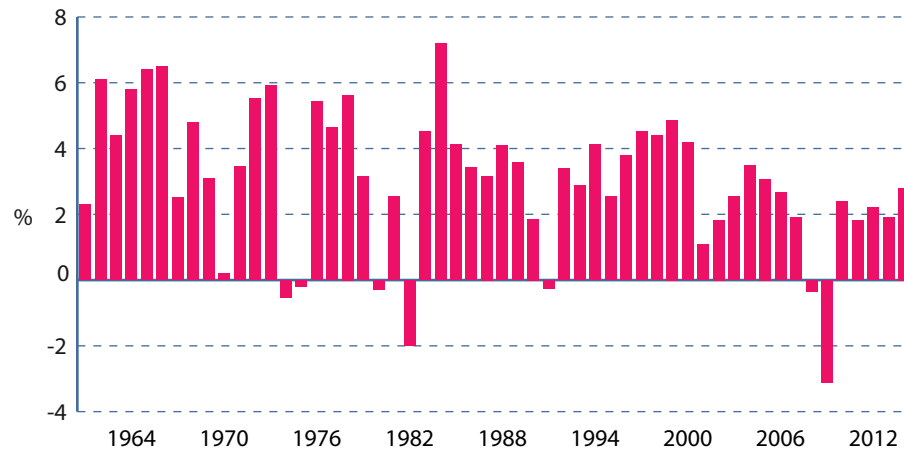
1948-1957:	3.80%
1958-1967:	4.28%
1968-1977:	3.18%
1978-1987:	3.15%
1988-1997:	3.05%
1998-2007:	2.99%
2008-2013:	0.73%

While economic growth has been modest, growth in the public debt has not (**figure 17**). Publicly held debt in the US is now at 73 percent of GDP, the highest since 1946 (Congressional Budget Office, 2013).

The widening gap between federal government outlays and revenues has only recently been capped by the Sequester (**figure 18**). However, the budget Sequester is temporary, and final resolution of public spending and taxation levels remains unclear given repeated gridlock in presidential-congressional policy making. High debt levels, combined with stalemate over taxes and budget cuts, have produced a case of policy instability or uncertainty in the last five years (Baker, Bloom, and Davis, 2013).

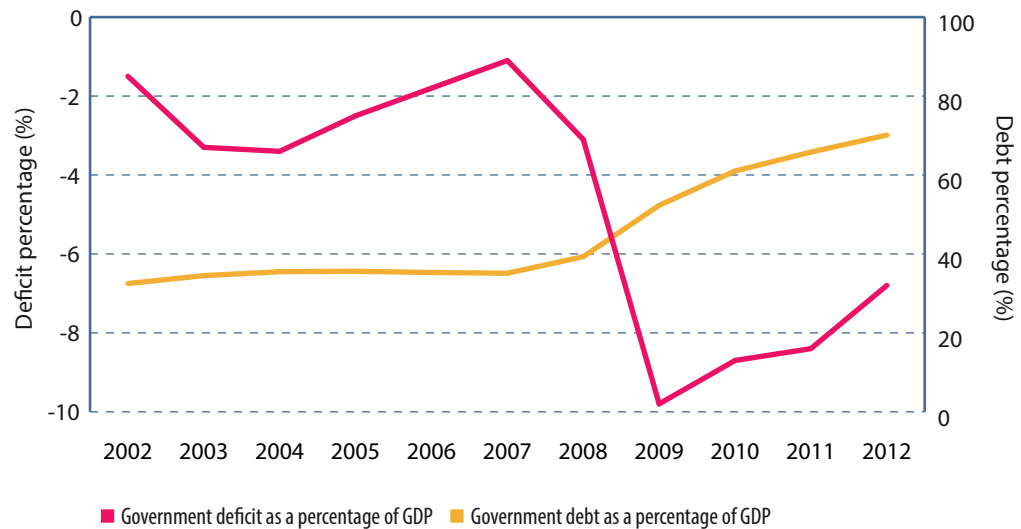
US policy uncertainty is further aggravated by inaction on the large 'entitlement' programs—Social Security, Medicare, and Medicaid—which are the major drivers of the long-term gap in revenues and spending.

Figure 16: US GDP growth rate, 1961–2013 (2014 forecast)

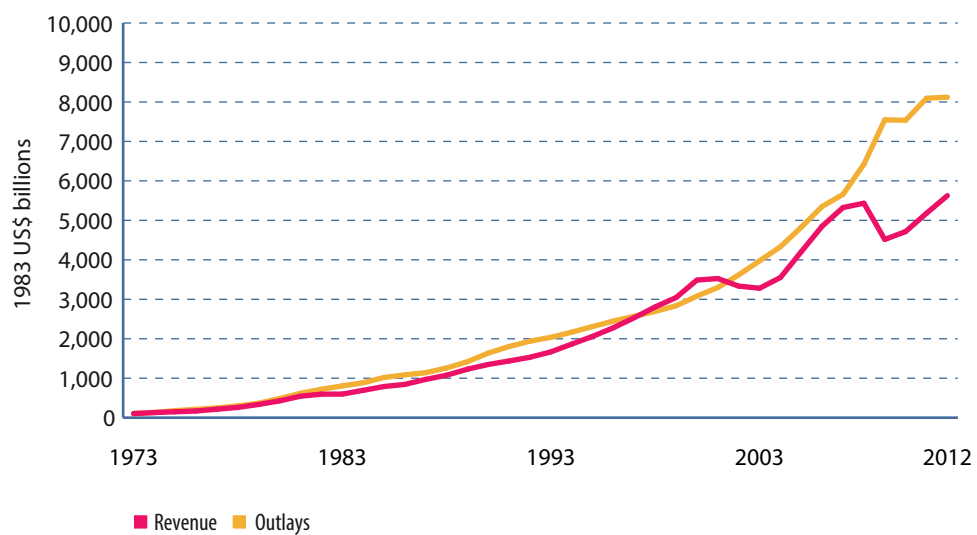


Source: The World Bank (2013b); OECD (2013).

Figure 17: US Government deficit and debt as a percentage of GDP, 2002–2012



Source: Congressional Budget Office (2013).

Figure 18: US Government revenue and outlays, 1973–2012 (1983 US\$ billions)

Source: Congressional Budget Office (2013).

Trade diversification

Given the weakness in near-term US opportunities, Canadians are (again) wondering how to pursue trade diversification away from the United States. The objective is logical and, if achieved, will prove advantageous; but various trends in trade and investment show that diversification for Canada is a slow and arduous journey ([table 14](#)).

In terms of overall share, exports to China in the last five years have doubled, but the numbers—from 2.17 percent to 4.26 percent—remain relatively low. In the same period, the US-bound share declined by 3 percent but remains a towering 74.54 percent. The pattern of small overall impact applies to all the other top trading partners. For example, exports to the UK have increased, but exports to Japan and Mexico have essentially stalled. When we consider average export growth rates over the last five years ([table 15](#)), we see a very strong rate for China (15.5 percent) and strong rates for the UK and South Korea (8.9 percent and 6.9 percent). However, a 15 percent increase in a 4 percent overall trade share produces little change. The point we are making is that, at this rate and pattern of trade ‘diversification,’ it will actually take a very long time—while relatively small upward trends in trade with the United States could have a quick and very large impact in the opposite direction.

On the import side we notice more trade diversification, with the US share at 50 percent and the Chinese share at 11 percent ([table 16](#)). The Chinese growth rate on the import side is less than on the export side ([table 17](#)). The most revealing number may be the high average over five years for Mexico, at 9 percent. This could be indicative of a growing supply chain with Mexico.

While foreign direct investment (FDI) is not a direct indicator of future trade, trends in investment may harbinger change. In terms of outbound FDI, we notice that only a small segment (less than 10 percent) is targeted for manufacturing ([table 18](#)). It is investment in this category in which one would expect growth in supply chains.

Table 14: Canada's merchandise exports, top ten destinations, 2008–2012 (2002 CA\$ billions)

	2008			2009			2010		
	Value	Rank	Share	Value	Rank	Share	Value	Rank	Share
US	329.1	1	77.7%	236.1	1	75.1%	256.4	1	74.9%
China	9.2	4	2.2%	9.7	3	3.1%	11.4	3	3.3%
UK	11.4	2	2.7%	10.5	2	3.3%	14.1	2	4.1%
Japan	9.7	3	2.3%	7.3	4	2.3%	7.9	4	2.3%
Mexico	5.1	5	1.2%	4.2	5	1.3%	4.3	5	1.3%
Netherlands	3.2	8	0.8%	2.4	8	0.8%	2.8	8	0.8%
South Korea	3.4	7	0.8%	3.1	7	1.0%	3.2	7	0.9%
Germany	3.9	6	0.9%	3.3	6	1.0%	3.4	6	1.0%
France	2.8	9	0.7%	2.3	9	0.7%	2.0	10	0.6%
Brazil	2.3	10	0.5%	1.4	10	0.4%	2.2	9	0.6%
Total	423.7			314.5			342.4		

	2011			2012			Average share
	Value	Rank	Share	Value	Rank	Share	
US	275.0	1	73.7%	278.3	1	74.5%	75.2%
China	14.0	3	3.8%	15.9	2	4.3%	3.3%
UK	15.7	2	4.2%	15.4	3	4.1%	3.7%
Japan	8.9	4	2.4%	8.5	4	2.3%	2.3%
Mexico	4.6	5	1.2%	4.4	5	1.2%	1.2%
Netherlands	4.0	7	1.1%	3.7	6	1.0%	0.9%
South Korea	4.3	6	1.1%	3.0	7	0.8%	0.9%
Germany	3.3	8	0.9%	2.9	8	0.8%	0.9%
France	2.6	9	0.7%	2.6	9	0.7%	0.7%
Brazil	2.4	10	0.6%	2.1	10	0.6%	0.6%
Total	373.2			373.4			

Source: Industry Canada (2013b).

Table 15: Canadian export growth rates, 2008–2012

	2008		2009		2010	
	%	Rank	%	Rank	%	Rank
US	5.6	7	-28.1	9	10.6	= 5
China	10.1	6	6.5	1	18.7	3
UK	1.6	9	-7.3	2	35.8	2
Japan	20.2	3	-25.0	7	10.6	= 5
Mexico	17.9	4	-17.8	6	4.3	9
Netherlands	-8.5	10	-25.5	8	18.3	4
South Korea	27.6	2	-8.0	3	5.2	8
Germany	16.0	5	-16.7	4	5.4	7
France	3.6	8	-17.4	5	-12.2	10
Brazil	70.6	1	-38.0	10	60.3	1

	2011		2012		Average %
	%	Rank	%	Rank	
US	10.4	8	2.7	2	0.2
China	27.0	4	15.2	1	15.5
UK	14.8	6	-0.2	4	9.0
Japan	16.1	5	-2.9	6	3.8
Mexico	9.4	9	-1.6	5	2.4
Netherlands	47.5	1	-5.5	7	5.3
South Korea	37.4	2	-27.2	10	7.0
Germany	0.5	10	-9.5	9	-0.9
France	31.1	3	2.3	3	1.5
Brazil	10.9	7	-9.2	8	18.9

Source: Industry Canada (2013b); calculations by authors.

Table 16: Canada's merchandise imports, top ten sources, 2008–2012 (2002 CA\$ billions)

	2008			2009			2010		
	Value	Rank	Share	Value	Rank	Share	Value	Rank	Share
US	199.2	1	52.4%	163.3	1	51.1%	174.5	1	50.4%
China	37.4	2	9.8%	34.7	2	10.9%	38.2	2	11.0%
Mexico	15.7	3	4.1%	14.5	3	4.5%	19.0	3	5.5%
Japan	13.4	4	3.5%	10.8	4	3.4%	11.5	4	3.3%
Germany	11.1	5	2.9%	9.5	5	3.0%	9.7	5	2.8%
UK	11.0	6	2.9%	8.2	6	2.6%	9.2	6	2.7%
South Korea	5.3	9	1.4%	5.2	7	1.6%	5.3	7	1.5%
Algeria	6.7	7	1.8%	3.3	10	1.0%	3.1	10	0.9%
Italy	4.5	10	1.2%	3.9	9	1.2%	4.0	9	1.2%
France	5.3	8	1.4%	4.9	8	1.5%	4.7	8	1.3%
Total	380.4			319.4			346.5		

	2011			2012			Average share
	Value	Rank	Share	Value	Rank	Share	
US	184.6	1	49.6%	192.2	1	50.6%	50.8%
China	40.2	2	10.8%	41.7	2	11.0%	10.7%
Mexico	20.5	3	5.5%	21.0	3	5.5%	5.0%
Japan	10.9	4	2.9%	12.3	4	3.3%	3.3%
Germany	10.7	5	2.9%	11.8	5	3.1%	2.9%
UK	8.6	6	2.3%	7.0	6	1.8%	2.5%
South Korea	5.5	7	1.5%	5.2	7	1.4%	1.5%
Algeria	4.6	9	1.2%	4.9	8	1.3%	1.2%
Italy	4.3	10	1.1%	4.3	9	1.1%	1.2%
France	4.6	8	1.2%	4.1	10	1.1%	1.3%
Total	372.3			379.6			

Source: Industry Canada (2013b).

Table 17: Old and new trade prospects—import growth rates, 2008–2012

	2008		2009		2010	
	%	Rank	%	Rank	%	Rank
US	2.9	8	-17.8	7	8.9	5
China	11.2	4	-7.0	2	12.3	3
Mexico	4.3	7	-7.7	4	33.7	1
Japan	-1.1	10	-19.2	8	8.9	4
Germany	10.5	5	-14.9	6	4.4	7
UK	9.5	6	-25.2	9	14.1	2
South Korea	12.0	3	-1.4	1	3.6	8
Algeria	51.8	1	-51.1	10	-5.0	10
Italy	1.1	9	-13.2	5	4.8	6
France	19.1	2	-7.0	3	-3.5	9

	2011		2012		Average %
	%	Rank	%	Rank	
US	8.8	5	5.7	4	1.7
China	8.2	6	5.3	5	6.0
Mexico	11.1	3	3.9	6	9.1
Japan	-2.9	9	15.1	1	0.1
Germany	13.2	2	11.7	2	5.0
UK	-3.6	10	-17.3	10	-4.5
South Korea	7.6	7	-3.7	8	3.7
Algeria	53.3	1	9.1	3	11.6
Italy	9.5	4	2.3	7	0.9
France	2.2	8	-9.7	9	0.2

Source: Industry Canada (2013b); calculations by authors.

Table 18: Top industries for outward stocks of FDI, 2012

Category	Value	% Share
Mining, oil and gas extraction	109.9	18.8%
<i>Oil and gas subcategory</i>	54.2	9.3%
Manufacturing	56.9	9.7%
Finance and insurance	233.4	39.9%
Management of companies and enterprises	75.7	12.9%

Note: Value in 2002 CA\$ billions. Categories in North American Industry Classification System.

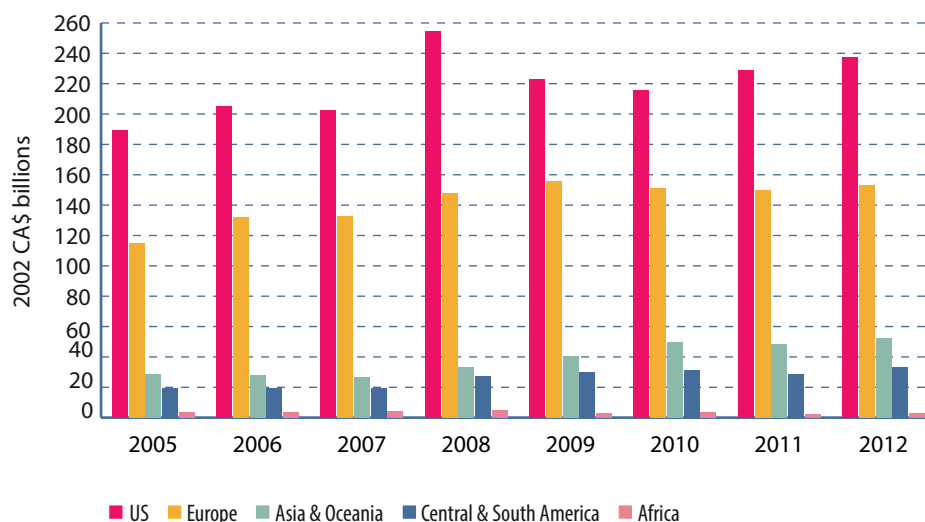
Source: Foreign Affairs, Trade and Development Canada (2013c).

In terms of overall Canadian outbound FDI, stocks in the US remain very high despite the recent US recession, while growth in stock in Asia is modest ([figure 19](#)). When we examine Canadian FDI in the so-called BRIC states, we notice that investment in both China and India is relatively small. Canadian mining investment in Brazil is much larger ([figure 20](#)). In fact, when we examine amounts of FDI, we find that Canada is not really a big BRIC investor other than Brazil. Chile, Hong Kong, and Peru are larger FDI recipients than China and India ([figure 21](#)).

In terms of FDI flowing *into* Canada, we notice the very large share (28.65 percent) in manufacturing, which indicates both the predominant share of US FDI and the extensive integrated supply chains in Canada-US manufacturing ([table 19](#)). Even more than for outbound FDI, inflow stocks show very large US preponderance ([figure 22](#)). Such continued concentration of US FDI in Canada suggests that Canadian trade diversification is not just a decision to be made by Canadian producers.

Like trade growth, Chinese FDI growth in Canada is positive but the overall numbers are small and do not show rapid growth in the last 3 years ([figure 23](#)).

Figure 19: Canadian foreign direct investment (stock), various regions, 2005–2012

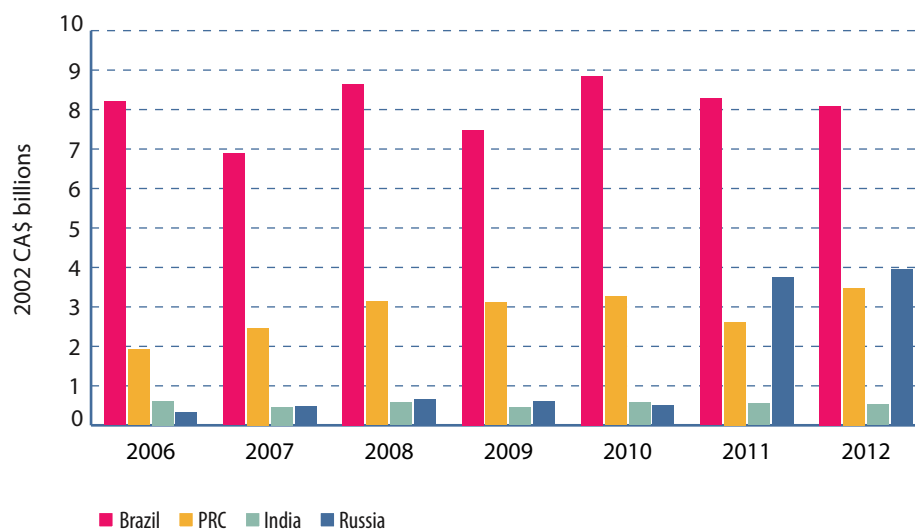


Notes: Excluding Mexico. Canadian FDI to Mexico in 2012 was \$5.57 billion.

Foreign Direct Investment measures the purchase of various forms of capital stock abroad. However, tax havens (Barbados, Bermuda, etc.) are frequently found to be some of the highest recipients of FDI. In reality, tax havens do not reflect economic growth as FDI figures invested into tax havens are often reinvested back to the source country in a concept known as round-tripping (Financial Post, 2013). We have accounted for tax havens by removing them from tables and figures in this section. The numbers corresponding to Figure 19 would be: Barbados (\$59.3 billion); Bermuda (\$11.8 billion); British Virgin Islands (\$2.1 billion); Cayman Islands (\$30.2 billion).

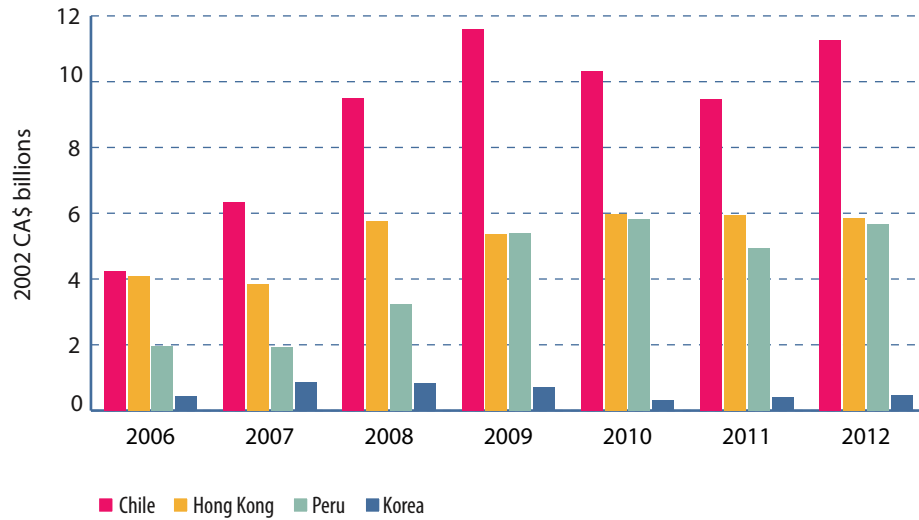
Source: Foreign Affairs, Trade and Development Canada (2013c).

Figure 20: Canadian foreign direct investment (stock), BRIC, 2006–2012



Source: Foreign Affairs, Trade and Development Canada (2013c).

Figure 21: Canadian foreign direct investment (stock), Chile, Hong Kong, Peru & Korea, 2006–2012



Source: Foreign Affairs, Trade and Development Canada (2013c).

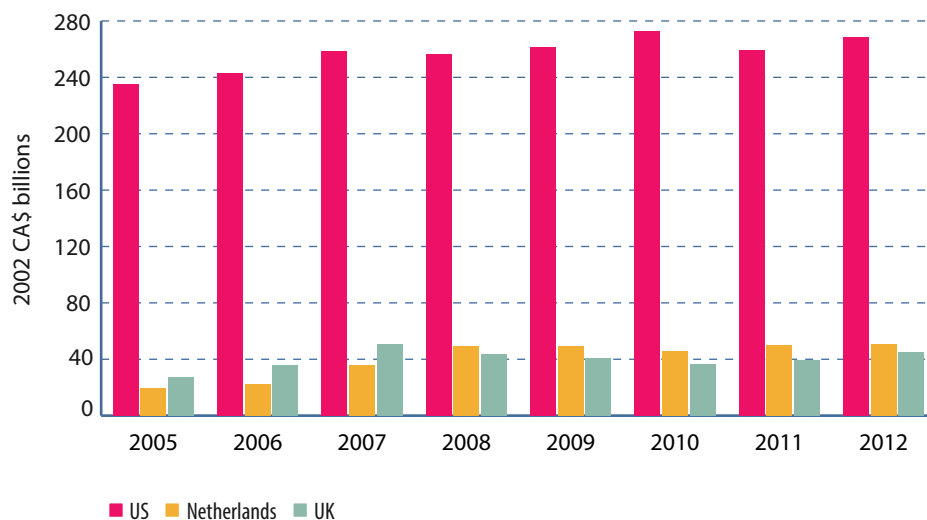
Table 19: Top industries for inward stocks of FDI, 2012

Category	Value	% Share
Oil and gas extraction	76.6	14.7%
Manufacturing	149.2	28.7%
Petroleum and coal products manufacturing	37.7	7.2%
Wholesale trade	39.5	7.6%
Finance and insurance	69.9	13.4%
Management of companies and enterprises	99.9	19.2%

Note: Value in 2002 CA\$ billions. Categories in North American Industry Classification System.

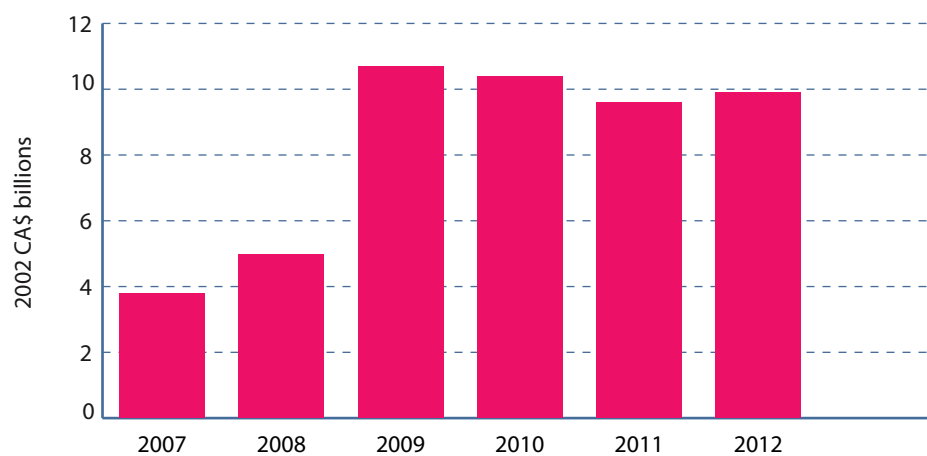
Source: Foreign Affairs, Trade and Development Canada (2013c).

Figure 22: Foreign direct investment (stock) in Canada from top three countries, 2005–2012



Source: Foreign Affairs, Trade and Development Canada (2013c).

Figure 23: Foreign direct investment (stock) in Canada from China, 2007–2012



Source: Foreign Affairs, Trade and Development Canada (2013c).

Conclusion: the bilateral and diversification agenda

China was Canada's second largest trading partner in 2012, with net merchandise totaling \$70 billion, but this was far behind US net merchandise trade at \$572.59 billion (Industry Canada, 2013b). Both trade and investment patterns suggest that change will be slow. Canada's foreign investment review process has signaled its concern with China's State-Owned Enterprises' predominant involvement in energy projects. Until China proceeds with more privatization of this sector, or Canada's changes its criteria, Chinese FDI levels in Canada will remain small. The flattening of FDI flows in the 2010–2012 period show this pattern (figure 23).

European economies remain among Canada's top export destinations and import sources, with at least four European countries consistently ranking in the top ten. The successful completion of the Comprehensive Economic Trade Agreement (CETA) with the European Union in 2013 bodes well for stronger trade growth with these countries. A joint report between Canada and the European Union, issued in 2009, predicts the gains from trade over seven years to be €8.2 billion and €11.6 billion, respectively (Foreign Affairs, Trade and Development Canada, 2012b). Trade liberalization in services and the elimination of tariffs on goods contribute the most to these GDP gains. Most recent estimates predict that Canadian exports to the EU will increase by 20.6 percent and that EU exports to Canada will increase by 24.3 percent (Foreign Affairs, Trade and Development Canada, 2012b).

The boost CETA offers in terms of Canada's trade diversification is not so much in volume as it is in perception, confidence, and possibly in terms of strategic trade position in North America. As both Mexico and Canada now have EU trade agreements, they may be in a better position to leverage this advantage within NAFTA as the US is pursuing a Transatlantic Trade and Investment Partnership (TTIP) with the EU. Another boost offered by CETA is that the agreement calls for lowering regulatory barriers in several sectors. It is both inside NAFTA, in TTIP, and in a potential Trans Pacific Partnership trade agreement that such mutual recognition on regulations or common standards can boost trade.

Ultimately, Canada's objectives intersect at the point where frustration with the US meets the limits of diversification. The most optimal short-term outcome for Canada remains a vibrant US economy coupled with lower trade barriers in North America. Helping to create a strategic focus at the highest levels in Washington for lowering regulatory barriers inside North America must remain a priority for Canadian officials, as progress on this file benefits Canadian consumers and producers most.

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About the authors

Alexander Moens

Alexander Moens (www.alexandermuens.com) is a professor of Political Science at Simon Fraser University in Vancouver, Canada, and a Senior Fellow in American Policy at the Fraser Institute. Moens is the author of *The Foreign Policy of George W. Bush: Values, Strategy, Loyalty* (2004) and *Foreign Policy Under Carter* (1990), as well as editor or co-editor of *Disconcerted Europe: The Search for a New Security Architecture* (1994), *NATO and European Security: Alliance Politics from the Cold War's End to the Age of Terrorism* (2003), and *Immigration Policy and the Terrorist Threat in Canada and the United States* (2008). Moens has published in numerous journals and newspapers. His most recent publications include: "Obama's Foreign Policy: Change Without Conviction," in Nikolaos Tzifakis (ed.), *International Politics in Times of Change* (Berlin and Heidelberg, 2012); "NATO and the EU: Canada's Security Interests in Europe and Beyond," in David S. McDonough (ed.), *Canada's National Security in the Post-9/11 World* (Toronto University Press, 2012); "Canadian Interests in Building Cooperation Between NATO and the African Union," with Jimmy Peterson, in Brooke Smith-Windsor (ed.), *AU-NATO Collaboration: Implications and Prospects* (NATO Defence College, 2013); and "George W. Bush Decision Maker: Take Two," Chapter 6 in Donald R. Kelley and Todd G. Shields (eds.), *Taking the Measure: The Presidency of George W. Bush* (Texas A&M University Press, 2013).

Alex Bartos

Alex Bartos holds a B.S.S. degree in Economics from the University of Ottawa, and a B.A. in Political Science from Simon Fraser University. He has worked for both federal and provincial elected representatives, founded and was president of the SFU Conservative Club, and acted in an executive capacity for the BC Conservative Youth Association. His specific research interests include Canada-US trade policy and international trade relations. Mr. Bartos is the recipient of several honours for both his academic and extracurricular volunteer activities.

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Prof. J.C. Herbert Emery	Dr. Vito Tanzi
Prof. Jack L. Granatstein	

Past members

Prof. Armen Alchian*	Prof. F.G. Pennance*
Prof. James M. Buchanan* [†]	Prof. George Stigler* [†]
Prof. Friedrich A. Hayek* [†]	Sir Alan Walters*
Prof. H.G. Johnson*	Prof. Edwin G. West*

* deceased; [†] Nobel Laureate