

CONSTRUCTING CONSTRUCTIVE ENGAGEMENT

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As befits an author who brings a wealth of experience and scholarship to the task, Michael Hart, in his chapter “Canadian Engagement in the Global Economy,” has presented an incisive diagnosis of the challenges that Canada faces: it is a globalized market served by global supply chains in goods and services, within which an increasingly integrated North American economy has to compete; but it also faces a United States preoccupied with security on the basis of cross-border rather than integrative rules. And the good doctor methodically reviews several symptoms of what may ail the country in addressing these challenges — including a retail trade policy too diffuse in its targets and too defensive in its posture, and a lack of focus and vision in building a more competitive North America. His prescriptions flow convincingly from his analysis: we must open Canadian trade and investment to the world and, vis-à-vis the United States, reduce the impact of the border, aggressively accelerating a process of “regulatory convergence” and building institutional capacity to implement this agenda.

Here I offer some comments and cautions respecting Hart’s recommendations. Despite the title of his chapter, Hart does not offer a complete diagnosis of the challenges Canada must address to compete effectively in the twenty-first century, and thus he invites reflection on additional, related public policy priorities.

THE INTERNATIONAL CONTEXT

Economic engagement

Hart devotes the majority of his analysis to Canada’s international engagement in the trade field. But, as he acknowledges in a passing reference to the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD), the international framework for trade and investment is determined under various instruments and in forums well beyond the North American Free Trade Agreement (NAFTA) and the World Trade Organization (WTO).

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The IMF, for example, is charged by its members under its articles of agreement with promoting stability and growth by fostering the macroeconomic conditions conducive to doing so. Its engagement with major industrialized and emerging economies plays an important role in reducing the likelihood of abrupt shocks to the global economy, in mitigating the impact of financial crises when they occur and in providing direction on fiscal and monetary policy — for example, regarding exchange rates — that supports a fair and level playing field for cross-border economic activity.

This agenda has long been at the centre of G7 summitry. More recently, in an effort to nurture greater co-ownership of and shared responsibility for global stability among emerging markets, the G20 group of finance ministers from developed and emerging markets — which first convened to address jointly needed improvements in international financial oversight in the wake of the Asian financial crisis of the late 1990s — has taken on an increasingly prominent role. And the OECD provides developed market economies with an important forum for drawing out best practices in macroeconomic policy and sectoral regulation.

Canada has long devoted considerable resources to supporting these institutions in their respective tasks. And these tasks are of a type that must be undertaken multilaterally. It would not be inconsistent with Hart's recommendation that priority be given to productive relations with the United States if Canada were to continue to assign high priority to a well-functioning international architecture for macroeconomic stability, rather than, as he suggests, merely sustaining its participation in these forums.

Foreign policy engagement

Similarly, as the thickening of the Canada-US border in the wake of 9/11 so starkly illustrated, threats to peace and security originating abroad can have a major impact on the functioning of the North American economy. For this reason alone, it behooves Canada to work in close partnership with the United States to curb these threats. Canada's significant commitment to Afghanistan is right for both Canada and North America; support for Haiti and for the Caribbean more generally should help to mitigate a growing immigration and refugee — as well as drug trafficking and money laundering — challenge that could otherwise reach the continent's shores; our holding of the gavel for the refugee working group in the context of the search for a lasting peace in the Middle East can contribute to solutions in the region that ultimately reduce the threat of terrorism, which could undermine a well-functioning Canada-US border. Accordingly, and as recommended by the Conference Board of Canada in volume 1 of its Canada Project report, *Mission Possible: Stellar Canadian Performance in the*

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Global Economy, Canada's foreign policy footprint should be focused but significant (Hodgson and Shannon 2007).

SOME COMMENTS AND CAUTIONS

Bilateral/trilateral, regional and multilateral trade negotiations

Hart suggests that the incremental benefits flowing to the Canadian economy due to active engagement in multilateral trade negotiations and to the pursuit of various bilateral and regional trade initiatives fail to outweigh the costs (in industry and bureaucratic time, and, just as important, in attention and focus) of these undertakings. Summarizing his view, he recommends a policy of "benign neglect."

A first caution is — given that the United States and other competitors are pursuing what some have called "competitive liberalization" as a means of gaining preferred market access — that there may be good, procompetitive reasons for Canada to keep pace. Major exporters stand to lose hundreds of millions of dollars in sales because of competitors' free trade agreements (FTAs). The cumulative effect on our national economy of losing our competitive position in market after market could be significant.

Second, as a legitimate part of the policy mix, we can advance our goal of closer integration with the US by seeking FTAs with countries that already have FTAs with the US. To do otherwise risks making Canada a less desirable place from which to export from North America to certain markets and also makes Canada a less desirable investment location. In other words, matching US FTA moves is part of what Canada can do to strengthen its position on the North American platform.

More rationally, from a global supply-chain perspective, Canada and the United States could work toward a triangulation of their respective third-country FTAs. If, for example, both countries agree that imports from Israel, or from Chile or from Costa Rica, merit preferred access, then such content should be given the same preferential lower-tariff treatment as intra-NAFTA trade. More boldly, as suggested in the American Assembly report *Renewing the U.S.-Canada Relationship* (2005) and the Council on Foreign Relations Task Force report *Building a North American Community* (Council on Foreign Relations 2005), Canada and the United States might usefully examine the desirability and feasibility of a NAFTA accession agenda — in the first instance, for free trade partners in the hemisphere (particularly given the ongoing stalemate plaguing negotiation of a free trade agreement of the Americas), and ultimately for trading partners important to both countries (such as South Korea).

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A third caution is that, as Hart himself notes, WTO rules underpin the bilateral trade relationship. In many areas, the Canada-US FTA and NAFTA cross-reference the General Agreement on Tariffs and Trade (GATT) and now WTO rules in such key areas as agriculture and trade remedies. In these sectors, WTO negotiations therefore provide the only avenue to further liberalization, and it is thus incumbent on Canada to devote the resources necessary to pursuing its objectives. So, too, the WTO as an institution provides an important dispute settlement forum to both countries, as demonstrated repeatedly in the course of the long-running softwood lumber dispute.

More broadly, given the transformations in global production and supply chains for goods and services that Hart identifies, active engagement in multilateral trade negotiations is the only means for Canada to address potential import substitution competition. Today, China is close to becoming the main source of US imports, despite numerous US barriers (for example, antidumping measures), substantial regulatory divergence from the US and the absence of NAFTA preferences. Canada's share of US imports fell from a high of 19.8 percent in 1996 to a low of 16.4 percent in 2006 (the figures for China are 6.5 percent in 1996 and 15.5 percent in 2006). Excluding oil and gas, Canada's share of US imports went from 20.9 percent in 1996 to 15.1 percent in 2006, whereas China's share grew from 8.6 percent in 1996 to 18.8 percent in 2006.

A further caution regarding the relative priority to be given to multilateral trade liberalization is that for Canada's service providers, third-country markets are more important than they are for Canada's producers of goods. According to the Conference Board of Canada, the US accounts for about 60 percent of Canada's service imports and exports; the remaining 40 percent is mainly accounted for by Europe and Japan, and the fastest-growing service markets are in developing countries. The WTO is the only forum for Canada to negotiate service market access with the European Union, Japan, China and India. Further, recent experience suggests that although (as Hart asserts) "most markets of interest to Canadian suppliers and investors" are fully open to international competition, the "few exceptions" (409) are still important (contrary to Hart's implication). Life insurance is a good example: Manulife and Sunlife are Canadian service export/investment leaders with a clear competitive edge in developing markets; but Vietnam, India, Indonesia, China and the Philippines, among others, are far from fully open to them, and these markets are thus the focus of considerable effort on the part of trade policy officials.

And the same is true for investment. Canadian investment capital is now being directed to markets other than the US, and foreign investment in Canada is no longer predominantly American. Indeed, as noted in a relatively recent Statistics

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Canada data series on the business activities of Canadian foreign affiliates (not captured in conventional cross-border data), the contribution of this diversified activity to Canada is underestimated (Statistics Canada 2007).

The border

Hart rightly places border administration at the top of his priority list. In fact, many initiatives have been launched in the past few years to streamline and manage the regulatory requirements administered at the border (for example, electronic notification) under the 2001 Canada-US Smart Border Declaration and the 2005 Security and Prosperity Partnership (SPP) agenda. The North American Competitiveness Council (NACC) gives similar priority to border-crossing facilitation for goods and people. But Hart may understate the extent to which core security concerns of Congress and/or the US administration have driven a number of measures that run counter to border facilitation — from the Western Hemisphere Travel Initiative to new fees for the US Department of Agriculture's Animal and Plant Health Inspection Service (APHIS) inspections. Although the security establishments in both countries acknowledge that threats may arise from within as well as outside North America, the concept of perimeter security does not represent a complete answer to those who argue that two borders are better (and more secure) than one.

One of the advantages of the approach reflected in the Security and Prosperity Partnership is that the closer cooperation between Canadian and US authorities responsible for security under the Smart Border and other accords is brought together with a prosperity agenda — that is, a trade- and investment-liberalizing agenda. And having respective authorities report to the prime minister of Canada and the president of the United States (as well as the president of Mexico) provides some assurance that effective security measures will not be taken at the expense of facilitation for legitimate trade in goods and movement of businesspeople. The two governments are thus already pursuing the agenda recommended by Hart — namely, greater cooperation and information exchange, greater infrastructure and technology investments and more targeted enforcement.

Regulatory convergence

In respect of border administration and domestic regulation, Hart makes a convincing case for regulatory convergence. And, indeed, again under the SPP, governments have adopted an ambitious agenda. It is fully supported by the private sector, as reflected in the first report of the North American Competitiveness Council.

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The report's initial recommendations identify specific and concrete areas for agreement over the next three years based on an assessment of mutual interest and achievability (NACC 2007).

But some caution is in order. Experience to date under the SPP confirms that the mandates of regulatory agencies are domestic. And in both Canada and the US, under sound principles of administrative law, regulatory authorities are granted independence of action, subject to judicial review. For this reason, in March 2006, the leaders of Canada, Mexico and the United States directed their "central regulatory agencies [to] complete a regulatory cooperation framework by 2007," endorsed fully by the NACC (White House 2006).

A second caution arises from the security concerns, discussed earlier, that are connected with the border. Trade in defence goods and technology is increasingly impeded by more stringent US regulations related to national-security-based export controls — for example, the International Traffic in Arms regulations under the *Trading with the Enemy Act*. With respect to border administration, harmonized regulation is but a piece of the puzzle; investigative cooperation, exchange of information and enforcement questions will also need to be studied further.

A third caution regarding regulatory convergence is related to the question of whether common regulation is always the right response. Mutual recognition has proven efficient and effective in areas ranging from electrical standards to corporate governance and audit. And such frameworks can often be negotiated more quickly than full regulatory reform. This is the approach recommended, for example, by both the Minister of Finance and the Secretary of the Treasury for liberalizing trade in equity securities, building on the earlier successful experience between the Ontario Securities Commission and the US Securities and Exchange Commission in relation to multijurisdictional prospectus offerings.

Other impediments

Hart identifies restrictions on foreign direct investment and sector-specific tariffs and subsidies as domestic impediments to Canada's global engagement. He rightly suggests that ownership restrictions may deprive a sector of the ability to raise sufficient capital to make the necessary investments to remain competitive in a North American and global context. But he does not delve deeply into the more comprehensive challenge of ensuring that the enabling sectors of transportation, telecommunications, financial services and energy — each of which provides productivity-enhancing support to every other realm of economic activity — remain competitive.

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In each of these sectors, government is taking meaningful steps toward reform, but Hart does not make it clear whether he considers these steps appropriate or adequate.

For example, the Canadian government's January 2007 Convergence Policy Statement and its response to the review of ownership and related issues conducted by two parliamentary committees reflect a clear recognition of the importance of ensuring a regulatory environment that supports continued innovation in the telecommunications sector. In transportation, as well, the government's announced intentions in aviation and surface transport are forward-looking.

More generally, Hart does not examine the challenge of access to capital faced by Canadian firms beyond considering the question of foreign investment. Successive governments have analyzed Canada's capital markets with a view to identifying funding gaps and, where possible, addressing these through appropriate policy actions. This includes looking at full-spectrum financing for Canadian firms, particularly venture capital and high-yield debt (or junk-bond financing).

There is widespread agreement in Canada that the efficiency and the further development of Canada's securities markets are being obstructed by the fragmented nature of securities market regulation, which increases administrative compliance costs. In 2003, the Wise Persons' Committee established by the federal minister of finance recommended the creation of a single national regulator. Recently, the Minister of Finance has underscored the priority that the Government of Canada attaches to achieving more efficient and effective regulation and enforcement. And in December 2006, at the invitation of provincial and territorial finance ministers, the federal government agreed to join the Council of Ministers of Securities Regulation to push for a common securities regulator.

In sum, for each of these enabling sectors, a key question is how much of a constraining effect do investment restrictions, as compared with other factors, have on their international competitiveness. The Conference Board of Canada's comprehensive *Mission Possible* study, cited earlier, identifies a shortage of managerial innovation and a lack of capital intensity as major impediments; its survey of foreign multinational CEOs highlights rising labour costs, interprovincial trade barriers, a lagging physical infrastructure and a limited supplier network as concerns (Hodgson and Shannon 2007). In the most recent competitiveness ranking of the World Economic Forum, Canada was ranked low on "tax neutrality," and Canadian executives themselves cited the general level of taxation and tax regulation as the greatest barriers to doing business in Canada, although the results were based on a limited survey (Porter et al. 2007).

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Further reflection on and analysis of current public policy directions, the pace of reform and the relative priority that should be given to the various policies implicated in each of these enabling sectors would be desirable.

Institutional capacity

Hart encourages the governments of Canada and the United States to “focus upon the functions that must be performed for the efficient governance of deepening integration” and to “create new institutions only where current arrangements are unsuitable” (427). He suggests a number of practical ways in which regulatory agencies can integrate a North American perspective into their work. But he follows his criticism of bureaucratically captured regulatory agendas with a series of recommendations for more bureaucracy.

First, Hart calls for the establishment of a bilateral commission “to supervise efforts to establish a more coordinated and convergent set of regulations” (428). However, the sources from which departments and regulatory agencies derive their rule-making and enforcement authority make the implementation of this recommendation challenging. These departments and agencies draw their mandates from domestic law, they are governed by regulations wholly within the four corners of the law’s requirements, and they function independently of executive branch authority. Any direction to these bodies must take the form of regulation and, if necessary, amendments to governing law. Although government departments are by definition expected to carry out the government’s agenda, requirements for transparency and provision of opportunity to comment, principles that both Canada and the United States adhere to, can act as a brake on the implementation of common North American approaches. The US Department of Agriculture discovered this in the process of developing rules to reopen the Canada-US border to beef and cattle trade following the discover of cases of BSE (mad cow disease) in Canada.

More fundamentally, creating a bilateral commission like the one Hart suggests would not only require legislation in each country but could also raise due process and constitutional questions, depending on the scope of authority to be delegated upward to such a body. Further legal analysis is called for. It may, in any event, be premature to propose such an institution if it is unneeded, according to Hart’s own criteria. Completion of a trilateral regulatory framework this year, as called for by leaders, and its prompt implementation by the departments and agencies responsible, could well meet the stated objectives without inviting difficult legal questions.

Second, Hart recommends the establishment of a bilateral task force to develop model mutual recognition arrangements for professional accreditation. This is, in fact, the

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route chosen by governments for accountants, engineers and lawyers, among others; in each country, the professions were charged with developing acceptable arrangements. Given the self-regulated nature of the professions in each country, it is unclear what benefits would derive from having an outside body make recommendations, as these would come back to a table already addressing the issue.

Third, Hart proposes an independent Canada-US secretariat “with a mandate to drive the agenda and report annually to the president and prime minister on progress.” In his view, such an entity could “prove critical to overcoming bureaucratic inertia” (428). An apparently separate body, styled as a joint advisory board to the president and the prime minister, “could contribute some creative drive to the development of new bilateral initiatives.” Caution is again in order. Canada and the United States in their FTA, joined by Mexico in the NAFTA, consciously opted for intergovernmental, not supranational, authority. They have benefited from several independent studies, task forces and secretariats, some of which have been cited here. Ultimately, while the concept of a shared agenda is supported by sound independent analysis and advice, its implementation depends on sufficient top-level political will, authority and capacity. And political will is bolstered in democracies when public policies are responsive to the interests of stakeholders. Viewed in this light, the institutional framework provided by the SPP may well meet Hart’s test for what is needed: an integrative approach to North American competitiveness that gives priority to the border and to regulatory convergence, that is premised on political leadership and, through the process of annual trilateral summits, that builds in accountability of officials for progress. Direct engagement of the private sector through the North American Competitiveness Council is likely a better litmus test of which issues are deserving of earliest attention to foster competitiveness.

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