Intraprovincial Trade And Intelligent Borders in Canada

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Some Canadian premiers are concerned about the significant drop in intraprovincial trade brought by NAFTA.

Intraprovincial trade in Canada has changed over the last 20 years, particularly since the modifications in economic policy implemented in the mid-1980s that led to trade and financial opening.

Canada had traditionally maintained greater protection for its investments and trade until the mid-1980s. However, it gradually became completely in step with the new form of trade relations in the world: globalization. This implied greater openness, which can be clearly observed recently not only in its deeper trade and financial ties to the United States, but also in its provincial trade, which has changed destination.

It is important to answer the questions: Why have international exports grown significantly while Canada's internal trade has dropped, and what is the short-term impact of this?

My answer is that globalization has linked Canada's provinces more to the United States than among themselves. This erodes trade relations within the federation and, more than characteristic of development, I see it as a medium-term problem, for several reasons. The first is that the world economy has not yet been able to recover from

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the economic slow-down demonstrated in a drop in global trade and investments; secondly, the United States is only very slowly recovering from its recent recession and its trade with and foreign investment in Canada have dropped significantly. Thirdly, this has postponed the Canadian national project of strengthening the domestic economy in light of the greater linkage to a market that may not respond to trade expectations, particularly since the events of September 11. This process, that makes for greater outward integration, may have enormous consequences, and not necessarily positive ones, particularly since the globalization model is increasingly coming into question and does not bode well for a rapid recovery of trade and investment in the world economy in the short run.

The Canadian Economy

The enormous growth of the U.S. economy in the 1990s, with very low inflation and unemployment levels, had its effect on Canada. The most important impact was the strengthening of the discourse about the blessings of the free market system and the insuperable benefits of U.S. capitalism. This can be observed in the different economic opening policies that Canada implemented since then. Another effect of the United States' impressive economic performance in that period is the undoubted increase in Canada's dependence on it, particularly with regard to trade and investment. The strong U.S. economic expansion in the 1990s increased the two countries' tendency to greater economic integration.

In that decade, the differences between the Canadian and the U.S. economies were seriously accentuated, particularly with regard to productivity and employment, indicators that were lower in Canada. These trends were also reflected in an unprecedented drop in the exchange rate, which showed uncertainty during the whole decade, in contrast with the economic upturn in the United States.

Nevertheless, the recent performance of the U.S. economy is different. The economic recession, openly recognized by the administration, and the very slow recovery, in addition to the events of September 11, have had an impact on trade between the two countries. A constant concern for Canadians has been their growing dependence on trade with their southern neighbor, which has increased since the terrorist attacks.

Since the bilateral Free Trade Agreement came into effect, the volume of Canadian exports to the United States increased spectacularly to 80 percent of all exports. Between 1989 and 1998, total trade volume with the United States increased 140 percent. Exports went from 27 percent of gross domestic product (GDP) in 1988 to more than 40 percent in 1999. Canadian exports are mainly raw materials, auto products, other goods like electrical machinery and services.

Parallel to this increase in international trade, intraprovincial trade in Canada has dropped from 27 percent of GDP in 1988 to less than 19 percent in 1999. It can therefore be said that Canada is evolving into being part of a group of regional economies that turn north-south around the U.S. axis, to the detriment of the east-east axis of trade among its own provinces.

General Trends Of Intraprovincial Trade

Until 1984, the Canadian economy, despite its always having been highly integrated into the U.S. economy, maintained large intraprovincial trade and a very well integrated domestic market.

> The changes in intraprovincial trade, which translate into a greater integration with the U.S. economy, are evidence of a structural transformation in Canadian trade.

This situation has changed for several reasons, among them the reduction of Canadian tariffs, weak GDP growth and weak growth of intraprovincial exports.

Among the general policies dictated by the General Agreement on Tariffs and Trade (GATT) and the Free Trade Agreement was the drop in tariffs, which went from an average of about 3.75 percent in 1981 to 0.93 percent in 1996. This has put intraprovincial exports more at the mercy of foreign competition.

In 1996, trade among the provinces represented 20 percent of Canadian GDP and in some provinces, like New Brunswick, Prince Edward Island, Manitoba and Alberta, more than 25 percent. Because of its vast territory, trade flows between neighboring provinces are considerable: that is, distance is an important aspect of trade relations within Canada.

If we look at the trade between the most industrialized provinces and those that contribute most to GDP, we find very interesting figures. For example, in 1996, 11.5 percent of Quebec's GDP came from its exports to Ontario, its next-door neighbor. For its part, 8 percent of Ontario's GDP came from its sales to Quebec. Also, more than 5 percent of British Columbia's GDP comes from its sales to neighboring Alberta province.[1]

The service industry, one of the country's most important, is the biggest contributor to Canada's domestic trade. It should be noted that 75 percent of jobs are in the service sector and the remainder in manufacturing. Four provinces (Quebec, Ontario, Alberta and British Columbia) concentrate 85 percent of all service provision.[2]

In fact, of Canada's 10 main industries that trade domestically, five belong to the service sector. Other very important industries for intraprovincial trade are automobile and truck producers, the food industry and mining, which all together tripled their internal trade from 1984 to 1996. Processed foods and mineral fuels are also involved in intraprovincial trade.

Nevertheless, the economic importance of Canadian intraprovincial trade has dropped since 1984. Interprovincial exports compared to GDP have fallen in all provinces except New Brunswick, where they have remained fairly stable. Oil-rich Alberta's intraprovincial exports have also fallen in absolute terms due to fuel sales being diverted to international markets.

While intraprovincial exports dropped, international exports more than doubled in the same period. The increase in foreign trade was particularly important between 1991 and 1996, with a 17 percent mean annual growth rate in exports, a much higher figure than the 4 percent mean annual growth rate for intraprovincial trade in the same years. Until 1991, intraprovincial and foreign exports had grown more or less at the same rate, diverging from that year on.

Import performance has been similar. On an average, imports from abroad have increased 150 percent and intraprovincial, 48 percent in the same period. This shows how, with the passage of time, the Canadian economy has become increasingly more dependent on international trade.

This trend coincides with the investment policy Canada implemented from the 1980s on that centered on three basic stages: the first, when the Foreign Investment Review Agency (FIRA) was replaced by Investment Canada under Brian Mulroney's government, which came into office in 1984 and had a more liberal trade and investment policy. This new policy had a new mandate: stimulating both the entry and outflow of investment and foreign trade, which is why Investment Canada opened the doors to foreign investment and foreign trade, albeit maintaining heavy protection for the biotechnology and cultural industries.

The second stage began with the signing of the first free trade agreement between the United States and Canada in 1989, which resulted in greater investment and trade both ways. The third stage was consolidated with the coming into effect of the North American Free Trade Agreement in 1994. Since then there has been a firm tendency toward foreign trade and a sizeable flow of foreign direct investment (FDI). Between 1985 and 1992, Canadian FDI grew an average of 9 percent a year.

These economic transformations also coincide with the reduction in U.S. tariffs, which dropped from 2.58 percent in 1981 to 1.91 percent in 1996, as well as the changes in labor costs per employee in the United States compared to Canada, which have gone up and down, and the constant fluctuation and instability of Canada's exchange rate.

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All the provinces, with the exception of Prince Edward Island, depended more on international than intraprovincial trade in 1996. However, there were appreciable differences among them as to the degree of economic dependence.

If we disaggregate GDP information by province for the same year, we can see that some oriented a significant part of their trade abroad, among them: the Yukon Territories (25 percent), Alberta (38 percent), Ontario (46 percent) and Quebec (35 percent). Ontario was the province most dependent on foreign exports in 1996.

All the provinces except Ontario had a deficit in their intraprovincial trade balance in 1996. For some, this deficit was important in comparison to their provincial GDP. For others like Quebec and Manitoba, intraprovincial exports and imports were almost balanced.

In 1996, more than 40 percent of Canada's intraprovincial commerce came from Ontario, the leading province in domestic trade. That year, it was the largest market for most of the other provinces, and it was also an important intraprovincial exporter. However, the most significant trade relationship in Canada is the one between Ontario and Quebec, which represents 22 percent of the total value of all domestic trade. The export of products and services to Ontario represents more than 11 percent of Quebec's GDP, while that of Ontario to Quebec represents 8 percent of the former's GDP. These two provinces, plus British Columbia, concentrate 75 percent of Canada's population and 87 percent of its GDP.[3]

And Since September 11?

The changes in intraprovincial trade, which translate into a greater integration with the U.S. economy, particularly of the most dynamic provinces, are evidence of a structural change in Canadian trade. This transformation occurred under particular conditions, geographically, by sector and by degree of intraindustrial specialization.

Seemingly the Canadian government, far from being concerned about this structural change and creating the conditions to turn around its trade relations, considers that the September crisis constituted an opportunity for building what has been called "an intelligent border" to avoid, among other things, the enormous lines at the border, reduce waiting and facilitate "just-in-time" shipments.[4]

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An intelligent border aims mainly at getting goods across the border more efficiently, as well as a safer flow of individuals. Ensuring this requires better infrastructure and more efficient exchange of information.

The project includes a series of controls at Canada's large production plants, constituting a kind of pre-customs check system for the approximately 700 large factories that dominate trade. It also would provide for U.S. customs agents to be stationed at Canadian airports to pre-check merchandise before it actually arrives in the United States.

These sorts of measures, far from propitiating Canada's trade diversification abroad and strengthening domestic trade, would create greater dependency vis-à-vis the United States and erode intraprovincial trade. They would also promote the concentration of controls, mainly for large corporations, while medium-sized and small companies would continue going through the traditional customs checks or would be absorbed by the large companies.

With the intelligent borders project, Canada seeks to strengthen its model of outward insertion and reinforce the concentration of its trade with the United States, which could make for grave consequences for its economy, particularly since there are no clear signs of the U.S. economy recovering rapidly. At the same time, the dynamism of north-south integration not only translates into a visible decrease in east-west trade, but in a greater concentration of foreign trade in few provinces, few industries and few sectors, which in the short term may have important repercussions —and not necessarily positive ones— for the Canadian economy. VM

Notes

[1] Patrick Grady and Kathleen Macmillan, *Une analyse des fleux du commerce interprovincial de 1984 a 1996* (Ottawa: Industrie Canada, 1998).

[2] *Annuaire du Canada 2001* (Ottawa, 2002), p. 499.

[3] Ibid.

[4] Cristhie Keith, speech delivered at the "Fronteras reales/fronteras simbólicas" seminar in Mexico City, 25-27 February 2002.