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WORKING PAPER

Emerging Economies

The Asian Economic Revolution and Canadian Trade Policy

JOHN WHALLEY

Working Paper No.8
August 2006

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[1] This paper has been prepared for the Festschrift Conference in honour of David Laidler, August 18-20 2006. I am grateful to Josh Svatek for his assistance.

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Thank you for your interest,

John English

Author Biography

John Whalley is one of Canada's most pre-eminent experts in the field of global economics. Currently, he holds a number of academic positions, including Professor of Economics and Director of the Centre for the Study of International Economic Relations at the University of Western Ontario, and Professor of International and Development Economics and Director of the Development and International Economics Research Centre at the University of Warwick. He is also the Co-Director of the ESRC Centre for the Study of Globalization and Regionalization (CSGR), a Research Associate at the National Bureau of Economic Research in Cambridge, Massachusetts, and a former Visiting Fellow at the Institute for International Economics in Washington, D.C.

Dr. Whalley has written and co-authored dozens of scholarly articles on a variety of subjects, including international trade and development, public finance, general equilibrium theory and computation, soviet and transition economies, environmental issues and the economy, and Canadian trade policy. He holds a B.A. in Economics from Essex University (1968), an M.A. from the University of Essex (1969), and an M.A.(1970), M.Phil. (1971), and a Ph.D. (1973) from Yale University.

Abstract

This paper discusses the broad orientation of Canada's trade policy relative to two major historical phases of development based on a secure national market behind the National Policy from 1879 until the 1930s, and progressive integration with the United States (US) through Bilateral Agreements (1930s), the Auto Pact (1965), the Canada-US Free Trade Agreement (1987) and the North American Free Trade Agreement (NAFTA) (1994). Currently, Canada exports approximately 85% to the US, but imports from China account for 8% and are growing at over 20% a year. Sharply unbalanced (surplus) trade with the US is counterbalanced by unbalanced deficit trade with China. A scenario of elevated growth in Asia (principally China, India, and the Association of Southeast Asian Nations or ASEAN) poses challenges of relative disintegration from North America and growing global integration centered on Asia. Seemingly a series of implications follow; including positioning Canada within the emerging network of regional agreements in Asia, more resource-based and Western Canada focused trade and infrastructure development, and responding to capital market integration with Asia. Broader issues include the potential adjustments facing Central Canada as Asian imports of manufactures displace both imported manufactures from the US and domestic production are raised.

1. Introduction and Summary

Canadian trade and external economic policy has undergone two major phases since Confederation in 1867. The first was associated with the events surrounding Confederation itself and the search for secure markets abroad reflected in the Elgin-Marcy treaty with the US (1854) and its termination in 1866, and subsequently, the search post-Confederation for trade arrangements with the United States and the United Kingdom. The failure to develop secure arrangements lead to the National Policy of Prime Minister, Sir John A. MacDonald in 1879 and development behind a national tariff to be based on transportation subsidies and Westward settlement. In the 1930s, this led to a three part tariff with the highest tariff against the US and Commonwealth preferences agreed in the 1932 Ottawa conference.

The second phase can be seen as progressive North American integration beginning with bilateral negotiation with the US in the 1930s and is characterized by ever-deepening trade engagement resulting in the Auto Pact (1965); the Canada-US Free Trade Agreement (1987) and subsequently trilateralized under the NAFTA (1994). This is despite multilateral engagement and negotiation first in the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO). During this phase, Canada's export share with the US grew from over 30% in the late 1990s to 75% at the time of the Canada-US Free Trade Agreement to approximately 85% today. This growing trade is heavily concentrated in automobiles and parts following the 1965 Auto Pact, with Canada's production in manufacturing concentrated in Ontario. This trade growth has also been central to four decades of consistent growth in Central Canada.

It is argued in this paper that high growth rates in developing Asia, and most notably in China and India, if they persist for several decades (as has been the subject of conjecture in discussion of the BRICs)[2] will inevitably affect trade patterns and subsequently, Canada's interests in access to foreign markets. The continuation of these growth rates for the coming decades in developing Asia is what I term the Asian Economic Revolution. Currently, Canada has 8% of its imports from China

[2] D. Wilson and R. Purushothaman, *Dreaming with BRICs. The Path to 2050*. Goldman Sachs, G*lobal Economic Paper no.99*, October 2003. Online: <http:www.gs.com>.

which are growing at 22% / year.[3] With only 1.6% of exports going to China this large trade deficit partially accommodates a large trade surplus with the US (the US only accounts for 56% of Canada's imports). The prospect is for China and other Asian imports to progressively displace imported manufactures from the US, and for Canada's export of resources to Asia to grow. This in turn will influence both Canada's negotiating approach to economic integration abroad, and in turn have implications for domestic policy.

To narrow the focus of the paper, I discuss only the larger countries in developing Asia (China, India, Association of Southeast Asian Nations (ASEAN)) and do not comment on developed Asia (Japan, Korea, Taiwan, Hong Kong). Japan and Korea, for now, have larger trade shares than all countries in developing Asia except China, however, the presumption is that this will change in the next few decades.

For Canadian policymakers, the growth prospects for Asia over the next few decades have significant implications for policy more broadly. Will US imports of manufactures be progressively displaced by Asian suppliers with ever-growing surplus trade with the US and deficit trade with Asia? Will trade-based manufacturing in Ontario and Quebec decline and growing resource exports occur from Western provinces? If trade shares with Asia have the potential to grow and access to these markets becomes more important, how should Canada modify its trade negotiating stance? The Asian economies are now seemingly engaged in a wave of new regional negotiation that goes beyond conventional goods and services negotiations to cover a range of less conventional issues (such as competition policy, mutual recognition, movement of persons, and others) and these agreements are as much process oriented as agreements on limitations on the use of trade instruments. Should Canada participate more actively in such negotiations even if seemingly different in focus from WTO or bilaterals with the US? How will capital market activity surrounding this integration change? Should long-term infrastructure projects (pipeline approval processes with environmental considerations) reflect an increasing Western focus for potential Asian trade more so than a Southern US focus? Should non-trade policies, such as immigration policy factor in the increased trade that follows where culturally-attuned communities develop?

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[3] Minister of Public Works and Government Services Canada. "Seventh Annual Report on Canada's State of Trade. Trade Update". Foreign Affairs and International Trade Canada, June 2006. Available online: <http://www.international.gc.ca/eet/trade/state-of-trade-en.asp> p. 24.

A central issue concerns whether Asian growth will persist, and there are conflicting views and opinions. Some such as Lin[4] see Chinese growth, in particular, as now firmly rooted in a twenty year experience that will persist for many decades. But others see Chinese growth as more fragile, with growing inequality, deepening environmental problems, demographic constraints of an aging population, and problems of financial structure. Growth prospects elsewhere in Asia, in India and in the ASEAN, encounter similar divisions of opinion.

These are broad ranging issues for the policy framework in Canada with implications beyond trade and economic integration. I focus more heavily on the trade policy dimensions as reflects my own area of relative expertise, but the broader questions facing Canadian policy remain. First, I briefly review the historical pattern of Canadian development and the extent of Canadian integration with the US that has evolved in recent years. Next, I discuss Asian growth, in China and India specifically, and discuss alternative views on its longer term sustainability. Finally, I turn to the seeming implications for trade policy negotiations and capital market integration. I will conclude with a discussion concerning possible broader policy implications.

2. Phases of Canadian Development and the Asian Challenge

The broad characteristics of Canada's development since Confederation are well known[5] and so I will only briefly summarize here and provide limited documentation, focusing more heavily on the potential departures from these processes which continued high growth in Asia may portend.

As summarized in Whalley,[6] trade concerns regarding access to natural resource exports led Upper and Lower Canada into negotiation with the United States and the subsequent forging of the Elgin Marcy Treaty (1854), providing the two provinces duty free access to a range of resource products. In 1866, under the terms of the

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[4] J.Y. Lin, "Is China's Growth Real and Sustainable?", in *Asian Perspective*, vol. 28, no. 3, 2004.
[5] C. Hamilton, R. Hill, and J. Whalley, *Canadian Trade Policies and the World Economy*. Research Studies, vol. 9, Royal Commission on the Economic Union and Development Prospects for Canada, Toronto, ON: University of Toronto Press, 1985, xv, p.147.
[6] R. Hill and J. Whalley, "Canada-US Free Trade: An Introduction" in J. Whalley with R. Hill, *Canada-United States Free Trade*, volume 11 of the Research Studies, Royal Commission on the Economic Union and Development Prospects for Canada, Toronto, ON: University of Toronto Press, 1985, pp. 1-42.

Treaty, the US gave notice of termination and the Treaty lapsed. This was one catalyst underpinning Confederation (1867) and the search for more secure markets spurred by nation-building. This was in part to be met through a secure internal market pending negotiation of trade arrangements abroad with enhanced bargaining power of the newly joined provinces.

Following Confederation in 1867, there were repeated attempts by the new Dominion to negotiate secure trade arrangements with both the US and the UK. These failed, and in 1879 Prime Minister Sir John A. MacDonald, committed the then government to the National Policy. This was to be a strategy for Canada's development behind a national tariff which would emphasize East-West linkage, Western development, transportation subsidies and the development of a national transportation system. It was to lead to the development of East West transportation routes, Western settlement, and the development of East-West trade within Canada rather than the seemingly more natural growth of North-South trade with the US which would have occurred in a barrier-free world.

Following the adoption of the National Policy (1879), debate in Canada continued concerning the merits of a freer trade stance towards the US, with overtures in 1896 and still later. This culminated in the negotiation of a free trade arrangement with the US in 1911 by then Prime Minister Sir Wilfrid Laurier following pressure from Western farmers who sought reciprocity with the US. The agreement was ratified by the US Congress, but upon return to Canada a vote was forced in the Parliament and the government was to fall. The resulting free trade election won by the Conservative party based on opposition to US free trade then cemented the policy stance in Canada towards internal development behind a national tariff. This was to intensify in the 1930s with the adoption of Commonwealth preferences, and effectively a three level tariff with the highest tariff directed against the US.

The change from and effective reversal of this policy stance began in the mid-1930s through bilateral negotiation with the US which effectively lowered trade barriers on North-South trade. This was born of the experience of the global depression (1929-31) and the attempt by the then US President Franklin D. Roosevelt to revive the global economy, in part, by reciprocal trade negotiations under the Reciprocal Trade Agreements Act (1934). This authorized the president to lower US trade barriers bilaterally if such reductions were reciprocated by foreign trade partners.

Between 1934 and 1938, three negotiations occurred with Canada which bilaterally lowered the US Smoot-Hawley tariff of 1929 and provided significant reductions in the trade barriers faced in the US markets. Canada granted the US Most Favoured Nation (MFN) status with some limited preferences. These events preceded reductions in bilateral barriers which were to follow in the post-war years both multilaterally under the GATT and bilaterally.

After World War II, Canada had a trade structure which reflected a heavy reliance on natural resource exports, including wheat. Roughly 30% of exports were to the US, however, 70% of imports, largely in the form of manufactures came from the US. Canada's exports were largely to Europe, and following the period of development under the National Policy the ratio of trade to GDP was much smaller than it is currently (around 20% as against 45% today).

Further trade reductions began multilaterally under the GATT concluded in 1947. The early four GATT rounds before the entry of Japan in 1955 and the formation of the European Economic Community under the Treaty of Rome in 1957 (now the European Union (EU)) limited lowering barriers on both sides as the primary focus was on bindings of tariffs. But trade barriers under the GATT later declined as a result of the later Dillon (1957-59), Kennedy (1963-64) and Tokyo Rounds (1973-1979) largely focused on manufacturers, and Canada's imports from the US were stimulated as a result. These negotiations reflected US-EU (and later Japan) reciprocity in which Canada participated under MFN

It was during these years, however, that both the size and composition of Canada's trade with the US began to change fuelled by the Canada-US Auto Pact (1965). This arrangement effectively removed duties on both finished automobiles and parts on a bilateral basis and was to lead to a sharp growth in two- way trade centered on Ontario, and to a lesser degree Quebec. In the years that followed, Canada was to move to a position that accounted for nearly 30% of production activity in automobiles and parts in North America (more than Canada's population share in North America), and bilateral Canada-US trade grew significantly. The reversal in policy stance reflected in the National Policy (1891) was striking.

This process was then fuelled by the signing of the Canada-US Free Trade Agreement (1987) containing many more provisions, including special dispute settlement over the use of antidumping and countervailing duties, provisions in such sectors as energy, wine, financial services, and a range of instrument agreements covering tariffs, safeguards, and other matters. The key 1965 arrangements in automobiles and parts were effectively grandfathered into the 1987 agreement. The later trilateralization of this agreement into the North American Free Trade Agreement (1994) continued this process of external engagement for Canada's economy through added preferential access to an expanding Mexican market. A large segment of this trade, however, remained in automobiles and parts (roughly 35% of trade). Canada's international engagement was then furthered in the GATT/WTO process with the completion of the Uruguay Round in 1994.

By the mid 1990s, in contrast to the National Policy years, Canada's trade amounted to 45% of GDP. Approximately, 85% of exports were to the US. Of these, around 35% were in automobiles and parts, and of Canada's manufactured exports, 90% originated in Ontario. Relative to the years of the National Policy, Canada's economy had become deeply integrated with the US with substantial two-way trade encompassed in a cross border integrated major manufacturing industry, with North-South trade growing rapidly relative to East-West trade within Canada.

This picture of continuing ever-deepening integration by the Canadian economy into a larger North American economy has been the presumption behind a range of policy-related activities beginning in the mid-1980s and the MacDonald Commission. Ever-rising trade shares with the US, trade negotiations on access dominated by the seemingly overwhelming interest in the market of Canada's near exclusive trading partner, and perceived further growth of integrated North-South trade.

It is the prospect of sustained and rapid growth in developing Asia that begins to challenge this presumption. While trade with Asia remains relatively small, its rapid growth poses several challenges for Canadian policy makers. One concerns a trade composition change which reverses the current direction and suggests a more towards resources as in the pre-Auto Pact years as Asia's demand for resource exports grows, suggesting major implications for Central Canada. Another concerns growing deficits in Asian trade and surpluses in North American trade as imports of manufactures from Asia displace those from the US. Yet another, is renewed emphasis on East-West infrastructure involving pipelines, ports and other elements as lumber and mineral deposits in the West are shipped to West Coast ports. Further, is Canada's trade policy negotiating stance given the recent rise of regional agreements in Asia assuming a different form than arrangements under the GATT/WTO and the Canada- US Free Trade Agreement. Issues begin to arise as to whether other areas of policy will be influenced by these developments. One area specifically concerns Canada's immigration policy if, as is often argued, trade growth is facilitated by domestic communities with cultural and other ties to particular trading partners, a reexamination of current policy may be warranted.

Table 1. Annual Growth Rates in China, India, and ASEAN(5) Compared to OECD[7]

	China	India	ASEAN(5)*	OECD
1985	13.50	5.63	0.23	3.83
1986	8.80	4.84	4.60	3.12
1987	11.60	4.27	6.15	3.35
1988	11.30	9.86	8.58	4.74
1989	4.10	6.44	9.14	3.88
1990	3.80	5.81	8.16	3.00
1991	9.20	0.91	6.88	1.36
1992	14.20	5.27	6.26	2.04
1993	13.50	4.87	7.05	1.21
1994	12.60	7.46	7.70	3.12
1995	10.50	7.65	8.10	2.59
1996	9.60	7.39	7.17	3.02
1997	8.80	4.48	3.77	3.34
1998	7.80	5.99	-8.79	2.47
1999	7.10	7.13	3.13	3.11
2000	8.00	3.94	5.85	3.55
2001	7.50	5.15	2.51	1.18
2002	8.30	4.09	4.27	1.38
2003	9.30	8.61	5.28	1.99
2004	9.50	6.91	5.98	3.23
Average 1985-2004	9.45	5.83	5.10	2.77

** Calculated as a weighted average using PPP-GDP share as used in the IMF-WEO Database*

[7] Source: A. Antkiewicz and J. Whalley, "The Sustainability of Growth in the BRICSAM countries" (*mimeo*), 2006, p.9. Based on World Development Indicators database and authors' own calculations.

3. Growth in Asia and Its Sustainability

The growth which has occurred in Asia since the second World War, first in Japan, subsequently in Korea and Taiwan, and now in China, India and also ASEAN is one of the striking features of global economic performance in recent decades. The combined size of China and India (40% of the global population) and their cumulative growth rate of approximately 8-9% suggests that if these current rates are sustained in the coming decades major global change will ensue. Trade patterns and investment flows will be affected and with it the global economy. For Canadian policy makers, the challenge will be whether the objective of trade policy is to benefit from integration into this changing global environment and how it is to be achieved. With continued growth in Asia, there is the prospect of reduced North American integration.

Central to this discussion is the speed and sustainability of growth in Asia. Table 1 sets out growth rates of the larger key developing Asian countries experiencing rapid growth in recent years as contrasted with Organisation for Economic Co-operation and Development (OECD) growth for the period 1985-2004.

China has experienced the most rapid growth, driven first by agricultural reforms and the introduction of the responsibility system in 1976, and subsequently by growth in output and exports of manufactures. Currently, China has nearly 60% of GDP originating in manufacturing and export growth which in the last few years has been in the 35% annual range. There has been active debate on the reliability of the GDP data that underlie these growth rates[8] noting the inconsistency between high measured growth and reduced energy consumption in the late 1990s and early 2000s.

A central element of this growth experience has seemingly been inward flows of foreign direct investment (FDI) beginning in early 1992 and driven by policy reforms and tax incentives. China currently accounts for a significant portion of FDI flows from OECD to non-OECD countries, running annually at approximately $60 billion. Foreign invested enterprises, who utilize this FDI, account for over 50% of manufacturing activity and nearly 60% of exports.[9]

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[8] See T. Rawski, "Measuring China's Recent GDP Growth: Where Do We Stand", in *China Economic Quarterly*, vol. 2, no 1, 2002.

[9] See J. Whalley and X. Xin, "China's FDI and Non-FDI Economies and the Sustainability of Future High Chinese Growth", *NBER Working Paper No. 12249*, National Bureau of Economic Research, 2006.

India's growth shows acceleration following policy reforms[10] in the late 1980s and thereafter (with the exception of 1991) shows high growth, but at rates below those of China. This growth profile has accelerated in the last two years, prompting some to link India and China as comparable large Asian economies, whose continued growth will transform the global economy.

In fact, the Indian experience differs from that of China. The initial base in terms of GDP/capital is lower (perhaps half), and there have been much smaller inflows of FDI (around $5 billion in 2003/2004). Trade growth has also been lower (around 10% per year), and the share of manufacturing in GDP has changed relatively little. There has been growth of output from the service sector, and a significant productivity surge.[11]

ASEAN growth experiences differ among the individual ASEAN countries, but the mean growth rate of ASEAN-5 (Thailand, Malaysia, Philippines, Indonesia, Singapore) is also high as compared to OECD growth rates. The impact of the Asian financial crisis of 1998 are most pronounced among this group of countries. Here again the sources of growth seem to differ from India and China. A claim often made is that Japanese outsourcing to countries such as Indonesia and Malaysia in the late 1970s was a significant trigger.

The combined growth rate of these countries, led by China, substantially exceeds that of the OECD, as can be seen from Table 1. This has lead to speculation[12] that by the year 2050 India and China could exceed both the US and the EU in GDP terms. This scenario suggests a changed global economic structure for Canada, signaling increasing trade with the Asian economies and declining relative trade with North America, trade that is more heavily conducted through West Coast ports, and trade that is more heavily concentrated on resource products.

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[10] A. Panagariya, "India in the 1980s and 1990s: A Triumph of Reform," *IMF Working Paper 04/43*, International Monetary Fund, 2004 and also D. Rodrik, A. Subramanian, and B. DeLong, "India Since Independence: An Analytical Growth Narrative" in D. Rodrick (ed.), *In Search of Prosperity: Analytic Narratives on Economic Growth*. Princeton, New Jersey: Princeton University Press, 2003.

[11] See D. Rodrik and A. Subramanian," From 'Hindu Growth' to Productivity Surge: The Mystery of the Indian Growth Transition", *NBER working paper No. 10376*, National Bureau of Economic Research, March 2004.

[12] Wilson and Purushothaman (2003).

A central element in evaluating the realism of such scenarios is the sustainability of these growth rates over extended periods of time in the Asian economies, and there are substantial differences of view on this front. China's high growth has now been sustained for over twenty years, despite claims from Western economists of its potential fragility. The central concerns have focused on China's financial structure, where high ratios of nonperforming to performing loans in the banking system have prompted suggestions of an interruption of growth. Longer term environmental constraints, and the demographic implications of the one child per family policy have also been raised.

But there are other issues. One concerns growing inequality in China, with the ratio of urban to rural average incomes increasing from around 1.8 in the early 1980s to 3.4 today. The concern is that political pressures for more redistributive policies may lower future growth. Another is plateauing inward foreign investment, which in 2006 may see a small decline. The sharp growth in FDI inflows is often taken to be a significant contributor to growth in both GDP and exports, and this could also constrain growth. Yet another is the absorptive capacity of the OECD economies for increased Chinese exports. China's share of world trade is doubling approximately every three years, and so eventual constraints may prevent the absorptive capacity of the global economy.

Those who view China as embarking on a historical transformation, related to but distinct from the description of the industrial revolution in Western Europe[13], stress the longer term transformation in social, as well as economic structure involved and portray long term growth at high rates for several decades.[14]

In the case of India, the potential constraints on growth differ. In the short term, a central factor concerns infrastructure and power. Other constraints relative to the case of China differ. FDI inflows have been relatively small, and trade growth has been more modest and so external factors in future growth performance seem less significant. Inequality has not increased until very recently, and non-performing loans in the banking system are not a major concern. Increases in manufacturing

[13] See Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*. Boston: Beacon Press, 1944.
[14] See J.Y. Lin, Fang Cai, and Zhou Li, *China's Miracle: Development Strategy and Economic Reform*. Hong Kong: Chinese University Press, 2002.

output are only modest, and urban unemployment has fallen little. The increase in output from the services sectors seems to reflect productivity growth in these sectors as much as employment growth. The drivers of growth, however, appear different and this has caused some to be more cautious of future growth. Opinions vary and there are those who portray India as lying on a golden turnpike with growth building on fifty years of democratic process[15], to those who question future growth[16].

ASEAN growth is at lower rates than India and China, as a higher base of GDP/ capita results from a smaller population size. ASEAN growth was subject to major interruption during the financial crisis of 1998 and the consequences of that episode still persist in Indonesia, even though recovery in the remainder of ASEAN has been more swift. Financial turbulence and contagion as shorter term interrupters of ASEAN growth are therefore a factor. Capital inflows have been more modest and growth rates of exports have been considerably below those of China.

The growth performance in Asia, however, despite concerns over medium to longer term sustainability raises the prospect of major global economic transformation. These economies growing markets, accelerated intra-regional trade,[17] are the sources of significant potential capital outflows, all of which both present opportunities and pose issues for Canadian trade and other OECD policy makers as they contemplate the coming decades.

4. Canada's Trade and Global Integration Policy- Challenges of Asian Growth

Canada's trade between 2001 and 2005 with developing Asia is shown in Table 2. The data indicates only current small export penetration by Canada of developing Asian Markets, but much more substantial and rapidly growing penetration of Canadian markets by Asian suppliers. Asian exports are predominantly of

[15] V.L. Kelkar, "India: On the Growth Turnpike," Paper presented at the Narayanan Lecture at Australian National University, Canberra, April 27, 2004.

[16] K.S. Parikh, "Indian economy: A Shining Star or a Passing Comet?" in Nagesh Kumar, Rahul Sen and Mukul Asher (eds.), *India-ASEAN Economic Relations: Meeting the Challenges of Globalization*. Singapore: Research and Information Systems for Developing Countries (RIS) and Institute of Southeast Asian Studies (ISEAS), 2006.

[17] China, for instance, is now India's second largest export market while five years ago that share was small.

manufactures (and mainly machinery). Canadian exports are heavily wood pulp, ores, fertilizer, and organic chemicals.

The highest growth rates occur on the import side, and are for imports from China. China's export growth rate globally in recent years is in the 35% range, and so the prospect may be for even more rapid growth in the coming years, but the implication would seem to be one of growing trade deficits with Asia, and growing surpluses with the US. The imports entering from Asia will likely displace both US imports of manufactures and domestic production in Canada generating potentially significant adjustment consequences for Canadian manufacturing.

As previously mentioned, there are a wide range of trade policy issues raised by these developments beyond the central developmental issues associated with a North American or global integration focus. Examples include policy in key product areas such as textiles and apparel, based on the termination of the Multi-Fiber Agreement (MFA) and the bargaining of remaining tariff-based restrictions for access improvements;

Table 2. Canada's Imports and Exports with Selected Countries from 2001 to 2005

EXPORTS

	2001	2002	2003	2004	2005	Share in 2001	Share in 2005	% Change 2001-5
United States	351,751	345,366	326,700	348,142	365,741	87.0%	83.9%	4.0%
China	4,264	4,132	4,798	6,655	7,060	1.1%	1.6%	65.6%
ASEAN	2,058	2,475	2,309	2,784	2,793	0.5%	0.6%	35.7%
India	676	675	762	860	1,082	0.2%	0.2%	60.1%
World	404,085	396,381	381,000	411,840	435,834	100.0%	100.0%	7.9%

IMPORTS

	2001	2002	2003	2004	2005	Share in 2001	Share in 2005	% Change 2001-5
United States	218,290	218,497	203,803	208,971	215,109	63.6%	56.6%	-1.5%
China	12,724	16,004	24,100	24,100	29,498	3.7%	7.7%	131.8%
ASEAN	7,000	7,222	8,353	8,353	8,154	2.0%	2.1%	16.5%
India	1,155	1,327	1,577	1,577	1,787	0.3%	0.5%	54.7%
World	343,111	348,957	380,691	356,056	380,056	100.0%	100.0%	11.0%

Source: Industry Canada, Trade Data Online, <http://www.strategis.gc.ca>

and the question of how to proceed with a growing use of dumping actions in Asia (and worldwide).

With slower export growth, one central issue will likely be how Canada can maneouvre to improve access to these Asian markets. In part, some reliance can be placed on WTO disciplines through lowered and bound tariffs in these markets for MFN suppliers, and the package of disciplines agreed to by China in 2001 under their WTO accession terms. But the pace of regional negotiation in Asia has been accelerating in recent years and the resulting agreements are quite different in both form and focus from more conventional WTO agreements and the Regional Trade Agreements which were largely mutual instrument limitation based.

Evaluating both the impact and potential future significance of recent regional agreements requires synthesizing these arrangements as many go well beyond the tariff barrel agreements studied by economic theorists. By way of example, the 2002 US- Singapore bilateral agreement is 210 pages of text and 1,375 pages of annexes; with a 299 page annex on Rules of Origin.[18]

One way to approach these agreements is as tariff plus agreements, a recognition that in many cases the plus component dominates the tariff part in length of text and likely in significance given that in many cases the MFN tariff rates are sufficiently low enough that the margins of preference involved have limited impacts on trade. But a further key element in assessing these agreements is to recognize their significance as process rather than simple instrument-based agreements that limit the use of trade-based interventions (tariffs).[19]

Several of the recent regional agreements, and especially those of China, are centrally labeled as cooperation and partnership agreements. Commitments are set out to cooperate in tourism, rural development, standards setting, and in other areas including poverty alleviation and the promotion of mutual understanding. Tariff arrangements are but one part of these agreements. Some agreements contain broad

[18] Office of the United States Trade Representative (USTR) online: <http://www.ustr.gov/Trade_Agreements/Bilateral/Singapore_FTA/...Final_Texts/Section_Index.html>.
[19] J. Whalley, "Recent Regional Trade Agreements: Why so many, why so much variance in form, why so fast, and where are they headed?", Paper prepared for CESifo summer institute, Venice, 2006.

commitments to cut tariffs with details to be substantially negotiated. In some cases, agreements on Rules of Origin, and even bilateral dispute settlement are to follow the concluded broad agreements.[20] And the move into newer areas not covered by current WTO disciplines (or current or prospective negotiations) such as standards setting, competition issues, mutual recognition and other areas is reflected in the language used to label agreements. The recent China-ASEAN agreement is a Framework Agreement on Comprehensive Economic Cooperation.

Having noted this tendency for regional agreements to evolve as formalized management arrangements for bilateral economic interaction, more so than as treaty-based agreements to mutually limit the use of border measures, a further striking feature is the diversity among the agreements themselves. In part, this is reflected in the sharply differing focus of agreements across the partners involved. Many are agreements between countries of sharply asymmetric size and follow a seemingly standardized pattern common to other agreements involving a large trading partner. China's recent agreements[21] appear customized to individual partners and reflect perceived Chinese opportunities in each bilateral negotiation.

I now discuss only a subset of recent agreements involving both ASEAN as a single entity, and individual ASEAN countries negotiating separately (Malaysia, Thailand and Singapore) due to the sheer number and complexity of agreements.[22] These go substantially beyond conventional free trade agreements in dealing with items not yet subject to WTO disciplines. They have instead become platforms for packaging a range of new and ongoing issues previously dealt with separately (such as visas / work permits) into a combined negotiation. These additional issues added to trade negotiation differ both between multilateral and regional negotiations, and across individual regional negotiations.

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[20] Association of Southeast Asian Nations (ASEAN) website: <http://www.aseansec.org/4979.htm>.

[21] See J. Whalley and A. Antkiewicz, "A BRICSAM Strategy for Canada?" in A.F. Cooper and D. Rowlands, *Split Images: Canada Among Nations 2005*, Montreal: McGill-Queens University Press, 2005.

[22] This discussion draws in part on O.G. Dayaratna Banda and J. Whalley, "Beyond Goods and Services: Competition Policy, Investment, Mutual Recognition, Movement of Persons, and Broader Cooperation Provisions of Recent FTAs involving ASEAN Countries". *NBER Working Papers: 11232*, National Bureau of Economic Research, 2005.

To date, ASEAN has concluded three formal framework agreements (with China, Japan, and India) and aims to activate more substantial arrangements and has a further two (with Korea, and Australia & New Zealand jointly) under negotiation. Singapore has concluded six substantive agreements (with the US, EFTA, Australia, New Zealand, Japan and Jordan) and is negotiating a further twelve. Thailand has concluded two full agreements (with Australia, Bahrain), two framework agreements (with the US, India), one ancillary agreement to a wider ASEAN agreement only covering vegetables and fruits (with China), and is negotiating a further five agreements. Malaysia has a single bilateral investment treaty with the US, but is negotiating a further five agreements. These agreements vary greatly in length, specificity and coverage; some are detailed with substantial specificity (specifically the Singapore-US agreement).

What is striking about these agreements is their breadth of coverage. Several areas beyond current WTO disciplines are dealt with including competition policy, mutual recognition (both of professional qualifications and product standards and testing), movement of persons and visa / work permit arrangements, investment, and cooperation in specific areas.

Of all the ASEAN regional agreements, six contain provisions relating to competition policy: Singapore-US, Singapore-European Free Trade Association (EFTA), Singapore-New Zealand, Singapore-Australia, Singapore-Japan, and Thailand-Australia. The two ASEAN-wide agreements (with China and India) have no coverage of competition policy. Singapore at the time of negotiation with the US had no formal competition law, but is now in the process of enacting such laws.

Investment is dealt with in more of the country agreements than is competition policy and is also covered in ASEAN agreements. There is also more commonality in approach, with central commitments being (either or both) National Treatment and MFN treatment for foreign investors (typically) alongside provisions relating to expropriation compensation, and (in some cases) repatriation of earnings.

Issues related to mutual recognition in these agreements arise under a number of chapter headings in the various texts. Issues of product testing and standards are in chapters on technical barriers to trade and sanitary and phytosanitary restrictions, and particular sectoral chapters, such as telecommunications, touch on product standards while chapters on services deal with recognition of professional certification.

The ASEAN bloc-wide and country agreements also deal with issues related to movement of persons and usually in separate chapters. This is reflective both of the growing significance of visa and work permit issues in the global economy and the absence of multilateral venues for addressing them.[23] In this case, country or regional agreements provide the platform for raising an issue under consideration, but provide no clear multilateral forum for discussion. Bargaining of diverse issues and with it, the greater probability of achieving results presumably provides the rationale for this.

The ASEAN agreements also contain a range of commitments relating to cooperation in a number of areas. Cooperation agreements are typically vague and appear tempting to dismiss as lacking in substance, however, they do represent a commitment to a deepening of bilateral relationships in specific and designated areas and hence are of substance from a process point of view.

The stress on cooperation in the China-ASEAN agreement is manifest in the title of the agreement as a "Framework Agreement on Comprehensive Economic Cooperation" indicating the significance attached to cooperation in bilateral relationship building. There are commitments to strengthen cooperation in five key sectors (agriculture, information and communication technology, human resource development, investment, and Mekong River basin development).

Though inevitably vague and difficult to interpret as legal text, these cooperation elements play a role in the deepening of country to country relationships in these agreements. For countries where sequential relationship building and deepening is seen as a critical way to proceed in international negotiations, the cooperation provisions of these agreements can play a major role as far as international economic management is concerned. These new partnership agreements unlike traditional tariff-based agreements are not typically negotiated as one-off treaty arrangements by countries with an exclusive focus on legal provisions and detailed text.

Canada thus far has not pursued active negotiations of this form with the developing Asian economies. In part, the presumption of continued reliance on North American trade and commitment to WTO process may be one reason, although Canada has been

[23] E. Ng and J. Whalley, “Visas and Work Permits: Can GATS/WTO Help or is a New Global Entity Needed?” *CESifo Working Paper no. 1614*, 2005.

actively involved in regional negotiation elsewhere. Since these negotiations tend to be broader than trade negotiations in coverage, they are also of symbolic importance in establishing linkages to policy structures and processes in Asian countries.

Another recent issue which has received much attention relates to the policy response elicited by a recent wave of both actual and proposed buyouts by Chinese companies of entities outside China.[24] While the majority of these cases have not resulted in completed transactions, they pose the issue of whether these activities might be a catalyst for a wider discussion of the implications for global arrangements covering cross border acquisitions and how Canada might respond. For some years, Chinese outward FDI has been relatively small (in the US$3-4 billion range in 2004) and heavily concentrated on both greenfield and joint venture activity, much of it occurring in Hong Kong. In the last two years, a change which has occurred is both a focus on direct acquisition and the emergence of potentially large transactions, some in the US$15-20 billion range, and with it a focus which goes well beyond Hong Kong. Examples include: the Lenovo buyout of IBM's PC business, CNOOC's (China National Offshore Oil Company) bid for Unocal, prospective bids by MinMetals for Noranda, the Haier Group bid for Maytag, and others. No direct WTO issues are raised by these, but questions of subsidization, lack of transparency, and national security have all been raised. National security issues regarding foreign acquisitions are not new and extend to Exon-Florio provisions of the American Defence Production Act of 1998 following concerns in the US in the late 1980s over Japanese buyouts. However, issues of subsidization of foreign acquisitions through low interest loans from central banks and the transparency of organizational form of acquiring entities (State-Owned Enterprises (SOEs)) are new.

The overarching feature is the apparent absence of globally-agreed disciplines covering not only cross border acquisitions, but more broadly all cross border factor flows. This situation stands in contrast to the goods and services flows covered by the WTO. Both the failed multilateral agreement on investment (MAI) and WTO competition policy negotiations did not touch directly on the newer issues in recent debate on Chinese buyouts, and neither do earlier bilateral trade and investment treaties.

[24] A. Antkiewicz and J. Whalley, "Recent. Chinese Buyout Activity and the Implications for Global Architecture". *NBER Working Papers: 12072*, National Bureau of Economic Research, 2006.

A number of factors underlie this recent upsurge in Chinese cross border acquisition activity. One is large accumulated Central Bank reserves in China (now close to US$800 billion), and a seeming change in policy stance by the Central Bank of advancing low interest loans to SOEs for foreign acquisitions rather than continued accumulation of US treasury notes. Chinese concerns over security for supply of resource inputs (especially oil) for Chinese manufacturing enterprises also motivate the change in activity. And for private manufacturing groups in China, the use of foreign acquisitions as a way of obtaining distribution networks in the OECD seems to be a factor. The picture is one of macro imbalances combined with pragmatic niche-driven foreign acquisition activity involving both Chinese SOEs and private groups, with differing resource and manufacturing acquisition structures. Thus far, central banks around the world have not engaged themselves in extending low interest loans for foreign acquisitions, but the policy structure in China with large communally-owned production units (by national, provincial and municipal governments) makes this logical from China's standpoint.

An issue for Canada is whether to link approval of individual transactions to negotiations (or renegotiations) of bilateral investment treaties. A broader approach is to seek a global regulatory framework covering purchases by prospective foreign parent entities, a matter rarely touched on by previous WTO and OECD investment discussions which have largely focused on translating existing system of trade rules (National treatment and MFN) into investment rules.

These are but two of several issues which could be discussed in light of the changing environment and illustrate the desirability of an adaptive response on the trade and economic policy integration front to developments in Asia.

5. Concluding Remarks and Broader Policy Implications

In a changing world of sustained high growth in developing Asia for several decades there are a wide range of policy challenges posed both for Canada and other OECD countries. The vista is broad, and I have maintained a focus in this paper on trade and economic integration policies. But in many ways the challenges have broader implications.

China's integration into the global economy has the potential to raise major global adjustment pressures. Analytical economists argue that these adjustments are simply the mirror image of the gains from trade, and there is little doubt of the benefits to consumers of low-priced high quality Chinese imports. But the size of the low wage labour pool in China and its current limited deployment in trade-related activities suggests that we may only be in the early stages of China's global integration process. Currently, foreign invested enterprises in China account for over 50% of China's exports but employ only 3% of the workforce.[25] Cumulative FDI into China may be in the $500 billion range, while the OECD capital stock using a rough capital output ratio of 3:1 may be $75 trillion. The amount of capital that could still be deployed in the medium term with immigration from constrained low wage labour in China appears large and hence the potential adjustments would seem to be a key concern to policy makers throughout the OECD. And this is prior to any further adjustment pressures from growth in India and ASEAN are considered.

The adjustments involved relate not only to the country composition of trade, with growing imports of manufactures from China displacing higher priced US imports, but also to domestic production. Since the majority of manufacturing activity in Canada is located in Ontario, the change implied in regional balance could be substantial. Central Canadian production of automobiles and parts will be further impacted by Asian auto production displacing North American production sold in US markets.

The adjustments continue with increased exports of resource- based products from Western suppliers, refocused infrastructure towards shipments from West Coast ports, and additional policy areas. One facet is immigration policy as trade research[26] tends to indicate more proclivity for trade to occur between countries where similar cultural communities reside. Canada's trade strategy for increasing exports to growing Asian markets could conceivably affect changes in immigration policy.

Seemingly these prospective changes have sufficient plausibility to be factored into trade and other policy making in Canada over the next few years. How best to approach and respond to these changes remains the challenge.

[25] See J. Whalley and X. Xin, "China's FDI and Non-FDI Economies and the Sustainability of Future High Chinese Growth", *NBER Working Paper No. 1224*, National Bureau of Economic Research, 2006.
[26] See J. E. Rauch, "Reconciling the Pattern of Trade with the Pattern of Migration," *The American Economic Review*, vol. 81, no. 4. (Sept. 1991), pp. 775-796.

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