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A CN Trade Relations Forum Globalization, Geopolitics, and the Shifting Sands of Trade Policy

Wednesday, February, 10, 2010

David Emerson

*Western Centre for Economic Research
School of Business, University of Alberta
Edmonton, Canada T6G 2R6
www.business.ualberta.ca/wcer*



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Helmut Mach:

Welcome to our CN Trade Relations Forum with David Emerson. Many of you attended our previous forum with Pierre Pettigrew, who also was a former Foreign Minister and International Trade Minister. This year we have had representatives from the United States including Grant Aldonas, former Undersecretary of Commerce, as well as some private sector representatives including Peter Kruselnicki from TransCanada Corporation. These sessions and my position as Director for the Western Centre for Economic Research (WCER) and CN Executive Professor for Canada-US Trade Relations are made possible by the support from CN. So I am pleased to welcome Jim Feenie from CN today. We are also pleased that our sessions are proving useful to our speakers. Peter Kruselnicki, after speaking in the fall, asked if he could sponsor the next one. We, therefore, thank TransCanada Corporation.

We will have a presentation that will run approximately 20-25 minutes by Mr. Emerson. There will be quite a substantial question and answer session following that, so you'll have the opportunity to ask Mr. Emerson your questions. Mr. Emerson will speak on Globalization, Geopolitics, and the Shifting Sands of Trade Policy.

“Globalization, Geopolitics and the Shifting Sands of Trade Policy”

David Emerson

Introduction

Thank you very much Helmut, and thanks to all of you for coming out today. It is great to be back at the U of A, my alma mater. As many of you know I earned my Bachelors and Masters in Economics here before I went to Queens, and a lot of what I have used throughout my career was inculcated here at the U of A. You will see some of what I have to say draws on my education as a graduate student at the U of A back in the days of thinkers like Bruce Wilkinson, Tom Powrie, and John Delahanty.

Alberta is also my home province. I was raised in Grande Prairie and I am doing a lot of advisory work in Alberta today for the Premier as well as some work in the energy sector. So it is good to be back home to talk about trade and globalization.

What I will do is take you through evolving trends and developments in the global economy and relate them to Canada’s economic situation. I always begin by reminding people that Canada has always been a small open economy: trade dependent, with a small population spread across an enormous land mass. Canada always was, is now, and always will be, a small trading economy. And that means we have been successful traders or our standard of living is going to plummet dragging with it our cherished health care and other social programs.

While I won’t have much to say about it today, it is important to recognize that we are also a natural resource dominated economy. Some like to pretend that we are not, but we are. And it has created both opportunities and tensions in our country. Natural resources tend to be western biased, while our population, spread as it is over our enormous landmass, is essentially eastern biased, sometimes giving rise to federal/provincial and regional stresses and strains in the country.

The Good Old Days: Multilateralism

Looking at our recent history with trade and trade policy I like to refer to what I call the ‘good old days’ for Canada. By the “good old days,” I’m referring to the era when multilateralism was the predominant framework in which global trade relations and trade linkages were developed, and North America became the world’s biggest and most dynamic free trade area.

We went through decades of multilateral trade negotiations culminating in broad based agreements, whether under the General Agreement on Trade and Tariffs (GATT) or its successor the World Trade Organization (WTO). Multilateral agreements were concluded under the Kennedy Round and the Uruguay Round, although we have been wading around for more than 10 years in the quagmire of the still incomplete Doha round.

In some of what I am going to talk about in terms of global shifts and changes, you will see causal factors behind the failure of the Doha round, although it has not yet been declared dead.

I also call them the 'good old days' for Canada because, as a small economy in geopolitical terms, multilateral agreements and mechanisms have enabled us to be an influential a player in a world of much larger and more powerful countries. The GATT/WTO is perhaps the only substantial framework for trade that is not subject to the legislative whims of individual countries. Without it we are basically back in a trading jungle in which the powerful take the spoils and drive the international agenda.

Even our vaunted North American Free Trade Agreement, while a robust trade framework at a high level, still leaves substantial discretion in the hands of legislators of the partner countries. This arises in dispute resolution and it arises with the proliferation of domestic measures that have all too frequently become new disguises for protectionism. And wherever such self-serving wiggle room exists it confers advantage on the larger and more powerful.

So the WTO does provide an international legal framework, an international dispute resolution mechanism, and an institution in which definitions, concepts, peer pressure and other institutional pressures can be brought to bear in pursuit of liberalized trade in the world.

And Canada has been good in multilateral trade negotiations. We had, and have, very good negotiators, and we historically made trade negotiations and participation at the WTO a high priority. We were seen as credible advocates and participants in trade liberalization and that earned us influence at the table and in the corridors.

In the 'good old days' there was also plenty of 'low hanging fruit' to make progress easier. Negotiations traditionally focused mainly on what are called 'bound' tariffs: the upper limit on the tariffs that a country can put in place on various product categories. Canada was willing to make very substantial reductions in both bound tariffs and applied tariffs so that, today, we have one of the lowest tariff regimes in the world. For some countries, the adjustments have been relatively painless because applied tariffs were so much lower than bound rates that lowering the bound rate had only modest real impact.

The Good Old Days: the NAFTA Narrative

The other part of the 'good old days' was the Canada-US Free Trade Agreement and its successor the NAFTA. Again, there was much low hanging fruit that enabled Canadian industry to deliver very substantial increases in incomes, productivity, and wealth creation through deeper integration, primarily of the Canadian and American economies. The US also gained substantially through the efficiencies of cross border supply chains offering gains from trade as well as strengthened North American competitiveness in dealing with emerging hyper competitive economies like China and India.

Canada also made powerful use of what I call the "NAFTA narrative." The NAFTA narrative ran something like this. Come to Canada, invest in Canada, expand

your commercial presence in Canada and gain access, not just to a market of 30-34 million Canadians, but to a market of over 400 million North Americans. And as a host, we were a 'non imperial' country without the geopolitical baggage some associate with the United States.

We then built on that narrative with our potential appeal as a 'gateway' between Asia and North America. Billions have been invested developing and fine tuning the transportation and logistics system that connects the heartland of Asia with the heartland of North America. So the Gateway story enriched the NAFTA narrative, providing us with a very compelling rationale for international investors and businesses to root their business in Canada. And it gave Canada real opportunity for an enhanced trajectory for growth and prosperity.

NAFTA also gave us alternative dispute resolution mechanisms for both trade and investment. As you know, the WTO dispute resolution mechanism is quite limited. I am not an expert, but essentially you go through dispute resolution panels and appellate bodies to determine the merits of your case. It can take years. And even winning is not an unmitigated blessing because the remedies take time, you do not get return of duties wrongly levied and, while you may eventually be entitled to retaliate, even that is difficult. (There is no real mechanism under the WTO to resolve investment disputes.)

I know this from my experience as Trade Minister when Canada was empowered to retaliate against the US for a particular infraction involving the so-called Byrd Amendment. Canada won the right to impose duties for a relatively paltry sum, less than \$30 million as I recall. But selecting US products on which to impose retaliatory tariffs, in a country where people depend on buying cost competitive inputs and products for the retail shelf is a very, very difficult thing to do. I can tell you, we had great difficulty finding sufficient retaliation targets that had broad based support for tariff increases. Ultimately, the tariffs would be substantially paid by Canadians in the form of higher prices so perhaps this not a surprising result.

While dispute resolution at the WTO enables adjudication, due process, transparency and peer pressure to be brought into play, it falls short of being a practical, timely way to resolve disputes. The resolution of disputes is no less complex under NAFTA and can take even longer, but you do have the prospect of return of duties wrongly paid and there is a Chapter providing for fairly rigorous dispute resolution for investment {Chapter 11}.

Maybe it is nostalgia, but I think of those as the 'good old days.'

Now we come to a messier world; a world of globalization and geopolitical change that has profoundly affected the entire world of international commerce. As author Thomas Freidman said so well, the world has been ‘flattened’ by globalization, technology, digitalization of communications and by the emergence of sophisticated supply chains that span the globe. We are now in a world where economic success and competitiveness are defined by your ability to participate in global value chains and networks. These global value platforms can be rooted here in Canada, or Canadians can be part of a value chain that is rooted in another country. But fundamentally, global trade success is about how competitive you are at participating in these networks of value creation.

When you look at the imperatives of trade and commercial success today the language is about ‘just in time delivery’; smooth, efficient and reliable supply chains; integrated, multi partner value networks; and symbiotic partnerships.

And it’s about knowledge and technology. Products today, whether forest products, agricultural products or RIM’s Blackberry, are distilled embodiments of technology, science, and knowledge, much of which has accumulated over decades. As Canadians, we pride ourselves on being extremely innovative, and indeed we are. But the cold hard truth is that maybe two or three percent of the worlds’ innovations and inventions are actually Canadian. The other 97 percent are developed elsewhere. This means that if you are going to drive globally competitive and successful value chains or networks, you must have efficient ways of identifying, sifting, sorting, obtaining and making use of the global reservoir of knowledge and technology.

And it’s a critical piece, because now anybody, anywhere in the world, can be your customer or your competitor. All this because geographic barriers and spatial friction have been flattened by technology. The global knowledge reservoir is increasingly accessible, and the knowledge content of goods and services is growing while transportation and logistics continues to improve.

Another trend that has been vital during this period of globalization has been the rise of developing countries, much of whose success can also be traced back to the ‘flatter world’. Most often we hear about the BRICs (Brazil, Russia, India, and particularly China). The world now acknowledges that China has accomplished, in a brief three or four decades, the most massive economic transformation in world history. But other developing countries are ascending rapidly as well: Viet Nam, Malaysia, Indonesia, Singapore, Taiwan and Korea for example.

The emergence of developing economies has also been a catalyst for governance stresses in the international community. The question increasingly is ‘who gets to call the shots internationally’? There was a time, fading fast, when the Americans could drive a global agenda with a little help from the Europeans and/or the Japanese. And Canada, as a senior middle power, could sit at the table as a friend and honest broker and exert a fair amount of influence.

But governance is shifting as developing countries assert themselves and demand a meaningful voice at international tables.

Ancillary to the emergence of developing economies has been an elevation of issues relating to the global distribution of wealth. No longer out of sight out of mind, global wealth distribution has become a prominent and fundamental driver of geopolitical positioning and decision making. It now plays in trade talks, environmental negotiations and security discussions as a major consideration.

Globalization has encompassed other issues as well. The environment is no longer a domestic ecosystem issue. It is a planetary issue where we are running up against the finite limits of destruction of the environment, whether it is climate change, endangered species, ecosystems, air or water. But debates around climate change and environmental issues are now entangled with stresses arising from large disparities in wealth distribution.

Countries like Canada and the US still enjoy standards of living many times higher than China and India, while discrepancies with the poorest countries of the world are truly shocking. So a driving motivation of developing countries has emerged from the reality that developed countries have had it pretty good for a long time, and the environment, or the 'commons', was taxed heavily to get there. Now, just as developing countries are beginning to take off economically, and are able to provide their poor with significant improvements to their standard of living, they are under pressure to deal with a problem largely of developed countries making. So the environment and wealth distribution have become closely linked global issues.

A second trend of concern flows from our deep embrace of the NAFTA. So deep has been the embrace that roughly 75-85 percent of our exports now go to the US. But the NAFTA narrative has been eroding bit by bit. A good trade lawyer can run through twenty or more US legislative or regulatory initiatives that are all part of a growing, insidious, and intractable pattern of protectionism. Whether it is food and product inspection, country of origin labeling, or security measures, the border is thickening. And it shows no real sign of reversing any time soon.

We may now have a clear view of the Achilles heel of the NAFTA. What I see is a US political system that is structurally and fundamentally motivated, not just by grassroots electoral interests, but by commercial interests whose financial support comes at a price, and all too frequently that price is government protection. Compared to Canada, where electoral financing reform has largely neutralized the political influence of individual and corporate wealth, the election finance issue is massive and ongoing.

Even a well-intentioned President has limited power in the face of a protectionist motivated Congress. And sadly, Congressional interest in Canada is perfunctory.

The special relationship enjoyed in the Bush/Mulroney hey days of the Canada-US relationship is all but dead. In spite of the potential for mutual gain through collaboration, Canada is treated much like any other American trading partner, and certainly not a particularly preferred one.

The gateway concept is also under threat. Canada's approach has been to share the competitive benefits of shorter distance to/from Asia, as well as uncongested corridors, to make the gateway a true North American asset. But the new reality is that crossing two borders has become a very significant problem. The risk is that travelers

and shippers will take a longer route, bypassing Canada, but crossing only the American border.

The third trend involving globalization is the weakening foundations of multilateralism. One of the beauties of a multilateral world has been that smaller countries benefitted from largely the same trade protections as big countries. It was a great equalizer. But all of a sudden multilateralism has fallen on hard times and the Doha round is foundering. Some believe the WTO requirement for a unanimous consensus is no longer realistic for an organization of 153 countries. Developing economies, much more active, informed, and into the game than ever before, realize that they can have a very powerful influence through multilateral channels. The result: significant divides have opened up between developing and developed countries with no obvious way of achieving consensus. Here again disparities in wealth distribution are never far from centre stage.

Frustrations with multilateralism and decision stalemates are a growing risk for trade, even for organizations like the UN where governance reform is increasingly being debated.

What Now: The Economics of A Billion

Countries are now saying, 'what do we do now'?

The answer for many has been to turn to less cumbersome regional blocs and partnerships. Within the 21 member APEC, for example, there are ongoing discussions about a free trade area of the Asian Pacific although, even here, there is resistance from some because it is too inclusive (of North America). So within APEC, you have sub coalitions of Asian economies, sometimes inclusive of Australia and New Zealand, sometimes not.

The 10 member ASEAN group plus China have now established their own trade agreement. Across the Atlantic, Europe has developed a powerful 27 member economic union. And Latin American economies are iterating toward several of their own groupings.

We are into a world where success depends on what I call the 'economics of a billion.' It's not an absolute but, as a country, if you do not have good market access and an ability to efficiently participate in a market of a billion people, your ability to be a leading global competitor will be seriously constrained. A country like China has, by itself, more than a billion, as does India. Europe is a few hundred million shy; North America is nearly 600 million short.

In my judgment, countries that have not developed broad based, deep and efficient linkages into markets of a billion people will be challenged in the years ahead because they will fall short of critical mass for global value chain/network leadership.

Canada is now finding itself increasingly marginalized even in North America, and has not done enough trade deals beyond North America to compensate for the repeated loss of privileged access to the US.

Here's the rub. We wax eloquent about the need to diversify from natural resources and we talk endlessly about building a more productive base of value adding,

innovative, and technologically advanced companies and sectors. But, in my estimation, even if we have world class innovation in Canada, or in Western Canada, and we do not have an international market of a billion people to sell into, we will not succeed in building a secure long term value chain and associated employment base.

Technologically we may succeed. We may be good inventors, and we may develop some great assets, but it's the companies and countries that have access to a billion people who will realize the real commercial benefits. They will buy, or replicate, your technology and build those globally competitive technology clusters, and the jobs will be theirs.

So as the WTO stumbles, we see trading economies forming regional blocs, and many are forging bilateral agreements. But Canada has been slow to respond. Canada has a few bilateral trade agreements, but they are not very big, and not very many, compared to Europe, America, Australia, Peru, Chile and a number of Asian countries/city states. We have entered into a world where trade dependent countries are not waiting for the WTO. They are aggressively forging trade and economic agreements to capitalize on the economics of a billion, and their global competitive strength will grow as they do.

Canada is in a precarious position. The fundamental principle of the WTO and multilateral trade liberalization is the 'most favored nation' principle. In other words, you will treat all your trading partners as well as your most favored trading partner. As the world gravitates to regional and bilateral deals the most favored nation principle is weakened. The result will be trade-diverting fragmentation in the global marketplace as each regional and bilateral agreement may involve different rules, standards, and approaches to trade policy. This is not good for Canada.

Making matters worse is the proliferation of new and more innovative forms of protectionism from our largest and best customer. You only have to look at trade remedies under the NAFTA, and what happened in softwood lumber, to realize that trade remedies (i.e. countervailing duties and antidumping duties) are being used more maliciously and arbitrarily, and have really become another form of protectionism. And under NAFTA, disputes are adjudicated under domestic law, through NAFTA processes. While use of domestic, as opposed to international law, is bad for free and fair trade, Congressmen have frequently decried even the use of NAFTA processes as an affront to their legislative authority.

Security issues have also become a favored disguise for protectionism and border thickening. One example is ITARs (International Traffic in Arms Regulations). These are regulations that are exempt from NAFTA on security grounds and make it extremely difficult for military and security contracts to be supplied from Canada.

Canadian companies often have dual nationals that are from American proscribed countries (e.g. Iraq, Iran, China) and who therefore are not allowed to work on a broad range of 'sensitive' US technologies. As a result, many contractors previously doing such work in Canada are shifting it to the States or forgoing the business.

Energy and environmental policy in the US has become another form of protectionism with the development of a legislative framework for carbon taxes at the border, massive subsidies to 'green energy' companies, cap and trade approaches to CO2 but with massive giveaways of carbon credits proposed for the worst polluters, and restrictions on energy forms mainly from Canada with no scientific basis. And, of course

we have Americana 'buy at home' and 'country of origin' labeling initiatives. Many of these policies may even be WTO compliant, again telling you that the WTO is stuck in the mud as a work in progress.

So the bottom line for Canada remains: we are critically trade dependant and we will always be critically trade dependant. But we are being squeezed by global developments, and we are being squeezed by our long time friend and largest trading partner, the USA.

Even our *bona fides* as a free trader are being tarnished.

You only have to look at what Helmut Mach wrote in an article in *The Globe and Mail* on supply management. In the Doha round, we've been somewhat neutralized, and ridiculed by some, because of our refusal to enter into negotiations on our protectionist supply management system in agriculture while we preach free trade to others. We have gone so far as to pass a parliamentary resolution, with passage by every single party in the House of Commons, that instructs negotiators in Geneva not to change any aspect of our supply management system. For a trade dependent country, where 90 per cent of our agriculture and most of our entire industrial base has a strong export interest, to take such a protectionist position undermines our trade future as well as our leadership position.

For Canada it's time to face up to the real risk of marginalization in the global community. If we do not act soon we risk sliding into irrelevance. And when that happens it's tough to change it because no one cares. At that point you're off the radar and the world moves on.

Where from Here Canada?

In my opinion, Canada needs an aggressive new commercial policy strategy. Let me offer what I think at least seven key ingredients should be.

First, we need to make an unqualified commitment to multilateral free trade. We can't afford, in a protectionist world, to be quiet and subdued. Canada should strive for headlines for getting the world back to rebuilding and strengthening the processes and mechanisms for advancing multilateral free trade.

Second, I believe all governments in Canada, federal and provincial/territorial, have to embrace what I call a 'next generation' approach to international commerce'. I won't go through the details again. But a new generation trade strategy does not need to focus as heavily on tariffs because, while still significant in certain areas, tariffs are far less of an issue than they were 10 or 15 years ago. Where tariffs and duties are a threat to trade, and work needs to be done, is to contain the increasing use and misuse of trade remedies. This will require strengthening of dispute resolution mechanisms in both the WTO and NAFTA.

But overall, it's the plethora of impediments to businesses ability to participate in, or drive, global value chains and networks.

What are those? For sure, transportation and logistics are critical to competitive participation in global value chains. That takes you into multimodal transportation, into ports, into airports, and into the web of restrictions and regulatory policies around transportation and logistics. It takes you into air services agreements that have to serve

the broader economy rather than one or two air carriers. And it gets you into a host of issues around the mobility of people, services and goods in a global value chain environment.

Of course, knowledge and technology are fundamental drivers and we have to look at impediments to Canada participating in global knowledge pool, where the other 97% of knowledge and technology is to be found. We must have ways of connecting to that knowledge pool in real time, with adequate broadband. We need to build provisions for research and innovation into our trade agreements. And we need to determine the limits to exempting products from trade commitments on security grounds. And we have to focus on resolving issues relating to intellectual property in a world where access to information also has to be a priority.

As we look to the future we need to anticipate that new discoveries, science and innovation are going to come increasingly from the countries that are producing most of the world's scientists, engineers and mathematicians. That means countries like China and India are going to become dominant, and the 'shoe of intellectual property protection will be on the other foot'. If we're not there in a substantive and collaborative way we will pay a price.

If there is one area where Canada absolutely must step-up, and where the trade frameworks have to be adapted, it is in the facilitation of direct investment. Direct investment is the critical anchor for the global value chain. You must have direct physical presence in the key markets in which you are going to participate. You must have plants, research, distribution, people and joint ventures. Trade policy has to be shaped to facilitate and encourage direct investment.

There was a time when we only concerned ourselves with incoming direct investment. It equated to jobs. Today it is just as important for Canadians to invest abroad as it is to attract more foreign investment to Canada. Direct investments are a primary tool for establishing your presence in today's global economy. When you make direct investments, you are making a long term commitment, a long term judgment, and you are showing and building confidence in the commercial framework between Canada and our trading partners. Foreign Investment Promotion and Protection Agreements must therefore be part of the bedrock of modern trade agreements, and they must have robust provisions for dispute resolution.

In terms of other legal and regulatory issues, the list of issues is long. Licensing, product standards, certifications and operating protocols number in the thousands. Multilateral approaches will make it tough to build agreements because you have to go so deep to make it work. So we will need to go piece by piece to drive these agreements, and much of the progress may need to be made through bilateral approaches and expanded from there.

Third, I do believe the multilateral framework is still critically important. It is not going to solve all the world's trade problems, but the WTO does provide an international legal framework, a form of peer pressure, and a way of judging countries' trade policies. This is a very critical and important role and Canada should be out there leading.

Fourth, we need to step up the priority we in Canada place on regional groupings like APEC and other trade partnerships that are emerging, particularly in Asia. While these trade arrangements can fragment the world trading system, a country

like Canada cannot afford to be on the sidelines. We can contribute to using regional agreements and bilaterals as eventual multilateral building blocs. Through all we do, Canada must absolutely be seized of the economics of a billion people.

Fifth, we need to establish top priority bilateral relationships and drive them with all of the leverage that Canada can apply. Number one is the United States. As much as I get frustrated with US protectionism, we must get louder, more articulate, more aggressive, and more committed in terms of trying to influence US decisions and policies. This is going to cost. It is going to take money, it is going to take focus on building relationships, and it will not come easily, but we have to do it. We have to drive toward a deeper, stronger, more robust NAFTA. People will say: "It's ridiculous. The Americans will never go for it!" Which is true and it's why we need to explain endlessly how it is in the interest of both countries and, more importantly, how it is in US interests to deepen, strengthen, and stabilize NAFTA. Failure may be tough for Canada, but in the end it will also be tough the rest of North America.

The second critical bilateral priority is China. All of you know that if you are not connected and engaged with China over the next 20-30 years you are running big risks economically. Yes, there are a number of other bilateral priorities – India, Brazil, Russia, Japan, and the EU; they are all important. But failure to engage China offers the greatest risk after the US. Even relatively limited deals, such as an investment agreement can be a substantial and important building bloc.

My final bilateral priority is simple. We should deal with countries that are ready to deal. Don't wait for Japan if they don't want to deal. Keep negotiations going where ever progress can be made, just do not sacrifice the US and China.

Sixth, unilaterally Canada can still take steps that would be important to our global competitive position. You only have to look at a critical area like air services agreements, agreements that are fundamental to building our global economic linkages. Yet we, in effect, say 'If Air Canada won't serve the route, nobody can serve the route.' That is a direct blow to the global competitiveness of Canada's economy. If necessary, we should unilaterally open up our skies. We should unilaterally improve our policies around mobility of skills, investment, tariffs and other protections in ways than enable Canadian industry maximum opportunity to compete. And sometimes enabling industry to compete is best done by forcing them to compete.

Seventh, provinces should not feel they have to sit on the sidelines and complain that the Federal Government is not doing enough fast enough. In the modern world of global value chains and networks, provinces have substantial powers and authorities to act. Natural resources, education, training, research, people mobility, large parts of transportation and infrastructure are critical building blocks for global value platforms. Quebec has shown they can do it by forging a labour mobility agreement with France. This, in turn, increased the pressure on Canada, and particularly the EU, to get moving on a Canada-EU economic framework agreement. Provinces/territories should be working with Canada to drive new generation economic agreements. But there is much that can be done without Ottawa to get ahead of the curve in this fast moving global economy.

A Very Brief Conclusion

Business-as-usual is going to be a slow, painful way to go for Canada. America's economic and fiscal malaise will be an aggravating factor.

Allowing the slide to marginalization to continue will make it harder to get back lost ground. We risk losing the power and strength to engage in negotiations and drive the linkages into the global economy that is our lifeline.

We don't have to go there. Let's not go there. That is not the legacy we want for our children and grandchildren.

Thank-you.

Helmut Mach: Thank you very much for that presentation and those arguments. We have a good half hour at least to field questions from the audience.

Questions

Question: Is the rise of the West going to drive us towards the reforms you suggest or, paradoxically, turn us towards more protectionist measures?

Answer: The political pressures are really enormous. As you know, I was Minister of Trade when we tried to do a free trade agreement deal South Korea. We were really close. We do not have a free trade agreement with any Asian country. Korea would be our first major agreement and it died because of misinformation and a negative branding campaign by the auto industry on both the labour and management front, supported by mayors in eastern communities. Eventually, you probably could not have passed a Canada-Korea free trade agreement in parliament and there was opposition from elements of all parties.

The reason I am saying this is because politics has really put us into a bind. If we are just going to accept politics as usual we are going to stay in that bind and our problems will go deeper, and deeper.

So if you look at the Korea free trade agreement as an example, where were the western voices: loud, aggressive and articulate, arguing for all of the opportunities we were throwing away with Korea for an auto industry that was not going to be impacted? We did at least three different studies that showed the impact of Canada-Korea free trade on the Canadian auto sector would be miniscule.

Why?

To begin with Korea is selling cars into Canada under the NAFTA from the United States. The US is looking at a Korea free trade deal which would have made it even easier for Koreans to compete against Canadian auto manufacturers.

Supply management is another really tough problem and I get in trouble every time I open my mouth on this issue. But other countries have done it. Australia and New Zealand have both dismantled supply management and replaced it with a different kind of policy and both countries are now very powerful agricultural competitors. Dismantling supply management does not mean you are destroying farmers' livelihoods. It means you are saying to them, "We are going to start changing and maybe it is going to take us twenty years. We are going to have a deliberate policy of reform so you can do well as an agricultural producer, but you are going to have to open up your market, get into foreign markets, apply technology and take advantage of the international marketplace."

There are many, many folks in Canada who, if they really knew how much they are individually paying for supply management, would say "I didn't know I am paying that." The amount you pay for a liter of milk due to supply management is probably double. You know what the over quota tariffs are? A good measure of how much protectionism is in supply management is in the tariff for allowing a small amount into Canada with what is called our 'over quota tariff', and some of those tariffs are over 200%. Over 200%, and nobody says anything. And who is paying that? Well I guess young families, not that many of which are well off, but they have to buy milk and dairy

products to feed their family. There is not enough discussion about it. I'd rather go to the grave trying to change the political culture in Canada than to say, "Well it's not politically doable so let's forget about it."

Question: One issue that crops up for me is the US legislation concerning the oil sands and the emergence of boycotts on 'dirty oil.' The response then is, "Oh well, we need to diversify our markets." Certainly we need access to the West Coast, via a pipeline, to gain access to Asian markets. What do you think is the probability of negotiating successfully with the various First Nations groups in B.C.? Then there is a strong coalition that is opposed to tanker traffic on the West Coast. Other than that it sounds easy.

Answer: I am actually a very strong advocate of Western collaboration across a range of areas. I just think that competition between the Western provinces is another form of economic insanity. There is no difference between the energy carbon resources in northeastern B.C. and the resources in Alberta or Saskatchewan. We need to be collaborating in terms of harmonizing policy. We need collaboration in terms of optimum configurations of infrastructure both north and south and east and west, because we absolutely must connect with Asia. If we don't, we are basically selling to one buyer, the United States, taking a significant discount for doing that, and locking ourselves into a risk exposure that any sensible business person would never do. So we have to build [a pipeline] to the coast. I don't think First Nations are going to be the biggest barriers. I think the First Nations would like to have an open discussion and dialogue, but they are going to have to be involved commercially. You are going to have to bring them into revenue sharing. You are going to have to let them set up companies and deliver services for some of the infrastructure and resource developments. I don't think that is the big issue.

The big issue is going to be tanker traffic. It is the oil sands thing all over again. Some ducks tragically died. It was unfortunate, and it was a bad incident. But really, should we be a global pariah because of it? Is it fair to brand Alberta because of it? Or the entire oil sands? I don't think so. It is not based on objective, balanced information. It is based on groups that are out there, again aided by the reach of modern electronic media and communications tools, and able to take one shocking image to establish an image of an entire industry and an entire province.

That could easily happen on the West Coast. Let's start with natural gas which is not nearly as dangerous as oil terms of tanker traffic. You must build confidence and get ahead of the curve to show the public that tankers, in this new era, are going to be coming in under a whole different regime, a safe regime. We have learned from the Exxon-Valdez. You can monitor corridors for these vessels in real time. You can have very good stand-by tug capacity if a vessel starts to founder or get into trouble. There are lots of ways that you can deal with problems. All the tankers are double-hulled these days, and probably multi-containerized within the hull. There is always that risk of a spill, but if we allow the extreme views to prevail, it will be just more pain for Canada. I think the First Nations will be a challenge, but I think they will be more constructive than the more extreme environmentalists.

Question: Moving forward, how can Alberta improve its international reputation and economic well-being?

Answer: I am not somebody who thinks that the status quo is going to do it for us. There are a number of areas that need serious attention and it is going to take serious money and in some cases it is going to take policy change. Just think of the oil sands and the Dutch disease problems that affected us when times were good. Think of how we are portrayed by international media and environment interest groups. It's not good. We really do need to look at ourselves and look at how we want to present ourselves to the world and to ourselves. And we need to assess what we are really prepared to do about it.

What is the narrative to which we are committed in terms of the development of the Alberta economy and the energy sector, green or carbon based, or oil sands. We need to put ourselves in a position where we can embrace a powerful narrative that we can articulate to the world: nationally, internationally, and here in Alberta. And changes may have to be made to ensure our narrative has an impenetrable foundation of truth. Anybody can build a narrative. What you have to do is build a narrative that is a fundamentally compelling elaboration about what you are actually doing.

There are always going to be rogues in every industry that can damage the reputation for all. There were rogues in the forest industry when we had problems with the environmentalists and forest management practices. There are probably a few rogues in the energy business. We need the government and industry collaborating and applying peer pressure. We need to step up to the reality that the world we are in is a global world which we cannot change. But we can and must adapt.

How are we going to get ahead in that world? I think Alberta has huge potential. I think the oil sands have huge potential. I have this thing about what I call the 'multigenerational imperative.' I don't think we should be paying for groceries with non-renewable natural resource revenues. Those resources belong as much to your grandkids and their grandkids as they do to us. When we liquidate the resource, we need to be doing it in a way that is creating multigenerational benefits for the generations that have yet to come. I think there is a lot of thinking that needs to be done in terms of fiscal management and what that implies for the long term fiscal stability of the province.

It is not just an Alberta problem. Federal programs like equalization are in effect creating a national dependency on non-renewable resource revenue. In other words, everybody is buying groceries from non-renewable resource revenues. Should something happen, if the critics were to succeed in shutting down the oil sands for example, people have not analyzed, much less grasped, the really serious fiscal and economic implications across the country. It will hit health care. It will hit education. It is an ugly picture, and it is not well enough understood, so we are getting a lot of political positioning and potential frictions starting to emerge. The bottom line is that we have a great future here, but I have to tell you we have work to do to secure it.

Question: What potential do you see for Northern Canada in the future?

Answer: It's great, great, great. When I think about the North, the decades of the North are on their way. And in some ways global warming will probably have a pro economic bias in the North. I may be wrong on that, but that is my instinct. When you think about the gateway and Asia Pacific, we now have to think about the gateway transportation and logistics not just as connecting Asia with Lower Canada and the US. We need to start looking at the Northern leg of the gateway. I think that is something that has not been receiving enough attention and will be vitally important in terms of creating wealth in northern communities and opening up broader based development of the North. A lot of mines and energy developments require transportation infrastructure to connect the north to Asia as well as to North America. It is a huge opportunity, and while we are talking about collaboration among western provinces, we really should be collaborating with the territories as well.

Question: You haven't said much about taxes. With large deficits and government debt issues, do you see taxes as a potential mechanism to solve these problems? Could tax instruments also be used as an industrial tool to spur growth and innovation?

Answer: I still have a bit of political blood in me and so I would say it is clear to me we have a fiscal problem in Alberta. It is clear that we have a structural deficit. I do not know the precise numbers, but if you have a large structural deficit you either have to cut your expenditure base dramatically, or enhance your permanent revenue base. Revenue needs to track approximately the growth over time in spending so you maintain equilibrium. So there is a gap and I am not going to pretend to prescribe to Albertans how to close that gap. Albertans have to figure it out. Other provinces have gone with a GST-like tax and some of them have sales taxes. There are literally hundreds of revenue sources that you can use. The bottom line is you must close the gap.

Albertans are going to have to come to grips with that. Again, that is one of those things people may not want to hear but eventually we have to get it right and Albertans will do that.

On tax policy as an industrial tool?

I like lower, broad based taxes myself. We have some pretty rich science and technology tax credits in Canada that are supposed to spur technology commercialization. But, even though our tax credits are among the best, we are pretty bad at commercializing technology. I am not hugely enamored with narrow tax instruments. I do not like the complexity and I am not sure they work that well. I will tell you what does work well is stiff competition. It does cause people to worry whether their business is going to survive tomorrow or not. That spurs innovation and productivity as a matter of survival, and maybe more of that wouldn't hurt.

Question: In regards to global value chains, how should the provinces go about successfully integrating themselves into them?

Answer: Sure. As I said, I guess repeatedly, throughout my remarks, gone are the days where trade is about producing something here, digging it out of the ground, or cutting off the stump, or whatever, and then shipping it into a world marketplace. The world today is about international value chains. One important component of international value chains is transportation. So you must drive transportation and logistics, whether it is the movement of resources, manufactured products, technology products, the movement of people, or data. These are all things over which we can, at the provincial level, have a very substantial amount of control. I would look at those as areas where we can, without any controversy at all, shape a lot of our policies and our infrastructure investments and so on to drive a trade/global value chain agenda.

I think the Alberta school system is probably doing better than most. If you want to do business in China you better ensure your kids are literate on China. We are going to have to have more of our kids learning the language and the culture and going there. We should, for example, send our young people for a degree at places like Beijing's business school. But we must do it in a way that builds the human capital capacity here in Alberta, to enable Alberta to competitively play globally. You have a fair amount of influence over federal immigration policy. You do not have to sit back; you can work with the government of Canada. They have been receptive. Decide what immigrants you want, what skills you want. You can influence that. You don't have to wait and let somebody else do it for you and just take whatever immigrants decide to come to Alberta. You can be proactive.

Science is another example where parochialism kills you. If you have a multiple of a billion dollars in investment capital and you say, "We want that to be invested in technologies, infrastructure, and commercial ventures that are going to build the long-term future of the economy." The parochial approach is to say, "Well only in Alberta businesses." So you go and chase Alberta business opportunities with multiples of a billion. You find there really are not sufficient good target investments to in Alberta, so what happens is you end up making bad investments, and eventually the investment fund itself gets in trouble.

What I believe we should be doing in Western Canada generally, not just in Alberta, is to have large funds available--and there are multiples of billion dollars in funds that are within the ambit of the crown--and we should be encouraging those investors to invest in Alberta companies, yes, and Canadian companies, but also in companies and joint ventures that are outside our region. I said in my remarks; direct investment linkages into the global marketplace are essential for competitiveness today. Maybe it is a Silicon Valley company that you should investment in because that company has a capability that you would like to import into western Canada. Or maybe it is a potential joint venture partner for an Alberta company. The same thing in China. If you don't start to connect into the China market and the China technology sector we'll soon be out of the game. We are going to have to look at the opportunities to create those

linkages through investment, and we are going to have to have the very best people we can get. You can't just hire our own. You have to get the best people that you can get from to help you to drive our economy. Albertans will benefit from that. Those some of things I think you can do.

Question: As the pace of globalization and the 'rise of the rest' increases, how do you see Canada's geopolitical future?

Answer: Well, as I said I still have a bit of political blood in me. The truth of the matter, the process of marginalization is underway. Most knowledgeable people, thinking about international geopolitics would tell you that if the G7 were formed today Canada would not be in it. If the G8 were formed today, Canada would not be in it. Yes, we will make it to the G20, but in ten years time if you set up a G20, would we make it? I don't know. So that process is under way and frankly I think we have developed a mindset in Canada where we are almost afraid to speak up about the nonsense at the border by the government in the US. We always want to avoid a confrontation because we want to be nice and we think friendship is ultimately going to win out. Frankly, 'national interests' win out and in the US, like any country that is governed in that way, business is going to equate its interests to the national interest. And too often it is at Canada's expense. We have to get out of this mindset of just allowing things quietly to keep sliding and hoping that an act of God will turn it around for us. I don't think it will.

Question: Do free trade zones, with removal of many internal tariffs, hold the greatest future potential in trade liberalization or should Canada be focusing on other means/measures?

Answer: Free trade zones are an interesting little wrinkle in the tax system. I frankly see them as a little bit of a marginal tinkering. To me, I think you are far better off to focus on the big pieces: the big infrastructure, regulatory, and transportation, and regulatory barriers to access to foreign markets. We have investment restrictions in Canada that have prevented us from forging trade agreements as well. We will only allow limited ownership of telecommunications and airlines, for example. So what happens is we go to the table with tariffs that are quite low anyway, and we're often willing lower them more but we won't give up all the other protections that our trading partners care about. Again we have to get out of that mindset. Most of these restrictions should be eliminated unilaterally.