

Sectoral Development

Canada has long prided itself on being a “trading nation.” From the time of European settlement, foreign trade, investment, and other international linkages have always been disproportionately important to our economy.

In the last decade, however, some extensive and unprecedented changes have occurred in the nature of Canada’s economic relationships with the rest of the world. This structural shift has had major implications for our international trade, our incomes, our productivity, our environment, and even our federation. The worldwide economic crisis has accentuated this structural shift in our economic direction (and, in some ways, Canada was uniquely vulnerable to the crisis *because of* these prior qualitative shifts). But the big changes in the sectoral make-up of our own economy reflect a longer and troubling trend, and are not just the result of the current recession.

The statistical evidence on the about-face in Canada’s qualitative economic evolution is startling. Chart 12 shows that Canada’s exports of goods and services have fallen dramatically, relative to the size of our overall economy. Ironi-

cally, by this measure Canada’s economy is *de-globalizing*— even though we are told every day that globalization is omnipresent and irresistible. The decline in exports is not limited to our troubled manufacturing sector (or so-called “smoke-stack” industries). Exports of services (such as tourism, transportation, and business services) have also fallen sharply as a share of GDP.

Because of our soaring currency (which makes our products much more expensive to foreigners), a deep recession in our the United States, our most important customer, and the neglect shown toward high-value export industries by governments that believe free trade will automatically solve all our trade problems, a larger share of our work and output now takes place within “non-tradeable” industries. These are industries which dedicate their output to local use, rather than selling into global markets.

This shift is not all negative: there are some benefits to being less dependent on export markets. But it does reveal that Canada’s role in the world economy is being re-made — and in ways that are clearly harming the prospects for keeping and generating good-quality jobs here at home.

CHART 12 Export of Goods and Services as a % of GDP



SOURCE Statistics Canada

Moreover, it's not just the quantity of our exports that has declined. The *quality* of our exports is also deteriorating. Pushed by the logic of free trade — in which Canada's prescribed role is to be a supplier of raw materials to other, more developed trading partners — Canada's exports have become increasingly concentrated in the harvesting and export of unprocessed or barely processed natural resources: minerals, agricultural products, forest products, and energy (*especially* energy).

Canada's total merchandise exports can be broadly divided into two categories: resources and "value-added" products (such as machinery, equipment, automotive products, and consumer goods). Chart 13 shows the rise and fall of value-added goods in Canada's total merchandise trade. Thanks to pro-active policies like the Auto Pact, an effective aerospace policy, successes in high-tech telecommunications equipment, and other value-added success stories, Canada's exports of value-added products grew steadily and impres-

sively from the 1960s through the 1990s. After continental free trade, however, the subsequent boom in commodity prices for much of the past decade, and the decline of Canada's manufacturing base, this progress has been dramatically reversed. Value-added products now account for just 35% of total merchandise exports — the lowest level in three decades, and down from 55% at the turn of the century.

For most of the 1990s, then, Canada tolerated the erosion of its value-added manufacturing base and ignored the crisis in service export industries, such as tourism. For a while, the boom in resource exports allowed us to continue "paying our bills" as a country in international trade. But with the global economic crisis (which reduced demand for our exports and led to a downturn in commodity prices), the wheels fell off the resource bandwagon. Then we experienced the downside of putting so many of our eggs in the resource extraction basket: our trade balance deteriorated rapidly and substantially. From tra-

CHART 13 “High Value” Exports as a % of Total Exports



SOURCE CAW Research from Statistics Canada

ditional trade surpluses (which were essential to allow us to offset the ongoing drain of payments resulting from Canada’s unique reliance on foreign investment), Canada has slipped into substantial trade deficits — the largest in our post-war history.

Much public attention and hand-wringing has been devoted to the issue of government budget deficits in recent months. But few are paying attention to the accumulation of *foreign debt*, which is the inevitable result of these trade deficits (and corresponding current account deficits). In the last four quarters of 2009, Canada’s current account deficit totalled over \$40 billion (twice as large as the federal government’s deficit over the same period, as measured in National Accounts data) — and this international deficit is getting worse, not better.

The only clear response from the federal government, however, has been an insistence that signing still more free trade agreements will be the cure for whatever ails our trade perform-

ance. But it was free trade that pushed Canada into the present “resource trap”: a reliance on extracting and exporting ever-greater quantities of natural resources — no matter the geopolitical or environmental consequences — in a fruitless effort to pay for the flood of higher-value products which we import from the rest of the world. Additional free trade agreements with other jurisdictions which are not dependent on natural resources (such as Korea or the European Union) can hardly rectify this imbalance. Canada already imports far more from the EU and Korea than we export, producing substantial bilateral trade deficits in each case.

Worse yet, with both these jurisdictions, Canada exports mostly resources, and imports mostly high-value products — so we face both a quantitative and a qualitative deficit. Table 16 summarizes this imbalance in the case of the EU. Canada’s top exports (with one exception) are all resource-based. Canada’s chief imports from the EU (again with one exception) are all

TABLE 16 Summary of 2010 AFB Sector Development Measures

Policy Measure	Annual Impact (\$million)	
	Revenue	Expense
Sector Development Councils	–	50 per year
Corporate Tax Increase, Petroleum	1,000 per year	–
Other Measures to Slow Petroleum Development <ul style="list-style-type: none"> • Environmental review • Stronger net benefit test 	–	–
Target 80-Cent Exchange Rate or Lower	–	–
New Model of Trade Negotiations	–	–
Negotiate a North American Auto Pact	–	–
Canadian Development Bank		1,000 per year share capital
Green Economy Programs <ul style="list-style-type: none"> • Sustainable forestry • Extended producer responsibility • Green manufacturing fund • Green skills development 	– 300 – –	200 300 500 100
Youth Summer Employment Program	–	112
Net Fiscal Impact		\$850 m net cost

value-added manufactured goods. A very similar pattern applies to Canada’s bilateral trade with Korea, with whom Ottawa is also pressing hard for a free trade deal. Providing more access for imports of European value-added products (for example, by eliminating any local procurement restrictions on Canadian purchases of public transit equipment — the key goal of European negotiators) can only make this imbalance worse.

The deindustrialization of Canada’s exports, and the failure of our trade policy makers to provide a more realistic and effective framework for the development of value-added export industries in Canada, is a key cause of the shocking devastation of Canada’s manufacturing base. Manufacturing led Canada into recession (real GDP in manufacturing has been falling steadily since 2006). Over a half-million manufacturing jobs — which pay, on average, 20% more than the typical Canadian job — have been lost (see Chart 15). Entire communities have been devastated. But all Canadians pay a price for this neglect, not just manufacturing workers. Any country which cannot participate successfully in global

trade for advanced, innovative products is destined to suffer chronic trade deficits, growing international debt, and growing economic and social polarization. The U.S. and U.K. economies provide vivid warnings of the long-run consequences when governments (lulled by the false confidence that free trade and “comparative advantage” always ensure a country’s international success) allow their manufacturing base to wither away.

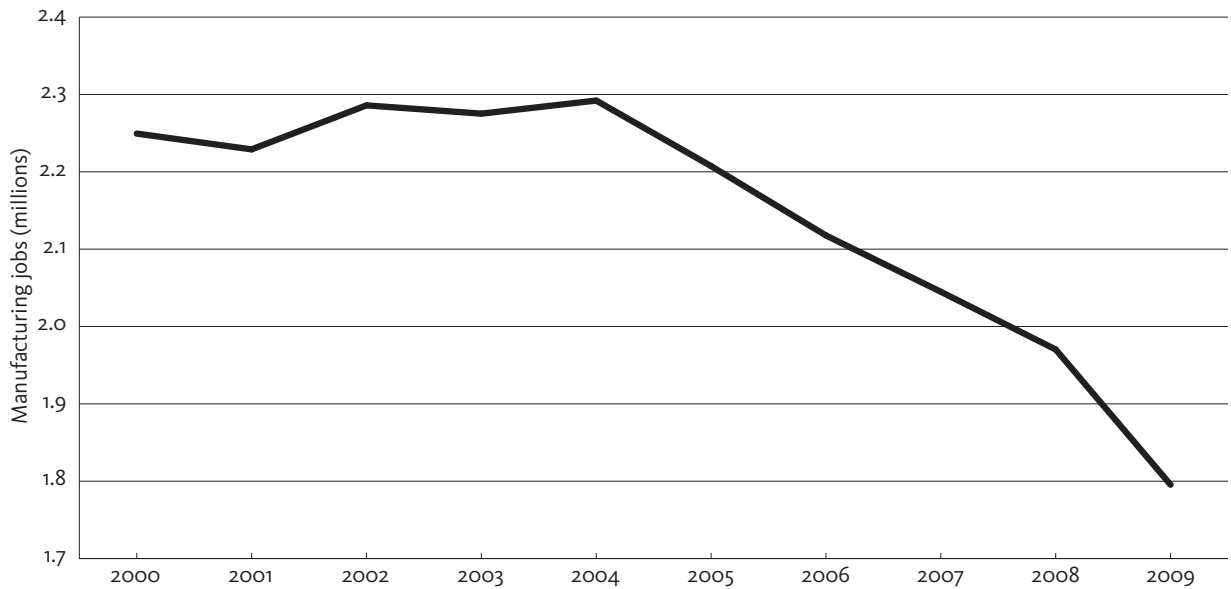
One of the most incredible ironies of the resource-led restructuring of Canada’s international linkages (and, indeed, of our entire national economy) has been its very negative impact on productivity growth. Resource industries are traditionally marked by stagnant or even declining levels of productivity (with resource depletion, it takes more and more work to produce the sought-after resource). Canada’s resource sector is no exception to this rule: average labour productivity has declined by as much as one-third this past decade, due both to depletion and the inefficient, helter-skelter pattern of development that was fostered in booming regions, like Al-

CHART 14 Goods and Services Trade Balance



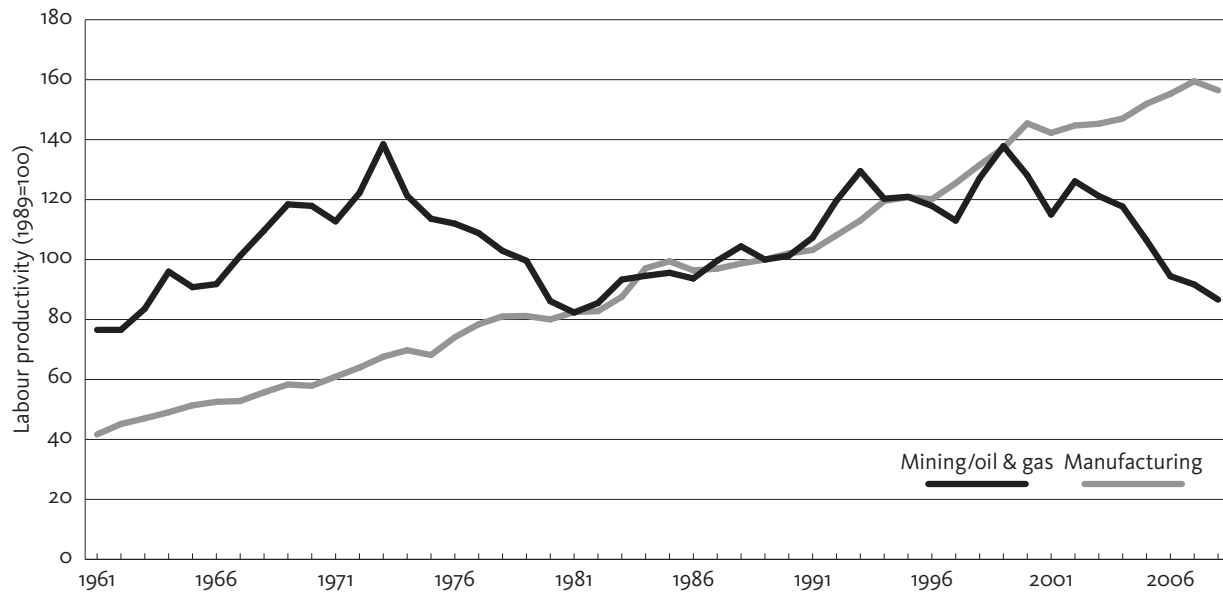
SOURCE Statistics Canada

CHART 15 Manufacturing Meltdown



SOURCE Statistics Canada, Labour Force Survey

CHART 16 Labour productivity indices



SOURCE Statistics Canada

berta’s tar sands. Yet free trade forces are leading Canada to invest more resources (including people) in resource industries with *declining* productivity — while our manufacturing sector (which possesses higher-than-average productivity and faster productivity growth) shrinks dramatically (see Chart 16). Little wonder, then, that Canada’s productivity performance (which has long been inferior) ground to an absolute halt in recent years. Incredibly, Canada experienced *no growth at all in labour productivity* between 2005 and 2008 while the resource boom was running flat out — leaving us all the further behind other, more innovation-focused countries.

Mix matters

The deterioration in Canada’s international trade performance and the resulting crisis in important export-oriented sectors (such as manufacturing, tourism, and other hard-hit sectors), reinforces the need for Canada to have a more deliberate,

pro-active vision and strategy for developing desirable, innovative, technology-intensive industries. These are the industries which provide better-quality jobs, thanks to higher productivity and higher incomes, and which will ensure that Canada maintains and expands a foothold in global markets.

Countries that deliberately aim to create, nurture, and expand innovative sectors — usually on the strength of growing export success — are the countries that successfully engage with global markets while at the same time developing their internal capacities. Successful Asian exporters have followed this recipe with great success: first Japan, then the so-called “Tigers” (including most notably Korea), and now China, whose government uses economic planning and a diverse toolkit of hands-on interventions to deliberately foster the domestic growth of high-tech, dynamic sectors.

Similar lessons can be gleaned from the experience of several European and Scandinavi-

an nations, where the sectoral make-up of the economy is not left to chance (and certainly not to the supposedly “natural” forces of free trade and markets). Instead, these countries mobilize a diverse set of policy levers, including skills, technology, finance, and procurement policies, to stimulate the domestic location and expansion of desirable, innovative industries. The Finnish experience — through which a once-resource-dependent economy was transformed into a world leader in innovation, productivity growth, and social equality — seems especially relevant for Canada.

The AFB measures which follow, therefore, are motivated by a common, unifying theme. It matters greatly what sorts of industries a country specializes in. In other words, “mix matters.” It is better to be heavily invested in industries that feature technological innovation, productivity growth, higher-than-average incomes, environmental sustainability, and a propensity for export success. Instead of passively waiting for free trade forces to determine which industries we specialize in (in which case our resource-dependence will only grow), it is better to pro-actively work to develop and expand our national participation in industries that offer a brighter future than a self-defeating quest to extract and export ever-more non-renewable raw resources.

Alternative Federal Budget sector development proposals

1. Establish a system of Sector Development Councils

The federal government will work with other stakeholders (including provincial governments, labour organizations, industry associations, businesses, universities and colleges, research and engineering institutes, and financial institutions) to establish a network of Sector Development Councils. These councils will be established in a range of goods-producing and services-producing

industries which demonstrate many or all of the following characteristics: technological innovation, productivity growth, higher-than-average incomes, environmental sustainability, and export intensity. A non-exclusive list of these sectors would include: green energy technologies; aerospace and space products; communications equipment and services; value-added forestry products; motor vehicles and components (with an emphasis on alternative fuel and sustainable technologies); tourism; high-value transportation services; specialized health services; film and broadcasting; software development; and composite materials.

The councils will work to identify opportunities to stimulate more investment and employment in Canada; to develop and mobilize Canadian technology; to transfer technology from universities and other educational institutions to productive use; to invest in sustainable products and practices; to better penetrate export markets. In other words, the councils will be established as the first step in rebuilding Canada’s national capacity for sector development planning (or what was once known as “industrial policy”). Each council will be asked to develop a medium-range plan for developing its sector in Canada, and a short-list of actionable items that could help to attain that plan’s targets.

The Sector Development Councils will each be given an annual operating budget of \$50 million to support their work, commission research, and perform other infrastructural tasks. (The actions that arise from their recommendations will be financed through other budget items, including those listed below.)

2. Develop energy resources in a slower, more deliberate manner

The willy-nilly energy boom of the 2000s imposed immense economic and environmental strains on Canada — despite the jobs and other economic spin-offs that were also associated with that boom. An over-valued exchange rate, im-

mense fiscal imbalances within Confederation, and the utter destruction of Canada's credibility to negotiate on climate change issues — these were just some of the collateral damage caused by the unregulated energy boom. The federal government will quickly take advantage of the pause in development that has resulted from the global financial crisis to implement a more sensible and sustainable framework for the development of these resources.

To accomplish this, income tax rates on petroleum production will be raised to the former 28% rate that prevailed prior to the series of corporate tax reductions that began in 2001. This measure will conservatively raise an estimated \$1 billion per year in additional revenues for the federal government (to be used to capitalize the Canadian Development Bank described below).

A new regime of environmental approval processes will also be imposed on major energy developments, to require (consistent with Canada's international treaty commitments) reductions in greenhouse gas emissions associated with those extraction projects.

Finally, a strengthening of the Investment Canada Act provisions regarding the demonstration of "net benefits" to Canadians from foreign takeovers of Canadian companies will prevent the wholesale sell-off of Canadian energy resources to foreign investors (as has occurred in recent years). The criteria of "net benefit" in regard to energy industry transactions will be explicitly broadened to ensure that the mere transfer of ownership of energy resources to foreign owners will not pass that test. Together, these policies will ensure that energy developments occur in a slower, more manageable manner, with fewer side-effects and greater net benefits for all Canadians.

3. Target a Canada-U.S. exchange rate of 80 cents or lower

Canada's currency has been trading at levels far above its "fair value" for most of the last three

years. This overvaluation has contributed substantially to the deterioration of all non-resource export industries in Canada (including manufacturing, tourism, and other tradeable services). A true fair value for our currency, based on comparisons of purchasing power, unit production costs, and other benchmarks, would be around 80 cents (U.S.) or lower.

The efforts described above to rein in the rampant, unplanned development and foreign takeover of energy extraction and export projects will automatically lead to an immediate and substantial pullback in the Canadian currency — given that speculative financial traders have come to associate (rightly or wrongly) Canada's currency with the prospects of the petroleum industry which has come to dominate our international trade and investment linkages. Merely slowing down and regulating the energy boom will take much of the excess steam out of the loonie. Additional downward pressure on the dollar could be mobilized, if needed, by explicit direction from the federal government to the Bank of Canada that a sustainable value for the currency (consistent with long-run price competitiveness of Canadian non-resource exports) should be taken into account in the setting of the Bank's monetary policy decisions and interventions.

4. A new model for trade negotiations

Whatever the problem, it seems, in Ottawa's view the solution is another free trade agreement. The federal government is pressing hard for new FTAs with Korea, the EU, Colombia, and others. Such agreements would reinforce the lopsided nature of Canada's international commerce: both in terms of quantity (importing more than we export), and quality (exporting resources, importing value-added products and services). The proposed deal with the EU would break new, dangerous ground by further constraining those limited tools of policy intervention (like public procurement) which Canadian governments still possess to stimulate the

domestic development of desirable industries and sectors. By their very nature, free trade agreements make it much more difficult to implement pro-active sector-building measures.

The 2010 AFB will immediately stop FTA negotiations with Korea, the EU, and Columbia. In place of more FTAs (with their built-in bias in favour of corporate mobility and privilege, at the expense of democratic economic governance), the federal government will pursue a different sort of trade negotiation with key partners — including those countries, the U.S., and other jurisdictions (such as China, whose massive \$30 billion trade surplus with Canada gets bigger every year, and has become a massive drain on employment and incomes here). The main goals of these alternative negotiations will be to find measures that 1) ensure balanced two-way trade, rather than the one-way beggar-thy-neighbour flows that characterize most of our trade relationships; 2) recognize the need and the legitimacy of government policies to promote sectoral development and economic diversity; and 3) impose equal adjustment costs resulting from trade imbalances on all parties (both surplus and deficit nations).

One concrete example of this new sort of trade agreement will be a new North American Auto Pact, which Canada will seek to negotiate with the U.S. and Mexico (in light of the near-death experience of North America's auto industry this year). Instead of the unconstrained race-to-the-bottom which currently describes the global auto industry, the three nations will seek a managed and balanced trade relationship: each country will retain a fair proportional share of continental production and employment, and global automakers will be compelled to allocate production to North America in proportion to their sales here. This approach allows us to combine the benefits of specialization and economies of scale (the theoretical benefits of trade) with the security that comes from having a guaranteed "fair share" of production and employment in desirable industries. Similar approaches could

be adopted in other industries, and other bilateral and multilateral relationships.

5. Establish a Canadian Development Bank

To provide financing for the ambitious development programs prepared by the Sector Development Councils, the federal government will create and endow a new publicly-owned economic development bank: the Canadian Development Bank. The Bank's initial capital will be provided through the first two years of the higher corporate income tax collected from the petroleum industry. Then the Bank (like other banks, both commercial and publicly-owned) will leverage that capital into an expanded quantity of loans or other placements in new sector development initiatives that advance the public policy goal of diversifying Canada's exports and stimulating and nurturing desirable innovative industries.

This expansion of public lending capacity will reduce the extent to which key long-term economic development priorities are vulnerable to the cyclical whims of private finance. It also allows for potential projects to be evaluated and funded on the basis of a more broad set of criteria (including an integrated social cost and benefit analysis) than is utilized by private lenders — so long as the Bank itself "breaks even" with its invested capital. The social benefits of a successful program to develop and expand innovative export industries (not to mention the fiscal return to government from that progress) justifies the government's role in this type of targeted lending activity.

Support for sustainable production, green manufacturing, and green skills development

The Alternative Federal Budget fully embraces the imperative of building a sustainable economy. We recognize that the adjustment to sustainability entails significant costs and transition challenges; but there are also many potential upsides and opportunities associated with the

TABLE 17 **Canada-EU Trade, Top Ten Products 2008** High-value-added products in bold (\$billions)

Top Exports to EU		Top Imports From EU	
Gold	\$4.4	Petroleum	\$8.2
Diamonds	\$2.5	Pharmaceuticals	\$5.4
Petroleum	\$2.2	Motor Vehicles	\$3.5
Aircraft	\$1.5	Aircraft	\$2.3
Uranium	\$1.2	Wine	\$0.8
Coal	\$1.1	Wind Generators	\$0.6
Iron Ore	\$1.0	Construction Machinery	\$0.4
Nickel	\$0.8	Beer	\$0.3
Ash	\$0.6	Tractors	\$0.3
Aluminum	\$0.5	Turbines	\$0.3

SOURCE CAW Research from Industry Canada Strategies site.

greening of our economy. To maximize those upsides, and ease the transition, our sector development strategy pays special attention to the need to stimulate the creation of good green jobs across a range of specific activities.

To that end, the 2010 AFB proposes four specific green jobs initiatives:

- *Sustainable forestry and skills program*: \$200 million per year to develop a higher-value-added profile for the Canadian forestry and forestry products sector, implement energy conservation and other sustainable practices, and invest in skills required for sustainable forestry and forestry products production.
- *Extended producer responsibility motor vehicle program*: \$300 million per year in investments in motor vehicle recycling, end-of-life conversion, and green motor vehicle components production, self-financed from a new \$200-per-vehicle Green Car Levy imposed on all sales of new motor vehicles in Canada (which would raise about \$300 million per year).
- *Green manufacturing fund*: In addition to financing for green manufacturing initiatives through the Canadian Development Bank, investments in green

energy components, alternative fuel vehicles, and other green manufacturing initiatives will be further supported through a \$500 million program to provide additional support (interest-free loans, grants, investment credits, or co-investments) to projects which commercialize green technologies and expand Canada's very small footprint in green manufacturing.

- *National green skills fund*: To support college and on-the-job training in enhancing the capacity of Canadian workers to perform high-level services in green industries (such as green energy systems, insulation and retrofit, green manufacturing, waste amelioration, and others), a \$100 million annual green skills program will be established under the umbrella of HRSDC to work in partnership with provincial governments, colleges, trade unions, and other stakeholders.
- *Improve Youth Summer Employment Program*: Canadian youth have been particularly hard hit by the current recession. We need to make sure that they don't sit out their first productive years

waiting in their parents' basement for the job market to improve.

Measured by the size of our exports, Canada's economy is "de-globalizing." Less than 30% of Canada's GDP is currently exported to world markets, compared to 45% in 2000.

It's not just the quantity of exports that's falling — it's their quality, too. Barely one-third of our exports now consist of higher-tech value-added products (down from 55% at the turn of the century). The rest are unprocessed or barely processed natural resources.

Canada traditionally enjoyed a trade surplus (that helped to offset the heavy foreign ownership of our economy). But since 2000 that has

deteriorated into a large trade deficit — the largest in our postwar history.

Since earlier in this decade, Canada's manufacturing sector has lost over one-half-million jobs — and the pace of job destruction has accelerated with the economic crisis.

Average labour productivity has fallen significantly in the mining and petroleum industries in Canada this decade. Productivity in manufacturing, on the other hand, is high and continues to grow. Free trade forces, ironically, are leading Canada to relocate resources from manufacturing to mining and petroleum — with a very negative effect on our overall national productivity.