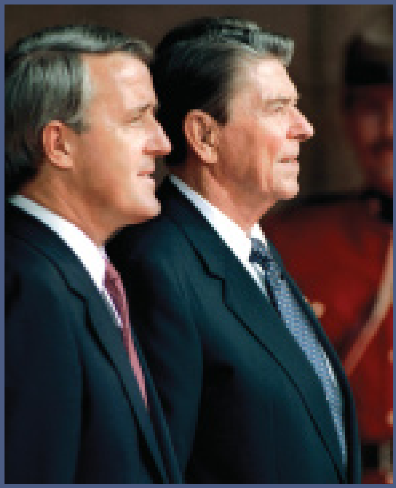
GATEWAYS, GLOBAL VALUE CHAINS AND TRADE CORRIDORS

Russ Kuykendall



Canada's international trade policy prioritizes the Gateways model with a view to increasing trade with Asia, especially China. Meanwhile, Industry Canada pursues research on global value chains, looking at how trade occurs inside binational and multinational companies. Russ Kuykendall raises questions about the net benefit to Canada from the China-focused gateways trade. He affirms the strengths of the global value chains model, but asks whether it provides an adequate explanation of trade. Instead, Kuykendall proposes that the Trade corridors model best explains Canada-US trade — Canada's most important trading relationship — and that the model suggests where Canada should pursue development of trade.

La politique commerciale internationale du Canada privilégie le modèle des « passerelles » en vue d'accroître les échanges avec l'Asie, en tout premier lieu avec la Chine. Entre-temps, Industrie Canada s'intéresse aux « chaînes de valeur mondiales » et au fonctionnement des échanges au sein des entreprises binationales et multinationales. Mais Russ Kuykendall s'interroge sur l'avantage net pour le Canada d'une telle stratégie de « passerelles » axées sur la Chine. Il convient des points forts du modèle des « chaînes de valeur mondiales » mais se demande s'il est vraiment justifié. Le modèle des « corridors d'échange », croit-il, décrit mieux le commerce entre le Canada et les États-Unis — première relation commerciale de notre pays — tout en indiquant dans quelle direction poursuivre notre expansion commerciale.

October 3, 2007, marks the 20th anniversary of the completion of the negotiation of the Canada-US Free Trade Agreement that was signed on January 2, 1988, and came into effect January 1, 1989. Twenty years ago, the focus of Canada's international trade policy was the United States economy, the largest market on the globe.

Today, three metaphors inform policy models of Canada's international trade and the integration of its economy with the world: *gateways, global value chains and trade corridors*. The metaphors emanate from at least three separate departments of the federal government. The Department of Foreign Affairs and International Trade — specifically, the Ministry of International Trade — are pursuing a Gateways model, particularly focused on Canada's trade with the Asia-Pacific rim. Recently, the federal Department of Industry has sought to drill down on how especially Canada-US trade occurs within corporate entities with the concept of "global value (supply) chains." Particularly in the mid- to late 1990s, the federal Department of Transport focused its policy development efforts on using "trade corridors" as a means of understanding Canada's infrastructure needs in respect of trade.

This article is an overview of each trade metaphor, including strengths and weaknesses of each and how they serve the Canadian economy. The focus shifts to the ability of trade corridors to account for the strengths of the other metaphors, and how Canada's largest export sectors or trade corridors are focused on the US market. Challenges arising from the three most valuable trade corridors are summarized and, then, how recent public policy has affected them. Finally, "the Canadian advantage" that arises from Canada's trade corridors is described — factors that position Canada favourably in respect of international trade with the United States, in particular.

Throughout the Chrétien and Martin governments, the gateways metaphor featured prominently, especially as Prime Minister Chrétien organized a series of Team Canada delegations. The most prominent of these was a series of trade delegations to the People's Republic of China (PRC), beginning in 1994 with provincial premiers and CEOs in tow, that served to highlight agreements already formalized and business already underway among Canadian companies operating in China. Gateways is focused on the Asia-Pacific rim, and especially on the PRC. This is not without good reason. The PRC market represents one of the great consumer growth markets in the world with well over a billion potential consumers. India similarly represents a huge consumer growth market, also in the Asia-Pacific rim. Roll in the mature markets of Japan, Australia, New Zealand, the United States and Canada, the Asian tigers of Korea, Taiwan, Singapore, Malaysia and Indonesia as well as Latin America's Pacific coast, and the combined Pacific rim consumer market totals more than 3 billion people, or approximately half the globe's population. More than 80 percent of this market constitutes a consumer growth market, versus the mature markets of Canada, the US, Japan, Australia and New Zealand.

It's worth pointing out: *the Asia-Pacific market is worth understanding*. But does the Gateways metaphor add to our understanding of trade in this market, and is it adequate to encompass it? Beyond this, what is the value added to the Canadian economy from Canada's trading in the Asia-Pacific rim, especially with the PRC?

In "Six Trade Corridors to the US: the Lifeblood of Canada's Economy" (*Policy Options*, July-August 2006), I argued that the advantage on trade and the growth in that advantage on trade with China goes to China. This is true of both US and Canadian trade with China. Year over year the rate of increase in China's trade surplus with Canada and the US is not in the single but double digits. In 2005, Canada's merchandise trade deficit with China was $22.4 billion. In 2006, the deficit was $26.8 billion — a rise of nearly 20 percent. Most of China's surplus is represented in consumer manufactured goods targeting the US and Canadian markets. Canada's trade deficit with China tends to be offset by commodities: food (grains and oilseeds), petroleum, coa, and iron. Canadian and US retailers have effectively shifted large segments of their consumer goods supply chain offshore to China. Wal-Mart may be only the most notable example. While trade deficits with China continue to mount up, Canada's merchandise trade surplus with the US was $141.7 billion in 2006.

Japan has long enjoyed a trade surplus with the US and Canada. Again, with Canada, the deficit is offset by Canada's supplying commodities. Japan's domination of the US and Canada automobile products market is represented in Toyota Motor Company's surpassing General Motors as the highest-selling automobile manufacturing company in the world. Whereas companies like Honda had to work very hard to find US and Canadian dealers in the early stages of its North American market entry, now the shoe is on the other foot with dealers taking less and giving more. Toyota and Nissan's penetration of the US and Canadian markets is so wide and deep that the companies' attentions are shifting to the PRC and Indian, markets with deals to manufacture and supply cars to these "cheap car" markets. Even so, there's enough room in the North American market for such interlopers as Hyundai to move from the entry stage to a brand with growing equity among US and Canadian consumers.

Waiting in the wings for North American entry is a relative newcomer (within the last five years) to car manufacturing, Tata Motors, which has long manufactured trucks for the Indian market. Tata has effectively recreated the "cheap car" market focusing, first, on its domestic consumer market in India, but it is well along entry into the Australian, New Zealand, Russian, eastern and

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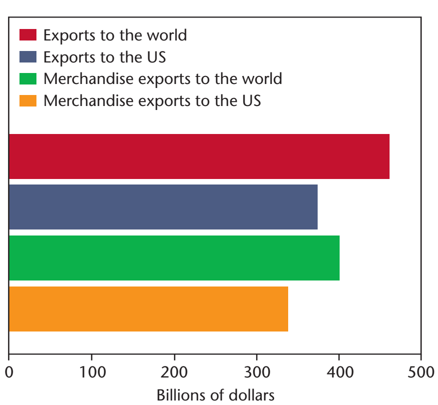
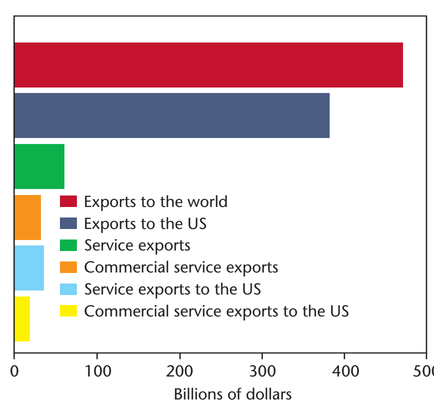
FIGURE 1. CANADA'S TOTAL EXPORTS AND MERCHANDISE EXPORTS



Source: Statistics Canada.

FIGURE 2. CANADA'S TOTAL EXPORTS AND SERVICE EXPORTS



Source: Statistics Canada.

central as well as western European, and the potentially huge Latin American markets. India's engineering acumen and capacity rivals that of Japan, western Europe and North America. India's cars are coming soon to a dealer near you!

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The recent expansions of capacity at the ports of Prince Rupert and Vancouver, and the expansions of highway and rail transportation capacity, have focused on container traffic of manufactured goods mainly coming into and commodities traffic heading out from Canada's Pacific shores. Further, most public policy in relation to the Gateways metaphor, including the series of policy forums on Gateways spearheaded by Simon Fraser University, focuses on making Canada's transportation infrastructure accessible to the Asia-Pacific trade. The abstract from one of a series of conferences on the "Gateway Corridor Initiative" organized by Simon Fraser University is revealing on this count. Out of some 23 presentations, virtually all concerned themselves with transportation infrastructure.

Measured by the ratio of exports to GDP, Canada's economy is the second most open to trade among the G8. Measured by the ratio of total trade (exports and imports) to GDP, Canada is, again, second among the G8. The value of Canada's exports represents 36.4 percent of Canada's GDP, compared to 44.9 percent for Germany's. They value of Canada's total trade is equivalent to 70.2 percent of GDP, compared to 84.5 percent for Germany, according to *Canada's State of Trade*.

The OECD struggles to measure China's GDP, so the ratio of exports to GDP is difficult to calculate. But in the *Asia Times Online,* Lynette Ong estimates that the ratio of China's exports to GDP is double that of India's. Ong suggests that India's growth is traceable to domestic entrepreneurship while China's is due to higher levels of foreign direct investment. According to a 2007 report in *Xinhua*, since the country opened to it in 1978, China's foreign direct investment (FDI) cumulatively exceeded US$750 billion by the end of June, including US$36.93 billion in FDI in the first seven months of 2007, according to Vice Minister of Commerce Wei Jianguo. He said China had cumulatively approved creation of 610,000 foreign-funded enterprises. Exports by foreign-funded enterprises accounted for 57 percent of China's exports.

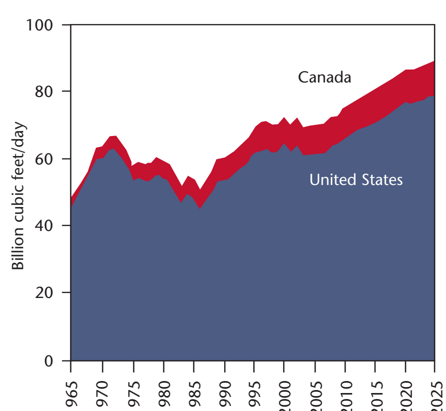
Further, while much of China's growth is traceable to suppliers focused on serving the North American markets who locate in China, India's growth is primarily focused on supplying domestic demand.

The following questions could be posed in respect of the Government of Canada's current Gateways, transportation infrastructure focus:

- As long as Gateways is the metaphor informing Canada's Asia-Pacific trade policy, will Canada focus on leveraging access to its market for Asian-manufactured goods in return for access to especially Asian and Latin American markets for Canada's higher-value-added goods and services?
- Are Asian and Latin American markets the best target markets for Canada's high-value-added, high-technology goods and services?
- While the Canadian market for Asian-manufactured goods is driven by Canadian consumer demand, is the expenditure of Canadian public monies the best investment in Canada's consumer, business, macro-economic and national interests?

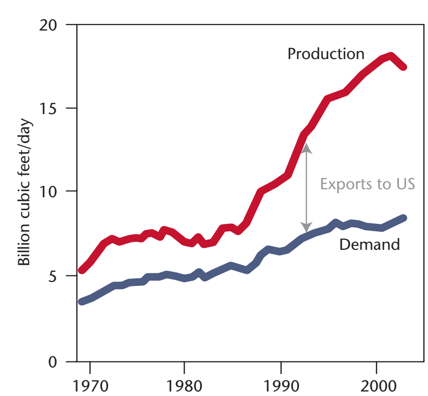
Global Value Chains — formerly known as global supply chains — research narrows further within sectors and attempts to get at how trade occurs inside or within bi-national or multi-national companies, especially those operating in the US and Canada.

FIGURE 3. NORTH AMERICAN NATURAL GAS DEMAND, 1965-2025



Source: NEG, EIA, *BP Statistical Review.* International Trade Canada, "Canadian Pipeline Industry Overview and Outlook." Presentation to the Canadian Energy Pipeline Association, March 7, 2005.

FIGURE 4. CANADIAN NATURAL GAS SUPPLY AND DEMAND



Source: NEG, EIA, BP Statistical Review. International Trade Canada, "Canadian Pipeline Industry Overview and Outlook." Presentation to the Canadian Energy Pipeline Association. March 7, 2005.

- Is there an untapped opportunity for Canadian investors and exporters in India's market?

The North American Industry Classification System (NAICS) was adopted by the United States, Canada and Mexico in 1997 in the aftermath of the ratification of the North American Free Trade Agreement (NAFTA) by all three countries. The system makes it possible to track exports and imports of all three, sector by sector, and compare "apples to apples" and "oranges to oranges." The NAICS is organized, sector by sector, from broadest to narrower and narrower categories.

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Because these transactions are internal to companies operating on both sides of the Canada-US border, the research requires a high level of cooperation from companies that are Industry Canada's research targets. A global supply chains conference was held in February 2006 in Ottawa for public servants in the Department of Industry, and a global value chains conference was slated for senior economic policy authorities from the Organization for Economic Co-operation and Development (OECD) member countries, policy analysts from the Federal Government, as well as representatives from businesses, think tanks, and academia, in September 2007.

Industry Canada and others are attempting to understand how this variety of trade — trade internal to companies — occurs: the management relationships and best practices, as well as transportation infrastructure and arrangements. Whether intentional or not, global value chains research takes a page from Adam Smith's understanding of trade in *The Wealth of Nations* as, in part, division of labour and his discussion of the advantages of importation of certain products over domestic production — in this case, within companies, in order to maximize profits.

The clearest advantage to this approach is that it widens its view beyond transportation infrastructure, and starts to get at how trade occurs, especially in terms of management and best practices. It recognizes that trade is more than transportation infrastructure. Further, global value chains research begins to paint a picture of how the Canadian and US economies are integrated by trade — at least, how a business enterprise operating on both sides of the US-Canada border integrates its operations by way of trade internal to the enterprise. Global value chains research offers a microcosm, company by company, of how the Canadian and US economies are integrated, sector by sector — especially in respect of the Ontario-Michigan automobile manufacturing industry.

The information collected should be extraordinarily useful in adding to our understanding of Canada-US trade. But it is necessarily limited by focusing its research scope on bi-national and multinational enterprises. Further, while it is not as limited in scope as the Gateways project, focused as it is on transportation infrastructure, global value chains research does not (yet, anyway) address the influence of contractual, regulatory, statutory and treaty arrangements, let alone matters of culture and human relationships. As I wrote last summer in *Policy Options*:

> *Global supply (value) chain research points to how Canada's trade is organized mainly in terms of businesses, offering a description of Canada's trade flows. It is helpful. But this presents an inadequate explanation by itself of Canada's trade capa-*

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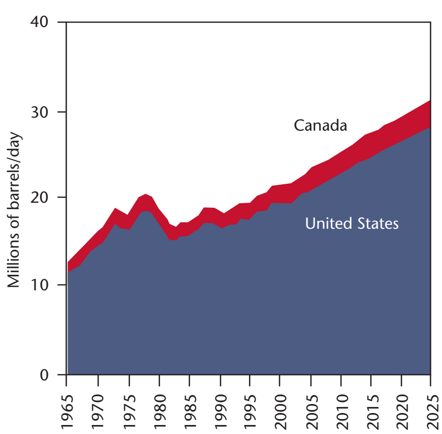
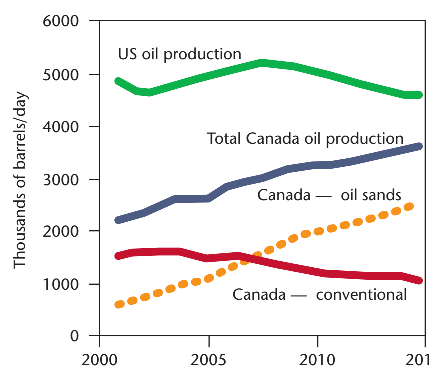
FIGURE 5. NORTH AMERICAN OIL DEMAND, 1965-2025



Source: NEG, EIA, BP Statistical Review. International Trade Canada, "Canadian Pipeline Industry Overview and Outlook." Presentation to the Canadian Energy Pipeline Association. March 7, 2005.

FIGURE 6. CANADA AND US OIL PRODUCTION, 2000-2015



Source: EIA, CAPP International Trade Canada, "Canadian Pipeline Industry Overview and Outlook." Presentation to the Canadian Energy Pipeline Association, March 7, 2005.

ble of informing and providing direction to Canada's international trade policy.

The concept of Trade Corridors was first developed in Canada as a public policy project of the federal Department of Transport in the late 1990s. For some time earlier, Trade Corridors had been adopted by a number of regional Canada-US trade marketing initiatives describing themselves as Trade Corridors. But Trade Corridors were consistently described and defined in terms of transportation infrastructure and transportation routes.

The Work Research Foundation departed from this limited understanding of Trade Corridors with its book *Greenlighting Trade: A Trade Corridors Atlas*. Using the North American Industry Classification System (NAICS) and the Harmonized System (HS) data at Trade Data Online, and certain other data from Industry Canada and Statistics Canada, *Greenlighting Trade* identified Canada's six highest value export markets, how these are focused on the United States as a destination, and how they tended to integrate the Canadian and US economies.

"Six Trade Corridors to the US: The Lifeblood of Canada's Economy" (*Policy Options*, July-August 2006) provides a summary of the arguments while *Greenlighting Trade* presents the detailed sector-by-sector research, and organizes it into a number of useful graphs and charts giving a "snapshot-at-a-glance" of Canada-US trade. *Greenlighting Trade* examines Canada's six largest export markets organized by sector under the broadest categories of the North American Industry Classification System (NAICS) and the Harmonized System (HS). These markets are described as six Trade Corridors, beginning with the highest value export sectors: automobile manufacturing, oil and gas products, machinery and equipment manufacturing, forest products, commercial services, and food (agriculture and fishing products). A definition of Trade Corridors was developed that endeavours to include and encompass not only the matters addressed under Gateways or Global Supply Chains, but also matters not included:

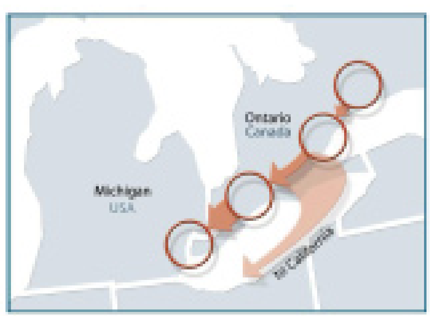
> *Trade corridors are more than transportation infrastructure. Therefore, trade corridors are defined as streams of products, services, and information moving within and through communities in geographic patterns according to a matrix or "culture" of trade agreements and treaties, statutes, delegated legislation, and customs that govern and guide trading relationships, institutions, and structures.*

With this definition, *Greenlighting Trade* attempts to understand Canada-US trade — and global trade, for that matter — in all its facets and fullness. This is an attempt to move the discussion from merely one of infrastructure and products — important as they are — to the role of contracts and the rule of law as well as the human elements of culture and relationships that frame and provide the contexts for trade. This understanding of trade can help to prioritize trade on a basis other than *solely* the value of exports and trade surpluses and deficits. It helps to understand why a trading relationship as Canada-US trade exists, and why it is so large. It also explains how trade tends to integrate the Canadian and US economies. Trade Corridors offers clues to other potentially fruitful trade relationships, bringing these into the prioritization of trading relationships.

Taking a cue from the example of the most valuable trading relationship

The Trade Corridors framework provides an explanation of how Canada's trading emphasis shifted away from Britain to the US in the 19th and 20th centuries. It takes into account the impacts of Canada's geographic proximity to the US over the United Kingdom as well as the US and Canada's shared history of adherence to common law and the sanctity of contracts, and the millions of human relationships among US and Canadian and US-Canadian dual citizens. There is more to say about the advantages that Canada enjoys in respect of its trade with the United States.

FIGURE 7. ONTARIO-MICHIGAN AUTO MANUFACTURING TRADE CORRIDOR[1]



Source: *Greenlighting Trade: A Trade Corridors Atlas* based on Statistics Canada data.
[1] Approximate major points of origin and destination, and volume of Canadian export trade. Does not necessarily portray transportation routes.

FIGURE 8. ALBERTA MINERAL ENERGY TRADE[1]

Source: *Greenlighting Trade: A Trade Corridors Atlas* based on Statistics Canada data.
[1] Approximate major points of origin and destination, and volume of Canadian export trade. Approximates major pipeline routes.

in the world and, perhaps, in recorded history — Canada-US trade conclusions can be drawn based on what makes this relationship, first, possible and then so fruitful. The most fruitful trading relationships will tend to entail geographic proximity; the similarity of legal systems and statutory/regulatory structure; the quality of international relations and treaties between governments; openness to exports and imports and to direct foreign investment; the similarity of business and trading cultures and contractual relationships; and the web and network of personal relationships on a human level.

Therefore, Canada may want to prefer trade with India with its quarter billion English-speakers and common law legal system over trade with the PRC.

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In *Greenlighting Trade* and since its publication, a number of opportunities and challenges were identified for Canada's six most valuable export Trade Corridors markets. Following are the challenges and opportunities of the three most valuable of these, namely automobile manufacturing, oil and gas products and machinery and equipment.

The Canada and US auto industries are, in fact, the North American auto industry centred in Ontario and Michigan. This industry represents approximately one-fifth of the total value of Canada's exports. More than one-quarter of Canada-US trade crosses at the Ambassador Bridge, Windsor-Detroit.

The industry was formerly governed mainly by the Auto Pact, 1965, but is now governed by the Canada-US Free Trade Agreement and the North American Free Trade Agreement and the attached regulations and tribunals. The highway transportation infrastructure serving the industry is further stressed because the Niagara peninsula (Canada) has become the transportation route of choice between New England and the US Midwest for US truckers and for US tourists and students.

The St. Lawrence Seaway and its infrastructure are subject to a Canada-US treaty and a binational commission, the International Joint Commission, established in 1909. As vessels have increased in size, significant expansion of the seaway has not been forthcoming. The 2007 federal budget privileged hybrid auto manufactures over non-hybrids and higher gasoline consumption vehicles. Tax credits were made available to the former, and tax levies were announced on the latter. This effectively privileged Toyota — with its emphasis on hybrids over Daimler-Chrysler — with its recent revival of "the hemi" engine. A North American auto industry already under pressure is feeling that pressure all the more.

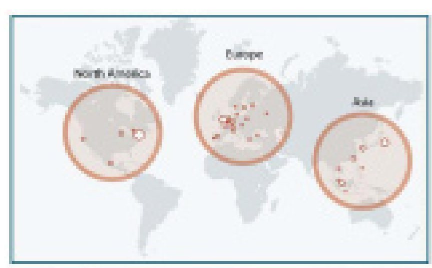
US demand for oil and gas continues to ramp up, matched in production by Canada's oil and gas industry, centred in Alberta (see the accompanying illustrations). The oil sands reserves of northeastern Alberta of bitumen that can be processed into crude, and the Elmworth gas fields of northwestern Alberta that straddle the Alberta-BC border, may represent the largest proven reserves of oil and gas in the world. Near Peace River, Alberta, is another site with huge potential for bitumen extraction

If Canada and the US are treated as a trading bloc, the value of its trade is exceeded only by the EU-25, or by all of Asia considered as one trading bloc. The two economies possess highly integrated transportation, communications, financial, business, cultural, military and family networks, and highly similar statutory, regulatory, civil, judicial, political and governmental frameworks. Sector by sector, corridor by corridor, bilateral trade serves to integrate the Canadian and US economies. This integration is mutually beneficial, with the advantage at present going to Canada, with its trade surplus.

FIGURE 9. ONTARIO-QUEBEC MACHINERY AND EQUIPMENT TRADE CORRIDOR[1]

Source: *Greenlighting Trade: A Trade Corridors Atlas*, based on Statistics Canada data.
[1] Approximate major points of origin and destination, and volume of Canadian export trade. Does not necessarily portray transportation routes.

FIGURE 10. ECONOMIC ZONES AND FINANCIAL CENTRES



already in the early stages of development.

Recent concerns about greenhouse gases and oil and gas consumption will tend — at least in the short to medium term — to put pressure on the industry. Extraction of bitumen generally requires the consumption of natural gas, with the attendant production of greenhouse gases.

For years, policy analysts have suggested the construction of a CANDU reactor near Fort McMurray and the oil sands extraction sites in northeastern Alberta, and near the projected oil sands sites in northwestern Alberta. A recent proposal would have seen the construction of a reactor near Whitecourt in northwestern Alberta, but the residents recently voted against it. As a result, Energy Alberta announced at the end of August 2007 that it is applying for "a Licence to Prepare Site with the Canadian Nuclear Safety Commission" situated near Peace River. From beginning the approvals process through construction to a CANDU being up and running will take up to ten years.

Alberta is effectively becoming a "super-province" on the order of Ontario because of its economic prowess from oil and gas, spin-offs, and from other infrastructure expenditures in health care. But Alberta doesn't enjoy the same kind of clout as Ontario in Parliament and the federal government. This requires addressing, and the aspirational culture of Alberta that tends to legitimize Alberta's political expectations.

In certain quarters of the broad machinery and equipment sector, there seems to be some lack of appreciation for the magnitude of the value-added and the multiplier effect of Canada's high-technology engineering sector in space, satellite, aerospace, communications and robotics technology. Other countries capable of such technology — and it's a relatively short list — actively support and privilege their players in this sector over foreign competitors. Even with a commitment to free trade, should the Government of Canada do any differently as long as other governments privilege domestic participants?

Increased US concerns with security add an extra hurdle in respect of technology sharing and the involvement of Canadian engineers and scientists born off-shore from Canada in countries considered suspect by the US government. This could also serve as an advantage to Canada in making it a more attractive destination for high-tech engineers and scientists who would be barred from certain kinds of pure and applied research in the US under its ITAR regime.

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For several years, the Alberta government has promoted "the Alberta Advantage" — in business, its regulatory regime, its access to energy, for professionals, and in terms of overall quality of life. Here is "the Canadian advantage" — Canada's trade assets identified by employing a Trade Corridors analysis:

- Canada shares a continent with the US: this gives Canada immediate geographic access to the largest economy in the world;
- Canada shares time zones with the US: the business day, banking and securities markets operate on the same time zones in both countries. Canadians and Americans work, go to school, and carry on their daily lives concurrently;
- Canada and the US share the Great Lakes and the St. Lawrence Seaway: Canada and the US share access and management of the St. Lawrence Seaway and the great inland transportation waterways of the Great Lakes;
- Canada and the US share a common language, English, and both are bilingual. Over the years, several prominent news anchors in the US have been Canadians, most notably the late Peter Jennings. That is because spoken English in one is generally understood in the other. Canada possesses a linguistic bridge to la *francophonie* — French-speaking countries throughout the world. The US possesses a linguistic bridge to iberophones — Spanish-speakers, by way of its large Hispanic and Mexican population;
- Shared legal framework — the common law — and both have jurisdictions that employ the civil code or Napoleonic Code (Quebec and Louisiana). Although differences between the legal regimes are present, the general adherence to the sanctity of contract informed by a majority common law regime tends to facilitate trade and business transactions between the two countries;
- Shared popular and mass culture. Canadians are knowledgeable of American pop culture. Several Canadians are American cultural icons. Both share similar spectator and participatory sports interests in baseball, football and golf. When their entrepreneurs meet, they have common ground and subjects to discuss in breaking the ice while they play the links;
- Shared electrical power grid. Hydro-Quebec sells power through

the US northeast grid. Both use electricity in the same way;
- Shared and highly integrated transportation network of air, sea, rail and roads. Major Canadian airports have pre-clearance facilities, and there is discussion of creating pre-clearance facilities for highway and rail border crossings;
- Shared communications grid of telephone, cellular service, BlackBerry and Internet;
- Highly mobile work forces. Canadians and Americans are among the most highly educated peoples in the world, and their credentials, skills and ways of doing business are highly transferable, country to country. This is further enhanced by the NAFTA worker visa;
- Security, police and armed forces integration and exchanges; and
- Similar systems of advanced education. Canada and the US take similar approaches to public education, and their universities are similarly structured.

No trading relationship is perfect. As the two-way trade in goods and services between Canada and the United States approaches $2 billion each and every day, trade irritants are likely to arise.

If Canada and the US are treated as a trading bloc, the value of its trade is exceeded only by the EU-25, or by all of Asia considered as one trading bloc. The two economies possess highly integrated transportation, communications, financial, business, cultural, military and family networks, and highly similar statutory, regulatory, civil, judicial, political and governmental frameworks. Sector by sector, corridor by corridor, bilateral trade serves to integrate the Canadian and US economies. This integration is mutually beneficial, with the advantage at present going to Canada, with its trade surplus.

Canada must guard and enhance its chief trading relationship while seeking to initiate and grow other trading relationships. Taking as a model its trading relationship with the US, Canada should target economies where it holds in common characteristics that will pave the way for mutually beneficial trade and economic integration. Trade Corridors is the best model for understanding how Canada-US occurs at present, for understanding how trade integrates the two economies, and for identifying Canada's best markets for future trade expansion.

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