

Shaping the future of the North American economic space

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The issues

1. Canada's economic challenges

- Growth in living standards lag US
- made-in-Canada weaknesses (stagnant productivity growth)
- Even when we do our homework, access to the large wealthy US market is essential
 - NAFTA negotiated in early phases of North American production networks and growth of knowledge-based clusters
 - NAFTA didn't take account of services trade
 - Cross-border flows of services, technology and people now essential to firms' success
 - Canada not getting its share of FDI headed to N America from ROW

The issues

2. **Asymmetric interdependence**

- While US exports more to Canada and Mexico than to 15-member EU
- Canada and Mexico export 90 percent of total to US

The issues

3. Current depth of integration unsustainable

- Pre-Sept. 11: FTA/ NAFTA had outlived its usefulness
- Post-Sept 11: Market access is less assured
 - Higher transactions costs for people/ services, goods
 - Effectively a higher tariff

Addressing Canada's problems in North America (Three to tango nice but not necessary)

- Deeper integration with US is the only way to address the obstacles to flows of services, technology, people
- How to interest the US in deeper integration?
 - Survey Canada's interests – what we want
 - Survey US interests – what they want
 - What are the outlines of a mutually-interesting bargain?

Canada's interests

- Secure the border, but make it *seamless*: remove the border as a factor in economic decisions
- Factor mobility
 - **People:** As trade and investment flows increase and production networks growth, people must move too
 - **Capital:** different withholding taxes inhibit capital flows into Canada; CIT tax base differentials complicate intra-firm trade in production networks
- Trade: US trade remedy law
 - Canada's long-time goal of modifying US CVD and AD laws still needs work as the softwood lumber case demonstrates

Choosing the route to deeper integration

- Choices influenced by such factors as:
 - Attitudes to sovereignty
 - Attracting and retaining US attention
 - Why focus even more on US over other alternatives?
- Two models, three paths, to choose from:
 - European model:
 - (1) customs union
 - (2) common market
 - Unique North American route

Degrees of economic integration (based on European experience)

Form of integration	Free trade in goods and services	Common external tariff or commercial policy	Free movement of people and capital	Harmoniz'n (or mutual recog) of rules, standards, tax & monetary policies	Supranational institutions
FTA	X				
Customs Union	X	X			
Common Market	X	X	X		
Economic Union	X	X	X	X	
Full economic integration	X	X	X	X	X

What would interest the US congress?

- Proposals that are perceived to affect US sovereignty. Two do:
 - Common trade policy would catch wide interest
 - Common market proposal could not be ignored either
- Stand alone trade negotiation not a starter
- Incremental ad hoc issues (softwood lumber) too small to notice
- A Big Idea
 - The US political system responds to Big Ideas
 - But only one at any time

US interests

- US has a different problem:
 - Openness necessary for globalization is a source of vulnerability
 - Homeland security is highest policy priority
- Any proposal should address security:
 - Securing the border: Smart Border Declaration is regarded to be a good start and a good example of bureaucratic and political cooperation
 - North American defense
 - Immigration: immigrants from third countries
 - Energy security
 - Saudi Arabian share of US oil imports almost the same as Canada's
 - Canada seen to have vast reserves
- (Canada's economic insecurity is not on the US radar screen)

What might be the Big Idea?

- Assumptions:
 - Proposal must be strategic and large or becomes orphan in US political system
 - European experience unique:
 - deeper integration a step toward ultimate goal of political union to end wars
 - Willingness to create common economic institutions in light of political goals
 - Canada and US already more integrated than Europe when it began
- No desire to give up political independence or distinctive institutions

Unique North American route to deeper integration: *A strategic bargain*

- Address key US interests in exchange for Canadian interests

Canadian Initiatives addressing US interests

- Border security
 - Implement Smart Border Declaration to speed low risk cargo and people (eg, “erased” border more attractive to FDI)
- Immigration
 - Reorganize policy frameworks: low risk NAFTA migrants move freely
 - Third country migration: build trust in common procedures and standards, but insist on mutual recognition
- Defense
 - How much are Canadians willing to commit to NA military defense?
 - Public debate of costs of various options leading to choice between shouldering our burden or continuing to free ride

Canadian Initiatives addressing US interests

- Energy
 - Disruptions in offshore supplies to US likely
 - Market forces drive the sector but market signals may not bring forth supplies in time if supply shortages emerge as critical US security issue
 - Canada would have to produce more
 - Anticipate US policy framework; define what Canada is prepared to do
 - Head off ad hoc reactive response (fed-prov disputes; utilities competing with each other; inadequate resource and infrastructure investment)

Canadian interests – deepen the FTA/ NAFTA

- Erase the border as a factor in economic decisions
- Be prepared to make mutual concessions
- Aim for customs-union–like and common market-like arrangements, but short of widespread harmonization; common institutions as necessary but not necessarily common institutions

Customs union (CU)- and common market (CM)-like arrangements (illustrative list)

- Harmonize/ bilateral eliminate tariffs; common tariff with third parties (CU)
- Extend business and professional visa to technicians (CM)
- Hi-tech border processing for low-risk business and tourist traffic (away from the border)
- Common competition policy (CM)
- Be prepared to harmonize/ give up supply management, state trading, government procurement (CM)
- Canadian content and IP
- Supportive institutional arrangement (as necessary; many exist but not used)
- North American natural resources area: mutual recognition of each other's regulatory regimes (oil, natural gas, electricity, forest products)

Economic union-like arrangements?

- Macroeconomic convergence and common currency? (no)
 - High degree of macroeconomic convergence
 - US shows no interest in common institution or currency
 - Would common currency fix Canadian economic performance?
 - Unilateral dollarization without common institutions and buffering mechanisms could force Canada to harmonize
 - A red herring

Risks of the Big Idea

- Better to stay invisible and accept the status quo
- Already too dependent on US market; better to diversify
- Deeper integration initiatives impossible because of asymmetry
- Deeper economic integration inevitably leads to political union

Conclusion

- Official resources and attention span are scarce resources: allocate them wisely
- A window of opportunity is open, but it is closing
- Canada must initiate -- exercise sovereignty
- Lots of domestic homework to be done:
 - Strategic Team Canada
- Bilateral initiative; include Mexico when it makes sense

The Strategic Bargain

- Big Idea needed to attract and retain US attention
- Strategic Bargain allows linkages and tradeoffs not available in stand alone, ad hoc, reactive mode of status quo
 - Wrap Canada's trade, investment and people interests in an initiative that addresses US security objectives
 - Enough US interests at stake that interest groups might cancel each other out