IS NORTH-SOUTH KILLING EAST-WEST?

Patrick Grady and Kathleen Macmillan

Canada is much more dependent on foreign trade than the other G-7 countries — four times more than the United States and Japan, two-thirds more than Germany, France, Italy and the United Kingdom. And Canada's exports have mushroomed in the past two decades, growing from 28 percent of our GDP in 1981 to over 40 percent in 1997, with the greatest growth occurring after 1989, when the Canada-US Free Trade Agreement (FTA) came into effect.

Canada's other important trading relationship is an internal one. Trade between the provinces accounted for 27 percent of GDP in 1981 – about on par with international trade. But while international exports have taken off since then, trade between provinces has collapsed, to the point where it accounted for only 20 percent of GDP in 1997.

Should these trends concern us? Do they signify a fatal fracturing of the Canadian market under the joint pressures of globalization and relentless federal-provincial bickering? Or are they just the fruits of trade liberalization begun under the FTA and continued under NAFTA and the WTO, which we should simply enjoy?

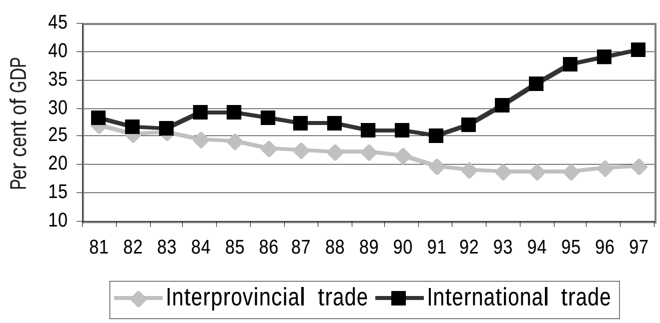
In fact, rumors of the death of our internal market are exaggerated. Almost half of the growing gap between international and interprovincial exports can be attributed to decreases in tariff rates between Canada and the US. Canada's thriving export performance of the past decade is almost all a result of sales to the US, spurred by lower US tariffs and better market access under the FTA and NAFTA. At the same time, lower Canadian tariffs have made imports from the United States cheaper relative to imports from other provinces.

The other half of the gap can be explained by the extraordinary growth in import demand in the United States. While Canadian exports to the US have outpaced growth in our GDP (thus explaining the rise in exports as a share of GDP), they have barely managed to keep pace with a ballooning US market for imports. The US has had a ravenous appetite for imports from all over the world, not just Canada.

Will the trend established in the 1990s continue? Will north-south trade eventually eliminate east-west trade? Probably not. With tariffs and other trade barriers between the US and Canada either eliminated or well on their way to elimination, there simply isn't any more room for boosting trade with tariff cuts. Likewise, the breathtaking growth in US imports that has been the driving force behind Canada's export success has given rise to a massive current account deficit that is clearly unsustainable. Eventually, it will have to be addressed by compressing imports from all sources, including Canada.

On the positive side of the ledger, interprovincial exports reduced their downward slide in 1995. Indications are that the Agreement on Internal Trade (AIT), which took effect in July 1995, is already helping to promote interprovincial trade. While the AIT is far from perfect, it is an important building block for future progress in improving our internal market.

International vs. interprovincial trade



North American economic integration took a quantum leap under the FTA and NAFTA. While the Canadian internal market hardly disintegrated as a result, it suffered from not-so-benign neglect. As international trade patterns return to normal after a time of spectacular growth, we should concentrate on bolstering the internal Canadian market. It is not in danger of breaking apart, but more glue would yield benefits in both economic and political terms.

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