CANADA WEST FOUNDATION GOING FOR GOLD PROJECT

Through the Gateway

UNLOCKING WESTERN CANADA'S POTENTIAL FOR ECONOMIC DIVERSIFICATION BY EXPANDING TRADE WITH ASIA-PACIFIC

FEBRUARY 2011 Michael Holden, Senior Economist

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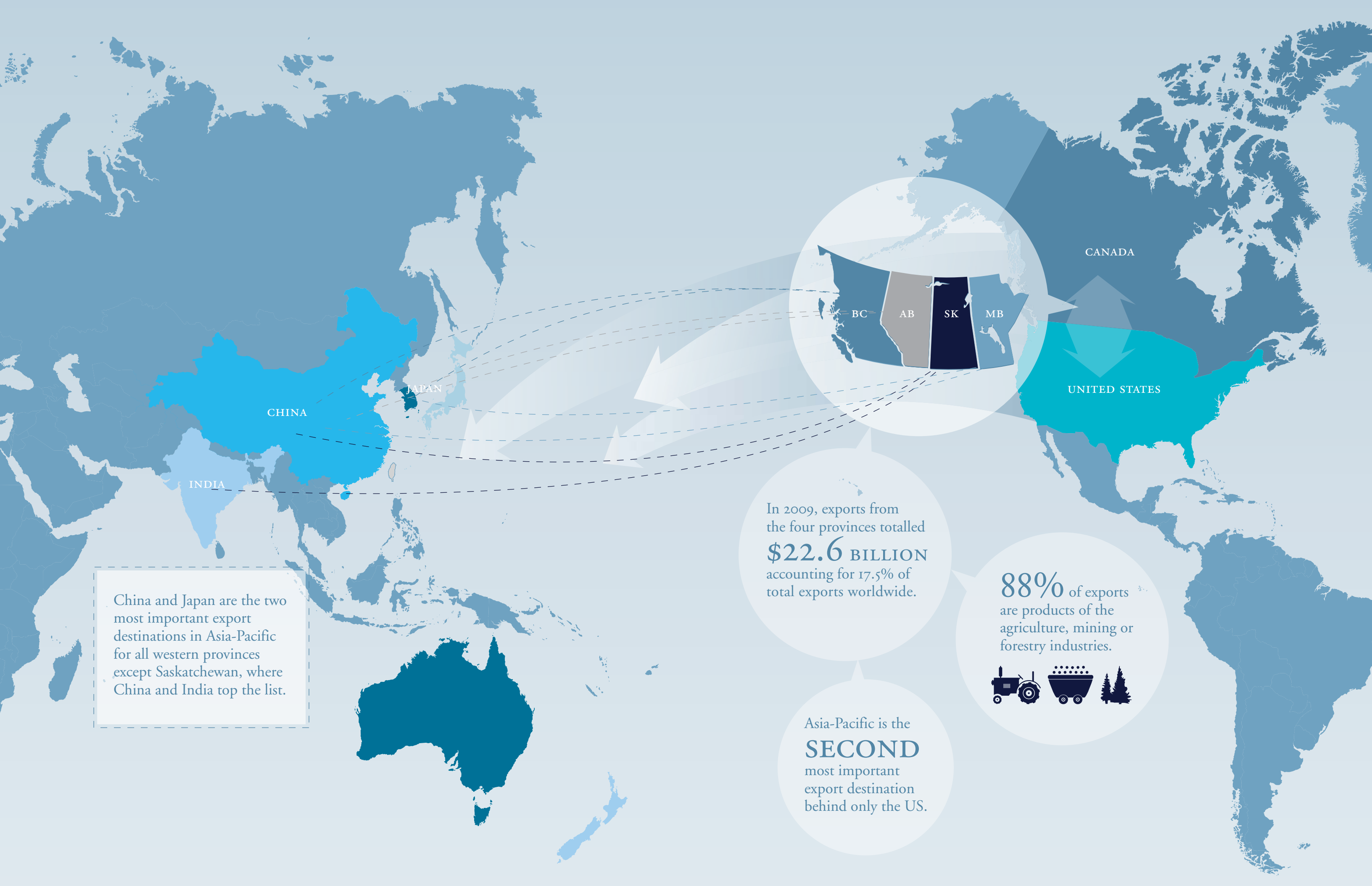
Contents



ASIA-PACIFIC

Home to over half the world's population.

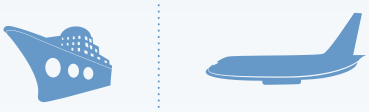
Accounts for a greater share of global economic output than the US and European Union combined.

Economic growth is being led by the region's developing countries which have grown by an average of

8.9% PER YEAR

since 2002 compared to 4.2% globally.

Developing Asia-Pacific markets accounted for 4.9% of western Canadian exports in 2004, rising to 8.9% by 2009. The share of exports to the US fell from 77.8% to 71.5% over the same period.



WESTERN CANADA

Asia-Pacific is the second most important export destination behind only the US.

In 2009, exports from the four provinces to Asia-Pacific markets totalled $22.6 billion, accounting for 17.5% of total exports worldwide.

The western provinces account for two-thirds of Canada's total exports to Asia-Pacific.

AT $9.5 BILLION

in 2009, BC exports more to that region than any other province.

China and Japan are the two most important export destinations in Asia-Pacific for all western provinces except Saskatchewan, where China and India top the list.

The West's exports to Asia-Pacific markets are dominated by natural resources and resource-based goods.

Nearly half of western Canada's exports to Asia-Pacific in 2009 ($10.8 billion out of $22.6 billion) were to the region's developed markets: Japan, South Korea, Taiwan, Australia, New Zealand, Singapore and Hong Kong. However, exports to these countries have grown by just 25% since 1990. By contrast, exports to China, India and other developing countries in Asia-Pacific have risen by

428%.

Trade with Asia-Pacific has helped Alberta and Saskatchewan to diversify the range of products they sell in foreign markets, although a contributing factor is the limited capacity in existing oil- and gas-related infrastructure to transport Alberta's largest export products overseas. The evidence suggests that exports to Asia-Pacific have not contributed to export product diversification in Manitoba and BC.

Asia-Pacific markets offer western Canadians a tremendous opportunity to a) increase trade; b) to diversify its customer base and its range of exported products; and c) to ensure economic growth and prosperity in the West for years to come.

Executive Summary

The western provinces depend on trade and investment to maintain their standard of living. While the vast majority of this trade takes place with the United States, the size and rapid growth in Asia-Pacific countries, notably in China and India, offer considerable opportunities for western Canadian exporters to expand the range and value of products they sell in international markets and to broaden their customer base; in other words, to diversify their exports and reduce their reliance on the US market.

It is difficult to overstate the size of the Asia-Pacific market. The region is home to 3.8 billion people, about 55.2% of the world's population; there are a dozen cities in Asia-Pacific that have a population larger than that of all of western Canada. Asia-Pacific is also an emerging force on the global economic stage. Put together, the Asia-Pacific economies are larger than the combined economies of the United States and the European Union. Moreover, led by China, India and other developing markets, economic growth in Asia-Pacific has consistently outpaced global economic expansion in recent years and is expected to continue to do so into the near future. Since 2002, developing markets in Asia have grown by an average of 8.9% per year, compared to 4.2% globally. The US and Euro area economies grew by 2.2% and 1.7% respectively over that period.

Western Canada's Trade with Asia-Pacific

Asia-Pacific is western Canada's largest export market outside of the United States. Total exports from the four provinces to Asia-Pacific destinations were valued at $22.6 billion in 2009, accounting for 17.5% of total sales abroad. About two-thirds of Canada's overall exports to Asia-Pacific come from western Canada.

Much of this trade takes place with Japan, South Korea and other industrialized economies in the region, although this allocation is changing rapidly. Exports to Asia-Pacific have nearly doubled since 1990, but most of that growth has been in trade with China and other developing countries. The value of shipments to developing economies in Asia-Pacific was 428% higher in 2009 than in 1990, while those to industrialized markets in the region were just 25% higher.

In spite of strong export growth in recent years, Asia-Pacific is actually less important to the western Canadian economies today than it was 20 years ago. In 1990, 26.8% of western Canada's exports went to Asia-Pacific market, compared to 17.5% in 2009. The decline in market share is largely due to two concurrent trends: the impact of the Canada-US free trade agreement; and the sluggish performance of the Japanese economy over that period. Western Canada trades less with Japan today than it did in 1990.

China is currently the largest or second-largest export destination in Asia-Pacific for all four western provinces. However, only Saskatchewan is a significant exporter to India thanks to large shipments of potash and legumes.

Western Canada's exports to Asia-Pacific are highly concentrated in natural resources and resource-based goods. The West's top ten exports, which account for two-thirds of total sales to the region, are all products of the agriculture, mining or forestry industries. In all, resource-based goods accounted for 88% of western Canada's total shipments to Asia-Pacific in 2009.

TRADE WITH ASIA-PACIFIC AND ECONOMIC DIVERSIFICATION IN WESTERN CANADA

There are two ways in which trade with Asia-Pacific countries can promote economic diversification in western Canada: 1) export market diversification (the expansion of exports to a wider range of countries and thus reducing reliance on any single market); and 2) export product diversification (the expansion of the range of goods produced and exported by businesses.)

The evidence suggests that increased exports to Asia-Pacific markets—the region's developing economies in particular—have contributed to export market diversification in western Canada over the past decade.

The evidence on export product diversification is less clear. For Alberta and Saskatchewan, there is some indication that exports to Asia-Pacific have helped those provinces to expand the range of products they export. In the case of Alberta, this diversification is in part because a lack of necessary infrastructure effectively prevents the province from exporting oil and gas overseas. For BC and Manitoba, the evidence suggests that trade with Asia-Pacific is not contributing to export product diversification; the products sold by those provinces to Asia-Pacific markets are largely the same as those exported elsewhere.

POLICIES ON EXPANDING WESTERN CANADA'S TRADE WITH ASIA-PACIFIC

Expanding trade and investment ties with Asia-Pacific is a recognized policy priority, both for the Government of Canada and for the western provinces. Both federal and provincial governments have been active in reducing barriers to trade and investment, promoting regional goods, and investing in strategic infrastructure to help get goods to market.

However, more work needs to be done to ensure that western Canadians are in the best possible position to capitalize on the tremendous economic opportunities presented by China, India and other Asia-Pacific economies.

Some outstanding policy issues include the following:

1) **Responding to demand for energy in Asia-Pacific.** Western Canada has the means to supply China and other Asia-Pacific markets with the energy it will need in the years ahead. However, the necessary infrastructure is not in place to ship oil and gas, and proposals to build it would need to reconcile competing priorities in regards to environmental impact and safeguards and economic development.

2) **Clarifying foreign direct investment rules.** Given the recent rejected takeover of Potash Corp. of Saskatchewan, it is important that steps be taken to ensure that Canada's investment review process be seen as predictable with well-defined rules and transparent evaluation criteria so as not to deter foreign direct investment from Asia-Pacific and elsewhere.

3) **More effectively leveraging western Canada's multicultural society.** Western Canada's large communities of Chinese-, Indo- and other Asian-Canadians are an important bridge to that part of the world. Governments and businesses alike would benefit from harnessing this advantage to build closer commercial ties with markets in Asia-Pacific.

4) **Determining the role of government in trade promotion.** The challenge from a policy standpoint is to translate awareness of market opportunities in Asia-Pacific into meaningful outcomes for domestic businesses. However, this challenge also raises questions about the role of governments in economic development and trade promotion.

5) **Capitalizing on opportunities in education and travel.** Approved Destination Status in China will open the door for Chinese tour groups to visit Canada. In addition, as many Asian economies grow wealthier, demand for western-style education services is growing. Countries like Australia have benefited from these opportunities through a concerted and sustained policy and promotion effort. The western provinces will have to do the same if they wish to have similar success.

6) **Striking a balance between domestic policies and international trade.** Trade liberalization is an important step in opening markets in Asia-Pacific, but sometimes domestic policies such as the federal government's position on supply management in agriculture prevent Canada from pursuing international agreements. An outstanding policy question for the western provincial governments is how to strike a balance between the expected benefits of trade liberalization and domestic policies that may stand in the way.

1.0 Introduction

Asia-Pacific is the largest and fastest-growing economic region in the world. For western Canadians, who depend significantly on international trade and investment to maintain their standard of living, capitalizing on the market opportunities in Asia-Pacific, and in emerging economic powerhouses like China and India in particular, offers a tremendous opportunity to ensure economic growth and prosperity for years to come.

Rapid growth in China, India and elsewhere in Asia-Pacific is fuelling demand for a wide range of imported goods and services, many of which are in industries of comparative strength for western Canada. On the production side, there is a tremendous need in Asia-Pacific for raw materials, and other inputs (including business services) to support domestic manufacturing and assembly. There is a complementary need for materials, expertise, and services support to assist with construction, infrastructure development and other public works. Finally, rising disposable incomes in many Asia-Pacific countries, especially those with large populations such as China and India, are creating a large middle class with a burgeoning demand for consumer goods and services as well, including food products, energy and education and travel services.

Calls to expand western Canada's market presence in Asia-Pacific are fed not only by the specific opportunities within that region, but also because the prospects for increasing overseas trade appear more positive than the long-term prospects for growth in western Canada's largest trading partner, the United States. To be sure, western Canada has profited tremendously from its close relationship with the US. Geographic proximity, a common language, similar cultures, its status as a world economic superpower, and a bilateral free trade agreement which has led to a significant degree of cross-border economic integration in many sectors, all ensure that the US will continue to be western Canada's largest export destination and largest source of imports. However, economic growth in the US over the past ten years has been about a quarter the rate of growth in many Asia-Pacific markets—a trend that is expected to continue into the near future. While the US is, and should continue to be, Canada's top foreign policy priority, it would be shortsighted to not act on the opportunities that Asia-Pacific markets represent.

Indeed, the western provinces have already benefited from their trade and investment ties with Asia-Pacific. Well-developed economic relationships with established markets like Japan and South Korea are being complemented by rapid expansion in two-way trade and investment with China, India and other developing markets in the region. The resulting increase in overall trade flows has already contributed to a stronger and more prosperous western Canada.

Even so, there is considerable room for improvement. A concentrated policy focus on expanding trade and investment linkages with Asia-Pacific offers western Canadians the prospect of even greater export growth and higher domestic economic activity. In addition, it can contribute to economic diversification in western Canada, by broadening the range of customers to which western Canadians sell their products, and by expanding the variety of goods and services they export.

This paper examines western Canada's current economic relationship with Asia-Pacific and the extent to which its trade ties with that region have contributed to economic diversification to date. It also identifies a number of policy issues that need to be addressed for the West to take fuller advantage of the considerable trade opportunities in Asia-Pacific markets and thus contribute to a prosperous western Canada.

2.0 Overview of the Asia-Pacific Region

Asia-Pacific is a vast and populous region. It consists of more than 50 distinct economies (including Chinese territories such as Hong Kong and Macau) across Asia ranging from as far west as Afghanistan (but not including Russia), as well as Australia, New Zealand and all the island countries, territories and protectorates in the South Pacific.

Asia-Pacific is characterized by remarkable diversity in history, geography, culture, language, political systems, economic and social development, and personal freedoms. It includes some of the most densely- and sparsely-populated countries in the world; as well as some of the richest and poorest economies. Democracies and market-based economic systems flourish in some countries, but exist alongside Communist systems, dictatorships and planned economies (House of Commons Standing Committee on Foreign Affairs and International Trade 2003).

Home to 3.8 billion people—55.2% of the world's residents—Asia-Pacific is the most heavily-populated region in the world. Led by China and India, with more than one billion citizens each, more than half of the people on Earth live in Asia-Pacific. Including those two nations, six of the ten most populous countries in the world are in Asia-Pacific (the others are Indonesia, Pakistan, Bangladesh and Japan). There are a dozen cities in Asia-Pacific with a population larger than that of all of western Canada.

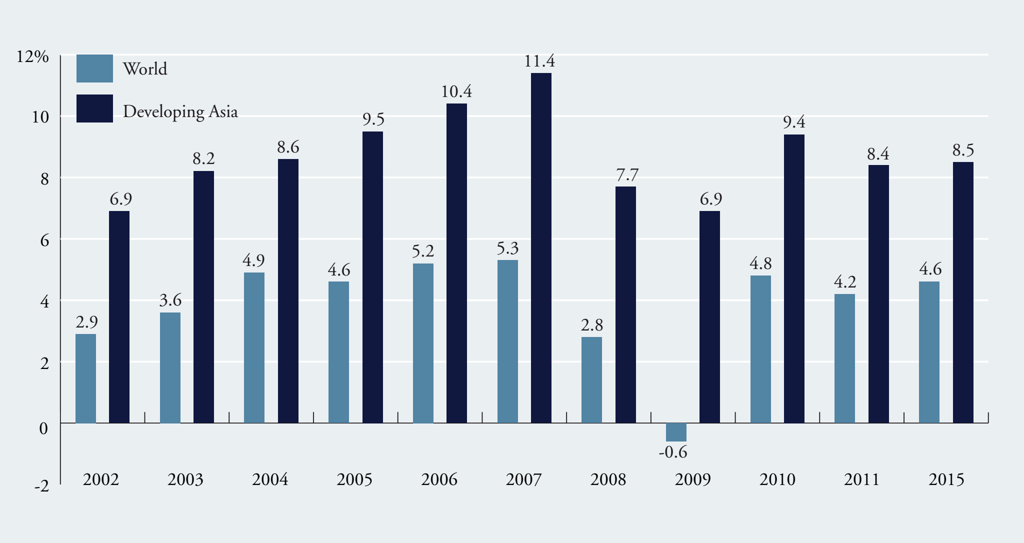
Asia-Pacific is also the largest economic region in the world. After adjusting for the effects of purchasing power, the total value of economic activity in Asia-Pacific in 2009 is estimated at more than US$23.5 trillion, comparable to the gross domestic product (GDP) of the United States and the European Union (US$28.6 trillion) combined (CIA 2010). In all, Asia-Pacific countries accounted for more than one third of global economic activity in 2009.

China is the dominant economy in Asia-Pacific. With a total GDP of US$8.8 trillion in 2009, China accounted for 37.4% of all economic activity in Asia-Pacific that year. It is the third largest economy in the world (behind the European Union and the United States) and produces more than Japan and India—Asia-Pacific's next largest economies—combined. In total, Asia-Pacific is home to four of the ten largest economies in the world—China, Japan, India and South Korea. Indonesia is in 11th place (CIA 2010).

Asia-Pacific markets are expected to become even more important to the global economy in the future. With the possible exception of Japan, which has experienced more than a decade of prolonged economic weakness, economic growth across much of the region has dramatically outpaced global economic growth through the past decade and economic forecasts suggest that this trend will continue into the near future as well. Since 2002, developing markets in Asia have grown by an average of 8.9% per year, compared to 4.2% globally (Figure 1). The US and Euro area economies grew by 2.2% and 1.7% respectively over that period.

Leading the way has been the rapid expansion in economic activity in China and, to a lesser extent, India. China has experienced double-digit growth in economic output through much of the 2000s and is expected to continue to expand strongly into the near future (IMF 2010). India has also experienced significant economic development over the past decade. Although growth rates have not been as high as in China, the Indian economy nevertheless is developing rapidly and is expected to continue to do so in the years ahead.

FIGURE 1: REAL GDP GROWTH (ACTUAL AND FORECAST), IN %



Source: International Monetary Fund, World Economic Outlook: October 2010

3.0 Western Canada's Economic Relationship with Asia-Pacific

How important is trade and investment with Asia-Pacific to the western Canadian economy? Unfortunately, because of data limitations only an incomplete picture is available. Data on services trade and foreign direct investment (FDI) stocks are not available at the provincial level and, as discussed in Text Box 1, province-specific merchandise import data do not necessarily reflect the final destination of imported goods. Because of these limitations, this analysis of western Canada's economic relationship with Asia-Pacific (and China and India within that larger bloc) is necessarily restricted to a discussion of merchandise exports.

TEXT BOX 1: PROVINCIAL TRADE STATISTICS AND DATA LIMITATIONS

The quality and availability of trade statistics are major limiting factors in any discussion of provincial trade patterns. In terms of international merchandise trade, it is relatively easy to track the origin of a product but it is altogether a different matter to determine its final destination. This results in two specific limitations when examining western Canada's trade with Asia-Pacific.

The first of these limitations is that Canadian export statistics are measured according to the last known destination of the product in question. This leads to potential inaccuracies in export data because once domestically-produced goods leave Canada, it is difficult to track them beyond the original destination if they are then re-exported to a third country.

As a result, except in cases where data reconciliation efforts have taken place, Canadian export figures to some countries may not reflect the actual final destination of the product. This type of distortion is heaviest when major trans-shipping countries are involved, such as the Netherlands, Hong Kong and Singapore. Exports to markets such as these tend to be overstated, and correspondingly understated to other countries.

This problem of improper allocation of export data casts some doubt on the precise dollar value of Canadian, and consequentially, provincial, export figures. However, it does not call into question the general trends that those data reveal. A significant increase in Saskatchewan's exports to India, for example, would be reflected in the available trade data, even if the corresponding dollar figure was not exact.

The second limitation to trade statistics is that once imports enter Canada, they are no longer tracked through to their final destination. While Canadian export statistics are collected according to the province or territory in which the exported good was produced, import statistics are collected according to the location at which goods clear customs, irrespective of their final destination within Canada.

As a result, provincial and territorial import statistics are more reflective of the location of major ports of entry than they are of provincial or territorial demand. For example, British Columbia imported $16.7 billion in goods from Asia-Pacific countries in 2009 while next door, Alberta imported only $2.7 billion in goods from that region. The difference between the two is not that BC consumes six times as much from Asia-Pacific as does Alberta, but that goods destined for either province typically enter Canada through BC.

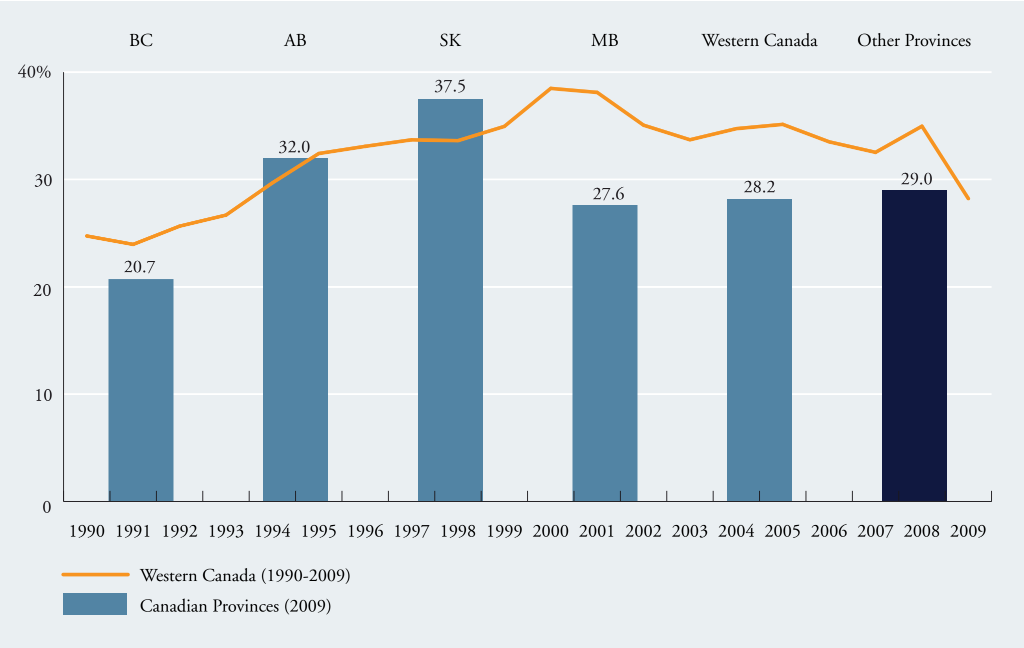
3.1 Global Context

Trade accounts for a considerable share of economic activity in western Canada. In 2009, exports of goods and services accounted for 28.2% of regional economic output. Although significant, this figure actually represented a 16-year low as the impact of the global financial and economic crisis hit especially hard on international trade flows. Typically within the past ten years, exports of goods and services have accounted for between 32.5% and 38.5% of western Canadian GDP.

Within western Canada, BC is the province least dependent on trade. In 2009, exports of goods and services from BC accounted for 20.7% of provincial GDP (Figure 2). By contrast, Saskatchewan is the most export-dependent of the western provinces with goods and services exports making up 37.5% of total economic output that year.

The vast majority of western Canada's trade takes place with the United States. Total merchandise exports from the four provinces were valued at $128.9 billion in 2009. Of that total, $92.2 billion (71.5%) represented goods sold in the US. By province, the share of total exports to the US in 2009 ranged from 83.2% in Alberta (totaling $60.0 billion) to 50.4% in BC ($12.9 billion).

FIGURE 2: EXPORTS AS A PERCENTAGE OF GDP (2009)

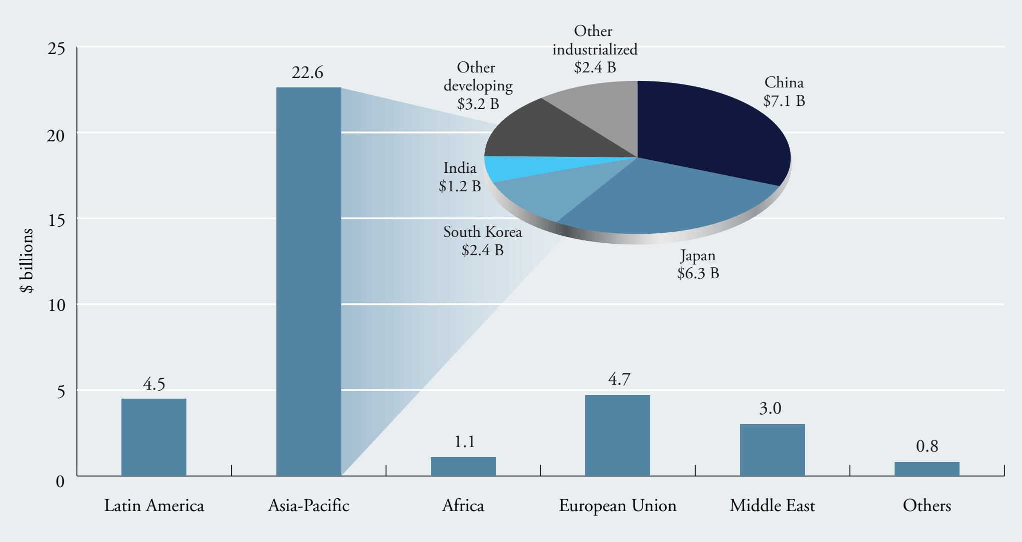


Source: Author's calculations using Statistics Canada data

3.2 Merchandise Exports to Asia-Pacific

The Asia-Pacific region is the most important trading partner for western Canada outside of the US. Outside of the United States, the western provinces export more to Asia-Pacific markets than to any other major region in the world. As Figure 3 shows, total exports from the four western provinces to Asia-Pacific destinations in 2009 were valued at $22.6 billion. They accounted for 17.5% of western Canada's total sales abroad and 61.4% of its exports to non-US destinations that year. The western provinces also accounted for most (about two-thirds) of Canada's overall exports to Asia-Pacific.

FIGURE 3: WESTERN CANADIAN EXPORTS TO NON-US DESTINATIONS (2009)

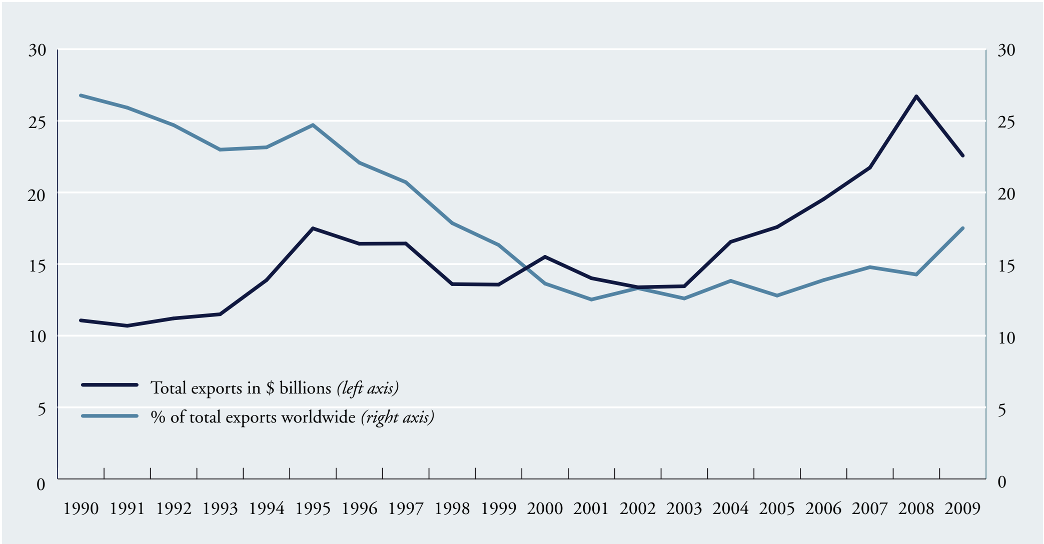


Source: Author's calculations using Statistics Canada data

Although Asia-Pacific is an important market for all four provinces, these aggregate numbers hide considerable variation within western Canada. BC and Alberta are Canada's two largest provincial exporters to Asia-Pacific, with total shipments in 2009 of $9.5 billion and $6.8 billion, respectively. For BC, this total accounted for 37.0% of provincial trade that year while for Alberta, the relative importance of Asia-Pacific was lower; it was the destination for 9.6% of Alberta's exports in 2009.

For its part, Saskatchewan exported $4.3 billion in goods to Asia-Pacific countries in 2009, equivalent to 19.9% of total provincial exports worldwide. For Manitoba, trade figures were somewhat lower; exports to Asia-Pacific markets were valued at $2.0 billion, making up 18.7% of provincial exports that year.

FIGURE 4: WESTERN CANADIAN MERCHANDISE EXPORTS TO ASIA-PACIFIC MARKETS



Source: Author's calculations using Statistics Canada data

Western Canada has enjoyed tremendous growth in exports in recent years (Figure 4), with a growing proportion of those exports bound for the Asia-Pacific. While sales of goods to that region have nearly doubled since 1990, most of the increase has taken place in the last five years. Even after considering the impact of the global financial and economic crisis, which contributed to a 15.5% drop in exports in 2009 (from $26.7 billion in 2008 to $22.6 billion), the value of goods shipments from the western provinces to Asia-Pacific markets has grown by an average of 6.4% per year since 2004, more than double the average rate of growth from 1990 to 2004. Exports to the US fell over that period.

The global financial and economic crisis also demonstrated the resiliency of western Canada's trade with Asia-Pacific. The crisis resulted in a dramatic decline in world trade flows, but for the western provinces, the decline in exports to Asia-Pacific was far less severe than it was to western Canada's others major export markets, especially to the United States. While the 15.5% drop in exports to Asia-Pacific countries in 2009 was a considerable decrease, western Canada's exports to all other destinations fell by 33.7% (from $160.4 billion to $106.3 billion).

Also evident in Figure 4 is that, in spite of some modest growth in market share since 2001, the proportion of western Canada's exports destined for Asia-Pacific markets in 2009 remains well below the levels seen in the early 1990s. In other words, Asia-Pacific is *less* important to the western Canadian economies today than it was 20 years ago.

Two factors explain this relative decline in market share through the 1990s. The first is the impact of the Canada-US free trade agreement which came into effect in 1989. That agreement caused a dramatic shift in economic structure and orientation in Canada as preferential access to the US market made the Canadian economy both more export-oriented and, at the same time, more closely integrated into a collective North American economy. As a result, Canadian exports to the US, including those from the western provinces, increased dramatically through the 1990s. For western Canada, the total share of exports bound for the US rose from 57.2% ($23.6 billion out of a total $41.3 billion in exports) in 1990 to 77.8% ($88.5 billion out of a total $113.7 billion) a decade later.

The second factor behind the decrease in the share of exports to Asia-Pacific in the 1990s was the sluggish performance of the Japanese economy over that period. Japan was by far western Canada's most important non-US export destination in 1990. In total, 16.1% ($6.6 billion) of the West's exports went to Japan that year; in the case of BC, that share was as high as 27.1% ($4.6 billion).

However, the Japanese economy took a significant turn for the worse in the early 1990s. Low interest rates and readily-available government financing in the 1980s contributed to inflation in asset prices in Japan, feeding a speculative bubble in equity and real estate markets in that country. When the bubble burst in the early 1990s, it resulted in an extended period of price deflation in Japan, eroding consumer spending and domestic production. Japanese businesses, which had overbuilt their productive capacity through excessive investments in the 1980s, were left with plants running nowhere near full capacity. Finally, the decline in asset values exposed the lax lending practices of many Japanese banks which were left holding volumes of non-performing loans. As such, the Japanese financial system was ill-equipped to deal with the effects of the Asian Financial Crisis, which swept through the region in 1997 and 1998 (House of Commons Standing Committee on Foreign Affairs and International Trade 2003). When all was said and done, the result was more than a decade of economic stagnation in Japan.

Japan's economic struggles through the 1990s took a toll on western Canada's trade relationship with that country. While exports to Japan continued to grow through the early 1990s, those gains were wiped out in the aftermath of the Asian Financial Crisis and were never recovered; while exports to most other major Asian economies have risen considerably, exports to Japan in 2009 remained 5.5% *below* 1990 levels ($6.3 billion compared to $6.6 billion).

In spite of this weakness in exports to Japan, the proportion of western Canada's exports going to Asia-Pacific markets has begun to rise again, after falling for more than a decade. As shown in Figure 4, Asia-Pacific's share of western Canadian exports grew from 12.5% in 2001 ($14.0 billion out of a total $111.9 billion in exports) to 17.5% in 2009. A more detailed examination of this increase, and what it means for economic diversification in western Canada, takes place below.

3.2.1 Major Export Destinations

Western Canada's largest export destinations within Asia and the South Pacific are shown in Figure 5. Although it accounts for just 5.5% of their exports, China is the largest customer in Asia-Pacific for the four western provinces (in aggregate). It is interesting to note, however, the extent to which western Canada's trade with the region continues to take place with its more established, wealthy and industrialized partners in the region. The four provinces trade far more with Japan and South Korea than they do with rising economic powerhouses like India and the 10-member Association of East Asian Nations (ASEAN) trade bloc (Thailand, Malaysia, Singapore, Indonesia, Philippines, Brunei Darussalam, Vietnam, Laos, Burma (Myanmar) and Cambodia). Indeed, nearly half of western Canada's exports to Asia-Pacific in 2009 ($10.8 billion out of $22.6 billion) were to the region's developed markets: Japan, South Korea, Taiwan, Australia, New Zealand, Singapore and Hong Kong.

FIGURE 5: TOP EXPORT DESTINATIONS IN ASIA-PACIFIC FOR WESTERN CANADA (2009)

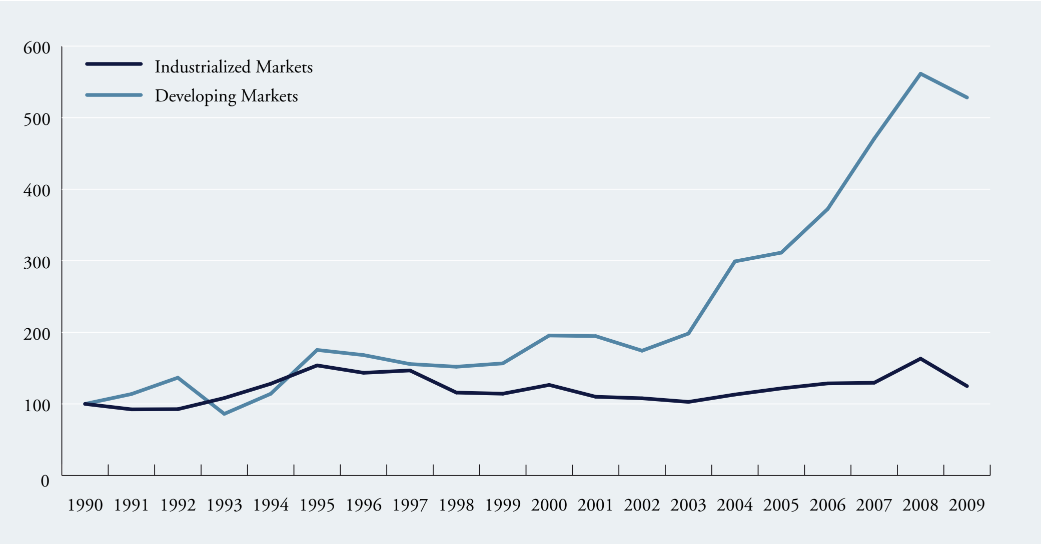
	Value	*Share of Total Exports (%)*	
	($ millions)	*to Asia-Pacific*	*to the world*
China	7,069.2	31.3	5.5
Japan	6,279.7	27.8	4.9
South Korea	2,430.7	10.8	1.9
India	1,233.6	5.5	1.0
Taiwan	724.9	3.2	0.6
Indonesia	707.7	3.1	0.5
Australia	654.9	2.9	0.5
Bangladesh	555.5	2.5	0.4
Hong Kong	535.9	2.4	0.4
Philippines	378.1	1.7	0.3

Source: Author's calculations using Statistics Canada data

The allocation of exports across Asia-Pacific is, however, changing rapidly. Growth in shipments of western Canadian goods to this region is clearly split along economic development lines. In part because of the weakness in exports to Japan, sales of western Canadian goods to industrialized (or "developed") markets in Asia-Pacific have been relatively flat since the early 1990s, while those to developing economies have soared.

These diverging growth trends are shown in Figure 6. It sets the 1990 value of western Canadian exports to 100 for both developed and developing markets in Asia-Pacific. Doing so allows for a clearer illustration of the differences in growth between the two from 1990 to 2009. Figure 6 shows that the value of shipments to Asia-Pacific's developing economies in 2009 was 428% higher than 1990 levels, while the value of those to developed markets were 25% higher than 1990 levels. In dollar-value terms, western Canadian exports to developed markets rose from $8.9 billion in 1990 to $11.1 billion in 2009 while those to developing economies rose from $2.2 billion to $11.5 billion over that same period.

FIGURE 6: GROWTH IN WESTERN CANADIAN EXPORTS TO INDUSTRIALIZED AND DEVELOPING MARKETS IN ASIA-PACIFIC (1990 = 100)



Source: Author's calculations using Statistics Canada data

Looking at the four western provinces individually, Asia-Pacific markets are well-represented in the list of top export destinations for each. As shown in Figure 7, all four provinces boast China and Japan among their top five markets around the world and each province counts four or five countries in Asia and the South Pacific among their top ten export destinations.

FIGURE 7: TOP PROVINCIAL EXPORT DESTINATIONS (2009)

British Columbia	*$ millions*	*% of total*	*Alberta*	*$ millions*	*% of total*
United States	12,909	50.4	United States	58,985	83.2
Japan	3,499	13.7	China	2,770	3.9
China	2,518	9.8	Japan	1,640	2.3
Korea, South	1,748	6.8	Mexico	1,063	1.5
Taiwan	476	1.9	Korea, South	537	0.8
Netherlands	448	1.7	Netherlands	306	0.4
Italy	345	1.3	Australia	274	0.4
United Kingdom	292	1.1	Russia	258	0.4
Brazil	254	1.0	Singapore	242	0.3
Germany	252	1.0	Saudi Arabia	213	0.3

Saskatchewan	*$ millions*	*% of total*	*Manitoba*	*$ millions*	*% of total*
United States	13,120	60.4	United States	7,158	67.1
China	1,133	5.2	China	648	6.1
India	976	4.5	Japan	511	4.8
United Kingdom	640	2.9	Mexico	267	2.5
Japan	630	2.9	Hong Kong	182	1.7
Indonesia	404	1.9	Australia	122	1.1
Mexico	375	1.7	Saudi Arabia	109	1.0
Bangladesh	357	1.6	United Kingdom	96	0.9
Italy	295	1.4	Iraq	94	0.9
Morocco	216	1.0	Russia	76	0.7

Source: Author's calculations using Statistics Canada data

3.2.2 Major Export Products

The types of goods sold by the western provinces in Asia-Pacific vary considerably by province and by destination. However, as Figure 8 shows, provincial exports to Asia-Pacific markets are, on the whole, highly concentrated in natural resources and resource-based goods. Western Canada's top ten export products to Asia-Pacific, which account for two-thirds of total sales to the region, are all products of the agriculture, mining or forestry industries. In all, resource-based goods accounted for 87.8% ($19.7 billion) of western Canada's exports to that part of the world in 2009.

FIGURE 8: TOP EXPORT PRODUCTS FROM THE FOUR WESTERN PROVINCES TO ASIA-PACIFIC (2009)

	$ millions	*% of total*
Coal and related	3,748	16.6
Canola seeds (and similar seeds)	2,572	11.4
Chemical woodpulp (soda, sulphate)	1,538	6.8
Wheat	1,326	5.9
Potassium-based fertilizers	1,107	4.9
Lumber	1,077	4.8
Copper ores and concentrates	1,067	4.7
Leguminous vegetables (dried, shelled)	1,061	4.7
Unwrought nickel	833	3.7
Swine meat	667	3.0

Source: Author's calculations using Statistics Canada data

Although the product mix varies from province to province, the dependence on resources does not. BC's main export products to Asia-Pacific are coal, wood pulp, lumber and metal ores. These goods, combined with other metals, minerals and forest products made up 84.5% of BC's total exports to Asia-Pacific in 2009 ($8.0 billion).

In the prairie provinces, there is a much greater focus on exports of agricultural goods: peas and lentils from Saskatchewan, swine from Manitoba and wheat and canola seeds from all three provinces. In total, agricultural products accounted for about two-thirds of exports from Saskatchewan ($2.9 billion) and Manitoba ($1.3 billion) and 40.6% of exports from Alberta ($2.7 billion). Metals, minerals (including coal) and potash (in the case of Saskatchewan) account for most of the Prairies' remaining exports to Asia-Pacific.

It is worth noting that the composition of exports to Asia-Pacific markets does not accurately reflect the overall makeup of economic activity in western Canada. For example, as shown in Figure 8, shipments of just three product types—oilseeds, wheat and legumes—accounted for 22.0% of western Canadian exports to Asia-Pacific markets in 2009. However, the entire contribution of all crop- and animal-producing industries in the western provinces was only 9.6% of goods sector GDP that year. Conversely, oil and gas extraction is a major contributor to goods sector GDP in western Canada (27.9% in 2009), but products from those industries made up just 1.5% of exports to Asia-Pacific in 2009.

To some degree, disparities between economic output in western Canada and exports are a reflection of specialization in production and trade. In many cases, goods are being produced in western Canada for the specific purpose of selling into the export market. By so doing, western Canadians are exploiting the region's comparative advantages in agriculture, forestry and other resource-based industries. At the same time, however, important elements of the western Canadian economies are noticeably absent from the mix of products exported to Asia-Pacific markets.

3.3 Merchandise Exports to China

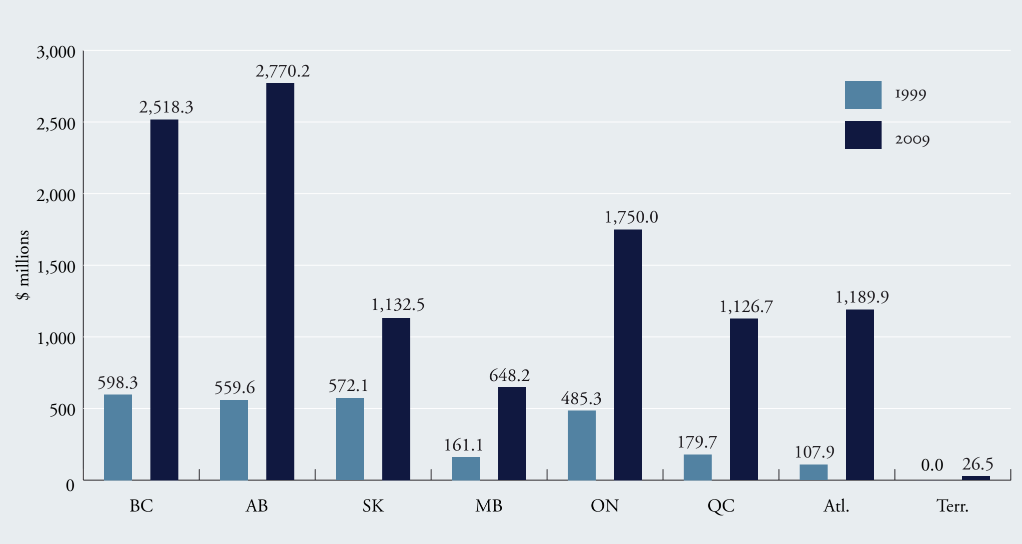
3.3.1 Overview

Economic relations with China have come a long way since the early 1960s, when the only commercial ties consisted of China-bound emergency shipments of western Canadian wheat. Fast-forward to the present and China has become one of western Canada's most important trading partners in the world.

As shown in Figure 7, China has become the second largest export market in the world for the three prairie provinces and the third largest for BC (where Japan holds the second position). In total, the four provinces exported goods to China valued at $7.1 billion in 2009. China was the destination of 5.5% of western Canada's total exports in 2009; the four provinces accounted for 63.3% of Canada's overall exports to China that year.

In dollar-value terms, Alberta is Canada's largest exporter to China, with total merchandise sales of $2.8 billion in 2009. BC is the next largest exporter, with total shipments valued at $2.5 billion. By comparison, exports from Saskatchewan and Manitoba were markedly lower, at $1.1 billion and $648 million, respectively (Figure 9).

FIGURE 9: MERCHANDISE EXPORTS TO CHINA



Source: Author's calculations using Statistics Canada data

However, when considering the importance of China relative to other export destinations, the story changes. While Alberta is the largest western Canadian exporter to China in dollar-value terms, it only sends 3.9% of its total exports worldwide to China, placing it last among the western provinces. Under this measure, China as an export market is most valuable to BC, which sends 9.8% of its total exports to that country. As for Manitoba, 6.1% of total merchandise exports in 2009 went to China as did 5.2% of exports from Saskatchewan.

3.3.2 Recent Growth Trends

Not only is China one of western Canada's most important trading partners, it is one of its fastest-growing as well. From 1999 to 2009, western Canadian exports to China rose by an average of 14.1% per year, compared to an average growth rate of 4.1% for all other destinations. This average growth rate is all the more remarkable given that it includes the impact of the global financial and economic crisis on world trade flows. Even in 2009, when demand for imported goods plunged and western Canada's overall exports followed suit, sales to China were up by 1.8% over 2008 levels.

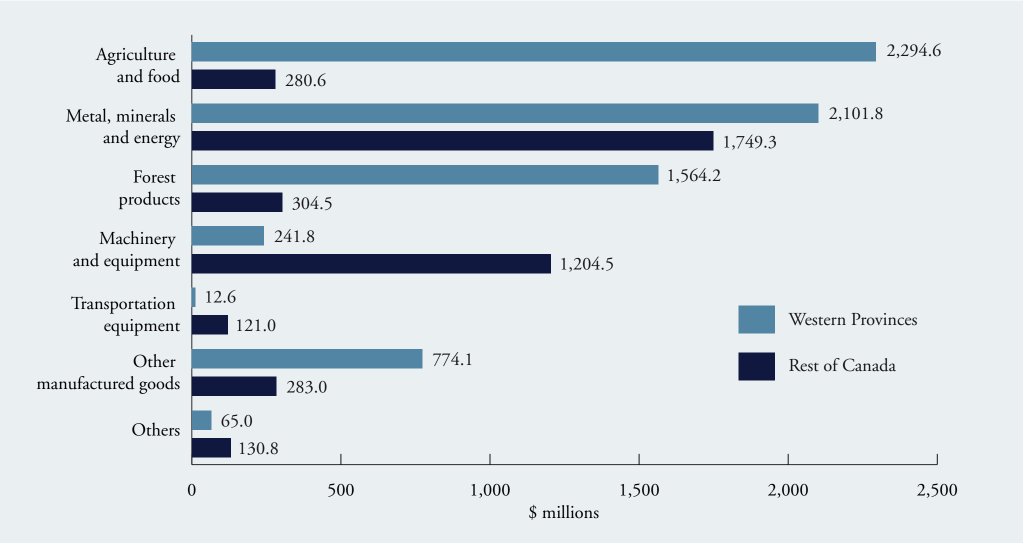
All four western provinces have contributed to the region's overall strong growth in exports to China. Saskatchewan exhibited the weakest rate of expansion of the four from 1999 to 2009 and even there, exports grew by an average rate of 7.1% per year. In the three remaining provinces, growth rates were exceptional. The largest increase in trade came from Alberta, where exports to China have grown by an average of 17.3% since 1999. BC and Manitoba also registered impressive growth in exports to China with average annual increases of 15.5% and 14.9%, respectively.

The strength of western Canada's exports to China over the past decade stands in sharp contrast to its overall trade performance over that period. Due in large part to the impact of the global financial and economic crisis, export growth from western Canada has, on the whole, been stagnant since the late 1990s. BC and Alberta saw an overall decrease in exports from 1999 to 2009, while Manitoba recorded only modest export growth over that period. Saskatchewan was the only province where exports in 2009 were significantly higher than a decade earlier.

3.3.3 Major Export Products

Natural resources and related products dominate western Canadian exports to China, accounting for $6.0 billion of the $7.1 billion in total shipments in 2009 (Figure 10). Leading the way were sales of agriculture and food products, valued at $2.3 billion that year (32.5% of total exports to China). Mining and energy products exports followed close behind at $2.1 billion (29.8%), while forestry product sales were worth $1.6 billion (22.2%).

FIGURE 10: EXPORTS TO CHINA BY PRODUCT TYPE (2009)



Source: Author's calculations using Statistics Canada data

The composition of exports from western Canada is dramatically different from that of the rest of the country. While the western provinces export mostly agricultural goods, energy and forest products, exports from the rest of Canada are more heavily concentrated in industrial and mining products. In 2009, Western Canada accounted for 89.1% of Canada's exports of agriculture and food products to China and 83.7% of Canada's forest products exports. At the other end of the spectrum, only 16.7% of Canadian machinery and equipment exports to China came from the West and 9.4% of sales of transportation equipment were from the region.

Although resources and raw materials are the big story in terms of western Canadian exports to China, the composition of those exports varies considerably within the region as well. Forest products and mineral fuels are the most important categories of goods originating in BC, accounting for 69.5% of the province's exports to China in 2009 ($1.8 billion). In terms of specific products, BC's main exports to China include various types of wood pulp, coal, lumber, and copper.

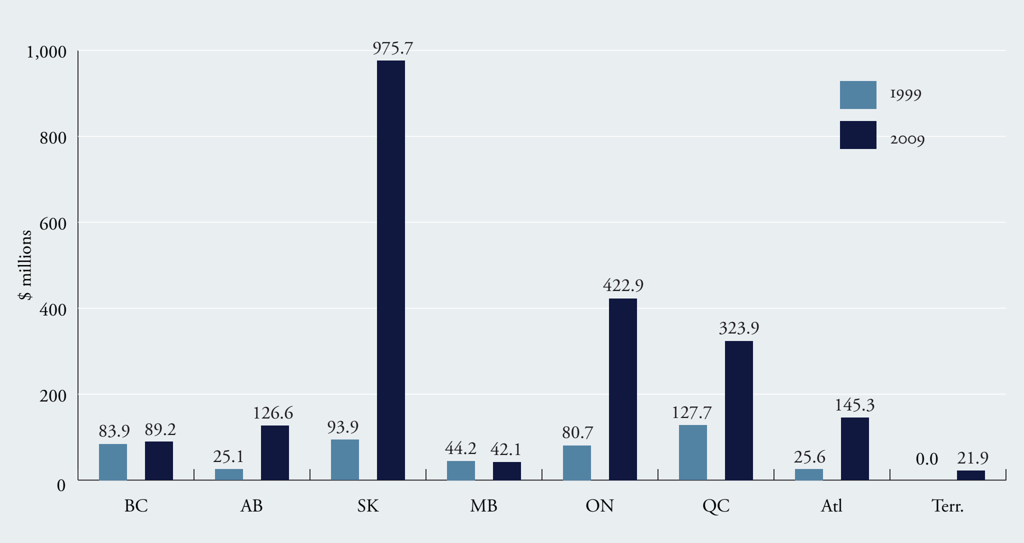
In contrast, the three prairie provinces are large exporters of canola seeds and nickel. In all three provinces, canola seeds are the top export product to China. In Manitoba, canola seeds and nickel made up 85.5% of the province's total exports to China in 2009 ($554 million). In Saskatchewan, canola seeds alone comprised nearly half of the province's exports to China that year ($553 million). Other major export products from Saskatchewan include wood pulp, potash, and various grains and legumes. Finally, Alberta is the most diverse western Canadian exporter to China; no one product type accounted for more than 20% of Alberta's exports to China in 2009. In addition to canola seeds and canola oil, the province's main exports to China include acyclic alcohols, nickel, ethylene products and crude oil.

3.4 Merchandise Exports to India

3.4.1 Overview

For western Canada as a whole, India is not, at present, an important export destination. In 2009, the total value of goods exported to that country was $1.2 billion, accounting for just 1.0% of the region's total exports worldwide.

FIGURE 11: MERCHANDISE EXPORTS TO INDIA



Source: Author's calculations using Statistics Canada data

Even so, western Canada has been more successful than the rest of the country at accessing Indian markets. Well over half of total Canadian exports (57.4%) to India in 2009 were products that originated in the West.

The fact that the western provinces account for most of Canada's exports to India is entirely because of Saskatchewan, which exports more to that country than any other province (Figure 11). Its $976 million in exports in 2009 accounted for four-fifths of all western Canadian trade to India and 45.4% of Canada's total exports to India. All told, India accounts for 4.5% of Saskatchewan's exports around the world and is the province's third largest export destination worldwide, behind only the United States and China.

By comparison, exports from Alberta, BC and Manitoba are modest. For all three provinces, India is just the 21st-ranked export destination worldwide. Of the three, Alberta is the largest exporter to India in dollar value terms, with total shipments valued at $127 million in 2009. For BC and Manitoba, total sales that year were $89 million and $42 million, respectively. In terms of market share, about 0.4% of Manitoba's exports in 2009 were shipped to India, while the share of exports from BC and Alberta were lower still.

3.4.2 Recent Growth Trends

Recent growth trends suggest that India will become a much more important market for western Canadian exporters in the years ahead. Over the past ten years, western Canadian exports to India have risen from $247 million to $1.2 billion—representing an average annual growth rate of 17.4%. Although this growth rate has taken place on a comparatively low base, western Canada's trade with India since 1999 has even outpaced growth in trade with China over the same period.

However, this strong growth for the region as a whole belies considerable variation in export performance on a province-by-province basis. In BC, a surge in sales of copper and newsprint led to a dramatic spike in exports to India from 2003 to 2006, but exports of those products declined just as quickly from 2006 to 2009. The end result is that BC's overall exports to India in 2009 were only slightly higher than a decade earlier.

The story in Manitoba is similar. A temporary surge in wheat sales and a one-time shipment of aircraft created a large spike in exports to India in 2006, but since that time, exports have returned to pre-2006 levels and, in 2009, were slightly below levels seen a decade earlier.

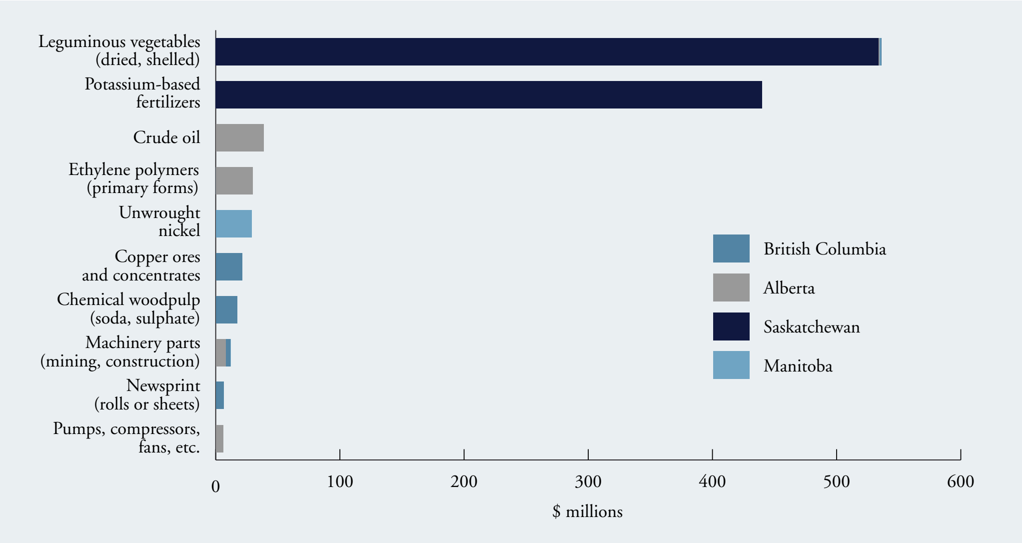
In Saskatchewan and Alberta, however, there has been a rapid expansion in trade with India over the past ten years. Saskatchewan-India trade in particular has seen near-exponential growth in that time. On the strength of soaring potash and legumes sales, provincial exports to India expanded by an average of 26.4% per year from 1999 to 2009 (from $94 million to $976 million), a figure that includes a 12.5% drop in exports in 2009.

Alberta's exports to India have also expanded considerably in recent years, although trade levels have been somewhat volatile, owing to a one-time spike in exports of telecommunications equipment in 2006. On the whole, exports have grown by an average of 17.6% per year from 1999 to 2009 (from $25 million to $933 million).

3.4.3 Major Export Products

In comparison to the range of goods the western provinces ship to China, their exports to India are heavily concentrated in just a few products. This narrow distribution is the result of Saskatchewan's dominant position as western Canada's largest exporter to India and its reliance on just two main export products.

FIGURE 12: WESTERN CANADA'S MAJOR EXPORT PRODUCTS TO INDIA (2009)



Source: Author's calculations using Statistics Canada data

Pulse crops (peas, lentils and chickpeas) and potash made up 99.8% of Saskatchewan's total exports to India in 2009. Because Saskatchewan itself accounts for 79.1% of western Canadian sales in the Indian market, this meant that fully 79.8% of western Canada's exports to India ($974 million out of $1.2 billion) were comprised of pulses and potassium-based fertilizers from Saskatchewan.

Exports of goods from other provinces pale in comparison (Figure 12). Important products from Alberta—the West's next largest exporter to India in 2009—included crude oil, ethylene polymers and machinery and equipment associated with natural resource extraction. For its part, BC's major exports to India that year were copper ores, wood pulp, newsprint and certain types of machinery. Finally, exports from Manitoba were largely comprised of nickel, as well as small amounts of legumes and mining-related machinery and equipment.

4.0 Asia-Pacific Trade and Economic Diversification in Western Canada

4.1 What is Economic Diversification?

To some degree, economic diversification is analogous to portfolio diversification in the world of finance. In financial circles, diversification refers to a reduction in the overall risk associated with an investment portfolio by spreading available funds across a wide variety of assets and asset types. The expectation is that this strategy will help protect the investor against any sudden negative shocks in any one investment without a significant cost in terms of his or her expected return.

Economic diversification is similarly based on the idea of risk mitigation. An economy overly reliant on the production of a limited range of products, or on the sale of its products to a limited number of customers, exposes itself to the risk of volatility based on external demand shocks; a change in market conditions for its products or in the economic health, or tastes, of its consumer base could generate considerable fluctuations in domestic economic activity. Diversification, whether through broadening its product base or its customer base, can insulate an economy against the impact of such external shocks (Western Centre for Economic Research 2010).

An analysis of export markets can provide some useful insight into the degree of economic diversification in a given jurisdiction. While the value and type of goods sold in foreign countries do not themselves provide a complete representation of the full breadth of activity in an economy, they do reflect what might be considered "discretionary" production, over and above that which is required to meet domestic needs. Export diversification is a particularly useful proxy for overall economic diversification in the case of small, open economies such as the western provinces where exports account for a significant share of overall economic activity; in recent years, exports of goods and services from western Canada have accounted for approximately one third of regional GDP.

4.2 Trade with Asia-Pacific and Economic Diversification in Western Canada

There are two main ways in which trade with China, India and other Asia-Pacific economies can promote economic diversification in western Canada. The first, and more straightforward of the two to demonstrate, is that by sending a growing share of exports to overseas markets, western Canada can reduce its reliance on the US as an export destination. Increasing overseas trade flows not only allow western Canadian exporters to take advantage of business opportunities in rapidly-expanding Asia-Pacific economies, but also, by tapping into a broader range of customer bases, the western provinces can better insulate themselves against economic downturns in any one export market.

At the same time, however, diversification of exports *markets* does not mean the same thing as diversification of economic *activity*. If western Canadians continue to produce the same goods but send them to a different address, then not much has been accomplished in terms of broadening the scope of regional economic output and building productive capacity in new industries.

As such, to generate a more complete picture of the impact that trade with Asia-Pacific markets has had on economic diversification in western Canada also requires an examination of the types of products that western Canadian businesses sell in those markets. The extent to which the mix of product types sold in China, India and elsewhere in Asia-Pacific differs from the products sold in the US and other major export markets provides an indication of whether or not western Canadian businesses are altering their production activity, or creating new products, to meet overseas demand.

4.3 Export Market Diversification

In the western Canadian context, export market diversification effectively refers to reducing the proportion of the region's total exports that go to the United States. This is not to suggest, however, that western Canada should forego trade opportunities in the US or that its trade with that country to date has not been beneficial. Indeed, the region owes much of its prosperity to the voracious appetite in the US for food, energy and other goods produced here.

In recent years, however, there has been a growing call for the western provinces, and Canada as a whole, to reduce its reliance on US markets. Trade disputes over softwood lumber, pork and beef, and more recent issues such as growing resistance in the US to so-called "dirty oil," have served as stark reminders of the dangers of overreliance on a single customer. Moreover, recent US policy developments such as country-of-origin labelling, the Western Hemisphere Travel Initiative (WHTI) and a host of new border regulations and security measures have all contributed to a "thickening" of the US border, making it more difficult for people and goods to cross back and forth between the two countries. These developments have considerable implications for the Canada-US economic relationship, as well as for the long-term competitiveness of the North American economic space.

As noted earlier, the combination of strong export growth to the US and weak growth in exports to Japan—at the time western Canada's most important trading partner in Asia-Pacific—resulted in Asia and the South Pacific decreasing in importance as an export destination for the western provinces through the 1990s. Since 2001, however, the trend has reversed and the share of western Canada's exports going to Asia-Pacific markets is beginning to rise.

Two factors are contributing to the rise in the proportion of western Canadian goods being shipped across the Pacific Ocean. The first of these is a dramatic slowdown in export growth to the US and the second is booming sales to China and other developing markets in Asia-Pacific.

The recent stagnation in exports to the US is a dramatic reversal of growth trends in the 1990s. From 1990 to 2000, western Canadian exports to the US grew at an average rate of 14.1% per year (rising from $23.6 billion to $88.5 billion). Since that time, however, exports have been nearly flat. From 2000 to 2009, cross-border sales grew by an average rate of just 0.5% per year and, because of a sharp drop in trade resulting from the effects of the global financial and economic crisis, the value of exports in 2009 fell below 2004 levels ($92.2 billion compared to $93.1 billion).

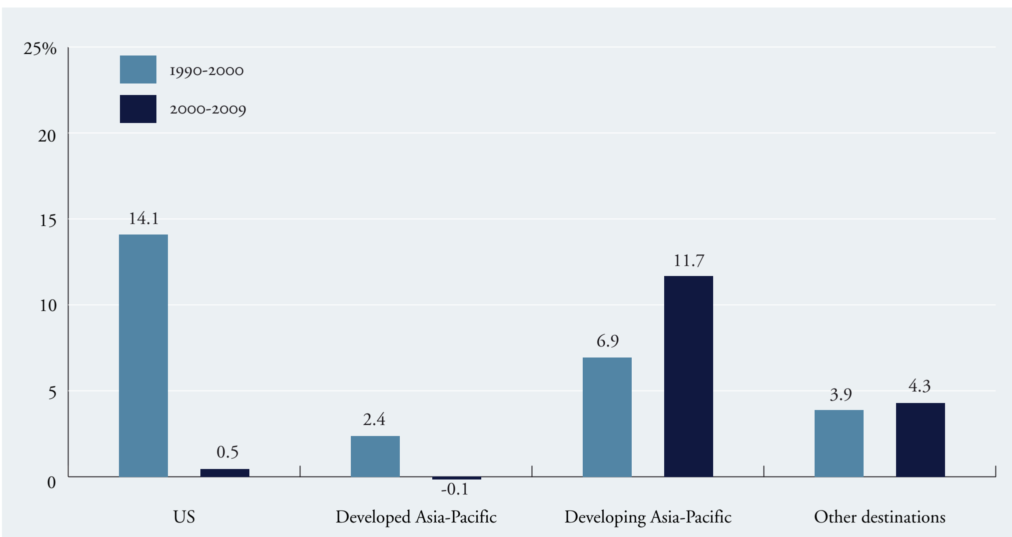
Several factors are playing a role in the weakness in western Canada-US trade growth since 2000. These include the global financial and economic crisis and the trade dispute and border issues described above, as well as the generally weak performance in the US economy in recent years, which has helped to dry up demand for foreign goods in that country. Perhaps the most important factor, however, has been the rise in Canada-US exchange rates since 2002. The Canadian dollar rose from about 62.5 cents US in January 2002 to over US$1.00 in late 2007. Since that time the exchange rate has fluctuated, but remained well above levels seen in the 1990s.

Exchange rates can have a tremendous impact on international trade. A higher Canadian dollar relative to the US currency increases Canadians' purchasing power, but it also makes Canadian products more expensive in US markets and less competitive with locally-produced goods. While it is difficult to quantify the specific impact of exchange rates on trade flows, there is certainly a direct link between the two.

At the same time as trade with the US was flattening, western Canada began to enjoy a surge in exports to Asia-Pacific markets. However, this growth has not been evenly distributed across the region. As noted earlier, the western provinces have enjoyed rapid growth in exports to China and other developing markets in Asia-Pacific, while shipments to wealthier, more industrialized countries have grown more slowly.

Figure 13 compares average annual growth rates in exports from the western provinces to selected destinations worldwide. Evident in Figure 13 is not only the dramatic slowdown in exports to the US since 2000, but also the strength of trade flows to developing markets in Asia-Pacific. From 2000 to 2009, western Canadian exports to developing economies in Asia and the South Pacific rose by an average rate of 11.7% per year. By comparison, exports to both the US and to wealthy markets in Asia-Pacific were essentially unchanged.

FIGURE 13: AVERAGE ANNUAL GROWTH IN WESTERN CANADIAN EXPORTS BY DESTINATION

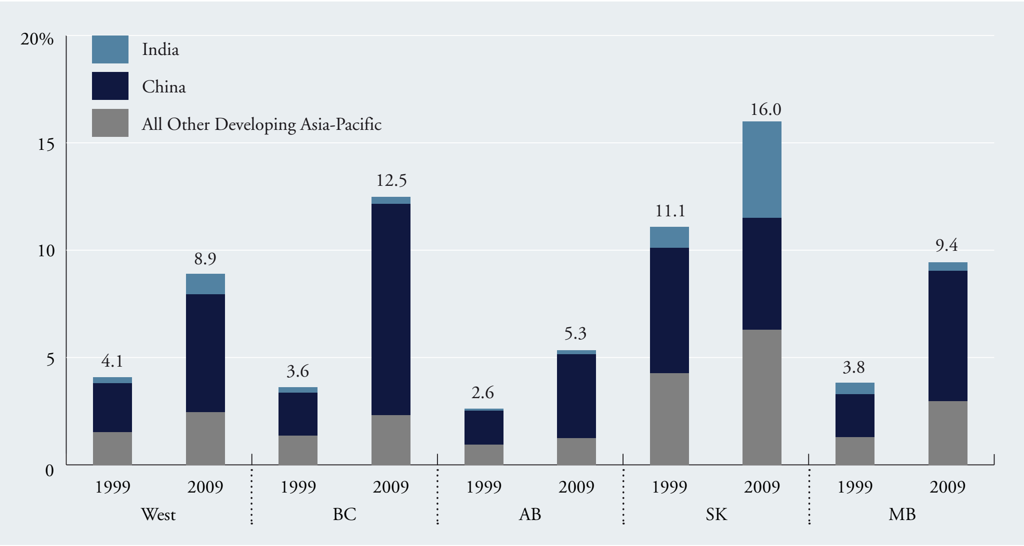


Source: Author's calculations using Statistics Canada data

The result of these concurrent trends has been a decline in the importance of the US and developed markets in Asia-Pacific as export destinations for western Canada, and a rise in the importance of China and other developing economies in that region. The share of western Canadian exports going to the US peaked in 2003 at 79.4%, falling to 71.5% by 2009—its lowest level in 11 years. All four provinces have seen a decline in the proportion of exports going to the US, led by BC where the US' share of provincial exports fell from 69.9% in 2002 to 50.4% in 2009. Similarly, the share of exports going to industrialized markets in Asia-Pacific has fallen from 12.2% in 1999 to 8.6% a decade later.

By contrast, China, India and other developing markets in Asia-Pacific are becoming more important to western Canadian exporters. As shown in Figure 14, those markets accounted for 4.1% of western Canadian exports in 1999, rising to 8.9% by 2009 (a total increase from $3.8 billion to $10.8 billion over that period). The trend is the same for all four provinces. BC has seen the greatest shift towards developing markets in Asia and the South Pacific in its export market portfolio; from 3.6% in 1999, the share of provincial exports sold in that region rose to 12.5% in 2009 (a total increase from $1.1 billion to $2.0 billion). Saskatchewan, however, sends more of its exports to that part of the world than any other province in western Canada. Thanks in large part to its involvement in the Indian market, 16.0% of Saskatchewan's total provincial exports in 2009 went to developing Asia-Pacific economies ($3.5 billion out of $21.7 billion).

FIGURE 14: SHARE OF TOTAL EXPORTS TO ASIA-PACIFIC MARKETS



Source: Author's calculations using Statistics Canada data

It would be misleading to suggest that western Canada's reduced dependence on the US market was solely the result of growth in exports to certain Asia-Pacific economies. As mentioned above, several factors independent of the attractiveness of Asian markets have contributed to relatively poor growth in exports to the US over the past decade, helping to drive down that country's share of western Canadian exports. Moreover, the western provinces have enjoyed considerable growth in trade with other parts of the world in recent years, most notably to Latin American and the Middle East. Nevertheless, it appears that strong growth in exports to developing markets in Asia-Pacific has contributed to export market diversification in western Canada, helping to shield the region, if only partially, from the impact of external shocks that may affect exports crossing the 49^{th} parallel.

4.4 Export Product Diversification

An analysis of the impact of trade with China, India and other Asia-Pacific markets on export product diversification in western Canada is somewhat more complex than an examination of export market diversification. Rather than a relatively straightforward analysis of the distribution of exports across destinations, a more specific measure is required to quantify, compare and contrast export product diversification in western Canada across a range of product types and destinations. The methodology used below is described in Text Box 2.

TEXT BOX 2: MEASURING EXPORT PRODUCT DIVERSIFICATION

To assess the degree of export product diversification in western Canada, and the extent to which increased trade with Asia-Pacific has affected diversification, requires finding a way to compare the diversity in western Canada's exports to one part of the world with its exports to another. The approach used here adopts one used elsewhere (Sanguinetti, Pantano and Posadas 2005) to measure trade diversification in South America by developing a *coefficient of product diversification*. This coefficient is analogous to the Gini coefficient—a commonly-used measure of income inequality. The Gini coefficient is a number between zero and one that measures the degree to which income distribution in a society deviates from perfect equality. A coefficient of zero represents a society in which every person has the same income, while a coefficient of one represents perfect inequality (where all income is concentrated in the hands of a single individual). For a discussion on how the Gini coefficient is calculated, see Osberg (1981), among other sources.

A similar measure can be constructed to determine the degree of export product diversification in the western provinces. A scenario in which each export product (or category of products) accounts for an identical share of total exports (by value) would constitute perfect diversity and would generate a coefficient value of zero. Conversely, a perfectly concentrated product portfolio would see a single product (or product category) account for 100% of exports and would generate a coefficient value of one.

The main challenge in such an approach to measuring export product diversification is in choosing the appropriate level of product detail. Statistics Canada publishes trade data according the Harmonized System (HS) of product classification which allows the user to choose between several levels of product specificity, ranging from one which counts a small number of broad product categories to one which includes hundreds of very narrowly-defined goods.

There are advantages and disadvantages to either extreme. Using more detailed information would capture diversification that might be missed in broader categories of products; for example, the increase in exports of chickpeas, lentils and other leguminous vegetables from Saskatchewan to India would not appear as product diversification if a general category such as "agricultural products" was used.

At the same time, however, a focus on very detailed product types risks clouding the big picture by treating very similar or easily substitutable goods as completely different. For example, at the most detailed (6-digit) level available, HS codes list potatoes and seed potatoes as two separate categories of exports. If this level of detail was used to measure export product diversification, then a scenario in which a province began to export more seed potatoes and fewer non-seed potatoes would register as positive export diversification, even though the two products are virtually identical.

In an effort to strike a balance between these considerations, this paper constructs a coefficient of product diversification that uses the "Product Chapters" category of (2-digit) HS codes, which includes 96 categories of export products, ranging from "live animals" to "aircraft and spacecraft."

It is important to note from the outset that, in this present analysis, export product diversification is interpreted in a relatively literal sense: it refers specifically to expanding the range of goods sold in foreign markets and thus mitigating the risks associated with overreliance on a limited range of products. This specification is important because the objective of economic diversification is sometimes taken to mean that producers should engage in a greater degree of value-added activity prior to selling their products; or to mean a shift away from resource-based production and a greater emphasis on manufacturing activity.

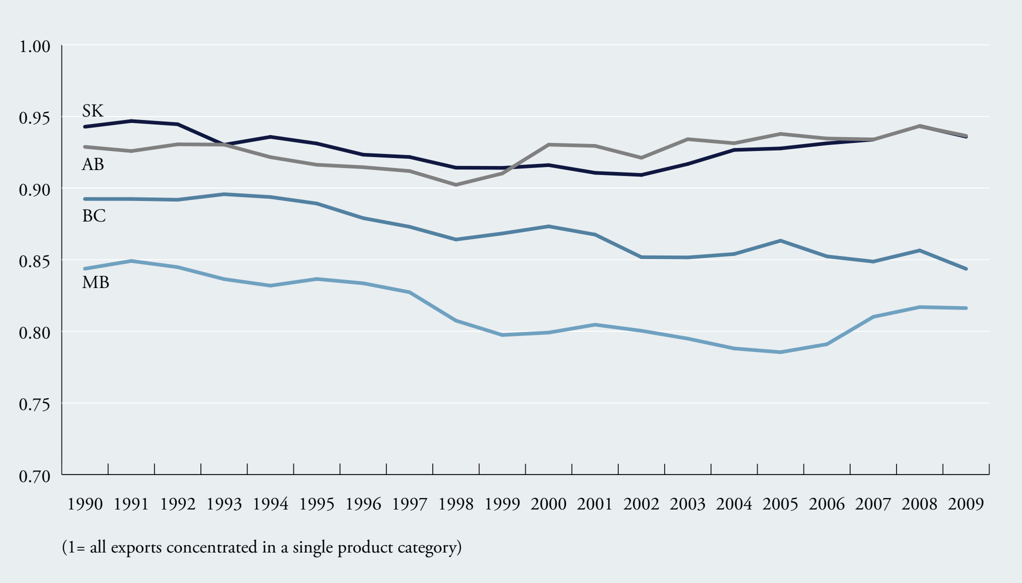
While many argue that these are desirable public policy objectives in their own right, they also imply a degree of subjectivity as to the types of goods that an economy—western Canada, in this case—should be producing. The purpose of this discussion is not to establish a set of preferences for western Canadian exports, but simply to focus on whether or not trade with Asia-Pacific generally, and China and India specifically, has expanded the range of products exported by the western provinces.

This analysis will take place in three stages. The first is to assess the overall degree of export product diversification in western Canada, in order to provide a frame of reference against which to compare diversification in exports to Asia-Pacific. The second is to evaluate the degree of diversification in exports to Asia-Pacific destinations, including specifically to China and India. Finally, the third stage is to determine the extent to which sales of goods in Asia-Pacific contributed to overall export product diversification in western Canada.

4.4.1 Product Diversification in Western Canada's Global Exports

Based on the methodology described in Text Box 2, Figure 15 shows the degree of diversification in exports from western Canada to all destinations from 1990 to 2009. According to this measure, the four western provinces can be divided in two groups: Manitoba and BC, which are comparatively diversified exporters; and Alberta and Saskatchewan, which are less so.

FIGURE 15: EXPORT PRODUCT DIVERSIFICATION IN WESTERN CANADA (ALL DESTINATIONS)



Source: Author's calculations using Statistics Canada data

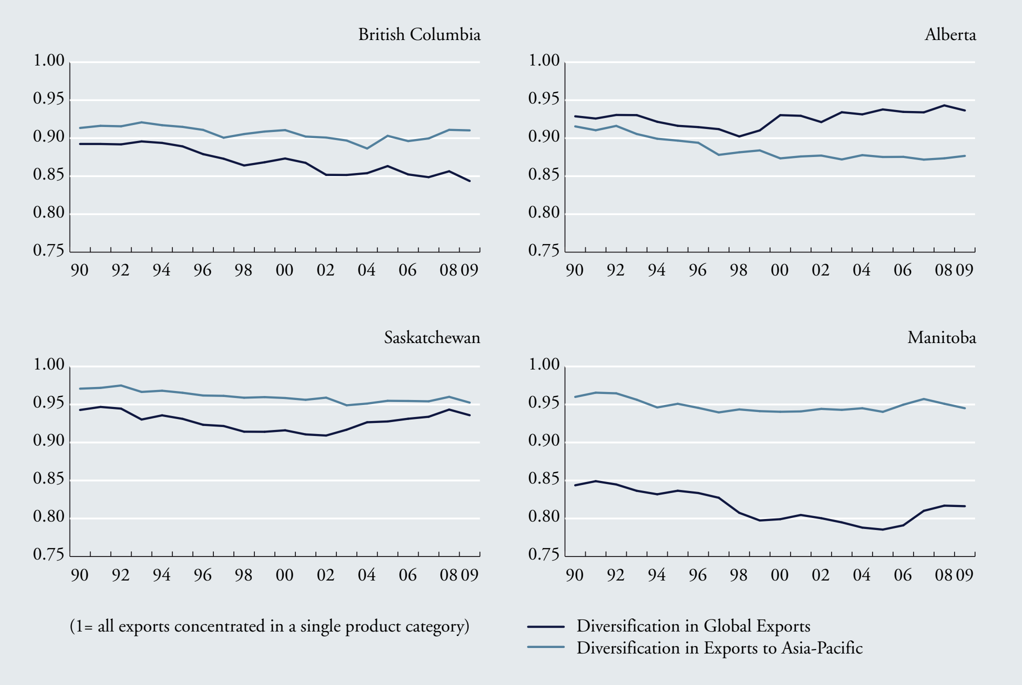
Manitoba and BC are, in fact, among the most diversified exporters in Canada. Only Ontario and Quebec had lower diversification coefficients in 2009, a direct result of the more well-developed manufacturing base in those provinces. Moreover, notwithstanding a slight decrease in product diversification in Manitoba since 2005, both Manitoba and BC have increased the range of products they export over the past 20 years.

By contrast, Alberta and Saskatchewan are among the least diversified exporters in Canada. In fact, those provinces have become *less* diversified over the past 10 years and, according to the export coefficient measure, have made no progress in expanding the range of products they export since 1990. To some degree, this concentration of exports is due to the fact that both provinces are rich in energy resources and that both are major exporters of crude oil and natural gas. In particular, crude oil and natural gas are by far Alberta's largest export products by value, accounting for about two-thirds of provincial exports in 2009. More than 99% of that oil and gas is sent into the US. However, even after factoring out the impact of energy exports, both Alberta and Saskatchewan remain less diversified exporters than Manitoba and BC.

4.4.2 Product Diversification in Western Canada's Exports to Asia-Pacific

For most of the western provinces, exports to the Asia-Pacific region are less diversified than their total exports worldwide. Figure 16 shows that, for all provinces except Alberta, the coefficient of export product diversification is consistently higher for exports to Asia-Pacific markets.

FIGURE 16: PRODUCT DIVERSIFICATION IN EXPORTS TO ASIA-PACIFIC



Source: Author's calculations using Statistics Canada data

This result is not surprising. A glance at the list of main products sold to Asia-Pacific countries in Figure 8 shows that western Canada's exports are highly concentrated in resource products, especially forest products; grains, pulses and other crops; and nickel and other metal ores. Moreover, this result is somewhat intuitive given that Asia-Pacific represents a subset of global trade. Export statistics are a compilation of sales made by individual businesses in foreign countries; reducing the value of trade and the number of countries under consideration suggests that fewer businesses are active in those markets and that overall exports therefore will be concentrated in a more limited number or range of products. This trend holds true at the intraregional level as well; provincial exports to individual countries such as China and India are less diversified than exports to Asia-Pacific as a whole.

Alberta stands as something of an exception to this general rule, however; exports to Asia-Pacific are considerably *more* diverse than the province's total exports worldwide. However, this higher degree of diversification is, somewhat ironically, the result of Alberta's limited ability to ship its most important export products overseas; the existing oil and gas transportation infrastructure is designed to serve North American markets and there is limited capacity in existing pipelines to transport oil and gas to the west coast to ship to overseas markets. Furthermore, no facilities are in place to convert natural gas to natural gas liquids (NGLs), effectively limiting Canadian gas producers to selling in the North American market.

It is also worth noting that as western Canadian trade with Asia-Pacific grows, the range of products sold in that region is expanding as well. Alberta—western Canada's most diverse exporter to Asia-Pacific—has seen a significant increase in the degree of export product diversification since 1990, while Saskatchewan and Manitoba, where exports to Asia-Pacific are highly concentrated in a few product types, have also expanded exports to include new product types. Only in BC has the degree of export distribution remained largely unchanged since 1990.

A similar trend exists at the national level. Looking specifically at China and India, the two most dynamic emerging markets in Asia-Pacific, as provincial trade with those countries increases, there has been a corresponding increase in export product diversification. The trend is especially robust with regard to China, which is not only a larger market for all western provinces (except Saskatchewan), but also is growing more quickly as an export destination (See Appendix I).

4.4.3 Impact of Exports to Asia-Pacific on Diversification in Global Trade

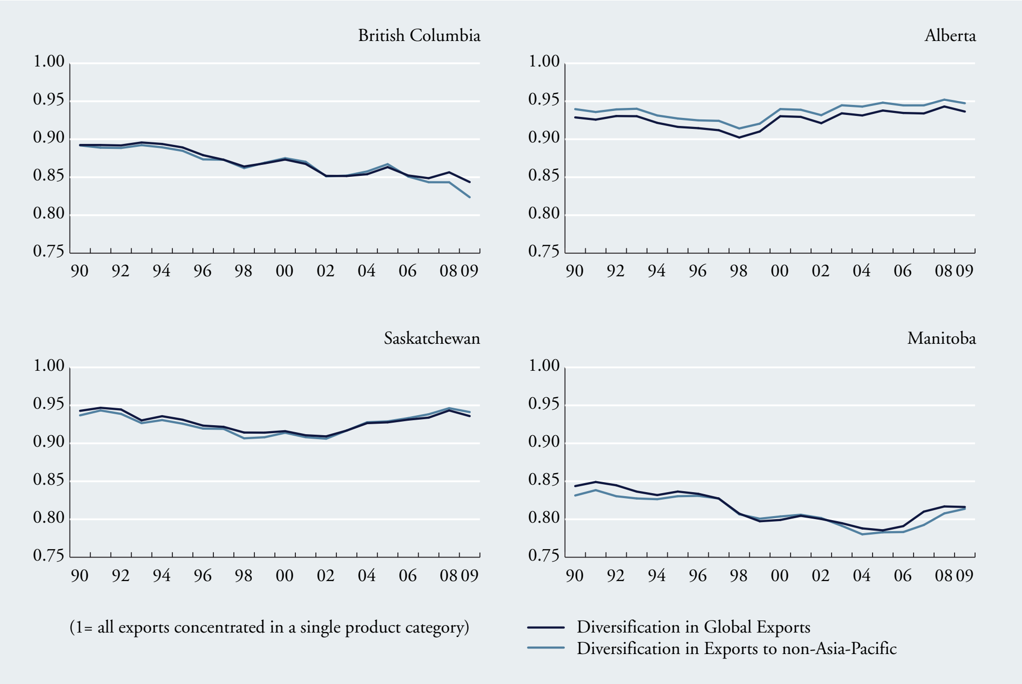
Another important fact to consider when examining export product diversification is that even if western Canadian exports to Asia-Pacific markets are not spread across a wide range of products, they can still contribute to *overall* export product diversification, depending on whether the goods sold in Asia-Pacific markets are the same as those sold in other destinations.

For example, suppose Saskatchewan sold only one product in foreign markets (say, crude oil), but did not export at all to Asia-Pacific. If Saskatchewan began to make potash shipments to Asia-Pacific, then its exports to that region would be completely undiversified (entirely comprised of potash), but would nevertheless contribute to the province's *overall* export product diversification because Saskatchewan now exported two types of goods instead of one.

To determine the impact of exports to Asia-Pacific on overall export product diversification requires comparing the diversity of each province's total exports (to all destinations) with the degree of diversification in exports to all destinations except those in Asia-Pacific. If total exports are more evenly distributed across the range of export products compared to exports to non-Asia-Pacific markets, then it can be argued that trade with Asia-Pacific has helped to diversify provincial exports. Conversely, if a province's total exports are more concentrated than exports to non-Asia-Pacific markets, then it can be concluded that trade with Asia-Pacific is not contributing to provincial export product diversification.

For each of the four western provinces, the degree of product diversification in total exports worldwide compared to diversification in exports to non-Asia-Pacific markets is shown in Figure 17. In the case of BC, the two measures are nearly identical, suggesting that trade with Asia-Pacific has done little to improve export product diversification in that province. In fact, since 2006, exports to non-Asia-Pacific destinations have been more diversified than total exports, suggesting that trade with that region is causing BC exports to become more concentrated.

FIGURE 17: IMPACT OF EXPORTS TO ASIA-PACIFIC ON EXPORT PRODUCT DIVERSIFICATION IN WESTERN CANADA



Source: Author's calculations using Statistics Canada data

In Alberta, by contrast, trade with Asia-Pacific is clearly contributing to export product diversification; even though Figure 17 shows that the province's overall exports are becoming less diversified on the whole, they are still more diversified than exports to markets outside Asia-Pacific. As mentioned above, this result can largely be attributed to the fact that transportation bottlenecks and a lack of necessary infrastructure effectively prevent Alberta from shipping its two most important export products—crude oil and natural gas—to overseas markets. Because oil and gas so dominate Alberta's export mix, trade with any destination to which the province does not sell those goods is bound to improve export product diversification.

The evidence for Saskatchewan suggests that exports to Asia-Pacific have had some impact on improving export product diversification in that province. In the early 1990s, total exports were less diversified than exports to non-Asia-Pacific markets, suggesting that trade with that region was concentrating, rather than more evenly distributing the province's exports. By 2009, that pattern had reversed, indicating that trade with Asia-Pacific is contributing to export product diversification in Saskatchewan.

Finally, the evidence suggests that trade with Asia-Pacific is not contributing to export product diversification in Manitoba. Except for a brief period in the late 1990s and early 2000s, exports to non-Asia-Pacific destinations were consistently more diversified than total exports, indicating that sales of goods to Asia-Pacific are not contributing to export product diversification in that province.

5.0 Policy Options for Enhancing Western Canada's Trade and Investment Relationship with Asia-Pacific

The evidence to date suggests that trade with Asia-Pacific has had some impact on export market diversification in western Canada, but mixed results in terms of improving export product diversification. However, this is not to suggest that Asia-Pacific does not hold enormous potential for the western provinces to both expand the volume of trade, and the range of goods it sells in that market.

The challenge, from a public policy standpoint, is to help western Canada realize that potential. To that end, governments at both the federal and provincial levels have implemented a number of policy initiatives aimed at identifying and overcoming the various impediments and barriers that are preventing economic ties with Asia-Pacific from reaching their full potential. Because the Government of Canada has jurisdiction over the signing of international treaties, most explicit policy initiatives aimed at opening Asia-Pacific markets are found at the federal level. Some of these initiatives are examined below, as are additional policy areas where further work is required.

5.1 Recent Policy Initiatives

5.1.1 The Global Commerce Strategy

Expanding Canada's commercial relationship with Asia-Pacific is a stated policy priority for the Government of Canada. In its 2007 Global Commerce Strategy (GCS), the federal government identified 13 priority markets around the world where "Canadian opportunities and interests have the greatest potential for growth" (Government of Canada 2009). Under the GCS, the federal government aims to improve Canada's international competitiveness in those markets and to help Canadian businesses increase their participation in global value chains.

Asia-Pacific is well-represented in this list of priority markets. China, Japan, South Korea, Australia and New Zealand (as a single entry), and the ASEAN countries all among Canada's stated priorities for enhanced commercial engagement. From a policy standpoint, the federal government has taken a number of steps to promote commercial ties with several of these markets. Since the GCS was introduced, Canada has pursued negotiations to protect and promote two-way direct investment with China, India, Mongolia, Vietnam and Indonesia. It has signed enhanced air transportation agreements with New Zealand, South Korea, the Philippines, Singapore and Japan. And finally, it continues to pursue free trade negotiations with Singapore and South Korea (both efforts predate the GCS), and has recently begun formal negotiations with India. Canada's bilateral initiatives with China and India will be discussed in more detail below.

However, in spite of these attempts to reduce the barriers to trade and investment with Asia-Pacific, the Government of Canada has made only limited progress in opening the Asian markets to Canadian businesses. To be sure, it has concluded a number of investment protection agreements in the region, but its two most important negotiations have been unsuccessful; India has expressed reservations about its agreement with Canada, and negotiations with China appear stalled. Moreover, free trade negotiations with Singapore and South Korea are effectively moribund because Canada has been unable to negotiate terms comparable to those the United States received in its trade agreements with those countries.

From the perspective of establishing effective policy aimed at increasing trade with Asia-Pacific, a major concern with the GCS is that it casts an extraordinarily wide net in its identification of priority markets. The 13 markets listed in the GCS include not only individual countries, but geographic regions and, in some cases, entire continents. Among Canada's stated priority markets are "Europe," "Latin America and the Caribbean," and the Gulf Cooperation Council. Together, those three groupings contain at least 90 countries. In all, more than 108 countries are covered in the Government of Canada's list of priority markets. This list is so large, that it is difficult to imagine how the federal government's foreign policy resources could be sufficient to be adequately engaged on all these fronts.

5.1.2 Canada-China Trade and Investment Policy

Although China has a prominent position as one of the federal government's priority markets, there has not been a large degree of federal government engagement with China on commercial issues. The most important initiative currently underway is the negotiation of a foreign investment promotion and protection agreement (FIPA), mentioned above.

FIPAs, also known as bilateral investment treaties (BITs), are agreements that help protect Canadian investors in developing countries by establishing legally-binding rights and obligations on signatory countries. FIPAs assist in promoting foreign direct investment by mitigating some of the risks that businesses face in developing countries.

Canada and China first discussed the possibility of negotiating a FIPA in 1994, but it was agreed at the time to postpone negotiations pending China's accession to the World Trade Organization (WTO). Negotiations began in earnest in 2004 and are ongoing. According to the Department of Foreign Affairs and International Trade (DFAIT), Canada's objectives are to obtain substantive commitments from China pertaining to national treatment and most-favoured-nation treatment and to establish an investor-state dispute resolution mechanism to protect Canadian investors from discriminatory treatment by Chinese authorities (DFAIT 2010a).

Completing a bilateral investment treaty with China is an important step in building economic relations between the two countries. Providing Canadian businesses with legal protection and recourse to an impartial dispute-settlement mechanism would help to allay some of the uncertainty they may have about investing in China. Moreover, it is widely believed that trade follows investment. Removing the barriers to investment between China and Canada could help to improve trade flows between the two countries as well.

There have been two other public policy developments in recent years at the federal level that could help increase trade and economic ties between western Canada and China. The first of these was in 2007 when the two countries signed a Science and Technology Cooperation Agreement in an effort to increase collaborative research and development activities.

The second development is the establishment of Approved Destination Status (ADS) between Canada and China. Chinese tour groups are only permitted to organize and operate excursions to countries that have been granted ADS by the Chinese government. Given the vast potential that an influx of tourism from the world's most populous country represents, ADS represents a considerable opportunity for the Canadian tourism industry, especially in British Columbia which is already a popular destination for Chinese tourists. After many years of lobbying by the Canadian government, it was announced in December 2009 that China would grant ADS to Canada; an agreement to that effect was formally signed in June 2010.

5.1.3 Canada-India Trade and Investment Policy

The Government of Canada has also taken a number of steps aimed at removing the barriers to trade and investment and improving commercial linkages between Canada and India. As mentioned above, the two most significant of these were the completion of a bilateral investment protection agreement in 2007, and the commencement of formal free trade negotiations in 2010.

As with its other FIPAs, the intent of Canada's bilateral investment treaty with India was to provide added security and predictability to the legal framework for two-way investment between Canada and India and to provide a solid platform from which the Canada and India commercial relationship could grow in the future. However, while FIPA negotiations concluded more than two years ago, the agreement has not yet entered into force. In October 2009, the Indian government indicated to Canada that it had some reservations about the text of the agreement. According to DFAIT, Canada is committed to resolving the impasse as quickly as possible; the federal government sees this FIPA as an important component of its policy to increase economic ties with India through its Global Commerce Strategy (DFAIT 2010b).

As discussed above in the context of the Canada-China FIPA negotiations, the full implementation of a bilateral investment treaty is an important step in improving commercial ties between two countries. With the exception of Saskatchewan, Canada's trade relationship with India is not well-developed given that country's population and the size of its economy. The Government of Canada needs to work closely with its Indian counterpart to address the latter's concerns about the agreement, in order that it be implemented as quickly as possible.

A more significant accomplishment in terms of boosting Canada-India economic ties would be the successful negotiation of a free trade agreement between the two countries. The two sides formally launched free trade negotiations on November 16, 2010, following the September 24 release of a Joint Study Group report which found that a bilateral agreement would produce expected GDP gains of US$6-15 billion for Canada and US$6-12 billion for India. The study also concluded that a free trade agreement would result in Canada's exports to India rising by between 39% and 47%, while India's exports to Canada would increase by between 32% and 60% (Government of Canada 2010).

No official deadline or objective has been set for the completion of free trade negotiations. The length of time it takes to negotiate such deals depends on a number of variables and can vary dramatically from one agreement to the next. In general, however, the entire process, from exploratory discussions through negotiation and implementation can be expected to take several years.

A free trade agreement with India would be a considerable step towards improving western Canada's economic ties with that country. Tariff barriers are a significant obstacle to western Canadian exports, especially for value-added goods. Tariff escalation—where the tariff rate rises with the degree of value-added production—is a know trade irritant for Canadian agricultural producers, as is tariff parity for like goods (when countries levy different tariffs on easily substitutable goods like canola oil and soybean oil).

5.1.4 Provincial Government Policy Efforts in Asia-Pacific

Canadian foreign policy is set by the federal government. However, the western provinces have also been active independently in seeking out opportunities for increased trade and investment linkages with Asia-Pacific, both by conducting trade missions to that region and in establishing a direct physical presence in key cities.

On the trade promotion front, the provincial governments of BC, Alberta and Saskatchewan, under the rubric of the New West Partnership (NWP), have been particularly active, working together to seek out trade and investment opportunities with Asian markets. The NWP includes four separate agreements, one of which—the New West Partnership International Cooperation Agreement—commits the three provinces to co-operate on trade and investment missions in international markets and to share foreign market intelligence to advance joint interests (Government of British Columbia 2010a). The most significant example of this effort took place in May 2010 when the premiers of BC, Alberta and Saskatchewan led a joint mission to Asia, visiting Shanghai, Beijing and Tokyo, with the objective of enhancing trade and investment ties with that region. There have been similar missions at the industry-specific level as well. Most recently, in October 2010, Agriculture Ministers from BC and Alberta visited China and Japan in an effort to increase exports of agricultural products to those countries. Individual provinces in western Canada have also pursued trade missions in Asia-Pacific. In September 2010, Manitoba Premier Greg Selinger led a trade mission to China and the Philippines, while in November, Alberta Premier Ed Stelmach visited India with the goal of strengthening trade and investment ties between the two economies.

The western provinces have also been active in establishing a physical presence in key Asia-Pacific markets. The objective of these provincial offices abroad is to attract investment, promote trade and enhance government-to-government relations with those markets. While in Shanghai, for example, the premiers of BC, Alberta and Saskatchewan opened a new Western Canada Trade and Investment Office to be operated jointly by the three provinces. Individual provinces have trade and investment promotion offices in other cities as well. In addition to the joint office in Shanghai, BC has five other provincial offices in Asian markets: in Beijing, Guangzhou, Seoul and Tokyo. Alberta has four other offices: in Hong Kong, Tokyo, Taipei and Seoul. Manitoba has recently been active on this front as well, appointing trade consulting firm Global Network International as its Representative of Trade and Investment in India.

Improving western Canada's visibility and profile in Asia-Pacific could be an important element of a strategy to increase trade and investment ties with that region. In many countries, commercial relations and government-to-government ties are closely connected and frequent visits by government leaders send an important signal that western Canada is serious about building its commercial ties with Asia.

Establishing provincial offices abroad also provides a gateway into Asia-Pacific markets. Businesses in western Canada can use those offices to gather market information and to establish contacts with potential importers or potential sources of direct investment. The flow of information works in the opposite direction as well; Asian businesses looking for contacts in western Canada can do so via these provincial offices abroad.

In particular, efforts by the three NWP provinces to work together to enhance commercial ties with Asia-Pacific should be applauded. By working together, the three provinces are able to use their individual resources more effectively and efficiently, and to put forward a co-ordinated effort and a cohesive message aimed at maximizing the benefit to western Canada of greater economic ties with Asia-Pacific.

5.1.5 Investments in Transportation Infrastructure

A lack of sufficient transportation infrastructure is a major impediment to enhancing trade between western Canada and Asia-Pacific. In recognition of this fact, the federal government has also been pursuing various initiatives to increase western Canada's transportation capacity under its Asia-Pacific Gateway and Corridor Initiative (APGCI). The most recent example is the July 2010 announcement of a $225 million dollar public-private partnership to upgrade the infrastructure at the Vancouver Port Authority. Several other APGCI initiatives have also taken place, all with the objective of improving road, rail, shipping and intermodal transportation linkages and capacity in western Canada in order to better access Asia-Pacific markets.

The issue of transportation infrastructure is one recognised by the provincial Premiers as well. At their June 2010 meeting, the western Premiers made a commitment to continue to support infrastructure development across the West (Government of British Columbia 2010b). While most transportation initiatives focus on land- and sea-based travel, it was also identified at that meeting that a lack of open skies agreements is hindering the West's ability to attract investors, trade, international students and tourists. As a result, the Premiers signed an Open Skies Declaration, the point of which is to encourage the federal government to aggressively pursue reciprocal international air service negotiations and liberalize existing restrictive agreements. It is hoped that by providing better air services and increased flight options, such agreements will create opportunities for increased tourism and student travel, as well as greater business-to-business ties between western Canadians and their counterparts in Asia-Pacific.

5.2 Current and Future Policy Considerations

Recent policy measures aimed at reducing tariff- and non-tariff barriers to trade with Asia-Pacific; at encouraging greater two-way direct investment flows; and at improving transportation linkages with the region are all important steps towards increasing western Canadian exports to Asia-Pacific. However, more work needs to be done in these and other areas to ensure that the right policy environment is in place not only for western Canada to capitalize on the tremendous economic opportunities presented by China, India and other Asia-Pacific economies, but also for the region to expand the range of products and services it exports to that part of the world.

Indeed, notwithstanding the growth in exports to Asia-Pacific in recent years, a glance at other countries' experiences in trading with that region shows that Canada has been relatively unsuccessful at expanding its presence in those markets. For example, Canada accounted for just 1.1% of Chinese imports in 2008. By comparison, Australia had three times that market share (National Bureau of Statistics of China 2009). Moreover, Canada has lost market share in China over the past ten years, while Australia's has increased considerably.

To be sure, Canada and Australia, although similar economically, are in a very different geographic positions. Over the years, Canada has benefited enormously as a neighbour to the world's largest economy. Considering the opportunities for two-way trade and investment with the US, and Canada's natural advantages in that market, expanding trade with regions like Asia-Pacific has been a relatively low priority. By contrast, there is no dominant market next door to Australia and, as a result, it has had to be more aggressive in its pursuit of economic opportunities in overseas markets.

While the US market should continue to be the top foreign policy priority for the western provinces (and for Canada as a whole), the Australian experience suggests that for Canada to be successful in increasing its economic linkages with Asia-Pacific requires a serious and concerted policy effort, one that involves both the federal and provincial governments. While most of the policy levers to pursue this objective are found at the federal level, considering that two-thirds of Canada's exports to Asia-Pacific come from the western provinces, it is the West, specifically, that would stand to benefit from an increased focus on Asia-Pacific markets.

Some of these outstanding policy issues, and areas where further policy work is required, are discussed below.

5.2.1 Responding to demand for energy in Asia-Pacific

The steps that have been taken through the APGCI and other initiatives aimed at building transportation capacity in western Canada are critical for the development of closer trade and investment ties with Asia-Pacific. However, one area where transportation infrastructure is lacking at present is in western Canada's capacity to ship oil, gas and other energy products to willing markets in Asia-Pacific.

Energy demand in China and other developing markets is expected to increase tremendously in the coming years. The Energy Information Administration estimates that China alone will account for nearly one quarter of global energy consumption by 2035 (EIA 2010). However, western Canada is ill-equipped to take advantage of this opportunity; the present capacity to export western Canadian crude oil or refined petroleum to Asia is limited and the capacity to export natural gas is almost non-existent.

In light of the opportunities for the western Canadian energy sector in Asia-Pacific, a number of proposals have been put forward by private interests to build the infrastructure necessary to better access those markets. Two of the most significant of these proposals are: the construction of a new gas pipeline and an LNG terminal in Kitimat, BC; and the Northern Gateway pipeline to ship oil from the Alberta oil sands to Kitimat. While these projects would go a long way towards opening new markets for western Canadian energy producers and reducing the region's reliance on the US market to buy its energy, they are still only at the proposal stage, meaning that, even under the most optimistic of scenarios, these projects are years away from completion.

Moreover, these projects face considerable obstacles and potential roadblocks which may prove insurmountable. The Northern Gateway project in particular has attracted considerable controversy and faces stiff resistance from certain environmental groups, local municipalities and First Nations communities, through whose land right-of-way passages must be negotiated.

Environmental and safety concerns represent legitimate and considerable obstacles to the development of pipeline transportation capacity to the west coast. At the same time, however, securing access to overseas markets could be an important consideration for the future expansion and development of the petroleum industry in western Canada. Calls for energy self-sufficiency in the US, coupled with some resistance in that country to the continued import of "dirty" oil sands oil from Alberta, could make overseas markets a more attractive alternative for western Canadian oil producers.

Access to overseas markets could also be a driving force behind the development of an unconventional natural gas industry in western Canada. While conventional gas reserves in western Canada are depleting, there is considerable untapped potential in the region's vast shale gas and other unconventional gas deposits. However, the US has its own abundant supply of shale gas, which it is anxious to develop in keeping with its desire to reduce its reliance on foreign energy imports. As such, for western Canada to develop its own shale gas deposits, it may be necessary to find new markets in need of that supply. In that sense, the development of a natural gas pipeline, LNG plant and shipping terminal on the west coast could be an important catalyst for the development of western Canada's unconventional gas beds.

Ultimately, the issue comes down to balancing the potential economic benefits of developing the capacity in western Canada to provide energy to meet the growing demand in Asia-Pacific countries against the environmental and safety concerns that would result. Addressing this issue requires a coordinated and cohesive approach to policy-making involving both provincial and federal governments.

5.2.2 Clarifying foreign direct investment rules

Trade and foreign direct investment are closely connected. For the simple reason that a significant share of global trade takes place at the intra-firm level (i.e., a company "exporting" materials or finished products from a facility in one country to a facility in another), an increase in foreign direct investment between two countries is often accompanied by a corresponding increase in bilateral trade.

For this reason, attracting foreign direct investment from Asia-Pacific is another important way in which western Canada can not only enhance its trade flows with that region, but also promote economic development and expansion at home. However, the recent decision by the federal government to block BHP Billiton's proposed $39 billion hostile takeover of Potash Corporation of Saskatchewan runs the risk of creating uncertainty in the international investment community as to how open the Canadian government is to foreign direct investment and as to how consistently the domestic investment review process is applied.

At present, the Government of Canada screens all proposed foreign investments above a certain value threshold to ensure that the investment does not endanger national security and provides a "net benefit" to the country. Since 1985, the federal government has, under the *Investment Canada Act* (ICA), reviewed more than 1,600 foreign acquisitions of Canadian companies. Until 2008, not one investment was ever rejected, although it should be noted that if investors felt they could not satisfy the demands of the Act, they would be more likely to withdraw their investment proposal in advance, rather than proceed through the rejection process.

The proposed takeover of Potash Corp. is the second foreign acquisition rejected by the Canadian government in the past three years. That rejection has drawn attention to the fact that the criteria spelled out in the ICA to determine if an investment provides a "net benefit" to Canada are vague and has led to calls to review the Act to improve clarity and transparency.

Also adding to the potential uncertainty surround the investment review process is the fact that many opponents of the BHP Billiton acquisition identified potash as a "strategic" Canadian resource. There are no provisions within the ICA that identify what a "strategic" resource is, nor is the question of strategic importance included in the list of criteria used in the "net benefit" test. Moreover, identifying potash as strategic appears inconsistent given that there have been no significant objections to recent major investments in the Alberta oil sands, including those by Chinese state-owned enterprises.

From the standpoint of attracting FDI from Asia-Pacific and elsewhere into western Canada, it is important that Canada's investment review process be seen as predictable with well-defined rules and transparent evaluation criteria. If the designation of a resource as "strategic" is to be used as a basis for accepting or rejecting future foreign acquisitions, it is important that specific criteria be established to ensure that would-be investors have a clear understanding of the domestic investment environment. Similarly, there is a need to ensure that businesses have a clear understanding of the criteria used in the "net benefit" test. An uncertain process, or one that appears to be arbitrary or inconsistent, has the potential to act as a significant deterrent to attracting the direct investment, from Asia-Pacific and elsewhere, needed to promote economic development in western Canada.

5.2.3 More effectively leveraging western Canada's multicultural society

While tariffs, trade rules and transportation infrastructure are all important trade-related issues at the macro level, at its most fundamental level, international commerce is about interpersonal relationships. As such, cultural and linguistic connections can be vital to cultivating business linkages. Indeed, the fact that Canada shares a common language and similar culture with the United States is an important factor in the development of the close economic ties that currently exist between those two countries.

For this reason, western Canada's large and diverse communities of Chinese-, Indo- and other Asian-Canadians are an important bridge to that part of the world. Asia-Pacific is the largest source of immigrants in all four western provinces, accounting for just over half of all immigration to the prairie provinces in 2008 and 68.5% of immigrants to BC that year.

These connections are an invaluable asset, not only from a cultural standpoint, but from an economic one as well. Western Canada can draw on the strength of its multicultural labour force to help bridge the language and cultural barriers between North American society and that of Asia-Pacific. There are opportunities for governments at both the federal and provincial levels, as well as private businesses, to harness this advantage to build closer commercial ties with markets in Asia-Pacific.

5.2.4 Determining the role of government in trade promotion

To take fuller advantage of the market opportunities in Asia-Pacific, and to expand the range of goods exported to that region, it is important not only to implement policies aimed at reducing the barriers to trade, but also to create an awareness of the specific sector-by-sector opportunities in Asia-Pacific countries. In this regard, Canadian governments have been generally successful. Information is widely available on the specific market opportunities in Asia-Pacific. DFAIT has, for example, identified five priority sectors for Canada in China and is developing a market plan to improve trade in those areas. The five sectors are: agriculture and agri-food; information and communication technologies; automotive, aerospace, and metals; minerals and related services; and equipment. Similarly, market opportunities exist in India, where growing infrastructure demands are creating opportunities in areas such as transportation, power generation, environmental technologies and urban planning (DFAIT 2010c).

The challenge from a policy standpoint is to translate awareness of these market opportunities into meaningful outcomes for domestic businesses. However, this challenge also raises important questions about the role of governments in economic development and trade promotion: To what extent should governments be involved in promoting domestic businesses abroad? Is it appropriate to favour specific sectors based on perceived market opportunities and desirability? The answers to these, and related, questions are important to determine the appropriate policy actions by provincial and federal governments regarding the pursuit of sector-specific trade opportunities in Asia-Pacific markets.

5.2.5 Capitalizing on opportunities in education and travel

International trade and investment policy in Canada tends to focus on merchandise trade flows and foreign direct investment stocks. However, services trade is an important component of international commerce. Data are not available at the provincial level, but Canadian services exports were valued at $69.8 billion in 2007. Services exports to Asia-Pacific made up about 10.6% of that total.

Although there is no way to determine how much of Canada's $7.4 billion in services exports to Asia-Pacific originated in the western provinces, there are considerable opportunities for the four provinces to increase services trade with that part of the world. As mentioned earlier, the granting of ADS to Canada by the Chinese government represents a significant opportunity for western Canadian businesses to boost the provision of travel services to China. Similar potential exists elsewhere in the region as incomes in India and other developing countries continue to rise.

Education services represent another trade opportunity for western Canada. There is a large and growing market in Asia-Pacific for western-style post-secondary educations from English-speaking countries. The US and the United Kingdom are long-established destinations for foreign students from around the world, although Australia has emerged as a leader in attracting students from Asia. For its part, Canada has lagged behind in this area.

Even so, in 2008, international students in Canada spent over $6.5 million dollars on tuition, fees and living expenses; spent what is estimated to be an additional $285 thousand on tourism; created over 83,000 jobs; and generated more than $291 million in revenue for the Canadian government (Kunin 2009). Western Canada's share of international student expenditures was $2.0 billion—36.4% of the national total. The vast majority of that total was in BC.

More aggressively pursuing foreign students from Asia-Pacific offers many potential benefits to western Canada. First, the region's post-secondary institutions benefit directly not only from higher tuition revenues from foreign students, but also from the increase in international profile those students offer. There are spillover benefits for local economies as well, through housing and living expenses and regional tourism. More important than all of these, however, is the fact that providing foreign students with a Canadian education forges an indelible link to Canada (House of Commons Standing Committee on Foreign Affairs and International Trade 2003). When foreign students return home after completing their studies, they take with them knowledge of western Canadian culture, institutions, businesses, goods and services. This knowledge could be an invaluable asset in building future trade and investment ties between western Canada and Asia-Pacific.

5.2.6 Striking a balance between domestic policies and international trade

Finally, the most important way in which western Canada, and Canada as a whole, can build trade and investment ties with Asia-Pacific is to take the steps necessary to promote economic integration and cooperation with that region. One of the most compelling present-day opportunities in that regard is the ongoing Trans-Pacific Partnership (TPP) negotiations.

The TPP began as a 2006 free trade agreement between Brunei, Chile, Singapore and New Zealand. Since that time, however, several other countries have joined the TPP, with the ultimate objective of creating an integrated trade bloc of countries that look onto the Pacific Ocean, including those in eastern Asia, Oceania, and North and South America. At present, Australia, Malaysia, Peru, the United States and Vietnam are also participating in active TPP negotiations.

Canada had originally expressed interest in joining the TPP but withdrew to the sidelines when it became apparent that the price of admission would be putting its system of supply management for dairy, poultry and eggs on the negotiating table. This withdrawal is consistent with Canada's position at other international trade negotiations; Canada has vigorously defended its system of supply management both at the WTO and at the bilateral and regional levels. However, Canada's unwillingness to move on this issue carries with it a cost.

Its position on supply management has made it difficult for Canada to pursue trade agreements that would reduce market access barriers for western Canadian exporters. Not only does that position prevent Canada from participating in TPP discussions, but it has isolated Canada at the WTO and has limited its ability to pursue bilateral and regional agreements.

This issue is of particular importance to agricultural producers in western Canada. As a result of several rounds of WTO negotiations, tariffs on industrialized goods are low in most countries around the world; only for agricultural products does tariff reduction continue to be a major issue. To the extent that Canada's position on supply management prevents it from participating in free trade negotiations, it also has the potential to limit the opportunities for western Canadian agriculture and agri-food exporters to explore trade opportunities in Asia-Pacific, and other markets around the world.

Because the negotiation of international treaties falls under the exclusive purview of the federal government, so too does the decision to protect supply management at the expense of participating in the TPP and possibly in other trade liberalization and economic integration initiatives. There is little role for provincial governments to play on this issue other than one of advocacy. As such, an outstanding policy question for the western provincial governments is whether or not the perceived benefits of trade and economic integration with Asia-Pacific through the TPP is sufficient to lobby the federal government to change its position on supply management.

6.0 Conclusion

The rise of China, India and other developing markets in Asia-Pacific represents a considerable economic opportunity for western Canada. Already, the western provinces have benefited from expanding trade and investment with those countries and the prospects for future growth are strong. Expanding trade ties with Asia-Pacific also has the potential to contribute to economic diversification in western Canada through spreading provincial exports across a wider number of markets, as well as by broadening the range of goods that western Canadians produce and export.

However, the evidence suggests that to date trade with Asia-Pacific has had only a limited effect on economic diversification in western Canada. On the one hand, there is evidence to support the claim that growth in trade with developing countries in Asia-Pacific is making a modest contribution to export *market* diversification—helping to reduce western Canada's reliance on the US as an export destination.

On the other hand, the evidence regarding the impact of trade with Asia-Pacific on export *product* diversification in western Canada is less clear. The range of products sold by the western provinces in Asia-Pacific is not especially broad, although there is some indication that it is improving in some provinces. At the same time, while the mix of products sold in Asia-Pacific is narrow, for some provinces it is sufficiently different from the range of goods exported to other markets around the world that overall export product diversification is taking place. Specifically, there is evidence to suggest that shipments of goods to Asia-Pacific are contributing to export product diversification in Alberta and Saskatchewan. However, there is little evidence that trade with Asia-Pacific has had similar benefits for BC and Manitoba.

While trade with Asia-Pacific markets has made only a modest contribution to economic diversification in western Canada to date, the fact remains that forging closer economic ties with Asia-Pacific—and with China and India in particular—is critical to ensuring the long-term prosperity of western Canada. Considerable opportunities exist for the western provinces to not only expand their market presence in Asia-Pacific in sectors of traditional strength, but to take advantage of new opportunities as well.

On the consumer side, the large and growing middle class in China and India is generating demand for travel and education services, telecommunications products, as well as for a greater quantity, and range, of food products. Rapid urbanization is also creating opportunities in construction services and public infrastructure. As energy consumption continues to rise, demand is increasing, not only for energy from traditional sources, but also for energy-related infrastructure, alternative energies and environmental technologies.

However, it is clear that more work needs to be done for western Canada to capitalize on these opportunities. While governments, both provincial and federal, have implemented policies aimed at building a more robust economic relationship with Asia-Pacific, the fact remains that western Canada, and Canada as a whole, has not had the same degree of success in expanding trade and investment with that region as have a number of Canada's international competitors in those markets, notably Australia and the United States.

One question not addressed in this paper is the extent to which trade with Asia-Pacific has contributed to increased value-added production in western Canada; there is too much room for subjectivity and interpretation in how trade data are organized and classified for such an analysis to produce meaningful results. However, even a cursory glance at western Canada's main export products to Asia-Pacific markets suggests that not much additional manufacturing or processing is taking place on those goods: the western provinces export canola seeds, not canola oil; lumber, not furniture or wood products; and minerals and metal ores, not products made of those materials.

Capturing a greater share of the overall economic benefit associated with the production of final goods can be critical to western Canada's future prosperity and long-run economic competitiveness. The issue of how trade with Asia-Pacific is affecting value-added economic activity in western Canada, and what supportive or correcting policy actions may be required as a result, is a subject that requires further study.

Western Canada has a number of natural advantages that, if properly harnessed, will contribute to a more robust economic relationship with Asia-Pacific countries, especially with China and India. The four western provinces already account for the majority of Canada's total exports to those countries; there are more Canadians of Chinese and Indian descent in the West than elsewhere in Canada; and China and India are important sources of foreign students for western Canadian universities. To leverage these and other advantages requires western Canada—and Canada as a whole—to enact sound policies that foster economic competitiveness; that create awareness of business prospects in China and India; that open doors for western Canadian enterprises; that ensure the proper transportation infrastructure is in place; and that reduce the various existing barriers to trade and investment. Doing so has the potential to make a meaningful contribution to the long-term economic prosperity and diversification of western Canada.

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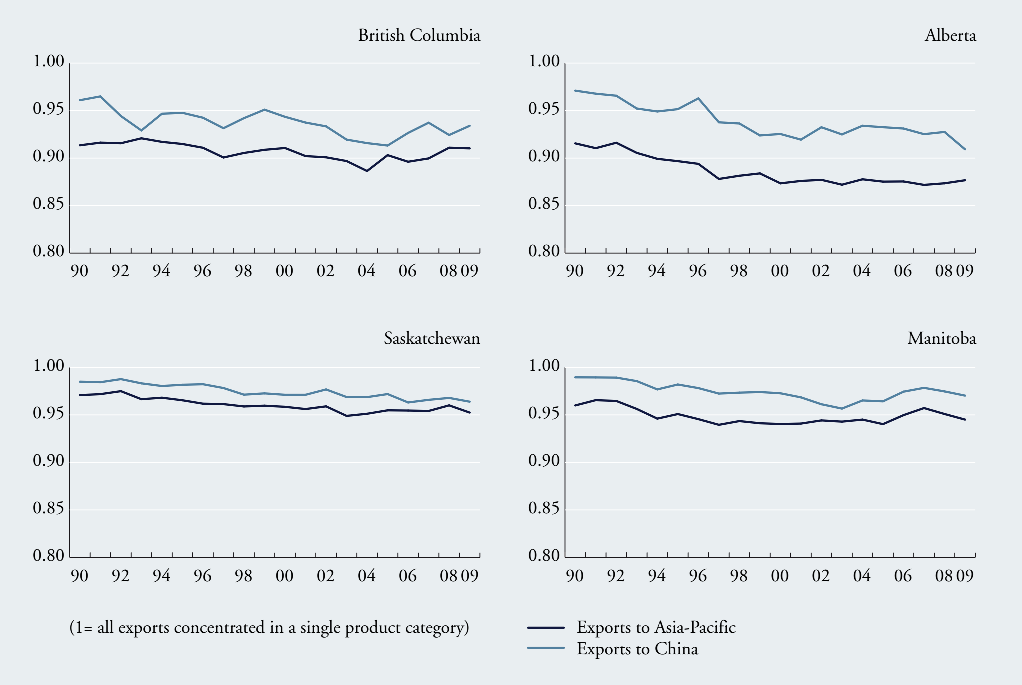
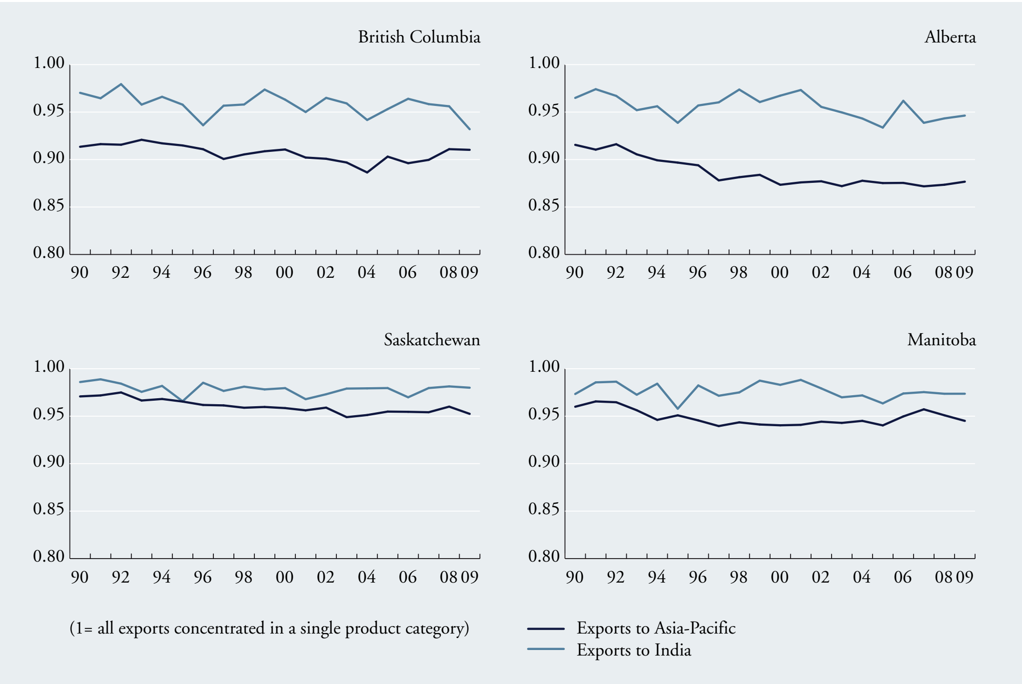
Appendix I – Additional Figures

FIGURE A-1: PRODUCT DIVERSIFICATION IN EXPORTS TO CHINA



Source: Author's calculations using Statistics Canada data

FIGURE A-2: PRODUCT DIVERSIFICATION IN EXPORTS TO INDIA



Source: Author's calculations using Statistics Canada data

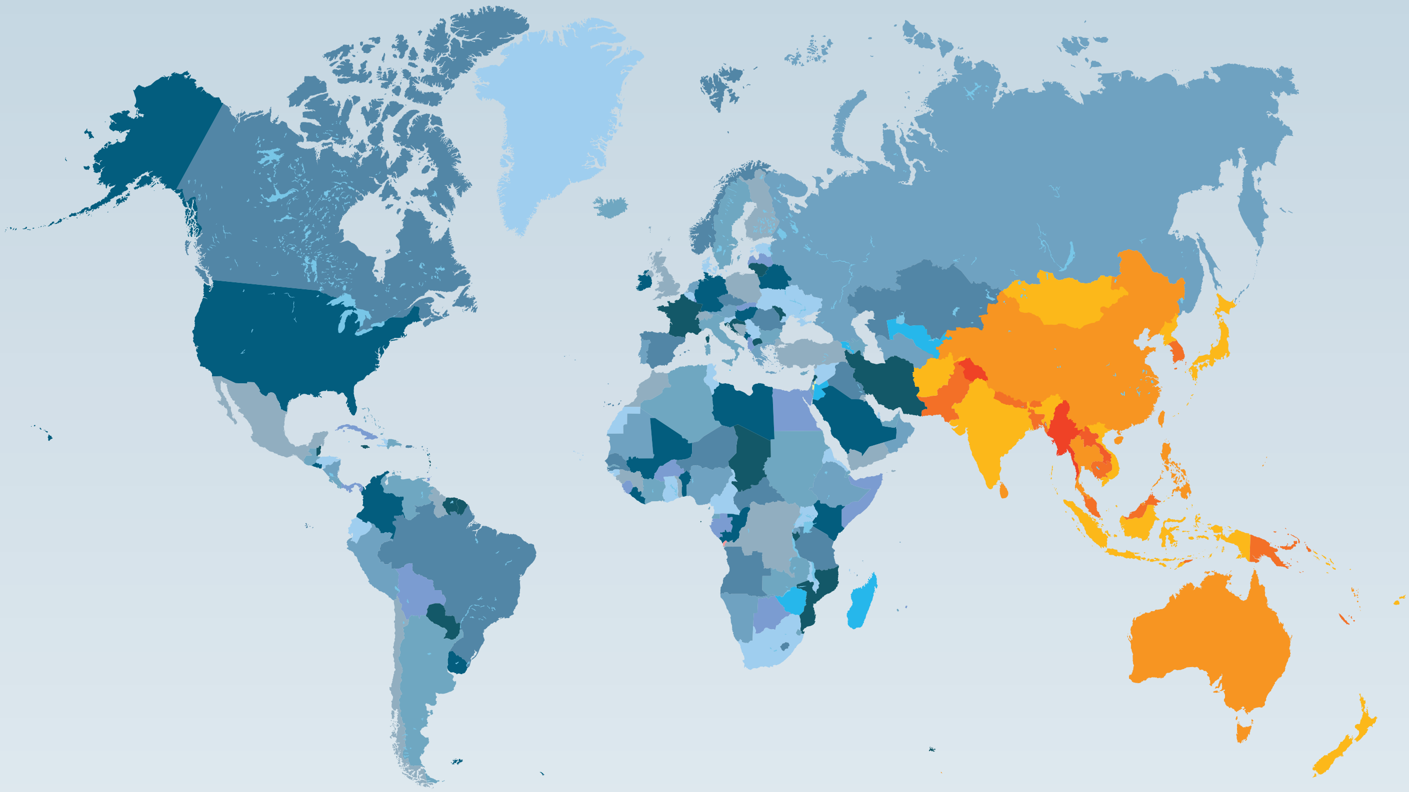


FIGURE A-3: ASIA-PACIFIC REGION

China	Afghanistan	Solomon Islands
Japan	Papua New Guinea	Cook Islands
South Korea	North Korea	Norfolk Island
India	Macau	Christmas Island
Australia	U.S. minor outlying islands	Cocos Islands
Hong Kong	New Caledonia	Tonga
Taiwan	Maldives	Bhutan
Singapore	French Polynesia	Pitcairn Island
Indonesia	Cambodia	Burma (Myanmar)
Malaysia	Fiji	Heard/MacDonald Island
Bangladesh	Brunei Darussalam	East Timor
Thailand	Mongolia	Kiribati
Philippines	Nepal	Nauru
Pakistan	Laos	Wallis and Futuna Islands
Sri Lanka	Vanuatu	Niue
New Zealand	Guam (U.S.)	Tokelau
Vietnam	American Samoa	Micronesia

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