



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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This report was prepared by Canada West Foundation Senior Economist Michael Holden.

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About this paper

This paper is an abbreviated version of a larger publication, *Through the Gateway: Unlocking Western Canada's Potential for Economic Diversification by Expanding Trade with Asia-Pacific*. The present document provides a summary of the main findings of the larger piece, with particular emphasis on western Canada's present economic relations with Asia-Pacific and the impact that trade with that region has had, to date, on economic diversification in the western provinces. In addition to providing additional details, the larger document, which is freely available on the Canada West Foundation website, includes an expanded discussion of some of the outstanding policy issues/challenges that, if addressed, would help further to expand and diversify western Canada's trade with Asia-Pacific.

Introduction

For a region like western Canada, where the standard of living is closely tied to trade and investment, it would be difficult to imagine a more attractive export market than Asia-Pacific. Not only is Asia-Pacific the largest and fastest-growing economic region in the world, but its growth is fuelled by demand for a wide range of imported goods and services, many of which are in industries of comparative strength for the western provinces.

To date, western Canada has achieved some modest success in expanding its market presence in 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.

However, these existing relationships are just a fraction of the potential that Asia-Pacific represents. Closer trade and investment ties can help not only to expand economic output in western Canada, but also can contribute to economic diversification: by broadening the range of customers to which western Canadians sell their products; and by expanding the variety of goods and services they export. Maximizing this potential could contribute to economic growth, prosperity and stability in western Canada for years to come.

About Asia-Pacific

Asia-Pacific is a vast region, characterized by tremendous diversity in geography, economic and social development, culture, language, political systems and personal freedoms. It consists of more than 50 distinct economies across Asia, stretching as far west as Afghanistan, and also includes Australia, New Zealand and the island countries, territories and protectorates of the South Pacific.

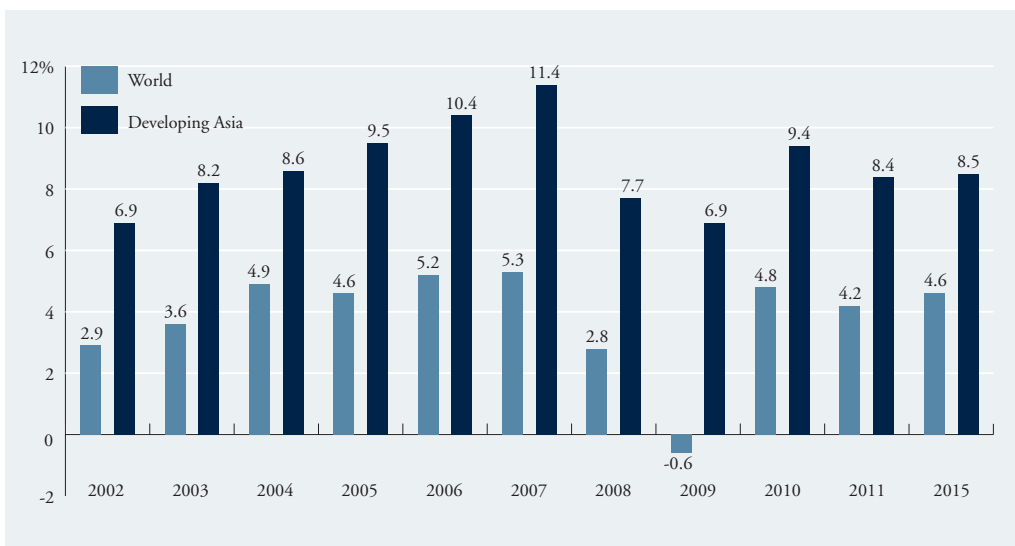
For the 10.4 million residents of western Canada, it might be difficult to fully appreciate the enormous size and potential of Asia-Pacific markets. There are a dozen cities in the region that each has a population larger than that of all four western provinces combined. Asia-Pacific counts six of the ten most heavily-populated countries in the world, including first- and second-ranking China and India. In total, 3.8 billion people reside in Asia-Pacific, accounting for well over half (55.2%) of the world's population.

Asia-Pacific is also a force on the global economic stage. It is home to three of the five largest economies in the world (China, Japan and India) and accounts for almost as much of total global economic activity as the United States and the European Union combined.

Moreover, the size and influence of Asia-Pacific on world markets is increasing. Developing countries in Asia are leading the charge; propelled by double-digit growth rates in China, developing Asian economies have consistently expanded at rates well above the global average. 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.

Asia-Pacific markets accounted for **29%** of global economic activity in 2009, almost as much as the United States and European Union combined.

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



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

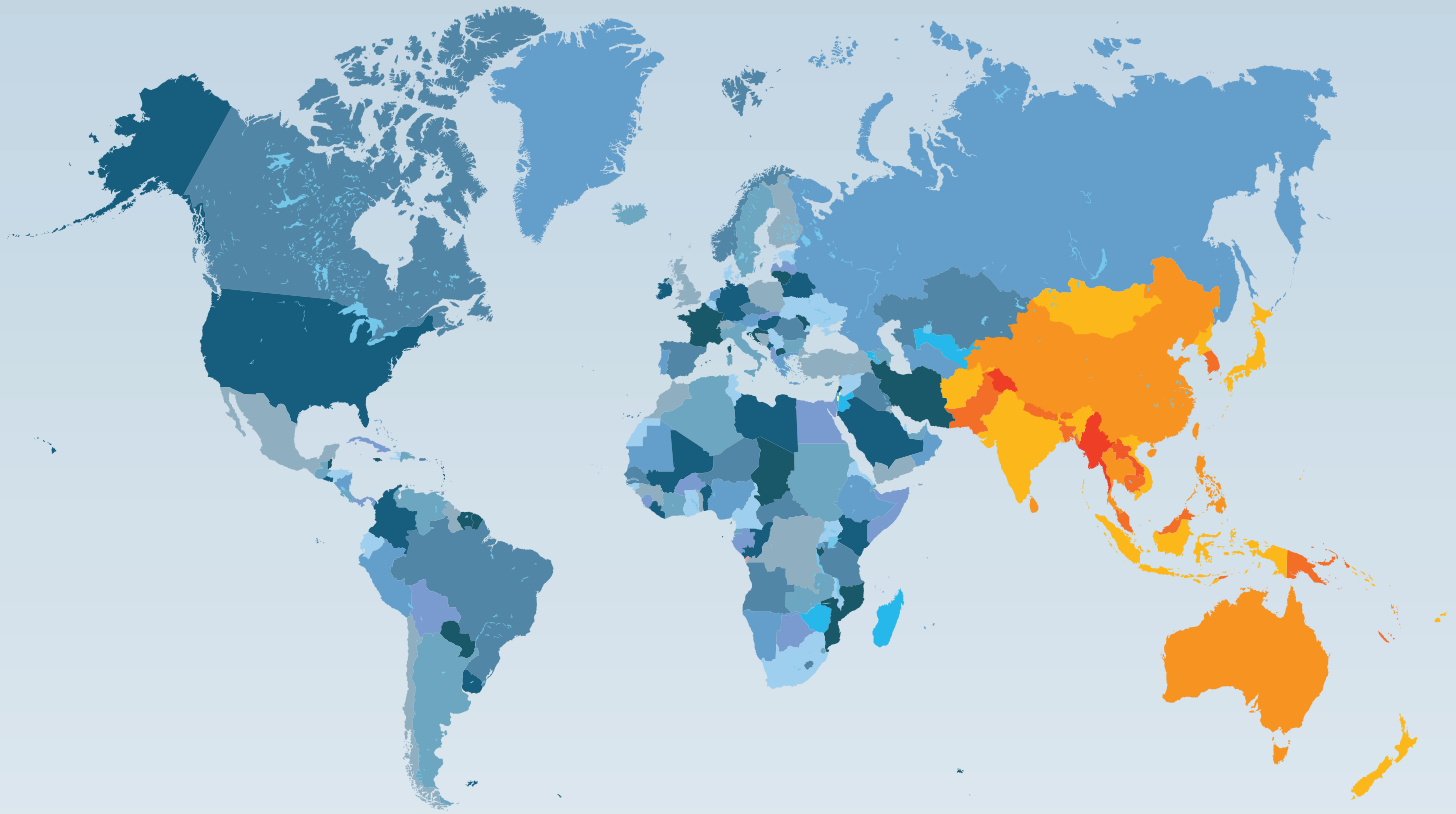


FIGURE 2: ASIA-PACIFIC REGION

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

Western Canada's Trade with Asia-Pacific

Trade is an important driver of economic activity in western Canada. Exports of goods and services typically account for about one third of total gross domestic product (GDP) in the four provinces.

Asia-Pacific markets represent a significant share of that activity. While the US is by far western Canada's largest export destination, comprising 71.5% of the region's \$128.9 billion in total exports in 2009, the four provinces sell more to Asia-Pacific than to all other non-US destinations combined. Valued at \$22.6 billion in 2009, exports to Asia-Pacific markets represented 17.5% of western Canada's total sales abroad that year. The four provinces also accounted for the majority—about two thirds—of Canada's overall exports to Asia-Pacific.

Moreover, western Canadian businesses are expanding their reach into Asia-Pacific markets. Over the last five years, exports to that region grew by an average of 6.4% per year, compared to a 0.6% increase in exports to all other destinations.

While a lot of attention is paid to China, India and other developing Asian markets, much of western Canada's trade with Asia-Pacific takes place with its wealthier and more established markets. In 2009, nearly half of western Canada's exports to Asia-Pacific were shipped to Japan, South Korea, Taiwan, Australia, New Zealand, Singapore and Hong Kong.

2/3

of Canada's exports to Asia-Pacific come from the four western provinces.

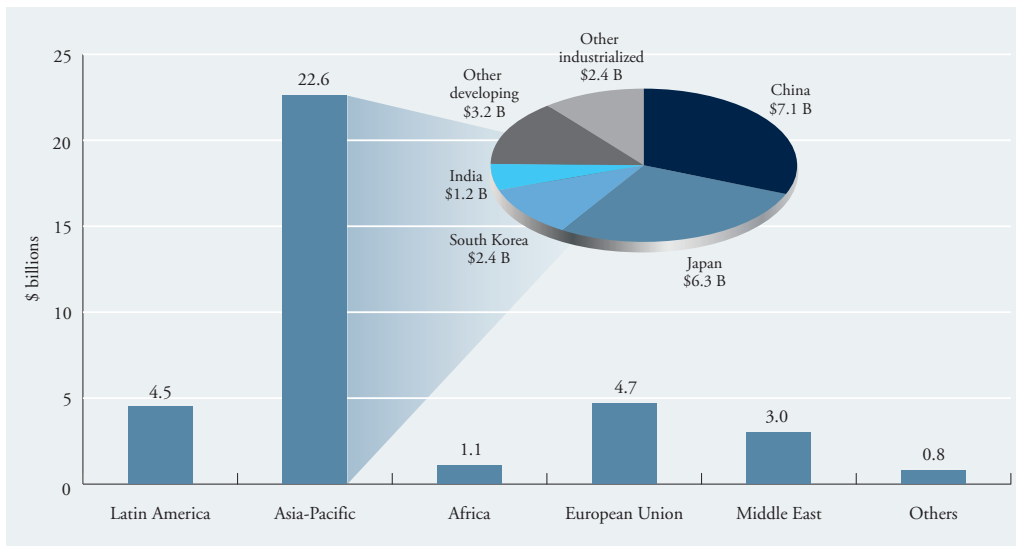
BC exports more to Asia-Pacific than any other province. Total shipments were valued at \$9.5 billion in 2009, equivalent to

37%

of provincial exports.



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



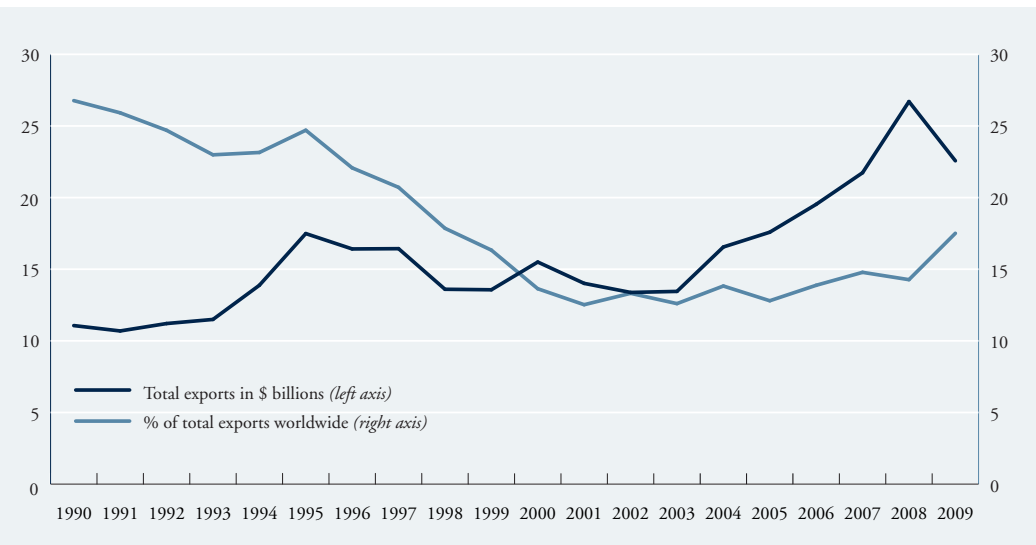
Source: Author's calculations using Statistics Canada data

Western Canadian exports to developing markets in Asia-Pacific rose from \$2.2 billion in 1990 to

\$11.5 B

in 2009. Exports to the region's industrialized markets grew from \$8.9 billion to \$11.1 billion over than same period.

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



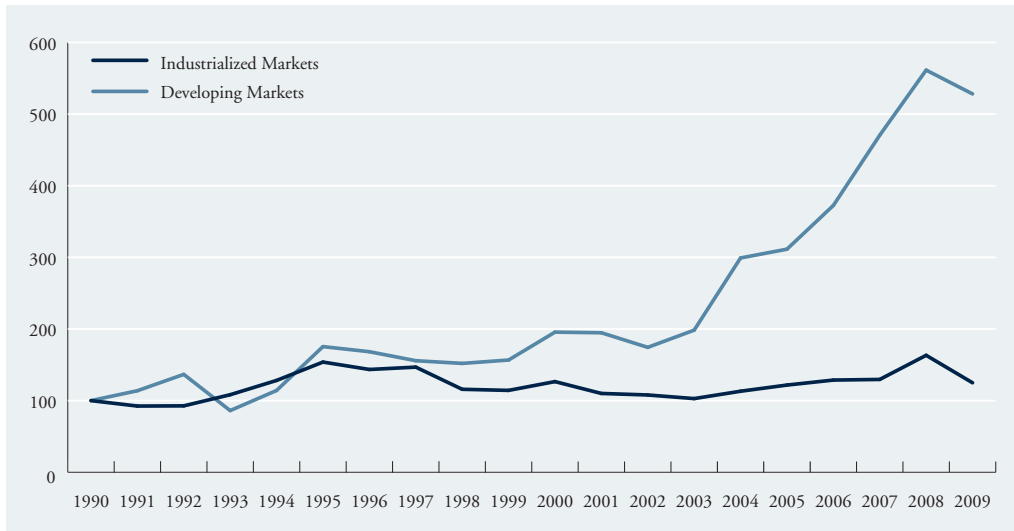
Source: Author's calculations using Statistics Canada data

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

Today, China is the second-largest export destination in the world for all western provinces except BC where it sits in third position (behind Japan and the US). India is not currently a major export destination for the western provinces, except for Saskatchewan where, on the strength of potash and legume exports, it is the province's third-largest export destination worldwide. No other province exports more to India than Saskatchewan.

In spite of the strong growth in exports to Asia-Pacific in recent years, especially to developing markets, that region is actually less important to western Canadian exporters than it was 20 years ago. This trend was largely the result of a combination of rapidly-expanding Canada-US trade in the 1990s, along with weak growth in exports to Japan—at the time western Canada's largest export market in Asia-Pacific. As a result, the share of western Canada's exports to Asia-Pacific markets fell from 26.8% in 1990 to 12.5% in 2001 before rising again to its present level of 17.5%.

FIGURE 5: GROWTH IN WESTERN CANADIAN EXPORTS TO INDUSTRIALIZED AND DEVELOPING MARKETS IN ASIA-PACIFIC (1990 = 100)



Source: Author's calculations using Statistics Canada data

FIGURE 6: TOP PROVINCIAL EXPORT DESTINATIONS (2009)

<i>British Columbia</i>			<i>Alberta</i>		
	<i>\$ millions</i>	<i>% of total</i>		<i>\$ millions</i>	<i>% of total</i>
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
<i>Saskatchewan</i>			<i>Manitoba</i>		
	<i>\$ millions</i>	<i>% of total</i>		<i>\$ millions</i>	<i>% of total</i>
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

Natural resources and resource-based goods made up **\$19.7 B** out of western Canada's total \$22.6 billion in exports to Asia-Pacific in 2009.

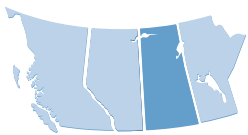


The products that western Canadians ship to Asia-Pacific vary considerably from province to province and by destination to destination. In general, however, exports are highly concentrated in natural resources and resource-based goods. Resource-based goods accounted for 88% of western Canada's total shipments to Asia-Pacific in 2009. 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.

It is worth noting that the distribution of exports to Asia-Pacific does not accurately reflect the scope of economic activity across the western provinces. Compared to their relative impact on the western economy, some goods (agricultural products, for example) are heavily over-represented while others—like oil and gas—are conspicuously absent. To some degree, these differences are an indication of specialization in production and the exploitation of comparative advantages in resource-based industries. In other instances, however, specific barriers such as an absence of pipeline capacity to the west coast of Canada effectively close Asia-Pacific markets to exporters of certain goods.

FIGURE 7: TOP EXPORT PRODUCTS FROM THE FOUR WESTERN PROVINCES TO ASIA-PACIFIC (2009)

16% of Saskatchewan's total exports go to China, India and other developing markets in Asia-Pacific, the highest share in Canada.



	<i>\$ millions</i>	<i>% of total</i>
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

Why just goods exports?

There is much more to western Canada's economic relationship with Asia-Pacific than simply merchandise exports. Not only are Asia-Pacific countries important sources of imports into western Canada, but they are also a large, and growing, source of foreign direct investment into the western provinces, particularly in energy and other resource-extraction industries. Unfortunately, data availability and data quality issues prevent an analysis of these components of western Canada's economic relationship with Asia-Pacific.

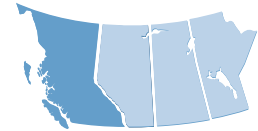
Trade with Asia-Pacific and Economic Diversification in Western Canada

Definitions of “economic diversification” vary, but at its root, economic diversification is about risk mitigation. Specifically, an economy overly reliant on the production of a limited range of goods, or on sales to a limited number of customers, is exposed to the risk of volatility based on external demand shocks.

There are two ways in which trade with Asia-Pacific markets can contribute to economic diversification in western Canada. The first is export market diversification: by exporting to a broader range of customer bases, the region can reduce the risk of overreliance on any single market. The second is export product diversification: expanding the range of goods produced and exported by domestic businesses.

12.5%

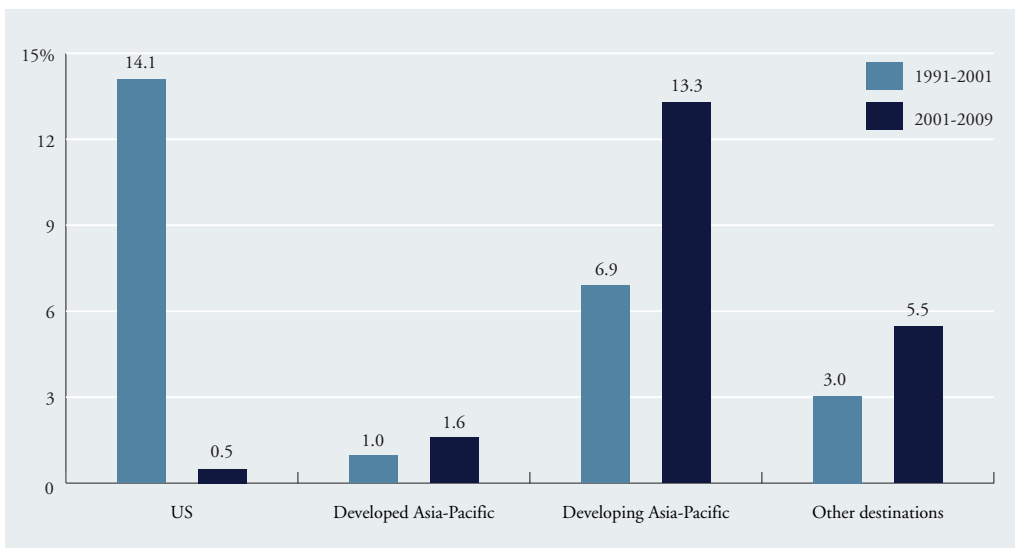
of BC’s exports in 2009 went to developing markets in Asia-Pacific, up from 3.6% in 1999.



A. Export market diversification

Since the US is such a dominant customer for western Canadians, any discussion of export market diversification is really about increasing the proportion of exports that go to non-US destinations. From that perspective, Asia-Pacific has contributed to export market diversification in recent years; based on a combination of strong growth in exports to developing markets in the region and weakness in trade with the US, the share of overall exports from western Canada to Asia-Pacific has been rising since 2001, while the share going to the US has fallen.

FIGURE 8: AVERAGE ANNUAL GROWTH IN WESTERN CANADIAN EXPORTS BY DESTINATION (%)



Source: Author’s calculations using Statistics Canada data

EXPORTS

to Asia-Pacific have not, to date, had a significant effect on export product diversification in western Canada.

As noted earlier, trade with China and other developing markets has soared, while exports to industrialized economies in Asia-Pacific have been much weaker. As a result, the share of exports to developing economies in the region have risen from 2.8% in 2001 to 8.9% in 2009, while the share of exports to industrialized economies has been largely unchanged.

In terms of Canada-US trade, a combination of factors including a higher Canadian dollar; a weaker US economy; the thickening of the Canada-US border; and the steep drop in energy prices in 2009; created uncharacteristically weak conditions for western Canadian exporters through much of the 2000s. It thus remains to be seen whether the growing proportion of trade headed to China and other developing Asia-Pacific markets points to a long-term shift in the redistribution of western Canadian exports, or simply reflects an isolated period of weakness in US markets.

B. Export product diversification

According to the measure of export product diversification developed for this paper, BC and Manitoba are among Canada's most diversified exporting provinces, while Alberta and Saskatchewan are among the least diversified. Moreover, both Manitoba and BC have expanded the range of products they export since 1990, while Alberta and Saskatchewan remain just as reliant on a few key export products.

However, there is some indication that trade with Asia-Pacific has helped Alberta and Saskatchewan to expand the range of products they export. In large part, this effect can be attributed to the limited capacity in place to transport oil and gas outside North America. Crude oil and natural gas make up 65.3% of Alberta's exports and 32.7% of exports from Saskatchewan. Because oil and gas so dominate those provinces' overall export mix, increased trade with any destination where those goods cannot be shipped is bound to improve export product diversification.

By contrast, there is no evidence that that trade with Asia-Pacific is contributing to export product diversification in BC and Manitoba; with some exceptions (electricity, for example) the products sold by those provinces to Asia-Pacific markets are largely the same as those exported elsewhere. In fact, there is some indication that trade with Asia-Pacific is making BC's export product mix less diversified.

Conclusion and Policy Issues

To date, western Canada has achieved some modest success in capitalizing on the economic opportunities presented by China, India and other Asia-Pacific markets. Led by the region's developing markets, trade with Asia-Pacific has increased considerably, contributing to a reduction in western Canada's dependence on the US as an export destination. However, given the sheer size of, and rapid economic growth in, the Asia-Pacific region, western Canada's \$22.6 billion in exports in 2009 is clearly just the tip of the iceberg in terms of market potential.

To improve on that record requires a concerted policy effort, both at the federal and provincial government levels. There are several specific policy issues that, if addressed, could help to improve the overall value and range of western Canada's exports to Asia-Pacific. These issues include the following:

- 1) Reconciling competing values and perspectives on developing the infrastructure required to ship oil and gas overseas;
- 2) Clarifying foreign direct investment rules to ensure that the investment review process does not appear arbitrary or inconsistent;
- 3) More effectively leveraging western Canada's multicultural society;
- 4) Identifying the role of government in economic development and trade promotion;
- 5) Developing policies to better capitalize on service sector opportunities, especially in education and travel; and
- 6) Pursuing trade liberalization efforts, while at the same time addressing the fact that the benefits of those efforts can sometimes conflict with domestic policy priorities.

Meaningful policy action in these and other areas has the potential to make a significant contribution to the long-term economic prosperity and diversification of western Canada.



CanadaWest
FOUNDATION

www.cwf.ca

HEAD OFFICE:

900 – 1202 Centre St. SE
Calgary, AB T2G 5A5
ph: 403-264-9535
email: cwf@cwf.ca

BC OFFICE:

810 – 1050 West Pender St.
Vancouver, BC V6E 3S7
ph: 604-646-4625

SASKATCHEWAN OFFICE:

KW Nasser Centre
256 – 3 Avenue South
Saskatoon, SK S7K 1L9
ph: 306-966-1251

MANITOBA OFFICE:

900 – One Lombard Place
Winnipeg, MB R3B 0X3
ph: 204-947-3958