



THE TPP

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This report was prepared by Carlo Dade, Director of the Centre for Trade & Investment Policy and Shafak Sajid, Policy Analyst at the Canada West Foundation. The authors benefited from comment by a wide group of experts during the research and review phases of writing the report. The authors endeavored to incorporate this feedback and would like to thank the reviewers paper for their comments. We would like to acknowledge the dedicated team at the Canada West Foundation who helped enrich the report. We offer particular thanks to Vice-President and Interim CEO Colleen Collins for her contributions to the report.

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EXECUTIVE SUMMARY

The Trans-Pacific Partnership trade agreement (TPP) is much more than the bilateral agreements to which Canadian business and the public have become accustomed. This 12-nation deal is the largest, most complex and potentially most impactful agreement Canada has been a part of, and it effectively updates and upgrades the North American Free Trade Agreement (NAFTA). By expanding the trade pact's reach to nine new members from across the Pacific, it will also open new regions of Asia for Canadian exporters.¹

Debate in Canada on the risks and opportunities in the agreement have focused on national-level impacts and on sectors that are of particular concern to central Canada, such as dairy and auto manufacturing. Because of those concerns, ratification by the Canadian government cannot be taken for granted. This paper makes an argument for ratification on the basis that the agreement will provide a net benefit overall and create opportunities for western Canada.

Two critical factors stand out.

First is a reality check. If the United States ratifies the agreement, then the TPP will change the trade relationship among our most important trading partners and competitors *regardless of what Canada does*. We do not face a choice between change and no change. Our choice is about how we best equip ourselves to adapt to change. Do we want to be inside the tent, with input on decisions affecting more than 80 per cent of our trade? Or on the outside, wondering what is happening and how it will affect us?

If the U.S. ratifies the agreement, then Canada faces two immediate scenarios, as demonstrated in Table A.

TABLE A: IF THE U.S. RATIFIES THE TPP AND...

Canada also ratifies → Win-Win		Canada does not ratify → Lose-Lose	
Benefits	Costs	Benefits	Costs
Canada protects business as it sources cheaper inputs from TPP countries	Canada loses some business, as the U.S. and Mexico source cheaper inputs from TPP countries	Canada retains power to try to protect some domestic industries, like dairy and auto manufacturing	U.S. and Mexico source cheaper inputs from TPP countries and supplant Canadian producers
Gains better access to new export markets	Faces new competitors in U.S. market	Nothing. No new market access	Faces new competitors in the U.S. market

¹ This is one of the leading claims in support of the TPP made by the U.S. Trade Representative, see for example: <https://ustr.gov/tpp/#upgrading-nafta>

Second, the agreement is a major advance in international trade architecture that offers unique benefits for Canada, and particularly western Canada, to expand trade.

The agreement will have the following benefits:

BENEFIT 1: Reduce tariffs for sectors that are important to the West.

BENEFIT 2: Reduce non-tariff barriers.

BENEFIT 3: Open trade in services, which is crucial to diversification.

BENEFIT 4: Keep Canada within an updated and more competitive NAFTA.

BENEFIT 5: Allow Canada to leapfrog its backlog of bilateral agreements in Asia.

BENEFIT 6: Build on the success of regional trade agreements, and,

BENEFIT 7: Create the best opportunity to negotiate deals favourable for Canada.

CANADA'S PLAN B

There is also a scenario where the agreement dies because the U.S. does not ratify.² If this happens, then Canada has the potential to salvage some of the agreement's benefits. It could:

01 Reprogram resources at the Ministry of International Trade to pick up on gains made with Asian countries during TPP negotiations. This would include devoting more resources to negotiating a trade agreement with China.³

02 Look to an alliance on this side of the Pacific by forging a smaller version of the TPP. This pact would incorporate TPP elements into a new regional agreement with the Latin American countries with whom Canada already has trade agreements.

03 Develop partnership facilitation services for Canadian small- and medium-sized enterprise (SME) exporters that would have been part of a TPP implementation strategy.

04 Use the time created by the failure of the TPP to prepare for the likely opening of the U.S. market as that country negotiates other more advanced trade agreements.

² For the TPP to come into effect, a minimum of six countries representing 85 per cent of the total GDP of the bloc must ratify the agreement. In effect, if either the U.S. or Japan, which form about 80 per cent of the bloc, do not ratify the agreement it will not come into effect. Both the leading Democratic and Republican candidates in the U.S. pre-election campaigns have expressed concerns about the TPP.

³ This paper does not discuss the impact of the TPP on Canada's engagement with China.

INTRODUCTION

With more than 5,500 pages of rules, 112 annexes of exceptions to rules and 12 economically diverse partners, the Trans-Pacific Partnership trade agreement (TPP) is three times as long and has six times as many partners for Canada as the North American Free Trade Agreement (NAFTA). The agreement will upgrade Canada's existing trade agreements with the U.S., Mexico, Chile and Peru and give Canada the equivalent of five new trade agreements in Asia all at once. This is the most ambitious and complex agreement Canada has ever signed.

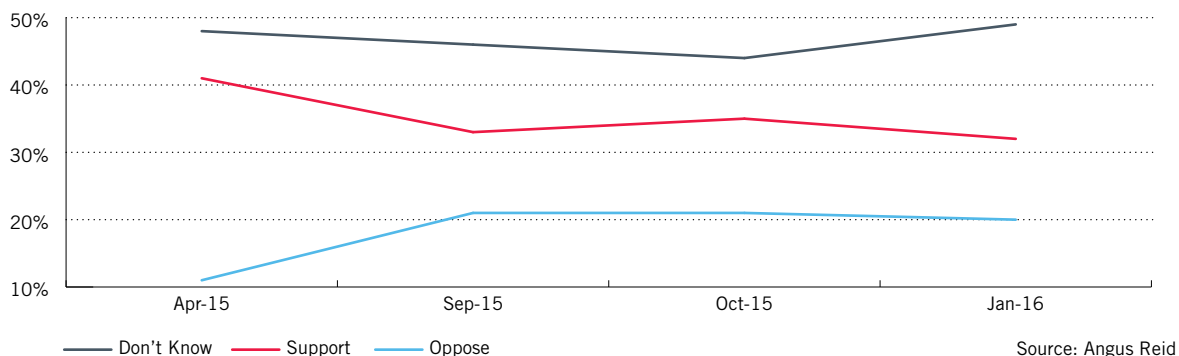
The TPP has initiated a vigorous political debate in Canada, just as the NAFTA was hotly discussed 20 years ago. Concerns related to the TPP involve the impact on specific sectors (dairy and auto manufacturing), intellectual property, investor-state dispute settlement mechanisms and environmental initiatives. Ratification of the agreement should not be taken for granted by its proponents in Canada. Though recent polling has shown that more Canadians support than oppose the agreement (32 per cent in favour versus 20 per cent opposed), a majority, or

49 per cent, still do not know enough about the agreement to form an opinion.⁴ Support for the agreement has also been falling while opposition has held steady. Rather than advocating for the agreement, the Canadian government has remained neutral and chosen to hold consultations. Given that the previous government was so vocal in support of trade agreements, the government's official silence has created room for doubt about the agreement and a dangerous vacuum of information.

Also missing from the nascent national debate has been analysis of the regional impacts of the agreement. The costs and benefits of the TPP will be felt differently in different parts of Canada. Preliminary analysis of the agreement indicates there are significant benefits for western Canada, where the TPP will change the rules for 83 per cent of our exports.

The paper lays out benefits of the agreement for Canada, and the West in particular, to inform the debate on ratification of the TPP.

FIGURE 1: SUPPORT FOR TPP IN CANADA



⁴ Angus Reid, <http://angusreid.org/trans-pacific-partnership-feb-2016/>



IMPACT OF THE TPP

The TPP will deliver broad impacts, such as increases in GDP, income and exports. There is some variation, however, in the estimates of how large those benefits will be. Modelling by the Peterson Institute for International Economics in Washington, D.C., forecast an annual increase of real incomes in Canada of US\$37 billion, or 1.3 per cent of GDP, by 2030 when the agreement is almost fully implemented. Exports are expected to increase by US\$58 billion annually, or seven per cent of exports. The same estimate predicted a delay of even one year in implementation would represent US\$25 billion in permanent opportunity cost to the Canadian economy, as well as create other risks.⁵

A recent study from the C.D. Howe Institute computed more modest benefits: an increase in real GDP of 0.02 per cent in 2018 and a \$4.3-billion increase in trade with TPP partners by 2035. While finding modest gains for the country as a whole, the C.D. Howe study identified significant benefits for agriculture,

meat (mainly pork and beef), and processed food. Conversely, the beef, canola, and financial and business sectors would be most hurt by Canada not joining the TPP. It found that losses for the auto sector cannot be avoided by staying out of the TPP.⁶

Although these forecasts differ in magnitude because of varying assumptions, one thing is clear: The agreement brings benefits for Canada.

In addition, and perhaps most importantly, the TPP will change the trade relationship among our most important trading partners regardless of whether we ratify. We don't face a choice between change and *status quo*. Our choice is about how we best adapt to change. Do we want to be inside the new trade tent or be on the outside looking in?

If the U.S. ratifies the agreement, then Canada faces two immediate scenarios, as evident in Table A.

TABLE A: IF THE U.S. RATIFIES THE TPP AND...

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⁵ Calculations by Peter A. Petri of the Peterson International Institute for International Economic Policy for the Canada West Foundation from data in *The Economic Effects of the Trans-Pacific Partnership: New Estimates*, Peterson Institute Working Paper 16-2.

⁶ C.D. Howe Institute, *Better in than Out? Canada and the Trans-Pacific Partnership*, April 2016 Available at: <https://www.cdhowe.org/public-policy-research/better-out-canada-and-trans-pacific-partnership>

BENEFIT 1

Tariff reductions for sectors that are important for the West

Tariffs are transparent fees charged by governments on imports to protect domestic producers of goods. For example, Japan imposes a tariff on Canadian beef that ranges from 38.5 to 50 per cent.

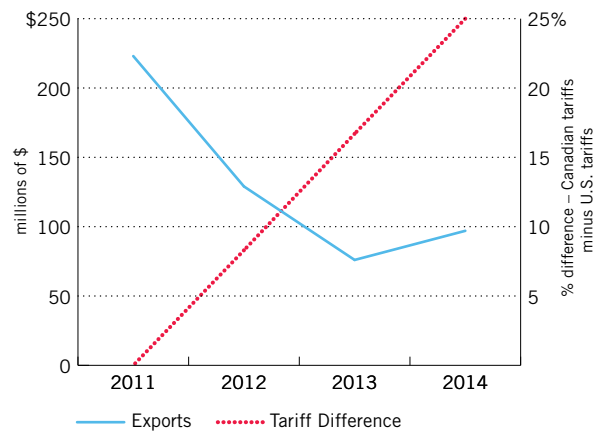
While tariffs on goods are generally low, thanks to negotiations through the World Trade Organization (WTO), some tariffs and tariff rate quotas have persisted in agriculture and specifically the dairy industry in Canada and for wheat and barley in Japan.⁷ Given the importance of agricultural exports for western Canada, reductions in tariffs on agricultural goods is an important benefit of the TPP.⁸

Canada faces the fifth highest average weighted tariff⁹ among TPP countries, at 3.1 per cent. Australia's averaged rate is 1.6 per cent, Chile is 0.6 per cent and the U.S. is 2.3 per cent. The biggest aggregate gains for Canada will be in Vietnam, where our average weighted tariff is 14.9 per cent, followed by Malaysia at 3.7 per cent and Japan at 3.6 per cent.¹⁰

Vietnam and Japan represent western Canada's biggest TPP opportunities. Vietnam is a market new to Canada and has a rapidly growing middle class and limited ability to produce many of the goods western Canada exports. In Japan, reduced tariffs will allow Canadian exports to remain competitive against Australia. Australia recently signed a trade agreement with Japan, which is the world's third largest economy and Canada's fifth largest trade partner.

Reductions in charges for pork and beef are important for western producers. Canada's recent history with pork exports to Korea, as shown in Figure 2, illustrates the risk when tariffs are reduced for our competitors but not for Canada.

FIGURE 2: CANADIAN EXPORTS TO KOREA DECLINE AS KOREAN TARIFFS FAVOUR U.S. PORK



Source: Global Affairs Canada



Sheila Fitzgerald/Shutterstock.com

⁷ A tariff rate quota (TRQs) is a two-tiered tariff used to limit imports and protect domestic producers. Generally when imports rise above a set amount, the tariff increases, most often quite substantially. TRQs were supposed to end with the 1995 Uruguay Round Agreement on Agriculture. TRQs, however, were allowed as a transition for countries to move to simple tariffs. However, 20 years later TRQs remain.

⁸ All agricultural and food exports account for roughly 8 per cent of exports from B.C. and Alberta, 36 per cent of all exports from Saskatchewan and close to 40 per cent from Manitoba. In Alberta, agriculture and food account for roughly 46 per cent of non-oil and oil-related exports.

⁹ Weighted tariff: Weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country.

¹⁰ Peter A. Petri and Michael G. Plummer, *The Economic Effects of the Trans-Pacific Partnership: New Estimates*, Peterson Institute for International Economics Working Paper 16-2, January 2016.

TABLE B: TARIFF REDUCTIONS UNDER THE TPP OF IMPORTANCE TO WESTERN CANADA IN JAPAN AND VIETNAM

<p><i>Wheat</i></p> 	<p>In Japan, feed wheat will be duty- and quota-free upon entry.</p> <p>In Vietnam, tariffs of up to five per cent on all wheat will be eliminated upon entry.</p> <p>Canada will also have access to a Canada-specific quota for food wheat which starts at 40,000 tonnes and grows to 53,000 tonnes within six years. Markups within this country-specific quota will be reduced by 45 or 50 per cent.</p>
<p><i>Canola seed & canola oil</i></p> 	<p>In Japan, tariffs of up to 13.20 yen/kg on canola oil will be eliminated within five years.¹¹</p> <p>In Vietnam, tariffs of five per cent will be eliminated within five years.</p>
<p><i>Beef</i></p> 	<p>Tariffs of 38.5 per cent on fresh/chilled and frozen beef, as well as tariffs of 50 per cent on certain offal in Japan will be reduced to nine per cent within 15 years.</p> <p>Tariffs of up to 50 per cent on processed beef and most offal in Japan will be eliminated within 15 years.</p> <p>Tariffs of up to 31 per cent on fresh/chilled and frozen beef in Vietnam will be eliminated within two years.</p> <p>Tariffs of up to 34 per cent on all other beef products in Vietnam will be eliminated within seven years.</p>
<p><i>Pork</i></p> 	<p>In Japan, 4.3 per cent over-gate price tariff on fresh/chilled and frozen pork cuts and pork offal will be eliminated within 10 years.</p> <p>Over-gate price and below-gate price tariffs in Japan to be eliminated within 10 years for preserved and processed pork.</p> <p>Tariffs of up to 20 per cent on pork products in Japan not currently subject to the gate price system will be eliminated within 10 years.</p> <p>Tariffs of up to 27 per cent in on fresh/chilled and frozen pork in Vietnam will be eliminated within nine years.</p> <p>Tariffs of up to 31 per cent on all other pork products, including sausages, in Vietnam will be eliminated within nine years.</p>

¹¹ This is extremely important in the case of Japan. Dan Ciuriak has noted that this eliminates “tariff escalation” in Japan, which reduces the margin from crushing oilseeds in Canada. When that happens, Canadian producers ship unprocessed canola seeds to Japan and its crushing industry benefits from processing. See for example, Ciuriak, Dan and Jingliang Xiao. 2016. Ciuriak Consulting Research Report, *Canola Market Impacts under Alternative TPP Scenarios*. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2740601

In March 2012, the U.S.-Korea trade agreement came into force. Figure 2 on page 6 shows the impact on Canadian exporters of the tariff reduction for U.S. exporters. For example, frozen pork (a sub-category of pork exports)¹² is a major U.S. and Canadian export. Tariffs on U.S. exports of frozen pork were cut from 25 per cent to 16.7 per cent when the agreement went into effect, to 8.3 per cent in 2013 and to zero in 2014. Canadian pork exports to Korea fell from \$223 million in 2011 to \$129 million in

2012 and \$76 million in 2013.¹³ Joining the TPP gives Canadian exporters access to small but important tariff reductions in specific sectors that otherwise only our competitors will benefit from.

The benefits for these tariff reductions are important to a range of Canadian exporters to TPP markets. A good indication of the competitive picture for western Canada is seen in a comparison of top exports from British Columbia and Chile, a TPP signatory.

TABLE C: CHILE AND B.C. TOP EXPORTS (2014): SIMILAR PRODUCTS, BUT DIFFERENT MARKET ACCESS VIA TRADE AGREEMENTS

Top Exports		Market Access		
Chile	B.C.	Pre-existing Trade Agreements with TPP Countries	Chile	Canada/(B.C.)
Copper/ores	Mineral products	Australia	2009	–
Ores, slag, ash	Wood products	Brunei dar as-Salam	2006	–
Fish (salmon)	Wood pulp	Canada	1997	N/A
Wood pulp	Machinery	Chile	N/A	1997
Wood products	Base metals	Japan	2007	–
Beverages/spirits/wine	Fish and meat	Malaysia	2012	–
Chemicals	Chemicals	Mexico	1998/2004	1994
Gems, Precious metals	Prepared foods/wine	New Zealand	2006	–
Fruits	Fruits and vegetables	Peru	2006/2014	2009
Meat	Machinery and appliances	Singapore	2006	–
		United States	2004	1989
		Vietnam	2014	–
		Total population/ GDP for all trade agreements signed	788 million/ \$27,787 billion	495 million/ \$19,323 billion

Sources: For B.C., Statistics Canada, Canadian International Merchandise Trade Database. For Chile, UN Comtrade Database. Over the past four years, exports of fish from Chile have increased by 95 per cent.

Source: OAS, SCIE database. Government of New Zealand, Ministry of Foreign Affairs and Trade.

¹² Customs line item 0203291000

¹³ Pork is a better example than beef as Canadian beef was banned by Korea during this period of time because of concerns related to reports of Bovine Spongiform Encephalopathy (BSE) disease in Canada.

BENEFIT 2

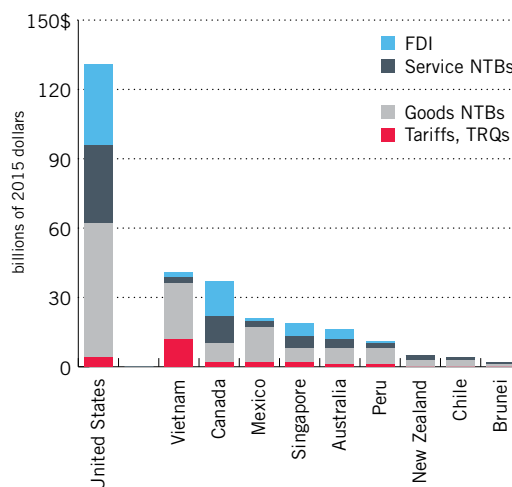
Reductions in non-tariff barriers (NTBs)

Under the TPP, Canadian exporters will benefit from the reduction of non-tariff barriers (NTBs). These are the non-financial and often non-transparent measures that countries use in place of tariffs to protect domestic industries from foreign competition. These include sanitary and health measures that protect domestic industries more than consumers; product labelling and certification requirements that are purposely more difficult for foreign firms to meet; lengthy and unpredictable customs procedures; or, just plain old-fashioned red tape. While NTBs don't prevent Canadian products from entering foreign markets, they restrict sales and add costs to an even greater degree than tariffs.

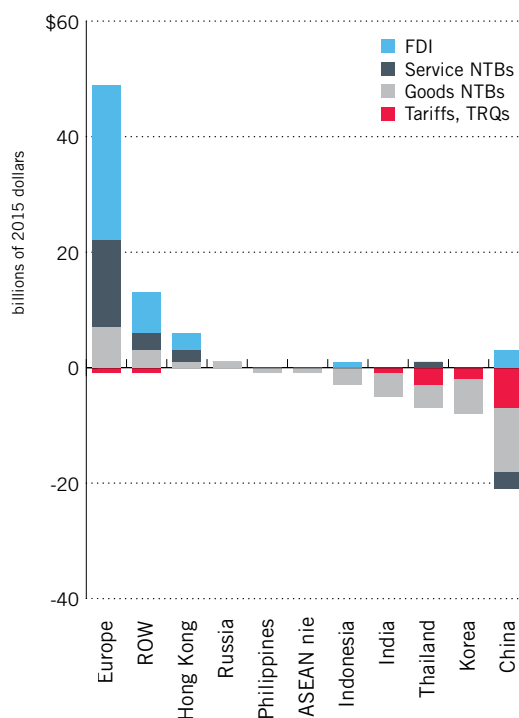
There is consensus among trade economists that the benefits of reductions in NTBs are more significant than benefits from tariff reductions.¹⁴ Figure 3 shows estimated tariff effects versus NTB effects in TPP countries, compared to neighbouring countries that are not part of the agreement. Benefits from NTB reduction fundamentally drive the gains from TPP for Canada and others. The benefits from reductions in NTBs, unlike direct benefits from tariff reductions, are difficult to quantify. Even defining NTBs is problematic. Many barriers – especially health and safety requirements or cultural requirements – are essential to a functioning market economy, even though they may also restrict trade flows. Distinguishing between regulations designed to protect the public and those designed to impede trade is difficult. Public concerns over bovine spongiform encephalopathy and genetically modified food products for example, led to trade barriers that restricted imports well beyond what was required to satisfy public safety needs.

FIGURE 3: TPP EFFECTS AND THEIR COMPOSITION, 2030

TPP COUNTRIES



NON-TPP COUNTRIES



ASEAN = Association of Southeast Asian Nations; nie = not included elsewhere; ROW = rest of world

Source: Petri and Plummer, *The Economic Effects of the TPP*, 2016

¹⁴ See, for example, the recent research from the United Nations Commission on Trade and Development. Available at <http://unctad.org/en/Pages/DITC/Trade-Analysis/Non-Tariff-Measures.aspx>

There are several NTB-related advantages to Canada joining the TPP. Two are compelling:

01 Within the TPP, non-tariff barriers are more prevalent among countries with which Canada does not already have trade agreements.¹⁵ Provisions in the NAFTA and the Pacific Alliance rules¹⁶ have kept NTBs in countries on this side of the Pacific relatively low.¹⁷ Thus, for Canada, there are substantial benefits to gaining market access to Malaysia, Vietnam, Singapore and Japan under the TPP. This is a big win for Canada as the previously lopsided benefits favouring these countries are now evened out. A Canadian company seeking to enter the Vietnamese market, for example, would now face the same barriers as a Vietnamese company seeking to enter the Canadian market.

02 The TPP will require greater transparency in the use of NTBs on agricultural trade, specifically trade of genetically modified organisms (GMOs).¹⁸ The TPP addresses GMOs in the chapters on market access and intellectual property. The agreement does not reference GMOs in the chapter on phytosanitary rules or safety rules for agricultural products. By treating GMOs as purely market access and intellectual property issues – and not as a health and safety issue – the agreement to some degree redirects discussion of GMOs. It does recognize that different countries have different levels of risk aversion to GMOs and

it does not require a convergence of practice. Yet it does require greater transparency of policies and justifications for sanitary and phytosanitary measures, and that certainly helps the cause of GMO proponents.²⁰

Chapter 7 of the TPP on sanitary and phytosanitary measures further states that any health and safety measures on agricultural products must conform to “relevant international standards and that deviations from these be undertaken only on the basis of documented and objective scientific evidence.”²¹ International bodies do not have definitive evidence that GMOs pose a threat to human health. The absence of such proof severely constrains the ability of TPP countries to impose limits on the trade of GMO products. Of course, this could change if new evidence is accepted by the WTO and World Health Organization. Further, none of this will likely alter the beliefs that inform the consumer buying habits, which in turn drive business purchasing decisions.

The rule prohibiting the use of NTBs to limit trade in GMO crops is a small victory for Canadian and U.S. food exporters. In 2009, GMO canola was grown on approximately 90 per cent of the 6.6 million hectares dedicated to canola cultivation in western Canada.²² In Australia, GMO canola accounts for 22 per cent of total canola planted in Western Australia, Victoria and New South Wales.²³ This means that Australia will no longer have an advantage in the TPP markets for canola as a result of its much greater non-GMO production.

¹⁵ Peter A. Petri and Michael G. Plummer, *The Economic Effects of the Trans-Pacific Partnership: New Estimates*, Peterson Institute for International Economics Working Paper 16-2, January 2016.

¹⁶ Pacific Alliance trade integration group includes Mexico, Peru, Colombia and Chile

¹⁷ In addition, and arguably more important in the case of the NAFTA, have been bilateral working groups like the Canada-U.S. Regulatory Compliance Council.

¹⁸ As noted in a Peterson Institute for International Economics analysis, the agreement does not reference GMOs at all in chapter 7 on sanitary and phytosanitary measures and instead deals with GMOs only in chapter 2 on market access and chapter 18 on intellectual property.

¹⁹ Peterson Institute for International Economics, *Assessing the Trans-Pacific Partnership Volume 1: Market Access and Sectoral Issues*, PIIE Briefing 16-1, February 2016.

²⁰ From email exchange with Cullen Hendrix, Associate Professor, School of International Studies, University of Denver

²¹ International standards such as the Codex Alimentarius and WTO SPS agreement

²² Agriculture and Agri-Food Canada, *GM Canola: The Canadian Experience*, 2011.

²³ Monsanto Australia, *Farmers to Plant Largest GM Canola Crop Yet*, June 2015. Available at <http://www.monsanto.com/global/au/newsviews/pages/farmers-to-plant-largest-gm-canola-crop-yet.aspx>

BENEFIT 3

Offers new pathways for diversification by opening trade in services

The TPP goes beyond trade in goods. It also covers trade in services, intellectual property and movement of people. And these are increasingly important areas of modern trade. The Organization for Economic Cooperation and Development (OECD) notes that “services account for about 75 per cent of GDP, 80 per cent of employment and two-thirds of foreign direct investment (FDI) inflows in OECD countries.”²⁴ Not surprisingly, then, the major benefits of the TPP are found in the reduction of non-tariff barriers and extension of rules to enable trade in services. Costs of barriers to trade in services had until recently been difficult to quantify because there were insufficient data. But recent work by the OECD shows that barriers to trade in services are quite high in Asia.

The importance of services for global growth has led to attempts by the United States to create a global Trade in Services Agreement (TiSA) involving 23 countries, including the European Union (EU) and eight TPP countries.²⁵ There is an active debate about the relative merits of the TPP's treatment of trade in services versus that of the TiSA. The TPP, however, includes countries that the TiSA does not and more importantly, the TPP is in the process of ratification while the TiSA is in its 17th round of negotiation, with more talks scheduled for this year – all with no end in sight.

All of this is important for western Canada in particular, because diversification is a major policy theme in Canada and especially in the West.

Arguably, one of the best opportunities for the West to grow its exports beyond commodities is to look to export the services tied to the production, management and regulation of commodity production. In this, Canada will compete with countries like Australia and the United States for markets like Malaysia and Vietnam. In essence, the TPP provides a jump start for Canada to prepare for a growing trade in services within a trade bloc that provides substantial room for liberalizing trade in services.

For Canadian businesses, the markets for services are more geographically diversified than those for goods. The U.S. is the largest market for Canadian services, but its share of service exports is 50 per cent while its share of goods exports is more than 75 per cent. A larger share of service exports go to Europe and emerging markets in the Asia-Pacific region.²⁶ In Asia, services account for between 37 to 45 per cent of GDP in the middle income countries of the Association of Southeast Asian Nations (ASEAN) and China. The services sector in these countries, more importantly, still has room for growth, with the introduction of new technologies and new providers.²⁷

Although Canada's overall trade in services has been declining, trade in commercial services such as banking, insurance and telecommunications has been largely holding steady.²⁸ According to the Business Council of British Columbia (BCBC), the relatively better recent economic performance of that province can be attributed to the diversification of the economy and particularly growth of service exports, aided by the low Canadian dollar.²⁹

²⁴ OECD Trade Policy Papers, *The Impact of Services Trade Restrictiveness on Trade Flows: First Estimates*, No. 178, OECD Publishing, p. 6. Available at <http://dx.doi.org/10.1787/5js6ds9b6kjb-en>

²⁵ The U.S., Mexico, Peru, Chile, Australia, New Zealand, Japan and Canada. Absent from the agreement are TPP signatories Singapore, Malaysia, Vietnam and Brunei.

²⁶ Conference Board of Canada, *Spotlight on Services in Canada's Global Commerce*, 2015, p. 9.

²⁷ OECD, *Economic Outlook for South East Asia, China and India*, 2014.

²⁸ Trade in services includes government services, transportation and travel/tourism in addition to commercial services. Travel and tourism have accounted for the largest drop in the services trade for Canada followed by government and transportation. See: <http://www.statcan.gc.ca/daily-quotidien/151008/cg-c001-eng.htm>

²⁹ Business Council of British Columbia, *BC Economic Review and Outlook*, 2016.

Trade in Services

Dodging a bullet

For Canada, trade in commercial services is a steadily growing segment. It is also an important yet often forgotten component of Canada's trade with the U.S. Canada enjoys hard-to-imitate advantages of geographic proximity, cultural alignment, language and long-standing integration. Services are also a critical path for diversifying western Canada's commodity-driven economy – from the export of commodities to the export of services tied to the production and management of commodity production.

Trade in commercial services, such as engineering, lawyering and banking, is a distinguishing feature of the TPP. The agreement has trade in services chapters, plus: intellectual property, temporary movement of business persons, investment, telecommunications, and electronic commerce. All of these are essential to the production of ideas and activities that underlie the provision of services in a country by a firm based in another country.

Chapter 10 of the TPP opens cross-border trade in services and allows greater competition from other TPP countries for Canadian firms in the U.S. market.

A key component of higher-value trade in services is being able to move executives, technicians and workers to provide services. The U.S., however, is the only country that has exempted itself from the related Chapter 12 on temporary entry of businesspersons. In essence, companies are free to bid on service contracts or opportunities in the U.S., but they will not have facilitated access to work or even simple entry visas. Canadians will continue to enjoy easier access to the U.S. through NAFTA visas and the NEXUS trusted traveller program.

This is a benefit for Canada and a disadvantage for other TPP countries. Winning a contract is often only half the battle; fulfillment is the other.

This is likely only a temporary reprieve. At some point, the U.S. is expected to liberalize the temporary entry of business travelers into the country. Canada has a window in which to prepare for the greater competition that will come with a U.S. that is more open to other TPP nationals entering the market.

FIGURE 4: CANADIAN SERVICE AND MERCHANDISE EXPORTS (2000-2014)



Source: UN Services Database

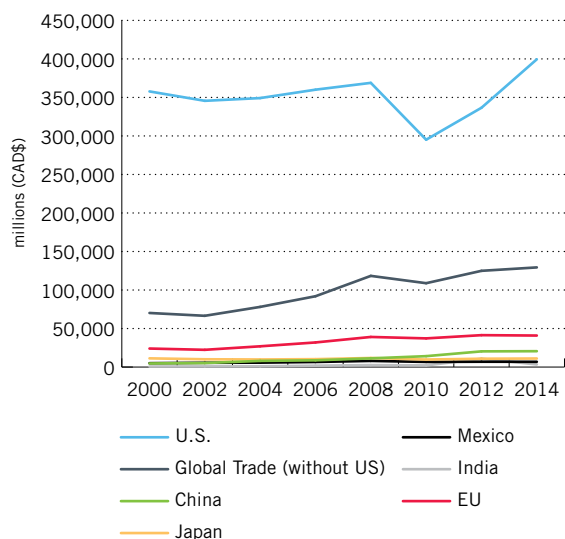
BENEFIT 4

Canada participates in an updated NAFTA

The TPP basically updates the NAFTA and extends it to nine other countries. If Canada does not ratify, the irony will be that the TPP countries with whom Canada will compete for share of the U.S. market will have better rules for accessing the U.S. than Canada, even though Canada is a NAFTA partner.

The U.S. is Canada's most important trading partner and by extension the NAFTA is Canada's most important trade agreement. Any change to rules for trade with the U.S. or composition of the NAFTA has immediate implications for Canadian exports.

FIGURE 5: CANADIAN EXPORTS TO KEY MARKETS (2000-2014)



Source: Statistics Canada, CANSIM 228-0069 and Canada West Foundation

"The TPP is the first major trade deal that tackles e-commerce as we know it today. It not only updates much of the North American Free Trade Agreement; it also promises to improve access to global markets for small and medium-sized businesses."

Andrea Stairs, managing director, eBay Canada

The NAFTA gave Canada unique access to the U.S. market, but the agreement has not been updated since it went into effect in 1994. U.S. domestic politics have frustrated every effort to update it. This was part of the impetus for the U.S. to join the TPP and use it as a back door to update the NAFTA.³⁰

While the NAFTA has remained unchanged, the competitive environment, technology, laws and demographics have evolved. Competitors in other trade blocs are using modern trade rules to close their competitiveness gap with North American exporters. Not updating the agreement for more than two decades is akin to a business not updating its core operational policies, like HR or procurement. Companies and trade blocs that can't adapt become less competitive.

The rise of the internet and digital commerce is one example of a major change to business and international trade. When the NAFTA was signed, the World Wide Web was in its infancy and commercial sectors like e-commerce, digital entertainment and online banking did not exist. A recent study by the McKinsey Global Institute found that digitization of commerce underlies all aspects of growth in modern economies. Digital technologies reduce production and distribution costs and create new, purely digital goods and services. The study also found "that cross-border e-commerce has grown to represent more than 10 per cent of trade in goods in less than a decade."³¹ Online marketplace eBay Canada reports that 99.8 per cent of its Canadian commercial sellers export and of that group 99.5 per cent export to TPP countries.³²

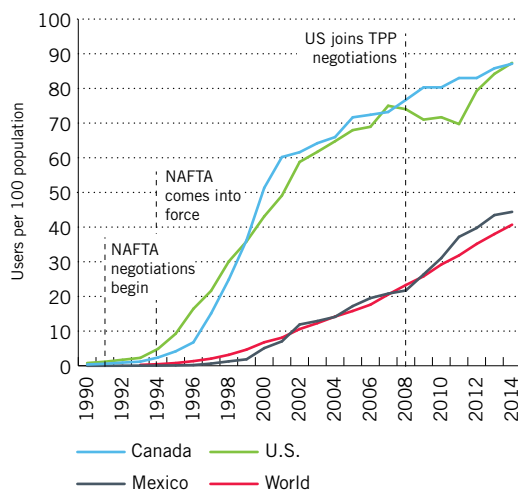
³⁰ New Yorker, *Why does Obama want this trade deal so badly?* Available at <http://www.newyorker.com/news/daily-comment/why-does-obama-want-the-trans-pacific-partnership-so-badly> and http://www.huffingtonpost.ca/carlo-dade/canada-tpp_b_7684612.html

³¹ McKinsey Global Institute, *Global flows in a digital age*, April 2014.

³² "Why the TPP is the right direction for e-commerce." Andrea Stairs, managing director, eBay Canada. Financial Post, January 7, 2016. <http://business.financialpost.com/fp-comment/why-the-tpp-is-the-right-direction-for-e-commerce>. A counter point to this view is offered by Michel Geist of the University of Ottawa. <http://www.michaelgeist.ca/2016/01/the-trouble-with-the-tpp-day-17-weak-e-commerce-rules/>. But a more in-depth, legal, opinion on the impacts on Canada supports the eBay position. See: <http://www.lexpert.ca/article/going-trans-pacific-part-ii/?p=&sitecode=lex>

Figure 6, from eBay Canada, shows the digital density of commercial selling activity by Canadians on its platform. It paints a jarring portrait of how out of sync the NAFTA is with the rise of e-commerce and digitally enabled trade. Though there is some debate over the full impact of the e-commerce and small- and medium-sized enterprises (SME) chapters of the TPP, this much is known: The TPP makes an attempt to incorporate these issues into the rules of a trade bloc that can serve as an easy basis for further action and these rules will come into effect as soon as the TPP is ratified.

FIGURE 6: E-COMMERCE, INTERNET USAGE (PER CAPITA) AND THE NAFTA



Source: World Bank

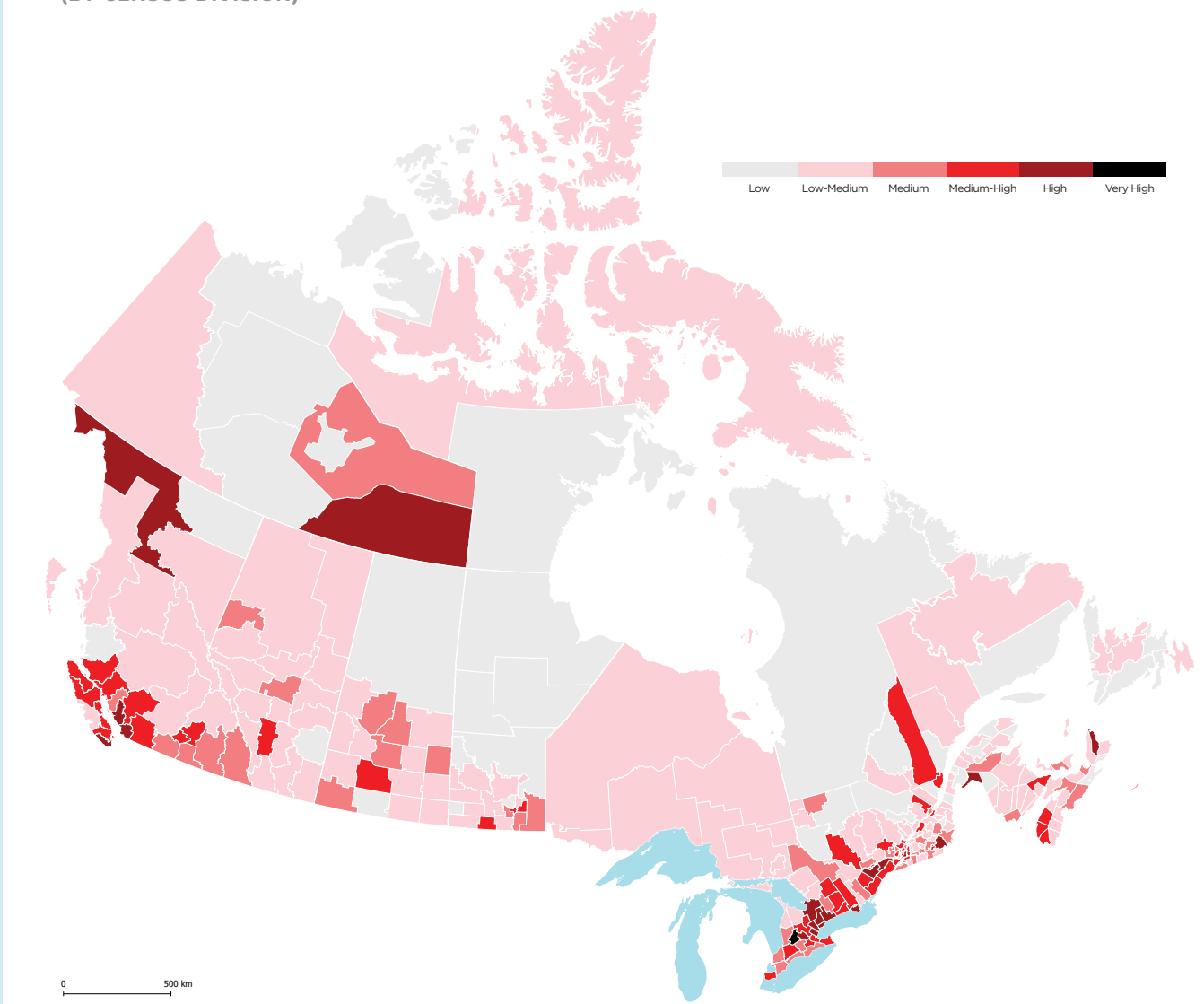
A hint of the importance, or potential, of digitally enabled commerce is shown in Figure 7 with data from eBay Canada on the digital density of online

commercial selling in Canada. Of particular interest is how well-represented western Canada is in the map. Given how well small online businesses in the West have done under current rules, it is reasonable to expect that, with improved rules covering the U.S., Australia and other key markets for Canadian online retailers, these business should fare better under the TPP. Digitally enabled trade is an area where more research is needed.

Unlike the NAFTA, the TPP has a means to update itself. The agreement contains provisions for regular consultations – in some cases mandatory – on updating the agreement. This is a benefit, should Canada join and an enhanced risk if it does not. There are future, unforeseeable risks as the agreement is updated. Just because something is not dealt with in the TPP today does not mean it will not be dealt with in the future. If Canada does not ratify the agreement, then its exporters would face a constant threat from the possibility that future changes to the TPP could give firms in TPP countries advantages over Canadian firms for trade with the U.S. and other markets.

The combination of an ability to update the agreement as needed, a number of markets from which to source inputs for producing goods, larger markets and unified rules all mean that this new trade bloc created by the TPP presents advantages over the NAFTA and bilateral agreements that Canada has signed. Conversely, these advantages also make the cost of not ratifying more damaging as Canada's competitors would gain advantages that go beyond those in a simple bilateral agreement.

**FIGURE 7: eBAY CANADA DIGITAL DENSITY:
COMMERCIAL SELLING ACTIVITY PER CAPITA
(BY CENSUS DIVISION)**



Source: eBay Canada

BENEFIT 5

Leapfrogging the bilateral agreement backlog

Canada needs to catch up to competitors like Australia, Chile and New Zealand in the race to sign agreements around the Pacific. The TPP will render the fight for signing bilateral agreements mostly irrelevant.

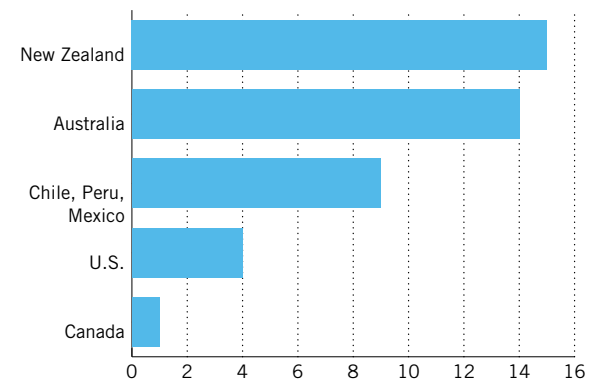
Should Canada opt not to ratify the agreement, then TPP members will have less appetite to sign separate bilateral agreements with Canada. TPP members will have access to the North American market through the U.S. and Mexico, markets of 318 million and 122 million people, respectively. A separate agreement for a market of only 35 million will not be on the top of anyone's to-do list. The TPP will shift the balance of negotiating power and Canada would have to offer a lot to draw countries like Japan to the table.

The TPP has also, in essence, skimmed the cream of the crop of desirable trade partners. The agreement is a reality check for countries serious about making concessions to open their markets to foreign trade. The countries in the region that are most serious about trade on terms that are most comfortable for Canadian firms are part of the TPP. Countries that are not part of the agreement are not. The countries that are part of the TPP are the ones with whom new trade negotiations could be concluded most rapidly and successfully. These are also the countries with whom business would arguably have the least difficulties.

Further, the TPP has a long list of countries on record as interested in joining at the next opportunity. These include Korea, the Philippines, Taiwan, Thailand and Indonesia. With the exception of Korea, which is the only Asian economy to have a trade agreement with Canada, opening negotiations for a bilateral agreement with Canada may be a good hedge if they are unable to join the TPP. But should these countries be able to join the TPP, their desire to conclude negotiations with Canada would be sharply reduced. This makes the bilateral path look unpromising.

Many of these risks disappear if Canada joins the TPP. Inside the TPP, Canada will have a fighting chance to expand its exports. Outside the agreement, Canada will struggle to negotiate bilateral agreements with TPP members, countries that no longer need such agreements with Canada or other countries that are focused on joining the TPP.

FIGURE 8: CURRENT TRADE AGREEMENTS WITH ASIAN AND OCEANIA ECONOMIES



Source: Canada West Foundation

BENEFIT 6

Benefits grow as the NAFTA expands to reach 40 per cent of global GDP

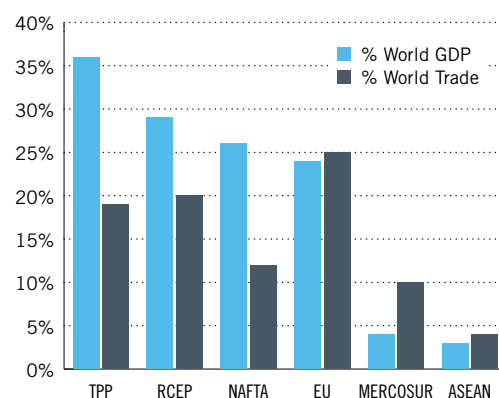
The TPP presents a major step forward in the architecture of global trade by creating a mega-regional trade agreement.³³

Figure 9 shows how mega-regional agreements build on the success of regional trade agreements by expanding their scope and reach.

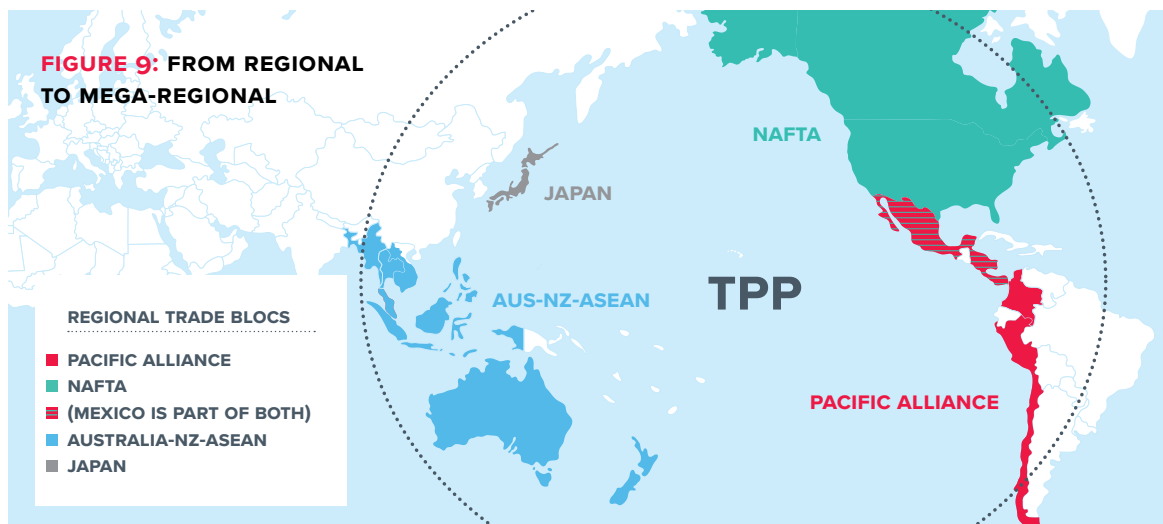
Trade agreements range in size and benefits. At one end are bilateral agreements, like the Canada-Korea agreement. One-off bilateral agreements tend to be easier to negotiate because there are fewer parties. The downside is that negotiating a number of country-by-country bilateral agreements is very time-consuming. At the other extreme are global agreements, like the WTO, involving trade provisions agreed to by all 162 countries. Such agreements are extremely difficult to negotiate because of the sheer number of members. For example, the most recent WTO Doha round of negotiations³⁴ began in 2001 and is not yet concluded.

In between are regional and mega-regional agreements, which tend to build upon pre-existing bilateral agreements among members to promote deeper integration of rules, procedures and sometimes institutions. This lowers costs and friction in moving productive inputs, like goods, information and people, and make the trade bloc more competitive. The TPP will subsume several of these regional agreements, including the NAFTA. This is a major advance over past trade agreements. Figure 10 shows the share of global trade and GDP covered by the TPP.

FIGURE 10: RELATIVE IMPORTANCE OF MAJOR TRADE BLOCS: SHARE OF WORLD GDP & EXPORTS³⁵



Source: World Bank, World Development Indicators 2015



³³ The EU, which covers 25 per cent of world trade was the first mega-regional agreement.

³⁴ The Doha Round is the latest round of trade negotiations among the WTO membership. Its aim is to achieve major reform of the international trading system through the introduction of lower trade barriers and revised trade rules.

³⁵ RCEP = Regional Comprehensive Partnership (ASEAN, Australia, China, India, Japan, Korea, New Zealand). MERCOSUR full members are: Argentina, Brazil, Paraguay, Uruguay and Venezuela

Large multilateral agreements, such as the TPP, provide a single set of rules

The TPP will allow companies to access the benefits of a single set of rules for trade with 40 per cent of the world's GDP. One set of rules makes compliance simpler and provides economies of scale. The rules for this mega-regional agreement are based largely on familiar NAFTA rules.³⁶ When firms, especially smaller ones, are overwhelmed by the complexity of paperwork and regulation across countries, they tend to fall back on the most broadly applied rules, like WTO, which provide much lesser competitive benefits.

Large multilateral agreements multiply partnership opportunities

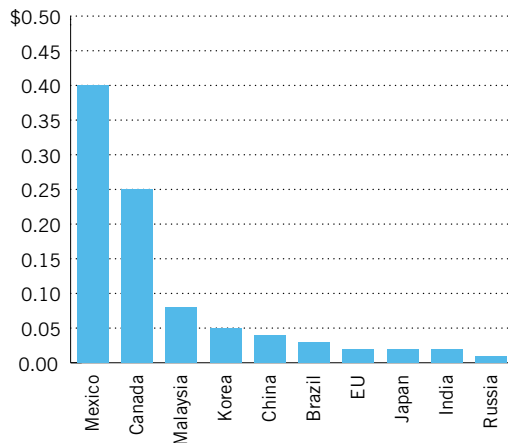
One of the most valuable benefits of multi-party agreements is derived from the opportunities to participate in integrated supply chains and partner with former competitors to supply markets more efficiently.

NAFTA provides a good example of what can be possible within a trading block. NAFTA facilitates integrated supply chains among the three partners. By producing goods and services together, the three countries are able to combine the competitive advantages of the three countries to sell goods and services to other countries. It is a truism that there is no longer such a thing as a "Canadian" or "U.S." car; there are North American cars.

Figure 11 shows just how integrated the NAFTA has made the three countries by ranking the value of U.S. content in its imports from other countries. For every dollar of goods or services the U.S. imports from another country, a certain portion of that good or service contains inputs that the exporting country purchased from the U.S.

³⁶ This is the contention of the U.S. Trade Representative in its argument that the TPP essentially updates the NAFTA. Available at: <https://ustr.gov/tpp/#upgrading-nafta>

FIGURE 11: VALUE OF U.S. CONTENT IN IMPORTS FROM SELECT COUNTRIES (USD)



Source: National Bureau of Economic Research Working Paper No. 16426. Cambridge, MA, 2010.

The TPP multiplies these opportunities to expand supply chains through source inputs for products sold across the TPP markets. For example, the rules of origin tied to bilateral agreements limit the ability of firms with supply chains that stretch to other countries to take advantage of the agreement. Products made with inputs from other countries generally do not qualify for lower tariffs or other advantages under bilateral agreements. These benefits, which exist under regional agreements like the NAFTA, are expanded under mega-regional agreements.

The mega-regional agreements also increase the pool of potential supply, sales and production chain partners for Canadian companies. A response to the increased competition for new TPP opportunities is to see competitors as potential new supply chain allies to sell to Asian markets. This could be a significant non-traditional benefit of the agreement for smaller and medium exporters.

Canadian participation in international supply chains has been understated. Although foreign affiliates have been a major component of Canadian export success,

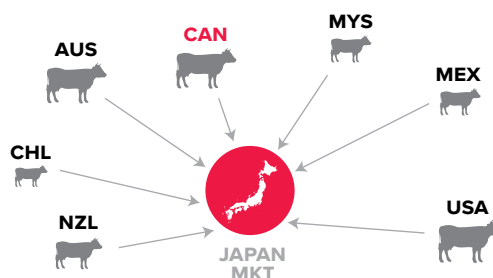
their importance was underestimated because sales by subsidiaries, joint-ventures and partners of Canadian companies are not recorded among Canadian exports. Recent research by Export Development Canada (EDC) shows that sales by foreign affiliates of Canadian companies have been growing at double the rate of direct export sales and are almost equal to the value of traditional exports. This phenomenon is more prevalent among large enterprises. The TPP has the potential to increase the ease – and therefore the prevalence – of these types of arrangements among small- and medium-sized enterprises (SMEs). Just as larger companies establish foreign affiliates, SME exporters can develop partnerships or joint-ventures in TPP countries. Partners with on-the-ground experience and connections could significantly lower the risk and cost of entry for SME exporters new to distant markets.

The case of the partnership between Sarto Sheep Farm of Manitoba and Integrated Foods of New Zealand to create Canada Sheep & Lamb Farms is an example of what can be done. It is an idea that made sense before the TPP was negotiated and makes even more sense should the agreement take effect.

A risk for Canada with this agreement is that other TPP countries can develop more integrated supply and production chains with the U.S. and Mexico, and thus supplant Canada's role in integrated North American supply and production chains. The fact that TPP member Malaysia is in third place in the integration index (Figure 11) underscores the importance of Canada ratifying the TPP and the risk if it does not.

Beef illustrates an important qualifier about the TPP tariff reduction benefits for Canada. TPP membership includes five of the top 10 global exporters of beef.³⁷ Thus, reductions on beef tariffs by Japan, for example, are shared with the U.S., Australia, Mexico and New Zealand.

FIGURE 12: OPPORTUNITIES COME WITH COMPETITION FOR BEEF PRODUCERS IN THE TPP



TURNING COMPETITORS INTO PARTNERS

In 2014, Sarto Sheep Farm of Manitoba and Integrated Foods of New Zealand partnered to create Canada Sheep & Lamb Farms. This new organization combined the production expertise and market knowledge of the New Zealand firm with the lower production costs and genetic advantages of the Canadian partner. Differences in peak breeding seasons, enabling more consistent year-round production of fresh lamb, made the partnership attractive.

Integrated Foods had initially considered an outright purchase of a Canadian entity or establishing a new operation. Instead, it decided

on partnership because it would bring in Canadian expertise at a lower cost. The agreement calls for Integrated Foods to fund and build a lamb processing plant in western Canada for the Canadian and export markets. It will also increase herd size in Canada.

For the New Zealand producer, cheaper land in Canada was a major factor in attracting investment. Growth in the dairy industry in New Zealand is driving up land prices there. Expansion to year-round fresh lamb supply and improved processing will benefit Canadian companies that have been unable to interest major retailers in carrying Canadian lamb.

Under the TPP, the partnership would make even more sense. With common rules of origin for shipping lamb into TPP markets, Integrated Foods would be able to seamlessly integrate Canadian production into its distribution networks in TPP countries. The ability to easily move workers from Canada and New Zealand into markets will help with sales and promotion. Sharing knowledge and investments will also receive greater protection under the agreement.

Interview with Pat Smith, President of Canada Sheep & Lamb farms, Jan 28, 2016 and Western Producer, *N.Z. firm invests in Man. sheep farm*, March 14, 2014.

³⁷ Australia (2nd), U.S. (4th), New Zealand (5th), Canada (7th) and Mexico (10th)

BENEFIT 7

Getting the best deal

Along with the defensive and offensive trade reasons for Canada to ratify the TPP, there is another critical argument. The agreement contains 130 pages of Canadian exemptions, carve-outs and adjustments, including protecting set-asides for First Nations, operation of Crown corporations at the federal and provincial levels, cultural industries and, essentially, continuation of supply management in the dairy industry. If Canada chooses not to ratify the agreement, it is highly unlikely that all of these exemptions would be back on the table should Canada try to join later.

It is understandable that some Canadians have real concerns and are unhappy with the agreement. This is not unique to Canada. In each TPP country, the agreement faces criticism from certain sectors and interests. Every country had to make sacrifices and do some horse-trading to get the best deal. A country's ability to do this depends on two factors – power and timing. Large economies like those of the U.S. and Japan obviously had more weight in negotiations than the economies of Singapore or Brunei. Timing is also

Every country had to make sacrifices and do some horse-trading to get the best deal.

important. Being part of the formation of a trade bloc gives bargaining power that is not available to smaller economies which try to join later. This is the case for Canada. Though the country is a G7 economy, it is simply not that important a market in the TPP context. Access to the TPP is about access to the U.S. and Japanese economies, not to the Australian or Canadian markets. Other TPP countries had reason to make concessions to Canada as part of the cost of gaining enough signatories to launch the new trade bloc. Once the bloc is up and running, the need to make those concessions is no longer there. Countries like New Zealand and even the U.S. that are unhappy with having made certain concessions to Canada in the first round will certainly not want to, nor will they have to, extend such concessions to Canada at a later date.

The bottom line is that Canada's negotiating power is at its best right now.



PLAN B

WHAT SHOULD CANADA DO IF THE U.S. DOES NOT RATIFY?

There is a real risk that the TPP agreement will not meet its minimum conditions for coming in to force: At least six signatories to the agreement representing 85 per cent of the GDP of the entire bloc must ratify the agreement. This means that both the U.S. and Japan must ratify it. While Japan is expected to ratify, there is much less confidence in the U.S., where the leading presidential candidates from both parties have spoken against the agreement.

If the agreement dies, then Canada will be back to being left with just one agreement across the Pacific. New competition in the U.S. market will also be reduced. If the TPP fails, then it seems likely that updating the NAFTA will also likely be off the table, except for specific initiatives, like improving trade infrastructure.

Could Canada realize any of the TPP benefits even if the agreement does not come into effect? There are four options that Canada could pursue to salvage gains from the TPP negotiation process:

01 Reprogram resources at the Ministry of

International Trade. At the federal level, the first priority would be to refocus efforts on a trade agreement with Japan, building on whatever is useful from the TPP negotiations. In terms of trade in goods, Japan was the major prize for Canada. Canada has eight active trade agreement negotiations, which included Japan and Singapore. These negotiations were put on hold with the TPP as both countries are also

part of the TPP. Should the TPP not come into force, resuming these negotiations would be low-hanging fruit and a logical step. Canada is also considering opening negotiations with China. To devote the necessary resources to trade negotiations in Asia, including with China, Canada will have to redirect resources that it may be devoting to negotiations with less important partners. Talks with the Caribbean Community and Common Market (CARICOM – one per cent of Canada's trade), the Dominican Republic and the Central American countries, for example, have all seen little progress.

02 Look to an alliance on this side of the Pacific.

Canada has been an active participant in the Pacific Alliance – a trade integration group composed of Mexico, Colombia, Peru and Chile. Canada has trade agreements with all four, three of whom are also parties to the TPP, and Canada has been active in the group since its founding. If the TPP fails, then Canada could try to reopen discussions to join the Alliance as a full member. As such, it could build and expand supply and value chains for trade with Asia, which is the *raison d'être* for the Pacific Alliance. Rationalizing Canada's series of bilateral agreements with the Alliance countries into one set of rules would create a new large-scale, multi-party regional trade agreement that would provide some of the benefits that would be expected under the TPP. This will do little to realize the Asian gains for Canada in the TPP

but as a Plan B it would offer something. Pacific Alliance countries also have trade agreements and strong connections with Asian markets that could benefit Canadian firms if they had access to Alliance trade enhancing mechanisms, like rules of origin and trade facilitation services.

The difficulty that Canada has had in closely integrating with the Alliance is the group's insistence on visa-free travel among its members. The TPP chapters on trade in services and temporary movement of business people, agreed to by Canada and three members of the Alliance, may offer a basis to revisit the issue. Another issue that Canada faces is that the Alliance conducts all business in Spanish. It will be a challenge for Canada to find government officials in ministries other than Global Affairs, e.g., Agriculture Canada and Transport Canada, to enable Canadian participation in Alliance working groups. This would be a non-issue for the U.S., which might also pursue this strategy if the TPP fails. The U.S. has bilateral agreements with all Alliance countries and an expanded agreement between the U.S. and the Pacific Alliance countries may be able to be structured to avoid the need for congressional approval. If the U.S. pursues this strategy as a response to its inability to ratify the TPP, Canada should be ready to follow suit.

03 Look to introduce partnership facilitation services for Canadian SME exporters. The recent case of New Zealand's investment in lamb production in Manitoba is an intriguing example of the importance of new and non-traditional supply chains to help Canadian SMEs enter new markets. Research from EDC shows that larger Canadian companies are taking advantage of affiliate relationships with either subsidiaries or

partnership for market access. Thinking about how to bring opportunities for foreign partnership to enter new markets to Canadian SMEs, beyond the traditional pathway of partnering with large Canadian companies, is something that needs further investigation. If warranted, new initiatives and support programs should be developed. While this idea makes more sense under the TPP, it still makes sense without the agreement, as shown by the Sarto Sheep Farm example.

04 Use the time to prepare for an opening of the U.S. market. Work that is done on analyzing new competitive challenges from the TPP to Canada's trade with TPP countries would also serve as the basis for identifying areas to lay out a future work program on protecting trade with the U.S. This analysis of TPP impacts on Canadian trade with the U.S. may also be useful to Mexico. Even though updating NAFTA may be off the table, specific issues, such as the attempt to improve cross-border trade infrastructure through the Beyond the Border initiative and enhancing the work of the regulatory co-operation council, have proven viable. It may be possible to bring these ideas forward, given recent improvements in relations between the three North American countries and a failure of the TPP may give impetus to doing so.

NOTES

THE CENTRE FOR TRADE & INVESTMENT POLICY
CHAMPIONS THE PROFITABILITY OF OUR EXPORT ECONOMY
BY SEEKING WAYS TO ENSURE ACCESS TO MARKETS
AND SECURING FOREIGN CAPITAL
WHILE PROTECTING CANADIAN INTERESTS.