Advantages and Disadvantages for Canada of Multilateral, Regional and Bilateral Trade Agreements

Notes for comments before the
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I should like to thank the Senate Committee on Foreign Affairs and International Trade for the opportunity to comment on the issue of Canada's trade policy options.

Canada is at an historic juncture with regard to trade policy. The Canadian Parliament will be considering ratification of the second largest bilateral agreement that Canada has ever signed, the Comprehensive Economic and Trade Agreement (CETA) with the European Union, and the largest regional trade agreement it has ever signed, the Trans-Pacific Partnership (TPP) agreement with 11 parties circling the Pacific Rim. Looming ahead is the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union, which would have significant ripple effects throughout the trading system.

The multilateral option is off the table. The WTO Ministerial Conference in Nairobi in December 2015 sounded the death knell of the Doha Development Agenda. While the Ministerial reaffirmed the centrality of the WTO to trade negotiations and global trade rule-making, it had the telling statement:

> "We recognize that many Members reaffirm the Doha Development Agenda, and the Declarations and Decisions adopted at Doha and at the Ministerial Conferences held since then, and reaffirm their full commitment to conclude the DDA on that basis. Other Members do not reaffirm the Doha mandates, as they believe new approaches are necessary to achieve meaningful outcomes in multilateral negotiations. Members have different views on how to address the negotiations."

Such ruptures are usually papered over in Ministerial Declarations with "constructive ambiguity". This was not the case at Nairobi.

The reason is clear. Trade and geopolitics have always been joined at the hip. The predecessor of the WTO – the General Agreement on Tariffs and Trade or GATT – emerged when the United States declined to ratify the Havana Charter that would have created the International Trade Organization (ITO) as the third leg of the Bretton Woods institutional framework. The GATT which stood in the place of the ITO excluded the communist bloc and was in effect an instrument of Cold War geopolitics.

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Today, geopolitical rivalry is again shaping the international trade agenda. The issue today is not so much traditional tariff reductions but writing the rules for international commercial relations.

President Obama has said that, through TPP and TTIP, his Administration is seeking to implement the US value system in trade conditions. In the 2015 *Report of the U.S. President's Economic Council*, President Obama states: "…new trade agreements would … ensure that all countries are playing by the same, fair set of rules. The trade deals that my Administration is negotiating in the Atlantic and the Pacific regions would do just that" (The White House, 2015; at 5). Likewise, he wrote a blog stating that, "Right now, China wants to write the rules for commerce in Asia. If it succeeds, our competitors would be free to ignore basic environmental and labor standards, giving them an unfair advantage over American workers" (Obama, 2015).

The emphasis in President Obama's remarks is on environmental and labour standards but the emphasis in the TTP is on intellectual property protection. We live in an age of industrialized innovation, where the United States is issuing on the order of 600,000 patents per year and China is approaching 1 million patents per year. The name of this game is Monopoly – the winning strategy involves acquiring as much intellectual property as possible, building companies on this property and charging rent to the rest of the world for its use. But there is an important wrinkle to this version of Monopoly: countries do not buy intellectual property, they create it by fiat, via a patent mill. There are no effective disciplines on the issue of intellectual property; yet international agreements commit countries to enforcing the intellectual property rights created by the other parties.

Increased intellectual property rights could not be attained through the WTO because it is not in the interests of most of the members. The vast majority of intellectual property payments flow to the United States, the European Union, Japan and Switzerland. China will soon be joining those ranks. Moreover, there is not enough left to give in terms of market concessions on goods and services to structure a conventional deal for higher intellectual property protection in exchange for improved market access.

Hence the shift of the trade negotiation action into the mega-regional forums (TPP, TTIP, etc.).

For Canada, the calculus on how to proceed is difficult indeed. The TPP will bring modest gains in the conventional areas of tariff elimination, no meaningful gains from reduction of non-tariff barriers to trade in goods, limited gains from liberalization of services (with the main factor being binding existing market access conditions rather than removal of actual barriers), and no impact to speak of on an already highly open regime for foreign direct investment (FDI). These gains would be, on my estimation, using conventional trade modelling techniques, on the order of C$3 to 4 billion per year in higher income, once all the liberalization has taken effect. A more precise estimate is forthcoming in a C.D. Howe study on the TPP.

Offsets are the welfare costs of preferential trade – the administrative costs of complying with rules of origin – and the subsidies that will be made for dairy (which will largely negate the welfare gains from the dairy concessions Canada made in the TPP and CETA).

The critical question which has not been answered – and cannot be answered by the available quantitative trade models – concerns the implications of the intellectual property package. New Zealand estimated that the copyright extension alone would cost it about $10 per person in the fullness of time. That adds up at the national level. The negative impact on innovation of extending copyright comes on top of that – an amicus curiae brief in the United States Supreme Court signed by 17 well-known economists, including five Nobel Laureates, when the United States was extending its copyright protection attests to this negative impact.[2]

There are additional issues for health care costs, and the impact of the TPP rules on the generic pharmaceutical industry in Canada.

Equally importantly, the TPP doubles down on an economic policy framework that has driven the global economy into stagdeflation (Ciuriak, 2015).

Canada under-performed in the last decade following conventional policy ("supply-side consensus"). There are many dimensions to this under-performance:

- 0.18% annual average per capita income growth in constant international dollars over 10 years;
- the economy went from 1.8% above potential in 2005 to -1.3% below potential in 2015, notwithstanding massive net fiscal stimulus as evidenced by the C$305 billion added to public debt over the period and a slide in the structural general government balance from a surplus of 0.8% in 2005 to a projected deficit of -1.0% in 2015.
- the external balance went from a surplus of 1.9% of GDP in 2005 to a projected deficit of -2.9% in 2015,
- consumption supported the economy: households increased their leverage from 0.95 to 1.63; given the trends in income distribution, the vast majority of Canadians went deeper into debt to support income gains by the top percentiles.
- household leverage is real, but the asset values supporting that leverage may be ephemeral, which has increased the risk profile of the economy and created a potential powder keg for the Bank of Canada, when it attempts to normalize monetary policy.
- waning business dynamism
- an historic collapse of its innovation sector.

The TPP is not the answer to these problems.

What are the options?

Bilateral trade agreements have the problem that the rules of origin are tailored to each agreement. Canada has already signed agreements with most major economies; China is the major outstanding economy with which Canada does not have an FTA. A Canada-China FTA would bring relatively significant benefits in terms of GDP and income (Dawson and Ciuriak, 2016). Agreements with India and ASEAN would represent potential follow-on steps, but the gains become small. Moreover, firms that align their sourcing to meet the ROOs for one agreement might not meet them for the ensuing agreements – there is a limitation to the effectiveness of serial bilateral agreements.

The main option not being considered by the Committee is unilateral liberalization. As documented in a paper by Ciuriak and Xiao (2014) for the Canadian Council of Chief Executives, such a move would have relatively significant liberalizing potential, with the lapsing of ROOs-related administrative costs with all of Canada's current FTA partners being a major factor in generating economic welfare gains.

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[2] See, "Brief of George A. Akerlof, Kenneth J. Arrow, Timothy F. Bresnahan, James M. Buchanan, Ronald H. Coase, Linda R. Cohen, Milton Friedman, Jerry R. Green, Robert W. Hahn, Thomas W. Hazlett, C. Scott Hemphill, Robert E. Litan, Roger G. Noll, Richard Schmalensee, Steven Shavell, Hal R. Varian, and Richard J. Zeckhauser As Amici Curiae In Support Of Petitioners", Amicus Curiae brief submitted to the Supreme Court of the United States in Eric Eldred et al., Petitioners,v. John D. Ashcroft, Attorney General, Respondent. For a partially dissenting view, see Liebowitz and Margolis (2005).

This would still leave open the question of the rules regime onto which Canada must sign. Not signing the CETA and TPP will leave Canada marginalized in its two major markets. Signing means accepting rules of the road that have locked Canada into under-performance.

Canada needs to do the math on the agreements. And it needs a trade and innovation strategy as a most urgent priority for the new government.

Thank you.

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