

Canada-US Economic Relations: No Time for Complacency

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Let me begin with some observations on the two summits this weekend, the G-8 which Canada is hosting and the G-20 which Canada is co-hosting with Korea. The focus of both is a coordinated return to sustained economic growth reinforced by a strengthening of financial regulation and a serious commitment to what you economists politely call “fiscal consolidation.”

The G-20 is a relatively new instrument in global governance. The track record to date has been encouraging, but resolving the major imbalances in the global economy and restoring confidence in the regulatory framework represent major challenges. Although it represents 85% of the world’s GNP, the G-20 embraces countries at very different levels of development, with varying growth potential and similarly different political systems. Consensus, which is the basis for greater certainty about global recovery, will not be easy.

Fortunately, Canada brings compelling credentials of solid financial and economic performance to both Summit tables. The Canadian recession was sharp but caused less damage and affected the economy for a shorter period of time than for all our G-8 counterparts.

Canada has the lowest debt to GDP ratio in the G-8 and, after the recession, will be lower still by an even wider margin. Economic growth meanwhile – First Quarter results annualized at 6.1% – are the clearest signal of robust recovery.

There are some downside risks. For all the celebration of our prudent banking system, we also have the highest level of consumer debt among OECD countries.

Financial sector reform will be a pivot point for both summits. Pending US legislation is a step forward but notably does not deal with Freddy Mac or Fannie Mae, which are essentially Congressional creations for “socializing risk”, although few American politicians would describe it that way. While there are some signs of recovery in the US, there is no evidence of fiscal restraint, especially with elections in November. The Europeans are pre-occupied with their own problems. The emerging powers are wary about solutions coming from those who generated the downfall. Clearly we need to avoid a regulatory structure that, in the words of Gord Nixon, is so complex and onerous that it could “create a host of unintended consequences, including smothering the sparks of a fledgling economic recovery.”

It would be easy to get this wrong. Compared to the chaos in the US and Europe, Canada's well-regulated and smoothly functioning financial sector mitigated the blow of the recession and we certainly do not need any lessons from delinquents on regulatory reform. But, the global financial system does need higher capital levels for banks, stricter leverage limits and tighter more transparent oversight.

The elephant in the Summit rooms is the looming crisis on sovereign debt. The amounts needed to rescue the more seriously indebted Europeans – the PIIGS – may dwarf the amounts spent in the private sector bailouts of 2008. Bailout packages in the absence of fundamental reform will not fool anybody for very long. Printing more money to accommodate more debt is not a real solution and will inevitably lead to lower standards of living in Europe. For some, the risk is higher inflation. Others fear deflation and another downturn.

There is an overriding need for sustained, painful and yet growth-friendly, fiscal discipline. A fine distinction. Canada has a more credible plan to bring the federal budget close to balance than others in the G8. Getting financial regulation right – itself a huge task – needs to be matched by specific, sustained and coordinated disciplines to counter the more serious threats of sovereign debt default.

Some have got the message but the problem for democracies is that they can be reluctant to act until they are about to hit a wall – like Canada in the mid 90's. Early signs of recovery may have the perverse effect of retarding needed reforms. Some, like Paul Volcker, worry that the recession may not have been serious enough to compel needed reform and discipline.

Global recovery is highly unbalanced, strongest in Asia, some signs of strength in the US and weakest in Europe. China's eleventh hour announcement about easing its currency could be significant, especially if it is real. Even better if it were matched by serious indications from Washington of a commitment to fiscal prudence. In striving for solutions to global challenges – not just economic – much will depend on the willingness of Washington and Beijing to work together.

Summitry will be judged not by the promises it makes but by the degree to which it delivers collective resolve, coherent coordination and injects confidence into global markets.

So, a daunting intro to my topic for today.

Canada – US relations are often characterized as being like two people examining one another through opposite ends of a telescope. Canadians can be a bit obsessed and hypersensitive, if not a bit neuralgic and even a tad smug, about a relationship that touches virtually every aspect of our public policy. And yet, despite the fact that we are still America's largest trading partner, allies in war and peace and neighbours with extensive family, as well as border linkages, this priority is seldom reciprocated. In fact, Americans can be a bit indifferent, almost taking for granted the connections and the advantages of ties with Canada. As Goldie Hawn casually observed in the movie "Protocol" - "I have never been in a foreign country. I was in Canada once but it is kind of attached."

"Not foreign but attached" can make management of the relationship very tricky. Small irritants become three alarm fires in Canada but barely hit the radar in Washington where other, more immediate, global issues capture attention.

I suspect that few Americans know that Canada is a larger market for US goods than all 27 EU member states combined. Or that Canada – US trade supports more than 7 million US jobs. Nor do many realize that Canada is the #1 foreign (but attached!) supplier of all forms of energy to the US. More than 2 million barrels of oil each and every day.

We hear a lot these days about Washington being dysfunctional or polarized into political paralysis. Customary US resilience and optimism is being severely tested while Wall Street, and most recently BP, have become easy targets for shame and blame. Tea partiers are rejoicing in their political strength and moderates are being pushed to the side in both parties. The country seems to be in a deep funk and that is not good news for Canada. Make no mistake, we need a resurgent US economy. We need the US to put its financial house in order. And we also need more confident global leadership from America.

On day to day management, the choice and the initiative usually rests with Canada but, for all the attitudinal reasons mentioned, Canadian governments, especially minority governments, usually tend to be more careful and correct than inspired. That is essentially the state of affairs today.

Some prefer a bold new vision for Canada – US relations with a EU-style Customs and Monetary union as the goal. I do not see that as politically viable. Complacency, or allowing matters to run in neutral may be the path of least resistance but it is not, in my view, the best guarantor of either Canadian or American interests. The fact that we are more “attached” than “foreign” and that so much of our economy is integrated with the US means that we can and should do more together to resolve real problems and chart creative, new ways to strengthen our relationship.

Here are some priority areas I believe we need to focus on.

First the border. Since 9/11, the border has been steadily thickening. Increased inspection fees, country of origin labelling, major penalties for minor infringements, more intense scrutiny of business visitors and a host of other measures undermine the basic purposes of the NAFTA and the WTO.

It is tempting to place all the blame on American paranoia about security. The thwarted terrorist attacks of late in Detroit and New York intensifies this preoccupation. Although these events had nothing to with border security, we need to recognize that some American concerns about Canadian immigration and refugee policies may be *legitimate*. We should not shy away from trying to address valid concerns nor indulge in the false luxury of made-in-Canada sentiments.

I would like to see our Prime Minister propose to the President establishment of a new, Bi-national Border Commission which, consistent with Parliamentary and Congressional prerogatives, would be empowered to do the following:

- a) streamline customs and entry provisions along our shared border and remove blockages that are protectionist, not security, inclined. The new Detroit-Windsor bridge and the new Gateways along the border should be used as pilot projects employing innovative technology to this end. Exporters and importers should have direct access to the Commission to air complaints about border restrictions.

- b) spearhead coherent rationalization of overlapping and needlessly different standards and regulations that hobble the integrated nature of our two economies. The auto sector alone has more than 150 different regulations for vehicles manufactured by the same companies. Now that governments are the beneficial owners of most of this North American industry, there should be even greater reason to improve, rather than retard, its efficiency and competitiveness.
- c) examine the merits of a Common External Tariff as a means to reduce complex Rule of Origin provisions and promote greater efficiencies. With most MFN tariffs already below 5%, excepting of course the agricultural sector, this should not be too difficult to consider.
- d) recommend sensible harmonization of immigration and refugee policies, countering the myths about security while redressing aspects of genuine concern.
- e) intensify police collaboration to address security concerns, illicit traffic of drugs, the activities of organized crime and broader threats from cyberspace.

Note that I said Bi-National, not Tri-National. The problems faced by the US on its northern and southern borders are different both in character and degree – as are the fundamental bi-lateral relationships. It is essential that we not allow US-Mexico border issues to drive US-Canada border policy.

The energy security and climate change debate needs a pragmatic, bilateral solution. Even if the oil spill in the Gulf and the reckless fumbling and bumbling by those involved is changing the tenor of the debate at the moment in the US, and perhaps even some attitudes about the oil sands, we should try to get our collective minds around a few home truths. One is that, for both Canada and the US, energy security and climate change are joined at the hip. Canada's role as the largest supplier of all forms of energy to the US will only increase over the next decade. This gives us a unique position from which to influence a constructive dialogue on these twin issues.

There is a risk of serious economic damage if either country goes its own way. Putting a price on carbon by whatever means has to take account of the competitiveness impact on a sector that is fully integrated. The negative potential is amplified by a spaghetti bowl of provincial and state measures whose purpose seems often to me to be more a demonstration of political correctness rather than serious commitment to emissions' reduction.

A few decades ago Canada and the US dealt with the problem of Acid Rain and the need to clean up the Great Lakes with bold, bilateral undertakings. The same spirit and commitment could help us shape consensus from rancour and establish a balanced outcome that preserves our shared environment while respecting our mutual economic need for a stable energy sector. The ideal would be a joint Canada-US plan. If that is beyond our reach, we need to align our objectives and seek to harmonize most of our measures. It is not a question of "waiting for" the US to act. Rather it is choosing to "work with" the US to find a sensible solution. Canada should not hesitate to lead, initiating concrete proposals in pursuit of a new accord.

There is a pernicious threat from green protectionism masquerading these days as climate change virtue. Proposals in the US Congress and various states would exclude electricity generated from large-scale hydro projects from a unique definition of “qualified” sources for the national renewable electricity standard. Other measures deliberately discriminate between domestic and foreign heavy oil of the same carbon intensity. We need to confront these threats to legitimate energy exports and the basic principles of international trade. To do that effectively we need to get our act together here on the homefront. Content provisions of Ontario’s new FIT program are regarded as clear violations of both NAFTA and the WTO.

Whatever priorities are selected for the bilateral agenda, Canada needs to engage systematically and confidently with the Administration and key Congressional leaders to ensure that our ideas, as well as our own concerns, register. Re-instating annual Summits between the Prime Minister and the President would certainly help drive the agenda. Despite the vast and complex network of relationships between our two countries, the institutional underpinnings are decidedly skimpy. It is no time for complacency.

Never forget, too, that what we choose to do or not do on global issues of great concern to America can influence our leverage and our credibility on bilateral issues.

Let me stress, however, that giving greater attention to the US does not mean we need to be exclusive to be more effective. About two-thirds of global growth is occurring in emerging-market economies. They account for close to 50 percent of imports over the past decade, will stimulate commodity prices and are thought to be leaders and innovators in public policy and business. They should command priority. We should focus particularly on the fast growing economies of Asia - which makes me wonder incidentally why our priority now is a negotiation with the beleaguered EU economies. (But I digress.)

We can bolster our competitive edge vis-à-vis the US and our competitive attraction to markets in Asia with advantageous corporate tax regimes, prudent fiscal policies, improved productivity and more open access for trade and investment.

If we are going to have a more vibrant economic relationship with the US and Asia that will anchor our future prosperity, there are also some things we need to do better here at home.

Most importantly, we need to shake free from the national pastime of complacency and address underlying domestic challenges. Too often, our wealth in natural resources and our proximity to the largest, most dynamic economy in the world leads us to put off serious decisions about what we need to do here at home. After all, when you are born on third base, you tend to think that it is because you hit a triple!

Everyone from Kevin Lynch to Mark Carney talks repeatedly about declining productivity in Canada but what is business doing to improve our performance?

Complacency is a drag in itself but the problem is deeper, structural and cultural. The hard reality is that Canadian business spends too little on research and development, and with the disappearance of Nortel, private sector investment in innovation will drop to derisory levels. Canadian companies are technology followers rather than leaders and it shows. Government spending on R&D ranks us at or near the top in the OECD. Private sector R&D spending places us at the bottom.

We would benefit from a more competitive retail sector in Canada. Why is it that Canadians can make big savings if they buy automobiles in the US? Is it a competition policy problem or are Canadians not demanding enough? As business stands to benefit from the HST, why not give consumers a break on retail prices?

We are less competitive, more risk averse, wary of innovation and reluctant to tackle global opportunities. Public policy is not really the problem. The corporate tax reductions and the harmonization of sales taxes with the GST are moving us to the goal of a tax and regulatory regime in Canada that is demonstrably better than that of the US. As the new book from the Macdonald-Laurier Institute attests, that should be a permanent feature of the Canadian “advantage”.

In fact, by 2012, with the cooperation of most of the provinces, Canada will have the lowest statutory corporate tax rates among the G-7. Also by 2012, Canada will have an overall tax rate on new business investment that is below the OECD average.

The recent pledge to free up the entry of foreign venture capital into Canada is particularly welcome. The creation of a national securities regulator would bring security regulation in Canada into the modern world of globalized capital markets adding coherence, and hopefully better discipline, to our regulatory system.

The federal budget makes Canada, exclusively among all G-20 countries, a tariff-free zone for manufacturers by eliminating all remaining tariffs on productivity-improving machinery and equipment and goods imported for further manufacturing in Canada.

Freeing up the rules on foreign investment will help because, as the OECD points out, Canada has one of the smallest welcome mats for foreign investors among advanced industrialized countries.

Last December, the government over-ruled the CRTC on a new wireless telecom venture, signalling both a desire for more competition and customer choice and the plain fact that our regulatory regime is out of sync. The Speech from the Throne promises to loosen the rules limiting foreign investment in telecommunications, satellites and uranium.

But I don't want to let the federal and provincial governments totally off the hook. There are a number of issues that need attention.

One is the regulation of major infrastructure prospects. There are too many processes with separate, overlapping and often mutually intrusive agendas serving little public purpose. (The \$4B expenditure to date for seemingly endless reviews of the MacKenzie Pipeline before one inch of pipe is laid is a notorious example.) The task is not to eliminate regulation but to inject reason and coherence over process. The Throne Speech promised that the government “will untangle the daunting maze of regulations that needlessly complicates project approvals, replacing it with simpler, clearer processes that offer improved environmental protection and greater certainty to industry.” Let’s hope actions will match the fine words.

We may well need better regulation of offshore drilling – as the US obviously does – but a hodge-podge of jurisdictions – the usual Canadian way - is no guarantee of “better.”

There has been a serial underinvestment in transmission facilities serving the power grid in both Canada and the US. That would have been a natural for stimulus funding. Instead, we are witnessing a stampede of subsidies for inefficient power generation. At some point, consumers will have to pay for this political largesse and they will not be happy.

Another priority is to revamp the way we do major government procurements. From my business experience, I know that the process is complex, expensive and that decision making is often opaque. There seems to be an innate preference in some quarters for foreign companies and foreign goods, services and technology. Of course, we need robust competition but a balance needs to be struck to give Canadian companies, especially those with indigenous, world class technology, a fair shot at Canadian government contracts, notably those on defence. That can be done within existing trade rules. We should give more determined and more enlightened support for Canadian global champions in energy, agriculture and natural resources, in aerospace, IT, telecoms and education.

Earlier this year I was pleased to chair the international Committee that selected the 19 inaugural recipients of the prestigious 10 million dollar Canada Excellence Research Chairs (CERC). This is a strategic initiative to inspire top level research in four areas deemed to be critical to our national interest and our future prosperity.

My basic message is that we need to stress excellence across the board. In a more competitive world, there is no room for second-rate. The hand-maiden of complacency is mediocrity. In Vancouver we were determined to “own the podium”. That shocked some Canadians for its audacity until they saw the results. We need more of that spirit from governments and the private sector to secure a brighter future.