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A Cure for Dutch Disease: Active Sector Strategies for Canada's Economy

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Introduction: The Resource Boom and Canada's Structural Regression

About a decade ago, Canada's economy began heading in a distinctly different direction. The extraction and export of largely unprocessed natural resources became, not for the first time in our nation's history, the primary driving force in our economic, political, and even environmental development.

Traditionally, Canadian policy-makers were preoccupied with escaping our status as a supplier of natural resources and commodities. A series of pro-active policy efforts aimed to allow Canada to overcome its role as a "hewer of wood, drawer of water," and helping us emerge as a full-fledged, diversified, industrialized economic power in our own right. And in the first decades after World War II, Canada made considerable progress in this regard. By the turn of the century, well over half of our total exports consisted of an increasingly sophisticated portfolio of value-added products (including automotive, aerospace, and telecommunications equipment); and Canadian firms and technology were increasingly recognized around the world.

That historic trend was reversed, however, beginning around the turn of the century. Since then, driven by various factors (some global, some national), resource industries have become ascendant once again in setting Canada's overall economic and policy direction. Resource industries have grown (led by enormous expansion in the petroleum sector, centred on Alberta's oil sands), and most of their output is exported in raw or barely processed form. Other export-oriented sectors of the economy have contracted in both relative and absolute terms. In part, they have been "squeezed out" by the macroeconomic side-effects of the resource boom. (Some economists call this "Dutch disease," named after a similar reorientation that occurred in the Netherlands following the discovery and exploitation of that country's North Sea petroleum resources in the 1960s and 1970s.)

This structural shift is profoundly remaking Canada's economy, our role in the world, and indeed our very federation. Yet apart from occasional bursts of rhetoric (such as followed the recent public exchange between the Premiers of Alberta and Ontario), it has been the subject of relatively little careful analysis. Moreover, while powerful market forces have certainly contributed to Canada's increasing resource-dependence, this remaking of the national economy is by no means inevitable or "natural." Canadians should think carefully about the costs and benefits of this historic shift in our national economic direction, and make the most of our ability to influence the course of our own economic destiny.

A number of key economic indicators testify to this conclusion that Canada's economy has been heading in a very different structural direction:

- Natural resource production and export has expanded strongly — especially petroleum, and especially from Alberta's oil sands.
- Manufacturing output and employment has sharply declined. Some 600,000 Canadian manufacturing jobs have disappeared since the turn of the century.
- Canada's currency has appreciated dramatically, rising 60 percent in value against its U.S. counterpart over the last decade.
- Canada's overall trade balance has deteriorated. The growth of resource exports has been inadequate to offset the decline in other exports (such as manufacturing, tourism, and services).
- The economy has experienced a broad shift from tradable to non-tradable sectors, so that exports in general constitute a significantly smaller share of total production than a decade ago.[1] This both reflects, and reinforces, the deterioration in national trade performance.
- The shift to non-tradable sectors, the loss of high-productivity manufacturing jobs, and the structural deterioration in our exports have all contributed to the worst decade of productivity growth in Canada's postwar history.
- Economic and fiscal gaps within Canada have widened considerably. In 2005, Newfoundland's GDP per capita exceeded the Canadian average for the first time in history — and the next year, Ontario's fell below the national average, also for the first time in history. Since 2006, then, there have been three "have" provinces: those which produce oil (Alberta, Saskatchewan, and Newfoundland & Labrador). All other provinces are "have-not" provinces, and the erosion of national fiscal federalism (due to simultaneous reductions in federal social programs, transfers, and taxes) has meant that those interprovincial gaps are showing up increasingly in major differences in economic and social conditions.

The appreciation of the currency is both a consequence of this resource-led reorientation of Canada's economy, and reinforces the broad structural trend. International organizations (like the Organization for Economic Cooperation and Development[2]) estimate that the "fair value" of Canada's currency is about 81 cents U.S. (according to purchasing power parity, or PPP, standards). In the 1990s, Canada's currency traded for well under this level, making Canadian costs and the prices of Canadian-made products and services seem highly attractive to international consumers and investors. As currency traders came to associate Canada's currency with the price of oil (rightly or wrongly), however, this advantage was lost. The dollar began to rise quickly, shooting through its PPP benchmark, and reached par with the U.S. dollar by 2007, where it has fluctuated since. At that level, our currency trades at about 25% more than its PPP fair value — which means that Canadian-made products and services seem 25% "too expensive" relative to their actual value. This has negatively impacted manufacturing, but also every other non-resource traded industry (including tourism, and tradable services like transportation and business services). Indeed, some non-manufacturing export-oriented sectors (like tourism) have been harder-hit by the dollar's overvaluation than manufacturing. Claims that the effect of overvaluation will disappear over time as companies "adjust" (including by investing in more capital equipment) have not been borne out. Only resource industries have been largely insulated from the impacts of the dollar's overvaluation. The dollar is the most important channel through which "Dutch disease" symptoms are felt, but it is not the only channel.[3]

Obviously, significant economic opportunities have been generated by the surge in resource extraction and export industries in Canada. The petroleum extraction industry directly employed 54,000 Canadians in 2011 — up 18,000 since 2000. Directly, then, the oil and gas sector's expansion offset only 3 percent of the net jobs lost in manufacturing in the same period. Indirectly, of course, there are other spin-off opportunities — concentrated most visibly in oil-producing regions, but some of which are experienced more broadly across the country. Those opportunities, however, must be measured against the costs and consequences of the resource boom, including its economic, social, and environmental side-effects. Given the overall deterioration in labour market, productivity, and international trade indicators that has been associated with the resource-driven restructuring of the national economy since the turn of the century, it is hard to avoid the conclusion that this overall trend has been negative for Canada as a whole.

The challenge facing policy-makers is to maximize the long-run, sustainable benefits to Canadians of resource development, and minimize its costs. This means leaning into the winds unleashed by powerful and profitable resource extraction opportunities, to ensure that these developments are managed in a manner consistent with Canadians' long-run economic, social, and environmental well-being — rather than simply endorsing the present, largely unmanaged trajectory as somehow optimal (and loudly condemning any critics of that trajectory as "unpatriotic"!). Many policy tools are available to tackle this task of managing the structural changes in Canada's economy, in order to avoid Dutch disease symptoms, maximize the benefits of resource developments, and minimize their costs.

One especially promising set of policy measures includes pro-active efforts to support investment, employment, innovation, and exports in targeted high-value sectors of the economy. We refer to this broad policy envelope as "*Sector Development Policy*." The purpose of this paper is to consider the sorts of sector development policies that could be invoked in order to reduce the symptoms of Dutch disease which have become increasingly visible over the past, resource-led decade.

The general goal of sector development policy is to attain a more desirable sectoral mix in the economy, winning a greater share of output and employment in identified high-value or "strategic" sectors than would otherwise be the case. Sector development policy has been historically important in Canada, given our ongoing national challenge to escape the "staples trap," and become more than just a resource-supplier to other countries. We need more industries that add value to our resources (rather than exporting them in raw form); that generate more high-income, high-quality jobs; that embody technology and innovation; and that contribute to greater success in world markets.

This Technical Paper consists of two parts. The first reports in more detail on the negative structural consequences of the mostly unregulated resource boom which has been remaking Canada's economy since the turn of the century. The second section proposes a set of measures which would help to minimize those negative side-effects of resource development, and contribute to a more balanced, successful, and sustainable industry mix in Canada's economy in future generations.

These policies, and the fiscal tools we propose to fund them, formed part of the 2012 *Alternative Federal Budget* (published in March by the Canadian Centre for Policy Alternatives). However, given the overarching historical challenges posed by the current resource boom, and the need to spark a broader policy debate among Canadians about its costs and benefits, we are issuing these proposals in this more comprehensive standalone Technical Paper.

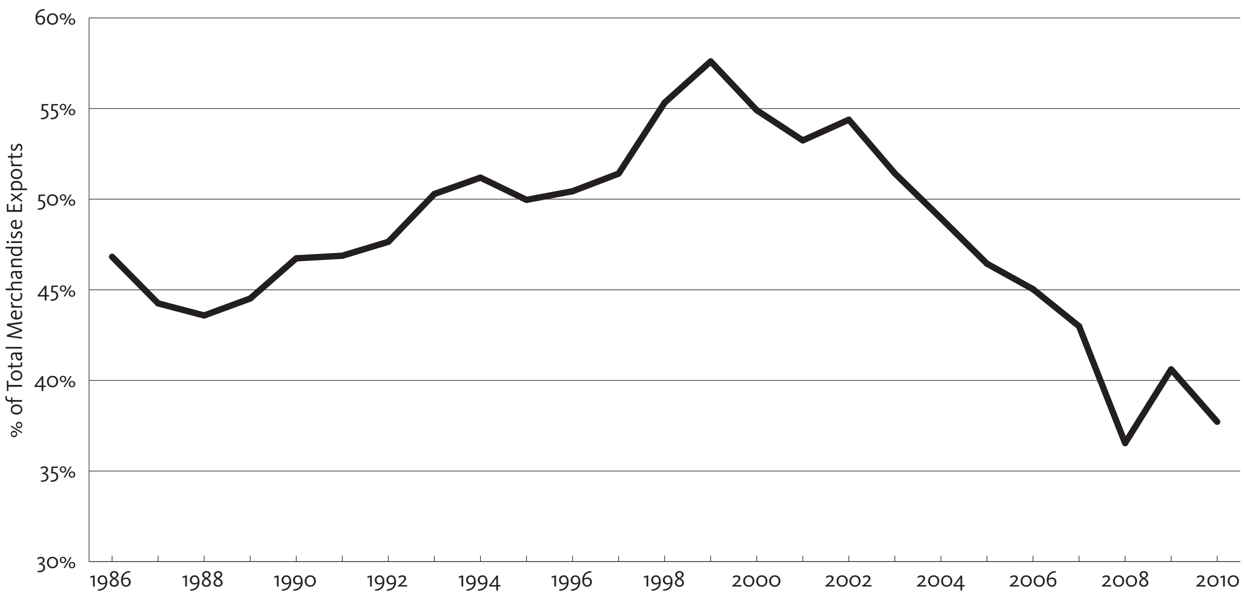
Part I: Symptoms of Dutch Disease

Canada's recent economic evolution has been disappointing. At the macroeconomic level, to be sure, Canada's economy is still suffering in *quantitative* terms: still recovering slowly and partially from a stubborn recession, experiencing a chronic lack of jobs and stagnant incomes, and other symptoms of malaise. But our economy is also regressing in *qualitative* terms. The structural make-up of the Canadian economy has become less balanced, and more dependent on exports of unprocessed resources. That trend has negative implications for a whole host of national economic indicators — including productivity, trade performance, our capacity for innovation, environmental performance, regional economic differentials, and more.

Here are just a few indicators and consequences of Canada's accelerating structural decline:

- *Reliance on primary resource exports*: In July 2011, unprocessed and semi-processed resource exports accounted for two-thirds of Canada's total exports, the highest in decades. In contrast, higher-value finished products accounted for just a third of our exports. Compare that to 1999, when finished goods made up almost 60% of our exports (see Figure 1). Decades of postwar progress in diversifying Canadian exports, and moving "up the value chain" in our trade, has been undone in just 10 years of this resource-led trajectory. And it seems that the more free trade agreements we sign, the more our role as global commodity supplier is cemented.
- *Deteriorating balance of payments*: This surge in resource exports, even with high global commodity prices, still isn't enough to pay our bills in world trade. Trying to pay for sophisticated high-tech imports by digging more resources out of the ground ever faster is a losing battle. Canada's current account balance (which considers all current international payment flows, including trade, tourism, and investment

FIGURE 1 Value-Added Products as Share of Total Canadian Merchandise Exports, 1986–2010



SOURCE Author's calculations from Statistics Canada, CANSIM Table 2280043, "Merchandise Imports and Exports by Sector and Sub-Sector."

income) was $50 billion in deficit in 2011. That's over 3% of national GDP — our worst performance since 1993. Because of our failure to produce and sell high-value products and services internationally, we're becoming increasingly indebted to the rest of the world. Continuing foreign takeovers of Canadian assets (incoming foreign direct investment, largely in resources, grew another $25 billion in just the first nine months of 2011) is the flip side of the coin of our failure to pay our way in international commerce.

- *Poor productivity growth*: One major problem with resource reliance is its negative impact on productivity. Productivity tends to decline over time in resource industries, because it is increasingly costly to extract more remote or marginal deposits. Canada is putting increasing economic emphasis on industries with *declining* productivity, and that pulls down our national performance. Cumulative productivity growth in Canada's business sector from early 2006 through autumn 2011 (five and a half years) was precisely zero. Canadian businesses are now only 70% as productive as U.S. businesses; in 1984, before we negotiated free trade with the U.S., we were 90% as efficient (see Figure 2). Canada ranks 30th out of 34 OECD countries in productivity growth over the past decade (see Figure 3).

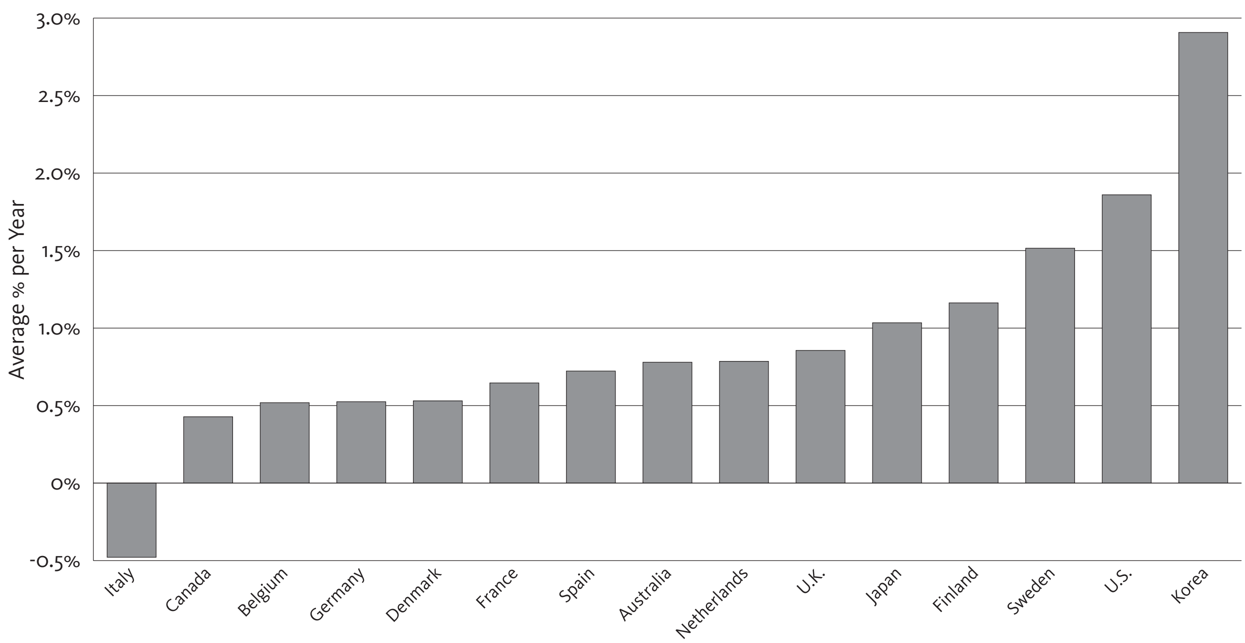
- *Lousy innovation*: Canada's structural regression became evident after the turn of the century, driven initially by a number of factors: the dot-com meltdown, the 9-11 attacks and subsequent economic problems in the U.S., and rising global commodity prices (which spurred oil sands and other resource projects). Perfectly overlapping this historical trend has been a long-run erosion in the R&D performance of Canada's businesses. Business sector R&D has declined by almost one-third since 2001, measured as a share of our economy, and it's getting worse. Business R&D now stands at just 0.9% of GDP — a fraction of the investments in innovation being made by businesses in other countries such as Korea, Sweden, Finland, the U.S., and even China. Canada has the most generous tax subsidies for R&D in the OECD, and ultra-low general corporate taxes too. But there is a growing consensus among innovation experts that across-the-board tax cuts have very little impact on business investment in capital and technology.

- *Failure to build global companies*: The combined effect of Canada's resource dependence, our open-door policy on foreign takeovers, and our unthinking commitment to free trade agreements has been a stunted domestic business community. Canadian firms are well-known in mining and petroleum, and a small number of other industries (e.g.,

FIGURE 2 Average Labour Productivity, Business Sector, Canada vs. U.S., 1947–2010

SOURCE Centre for the Study of Living Standards, www.csls.ca.

FIGURE 3 Average Labour Productivity Growth, Selected OECD Countries, 2001–10



SOURCE Author's calculations from Organisation for Economic Cooperation and Development, *Economic Outlook* (June 2011), Table 12.

banking). But in terms of being able to develop and sell high-value, innovative products to the world, Canadian firms are almost invisible. Our national failure to nurture globally successful companies is exemplified by the current troubles of Research in Motion. RIM was a rare exception to our national lack of corporate innovation; like the downfall of Nortel Networks a decade earlier, RIM's accelerating decline only highlights our general failure to build a national innovation system.

- *Environmental disaster*: Perhaps the most destructive consequence of our rush back to a "staples" economy is the impact on the environment — and Canada's environmental reputation. According to a recent CCPA study,[4] the emissions associated with expanded oil sands production will account for over 100% of Canada's total expected growth in GHG pollution between 2005 and 2020; and this doesn't even count emissions caused when that production is burned for energy. By 2020, under current policies, the oil sands will account for more emissions than our entire passenger transportation sector and domestic aviation combined.[5] Yet according to the Copenhagen Accord, Canada is supposed to be reducing emissions by 17% over this time frame. Without a clear plan to tackle these growing emissions, it will be extremely difficult for Canada to meet its reduction commitment. By delaying serious action, it also puts future job creation at risk by failing to invest in green job creation and skills development while locking in carbon-intensive infrastructure that will be quickly outdated as global climate protection actions progress. The enormous economic and political influence of the petroleum industry over the Harper government is a clear factor in this government's abysmal environmental actions — culminating last year in Canada becoming the first nation in the world to withdraw from the Kyoto treaty.

All these signs of structural decline in Canada's economy are at odds with the confident predictions of free-market, free-trade advocates. They promised that "perfecting" the private sector (through trade deals, deregulation, tax cuts, and privatization) would usher in a new era of innovation, efficiency, and trade success. Confronted with the evident failure of their *laissez faire* recipe, these thinkers look around for more "barriers" to business that might still be dismantled; perhaps *then* will the benefits finally start to trickle down. They propose more free trade deals (Europe, India, Korea, Japan, Trans-Pacific), more foreign investment (communications), more deregulation (the Regulatory Cooperation Council with the U.S.), and more tax cuts (the latest phase of the Harper corporate tax cuts took effect January 1, 2012).

For them, the qualitative failure of Canada's economic development despite an increasingly free-wheeling, business-friendly framework is a paradox. But what if the starting assumption (namely, that an all-knowing private sector, freed from government intrusion, is the best vehicle to facilitate development) is all wrong? What if markets need to be challenged, not "freed," in order to maximize investment, innovation, and exports?

International experience should spur a fundamental rethink of Canada's recent market-driven policy direction. The successful state-led industrialization experience of several Asian and Latin American economies in recent decades, where policy was pro-active and interventionist, suggests that innovative, productivity-enhancing growth does not occur spontaneously as a result of market forces. Instead, the "visible hand" of government intervention, in various shapes and forms, is necessary for sustained quantitative and qualitative economic progress. The toolbox used by these countries is diverse and creative: targeted subsidies, strategic trade interventions, active industrial strategies in high-tech industries, domestic procurement strategies, and even public ownership of key firms. These approaches have been far more effective in promoting innovation and export success than Canada's hands-off approach.

Canada's own economic development experience also reinforces this conclusion. Most of the rare high-tech success stories in Canada directly reflected the earlier willingness by our policy-makers to be pro-active, rather than *laissez faire*. These success stories include the auto industry (use of strategic trade policy and other tools), aerospace (public investment, public procurement, and trade policy), and telecommunications (public research support and procurement).

However, these approaches have fallen out of favour since the 1980s, when signing free trade agreements became, by default, Canada's primary industrial strategy. Revitalizing a more pro-active policy stance will be essential if we hope to attain a more balanced, prosperous, and sustainable economic structure. Part II of this report will describe several initiatives to this end.

Part II: A Cure for Dutch Disease: Active Sector Strategies

We hope for a Canadian economy in which high-value, innovative industries have a larger presence, creating higher-income jobs, and paying our national bills in international trade. Visioning and implementing a progressive, pro-active sector development strategy to improve the qualitative make-up of the economy must therefore be a crucial element of an overall alternative economic program — complemented by strategies to address other economic weaknesses (especially unemployment).

The *Alternative Federal Budget* project is undertaken annually by a coalition of research, community, environmental, and labour organizations. Its goal is not just to show that there are alternative, more socially constructive ways for the federal government to balance its books. It also aims to present a comprehensive alternative vision for developing Canada's economy in the interests of Canadians and the environment. Given the increasingly obvious symptoms of "Dutch disease" in Canada's economy, and the growing costs and imbalances associated with unmanaged resource developments, it is increasingly important that our progressive economic alternative feature powerful measures aimed at reigning in resource-led development, and better managing it. Here are the major initiatives in the area of Sector Development Policy, that were proposed as part of this year's *Alternative Federal Budget*:

1. Establish a System of Sector Development Councils

The federal government will work with other stakeholders (including provincial governments, labour organizations, industry associations, businesses, universities and colleges, research and engineering institutes, and financial institutions) to establish a network of Sector Development Councils. These councils will be established in a range of goods- and services-producing industries that demonstrate many or all of the following characteristics: technological innovation, productivity growth, higher-than-average incomes, environmental sustainability, and export intensity. A non-exclusive list of these sectors would include: green energy technologies; aerospace and space products; communications equipment and services; value-added forestry products; motor vehicles and components (with an emphasis on alternative fuel and sustainable technologies); tourism; high-value transportation services; specialized health services; film and broadcasting; software development; and composite materials. The councils will work to identify opportunities to stimulate more investment and employment in Canada; to develop and mobilize Canadian technology; to utilize technologies developed in universities and other educational institutions for industrial applications; to invest in sustainable products and practices; to better penetrate export markets. In this way, the councils would constitute the first step in rebuilding Canada's broader national capacity for sector development planning. Each council will be asked to develop a medium-range plan for developing its sector in Canada, and a short-list of actionable items that could help to attain that plan's targets. The Sector Development Councils would be given an annual operating budget to support their work, commission research, and perform other infrastructural tasks. (The actionable items that arise from their recommendations would be financed through other policy vehicles, including those listed below.)

2. Take Immediate Efforts to Enhance Value-Added Production and Investment in Key Sectors

The Sector Development Councils will begin the medium-term task of developing comprehensive strategies for many key tradeable sectors. In some sectors, immediate measures can be taken to address current challenges and opportunities. These initiatives will include:

Green Energy Manufacturing: Current initiatives in energy policy hold great potential to stimulate the Canadian manufacture of components for solar, wind, and other green energy systems. Federal policy can complement and support these initiatives with a 10% investment tax credit for new capital and tooling in green energy manufacturing, and support for skills development for newly hired "green collar" jobs.

Automotive: A comprehensive new auto industry strategy will include support for product development and tooling for alternative fuel vehicles (including electric and hybrid vehicles); skills support to assist the industry through the coming demographic transition of its skilled workforce; and trade policy measures to address the debilitating one-way imbalances in automotive trade between North America, Asia, and Europe. The auto strategy would also feature a new Extended Producer Responsibility (EPR) initiative, consisting of investments in motor vehicle recycling, end-of-life conversion, and green motor vehicle components production. This EPR program would be self-financed from a new Green Car Levy imposed on all sales of new motor vehicles in Canada.The federal government should maintain its current equity share in General Motors to leverage continuing investments by that company in Canadian plants and technologies. Fiscal participation by the federal government in future auto investments must be accompanied by measures that commit each participating firm to maintaining a proportional Canadian production footprint (sufficient to match or exceed the value of each company's sales into the Canadian market).

Aerospace: The federal government has touted its proposed mega-purchase of new fighter aircraft as a great boon for Canadian aerospace producers. This claim is vastly overstated; in contrast to previous major defence purchases, there is no guarantee that Canadian aerospace producers will win anything like a proportionate share of Canadian value-added spin-offs through this contract. The first priority of a national aerospace strategy should be to maximize Canadian production of domestic civil aviation products (including commercial airlines, search-and-rescue, and fire-fighting equipment). This will require further active partnerships with Canadian aerospace producers (including Bombardier, Pratt & Whitney, and others), with special emphasis on supporting new product programs to improve fuel efficiency and reduce greenhouse gas emissions. Whatever defence purchases are eventually considered appropriate (consistent with a progressive foreign policy and recognition of other budgetary priorities) must be sourced through offset agreements that ensure dollar-for-dollar Canadian content in the final purchase.

Primary metals: No sector of the economy has been more damaged by foreign takeovers than primary metals; long-standing Canadian companies that were pillars of our national development (Stelco, Dofasco, Algoma, Inco, Falconbridge, Alcan) no longer exist, and in every case the new owners have exacted a terrible toll on workers and communities. The actions of U.S. Steel are the most egregious of all; the company extorted concessions from its workers, blatantly violated the weak conditions attached by Investment Canada officials to its takeover of Stelco, and then received a token slap on the wrist from the federal government as "punishment" for its abrogation of those conditions. The U.S. Steel experience vividly demonstrates the necessity for a totally new approach to regulating foreign direct investment in Canada. The new Canadian Ownership Act (described below) will ensure commitments regarding maintenance and modernization of Canadian primary metal production are negotiated with all the foreign owners who now control primary metals production.

Forestry: Forestry and wood/paper products are important export industries and important employers in many regions of Canada. Sadly, the industry has been hammered by the decline in the U.S. housing market, the overvalued Canadian dollar, and a vast insect infestation (the pine beetle) in Western Canada induced by global warming. Support for the industry's sustainable recovery will be provided through an annual fund to enhance the production of value-added forestry, wood, and paper products; implement energy conservation and other sustainable practices; and invest in skills required for sustainable forestry and forestry products production.

Agriculture: As with forestry, the goal of sector policy in agriculture is to maximize the potential for value-added production and innovation in Canada, and address the needs of environmental sustainability. Farm incomes in Canada have been devastated by the recession and low prices, and will be further undermined (for grain farmers) by the Harper government's attack on the Canadian Wheat Board. Farm income supports in Canada must be restructured to place special emphasis on sustainable and organic production, and on production for local use (reducing much of the pointless trade in foodstuffs that can and should be produced locally). Operating income supports must be capped to avoid making subsidy payments to large corporate farms. To achieve these aims, the AFB proposes an annual Sustainable Farming Income Support program. Much of the cost of the program will be offset by the elimination of subsidies for biofuel crops. The collective marketing authority of the Canadian Wheat Board will be reinstituted.

3. National Green Skills Initiative

The AFB fully embraces the priority of building a sustainable economy. We recognize that the adjustment to sustainability entails significant costs and challenges, but there are also many upsides and opportunities associated with the greening of our economy. In all sector development strategizing, the reduction of pollution, the development of clean technology, and the amelioration of existing environmental damage will always be top priorities in the list of criteria for ranking selected initiatives. To maximize the environmental upside of sector development strategies, and ease the associated transitions, our sector development strategy pays special attention to the need to stimulate the creation of good green jobs across a range of specific activities. In addition, and to facilitate faster growth of green industries, the 2012 AFB proposes a National Green Skills Initiative, established under the umbrella of HRSDC, to support college and on-the-job training that will enhance the capacity of Canadian workers to perform high-level services in green industries. This program would operate in partnership with provincial governments, colleges, employer associations, trade unions, and other stakeholders. Its activities would include the development of new transferable certifications in green job skills (such as green energy systems, insulation and retrofit, and environmental management), thus supporting the emergence of brand-new green jobs careers.

4. Control Non-Renewable Energy Developments (Especially in the Oil Sands)

The willy-nilly energy boom of the last decade imposed immense economic and environmental strains on Canada — notwithstanding the jobs and other economic spin-offs that were generated by that boom. The federal government (in partnership with provincial governments, where provincial governments choose to work cooperatively in this area) should implement a more sensible and sustainable framework for the development of these resources, in the interests of all Canadians and global environmental sustainability. To accomplish this, the federal government would reinstate corporate income tax rates on petroleum production to the former 28% rate that prevailed prior to the series of corporate tax reductions that began in 2001. This measure would raise additional annual revenues for the federal government (to be used to capitalize the Canadian Development Bank, as described below). The federal government would also impose a new regime of environmental approval processes on major energy developments to constrain new developments (especially bitumen projects) consistent with Canada's international treaty commitments, including our national targets to reduce greenhouse gas pollution. The government would also impose new targets on petroleum developments regarding Canadian content in purchases of capital equipment, supply, and services (similar to the Canada Benefits programs, which the federal government applied to frontier energy developments), and set increasing targets for Canadian processing and refining of bitumen. This deliberate effort to slow and regulate new energy developments, while working to maximize the Canadian value-added spin-offs from those developments, would ensure that they occur in a more manageable manner, with fewer side-effects and greater net benefits for all Canadians.

5. Replace the Investment Canada Act

The continuing expansion of foreign ownership and control in Canada's economy is both a consequence, and a reinforcing cause, of the general structural regression in the sectoral make-up of our economy. The Investment Canada Act (introduced in 1985 to replace the former Foreign Investment Review Agency) has facilitated this process. The Act's vague "net benefit test" is opaque and ineffective. The Act should be scrapped and replaced with a new Canadian Ownership Act, which would review all large takeovers of Canadian businesses. The new Act would specify the methodology for a transparent cost-benefit test. For a takeover to be approved, a foreign investor would have to make binding commitments to production and employment levels, new investments in fixed capital and technology, and an expansion of Canadian content in supply contracts and other inputs. Failure to live up to those commitments would incur sanctions up to and including the retroactive revocation of the acquisition. Lower levels of government, community stakeholders, and workers' organizations would be allowed input into the process of evaluating and reviewing a proposed foreign takeover. The new cost-benefit test would consider the long-run future cost of exported profits and dividends, and the potential economic and strategic implications of the loss of control over key resources or technologies. It would exclude share purchase payments to a company's existing owners from the national cost-benefit test: an acquiring company cannot "buy" its way to positive net benefit just by increasing the premium it is willing to pay for the target company's shares (since the windfall gains from those share purchases do not flow to Canadian society generally). Rather, costs and benefits would be judged on the basis of the company's future real operations in Canada. Companies that invest in Canada in order to add real capital, technology, business expertise, and with a commitment to grow their real operations here, would be welcomed under this new Act.

6. Reduce the Canada-U.S. Exchange Rate

Canada's currency has been trading at levels far above its "fair value" for most of the last several years, driven higher by speculative financial pressures and global commodities prices. This over-valuation has contributed substantially to the deterioration of all non-resource export industries in Canada (including manufacturing, tourism, and tradeable services). A true fair value for our currency, based on comparisons of purchasing power, unit production costs, and other benchmarks, would be around 80 cents (U.S.). The efforts described above to rein in the rampant, unplanned development of energy extraction and export projects, and to regulate and limit foreign takeovers, would automatically lead to an immediate and substantial pull-back in the Canadian currency. Additional downward pressure on the dollar could be mobilized, if needed, by the federal government instructing the Bank of Canada that a sustainable value for the currency (consistent with the long-run success of Canadian non-resource exports) should be taken directly into account in setting the Bank's monetary policy decisions and interventions. Ultimately, Canada must work with other countries to establish a global trade and exchange rate regime that is more cooperative and stable than the current system. This system must commit to promoting an expansion of global demand (in contrast to the current system's deflationary bias), a sharing of adjustment burdens between deficit and surplus countries, and limits on financial markets' power to control exchange rates.

7. A New Approach to International Trade

The federal government is pressing hard for several new free trade agreements (FTAs), including a very dangerous proposal for a comprehensive trade pact with the EU that poses enormous threats to Canadians in numerous areas, ranging from the liberalization of public procurement, to stronger intellectual property rules (and hence higher prices) in pharmaceuticals, and the general loss of jobs and markets for a wide range of manufactured products. The proposed deal is just one of a flurry of NAFTA-style trade pacts that the Harper government is rushing to seal, now that it holds a majority in Parliament. Others on the front burner include prospective deals with India, Japan, the Trans-Pacific Partnership, and Korea. In every case, the government invokes the same knee-jerk but unsubstantiated claims about diversifying Canada's exports away from the struggling U.S. market, enhancing productivity, and stimulating new exports from Canada. The reality of Canada's past trade deals refutes that optimistic vision: our exports have grown more slowly with FTA partners than with other trade partners, but our imports have grown more quickly, and bilateral balances have deteriorated.[6]

As noted above, Canada's international trade performance has been miserable in recent years, deteriorating in both qualitative and quantitative terms. The government's only answer to this record seems to be to sign more free trade deals. History proves that these FTAs will not solve Canada's trading problems — they will make them worse. The failure of our exports is due not to foreign trade barriers, but to the inadequate capacities of Canadian businesses (as discussed above), which continue to rake in short-term profits from resource extraction, but lack the wherewithal to develop more innovative, valuable products for export markets. Developing strategic sectors, not signing more FTAs, is the best way to improve Canada's trade performance. In fact, FTAs perversely constrain the ability of governments to foster investment and exports from key sectors (although that hasn't stopped many other countries, from Finland to Brazil to China, from doing just that). The 2012 AFB recommends the cessation of FTA negotiations with the EU, India, Japan, Korea, and the proposed Trans-Pacific deal. Instead of more FTAs (with their built-in bias in favour of corporate mobility and privilege, at the expense of democratic economic governance), the federal government should pursue a different model of trade agreement with key partners — including Europe, the U.S., and other jurisdictions (such as China, whose massive $40 billion trade surplus with Canada gets bigger every year, and is now a massive drain on Canadian employment and incomes). The main goals of these alternative negotiations would be to extract commitments to balanced two-way trade flows (reducing the lopsided deficits that characterize most of our trade relationships); to recognize the need for and the legitimacy of government policies to promote sectoral development and economic diversity; and to spread adjustment costs more evenly across all parties (both surplus and deficit nations).

The crucial factor for improving Canada's trade performance, however, has nothing to do with trade deals — whether free trade deals or alternative models. The real barrier to enhancing the value, diversity, and success of our exports depends more importantly on whether we are able to stimulate more dynamic, innovative, and globally-oriented industries and businesses.

8. Establish a Canadian Development Bank

To provide financing for the ambitious development programs prepared by the Sector Development Councils, the federal government will create and endow a new publicly-owned economic development bank, the Canadian Development Bank. The bank's initial capital would be provided from a share of the higher corporate income taxes collected from the petroleum industry. The bank (like other banks, both commercial and publicly-owned) would leverage that capital into an expanded portfolio of loans and other financial placements (including equity in some cases) in new sector development initiatives that advance the public policy goal of diversifying Canada's exports and stimulating industries that are both desirable and innovative. In other words, this new public bank — like existing private banks — would have the power to create credit and allocate it to selected projects and enterprises in the real economy. The main difference is in the criteria that would guide its financing activity; the Canadian Development Bank's mission is to foster innovative investment in targeted sectors of the economy, with the condition that the bank breaks even with its invested capital. (This implies charging relatively lower rates of interest for loans and other placements, combined with an appropriate cushion for loan losses.) This expansion of public lending capacity will reduce the extent to which key long-term economic development priorities are vulnerable to the cyclical whims of private finance. It also allows for potential projects to be evaluated and funded on the basis of broader criteria (including an integrated social cost-benefit analysis) than is utilized by private lenders. The broad economic and social benefits of a successful program to develop and expand innovative export industries (not to mention the fiscal return to government) justify the government's role in this type of targeted lending activity.

One division of the new bank would have a specific mandate to focus on the allocation of capital towards social enterprise, including micro-credit, community economic development, and co-operative initiatives. This division would work to implement the recommendations of the Canadian Task Force on Social Finance, including partnering with philanthropic and foundation investors to establish tax-supported pools of finance that support "impact investing" initiatives in the areas of community and environmental sustainability. It would also provide start-up financing (through an expansion of the existing Co-operative Development Initiative) on favourable terms for the creation of new co-operatives in the areas of production, retail, housing, and credit unions. In light of the documented failure of private corporations to reinvest their cash flow (as of the third quarter of 2011, for example, non-financial businesses in Canada were sitting on $575 billion in cash and short-term assets), taking pro-active measures to support alternative channels of investment spending is timely and appropriate. 2012 has been declared International Year of the Co-operative by the United Nations, making it all the more suitable that the 2012 Alternative Federal Budget take this initiative to recognize the important long-run potential of social enterprise, and the need for government to be pro-active in realizing that potential.

Notes

1 Measured as a share of GDP, total exports of goods and services have declined by about one-third: from 45 percent in 2000, to under 30 percent ten years later. This is an imperfect measure of export intensity (since exports are a gross measure, and GDP is a value-added measure, hence exports double-count the value of imported inputs embodied in them), but it is nevertheless a useful indicator of the broad trend.

2 "Purchasing power parities for GDP: National Currency Units per U.S. Dollar," Economics: Key Tables from the OECD, Table 11, January 2012, http://www.oecd-ilibrary.org.libaccess.lib.mcmaster.ca/docserver/download/fulltext/190200031x1t004.xls?expires=1331138560&id=id&accname=guest&checksum=F1BF43AD3605C62AF48C80A582B24CC2.

3 Even without a fluctuating currency, a country could experience Dutch disease symptoms resulting from the rapid development of resource exports, through the workings of factor markets, price differentials (especially prices for traded and non-traded output), and other mechanisms.

4 Lee, M. and Card, A. (2011). *Peddling GHGs*. Ottawa: Canadian Centre for Policy Alternatives.

5 *Canada's Emission Trends*. (2011). Ottawa: Environment Canada.

6 Stanford, Jim. (2010). *Out of Equilibrium*. Ottawa: Canadian Centre for Policy Alternatives, pp. 29–32.

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