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Chair

Mr. John Cannis

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● (1540)

[*English*]

The Chair (Mr. John Cannis (Scarborough Centre, Lib.)): I call this meeting to order.

I'd like to open by welcoming our witnesses today to the Subcommittee on International Trade, Trade Disputes and Investment of the Standing Committee on Foreign Affairs and International Trade. Our topic for the day is emerging market strategy.

Our witnesses are, from the Centre for Trade Policy and Law of Carleton University, Mr. William Dymond; from the Bank of Canada, Mr. John Murray, adviser to the governor; and Liam McCreery, president of Canada Agri-Food Trade Alliance, along with Patty Townsend, executive director.

Welcome.

Mr. Murray, would you like to begin?

Mr. John Murray (Adviser to the Governor, Bank of Canada): It's my pleasure.

Thank you for inviting the Bank of Canada to participate. When I looked at the terms of reference I guess I was a little surprised, but I hope I'll have something of interest to say.

Our concerns at the bank are broad and macroeconomic in nature. I guess the two key messages I'd like to relay, not surprisingly, both concern the macroeconomic scene, but more particularly financial markets. As we look for areas where one might try to improve the competitiveness and strength of Canadian firms, there are things that I suggest we could do on the domestic financial front, as well as the international financial front.

We obviously have more control of one than the other, and here I'm thinking of our domestic financial markets and our domestic financial regulation. Nevertheless, we do have some influence in the international sphere on the international financial system, so I'll say a little about that as well.

I should indicate that I passed around some handouts and I'll be referring to those, albeit loosely.

The first part of my talk concerns what I'll call the notion that international competitiveness begins at home. There's a lot we could do here that would not only improve our capability to penetrate markets internationally and succeed, but obviously increase economic welfare at home.

The other point related to this is what I'll call a side benefit to globalization. We're familiar with the advantages that accrue from specialization—trading on comparative advantage through open trade—but the increased competition also brings other benefits. It encourages—some might say forces—Canadian businesses to adopt leading-edge technologies and stay on the frontier. There'a also a reduced tolerance for policy mistakes.

If you're a closed economy, you can get away with quite a bit because you're not facing any international competition from other countries, but there's a certain edge to things once you open up and you're in competition with a number of countries. This is true in an even more exaggerated form when we look at the emerging market economies and the enormous challenges and competitions they sometimes bring as they come into their own.

I will talk briefly about the importance of structural reforms, as well as strong fiscal and monetary policies. We start from a very positive place. Over the last ten years, fiscal policy and monetary policy have done pretty well, if I can say that. That's not to say everything is perfect and there isn't room for improvement in these spheres. But I think there are areas relating to structural reforms in our domestic economy that perhaps deserve more attention, and where the benefits realized would be even greater in terms of enhancing the competitiveness of Canadian firms and our ability to penetrate foreign markets.

Some of these policy prescriptions relating to structural reforms and market liberalization can be seen in the advice given by the IMF and the OECD in their annual examinations of Canada, as they do for all other countries.

There are two that I'd like to focus on. The first concerns interregional trade in Canada. We know there still exists serious interprovincial trade barriers; restrictions inhibiting the flow of goods, services, labour and capital, even among our own provinces. It's a little ironic that we talk about what we can do internationally to penetrate foreign markets, when at times we do so little to penetrate our own. What we need is a strong domestic base from which to operate if we hope to succeed internationally.

I'll have more to say a little later about the importance of a flexible domestic economy in which you can easily reallocate factors of production, labour, and capital.

What I'd like to turn to now is really my pet theme for the first part of my brief presentation: financial sector efficiency and stability, an obvious interest of the Bank of Canada.

We know financial sector efficiency and stability are very important contributors to economic growth. As you do country comparisons it's no surprise that the countries with the strongest institutional framework as well as the countries with the strongest financial systems seem to flourish.

Canada has a very positive history here. For a long time through the post-war period—I'm thinking particularly of the late sixties, seventies, into the eighties—we had among the biggest, strongest banks in the world, and some of the most progressive and active domestic capital markets. We still do very well, but in the interim other countries have caught up to where we were, countries like the United States, which never used to allow nationwide branch banking, for example, and which has now eliminated some of those barriers. So we've seen the emergence of truly large concentrated banking entities, which may or may not carry certain advantages. But certainly there's a sense that if we want to do the best we can by our firms, and here I'm thinking in particular of small and medium-sized firms, which are particularly dependent on bank loans for their financing—we need to pay careful attention to what's happening in the domestic financial system.

We also need to care about the liquidity and efficient asset pricing in our domestic capital markets. There are three topics that have received a lot of public interest and debate recently: bank mergers, ownership restrictions, and security regulation in Canada, all of which are important and deserve careful attention. I'm not presuming any answer or outcome here, but you just have to ensure you're doing the right thing in those areas, whatever it is.

That's it for the domestic side and the things we could do to strengthen the domestic financial system and enhance our competitiveness. I'd like to turn for the last minute or two to the international scene, and really talk to two sub-themes. One is the international pressures that Canadian businesses and the Canadian economy as a whole have been facing the last few years and are likely to face in the next couple of years. But second, related to that, are some problems or frictions that exist in the international financial system and about which we might want to do something, again with a view to enhancing the competitiveness of our firms as well as the ability of our economy to succeed as it might.

We've seen the emergence of China, India, and other developing economies as major international players. That's almost all anyone talks about any more, but it's true. Interestingly, but not coincidentally, all of these economies have followed what's called an export-led growth strategy similar to what Japan and Korea before them followed successfully in the fifties, sixties, seventies, and eighties. Of course, now we're talking about economies that are much, much larger than even Japan, so when they succeed there's a major impact on the world economy.

To a degree, these strategies have relied on a fixed exchange rate in which their currencies have been pegged either officially or unofficially to the U.S. dollar. For the last few years, of course, with the U.S. dollar depreciating against other industrial currencies, this has implied that these countries have gained an additional competitive advantage as their currencies have depreciated along with the U.S. dollar against the currencies of Europe, Japan, Australia, U.K., and yes, Canada.

Through this process of rapid growth we've also seen the emergence of enormous and indeed unsustainable trade imbalances in the global economy. We've seen an enormous trade deficit emerge in the U.S., mirrored with growing surpluses in Asia.

● (1545)

This has to be resolved one way or another. It's probably going to involve a number of things. But one of the vehicles for this, and we've already seen it at play, is currency realignment. The U.S. needs to import less and export more. Asia, Canada, and Europe need to import more and export less. This much is a given, to put the international economy on a more sustainable track. This has involved a depreciation of the U.S. dollar to enhance the competitiveness of American industries and the converse for Canada, Europe, and other countries.

This isn't necessarily a bad thing. I want to be very clear about this. Our exchange rate has appreciated along with our terms of trade, the prices of the goods and services we export have increased in value, and Canadians as a consequence have been made better off through their ability to import goods more cheaply. This is all a good thing. But it's coupled, of course, with at times a painful and awkward adjustment. The trick associated with successful monetary policy as well as structural reform and good fiscal policy is to try to facilitate that adjustment and minimize the pain while easing the transition to this better economic state.

One of the things that would help along the way is if we also saw more flexibility in the exchange rates associated with the countries in Asia. I put in a number of graphs here, graphs one through four. I'd like to flip through them quickly.

The first graph plots the track of reserve accumulation in Japan, China, and other Asian countries. Asia collectively now holds about $2.5 trillion in U.S.-dollar-denominated reserves. That's phenomenal in size, and you can see the phenomenal growth track this has followed. This is a testament to the aggressive foreign exchange intervention policy that has been pursued by these countries in an effort to keep the value of their currency down. Here I'm thinking in particular of China.

Graph two shows how the exchange rates of the major industrial countries, including Canada, have moved through time. Perhaps to some committee members' surprise, you'll notice that Canada has actually appreciated a little less than some of these other countries against the U.S. The caveat here, of course, is we're much more open than a lot of these other countries, and the U.S. is a lot more important to us, so that when we appreciate against the U.S., it really matters.

Three is really what I'm coming to. The third graph is like the program my children used to watch when they were little, *Sesame Street*: one of these things does not look like the other. You can see wiggly lines, but then you see one flat line. That's the value of the Chinese renminbi or the yuan. You can see that it has not been appreciating. As a consequence, they have been securing additional competitive advantage.

One of the things the international community has been at pains to encourage over the last few months is reconsideration of that strategy on the part of the Chinese and for them to move to a more flexible exchange rate system, which would not only help us and other trading partners secure some advantage and relief but would also help the Chinese relieve some of the pressure that's building up in their economy, which by some measures is growing far too quickly to be sustainable. A flexible exchange rate would also give them a greater measure of control over their own monetary policy and would help diffuse some of the speculative inflationary pressures that are building in their economy. This call for greater flexibility and liberalization in the international monetary system is a win-win situation. It would help the Chinese and us and other trading partners, and it is something that would help the competitiveness of Canadian firms.

Graph four shows you some of the current account balances: in the U.S. an enormous deficit, offset by surpluses almost everywhere else.

Where does all this leave us? We have Canada as the most important trading partner of the U.S. and, whether we like it or not, part of the global solution to the U.S. trade deficit. So we have something to contribute, and we have been contributing.

● (1550)

There have been fundamental forces affecting the value of the Canadian dollar. We've been appreciating, but appreciating for a reason. One of the most important factors, in part because of the growth of Asia, is the phenomenal demand for our primary products that we've witnessed, including energy.

Our net exports of energy, the net surplus on energy trade for Canada, now equals about $60 billion a year. That's big. You add wood, grains, other minerals. This is very important to Canada. Those prices have been rising.

As a consequence of that demand, it's no surprise that our exchange rate has also been appreciating. Indeed, there's a Bank of Canada equation we've calculated that tries to explain the movements of the Canadian dollar just looking at movements in interest rates in Canada and abroad, but more importantly, movements in world commodity prices.

And if you turn to graph 5, you can see two lines. The dark line is the actual exchange rate. The dashed line is the line predicted by what I sometimes just half seriously call the magic Bank of Canada exchange rate equation line. And you can see that commodity price movements alone do a pretty good job explaining some of what we see—not all of it.

Another important factor, and this is one shared by all major world currencies, has been the generalized appreciation against the U.S. dollar. One of those graphs I showed you earlier showed you how all of the major industrial currencies have appreciated against the U.S. dollar.

This is part of solving the global imbalance problem, and it's not necessarily a bad thing. What it implies is that we can expect, and indeed we'll need to see, most of the strength coming from the domestic as opposed to external side of the economy looking ahead. This doesn't mean we shouldn't focus on exports and enhancing our competitiveness; it just means the only way to square the international circle, and to have the U.S. export more and import less, is if its major trading partners do the reverse. So as we look at resolving some of these global imbalances, I guess the positive way of looking at it is that we get to keep more of what we produce for ourselves.

I'm being signalled, and I'll end on that.

There are two messages. We could help ourselves enormously if we focused on improving our domestic financial system. There are also things internationally that one can do to reduce some of the frictions there and facilitate adjustment. If some of the Asian countries had a more flexible exchange rate, it would relieve some of the competitive pressures that have otherwise been shifted onto floating currencies such as the Canadian dollar and help the situation faced by our firms.

● (1555)

The Chair: I'm sure there'll be ample opportunity in questions to add on, Mr. Murray.

Mr. McCreery.

Mr. Liam McCreery (President, Canadian Agri-Food Trade Alliance): Thank you, Mr. Chair.

I'm going to start by saying thank you for allowing me to appear in front of this committee today. It's an honour. You are the decision-makers in Canada, and to be allowed to have input is a great honour.

We have a submission we've given to clerk. It will be translated and provided to all members. Please take the time to read it. There are many excellent details and excellent points from the agriculture sector that I think you should know about.

I have seven minutes, I understand, Mr. Chair.

The Chair: You have a maximum of ten minutes. I'll put it that way.

Mr. Liam McCreery: So I'll be brief, no matter how long it takes.

I'll start by introducing CAFTA, the Canadian Agri-Food Trade Alliance. We are a group that represents the two largest sectors in primary agriculture—the grain and oilseeds sector and the beef sector. That's number one and number two. Between those two organizations we represent over half the producers in this great country. But we're more than that. We're the entire value chain in the food sector. We represent the genetics people, the people who provide us the feed for the farmers. We're the further-value-adders, the exporters, the consuming people. We represent the entire chain. We're very proud of our constituency, and our goal is more open, free-trading market systems.

I don't have to say this to this room. Trade is important to Canada. Over 40% of our gross domestic product is derived from international trade. But please understand that trade is also very important to the Canadian agriculture and agrifood sector. Over 50% of our farm gate production leaves this country—over half. The line I like to use is, if we decided not to participate in international markets, we would have to give somebody a job to fire half the farmers in Canada. That's pretty stark.

We are the third-largest exporter of agriculture and agrifood products in the world and the fifth-largest importer. I understand why half of our production leaves this country—91% of us realize our prices in international markets. When I sell my corn in southern Ontario to a beef producer in northern Ontario, the price I receive is established internationally. So even though I'm not exporting that corn, the price is established internationally. That's 91% of us. It sounds pretty great, doesn't it? But we face some very tough obstacles.

Number one is that we are in a very competitive environment around the world and our competition is good at what they do. That's fair. We are very competitive in Canada. If you look at our sectors, we've been very successful in exporting our products around the world.

But point number two is what I want to talk about today. It's the unfair barriers that are in place. Agriculture is the most distorted sector in the world when it comes to international trade, and when international trade is so important to Canada, those poor rules affect us very adversely.

To give you a quick rundown—I think you know these numbers—currently the WTO allows for, and there is, over $300 billion U.S. spent every year on trade-distorting subsidies. We face huge tariffs around the world. The average agricultural tariff is 60%. The average industrial tariff is 4%. If you look back, that makes a bit of sense. The WTO started in 1947, and they've taken about 60 years to ratchet those tariffs down to 4%. Agriculture came into the WTO in the Uruguay Round back in 1994.

What can the Government of Canada do to help agriculture in Canada? Let's talk about bilateral and regional trade agreements first. As was discussed earlier, this is a double-edged sword. Our bilateral and regional agreements are great agreements if you're part of them, but they're awful if you're not. The positive example is NAFTA. The NAFTA agreement has helped Canadian agriculture, has helped increase our trade surplus. On the other side is the bilateral between the United States and Morocco, which gives American wheat producers an unfair advantage over Canadian wheat producers in entering that market. Understand that these bilateral and regional agreements usually leave agriculture out altogether because it's too sensitive and never touch the subsidies side of the equation.

You've heard it from me before. The best route to help Canadian agriculture is through the WTO.

I've been asked to talk specifically about emerging markets today. I've talked about them in fairly broadly terms so far, but I'd like to give you some specific examples—examples that hit the bottom lines of Canadian farmers and Canadian industry.

The first example is discriminatory tariffs. This is when you have a product, say vegetable oil, that you can source from different seeds. India is the largest vegetable oil market in the world. The tariff they apply to soybean oil is 45%. The tariff that's applied to canola is 85%. So India sources its oil from the United States and Brazil instead of from Canada, because Canada, while we do have a strong soybean production system in Ontario and Quebec, is big in canola. That hurts us directly.

● (1600)

Another example is China, the world's number two vegetable oil market, where canola, again, has a higher tariff applied to it than to soybeans. That keeps us out of that market as well.

These are clear examples of why Canada has to be engaged not only in bilateral agreements but at the WTO, and at both the government level and industry level, so we can point out these inequities. These don't help the importing country; they just hurt us, the exporters.

The second example I'll use is tariff escalation. The classic examples are beef into Korea and canola into Japan. Tariff escalation means one tariff for the raw product and a higher tariff for the processed product, the value-added product. Think of it in these terms: we take our great products, canola and beef, and export them over to Korea and Japan. We export our jobs, as well. The jobs, instead of being in western Canada, are in the Pacific Rim, in countries we have huge trade deficits with.

To conclude, there are two paths we can go down. One is the bilateral agreement. And let's recognize that those bilateral agreements are important to Canadian agriculture, especially when we happen to be a part of them, and understand that they hurt us when we're not. There are four pillars around bilateral agreements, one being that we have to be able to increase market access. That means lower tariffs. We have to help emerging markets with trade facilitation. This means helping importing countries to use commercial terms in a consistent manner. Canada has to continue to have a reliable and cost-effective infrastructure to get our products into those international markets. And—I tried to bring this up under the canola discriminatory tariff examples—Canadian industry must be involved with the government in making sure we're at the table identifying the clear inequities that we face in the world.

The second method of obtaining access into the emerging markets is through the WTO. For agriculture, this is our ace. It attacks both the tariffs and subsidies in a way that no other mechanism in the world right now does. And it helps us in all emerging markets.

We've always taken a bit of a different view on emerging markets. I think they've been identified as Korea, China, India, and Brazil. To Canadian agriculture, they are all markets that we're kept out of artificially. With the successful conclusion of the current round of the WTO, we see that as our entryway, our gateway into these new markets that will be emerging for us.

Mr. Chair, thank you for taking the time to listen.

● (1605)

The Chair: Thank you, Mr. McCreery.

We'll go to questions.

Ms. Stronach, go ahead, please.

Ms. Belinda Stronach (Newmarket—Aurora, CPC): Thank you very much.

Mr. Murray, we'll start with you. Where do I begin?

One of your points was that to round out—I don't know whether you said the square edges on the global trade picture—the U.S. should, in all likelihood, export more and import less. That may affect Canada's trade relationship with the U.S., and we may have to, to some degree, focus more on our domestic economy and strengthen that, strengthening domestic consumption for some of our products. That worries me a little bit—well, quite a bit—because Canada, first of all, is about 10% of the size of the U.S. economy. We don't have the internal market that the U.S. does. We rely on trade to create the wealth and prosperity that we want to have here to be able to pay for the social programs that we want to have across this country. So we are dependent on trade.

To jump for a moment, business has the opportunity to invest all over the world, where it can make the most profit. That is the responsibility of business. My question centres on—really it's a big-picture question—what Canada's competitive advantage will be. What do you see that can be Canada's competitive advantage, to make sure we encourage investment to come to Canada so that we can, at the end of the day, have good jobs here in this country, high-quality paying jobs?

I'm of the view that we should be exporting more to build more wealth to be able to pay for the social programs we have. It's really by trenching the right channels here in Canada that we can encourage investment to flow here. What do you see that Canada's competitive advantage can be in this global economy?

Just to relate a little bit to my previous example, if you had a factory that paid say $30 an hour in Canada or the U.S., that same factory might pay $3 an hour in Mexico, and perhaps $3 in China. So what can Canada do to facilitate our businesses' being more competitive or what do we have to do to trench the right water channels to make the desert bloom here in Canada?

Mr. John Murray: Those are big-picture questions, but I think we're more closely aligned in our views than your question might suggest.

I welcome your questions, because I can perhaps sharpen what I was saying a little and be a little more precise. I'll try to organize my response in three ways.

I guess my first concern was to outline some of the broader international forces that were at work and which, realistically, you probably can't resist—and you wouldn't want to resist. One of those forces is the need to adjust the U.S. current account deficit. It's unsustainable dynamically speaking; it cannot continue growing the way it has.

Part of that, of necessity, is going to involve countries exporting less. Now, that's a little misleading, which is another point I'd make. At the margin, it could happen by growing not as quickly, and importing a little more, and not exporting quite as much. That may sound like a bad thing, but it still allows for growth. I've mentioned just the U.S., but it doesn't preclude trade into other markets. You would hope and think that countries in Asia, for example, as emerging market economies, should be drawing in more products and services than they are. There's a typical kind of production or life cycle to economic development, and it's unusual for countries at this stage of development not to be importing more than Asia is. For Asia to be an enormous surplus area at this stage in their development is unusual.

So when we say something has to be done to correct the U.S. trade imbalance—and that will involve Canada to a degree—it isn't necessarily a bad message for the economy, nor does it preclude other options or growth in trade in a gross form.

I guess the second point I'd make is that it's important that the price signals that direct production and trade not be biased. Right now, there's a sense in which the international monetary system is not being allowed to work as it should, and price appropriately, because of some of the exchange rate actions taken by other countries. So this affects our competitiveness and biases the price signals that direct domestic production and trade. That's why I would say that attention needs to be paid to correcting this practical problem relating to the way the international monetary system is operating right now.

The third thing really focuses on the last question you address: what is our advantage in all of this and how will we survive, a “what-will-become-of-us” notion. I guess I've got a two part answer to that last thing.

First is comparative advantage, and that we've learned from experience that you don't have to be more productive in absolute terms or cheaper than everyone else to succeed, but rather that it's through specializing. So I am confident that we will survive, even if *ex ante* we seem to be the more expensive provider at times.

But the second part of my answer links in the following way to what I said earlier. Provided the price signals are appropriate, provided the exchange rates are appropriately valued, this process of reallocating resources, labour, and capital and exploiting your comparative advantage will take place and succeed. But the important thing is to get those price signals correct, and part of that involves a more flexible exchange rate system in Asia. Flowing from that, one would probably expect more currency appreciation on their part and what you might call more equitable burden-sharing with regard to solving the U.S.'s trade problem.

Some more of that needs to be taken on by the countries in Asia, so that those who are floating don't bear a disproportionate burden in that adjustment process.

Does that...?

● (1610)

Ms. Belinda Stronach: I get it.

Do I still have some time to keep going?

The Chair: Yes, three minutes.

Ms. Belinda Stronach: First of all, on Canada working without the U.S., at the end of the day I obviously would like to see, for example, on softwood that we don't lose market share. The U.S. still imports the same amount of softwood, but gets it from Russia as opposed to Canada. What can we do to work with the United States to make sure that our economies both remain competitive? Because we do share many of the same democratic values, principles, and rules of law.

That's one. I have another general question on the whole relationship, but it relates to trade. What can Canada do? Is there a role Canada can play in encouraging China to adopt a more flexible exchange rate, or to help speed up that process? What can we do? Because I do agree with you on that point. You could go on to future trade arrangements as well, because there really isn't a level playing field at the end of the day. Business again can go where it will make the most money. Countries have different standards of living, different laws, regulations, and that's all the cost of doing business.

Mr. John Murray: I'd start three things again, but return to the comparative advantage notion. You can't underplay the importance or stress too much the importance of that notion. The fact that countries have different standards of living and different wage rates doesn't preclude profitable two-way trade and win-win solutions for both. So it's not a case of the low-cost, low-wage country taking over the world, the sort of great sucking sound that Ross Perot referred to with regard to Mexico, but now transferred to China and India in this fear that they may just do everything. That won't happen. We know that eventually things adjust and you do what you do relatively best. That may change through time, but it's important to encourage that adjustment process.

You're right about working with the U.S. and other countries to make sure that the system within which you operate works well, that the institutional framework provides a level playing field, as it were. Part of it relates to trade and the success of the WTO and ensuring that works well. Part of it, as I suggested, relates to the international financial system and what you can do there. There your leverage is a little more limited. I have countries choose to accumulate a lot of reserves and peg their currencies. There are some things you could do, but it's really force of argument, and in various fora Canada, the Bank of Canada, the Department of Finance, and others have been quite active, whether it's in the G-7, the G-10, the G-20, the IMF.

This is where the advice is provided. Again, the message, just to be clear, isn't “You have to share part of this burden—we're suffering.” But it's also stressing the fact that we believe, even from their standpoint, that greater flexibility in terms of their currency arrangements would help them in a number of ways domestically, that this is something they need as much as we do.

● (1615)

Ms. Belinda Stronach: I understand the dilemma.

Mr. John Murray: So discussions are under way, and there are signs that this is being taken on board. Certainly the Chinese acknowledge the need to move to a more flexible system. The issue, as is often the case, relates to timeframe. How soon? They have domestic problems that they suggest they need to deal with first. There may be some merit to that argument, but still there's a lot of encouragement coming internationally to “do the right thing” on the currency side.

The Chair: I'm sure you'll be asked again on that one.

We'll go to Monsieur Paquette.

[*Translation*]

Mr. Pierre Paquette (Joliette, BQ): First, I would like to thank you for your presentations.

I would like to stay with China. In the early 1990s, the American economist Krugman said that the growth of the Asian tigers was not sustainable because the accumulation of assets was not adequate to support this rate of growth. And sure enough, we had a deep financial crisis in the late 1990s.

China is in a similar situation. At the beginning of your presentation, you talked about growth in China and India. What are the differences between the present growth in China and India, and the one experienced in some countries of south-east Asia? Some people are concerned that the Chinese economy will not have a soft landing after such a strong growth, since it will not be able to sustain a 9% rate, and that could spell problems for international trade. Do you think this concern is justified?

I will ask all my questions right away, Mr. Chair.

I also have a question on your remarks on the Canadian economy. I think one aspect has been under-emphasized. I may be more sensitive to this, coming from Quebec, where this is more on the radar screen. The Canadian industry, certainly in Quebec, is mainly made up of small and medium businesses. How can they possibly manage to compete? We are talking a lot about productivity, but it seems to me that innovation is another very important factor. I remember Louis Garneau saying that Asian countries are copying his products every six months. He said he was trying to be ahead of them by at least six months and that otherwise, he could not compete with them. I would like you to talk about that.

Concerning the agricultural industry, you talked about the agreement between the United States and Morocco. I would like you to explain that further so that we can better understand your approach. I inferred from your remarks that you like multilateral agreements more than bilateral ones. It seems that the Americans are now making a lot of bilateral agreements, and these agreements end up altering the spirit of the North American Free Trade Agreement. We have seen that in the textiles sector, for example. They use American textiles, have them processed in the Caribbeans through a special agreement and they bring them back on their own market. Obviously, our Canadian clothing and textile industry is penalized. I thought your example of Morocco is similar to that.

Finally, do you think Canada should invest more in WTO negotiations or in bilateral agreements, for example with South Korea or other countries.

These are my questions. I will let you answer now.

● (1620)

Mr. John Murray: I will answer in English.

[*English*]

I imagine it will be easier for you to understand.

I understood your questions, and there are really two parts. First, regarding the parallels between what we're seeing now in China and India versus the experience through the 1990s in other Asian tiger countries and whether that makes one feel a little uncomfortable, my quick answer to that is yes. I'll return to that in a minute. The second part of your question relates to small and medium-sized enterprises and what advice one could give with regard to surviving and even flourishing in this world.

On the first part, yes. One of the reasons people are concerned about what's happening in China and India right now is because of the instability this can lead to financially. They are growing at phenomenal rates, and because they lack some of the instruments necessary to contain that activity, and I'll explain in just a minute what I mean by this, there is a risk of having too much of a good thing—too rapid growth, too much speculative activity—and as a consequence, a hard landing.

There are parallels you can draw in terms of what happened in other parts of Asia through the early 1990s, feeding into the Asian financial crisis of 1997-98, where again, with too much of a good thing, the system just sort of imploded. This is part of the advice that is being given to China.

If you fix your exchange rate, for example, one of the things you cede control of is domestic monetary policy, because you can't do two things at the same time. You can't control your own economic activity and domestic inflation and at the same time control the exchange rate. You have only one monetary policy instrument, so it's an either-or situation.

Effectively, China and many other Asian countries have ceded responsibility for monetary policy to the Federal Reserve of the U.S. While the Federal Reserve has done a very good job directing monetary policy in the interests of the U.S. economy, it would be remarkable if those interests happened to coincide with the needs of the Asian economies.

Essentially, they are importing U.S. monetary policy, and as a consequence they lack the control mechanisms needed in part to contain or direct economic activity within their borders. They have to use other, more crude, I would say, or rough administrative measures to try to contain things. They have applied some recently, but there's a question as to whether they'll succeed.

So your question is a very good one. There's a real concern that instead of having a nice soft landing to a more sustainable track, it could be a hard landing. This isn't to say it's inevitable, that it has to happen, but certainly this is one of the reasons people are encouraging an earlier exit out of the fixed exchange rate arrangement they're now in and a move toward at least a little more flexibility, if not complete flexibility, in their currencies.

With regard to small and medium-sized enterprises, I can't pretend to be an expert on any of that. The only guidance I could provide is the sort of guidance I gave at the start, where if we follow sensible policies domestically that benefit all of our firms, small and medium-sized enterprises are part of that. Small and medium-sized enterprises, in particular, benefit from a very strong domestic financial sector, a strong banking sector, as an aid to generating the necessary financing for their activities. But admittedly, as a small or medium-sized enterprise you face challenges penetrating markets that are far away. I don't know if there's any magic solution to that.

Mr. Liam McCreery: Thank you, Mr. Paquette, for the question. It gives me a chance to explain a bit more slowly, maybe a little more clearly.

I talked about a double-edged sword. Bilaterals and regional agreements can really help Canadian agriculture, and have. An example I used was the NAFTA, where our trade surplus has increased greatly.

Then on the other side is the example of what the United States has done in its bilaterals, and the bilateral I emphasized was the one they have with Morocco. Morocco has lowered their tariffs for wheat, and Morocco can be seen as the gateway into Africa, so that gives American producers and American exporters an advantage over us.

So you talk about where we should be allocating our resources. Again—I feel like I'm preaching to the choir—if you look at Canada's last major regional agreement, it was signed in 1993. Since 1993, I think we've signed—please correct me if I'm wrong—two bilaterals, one with Chile and one with Israel.

● (1625)

Mr. Pierre Paquette: And Costa Rica.

Mr. Liam McCreery: And Costa Rica.

We clearly have to increase our efforts on bilateral and regional agreements. There will be positive things for agriculture, but typically agriculture is the toughest thing to deal with in bilateral and regional agreements. Usually the tariffs don't come down, and subsidies never come down. So for agriculture, while there are positives for bilateral and regional, the main game in town for us is the WTO. Fundamentally, as a Canadian, I believe we should be plowing more resources into all prongs of international trade, but for agriculture the most important is the WTO.

The Chair: We'll go to Mr. Eyking.

Hon. Mark Eyking (Sydney—Victoria, Lib.): Thank you.

My first question is to Mr. Murray. When you're talking about the trade imbalance that the United States has with the world—and we're one of the culprits, I guess you would call it—and you look at the projections in the next ten years, I don't think it's going to change.

Ideally, yes, we should do more business with the emerging economies, because that would offset it a bit and it would help, but the reality is we're right next door. When you see the numbers for the production for oil in the tar sands alone over the next ten years, they say we're going to be close to Saudi Arabia in the production of oil. It's just a given where the oil is going to go. Sure, some could go to China, but the Americans are going to have a thirsty appetite for it. So that in itself is going to cause more exporting.

I have a couple of questions. When you have so many U.S. companies running our companies in Canada, say, lumber companies, oil companies, or what not, doesn't that create a counterbalance because these companies are making money and producing products and some of the revenues are going back? Doesn't that help the United States more? So wouldn't it make it look different with Canada in their trade balance with China, for instance? That's my first question.

The other question has to do with Hillary Clinton and the Democrats and her proposal of somehow strong-arming or forcing a trade balance. Now, if you think about it, how do you do that? How have other countries done that? You would almost have to pick products that would either increase tariffs, or make excuses that products cannot come into your country, I guess—but also having the population in favour of that. I just want to know your opinion on her proposal. Do you think it could even happen down there?

My other question is for Mr. McCreery and has to do with our whole WTO talks in December. We've been the good guys in the last ten years with a lot of the talks. We've been following the rules, and Europe and the United States have often kept their subsidies, or even increased them. There is talk that Europe and the United States are going to start pulling back on export subsidies in the next round. My question is, with you being involved, do you see that happening? Or do you see us again being the good boy scouts, playing by all the rules and dropping our tariffs on products coming in and then turning around and because of political backlash they just go back to where they were?

● (1630)

Mr. John Murray: Okay. Those are good questions again. I'm glad you asked both of them, although I'll try to skirt around Hillary Clinton.

On the first question, when I talk about adjusting these global trade imbalances and Canada's contribution to that, it's important to put it all in perspective. Nothing I suggest is going to in any significant way diminish the importance of the United States economy to Canada.

Right now, as you know, exports account for about 45% of our gross domestic product in Canada. We're one of the most open industrial economies in the world, and the U.S. accounts for about 85% to 90% of those exports. When I talk about contributing, it's very much at the margin. Our net trade surplus is $50 billion. It's about 2% of our gross domestic product. So adjusting a little of that at the edge is what one might be talking about, as Canada's sort of contribution to this adjustment.

The emphasis rather has to be on what others can do, and whether we have this sort of reasonable burden-sharing globally going on. Most of the U.S. trade deficit is with countries in Asia. If you look at my chart that shows current account balances, that becomes clear. That's why I think it's important, realistically, that this adjustment take place there.

It involves a number of things, though. It isn't just going to be currency realignment. One of the problems we've seen in the last few years globally that has contributed to the imbalances is the absence of growth in Europe and Japan. One of the things these areas need to do that is obviously in their own interest, as well as in the interest of correcting these global imbalances, is to grow faster. So it's simply through this process of growth.... They are importing more from the U.S.

One of the reasons why the surpluses in Japan and Europe have been so large is that their domestic economies have been so depressed. So those surpluses are actually a sign of economic weakness. As they grow—as we all hope they will—some of that imbalance will be corrected automatically. So this is not all on Canada. It's not all through exchange rates, I want to stress. Trade is going to remain incredibly important for Canada, and will probably in the future get ever more open.

Hillary Clinton in her proposal is a little frightening for those who favour free-market processes, but it's one of the risks that arise if you don't let the market run as it should. If people don't play by the rules and the system isn't framed appropriately, often the unfortunate recourse is increased protectionism. So her proposal is an example of something that should be worrisome. If it has a salutary effect, maybe it will help drive more appropriate solutions, or more what I'd call market-directed means of adjusting imbalances globally, as opposed to recourse to trade protectionism and sort of forced rebalancing.

I don't know if that's an answer.

Hon. Mark Eyking: There was the first one about U.S. companies owning operations in Canada, and how that changes the water on the beams, I guess you would say.

Mr. John Murray: It does to a degree, although U.S. companies operate everywhere. They're clearly very active in Canada. They do realize profits that they repatriate. Those profits are already included in the trade figures I reported. So recognition is already given to the stream of profits that flows again when we talk about trade in goods and services.

The Chair: Mr. McCreery.

Mr. Liam McCreery: Thank you, Mr. Chair

Thank you for the question, Mr. Eyking.

You're absolutely justified in being outraged at the amount of money that countries are spending on trade-distorting subsidies. You're absolutely justified in being outraged at the tariffs that are imposed on our products as they go around the world. You're justified to be outraged about the Europeans threatening to use export subsidies again. But understand that with the Uruguay Round that we signed onto in 1993-94, those countries are abiding by the rules.

One of the tough parts of these negotiations is dealing with the Americans and their subsidies. If we take their level of subsidies for what they're allowed to do under WTO and what they're actually spending, there's a huge gap. To actually bring that level down so that it actually bites into cutting spending in the United States means huge cuts. You're right to be outraged, but understand that this is why Canada needs a very progressive and aggressive outcome in December.

I want to emphasize that December sounds like a long way away. The main work on moving towards Hong Kong and a WTO agreement will be done by the end of July. I absolutely stress to the committee, in the strongest way I can, that it's very important for Canada to be engaged now and over the next couple of months, and to continue beyond July, of course. July is crucial on the road to Hong Kong in December.

● (1635)

The Chair: Mr. Julian.

Mr. Peter Julian (Burnaby—New Westminster, NDP): Thank you very much, Mr. Chair.

I apologize for my tardiness. I was speaking in the House, so I missed what I'm sure were excellent presentations. I hope you don't mind, but I may ask you to cover ground that you've already covered during your presentations.

I'm concerned about the issue of the quality of jobs. We've been in a free trade regime now for 15 years, and the average Canadian worker is earning 60¢ an hour less, in real terms, than they were 15 years ago. As I'm sure you may have noted in the Statistics Canada study that came out in January, we're seeing that there are a decreasing number of jobs with pension benefits. It used to be most jobs or 50%, and now less than 40% of jobs actually have pension benefits. More and more are part-time or temporary jobs; fewer and fewer are the kinds of jobs that allow a living wage to raise a family.

I guess this is the sacrifice that Canadians have made over the past decade and more. There are a certain percentage of Canadians who are certainly seeing wealth that would be beyond belief 20 or 25 years ago, but most Canadians are actually seeing a deterioration in quality of life.

Mr. Murray, I noted in the presentation, at least in the written part, that you talked about necessary adjustments. Exports are primary materials, as opposed, I imagine, to value added. I may be mistaken in that understanding. If I am, please correct me.

How do we create quality jobs through an emerging market strategy? How do we get jobs that allow Canadians to raise a family, both in the cities and in rural Canada? Rural Canada, as you know, is in a crisis, not only because of the cattle industry's inability to cross the border, but for a variety of factors. How do we create quality jobs that seem to be missing from our economy more and more?

The Chair: We'll start with Mr. McCreery. We'll reverse it this time around. We'll start with Mr. McCreery and go back to you, Mr. Murray.

Mr. Liam McCreery: Thank you for the question, Mr. Julian. It allows me to make a point that I made before you got here. Of course, it's no problem. You're working in the House and that's an honourable thing to do.

Half of our agricultural production leaves Canada. If we decide not to trade in international markets, half the farms in Canada would simply have to go and do something else. You asked a question on how we can make better jobs and higher-paying jobs.

In my profession, how can I make my farm pay me more? Take the distortions out of international markets to allow me to compete. If I'm going into some of the richest markets in the world, like Japan and Norway, and I'm facing dirty tariffs of 500%, 600% or 700%, obviously I can't go there. For my industry, take away the artificial barriers and take away the trade-distorting subsidies so that we can compete in international markets and have a chance to prosper for ourselves and our families.

The Chair: Mr. Murray.

Mr. John Murray: I'm glad Liam went first. He gave a good answer.

I'm aware of the Statistics Canada study, and I won't debate the results, but I think it's misleading, even dangerous, to make the connection between that and free trade. Experience suggests to many of us that free trade gives you a better chance at enhancing economic welfare, as opposed to a more protectionist existence or a closed economy state.

It's just like you and me: if we tried to do everything ourselves, we wouldn't get very far. The same thing translates to countries. If you promote freer trade and let the market speak—not to sound too much like a free market person—almost always the results are favourable. You flourish economically and people do better on average—not everyone, but certainly the countries on average succeed. So I just caution against making this link between NAFTA and people being poorly off. You don't know what the control solution would have been otherwise.

● (1640)

Mr. Peter Julian: My point is this. In B.C., for example, we've lost 20,000 jobs in the softwood industry. We've seen the promise of NAFTA and the dispute settlement mechanism we negotiated with the Americans simply disregarded, ripped up, while we continue to provide preferential and privileged proportionality access on energy exports. Under NAFTA the Americans continue to have access to our energy resources, while we don't have access to something we negotiated. So the promise of what we signed and the reality of what most Canadians are living are two different things.

That's why my question is, how do we move to quality jobs? I'm not talking in a theoretical way, I'm talking in practical terms. Most Canadians demonstrably are worse off than they were a decade ago. How do we correct that imbalance, when what I hear from a number of sectors is that more of the same might make us do better?

Mr. John Murray: I don't have an easy answer to that. As we look at where we are now versus where we were 10 or 15 years ago, a lot has happened in the interim, some of it of a domestic nature as opposed to international. But again, I think it's a false assumption to link the trade with other economic consequences. So many other things have changed. I'd assert that absent NAFTA, albeit with some flaws, softwood lumber and so on, the situation could and would be far worse.

We've just seen an enormous growth in trade, exports and imports, two-way, in both countries, that far exceeds what any of us had anticipated as we constructed our little economic models and tried to make projections. This has been a period in which Canada really has enjoyed support from the external side at a time when its domestic side was weak. There were necessary and important physical adjustments, for example, we had to go through, which depressed domestic demand, and trade filled that gap and provided the support as necessary through this difficult work-out period or transition. We've been through a lot of shocks, some of them domestic, during this period, and I'd say if anything, trade has been a source of tremendous support. Without that, I think we would have been in real trouble.

As for value jobs, I don't make judgments about what's a good job and what's a bad job. I think that if you let people do what they do best under the circumstances, generally they will succeed both materially and psychologically.

The Chair: Mr. McCreery.

Mr. Liam McCreery: It's interesting that you use softwood lumber as the example. Clearly, the issue wasn't free trade; the issue was the rules around trade, the dispute settlement mechanism. One of the best ways to have better dispute settlement mechanisms and to go after things like anti-dumping and countervail is through the WTO. The point you're making actually points to the need for stronger rules at the WTO so that we can resolve these issues with our trading partners.

Mr. Peter Julian: That brings me to my next question. Since the chair is otherwise engaged, I may be going overtime, but I'll slip in there just the same.

Are you concerned about the supply-side institutions and the impact on the WTO negotiations we're having? Our Canadian supply-side institutions have been very important for rural Canada.

● (1645)

Mr. Liam McCreery: My job here is to represent the 91% of farmers who aren't in the industries that are protected by tariffs. I don't think it's appropriate for me to talk about them, as it's not appropriate for them to talk about what our industry needs. We need to grow, and we need access to the markets, and we need to get rid of those subsidies that are hurting us artificially in the international markets.

The Chair: You've got a minute left.

Mr. Peter Julian: Oh, really? Is it ten minutes, sir?

The Chair: Yes, it's ten minutes, and you've got just shy of one minute left.

Mr. Peter Julian: Okay, great, thank you. Here I thought I was taking advantage of you, Mr. Chair, but it's not the case.

The issue of the trade deficit in the U.S.... Now in our case, in the service sector, we have a significant trade deficit with the U.S. We also have deficits in other areas. You raised the idea, Mr. Murray, about being part of the solution to the U.S. trade deficit. I'm raising concerns about how much of a price Canadians are already paying, but that's, I guess, a matter of debate. We'll just have to agree to disagree on that.

What do you think the impact would be if we addressed the issue of the U.S. trade deficit when we have a deficit in various sectors with the U.S., including the service sector?

Mr. John Murray: I have two points, both related. When I speak about correcting global trade imbalances, there shouldn't be any presumption that the appropriate equilibrium implies zero balances for every country and every product.

Canada, at present, has a sizable trade surplus. We have deficits with some countries, surpluses with others—more others—especially the U.S. We do have a deficit in services. We do have a deficit in some products. Indeed, for manufactured goods, we run a trade deficit of about $50 billion. For primary products, we run a trade surplus of about $100 billion, which more than offsets that. That leaves us with a pure trade surplus of about $50 billion. Were it not for primary products, we'd have a sizable trade deficit.

That's the way it should be. You specialize in those areas in which you have an advantage. We're blessed with a certain endowment of resources and other advantages, which you direct activity to, naturally.

This is a little pet peeve of mine, but there is a notion out there that if only we could be in computers, or whatever the highest-tech thing of the day is, or constructing rockets, we'd be rich, and that would be the path to success. But clearly, if everyone in the world built computers or built rockets, there wouldn't be a market. You wouldn't be rich.

You have to specialize. You have to provide what others want and what you're best able to do. If you don't want to do that, that's fine too. If you still want to be a rocket scientist, even though there's no market for it, or build computers, even though the market is saturated, you're welcome to do it. The economy doesn't say you can't do it, but you can't expect others to always subsidize your interest in those things.

The Chair: Very well said. Thank you.

Madam Jennings.

Hon. Marlene Jennings (Notre-Dame-de-Grâce—Lachine, Lib.): Thank you, Mr. Chair.

I found your presentation very interesting. Mr. McCreery, your message is very clear and I'm sure that everyone around the table understood it. In terms of the agricultural industry in Canada, the WTO is really important. Canada has to have a strong voice in seeing to the trade distortions and the tariff distortions, to seeing them reduced or ultimately eliminated, if possible. You gave some striking examples.

I do have a few questions for you, Mr. Murray. At the beginning of your presentation, you talked about the importance of structural reform and strong fiscal and monetary policies. You also mentioned, very briefly—you just glossed over it—some policy prescriptions from the IMF and the OECD, like the interprovincial trade barriers that exist within Canada. When you juxtapose that with the other point that you made, that Canada should be attempting, as well, to try to grow our own domestic market.... Could you give us an example of an interprovincial trade barrier that exists within Canada that forces our companies in a particular region to grow through exporting out of the country, rather than through exporting domestically?

● (1650)

Mr. John Murray: That's a good question. I would find it difficult to identify specific examples, my excuse being that we tend to operate at a pretty high level.

Hon. Marlene Jennings: I have a sense that Mr. McCreery can, Mr. Murray.

Mr. John Murray: Yes, good. I'm glad again that Liam's here.

Just as background, the IMF visits Canada every year and conducts what it calls an article IV examination. It does it for every country, all 184 or 185 member countries, so it's not as though we're singled out. And even though you're doing very well—and we're almost a poster child for the IMF—still, nobody does everything perfectly, so there's a list of recommendations at the end.

It's the same with the OECD in Paris. It conducts annual exams for its members and has recommendations. Lately we've been getting very high marks for fiscal policy, monetary policy, and for some of the structural reforms that have been introduced in Canada, the adjustments to the Employment Insurance Act in the past, and so on. But it does have a sort of shopping list, and many of the items on the shopping list relate to market liberalization initiatives that should be undertaken or structural reform.

One of the items has been for years this notion of interprovincial trade barriers. I know and assume they take many forms, and they're serious. And the idea isn't just doing more with what you have internally as a substitute for international trade, but why not do both? I mean, it's not either-or. Why not make your domestic economy as flexible and productive as possible? Why not do this for its own sake, but also as a base of operations to go internationally?

The other thing is that as an open economy, we're continuously hit by external shocks like the Asia financial crisis. In 1997-98 world commodity prices plummeted. The Canadian dollar depreciated dramatically, as it should as a buffer for our economy.

It's more difficult for our economy to adjust and move labour and capital between sectors and regions in response to these shocks if you have all of these barriers. So we're not operating as efficiently as we can. We're not adjusting as flexibly and effectively as we could to these shocks because of these barriers that are being put up. This is a significant factor.

There are a number of things on the shopping list, though. I invite people to look at it. Among the items on this list are the trade barriers that exist. We get some bad marks for the supply management and subsidies that we provide, just as they scold other countries for similar things in agriculture. Of course the list doesn't end there. They note health, the financial sector—they go through a whole list of recommendations.

I chose to mention in passing the interprovincial trade barriers because I think there is a certain irony there; we sit here talking about international trade, when we have work to do in our backyard that could help us. But the second thing was picking out the domestic financial sector, because there are some issues at play here.

These are areas that both the OECD and the IMF identified as needing attention here in Canada, and this would, again, not just strengthen our domestic economy, but strengthen the base it provides for our international activities.

Hon. Marlene Jennings: But I think that's the important point. In fact, if we didn't have these barriers that existed domestically, then, as you said, it would strengthen our economy and allow us better tools with which to withstand the buffeting of adjustments on the international market when you do have crises that take place in other regions of the world that perhaps we do business with or that have an impact on commodity prices, etc.

That's probably the most important point in terms of the interregional or interprovincial barriers that exist.

● (1655)

Mr. John Murray: Now Liam wants to give you some examples.

Hon. Marlene Jennings: Yes, go ahead please.

Mr. Liam McCreery: Thank you, Ms. Jennings.

Thank you for your kind comments on my presentation. You did a great synopsis in 30 seconds, so we could have just had you.

Specifically, there are interprovincial trade barriers, artificial barriers within the Canadian economy, around margarine in Quebec and vegetable oils in Ontario. Companies have to package differently depending on whether they sell in Ontario or in Quebec. The example in Ontario is butter oil.

So there are companies that have to package differently to sell to Manitoba, package differently to sell to Ontario, package differently to sell to Quebec. Many of these companies want to compete internationally, and they're having to set up all these lines. They have undue restrictions, so they cannot provide products that they want to present to consumers. They can increase their market share and help vegetable oil producers like me in Ontario; they simply are not allowed to do it by regulations of the province of Ontario and the province of Quebec.

Hon. Marlene Jennings: But doesn't that also mean that the consumer is ultimately paying more for their product? The actual cost per unit normally depends on the number of units you're able to run. So if a line is only able to run 1,000 units, whereas another one can run 10,000, the latter is going to cost the consumer less than the one that runs 1,000. Or do we average it all out and take the price of both, with everyone ending up having to pay more?

Mr. Liam McCreery: Bingo.

But it's more than that; it's also consumer choice. Consumers are denied products by fiat, by government action. Instead of being allowed to pick what they want to buy, the government has dictated through regulation that you cannot buy certain products.

So, yes, but it's more than that. It's also consumer choice.

Hon. Marlene Jennings: This is an aside.

The Supreme Court of Canada ruled recently that the Quebec legislation requiring that margarine be white rather than butter-coloured is okay. I'd just like an idea of what your industry thought about that, because that's the rule of the land. They've just said that particular barrier is okay.

Mr. Liam McCreery: I'm not a lawyer, but I think the ruling that came out of the Supreme Court of Canada was basically saying that it's not up to them to decide, but it's up to the regulators in Quebec to make it fair. That's my understanding of it. So the onus is still on our elected officials, our friends in Quebec and Ontario, to level the playing field for all.

Hon. Marlene Jennings: To negotiate.

Mr. Liam McCreery: Yes.

Hon. Marlene Jennings: Create our own WTO.

Mr. Liam McCreery: Cool.

Hon. Marlene Jennings: Okay.

I've pretty much covered what I wanted to cover. Thank you very much. Both of your presentations were very clear and gave us food for thought—at least gave me food for thought. Thank you.

The Chair: You mentioned, Mr. Murray, a certain instability in terms of China, India, and emerging markets with respect to what is unfolding and compared it with the previous Asian crisis. I know that Ms. Stronach mentioned in her presentation, and rightfully so, how industry or corporations today look and go to locations or countries where there are facilities, which we know are portable today and can be set up much more easily than they could 30 or 40 years ago, looking to find areas where they can best improve their bottom line as their responsibility to their shareholders, staff, and so on—and rightfully so, as Ms. Stronach says.

But do you not see today, with these new or emerging markets such as China and India, that they've learned from the past experience and that certain other adjustments are being made, so that these major corporations, who are in the position of flexibility and ability, are saying, “We're going to go a China, for example, but we're going to do things a little bit differently than what was done 10 or 20 years ago”, and are able to adjust much more easily and prevent what happened in the past from happening again?

Mr. John Murray: Certainly we always hope we learn from experience, and the Chinese are aware, obviously, of what happened not that many years ago and make reference to it.

The officials are determined to avoid those errors. The rest of us hope they succeed. Companies enter the market with their eyes wide open—and hope. But there's still a sense that it's possible for things to unwind much faster than one imagines and unexpectedly.

I remember giving a presentation in 1997 out west to a group of international investors. I talked to some friends recently, and they expressed some concern about what was happening in some of the Asian countries. I shared these concerns, and my own, with the audience, because basically this was a very enthusiastic crowd. They were very interested in investing in Asia. It wasn't China and India, but Malaysia, Thailand, Taiwan, the Philippines, Indonesia.

After my presentation someone from the World Bank, who I won't name, came up to me and said, “How could you say that? How could these countries ever be in trouble? Look at the size of their reserves and how fast they've been growing.”

Not to suggest that my friends and I are smarter than he is, but he reflected what was the consensus view at the time, and this would have been just months before the countries in Southeast Asia cracked and the crisis unfolded. So right up until it happened there was a sense of optimism shared by almost everyone, and that's when, as central bankers, maybe we get naturally concerned—too much optimism.

In the case of China, they've been growing at 9%, 10%, 11% for a while. There's concern about unbridled speculative activity, especially in certain real estate areas. It's a concern the Chinese have. They've been applying administrative measures. They just sent out a new order to the provincial governments, asking them by edict to keep prices down and reduce inflation—as though that will solve it, by edict. But I think there's some honest concern on the part of the Chinese that the methods they've been applying so far just aren't having the sort of bite that's necessary.

I don't want to suggest a crisis is imminent or even likely. It's just that to your point, you want to learn from the past, and hopefully that's going to encourage people to take action sooner rather than later.

● (1700)

The Chair: Mr. McCreery, if I may, you consistently referred to the WTO. If you had one wish that could be carried out with respect to the WTO, which you have emphasized over and over again, you said it would be that the system, the body, the method could help create uniformity, if you will, or balance. What would you want to see done with the WTO to reinforce, to make things more competitive, more fair, etc.? What would it be, if you had an opportunity to implement one system?

Mr. Liam McCreery: Thank you, Mr. Chair.

Clearly, from a capitalist point of view our ultimate goal is to be in a trading regime with no trade-distorting subsidies. That would be part of the wish.

I'm going to make it parts of wishes so I can make a bigger wish.

Also, I'd wish that export subsidies just be gone and that we compete in a tariff-free environment where we can let comparative advantage rule, as opposed to government interference in our industry's affairs.

The three things I've said are the goal of the WTO. And we need to do it in a timely manner. It will take time to do this. I don't think it has to be 50 years, but 20 years is a noble goal.

We've also talked about—and Mr. Julian brought it up—the importance of having proper dispute settlement mechanisms, so as we do lower tariffs, lower subsidies, when there is a conflict between two countries it can be resolved in a timely way and we can resume normal trading.

Thank you for the question, sir.

The Chair: What you're saying is that the mechanism to apply compliance or enforcement is really what we're all hoping to achieve in terms of WTO.

Mr. Liam McCreery: That's a very important part of the puzzle.

● (1705)

The Chair: What is the “tooth” that is needed to make the WTO enhanced or to make your suggestions come to reality?

Mr. Liam McCreery: I'm sorry...?

The Chair: What “tooth” does the WTO need to be able to implement what you just suggested?

Mr. Liam McCreery: The WTO is a very interesting international body. It does have dispute settlement mechanisms, but it has to be countries dedicated to the process and respecting the laws. It doesn't have enough bite right now.

What's the proper mechanism? I'm not sure, but it has to be a timeline that makes sense. We talked about our friends in British Columbia and softwood lumber. It has been four and a half years. That's a long time.

The Chair: That is a long time.

Thank you very much.

Belinda, do you have anything else?

Ms. Belinda Stronach: Do we have time?

The Chair: We have time, yes.

Ms. Belinda Stronach: Okay. I'd like to hear from both of you on your thoughts on a customs union with the United States. That's being explored potentially by this government to deepen our interdependence with the United States because our economic interests are linked. I'd be curious to hear from both of you on your views on a customs union.

Mr. Liam McCreery: Thanks for the question, Ms. Stronach. I'll answer first, because it will give John time to think.

CAFTA doesn't have a position on that, and I'm not really able to comment on it right now. I'm going to have to defer to John and the Bank of Canada.

Mr. John Murray: I'm glad you gave me a little time to think.

This isn't our area, of course, so what I'm about to say, as for many of the things I've said, reflects my personal views rather than any institutional position on a customs union.

I think it would be the next logical step. It would be a definite positive move to have a customs union in which you have similar trade treatment across the two countries vis-à-vis third parties. As well, even moving beyond that, as you know, the next step would be to have more of a common market where you anticipate the freer movement of labour and capital, not only goods and services.

I think that a customs union could definitely be an aid for a number of reasons. Being inside the tent when it comes to trade disputes would definitely help with softwood lumber and other things.

Ms. Belinda Stronach: Thank you.

I could keep going if no one else has any questions.

The Chair: I was just going to say that I'm keeping it to five minutes. We went from ten to five minutes, and we can go around.

Ms. Belinda Stronach: Do I still have a couple seconds of my five minutes?

The Chair: Yes.

Ms. Belinda Stronach: Thank you.

You raised a point on which I'm curious to better understand the impact, Mr. Murray. I can't recall the number off the top of my head, but the amount of U.S. debt held by foreign countries, including China and Japan, is a very large amount. I'd like to better understand the impact of that.

Again, because our economies are linked, I'm concerned about what is happening with the U.S. economy and its currency, and the valuation of its currency and where it's going. I'd like you to comment on that.

Mr. John Murray: I'll provide some background or some information.

One of the graphs that I circulated, graph four, shows a type of snapshot. As of 2004, the U.S. current account deficit, which includes goods and services and some other transfer items, was over \$600 billion U.S., or 5% to 6% of their GDP. A lot of this reflected surpluses with Japan and developing Asia. Canada's on that graph with a little narrow pink line.

Ms. Belinda Stronach: I'm talking more about the foreign reserves, bonds, and treasury bills held by China, Japan, and other Asian countries.

Mr. John Murray: Yes, it's graph one, I guess, where I show the reserve accumulation, at least by Japan, China, and other Asian countries alone. I indicated, I think, at the start of my presentation that together they currently hold, just in their international reserves—this doesn't include private investment or anything like that in the U.S—about \$2.5 trillion U.S. That's enormous.

Now, there's debate within the economics profession, but clearly their willingness to buy U.S. treasury bonds has helped keep U.S. interest rates lower than they would be otherwise. It's made it easier for the U.S. government to finance its fiscal deficit, which is really a counterpart to the trade deficit we're seeing now.

It's also helped, of course, to support the level of the U.S. dollar and keep it a little higher than it would be otherwise, but at the same time keep the value of their currencies lower. So through this process of aggressive—or “active” might be a less emotive term—foreign exchange intervention policy in this reserve accumulation, what they've been trying to do with some success is keep the value of their currencies down and help support the U.S. So they preserve the peg, and the consequence is lower interest rates in the U.S., a somewhat higher U.S. dollar, at least vis-à-vis their currency, but displacing some of this pressure that has to go elsewhere to other currencies, other countries.

● (1710)

Ms. Belinda Stronach: That's a factor in the offshoring that has now become a very political issue in the U.S.

Mr. John Murray: There has been offshoring for a number of reasons. Some of it is just the natural advantage that India and China have, so you would anticipate some real allocation of activity internationally in response to that.

The U.S. trade deficit and its growth has served as a hot point politically and made it easier for certain industries to lobby for protection and decry outsourcing.

It's very interesting, though, that even in the U.S., the Commerce Department there published a study about a year or two ago, and there have been other studies that looked at all of the net benefits and costs of outsourcing and have found there has been tremendous net advantage to the U.S. from this. So I just throw that out.

Ms. Belinda Stronach: Thank you.

The Chair: Monsieur Julian.

Mr. Peter Julian: You mentioned, Mr. Murray, about seeing a customs union and common market as the next logical step. There have been some people who have raised the possibility of adopting the American dollar. Would you be in favour of that?

Mr. John Murray: That's actually a question I'd feel more comfortable with, because we've done a lot of work on this at the Bank of Canada.

What I'm about to say is going to sound suspiciously like job protection, but here I would favour for now separate and floating currencies. Of course, with a common dollar, which is sort of the ultimate fixed exchange rate, we would be importing U.S. monetary policy, as I've described earlier, and there'd be a great deal less for the Bank of Canada to do as a consequence.

Seriously, the reason we favour this now is we believe the structures of our two economies are still different enough that the flexible exchange rate helps insulate us from external shocks that would otherwise distort activities. If we were forced to move with the U.S., as they would want to respond to those same shocks, it wouldn't suit the structure of our economy. So we actually benefit in a macro-economic sense in terms of preserving jobs, if you will, or stabilizing real output and income in the economy through flexible and separate currencies. However, we're on record as saying that there are obvious benefits to a common currency: there are reduced transaction costs, and you eliminate exchange rate uncertainty, at least vis-à-vis the U.S. dollar, which would still be floating against other currencies.

It's an important and honest question. How do you balance those things off: the micro-economic advantages, for the most part, of a common currency, versus the macro-economic advantages of monetary policy independence and a floating exchange rate?

You could easily see a time at which our two economies would have become so integrated, so insinuated, that in fact the micro advantages of a common currency would more than offset the macro advantages. It's one of our responsibilities at the Bank of Canada, together with other interested observers, to try to monitor this, and if that point is reached, to say, “You know, a common currency wouldn't be a bad idea. All in, now.” it would be better. The trade-enhancing properties of that and the efficiency consequences associated with that now more than offset whatever macro-economic inconvenience might arise from the lack of an independent monetary policy and the insulation provided by this floating exchange rate.

For now, we have separate and floating currencies. In the future, maybe we will have a common currency.

● (1715)

Mr. Peter Julian: You can understand that your words are very frightening to those Canadians who are already living in much more difficult circumstances. I think it takes us back to the difference between the theoretical framework of going to a trading regime where the lowest common denominator—whether it's forced labour in China or pennies a day in India—is the selling out of our resources, and the reality of the proportionality agreement on energy, which, though we have the second-largest energy resources in the world, means Canadians aren't benefiting from those resources.

To me, hearing your words of moving toward a common customs union and a common market, and taking your logic that the more integrated our economies become, the less need we would have for a Canadian dollar, means handing over, in a sense, monetary policy to the United States. I see that as completely wrong-headed, given the track record of what we've seen over the past ten years. It doesn't appear to me at all that a greater dose of the poison that seems to be killing a lot of communities across the country is going to bring prosperity.

We have a lot of difficulties, a lot of issues, and to move to more of the same or to increase integration, when that's already made us very vulnerable in communities across the country—-we've seen that with softwood and we've seen that with our cattle industry.... I'm just very frightened by your words, because I don't think it's what Canadians want to see, and I don't think it's what Canadians would accept.

I think there is increasing frustration out there that a number of individuals seem to be pushing more of the same when it's not working now.

I'll just end on that comment.

The Chair: Thank you.

Madam Jennings.

Hon. Marlene Jennings: Thank you.

Graph one represents the total reserves, excluding gold, in billions of U.S. dollars held by Japan, China, and other Asian countries. Graph two represents the exchange rates of a number of a countries or areas vis-à-vis the American dollar. One of the points you've made is the fact that China, for instance, having pegged its currency to the U.S. dollar, creates a particular situation. It actually means that American monetary policy and domestic policies are in fact imported into China.

I look at the euro, which has held its standing against the U.S. dollar. The U.S. dollar is depreciating. The euro, to my knowledge, has not depreciated; it has remained strong. What would be the impact if one of these countries, like China, that has pegged its currency to the U.S. dollar and holds enormous reserves made a monetary policy that it will now peg its currency to the euro? What would be the impact of such a decision internationally? We know that for China it would now mean their domestic policies are determined by the euro. But in terms of Canada, what would be the impact of that?

Mr. John Murray: It's an interesting question.

Hon. Marlene Jennings: It didn't come from me; it came from one of our researchers. But I thought it was a fascinating question.

Mr. John Murray: It's quite current for a number of reasons. One of the suggestions that has been put forward, even by the Chinese, perhaps as a trial balloon, is the notion of not pegging to the U.S. dollar in the future, but at least as an intermediate step moving to a basket of currencies that would include the euro, the yen, the U.S. dollar, and perhaps other currencies—a trade-weighted basket that they'd now peg against.

The suggestion that they might do this, coupled with suggestions—threats—that they may diversify their reserves into other currencies, has had, periodically, some unsettling effects in world currency markets, because the implication is that the support now being provided for the U.S. dollar might diminish and be shifted onto the euro and other currencies. What it would do is put more downward pressure on the U.S. dollar than we've already seen. It could depreciate further, with more upward pressure on the currencies they're now investing in and choosing to peg to.

The consequences of that for Canada aren't exactly clear. How that would play out just doesn't have an obvious answer. In one sense, the U.S. is going down now, but whether we'd follow with them or be more like the euro and go up in that situation is hard to predict *ex ante*.

With regard to what would happen to China following that.... Say it pegged to the euro; forget the basket. It decided to abandon the U. S. dollar and peg to the euro. If the euro were to continue to appreciate, suddenly, of course, China would start losing competitiveness as well against the U.S. dollar. It would have tied its wagon to that currency. Whatever the future path of that currency, that's what would happen to theirs as well.

If the euro continued to appreciate, as you can see with the red line in graph two, China, which is the red line on the next graph, would have had a very different path. It would have followed the red line on graph two instead of being flatlined like this against the U.S. dollar had it chosen to peg to the euro in 2002. If it does it in the future, the simple answer—it isn't really very useful or revealing—is that the yuan or renminbi, as it's called, would do whatever the euro does. It would be interesting to see if....

Predicting exchange rate movements is the most difficult thing in the world.

● (1720)

Hon. Marlene Jennings: But you're not in a position to speculate on the impact on Canada if China, for instance, decided to peg its currency to the euro rather than to the U.S. dollar. You know it would mean that the U.S. dollar would further depreciate, but the short-term and medium-term impact for Canada is not clear.

Mr. John Murray: One of the things you might expect is that to the extent this peg to the euro was associated with a perhaps one-time appreciation or revaluation of the yuan, it would relieve some of the pressure that has been brought to bear on our currency, and we can find ourselves in a better competitive position.

Depending on how they peg to the euro, at what value they chose to peg, this might or might not relieve some of the pressure we've been feeling, because suddenly these Asian countries would be sharing more of the adjustment burden, as it were.

Hon. Marlene Jennings: Thank you.

The Chair: We're an efficient committee.

Let me thank our witnesses for being here with us today. It was certainly very enlightening, and there were a lot of good questions.

With that, we'll adjourn our meeting.

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