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Intelligence MEMOS

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From: Glen Hodgson
To: Trade Watchers
Re: CAN CANADA ACCELERATE ITS GLOBAL TRADE DIVERSIFICATION?

The Trump tariffs and other threats have re-energized the federal government's desire to diversify Canadian trade and investment. The 2025 federal budget committed to double exports of goods and services to non-US markets over the next decade, to a target of $600 billion in 2035 (in current dollars).

To meet its ambitious goal, the budget provided $5 billion for investment in trade infrastructure to get products to global markets. Export Development Canada is expected to increase total business it facilitates by $25 billion by 2030, in sectors of strategic importance including critical minerals, energy, clean technology, infrastructure, and defence. Prime Minister Mark Carney has been travelling the globe to advance trade negotiations and seek out trade and investment opportunities.

Is much greater trade diversification achievable? Traditional economic models suggest that trade follows "gravity," meaning it is easier to do business when foreign markets are close geographically. In its attempt to overcome gravity, the Ottawa has pursued trade diversification for decades through an ongoing commitment to negotiating additional bilateral and regional free trade agreements, and by encouraging and supporting Canadian firms seeking to do more business in more foreign markets. Yet the United States remains Canada's dominant trading partner; Canada's share of exports to the United States peaked at more than 90 percent in the early 2000s and has slowly declined to around 70 percent of exports of goods and services more recently.

Where are the best trade diversification opportunities? Diversification could take place both geographically and in terms of the products and services that are traded. Geographically, the federal government has stated its focus will be on the Indo-Pacific region and in Europe. Are these the right priority regions?

Global growth, trade and investment are continuously shifting toward emerging markets and away from more mature economies. Developing Asia in particular is at the centre of global growth and investment activity. China is the dominant economy in Asia, a priority trade market for Canada, and a vital hub of global manufacturing.

Restoring more normal trade relations with China is important for many export sectors, but let's also acknowledge that China is not going to be the kind of friend with shared values that can foster deep trade ties across the board. China's population has peaked and its growth per capita is already slowing from the torrid pace of the past three and a half decades; the full impact of these trends on China's share of world GDP will unfold slowly over the coming decades.

In contrast, India is seizing its economic potential after many decades of under-performance as a relatively closed economy. Completion of a bilateral free trade agreement with India, after years of frustrating negotiations, would be a welcome step forward in building a deeper trade relationship. Many other Asia-Pacific developed and emerging markets, including Japan, South Korea, Australia, and members of the Association of Southeast Asian Nations like Indonesia and Singapore, are attractive partners.

Europe has obvious trade advantages, including its proximity, a population base of more than 500 million consumers with relatively high incomes, established business links, and many shared interests and values. But Europe is also aging, with slow economic growth in most major countries. Decision-making can be cumbersome; full ratification of the CETA trade deal with the EU has yet to be completed, a decade after signature. It is reasonable to treat Europe as a priority market for expanded Canadian two-way trade and investment, but also to understand that competition will be acute in a mature European market.

Other developing regions – notably Latin America and the Caribbean, Africa, and the Middle East – also deserve attention, since they can offer attractive business opportunities for Canadian exporting businesses. Logistical, credit and political risk issues will need to be managed successfully in these and all markets.

As for what is actually traded, goods were the traditional focus – but things have changed. Many services, from insurance to engineering to architecture to financial, are sold globally. Advances in artificial intelligence are creating new trade opportunities in high-value services; the digitization of information, instant translation and cloud-based collaboration make proximity much less important. As an economy dominated by high-end services, Canada can be an active participant in global services trade. Yet Canada also remains a trustworthy and efficient provider of crucially needed raw and processed materials to the world, which is core to any diversification strategy geographically and by product and service. On that score, Canada can boost its role in the provision of competitive services, expertise, and manufactured goods that extract additional value from the resources.

Much more diversified Canadian trade is indeed possible, and active public policy can help to overcome gravity. And with the prospect of more restrictive and uncertain rules governing trade with our most natural partner, businesses now also have a huge incentive to deliver on diversification.

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