



Business Council of
British Columbia

BRITISH COLUMBIA'S GLOBAL LINKAGES: A SNAPSHOT

Jock Finlayson and Ken Peacock, Business Council of BC, June 2009

Notwithstanding the current world-wide economic slump, it is important to remember that international trade and investment flows and the global integration of supply chains have been increasing for several decades. And while recent events are stoking fears of protectionism and a downward spiral in trade, most forecasters believe an economic recovery will take hold by 2010 and the longstanding upward trend in global trade will resume. Looking out to 2020, it is difficult to believe that BC will not be even more integrated with the global economy than it is today, especially within the Asia Pacific region.

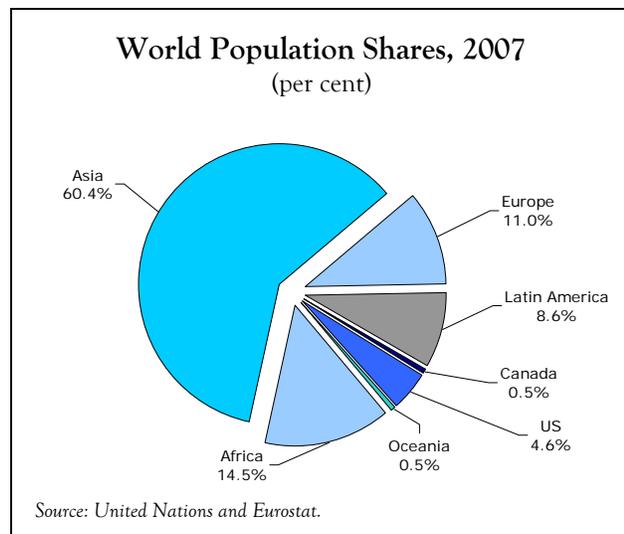
As a small, open economy British Columbia has always depended on and prospered from its international connections. These linkages have been steadily enhanced and supported by improved global transportation and communications; expanding cross-border flows of goods, services, capital, and technology; the growth of international travel; and rising numbers of international migrants. When the global economy starts to grow again, BC should be well-positioned to benefit from the different but inter-related elements of what is often referred to as "globalization."

What follows is a brief review of BC's international trade and foreign investment linkages. We begin with the most visible element of global commerce, international trade.

International Trade

Where do BC's Exports Go?

Exports are vital to sustaining and increasing BC's standard of living because they allow us to pay for imports of goods and services not produced locally, they support hundreds of thousands of jobs, and they provide local firms with opportunities to grow and the financial means to invest. In addition, export-oriented industries tend to have above-average levels of productivity and therefore are able to pay above-average wages/benefits.



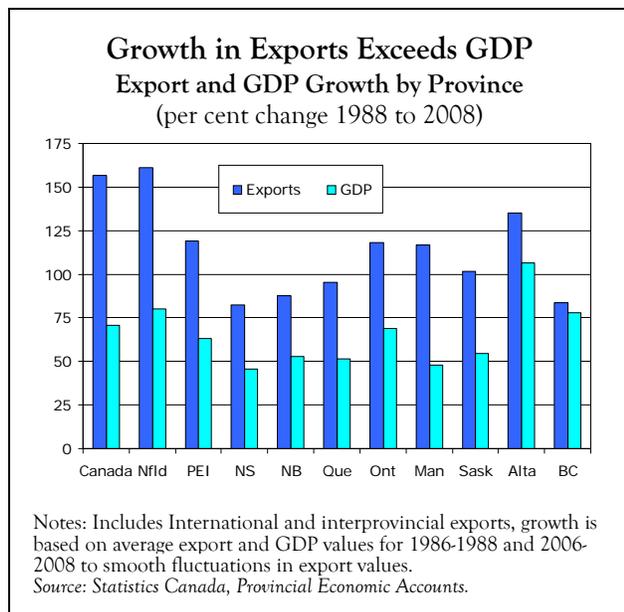
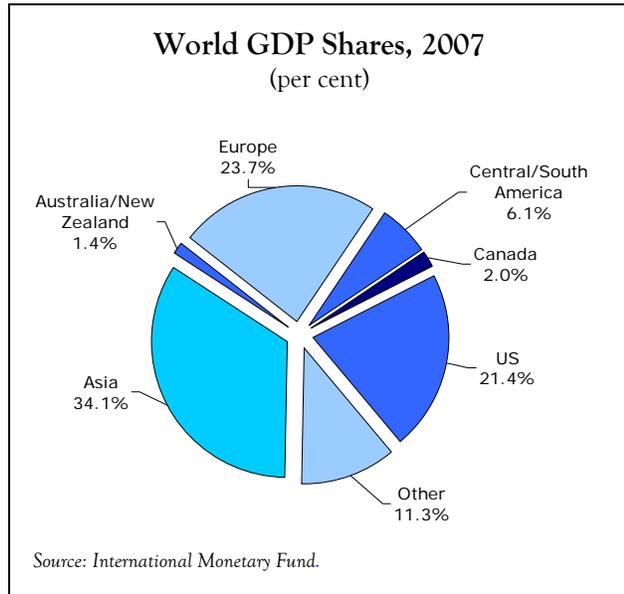


Canada and British Columbia have participated in and gained from the impressive expansion of global trade that has occurred in the post-war era. Like many other advanced economies, Canada has become more dependent on trade to drive its economy. Over the past two decades, the real value of Canadian exports has grown more than 150%, outstripping the 70% increase in total economic activity (GDP) over the same period.

BC's international exports have also increased steadily, although growth has not kept pace with the national benchmark (in the past two decades, total exports grew 84%). As shown in the accompanying chart, BC has recorded comparatively modest export growth relative both to Canada and to the province's GDP.

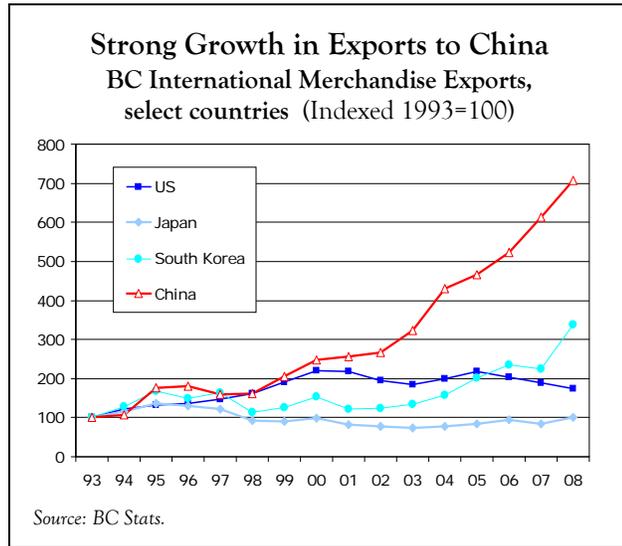
This is a symptom of structural weaknesses in our economy and raises questions about our future prosperity. An often-overlooked feature of "global trade" is that much of the growth in cross-border commerce has been regional in nature. In particular, there has been a dramatic increase in trade within broad regions such as North America, Western Europe, and Asia. Regional free trade accords and other kinds of regional agreements have reinforced the tendency for intra-regional trade to grow faster than trade between regions.

This regionalization of trade was evident for British Columbia in the wake of the Canada-United States Free Trade Agreement and NAFTA agreements: the share of the province's international goods exports destined for the United States climbed from 45% in 1990 to a peak of 70% in 2001. Japan's economic stagnation through most of the 1990s also helped to boost the prominence of the US in our trade statistics, as the value of exports to Japan slipped over that decade. More recently, however, the

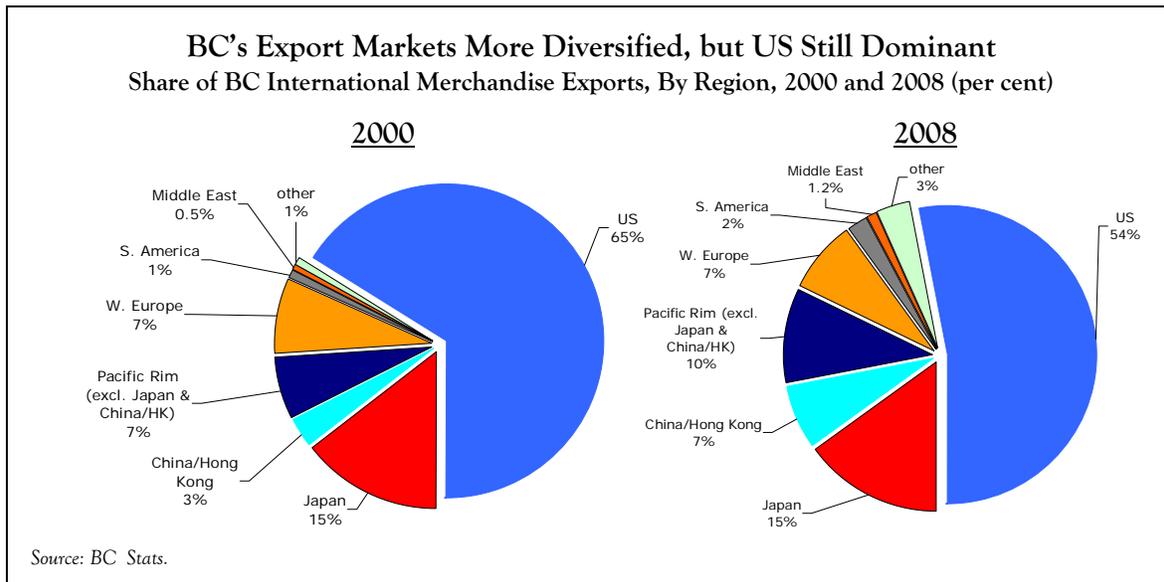




province's US bound exports have fallen, mostly owing to a steep drop in lumber shipments amid the unprecedented collapse in US home building since 2006. The stronger Canadian dollar and the overall American recession have also trimmed exports in other product segments. The net result is that over the past few years the share of BC's exports destined for the US has gradually declined to just 53% in 2008.



When it comes to trading partners, BC's international export markets are more diversified than those of other provinces. Our west coast location, historic ties to the outside world and natural resource wealth have helped to forge strong linkages to Pacific Rim markets.¹ These linkages are not as developed in the case of other Canadian provinces, which rely more heavily on the American market than does British Columbia. The rise of China and other Asian economies, including a partial revival in Japan, resulted in healthy export gains to this part of the world in the post-2000 years (until 2008).



¹ The Pacific Rim region is defined by BC Stats to include China, Japan, Australia, New Zealand, Hong Kong, South and North Korea, Malaysia, Brunei, Singapore, Indonesia, the Philippines, Taiwan, Vietnam, Fiji, Laos, and Mongolia.



Today, more than 30% of BC exports are destined for the Asia – Japan, China, South Korea, Hong Kong, and various other Pacific Rim countries. The surge in BC's exports to China has been remarkable. In 1990 BC shipped about \$200 million in goods to China, representing barely 1% of all merchandise exports. Last year the province sold over \$2 billion worth of goods to China. With this ten-fold increase China now accounts for 6% of BC merchandise exports and ranks as the province's third largest foreign market.

Another Asian country that features prominently in BC trade is South Korea. After making little headway during the 1990s, BC's exports to South Korea have advanced by more than 200% over the past 10 years. With exceptionally strong growth in coal shipments last year, the value of exports shipped to South Korea almost matched sales to China.

What Does BC Export?

With the changing global economic climate, the composition of BC's exports has shifted in recent years. The rise of China and of Asia more generally in the world economy has paved the way for a solid expansion in BC's exports of coal and metals, while the US home building slump has caused a sharp downturn in shipments of wood products. As recently as 2004, BC exported more than \$10 billion of wood products to other countries (mostly the US), equal to about one-third of all international merchandise exports. The related pulp and paper and newsprint segment made up another \$5 billion in exports.² After a number of years of decline, however, exports of wood products slumped to just \$5.4 billion in 2008 and a further drop is likely this year. On the other hand, buoyant global demand lifted the value of BC mineral product exports to \$3.3 billion last year, nearly twice the value of five years earlier.

The growth of BC's exports has been even more pronounced in the case of energy products. In a mirror image of what has occurred with wood products, the province's energy exports have jumped from just under \$5 billion a few years ago to nearly \$10 billion in 2008. Hefty increases in natural gas production and a substantial pick-up in coal exports mean that energy now counts as the province's largest export category (comprising 30% of merchandise exports last year). With the doubling of mineral products exports over the past five years this category now accounts for 10% of BC's foreign shipments

From this brief review, it is clear that BC's export base is heavily tilted towards resource-based products. Altogether, about three-quarters of the province's international merchandise exports consist of natural resources or related downstream products. This proportion is down from almost 85% just a decade ago, reflecting significant increases in export shipments of high technology products, machinery and equipment, plastics, and a host of other non-resource goods. Still, the fact remains that resource-based products constitute the core of the province's export base.

² All dollar figures in this section are in Canadian dollars.



Service Exports

World trade in services has increased dramatically over the past few decades, especially in advanced economies, where the broadly defined services sector generates around three-quarters of total economic activity. The growing importance of services also extends to the export sector. In 2008, BC sold just over \$10 billion worth of services to other countries, equal to roughly one-third of \$32 billion in merchandise exports.³ BC has a much greater share of service exports than do most other provinces. Looking ahead, services are likely to account for a bigger share of BC’s overall foreign trade, as the rules governing global services trade are gradually liberalized, China and other emerging economies increase their demands for many types of imported services, and the aftermath of the pine beetle leads to a contraction in the size of the interior forest sector.

Among the main services exported by British Columbia (other than those based on tourism, which is discussed below) are business services, engineering and other professional services, financial services, computer and information services, royalties and license fees, and services related to research and development. British Columbia is also becoming known for its capability to provide education for foreign students, which gives rise to “exports” of educational services. There are currently more than 55,000 foreign students studying in BC. BC attracts 28% of all foreign students coming to study in Canada, which is well above our 13% share of the national population.

Another key export category, and one of the main reasons BC has proportionally more



service exports, is transportation services. As a major global transportation and commercial gateway, the province’s extensive marine and air links to the rest of the world facilitate provincial and national trade with outside markets. In particular, despite the cyclical downturn in trade activity, the longer term growth in the flow of goods between North America and the Asia Pacific has created new business opportunities for BC service providers in industries like commercial transportation, logistics, wholesale trade, and specialized financial and professional services.

³ Measured in 2002 chained dollars.



Tourism

Tourism is another area where BC's extensive participation in international commerce is readily apparent. Although the tourism "product" – the leisure/adventure experience – is consumed locally, in economic terms tourism is considered an "export" because tourist expenditures (at least those by non-British Columbians) constitute an injection of money into the province from external sources. This inflow of tourist-related spending amounts to about \$4 billion annually, making tourism BC's third largest source of export earnings, after forestry and energy products.⁴ The movement of visitors through BC's large and diverse tourism sector also creates additional business for the local transportation industry.

In terms of international markets, tourism follows a pattern similar to merchandise exports. The United States has long been and remains BC's largest tourist market. Although this market has generally grown over time, the thickening of the Canada-US border since September 2001 and the stronger dollar have led to a drop in US visitors over the past several years. Americans staying overnight account for nearly three-quarters of all international visitors (this excludes same-day visitors). The number of US overnight visitors has fallen from 3.8 million in 2002 to just over 3 million last year. Short duration visits have been even harder hit with the number of Americans making day trips to BC dropping from 2.8 million to 1.4 million over the same period.

Continuing to mirror the market structure of merchandise trade, the Asia Pacific region is the next largest source of international tourists (approximately 12% of all overnight foreign visitors), followed by Europe (9%). Many industry experts believe that tourism from Asia will grow dramatically in the coming decade. Japanese tourist visits to BC have levelled off, but the rise in the number of tourists from Taiwan and South Korea has been impressive. And while the Chinese market is still under-developed, that country's ongoing economic modernization is fuelling the emergence of a huge middle class population that will be more inclined to travel abroad in the future.

The 2010 Winter Olympics should be a tremendous plus for the province's tourism industry. No other venue or event can provide comparable world-wide coverage and market exposure, something that is welcomed in the face of the challenges the industry in BC has faced. A second and related boost for the sector is the opening of new Vancouver Trade and Convention Centre. This major facility allows Greater Vancouver to compete for large-scale international conventions and will help the city leverage the worldwide exposure which the Olympics is sure to provide.

Vancouver's superb airport and other transportation infrastructure also support tourism growth. Vancouver International Airport is routinely rated as one of the best in North America and indeed the world. Having a world-class airport (which will soon have a rapid-transit connection to downtown) improves the tourism experience and enhances the

⁴ Tourism British Columbia, The Value of Tourism, (February 2003) p.8.



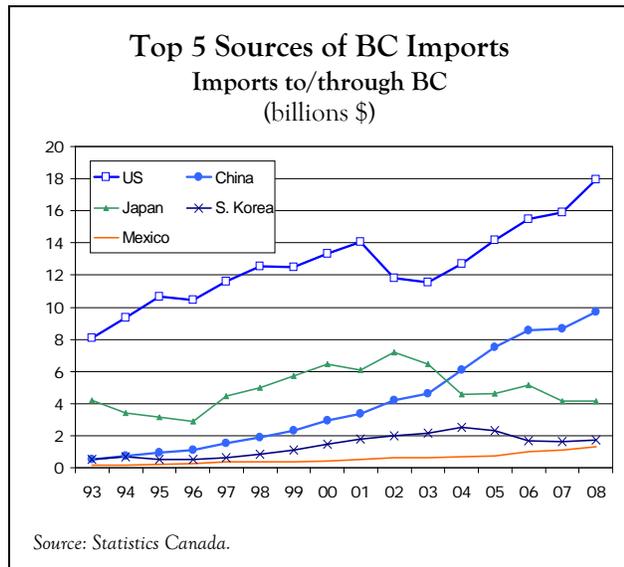
province's capacity to host international conventions. Increasingly, Vancouver is becoming a key hub for air traffic between North America and Asia.

On the Other Side of the Trade Ledger...

Discussions of the benefits of international trade commonly focus on the gains from exporting, such as bigger markets for domestic producers, additional foreign exchange earnings, enhanced competitiveness, and the jobs that flow from selling in foreign markets. But the dividends from international trade are not limited to exports. Like other jurisdictions, BC also benefits from having access to imported goods and services from around the world.

Imports provide our residents and businesses with a vast and expanding array of consumer products, capital goods, and advanced technologies. Imports also result in greater competition in the domestic market, leading to lower prices and better choice for our consumers. In this era of globally integrated production, imported technology, components and machinery helps to raise the productivity of domestic businesses, which is critical to their ability to succeed in global markets.

The United States is the number one source of BC's merchandise imports, supplying, according to the official statistics, around 40% of the total in the past few years. But recent figures also underscore why China is destined to loom larger in BC's future. Over the past decade the total value of international merchandise imports to BC (or shipped through the province) has risen by 67%, but imports from China (some of which go to other provinces) have soared by 415%. China surpassed Japan to become the second largest source (by value) of BC's international imports a few years ago and now accounts for 23% of all merchandise imports.



Interestingly, Mexico recently surpassed Taiwan as the fifth largest supplier of imports to the province. It should be noted that considerable caution is required in interpreting the official data on provincial imports. The figures supplied by Statistics Canada do not distinguish between foreign goods entering BC but subsequently shipped to other parts of Canada, and imports actually consumed by British Columbians. A large but unknown share of the Asian



imports entering BC is destined for the rest of Canada. In contrast, most of the American or Mexican imports entering BC are probably consumed within the province, suggesting that North American sourced imports may be proportionally larger within the provincial economy than the data indicate.

Foreign Investment

Just as increases in international trade have outstripped the growth of GDP, foreign direct investment (FDI) has also expanded more rapidly than domestic investment over the past couple of decades.⁵

Empirical work on the impact of FDI in “host countries” has identified a variety of benefits associated with such investment, including higher productivity and a greater propensity to invest in research and development. Research also indicates FDI has a positive impact on human capital formation and strengthens international trade integration.

Inbound investment augments domestic sources of finance, and thereby improves the growth prospects for BC-based firms. The global connections and knowledge embodied in international capital flows have a number of other advantages that are harder to quantify. For example, FDI and international business alliances often provide local firms with access to leading-edge technologies and new markets. The evidence points to a positive relationship between inward investment and subsequent export activity. Foreign investment is also a key source of management expertise. Foreign companies often bring innovative international marketing strategies, better management practices, and sophisticated organizational techniques that make an existing company more productive. The positive effects of these investments typically spill over to domestic firms, as employees who have had exposure to foreign-owned businesses leave to work with other organizations and new technologies become more widely diffused.

Unfortunately, there are no provincial estimates of the flow or stock of foreign direct investment. But Statistics Canada does produce estimates of how much foreign-controlled companies actually invest in machinery and equipment and structures by province. These figures refer to investment in physical assets (non-residential buildings and machinery and equipment), and differ from the foreign direct investment figures discussed above in that they do not pertain to investment in equities. They do, however, provide insight into the willingness of foreign companies to invest in physical plant and equipment in the province.

⁵ Foreign direct investment refers to a foreign company’s investment in a Canadian company, whether an existing company or one that is newly established here. It is defined as an investor that has a significant voice in the management of a Canadian corporation, which by convention is taken to mean 10% or more of the Canadian company’s equity. Foreign direct investment is distinguished from foreign portfolio investment which is a more passive form of investment. Portfolio investors are more likely to shift their capital based on short-term economic developments.



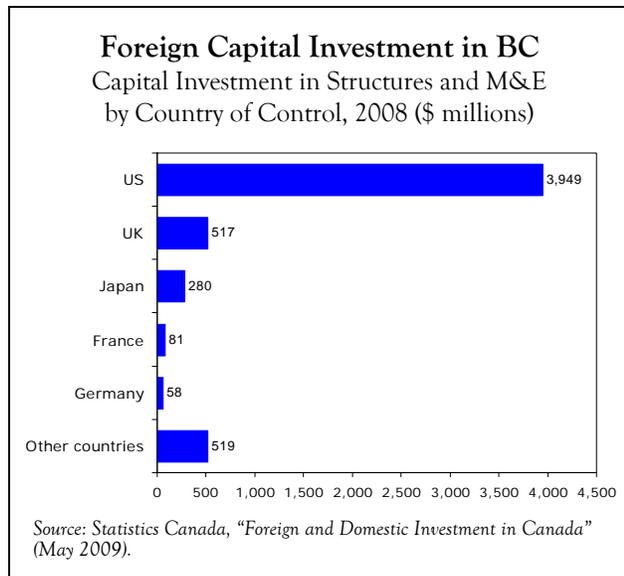
The most recent published figures indicate that⁶:

- In 2008, foreign-controlled companies invested an estimated \$6.3 billion in structures and machinery and equipment in BC, making them responsible for 13% of all non-residential investment (nationally foreign companies accounted for 16%).
- Note that 75% to 85% of capital investment in BC (depending on the year) comes from domestic sources, much of which is from other provinces.⁷
- In terms of machinery and equipment, which is more closely aligned with innovation and productivity, foreign companies made up 26% of total M&E investment in the province last year.
- In 2008, the US was the source of fully 62% of all foreign capital investment in structures and machinery and equipment in BC, followed by the United Kingdom (8%), Japan (4%) and France (1%).

There is a consensus among experts that the economic contributions made by foreign direct investment to the Canadian economy are significant. Jurisdictions today are competing intensely to attract foreign direct investment across a range of industries which are important to the province’s economic future, including high technology, other value-added manufacturing and services, customer support services (call centres), and some parts of tourism and the resource sector. Like Canada, BC is very dependent upon external sources for investment, suggesting that in order to “develop its industries it is going to have to continue to attract investment from the rest of Canada and overseas.”⁸

Summary and Conclusions

It is natural to think about trade in goods when examining global linkages. But other dimensions of international economic activity, such as trade in services, tourism, foreign investment, immigration, and transportation, are also reshaping British Columbia’s business landscape. A review of these external linkages and the



⁶ Statistics Canada, “Foreign and Direct Investment in Canada,” (May 2009).

⁷ See J.Baggs, D. Scoones and G. Voss, “Situating BC in the Global Economy,” (June 2009) www.bcbc.com.

⁸ J Baggs, D. Scoones and G. Voss, “Situating BC in the Global Economy,” (June 2009) p.24, www.bcbc.com.



opportunities presented by the dynamic global economy suggests that BC is well-positioned to prosper as North America, Asia and Europe recover from the current recession and international trade, travel and investment expand over the coming decade.

Although far from perfect, the Canada-US Free Trade Agreement and its successor, NAFTA, have fostered closer economic ties with the United States and, increasingly, Mexico. America's proximity to BC, a common language, similar business rules, and the massive and steadily growing American market mean that doing business with the United States remains critical to the province's well-being.

At the same time, the Asia-Pacific region is becoming a bigger factor in BC's economic development. The region includes many of the world's most dynamic and rapidly developing economies, notably China and India, which together have some 2.2 billion people. Today, Asia is home to more than 60% of the world's population, but generates just one-third of global economic production. Asia's share of global economic output is forecast to climb over the coming decades. Given these global trends, BC is fortunate to have a diverse multicultural population that features many people of Asian origin. The large number of Asian immigrants and the growing number of Asian students will help to strengthen the province's linkages to the Asia Pacific. Asian countries are likely to account for an increasing proportion of BC's international trade in the years ahead.⁹

Resource-based industries continue to supply the lion's share of BC's merchandise exports, but several other industries are taking their place in the province's export mix. High technology goods and services, other non-resource manufactured products, and agri-food products all produce substantial export earnings for BC businesses. Trade in services is also expanding quickly, providing attractive opportunities to grow and diversify the province's export revenues.

⁹ For a more comprehensive discussion see R. L. Tung, "The Rise of Asia: Opportunities and Challenges for British Columbia," (June 2009) www.bcbc.com.