POLICY PERSPECTIVES

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LONG-TERM EXPORT UNDERPERFORMANCE UNDERSCORES THE NEED TO ADDRESS CANADA'S AND B.C.'S COMPETITIVENESS PROBLEMS

HIGHLIGHTS

- For small, trade-dependent economies such as Canada/B.C., exporting delivers widespread economic benefits and is essential for sustaining growth and advancing prosperity.
- In both Canada and B.C., export growth has been sub-par for an extended period. Growth in exports of goods and services has lagged growth in the rest of the economy. The result is that the share of exports in overall GDP for the country and also for British Columbia has fallen significantly over the past two decades.
- In contrast, OECD and Euro area averages show strong gains in the share of exports in GDP over the past two decades.
- Canada stands out among individual OECD countries as one of just a handful that saw exports/GDP shares decline between 2000 and 2019. In addition, Canada recorded the largest decrease in export shares of any OECD country.
- In the 1990s Canada did enjoy a period of temporary gains in the share of exports in GDP, but this upturn was subsequentially reversed.
- Despite improved access to the world's largest and richest market under NAFTA, Canada's moves to sign several other bi-lateral and multi-lateral trade agreements, and a backdrop of a long period of robust global economic and trade growth, the performance of Canadian and B.C. exports has been underwhelming.
- Exchange rates, commodity prices (particularly energy), the strength of the U.S. economy, and China's rise and full participation in the global economy are among the relevant considerations when assessing trends in Canadian exports. However, the duration and magnitude of Canada's comparative underperformance suggests the country's weak export growth also reflects the existence of deeper, home-grown structural and competitiveness issues.

Within the business community and among some leading Canadian and global think tanks, it is widely recognized that Canada has significant competitiveness problems. One way to see this is to track the country's export performance over time. The share of exports of goods and services in GDP – for both Canada and B.C. – has been declining for two decades. That is, the value of Canadian and B.C. exports has grown more slowly than output (gross domestic product, or GDP) in the rest of the economy, meaning the proportion of the economy comprised of exports has been diminishing. As discussed below, this makes Canada/B.C. different from most other advanced economy jurisdictions. A multi-decade pattern of sluggish Canadian exports is alarming. The jobs, incomes, additional business activity, and wealth created by exports are key drivers of overall prosperity, especially for small and mid-sized economies like B.C. and Canada.

In most developed economy jurisdictions, exports of goods and services have grown to represent a larger fraction of total GDP over the past few decades. Most other affluent economies have done a better job of leveraging the rise of globalization and the rapid growth of the global middle class to deliver broad economic gains by increasing the value of their exports at a faster pace than Canada and B.C. have managed to achieve.

A DISAPPOINTING EXPORT PICTURE

Gross domestic product (GDP) captures the final value of all goods and services produced in an economy. One method economists and statisticians use to estimate GDP is to segment expenditures into different categories – spending by households (household consumption), business investment (in new housing, non-residential structures, machinery and equipment, and intellectual property), government investment and spending, and exports (the production of goods and services sold outside of a country).

For small, trade dependent economies such as Canada/B.C., exporting products and services has multiple benefits. Most fundamentally, it generates income to pay for imports of consumer products and business inputs. But exporting also leads to other economic gains. It expands the potential market for local firms, allowing companies/industries to scale up in size and sophistication. Export-oriented businesses are typically larger in size, more productive and often pay higher wages compared to non-exporting firms. Another factor to consider is that exporters purchase a wide range of services and other inputs from local businesses and other domestic suppliers. This is most evident in communities with large anchor industries (lumber mills, mines, other industrial facilities), but the effect, although less visible, also applies at the broader provincial and national levels.

Economies differ in domestic market size, geographic location, industrial structure, resource endowments, and many other dimensions. So, it's not surprising that the share of exports in GDP varies across countries. In advanced economies that are members of the Organization for Economic Cooperation and Development (OECD), the share of exports in GDP generally ranges between 25% and 60% — although some countries have higher proportions and are more trade oriented.[1]

FIGURE 1: **EXPORTS ARE A SMALLER SHARE OF THE CANADIAN AND B.C. ECONOMIES THAN TWO DECADES PRIOR**

Source: World Bank national accounts data and OECD National Accounts data files. Statistics Canada Table 36-10-0222-01 for B.C. data.

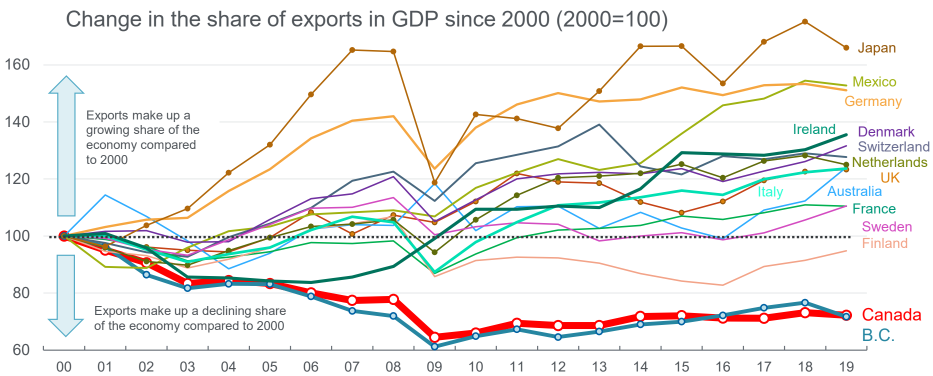
Our focus here is not so much on the current place of exports in Canada's GDP. Rather the question of interest is the trend in the proportion of exports in the overall economy over time. Have Canada and B.C. capitalized on the major expansion in global trade and in the size of the global middle class in the past few decades? Has Canada's long-term strategy and substantial investment in negotiating trade agreements been effective?

Figure 1 traces the changes in the share of exports in GDP since 2000. It shows that exports/GDP ratios have fallen in Canada and B.C. over most of the past two decades, while the opposite has occurred across OECD and Euro area countries.

The differences are striking. In the OECD and Euro area, exports on average make up a significantly larger share of GDP than two decades ago, while in Canada (and B.C.) the share of exports in GDP is substantially lower than it was twenty years ago. The OECD and Euro area averages show the share of exports in GDP rising for most of the 2000s, dropping amid the 2009 global recession, but then rebounding and surpassing the pre-recession levels before resuming a gentle upward trend. In Canada, the share of exports in GDP fell between 2000 and 2008 and then dropped sharply in 2009. But unlike the OECD and Euro area, Canada's export share never regained its 2009 pre-recession level. B.C.'s export recovery in the decade following the 2009 global recession was similar to Canada's and was also underwhelming relative

[1] 26 OECD countries had export shares ranging between 25% and 60% in 2019, 11 had shares above 60% and 3 below 25%. Country details of export shares in GDP are shown in Table 1.

FIGURE 2: **CANADA HAS SEEN THE BIGGEST DECLINE IN THE SHARE OF EXPORTS IN GDP**



Source: World Bank national accounts data and OECD National Accounts data files. Statistics Canada Table 36-10-0222-01 for B.C. data.

to many other advanced economy jurisdictions.

Amid the 2020 COVID shock, the share of exports in GDP again fell significantly in almost all countries. Given past patterns and the robust global economic recovery from the 2020 downturn, exports/GDP shares for many countries will likely rebound quickly. In 2020, Canada's exports/GDP ratio also decreased. Indeed, in Canada the decline was enough to pull the share all the way back to the 2009 low point, underscoring how muted the gains were over the preceding decade. Based on previous trends and current competitive headwinds facing large parts of Canada's export economy, any sustained recovery in the share of exports in GDP will likely be anemic and gradual. We see a risk that Canada may even fail to return to the (already low) pre-COVID share of exports in GDP due to an increasingly unattractive domestic business environment and a seeming lack of interest among policymakers in addressing the factors holding back many of the country's most important export sectors.

Changes in this straightforward and foundational economic metric – the share of exports in GDP – put a spotlight on Canada's (and B.C.'s) eroding competitive position on both a global and a North American basis. They also raise questions about Canada's capacity to expand exports going forward. In other advanced economies, exports became more important in the last 20-30 years. Businesses in many small- and mid-sized OECD jurisdictions were able to take fuller advantage of the expansion of global trade, lower trade barriers, increased cross-border economic integration, and dramatic growth in the size of the global "middle class" population.[2] They did so by growing their exports of goods and services more quickly than their domestically oriented spending (notably consumption, housing investment, and government outlays). Unfortunately, Canada and B.C. have benefitted less from these positive global trends over the past 2-3 decades – our export growth has not kept pace with rest-of-the-economy growth.

A CLOSER LOOK AT CHANGES IN THE SHARE OF EXPORTS IN GDP

The remainder of this brief review provides additional context. To shed more light on Canada's (and B.C.'s) export underperformance, the comparisons of changing export shares are broadened to individual countries (Figure 2) and the review of export patterns is extended back to the 1980s and 1990s (Figure 3). This additional information does not alter the basic conclusions. If anything, it confirms the concern over Canada's (and B.C.'s) languishing export performance.

Canada's underperformance stands out among individual countries

Between 2000 and 2019, the share of exports in Canadian GDP dropped by more than 12 percentage points.[3] Just four other advanced economies (Finland, Norway, New Zealand and Israel) saw their exports/GDP ratios decline over the same period. A few other countries (Costa Rica, Chile and Columbia) also recorded declines over the two-decade period. In all other OECD and Euro area countries[4], the share of exports in GDP increased. And, among the handful of countries where export

[2] For a recent examination of the expansion of the global middle-class population and the persistence of poverty in some developing countries, see Homi Kharas and Meagan Dooley, The Evolution of Global Poverty, 1990-2030 (Brookings Institution, February 2022).

[3] Comparisons across individual countries end in 2019 for clarity and graph legibility. Almost all countries shown had their exports/GDP share fall in 2020, but to varying degrees.

[4] Malta and Cypress are the only two Euro area countries that are not OECD members.

shares did fall, Canada suffered the largest decline. As noted, B.C.'s decline was similar. If B.C. were a country, it would be one of the few to see export shares decline and would rank 38th with respect to the change in its exports/GDP share, just ahead of Canada's bottom place ranking (Table 1).

Canada did experience a period of rising export shares

Figure 3 recreates Figure 1 but traces changes in exports/GDP shares over the past four decades (rather than two decades) and rebases the series to 1980 (rather than 2000). Reviewing the trends in earlier decades confirms that Canada and B.C. have unperformed other advanced economy jurisdictions in growing their export sectors, but the story becomes more nuanced.

Examining the longer period, it is evident the year 2000 was a high-water mark for the share of exports in Canada's GDP. It was also a (less pronounced) high-water mark for B.C. During earlier decades, Canada (and B.C.) did enjoy periods of comparatively robust export growth characterized by rising exports/GDP shares. But the shares peaked in 2000 and fell steadily thereafter. Successive decreases throughout the 2000s were punctuated by the large 2009 decline that pushed Canada's and B.C.'s exports/GDP shares back to/below 1980 proportions.

From 2010 through 2019, exports/GDP shares in Canada and B.C. rose gradually. But the slender gains posted over that decade were erased in 2020. Amid the COVID shock, the share of exports in GDP in Canada and B.C. was again pulled back to 1980 levels.

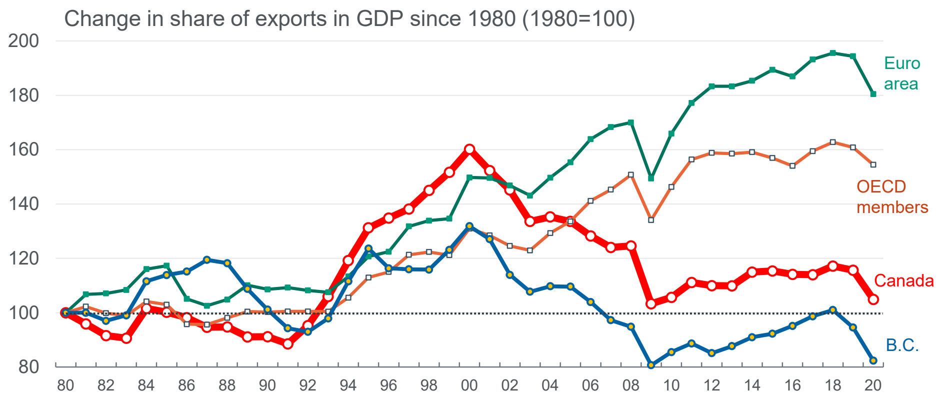
TABLE 1: **SHARE OF EXPORTS IN GDP, OECD COUNTRIES RANKED BY CHANGE 2000-2019**

Rank	Country Name	Change in share of exports in GDP (percentage points)		Share of exports in GDP		
		2000-2019	1980-2019	1980	2000	2019
	OECD	**5.2**	**10.7**	**17.6**	**23.0**	**28.2**
1	Luxembourg	60.3	121.0	87.7	148.5	208.8
2	Slovak Republic	39.2	-	-	53.2	92.4
3	Lithuania	38.8	-	-	38.6	77.4
4	Slovenia	33.8	-	-	50.1	84.0
5	Ireland	33.5	83.6	44.4	94.4	127.9
6	Poland	28.3	-	-	27.2	55.5
7	Czech Republic	25.8	-	-	48.1	73.9
8	Latvia	23.4	-	-	36.8	60.2
9	Netherlands	16.5	32.1	50.4	66.0	82.5
10	Greece	16.4	20.8	19.3	23.7	40.1
11	Germany	15.8	28.0	18.6	30.8	46.6
12	Hungary	15.4	82.3	-	66.9	82.3
13	Portugal	15.3	22.1	21.5	28.2	43.5
14	Switzerland	14.2	19.2	46.3	51.3	65.5
15	Denmark	14.2	26.5	32.5	44.8	59.0
16	Mexico	13.4	28.7	10.1	25.4	38.8
17	Turkey	12.9	27.6	5.2	19.9	32.7
18	Estonia	12.4	-	-	61.6	74.0
19	Austria	12.2	23.9	31.7	43.3	55.6
20	Iceland	12.2	9.3	35.0	32.1	44.3
21	Belgium	9.3	31.7	50.1	72.5	81.8
22	Japan	6.9	4.24	13.1	10.5	17.4
23	Spain	6.4	20.7	14.3	28.6	35.0
24	Italy	6.1	11.5	20.2	25.6	31.7
25	Korea, Rep.	6.0	11.5	28.4	33.9	39.9
26	United Kingdom	5.9	4.5	26.6	25.2	31.1
27	Australia	4.7	7.7	16.4	19.4	24.1
28	Sweden	4.6	20.7	27.2	43.3	47.8
29	France	3.0	10.6	21.0	28.6	31.6
30	United States	1.1	1.9	9.8	10.7	11.8
31	Colombia	-0.1	-0.4	16.2	15.9	15.9
32	Finland	-2.2	9.0	30.8	42.0	39.8
33	Chile	-2.5	6.4	21.7	30.5	28.0
34	Israel	-5.7	-	-	35.5	29.8
35	New Zealand	-8.8	-1.8	28.8	35.7	27.0
36	Costa Rica	-9.1	7.4	26.5	42.9	33.8
37	Norway	-9.4	-6.4	42.8	45.7	36.3
38	**B.C.**	**-9.6**	**-1.4**	**25.9**	**34.1**	**24.5**
39	**Canada**	**-12.3**	**4.3**	**27.6**	**44.2**	**31.9**

Source: World Bank national accounts adata and OECE National ACcounts data files. https://data.worldbank.org/indicator and Statistics Canada Table 36-10-0222-01 for B.C. data.

In contrast, the share of exports in GDP in the OECD and Euro area countries has generally trended higher since 1990. There have been occasional dips, but for the most part these proved temporary. Based on the averages shown in Figure 3 below, OECD and Euro zone countries have benefitted from the contemporaneous rise in international trade by building and expanding their export sectors. Canada has struggled to follow suit.

FIGURE 3: **IN CANADA AND B.C. EXPORTS MAKE UP SAME/SMALLER SHARE OF GDP AS IN 1980**



Source: World Bank national accounts data and OECD National Accounts data files. Statistics Canada Table 36-10-0222-01 for B.C. data.

Re-basing the series to 1980 does not change the overall picture. Exports/GDP shares in the Canadian and B.C. economies are essentially the same as they were four decades earlier, while the OECD/Euro area averages are substantially higher. Across individual OECD and Euro area countries, Canada and B.C. stand out for having unusually weak export growth (as proxied by changes in export shares in GDP). Only four countries registered weaker advances or decreases over the longer four-decade period. Essentially, apart from an eight-year period during the 2000s, for the past four decades Canadian and B.C. exports have not kept pace with growth in the rest of the economy.

THE (SHORT-LIVED) PERIOD OF RISING EXPORT SHARES

The original bilateral Canada-U.S. Free Trade Agreement came into effect on January 1, 1989. It laid the foundation for solid export growth and an increase in Canada's trade/export orientation for the decade that followed. As tariffs were gradually phased out and Canadian manufacturers and exporters retooled and adapted to the more integrated Canada-U.S. market, Canada's share of exports in GDP turned up in 1992 and climbed higher over the rest of the decade. The North American Free Trade Agreement (NAFTA), which superseded the bilateral FTA, came into force on January 1, 1994, with Mexico included. NAFTA enhanced cross-border market access for services and further fueled the expansion of Canada's export-oriented industry sectors.

Canada's shift to a modern national consumption tax in the form of the Goods and Services Tax (GST) was another important policy change that supported a decade of relatively strong Canadian export growth. Introduced on January 1, 1991, the GST replaced the antiquated and previously hidden 13.5% manufacturer's sales tax (MST).[5] The competitive position of Canadian manufacturers and natural resource companies improved significantly with the elimination of the MST, which raised the cost of producing almost all manufactured goods in Canada – whether for export or domestic consumption. The GST is a classic consumption tax that is levied only on the final sale of goods and services within the country. This meant that investments by manufacturers (and other businesses) in machinery, equipment, advanced process technologies, and other business inputs were not subject to the new tax. Critically, the structure and application of the GST helped ensure that Canada's tax system did not discourage businesses from investing in productivity-enhancing equipment and other forms of tangible capital.

In general, securing duty-free access to the massive U.S. market coupled with a major tax policy reform that significantly improved the competitive position of Canadian manufacturers and other exporting firms seems to have underpinned a

[5] The GST was introduced at a rate of 7% but was reduced twice and is now 5%. The GST also replaced the Federal Telecommunications Tax of 11%.

Governments need to develop a deeper understanding of what it takes to build and support globally competitive "traded industry clusters" that can sell into and increase their presence in international markets. Federal and provincial policymakers should make fostering growth in export-oriented sectors a priority.

near decade-long rise in Canada's share of exports in GDP. B.C.'s export sector also gained from these policy changes, but to a lesser extent.[6]

After 2000, however, these benefits appear to have waned. Since 2000, Canada's export share in GDP weakened – dramatically. China's admission to the World Trade Organization in 2001, and its subsequent ascent to become the world's top global manufacturing and exporting powerhouse, was no doubt a factor. In the years after 2000, China captured North American market share from Canadian firms in many manufacturing industries. But B.C.'s (and to a lesser extent Canada's) exports to China also grew over this period as the latter's economy developed and incomes rose rapidly. Other western Canadian provinces also enjoyed strong export gains to China. So, the net contribution of China's dramatic GDP growth and its integration into the global economy to the sustained downtrend in Canada's exports/GDP share is probably more limited. Most other OECD countries did not see a similar decline in their exports/GDP shares, even though they too have felt the effects of China's global rise to become the world's top manufacturer.

CONCLUDING THOUGHTS

Despite improved access to the world's largest and richest market under NAFTA, Canada's moves to sign several other bi-lateral and multi-lateral trade agreements, and a backdrop of a long period of robust global trade growth, the performance of Canadian and B.C. exports has been underwhelming – particularly compared to most peer jurisdictions. Since 2000, the share of exports in the Canadian economy has fallen markedly. Taking a somewhat longer-term perspective, Canada did enjoy a decade of decent export growth in the 1990s. However, that proved short-lived and the share of exports in Canada's GDP faded in the 2000s. Strikingly, exports of goods and services now account for nearly the same share of Canadian economic output as back in 1980.

Why was Canada unable to sustain the competitive benefits yielded by trade agreements, significant domestic policy reforms, a fast-growing global middle class, and ongoing globalization? Shifts in the exchange rate, commodity prices (particularly energy), China's rise and integration to the global economy, and the strength of the U.S. economy are among the relevant cyclical considerations. But the persistence and magnitude of the comparative underperformance suggests Canada's weak export growth also reflects deeper, home-grown structural and competitiveness issues. Canada has long struggled with sluggish private sector capital investment (especially on a per worker basis and in machinery, equipment, and intellectual property), relatively feeble productivity growth, sub-par private sector innovation, and the imposition of increasingly complex and costly regulatory burdens on several of the country's leading export-capable industries. Unless Canada materially improves the business environment for private sector investment (outside of the housing sector), business innovation, and productivity growth, the outlook for not only exports but also future gains in living standards will remain bleak.

The story of Canada's (and B.C.'s) worrying export underperformances warrants further research and policy discussion. The challenges facing Canada's energy and other natural resource sectors probably help to explain some of the decline/limited gains in the export share of Canadian GDP. But the competitiveness headwinds impinging on investment and business growth also weigh on exporting sectors apart from those tied to natural resources. It is reasonable to ask why Canada has demonstrated such an uninspiring export record given the country's role as a champion of an open global economy and a signatory to many free trade agreements over the past few decades.

Whatever the mix of causes, the trends examined here must be reversed. Governments need to develop a deeper understanding of what it takes to build and support globally competitive "traded

[6] The Free Trade Agreement and NAFTA both excluded softwood lumber. Protective measures levied on softwood exports by the US may help explain why B.C.'s gains in export share were more modest than Canada's.

industry clusters" that can sell into and increase their presence in international markets. Federal and provincial policymakers should make fostering growth in export-oriented sectors a priority. For British Columbia, a small regional economy within the larger Canadian market, it is vital that policymakers put more emphasis on strengthening existing and emerging industry clusters in export-capable sectors. As a recent Brookings Institution report noted:

"Regional economies grow and decline based on their ability to specialize in high-value industries and evolve those specializations over time."[7]

In a small jurisdiction like B.C., most "high value-added" industries will be oriented toward exporting much or even all of what they produce – that is, selling beyond the domestic market. Ensuring that B.C. develops and maintains competitive hosting conditions for companies in sectors that generate export earnings should be at the heart of a smart and sustainable provincial economic growth strategy.

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[7] Ryan Donahue, Joseph Parilla and Brad McDearman Rethinking Cluster Initatives (Brookings Metropolitan Policy Program, July 2018).