STAPLES, DEINDUSTRIALIZATION, AND FOREIGN INVESTMENT: CANADA’S ECONOMIC JOURNEY BACK TO THE FUTURE

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Without much fanfare, Canada’s economy is experiencing a profound structural change that will define and limit our national prospects for decades to come. Canada’s economic trajectory has become increasingly dominated by the production and export of unprocessed or barely processed natural resources — especially petroleum and other minerals. Higher-stage export industries (especially manufacturing, but also tradable service industries, such as tourism) are declining rapidly. This structural regression largely originates with extremely high global prices for natural resources (including energy, nonenergy minerals, and agricultural products). Those prices partly reflect growing world demand, especially from rapidly industrializing regions like China and India, and concerns about the adequacy and reliability of future resource supplies. The dramatic rise of resource prices may also reflect the influence of speculative financial pressures and the growing involvement of hedge funds and institutional investment vehicles in commodity markets. Record prices for natural resources have had multiple and complex impacts on Canadian financial indicators, exchange rates, and the sectoral allocation of real investment and production. The resource-led restructuring of Canada’s economy has been ratified and facilitated by the laissez-faire stance of neoliberal economic policy in Canada, the reinforcing role of free trade agreements (especially the North American Free Trade Agreement (NAFTA), which explicitly assigns Canada a special role in the continent as energy supplier), and the daunting political influence of Canadian resource elites (especially over Canada’s Albertan-led Conservative federal government).
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Staples Dependence, Revisited  This resource-led sectoral restructuring of Canada’s economy taps into some long-standing themes and concerns in radical Canadian political economy. The staples tradition of Harold Innis, of course, emphasizes the leading role of successive waves of resource-led development in Canadian economic history.¹ Those waves (from fish, furs, and forestry to agriculture, minerals, and now energy) were always oriented around exports to (and, generally, incoming foreign direct investment (FDI) from) colonial or neocolonial metropolitan powers. This analytical approach received modern application in the 1970s from writers such as Mel Watkins and Kari Polanyi Levitt, who analyzed the structural underdevelopment of Canada in the context of the economy’s continuing dependence on resource exports and incoming foreign direct investment.² This stream of thought influenced radical political economy in Canada for decades, among other things influencing progressive opposition to the Canada-US free trade agreement (FTA) in the late 1980s (on grounds that the intensification of free trade links with the United States would likely reinforce Canada’s latent specialization in resource industries and its dependence on incoming foreign direct investment). More recent versions of this staples-like analysis have emphasized the effect of the FTA and the NAFTA in narrowing Canada’s economic specialization, and the ideological dominance of US-oriented ideas in Canadian political debates.³

At the same time, however, it is also clear that Canada’s economic structure progressed in qualitative terms through the later decades of the twentieth century, despite the constraints of staples dependence on both the economic and the political spheres. This visible qualitative economic development refuted more extreme, unidimensional expressions of staples analysis (which implied that full-fledged capitalist development was impossible in the Canadian context) and sparked an alternative stream of thought within Canadian radical political economy that criticized the staples approach and emphasized the structural strengths of Canadian capitalism.⁴

Various pieces of empirical evidence supported the thesis that Canada’s economy was gradually escaping its traditional staples “trap.” Beginning in the late 1960s, Canada’s manufacturing sector developed both quantitatively and qualitatively (producing a greater quantity of more sophisticated
products). The rapid development of the Canadian auto industry (in the wake of the Canada-US Auto Pact), and similar progress in the aerospace and telecommunications equipment sectors, were important in motivating this forward progress. During the 1980s and 1990s, manufacturing investment was stimulated in Canada (from both domestic firms and through foreign investment) by an undervalued exchange rate, the pro-competitive effects of Canada’s public health care system (which reduces employer-paid health benefits relative to US levels), and strong productivity and technological performance inside Canadian plants. Canada’s manufacturing sector outperformed those of most other developed capitalist countries in the 1980s and 1990s (despite enduring a painful restructuring in the early 1990s as a result of the Canada-US FTA). By the end of the century, Canadian manufacturing was a significantly larger share of total production and employment than manufacturing of the United States, the United Kingdom, and some other OECD countries.

Simultaneously, the relative importance of incoming foreign investment also began to wane: the stock of foreign direct investment in Canada shrunk significantly as a share of Canadian gross domestic product (GDP) through the 1980s and early 1990s. Moreover, Canadian-based companies (led by Canadian minerals companies and Canadian banks) were expanding their own foreign direct investments abroad. Indeed, by 1996 a watershed turning point was reached when the stock of Canadian-owned FDI in foreign countries exceeded the stock of foreign-owned FDI inside Canada for the first time in our national history. By these varied indicators, therefore, for a time it appeared as if Canada were escaping its traditional niche as a “hewer of wood and drawer of water.” The Canadian economy was becoming more capable of providing a full variety of products and services into international markets, and more self-reliant (on a net basis) in capital markets. Again, for some theorists (both orthodox and radical), this motivated a new emphasis on the multidimensional strengths of Canadian capitalism (rather than highlighting its structural weaknesses). However, it was also clearly true that, despite this qualitative development, Canada remained uniquely dependent on resource extraction and export, and demonstrated a higher reliance on foreign investment than other developed capitalist countries. In
this regard, neither a simplistic staples model nor the countervailing view that Canada had become a fully fledged and independent capitalist power in its own right was accurate. The reality lay somewhere in between.

Since the turn of the present century, however, whatever forward structural progress Canada was able to attain in earlier decades has been clearly reversed, and sectoral structure and ownership patterns more typical of a resource-dependent past have reasserted themselves strikingly quickly. This article describes this process of structural regression, which dates back to 1999–2000, and considers policy options that might help to slow or reverse this trend. The article is organized as follows: the second section summarizes the major qualitative aspects of Canada's structural regression. The third section reviews a selection of empirical evidence to describe Canada's structural U-turn in more detail. The fourth section focuses on the deep and rapid decline in Canada's manufacturing sector. The fifth section discusses the relationships between global commodity prices, the boom in Canadian resource industries, the appreciation of the Canadian currency, and deindustrialization. The final section discusses some policy implications of this important change in qualitative economic direction, and proposes several possible policy alternatives that could be advanced by progressive forces and movements concerned with the long-run economic, geopolitical, and environmental implications of Canada's renewed reliance on staples production and export.

Links in the Chain of Structural Regression Here is a summary of the main links in the causal chain that explains this significant and rapid reversal of Canada's economic structure:

**Commodity Prices and Profits** Astronomical increases in global commodity prices have produced a dramatic rise in profitability on the part of Canadian resource producers (especially in the energy and minerals sectors). The petroleum and mining industries enjoy before-tax profits worth 20 percent or more of total revenues, generating a return on shareholders' equity of 20 percent or more (twice as high as average profitability in other sectors of Canada's economy). Petroleum profits alone grew by almost $30 billion
between 1999 and 2006, contributing importantly to the rise in Canadian corporate profits to record levels during this period.  

**Corporate Valuations** This rise in resource profits has produced a corresponding and rapid expansion in the market value of Canadian resource companies. This is reflected, for example, in stock market indicators: the Toronto Stock Exchange diverged notably from its US counterparts beginning in 2005. It has recently reached record highs, even as US markets were retrenching in the wake of the US financial crisis and even as Canadian GDP began to shrink in 2008. Energy and mining companies now account for half of the total traded value of the exchange — up from 30 percent in 2004.

**Foreign Takeovers** Soaring corporate valuations are also reflected in an inward surge in foreign investment, led by foreign purchases of Canadian resource companies. Canada attracted over $200 billion in inward foreign investment in 2007.

**Figure 1 Net Cumulative Stock of Foreign Investment, 1994–2007**

Source: Statistics Canada CANSIM Table 376-0004. Measures the net balance in cumulative stocks of outward (positive) and inward (negative) foreign direct investment.
investment in 2006 and 2007 alone, by far the greatest inward FDI surge
in Canadian history. As illustrated in Figure 1, this was sufficient to push
Canada back into net debt on its foreign direct investment account
(measuring cumulative stocks of inward and outward FDI) for the first time
since 1996.7

**Exchange Rate Appreciation** The global commodity price boom, the super-
profitability of Canadian resource companies, and the rapid inflow of foreign
investment in Canada have together produced a dramatic and historic appreci-
ation of the Canadian currency, which rose by more than 60 percent
(measured against the US dollar) between 2002 and 2008. Now roughly at
par with the US dollar, the Canadian currency is approximately 25 percent
overvalued (relative to its purchasing power parity level).8 This is a sharp
contrast to the experience of most of the 1980s and 1990s, when the
Canadian currency was undervalued relative to purchasing power parity.9

**Modest Growth in Resource Production** Record prices and profits have
produced only a modest increase in the real production of energy and
minerals, and in employment in energy and minerals industries. The positive
supply response from these industries to the dramatic changes in resource
markets has been muted by binding constraints in the availability of new
resource deposits, the declining quality and productivity of new deposits,
and time lags associated with new developments. Resource production is
growing, but not dramatically, and new developments have been hampered
by declining productivity and (especially in the Alberta tar sands) by
construction backlogs and massive cost overruns.

**Crisis in Manufacturing** The combination of an overvalued currency, the
modest reallocation of real capital and labour resources towards resource
industries, and significant shifts in global trading patterns (like the rise of
exports from China and other low-cost jurisdictions) has resulted in a rapid
and painful decline of Canadian manufacturing industries. More than
400,000 manufacturing jobs (more than one-sixth of the total) have been
lost since employment in the sector peaked in 2002, the share of manufac-
turing in total employment has fallen by almost one-third in the same time, and Canada’s manufacturing trade balance has deteriorated from a roughly balanced position to a massive and growing manufacturing trade deficit.\textsuperscript{10} Real output in manufacturing began declining in 2005, and declined by about 10 percent by 2008.

**Downturn in Other Tradable Industries** It is not just manufacturing, however, that has experienced the downside of the resource boom and associated currency appreciation. For example, the downturn in Canadian tourism has been even more dramatic than manufacturing: foreign visits to Canada reached their lowest-ever recorded level in spring 2008, and Canada’s deficit in international tourism has widened dramatically. Overnight visits to Canada decreased by 25 percent between 2002 and 2008.\textsuperscript{11}

**Deteriorating Trade Balance** Canada’s overall balance of payments has also deteriorated quickly under these circumstances. Yes, resource exports are attracting incredibly high prices (and, to a lesser extent, the quantity of exports has also expanded). But the resulting boost to resource-related export incomes has been more than offset by the dramatic dollar-driven decline in earnings on manufacturing exports, tourism, and other tradable services. The current account balance (considering both merchandise and services exports, and investment income) has declined dramatically to near-zero by 2008 (contrasting sharply with the large surpluses of earlier years).

**Growth of Nontradables** The largest sectoral reallocation of real output and employment, perhaps surprisingly, has not been from manufacturing industries to resource industries (since the expansion of the latter has been very small relative to the contraction of the former: just one new job has been created in resource industries since 2002 for every six lost in manufacturing). Rather, the more obvious real reallocation has been from tradable industries to nontraded industries. The services sector has been the source of all net employment creation in Canada since 2002. Nontradable industries are relatively insulated from the direct negative pressures from an overvalued currency, producing a counterintuitive “deglobalization” of Canada’s
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economy. Figure 2 illustrates total goods and services exports measured as a proportion of total GDP; this indicator of the export intensity of Canadian output has fallen by one-fifth since 2002. Lower productivity and income levels in services jobs (especially in private services jobs, which account for two-thirds of all new services employment since 2002) suggest that this structural shift to nontradables will have negative implications for national productivity, income, and trade success.

**Figure 2**
**Total Goods and Services Exports as Share GDP, 1960–2007**

Source: Author’s calculations from Statistics Canada data, CANSIM Table 380-0002.

**Regional Shifts** Other negative consequences of the resource boom include a dramatic reorientation of regional economic and fiscal relationships within Canada. Measured by per capita GDP, the three oil-producing provinces (Alberta, Saskatchewan, and Newfoundland) are now the only provinces with above-average prosperity. Alberta has long been one of Canada's "have" provinces, but the size of the gap between Alberta and the rest of the country has escalated dramatically: through the 1990s, Alberta’s GDP per capita averaged 20 percent higher than the Canadian average, but that
gap widened in the wake of the resource boom to 65 percent by 2007. There has been a corresponding shift in political and fiscal power as well, towards the oil-producing provinces (especially Alberta), and away from the traditional economic centre of gravity in central Canada. Ontario’s GDP per capita is now lower than the national average, and the province will soon qualify to receive (small) payments under the federal government’s equalization program.

**Environmental Costs** The renewed reliance on resource production (especially energy, and especially from the Alberta tar sands) has substantial environmental consequences. Critical attention to the environmental damage caused by tar sands facilities (which rely on strip-mining of vast swaths of northern forest, followed by the energy- and water-intensive processing of mined sand in huge refineries) is growing. Greenhouse gas (GHG) emissions from the energy industry have also grown dramatically. For example, GHG emissions associated with Canadian energy exports almost tripled between 1990 and 2006 — accounting for almost half of the increase in total Canadian GHG emissions during this time.\(^\text{13}\)

In short, an unprecedented surge in global commodity prices has sparked an equally unprecedented surge in the profitability and market value of Canadian resource firms. The growing value of resource exports (due mostly to higher prices, not higher quantities) and an inflow of foreign investment (aimed largely at purchasing Canadian resource companies) has led to a dramatic appreciation in the Canadian currency and a substantial decline in nonresource tradable industries (most visibly, but not solely, manufacturing). Nonresource trade balances, and the overall balance of payments, are deteriorating rapidly. Net production and employment are shifting mostly to nontradable services, which demonstrate low levels of productivity and income. And the resource boom is having important effects on Canadian federalism and environmental performance.

**Describing Canada’s Backwards Structural Evolution** One composite indicator conveniently summarizes the extent to which Canada’s economy
is currently hurtling “back to the future,” as a result of the resource boom on one hand and the corresponding decline of value-added activities on the other. Figure 3 illustrates the proportion of Canada’s total merchandise exports that consist of unprocessed or barely processed resource products (including energy, minerals, bulk products, forestry products, and agricultural products). This ratio declined steadily during the last four decades of the twentieth century, reflecting Canada’s qualitative economic development and growing capacity to produce a broader range of products (for both the home and global marketplaces). This expanding portfolio of export products included automotive products, aerospace, telecommunications equipment, other higher-value manufactured products, and tradable services.

Figure 3
Share of Unprocessed and Barely Processed Resource Products in Total Exports, 1945–2007

Source: Author’s calculations from Statistics Canada data, CANSIM Table 228-0003.

Deliberate, proactive government programs played an important role in this gradual industrial progress. These active measures included the careful use of military spending to promote domestic industrial development in World War II and subsequent years, the Canada-US Auto Pact of 1965,
strong government efforts (including, at times, equity investment) to develop a domestic aerospace industry, and efforts to stimulate Canadian research and engineering capacities, including through government-funded research programs that supported many commercial applications.

Broader economic and social factors also played a role in Canada’s qualitative economic progress. For example, Canada’s currency was undervalued for much of the 1980s and 1990s, and Canada’s public health care system significantly reduced labour costs for private employers (in contrast to the United States, with its inefficient and expensive private health care system). These factors helped to attract investment in value-added manufacturing industries. Right up to the late 1990s, Canada’s economy demonstrated growing qualitative strength: a greater diversity of production and exports, a falling reliance on pure resource production, and a greater national capacity to take on more complex and value-adding economic functions. By the mid-1990s, for the first time in its national history, unprocessed or barely processed resources accounted for less than half of total Canadian exports, and Canada carried its own weight in global manufacturing trade (exporting as much as it imported).

Since 1999, however, Canada’s economic trajectory has been fundamentally altered because of the powerful combination of factors described earlier. From a low of just over 40 percent that year, the proportion of exports consisting of unprocessed or barely processed resource products has expanded by almost half — to nearly 60 percent in 2007. This reflects both an increase in resource exports (mostly reflecting very high prices for these commodities, and only secondarily a modest expansion in the quantity of those exports), and a decline in value-added exports. Manufactured exports have declined as a result of a slowdown in the US market (the destination of most of our exports), competition from new global producers (such as China), and the rise of the Canadian dollar (which has made Canadian-made products very expensive to global customers).

The expansion of real resource output has been surprisingly modest. In employment terms, new jobs created in the broader mining sector (including oil and gas) since 2002 offset only one-sixth of the jobs lost in Canadian manufacturing facilities over the same time period; new jobs in the oil and
gas industry alone offset only one-fifteenth of lost manufacturing jobs. In both GDP and employment terms, private services industries have grown much faster than the mining and energy sectors. So the main change in the Canadian economy has not been a reallocation of real output and employment towards resource industries. While prices and profits in minerals industries are booming, real output and employment have remained (perhaps surprisingly) relatively stagnant.

Real economic expansion in minerals industries has been held back by supply constraints (after all, these are nonrenewable, inherently limited resources) and time lags in developing new projects. The main effect of the global commodities boom on these industries, therefore, has been a dramatic increase in one-time profits (or “rents,” in economic terms) that resource producers are able to extract from their existing activities. In fact, the productivity of minerals production has declined notably in the face of both the deteriorating quality of incremental production (high prices allow minerals
producers to tap into marginal resources that would not be profitable at lower prices) and the boom-time conditions (especially in northern Alberta) that have been sparked by super-profits and unregulated development. As indicated in Figure 4, productivity in the broader mining sector (including oil and gas, and measured by real GDP per employee) has declined by about 20 percent since 2003. This sharp deterioration in real productivity undermines the orthodox claim that Canada’s resource-oriented restructuring will in fact enhance national productivity (by reorienting production to reflect our so-called comparative advantage). Productivity growth in the manufacturing sector, meanwhile, has continued — although now partly as a result of the outright closure of dozens of less productive, less profitable facilities.

With resource production growing mostly in value terms (rather than real quantities), new opportunities in resources do not offset the decline in production and employment in manufacturing. The expansion of services production absorbs the remaining segment of people and capital displaced from manufacturing and not utilized in resource production. For the purposes of Canada’s role in the international economy, an important issue, already noted, is that most services production is nontraded; that is, its production and consumption occurs within the same region (by virtue of the inherent nature of its production and consumption). Thus the shift to services production is associated with the decline in exports (as a share of GDP) noted above.

The Crisis in Manufacturing  Following decades of deliberate, concerted effort by all stakeholders, by the mid-1990s Canada had become a global manufacturing powerhouse. For the first time in history, Canada had become, in aggregate, self-sufficient in the production of manufactured products: in other words, Canada exported as much as it imported — and then some. For a country that had traditionally relied on the export of natural resources to pay for imports of value-added merchandise, this was a tremendous achievement. Sadly, however, this achievement would not last. Since 2001, Canada’s reasonably successful manufacturing trade position has melted down into a manufacturing trade deficit that reached $32 billion in 2007, and continues to grow rapidly (Figure 5).
At the time of writing, Canada’s manufacturing sector has lost over 400,000 jobs since employment peaked in 2002. In relative terms (measured as a share of total employment), the decline began earlier: in 1999, about the same time as Canada’s manufacturing exports and manufacturing trade balance began to decline. As indicated in Figure 6, the share of manufacturing in total employment has fallen by four percentage points (or more than one-quarter) since then, to 11.5 percent by the end of 2007 — by far the lowest in postwar history. Manufacturing still employs a slightly larger share of the workforce in Canada than in the United States (where manufacturing accounted for just over 10 percent of employment in 2007), but it is falling more rapidly and this remaining gap (if trends continue) will soon be eliminated.

Canada’s postwar success in building a more diversified, productive, value-added industrial base reflected incremental progress across a range of different high-value industries — including aerospace, specialty vehicles, telecommunications equipment, and certain types of machinery. No single
sector was more important to that postwar industrial development, however, than the automotive industry, which remains (despite recent tribulations) the most critical pillar in Canada’s industrial economy. When Canada's automotive industry peaked in 1999, Canada ranked as the fourth largest assembler of motor vehicles in the world, and the largest on a per capita basis; Canada enjoyed a $15 billion trade surplus in automotive products (Figure 7). Canadian facilities benefitted from strong investment throughout the 1990s, attracted by highly cost-competitive conditions. That strong competitive position resulted in part from an undervalued currency, an efficient public health care system (which saved automakers as much as $10 per hour worked in total labour costs), and superior productivity performance (the auto industry was a rare example of a manufacturing sector in which labour productivity is higher in Canada than in the United States).

By 2006, however, large automotive trade surpluses had melted away into Canada’s first automotive trade deficit in a generation — and that deficit exploded in 2007 to $7 billion. Linked to the deteriorating automo-

Source: Author’s calculations from Statistics Canada data, CANSIM Table 282-0007.
tive net trade performance, around 30,000 well-paid auto jobs have been lost since 2001 (most of those since 2004). More employment losses are occurring with announced layoffs and plant closures by auto assemblers and auto parts producers. The shocking decline of Canada’s once-vaunted automotive sector has been a major source of the decline in overall value-added industrial capacities and trade performance during this decade.

Some market-oriented analysts argue that the loss of manufacturing jobs is being experienced broadly across other developed economies as a result of the transformation towards a “service economy,” and that displaced workers will be reabsorbed in new capacities which presumably better reflect the inherent capabilities and advantages of the Canadian economy. It is certainly true that services are growing as a share of total employment and GDP (although addressing the fundamental weakness in quality and productivity of many service jobs should be a central concern of economic policy).

But it would be wrong to write off the manufacturing sector entirely as yesterday’s industry. Since the turn of this century, Canada’s manufacturing sector has declined much more rapidly as a share of total employment than...
in comparable OECD economies. That decline will have negative impacts on income and economic security in industrial regions of Canada because, for several important reasons, manufacturing makes a disproportionate contribution to overall productivity and well-being:

- Manufactured goods are still essential to successful participation in global trade. Manufactured products account for 75 percent of total merchandise trade.\(^{16}\) A country must be able to participate successfully and competitively in global markets for manufactured goods, to support overall engagement with the global economy, and avoid chronic balance of payments difficulties.

- Manufacturing industries demonstrate both higher productivity levels and higher rates of productivity growth than other sectors. On one hand, this implies ongoing negative pressure on manufacturing employment levels (unless demand for manufactured output is growing fast enough to absorb higher-productivity labour, which does not consistently occur). On the other hand, it implies that manufacturing is especially important to national productivity performance. Heterodox economists since Kaldor and Verdoorn have recognized that a smaller manufacturing sector implies both lower average productivity and lower productivity growth in the broader economy. In this context, the sharp decline (both relative and absolute) in Canadian manufacturing this decade has been a crucial factor behind Canada’s generally poor productivity performance.\(^{17}\)

- Higher productivity (combined with pressure from unions) allows manufacturing employers to pay incomes that are, on average, some 25 percent higher than in the rest of the economy. Manufacturing jobs are a crucial source of well-paid, higher-quality employment for working-class Canadians. They are important to maintaining decent income and employment opportunities in key communities (including newcomer Canadians).

- Manufacturing firms demonstrate much higher levels of research and development (R&D) activity and other forms of innovation. Manufacturing accounts for well over half of all private-sector R&D spending in Canada (even though manufacturing accounts for a much smaller share, only 15 percent, of national GDP). Manufacturers devote a much higher share of GDP to R&D than resource or service producers. Again, the decline of Canadian manufacturing during this decade is a key
factor behind the continuing poor R&D performance of Canadian business. Minerals and energy firms enjoyed rapid growth in revenues and profits in this decade, yet reinvest very little of their revenues back into innovation.

There are concrete, strategic reasons why policymakers should work deliberately to retain a viable, competitive manufacturing sector — with special emphasis on high-productivity, technology-intensive sectors (such as automotive products, aerospace, advanced electronics, life science products, and other high-value industries). In other words, manufacturing still matters.  

The Soaring Loonie Beginning late in 2002, the Canadian currency began to rise dramatically against its US counterpart. The dramatic run-up in the loonie is both a consequence and a further cause of the structural regression in Canada’s economy described above.

Currency traders have come to associate Canada’s currency with global commodity prices (especially prices for oil and metallic minerals). The loonie has appreciated against the US dollar by more than 60 percent in the last six years. This has been the most dramatic appreciation over this time of any of the largest exporters to the United States. The rise in Canada’s dollar against the US dollar has been almost three times as large as the overall global decline in the value of the US dollar (measured against the broad basket of global currencies). This suggests that most of the upward pressure on the loonie reflects unique factors in Canada’s economy and policy, not the general, global weakness in the US currency.

Canada’s currency clearly rises and falls on financial markets in line with changes in global minerals prices (especially the price of oil). This correlation has strengthened since 1999 — perhaps as a result of reduced investor concerns regarding Canadian public debt levels, Quebec separatism, and other factors. But is the judgment of currency traders that the loonie is now a “petro-currency” really justified by Canada’s economic fundamentals? And if so, how are the links between global oil prices (and, to a lesser extent, other minerals prices) and the value of our dollar concretely experienced?

Oil and gas production accounts for just two percent of Canada’s GDP (and in real terms, that share has declined during the current boom). The
oil and gas industry directly employs just 0.3 percent of all Canadian workers. Oil and gas accounted for less than 15 percent of total exports in 2007. Moreover, almost 60 percent of the value of Canadian oil exports is offset by imports of oil to eastern Canada. Hence, net petroleum exports (after deducting imported oil) are much smaller: $17 billion in 2007, or just 1.1 percent of GDP. It seems unjustified to conclude that Canada’s entire national economy now depends on the course of oil prices — and just as wrong to assume (as currency traders seem to do) that the future of the oil and gas industry is essential to our future national prosperity.

The upward pressure on the dollar clearly does not result from a resource-driven improvement in Canada’s trade balance. In fact, the trade balance has deteriorated markedly with the rising loonie: a flood of lower-cost imports and the steady decline in nonresource exports is more than offsetting the rising value of resource exports. Manufacturing and services trade balances have deteriorated badly, and the current account balance has eroded to near zero. It is only the inflated prices received for oil exports that subsidize — for now, anyway — the growing deficit in all our other international commerce. Nor can it be explained by an expansion of foreign-financed real investment in new Canadian productive facilities (in fact, measured as a share of both GDP and available cash flow, fixed investment spending by nonfinancial companies in Canada has declined during the resource boom — despite the mighty cost of huge developments in Alberta’s tar sands).

Instead, the link between oil prices and the loonie has been felt mostly through corporate profitability and financial channels. Canadian resource companies have collected immense, unprecedented profits as a result of the global commodity price boom. Led by these resource profits, the overall profitability of Canadian business has increased dramatically, with corporate profits reaching record levels (as a share of total GDP). Indeed, Canadian businesses are now more profitable (again, measured by the profit share in GDP) than American businesses (see Figure 8). Correspondingly, Canadian equity prices have soared (outstripping US equity prices, as proxied by the relative levels of stock market indices in Toronto and New York — the Toronto Stock Exchange composite index surpassed the Dow Jones Industrial average late in 2005, and the gap between the two indices has widened since
then). In turn, rising equity valuations have attracted interest from foreign financial investors. It is the resulting inflow of financial capital, seeking to take advantage of the immense profitability of Canadian resource production, that has driven up the dollar.

As indicated in Figure 9, the rise of relative Canadian corporate valuations (proxied by the ratio of the major Toronto and New York stock exchange indices) is quite closely associated with the rise of the Canadian currency. It is the value of, and demand for, Canadian companies which explains the rise of the Canadian currency, not the value of (and demand for) Canadian output.

The monetary policy actions of the Canadian central bank have reinforced the rise of the dollar. The Bank of Canada has adopted a narrow and aggressive interpretation of its mandate to target domestic inflation at or near two percent per year, neglecting other factors (such as overall international competitiveness) that are just as relevant to long-run economic stability. The Bank increased Canadian interest rates relative to US levels even as the Canadian dollar soared. Interest rate differentials are a well-known deter-
ominant of the exchange rate. However, blame for the dramatic appreciation of the Canadian dollar since 2002 does not rest solely, or even mostly, with the Bank of Canada. It is the resource boom and the structural shift in Canada’s economy, more than the impact of monetary policy alone, that explains the dollar’s unprecedented and destructive rise.

This analysis suggests that measures aimed at regulating both the profitability of resource extraction and the foreign takeover of Canadian resource companies would have a powerful effect on limiting upward pressure on the Canadian currency during the resource boom (however long that boom lasts).

**Policy Implications and Alternatives** This article has described powerful, long-lasting changes that will fundamentally reorient the sectoral (and regional) structure of Canada’s economy, and its role in the global economic system. Future generations of Canadians will experience the impacts and consequences of this historic structural change in Canada’s economy. Yet
despite the vast stakes, this backwards evolution does not reflect any deliberate government or collective decision. It reflects the power of global market forces and private investment decisions over our economic destiny. And by accepting and even celebrating the power of private businesses to fashion our economic future in this way, Canadian governments are ratifying this profoundly important change in our economic direction.

We need to think carefully about this resource-led restructuring of our entire economy and what it implies for our national economic and social prospects — including our technological development, our economic and political stability, our role in the world, and our environment. We should not blindly accept the role of global commodity prices (which are always unpredictable, and unlikely to stay at such high levels for long) in shaping our entire national economy. We should not grant immensely profitable resource companies the sole power to shape our economic future, by virtue of their decisions to commit tens of billions of dollars to new resource extraction projects. The various regulatory powers of government (including competition policy, regional development policy, environmental policy, international trade policy, and foreign investment policy) could all play an important role in moderating and reversing these structural shifts, and promote a more balanced and sustainable mode of economic development.

Indeed, as already noted, a long series of important policies — from the National Policy, to the Auto Pact, to other interventionist measures — was motivated by the effort to harvest more value, more jobs, and more stability from natural resources, and to stimulate the development of a more diversified and stable industrial structure. During the neoliberal era, however, Canadian governments have adopted a largely hands-off role in overseeing our national economic development. For a mixture of ideological and fiscal reasons, governments have endorsed (actively and passively) the market-driven regression of Canada into global energy and resource supplier. Free trade agreements (especially the NAFTA, which explicitly assigns Canada a role as energy storehouse for the US economy with its still unprecedented and far-reaching energy-sharing provisions) have been important in cementing this trend.

It is certainly possible for governments to address this structural regression with measures that would control and moderate the resource boom
(and its associated consequences, including inward foreign investment and the appreciation of the Canadian currency), and attain a more sectorally diverse and regionally balanced model of development.

**Consciously Act to Slow the Resource Boom** The gold-rush mentality of the tar sands boom in northern Alberta, as companies outrace each other to develop massive new projects, is undermining productivity and leading to wasteful cost overruns. New investment projects in the oil and gas sector should be deferred. While much of the responsibility for managing resource projects lies with provincial governments, the federal government also has the ability to play a role through the more stringent application of environmental regulations, fiscal tools, and other measures to slow down development.

**Ensure that the Canadian People Receive a Larger Share of Windfall Rents from the Resource Boom** The enormous profit rates in Canadian minerals production (again, especially in the oil and gas sector) indicate a failure of Canadian policy to capture a normal share of the one-time rents associated with the exploitation of nonrenewable resources in the context of record global prices. Canadian governments must ensure that Canadians receive full value for the resources that they own. Again, provincial governments have the lead on this front, given their constitutional responsibility for natural resources. Oil-producing provinces should be pushed to increase royalties. But the federal government can play a legitimate role, too, for example, through corporate tax rates. The establishment of differential profit rates for highly lucrative resource industries, either through higher statutory rates or by imposing excess profits surtaxes, would collect a larger share of resource rents for Canadians while simultaneously reducing the incentive for accelerated resource developments.

**Regulate Foreign Takeovers of Canadian Companies** The inflow of finance to pay for takeovers of important Canadian firms has reinforced the destructive run-up of the Canadian currency. The takeovers have also undermined overall Canadian economic control, and will result in a long-run export of capital (through the eventual repatriation of profits, interest, and dividends) that will further weaken Canada’s already deteriorating current account...
balance. Many of Canada’s most productive and important industries were built with the assistance of foreign direct investment; investments from foreign companies that enhance the genuine capacity and capabilities of Canadian operations should be welcomed. However, foreign takeovers that do nothing but transfer control of existing companies to foreign owners result in no benefits, and significant costs, for Canadians; these takeovers should be discouraged through regulatory oversight.

**Actively Manage the Canadian Currency to Offset the Impacts of the Resource Boom** The preceding measures alone would substantially reduce foreign financial inflows to Canada and reverse much of the Canadian dollar’s recent appreciation. But monetary authorities would have a role to play as well in any effort to guide the currency to a more sustainable level. The Bank of Canada could be instructed to take explicit account of the need to preserve a broader competitiveness of Canada’s economy, and the impact of currency fluctuations on investment decisions, in its interest-rate decisions. This direction would be fully consistent with the bank’s mandate, as specified in the *Bank of Canada Act*, to promote the general prosperity and monetary stability of the Canadian economy.

**Actively Foster Business Investment Spending in Nonresource Sectors** Significant federal corporate income tax cuts have had no visible effect on real business investment spending. Strip away extremely expensive investments in resource developments (especially the tar sands), and business investment has been weak. Tax incentives are like pushing on a string by further boosting corporate cash flow (which already exceeds real capital spending, producing the strange result that nonfinancial businesses in Canada are lending funds back into the financial system instead of the other way around). An alternative approach would be to reimpose higher base corporate tax rates on profit, while providing generous tax support for new investment spending (in the form of accelerated depreciation allowances for nonresource companies, a refundable investment tax credit, or other measures), focused on target sectors (like manufacturing and other nonresource export industries). Sector-specific investment and development
initiatives (such as for the auto industry and other targeted high-value industries) can also play an important role in sustaining investment in key nonresource sectors.

**Challenge Free Trade** The future viability of Canada's nonresource export industries is fundamentally threatened by imbalances in the current global trading system. Free trade rules provide incentives for countries to run up large, chronic trade surpluses to support domestic employment and investment opportunities — hence “exporting” their unemployment problems to other countries. Within NAFTA, free trade pressures have clearly accelerated Canada's specialization as a continental energy supplier. Outside of the NAFTA region, Canada's trade is also marked by precarious imbalance — both in terms of the quantities of merchandise flowing in the two directions and the sectoral composition of those flows. We export natural resources to Europe and Asia, in return for huge and growing net imports of high-value manufactured goods. Overturning NAFTA's provisions regarding compulsory sharing of energy resources, and interfering with trade flows to require proportionate Canadian content in key strategic industries, will be an essential part of any effective policy response to the resource boom and associated deindustrialization.

**Regulate Service Sector Work and Production** Proactive efforts to improve the quality, productivity, and incomes of service sector jobs (through labour standards, unionization and collective bargaining, and skills and education initiatives) will be essential to ensure that the growth of services employment does not drag down overall labour conditions. These sectors are not subject to the same constraints of international competition as tradable industries, and hence the standard claim that globalization prevents efforts to improve labour standards and compensation is especially dubious in this context.

All of these proposals would obviously constitute a dramatic and interventionist departure from the liberalization and deregulation that have characterized Canadian development policy in the neoliberal era. It is clear that if this general laissez-faire direction is maintained, then the trends that have become visible in this decade — growing reliance on resource exports,
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dramatic decline in manufacturing, unsustainable appreciation of the currency, and the dominance of low-productivity, nontradable services industries — will be reinforced, and Canada's future economic prospects will be handicapped accordingly.

While this type of interventionist agenda may be economically feasible, what are the political prospects for such a significant redirection of Canada's overall economic development policy? There is no disputing that the political and ideological power of the free trade, resource-driven model is well entrenched in Canada. Under the current Conservative government, the dominance of Western resource elites (in coalition with dominant corporate and financial interests in other parts of the country) is especially clear. On the other hand, it is equally apparent that many Canadians — even in Alberta — are increasingly concerned with the economic, political, and environmental consequences of a development model driven by resource extraction, exports, and foreign investment. The popular backlash against the proposed sale of the Canadian space firm MDA to a US firm (which forced the Harper government to reject the takeover — the first time since 1984 that a foreign takeover of a Canadian company has been turned down) indicates the potent political power of this concern.

Many important elements of Canadian society would seem to have an interest in promoting a more balanced, regulated approach to economic development. This would include, for starters, major sectors of the Canadian labour movement — especially manufacturing unions — concerned with promoting a more sectorally balanced development model. Canada's aboriginal peoples have been fighting unfettered resource development on the front lines for generations, and their campaigns have become more activist and forceful (including campaigns to reform mining law in Ontario, and campaigns to stop further tar sands developments in northern Alberta). The environmental movement has an obvious interest in regulating and slowing resource development. Even some sectors of Canadian business (certainly including much of the manufacturing sector) will react favourably to measures that would improve the conditions for nonresource development (including calls for a moderation of the Canadian dollar) — although the dominant share of Canada's corporate sector (especially including its powerful
A latent coalition of forces with a shared interest in reforming the whole direction of Canadian economic development would face a daunting obstacle, in the form of adherence to the principles of free trade and market-driven development. On the other hand, a great many Canadians aspire for more from their country than to be a “hewer of wood, and pumper of oil” to world markets. Campaigns for a moratorium on tar sands development, for the imposition of taxes on resource super-profits, and for proactive efforts to sustain and nurture other high-value industries in Canada could surely tap into this sensibility and become an influential political force. Several of the preceding policy themes were incorporated in the 2008 edition of the Alternative Federal Budget; subsequent efforts should be aimed at broadening that coalition (especially through the greater participation of aboriginal movements) and enhancing its visibility and influence.

Notes
Some of the issues addressed in this article are considered in more detail in the CAW’s recent submission to the federal Competition Policy Review Panel, “Building a Diversified, Value-Added, Productive Economy” (January 2008), <http://www.caw.ca>.

4. These writers argue that the staples model overstates the limitations imposed by Canada’s resource orientation and reliance on foreign investment. For example, see Paul Kellogg, “Kari Levitt and the Long Detour of Canadian Political Economy,” Studies in Political Economy 76 (2006), pp. 31–60, and W.K. Carroll, Corporate Power in a Globalizing World: A Study in Elite Social Organization (Oxford: Oxford University Press, 2004). Other critics have challenged the staples theory for diverting attention away from what they see as the more central struggle against capitalism within Canada; see, for example, J. Klassen, “Hollowing Out? Myth and Reality,” Relay 22 (2008), pp. 8–11.
5. The Bank of Canada maintains an index of global commodity prices for Canadian resource exports. According to this index, average global prices for Canadian-produced resources increased by 117 percent between 1999 (when resource prices were at a low point) and 2007; average energy prices increased 250 percent.
6. Author’s calculations from Statistics Canada data, CANSIM Table 187-0001. For a more detailed sectoral and regional decomposition of the tremendous rise in Canadian business profits, see J. Stanford, “Picking Winners: The Distorting Effects of Federal Corporate Tax Cuts (Ottawa: Canadian Centre for Policy Alternatives, 2008).  

7. Author’s calculations from Statistics Canada data, CANSIM Table 376-0004.  

8. The Organization for Economic Cooperation and Development (OECD Main Economic Indicators) estimates the purchasing power parity level of the Canadian dollar at approximately 82 cents (US). This is the level at which average consumer prices are equalized internationally (and hence there is no incentive for cross-border shopping in either direction).  

9. The exception was the 1990–91 period, when uniquely harsh Canadian monetary policy temporarily drove the dollar to more than 90 cents US.  

10. Author’s calculations from Statistics Canada data, CANSIM Table 282-0007.  

11. Author’s calculations from Statistics Canada data, CANSIM Table 427-0001.  

12. Of course, GDP per capita is not an accurate measure of mass prosperity, since it does not take account of the distribution of GDP across factors of production or between individuals, the value of leisure time, and other determinants of the quality of life.  


14. The term “value-added” activities is used here to refer to industries that aim to enhance and diversify higher-level secondary and tertiary production through the additional processing and secondary manufacturing of resources; the development of more sophisticated supply industries to feed into resource production activities; the development of other highly-technology manufacturing industries; and the expansion of tradable services industries. All of these higher-level activities help Canada to both reduce its reliance on raw resource extraction and to maximize the domestic economic spin-offs from resource sectors.  

15. Only about two percent of Canadian services production is exported, and this proportion has actually declined slightly in recent years.  


17. According to data prepared by the Centre for the Study of Living Standards (<http://www.csls.ca>), average hourly productivity in the Canadian business sector grew steadily as a share of US productivity levels from the end of World War II until 1984 (a peak of 91 percent of US productivity). It then fell steadily until 2006 (most recent data), when it equalled 74 percent of US productivity.  


19. The basic federal rate was 28 percent in 2000. It was cut to 21 percent by the former Liberal government, and the current Conservative government now plans to cut it to 15 percent by 2012. That represents by far the largest proportional reduction in Canadian tax rates engineered during this period (far deeper than cuts in personal income taxes and sales taxes). The reductions still to come will reduce federal revenues by an estimated $14 billion per year. See Stanford, Picking Winners, for more discussion and critique of the structural and regional impacts of these corporate tax reductions.  