Third Annual Report on Canada's State of Trade

Trade Update

MAY 2002

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ABOUT THIS DOCUMENT

As international trade and investment have led to improved opportunities and prosperity over time while simultaneously influencing and touching on day-by-day developments for each and every one of us, issues in the international economic domain are becoming increasingly of interest to Canadians. This important aspect of our economy has led to an increased demand from those in all walks of life for continuing and comprehensive information and analysis on Canada's international trade and investment performance. This document, prepared and published annually, is intended to help fill this demand. It reviews and analyzes key developments and outcomes with respect to Canada's international trade and investment in 2001 against the background of economic trends and performance at home and abroad.

The Economic and Trade Analysis Division (EET) of the Department of Foreign Affairs and International Trade prepared this third annual report under the direction of John M. Curtis, Senior Economic Advisor and Coordinator. Hung-Hay Lau, Deputy Director and Senior Research Coordinator, oversaw and wrote the report, with contributions from Shenjie Chen, Suzanne Desjardins, Bjorn Johansson, Samad Uddin and Mira Patel.

Suggestions for next year's edition would be welcome. Please e-mail John Curtis at john.curtis@dfait-maeci.gc.ca.

ISBN 0-662-66579-1

Catalogue number: E2-202/2002

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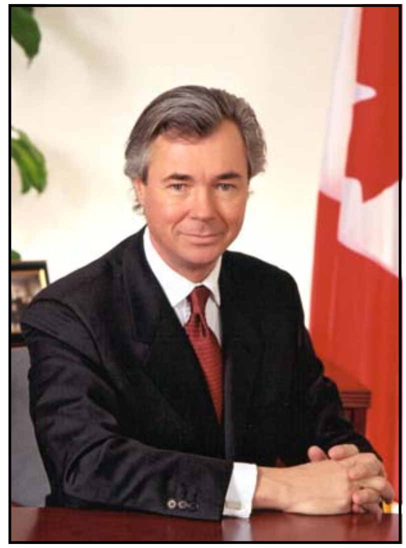


A MESSAGE FROM THE HONOURABLE PIERRE S. PETTIGREW, MINISTER FOR INTERNATIONAL TRADE

Buffeted by dramatic downward evaluations in technology stocks and rocked by terror attacks, the North American and global economy in 2001 seemed very vulnerable indeed. While Canada's prospects appeared equally uncertain, one word – resilience – best describes Canada's economy and its trade and investment performance last year. Far from succumbing to these and other negative forces, Canada posted a surprisingly strong performance on the international trade and investment fronts. This year's Trade Update report highlights two impressive realities about Canada's international performance in 2001.

First, Canada recorded strong trade and investment results last year despite the global economic slowdown. Our exports and imports of goods and services with the world totalled $880.5 billion for the year, on average $2.4 billion per day in 2001. About $43 billion in new direct investment flowed into Canada in 2001, bringing the stock of foreign direct investment (FDI) in Canadian wealth-creating enterprises to $320.9 billion. Canadians invested more abroad in the form of both direct and total investment flows in 2001 reflecting the mature state of our economy.

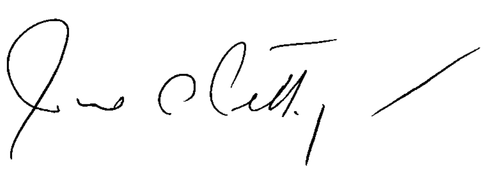
Taking exports and imports separately, Canadians in 2001 exported nearly $468 billion in goods and services, about 43.1 percent of Canada's gross domestic product (GDP) and imported $413 billion in goods and services or 38.1 percent of GDP. This impressive trade performance had immediate job-creating benefits for Canadians. A total of 167,100 net new jobs were created in Canada last year, linked in part to trade and investment with the world. In fact, an estimated one of every four jobs in Canada has been linked to our export success in global markets.

Second, Canada's 'new economy' played an increasingly important part in our overall trade success. New or knowledge-based industries are now more prominent than ever in our exports. Moreover, the widespread application of new technology has enhanced Canadian productivity, improving our capabilities even in many of our traditional export industries. Exports of machinery and equipment continued to be the most important component of our merchandise exports. Exports of services have generated royalty and licence fees that grew 26.6 percent annually since 1993 to $2.04 billion last year. Imports in this and other sectors have increased as well, reflecting strong investment in the future knowledge base of the Canadian economy.

With Canada as host of the G-8 Summit this summer, and given the Prime Minister's agenda for this meeting arising from Genoa last year, Canadians will be interested in facts about Canada-African trade. Since 1993, Canadian merchandise imports from Africa have expanded by 63 percent to $2.3 billion in 2001, reflecting greater Canadian purchases of goods produced in Africa. Canadian also sold more to Africa, some 48 percent more over the period 1993-2001. Canadian investment in Africa has also increased rapidly over the years – by more than 600 percent between 1993 and 2001 to $2.8 billion.

Coming off the enormously successful trade year in 2000, I cautioned when I reported last May on that year's performance that it was no time for complacency. As the year evolved, we saw clearly how important an open, rules-based international trade and investment system underpinning the continued flow of goods and services was to our economy and to the millions of Canadians whose livelihoods are linked directly or indirectly to our trade success.

As Minister for International Trade, I invite you to help build on our successes with renewed determination to harness as many benefits of globalization as we can through our international trade and related investment activities. We want all Canadians to share in those benefits – better and higher-paying jobs, greater competitiveness of our companies, more choices for consumers, and brighter futures for all Canadians in a more stable and more peaceful world.



THE YEAR IN TRADE 2001

HIGHLIGHTS OF CANADA'S INTERNATIONAL TRADE AND ECONOMIC PERFORMANCE

For Canada, 2001 was a noticeably slower year of economic growth. Nevertheless, it marked the tenth consecutive year of economic expansion, the longest and most stable economic expansion since the 1960s.

2001 Trade and Economic Highlights[1]

- **Gross domestic product** at current prices rose to $1.08 trillion in 2001, or $36,128 per capita for a population of just over 30 million.

- **Real GDP** (adjusted for inflation) grew by 1.5 percent in 2001.

- **Consumer price inflation** on an annual basis edged down to 2.6 percent in 2001, from 2.7 percent in 2000. Core inflation, which excludes food and energy, was 2 percent in 2001, up from 1.5 percent in 2000.

- **Job growth** in 2001 as a whole was 1.1 percent (167 thousand), with more than 80 percent of the increase occurring in full-time employment.

- **However, the unemployment rate** rose to 7.2 percent for 2001 as a whole, after having fallen to 6.8 percent in 2000, the lowest since 1974. The rise in the unemployment rate in 2001 was due to increased participation in the labour force

- **Exports of goods and services** decreased by 2.1 percent in 2001, following a dramatic increase of 14.6 percent in 2000. This decline was the first since 1991. By major groups, the decline in exports in 2001 was confined to machinery and equipment, forestry and automotive products, as well as to freight and shipping services.

- **Imports of goods and services** declined by 2.9 percent in 2001, after rising by 10.5 percent in 2000. This was the first such decline since 1982. The decline in imports was widespread among most major groups such as machinery and equipment, industrial materials, automotive and forestry products. Services imports associated with foreign travel and freight and shipping also fell.

- **The current account balance** established a new record surplus of $29.1 billion in 2001, up from $26.9 billion in 2000, because of the smaller decline in exports than in imports. This included a merchandise trade surplus of $61.5 billion in 2001

- **Canada's net foreign liability** fell to 18.8 percent of GDP, the lowest since mid-1940.

- **The Canadian dollar** closed the year 2001 at US$0.634, down from US$0.667 at the close of 2000. For 2001 as a whole, it averaged US$0.6458, down 4.1 percent from US$0.6733 in 2000. Against the euro, its average value was down by 1.2 percent to 0.72 euro per dollar. Against the Japanese yen, however, the average value of the Canadian dollar strengthened by 8.0 percent in 2001.

International trade affected by the substantial slowdown in global economic growth in 2001.

- In 2001, the economies of a number of Canada's trading partners lapsed into recession. In this unfavourable international environment, Canada's exports of goods and services declined slightly by 2.1 percent to $467.6 billion after increasing by 14.6 percent in 2000. Exports of goods and services represented 43.1 percent of Canada's nominal GDP in 2001, down somewhat from the peak level of 45.3 percent in 2000.

- Imports of goods and services declined by 2.9 percent in 2001 to $412.9 billion, after a 10.5 percent jump in 2000. The ratio of imports of goods and services to GDP fell to 38.1 percent in 2001, after reaching a peak of 40.3 percent in 2000.

[1] All monetary amounts throughout this report are expressed in Canadian dollars, unless otherwise indicated.

- The current account surplus rose to a new record of $29.1 billion in 2001 or 2.7 percent of GDP, from $26.9 billion or 2.5 percent of GDP in 2000. This improvement reflected the increase in Canada's merchandise trade surplus to a new record high of $61.5 billion in 2001 from $59.3 billion in 2000.

On a regional basis:

- Exports of goods and services to the United States were hurt by the decline in economic growth in that country accentuated by trade interruptions associated with the September 11 terrorist attacks. Growth in real GDP in the United States moderated sharply, from 4.1 percent in both 1999 and 2000 to 1.2 percent in 2001. Canada's exports of goods and services to the United States fell by 2.2 percent to $382.6 billion in 2001 from a record high of $391.2 billion in 2000.

- Sales to the European Union declined by 2.4 percent in 2001, following a 13.2 percent jump in 2000, as growth in several major Western European economies slowed, especially in the second half of the year.

- Exports of goods and services to Japan fell sharply by 8.9 percent, a continuation of the steady declines observed between 1994 and 1998. This occurred as Japan slid back into recession for the third time in a decade, with three quarterly declines in GDP starting with the second quarter of 2001.

- Exports of goods and services to countries other than the United States, the EU, and Japan rose by 0.4 percent to a record high of $43.2 billion in 2001.

- Trade with most East Asian economies outside of Japan was little changed. In the case of the People's Republic of China, however, Canada's merchandise exports grew strongly, by 14.6 percent in 2001, reflecting continued robust growth in the Chinese economy.

- Merchandise exports to most major Latin American destinations grew further in 2001, with much of the increase concentrated in shipments to Mexico and Venezuela.

- Canada's merchandise trade with most African economies rose in 2001. However, since exports to several of Canada's major African trading partners such as Algeria and South Africa fell sharply, exports to the African region as a whole declined (see Box B on page 14).

The product mix of Canada's merchandise exports experienced significant shifts in 2001.

- Exports of machinery and equipment, automotive, and forestry products dropped sharply in 2001. On the other hand, a number of other major exports, such as agricultural products, consumer goods and energy products, increased strongly. Energy trade played a particularly dominant role in Canada's merchandise trade performance. In 2001, the energy surplus reached a new record high of $37.6 billion, building on the strength of high energy prices, accounting for 61.1 percent of Canada's 2001 merchandise trade surplus of $61.5 billion. (Box C on page 19 reviews Canada's energy trade from a global perspective.)

- While exports of machinery and equipment fell by 7.6 percent in 2001, more sharply than that of 5.3 percent for exports of automotive products, this sector's exports continued to be the most important among all major sectors in Canada's export sales at 24 percent of total Canadian goods exports. The decline in the value of machinery and equipment exports was led by exports of high-tech products such as telecommunications equipment, which dropped by more than 60 percent in the year.

- Exports of agricultural and fishing products increased by 12.6 percent in 2001, reflecting widespread gains in shipments of live animals, meat products, beverages, food, feed and tobacco products.

- Exports of services edged down by 0.4 percent in 2001, as exports of freight and shipping services fell along with the decline in merchandise exports. Interestingly, tourism receipts rose by 2.8 percent in the fourth quarter, even though tourism was hurt by the September 11 terrorist attacks. (See Box D on page 27 for a review of potential growth in services trade.)

Two-way direct investment flows with the world continued at historically high levels, though down from the 2000 peak. Canada's net external indebtedness as a percent of GDP declined to its lowest point since the mid-1940s.

- As it did in the period from 1993-1998, Canadian direct investment abroad (CDIA) in 2001 exceeded the inflow of foreign direct investment (FDI) in Canada. This trend reversed the situation that had occurred in 1999-2000, when large mergers and acquisitions of several Canadian-based assets had taken place.

- The flow of CDIA remained at a very high level of $57.3 billion in 2001, though down from a record $65.4 billion in 2000, largely as a result of a sharp drop in investment in the EU.

- Meanwhile, FDI from the EU to Canada fell to $0.1 billion in 2001 after unusual merger activities had led to a dramatic jump to $72.1 billion in 2000. As a result, FDI from the world as a whole fell to $42.8 billion in 2001, from the record $94.1 billion in 2000. Nevertheless, inflows of FDI from the United States reached a record high of $40 billion in 2001 while FDI from Japan edged down from $0.9 billion in 2000 to $0.8 billion in 2001.

Canada's Trade and Investment, 1997-2001 ($ billions)

	Exports of Goods and Services					Imports of Goods and Services				
	1997	1998	1999	2000	2001	1997	1998	1999	2000	2001
World	347.1	375.5	417.0	477.9	467.6	330.3	359.3	385.0	425.3	412.9
United States	267.4	297.9	340.0	391.2	382.6	244.3	268.4	285.3	305.9	293.1
EU	25.0	27.1	28.0	31.7	30.9	32.8	34.8	38.0	43.7	45.4
Japan	13.5	11.0	11.0	11.9	10.8	9.9	11.0	12.4	13.6	12.5
ROW*	41.1	39.5	37.9	43.0	43.2	43.3	45.2	49.3	62.0	61.8
	Exports of Goods					Imports of Goods				
	1997	1998	1999	2000	2001	1997	1998	1999	2000	2001
World	303.4	326.2	365.2	422.6	412.5	277.7	303.4	326.8	363.3	351.0
United States	242.5	269.3	309.2	359.6	350.8	211.5	233.8	249.3	267.7	255.5
EU	17.9	19.0	19.3	22.1	21.8	24.2	25.2	28.4	33.4	35.1
Japan	11.9	9.6	9.6	10.3	9.3	8.7	9.7	10.6	11.7	10.6
ROW	31.0	28.2	27.2	30.6	30.6	33.3	34.7	38.5	50.5	49.9
	Exports of Services					Imports of Services				
	1997	1998	1999	2000	2001	1997	1998	1999	2000	2001
World	43.8	49.4	51.7	55.3	55.1	52.6	56.0	58.2	62.0	61.9
United States	24.9	28.5	30.8	31.7	31.8	32.9	34.6	36.0	38.3	37.7
EU	7.1	8.1	8.7	9.6	9.2	8.6	9.6	9.6	10.3	10.3
Japan	1.6	1.4	1.5	1.6	1.5	1.2	1.3	1.8	1.9	1.9
ROW	10.2	11.3	10.7	12.4	12.6	10.0	10.5	10.8	11.6	12.0
	Canadian Direct Investment Abroad					Foreign Direct Investment in Canada				
	1997	1998	1999	2000	2001	1997	1998	1999	2000	2001
Flows										
World	31.9	51.3	27.4	65.4	57.3	16.0	33.5	37.4	94.1	42.8
United States	12.5	26.7	18.5	40.5	38.9	11.7	24.6	37.5	17.3	40.0
EU	6.8	10.4	1.8	9.7	4.9	2.8	6.7	2.8	72.1	0.1
Japan	0.7	-0.2	0.9	3.5	1.3	0.6	0.5	-4.2	0.9	0.8
ROW	11.9	14.5	6.2	11.8	12.1	0.9	1.8	1.3	3.8	1.8
Stocks										
World	218.6	262.9	283.2	340.4	389.4	194.3	219.4	248.6	302.3	320.9
United States	110.7	133.3	143.6	164.5	198.4	129.0	146.9	172.8	191.0	215.0
EU	45.1	54.1	53.4	72.2	76.5	41.3	48.2	50.8	82.8	76.3
Japan	3.0	3.3	3.9	5.6	6.4	8.0	8.4	8.2	7.9	8.3
ROW	59.8	72.3	82.3	98.0	108.1	16.1	15.9	16.8	20.6	21.4

Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue 67-001-XIB, 4th Quarter
Statistics Canada, *Canada's International Investment Position*, Catalogue 67-202-XIB, 4th Quarter

* Rest of World

- The cumulative stock of CDIA rose by 10.5 percent in 2001 to $389.4 billion. The U.S. accounted for 51 percent, followed by the United Kingdom at 9.8 percent. The EU as a whole accounted for 19.6 percent in 2001, down from 21.2 percent in 2000.

- With respect to FDI, the U.S. accounted for 67 percent of the $320.9 billion cumulative stock in 2001. The EU's share fell to 23.8 percent in 2001, from 27.4 percent in 2000.

- Canada's net external indebtedness, which had been declining rapidly since 1976 as a share of GDP, was little changed at $203 billion in 2001, after falling in absolute value in 1999 and 2000.

Trends

- Trade in 2001 sustained a mild decline following a decade of exceptional growth. Over the period 1990-2001, during which real (inflation-adjusted) GDP grew by 2.5 percent at a compound annual rate, growth was 6.8 percent for real exports of goods and services and 5.3 percent for imports of goods and services.

- The sustained high rate of expansion of trade relative to GDP is associated with the reorientation of Canada's industrial structure. This reorientation was encouraged by the new opportunities and competitive pressures created by the Canada-U.S. Free Trade Agreement (FTA) and its successor, the North American Free Trade Agreement (NAFTA), as well as by the multilateral reduction of trade barriers pursuant to the agreements reached in the Uruguay Round of trade negotiations.

- The higher rate of growth of exports over imports over the last decade reflected principally the more robust rate of economic growth in the United States than in Canada.

Table 1: Trade as a percent of GDP, 1989-2001

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total exports	26.5	25.4	25.6	24.9	26.8	29.9	33.8	37.1	38.1	39.2	41.0	42.8	45.3	43.1
Goods	23.4	22.3	22.3	21.5	23.3	26.1	29.5	32.7	33.4	34.3	35.6	37.4	40.0	38.1
Services	3.1	3.2	3.3	3.4	3.6	3.9	4.2	4.4	4.8	4.9	5.4	5.3	5.2	5.1
Total imports	25.8	25.5	25.5	25.5	27.3	30.0	32.6	34.0	34.2	37.3	39.2	39.5	40.3	38.1
Goods	21.6	21.1	20.7	20.5	22.0	24.3	26.9	28.3	28.3	31.4	33.1	33.5	34.4	32.4
Services	4.2	4.4	4.8	5.1	5.3	5.7	5.7	5.7	5.8	5.9	6.1	6.0	5.9	5.7

Source: Statistics Canada, *National Income and Expenditure Accounts*, Catalogue no. 13-001-PPB, 4th Quarter 2001.
Statistics Canada, *Canada's Balance of International Payments*, Catalogue, no. 67-001-XPB, 4th Quarter 2001.

The dominant position of the United States in Canada's trade remained in 2001[2]

- In 2001, two-way trade in goods and services with the United States dropped by 3.1 percent, mainly as goods trade was down by 3.3 percent while services trade fell by just 0.7 percent. The interruption of Canada-U.S. trade flows associated with the terrorist attacks in September 2001 affected imports more substantially than exports, as Canadian imports are more dependent on road and air transport than are exports.

- In Canadian dollar terms, two-way trade in goods and services fell to $675.7 billion in 2001 from $697.2 billion in 2000. On a daily basis, two-way trade in goods and services with the U.S. edged down to $1.85 billion in 2001 from $1.91 billion in 2000. In U.S. dollar terms, two-way trade in goods and services with the U.S. averaged US$1.20 billion per day in 2001, a decline from US$1.28 billion daily in 2000. The somewhat steeper decline in this U.S. dollar measure reflects a 4.1 percent drop in Canada's exchange rate from 67.33 cents U.S. in 2000 to 64.58 cents U.S. in 2001.

- As exports declined less substantially than imports, Canada's surplus in goods and services trade with the United States rose to a new record of $89.5 billion in 2001, from $85.3 billion in 2000. This improvement reflected both an expansion of the traditional bilateral surplus in merchandise trade, as well as a substantial reduction in the long-standing deficit in services trade.

[2] A review of regional trade between Canada's provinces and U.S. states is shown on pp. 10-14 of the *Annual Report on Canada's State of Trade*, Department of Foreign Affairs and International Trade, May 2001.

♦ Canada's current account surplus with the United States also increased to an all-time high of $66.8 billion in 2001, from $63.3 billion in 2000.

Table 2: Two-way Trade, Canada and the United States, 1990-2001

	Value (millions of current dollars)			Annual growth (percent)		
	Goods	**Services**	**Goods & Services**	**Goods**	**Services**	**Goods & Services**
1990-2001	399,573	52,088	415,661	10.0	8.0	9.8
1997	453,993	57,798	511,791	12.8	7.8	12.2
1998	503,095	63,149	566,244	10.8	9.3	10.6
1999	558,525	66,812	625,337	11.0	5.8	10.4
2000	627,226	69,950	697,175	12.3	4.7	11.5
2001	606,282	69,461	675,744	-3.3	-0.7	-3.1

Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue, no. 67-001-XPB, 4th Quarter 2001.

♦ The trading relationship with the United States dominates Canada's statistics on foreign trade: the U.S. accounted for 81.8 percent of Canada's exports of goods and services in 2001, a small decline from 81.9 percent in 2000. In 2001, exports of goods and services to the United States represented 35.3 percent of Canada's GDP. Imports of goods and services from the United States represented 71 percent of total imports from the world in 2001, down from 71.9 percent in 2000. Thus, Canada's imports are more diversified geographically than its exports.

♦ However, data on Canada's exports to the United States, which are compiled from U.S. import data sources, are overstated as they include some shipments to third countries via the United States. As a result, Canada's exports to the rest of the world are correspondingly understated. This is one major reason why our trading partners' import data reveal that Canada's exports to these countries are invariably higher than are indicated by our own official export statistics. Ongoing work on data reconciliation with Canada's major trading partners such as Japan, the EU, Mexico, China and Korea will improve our knowledge of the actual destination of Canadian exports.[3]

♦ From the U.S. perspective, Canada is its largest trading partner, in terms of both exports and imports. Canada carries a trade weight in the U.S. market that is substantially greater than our economic weight in the global economy. In 2001, Canada accounted for 18.7 percent of U.S. exports of goods and services and 17.5 percent of its imports. In terms of merchandise, Canada's share of U.S. trade is even larger (Table 3). As a percent of U.S. merchandise imports, Canada's market presence in the United States increased from 18.8 percent in 2000 to 19 percent in 2001. In 2001, the value of U.S. merchandise imports from Canada was about two thirds higher than that of U.S. merchandise imports from Mexico. (See Box A on page 10 for an analysis of the comparative position of Canada's and Mexico's merchandise trade in the U.S. market.)

Table 3: Shares of U.S. Goods Imports From, and Exports To, Five Main Trading Partners, 1994-2001

	As percent of total U.S. Imports					As percent of total U.S Exports				
	1994-1997	1998	1999	2000	2001	1994-1997	1998	1999	2000	2001
Canada	19.4	19.0	19.4	18.8	19.0	21.8	23.0	23.7	22.6	22.4
EU	18.0	19.3	19.1	18.1	19.3	20.7	21.8	21.9	21.1	21.8
Mexico	8.8	10.4	10.7	11.2	11.5	9.4	11.5	12.6	14.3	13.9
Japan	15.6	13.4	12.8	12.0	11.1	10.4	8.5	8.3	8.4	7.9
China	6.5	7.8	8.0	8.2	9.0	1.9	2.1	1.9	2.1	2.6

Source: U.S. Census Bureau, *International Trade Statistics*. Note: Data are on a Customs basis.

[3] For details on the analysis, see *CanadExport*, Vol. 19, No. 1, January 15, 2001 Supplement: Canadian Trade Review, Third Quarter 2000, "The Impact of Transhipments on Canada's International Trade Statistics," Department of Foreign Affairs and International Trade.

Prospects for trade contingent on economic developments in the United States and abroad.

- Canada's long-standing reliance on trade with the United States exposed Canada directly and quickly to the slowdown in U.S. economic activity in 2001. By the same token, Canada stands to benefit from the current recovery in economic growth in the United States. At present, the consensus forecast calls for an acceleration in U.S. economic growth, particularly in the second half of this year.

- Historically, any rebound in the U.S. economy is also likely to propagate quickly also through the economies of Canada's other major trading partners. Most forecasters are expecting a rebound in economic growth in the European economy this year and next. In addition, economic prospects in most Asian economies other than that of Japan have also improved. In effect, the current upswing in U.S. economic growth will, in turn, impact indirectly but favourably on Canada's exports of goods and services to the EU, Asia and the rest of the world.

- The forceful actions taken by the U.S. monetary and fiscal authorities throughout 2001 to revitalize economic expansion continue to bolster the housing sector and big-ticket consumer purchases via reduced mortgage payments, lower financing costs, and higher after-tax income. These interest rate sensitive sectors figure prominently in Canada's exports of building materials and consumer products such as motor vehicles and parts. In addition, exports of machinery and equipment, which were hard hit by the decline in high-tech spending in 2001, will most likely rebound strongly in the cyclically strengthening international economy.

- Canada's energy trade will continue to contribute increasingly to Canada's overall trade surplus with the United States, given high demand for Canada's energy exports and growing production from tar sand and offshore sources as well as increased pipeline capacities in Canada. In 2001, fully 100 percent of Canada's $45 billion worth of exports of crude petroleum, natural gas and electricity was shipped to the United States, accounting for 13 percent of Canada's merchandise exports to the United States.

I. MERCHANDISE TRADE

The high degree of economic uncertainty in the global economy in 2001 was generally unfavourable for Canada's exporters: economic growth eased steadily throughout the year, investment spending declined, and prices for key commodity exports, such as metals and chemicals, fell markedly. In 2001, the value of Canada's merchandise exports fell by 2.4 percent to $412.5 billion, led by declines in exports to Japan, the United States and the EU. Meanwhile, Canada imported goods worth $351 billion, down 3.4 percent from $363.3 billion in 2000, as a result of widespread declines in imports from Canada's major trading partners other than the EU. This resulted in a record merchandise trade surplus of $61.5 billion, an increase from $59.3 billion in 2000.

The Direction of Trade in 2001

The share of Canada's merchandise exports to the United States edged down to 85 percent in 2001, after rising steadily over the last decade to a peak of 85.1 percent in 2000. As Japan again slid into recession in 2001, that country's share in Canada's merchandise exports declined further, reaching 2.3 percent. In 2001, the declines in the share of the United States and Japan were mirrored by an increase in the shares of the European Union and of the rest of the world.

Table 4: Shares of Canada's Merchandise Exports (percent) 1971–2001

	1971-1980	1981-1990	1991-2001	1998	1999	2000	2001
U.S.	67.7	74.1	81.2	82.6	84.7	85.1	85.0
EU	11.5	7.8	6.0	5.8	5.3	5.2	5.3
Japan	5.8	5.5	3.6	3.0	2.6	2.4	2.3
ROW	14.9	12.6	9.2	8.6	7.4	7.2	7.4

Source: Statistics Canada, CANSIM. Table 228-0001: "Merchandise Exports on a Balance of Payments Basis by 64 Major Groups and by 6 Principal Trading Areas based on the Standard Commodity Classification."

Review of export performance by major partner economies and regions in 2001

The United States

As set out in detail above, market conditions in the United States worsened in 2001, after the longest peacetime economic expansion dating from early 1991. According to the U.S. National Bureau of Economic Research, the authority in dating recessions and expansions, the U.S. economy lapsed into recession in March 2001. For 2001 as a whole, growth in the U.S. economy moderated to 1.2 percent, from 4.1 percent in both 1999 and 2000. Business investment in plants and equipment fell sharply in 2001, reducing U.S. demand for imports of machinery and equipment from Canada.

- The value of business investment in equipment and software in the United States fell by 6.5 percent in 2001, reflecting declines in both price and volume.

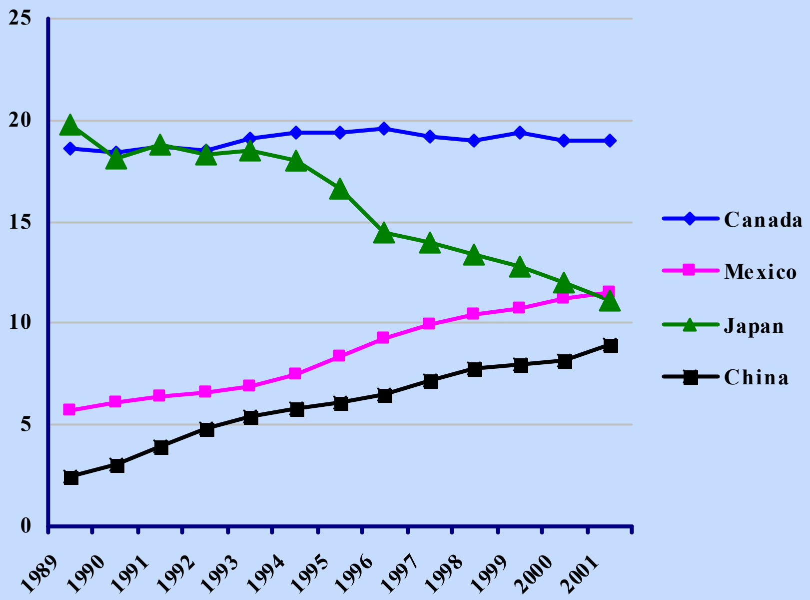
- Two-way cross border shipments were interrupted by intensified security measures implemented in the aftermath of the September 2001 terrorist attacks.

In this environment, Canada's exports of goods to the United States declined by 2.4 percent in 2001 after a robust gain of 16.3 percent in 2000. Exports to the United States represented 85 percent of the goods total in 2001, down marginally from 85.1 percent in 2000.

Box A: Canada's and Mexico's merchandise trade with the United States

Both Canada and Mexico rely on U.S. import demand to fuel much of their respective economic activity. In 2001, shipments to the United States accounted for 88.5 percent of Mexican and 87.3 percent of Canadian merchandise exports.[4] In the last decade, both Canadian and Mexican exports to the United States have risen sharply. Canada has been the premier source of imports into the United States since 1992, when it surpassed Japan.[5]

Chart A.1: U.S. Merchandise Imports, 1989-2001



Source: U.S. Census Bureau, U.S. Department of Commerce (data on U.S. Census basis)

Chart A.1 (based on data presented in Table A.1) depicts the respective shares of U.S. merchandise imports occupied by Canada, Mexico, Japan and China. In the period from 1988 to 2001, Canada has maintained a fairly stable share of between 18.4 percent and 19 percent. On the other hand, Mexico's share of U.S. imports has grown from 6.9 percent in 1993 to 11.5 percent in 2001.

The rise in Mexico's share of the U.S. import market has largely been at the expense of a falling market share for Japan, combined with a rapidly developing China, which is also emerging to occupy an increasingly large share of U.S. imports. As of 2001, Canada's share of the U.S. market was 65 percent larger than that of Mexico. Based on current trends, Canada will continue to occupy a predominant position of trade on a bilateral basis with the United States in the foreseeable future.

Table A.1: U.S. Merchandise Imports and Percentage Distribution by Country, 1988-2001

U.S. Merchandise Imports (US$ billions)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
World	441	473	495	487	533	580	663	744	795	870	912	1,025	1,218	1,142
Canada	81	88	91	91	99	111	128	144	156	167	173	198	231	217
Mexico	23	27	30	31	35	40	49	62	74	86	95	110	136	131
Japan	90	94	90	92	97	107	119	123	115	122	122	131	146	127
China	9	12	15	19	26	32	39	46	52	63	71	82	100	102

Percentage Distribution of U.S. Merchandise Imports

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Canada	18.5	18.6	18.4	18.7	18.5	19.1	19.4	19.4	19.6	19.2	19.0	19.4	19.0	19.0
Mexico	5.3	5.7	6.1	6.4	6.6	6.9	7.5	8.4	9.3	9.9	10.4	10.7	11.2	11.5
Japan	20.3	19.8	18.1	18.8	18.3	18.5	18.0	16.6	14.5	14.0	13.4	12.8	12.0	11.1
China	1.9	2.5	3.1	3.9	4.8	5.4	5.8	6.1	6.5	7.2	7.8	8.0	8.2	9.0

Source: U.S. Census Bureau, U.S. Department of Commerce (data on U.S. Census basis)

[4] These figures are based on customs data, which are somewhat different from balance of payments information that is available for Canada and used as the primary basis for this Report overall.

[5] For details on the analysis, see *CanadExport*, Vol. 20, No. 1, January 15, 2002 Supplement: Canadian Trade Review, Third Quarter 2001, Canada and Mexico Trade with the United States, pp. 4-8.

The European Union

Economic growth in the European Union moderated to 1.6 percent in 2001, from more than 3 percent in 2000. In the fourth quarter of 2001, real GDP declined by 0.2 percent, the first decline in almost nine years. Reflecting this moderation in foreign income growth, Canada's exports of goods to the EU fell by 1.5 percent in 2001. The average value of the euro rose by 1.2 percent in 2001 relative to the Canadian dollar, to $1.39 per euro, after falling by 13.5 percent in 2000 to $1.37 per euro from the 1999 rate of $1.58 per euro.

In the case of merchandise, for which comprehensive country information is available, Canada's exports to the key countries in the EU increased over the last decade in all categories (Table 5A). However, these increases over the last decade were smaller than the growth in Canada's overall exports. As a result, the EU's share of Canada's merchandise exports fell from 8.3 percent between 1989 and 1992 to 4.5 percent in 2001. This decline in export share was widespread among all of the principal EU members.

Table 5A: Canada's Merchandise Exports to the EU Economies, 1989-2001

Economies	Average 1989-1992	Average 1993-1996	1997	1998	1999	2000	2001
Level in $ billions							
Germany	2.2	2.9	2.7	2.7	2.4	3.1	2.9
France	1.4	1.6	1.7	1.7	1.9	1.9	2.2
United Kingdom	3.3	3.6	3.9	4.4	4.8	5.7	5.0
Italy	1.1	1.4	1.5	1.5	1.4	1.7	1.6
Other EU	4.4	4.7	5.6	5.9	6.0	6.6	6.5
EU-15	12.4	14.1	15.4	16.2	16.5	19.1	18.2
As percent of total exports							
Germany	1.5	1.2	0.9	0.9	0.7	0.8	0.7
France	0.9	0.7	0.6	0.5	0.5	0.5	0.5
United Kingdom	2.2	1.5	1.3	1.4	1.4	1.4	1.2
Italy	0.8	0.6	0.5	0.5	0.4	0.4	0.4
Other EU	2.9	2.0	1.9	1.8	1.7	1.6	1.6
EU-15	8.3	5.9	5.2	5.1	4.7	4.6	4.5

Source: Statistics Canada, *Canadian International Merchandise Trade 2001*. Catalogue no. 65-001-XPB, December 2001.

Regional integration in both Europe and North America in the past decade or so has tended to favour intensified intra-regional trade at the expense of trade with the rest of the world. However, it is surprising to note that intra-EU trade as a percent of total EU trade declined substantially from 62.9 percent in 1989-1990 to 57.9 percent in 2000 (Table 5B). Canada's share of imports of the European Union (from outside of the EU) edged up to 1.9 percent in 2000, from 1.8 percent in 1999. This occurred even though the Canadian dollar appreciated sharply against the euro from 0.63 euro per Canadian dollar in 1999 to 0.73 euro per dollar in 2000. Meanwhile, there were notable declines in the share of the EU market accounted for by the United States, Japan and Switzerland in 2000.

Table 5B: Intra-EU Merchandise Trade and Imports from Selected Trading Partners, 1989–2000

	1989-1990	1993-1994	1998-1999	2000
Share of EU-15 Imports from major trading partners (percent)				
Intra-EU	62.9	59.8	60.2	57.9
EU - ROW	37.1	40.2	39.8	42.1
Percentage breakdown of EU-15 imports from ROW				
Total	100	100	100	100
Canada	2.4	1.8	1.8	1.9
U.S.	20.2	19.4	20.3	19.6
Japan	12.1	11.3	9.2	8.5
China	2.2	4.3	5.4	6.2
Switzerland	8.1	7.7	6.6	5.8
Other countries	55.0	55.5	56.7	58.0

Source: International Monetary Fund, *Direction of Trade Statistics*, various issues.

However, the recovery in Canada's share in total EU imports (from non-member countries) in 2000 followed a period of declining market shares to 1.8 percent in 1998-1999 from 2.4 percent in 1989‑1990. The market share of the United States, the EU's largest supplier, recovered during 1998‑1999 but fell back to below 20 percent in 2000. China's market presence continued to expand rapidly. By contrast, the market shares of Japan and Switzerland dropped steadily through the 1990s.

East Asian Economies

Exports to most of Canada's major markets in East Asia fell in 2001 after having staged a marked rebound in 2000 from the financial and economic crisis of 1997-1998. Table 6 summarizes developments in Canada's merchandise exports to these East Asian markets.

Table 6: Canada's Merchandise Exports to East Asian Economies ($ billions), 1989-2001

Economies	1989-1992	1993-1996	1997	1998	1999	2000	2001
Japan	7.93	10.38	11.17	8.64	8.5	9.2	8.1
South Korea	1.63	2.38	3.03	1.82	2.0	2.3	2.0
People's Republic of China	1.78	2.62	2.41	2.50	2.7	3.7	4.2
Hong Kong	0.85	1.25	1.75	1.43	1.1	1.5	1.2
Taiwan	0.95	1.35	1.62	1.18	1.1	1.2	1.0
Indonesia	0.35	0.64	0.80	0.55	0.5	0.7	0.5
Malaysia	0.25	0.41	0.70	0.48	0.4	0.4	0.3
Philippines	0.21	0.25	0.43	0.26	0.3	0.4	0.3
Singapore	0.35	0.45	0.55	0.42	0.38	0.37	0.37
Thailand	0.39	0.48	0.47	0.30	0.3	0.4	0.4
Nine Major East Asian economies	6.76	9.83	11.76	8.95	8.9	10.9	10.3
Total East Asia	**14.70**	**20.21**	**22.92**	**17.58**	**17.3**	**20.0**	**18.4**

Source: Statistics Canada, *Canadian International Merchandise Trade 2001*. Catalogue no. 65-001-XPB, December 2001. Customs basis.

The decline in Canada's exports to East Asia in 2001 was sharper than that of Canada's overall merchandise exports. As a result, the share of these nine East Asian economies in Canada's exports fell to 4.6 percent in 2001 (Table 7), despite notable gains in Canadian exports to China and Singapore.

Table 7: East Asian Economies' Share of Canada's Merchandise Exports (percent) 1989-2001

Economies	Average 1989-1992	Average 1993-1996	1997	1998	1999	2000	2001
Japan	5.32	4.36	3.75	2.71	2.39	2.23	2.02
South Korea	1.10	1.00	1.02	0.57	0.56	0.55	0.49
People's Republic of China	1.19	1.10	0.81	0.78	0.75	0.89	1.04
Hong Kong	0.57	0.52	0.59	0.45	0.31	0.36	0.29
Taiwan	0.64	0.57	0.54	0.37	0.32	0.28	0.25
Indonesia	0.24	0.26	0.27	0.17	0.15	0.17	0.17
Malaysia	0.17	0.17	0.23	0.15	0.12	0.10	0.08
Philippines	0.14	0.11	0.14	0.08	0.08	0.09	0.09
Singapore	0.23	0.19	0.18	0.13	0.11	0.09	0.09
Thailand	0.26	0.20	0.16	0.10	0.08	0.09	0.11
Nine East Asian economies	4.54	4.09	3.94	2.81	2.49	2.63	2.56
Total East Asia	**9.89**	**8.46**	**7.69**	**5.52**	**4.88**	**4.85**	**4.58**

Source: Statistics Canada, *Canadian International Merchandise Trade 2001*. Catalogue no. 65-001-XPB, December 2001

Table 8: Intra-Asia Trade and Imports from Selected Trading Partners, 1989-2000

	1989	2000
Share of Asia's imports from major trading partners (percent)		
Intra-Asia	28.7	40.8
ROW	71.3	59.2
Percentage breakdown of Asia's imports from ROW		
Total	100.0	100.0
Canada	2.0	1.6
United States	22.2	20.9
Australia	3.9	3.9
France	2.7	2.5
Germany	6.1	5.5
United Kingdom	3.7	3.3

Source: International Monetary Fund, *Direction of Trade Statistics*.

Canada's market penetration measured in terms of Canada's share in total Asian countries' data on merchandise imports, excluding intra-Asian imports, was 1.6 percent in 2000, down from 2 percent in 1989 (Table 8). Similarly, market shares fell in the case of the United States, France, Germany and the United Kingdom over the same period. At the same time, intra-Asian trade expanded rapidly over the last decade.

Latin America

Notwithstanding the economic performance of Mexico and Argentina, Canadian exports to the major Latin American economies rose by 6 percent in 2001. These economies absorbed 1.25 percent of Canada's merchandise exports in 2001, an improvement from 1.15 percent in 2000. Double-digit rates of growth were recorded in exports to Mexico, Colombia and Venezuela.

Table 9: Canada's Merchandise Exports to Key Latin American Economies, 1989-2001

	1989-1992	1993-1996	1997	1998	1999	2000	2001
Exports ($ millions)							
Mexico	673	1,082	1,277	1,467	1,612	2,044	2,461
Argentina	67	198	409	343	211	244	132
Brazil	575	1,123	1,693	1,382	1,043	1,052	914
Chile	155	333	392	340	360	444	359
Colombia	204	401	473	471	255	309	357
Venezuela	356	656	954	705	524	636	792
Total	2,029	3,792	5,198	4,708	4,006	4,730	5,014
Share in Canada's total exports to the world (percent)							
Mexico	0.45	0.46	0.43	0.46	0.45	0.49	0.61
Argentina	0.04	0.08	0.14	0.11	0.06	0.06	0.03
Brazil	0.39	0.47	0.57	0.43	0.29	0.25	0.23
Chile	0.10	0.14	0.13	0.11	0.10	0.11	0.09
Colombia	0.14	0.17	0.16	0.15	0.07	0.07	0.09
Venezuela	0.24	0.28	0.32	0.22	0.15	0.15	0.20
Total	1.36	1.59	1.74	1.48	1.13	1.15	1.25

Source: Statistics Canada, *Exports by Country*, Catalogue no. 65-003-XPB.

Box B: Trade and Investment with Africa

Building a new and strengthened partnership with Africa is a key priority for the Kananaskis G-8 Summit to be hosted by Canada in June this year. In the interest of providing background information from a Canadian perspective, this section analyzes Canada's trade and investment relationship with Africa in the context of global developments.

- In 2001, Canada's trade with Africa represented less than 1 percent of Canada's global merchandise exports and imports. From the perspective of Africa's global trade, however, the African-Canadian bilateral relationship is much more important.

- Over the last two decades, the pattern of Canada's trade with Africa has undergone substantial changes. A distinct feature is that Canada's merchandise imports from Africa (based on the latest IMF customs data measured in U.S. dollars) have grown substantially, while exports were essentially unchanged over the last 20 years—in contrast to developments in Canada's trade with the rest of the world. Over much of the 1980s, Canada recorded a merchandise trade surplus in transactions with Africa. With imports increasing more than 300 percent over the last two decades, Canada's balance turned into growing deficits to the tune of US$1.1 billion by 2000.

- With little growth in exports to Africa, in combination with rapid expansion in Canada's exports to the rest of the world, the share of Canada's exports to Africa has declined steadily from 1.4 percent in the early 1980s to only 0.3 percent in 2000. On the other hand, Canada's imports from Africa have kept pace with the rapid growth in Canada's global imports over time. As a result, Africa's share in Canada's merchandise imports from the world did not experience any decline over the last two decades.

- One factor behind the sluggish performance of Canada's exports to Africa is the slow growth in Africa's overall import demand from the world. In the context of Africa's trade with the world, imports from Canada only edged down from 1.3 percent of the region's overall merchandise imports in the early 1980s to 0.9 percent by 2000.

- The expansion in African exports to Canada over the last two decades has been much more robust than that in the region's exports to the rest of the world. As a result, Canada's share in African exports to the world rose from 0.5 percent in the early 1980s to 1.3 percent by 2000.

Table B. 1: Canada's Trade with Africa (US$ millions) 1980 -2000

Trade	1980	1982	1984	1986	1988	1990	1992	1994	1996	1998	2000
Africa's merchandise trade with the world											
Exports	64,854	65,118	66,333	54,506	64,324	82,275	81,623	80,079	102,786	92,935	121,435
Imports	60,991	74,329	60,286	55,270	65,260	83,618	92,841	91,110	108,642	110,106	114,562
Balance	3,863	-9,211	6,047	-764	-936	-1,343	-11,218	-11,031	-5,856	-17,171	6,873
Canada's merchandise trade with Africa											
Exports	918	987	916	650	927	851	594	694	907	940	912
Imports	504	588	806	752	815	1,033	940	1,238	1,653	1,490	2,011
Balance	415	400	110	-101	112	-182	-346	-544	-746	-550	-1,099
Share of Canada's merchandise trade with Africa (Canada as the reporting country)											
Exports	1.4%	1.4%	1.0%	0.7%	0.8%	0.7%	0.4%	0.4%	0.5%	0.4%	0.3%
Imports	0.8%	0.9%	1.0%	0.8%	0.7%	0.8%	0.7%	0.7%	0.9%	0.7%	0.8%
Share of Canada's merchandise trade with Africa (Africa as the reporting country)											
Exports	1.1%	1.5%	1.0%	0.8%	0.8%	0.6%	0.8%	1.1%	1.1%	1.1%	1.3%
Imports	0.5%	0.6%	0.7%	0.4%	0.4%	1.2%	0.9%	1.1%	1.0%	1.2%	0.9%
Canada's merchandise trade with the world											
Exports	67,730	71,237	90,293	89,706	116,418	126,447	133,447	161,269	200,146	211,355	275,183
Imports	67,105	62,389	83,521	91,639	121,110	131,640	137,314	166,670	187,042	219,150	262,721

Source: IMF, *Direction of Trade Statistics,* Customs valuation.

- More than 80 percent of the value of Canada's trade with Africa (a region comprising 53 countries) is represented by trade with just five countries. On the export side, the top five countries are Algeria, South Africa, Morocco, Nigeria and Ghana. With respect to imports, the topic five countries are Algeria, South Africa, Nigeria, Morocco and Côte d'Ivoire.

- The commodity mix of exports to African countries has changed substantially over the years. In 2000, the key exports were wheat, rail locomotives, lentils, sulphur, clothing and textiles, aircraft, and wood pulp. Exports of wheat have dominated the picture, representing slightly more than 50 percent of total exports in 2000. However, a number of Canada's commodity exports such as asbestos, sulphur, milk products and electrical apparatus have fallen precipitously—a major development that has impeded the growth in Canadian exports to the region. Manufactured products figure more prominently in Canada's exports to Africa than imports from Africa.

- On the import side, the dominant commodities are crude petroleum, non-crude petroleum oils, uranium, and agricultural products such as mandarins, cocoa beans and oranges. In 2000, imports of crude petroleum accounted for about two thirds of the value of Canada's merchandise imports from Africa. Most of the items among the top 25 import categories in 2000 are resource products such as platinum, metals and minerals, and cotton, in addition to oil and agricultural products mentioned above.

- The global inflow of FDI to Africa has been rather volatile in recent years. It surged by 72 percent in 1997 to US$11 billion and seesawed over the next three years. In 2000, it declined more than 13 percent to US$9.1 billion, reflecting a 50 percent drop in Angola, Morocco and South Africa, the main recipient countries of FDI. Africa's share in world FDI inflow is very small, at below 1 percent in 2000. As a percentage of total business investment, FDI inflow into Africa was at about 10 percent in 1999, the latest year for which information is available. This 10 percent ratio is about four times as high as in 1990, primarily because many countries in Africa have made substantial improvements to their investment climate.

- Direct investment transactions with Africa represented a small portion of Canada's global total in 2001, despite very rapid increases since 1988. In 2001, the stock of African direct investment in Canada was $100 million, up sharply from just $7 million in 1988. The $100 million amount was about 0.03 percent of Canada's total FDI stock in 2001. The stock of Canadian direct investment in Africa amounted to $2,819 million in 2001, which accounted for 0.7 percent of Canada's total CDIA. Over 1988-2001, CDIA in Africa recorded a twelvefold increase.

Sources of Canada's Merchandise Imports

As noted earlier, Canada's merchandise imports declined by 3.4 percent in 2001 to $351.0 billion. The drop in imports was broadly distributed among Canada's trading partners, except for the EU. Imports from the United States and Japan fell more substantially than imports from the rest of the world. As a result, the U.S. share of Canada's total imports decreased from 73.7 percent in 2000 to 72.8 percent in 2001 (Table 10). While the share of imports from the EU fell during the 1990s, some recovery occurred over the last three years, reaching 10 percent in 2001. In 2001, imports from the EU grew strongly, led by increases in consumer goods, automotive products, industrial goods and agricultural products.

Table 10: Canada's Merchandise Imports, 1950–2001

	1950-1959	1960-1969	1970-1979	1980-1989	1990-2001	1998	1999	2000	2001
					Share (percent)				
U.S.	71.6	70.8	70.1	70.4	77.4	77.1	76.3	73.7	72.8
ROW	28.4	29.2	29.9	29.6	26.8	22.9	23.7	26.3	27.2
EU	n.a.	n a	9.5	10.0	9.4	8.3	8.7	9.2	10.0
Japan	n.a.	n a	4.2	5.8	3.9	3.1	3.2	3.2	3.0
					Annual Growth (percent)				
U.S.		10.4	16.1	7.5	8.4	10.6	6.7	7.4	-4.7
ROW		8.1	15.4	7.4	7.1	5.0	11.3	23.3	-0.2
EU		n. a.	n. a.	11.5	7.5	4.1	12.7	17.6	4.8
Japan		n. a.	n. a.	6.6	2.0	10.9	9.6	10.6	-9.6

Source: Statistics Canada, CANSIM, Table 228-0001: "Merchandise Imports on a Balance of Payments Basis by 63 Major Groups and by 6 Principal Trading Areas based on the Standard Commodity Classification.." n.a. = not available.

Structural developments in merchandise import growth

In volume terms, merchandise imports dropped by 5.8 percent in 2001, reflecting the deceleration in Canada's output growth to 1.5 percent in 2001 (Table 11). The decline in the value of Canada's imports of goods in 2001 was notably smaller, at 3.4 percent, reflecting the impact of the higher average price of imports.

Table 11: Canada's Merchandise Imports by Sector - Growth (percent) in 2001

Products	Value of imports ($ billions)	Growth in current dollars	Real growth in 1997 constant dollars
Agriculture and fishing	20.4	9.7	5.9
Energy	17.7	-0.9	2.2
Forestry	2.9	-5.8	-5.7
Industrial goods and materials	68.5	-2.9	-6.3
Machinery and equipment	112.4	-8.4	-10.1
Automotive products	72.5	-6.3	-8.7
Other consumer goods	42.9	7.1	2.5
Total	351.0	-3.4	-5.8

Source: Statistics Canada, *Canadian International Merchandise Trade 2001*. Catalogue no. 65-001-XPB, December 2001.

The double-digit rate of decline in the volume of machinery and equipment imports in 2001 occurred at a time when domestic business spending fell in an environment of very low rates of capacity utilization. The decline in imports of machinery and equipment and parts also reflected reduced demand for inputs into domestic production of machinery and equipment destined for markets abroad.

Merchandise Exports and Imports by Sector

The main developments in the composition of Canada's merchandise trade by sector in 2001 included the following:

- The machinery and equipment sector remained the largest in Canada's exports and imports, despite the collapse in global investment and related activity in electronic and telecommunications equipment;
- The resource sector's contribution to merchandise trade rose marginally; and
- Trade in energy products continued to account for the lion's share of Canada's trade surplus.

Resources

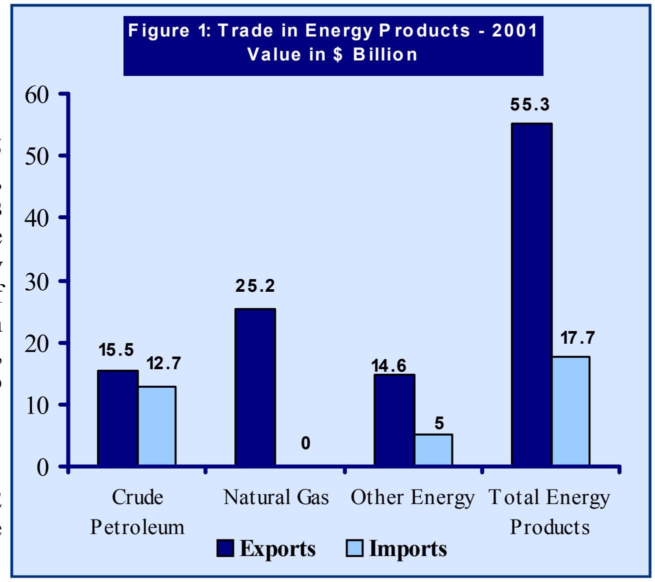
- Since 1994, Canada's exports of resources and related commodities have represented less than half of its annual merchandise trade. Indeed, the portion of Canada's trade in commodities and other resource products has declined sharply in the last decade. Commodity exports, which accounted for almost 61 percent of total merchandise export volume in 1981, fell to 41.4 percent in 2000 before rising to about 42.8 percent in 2001.[6] Factors behind this long-term decline include the greater use of raw materials for processing in Canada to enhance higher value-added exports, as well as the rapid expansion of trade in manufactured and other non-resource products.

- As in the case of exports, imports of resource products have also declined in importance over time. Imports of resource commodities represented 29.2 percent of the total merchandise import volume in 2000, down from 36.1 percent in 1981. In 2001, this ratio edged up to 30 percent, reflecting the large declines in imports of machinery and equipment and other manufactured products.

Energy products

- Higher prices, on an annual average basis, led to a 4.5 percent rise in the value of exports of energy in 2001, even though the volume of exports was down slightly. As imports of energy products fell back by 0.9 percent in the year, Canada's surplus in energy trade rose to a new record high of $37.6 billion, representing 61.1 percent of Canada's merchandise trade surplus of $61.5 billion. In response to strong demand from the United States, exports of natural gas shot up by 23.6 percent in 2001, to $25.2 billion.

- The energy trade surplus in 2001 was derived 67.1 percent from natural gas, 14.3 percent from coal, 11.2 percent from electricity and 7.4 percent from crude petroleum.



Source: Statistics Canada, *Canadian International Merchandise Trade* no. 65-001-XPB, December 2001

Agriculture and fishing and forestry products

- In 2001, exports of agricultural and fishing products rose by 12.6 percent as a result of increases in both price and volume of shipments. Exports of forest products fell by 7.5 percent reflecting, in part, declines in the export of lumber in the face of antidumping and countervailing duties imposed by the United States. Imports of these two categories also behaved similarly, up by 9.7 percent for agricultural and fishing products and down by 5.8 percent for forest products.

- The combined surplus in trade in these two sectors fell to $46.2 billion in 2001, from $47.5 billion in 2000.

Industrial goods and materials

- Exports of industrial goods (a category that includes intermediate inputs such as metals, chemicals, plastics and fertilizers) edged up by 0.5 percent in 2001, as the impact of higher demand offset that of lower prices.

- By contrast, imports of these products declined by 2.9 percent, even though the average price for the basket of imports rose in 2001.

- This disparate pattern of trade resulted in a sharp reduction in Canada's deficit on trade in industrial products, to $2.2 billion in 2001, from $4.6 billion in 2000.

[6] Resources include energy such as crude petroleum, natural gas, electricity, coal and other energy products, agricultural products such as wheat and other farm and fish products, forest products such as lumber, pulp and paper, and industrial materials such as metals, minerals, chemicals and fertilizers. The subaggregates of volume series rebased to 1997 Fisher-chained dollars are close mathematical approximations. For detailed information on chain Fisher aggregations, please visit the Statistics Canada Web site: www.statcan.ca/english/concepts/snachanges.htm.

Machinery and equipment

- In 2001, machinery and equipment (M&E) exports fell by 7.6 percent, the largest rate of decline among all major exports. Despite this decline, exports in this sector remained at a near-peak level of $98.8 billion. Within this category, exports of "other machinery" (which includes telecommunications equipment, computers and other office machines), fell by 17.6 percent, led by a 39 percent decrease in exports of telecommunications equipment in the wake of the global reductions in M&E investment spending. Despite the impact of September 11, exports of aircraft and parts for the year as a whole increased by 26.3 percent, moderating the decline in other M&E exports.

- M&E imports also decreased sharply, by 8.4 percent, to $112.4 billion. Imports of communications equipment declined most substantially among the various subcategories of M&E, by 29.7 percent, reversing the increase observed in 2000.[7]

- Canada's deficit in trade in machinery and equipment dropped from $15.8 billion in 2000 to $13.6 billion in 2001, the lowest level since 1991.

- In 2001, M&E represented 24 percent of merchandise exports and 32 percent of merchandise imports, remaining as the most important among all major groups of exports and imports.

Automotive products

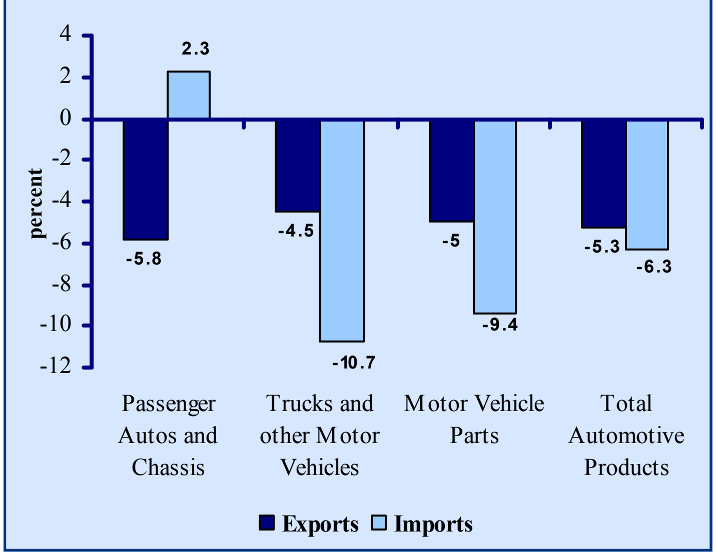
- After attaining a record high in 2000, exports of automotive products fell by 5.3 percent in 2001, reflecting falling demand from the United States as the year progressed, as well as the interruption of cross-border shipping of merchandise (Figure 2). This decline was widespread among shipments of passenger autos, trucks, and motor vehicle parts.

- Imports of automotive products also fell in 2001 by 6.3 percent from a record high in 2000. Imports of trucks and motor vehicle parts fell sharply, but imports of passenger autos rose by 2.3 percent.

- In 2001, trade in automotive products accounted for 22.5 percent of exports and 20.7 percent of imports.

- Canada's surplus in automotive trade eased to $20.2 billion in 2001, from $20.5 billion in 2000.

Figure 2: Trade in Automotive Products, change in 2001 over 2000, by Categories



Source: Statistics Canada, *Canadian International Merchandise Trade* no. 65-001-XPB, December 2001

Consumer goods other than motor vehicles[8]

- Exports of consumer products, an item representing less than 4 percent of merchandise exports, grew by 6.7 percent in 2001, in continuation of a decade of exceptional growth.

- Imports of consumer goods rose 7.1 percent to a new record high in 2001, reflecting buoyant consumer spending in Canada.

- Historically, Canada runs a deficit in consumer goods trade; in 2001, the deficit widened further to $27.1 billion.

[7] For a review of Canada's position in global high-tech trade, see pp. 23-28 of the 2001 issue of *the Annual Report on Canada's State of Trade*, Department of Foreign Affairs and International Trade, May 2001.
[8] Consumer goods include furniture and other household goods, apparel, footwear, photographic goods, medicinal and pharmaceutical products and other personal items.

Box C: Canada's Energy Trade from a Global Perspective

Introduction

As a net exporter of energy resources, Canada is one of the few industrialized countries that benefits from higher world energy prices. During the 1990s, for example, the energy sector contributed to more than 65 percent of Canada's merchandise trade surplus. However, as energy prices have tended to be volatile, so too has Canada's surplus in trade in energy products. Since the second half of last year, energy prices have come down substantially, and have had an impact on Canada's energy trade. This section analyzes past trends in the energy market and attempts to determine what the future may hold for Canada's energy trade. It focuses on the extent to which Canada's trade balance would be affected in the event of a decline in oil prices.

Canadian Trade in Energy Products

Through much of the 1990s, Canada's energy exports kept pace with the growth in merchandise exports. In 2000, however, trade in energy grew substantially more rapidly than overall merchandise trade as a result of the dramatic increase in energy prices. Canada's surplus in energy trade shot up from $19.1 billion in 1999 to $35.1 billion in 2000, representing 3.3 percent of GDP in 2000. Energy trade accounted for 59.2 percent of the merchandise trade surplus of $59.3 billion in 2000.

Traditionally, much of the energy surplus emanates from trade in natural gas. In 2000, 58.2 percent of the energy surplus was in natural gas, 16.3 percent in crude petroleum, 11.6 percent in electricity and 14.4 percent in coal. Imports of energy products, such as crude petroleum and coal, are significantly lower than those of exports. Provinces in Eastern Canada consume much of Canada's energy imports, while all of Canada's exports of oil, gas and electricity are destined for the United States.

Through the second half of 2001, Canada's energy trade was affected by the downturn in energy prices associated with weak demand. While trade in crude petroleum dropped sharply in 2001, Canada's energy exports increased by 4.5 percent on the strength of exports of natural gas, coal and electricity. The value of energy imports edged down by 0.9 percent in 2001, reflecting a 5.7 percent drop in imports of crude petroleum. In 2001, trade in natural gas accounted for more than two thirds of the energy surplus. Trade in coal became the second most important contributor to the energy surplus, followed by electricity and crude petroleum.

Table C.1: Decomposition of Canadian Energy Trade ($ millions), 1992-2001

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Change (%)
Crude Oil											
Exports	5,885	6,223	6,507	8,264	10,497	10,366	7,830	11,017	19,166	15,469	-19.3
Imports	4,175	4,688	4,609	4,833	6,708	7,189	5,227	7,160	13,445	12,684	-5.7
Balance	1,710	1,535	1,898	3,430	3,789	3,177	2,602	3,857	5,721	2,785	-51.3
Natural Gas											
Exports	4,730	5,903	6,428	5,649	7,433	8,626	8,967	10,951	20,421	25,231	23.6
Imports											
Balance	4,730	5,903	6,428	5,649	7,433	8,626	8,967	10,951	20,421	25,231	23.6
Coal											
Exports	4,123	4,768	4,937	5,294	6,905	6,809	5,415	5,929	9,283	10,393	12.0
Imports	2,303	2,281	2,350	2,404	2,898	3,438	3,406	3,548	4,419	5,028	13.8
Balance	1,820	2,487	2,587	2,890	4,008	3,370	2,009	2,382	4,863	5,365	10.3
Electricity											
Exports	714	857	1,329	1,186	1,218	1,377	1,600	1,923	4,059	4,218	3.9
Imports											
Balance	714	857	1,329	1,186	1,218	1,377	1,600	1,923	4,059	4,218	3.9
Total Energy											
Exports	15,452	17,751	19,201	20,393	26,053	27,178	23,812	29,821	52,928	55,311	4.5
Imports	6,478	6,969	6,960	7,237	9,605	10,628	8,634	10,708	17,864	17,712	-0.9
Balance	8,974	10,782	12,241	13,156	16,448	16,550	15,179	19,113	35,064	37,599	7.2
Energy as percent of total merchandise											
Exports	9.5	9.3	8.4	7.7	9.3	9.0	7.3	8.2	12.5	13.4	
Imports	4.2	3.9	3.3	3.1	4.0	3.8	2.8	3.3	4.9	5.1	
Balance	99.3	82.4	60.3	37.2	38.8	64.5	66.6	49.8	59.2	60.1	

Source: Statistics Canada, CANSIM tables 226-0001, 226-0002 "Exports and Imports by Commodities, Customs basis"

Crude oil: As the world's tenth-largest conventional oil producer, Canada accounted for 3.5 percent of the world production of 74.51 million barrels daily in 2000. With more than 60 percent of crude oil production destined for exports, Canada contributed 4 percent of global exports of crude oil in 2000, making it the twelfth-largest exporter of crude oil in the world. Canada's exports of oil accounted for 14.5 percent of U.S. oil imports, equivalent to 9 percent of U.S consumption in 2000. Crude oil accounted for 36.2 percent of the value of Canada's energy exports in 2000. In 2001, however, crude oil's contribution to total energy exports dropped to 28 percent.

Although the value of crude oil exports jumped by about 75 percent in 2000 to $19.2 billion, from $11 billion in 1999, much of the increase resulted from gains in the price of exports. The benchmark WTI (West Texas Intermediate) crude priced at US$19.31 a barrel in 1999 jumped to US$30.37 a barrel in 2000, an increase of 57 percent. The volume of oil exports also increased strongly, by about 10 percent, from 1.27 million barrels a day in 1999 to 1.38 million barrels a day in 2000. A large part of the increase in the value of oil exports was offset by a corresponding jump in the value of oil imports. Canada's trade in crude petroleum only accounted for 16.3 percent of Canada's overall energy surplus in 2000. In 2001, this contribution to the energy surplus fell to 7.4 percent, as the surplus in oil trade dropped from $5.7 billion in 2000, to $2.8 billion in 2001.

Natural gas: As the world's third-largest producer, Canada accounted for 6.9 percent of global production of natural gas in 2000. In recent years, more than 60 percent of gas production has been exported. Natural gas exports have shot up by 86 percent from 1999, to $20.4 billion in 2000. Imports of natural gas, chiefly from Venezuela and Trinidad, are trivial in value terms relative to exports. As a result, Canada has a growing surplus in natural gas trade that accounted for about 60 percent of the overall energy surplus in 2000. In 2001, Canada's natural gas exports surged by 24 percent to $25.2 billion, accounting for 46 percent of total energy exports and 67 percent of the energy surplus.

In 2000, Canada exported a record volume of 9,683 million cubic feet a day of natural gas to the United States, accounting for 93.8 percent of U.S. natural gas imports and 14 percent of U.S. natural gas consumption. This volume of exports was up by 4.4 percent from 1999. As in the case of crude petroleum, the increase in the value of natural gas exports was dominated by the gains in the price of exports. Canada's natural gas export price increased by 74 percent from $3.02 per gigajoule in 1999 to $5.25 per gigajoule in 2000, reflecting increased demand from the United States.

Coal: Canada produced 37.2 million tonnes and consumed 29.3 million tonnes oil equivalent, and had a proven reserve of 8.6 billion tonnes in 2000. Canadian coal consumption is predominantly for electricity generation, with the balance for steel making.

Trade in coal and coal products increased by more than 12 percent in 2001, resulting in a further increase in the energy surplus to $5.4 billion, substantially higher than the $2.8 billion surplus in crude petroleum trade. Exports of coal and coal products represented 18.8 percent of Canada's energy exports in 2001, somewhat higher than that of 17.5 percent in 2000. About 80 percent of exports of coal belong to the metallurgical category, and these are destined mostly for Japan and South Korea.

Electricity: Canada's electricity exports more than doubled in 2000 as a result of strong demand from the United States and higher prices associated with increased generation costs in the wake of a jump in the price of natural gas. In 2001, Canada's electricity exports increased by a further 3.9 percent, to a new record high. However, its share in total energy exports edged down from 7.7 percent in 2000 to 7.6 percent, and its contribution to the energy surplus fell from 11.6 percent in 2000 to 11.2 percent in 2001.

Table C.2: Exports of Electricity by Province ($ millions), 1992-2001

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Change (%)
BC	197.2	106.5	145.0	62.6	120.7	222.6	323.3	458.0	1,986.6	2085.3	5.0
Quebec	271.3	328.3	454.3	488.0	533.3	515.2	608.2	715.8	1,062.6	929.0	-12.6
Manitoba	96.2	203.9	280.7	279.9	284.8	309.8	356.2	343.0	442.7	534.7	20.8
Ontario	59.8	134.7	360.8	238.2	162.2	161.6	121.1	172.6	288.8	201.8	-30.1
NB	87.8	80.5	87.6	115.8	113.5	165.1	183.9	225.3	254.2	247.0	-2.8
Sask	1.7	3.5	0.4	1.8	3.6	3.0	6.6	7.8	17.8	16.2	-9.4
Alberta	0.0	0.0	0.0	0.0	0.0	0.0	1.2	0.8	6.3	203.6	5.0
Total Canada	714.0	857.4	1,328.7	1,186.2	1,218.0	1,377.4	1,600.4	1,923.4	4,059.0	4,218	3.9

Source: Statistics Canada, CANSIM Table 127-0001 "Electricity Power Statistics."

British Columbia accounted for about half of the export revenue in 2000 and 2001, although it was ranked second to Quebec in terms of export volume. The provinces of Manitoba, Ontario and New Brunswick also accounted for an important share of electricity exports (Table C-2).

In 2001, Canada's trade in electricity accounted for 11.2 percent of the energy surplus of $37.6 billion. The $4.2 billion surplus in electricity trade in 2001 was substantially larger than that of the $2.8 billion surplus in Canada's crude petroleum trade.

Energy Prices and the Impact on the Trade Balance

Canada's energy trade surplus typically fluctuates along with the growth in energy prices. Historically, energy prices have tended to be very volatile, as they reflect a number of economic and political developments. Events such as the Gulf war, the Asian economic and financial crisis, cyclical developments in the U.S. economy, the September 11 attacks on the United States, and OPEC production cutbacks, have affected world oil prices in a major way. Over the short term, weather conditions and changes in the level of inventories also have affected energy prices. Changes in the price of crude petroleum also have implications on the demand for natural gas, coal and electricity, which in turn impacts the prices of such alternative forms of energy over time.

In the course of 2001, the price of Canada's exports of crude petroleum fell by 10.5 percent, a major factor behind the decline in the value of crude petroleum exports. However, the price impact on Canada's balance of crude petroleum trade was mitigated by a corresponding drop in the value of crude petroleum imports. The value of Canada's imports of crude petroleum was 82 percent that of Canada's crude petroleum exports. In the case of coal, the import offset is somewhat lower, as the value of imports is typically half of that of exports. By contrast, movements in natural gas and electricity have a direct impact on the energy balance, as there are virtually no imports of natural gas and electricity. In any event, Canada's energy exports increased to a new record high in 2001, as there were widespread increases in the prices of Canada's exports of electricity, natural gas and coal.

It appears that the decline in the international price of crude petroleum seen throughout 2001 had halted by the end of the year. Indeed, Canada's crude petroleum export and import prices shot up in December 2001, resulting in increases in the value of exports and imports. Energy prices have increased further in the first quarter of 2002. With economic growth in the United States and elsewhere in the world picking up steam as the year progresses, further increases in energy prices and then on Canada's trade balance can be expected.

Canada's Energy Export Potential

Measured in gigajoules, Canadian production of all types of energy commodities and products increased by 33 percent between 1989 and 2000, at twice the rate of the growth of domestic consumption. As a result, Canada's exports of energy shot up by 84 percent over the same period. As production increased at a much faster rate than the growth in consumption, the share of energy production that is exported rose from 38 percent in 1989 to 53 percent by 2000. Canada's surplus in energy trade has more than doubled since 1989, despite robust increases in oil and coal imports in the second half of the 1990s. As of 2000, Canada's energy surplus represented 35 percent of Canada's energy production.

Canada has substantial potential in oil production even though its proved conventional oil reserves (recoverable under existing economic and operational conditions) of 6.4 billion barrels are just 0.6 percent of the world total of 1,046.4 billion barrels in 2000.[9] Canada's offshore reserves for Hibernia totalled 515 million barrels, and Terra Nova has reserves of 370 million barrels. In addition to conventional and frontier oil reserves, Canada's Athabasca has the world's largest recoverable oilsand reserves of 300 billion barrels, a level that exceeds the 262 billion conventional oil reserves of Saudi Arabia.

Canada is the world's third-largest producer of natural gas, after the United States and Russia. In 2000, Canadian production accounted for 6.9 percent of world production of 2,422 billion cubic metres, compared with 22.9 percent for the United States and 22.5 percent for Russia. Over the last decade, Canada's natural gas production has trended up sharply. U.S. reliance on imports of natural gas from Canada has increased sharply, with the volume of imports having quadrupled since 1985. However, Canada's proved natural gas reserves of 1.73 trillion cubic metres represented only 1.1 percent of the world total of 150.2 trillion cubic metres at the end of 2000. Deliverability in the conventional producing

[9] Essentially, Canada's level of reserve would be depleted in only 8.5 years at the current rate of production in the absence of new discoveries.

areas is becoming a greater challenge with the aging of the Western Canada Sedimentary Basin. On the positive side, Canada's Sable Island has natural gas reserves of 85 billion cubic metres. Over the longer term, Canada has an abundant natural gas supply. Developments are ongoing to deliver gas from Deep Panuke, a new field, and from deep-water projects on the East Coast. There are also unconventional sources of natural gas from drilling coalbed methane wells and liquefied natural gas (LNG). There is also tremendous natural gas potential from the Grand Banks and from offshore British Columbia.

Conclusion

Energy is an extremely important contributor to Canada's merchandise trade surplus. Movements in world energy prices play a dominant role in Canada's surplus of energy trade. However, the impacts associated with crude petroleum prices alone are much smaller relative to those associated with natural gas and electricity export prices because of the high level of Canada's petroleum imports.

Prospects for Canada's energy exports appear excellent in view of the country's abundant supply potential, combined with the needs of its largest market, the United States. This development should further boost Canada's future surpluses in energy trade.

Table 12: Value, Share and Growth of Canada's Goods Trade, (Balance of Payments Basis)

Industry	**Level ($ billions)**			**Share of total in percent**			**Cumulative % Growth 1989-2001**	**Growth 2000-2001 (percent)**
	1989	2000	2001	1989	2000	2001		
Exports								
Total	147.0	422.6	412.5	100.0	100.0	100.0	180.7	-2.4
Agricultural & fishing	11.6	27.4	30.8	7.9	6.5	7.5	166.2	12.6
Energy	13.7	52.9	55.3	9.3	12.5	13.4	303.0	4.5
Forestry	21.5	41.8	38.6	14.6	9.9	9.4	80.0	-7.5
Industrial	32.3	65.9	66.3	22.0	15.6	16.1	105.3	0.5
M&E	24.0	106.9	98.8	16.3	25.3	24.0	312.4	-7.6
Automotive	34.0	97.9	92.7	23.1	23.2	22.5	172.9	-5.3
Consumer goods	2.6	14.8	15.8	1.8	3.5	3.8	499.0	6.7
Imports								
Total	139.2	363.3	351.0	100.0	100.0	100.0	152.1	-3.4
Agricultural & fishing	8.3	18.6	20.4	5.9	5.1	5.8	146.6	9.7
Energy	6.2	17.9	17.7	4.5	4.9	5.0	184.7	-0.9
Forestry	1.4	3.1	2.9	1.0	0.8	0.8	112.6	-5.8
Industrial	26.9	70.5	68.5	19.3	19.4	19.5	154.2	-2.9
M&E	43.3	122.7	112.4	31.1	33.8	32.0	159.6	-8.4
Automotive	31.9	77.4	72.5	22.9	21.3	20.7	127.1	-6.3
Consumer goods	15.0	40.1	42.9	10.8	11.0	12.2	185.7	7.1
Balance								
Total	7.7	59.3	61.5					
Agricultural & fishing	3.3	8.8	10.5					
Energy	7.5	35.1	37.6					
Forestry	20.1	38.7	35.7					
Industrial	5.3	-4.6	-2.2					
M&E	-19.3	-15.8	-13.6					
Automotive	2.0	20.5	20.2					
Consumer goods	-12.4	-25.3	-27.1					

Source: Statistics Canada, *Canadian International Merchandise Trade*. Catalogue no. 65-001-XPB, December 2001. Note: Sums may not add up to 100 because special transactions and inland freight and other balance of payments adjustments figures, which are part of the merchandise trade account, are not included.

Merchandise Trade Balance

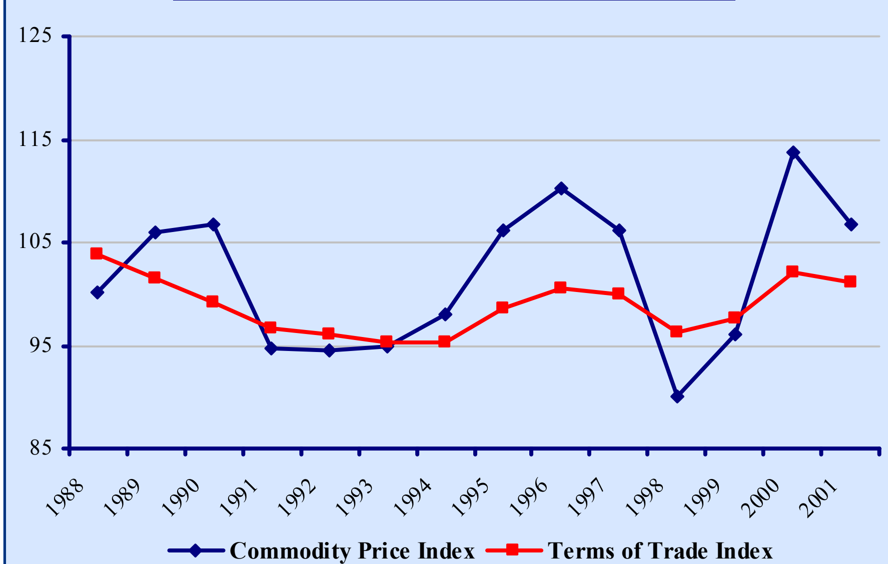
In 2001, the merchandise trade surplus increased to a record high of $61.5 billion from $59.3 billion in the previous year (Table 12). The overall surplus in agriculture and fishing and energy products trade continued to expand sharply, while the deficit in trade in industrial products and machinery and equipment fell substantially. The surplus on trade in automotive and forestry products dropped in 2001, while the deficit on trade in consumer goods increased.

In terms of trading partners, the merchandise trade surplus with the United States grew to a record $95.4 billion in 2001, up from $91.9 billion in 2000. The merchandise trade deficit with Japan improved to $1.3 billion in 2001, from $1.4 billion in 2000. However, the deficit in merchandise trade with the EU widened, to $13.3 billion in 2001 from $11.3 billion in 2000. The balance on trade with countries other than the U.S., the EU and Japan improved slightly in 2001, to a deficit of $19.3 billion from $19.9 billion in 2000.

Developments with respect to the Terms of Trade[10]

Canada is a net exporter with respect to commodity trade: in 2001, exports of food, energy, forestry products and industrial materials totalled $190.1 billion, while imports amounted to $109.4 billion, generating a surplus of $81.6 billion. The price of all merchandise exports rose by 1.6 percent in 2001, moderated by a decline in commodity prices. At the same time, merchandise import prices rose by 2.5 percent, resulting in a 0.9 percent decline in the terms of trade. Although Canada's dependence on commodity trade has been declining steadily, commodity prices continued to affect Canada's terms of trade. The direction of movement in the terms of trade followed closely the movement of commodity prices (Figure 3). In general, fluctuations in the terms of trade are smaller than those in commodity prices, since the prices of non-commodity products such as automotive products, machinery and equipment and consumer goods that dominate Canada's trade do not fluctuate sharply over time.

Figure 3. Canada's Commodity Price Index and Merchandise Chain Fisher Terms of Trade, 1988-2001



Source: Bank of Canada, *Banking and Financial Statistics*.

[10]Movements in the price of exports relative to the price of imports are referred to as changes in a country's "terms of trade." An improvement in the terms of trade (i.e. a rise in export prices relative to import prices) means that a country's purchasing power has increased. In other words, earnings from a given quantity of exports purchase a greater quantity of imports. Conversely, a decline in the terms of trade requires a country to export more to pay for a given quantity of imports. The terms of trade are commonly measured as the index of average export prices, divided by the index of average import prices. This measure of the terms of trade is influenced by many factors, including commodity price changes, exchange rate movements, domestic and international supply and demand conditions, changes in the mix of products exported and imported, and domestic cost and productivity trends; accordingly, care must be exercised in interpreting changes in this indicator. In this analysis, the chain Fisher series is used, since it is more indicative of pure price movements than other price indices.

II. TRADE IN SERVICES

In 2001, Canadian exports of services edged down by 0.4 percent to $55.1 billion, which accounted for 11.8 percent of total Canadian exports of goods and services. At the same time, imports of services also edged down by 0.1 percent to $61.9 billion in 2001, which accounted for 15 percent of total Canadian imports of goods and services.

Services trade is classified into four categories: travel services, transportation services, commercial services (which includes accounting, legal, insurance, architecture, engineering, and management consulting), and government services.

With regard to Canadian services exports in 2001:

- Commercial services exports increased by 0.1 percent to a record high of $27.2 billion or 49.4 percent of total services.

- Travel receipts grew by 2.8 percent to $16.3 billion, representing 29.7 percent of total services exports.

- Transportation services fell by 6.6 percent to $10.1 billion, or 18.4 percent of total services exports.

- Government services rose further, by 2.9 percent, to $1.5 billion, accounting for 2.7 percent of total services exports.

With regard to Canadian services imports in 2001:

- Commercial services imports grew by 1.4 percent to a peak of $30 billion or 48.5 percent of total services imports.

- Travel payments declined by 2.2 percent to $17.6 billion, as spending by Canadians in the United States fell by 5.4 percent. The appreciation of the Canadian dollar against the yen appeared to have contributed to increased travel to Japan. In 2001, travel payments represented 28.5 percent of total services imports.

- Transportation services declined by 0.6 percent to $13.6 billion or 22 percent of total services imports. This decrease reflected the drop in two-way merchandise trade.

- Government services imports edged up by 0.1 percent to $0.70 billion, accounting for only 1.1 percent of total services imports.

Canada has traditionally been a net importer of services, overall and in all of the individual services categories except government services, which accounted for 1.9 percent of two-way services trade in 2001. The largest deficit has traditionally been in the commercial services account and in the transportation sector, followed by travel services. In 2001, the deficit in overall services trade was $6.8 billion (0.6 percent of GDP), down from $13.6 billion (or 1.9 percent of GDP) in 1993, though up slightly from $6.7 billion in 2000 (0.6 percent of GDP). This reduction over the years was due in large part to improvements in the commercial services and travel balances.

With regard to the direction of Canada's trade in services, the United States remains Canada's principal trading partner. The share of the United States in Canada's two-way trade is smaller for services (59.4 percent) than for merchandise (79.4 percent). The United States is becoming an increasingly important market, accounting for 57.7 percent of Canada's services exports in 2001, compared to 56.8 percent in 1989. Turning to imports, the U.S. share fell from 62.5 percent in 1989 to 60.8 percent in 2001.

The share of the EU declined both as a source and as a destination of services trade. The share of exports to Japan dropped sharply as well over the 1989-2001 period, but Japan's share in Canada's services imports was 3.1 percent in 2001, somewhat higher than its 1989 level of 2.3 percent. The relative shares of other countries increased over 1989-2001 for both exports and imports.

With these developments, Canada's deficit in services trade with both the U.S. and the EU fell between 1989 and 2001, while the small surplus with Japan in 1989 turned into a small deficit by 2001.

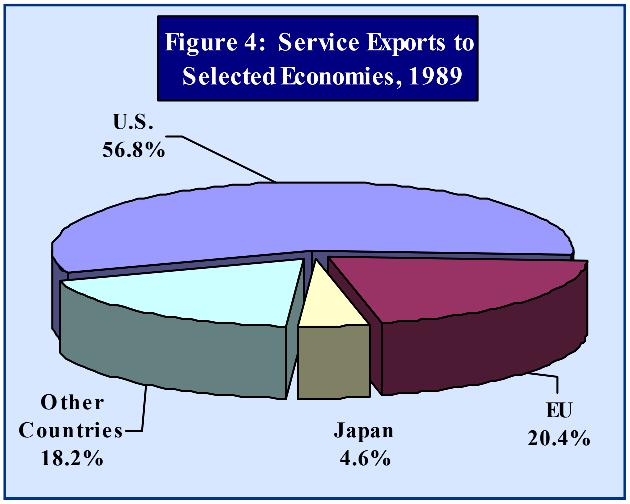


Figure 4: Service Exports to Selected Economies, 1989

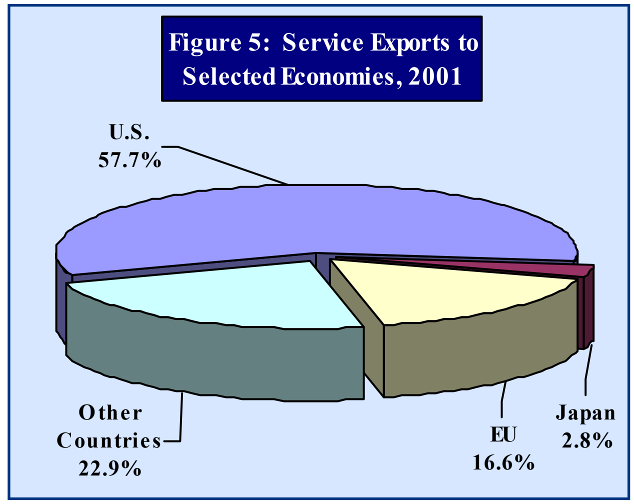


Figure 5: Service Exports to Selected Economies, 2001

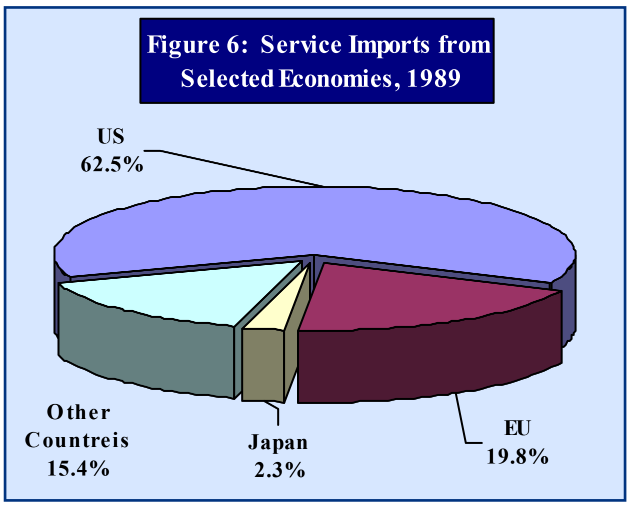


Figure 6: Service Imports from Selected Economies, 1989

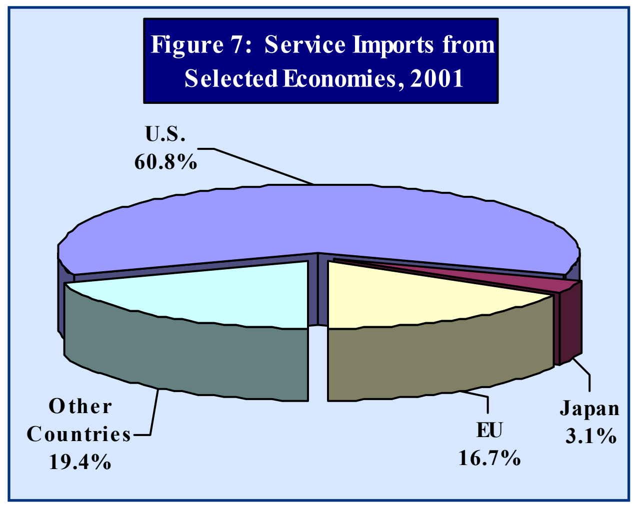


Figure 7: Service Imports from Selected Economies, 2001

Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XPB, 4th Quarter 2001.

Developments in Canada's Services Trade

Canada's exports and imports of services have risen at a steady pace over the last two decades. As a share of GDP, Canada's services exports rose to 5.1 percent in 2001 from 3.4 percent in 1989-1992 and 4.4 percent in 1993-1996. Services imports have also expanded faster than GDP; in this case, however, the expansion has been more moderate—from 4.9 percent in 1989-1992 to 5.8 percent in 1993-1996—and easing to 5.7 percent in 2001.

Compared to merchandise trade, the pace of growth of services trade has lagged over the last decade despite the rising importance of trade in commercial services. Accordingly, the share of services in Canada's goods and services trade fell to 11.8 percent in 2001 for exports, and to 15 percent for imports, from the recent peaks of 13.6 percent, and 19.8 percent, respectively, in 1991. Note that because the decline in services trade in 2001 was somewhat smaller than that in merchandise trade, the share of services in total trade in goods and services increased slightly in 2001 from 2000.

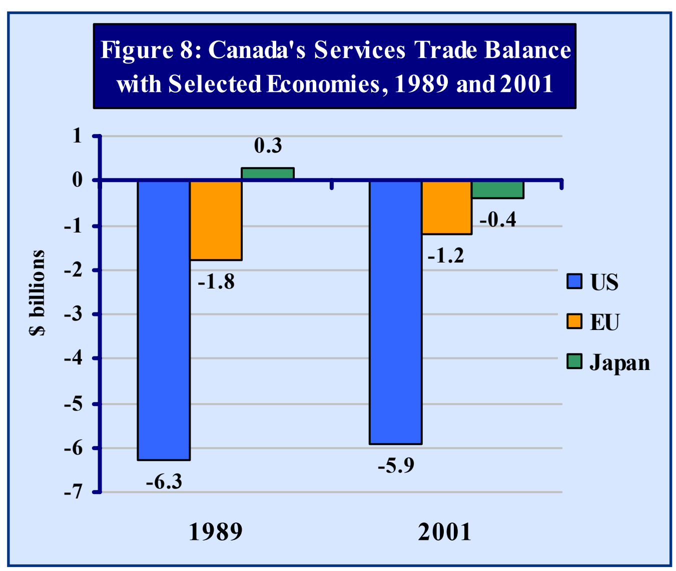


Figure 8: Canada's Services Trade Balance with Selected Economies, 1989 and 2001

Source: Statistics Canada, *Canada's Balance of International Payments,* Catalogue no. 67-001-XPB, 4th Quarter 2001.

Table 13: Average Annual Trade in Services, 1960-2001

	1960-1969	1970-1979	1980-1989	1990-2001	1999	2000	2001
				$ millions			
Total exports of services	1,543	4,381	13,867	38,559	51,723	55,291	55,095
Total imports of services	1,984	6,588	19,284	48,070	58,176	62,005	61,926
				percent			
Share of services in total exports	14.0	11.2	10.8	12.4	12.4	11.6	11.8
Share of services in total imports	18.3	16.9	16.1	16.5	15.1	14.6	15.0

Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XPB, 4th Quarter 2001.

Knowledge-based Sectors Drive Commercial Services Trade

The commercial services sector has established by far the largest share and the fastest growth record in Canada's trade in services. In 2001, commercial services accounted for 49.4 percent of exports of services and 48.5 percent of imports, up from corresponding figures of 40.8 percent and 41.5 percent in 1989.

Commercial services include many of the sectors in which knowledge-based activities predominate. Accordingly, success in this sector is important to Canada's continued evolution as a knowledge-based economy. As shown in the table below, the fastest growth has been recorded in the knowledge-intensive subsectors of commercial services, particularly in royalties and licence fees, research and development, and audio-visual services.

Table 14: Components of Commercial Services Exports, 1993-2001

Components of commercial services	Value ($ millions)		Annual percent growth 1994-2001
	1993	**2001**	
Communications services	1,417	1,751	2.7
Construction services	88	286	15.9
Insurance services	2,810	3,498	2.9
Other financial services	850	2,281	13.1
Computer and information services	1,043	1,976	8.3
Royalties & licence fees	308	2,039	26.6
Non-financial commissions	383	682	7.5
Equipment rentals	204	323	5.9
Management services	1,120	2,904	12.7
Advertising & related services	160	306	8.4
Research and development	997	3,171	15.6
Architectural, engineering, & other technical services	1,398	2,467	7.4
Miscellaneous services to business	1,603	3,813	11.4
Audio-visual services	599	1,678	13.7
Total	13,113	27,174	9.5

Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XPB, 4th Quarter 2001.

Box D: Canada's Services Trade – Is There Room to Grow?

Production in Canada's services sector is almost twice that in Canada's goods sector. However, the value of Canada's exports of services is substantially smaller than that of merchandise exports. This section reports on a number of factors that help explain the lower export orientation of Canada's services sector. It also suggests that there is plenty of scope for Canada's services exports to expand rapidly, especially in the event of significant liberalization in services trade.[11]

Table D.1 presents industry data on exports as shares of the particular industry's GDP, using IO data for 1997 as an illustration. These "artificial" indicators of export orientation show that manufacturing, agriculture and mining are among the most trade-dependent sectors in the Canadian economy.[12] This export-orientation measure is most prominently high in the case of manufacturing, a sector in which the import content of exports is particularly large.

Table D.1: GDP and Domestic Exports as a Share of Current Dollar GDP by Industry in 1997

	GDP ($ millions)	Share of GDP (%)	Domestic Exports ($ millions)	Exports/GDP (%)
Agriculture	11,676	1.5	9,730	83.3
Fishing & logging	7,311	1.0	782	10.7
Mining	34,179	4.5	26,394	77.2
Manufacturing	144,293	18.9	223,773	155.1
Construction	40,785	5.4	61	0.1
Utilities	26,025	3.4	1,537	5.9
Transportation & storage	34,661	4.6	20,368	58.8
Communications	22,755	3.0	2,169	9.5
Wholesale trade	43,150	5.7	10,560	24.5
Retail trade	41,781	5.5	680	1.6
Finance, insurance & real estate	124,051	16.3	6,710	5.4
Finance & real estate	58,590	7.7	3,653	6.2
Owner occupied dwellings	54,138	7.1	0	0.0
Insurance	11,323	1.5	3,057	27.0
Business services	41,576	5.5	9,737	23.4
Professional services	18,565	2.4	7,123	38.4
Advertising	2,078	0.3	252	12.1
Other business services	20,932	2.8	2,362	11.3
Education	41,798	5.5	592	1.4
Health and social services	51,187	6.7	188	0.4
Accommodation & food	19,494	2.6	5,536	28.4
Other services	31,333	4.1	4,467	14.3
Amusement & recreation services	8,286	1.1	2,918	35.2
Personal and household services	6,105	0.8	344	5.6
Membership organization	14,509	1.9	74	0.5
Other services	16,942	2.2	1,131	6.7
Government services	45,798	6.0	905	2.0
Total services	497,584	65.3	61,912	12.4
Non-tradable services	192,921	25.3	1,876	1.0
Tradable services	304,663	40.0	60,036	19.7
Total merchandise	264,269	34.7	262,277	99.2
All industries	761,853	100.0	324,189	42.6

Sources: Statistics Canada's CANSIM database and 1997 input-output statistics.

[11] For more detail, see Trade Policy Research 2002, Department of Foreign Affairs and International Trade, 2002.

[12] Note that the value of exports could exceed that of the industry's GDP, because GDP measures value added in Canada while an important percentage of exports consists of imports from abroad. For this reason, these artificial constructs overstate industrial export-orientation, especially for merchandise because import contents are substantially higher for exports of merchandise than for exports of services. See Cameron, G. and P. Cross. "The Importance of Exports to GDP and Jobs," *Canadian Economic Observer*, November 1999, p. 3.3, figure 3.

Services industries appear to be far less trade-dependent than the goods sectors, since services exports represented just 12.4 percent of services production in 1997, compared with that of 99.2 percent for merchandise exports (Table D.1). In all subsectors among services industries, the services export share of sectoral GDP in 1997 was well below that for merchandise exports. The measure of export orientation is low for services, as a large number of Canada's private commercial services remain almost completely outside of the global trading system. For instance, exports of retail trade, real estate, as well as personal and household services, represent only minuscule shares of their sectoral GDP.

Why do services industries lag behind goods industries in their propensity to export? The following addresses some barriers that limit services production from reaching its export potential, and reviews areas in which services trade can be enhanced. First of all, services are not as trade-dependent as goods because they include a number of activities that are non-commercial in nature. Typically, non-commercial services are neither cross-border tradable nor commercial deliverable through establishing affiliates abroad. These activities include much of those associated with owner-occupied dwellings, governmental, education, health and social services, and are mainly carried out within national boundaries. In 1997, total output of these non-tradable services combined represented 25.3 percent of Canada's GDP. This means that while services production represented 65.3 percent of GDP in 1997, the potentially tradable group of services was equivalent to 40 percent of GDP. Secondly, services delivery in a number of industries requires the physical presence of suppliers in proximity to the consumers. For these industries, commercial presence is needed in order to provide services where they are consumed. For instance, a Canadian-based company must deliver its services by sending suppliers abroad to where the services production is needed. This process involves either the movements of "natural" persons across the border or the establishment of an affiliate abroad. Since commercial presence implies residency in the economic territory, supplies of services within the same country represent transactions between residents. By convention, such supplies by Canadians abroad escape trade data accounting, even though the resident suppliers are affiliates of Canadian institutions. In fact, Canadian firms provide a significant amount of services production abroad through their affiliates abroad, not only because of commerce-presence requirements, but also for other reasons such as the

Table D.2: Sales of Services to U.S. Persons by Majority-owned Non-bank U.S. affiliates of the Canadian firms, 1989-98 ($ millions)

	1989	1998	Annual average growth (%)
All industries	22,351	64,318	12.5
Wholesale trade	199	n.a.	n.a.
of which: auto vehicles	n.a.	242	n.a.
Retail trade	292	24	-24.4
Finance, except depository institutions	230	4,488	39.1
Insurances	10,479	15,196	4.2
Real estate	4,930	3,533	-3.6
Hotels & other lodging places	123	258	8.6
Advertising	7	99	34.1
Equipment rental & leasing	n.a.	222	n.a.
Computer & related services	173	1,065*	22.4*
Motion pictures, including TV tape & film	552	5,632	29.4
Engineering & architecture	197	310	5.2
Accounting, management, R. & D.	18	191	30.2
Transportation	n.a.	5,862	n.a.
Services component in other sectors			
Agriculture, forestry & fishing	6	34	21.5
Mining	24	96	16.9
Manufacturing	n.a.	630	n.a.
Public utilities	n.a.	3,233	n.a.
Construction	n.a.	49	n.a.

Sources: U.S. Department of Commerce, Bureau of Economic Analysis, converted to Canadian dollars.
*Supplemented by data available for 1996.
n.a. – not available.

prevalence of trade barriers. Such sales in the United States, shown in Table D.2, are reported by the U.S. Department of Commerce in Foreign Affiliates Trade Statistics (FATS). They can be used to supplement Canada's balance of payments export data to provide a more comprehensive measure of Canada's services exports. Thirdly, various barriers and impediments limit trade in services. Even in industrialized countries that have relatively liberal merchandise trade regimes, barriers to trade in services and movements of natural persons can be particularly restrictive.[13] Table D.3 presents trade indexes in selected services in a number of major trading countries. This index quantifies the nature and extent of governments' regulatory restrictions that prohibit a foreign services supplier from entering and operating services activities in the host country.[14] Finally, while natural barriers such as languages, cultures and the legal systems apply to both goods and services trade, they appear to be a more formidable challenge to service suppliers. Engineers would find it extremely difficult to market their skills to foreign customers if they do not know the language of their customer. Service suppliers would hesitate to establish a permanent presence in a host country in which the language, culture and legal systems depart drastically from those in the home country.

From the above analysis, it can be seen that a large proportion of services activity is still confined to within a national boundary and carried out by domestic producers within their own borders, despite tremendous growth in cross-border services trade over the last decade. Nevertheless, there remains plenty of scope for trade in services to increase over time, to the extent that regulatory trade barriers are relaxed. A recent study indicates that an assumed 33 percent reduction of services barriers could increase world services exports by US$118.6 billion, with US$35.5 billion for the United States and US$6.6 billion for Canada.[15] This would raise Canada's services exports by about 20 percent in the short term.

Table D.3: Trade restrictiveness index for foreign services suppliers in selected services

	Accountancy	Architecture	Banking	Distribution	Engineering	Legal	Maritime	Telecom
Argentina	0.29	0.16	0.07	0.09	0.15	n.a.	0.33	0.29
Australia	0.41	0.15	0.12	0.10	0.08	0.42	0.42	0.04
Brazil	0.39	0.16	0.51	0.23	0.23	n.a.	0.52	0.31
Canada	0.42	0.33	0.07	0.19	0.16	0.52	0.32	0.44
Chile	0.35	0.14	0.40	0.13	0.24	n.a.	0.50	0.09
France	0.31	0.14	0.07	0.33	0.03	0.58	0.33	0.21
Germany	0.39	0.15	0.07	0.24	0.28	0.49	0.39	0.05
Hong Kong	0.32	0.22	0.09	0.05	0.13	0.27	0.40	0.21
India	0.44	0.08	0.60	0.32	0.10	0.40	0.61	0.69
Indonesia	0.56	0.30	0.55	0.32	0.24	0.57	0.56	0.67
Italy	0.43	0.30	0.07	0.29	0.17	0.54	0.38	0.14
Japan	0.43	0.19	0.19	0.25	0.18	0.52	0.41	0.04
South Korea	0.48	0.19	0.43	0.33	0.12	0.44	0.58	0.68
Malaysia	0.51	0.33	0.65	0.40	0.26	0.54	0.52	0.58
Mexico	0.36	0.31	0.17	0.11	0.33	0.49	0.48	0.53
Philippines	0.63	0.33	0.53	0.37	0.15	0.54	0.64	0.45
Singapore	0.41	0.08	0.37	0.07	0.11	0.42	0.21	0.44
South Africa	0.44	0.11	0.19	0.07	0.10	n.a.	n.a.	0.59
Thailand	0.49	0.12	0.39	0.39	0.11	0.44	0.60	0.79
United Kingdom	0.19	0.07	0.07	0.19	0.07	0.31	0.24	0.00
United States	0.33	0.23	0.06	0.16	0.19	0.48	0.60	0.03

Sources: The Australian Productivity Commission's Trade Restrictiveness Index database, http://www.pc.gov.au/research/memoranda/servicesrestriction/index.html

Note: The value of the restrictiveness index ranges from 0 to 1. The higher the index value, the greater the restrictions imposed on a foreign supplier.

13 McCallum, J. (1996) "National borders matter: Canada-U.S. regional trade patterns." *American Economic Review 85* (June): 615-623. Helliwell, J. (1998) *How Much Do National Borders Matter?* Washington, D.C.: Brookings Institution.

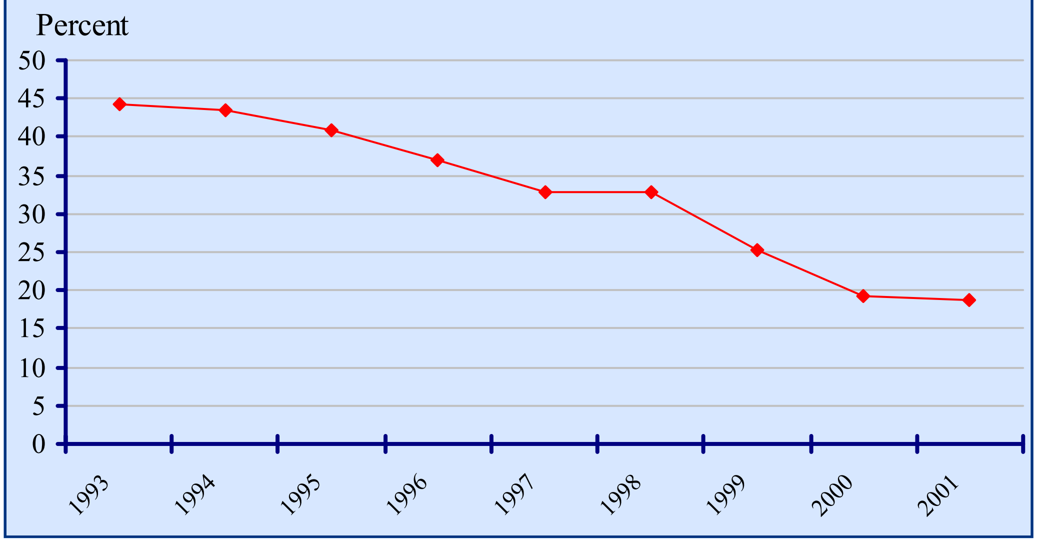
14 For each service subsector, the trade restrictiveness index calculated by the Australian Productivity Commission is based the government regulation pertaining to the subsector. Restrictions on establishment often include licensing requirements for new firms, restrictions on direct investment in existing firms and restrictions on the permanent movement of people. Scores are assigned to each restriction on the basis of how stringent it is. The restriction categories are then weighted according to a judgment about their relative economic cost for foreign services suppliers. The weights are generally chosen so that the value of the total restrictiveness index ranges from 0 to 1. The more stringent the restriction, the higher the index value.

15 Brown, Deardorff and Stern (2001) "CGE Modeling and Analysis of Multilateral and Regional Negotiating Options," Discussion Paper no. 468, University of Michigan.

III. INVESTMENT INCOME

Canada has historically run a deficit on its net investment income account, as money earned by non-residents on their Canadian investments has substantially exceeded the earnings of Canadians on their investments abroad. This reflects the fact that, for the most of its history, Canada has been a net capital importing country because of its abundance of investment opportunity. Accordingly, the stock of Canada's external liabilities (on which foreigners earn investment income), which stood at $1,107.9 billion at the end of 2001, was substantially greater than the stock of Canadian assets abroad (on which Canadians earn investment income), which was $904.5 billion. As a result, Canada had a net international investment position of $203.4 billion or about 18.8 percent of GDP, the lowest level since the mid-1940s. This share has been declining steadily in recent years (see Figure 9).

Figure 9: Net Foreign Liabilities as a share of GDP, 1993-2001



Sources: Statistics Canada, *National Income and Expenditure Accounts*, Catalogue no. 13-001-PPB, 4th Quarter 2001.
Canada's International Investment Position, Catalogue no. 67-202-XIB, 2001.

For the Year 2001:

- Investment income earned by Canadian residents on investments abroad totalled $37.4 billion. Of this, 48.6 percent was on direct investment, 20.2 percent on portfolio investment and the remaining 31.2 percent on other investment (including loans, deposits, reserves and other assets).

- Income earned by foreign residents on investments in Canada totalled $64.9 billion. Of this, about 36.7 percent was on FDI, 44.5 percent on portfolio investment, and the remaining 18.8 percent on other investment.

- Canada thus had a deficit of $27.4 billion on the investment income account, an increase of $0.3 billion from the previous year. About 78 percent of this deficit was contributed by the deficit in portfolio investment earnings.

- The deficit on investment income was 44.6 percent as large as Canada's record merchandise trade surplus of $61.5 billion.

IV. CURRENT ACCOUNT

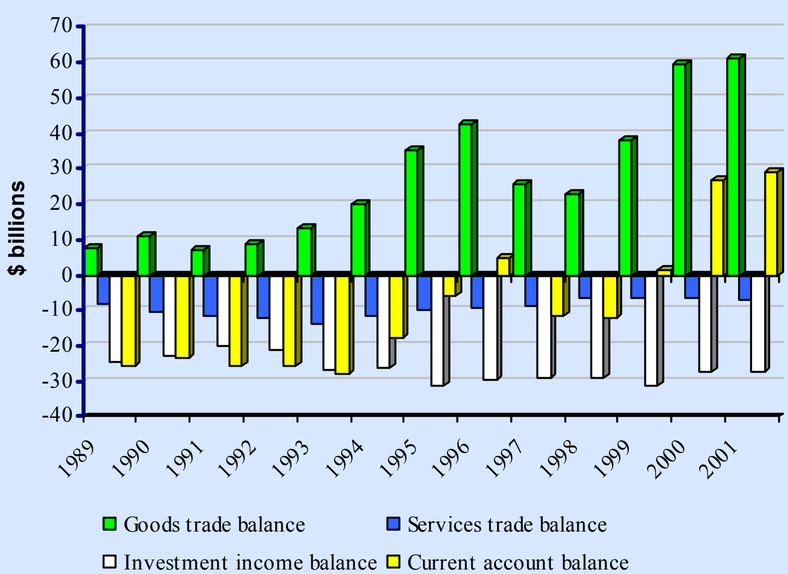
Through most of the period since the early 1970s, Canada has run deficits on the current account, coinciding with the emergence of a structural deficit in its public-sector finances.[16] At the same time, however, the share of private savings in Canadian GDP has fallen continuously, to a low of 16.8 percent in 1998, from 23.4 percent in the first half of the 1980s. As a result, Canada has consistently required net borrowing from abroad to finance domestic investment through much of the last three decades. In the 1990s, Canada brought the public-sector deficit down dramatically (at the fastest pace among the G7 economies) and, since 1997, has turned the balance into a surplus. The improvement in the budget surpluses implies a corresponding reduction in debt-servicing costs and has contributed favourably to Canada's current account balances in recent years.

Table 15: Domestic Savings and Investment, as Percent of GDP, 1981–2001

	Private			Public	
	Saving	Investment	Excess saving over investment	Budget surplus (+) Budget deficit (-)	Current account balance
1981-1985	23.4	17.9	5.5	-5.1	-1.2
1986-1990	21.0	19.2	1.8	-4.0	-3.3
1991-1995	19.8	15.6	4.2	-6.7	-2.8
1996	19.1	15.7	3.4	-2.5	0.5
1997	17.4	18.4	-1.0	0.1	-1.3
1998	16.8	18.3	-1.5	0.4	-1.3
1999	17.3	18.0	-0.7	1.5	0.2
2000	18.0	18.1	-0.1	3.6	2.5
2001	17.5	16.8	0.6	2.8	2.7

Source: Statistics Canada, *National Income and Expenditure Accounts*, Catalogue no. 13-001-PPB, 4th Quarter 2001.
Note: Due to the statistical discrepancy in the national accounts, the sum of the shares of excess private saving over private investment and budget surplus or deficit in GDP may not add to the share of current account deficit in GDP.

Figure 10: Structure of Canada's Current Account, 1989-2001



Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XPB, 4th Quarter 2001.

For 2001, Canada had a surplus on the current account of $29.1 billion, representing 2.7 percent of GDP (see Table 15 and Figure 10). The improvement in the current account in 2001 was largely driven by an increase in the merchandise surplus with the United States, to a record high of $95.4 billion.

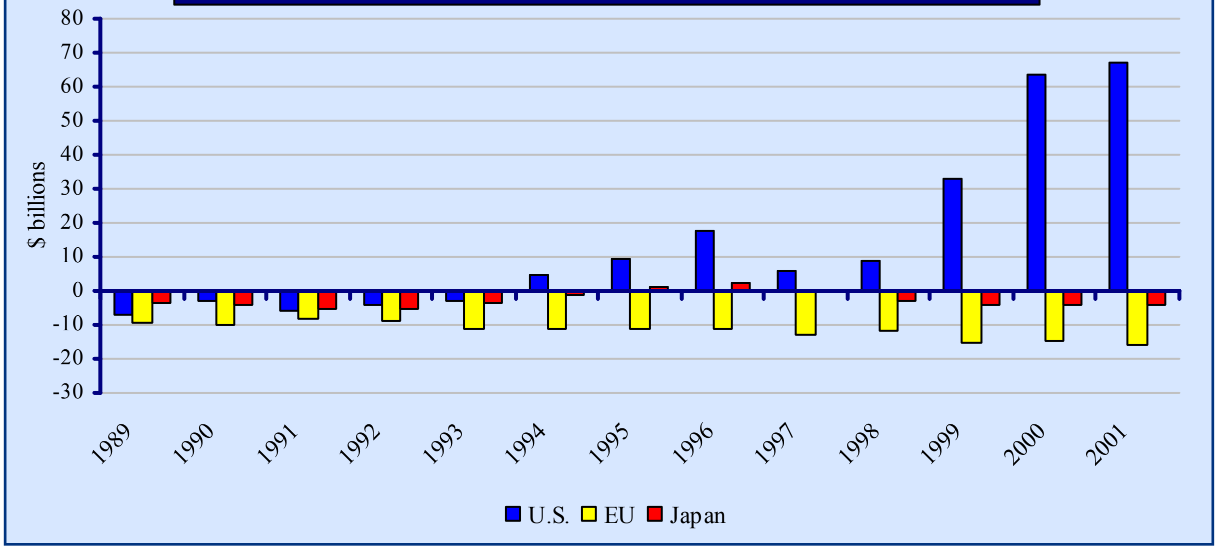
During 1994-2001, Canada's growing current account surplus with the U.S was partly offset by a rising deficit with the EU. The balance with Japan has tended to be small, with some cyclical variation (see Figure 11). Canada's current account surplus with the United States—$66.8 billion in 2001—was the largest ever on this account. Canada's current account deficit with the EU widened to $16.1 billion in 2001 from $14.9 billion in 2000. With respect to Japan, Canada

[16] The current account balance is the sum of the balances on trade (in merchandise and services), investment income and transfers. A surplus on the current account indicates that a country has earned (or obtained via transfers) more money abroad than it has paid out, and is thus a net saver internationally. This surplus, which is mirrored in a deficit on the capital and financial accounts, requires a net outflow of capital. Theoretically, the cumulation through time of the current account is equivalent to the net international investment position. By the same token, a current account deficit means that a country is a net borrower internationally (as reflected in a net inflow of capital and thus a surplus on the capital and financial accounts). In an accounting sense, a current account deficit reflects a shortage of domestic savings relative to domestic investment.

had a brief period of current account surpluses during the period 1995-1997, but these turned into deficits of $3.2 billion in 1998, widening to $4.2 billion in 1999, before narrowing to $4.1 billion in 2000 and $4 billion in 2001. Canada's current account deficit with countries other than the United States, the European Union and Japan rose slightly in 2001, to $17.6 billion from $17.5 billion the previous year.

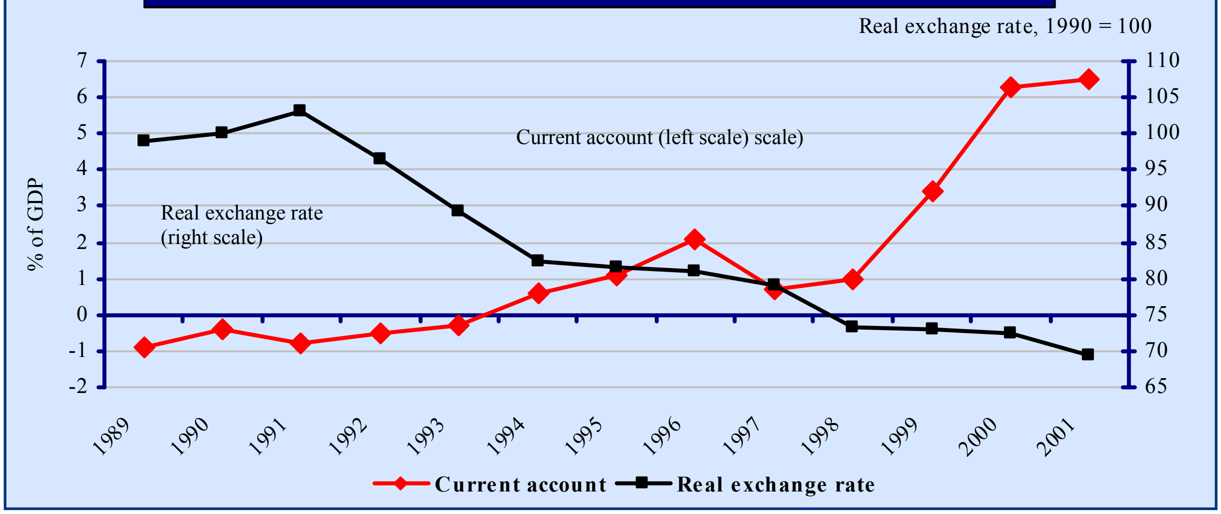
As can be seen from Figure 12, the improvement in Canada's bilateral balance with the U.S. from deficit to surplus since 1994 was associated, among other things, with the depreciation of the Canadian dollar in real terms over this period;[17] other factors, such as the stronger economic expansion in the United States over the years and the FTA/NAFTA, were also important.

Figure 11: Current Account Balance with Major Trading Partners, 1989-2001



Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XPB, 4th Quarter 2001

Figure 12: Canada's Real Exchange Rate vis-à-vis U.S. Dollar and Current Account Balance with the U.S., 1989-2001



Sources: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XPB, 4th Quarter 2001.
Bank of Canada, *Banking and Financial Statistics*.

[17] In Figure 12, Canada's real exchange rate vis-à-vis the U.S. is calculated as the price of Canadian goods (measured in U.S. dollars) in terms of the price of U.S. goods (as the term "real" implies). This series it calculated as the U.S. dollar value of the Canadian dollar multiplied by the Canadian consumer price index and divided by the U.S. consumer price index. The results, converted to an index with 1990 = 100, show that in 2001 the real price of a bundle of Canadian goods in terms of that of the U.S. has come down to 70 percent as much as that in 1990.

V. CAPITAL AND FINANCIAL ACCOUNTS

The capital and financial accounts consist of transactions in financial assets and liabilities. The capital account includes capital transfer such as migrants' assets and inheritances, and federal government superannuation. The financial account covers inflows and outflows of direct investment, portfolio investment and other investment.[18]

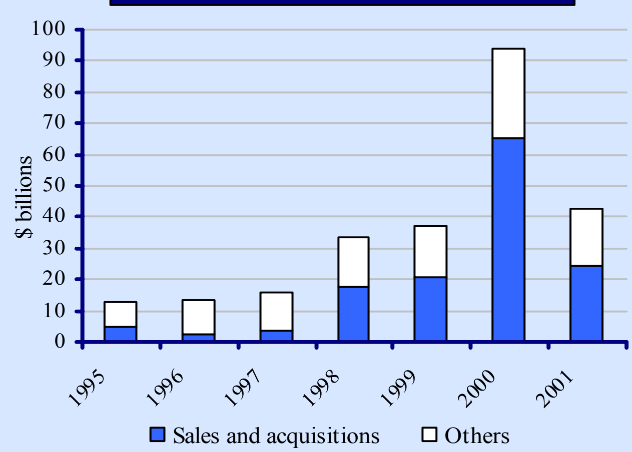
Direct Investment

FDI flows into Canada fell sharply in 2001, coinciding with a drop of 40 percent in FDI inflows for the world as a whole, the first decline since 1991 and the largest year-on-year global fall over the past three decades. The global decline was associated with the slump in the dollar value of cross-border mergers and acquisitions, in part because the prices paid for many companies have come down substantially from "overvalued" levels in 2000, especially for those in the technology sector. (The shocks such as September 11 and the Argentine default later in the year had marginal impact on global FDI flows in 2001.) Inflow of FDI into Canada remained at an historical high level of $42.8 billion in 2001, though it fell by about 55 percent, after surging by more than 150 percent in 2000 to a record level $94.1 billion. This drop in FDI in 2001 occurred as inflows from the EU collapsed from $72.1 billion in 2000 to just $0.13 billion in 2001, following the completion of takeovers of Seagram Co. by Vivendi SA of France and of Newbridge Networks Corp by Alcatel SA of France in 2000. In contrast, inward FDI flow from the United States jumped to a record high of $40 billion in 2001 from $17.3 billion in 2000, as a result of takeovers of several Canadian companies in the energy sector.

The outflow of direct investment (CDIA) in 2001stayed at a high level of $57.3 billion, despite a 12.5 percent drop. This drop in investment outflow was concentrated in markets in the U.S., the EU and Japan. CDIA into the United States fell to $38.9 billion in 2001, from $40.5 billion in 2000, representing 67.9 percent of total outflows. CDIA into the EU fell to $4.9 billion in 2001, from $9.7 billion in 2000. The movement in CDIA resulted from acquisitions of foreign companies in the United States and Europe, and was concentrated in the finance and insurance sector and in the traditional sectors such as energy and metallic industries.

Over the period 1993-1998, CDIA consistently exceeded FDI. In 1999 and 2000, the flow of FDI exceeded CDIA (Figure 14). In 2001, however, CDIA again exceeded FDI. The high level of two-way flows in 2000 and 2001 suggests that the main driving forces have been shifts in the underlying structure of industry and trade in response to globalization pressures, rather than transient factors such as exchange rate movements or cyclical fluctuations.

Figure 13: FDI in Canada: Sales, Acquisitions and Other Flows, 1995-2001

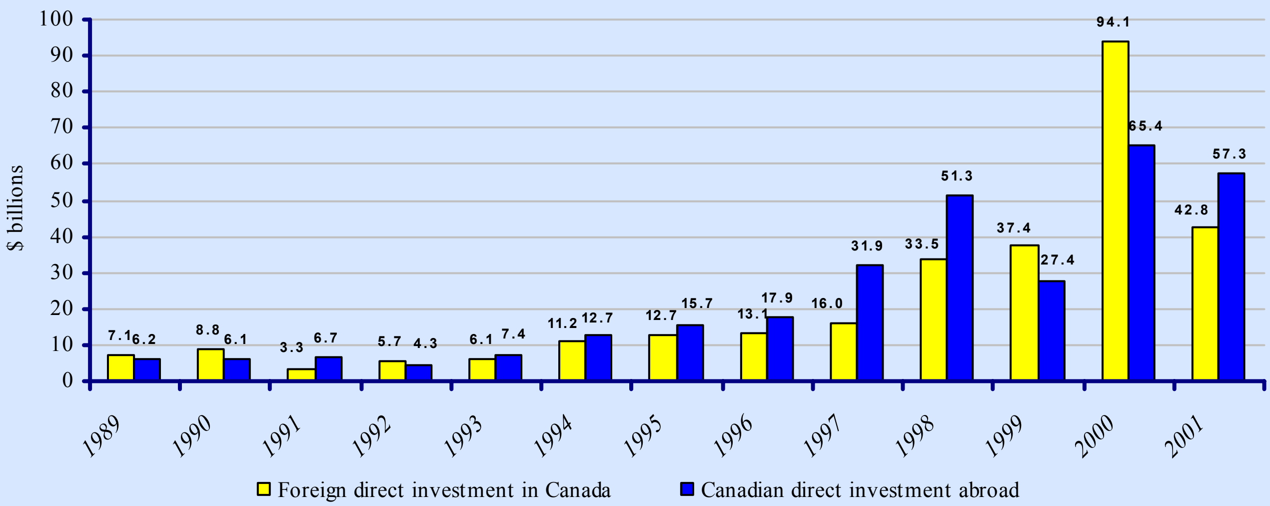


Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XP, 4th Quarter 2001

The stock figures represent values recorded in the balance sheets of the enterprises where the investment is made. They include not only the stream of past investment flows cumulated through time, but also capital gains/losses on existing assets, reinvested earnings, exchange rate revaluations and other adjustments (Table 16A). The exchange rate revaluation takes account for the change in the position of an asset or a liability, denominated in foreign currencies, due to changes in the value of the currency of issue versus the Canadian dollar from December 31 of the previous year to December 31 of the current year. Other revaluation changes take account of the difference between the price at which the transactions occurred and the value recorded in the balance sheet, as well as write-ups or write-downs of investment. Reinvested earnings are earnings that the enterprises do not distribute as dividends, which are treated as direct investment in the balance of payments investment position. Other changes include corporate reorganizations, which lead to reclassifying a portfolio investment to direct investment when ownership increases to 10 percent or more of that stock.

[18] Direct investment refers to investment that allows investors a significant influence in the management of an enterprise. For practical purpose, direct investment pertains to transaction in which the investor has ownership of at least 10 percent of an enterprise's voting equity. Recent data show that 88 percent of the outward investment stock went into Canadian subsidiaries with ownership of more than 50 percent. Portfolio investment includes transactions between non-residents and Canadian residents in bonds and stocks and Canadian money market papers, which are debt instruments with original maturities of one year or less. Other investment includes loans, deposits, official international reserves, and assets such as trade credits, deferred immigrants' funds and progress payments.

Figure 14: Flows of FDI and CDIA, 1989-2001



Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XPB, 4th Quarter 2001.

Exchange rate and other valuation changes contributed almost as much as the flow of new investment in increasing the stock of CDIA in 1994 (Table 16A). In 2001, exchange rate revaluation accounted for about 28% of the increase in the stock of CDIA, largely reflecting the depreciation of the Canadian dollar against the U.S. dollar. In the case of FDI, reinvested earnings contributed to more than 50 percent of the increase in the book value of the stock in 2001.

Table 16A: Contribution to Net Change in Book Value of Investment Stocks – 1994 and 2001

	CDIA ($ millions)		FDI ($ millions)	
	1994	**2001**	**1994**	**2001**
Book value of investment stock at year end	146,315	389,426	154,594	320,931
Net change in book value of stock	23,888	49,061	13,101	18,631
Net investment flow	12,694	57,268	11,206	42,767
Capital flows from direct investment	8,381	48,253	8,514	32,767
Reinvested earnings	4,313	9,015	2,692	10,000
Exchange rate valuation	6,311	13,886	n.a.	n.a.
Net change, all other factors	4,883	-22,094	1,895	-24,136

Source: Statistics Canada, *Canada's International Investment Position*, Catalogue no. 67-202-XIB, 2001.

Table 16B: Stocks of CDIA and FDI by Sector, Year End 2001

	CDIA		FDI	
Industry Group	$ billions	% of total	$ billions	% of total
Wood & paper	10.8	2.8	18.3	5.7
Energy & metallic minerals	75.1	19.3	67.2	20.9
Machinery & transportation equipment	23.5	6.0	47.9	14.9
Finance & insurance	147.9	38.0	45.3	14.2
Services & retailing	54.1	16.0	26.0	8.1
Other industries	77.9	20.0	115.9	36.1
Total	389.4	100.0	291.5	100.0

Source: Statistics Canada, *Canada's International Investment Position*, Catalogue no. 67-202-XIB, 2001.

With respect to the country of source, the U.S. accounted for 67 percent of the total FDI stock in Canada in 2001, up from 63.2 percent in 2000. The EU's share fell to 23.8 percent in 2001, after rising to 27.4 percent in 2000, up from 20.4 percent in 1999. As for the stock of CDIA, the United States accounted for 51 percent, followed by the United Kingdom, at 9.8 percent. The EU accounted for 19.6 percent in 2001, down from 21.2 percent in 2000.

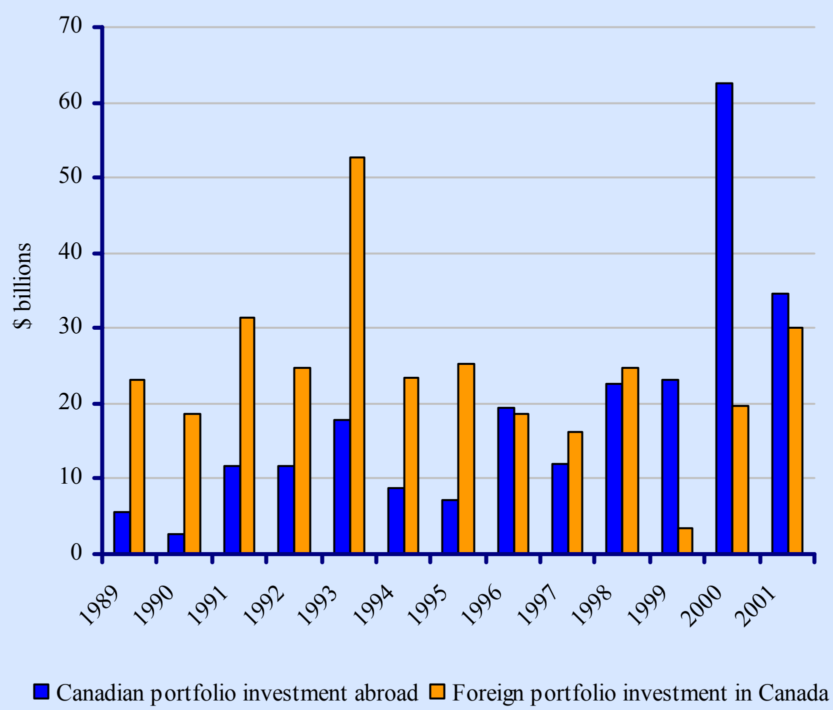
Portfolio Investment

Portfolio investment, which is interest-rate sensitive, historically has fluctuated sharply, reflecting projected financial returns in the respective host countries. Inflows, which include investments in Canadian bonds, stocks and money markets, rose from $19.6 billion in 2000 to $30.1 billion in 2001. Foreign investors acquired a record $33.6 billion of Canadian bonds in 2001, largely due to increased purchases from the United States.

The flow of Canadian portfolio investment abroad declined from $62.7 billion in 2000 to $34.5 billion in 2001. The composition of Canadian portfolio investment outflows shifted to purchases of foreign stocks, as the foreign content limit for tax-sheltered registered pension plans rose to 30 percent in 2001 from 25 percent in 2000. Canadian investment in foreign stocks remained at a near-record high of $34.6 billion in 2001, though down substantially from $58.7 billion in 2001.

The year 2001 marked the fourth time since 1956 that the flow of Canadian portfolio investment abroad exceeded foreign portfolio investment in Canada. The other years were 1996, 1999 and 2000, when outflow exceeded inflows by $0.6 billion, $17.6 billion and $43 billion respectively. In 2001, Canada's portfolio investment abroad exceeded foreigners' corresponding investment in Canada by $4.4 billion (Figure 15).

Figure 15: Foreign Portfolio Investment in Canada and Canadian Portfolio Investment Abroad, 1989-2001



Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XPB, 4th Quarter 2001.

With the developments in 2001, the stock of portfolio investment abroad by Canadians reached $231.2 billion, whereas the stock of foreign portfolio investment in Canada rose $527.1 billion.

International Investment Position

Canada relies heavily on inflows of foreign capital to finance domestic investment activity and to finance imports of technology from abroad. As a result, Canada's foreign accumulated debt has traditionally exceeded its corresponding assets. However, Canada's foreign indebtedness fell from 44.7 percent in 1993 to 18.8 percent by 2001, reflecting a marked improvement in the FDI account from the traditional debtor position to that of a creditor since 1996, as well as the surge in investment in foreign stocks in response to the higher foreign content limits for tax-sheltered Canadian investment funds.

VI. SUMMARY OF BALANCE OF PAYMENTS

Table 17 summarizes Canada's overall balance of payments picture in 2001. By standard accounting practices, a country's balance of payments account is always balanced. In 2001, Canada registered a current account surplus of $29.1 billion. Statistically, this surplus is offset exactly by a deficit in the capital and financial accounts, as explained in footnote 16 above.

Of particular note, the Canadian official settlement balance was a positive (the table shows negative in the same way as direct investment abroad) $3.4 billion, which indicates that the Bank of Canada added that much to its foreign exchange reserve (primarily in the form of U.S. dollar and other foreign currencies).

The statistical discrepancy refers to the net position on transactions with non-residents not adequately captured or measured in the BOP entries. It covers unrecorded transactions and measurement errors. It is derived as the arithmetic sum (with the reverse sign) of the current account balance and the financial account and capital account balance. In 2001, this discrepancy was negative, indicating net outflows of funds (of $8.3 billion) from Canada to the rest of the world.

Table 17: Canada's 2001 Balance of International Payments Accounts ($ millions)

CURRENT ACCOUNT			
♦ Exports of goods and services	$467,605		
♦ Imports of goods and services	$412,925		
a. Trade balance		$54,676	
♦ Investment income abroad	$37,436		
♦ Investment income of foreigners	$64,883		
b. Net investment income		-$27,446	
c. Net current transfer		$1,870	
1. Current account balance (a + b + c)			**$29,100**
FINANCIAL ACCOUNT*			
♦ Canadian direct investment abroad	-$57,268		
♦ Foreign direct investment in Canada	$42,767		
d. Net foreign direct investment		-$14,501	
♦ Portfolio investment abroad	-$34,544		
♦ Portfolio investment in Canada	$30,119		
e. Net portfolio investment		-$4,425	
f. Other net investment		-$7,572	
2. Financial account balance (d + e+ f)			**-$26,499**
Of which: - official international reserve		-$3,353	
3. Capital account balance			**$5,678**
4. Statistical discrepancy			**-$8,280**
Balance of payments (1 + 2 + 3 + 4)			**$0**

*A negative sign denotes an outflow of capital associated with an increase in assets or a decrease in liabilities.
Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XPB, 4th Quarter 2001.