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UPDATE

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Title: *Le Québec face à la recomposition spatiale et sectorielle de l'activité économique dans l'hémisphère ouest* (Québec in the face of the spatial and sectoral recomposition of economic activity in the Western Hemisphere)

An examination of macroeconomic data, foreign direct investment and trade flow with the other Canadian provinces and the U.S. states, as indicators of the process of economic integration

Comments: This update also incorporates the updated study by the same author for the Committee to examine matters relating to the accession of Québec to sovereignty, entitled *Intégration économique, souveraineté et relations commerciales* (economic integration, sovereignty and commercial relations) (Vol. 3, pp. 101-118).

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QUÉBEC IN THE FACE OF THE SPATIAL AND SECTORAL RECOMPOSITION OF ECONOMIC ACTIVITY IN THE WESTERN HEMISPHERE:

Examination of macro-economic data, foreign direct investment and trade flows among Canadian provinces and American states as indicators of the economic integration process.

Report to the Ministère du Conseil Exécutif, Bureau de coordination de la mise à jour des études

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SUMMARY

This report is an update of and the follow-up on two studies of Québec's trade flows with the other provinces, the United States and the rest of the world prepared in 1991 for the Bélanger-Campeau Commission and the Commission d'Étude des questions afférentes à l'accession du Québec à la souveraineté.

The analysis of trade flows was updated. However, the advancement of the economic integration process in the Western Hemisphere led to the analysis of two other topics. The evolution of Québec in North America was examined using demographic and macro-economic data. An examination was also made of foreign direct investments (FDI) and mergers and acquisitions and their roles in the economic integration process.

The hypotheses that guided the author in the analysis of numerous, highly varied topics is presented here. Québec is a small open economy involved in a north-south integration process that affects the provinces of Canada, the American states and the countries of Latin America. Understanding the evolution of Québec in North America requires that we accept that it is located in a transborder area in the northeastern part of the continent. This area is in relative decline, although there are some places experiencing dynamic growth. Consequently, Québec businesses must improve their performance in terms of productivity and competitiveness if they are to compete in Québec, but also on the big American market, in the face of the ever-growing presence of Mexican and Chinese businesses. We face considerable challenges, as we have to form and join networks and engage in intra-firm and intra-industry trade. This requires local and regional networking activities in Québec along with a notoriety, specialization and a level of productivity that are much greater than what we have achieved to date.

The convergence of information technologies, biotechnology and nanotechnologies are at the very heart of the technological change process and are giving rise to ever more numerous and substantial ties between local firms and foreign suppliers, partners and clients.

In the 1990s a large number of economic ties between the economies of Canada and the United States became stronger in part under the influence of trade agreements such as the FTA, NAFTA and the WTO but also under the influence of technological change in communications and transportation. The north-south shift, identified and documented in the report of 1991, is indeed present and as originally anticipated, north-south trade flows have increased in relation to inter-provincial trade under the influence, among other things, of the FTA and NAFTA, which have encouraged north-south trade. The border effect (in part linked to the existence of different currencies) remains, but is waning progressively to the point where the author believes *that the time has come to envisage setting up a customs union between Canada and the United States*, a measure explored in the work of 1991.

The integration forces are such that while authorities are not likely to opt for the creation of a common market, there will be more serious discussions on measures to facilitate e-trade and on the harmonization of regulatory

barriers to facilitate access to transportation, telecommunications and financial services infrastructures. The creation of R&D consortiums will likely be facilitated, and there are numerous proposals concerning the harmonization of regulatory regimes in the air transportation, trucking, telecommunications and financial services fields. The number of proposals seeking to have North America adopt an integrated SO₂ and perhaps CO₂ emission permit system is growing. The persons and groups concerned about the redistributive aspects of the integration process have been identifying relevant topics that will be added to the discussion agenda.

Mexico and China have become important players and serious competitors for Québec in the big American market. This question is examined in Part III of the report.

Various analyses, including the present one, have confirmed the decline of Canada (and likely of Québec, which may only be surmised in the absence of data) as a destination for FDI and particularly European FDI. Indeed, a large proportion of these FDI head directly for the United States in order to penetrate the North American market. *The Canadian share of European FDI in North America fell from 3% in 1992 to 1% in 1998. This is one of the main reasons why the proportion of FDI stock entering Canada in relation to the sum total of FDI entering the Americas as a whole has been on the decline, going from 20.24% in 1990, to 16.46% in 1995 to 12.89% in 1999, and to 11.75% in 2000.*

The examination of Québec's trade flows in North America seeks to clarify certain elements of a strategy that aims to encourage European investors and those of other continents to set up operations in Québec rather than in the United States or in the *maquiladoras* and elsewhere in Mexico in order to penetrate the North American market. An identification has been made (in Part III of the report and based on various criteria) of products for which Québec's share of American imports are substantial and growing, in order to contribute to this reflection.

The demographic and economic studies that were consulted or carried out (see Parts I and III of the report) indicate *that a progressive decline is occurring in the northeast north america where Québec is located. Québec's share of the total population of the provinces and states of North America went from 2.6% in 1960 to 2.36% in 2000.* This ensues from the territorial recomposition of activities, a phenomenon accompanying the

integration process. These analyses underscore one of the original conclusions to the effect that one of our challenges is to review our FDI and export market promotion and prospecting policies in order *to help Québec businesses to reach more remote American and Latin American markets and thus improve our economic performance*. The nature of the goods and services of the new economy makes such a strategy possible in that high-technology and value-added goods “travel” and can help offset the negative effects of distance on our activities. *However, pursuing such a strategy requires networking activities and local and regional synergies that support the formation of increasingly specialized cities and regions in North America. The implementation of a renewed development strategy in Québec based on industrial-regional clusters is called for.*

This report was drafted with the help of some 300 tables containing statistical data compiled to permit comparisons between Québec, the other Canadian provinces and the American states. Increasingly, competition is becoming interregional-international in scope. This is largely due to agglomeration effects that lead to the development of cities and regions as choice sites for economic development.

Readers will find in the executive summary of this report as well as in the actual report and its tables data and comparisons that make it possible to confirm and in many cases complement the assessment of Québec’s strengths and weaknesses in North America.

Various topics are discussed including some that may well find their way on to the negotiation table with the United States as integration progresses, including: a) the setting up of a customs union; b) the relevance for Québec businesses to adopt a strategy for direct foreign investment abroad; c) the importance of targeting North American cities and regions to guide promotion and prospecting efforts; d) the importance of acquiring better statistics on trade flows (given the indirect trade that passes through the United States) and on incoming and outgoing foreign direct investments; e) the nature of the growing competition from Mexico and China that we face in the American market; f) the decline in Québec’s share of inter-provincial shipments ensuing from the north-south integration process, the FTA, NAFTA; g) the role of separate currencies and a strong American dollar in expanding Québec’s exports to the south and its purchases in the other Canadian provinces,(a form of trade diversion) h) productivity gaps that vary according to the sector, etc.

The report also raises a number of questions on which research work might focus in order to help develop an effective economic development strategy for Québec's small open economy including that of a development strategy promoting industrial-regional clusters.