POLICY STAFF PAPER

Department of Foreign Affairs and International Trade

Ministère des Affaires étrangères et du Commerce international

CANADA

Dealing with Diversity:

Canada's Economic Relations with Developing Countries

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DECEMBER 1995
95/15
SP73A

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Dealing With Diversity: Canada's Economic Relations With Developing Countries

Executive Summary

Over the past ten years, the world has undergone stunning, fundamental change. The reality and ideology of growth have converged to a considerable degree and on a more global scale than ever before. Moreover, what have long been called universal human and political rights have gradually found wider acceptance in practice. Major, often painful gaps remain, of course. Political and social reforms often do not march in close unison with economic reform over the short to medium term. Nonetheless, at the broadest level, the direction seems to be towards greater commonality - toward the acceptance of an increasingly global basis of certain fundamental beliefs and practices. Yet change inevitably occurs at different speeds in different countries and societies, the result of timing, of different factor endowments, of varying political and social traditions and institutions. A sea change is taking place, visible in outline when viewed from a distance. But the closer one is to the shoreline, the more one is also struck by the diversity of detail in the practical responses of individual countries.

There is no longer the perception among developing countries and the economies in transition in eastern Europe that they share a common approach to relations with OECD countries, nor that individual developing countries share anything close to an equal base or capacity from which to achieve development. These countries recognize their own diversity of circumstances and capacities. For Canada and others, this shift creates its own challenges. On the one hand, the new approach enhances both competitive pressures <u>and</u> the prospects for more balanced and creative economic partnerships. On the other hand, the diversity among developing countries and the transition economies has become sharper, requiring greater policy flexibility in the responses of developed countries.

This Paper identifies two broad groups of developing countries. Zone 1 economies most immediately come to mind in discussions on the "coming anarchy" thesis. These countries are typically very poor. More than that, their economies are stagnant. Even more critically, Zone 1 countries often suffer from insufficiently articulated political structures, feeble and inconsistent economic management and a narrow resource base. Political stability is often fragile and governments are frequently weak and, in some instances, simply dysfunctional.

The institutional structures and philosophy of society of Zone 2 economies can vary considerably. Unlike their Zone 1 counterparts, however, these countries have passed a critical threshold of political and economic institutional viability. With exceptions, Zone 2 countries demonstrate greater respect for political rights and civil liberties. Moreover, they are committed to sounder fiscal and monetary policies, rely increasingly on international trade and have a growing impact on regional and world trade flows, while many enjoy an increasing capacity to raise financing in international capital markets and to attract investment. In addition, many of these economies can make a major contribution to shaping global environmental policy and often wield considerable influence in their respective regions. Zone 2 countries are often active players who "count" internationally and, on an issue-specific basis, can be helpful to Canada in pursuing our goals abroad.

Canada can draw on a wide range of possible policy responses in order to address effectively the quite different challenges of cooperation presented by Zone 1 and Zone 2 economies. These responses include assisting Canadian NGO activity, emergency relief operations, government-to-government assistance covering basic human needs, institutional partnerships with the focus on higher level technical cooperation, government-to-government programmes with a greater focus on environmental partnerships and more sophisticated technical assistance, international cooperation between private sectors, and bilateral investment and taxation agreements.

When analyzing how and where these various tools might best be deployed, it will be essential to recall that needs greatly outstrip our resources. Tough choices will be inevitable. We should focus on countries and programmes where we can make a real difference and where economic partnerships will most effectively reinforce Canadian foreign policy objectives. This Paper argues that our different objectives for each Zone suggest a repackaging of our tools to allow a more strategic and cohesive approach to our relationships abroad.

In light of the above considerations, this Paper suggests that the co-financing of NGO activity should be available for countries in both Zones; that CIDA's mandate should be refocussed even more sharply to concentrate primarily on emergency humanitarian relief and government-to-government assistance that targets basic human needs development and improved grass-roots civil and political practices in Zone 1 countries; and that a new economic and environmental cooperation mechanism should be established to focus on higher level technical and private sector partnerships with economies drawn from Zone 2. Funding for this latter approach could be redirected from several sources, including CIDA, current programmes of Foreign Affairs and other government Departments and the Export Development Corporation. For selected Zone 2 countries, the activity supported under this mechanism could be reinforced through the negotiation of bilateral investment protection and taxation agreements, as well as a more comprehensive trade and investment framework on a case-by-case basis.

Résumé

Au cours des dix dernières années, le monde a connu des changements fondamentaux stupéfiants. La réalité et la théorie de la croissance ont convergé dans une grande mesure et sur une échelle plus mondiale que jamais auparavant. En outre, les droits de la personne et les droits politiques, qualifiés depuis longtemps d'universels, ont progressivement été acceptés plus largement dans la pratique. Naturellement, il subsiste de grandes lacunes, quelquefois pénibles. Les réformes politiques et sociales souvent ne vont pas de pair avec les réformes économiques, à court et à moyen terme. Néanmoins, au niveau le plus large, on semble s'orienter vers une plus grande uniformité, vers une acceptation d'une base de plus en plus mondiale de certaines croyances et pratiques fondamentales. Pourtant, des changements se produisent inévitablement à divers rythmes selon les pays et les sociétés, en raison de la chronologie, des dotations en facteurs variées ainsi que de traditions et d'institutions politiques et sociales différentes. De grands changements sont en train de se produire dont les grandes lignes sont visibles quand on se tient à une certaine distance. Mais plus on se rapproche et plus on est frappé par la diversité des détails dans les réponses pratiques de chaque pays.

Les pays en développement et ceux en transition en Europe orientale n'ont plus l'impression d'avoir une attitude commune à l'égard des relations avec les pays de l'OCDE, ni de disposer chacun de quelque chose qui ressemble à une base ou à une capacité égale à partir de laquelle se développer. Ces pays reconnaissent leurs situations financières et leurs capacités diverses. Pour le Canada et d'autres pays, ce changement engendre ses propres difficultés. D'une part, cette nouvelle attitude met l'accent à la fois sur les pressions concurrentielles <u>et</u> sur la perspective de partenariats économiques plus équilibrés et créatifs. D'autre part, la diversité parmi les pays en développement et ceux en transition s'est accentuée, demandant une plus grande souplesse dans les réponses des pays développés.

Le présent document détermine deux groupes principaux de pays en développement. Les pays de la zone 1 viennent plus immédiatement à l'esprit dans les discussions sur la thèse de « l'anarchie à venir ». Ces pays sont habituellement très pauvres. Pire encore, leur économie est stagnante. Bien plus grave encore, les pays de la zone 1 souffrent souvent de structures politiques mal définies, d'une gestion économique médiocre et incohérente et d'une base de ressources étroite. La stabilité politique est souvent fragile et les gouvernements sont fréquemment impuissants et, dans certains cas, simplement dysfonctionnels.

Les structures institutionnelles et la philosophie des sociétés dans les pays de la zone 2 peuvent varier considérablement. Toutefois, contrairement à leurs

homologues de la zone 1, ces pays ont franchi un seuil critique de viabilité institutionnelle en matière politique et économique. À quelques exceptions près, les pays de la zone 2 manifestent un plus grand respect pour les droits politiques et les libertés civiles. En outre, ils sont déterminés à avoir des politiques financières et monétaires plus saines, dépendent de plus en plus du commerce international et ont une influence croissante sur le commerce régional et mondial, alors qu'un grand nombre dispose d'une capacité accrue d'emprunter sur les marchés des capitaux étrangers et d'attirer les investissements. De plus, un grand nombre de ces pays peuvent apporter une grande contribution à l'élaboration d'une politique environnementale mondiale et exercent souvent une influence considérable dans leur région respective. Les pays de la zone 2 sont souvent des intervenants actifs qui ont du poids sur la scène internationale et, sur une question particulière, peuvent aider le Canada à atteindre ses buts à l'étranger.

Notre pays peut faire appel à une gamme étendue de réponses politiques possibles afin de résoudre efficacement les problèmes de coopération très différents que posent les pays de la zone 1 et de la zone 2. Parmi ces réponses, on peut citer l'aide aux activités des ONG canadiennes, les opérations de secours d'urgence, l'assistance de gouvernement à gouvernement pour les besoins essentiels, des partenariats institutionnels qui insistent sur une coopération technique de haut niveau, des programmes de gouvernement à gouvernement qui portent davantage sur les partenariats en matière d'environnement et une aide technique plus avancée ainsi qu'une coopération internationale entre les secteurs privés et des accords bilatéraux en matière d'investissement et d'imposition.

Lorsqu'on analyse comment et où ces divers outils peuvent être le mieux déployés, il est essentiel de se souvenir que les besoins dépassent de loin nos ressources. Des choix difficiles seront inévitables. Nous devrions nous occuper des pays et des programmes où nous pouvons produire des résultats concrets et où les partenariats économiques renforceront plus efficacement les objectifs canadiens en politique étrangère. Le présent document soutient que nos objectifs, différents pour chaque zone, laissent supposer un reconditionnement de nos outils pour permettre une démarche plus stratégique et plus cohérente pour nos relations à l'étranger.

Étant donné les considérations susmentionnées, le présent document propose de cofinancer les activités des ONG dans les pays des deux zones, de redéfinir encore plus soigneusement le mandat de l'ACDI pour le concentrer principalement sur l'aide humanitaire d'urgence et l'assistance de gouvernement à gouvernement qui concerne le soulagement des besoins essentiels et l'amélioration des pratiques civiles et politiques de base dans les pays de la zone 1, et d'établir un nouveau mécanisme de coopération économique et environnementale pour s'occuper des partenariats techniques de haut niveau et des partenariats avec le secteur privé, dans les pays de la zone 2. Le financement de ce mécanisme devrait provenir de diverses sources, notamment de l'ACDI, des programmes actuels des Affaires étrangères et d'autres ministères ainsi que de la Société pour l'expansion des exportations. Pour certains pays de la zone 2, l'activité appuyée par ce mécanisme pourrait être renforcée par la négociation d'accord bilatéraux en matière d'imposition et de protection des investissements, ainsi que par un cadre de commerce et d'investissement plus global, établi au cas par cas.

1. The Challenge of Diversity[1]

Over the past ten years, the world has undergone stunning, fundamental change. Most spectacularly perhaps, the end of the Cold War has forced a radical reinterpretation of the meaning of security, while also removing a major ideological barrier to the further integration of the world trade and payments system. The stark demythologizing of central planning and the so-called workers' state has combined with the at best mediocre gains generated by import substitution policies in many developing countries compared to the relative success of those régimes that wagered heavily on export growth and careful domestic economic management. The balance sheet - while inevitably replete with nuances - indicates more clearly then ever before the substantial merits of the competitive market place.

Persistent economic and social failure in some countries, especially in sub Saharan Africa, and the deterioration of income distribution in several (but not all) developing countries that are adjusting through the market place serve as salutary reminders that success overall can still carry within it challenges of addressing marginalization and the costs of transition.[2] But few analysts believe that command economies can provide lasting solutions to such challenges. Rather, the debate now centres on the detail of government involvement <u>within</u> the context of solid domestic economic fundamentals and <u>in light of</u> the critical importance of competing in regional and world markets. Moreover, the growing acceptance of market forces[3] has strengthened an underlying trend toward deepening cross-border economic integration reflected in flows of goods, services, investment and technology that have increased at rates that have consistently outpaced growth in domestic economies over the past generation. In turn, increasing cross-border competition and integration continue to create further pressure for minimizing substantive differences between jurisdictions in many areas that most policy makers had considered quintessentially domestic and local in the past.

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[1] The authors would like to recognize the assistance of our colleague Keith Halliday who contributed helpfully to an earlier draft of this Paper.

[2] On recent income distribution trends, see the draft paper by Albert Berry and Frances Stewart, "Market Liberalisation and Income Distribution: The Experience of the 1980s", (Ottawa: The North-South Institute, June 1994); also see Albert Berry "The Social Challenge of the New Economic Era in Latin America", Centre for International Studies (University of Toronto) and the Canadian Foundation for the Americas (FOCAL), Discussion Paper 1995-8 (Toronto, 1995).

[3] With governments debating how best to address "imperfect" markets and market "failures" where these occur and have an anti-competitive impact.

The reality and ideology of growth have thus converged to a considerable degree and on a more global scale than ever before. Moreover, what have long been called universal human and political rights have gradually found wider acceptance in practice, ranging from the reestablishment and deepening of democratic institutions in Latin America to electoral reform in Korea and Taiwan to renewed interest in internationally accepted labour standards to the growing emphasis on family planning in certain Islamic countries with some positive impact for the status of women in those societies. Major, often painful gaps remain, of course. Political and social reforms often do not march in close unison with economic reform over the short to medium term. Yet, at the broadest level, the direction, although more opaque perhaps than in the area of economic policy, seems to be toward greater commonality - toward the acceptance of an increasingly global basis of certain fundamental beliefs and practices.

We should view much of what is occurring internationally as evidence of greater <u>integration</u> of beliefs, policies and practices. It is a process with which Canada is generally comfortable and which Canada has usually promoted. Yet change inevitably occurs at different speeds in different countries and societies, the result of timing, of different factor endowments, of varying political and social traditions and institutions. The power and widespread legitimacy of integrative forces have never been greater. A sea change is taking place, visible in outline when viewed from a distance. But the closer one is to the shoreline, the more one is also struck by the diversity of detail in individual responses: Chile is not exactly like Mexico or Malaysia - and none of these is anything like Zaïre or Somalia. A sensible conclusion from a Canadian perspective is that the broad thrust of our foreign policy should reflect the nature of the sea change toward greater commonality and community; but that policy should also recognize more clearly than it does at present the diversity we face over the shorter term. The end point remains the same; but the means and tactics involved in moving forward must be flexible.

Take the "Third World", the "South" in the North-South Dialogue. The Third World was always an artificial construct in that it attempted to paper over widely different economic and political realities. It flourished for a time as a convenient instrument of pressure during the generation following World War II and was influenced by three transitional events: decolonization, the Cold War and the still intact legitimacy of socialist economic models. Third Worldism reflected an underlying perception that developing countries shared a fundamental interest in managing as a bloc their relations with the "North" in order to facilitate their progress from underdevelopment to development. There was, in fact, a sense that underdevelopment was more an exogenously <u>created</u> phenomenon for which the capitalist world in particular was to blame, rather than the result of domestic policy failures.

In the 1960s and 1970s, many developing countries shared an agenda in international fora that focussed on state-directed resource transfers and reform of what was called the World Economic Order in their favour. This strategy of a monolithic "South" found reflection in the Non-Aligned Movement and the Group of 77 concepts and in the North-South Dialogue. It also underpinned the work of international institutions such as the UN Conference on Trade and Development (UNCTAD).

Today, the goal of development naturally enough remains intact. But there is no longer any coherent pretence among developing countries that they share a common approach to relations with OECD countries, nor that individual developing countries share anything close to an equal base or capacity from which to achieve development. The once tidy notion of homogeneity among developing countries has long faded from favour. LDCs, joined more recently by the "economies in transition" of eastern Europe and the former Soviet Union, recognize their own diversity of circumstances and capacities. Those that can have moved impressively to attract foreign investment, to open progressively their markets to competition, and to mine the benefits of export-led growth. Instead of focussing on the static redistribution of the current stock of global wealth, the emphasis has shifted in many instances toward establishing the conditions for active participation in the creation of new wealth. For Canada and others, this shift creates its own challenges. On the one hand, the new approach enhances both competitive pressures <u>and</u> the prospects for more balanced and creative economic partnerships. On the other hand, the diversity among developing countries and the economies in transition has become sharper, requiring greater policy flexibility in the responses of developed countries.

The next section will outline the main characteristics of two broad groups of developing countries that have emerged more clearly over the last decade. These two groups overlap to some degree. The categories presented in this Paper represent broad generalizations or "ideal" types, the boundaries of which begin to fray the closer one looks at individual, isolated details. Nonetheless, the generalizations help to capture a broad truth - many developing economies are well launched on a process of transition; others have not found the means nor the will to adapt. Each group requires a different response from Canadian foreign policy in light of the objectives set out in the federal government's policy Statement released in early 1995.[4]

[4] Canada in the World: Government Statement (Ottawa, February 1995).

Subsequently, the Paper will briefly review the broad types of Canadian economic cooperation programmes available and suggest the realignment of resources to create two consolidated funding mechanisms to address the different needs of and Canada's differing relations with each of the two Zones.

2. Diversity Defined

2.1 Zone 1 Countries

These countries most immediately come to mind in discussions on the "coming anarchy" thesis. Some observers view the troubled west African states as a microcosm of a condition taking hold throughout the developing world, typified by "the withering away of central governments, the rise of tribal and regional domains, the unchecked spread of disease, and the growing pervasiveness of war."[5] This badly misrepresents the dynamism and creativity now found in many developing countries, but it comes disturbingly close to the mark with regard to some LDCs, many of whom are located in sub Saharan Africa.

These countries are typically the very poor, as measured in per capita income. But more than that, their economies are stagnant. The World Bank has measured changes in GDP per capita over a recent 25 year period - 17 of the 20 worst performers were sub Saharan states. Even more critically, Zone 1 countries often suffer from insufficiently articulated political structures, feeble and inconsistent economic management and a narrow resource base. Political stability is often fragile and governments are frequently weak and, in some instances, simply dysfunctional (e.g., Somalia, Zaïre, Liberia, Rwanda, Cambodia). The observance of political and civil rights is disarticulated at the centre and under assault at the local level.

Rather than working actively to take advantage of the global economy, Zone 1 countries appear overwhelmed by it - small pebbles in a fast moving current. They are minor players on the world stage, with virtually no influence in international fora addressing trade, investment and financial issues. They are the archetypical "takers", rather than "setters" in international negotiations.

Zone 1 countries depend on foreign handouts, not capital markets. For example, in 1994 projected funding provided by OECD governments accounted for about 90% of net financial resource inflows to low-income developing countries

[5] Robert D. Kaplan, "The Coming Anarchy", in Atlantic Monthly (February 1994), p.46.

(excluding China and India); private flows have been negligible. Sub Saharan Africa received only about 1% of total private capital flows to developing countries during 1989-93.[6]

This striking hesitancy on the part of the foreign private sector will not change in the foreseeable future. These countries are also marginal participants in the world trading system. During 1980-90, the average annual growth rate of exports by value from the 45 least developed countries was zero, with average exports actually declining in the early 1990s.[7] None of these countries is among the world's top 50 exporters.[8] The average annual rate of export growth for Africa separately and as a whole was actually worse: a dismal -1.9% for 1980-92, and -3% during 1990-94. Africa's share of world merchandise exports (by value) fell by more than half to just 2.2% between 1980 and 1994.[9]

International commodity prices underlie part of the problem. For example, the terms of trade for sub Saharan Africa declined on average by almost 5% annually during the 1980s. But the vagaries of international commodity markets cannot shoulder all the blame for that region's poor export performance - the export prices of minerals and non-ferrous metals (excluding crude petroleum) in fact held up reasonably well over the 1982-1992 period as a whole, with the early 1990s and especially the late 1980s outperforming the first half of that decade.[10] Internal decay and incoherence were more critical to very weak economic performance.

[6] World Bank, **World Debt Tables 1994-95**, Vol.I, pp.8, 10, 24. The inability of Zone 1 countries to attract private capital is particularly striking as the share of private long-term flows to developing countries continues to increase, now accounting for about three-quarters of all flows to the LDCs. See **ibid.**, p.3.

[7] General Agreement on Tariffs and Trade (GATT), **International Trade 1993 - Statistics** (Geneva, 1993), p.6. 29 of these countries are sub Saharan. For a brief evaluation of the performance of the 45 least developed countries in the early 1990s, see GATT, **International Trade: Trends and Statistics - 1994** (Geneva, 1994), pp.5-6.

[8] Even with the European Union counted as a single entity. Moreover, none is included in the list of Canada's top 50 export markets.

[9] GATT, **Trade 1993**, p.28 and **Trade 1994**, p.44; WTO, **International Trade: Trends and Statistics - 1995** (Geneva, 1995), pp.6-7.

[10] GATT, **1993**, pp.28, 120 and **1994**, pp.55, 132. For example, copper prices started to climb in 1987 and remained reasonably strong through 1992, well ahead of the 1982-86 period. On terms of trade, see Berry and Frances, p.34.

In Zone 1 countries, the traditional concept of security is real (civil war of one form or another is occurring or threatening to occur in many of these states), but presents only part of the problem. The deeper issue is the failure of broadly defined "human security" which local institutions are singularly incapable of delivering consistently and effectively. For example, the UN Development Programme has constructed its Human Development Index (HDI) to attempt to define more adequately a broader concept of quality of life through socio-economic indicators that balance:

- life expectancy - representing a long and healthy life;
- educational attainment - representing knowledge empowerment; and
- real gross domestic product (in purchasing power parity dollars) - representing access to the resources needed to sustain a decent standard of living.

Zone 1 countries have the poorest HDI scores. For example, Costa Rica's HDI value is more than four times greater than that of Niger (which has the lowest HDI rank); Brazil (with the 20th highest HDI rank among developing countries) outscores Ethiopia (4th from the bottom in 1992) by a ratio of 3.5 to 1. Eighteen of the HDI's bottom twenty countries are African.[11] Discrepancies between male and female development opportunities are significantly larger in Zone 1 countries, with women lagging significantly behind men in schooling and equitable access to resources. Population growth rates are also considerably higher in Zone 1 countries, including in Africa.

A full listing of which countries should fit in Zone 1 must remain somewhat subjective due to changes that may occur over time and the different nature of the various indices that can be marshalled to provide guidance. But agreement on most of the appropriate candidates need not be complex. By way of example, all but three of the 50 countries which have the lowest HDI scores, with a total population of over 600 million, could be included in Zone 1.[12]

[11] United Nations Development Programme, **Human Development Report 1995** (New York: Oxford University Press, 1995), p.20.

[12] **Ibid.** The three exceptions are Pakistan, India and (perhaps) Nigeria, given their economic size, regional influence and greater internal state coherence and stability. None of these three is among the lowest 30 countries in the HDI index.

2.2 Zone 2 Countries

These countries' institutional structures and philosophy of society can vary considerably. They include both certain developing countries and the economies in transition in eastern Europe. But first, foremost and at the highest level of generality, these are countries that have passed a critical threshold of political and economic institutional viability. Although painful gaps in social and economic development may well remain and need to be addressed, such societies do not suffer from systems failure of the "coming anarchy" type.

These countries are reasonably "solid" in the sociological sense. Broadly speaking, they "work". Their institutions provide sufficient stability to sustain an environment in which longer term decision-making by the private and public sectors is taking place.

This does not mean that democratic rights are necessarily better entrenched in Zone 2 compared to Zone 1 countries. This is the most complex area about which to make meaningful comparisons. The respected non-governmental agency Freedom House has developed indices to assess political rights (e.g., free and fair elections, competitive parties, self-determination for minority groups) and civil liberties (e.g., freedoms of expression, assembly, demonstration, religion and association).[13] By and large, in the early 1990s, countries with Zone 1 characteristics score poorly, but there are a number of exceptions where democratic rights are better established despite enormous economic and social difficulties (e.g., Bangladesh, Benin, the Gambia, Zambia). On the other hand, and broadly speaking, Zone 2 countries currently score better (testimony to relatively well developed civil institutions). But again, exceptions exist, with several important countries judged to have a poor political and civil rights record (including China, Egypt and Indonesia). Thus, there is considerable correlation that favours Zone 2 countries, but important nuances are also present.

With regard to economic policies and institutions, Zone 2 countries clearly perform well. These countries are broadening and deepening their reliance on the marketplace as the fulcrum of economic development. The principal characteristics of this success include:

- A reasonably coherent and sustained commitment to sound fiscal and monetary policies.

[13] See Freedom House's **Freedom in the World: The Annual Survey of Political Rights and Civil Liberties.**

- The increasing importance of trade for these economies and, conversely, their growing impact on regional and world trade flows. For example, the top 30 exporters in world merchandise trade include China, Taiwan, Korea, Singapore, Mexico, Malaysia, Brazil, Thailand and Indonesia. Several have also made their mark as exporters of commercial services.[14]

- The evident capacity of many of these states to raise financing in international capital markets and to attract foreign direct investment, coupled with a relatively open regulatory régime for investment. For example, in 1993 private loans, foreign direct investment and portfolio equity investment accounted for more than 80% of net financial resource inflows to both Latin America and East Asia/Pacific.[15] During 1989-93, Latin America and East Asia/Pacific attracted 70% of all cumulative private capital flows to the LDCs.[16] For their part, Canadian companies have significant long-term direct investments in several Zone 2 countries, including Brazil, Chile, Argentina, Mexico, Singapore, Indonesia, Hong Kong and Malaysia.[17]

Many Zone 2 countries can also make a major contribution to shaping global environmental policy on issues of interest to Canada, such as:

- climate change - for example, China accounts for one-third of total carbon dioxide emissions from developing countries, a proportion that is

[14] GATT, 1994, pp.8-9. Moreover, 17 of Canada's top 30 export markets are Zone 2 countries: Korea, China, Taiwan, Mexico, Hong Kong, Brazil, Venezuela, Saudi Arabia, Indonesia, Thailand, Singapore, Iran, India, Algeria, Colombia, Malaysia and Chile (in descending order).

[15] World Bank, **World Debt 1993-94**, Vol. I, p.5.

[16] European and Central Asian transitional economies accounted for about another fifth. Put another way: "In 1989-93, Argentina, Brazil and Mexico accounted for about 40 percent of long-term bond financing flows (gross) to all developing countries. Similarly, more than half of portfolio equity flows to developing countries in 1989-93 went to three countries: Brazil, Mexico and the Republic of Korea. Five countries (Argentina, China, Malaysia, Mexico and Thailand) accounted for more than half of total FDI flows to all developing countries in 1989-93." See World Bank, **Debt Tables 1994-95**, Vol. I, pp.9-10. Note that in the case of China, part of the FDI comprises PRC capital channelled indirectly into investments in the PRC itself through Hong Kong in order to benefit from the more favourable treatment afforded "foreign" investment in China. This is the so-called "round-tripping" phenomenon.

[17] Policy Staff (CPE), Economic and Trade Statistics Mini Database, No.7 (October 1995), Table 15.

increasing; in 1991, China, Brazil, India and Indonesia alone emitted almost 20% of global greenhouse gases;[18]

- international forestry issues, especially with regard to the developing countries with the greatest expanse of forests and thus the greatest impact on and stake in negotiated outcomes - including Brazil (by far the most important in this regard), followed by China, Indonesia, Peru, India, Bolivia, Colombia and Mexico;[19]

- fisheries conservation issues - for example, several Latin American countries have been active players in the development of international fisheries régimes because of important fisheries production.

Moreover, several Zone 2 countries wield considerable influence in their respective regions. Sustained economic growth in these countries holds out the promise of creating regional development poles that can benefit neighbouring, less dynamic economies. More broadly, Zone 2 countries exercise a powerful demonstration effect on their neighbours with regard to security, good governance and economic policies. They are countries that "matter" in the sense that they can make an important contribution to resolving problems of interest to the international community or they can make the search for solutions noticeably more difficult.

One of the defining characteristics of Canadian foreign policy is its focus on international rule-making. Canada's security and prosperity are inextricably connected with the health of the international system, including the predictability of inter-state behaviour. One essential technique for working toward a secure environment abroad has been to focus on the elaboration of international institutions underpinned by a gradually more complex and effective network of rules governing relations among nations and between governments and their citizens. This network addresses (with varying degrees of success and completeness) issues ranging from conflict resolution at the state level to respect for fundamental human rights to trade and investment relations and environmental sustainability.

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[18] World Resource Institute, World Resources 1994/95.

[19] Three Zone 1 African countries also have extensive forests - Zaïre, Angola and the Sudan - but their domestic economic and political dysfunctionalism greatly limits their international presence and makes effective large-scale collaboration on internal reforestation/conservation impossible as a practical matter.

Of course, not all state players are equal. For most of the post World War II period, the basically bipolar threat of nuclear mass destruction coupled with a massive, technologically sophisticated "conventional" military capability provided the U.S. and the Soviet Union with inordinate influence on the pace and direction of the construction of the international system. Although more than occasionally obscured by the complications of super-power geopolitical rivalry, a similar pattern emerged with regard to the international trade and payments system. In this respect, the increasing competitiveness of the European Union and Japan has transformed the U.S.'s post War dominance into a somewhat more balanced Triad of economic interests (especially evident since the collapse of the Soviet Union). Recognition of this reality does not mean that there are no disagreements among Triad members on specific issues. Quite the contrary can and does occur, the continuing controversy over agricultural subsidy reform being just one case in point. Nonetheless, the U.S., the EU and Japan do share one fundamental characteristic: more than smaller powers, they more than occasionally view international rules as mere guidelines to facilitate the political mediation of inter-state differences rather than as an evolving body of binding rights and obligations to be considered increasingly as the external equivalent of domestic law requiring acceptance and entailing enforcement.

In a context of evolving and increasingly comprehensive, international economic rule-making, the ever-present domestic pressures in the Triad to act unilaterally and to preserve domestic administrative "flexibility", and the lessening but still palpable hesitancy of some developing countries to deepen significantly their adherence to binding instruments, Canada has by and large championed the continued broadening and deepening of a rules-based international system.

This orientation entails nothing less than the building of Canadian sovereignty. International rules also discipline Canadian practices. But no (or ambiguous) rules simply expose us to the prospect of arbitrary unilateralism from those with greater economic clout. Without binding rules, Canada retains the formal right to exercise the same degree of arbitrariness against others. Nonetheless, in the real world this right provides faint cover for the smaller economy - new rules limiting the use of financial incentives to attract investment would limit a traditional Canadian practice, but what benefit is there in that practice if the U.S. and the EU (with deeper pockets) simply outbid us, obscuring the merits of what might otherwise be a competitive Canadian location? Canadians are rightly concerned about certain environmentally unsound practices in, for example, Brazil and China. We might be tempted to pull economic levers available to us to register our unhappiness (GPT eligibility?; the increasingly active use of our trade remedy régime against imports from China?) were it not for the encouragement that such action would provide to U.S. unilateralism vis-à-vis Canadian practices (e.g., in the forestry sector).

The fact is that we live in an increasingly interdependent world facing rapidly growing trade in goods and services, more foot-loose capital flows, many additional competitors for market share and quality investments, and ever more pressing concerns related to the environment and population growth and movements. An increasing number of policies heretofore considered to be primarily domestic in nature are subject to international scrutiny. Evolving international practices will have an impact on Canada. The only real question is whether Canada can ensure that it will have an important role in shaping the rules to reflect Canadian priorities and sensitivities and in ensuring that rules are transparent, unambiguous and enforceable so as to limit the capacity of the economic super-powers and others to act unilaterally.

In this multilayered process, there are issues with regard to which close collaboration with one or more of the Triad economies might well be appropriate (e.g., further multilateral action aimed at limiting greenhouse gas emissions, including in such major players as China; or cooperation to open financial services markets in ASEAN countries or to strengthen international investment-related disciplines on government actions that are otherwise trade and investment distorting).

On the other hand, many Zone 2 countries share Canadian concerns about Triad unilateralism and at least partially share our objective of developing clear, transparent and binding rules. Such countries are often active players who "count" in the international arena. Collaboration with these partners on an issue-specific basis can be potentially helpful with regard to such matters as the development of an appropriately balanced international forestry convention or further reform of trade-distorting agricultural practices. The work of the Cairns Group on agricultural issues during the Uruguay Round[20] is illustrative of the potential for influencing international rule-making that we could explore further on this and many other matters.[21]

Frankly speaking, we need to facilitate such collaboration through a holistic marshalling of the various economic instruments of Canadian foreign policy to reinforce the concept and practice of creative economic partnerships. The most likely non-traditional partners are found among Zone 2 countries. And they are most likely

[20] The Cairns Group comprised Colombia, Brazil, Argentina, Uruguay, Chile, Thailand, Indonesia, Malaysia and the Philippines, as well as Canada, Australia and New Zealand.

[21] Such issues also include trade and the environment in the World Trade Organization, high seas fisheries conservation, further reform of antidumping practices, the use of trade sanctions to pursue social policy harmonization objectives related to environmental and labour practices, certain provisions of U.S. trade law enshrining unilateralism (e.g., Section 301).

to take Canada seriously, as a "full-scope" partner, if we take a comprehensive approach to our economic relations.

3. The Diversity of Responses

Broadly speaking, Canada's objectives with respect to Zone 1 countries and the very poor in Zone 2 reflect the desire of Canadians to help the less fortunate and Canadians' strong sense of social justice. With respect to Zone 2, the focus more generally is on our interest in promoting prosperity and employment underpinned by the growing need to protect the environment.[22] By tackling key threats to human security such as the grass-roots abuse of human rights, disease and population growth in Zone 1 countries and by working with Zone 2 countries to promote prosperity objectives and environmental cooperation, Canada can contribute to overall global security. The fact is that Canada can draw on a wide range of possible programmes and measures in order to achieve our objectives in light of the quite different challenges presented by Zone 1 and Zone 2 countries.

These possible responses include tools such as:

(a) Grants to Canadian NGOs for activity with a focus on direct, basic human development and the strengthening of structures that underpin political and civil rights at the grass-roots in cooperation with local counterpart organizations.

(b) The Canada Fund managed by Canadian Heads of Mission to provide seed-funding to local NGOs in their countries of accreditation to encourage grass-roots development among the poorest.

(c) Emergency relief, including food aid.

(d) Government-to-government assistance programmes both bilateral and indirectly through multilateral financial institutions that cover the most fundamental components of development consistent with Canadian values, including particularly basic human needs activities where appropriate (e.g., primary education; basic preventive health care - including family planning and particularly in rural areas; greater food self-

[22] These objectives are developed more fully in **Canada in the World**.

sufficiency through a stronger rural development focus), and improved local-level civil and political practices.

(e) Bilateral institutional partnerships with the focus on higher level technical cooperation between private and semi-public institutions and agencies in donor and recipient countries.

(f) Government-to-government programmes, including indirectly through multilateral financial institutions, with greater focus on environmental partnerships with a global commons impact (e.g., forestry management); and technical assistance aimed at encouraging the further development of an already relatively stable and sophisticated governance structure toward the next stage required for sustained development in a global economy (e.g., improvements with regard to environmental standards and enforcement techniques, corporate governance law and regulations, consumer protection standards and systems, taxation systems, transparent government procurement bidding practices, effective trade policy management).

(g) International business development cooperation between the private sectors of Canada and the partnership country with a semi-concessional seed financing component.

(h) Foreign Investment Protection Agreements (FIPAs) and bilateral double taxation agreements with developing countries where Canadians have a significant investment stake.

(i) The negotiation of comprehensive trade and investment agreements between Canada and the most advanced developing countries, as was done with Mexico in the NAFTA context.[23]

When analyzing how and where these various mechanisms might best be deployed, it will be essential to recall that needs greatly outstrip our resources. Any generic matching of mechanisms with groups of countries will not release policy makers from having to make choices. Needless to say, we must endeavour to choose carefully. In this regard, we should focus on countries and programmes where

[23] This component could take the form of accessions to the NAFTA (e.g., Chile) or through regional efforts, such as the proposals for a Free Trade Area of the Americas and APEC-sponsored free trade in the Asia Pacific region. For additional information and considerations on these activities, see Keith H. Christie, **The Four Amigos and Beyond: Towards the Free Trade Area of the Americas**, Policy Staff Paper No.95/10 (October 1995).

Canada can make a real difference and where economic partnerships will most effectively reinforce Canadian foreign policy objectives. Consequently, the final section of this Paper takes the present analysis one necessary step further by tentatively matching the programmes and measures identified in the previous paragraph with each of the two Zones identified in this Paper.

4. Adapting To Diversity

The range of responses available as well as the radically different needs and challenges that different developing countries and the economies in transition present for Canadian foreign policy suggest that we need to take stock continuously and to refocus our institutional arrangements accordingly.

In recent years, there has been an active debate in the OECD's Development Committee (DAC) with regard to which countries should remain on the eligibility list for the purpose of calculating official overseas development assistance. This discussion has led to the recognition that (a) some nations have clearly moved well beyond the condition of "poor" countries, while others are not far behind; and (b) many, although not all countries of the Former Soviet Union and central and eastern Europe have characteristics of the more advanced LDCs in Zone 2 while others reside in Zone 1.

Canada's foreign policy objectives of promoting prosperity, strengthening global security and projecting Canadian values and culture naturally enough combine in different ways with regard to Zone 1 and Zone 2 countries respectively. Before outlining our views on how the various tools presented in section 3 might be most effectively targetted as between the two Zones, we note that there are two "universal" tools that address poverty and Canadian interests generally while providing excellent value in making Canada a global player and projecting a positive image of this country and its citizens: the work of Canadian non-governmental organizations and the Canada Fund.

First, poverty, often desperate poverty, exists in all developing countries. There remain significant pockets of despair even in Zone 2 countries such as Brazil, Mexico, Indonesia and India. Well into the foreseeable future, and despite relative and heartening progress, there clearly will remain a role for direct grass-roots activity to alleviate basic human needs and to strengthen local-level civil and political practices in both Zone 1 and Zone 2, i.e., the fundamental underpinnings of democracy and the creation of respect for human rights. This is a role consistent with Canadian values that can most effectively be undertaken by Canada's non-governmental community, with CIDA continuing to co-finance such work regardless of the country in which it may occur (instrument (a) above).

Second, the Canada Fund, financed by CIDA, has proven to be a remarkably flexible and speedy means to address a wide range of grass-roots needs and Canadian interests (instrument (b) above). It delivers a solid local development impact. It is an excellent "flag-raiser" and satisfies a desire for a global presence.

Third, the Zone 1 countries are in a desperate state and require a focussed government-to-government commitment from donors. Their economies are by-and-large stagnant and political and economic management is weak to dysfunctional. Their ability to attract financial resources from the private sector is poor. Inevitably and regretfully, this will result in a need for emergency relief to cope with crises, man-made and natural ((c) above). But it is also essential to tackle longer term development needs. Such engagement seeks to avert the political and economic catastrophes that lead to much greater expenditures in emergency relief, peacekeeping and rehabilitation and reconstruction, and to lay the framework for future development. This must be undertaken in full recognition of the institutional and resource incapacities of such countries to sustain development efforts on their own and of Canada's financial resource restraints. Canada has the largest number of recipients of any DAC donor. To assist most effectively, CIDA should focus its mandate to concentrate even more sharply on a limited number of Zone 1 countries, and primarily on basic human needs development and on strengthened grass-roots civil and political practices needed to underpin our development assistance investments ((d) above). Since poverty is widespread, the number of potential recipient countries large and fiscal resources diminished, 10 to 15 countries might be selected. The substantial challenge clearly calls for a concerted and coordinated multilateral and bilateral donor effort. Bilateral interventions would supplement the greater efforts of the multilateral financial institutions.[24] This approach would strengthen CIDA's expertise (it would no longer have to try to be all things to all people) and should simplify and likely reduce administrative overhead. This re-focussed CIDA would continue to report to the Minister of Foreign Affairs.[25]

[24] Some institutional and private sector partnership activity bilaterally may also occasionally be useful and could also be encouraged indirectly through the programmes of multilateral financial institutions including the World Bank and the regional development banks. But such cooperation should not be the central focus of assistance to Zone 1 countries.

[25] This approach would be consistent with one central theme in the Government's 1995 Statement on Canada's foreign policy, with its emphasis on poverty reduction and low-income countries (with Africa continuing to receive the "highest share of resources in keeping with the immense challenges facing that

Fourth, at present the Canadian economic instruments aimed at Zone 2 countries are diverse and their management is fragmented. Steps have been taken to give more geographic and sectoral focus to CIDA's industrial cooperation programme and to coordinate several other instruments somewhat better. Greater coordination is also being sought for the international business development programmes of the federal and provincial governments. In an era of unrelenting fiscal restraint and to ensure greater policy coherence and the fuller marshalling of government-wide resources, it is for consideration whether to take one step further and establish a new economic and environmental cooperation mechanism to manage enhanced and more strategic partnerships with priority Zone 2 countries.

This co-operation mechanism could focus primarily on the institutional, government-to-government and private sector programmes outlined above in (e) through (g). It could consolidate in one location funding now provided through CIDA (industrial cooperation; some "institutions" financing; part of the current bilateral programmes), Foreign Affairs and International Trade (e.g., the major share of the Department's export promotion funding, with its new focus on small and medium sized enterprises and non-traditional markets), Canada Account concessional funding available through the Export Development Corporation, Canadian Wheat Board credits and part of the export financing provided through other government Departments. The new mechanism would focus on countries with good potential for economic partnerships with Canada, on key players on global environmental issues of interest to Canada, and/or on regional powers which could affect Canada's economic security. For selected Zone 2 countries, the activity supported under this mechanism could be reinforced through the negotiation of bilateral investment protection and taxation agreements, as well as a more comprehensive trade and investment framework on a case-by-case basis ((h) and (i) above).

Finally, it is also for discussion whether this new mechanism should report to an inter-departmental committee co-chaired by the Minister of Foreign Affairs and the Minister for International Trade to ensure maximum coherence in the management of Canada's foreign policy, especially in light of the much more extensive nature of Canada's relations with Zone 2 countries. The mechanism could be located within a single government department or it could have independent agency status (e.g., as a crown corporation with Board membership drawn from selected Government departments).

continent"), and the importance of focussing Canada's bilateral ODA efforts on a limited number of countries. See Canada in the World, pp.40-7. The approach suggested in this Paper, however, would result in further movement toward sharpening CIDA's mandate.

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