Canada’s “Missing” Trade With Asia
EXECUTIVE SUMMARY

Canada’s “Missing” Trade With Asia

At a Glance

- Conventional trade data fail to adequately capture globalized production and are misleading.
- To address the gap, this report estimates the amount of Canada-Asia trade that is overlooked or “missing.”
- With “missing” trade included, Canada has a much more sizable economic relationship with Asia than official data capture.
- But the trends are not encouraging: Canada underperforms by even more than official data suggest in key areas, particularly services sales to Asia.

Trade statistics can be quite misleading. Every US$300 Apple iPod adds $150 to the official U.S. imports from China, but only $3 of its value is actually created in China. About $147 is created in the rest of Asia, and another $149 in the United States. This is one example of the major gap between official data and analysis and complex globally integrated realities.

This paper promotes the use of relevant language and metrics to describe these realities. Instead of using conventional trade statistics and analysis, the Conference Board of Canada takes a fresh approach. Taking Canada’s trade with rapidly growing Asia, the Board first evaluates what is “missing” from current statistics and analysis. For example, official statistics significantly under-represent the role of services trade and Canadian goods exports to Asia. The undercount is more pronounced for trade with Asia relative to trade with the United States. Also, public discussions and most analyses ignore foreign affiliate sales. While not a new phenomenon, such sales by affiliates abroad have become an increasingly important method for selling to foreign markets, especially the more geographically distant ones. And when China assembles goods with parts from the rest of Asia, official statistics—and the related political debate—“miss” imports from the rest of Asia and overstate imports from China.

A major gap exists between official data and analysis and complex globally integrated realities.

With these data problems in mind, the Board estimates the magnitudes of “missing” trade—and how those magnitudes change over time. The estimates include adjustments for undercounting and the share of foreign affiliate sales. The estimates are generally conservative. This report presents the results on charts and maps to reflect the relationships between sales and purchases and to give readers a sense of relative magnitudes.

The results reveal a different portrait from the one official data show. With “missing” trade included, total Canadian sales to and purchases from Asia are at least
double conventional trade figures. Yet despite this larger overall magnitude, Canadian services sales to Asia declined over 2000–05, a worse result than conventional statistics reveal. Moreover, Canada does not appear to be tightly linked into Asian supply chains: we import predominantly final goods and export mostly raw materials. Finally, though official statistics and most analyses conclude that goods trade is much larger than services trade, Canadian services purchases from Asia were larger than Canadian goods sales to Asia in 2005 when we include “missing” trade.

The information gap that this paper demonstrates between current statistics and globally integrated realities could seriously undermine sound policy development. To close this information gap, governments, businesses, academics, and the media should promote the use of relevant language and metrics for international trade. Relative magnitudes and trends are more important than perfect measures for decision making. Proportionate to official measures, more services trade is “missing” than goods trade. Therefore, governments should shift data and analytical efforts toward the timely measurement of services trade. They should also highlight the role of foreign affiliate sales in discussions of trade, and make the public aware of trade undercounts—many of which are known and quite material.

The gap between current statistics and globally integrated realities could undermine sound policy development.

Business and government leaders should marshal attention to Canada’s services sales underperformance, as well as to our overall trade underperformance in Asia. Policy-makers need to pursue market access and domestic policies that promote flexibility and competition to optimize Canadian firms’ chances of taking advantage of global supply chain opportunities.
Introduction

Chapter Summary

- Trade statistics can be very misleading: Every Apple iPod adds $150 to the U.S. trade deficit with China; only $3 of its value is actually created in China.
- There is a major gap between official data and analysis and business realities.
- Trade statistics dramatically under-represent Canada’s actual sales and purchases from Asia.
- This report presents maps and charts that give a sense of the relative magnitudes of Canada’s overlooked trade with Asia, with the aim of providing a broader picture of Canada’s business activities with Asia.

TRADE STATISTICS CAN MISLEAD

When an iPod assembled in China enters the United States, U.S. customs records half of its value as a U.S. import from China. This appears to boost the U.S. trade deficit with China—and adds to the political backlash in the United States against that country.

Several California researchers took apart an iPod to determine the value of each component or service input to the product at each place where that value was actually created. They found a much different story from the one official trade figures tell.1 (See Chart 1.) Their work shows that the Chinese account for only 1 per cent of the iPod’s value. The other 49 per cent mistakenly attributed to China should be attributed to other countries in Asia. This reflects the high degree of joint production in Asia, often with only final assembly done in China. Moreover, public outcries against offshoring of production overshadow the researchers’ other finding—the remaining half of the iPod’s value is created in California.

Chart 1
The Apple iPod: Where Is Value Actually Created? (approximate iPod value; share, per cent)

<table>
<thead>
<tr>
<th>Component</th>
<th>Value</th>
<th>Share, Per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>$3</td>
<td>1%</td>
</tr>
<tr>
<td>Rest of Asia</td>
<td>$147</td>
<td>49%</td>
</tr>
<tr>
<td>U.S.</td>
<td>$148</td>
<td>50%</td>
</tr>
<tr>
<td>Total</td>
<td>$299</td>
<td>100%</td>
</tr>
</tbody>
</table>

Sources: The Conference Board of Canada; Linden et al., 2007.

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The iPod case is just one example of how the trade statistics that governments, media, and businesses use daily can mislead or misdirect our policy and public discussions. Conventional statistics miss the richness and complexity of global economic linkages. This paper is a first step toward revealing this richness and assessing Canada’s overlooked—what we call “missing”—trade.

**The use of foreign affiliates has accelerated rapidly. Rather than supplanting trade, foreign direct investment is a key enabler of trade.**

Our enhanced measures of Canada’s global business activity represent a creative attempt to capture the complexity behind global products and services, such as the iPod.

**GLOBAL INTEGRATION HAS ACCELERATED**

The iPod is not an isolated example of a product made with inputs from different parts of the world. A growing body of evidence shows that companies are accelerating their use of global and regional supply chains, or “integrative” trade. Instead of asking where to create an entire product or service, businesses now ask where is the best place to locate each specific activity—such as design, engineering, manufacturing, marketing, and aftersales service. Companies can maximize efficiencies and reap gains from trade for every activity along a supply chain, rather than for the good or service as a whole.

And activities that Canadian companies carry out elsewhere to create products and services make them more efficient and better able to compete globally. China, India, and other large, lower-wage developing economies are now conducting activities that are part of global supply chains, tightly integrated with activities in the United States and other richer economies. These changes have important consequences for Canadian living standards, public policies, and business strategies, as competition for each part of the process to make a product or deliver a service intensifies at a dramatic pace.

Companies also increasingly trade in non-traditional ways. For example, rather than shipping a good across a border, iTunes sells music downloads online. As well, Canadian insurance companies set up branches abroad and sell through those branches, but they do their risk analysis through computing systems in Canada. A large and growing share of trade takes place through foreign affiliates, rather than through traditional cross-border channels. Though not a new phenomenon, the use of foreign affiliates has accelerated rapidly in recent years. Rather than supplanting trade, foreign direct investment is a key enabler of trade. (The Organisation for Economic Co-operation and Development [OECD] estimates that each $1 of outward direct investment generates $2 of additional exports for the originating country.)

**THERE IS AN INFORMATION GAP**

Unfortunately, there is a major gap between these realities and the data and language that we use to describe such activities and that form the basis for government and business decisions. Official statistics and traditional analytical tools were not designed to capture today’s globally integrated activity. Current tools greatly under-represent the complexity and richness of global linkages.

Current official statistics are largely set up along industry and country lines, rather than in a way that can represent activities taking place around the globe to create a product or service. This is because all countries designed their statistical systems to measure everything within their nation, to build measures of gross domestic product and national accounts. These are important for a variety of policy and research purposes, but they are inadequate for assessing the way in which a country’s economy is linked to the world’s.

Trade statistics in the current system describe one-time, bilateral transactions that are not linked to other transactions. In reality, trade takes place between multiple partners, and at different stages of an overall process. Moreover, the way trade data are classified focuses almost entirely on goods trade, despite the greater role—and

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the greater potential role—of services. (See box “Why Goods Get All the Attention: The Tariff and Quota Legacy.”) And, as the iPod example illustrates, trade statistics fail to capture where value is actually created.

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**Public discourse and analysis is usually narrowly focused on goods exports as a measure of trade success.**

There is also compelling evidence that the Canadian trade statistics systematically understate trade to non-U.S. destinations. This is true for both goods exports and services trade. It is even more so for Canada’s non-traditional trade partners, such as India and China. The statistics likely also understate two-way Canadian foreign direct investment with Asia. In addition, official sources provide only limited and highly aggregated information on sales conducted by Canadian affiliates abroad, and they provide no direct information on sales conducted by foreign affiliates in Canada.

Moreover, public discourse and analysis is usually narrowly focused on goods exports as a measure of trade success. Discussions often ignore the role that services trade, sales by Canadian affiliates abroad or foreign affiliates in Canada, and imports play in Canada’s prosperity and ability to compete in global markets. Most analyses treat all trade as if it consisted entirely of final products, when much trade is in parts or service inputs. For example, a November 2007 Statistics Canada special report on Canada–China trade focuses strictly on goods trade, devotes four times as much space to exports as to imports, and does not mention services trade, foreign affiliate sales, or the relationship between exports and imports. A December 2007 Statistics Canada report on Canada’s trade with China also focuses strictly on goods trade. That report, however, takes a step in the right direction by examining exports and imports within the same product categories to evaluate the degree of integrated trade between the two countries.

Moreover, mercantilist views—that exports are good and imports bad for Canada—are still common among policymakers and the general population. But today, imports are integral to domestic production and exporting. All of this suggests that we must fundamentally shift the way we collect, interpret, and discuss trade statistics. This paper suggests one approach to spark the debate.

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**Why Goods Get All the Attention: The Tariff and Quota Legacy**

Canada requires importers of woven fibres to declare in which of over 100 statistical categories their fibres fall. Why? Because of a quota agreement that no longer exists. These categories are a holdover from another era—one in which tariffs and quotas tightly governed the world trading system and Canada used them extensively as instruments of industrial policy. In fact, Canada’s—and its peers’—statistical systems were developed to facilitate tariff collection and count quotas for goods.

In addition to the tariff and quota imperative, analysts have traditionally assumed that services were not tradable. As well, services are more difficult to measure than goods. The result is that Canada has 8,000 categories to classify goods trade, and a mere 28 for services trade. (The United States’ situation is even worse, with 16,000 for goods versus 17 for services.) The imbalance grows when we consider goods imports specifically. According to Statistics Canada, Canada has over 19,000 categories for goods imports—of which one-quarter are inactive. (The European Union, by comparison, has 9,500, and Japan has 11,500 goods import categories.)

But times have changed. Tariffs are no longer a key instrument of Canadian industrial policy. They are also inadvisable, given that imported inputs enable Canadian companies to better compete globally. Also, tariffs are no longer an important Canadian revenue source.

Perhaps more importantly, services make up the dominant portion of the economy. Services now account for about 75 per cent of economic activity in Canada. Though the services’ share of trade is still less important than the goods’ share, that is changing rapidly. Many services can now be traded globally. Digitization and declines in communication costs make it both more attractive and technologically possible to trade services with more geographically distant markets. Tradable services represent high-value activities and are a critical area for potential economic growth.

Therefore, the historical weighting of attention toward classifying and measuring goods trade no longer makes sense—if it ever did.

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4 Some government documents—for example, the Department of Foreign Affairs and International Trade’s Canada’s State of Trade 2007—are starting to show a broader range of measures, but it is not yet the norm in most policy and public discourse.


6 Khondaker, Canada’s Trade with China, pp. 1–7.
ADDRESSING THE GAP: FINDING CANADA'S "MISSING" TRADE

Good data are the foundation for effective policies. Therefore, we must develop tools that fix these information gaps and capture the complexity and richness of global linkages. However, this will not be easy. Governments and researchers in Canada and other countries are grappling with the challenge of how to better measure these realities and assess their implications.

A few efforts are under way to fill this information gap. The Conference Board’s International Trade and Investment Centre recently examined Canada’s changing role in global supply chains by looking at trade in a non-traditional but more realistic way: from the buyer’s supply chain perspective. Some U.S. academics have established new frameworks for thinking about the most relevant types of data to collect, given the new realities. As well, our federal government is conducting a feasibility study to collect trade data on the basis of supply chain activities—rather than current industry-specific data. And the federal government is also working on a number of case studies of industry-specific “global value chains.”

This report’s contribution is to present visually a broader picture of Canada’s trade based on available data.

It will take many years, however, before statisticians make major changes to the way they measure official trade. In the interim, leaders will need to make many decisions. This report’s contribution is to present visually a broader picture of Canada’s trade based on available data. We start with available trade figures and add to each a conservative estimate of what traditional analyses overlook. We base our estimates on reasonable assumptions and other data sources. The resulting maps display the “missing” trade and provide a more complete picture of Canada’s trade.

This report measures Canada–Asia trade, leaving other regions for future research. We focus on Asia for several reasons:

- There has been considerable recent public interest in Asia.
- Official statistics suggest that Canada’s economic activity with that region has been growing rapidly.
- Asia offers unprecedented growth opportunities for Canada’s services and goods trade.
- That region is playing a dominant role in driving global competitive pressures.
- Canada is most likely missing or overlooking even more trade with Asia than with its traditional partners, such as the United States, for reasons we explore in more depth later.

We do not aim to create perfect measures. Our measures are estimates that do not fully capture the richness and complexity of Canada–Asia linkages. Rather, we hope to raise awareness of the relative importance of trade that is traditionally overlooked. Our goal is that these measures will promote a more informed discussion on Canada’s international trade and investment performance and strategies. This is a first step toward obtaining a complete picture of Canada’s international business activities.

The following chapters highlight important weaknesses of conventional statistics for both services and goods. Those weaknesses provide a basis for estimating—conservatively—what may be “missing” or overlooked in traditional statistics. Maps show these new trade measures for Canada–Asia activity. The paper then highlights the implications of the new measures and recommends improvements to current methods for gathering and interpreting data to inform better decision making.

7 Goldfarb and Beckman, Canada’s Changing Role in Global Supply Chains, pp. 1–36.
8 See Sturgeon and Gereffi, The Challenge of Global Value Chains, for example.