

# The (New) Geography of International Trade and Investment: Exploring the extent to which ‘distance’ matters in the establishment of economic relations between Canada and the UK

## About the project

It is a widely held view among economics and business scholars that regional trade agreements, such as the North American Free Trade Agreement (NAFTA), and the European Union have provided benefits to member countries, including Canada and the United Kingdom. These might be threatened by the newly renegotiated United States-Mexico-Canada Agreement and by Brexit. Both Canada and the UK are interested in trying to diversify their trade and foreign direct investment partners to include more distant countries. In response to such concerns, this knowledge synthesis project explores the impact of distance on trade and investment by reviewing relevant literature from economics, economic geography and international business.

## Key findings

- Both Canada and the UK trade primarily with, and invest in, nearby partner countries. While the effect appears to be declining slightly, there is little empirical evidence from gravity models, which are used to estimate the amount of interaction between the two countries, that the impact of geographic distance on trade in goods has fundamentally changed over time. Therefore, geographic distance remains a deterrent to trade, and the current relatively low percentage of trade between Canada and the UK will be difficult to change.
- Geographic distance matters less for trade in services than for trade in goods. The economies of both Canada and the UK are services-driven but the UK's ratio of goods/services exports is around 1.2 while that of Canada is nearly five to one. The gravity model suggests that Canada is under-trading with the UK in terms of services. This suggests Canada has considerable scope for diversifying export around services.
- Trade in services is more complex than trade in goods because it often involves combining movements of knowledge, people and capital (cross-border transactions, transportation services, tourism, local offices providing banking, insurance, communications services, and the short-run movement of service workers). Trade in services, while less sensitive to geographic distance, is more sensitive to other differences in national characteristics, such as administrative, cultural and economic (CAGE)

differences. In some dimensions, this favours UK-Canada trade diversification, while in others it might hinder.

- Trade in services is concentrated in a relatively small number of city regions, sometimes referred to as 'global cities.' Such areas can minimize some of the costs of doing business abroad by providing a strong supporting physical and knowledge infrastructure. These benefits have become increasingly important, as global value chains become dispersed around the world. The economies of both Canada and the UK are concentrated in a relatively small number of cities, which provide the basis for enhanced trade in services between the two.
- The relationship between innovation and trade diversification has not yet been explored fully, and we suggest that more research on this topic is warranted. ■

### Policy implications

Our analysis suggests a clear focus on trade in services, and that the agreement should achieve a breadth and depth of coverage that both includes new industries and minimizes the exemptions provided to older ones. Given the importance of cities, it is essential to consider ways to include them in the crafting of these agreements.

- Both countries could profitably explore alternative and complementary approaches to increasing trade in services. These could include mechanisms ranging from multilateral regulatory cooperation agreements to bilateral cooperative agreements between cities. In particular, we suggest that greater attention be paid to the roles of investment and trade promotion agencies, notably at the subnational level, and their potential role in creating trade and investment linkages across a network of cities and city-regions. Similarly, export and investment promotion agencies could collect and disseminate information regarding the CAGE distance across countries and between cities.

- Both countries might explore the potential for facilitating trade in services through the promotion of innovation and cluster development in cities, and the creation of the relevant infrastructure to support linkages between global and peripheral cities. ■

### FURTHER INFORMATION

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