Canadian Journal of Regional Science Special Issue on North American Trade and Investment

William P. Anderson
Department of Geography
Centre for Transportation Studies
Boston University
Boston, MA 02215

The North American Free Trade Agreement (NAFTA), which went into effect January 1, 1994, represents the culmination of one long process and the beginning of another. It is the culmination of a process of trade liberalization between Canada and the United States that has been ongoing for decades. Building upon its recent predecessor, the Canada-US Free Trade Agreement (FTA), NAFTA provides the general framework that will shape the already strong economic relationship between those two countries well into the new century. This does not mean that "free trade" between the US and Canada is a current reality, but rather that the ground rules are more clearly defined than ever before.

For Mexico, NAFTA represents the beginning of a process of economic integration with its two high-income neighbours to the North. Aside from special arrangements that allowed integration of Mexican labour into US manufacturing systems under the "Maquiladora" system, there had been little in the way of bilateral trade agreement between Mexico and either the US or Canada. This process will have to overcome significant (and legitimate) public fears in all three countries. In Canada and the US, there is the fear that the huge resource of low-cost Mexican labour will undermine the already precarious position of workers at the lower end of the skills spectrum. In Mexico, there is the fear that integration with the more economically powerful northern countries (especially the US) will lead to a loss of autonomy and a cementing of peripheral economic status.

These fears are overcome by growing perception that in a world where the economic significance of national frontiers is declining, isolationist economic policies provide a sure path to stagnation. Through participation in a regional trading block a country can embrace liberal trade and investment policies within an institution in which it has a strong voice. Also, NAFTA is a potent symbol. For Canada, NAFTA and FTA represent an acknowledgement that Canada's economic future is inexorably tied to that of the U.S -- a notion that earlier Canadian governments had resisted. For Mexico and the US, NAFTA is an opportunity to turn the page on a rather ugly history that had effectively precluded comprehensive economic cooperation.

This special issue of *CJRS* presents six papers that address different aspects of international trade and investment in North America. It is not, in a strict sense, a special issue "on NAFTA" as the papers address economic processes that predate NAFTA and a number of issues that were neither created nor resolved by NAFTA. The scope of the papers is limited to the NAFTA area, however, and in many cases the authors ask the question "What difference has NAFTA made so far?" In keeping with the perspective of Regional Science, different levels of spatial resolution are employed -- the international, national, regional and local. Also, in keeping with the multidisciplinary nature of Regional Science, the papers transcend simple economic analysis to integrate institutional and social processes that affect and are affected by economic integration.

It has become popular to discuss NAFTA, and trade liberalization in general, as having "winners and losers." Some people, places, firms, and institutions benefit from access to broader markets, cheaper inputs, and international sources of capital, while others lose because of foreign competition and the elimination of a range of subsidies. Entering into trade liberalization arrangements is justified by the argument that the total gains to the "winners" exceed the total losses to the "losers."

This is a static and perhaps a simplistic view. Freer movements of goods and capital present a new set of challenges and opportunities to everyone involved. It may be easy to pick out the winners and losers in the short run, but in the long run the winners will be those who adapt most successfully to the changing economic, institutional, and social environment. Furthermore, NAFTA doesn't create a new environment so much as set in place mechanisms for dispute resolution, policy harmonization and border procedure. The way the new environment evolves -- and the speed at which it evolves -- will depend on how the three national partners make use of those mechanisms.

The papers in this special issue are united by their attention to the complexities of the new institutional environment and by the role of various players in business and at various levels of government in shaping it. Most importantly, they all view North American economic integration as a process rather than an event.

Background

Trade relations have been at the center of US -- Canada relations for well over one hundred years. During the 1850's and 1860's there was a period of relatively free trade under the Reciprocity Treaty of 1954. But ill feelings following the US Civil War (in which some US politicians perceived Britain to have favoured the South) led to the abrogation of that treaty by the US and a period of flux in trade relations. It was Canada, however, that instituted a policy of tariff protection under the National Policy of 1979, initiating a period of restricted trade and placing US -- Canada trade policy at the centre of Canadian economic policy.

The rationale for Canada's decision to erect protectionist barriers still has resonance in current debates. In addition to protecting infant manufacturing industries from US competition, the policy sought to promote east-west trade among Canadian provinces by discouraging north-south trade. Thus protectionism was a critical part of the Canadian program of nation-building. At the end of the twentieth century, the fear that strengthening cross-border ties will undermine the sense of economic interdependence among Canadian regions is still real.

Despite the imposition of tariff barriers by both governments, the US supplanted the UK as Canada's principle trading partner by the 1950s. In fact, long before the recent era of US -- Canada trade liberalization, their bilateral trade relation emerged as the largest in the world. Perhaps the most critical step in cementing this powerful trade link was the US-Canada Auto Pact of 1965, which allowed tariff free movement of automobiles and parts. The rationale was that it was more efficient for the big three auto makers to produce each model in a single plant for the entire North American market than to duplicate each of their production runs in Canada. Thus the benefits of specialization and scale economies became the main impetus to removing tariff barriers. (It should be noted that with significant safeguards for Canadian production, the Auto Pact is better viewed as an example of managed, rather than free, trade.)

With automotive products emerging as the leading category of merchandise trade, and with a broad range of tariffs declining due to international trade liberalization under the GATT, the average tariff on cross-border goods continued to fall throughout the sixties and seventies. The most dramatic step in the process of trade liberalization occurred in the 1980's, when the election of like-minded national leaderships in Canada and the US set the stage for the most comprehensive US-Canada trade agreement in history: the Canada -- US Free Trade Agreement (FTA) of 1988. Besides phasing out most tariffs over a decade, this agreement included a number of innovative provisions including free trade in services and liberal cross-border investment rules.

Until recently, trade relations between the US and Mexico were based on shaky foundations, and trade relations between Canada and Mexico were of little concern for either country. Having lost nearly half of its territory (including California) to the US in the 1840s, the struggle against political and economic domination by its powerful neighbour has been a central theme for all Mexican governments. Nevertheless, the Mexican economy is inevitably tied to the US, not only because of the volume of trade but also because US-earned remittances from expatriates and temporary workers form an important component of Mexican income.

While there has been little in the way of pre-NAFTA trade agreement *per se*, complementary provisions enacted by US and Mexican customs have facilitated growth of the "Maquiladora" system, under which US components are assembled in Mexican factories. Mexican customs allows US components to enter duty-free and be held in bond at the Maqiladora site, so long as the finished product is re-exported to the US. American customs charges tariff only on the Mexican value added. This is viewed as mutually beneficial in that it generates jobs and income in Mexico while it keeps US producers competitive and preserves jobs in component manufactures.

The principal components of NAFTA are modelled closely along the lines of the FTA. The main difference is the establishment of more formal dispute resolution mechanisms. Other new provisions relate the areas where the US had concerns that are more specific to Mexico, as in intellectual property rights and provisions to open up government procurement. At the same time, however, exceptions are made to protect certain industries, such as railroads, where foreign ownership is specifically forbidden under the Mexican constitution.

The Current Trade Picture

Table 1 shows US-Canada merchandise trade broken out by industry for the years 1993 and 1997. These numbers would come as a surprise to some people, as there is still a lingering impression that the gross trade pattern is one of resource goods being exported from Canada to the US in exchange for manufactured goods. Indeed, more minerals and crude materials pass from Canada to the US than from the US to Canada. Manufactured goods, however, account for more than 70% of Canada's exports to the US. More specifically, Machinery and Transport Equipment accounts for more than half of Canada's exports -- almost certainly the result of trade growth associated with the Auto Pact. At the same time, a roughly comparable amount of Machinery and Transport Equipment flow from the US to Canada. This reflects the development of a cross-border industrial complex based around the automotive and related industries, which is located primarily in the Great Lakes states and Ontario, and to a lesser extend in Quebec. The general breakdown of trade shows little change between 1993 and 1996.

The structure of trade between Canada and the US seems to conform nicely to the "new" view of international trade espoused, for example, by Krugman (1991). The traditional comparative advantage view held that most trade flows could be explained by differences in national endowments of the factors of production. The new view recognizes that many of the largest trade relations are between countries with very similar endowments. In such cases, gains from trade are in the form of scale economies reaped when firms in each of the countries specialize in a more narrow range of goods than they would under autarky. This, in essence, was the rationale behind the Auto Pact and explains the high volume of intraindustry trade observed in Table 1.

TABLE 1 U.S. Trade with Canada 1993 and 1997 (millions of dollars)

TABLE 1 U.S. Trade with Canada 1993 and 1997 (millions of dollars)

U.S. Exports	1993	%	1997	%
0. Food and Live Animals	5,573	5.5	6,879	4.5
1. Beverages and Tobacco	148	0.1	320	0.2
2. Crude Materials, Inedible, Except Fuels	3,144	3.1	4,453	3.0
3. Mineral, Fuels, Lubricants, and Related Materials	1,257	1.2	2,420	1.6
4. Animal and Vegetable Oils, Fats, Waxes	89	0.1	229	0.1
5. Chemical and Related Products N.E.S.	8,419	8.4	13,093	8.7
6. Manufactured Goods Classified by Material	12,431	12.4	19,652	13.1
7. Machinery and Transport Equipment	54,273	54.2	82,961	55.3
8. Miscellaneous Manufactured Articles	10,458	10.4	14,773	9.8
9. Other	4,397	4.4	5,344	3.6
Total	100,190	100	150,124	100
U.S. Imports				
0. Food and Live Animals	4,899	4.4	7,434	4.4
1. Beverages and Tobacco	1,138	1.0	823	0.5
2. Crude Materials, Inedible, Except Fuels	8,417	7.6	11,983	7.1
3. Mineral, Fuels, Lubricants, and Related Materials	11,772	10.6	17,908	10.7
4. Animal and Vegetable Oils, Fats, Waxes	219	0.2	379	0.2
5. Chemical and Related Products N.E.S.	5,499	5.0	9,514	5.7
6. Manufactured Goods Classified by Material	17,765	16.0	27,336	16.3
7. Machinery and Transport Equipment	48,999	44.1	72,101	42.9
8. Miscellaneous Manufactured Articles	5,255	4.7	10,306	6.1
9. Other	6,958	6.3	10,266	6.1
Total	110,921	100	168,051	100

Source: U.S. Department of Commerce, *U.S. Foreign Trade Highlights*.

The trade relationship between Canada and Mexico is probably too immature to support much analysis at this point. It is questionable, however, whether intraindustry trade based on separation by production phase will develop given the long distances between Canadian and Mexican production sites. Both the emergence of the Maquiladora system and the long-established Great Lakes cross-border industrial complex indicate that geography matters in determining the volume and structure of trade.

Overview of the Special Issue

The papers in the special issue address the current state and potential futures of trade and investment in the NAFTA area from a number of angles. The first "Is the Impact of the North American Trade Agreement Zero: The Canadian Case," by John Britton looks at the "big picture," but with a geographer's eye for diversity and detail. The paper responds to a provocative statement by Paul Krugman that NAFTA would have no discernable effect on the North American economies. Britton argues that in the more open and vulnerable Canadian economy, discernable impacts are already evident. Some, such as diversification of Canadian exports, are beneficial. Others, such as the decline in East-West economic bonds, are a matter of some concern.

In the second paper, "Regional Impacts of Trade and Investment on Labour," Morely Gunderson provides a lucid overview on how trade arrangements can affect the spatial allocation of production both between and within countries. Depending upon the circumstances, reduction in trade barriers can either draw production toward border areas or reinforce the position of the existing core areas. He reviews the circumstances and likely outcomes for Canada, Mexico, and the US.

Kirton and Rugman's paper "Regional Environmental Impacts of NAFTA on the Automotive Sector" is an insightful appraisal of the outcome of the NAFTA's environmental provisions, which were a major source of public concern during the negotiation and ratification phases. Their study, which focuses on the automotive industry (by far the largest trade category in the NAFTA area), draws generally positive conclusions. Instead of the regulatory "race to the bottom" that was anticipated by some critics of NAFTA, they observe a "push to the top" in terms of environmental practice.

Buckley, Clegg and Forsans provide an often-overlooked perspective on NAFTA in their paper "Foreign Market Servicing Strategies in the NAFTA Area." They consider how the formation of NAFTA affects the foreign direct investment (FDI) strategies of global corporations -- including those based outside the NAFTA area. They point out that FDI provides the link between the global economy and the emerging system of trade blocs, and speculate about how multinational firms may adjust their North American investment strategies to suit the new trade regime.

In "Whatcom County, Washington and the Greater Vancouver Region -- What is So Enticing over the Border" Kathrine Richardson provides a refreshing change of pace by considering how international trade developments play out at the local level -- which, after all, is where everything actually happens. She considers a US county that is contiguous to the Canadian border and well within the geographical field of influence of the Greater Vancouver economy. She uses extensive interviews to explore both the reality and the perception of where this locality fits in the world of dissolving borders.

In the final paper "Regional Trade Policy and the Integration of the American and Canadian Economies" Mark Brown brings the tools of statistical analysis to bear in exploring where the greatest potential for cross-border integration lies. His conclusion is that both geographical proximity and similarity of industrial structure provide favourable conditions for expansions of cross border economic ties at the regional level. Based on these results he argues that trade policy must be viewed as an inextricable component of regional development policy.

References

Krugman, P. R. 1991. *Geography and Trade*. Cambridge: The MIT Press.

World Bank. 1999. *World Development Report 1998-1999,* Washington