DRAMATIC INITIATIVES NEEDED TO PROMOTE FURTHER BILATERAL INTEGRATION

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Introduction

In the aftermath of the terrorist attacks of September 11, 2011 (9/11), much of the attention of corporate executives, policymakers and researchers has focused on the "thickening" of the Canada-U.S. border subsequent to a tightening of security procedures. The available evidence, while not completely consistent, identifies a post-9/11 border thickening phenomenon that has harmed bilateral trade growth.[2] Border security procedures have also apparently contributed to a reduction in cross-border shopping by tourists.[3] The Canadian and U.S. Governments have responded to complaints about increased border issues – crossing costs and delays with several policy initiatives including the Smart Border Accord (2001) and Beyond the Border (2011).[4] Indeed, there is evidence that the initiatives, particularly the implementation of trusted shipper programs such as FAST, have mitigated some of the adverse consequences of heightened border security procedures, albeit primarily for companies involved in the transportation equipment sector. Hopeful focus has now turned to streamlining and possibly harmonizing product regulations as an additional initiative to reduce the costs associated with bilateral trade.

The broad claim made here is that post-9/11 border security developments and increased costs and complexities associated with the proliferation of customs procedures tied to government regulations, while significant, are not really all that important in the grand scheme of increased bilateral integration. Indeed, there is plenty of evidence that bilateral integration began stalling out well before 2001, the Canada-U.S. Free Trade Agreement (CUSTA) notwithstanding. One might argue that the "low-hanging fruit" of tariff reductions, particularly the product economies of scale that were facilitated by tariff reductions, were largely harvested before the CUSTA was implemented, and that subsequent bilateral policies to promote further integration have amounted to fiddling at the margin, particularly in light of the emergence and growth of China and Mexico as major trading partners with the United States. In this

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[2] For some statistical evidence and a review of other relevant studies, see Globerman and Storer (2009). Sands (2009), offers a detailed identification and assessment of the border policy environment.

[3] See Ferris (2010).

4. On the other hand, the Western Hemisphere Travel Plan, implemented in phases beginning in 2007, is seen as increasing the costs associated with cross-border tourism, particularly same-day visits. See, for example, Bradbury (2013).

context, serious discussion of bilateral integration initiatives going forward must encompass controversial policies including the elimination of all existing barriers to foreign direct investment, and the creation of a fully integrated labor market, especially for professional and technical workers.

Some Data

While it is impossible in this presentation to provide a comprehensive discussion of bilateral economic integration over the past two decades, it is possible to provide some selective and provocative data which support a contention that the Canadian and U.S. economies may be less fully integrated today (at least relative to the sizes of the two economies) than they were in 1990, and that security-related developments aren't the main explanation.

One broad measure of economic integration is the degree to which North American companies have developed and deepened cross-border supply chains. Stephen Blank (2010), among others, has identified this phenomenon as a manifestation of the two countries "making things together." While it is difficult to quantify the extent and nature of cross-border supply chain activities, one relevant proxy measure is the magnitude of bilateral trade in intermediate goods. In this regard, it is noteworthy that total bilateral intermediate goods' trade as a percentage of total bilateral trade (net of fuel products in both cases) was actually higher in 1990 than in 2010.[5]

Another broad measure of cross-border integration of production, and of industrial clustering more generally, is the degree to which bilateral trade is intra-industry in nature. Intra-industry trade (IIT) measures trade in goods within industries rather than across industries and reflects the importance of product specialization as a driver of bilateral trade. In the 1970s, Canadian economists in particular argued that the major benefits of freer bilateral trade would arise from increased product-level economies of scale associated with cross-border product specialization. Such specialization was, indeed, a major and planned consequence of the Canada-U.S. Auto Pact of 1965, and IIT was an increasingly large share of total bilateral trade throughout the 1970s and 1980s; however, IIT as a share of total bilateral trade was virtually unchanged when comparing 1990 (45 percent) to 2000 (44 percent), and in 2011, it was lower (at 41 percent) than in either of the earlier years.[6]

Even very broad measures of the value of goods crossing the Canada-U.S. and the number of visitors crossing the border suggest that closer integration of the two economies began petering out years ago. For example, U.S. real exports to Canada in 2011 were lower than in 2000, while U.S. real imports from Canada in 2011 were only eight percent higher than in 2000.[7] In terms of tourism and cross-border shopping, the number of Canadian visitors to the U.S. peaked in 1991 at approximately 73.4 million. In 2009, when the exchange rate was approximately the same value as in 1991, only 36.4 million Canadians travelled across the border.[8] Similarly, the number of American visitors to Canada declined over the same period from 28.2 million in 1991 to 14.9 million in 2009.

While my discussion is focused on Canada-U.S. economic integration, my sense is that these broad conclusions also apply to economic integration between Mexico and the United States.

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[5] Globerman and Storer, 2011

[6] Globerman and Storer, 2013

[7] Globerman and Storer, 2011

[8] The data are from Bradbury (2012). Obviously, individual Canadians, and Americans for that matter, made multiple border crossings.

Assessment

Surprisingly little attention has been paid to what appears to be a long-run hiatus in the degree of economic integration between Canada and the United States. As mentioned above, a number of researchers have highlighted the growth of China as a trading nation as one reason for the hiatus. Simply put, Chinese trade with Canada and the U.S. displaced some bilateral trade.

Another plausible, albeit less well discussed reason is the growing importance of services in the North American economy. Of particular relevance is the growth of services that are financed by government with health care as the primary example. In 1970, health care expenditures were about seven percent of GDP in the U.S. By 2008, health care expenditures accounted for around 16 percent of GDP in the U.S. with over 50 percent of health care financed by major government programs, notably Medicare and Medicaid. The relative growth of health care was somewhat smaller in Canada. In 1970, the share of total GDP accounted for by health care expenditures was approximately seven percent and increased to around 10.5 percent in 2008. Most health care in Canada is funded by government. There is little direct or indirect trade in health care services, in part because patients using government funded insurance to pay for health care services have limited authority or incentive to shop for better quality or lower priced health care in foreign jurisdictions. The higher education sector is also geographically balkanized by, among other things, differential tuition between in- state (or province) students and foreign students. Licensure and other regulatory restrictions, visa requirements and other institutional differences make it very difficult for medical doctors, academics and other professionals linked to these prominent sectors to provide services outside their home countries.

In short, a substantial and growing share of the North American economy consists of services that are directly or indirectly isolated from any meaningful integration in the form of either trade or direct investment. Many, albeit not all, medical services are currently untraded because the costs of shopping for and acquiring the services are high relative to geographic differences in prices and/or the quality of those services; however, this situation might well change with the growth of telemedicine and other innovations. Certainly online educational services are a growing phenomenon, as are in-residence degree programs where students spend individual semesters at different but affiliated universities. The limitations on the migration of health care service providers, educators and the like between the two countries are legal and regulatory in nature. The elimination of those mobility barriers would likely promote increased cross-border shopping for health care, education and other publicly funded services as consumers on both sides of the border became more aware of potential service offerings on the other side.

To imagine a system where governments gave vouchers to citizens to acquire health care or educational services anywhere in North America is virtually science fiction at the present time. Certainly, differences between the two countries in the real costs of those services pose a huge political hurdle, particularly for governments in the “low-cost” country, although meaningful geographic integration of the markets for those services would contribute to some convergence in local prices. To the extent that North American governments are simply unwilling to consider initiatives that facilitate cross-border shopping for economically important publicly funded services, they are not really serious about promoting bilateral integration in the 21st century.

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