

Symposium: Analytical and Empirical Studies of North American Trade and Investment Relations

Introduction and Overview

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IN March 1990, the Donner Canadian Foundation made a grant to the University of Western Ontario to undertake a programme of workshops, conferences, case studies and academic papers dealing with issues and problems in the design and implementation of the Canada–US Free Trade Agreement (CUSTA) and with broader North American issues of international trade and investment. The project directors were David Conklin of the School of Business and John Whalley of the Centre for the Study of International Economic Relations of the University of Western Ontario. In carrying out the academic portion of the Donner project, it was decided to establish a Canada–US Trade Research Group comprised of faculty members from the University of Western Ontario, University of Toronto and the University of Michigan.

The Canada–US Trade Research Group was co-chaired by John Whalley of Western Ontario and Robert M. Stern of Michigan. Trade specialists at the individual institutions were enlisted in the Research Group and requested to prepare papers on topics pertinent to the stated theme dealing with CUSTA and broader North American trade and investment relations. Those involved included: Rodney Ludema, Irene Trela, John Whalley, Ronald Wonnacott and Ian Wooton from Western Ontario; Aileen J. Thompson and Daniel Trefler from Toronto; and Alan V. Deardorff, David L. Hummels, Gary R. Saxonhouse and

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Robert M. Stern from Michigan. Drusilla Brown of Tufts University was also involved as a member of the Michigan group. The Research Group had three meetings: Western Ontario in March 1991; Michigan in December 1991; and Western Ontario in October 1992. These meetings were devoted to presentation of work in progress. It was originally contemplated that the Research Group papers would be published in book form. However, because of time and resource constraints, this was not feasible and some other publication arrangements were sought. When the editors of *The World Economy* expressed interest in publishing a special symposium issue containing the papers, Robert Stern agreed to serve as guest editor for this purpose. While there were originally eight papers prepared by members of the Research Group, it was decided because of space constraints and topicality to include only six of them in revised and considerably shortened form.

The first paper in the symposium, 'Evolving Patterns of North American Merchandise Trade and Foreign Direct Investment, 1960–1990', is by David L. Hummels and Robert M. Stern. They present data and a graphical exposition and interpretive analysis of the major changes that have occurred in the commodity and geographic structure of the merchandise exports and imports, and of outward and inward foreign direct investment (FDI) of the United States, Canada and Mexico covering three decades. They document the asymmetry between the United States and Canada and Mexico insofar as US trade and FDI are much more directed to countries/regions outside of North America as compared to the United States being of dominant importance for the trade and FDI of both Canada and Mexico. They also note that trade and FDI in agricultural products and minerals/fuels for the three North American economies has declined markedly compared to manufactures and that the geographic pattern of US trade and FDI has changed significantly. Finally, the effects of changes in US macro-financial policies and real exchange rates during the 1980s are reflected in the very substantial overall and bilateral trade deficits that the United States has experienced.

The second paper, 'Differences Between Explicit and Ad Valorem Barrier Representations in Analyses of the Effects of North American Economic Integration', by Irene Trela and John Whalley takes issue with a number of computable general equilibrium (CGE) model-based analyses of CUSTA and the North American Free Trade Agreement (NAFTA) in which the major changes in barriers are modelled in *ad valorem* tariff-equivalent form rather than explicitly in terms of the form in which changes in the barriers were in fact negotiated in CUSTA and NAFTA. They show that explicit representation of the changes in barriers involves quite sizeable differences in both the sizes and sign of effects as compared to their *ad valorem* equivalent treatment in comparable CGE models.

Noel Gaston and Daniel Trefler's third symposium paper, 'The Role of International Trade and Trade Policy in the Labour Markets of Canada and the

United States', considers the major changes in employment and wages in Canada and the United States prior to and after implementation of CUSTA in January 1989 and then uses econometric methods to isolate the impact of CUSTA on these changes. They find that the CUSTA tariff reductions resulted in job losses in Canada, but there were other important factors affecting Canadian employment adversely in the post-CUSTA period, including increased Canadian interest rates designed to deal with the Canadian government budget deficit and inflation, ongoing recession, appreciation of the Canadian dollar, and continuing structural change in both Canada and the United States.

The fourth symposium paper by Aileen J. Thompson, 'Canada—United States Free Trade and Investment', analyses the stock market evidence concerning the expectations of investors about the consequences of CUSTA and how the actual investment patterns in Canada following implementation of CUSTA compared to the stock market results. She found that CUSTA was expected to have a substantial impact on profits within some sectors of Canadian industry, and that there was some, albeit weak, evidence that CUSTA had an impact on actual Canadian manufacturing investment patterns in the period after 1988.

Alan V. Deardorff's fifth paper in the symposium, 'Third-Country Effects of a Discriminatory Tariff', focuses on how the interests of member countries in a free trade area (FTA) may be affected when their PTA partners take trade policy actions against outsiders. While the results of the theoretical analysis are mixed, there are nonetheless several cases in which an FTA member country may be adversely affected by the external trade policies of other FTA members. This suggests the need for coordinating the external trade policies among members of an FTA in order to avoid potentially damaging effects of individual members actions against non-members.

The final paper in the symposium by Gary R. Saxonhouse, 'Do Japanese Firms Price Discriminate in North America?', uses a model of 'pricing to market' to analyse issues of exchange-rate pass through, and to determine the extent to which the behaviour of foreign (i.e. Japanese) firms involved efforts to set differential prices so as in effect to segregate the three North American markets from one another. Using monthly data for 41 products for the period from January 1983 to June 1988, he found pervasive evidence of strategic pricing by Japanese exporters in all three North American markets. The implication drawn is that the removal of intra-North American trade barriers in CUSTA and NAFTA will reduce or eliminate the ability of foreign firms to segregate the individual markets and thus lead to the enhancement of North American economic welfare.

While the symposium papers by no means cover all of the problems and issues of trade and investment involving the United States, Canada and Mexico, it is hoped that their treatment of modelling and empirical analysis may further the understanding of North American economic relations and suggest ways in which important regional relationships elsewhere can be fruitfully studied.

