Introduction

The Canada-U.S. Free Trade Agreement: Regional Curse or Blessing?

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This special issue of the Canadian Journal of Regional Science pulls together studies by geographers, economists, and management scientists of the impact of the Canada-U.S. Free Trade Agreement (FTA) on the regional economies of the two countries. The regional effects of this agreement are important for two reasons. First, when bordering countries are as large as Canada and the United States, national-level analyses obscure a great deal of the trade, interaction, and results. Second, the experience of freer trade—whether jobs or joblessness, wealth or poverty—is borne by individuals and households who are bound to particular regions by property, preference, or culture.

Regional Studies

The first seven articles in this issue investigate particular regions of Canada and the United States—their prospects for altered trade flows and the extent of their roles in bilateral private investment. These contributions also look at the mechanisms for estimating international integration on a regional scale. Two themes emerge from these papers. First, the FTA may not be the salient cause of regional changes (whether perceived, measured, or projected). The secular tendency toward increased international interaction, and especially
the increased awareness of opportunities across the Canada-U.S. border, may go further in explaining regional changes. Second, interregional empirical study across national borders is rendered almost impossible by the lack of regularly collected and published data. The usual route to circumventing this deficiency—primary surveys by individual researchers—is fraught with problems of sample identification and response bias.

In his contribution, F. J. Calzonetti summarizes both the provisions of the FTA that apply to the energy trade and the fears of each country about the results of increased trade. Among other things, he notes that the prospects of and economic rationale for increased sales of Canadian hydroelectric power to the northeastern United States are partially thwarted by the physical difficulties of long-distance electricity transmission. Such physical limitations to trade serve to reduce its regional-economic impact.

Barney L. Warf and Joseph C. Cox look at the physical reality of trade in another area—merchandise. The degree of interest that U.S. regions have in the FTA reflects the extent to which regions, depending on their economic specialization and location, are affected by trade. The Buffalo (New York) and Detroit (Michigan) metropolitan areas play key roles in the physical flow of goods between the United States and Canada by virtue of their positions in those countries' joint manufacturing belt. Warf and Cox use a simple methodology of manipulating tariff reductions, demand elasticities, and the current distribution of goods flow to project an increased flow of goods between the two countries. But, although the makeup of the traffic should change to reflect the differential decline in tariffs across commodities, the traffic shares of the key crossings at Buffalo and Detroit probably will not be much affected. There should be a slight increase in the case of Buffalo and a slight decrease in the case of Detroit. The regional economic impact of increased trans-shipment flows, however, is difficult to predict. Although travel and freight services and toll road receipts are straightforward, the likelihood of private investments in warehousing or other value-added is an open question that occupies chamber of commerce officials in several border regions.

To investigate such private investments, James E. McConnell and Alan D. MacPherson conducted a postal survey of operations in the Buffalo-Niagara Falls (New York) area owned by Canadian parent organizations. These operations are quite varied in size and sector, but most share a market-opportunity orientation, although their foreign investment is not generally motivated by tariff barriers and their plans for future investment or disinvestment are largely unaffected by the FTA.

Prem P. Gandhi's research focuses on a region with a somewhat different orientation. In contrast to the nineteenth-century industrialization heritage of Buffalo and Niagara Falls, northern New York and the St. Lawrence Valley are part of a long agricultural frontier between New York City to the south and Montreal immediately to the north. Increased border traffic is unlikely to lead to many local economic linkages for such a region. The major effects of changes in the trade regime on this area will stem from actual investments or disinvestments made in response to the elimination of government-imposed barriers. Gandhi's 1989 survey of companies of Canadian parentage in the region suggests that these operations (half of which are engaged in manufacturing; only a quarter have warehousing or trade-services functions) were drawn to the region's proximity to the parent's operations (for ease of cross-border management by these small companies) as well as to the U.S. market targeted by the company. Tariffs, whether high or low, had little effect on the location decision. Thus, the FTA can be expected to have little direct influence (negative or positive) on these operations and others that might follow.

Sam Cole aims for a more general understanding of the economic linkages between two cross-border regions: western New York State and southern Ontario. In trying to side-step the problems of partial coverage and respondent self-selection inherent in survey research, he runs into the problem of data inadequacy for regional economic research. Thus, his article is a guide for overcoming these problems. He suggests location-quotient and shift-share analyses of the combined regions and then explores the possibility of estimating a multiregional input-output model from available data. The use of traditional regional science techniques for a cross-border region exploits both the unrealized synergy between trade models and regional models and the recognition that the two regions under study are evolving into an integrated regional economy.

Morley Gunderson views the effects of the FTA on Canadian regions through the lens of employment and employment conditions. In his first analysis, differences in the regional effects reflect differences in the sectoral composition of the regions: non-durable manufactures, in particular, were heavily protected under the former trade regime; thus, Ontario and Quebec will face particularly severe employment adjustment. Increased bilateral competition, however, will increase the pressure toward bilateral harmonization of employment conditions, including a reduction in the interprovincial differences in industry-specific wage levels and work rules.

At the outset of his article, Benjamin Higgins questions whether studies of the regional impacts of the FTA should presume that it will result in free trade. He argues that the yet-to-be-negotiated bilateral
standards on allowable subsidies—as well as the political process by which subsidies are defined and countervalled—are likely to bring anything but efficiency at the national, regional, or sectoral levels. Taking into account the direct and indirect subsidies provided by the United States and Canada’s sovereign prerogative to implement regional development policy, Higgins develops arguments and strategems that Canada could use in trying to maintain its regional incentives in the face of negotiations on subsidies.

Higgins observes that regional development programmes in Canada, especially those involving subsidies, are subject to potential U.S. countervailing-duty actions if goods using the subsidized inputs are exported to the United States. He gives a spirited economics-based defence of regional development programmes by arguing, for example, that U.S. monopolies must be offset by Canadian subsidies or that infant industry-type arguments are valid for regional development. Also according to Higgins, U.S. industry receives subsidies, which is correct. This has led some of us to argue that the net differences in national subsidies should be calculated, but legal procedures in both countries prevent this simple economic solution; the laws state that only the subsidies of the importers are to be assessed.

Bilateral and National Studies

The next four articles focus on particular economic sectors and the reactions of their constituent firms to changes in the bilateral trading environment. Two approaches are evident in these articles: (1) a concern with sector-specific characteristics such as industry structure and tariff reductions, and (2) a strategic framework that looks upon corporate behaviour as the result of the development and exploitation of monopolistic advantages. The first approach focuses primarily on the industry-wide competitive changes brought about by reductions in tariff and non-tariff barriers. The second approach studies economic integration as an environmental change to which firms react within the constraints of their firm-specific advantages.

Along the lines of the first approach, Fernand Martin takes an unusual route toward predicting regional differences in the sector-specific impact of the FTA. Instead of disaggregating national models, he assesses the tariff reductions facing particular commodities—in this case, commodities in the pulp and paper industry—and then predicts entrepreneurial responses based on regional factors of costs and other environmental variables. This approach is more useful for the regional policy makers who must actually design mechanisms to ease the adjustment process in their unique localities.

Alan M. Rugman, Alain Verbeke, and Stephen Luxmore take an explicitly behavioural approach to corporate response to trade liberalization, conceptualizing corporate behaviour as prompted by corporate strategy. Their unit of analysis is the strategic business units of large firms. Their framework specifically juxtaposes the firm-specific advantages that underlie corporate strategy against the country-specific advantages that reinforce corporate actions. These country-specific advantages take on increased importance when international trade barriers are lowered, as by the FTA. In Canada’s natural resource sectors, the eventual end of country (or region) cost advantages will require the development of firm-specific product and process advantages for continued international competitiveness.

James W. Harrington, Jr., develops a strategy-based framework as well—for understanding the international and regional location decisions by commercial banks. Banks have a wide range of service and location options, although these options are constrained by national regulation. The FTA’s treatment of financial institutions is based on the principle of national treatment, under which each country’s banking subsidiaries in the other (host) country are subject to the same regulations as the banks based in the host country. These regulations are quite different on either side of the border, resulting in a few nationwide banks in Canada and thousands of banks in the United States. In investigating the status of U.S.-Canadian commercial bank linkages before the FTA, Harrington discovered that all Canadian banks had U.S. linkages, but only certain large U.S. banks had Canadian linkages of various sorts. The FTA should yield a moderate increase in the level and number of these linkages, especially tied to the servicing of international ventures by banks’ clients.

Also using the industry-structure approach, Janos L. Wimpffen presents some general postulates about transport along and across international borders and about international differences in common carrier regulation. Because the FTA does not include transport services, this paper is more a treatment of bilateral differences in the regulation of transport modes, the ways in which countries’ changing regulations affect transborder flows, and the prospects for changes based on the General Agreement on Tariffs and Trade.

Other Studies

An important part of the economic impact of bilateral trade changes is the reactions of third-country actors. The development of a freer North American trading bloc should encourage inward foreign investment to serve the larger market area. The locations of these investment flows will influence the regional impact of the FTA. David
W. Edgington takes such a third-country view of the regional study of the FTA, inspecting the current and projected flows of Japanese investment in North America. From original and previously published studies, he relates the marketing and production strategies of Japanese firms to their decisions to locate production in the United States versus Canada. He finds that the FTA is likely to have a minimal influence on the division of Japanese investment between the two host countries, in part because of Canada's small market size and in part because bilateral integration has long been recognized and expected by Japanese companies.

Also of great concern for regional scientists are the potentially polarizing effects of economic integration. Wimpffen et al. address this possibility in the final article on research agendas. They point out the spatial division of labour in the European Community, with Ireland having long played the role of a labour-surplus site for manufacturing. What roles will evolve for peripheral regions in the smaller North American trade partner such as Canada's Atlantic provinces? Will increased international competition force greater parity of interregional labour conditions as Gunderson suggests? In the realm of services, which gain greater international entry under the FTA? Will foreign investment increase the concentration of high-level services in core regions? Or will competition drive service providers to follow smaller markets in more peripheral regions (as may be occurring in the banking sector)? The authors close with a plea for better data collection and harmonization by major trading partners. While data collection must be improved for investigation of the regional effects of international integration, our methodological and conceptual tools must also be improved to handle the complexity of interregional and international exchange simultaneously.

Most of the authors' analyses project relatively small changes in the investment actions of large companies as the FTA is implemented. The volume of bilateral trade should continue to increase, with economic implications for the sectors and border regions that support this trade. International location of production will continue to seek advantageous regional input factors and markets. Tariffs or no, reliable service for an international market is aided by service, distribution, and perhaps even manufacturing operations in that market. The authors who see the greatest regional impact of the FTA are those studying regional and labour policy. While businesses have recognized the de facto economic integration of the two countries for some time, the official economic interaction of the FTA may prompt greater harmonization of government actions. The resultant national and regional political debates may be the most salient result of the agreement.