Trade Imbalances Growing Within NAFTA

Canada's trade with its NAFTA partners Mexico and the United States has been growing much faster than its trade with countries outside North America.

While overall Canadian exports rose 110 per cent between 1990 and 1998, exports to Mexico increased 133 per cent, and exports to the United States rose 139 per cent.

Over the same period, imports from the United States rose 132 per cent, significantly faster than the 119 per cent overall increase in imports to Canada from all countries. Imports from Mexico rose a remarkable 339 per cent.

To some extent import and export trade with Mexico and the United States is linked. Growing continentalisation of manufacturing under the North American Free Trade Agreement (NAFTA) means that products assembled in one NAFTA partner are likely to contain components manufactured in another. More exports of cars from Mexico to Canada, for example, can mean more Mexican demand for electronic automobile components manufactured in Canada.

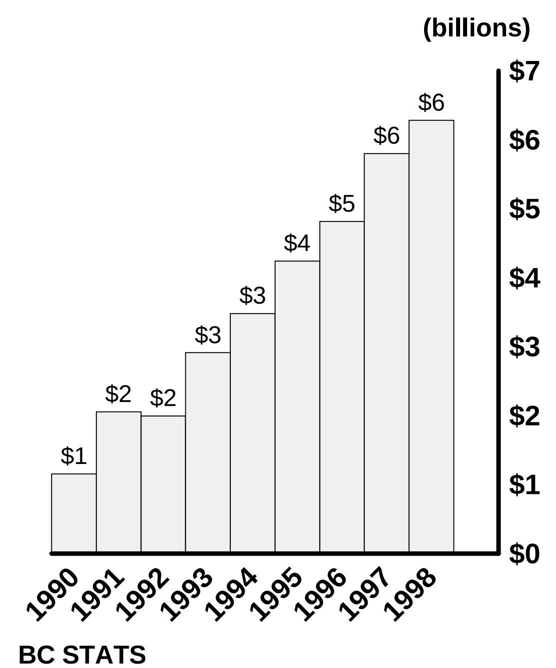
However continental trade flows are also affected by exchange rates, labour costs and income levels. The net effect of all these various factors has been increasingly unbalanced merchandise trade between NAFTA partners during the 1990s.

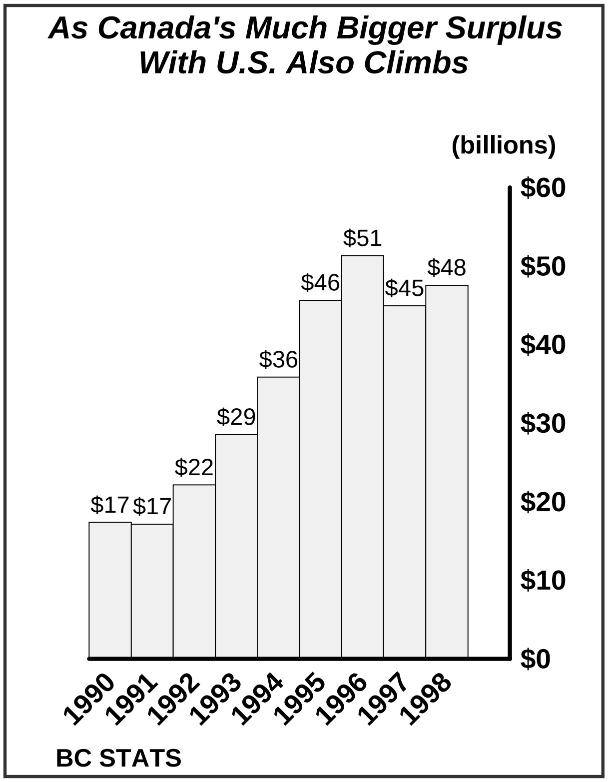
Of Surpluses and Deficits

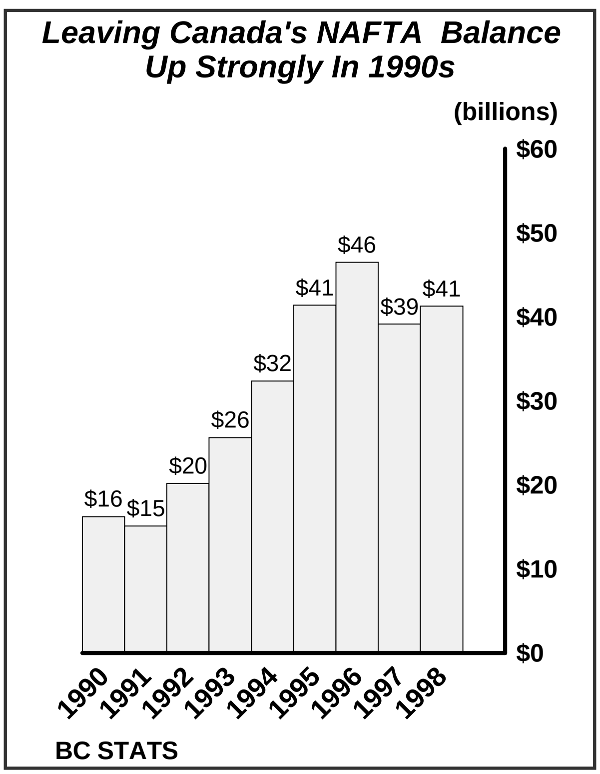
As free trade has increased the volume of continental trade, it has also altered the pattern of exports between NAFTA partners. Very rapid growth of trade imbalances has been one effect of this.

Canada has experienced a fast growing merchandise trade deficit with Mexico on the one hand, and a much larger surplus with the United States on the other. Overall, NAFTA has been very good for Canadian trade balances.

Mexican Trade Surplus With Canada Climbs Rapidly Through 1990s







While Canadian trade deficits with Mexico have grown six fold since 1990, they have remained far smaller than trade surpluses with the United States. Deficits with Mexico increased from $1 billion in 1990 to $6 billion in 1998. Surpluses with the United States increased from $17 billion in 1990 and 1991, to a high of $51 billion in 1996, before falling back to $48 billion in 1998.

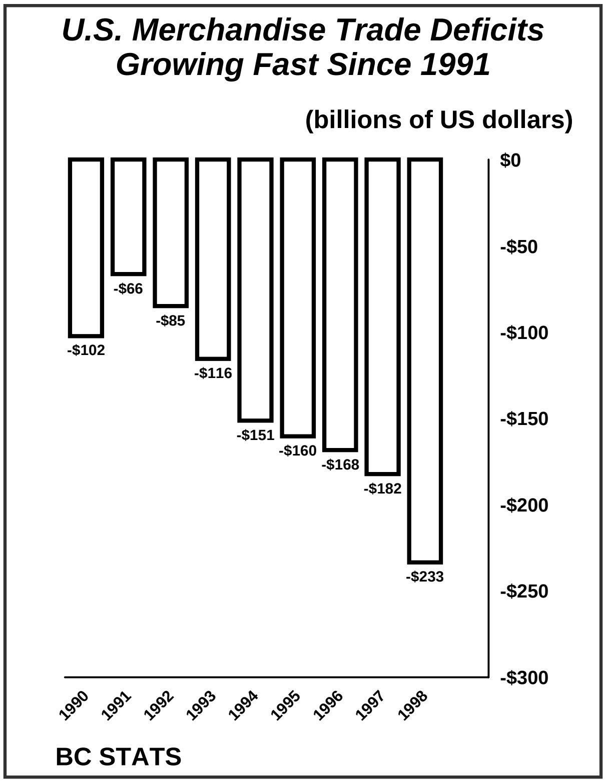
When deficits with Mexico are subtracted from surpluses with the United States, Canada's continental trade surplus increased from around $16 billion in the first two years of the decade, to a high of $51 billion in 1996. It dropped down to a still high $41 billion in 1998.

NAFTA and The U.S. Merchandise Trade Deficit

Growing surpluses for Canada and Mexico in trade with the U.S. have naturally contributed to a growing U.S. trade deficit problem.

The United States has run steadily larger merchandise trade deficits with the world since 1991, starting with $US 66 billion in that year and climbing to $US 233 billion in 1998. If they continue, as seems likely for the short term at least, U.S. trade deficits may eventually lead to a devaluation of U.S. currency, with the risk of inflation and higher interest rates.

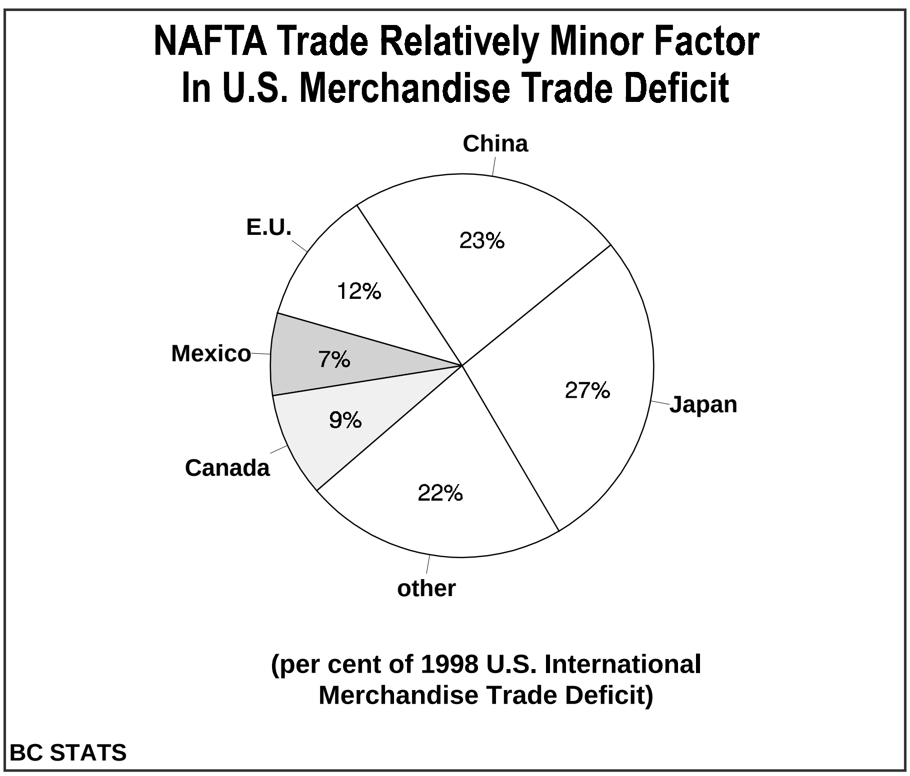
The U.S. dollar has so far remained strong in spite of very large deficits because of the continuing strength of the U.S. economy, and because of the special status of the U.S. dollar in world financial markets.



The dollar is still the world's principal reserve currency and serves as a safe haven for international investors. If U.S. economic conditions worsen relative to other countries, or if another currency, such as the euro, challenges the dollar's status as the world's principal reserve currency, U.S. dollar exchange rates could fall. This could well make merchandise trade deficits a matter of much more urgent concern to U.S. authorities, strengthening the hand of protectionist lobbies in the United States.

Trade with Canada has accounted for about 10 per cent of the U.S. deficit in most years of this decade, with no consistent signs that this proportion is either expanding or shrinking.

The proportion of the U.S. deficit attributable to trade with Mexico has been slightly smaller. The U.S. actually ran surpluses in its merchandise trade with Mexico in the early part of this decade. However these turned to deficits after NAFTA brought Mexico into the North American free trade zone in 1995.



But even when the U.S. deficits with Canada and Mexico are combined, they still account for a relatively small portion of the U.S. international merchandise trade deficit - 16 per cent of the total in 1998. This was considerably less than the 27 per cent attributable to trade with Japan or the 23 per cent attributable to trade with China.

Canada A Resource Pool For NAFTA

Canada's exports within NAFTA are far more heavily concentrated in resource commodities than are Mexico's. And if any NAFTA resource partner could be said to serve as a resource pool for the continent, it would be Canada.

Resource commodities (agricultural, fisheries, forestry, and mineral) amounted to almost half (48 per cent) of Canadian exports to Mexico in 1998, but only 8 per cent of Mexican exports to Canada. Canadian exports to the United States included 26 per cent resource products; but imports from the United States included only 9 per cent.

Resource commodities do not figure largely in trade either way between Mexico and the United States. They accounted for only 11 per cent of Mexican exports to the United States in 1998, and 11 per cent of U.S. exports to Mexico.

Resource Commodity Portions of 1998 NAFTA Trade Flows

	Importers		
	Canada	**Mexico**	**U.S.A.**
Exporters			
Canada	NA	48%	26%
Mexico	8%	NA	11%
U.S.A.	9%	11%	NA

BC STATS

What Has NAFTA Meant For Canada?

In the sometimes heated debate leading up to the signing of the Canada-U.S.A. Free Trade Agreement in the late 1980s there were predictions that the Agreement would put Canadian social programmes and employment standards at risk. Some of these same issues were raised again five years later during discussions about NAFTA, the expanded Agreement including Mexico.

At the close of the decade it is not obvious that free trade has so far done serious damage to Canadian social programmes or employment standards. Indeed it could be argued that a more liberated continental trading environment has enhanced the national capacity to support expensive social programmes because it has produced an export driven spurt of economic growth.

Critics of NAFTA might point to the Canada-USA Softwood Lumber Agreement as evidence that continental free trade has not worked well for Canada. But others might counter that protectionist U.S. lumber interests could have inflicted far worse restrictions on Canadian lumber exporters if there had not been some sort of higher level trade Agreement in place, however imperfect.

One positive development from NAFTA that few would dispute is the remarkable increase in secondary manufactured exports (many of them high technology products) to the United States. NAFTA and the earlier Canada-U.S.A. Agreement reduced barriers to finished goods and, perhaps equally important, they provided some measure of assurance that Canadian manufacturers could count on access to American markets. Access to the immense U.S. market has allowed competitive businesses to invest in new or expanded research and production facilities in Canada that might otherwise have been located in the United States.

Adapting to more liberalised trade in North America has meant that domestic producers have had to face new competition from American and Mexican exports. Some have failed and some have thrived in the new environment. Those that have thrived have been able to concentrate on more specialised product lines in which they hold some competitive advantage. In some cases, success in North America has led to export sales overseas.

Other winners in this process have been Canadian consumers, who have gained access to a wider range of goods at lower prices. It is arguable that price competition under free trade has helped tame inflation in Canada.

The benefits to Canadians of more open trade with Mexico are less readily apparent than the benefits of free trade with the United States. On the face of it, the growing merchandise trade deficits with Mexico are an undesirable development for Canada. But this may be a short or medium term trend that could reverse as trade boosts Mexican industrial and living standards to the point where Mexico can become an important market for finished goods from Canada. This notion of long term benefits has been one of the important arguments for opening continental and world trade generally.

Judging by history in Asia, it bears some merit. Canadian exports to Asia of machinery and equipment, high value food products, and value added wood products have risen strongly since 1990. Some of this export trade has been set back since the 1997 Asian economic crisis, but there is little doubt that Canada can expect to sell more of these products to Asia in future, as economies in that region become more fully developed.

On the same somewhat theoretical basis, Canadian exporters might eventually hope to find new markets in a more affluent Mexico for similar high value products.

Up to the late 1990s, the most important Canadian export gains in Mexico have been in motor vehicle parts and electronic components. Shipments of goods in these categories have increased in both directions, as the motor vehicle and electronics industries have become integrated on a continental basis.

This trade has so far benefited mainly Ontario and Quebec, where Canadian automotive and electronic production is concentrated. Agricultural producers in the prairie provinces have benefited from significant sales of canola and wheat.

But free trade with Mexico has not as yet produced any significant export benefit for British Columbia. Since 1990, British Columbia's exports to Mexico have remained at about 0.2 per cent of the province's total exports. The $60 million shipped to Mexico in 1998 is trivial by comparison with the $2,009 million shipped to Europe from the province, the $4,532 million shipped to Japan or the $16,406 million shipped to the United States.

Commodities exported from British Columbia to Mexico can still be summarised as minerals and pulp and paper, with occasional small shipments of miscellaneous other products.