Canada and Mexico Minor Players in North America's Economic Integration?

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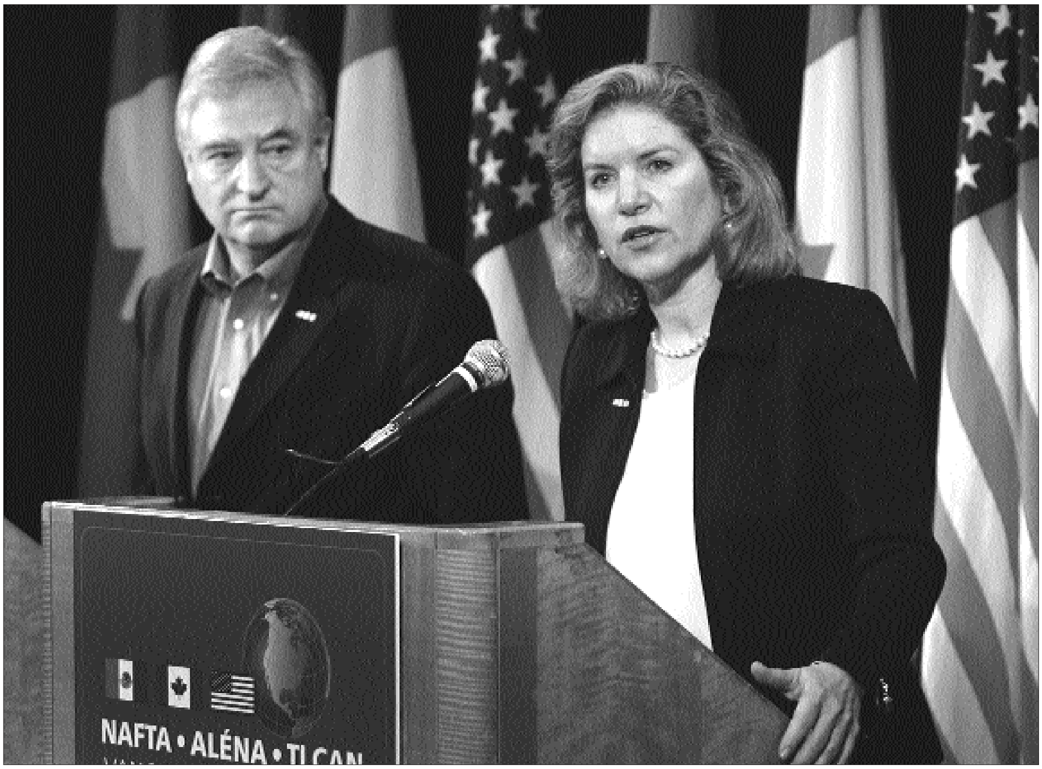

Lyle Stafford/Reuters

Canadian and U.S. representatives at the August 2007 NAFTA Free Trade Commission meeting in Vancouver.

Since the North American Free Trade Agreement (NAFTA) was signed, exchanges of goods and services between Canada and Mexico have grown relatively quickly, with Mexico's exports to Canada increasing more, turning the latter into our second largest trade partner. In 2004, Mexican products made up 3.9 percent of Canada's total imports, although only 1.7 percent of its total exports went to Mexico, making Mexico the fifth largest destination for Canadian products.

Despite significant growth in Mexican-Canadian trade over the last 10 years and our status as a NAFTA partner, the Mexican economy is not yet a priority for Canada. However, this does not prevent Canada from being considered a big potential market for our economy if we take into account that our net trade balance came to a U.S.$6.7 billion surplus.

Canada's Economic Vocation: Centers on Export Markets

The Canadian economy's long-term development strategy was initially based on the production of raw materials for the international market, fundamentally the United States. Particularly at the end of World War II, Canadian authorities fielded policies aimed at becoming strategic suppliers for the industrialization process taking place in the U.S.

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Northeast. The most illustrative cases are the auto industry and the supply of oil and electricity.

This form of linking economies is key for explaining Canada's trade and financial gravitation toward its next-door neighbor, confirmed by the different auto pacts signed over the years and the free trade agreement between Canada and the United States that preceded NAFTA. In 1994, exports to the U.S. came to U.S.$207 billion, 86.78 percent of all Canadian exports. Ten years later, they were U.S.$316.55 billion, or 86.08 percent of the total. These figures illustrate the strategic importance of the United States for Canada.

Canada's trade dependence is increased by other factors that favor intra-regional trade, like the relative proximity of consumer markets and the supply of energy, or, the important advantages in transportation costs. The high concentration of Canada's trade —and Mexico's— is influenced by exporters and authorities' wide-ranging knowledge of U.S. sanitary, customs and other regulations.

Clearly, Canada has built very close trade and financial relations with the U.S., which have benefited it in prosperity and adversely affected it during recessions.[1] In short, Canada's bilateral trade with the U.S. generates more than U.S.$2 billion a day. Indicators demonstrate Canada's economic and trade solvency, confirming it as the world's seventh largest capitalist economy.[2]

In the context of Canada's trade pattern, highly concentrated with the United States, we can understand how urgent it is for both countries to intensify bilateral trade and trade with other countries in the hemisphere and the Asian Pacific. This becomes fully comprehensible when we look at Canada's modest —and Mexico's practically marginal— trade position regarding their exports to the Asian economies.

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TRADE ASYMMETRIES BETWEEN CANADA AND MEXICO

Taking NAFTA as the starting point, let us look at some figures for Mexican-Canadian trade: in 1994, it was U.S.$4.91 billion and by the end of 2006, it came to U.S.$21.4 billion, an increase of 400 percent. However, that expansion was inevitably overshadowed by the relatively more visible high levels of U.S. trade and investment with Canada and Mexico.

There are also fundamental differences between the two economies given that Canada has a trade surplus with the U.S. and a deficit with Mexico. But its trade with the rest of the world is in surplus (see graph 1). This facilitates its acting as a net exporter of capital. Mexico also has a trade surplus with both the United States and Canada, but its global trade balance is negative; it is a net recipient of foreign capital.

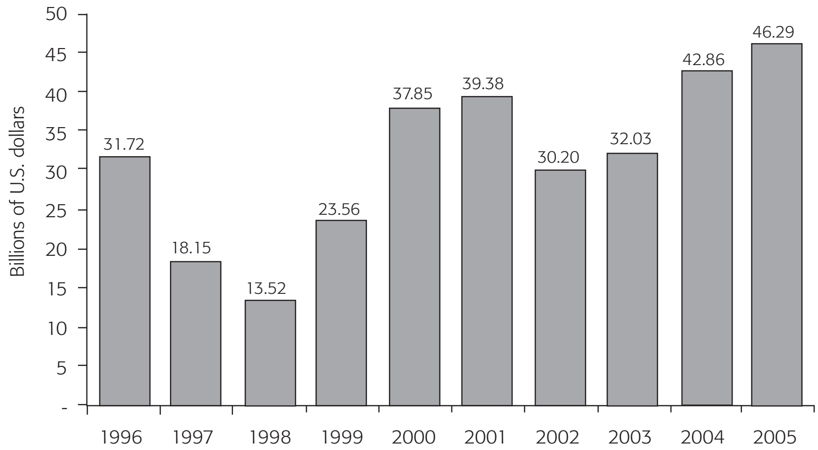
One indicator that confirms the weight of foreign trade in the Canadian economy is the ratio between the value of international transactions and GDP; for the period 2001-2003, on an average, this ratio was 79.4 percent. For the years 2001 to 2003, trade per capita averaged U.S.$18,943, higher than Taiwan (with U.S.$17,987) and Mexico (with U.S.$3,730) (see table 1).

TABLE 1
COMPARATIVE TRADE INDICATORS (2003)

Mexico, China, Canada, South Korea and Taiwan						
	Trade Per Capita (U.S. dollars, 2001-2003)	*Trade/GDP Ratio (2001-2003)*	*Exports 2003 (1995=100)*	*Imports 2003 (1995=100)*	*Average Growth 1995-2003 (1995=100)*	
			Exports	*Imports*		
Mexico	3,580	57.1	190	241	8	12
China	572	57.1	342	327	17	16
Canada	18,943	79.4	143	139	6	6
South Korea	8,220	71.9	268	172	13	7
Taiwan	17,087	136.2	136	115	4	2

Source: World Trade Organization, http://www.wto.org/indexsp.htm.

Graph 1
Canada's Total Trade Balance



Source: Statistique Canada, *Commerce par produit du Canada et des États-Unis, Importations, exportations et balance commerciale par produit.*

Canadian-Mexican Trade Benefits the Latter

One of the transformations in the structure of world trade can be seen in intra-industry trade, even of similar goods, in demand because of their brand name, style or design or due to advertising. This kind of trade also includes intermediate goods and inputs with the need to move products from one country to another at different stages of production, such as what happens with *maquila* plants, also called "shared-production" models.

In this context, we can briefly examine some of the general trends in bilateral Canadian-Mexican trade since NAFTA. Although, as already mentioned, Mexico-Canadian trade increased from almost U.S.$5 billion to U.S.$21 billion from 1994 to 2006, Canadian exports remained relatively low, increasing form U.S.$1.6 billion to U.S.$7.37 billion. In comparison, Mexican exports went from U.S.$3.13 billion to a record U.S.$14.10 billion in that same period, giving Mexico a trade surplus of U.S.$6.72 billion.

Despite being a NAFTA partner, Mexico is the destination for only a relatively small part of Canada's exports, only about 1 percent. In 2004, total Canadian exports came to U.S.$316 billion, while those to Mexico came only U.S.$2.3 million, barely 0.7 percent. Canada's trade balance with Mexico has been negative for the last 10 years, denoting a trend favorable to the Mexican economy (see graph 2).

In 2004, Canada's total exports by branch of the economy showed a predominance of manufactured goods (60.45 percent), 12.2 percent of which are high tech. Fuel and mineral products contributed 20.5 percent. The size of agricultural and forestry exports should also be underlined: 12.7 percent.

The main products exported in 2004 include automobiles and auto bodies (11.5 percent); natural gas (6.9 percent); and crude oil (5.4 percent). These are followed by auto parts excluding engines (5.1 percent) and trucks and tractors (3.6 percent). Oil and coal derivatives contributed with 2.9 percent and telecommunications equipment and materials, 2.4 percent. If we amalgamate all the goods from the auto industry, they come to 20.2 percent.[3]

The structure of Canada's imports by country of origin indicates that its economy is less concentrated than if we look at the structure of its exports. In 2004, it imported U.S.$272.97 billion from the United States, 58.8 percent

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of all its imports. This figure shows significantly less concentration in its imports than in its exports to the U.S. market, which came to 86.08 percent.

Canada's trade pattern, then, indicates a considerably smaller concentration of imports by country of origin, particularly with regard to the United States. This pattern shows a relatively broader diversification than with its exports. This is influenced by the emergence of China in world markets.

There are indications, considered frankly alarming by some analysts, about the structure of Canada's exports and imports that is undergoing a kind of *substitution effect*, whereby U.S. and Mexican goods are being replaced with Chinese ones. Recently, China has replaced Canada as the United States' most important trade partner, putting Canada in third place and bumping Mexico down from third to fourth place on the list.[4]

Some of the general trends in the structure of Canada's imports are present in its trade with Mexico. From 1994 to 2004, imports of goods from Mexico increased from U.S.$3.3 billion to a little over U.S.$9 billion. This made Mexico Canada's second largest supplier, contributing 3.6 percent of its total volume of imports.

Among the 10 main products exported from Mexico to Canada in 2004 were auto parts (except engines) (18.3 percent); computer equipment (10.3 percent); and telecommunications equipment and materials (9.7 percent). These goods are followed on the list by automobiles and auto bodies (9.5 percent); trucks and tractors (6 percent), and measuring and regulating instruments (2.8 percent).

It is interesting to note that the first three kinds of goods on the list represent a little over 40 percent of total Mexican exports to Canada. But, if we aggregate finished and intermediate goods from the auto industry alone, the value of these exports to Canada comes to 33.8 percent of the 10 main products.[5]

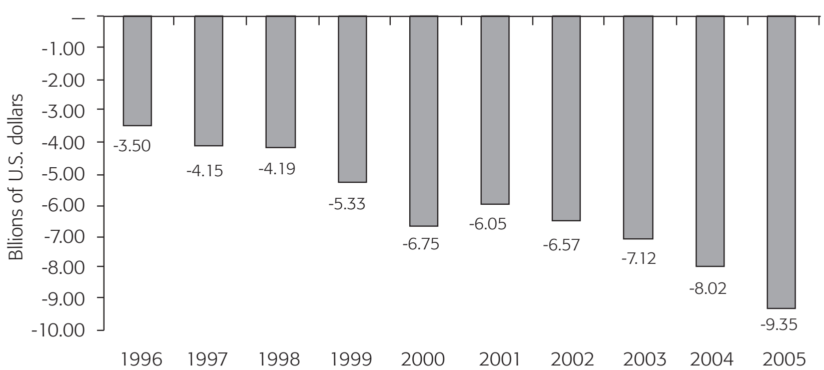
MEXICAN AND CANADIAN TRADE WITH CHINA

China's presence in world trade has changed competition worldwide. Its production costs are so low compared both to the industrialized and developing countries that even a moderate hike in the yuan or an increase in production costs does not affect their goods' ability to penetrate foreign markets. Canada, Mexico and the United States are no exception.

Following the trends in markets influenced by Chinese trade, in recent years Canada and Mexico have rapidly been penetrated by Asian —mainly Chinese— imports. This has created a growing deficit in both countries' trade balance, with negative effects in domestic job creation.

In 2004, products imported by Mexico from the United States were 56.6 percent of total imports; and from China, 7.3 percent, making it Mexico's second largest supplier. Japan was in third place with 5.4 percent, followed by Germany, with 3.6 percent.

GRAPH 2
CANADA'S TRADE BALANCE WITH MEXICO
(BILLIONS OF U.S. DOLLARS)



Source: Statistique Canada, *Commerce par produit du Canada et des États-Unis, importations, exportations et balance commerciale par produit.*

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The velocity with which imports from China have grown contrasts with the slow increase in Canadian exports, underlying the weakness of Mexican goods in the northeastern part of the Asian Pacific, whether in China, South Korea or Taiwan. This sluggishness of Canadian and Mexican exports prevents them from benefiting significantly from the economic boom that that region has been experiencing for more than two decades.

In conclusion, first of all, in the context of NAFTA, Canada and Mexico require a new trade strategy to permit greater penetration and diversification of their products and services in their respective markets. Mexican producers would do well to remember that Canadian society —and consequently, its markets— is ethnically and culturally diverse, with marked seasonal differentiation and high income. These factors have a decisive impact on consumption patterns and the public's preferences for specific products and services, which makes for potential demand for Mexican goods.

It cannot be forgotten that the concentration of Mexican exports to Canada in a small number of industries and goods is characteristic of our trade pattern, probably linked to the high volumes of imports and exports of intermediate and capital goods by the industries and firms themselves. This confirms the hypothesis about the influence of large multinational corporations on the globalization process.

Under these conditions, the question is whether Mexican authorities have sufficient determination and conviction to be able to design and promote an export trade policy with horizons transcending the interests of the large exporting corporations, making room for the country's small and medium-sized firms. VM

Notes

[1] Let us simply take as a reference point the Canadian economy's rapid growth over the last decade, closely tied to the boom in the U.S. economy. It is understandable, then, that the United States is its most important trade partner.

[2] In 2004, total exports came to U.S.$316 billion, 31.9 percent of the country's GDP. If we include services, this indicator increases to 38.2 percent, demonstrating the importance of the country's export markets. In the same year, Canadian imports reached U.S.$272 billion, or 27.5 percent of GDP; if we again add services, the total came to 34.0 percent.

[3] Canada's main exports to Mexico are from the auto industry: automobiles, transmissions, auto parts and accessories. Other important exports are wood pulp, plastics, metal products, wheat and different kinds of seeds. The automobile industry with 24.5 percent and agricultural goods, with 17 percent of total exports, predominate.

[4] In 2004, Canada's overall import structure showed a high percentage of manufactured goods (81.7 percent), followed by mineral products (8.7 percent) and agricultural goods (7.5 percent). An analysis of this structure by kind of goods indicates that in 2004, the Canadian economy acquired a large volume of intermediate and finished products from the auto, electronics and telecommunications industries.

[5] The Grubel and Lloyd Index gauges the amount of trade generated by reciprocal exchange of goods from the same industry. In 1994, this kind of exchange between Canada and Mexico represented 64.8 percent of the total, rising to 74.7 percent in 1998, showing a notable advance in intra-industry trade. This implies that for every dollar's worth of goods imported from Mexico by Canada, 74.5 cents correspond to the exchange of goods within the same industry. In practical terms, this kind of trade reminds us that among those most benefited by NAFTA are precisely the big multinational corporations in the auto, electronics and telecommunications sectors.

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