Farm Foundation

Issue Report

North American Market Integration

The extent to which economic, market and policy integration occurs in North America is a contentious policy issue in Canada, Mexico and the United States.

The degree to which the markets, policies, and economies of Canada, Mexico and the United States should be integrated has been an issue since implementation of the North American Free Trade Agreement (NAFTA) began in 1994. In the past, the issue was frequently referred to as one of free trade. In recent years, however, the terms market integration, policy integration, and economic integration have received increased attention because they more fully and accurately reflect the issues that are involved. But these terms are seldom explicitly defined and are left to the reader or listener for interpretation.

The number of regional trade agreements in the world has increased from two in 1958—when the European Economic Community, predecessor to the European Union, was formed—to 64 in 1994 when implementation of NAFTA began, and 187 in 2003. By May 2004, the United States had signed five regional trade agreements, negotiated four that had not yet been signed, and was negotiating four more. When combined with similar initiatives by Canada and Mexico, a spaghetti bowl of trade agreements now exists in the Americas. These are in addition to the World Trade Organization (WTO), which had 147 member countries as of April 2004.

While the objective of freer trade is common among countries participating in regional trade agreements, each agreement differs in the degree of market, policy and economic integration. Some academics assert that there are persistent economic pressures for higher levels of integration, regardless of the provisions of the trade agreements and the policies that are pursued. This appears to be the case under NAFTA. It can also be argued that institutions, such as the WTO and the European Union (EU), and threats, such as terrorism, or outbreaks of maladies such as mad cow disease, create incentives for policy integration in North America.

Definitions of Integration

Economic integration occurs when barriers to commercial exchange across countries are removed. Economic integration applies to all forms of commercial exchange: buying and selling goods and services, combining inputs to produce goods and services, capital investments, and employment, including immigration. Barriers to commercial exchange—tariffs, quotas or administrative standards—are often politically motivated to protect domestic industries. Likewise, exchange rates can be distorted by managed misalignment of macroeconomic policies that favor a country's competitive position in the world market.

Market integration exists when product flows between countries are on the same terms and conditions as within countries. Market integration occurs when two or more formerly separated national or regional markets are combined. It emphasizes the trade and foreign investment components of economic integration. If markets do not integrate through trade, they will integrate through capital investments. Therefore, what is required for markets to

integrate is removal of significant barriers to entry or costs of exit, over and above the economic costs of transferring ownership of the business assets.

Policy integration is the explicit and proactive development of common policies, laws and regulations. Both economic and market integration may be hindered by the lack of policy integration. Markets work unless they are actively prevented from doing so. Markets can integrate without policy integration, however, inconsistent or incompatible policies will inevitably generate pressures for change. The greatest deterrent to policy integration is the need to take multilateral views of policy issues, but some see this as reducing national sovereignty.

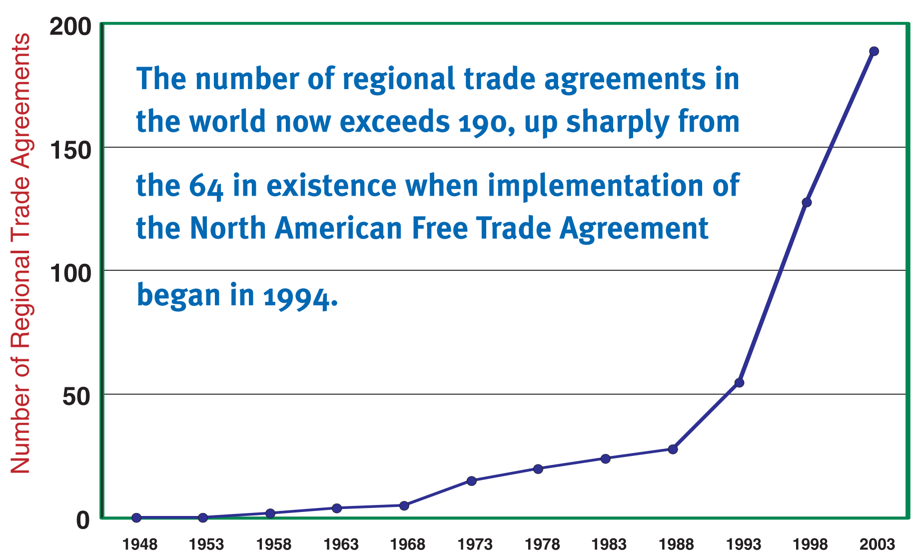
Forces Influencing Integration

In a world free of impediments to trade, the main force spurring integration is the self interest of individuals in improving their income, reducing expenses, and/or improving their standard of living. People in the United States and Canada buy fruits and vegetables from Mexico because the produce is less expensive and can be purchased when domestic supplies are not available. Thus, trade reduces living expenses and diets are improved—people live better. Mexicans buy U.S. beef because of its quality. Mexican poultry producers import corn and soybeans from the United States to lower their costs. U.S. brewers import malting barley from Canada because it makes better quality beer.

Through trade, people have the potential to increase their incomes, reduce expenditures, and have more money to spend on other goods and services, all of which spurs growth. Businesses expand though growth within countries and by investments in other countries. Mexican laborers come to the United States to improve their income and that of their families back in Mexico. People benefit from trade and from integration of our economies, which is what NAFTA was designed to do. Unfortunately, some people are hurt as markets are integrated through trade, and domestic firms are exposed to additional competition. Individuals employed in these sectors may require economic assistance to find new employment so they can also participate in the benefits of improved economic growth. Just because Wal-Mart, through competition, put many small hardware, clothing and grocery stores out of business does not mean that the United States did not benefit from Wal-Mart—consumers enjoyed a higher standard of living as a result of greater selection and lower prices.

Globalization is a term widely used to indicate the process by which economies, cultures and political systems become increasingly interdependent. Increasing globalization requires governments and economic agents to consider the effects of their actions on other countries, as well as how they may be affected by the actions of others. Once U.S. agriculture had adjusted to serving the world market by expanding its production capacity and infrastructure, it was both economically and politically infeasible to turn back. U.S. policy makers in the 1980s contributed significantly to this by their insistence that agriculture be a major focus of the Uruguay Round of multilateral trade negotiations, and by initiating the hemispheric trade talks that led to NAFTA. The EU had earlier developed a trading bloc, and subsequently other countries followed suit.

Biological, behavioral and competitive threats cause policy makers to consider actions that either integrate or disintegrate our economies. For example, foot and mouth disease and BSE have caused Canada and the United States to develop means of assuring that these maladies do not destroy agriculture. With expansive common borders, this can effectively be done only through a set of common regulations, programs and policies that cover the North American continent. Dealing with the new threat of bioterrorism can also be most effectively dealt with by common regulation covering the North American continent.



Competitive threats can either have an integrating or disintegrating effect, depending on whether policy makers consider the effects on particular constituents or the welfare of people as a group. If, for example, the impacts on California avocado growers were the determining factor, there would be no avocado imports into the United States from Mexico. When policy makers looked at the bigger picture, they realized that the benefits of imports to U.S. consumers were much greater than the potential losses to avocado growers who had other options for what they could produce.

Integration Options

The emphasis here is on political integration—the degree and means by which governments might encourage economic and market integration. Four general options exist:

Do nothing. Over time, the forces of self interest and globalization result in increased integration. This has happened throughout the history of mankind. Benefits have been realized through the competitive process, migration and new business ventures. The issues are whether unimpeded competition, immigration and business investment are the best means by which to realize the benefits of integration while minimizing its costs.

Policy coordination. Without question, differences in regulations, programs and policies hinder the process of integration. Some of these differences were deliberately designed to be disguised barriers to trade. Other differences simply evolved as ways to deal with issues such as food safety, product quality or low farm prices. Coordination will gradually reduce policy differences—through dialog among policy makers in the three NAFTA countries and by adherence to the substance and/or spirit of international codes of practice, such as WTO. Formal institutions or understandings may be required to implement policy coordination due to the competitive and political pressures not to coordinate.

Roadmap to Agricultural Policy Integration

While some would suggest the priority need is to begin by establishing a common agricultural policy, a more logical starting point for integrating the agricultural policies is with the harmonization of regulations that often lead to sanitary and phytosanitary (S&P) barriers to trade. Not only are these easier issues to deal with politically, but experiences such as bovine spongiform encephalopathy (BSE), salmonella contamination and karnel bunt disease have taught us that harmonization of regulations is very important to maintain trade flows.

Attention must not only be given to the science that undergirds the regulations, but also to the infrastructure supporting its implementation. For example, veterinary training, testing, traceability, certification standards and data collection programs need to be harmonized across the NAFTA countries.

With common regulations, an important door is opened for freer trade, and the likelihood of S&P disruptions is materially reduced. The resulting increases in competitive pressures in areas such as livestock and poultry make the need for reform of specific domestic farm policies more transparent.

Systematically pursuing harmonization one step at a time has the basic advantages of preparing and leveling the agricultural infrastructure for change while allowing gradual adjustment to the newly evolving economics of agriculture and food. Central to the implementation of this approach will be the development of an action-oriented triad composed of one representative appointed by each agriculture secretary/minister having a primary mission of systematically achieving the policy harmonization objective.

The Source

The North American Agricultural Market Integration Consortium fosters dialog among policy makers, agrifood industry leaders, and academics on agriculture and food-related market integration issues among the NAFTA countries. This *Issue Report* is a result of the Consortium's May 2004 workshop, sponsored by Farm Foundation and the ministries and departments of agriculture of Mexico, Canada and the United States. Contributing authors are Ron Knutson and Rene Ochoa, both of Texas A&M University, and Karl Meilke of the University of Guelph. More information on the Consortium and its workshops is available at *www.farmfoundation.org*.

Equivalence agreements. Some regulations or programs may not be identical, but they may achieve the same objective or standard, thereby achieving integration. Accepting the regulation or program of another country as equivalent can be a strong form of mutual recognition and promote integration. As with policy coordination, open and agreed on standards and mechanisms for determining equivalence must be established.

Harmonization. The highest level of policy integration, while maintaining country identity, involves adopting identical regulations and programs. This was accomplished in the EU through adoption of a Common Agricultural Policy and later, a common currency. It is important to note that harmonization can be taken one step at a time. However, with each step a degree of national sovereignty is lost, which may be the greatest deterrent to harmonization.

Summary

The extent to which the markets of Mexico, Canada and the United States should be integrated has become a contentious policy issue. Currently, it is driven by the need for harmonized regulations to control animal diseases and to deal with threats of bioterrorism. In addition, since the enactment of the Farm Security and Rural Investment Act of 2002 in the United States, there has been increased pressure to harmonize farm policies. Action could be taken by the three governments to smooth the transitions and speed the process.

Market integration and direct foreign investment will continue to move forward regardless of what governments do with regulations, programs and policies. How quickly or fully this happens depends in part on whether reliance on market forces is sufficient, and whether the NAFTA countries decide to go into the WTO or regional negotiations with a common position. The latter does not require complete harmonized/identical regulations, programs and policies. It can also be accomplished by policy coordination and by actions that are agreed to be equivalent.

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