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POTENTIAL IMPACT OF THE PROPOSED NORTH AMERICA FREE TRADE AGREEMENT ON THE STRUCTURE OF CANADIAN EXPORTS AND IMPORTS

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INTRODUCTION

Canada, the United States and Mexico have entered into three way negotiations which may result in a North America Free Trade Agreement (NAFTA). Since bilateral trade between Canada and the U.S. and between Mexico and the U.S. rank first and ninth respectively, in terms of the world's largest bilateral trading partners (Chart 1), such a free trade agreement will likely have considerable impact on the structure of Canada's exports and imports.

Chart 1

World's Largest Bilateral Trading Partners

1989

Countries	($Bil US)	% of World Trade
U.S. - Canada	170.9	5.55
U.S. - Japan	138.5	4.43
Germany - France	73.4	2.38
Germany - Italy	60.0	1.95
Hong Kong - China	57.8	1.88
Germany - Netherlands	55.9	1.82
Germany - U.K.	55.3	1.80
Germany - U.S.	45.1	1.46
U.S. - Mexico	44.0	1.43
U.S. - U.K.	42.4	1.38
Total of Above	739.3	24.01
Grand Total	3078.5	100.00

This study examines the nature of this potential impact. It attempts to define, in broad terms, how Canada-Mexico trade fits

in the context of total Mexican trade; it provides an overview of Canadian and Mexican exports to the U.S.; and, it presents a detailed analysis of these exports by principal commodities.

This paper is based on two articles which appeared previously in the Summary of Canadian International Trade (Catalogue 65-001). The first, **Trade with Mexico**, (D. Calof) appeared in the January 1991 issue; the second, **Canada's and Mexico's trade position in the United States (U.S.) market**, (D. Kotsovos) was published in the December 1991 issue.

DATA SOURCES/CONCEPTS

The data employed in this study are from three sources:

1) The World Trade Data Base (WTDB): For a detailed description of the WTDB, see Bordé, F., "A Database for Analysis of International Markets", Summary of Canadian International Trade, (65-001), pp.xiii-xxv, November 1990, Statistics Canada;
2) Canadian export and import trade statistics, collected from Revenue Canada, Customs and Excise administrative sources;

3) U.S. export and import trade statistics as disseminated by the United States Bureau of the Census.

Using the WTDB means that Mexican imports reflect Mexican trade concepts, and Mexican exports use the trade concepts of the countries to which Mexico exports. One of these conceptual differences is the maquiladora program.

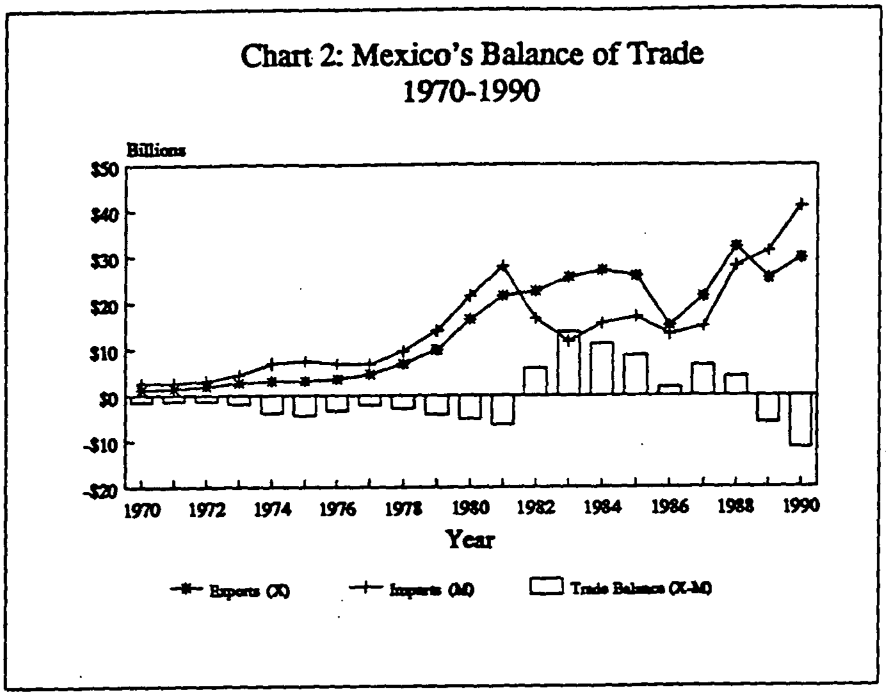
A **maquiladora** is an in-bond manufacturing plant set up to transform imported and domestic inputs into manufactured exports using Mexican labour. The inputs enter duty free, and the Mexican government does not consider merchandise flows between maquiladoras and other countries as imports or domestic exports. Mexican trade statistics only consider the value-added portion of the exported commodity as a domestic export. However, many countries, including Canada, do consider these flows as trade. Therefore, the concepts under which both Canada's and Mexico's export data are compiled are not identical with the concepts implicit in the World Trade Data Base, and result in differences in value.

The WTDB contains data from 1971 to 1990. All value figures from the WTDB are expressed in U.S. dollars. Data from International Trade Division sources are in Canadian dollars. The data from the U.S. Bureau of the Census have been converted to Canadian dollars.

MEXICO'S GLOBAL TRADE ($US)

Mexico's patterns of trade, and its overall economic state, reflect a number of important realities. The country's geographic proximity to the United States explains the fact that the U.S. is by far its major trading partner. The presence of large oil reserves explains the fact that petroleum products dominate its exports. The relatively low wage rates determine in large part the other major exported and imported commodities.

Mexico's total trade grew through the 1970's with a peak in 1981. However, the foreign debt crisis in the early 1980s sharply curtailed imports and resulted in restrictive trade policies. Exports continued to rise, led by petroleum. This resulted in large balance of trade surpluses until 1986 (Chart 2), when petroleum exports decreased dramatically. Recently, however, Mexican imports have risen. Mexico is liberalising its trade by reducing tariffs and the number of commodities subject to import licenses. Due to policies such as these and the development of the Mexican manufacturing sector, total Mexican trade is continuing to rise and diversify.



The total value of Mexico's exports in 1990 measured $29.6 billion. This was a $2.4 billion decrease from the record high of $32.0 billion in 1988. The total value of Mexico's imports in 1990 was an all time high of $40.9 billion, which represented a large increase of $7.8 billion from 1989's level of $33.1 billion. Both the 1990 and 1989 export and import figures show a significant increase from comparable 1987 data ($23.3 billion and $15.1 billion respectively). The volume of trade between Mexico and the rest of the world, therefore, increased during the same period from $38.4 billion to $70.5 billion, and the balance of trade went from a surplus of $8.2 billion to a deficit of $11.3 billion.

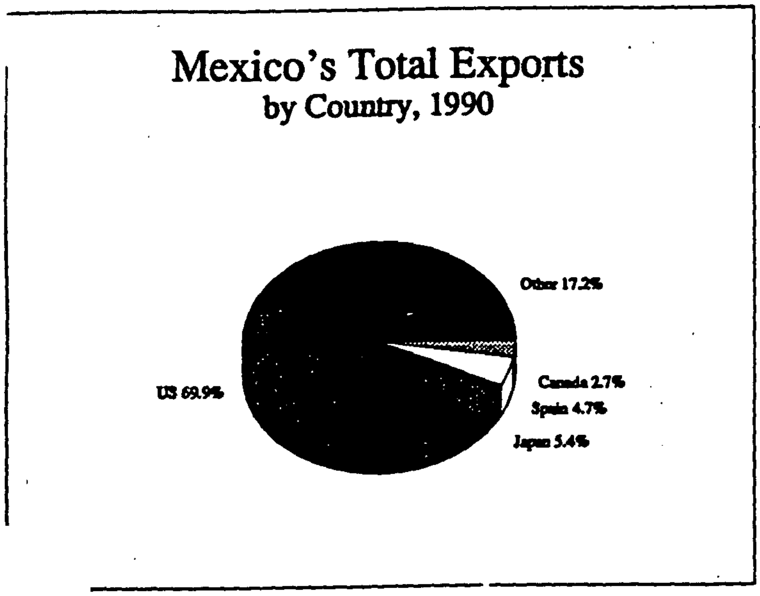
The substantial increase in Mexico's trade in 1988-1990,

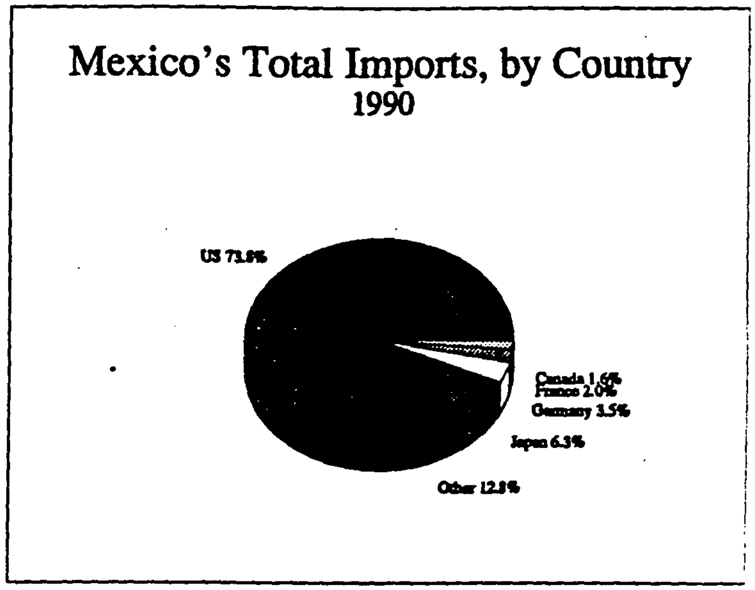
particularly in imports, is attributable to a Mexican initiative to open its economy. Previously, its heavy foreign debt, high rate of inflation and resulting high interest rates resulted in a protectionist trade policy. Mexican trade policy consisted of the following major components: maximum tariffs were 100%; most products in the Mexican tariff schedule required import licenses (in 1983 all 8000 items in the tariff schedule required licenses); and official reference prices were used in valuing more than 1500 tariff categories in the mid-eighties. During 1987, the maximum tariff was reduced to 20%, the number of products requiring import licenses was cut to 329 and official reference prices were eliminated.

MEXICAN EXPORTS BY COUNTRY ($US)

Mexico sells most of its exports to the United States. In 1990, exports valued at $20.7 billion, or 69.8% of total domestic exports of $29.6 billion, went to the U.S. (Chart 3). This progressively increasing share of the U.S. started in 1987. In 1987, shipments to the U.S. accounted for 65.1% of Mexican exports, a percentage that had been relatively constant since 1980. After the U.S., Japan and Spain were the largest importers of Mexican products

Chart 3





throughout the 1980s. During this period they purchased approximately 18% of Mexican exports between them. By 1990, however, their combined market share was reduced to 10.3% and their level of imports had fallen to $2.0 billion from $2.7 billion in 1987. This dramatic decrease in market share was due to the large increase in US/Mexican trade.

MEXICAN EXPORTS BY COMMODITY ($US)

The major commodity exported throughout the 1980s was petroleum. It accounted for between 60% and 75% of total exports since 1980. However, in 1987 and 1988, Mexico started exporting more machinery, electrical and transportation equipment and less petroleum. Thge majority of these commodities are manufactured in maquiladoras, or Mexican in-bond manufacturing plants. Maquiladoras account for approximately 65% of Mexico's manufactured exports.

MEXICAN IMPORTS BY COUNTRY ($US)

Of Mexico's total imports of $40.9 billion in 1990, $30.2 billion (73.8%) originated in the United States (Chart 3). This represented a significant increase from 1987 imports and was due to Mexico's initiatives to open its economy. In 1987, Mexican imports were valued at $14.9 billion, of which $10.4 billion came from the United States. From 1980 to 1987 the United States supplied between 65% and 70% of Mexico's imports.

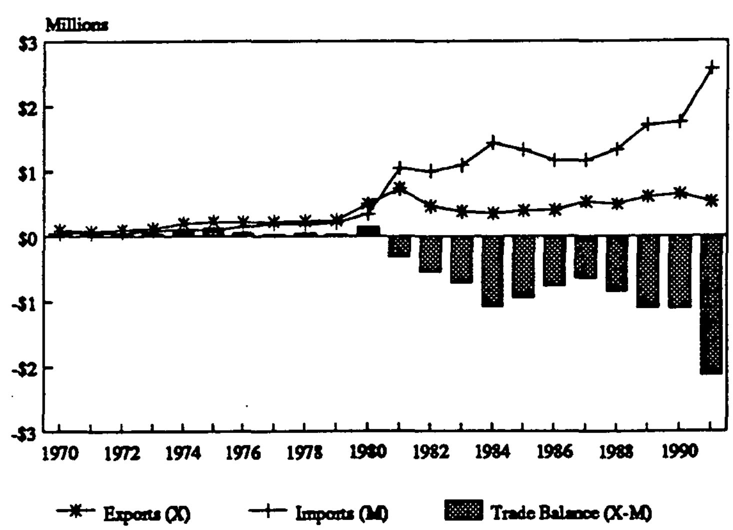
MEXICAN IMPORTS BY COMMODITY ($US)

The major commodities imported by Mexico have been machinery, electrical and transportation equipment. This was consistent throughout the 1980s. However, these import figures do not include maquiladora imports. Therefore, the total Mexican imports -- especially of these commodities -- are undervalued. A large proportion of the imports of machinery, electrical and transportation equipment are duty-free and have as their destination the Mexican automobile manufacturing plants. Because these plants are not considered maquiladoras, the imports of these goods are included in trade statistics.

CANADA - MEXICO TRADE ($Cdn)

From 1970 to 1980 trade with Mexico was at relatively low levels both for imports and exports, with Canada enjoying a slight balance of trade surplus (Chart 4). However, in 1980, both imports from and exports to Mexico began to grow, with imports from Mexico being dominated by petroleum. In the mid-eighties Canada decreased its petroleum imports from Mexico, and due to an expansion of the maquiladora program, began to import more machinery and equipment.

Chart 4: Canada's Trade Balance With Mexico



Since 1981, Canada has been in a balance of trade deficit position with respect to Mexico.

In 1991, Canada's exports to Mexico, as compiled from Canadian sources, totalled $525 million whereas total imports from Mexico were $2,574 million, for a balance of trade deficit of $2,049 million. Total trade values have increased significantly since 1988 ($1,818 million, $2,258 million, and $3,099 respectively). The Canadian balance of trade deficit has increased from $837.2 million in 1988 to $2,049 million in 1991, continuing the upward trend of the 1980s.

International Trade Division has discovered that part of this increase in the trade deficit for 1990 and 1991 is due to documentation problems. The implementation of the Canada/U.S. Data Exchange of Import Data in January 1990 did away with the requirement of providing Customs export documentation for Canadian exports to the United States. This has resulted in a certain number of Canadian exports to Mexico, travelling in transit through the U.S., not having proper export documentation submitted to U.S. Customs, thus, being excluded from Canadian trade statistics.

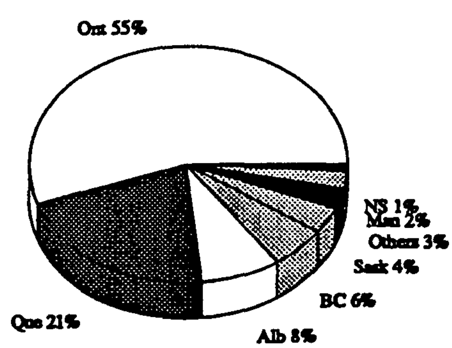
Initial research by the Division revealed an unreported value of $84 million of Canadian exports. The initial value of Candian exports to Mexico released by the Division, $441 million, has been recently revised to $525 million. The International Trade Division

CANADIAN EXPORTS TO MEXICO: BY COMMODITY ($Cdn)

For the years 1989 to 1991, the largest commodity exported from Canada to Mexico was automobile parts. The proportion of the value of exports of auto parts to Mexico to the value of total domestic exports to Mexico increased from 11.5% in 1989 to 14.2% in 1990 and to 17.3% in 1991. Other leading commodities were paper (newsprint and other), 11.8% of domestic exports to Mexico in 1991; steel (9.9% in 1991; 8.8% in 1990; 11.5% in 1989); powdered milk (3.1% in 1991; 11.3% in 1990; 8.6% in 1989) and machinery (9.2%; 10.8% and 10.2% in 1991, 1990, and 1989 respectively).

The highest percentage of exports originated in Ontario. These represented 55% of total domestic exports to Mexico for the 1990-1991 period (Chart 5).

Chart 5: Canada's Exports to Mexico
By Province, 1990-1991



CANADIAN IMPORTS FROM MEXICO: BY COMMODITY ($Cdn)

The major commodities now being imported from Mexico are complete automobiles or related to motor vehicles such as engines, engine parts and radio parts that are assembled in Mexico and purchased by the major North American automobile manufacturers. Machinery (engines), electrical (auto parts and radio parts) and transportation equipment (complete automobiles) accounted for between 65% and 85% of Canada's imports from Mexico for the time period 1989-1991.

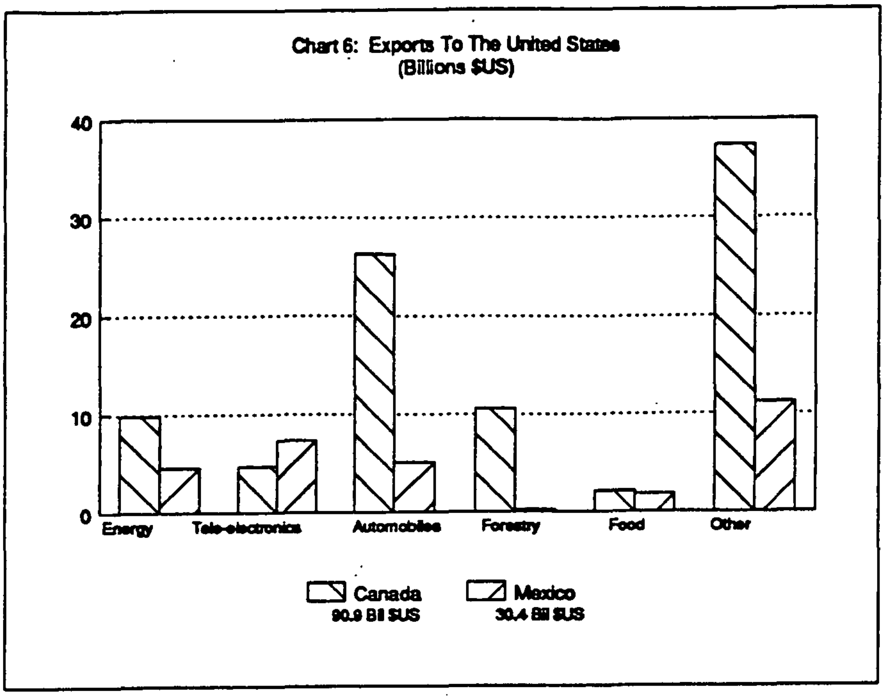
Complete automobiles have moved from the third most important Canadian import from Mexico 17.7% in 1989 to become second at 23.6% in 1990, and now rank first (47.6%) in 1991. These complete automobiles have displaced automobile engines, which were the largest import from Mexico in both 1989 and 1990.

MEXICAN AND CANADIAN EXPORTS TO THE U.S. ($US)

Historically, Mexico has sent 65% to 75% of its exports to the U.S. The geographic proximity of the two countries and the relatively lower labour costs in Mexico have induced many American corporations to set up subsidiaries in Mexico. The Mexican government has encouraged this foreign investment through policies such as the maquiladora program, which removes tariffs from imported inputs to specific qualifying plants that will then export most of the finished products. In 1990, these maquiladoras accounted for nearly 50% of Mexico's exports to the U.S. The major products exported under the maquiladora program included motor vehicle parts, electrical conductors, televisions, electrical circuits, combustion engines, textiles and apparel.

In 1991, Mexico's exports to the U.S. totalled $30.4 billion and were concentrated in three major industries (Chart 6). The tele-electronics industry, with exports of $7.4 billion, accounted for 24.3% of Mexico's domestic exports to the U.S. Energy accounted for $4.6 billion or 15.1% of the Mexican domestic exports to the U.S., while the automotive industry represented 16.8% of the Mexican exports market with $5.1 billion worth of goods shipped to

the U.S.



The United States is Canada's largest trading partner; as mentioned above, the transborder shipment of goods represents the largest two way flow of trade between any two countries in the world (Chart 1). In 1989, these trade flows amounted to 5.6% of world trade. In 1991, Canada exported $90.9 billion worth of merchandise to the U.S., representing 74.9% of its total domestic exports.

The automotive, forestry, and energy sectors dominated Canadian exports to the U.S.. Collectively, they represented 51.5% of all Canadian exports to the U.S. The automotive industry accounted for over $26.3 billion or 29.0% of Canada's total domestic exports to the U.S. The United States - Canadian Automotive Agreement or

Autopact (1965) rationalises the North American automobile industry by allowing duty free imports into Canada or the U.S. of North American built cars provided that a minimum level of production is attained in that country. It allows Canada to increase its output to attain the proper economies of scale needed for the efficient production of automobiles and protects the market share of Canada's automotive industry.

The forestry industry was the second largest exporter of goods to the U.S. Exports of lumber, wood pulp and paper totalled $10.6 billion, or 11.6% of total domestic exports to the U.S. Canada's third most important export product was energy, accounting for $9.9 billion worth of exports or 10.9% of the total.

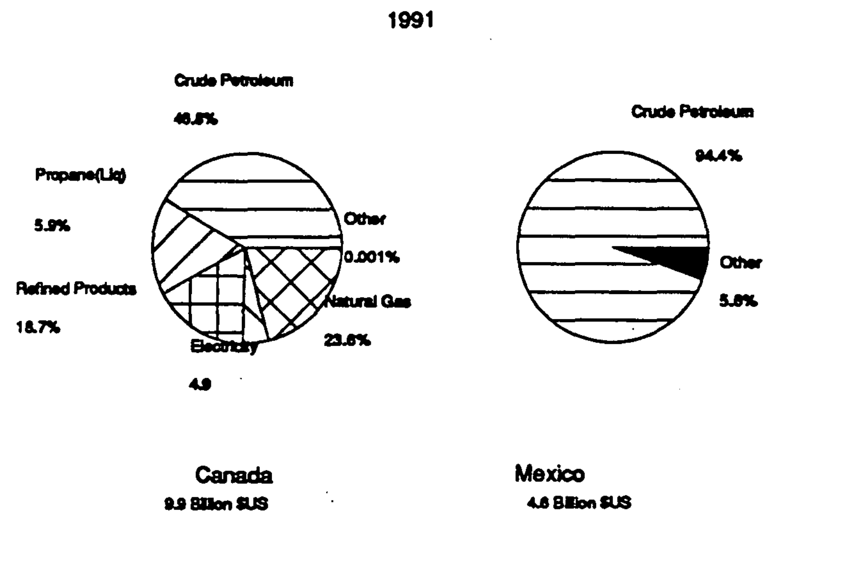
EXPORTS TO THE UNITED STATES BY PRINCIPAL COMMODITIES (1991)($US)

ENERGY PRODUCTS

The magnitude and composition of Canadian and Mexican energy exports to the U.S. is illustrated in Chart 7.

Crude petroleum dominated Mexico's energy exports to the U.S., accounting for $4.3 billion in 1991 or 94.4% of total Mexican

Chart 7: Exports of Energy to the U.S.

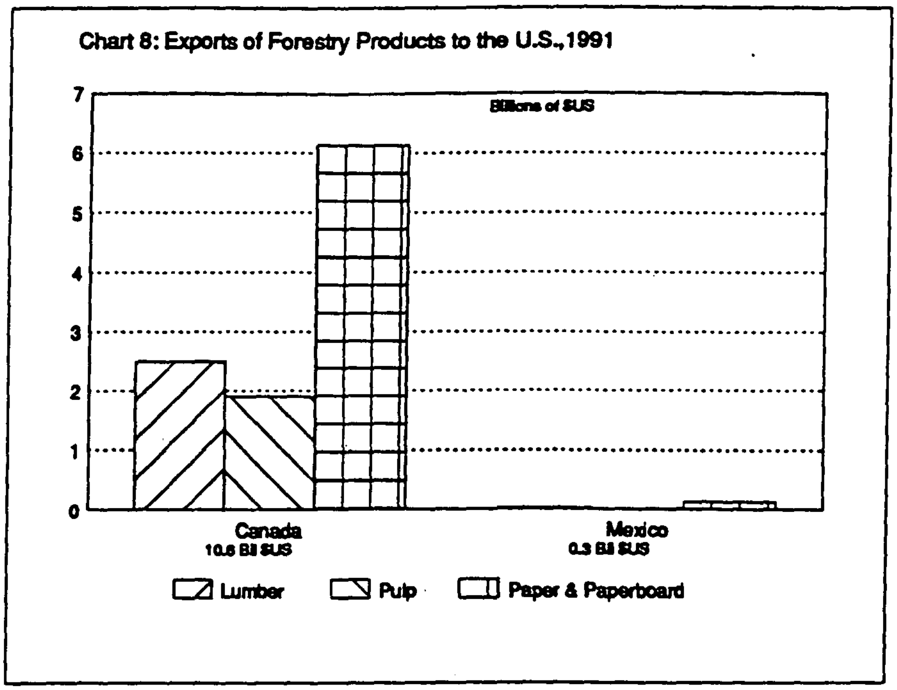


energy exports to the U.S. Other energy related products exported to the U.S. included $164 million of refined petroleum products and $93 million of liquified propane.

Canadian energy exports are not only more significant than Mexico's ($9.9 billion vs $4.6 billion) but also are more diverse. Canada exported $9.9 billion worth of energy in 1991 representing 10.9% of total domestic exports to the U.S. The dominant export commodity was crude petroleum, at $4.6 billion, followed by natural gas at $2.3 billion and refined petroleum products at $1.9 billion. Canada also exported $487 million of electricity and $583 million of liquified propane.

FORESTRY PRODUCTS

The magnitude and composition of Canadian and Mexican exports of forestry products is illustrated in Chart 8.



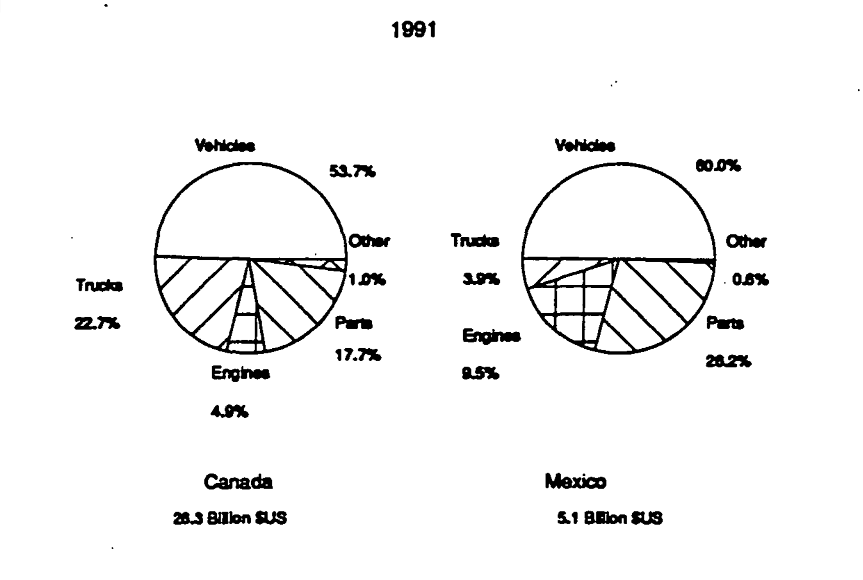
Mexico's forestry exports to the U.S. totalled only $255 million, or 0.8% of Mexico's total domestic exports. The total value of lumber exported was $29 million, woodpulp was $1.5 million, and paper or paperboard amounted to $120 million.

The Canadian forestry industry exports lumber, woodpulp and paper or paperboard to the U.S. These exports in 1991 totalled $10.6 billion or 11.6% of Canada's total domestic exports to the U.S. Of this total, $2.5 billion was lumber, $1.9 billion was woodpulp, and $6.1 billion was paper or paperboard.

AUTOMOTIVE PRODUCTS

The composition and magnitude of Canadian and Mexican automotive exports to the U.S. is presented in chart 9.

Chart 9: Exports of Automobile Products to the U.S.



The automotive industry is vital to both Canada and Mexico. Automotive exports accounted for 29.0% of Canada's exports to the U.S., or $26.3 billion, and represented the most important Canadian export product. In Mexico, automotive exports accounted for 16.8% of the country's total exports to the U.S., the second largest export industry.

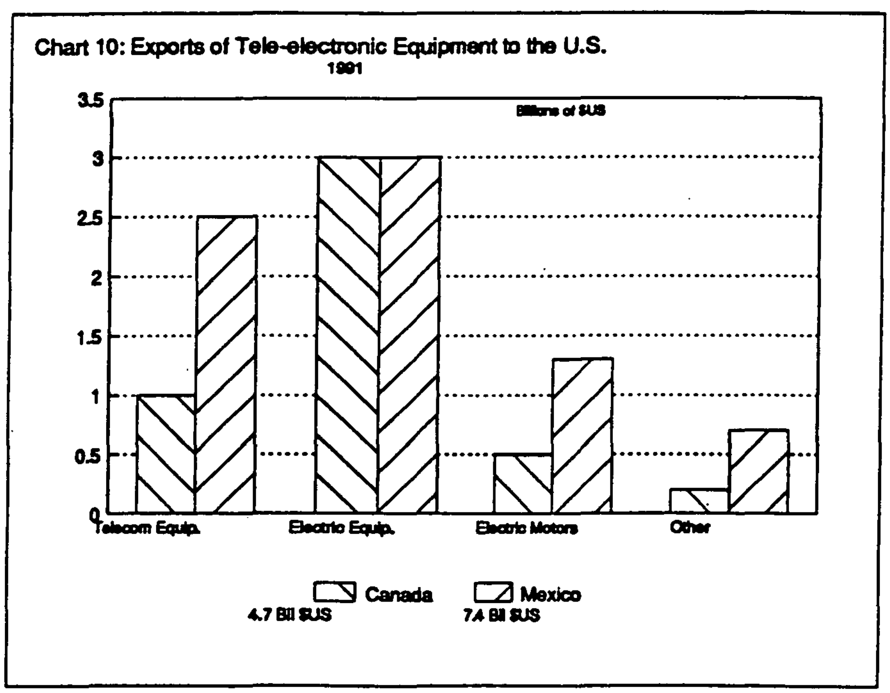
Mexico's automotive exports to the U.S., in 1991, amounted to $5.1 billion. The majority of these exports were motor vehicles at $3.1

billion, motor vehicle parts at $1.4 billion, motor vehicle engines at $484 million and trucks at $198 million.

Canadian exports to the U.S. are dominated by the automobile industry. In 1991, Canada exported approximately $14.1 billion worth of automobiles; $1.3 billion worth of combustion engines; $6.0 billion worth of trucks; and, motor vehicle parts worth $4.9 billion.

TELE-ELECTRONIC PRODUCTS

Chart 10 illustrates Canadian and Mexican exports of tele-electronic products to the U.S.



Exports of tele-electronic products accounted for 24.3% or $7.4

billion of Mexico's total domestic exports to the U.S. In Canada, exports of tele-electronic products accounted for only 5.1% of total domestic exports to the U.S., amounting to $4.9 billion.

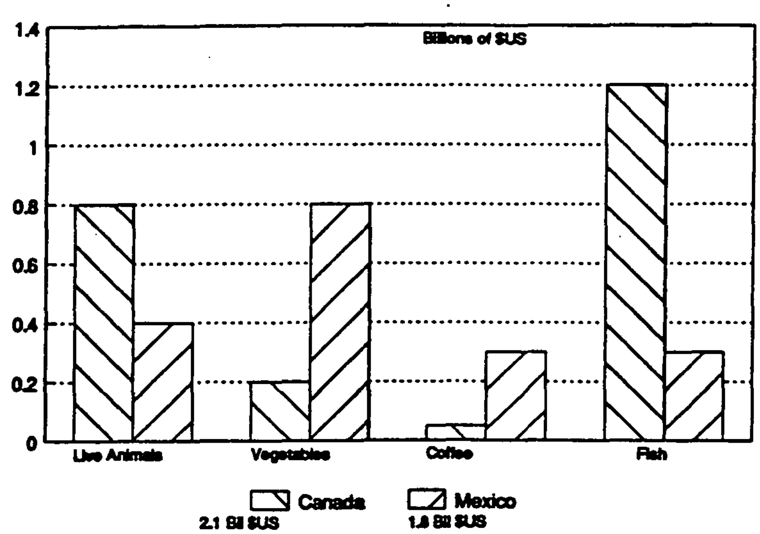
Mexico's exports of tele-electronic products were dominated by electric equipment worth $3.0 billion. Telecommunication equipment and electric motors are also important exports, valued at $3.2 billion and $1.4 billion respectively.

In 1991, Canada exported $3.0 billion worth of electric equipment, $1.0 billion of telecommunication equipment and $490 million of electric motors to the U.S.

FEED AND ANIMAL PRODUCTS

Chart 11 compares 1991 Canadian and Mexican exports to the U.S. for food and animal products.

Chart 11: Exports of Food Products to the U.S.,1991



Both Canada and Mexico export a large amount of food and food products to the U.S. In 1991, Mexico exported $1.8 billion worth of food products (5.9% of total domestic exports) to the U.S. The dominant commodities were vegetables at $812 million, coffee at $333 million, and live animals at $363 million. Canada exported $2.1 billion of food products to the U.S. in 1991. The dominant Canadian export commodities were fish and aquatic invertebrates valued at $1.2 billion and live animals valued at $754 million.

CONCLUSIONS

The value of Mexico's international trade has recently been increasing. A high percentage of the increase has been in trade with the United States, but most countries, including Canada, have also shown increased bilateral trade with Mexico. Mexico's trade initially was dominated by petroleum exports, but more recent trade figures show the rising importance of the manufacturing sector. The manufacturing sector has always been important in terms of Canada-Mexico trade, but its importance has also risen in terms of Mexico's global trade. Corporations are taking advantage of the low cost of labour in Mexico and have, therefore, expanded production there. Recent domestic and international policy initiatives, such as a
proposed continental trading block, would suggest that the trend to an increasingly open economy will continue in Mexico.

Mexico is not a major trading partner of Canada at this time. However, if free trade between Canada and Mexico does occur, the trading relationship may change. In order to understand the possible effects, it is important to understand the present situation.

Analysis of the 1991 Canadian and Mexican exports to the U.S. underlines several important trade features:

- The U.S. market is vital for both Canadian and Mexican exporters. This market represents 74.9% of total Canadian exports and 69.8% of the total Mexican exports. The ratio of Canadian exports to Mexican exports was 3 in 1991 down from 3.3 in 1980 indicating that Mexican exports to the U.S. grew somewhat faster than Canada's exports.

- The three most important Canadian export sectors, in order of importance are: (1) automobiles, (2) forestry, (3) energy. Combined, they represent $46.8 billion or 51.5% of total Canadian exports to the U.S.

- The three most important Mexican export sectors to the U.S. are: (1) tele-electronics, (2) energy, (3) automobiles. They represent $17.1 billion or 56.2% of Mexico's exports to the U.S.

- Most (94.4%) of Mexico's exports of energy is crude oil while this commodity represents only 46.8% of Canadian exports of energy products. Mexico, unlike Canada, is not an exporter of natural gas or electricity.

- Both Canada and Mexico export forestry products to the U.S. Canadian exports, however, due to Canada's relative abundance of forests and its cost advantage in the production, dominate the U.S. market.

- Both Canada and Mexico rely heavily on exporting their automobile products to the U.S. In 1991, Canada exported $26.3 billion worth of automotive products, while Mexican exports amounted to $5.1 billion. Currently (1991) Canada exports relatively more complete vehicles including trucks to the U.S. than Mexico (76% vs 64%). This difference is decreasing. In 1990, complete vehicles (including trucks) only comprised 55% of total automotive exports from Mexico to the U.S. (vs 72% for Canada). Mexico exports relatively more engines than Canada (9% vs 5%). Twenty-three percent (23%) of Canadian exports of automobile products consisted of trucks, while the corresponding proportion for Mexico was only 4%.

- Both Canada and Mexico are important exporters to the U.S. of tele-electronic products. Canada has a slight edge over Mexico in the production and exportation of sophisticated high technology goods while Mexico exports more labour intensive products such as TVs, radios and telecommunication equipment,

which are not produced in large quantities in Canada.

- Canadian and Mexican exports to the U.S. of food and animal products amounted to $2.1 billion and $1.8 billion respectively. The mix of these exports however, is significantly different with Mexico specializing in the exportation of vegetables and coffee and Canada exporting predominately fish.

With the exception of automobiles, crude petroleum and, to some extent, tele-electronic products, Canada and Mexico export a complementary rather than competitive mix of commodities to the U.S. Consequently, a trilateral Free Trade Agreement may not present any immediate threats to either country's exports to the U.S. (with the possible exception of complete automobiles). It will be interesting, however, to analyse just how the North American Free Trade Agreement, if successfully concluded, will or will not effect the volume and composition of Canadian and Mexican exports to the U.S.