

Institutional Challenges and the Means To Deepen Continental Integration

The policy agenda that must be addressed if further market integration is to take place within North America is likely to be more complex than the agenda that was accomplished by CUSTA and NAFTA. Initially, the primary focus of these agreements was the progressive dismantling of tariff barriers. It is now critically important to address institutional obstacles to the unification of markets within North America. The major dilemma confronting the single North American economy is that while product and factor markets are becoming more integrated across international borders, the institutions to support this integration remain largely national.

Deeper integration is dependent upon the provision of public goods such as the harmonization of standards to ensure that health, quality, safety, and environmental concerns are met throughout North America. It also is dependent upon the relaxation of such nontariff barriers as rules-of-origin, anti-dumping, and countervailing duties. Moreover, market distortions that inhibit deeper integration can stem from national policies and institutions, including domestic supply-managed programs, state trading enterprises, and cross-border differences in macroeconomic objectives.

More interaction and dialogue among the three NAFTA governments and their citizens would help identify and implement common approaches to common problems. The process of arriving at a consensus is often exceedingly difficult. As Helliwell put it, "trying to agree whether individual nations are legitimately exercising sovereign choices or, alternatively, are engaging in behavior that is unfair or damaging to other nations is invariably contentious."

Efforts to unify markets generate tension whenever integration erodes cultural and institutional differences among national economies or undermines sovereign autonomy (Lawrence et al.). While *openness* can advance the cause of market integration, *diversity* and *cohesion* are also important. Diversity accommodates different national conditions, preferences, and traditions. It also allows for experimentation and innovation. Cohesion holds a community together by trust, mutual respect, shared basic values, and institutions. It is needed if openness is to remain viable and diversity tolerated. There are often difficult choices policy-makers must make that involve tradeoffs between openness, diversity, and cohesion—even though the latter two forces may inhibit integration.

Greater market integration within North America can be achieved either through the development of harmonized NAFTA policies and/or through the coordination of the various national policies mutually affecting the three economies. Coordination can occur using the mechanisms of convergence, compatibility, and/or mutual recognition.

Harmonization

Harmonization involves the enactment of common policies and policy instruments (Josling). It is linked to the willingness of a country to suspend a degree of sovereignty. Within the context of NAFTA, harmonization entails a departure from country-based decisionmaking in favor of a supra-national process that introduces uniform or essentially similar policies and regulations in different countries.

Harmonization can improve economic efficiency. It often lowers production and marketing costs, benefiting both producers and consumers. For example, different product standards among member countries impose costs on processing firms, some of which are passed up to the retail level. Costs increase when products have to be tailored to the regulations in different countries because manufacturers need separate production runs for each market. Such regulations make it more difficult to manage inventories and product distribution. Moreover, regulatory systems that require producers to perform specific scientific tests and submit results are expensive. As such regulations have a substantial fixed-cost component, they impose a particularly large burden on small- and medium-sized firms that cannot spread implementation costs across a large sales volume (Short).

Harmonization can be accomplished within NAFTA through the establishment of uniform laws and regulations that require traceability of products and their ingredients. The countries in North America have already reached agreements on issues such as tariff reductions, common packaging standards and labeling, and the establishment of uniform sanitary and phytosanitary regulations (Short).

Food and consumer product trade associations play an important role promoting market integration for processed products throughout North America (Fogarty). In 1998, the North American Alliance was established, bringing together the Grocery Manufacturers of America, the Food and Consumer

Products Manufacturers of Canada, and Conmexico. All three associations influence the formation of science-based public policies in their own countries and provide legal, educational, and political expertise to member companies. The objectives of the North American Alliance are to facilitate harmonization of labeling, promote the establishment of uniform food safety standards, and reduce trade barriers that lead to market disintegration within North America.

Convergence

Another unifying path that can be followed to increase market integration is policy *convergence*. Convergence entails movement towards harmonization of programs and/or regulations over time. It is associated with changes in domestic policies (both internal and external) attributable to pressures that emerge due to increased interdependence among national economies as well as to reactions to common influences such as technical change (Josling). Convergence occurs in North American agriculture when increased market access and competition (due, in part, to market-liberalizing reforms) constrain the effectiveness of traditional domestic programs.

In Canada, the two-price wheat program was eliminated before the 1988/89 crop year. Policymakers recognized that the program would not be sustainable under the free trade agreement with the United States because Canadian millers and bakers could import wheat and wheat flour from the United States duty-free. Similarly, the United States refrained from using the Export Enhancement Program (EEP) for grain shortly after CUSTA was implemented. Continued implementation of EEP export subsidies was not tenable after Canada, a large grain supplier, gained unlimited access to the U.S. market. The boost in U.S. domestic prices due to these subsidies would have provided incentives to the Canadian Wheat Board to move more grain into the U.S. market. Increased Canadian imports would not only have rendered the EEP program prohibitively expensive, but would have put downward pressure on U.S. domestic prices, undermining the intended purpose of EEP subsidies to increase producer prices in the United States.

Compatibility

Compatibility is a third mechanism that can enhance market integration. Compatibility involves the development of policies, programs, regulations, and instruments which mitigate conflict (Josling).

One source of contention among NAFTA members is the application of national trade remedy laws that

often protect domestic industry from import competition (Loyns et al., November 2000). Legal mechanisms used to shield domestic producers include anti-dumping, countervailing duties, and the application of special duties or quotas when "safeguards" are triggered. The use of domestic-based laws to settle dispute among countries in North America encourages adversarial behavior and fosters market segmentation.

CUSTA/NAFTA created formal institutional mechanisms to help resolve trade disputes, strengthening the ability of member countries to render national policies more compatible. Under the agreement, member countries can request judicial review of anti-dumping and countervailing duties via NAFTA arbitration panels (Gifford, 1997, 2000). No party involved in a NAFTA dispute-resolution suit is allowed to block the adoption of the panel report.

Less formal institutional mechanisms under NAFTA capable of rendering member policies more compatible include the formation of committees, working groups, and other subsidiary bodies. While a primary aim of such organizations is to ensure effective implementation and administration of the free-trade agreement, they provide a vehicle for member countries to explore areas of mutual interest and to discuss possible alternative solutions for deepening continental integration. To date, 30 such organizations have been established. Examples include the Committee on Sanitary and Phytosanitary Measures, the Working Group on Grading and Marketing Standards, the Working Group on Rules of Origin, and the Animal Health Technological Working Group.

NAFTA institutional mechanisms, as well as government consultations and informational exchanges among experts, represent ways to reach agreement about contentious issues and remedial courses of action. Observers contend that conflict among NAFTA countries can be better managed and problems avoided should greater use be made of such resolution processes (Young et al.; Young, 2000).

Mutual Recognition

Mutual recognition is another coordinating mechanism that can increase market integration. It allows for the suspension of domestic regulations, standards, and certifications in favor of member-country procedures. One advantage of mutual recognition is that it helps preserve national diversity. Diversity accommodates cultural traditions and allows for experimentation and innovation (Lawrence et al.).

Mutual recognition has been used extensively in the European Union (EU) to reinvigorate market unification. By the early 1980s, EU policymakers had become aware that the much celebrated Common Market was not so common after all (Lawrence et al.). Many of the official barriers that had previously been removed had been replaced by a collection of nontariff barriers, national regulations, and private practices with a strong national bias. This led European leaders to launch the EU-1992 project. The principle of mutual recognition was a central feature of this new initiative.

Compared with the EU, there has been relatively little use of the mutual recognition mechanism in North America. One example of mutual recognition in NAFTA is "national treatment" of red meat, whereby the United States and Canada have excluded each other from their domestic import laws.

To summarize, deeper market integration within North America is dependent upon the formation of policies that address institutional barriers to reform. Harmonization, convergence, compatibility, and mutual recognition are distinct mechanisms that can be used to promote institutional change that lead to more integration. Greater integration can be achieved through the adoption of a more universal system of commercial law, common antitrust and regulatory procedures, and harmonization of product standards. It can also be achieved through better coordination of domestic farm, marketing, and macroeconomic policies. Institutional reform can greatly enhance the efficiency and legitimacy of markets. It is likely to draw strength from commercial and consumer demands that markets be allowed to function more effectively.