

# **T** rading up: the prospect of greater regulatory convergence in North America

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## Abstract

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Through the North American Free Trade Agreement (NAFTA), Canada, the United States, and Mexico have succeeded in achieving the benefits of shallow integration, removing the final vestiges of traditional market segregating policies. Changes in the nature of production, however, in part the product of market integration arrangements such as NAFTA, suggests that further steps may be needed to reap the full benefits of economic integration. This paper explores the role of earlier trade liberalization and market responses in shaping the emerging trade agenda in North America. It draws on experience in Europe in forging a more integrated market to point to the benefits that would accrue to Canadians, Americans, and Mexicans from taking deliberate steps to reduce the impact of border administration, to promote greater regulatory convergence, and to forge the necessary institutional infrastructure to govern deepening cross-border integration. To that end, the paper concludes by pointing to a series of modest steps the three governments can take to accelerate the trilateral integration agenda, and points to areas of further research required to achieve this agenda.



## I. Introduction

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Over the past 20 years, governments have made major strides in developing procedures and institutions to facilitate and encourage international regulatory cooperation. Markets have, at the same time, pushed governments to reduce regulatory differences and pursue regulatory convergence. Global standardization efforts at the ISO, FAO, and other international organizations have facilitated this process. Additionally, private and quasi-public standards-development organizations and certification bodies – such as the Standards Council of Canada and the American National Standards Institute in the United States – have accelerated their efforts to develop common, widely accepted and applied standards. Intergovernmental discussions at the OECD and WTO and through APEC, NAFTA, the Transatlantic Dialogue, and the North American Security and Prosperity Partnership have all contributed to a strong default position favouring cooperation and convergence in standards and regulations. The focus of much of this intergovernmental effort, however, has been on activity rather than on results. From the perspective of industry, consumers, and the standards-setting, testing, and certification community, the time has come for all this activity to be translated into programs leading to concrete, measurable results.

Lack of compatibility of regulations in various sectors from transportation and food safety, to telecommunications, pharmaceuticals, environmental protection, labour markets, and professional services adds to compliance and enforcement costs for both government and industry, continues to segment the three

national markets of North America, and requires continued border administration. Insufficient investment in infrastructure to keep pace with the near tripling in North American trade volumes since the mid-1980s has added pressure to the smooth operation of border crossings. Lessons from Europe and elsewhere suggest significant benefits from cooperation leading to more effective regulation, higher levels of compatibility, and reduced border administration.

For consumers, regulatory divergence is tantamount to a concealed “inefficiency tax” that citizens pay on virtually everything they purchase. This tax is the sum of the costs of duplicate regulations, border administration delays, and other regulatory impediments. For businesses, higher costs of compliance hinder their international competitiveness and complicate the most efficient deployment of scarce resources. For governments, regulatory divergence increases risk, reduces efficiency, and leads to less than optimum outcomes in achieving regulatory goals. Polling in all three NAFTA countries has suggested strong public support for regulatory convergence and more cohesive North American policies to improve living standards.

Since the implementation of the Canada-US Free Trade Agreement in 1989, the Canadian and US economies have become ever more deeply integrated, indicating the extent of broad regulatory compatibility but also bringing out in sharp relief the need for further efforts to ensure that remaining regulatory differences between the two countries serve a compelling public purpose rather than reflecting inertia, policy paralysis, or rent-seeking behaviour. The successful implementation of the North American Free Trade Agreement in 1994 accelerated the integration of the Canadian and US economies and added Mexico to the mix. Within a period of less than a generation, Mexico has become an integral part of North American markets and industrial structures and has made significant progress in modernizing its regulatory regimes in order to facilitate integration and underwrite its economic development. Mexican participation in North American regulatory cooperation networks, however, remains at a preliminary stage.

This paper examines the record of recent efforts to strengthen regulatory cooperation, considers the degree and pace of cross-border and North American integration, and explores the extent to which remaining regulatory impediments to integration can be addressed through intergovernmental cooperation strategies. To that end, the paper:

- Explains the changing global and North American industrial structures and their role in accelerating integration among the three North American economies;
- Defines the resulting challenge for the three North American governments in governing deepening economic integration and reducing transaction costs and regulatory divergence;
- Considers Europe’s experience and any lessons that may be applicable in North America;
- Formulates proposals for addressing and reducing regulatory differences;
- Proposes priorities in national policy strategies to reduce transaction costs within NAFTA; and
- Sketches out areas for future research that would add specificity to the proposals for greater regulatory cooperation to reduce transaction costs and border administration.



## **II. The changing face of international regulatory cooperation**

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Progress over the past sixty years in the development of international norms and disciplines on the development and application of standards and related regulations have significantly reduced regulatory barriers to trade in goods and services. Nevertheless, an explosion in quality-of-life regulations<sup>1</sup> has led to ever-growing demand that a wide range of products and production processes be tested and certified to exacting requirements. An equally broad range of services can only be supplied following onerous and often repetitive qualification and certification requirements. Compliance with different national and sub-national rules, together with the repetition of redundant testing and certification of products, processes, and providers for different markets, raise costs for manufacturers and providers operating in an integrated market. Complex and lengthy product- or provider-approval procedures can slow down innovation, frustrate new product launches, operate to protect domestic producers from foreign competitors, and create a drag on competitiveness, productivity, investment, and growth. Canada's Fraser Institute estimates that Canadian federal and provincial governments introduce more than 4,500 new or amended regulations every year while the Canadian Federation of Independent

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<sup>1</sup> The growth in quality-of-life regulations is focused extensively on matters of safety. The combined impact of both regulations and liability lawsuits has made manufacturers of vehicles, toys, children's products, bicycles, sporting equipment, and more find ways and means to meet increasingly exacting expectations about performance, reliability, and safety.

Business (CFIB) estimates that Canadian business annually spends \$33 billion or 2.6 percent of Canada's GDP in complying with this profusion of regulatory activity.<sup>2</sup> Similar orders of magnitude in the United States and Mexico underline the critical importance of regulations to modern life and suggest the need to consider the economic impact of subtle cross-border differences.<sup>3</sup>

Canadians, Americans, and Mexicans look to their governments to pursue largely similar goals and objectives in their regulation of the market and in managing risk. Canadians may insist that they want to remain a distinct entity north of the US border, but they also expect many of the things that Americans demand and they look to government to ensure that they get them. Mexicans have made great strides in the last two decades in modernizing their regulatory regimes and bring them up to the standards of Canada and the United States. As work at the OECD and elsewhere has made clear, competent jurisdictions seek and achieve fundamentally similar regulatory outcomes. Continuing differences are more likely to be matters of detail and implementation than of fundamental design and objectives. Nevertheless, the regulatory differences that persist and new – often small – differences that emerge in regulatory design, objectives, implementation, and compliance procedures, impose costs and maintain distortions that undermine the three economies of North America achieving their full potential. As the World Bank points out: “the cost of complying with regulations is a key determinant of a country's competitiveness and investment climate. These costs can be direct, such as capital and operating costs, or indirect, in the form of reduced innovation, investment, and productivity. Many governments are developing new initiatives to reduce the compliance costs of achieving public policies, which, when properly implemented, can reduce regulatory costs and improve policy results.” (World Bank 2006).

The regulatory “output” in all three countries may be roughly identical, but the United States disposes of much larger regulatory resources than does either Canada or Mexico; as a result, US regulatory “input” is roughly ten times that of Canada and even more than that of Mexico. Common sense suggests that all three countries can both reduce their costs and gain superior results by aligning more deliberately with each other and benefiting from much larger joint regulatory effort in selected areas, from drug approvals to environmental standards. Canada's smaller resource level

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<sup>2</sup> In its latest survey (Jones and Graf 2001), the Fraser Institute indicated that between 1975 and 1999, over 117,000 new federal and provincial regulations were enacted, an average of 4,700 a year. It estimated administrative costs to have reached \$5.2 billion by 1997/98, compliance costs \$103 billion, and “political” costs (regulation-related lobbying) \$10.3 billion, adding up to the equivalent of more than 12 percent of Canadian GDP. The CFIB (2005) estimate of \$33 billion is limited to business compliance costs. Such estimates are at best an inexact science but do provide an indication of orders of magnitude. Canada's Policy Research Initiative is looking at better ways to measure the extent and costs of Canada's regulatory regimes. See Ndayisenga and Downs (2005) and Ndayisenga and Blair (2006).

<sup>3</sup> An extensive survey of these costs in the United States has been catalogued by the Cato Institute. In a 2004 limited to federal regulations alone, it reported that:

- The 2003 Federal Register contains 71,269 pages.
- In 2002, the Register contained a record 75,606 pages.
- Regulatory agencies issued 4,148 final rules in 2003.
- In the 2003 Unified Agenda, agencies reported on 4,266 regulations that were at various stages of implementation throughout the 50-plus federal departments, agencies, and commissions, an increase of 2 percent from the previous year.
- Of the 4,266 regulations now in the regulatory pipeline, 127 are “economically significant” rules that will have at least \$100 million in economic impact. Those rules will impose at least \$12.7 billion yearly in future off-budget costs.
- Of the 4,266 regulations now in the works, 859 affect small business.
- The five most active rule-producing agencies, which accounted for 46 percent of the rules under consideration, were the Departments of Treasury, Transportation, Homeland Security, and Agriculture, and the Environmental Protection Agency.
- Regulatory costs are more than twice the \$375 billion budget deficit.
- Regulatory costs of \$869 billion are equivalent to 7.9 percent of U.S. gross domestic product, estimated at \$10,980 billion for 2003.
- Federal regulatory costs of \$869 billion combined with outlays of \$2,158 billion bring the federal government's share of the economy to some 27 percent.
- Regulatory costs also exceed all corporate pretax profits, which totaled \$665 billion in 2002 (Crews 2004).

Mark Crain calculates that the total cost of the federal regulatory burden had risen to US\$1.1 trillion by 2004 (Crain 2005; see also Crain and Hopkins 2001).

also translates into higher relative enforcement costs. Hopkins (1992) and Winston (1993) estimated that, on a per capita basis, the United States spends only about half of what Canada spends on regulatory compliance. Little work has been done to estimate the costs of enforcement and compliance in Mexico, but they are unlikely to be smaller than those of Canada.<sup>4</sup> Additionally, Mexico continues to face the major challenge of bringing its regulatory enforcement and compliance up to the level of its two North American partners. Canadians and Mexicans, in particular, would thus benefit from higher levels of cooperation and greater acceptance of the virtues of convergence.<sup>5</sup>

The OECD describes regulatory co-operation as the range of institutional and procedural frameworks within which national governments, sub-national governments, and the wider public can work together to build more integrated systems for rule-making and implementation, subject to the constraints of democratic values such as accountability, openness, and sovereignty (OECD 1994: 15). Such co-operation can be bilateral, for example, between Canada and the United States, regional as among all parties to NAFTA or to the European Union, or multilateral as among signatories to the World Trade Organization or the Food and Agriculture Organization. It is often described as a continuum, ranging from the least formal approach, such as basic information sharing, to complete harmonization. Canada's Policy Research Initiative describes regulatory co-operation as a toolbox of practices, and provides examples where Canadian regulators have used them, and potential advantages and disadvantages of applying the tools in practice (Canada PRI 2004).

Canadian and US experience in forging cooperative regulatory strategies has generally been positive. The North American food safety system, for example, in recognition of the highly integrated nature of food production in the two countries, is deeply dependent on cooperation among officials in all three countries. The 2003-05 BSE crisis, however, demonstrated that when market integration outstrips regulatory cooperation, trade can easily become hostage to minor regulatory differences (Caswell and Sparling 2005). It is also not difficult to find examples of sectors and regimes where there is room for more cooperation. Regulatory differences in the financial services, transportation, telecommunications, securities, competition, professional accreditation, drug approval, and similar areas suggest that there is considerable scope for exploring ways and means to reduce unnecessary duplication and divergence in regulatory design and compliance requirements.

Cooperation between Mexico and the United States remains at a much lower level than Canada-US cooperation, while Mexico-Canada cooperation is in its infancy. The 2005 Security and Prosperity Initiative recognizes that reality but places the desire for greater cooperation and convergence squarely on the trilateral agenda. Experience to date in implementing trilateral strategies are encouraging. The NAFTA Technical Working Group on Pesticides, for example, which brings together regulators from all three countries, is considered a model of regulatory cooperation, with results that have earned the confidence of regulators in all three countries (Doern 2006: 21-3). Similarly, the North American Council on Environmental Cooperation has made

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<sup>4</sup> Mexico's regulatory reforms since 1990 have significantly reduced the economic costs of regulation and placed Mexico among the World Bank's top ten regulatory reformers. The distance it had to travel, however, was such that the gap between the economic costs of regulation in Mexico and those in Canada and the United States remain substantial (World Bank 2006b). The extent of that gap can, to some extent, be extrapolated from the annual index of economic freedom prepared by the Fraser Institute: the United States was tied for 3<sup>rd</sup>, Canada placed 6<sup>th</sup> and Mexico was tied for 60<sup>th</sup> (Gwartney and Lawson 2006: 13).

<sup>5</sup> Efforts to estimate the economic and commercial benefits to Canada from regulatory cooperation remain at an early stage. The federal government's Policy Research Initiative reports one such study (Canada PRI 2004) based on a cash-flow analysis of the benefits of cooperation in approval for five classes of drugs and chemical substances. The results suggested an 8.2 percent gain in net income for Canadian producers, based on a 10.7 percent gain in the value of new product sales and a 4.8 percent gain in rate of return for new products.

substantial progress in bringing regulators together and encouraging a North American rather than national approach to environmental regulations (Kirton and Richardson 2006).

Historically, regulatory cooperation between Canada and the United States has been driven by market forces, similar to the forces that have deepened and accelerated integration between the two countries. In most instances, it is the natural result of officials with similar responsibilities and shared outlooks seeking support and validating relationships to pursue them. As a result, they have developed a dense network of informal cooperative arrangements to share information, experience, data, and expertise with a view to improving regulatory outcomes, reducing costs, solving cross-border problems, implementing mutual recognition arrangements, establishing joint reviews and common testing protocols, and more.<sup>6</sup>

Regulatory cooperation between Mexico and the United States is a more recent phenomenon, flowing increasingly from proximity and market integration, but grounded in policy efforts to modernize the Mexican economy and provide a better basis for economic development and bilateral trade and investment. Dialogues between US and Mexican officials are based on a number of realities and date back to Mexico's historic decision in the early 1980s to end its isolation from its North American neighbours and promote greater economic and other interaction. US interests initially focused on shared environmental concerns along the US-Mexican border, drug trafficking, and illegal migration, but have increasingly broadened in scope as a result of deepening economic integration. Cross-border cooperation now covers a broad range of areas where the two societies interact, but remains very asymmetrical in recognition of the need to enhance Mexican regulatory capacity.

Virtually all such regulatory cooperation takes place below the political radar screen. The issue that has now arisen is whether this piecemeal, incremental approach best serves the regulatory and economic development interests of all three countries. As George Haynal, a former senior Canadian diplomat, observes about Canada-US regulatory cooperation: "a process of policy convergence is already well in train ... The question is less whether we need to negotiate new instruments to further the process, but whether the public realm is capable of keeping up with emerging forces pushing us into deeper integration." (Hart 2000:6). The European Union (EU) determined in the mid-1980s that it had to adopt a comprehensive, top-down approach to reducing regulatory divergence among its member states in order to gain the full benefits of a single, integrated market. Is it time for Canada, the United States, and Mexico to consider a similar effort to get more out of cross-border regulatory convergence among themselves?

## 1. Regulatory convergence, divergence, and economic impacts

In any well-functioning modern industrial economy, regulations are ubiquitous.<sup>7</sup> They serve a welter of public purposes, from ensuring safety and social welfare to reducing abuses of power and ameliorating market failure. The effective operation of the market, for example, is critically dependent on the existence of a supporting framework of rules, regulations, and institutions such as

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<sup>6</sup> Anne-Marie Slaughter describes the broader, global manifestation of this kind of networking in considerable detail in Slaughter (2004).

<sup>7</sup> Tony Campbell, former chief of regulatory reform for the federal government in Canada, reports that his group identified 145 discrete regulatory programs in effect at the federal level in the mid-1980s. In addition, there were countless more operating in each of the ten provinces and three territories, some complementary or additional to federal programs, others duplicating federal efforts (Campbell 1991: 4).

private property, the courts, and more.<sup>8</sup> Rising living standards have amplified demand for such social priorities as higher levels of health, safety, reliability, environmental protection, human rights, and access to information, all of which rely on regulations. The University of Calgary's William Leiss observes that "although governments had accepted responsibility for some types of hazards early on, such as food safety and infectious disease, other mandates – especially for environmental risks – were added much later, layer by layer, down to the present." (Leiss 2000, 62). Like earlier economic regulation, much of this quality-of-life regulatory activity can have profound effects on trade and investment, pointing to the need to consider cooperative approaches aimed at reducing the trade distorting impact of differential regulation (National Research Council 1995).

In the widest sense, regulations encompass a diverse set of instruments by which governments set requirements on firms and citizens. Regulations can include laws, formal and informal orders, and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to which governments have delegated regulatory powers. Regulations are the means by which governments translate broad social and political goals into manageable tasks to achieve specific outcomes. It is how bureaucracies implement policies by translating the political goals of legislators into manageable tasks for officials. The secret to good regulatory practice thus often lies in appropriate definitions of goals and objectives. When goals are poorly defined, regulations become task driven, expensive, and not well received. Governments routinely add to the corpus of regulations, sometimes to good effect, as often to little purpose other than the political symbolism of being seen to be doing something about a perceived or an intractable problem. Regulators, in turn face the unenviable task of translating broad legislative intent into effective regulatory practice. The challenge of modern governance is to maintain a balance in the constant ebb and flow of regulatory demands, capacity, and effective delivery. An important contributor to meeting this challenge is learning from others, working with others, and cooperating with others.<sup>9</sup>

Regulations fall into three broad categories: economic regulations, which intervene directly in market decisions such as pricing, competition, market entry, or market exit; social regulations, which protect public interests such as health, safety, the environment, and social cohesion; and administrative regulations, such as paperwork and administrative formalities through which governments collect information and intervene in individual economic decisions (OECD 1997).

In most OECD countries, legislatures and officials, at national and sub-national levels, are engaged in a continuing process of rule making and adaptation. The vast majority of rules created by this dynamic process reflect similar policy objectives but diverse regulatory styles, legislative practices, institutional assignments, and implementation experiences. In the final analysis, however, many of these differences are marginal in their regulatory outcomes,<sup>10</sup> particularly between Canada and the United States – and over time between Mexico and its two northern neighbours – but annoying and even dysfunctional in their economic impact. The need to produce multiple versions of the same good, for example, can increase design and production costs, and prevent firms from enjoying the economies of scale that would flow from producing to satisfy a single globally accepted standard. For companies exporting to multiple markets, the promise of "one standard, one test, accepted everywhere" has become increasingly attractive.

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<sup>8</sup> There is no basis for the popular criticism that markets and governments operate in opposition to each other. See, for example, Rosenberg and Birdzell (1986) for a discussion of the critical role of rules and institutions in the economic development of western Europe and North America. The late Milton Friedman trenchantly observed that "privatization is meaningless if you don't have the rule of law. What does it mean to privatize if you do not have security of property?" (Gwartney and Lawson 2003: xviii).

<sup>9</sup> For excellent introductions to the difference between effective and ineffective regulation, see Sparrow (2000) and Wilson (1989).

<sup>10</sup> Outcomes refer to the actual, measurable outcomes intended by regulation, such as real reductions in risk as measured by lives saved, injuries avoided, and quality of life improvements. It does not refer to the act of regulation itself, seen by some as an outcome demonstrating sovereignty and distinct values.

Not all economic sectors, of course, are affected equally by the international dimension of regulatory diversity. Highly export-oriented firms such as those in the telecommunications, food, pharmaceutical, and forestry sectors, have a greater interest in international convergence than import-competing sectors. The nature of products (e.g., undifferentiated commodities versus goods and services with unique attributes) and the basis upon which they compete (e.g., price versus quality or performance) also have important implications for the role different regulations will play. Not surprisingly, therefore, sector-by-sector discussions about regulatory issues often yield the most satisfactory results in reducing unnecessary and costly barriers to trade.

## 2. Economic impacts

Despite progress in the development of international norms and disciplines, regulatory barriers to trade in goods and services remain a serious potential impediment to cross-border exchange. For suppliers of goods, the proliferation of diverse standards and regulatory requirements has been accompanied by a growing demand that, as a precondition of sale, compliance with standards be demonstrated through independent inspection, testing, or certification procedures. Such procedures are carried out either by the regulatory authority of the importing country or, increasingly, by quasi-public or private bodies operating on their behalf. For service providers, the need to demonstrate competence and reliability to multiple regulatory bodies can severely limit their mobility and capacity to specialize and develop innovative products.

From the firm perspective, the impact of similar but differentiated regulatory regimes can influence investment decisions. For small- or medium-sized firms, which lack subsidiaries or an established presence in foreign markets, the cost of acquiring knowledge of, and access to, another country's regulatory regime can effectively dissuade them from attempting to develop that market altogether. Furthermore, the imposition of arcane and burdensome standards, testing, certification, and accreditation requirements can be used effectively to frustrate imports and shelter domestic companies from competition.

Little systematic research has been done on the economic costs and harmful trade effects of differing regulations nor is there *prima facie* evidence that regulations are necessarily economically harmful or trade distorting. Indeed, there is much evidence that well-conceived regulations can be trade promoting and facilitating. As David Vogel points out: "while conflicts between trade and regulation are becoming both more numerous and more important, the policy goals of liberalization and more effective protective regulation are not incompatible." (Vogel 1995: 3). There is also no evidence to suggest that regulatory competition is necessarily harmful, although the costs of duplicative efforts may render such competition less helpful than some of its advocates assert.<sup>11</sup> In a North American context, in particular, regulatory competition is likely to impose a higher burden on Canadian and Mexican-based producers than on their US counterparts.<sup>12</sup> Unlike efforts to reduce and even eliminate tariffs and quotas, whose harmful effects are well-documented, governments' international approach to regulatory-related issues has been to isolate the problems they may raise and address these with measures to reduce or eliminate their trade-distorting effect.<sup>13</sup> As Michelle Egan points out: "technical barriers to trade – stemming from differences in standards, regulations,

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<sup>11</sup> See Stephan (2001) for an alternative perspective.

<sup>12</sup> A good example of regulatory competition gone awry was Canada's misguided decision to go metric in the 1970s, ostensibly to enhance prospects for trade with Europe. The result has been a major, and expensive, difference between Canada and its principal economic partner, and no perceptible increase in trade with Europe. Going metric would only have made sense in concert with the United States.

<sup>13</sup> For a fuller discussion of the economics of standardization and regulation, see Sykes (1995: 27-56). Useful discussions on changing regulatory issues can also be found in Doern, Hill, Prince, and Schultz (1999), Doern and Reid (2000), Sparrow (2000) and Doern and Johnson (2006).

testing, and certification policies – affect business operations directly, in terms of design, production, sales, and marketing strategies. ... [However,] empirically assessing the efficiency gains from removing technical barriers to trade is inherently difficult, since determining the size of the effects requires in-depth knowledge of the structure of the industry, including the relationship between market demand and price, and the slope of the cost curve.” (Egan 2001: 51-2).

### **3. Differences in standards related to compatibility**

Sorting out who does what varies among societies with different perspectives on the role of government and of the market. Should governments, for example, set compatibility standards or only ensure that private bodies do not set them in a manner to protect private interests or restrain trade? Is it a matter of safety or quality or one of compatibility? Problems of trade-inhibiting differences in product standards related to compatibility are generally well disposed of either as a result of market forces or the work of international standardizing bodies such as the International Standards Organization (ISO), the International Electrotechnical Commission (IEC), or the Codex Alimentarius – the Food and Agriculture Organization’s code on food safety standards. US analyst Alan Sykes notes that “both theory and experience suggests that market incentives to eliminate undesirable incompatibilities are often powerful and that much will be accomplished when the private sector is left to its own devices. Collective action problems and competitive imperfections, however, are a source of potentially important market failures.” (Sykes 1995: 36). Those that do distort trade tend to fall into two broad categories: those that predate efforts to create international standards (e.g., left- vs. right-hand drive vehicles) and those that were deliberately established to promote proprietary technologies (e.g., VHS vs. Beta videotape technologies or Apple vs. Microsoft computer operating systems). Neither of these are easily susceptible to efforts to eliminate differences.

### **4. Differences in standards related to quality or safety**

Problems of trade-inhibiting differences in standards related to quality or safety are a different matter. These often involve matters of social and other preferences, embedded either in law or in national practice. In such circumstances, it is important to distinguish between differences that are critical and those that can be met on the basis of satisfying similar objectives. Three principles can be used to mitigate differences: using the least restrictive means available, applying the regulation on a non-discriminatory basis, and promoting use of equivalence and mutual recognition provisions for differing regulatory or assessment procedures that meet similar or equivalent objectives. The WTO Agreements on Technical Barriers to Trade (TBT) and on Sanitary and Phyto-Sanitary Measures (SPS), for example, have already made significant progress in enshrining these principles into enforceable rules governing trade in goods, but they could be refined further and extended more fully to sub-national authorities and private standards-setting bodies. In the services area, the General Agreement on Trade in Services (GATS) and its annexes provide a good start in creating a framework within which to address problems created by regulatory differences affecting trade in services. Similar provisions in regional agreements seek the same objectives among more limited contracting partners, often with greater effect.

The trade impacts of regulations can be divided into two broad categories: those intended to discriminate in favour of local producers, and those that are the incidental result of measures aimed at other objectives. The first represents the residual elements of traditional trade liberalization negotiations, and includes such measures as remaining tariffs, government procurement restrictions, trade remedy laws, and similar measures. The second involves a wide range of measures that reflect the complexity of modern economies and the response of governments to demands ranging from

consumer protection to environmental stewardship and human rights. Michelle Egan points out in her study of the European experience that “many regulations have laudable public policy goals, [but] like standards, they can create non-tariff barriers by making it more difficult or costly for foreign importers to market their products. ... Distinguishing between those forms of rent-seeking domestic regulations that were easily identifiable as illegitimate and other forms of restriction on exchange such as regulations on health, safety, and the environment has become increasingly difficult.” (Egan 2001: 56-7). The trade and investment effects of the first can continue to be addressed with the traditional approach embedded in trade and investment liberalization agreements; the second may require higher levels of cooperation to identify those regulations that no longer serve any useful public purpose, those that can be implemented and administered on a basis that limits or eliminates the impact of differences, and those where differences are profound and important. Only the latter may need to continue to create any substantive barriers to trade, but on a much more limited basis than is often the case today.

Research by the OECD and other institutions indicates that divergent standards and technical regulations in different national markets, coupled with the costs of testing and certifying compliance with those requirements, can constitute between 2 and 10 per cent of overall production costs (OECD 1996). Similarly, industry surveys and other studies almost unfailingly document conformity testing and certification provisions as a significant, and growing, obstacle to international trade. Not surprisingly, conformity assessment has become an important service industry in its own right, as seen in the rapid growth in the number and size of testing laboratories, certification and quality assurance bodies, auditors, and accreditation organizations in industrialized and developing countries alike.

## 5. Regulatory convergence and standardization

In considering the issues involved in promoting intergovernmental regulatory convergence, it is important not to confuse what is happening and may be required on the regulatory front with ongoing efforts to increase standardization. In all three countries, there are a range of private sector standards developing organizations (SDOs), working closely with industry and government in developing both product and process standards. Much of their work, in turn, influences the regulations developed by governments.<sup>14</sup> In Canada, the Standards Council of Canada (SCC) is the principal SDO, working through various committees with industry and the International Standards Organization and the International Electrotechnical Commission. Canadian officials, have provided the secretariat for standards development for the ISO 9000 (quality) and ISO 14000 (environmental) management systems and also for several important industries, including paper, board and pulp, nickel and nickel alloys, and timber structures. Although Canada’s participation in the IEC is more limited than in the ISO, Canada holds the secretariat for four technical committees. Through the SCC, Canadians are also active in key regional and international accreditation forums, including the International Accreditation Forum, Inc. (IAF), the International Laboratory Accreditation Cooperation (ILAC), the Pacific Accreditation Cooperation (PAC), the Asia Pacific Laboratory Accreditation Cooperation (APLAC), the North American Calibration Cooperation (NACC), and the International Auditor Training and Certification Association (IATCA). These bodies promote the international acceptance of accreditations related to management systems registration, calibration and testing, product certification, and the training and certification of auditors. Canadians also participate in many of the other organizations that develop standards used internationally, including various prominent American standards-development organizations such as

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<sup>14</sup> Standards are established by recognized bodies and set out non-mandatory rules, guidelines, or characteristics for products or related processes and production methods. Regulations are established, directly or indirectly, by governments and set out product and production characteristics and performance requirements compliance with which is mandatory.



the Institute of Electrical and Electronic Engineers (IEEE), the American Society for Testing and Materials (ASTM), the American Society for Mechanical Engineers (ASME), National Fire Protection Association (NFPA), and the Society of Automotive Engineers (SAE), which sets the de facto standards for the North American automotive industry.<sup>15</sup>

The American National Standards Institute (ANSI) similarly coordinates the development and use of voluntary consensus standards in the United States and represents the needs and views of US stakeholders in standardization forums around the globe. In Mexico, the General Bureau of Standards (Dirección General de Normas, DGN) performs the same function. Both oversee the creation, promulgation, and use of thousands of norms and guidelines that directly affect businesses in nearly every sector: from acoustical devices to construction equipment, from dairy and livestock production to energy distribution. Both are also engaged in accrediting programs that assess conformance to standards – including globally-recognized cross-sector programs such as the ISO 9000 and 14000 systems. Similar to the SCC, ANSI is the US representative of the ISO and the IEC in the United States, via the US National Committee (USNC), and DGN performs this function in Mexico.<sup>16</sup>

Because of the inter-connected natures of the Canadian and American economies, Canadian and US regulatory and standard-setting officials work closely together to manage and implement a vast array of similar but not identical regulatory regimes and standards.<sup>17</sup> In effect, they have developed a dense network of informal cooperative arrangements to share information, experience, data, and expertise with a view to improving regulatory outcomes, reducing costs, solving cross-border problems, implementing mutual recognition arrangements, establishing joint testing protocols, and more. On any given day, dozens of US and Canadian officials at federal, provincial, state, and SDO levels are working together, visiting, meeting, sharing e-mails, taking phone calls, and more. Virtually all of this activity takes place below the political radar screen. Little of it is coordinated or subject to a coherent overall view of priorities or strategic goals. Some of it is mandated by formal intergovernmental agreements ranging from the NAFTA to less formal memorandums of understanding among SDOs. More importantly, much of this activity is the natural result of officials with similar responsibilities and shared outlooks seeking support and relationships to pursue them. This activity also reinforces, subtly and indirectly, deepening integration. In North America, unlike in Europe, integration has been largely “silent,” i.e., flowing from market forces and proximity, rather than from government direction. The NAFTA and similar arrangements mark efforts by governments to catch up with these forces of silent integration and provide appropriate and facilitating governance.

Similarly, private industry in Canada and the United States, in setting and adopting standards, indicate an overwhelming preference for each other’s standards, certification, and conformity assessment procedures. While specific firms and industries may occasionally opt for non-North American standards due to specific market opportunities, government and industry alike operate increasingly within the reality of an integrated North American economy.

While these informal, cross-border Canada-US activities probably occupy more of the time and energy of officials, particularly of officials in domestic departments and agencies responsible for the bulk of regulatory activity, they do not enjoy the same political and public profile as various “dialogues” on regulatory cooperation with selected trading partners. Various such dialogues are

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<sup>15</sup> See the website of the SCC, <http://www.scc.ca>, for more detail on these and other activities.

<sup>16</sup> See the website of the ANSI, [www.ansi.org](http://www.ansi.org), and DGN, [www.digenor.gov.do](http://www.digenor.gov.do), for more detail on these and other activities.

<sup>17</sup> For example, the SCC and the US National Institute for Standards Technology (NIST) manage a 1994 agreement for the mutual recognition of the testing laboratory systems they each administer. For the benefit of an industry that exports \$1 billion in fasteners annually to the United States, the SCC has concluded an agreement with relevant American agencies so that assessments for conformity with US regulations on Canadian-made fasteners can be performed in Canada.

currently in play, including with the EU, with Japan, and as part of APEC (Asia-Pacific Economic Cooperation).<sup>18</sup> Similar activity forms part of the negotiations for a Free Trade Area of the Americas and figures on the agenda of a number of smaller bilateral free-trade negotiations. None of these, however, have the same impact as the largely unseen but vast cooperative networks among Canadian and US officials and among Canadian and US private-sector actors.

All three governments are also actively involved in mutual recognition agreements. Agreements can be negotiated between governments (e.g., the 1998 Canada-EU MRA covering telecommunications equipment, electro-magnetic compatibility, recreational craft, electrical safety, good manufacturing practices for pharmaceuticals, and medical devices), between accreditation bodies (e.g., the agreement between the SCC and ANSI and the Registrar Accreditation Board on quality management systems registration, and between testing and certification organizations (e.g., the agreements the SCC has concerning electrical safety standards with standards bodies in more than 30 countries).<sup>19</sup> The WTO TBT Agreement encourages members to accept other members' product tests and approvals as long as they provide equivalent guarantees in terms of quality, health, safety and other requirements.

As important as standards-setting activity is to a well-functioning North American economy, the focus of the rest of this paper is on regulatory regimes. Market forces dispose SDOs to pursue their activity with dispatch and efficiency. Politics and bureaucratic behaviour, on the other hand, limit both the scope and the pace of intergovernmental regulatory cooperation, whether within Canada, the United States, or Mexico in dealing with differences among the states or provinces, or among the three federal governments on a North American basis. The challenge, therefore, is to look for ways and means to ensure that intergovernmental regulatory cooperation in North America meets the needs and aspirations of the people of Canada, the United States, and Mexico.

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<sup>18</sup> Further detail on these activities is available at the combined website operated by the departments of Foreign Affairs and International Affairs, [www.international.gc.ca](http://www.international.gc.ca).

<sup>19</sup> Other recent MRAs pursued by Canada include the Asia-Pacific Economic Cooperation (APEC) Mutual Recognition Arrangement for Conformity Assessment of Telecommunications Equipment (signed 8 May 1998); the Pacific Accreditation Cooperation (PAC) and International Accreditation Forum (IAF) MRAs on quality management systems registration accreditation (signed 24 January 1998); the APEC MRA on Food and Food Products Safety (not yet signed). MRAs are also planned under the North American Calibration Cooperation (NACC – Canada, United States, and Mexico) for metrology and similar issues. The US-EU Transatlantic TEP contemplates a continuing program of activity. As Charles P. Ries, Principal, Deputy Assistant Secretary for European and Eurasian Affairs told the Senate: "While these arrangements are therefore informal in nature, they enhance regulatory cooperation between the parties involved to an unprecedented degree. As US and EU officials exchange information, ideas, and opinions, they build trust and confidence, and, as a result, make more informed and coordinated decisions. In promoting trust, transparency, and more informed regulation, these arrangements demonstrate the effectiveness and desirability of working-level discussions between the US and the EU." (Ries 2003).

### III. The new industrial context: fragmentation and integration

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Consideration of the emerging regulatory agenda in North America is taking place against the background of a much more integrative form of cross-border trade and investment than was common only a generation ago.<sup>20</sup> Many more goods traded internationally today are parts and components for assembly into end-products closer to the point of final consumption. Production is being geared to a much wider market, the range of goods and services that are exchanged internationally has widened considerably, and capital and technology move between nations much more easily. Global competition, scientific and technological breakthroughs, as well as consumer sophistication are shortening the product cycle and placing a premium on quality, manufacturing fluidity, and innovation. International exchange now involves a much more complex and sophisticated range of economic transactions and is as likely to involve dealings among related than unrelated parties. The vertically integrated firms of the early post-war years have given way to much more flexible, horizontally organized enterprises.<sup>21</sup> Production is steadily being

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<sup>20</sup> The UNCTAD Division on Transnational Corporations and Investment reports that by 2005, some 77,000 firms qualified as multinational in their activities, each accounting for an average of ten separate foreign affiliates. World-wide sales by foreign affiliates had reached US\$22.2 trillion in 2005, nearly double world-wide exports of goods and services at US\$12.6 trillion (UNCTAD 2006).

<sup>21</sup> See Lamoreaux, Raff, and Temin (2003). Much of the article is a critical analysis of the lessons of business history since Chandler wrote *The Visible Hand*. See also Chandler (1990) and Williamson (1985) for the essential theoretical underpinnings of our understanding of the modern firm. See also the literature cited in Bernard 2006.

re-organized on a global basis and the nature of extra-national economic transactions reflects this change. In the words of the University of Manchester's Peter Dicken, the global economy has been transformed into "a highly complex, kaleidoscopic structure involving the fragmentation of many production processes, and their geographical relocation on a global scale in ways which slice through national boundaries." (Dicken 2003: 9).

The literature suggests that there were three basic catalysts to the acceleration of globalization: the steady liberalization of trade and investment among industrialized countries after the Second World War, the more recent rapid industrialization of the third world, and the impact of technological breakthroughs that have brought down the costs of transportation and communication. The impact of these three factors has been mutually reinforcing and cumulative. Duke University sociologist Gary Gereffi insists, however, that "of far greater significance are several novel features in the nature of international trade that do not have counterparts in previous eras: ... (1) the rise of intra-industry and intra-product trade in intermediate inputs; (2) the ability of producers to 'slice up the value chain,' ... by breaking a production process into many geographically separated steps; and (3) the emergence of a global production networks framework that highlights how these shifts have altered governance structures and the distribution of gains in the global economy." (Gereffi 2005: 166).

The fragmentation of production through a process of outsourcing and subsequent re-bundling within large and technologically sophisticated supplier networks has become increasingly prevalent in industries from food processing, aviation, and motor vehicles to apparel, electronics, and household products.<sup>22</sup> Both value-chain fragmentation and the sophistication of the firms that make up the fragments have made it easier to relocate specific nodes of production and to take advantage of a range of distant factors, from low-cost labour and specialized skills to access to critical inputs and public policy considerations. As the production of manufactured goods becomes ever more disaggregated, varied, and sophisticated, the cost of developing and manufacturing new products has increased exponentially. More and more, the costs are concentrated in developing the product – both the product and the most cost-effective process by which to manufacture it – rather than in production, devaluing the labour content in many products and increasing the risk in producing it. MIT geographer Tim Sturgeon points out: "In both manufacturing and service industries, ... many companies have been shifting specialized activities out-of-house to an increasingly competent set of suppliers, contract manufacturers, and intermediaries. ... While offshore assembly was initially done by the subsidiaries of multinational firms, growing capabilities in the supply-base led to the emergence of independent and highly sophisticated developing country suppliers in places like Taiwan, Korea, and Singapore as well as a cadre of huge 'global suppliers' headquartered mainly in developed countries but with extensive worldwide operations." (Sturgeon 2005; see also Sturgeon 2006).

Li & Fung of Hong Kong is a prime example of a modern specialist in managing the economics of fragmentation and agglomeration. It has access to a network of about 7,500 contract suppliers all over Asia employing at any one time as many as 1.5 million workers, providing a critical mediating service bringing brand-name firms together with highly efficient contract manufacturers. Li & Fung takes orders from companies all over the world to "make things" for them, from toys, ballpoint pens, and golf clubs to computers, refrigerators, and televisions. It in turn finds the right contract manufacturer and organizes the logistics to supply the ordered "thing" to the customer, based on the customer's specifications. Many contract suppliers maintain offices in

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<sup>22</sup> Arndt and Kierzkowski note "fragmentation is not a new phenomenon; nor is outsourcing. ... In the modern era, however, both have acquired international dimension and complexity and probably represent one of the most important distinguishing features of contemporary globalization." (Arndt and Kierzkowski 2001: 2).

Hong Kong to liaise with Li & Fung and provide it with product development and engineering information (Curzon Price 2001: 96).<sup>23</sup>

Firms like Li & Fung are key to understanding the increasing role of China in the value-added chain: the location of choice for “making things.” India, on the other hand, has become the favoured place for service inputs. An increasing range of service inputs are being sourced in India, taking advantage of its wealth of information technology professionals and English-speaking, well-educated office workers. Its contribution began with low-value-added activities, such as back-office transactions and call centers, but steadily expanded to include software programming, engineering, design, accounting, legal and medical advice, and a broad array of other professional services. “The computerization of work, the advent of the Internet, the standardization and automation of a range of business processes, and the availability of very low-cost, high-speed data networks have made it easier for firms in advanced economies like the United States to connect to the capabilities that exist in developing countries like China, Ireland, Australia, Canada, India, and the Philippines, and this combination of factors appears to be causing a wide range of ‘knowledge work’ to become more footloose.” (Sturgeon 2005).

Fragmentation and integration combine to increase the extent and intensity of international transactions, allowing slices of the production process to be moved to the best possible location. The speed and efficiency with which these slices can be integrated clearly have a bearing on the optimal degree of fragmentation. Fragmentation thus allows firms to specialize to a much greater degree and reap greater advantages from economies of scale and scope. Gereffi notes that “today, we live in a world in which deep integration, organized primarily by transnational corporations (TNCs), is pervasive and involves the production of goods and services in cross-border value-adding activities that redefine the kind of production processes contained within national boundaries. ... While the postwar international economic order was defined and legitimized by the United States and the other core powers that supported it in terms of the ideology of free trade, it was the way in which transnational corporations linked the production of goods and services in cross-border, value-adding networks that made the global economy in the last half of the twentieth century qualitatively distinct from what preceded it.” (Gereffi 2006: 163-4).

Systematic data on the extent of this integration is difficult to find, in part because official statistics still pay too little attention to trade in parts and components and cannot capture the full value of cross-border service links or the input of services provided through proprietary and other networks, e.g., design, engineering, and marketing, whether done in-house, outsourced locally, or outsourced internationally. Statistical agencies have no way of counting the value of Italian design and German engineering in a toilet ultimately manufactured in Mexico and imported into Canada through a US distribution network. They count the computer on which this is being written as a Chinese import, rather than as the fruit of the design, engineering, and marketing input of Apple’s Cupertino, California campus.<sup>24</sup> In a world in which tariffs are increasingly unimportant, customs officials are less interested in the origin or foreign value-added of a particular cross-border transaction and are content to record its final transaction price. The data they supply to statistical

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<sup>23</sup> As its website boasts, “Li & Fung is today one of the premier global consumer-products export trading corporations managing the supply chain for high-volume, time-sensitive consumer goods. Our mission is to deliver the right product at the right price at the right time.” [www.lifung.com](http://www.lifung.com). See also “Manufacturing Survey,” *The Economist*, June 20, 1998.

<sup>24</sup> As Business Week points out, the statistical wizards at national statistical agencies “have no way of tracking the billions of dollars companies spend each year on innovation, product design, brand-building, employee-training, or any of the other intangible investments required to compete in today’s global economy.” (Mandel 2006). The increasing proportion of services in national accounts reflects not only a more prosperous economy with an increasing desire for services rather than goods, but also the disaggregation of production into increasingly smaller slices, many of which are counted as the production of services rather than as part of the goods in which they are embedded, as well as the service links required to bring the spatially separated slices together. See also Ridgeway (2006).

agencies often severely overvalue the last transaction and undervalue the diverse inputs from other countries.<sup>25</sup>

From a policy perspective, governments are particularly interested in the intersection of firm-specific and location-specific value. Firms are now less constrained in their choices of geographic location by distance and policy, and seek to enhance value by dispersing their activities spatially. Governments, in the interest of attracting value-added activity to their location-specific jurisdictions, now compete in promoting policy settings that are congenial to increasingly mobile slices of production by removing barriers and providing positive incentives. In this quest, they are learning that the trade agreements of the past may have been critical to providing the framework of rules that initially promoted fragmentation and integration, but are no longer sufficient. The new rules of the game involve the regulatory regimes that now condition investment and production decisions.

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<sup>25</sup> Alexander Yeats, by analyzing data for selected industries and extrapolating the results more widely, estimates that a third or more of world trade is made up of parts and components (Yeats 2001).

## IV. North American integration

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The integration that increasingly characterizes the global economy has a longer history at a bilateral Canada-US level. In an earlier era, proximity disposed Canadians to develop a trade and investment dependence on the US market and US capital. The exploitation of Canada's storehouse of raw materials and the establishment of miniature-replica branch plants both developed with heavy doses of US capital. Today, Canada exhibits a high level of both production and consumption dependence on the United States (Wallace 2002). Its earliest modern manifestation involved the automotive industry. A unique set of circumstances at the time, captured in the Autopact, encouraged the development of integrated, cross-border production (Hart 2002: 240-47; Anastakis 2005). Much of what is now commonplace was pioneered in the auto sector: in-house fragmentation and outsourcing on a continental rather than regional or national basis, followed by out-of-house cross-border fragmentation. The successful introduction of lean, just-in-time production techniques, pioneered in Japan and introduced in North America in the 1980s, further accelerated this fragmentation process (Womack, Jones, and Roos 1990).

Mexico joined this process with the introduction of its Maquiladora program in the 1960s, particularly for those firms who were able to leverage Mexican tax, investment, and customs programs with US outward processing rules. An increasing number of US-based firms experimented with locating labour-intensive slices of production in northern Mexico, including auto assemblers looking to create a

broader production base in North America to compete with Asian assemblers. Some Canadian-based firms similarly experimented with moving parts of their production process to Mexico, but with less satisfactory results.<sup>26</sup>

Since the implementation of the CUFTA and the NAFTA, fragmentation has become commonplace throughout North American industry, involving both manufacturing and service industries.<sup>27</sup> High levels of both two-way intra-industry trade and foreign direct investment indicate continued cross-border integration and rationalization of production between Canada and the United States and the United States and Mexico, as well as a deepening interdependence of manufacturing industries. Canada is the second-leading destination for US foreign direct investment while the United States is the prime destination of Canadian FDI. The United States is by far the largest investor in Mexico and Mexican investment in the United States has increased rapidly over the past decade. Proximity of the US and Canadian industrial heartlands, well-developed infrastructures, and transparent legal systems all contribute to the highly integrated nature of the Canadian and US economies. In turn, this integration contributes to a high level of trade as each country is the other's largest foreign market and leading supplier of imported goods.<sup>28</sup> US-Mexican integration grew rapidly in the 1990s, but has slowed somewhat since then as US investors re-consider the best locations for low-cost production value-added activities.

Discussion of international economic patterns often focuses on trade in goods and emphasize exports. A more realistic picture emerges, however, by looking at imports and exports of both goods and services, at inflows and outflows of investment capital, at sales by foreign affiliates, and at exports of goods as a share of domestic shipments. As Howard Lewis and David Richardson point out, "it is becoming increasingly meaningless, if not outright impossible, to think of trade as something separate from cross-border investment, or of exporting as something separate from importing products and innovative ideas. All are tied together in the extended family of global commitment." (Lewis and Richardson 2001: 11). As such, North America's involvement in the global economy is much more diversified and the full importance of international exchange becomes clearer. It also makes clear why, as the US economy moves further up the value chain, so do the Canadian and Mexican economies, increasing trade opportunities for foreign exporters to North American markets and investment opportunities in overseas economies.

## 1. The extent of Canada-US integration

In 2005,<sup>29</sup> Canadian firms and individuals produced \$520 billion in goods and services for export and imported C\$468 billion in goods and services from all sources. The United States remained by far the most important destination for Canadian merchandise exports at C\$369 billion (84 percent), and the principal supplier of Canadian merchandise imports at C\$260 billion (67 percent). On the

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<sup>26</sup> The Mexican Maquiladora or "in-bond" industries were set up to take advantage of US legislation relating to foreign production using US inputs. Maquilas could import US components duty free and in-bond into Mexico and use these in the assembly and further manufacturing of upstream products which were then exported back to the United States. US importers needed to pay duty only on the value-added in Mexico. Mexican tax and investment incentives added to the attractiveness of the program to US firms. In the absence of a similar program in Canada, few Canadian companies invested in maquilas. The full implementation of the NAFTA by the beginning of the 21<sup>st</sup> century made much of the program redundant. It has now largely disappeared other than for products that cannot meet NAFTA's rules of origin or for trade with Non-NAFTA countries.

<sup>27</sup> For example, the North American agri-food sectors have become much more integrated. Canadian and US fresh fruit and vegetable consumption is growing and increasingly involves two-way trade, with the direction dependent on the season. Cross-border production by Canadian and US multinational food companies has steadily risen, lowering production costs and giving consumers access to a wider variety of products (Zahniser 2005).

<sup>28</sup> See USITC 1999 for a detailed assessment of the extent and nature of cross-border production sharing in the motor vehicle, aircraft, rail locomotives and rolling stock, computer hardware, semiconductor, and telephone equipment industries.

<sup>29</sup> Figures from Statistics Canada, Gross Domestic Product, Expenditure-Based, at [www40.statcan.ca/101/cst01/econ04.htm](http://www40.statcan.ca/101/cst01/econ04.htm), and Imports, Exports and Trade Balance of Goods on a Balance-of-Payment Basis.



investment front, Canadian direct investment abroad, with a cumulative book value of C\$465.1 billion in 2005, continued to outpace the cumulative book value of foreign direct investment in Canada at C\$415.6 billion. The value of Canadian direct investment abroad exceeded the value of foreign direct holdings in Canada for the first time in 1997 and has remained that way ever since. As a result of rising cross-border investment, Canadian firms are increasing their presence in the United States through sales by affiliates, particularly in the services sector, just as US-owned affiliates continue to have an important place in the Canadian market place. Analysis of cross-border investment patterns indicates that much of it is trade enhancing as Canadian and US firms strengthen their position in supply chains and distribution networks while overseas investment is geared more to substituting for trade. McCain's, for example, invests in Europe to process locally sourced inputs while it invests in the United States to enhance its ability to distribute product from its Canadian operations. Canadian firms have become increasingly involved in cross-border mergers and acquisitions, the principal vehicle for FDI flows and for seizing the advantages of deepening integrative trade. From the beginning of 2003 through the first quarter of 2006, Canadian firms acquired more than 1,000 foreign firms, while foreign firms acquired 373 Canadian firms (Yalden 2006).

In 2003, the latest year for which such data is available, about 43,310 Canadian-based firms were engaged in exporting. Of these, 27,747 (64.2 percent) exported to the United States alone, 5,802 (13.4 percent) exported only to non-US destinations, and 9,671 (22.4 percent) to both. Fewer than 4 percent of these firms, accounted for more than 80 percent of total exports, and 12 percent accounted for 93.5 percent of Canada's total merchandise exports. The profile of successful exporting firms is also highly skewed toward foreign-controlled firms. Of the 44,469 firms who registered as exporters in 2002, only 3,597 (9 percent) were foreign-controlled, but they were responsible for nearly half of merchandise exports (Byrd 2006; Canada 2005a).

Similar data is not available on the number of Canadian-controlled exporting establishments with assets or affiliates in foreign markets, particularly the United States, or of the ownership and investment profile of importing establishments, but the data on the dominant position of foreign-controlled exporters suggests that firms active in international markets as traders are also active in those markets as investors. As Lewis and Richardson discovered, internationally engaged firms are more productive and innovative, pay higher wages, and are more profitable, not just in the United States, but in most other economies (Lewis and Richardson 2001).

Both cross-border and global supply chains today depend critically on relationships that extend well beyond arm's-length transactions between customer and supplier. As US business economist Stephen Blank notes "Ottawa and Washington talk about the world's largest bilateral trading relationship. But we really don't trade with each other, not in the classic sense of one independent company sending finished goods to another. Instead we make stuff together; ... [we] share integrated energy markets; dip into the same capital markets; service the same customers with an array of financial services; use the same roads and railroads to transport jointly made products to market; fly on the same integrated airline networks; and increasingly meet the same or similar standards of professional practice." (Blank 2005).

Philip Cross and his colleagues at Statistics Canada have done extensive work trying to understand the changing nature of cross-border trade, production, and investment patterns. They have calculated that the import content of Canadian exports has risen steadily over the past two decades. It was 25.5 percent in 1987 and peaked at 33.5 percent in 1998. The rapid rise in trade in the 1990s was in large part the result of rationalization, with imported components replacing domestic components, with the final product exported to a broader market base. More significant than the rise in exports as a share of GDP was the rise in value-added exports in GDP, which rose from 21.4 percent in 1987 to reach 28.8 percent in 1999 (Cross and Cameron 1999 and Cross 2002).

The recent increase in the value of sales of energy products has had a dampening effect on a further rise in the import content of Canadian exports, but not on their Canadian value-added content.

The extent of the import content of Canadian exports varies considerably from industry to industry. Not surprisingly the auto sector, benefiting from high levels of cross-border ownership since its inception and, since 1965, the impact of the Canada-US Autopact, is by far the most integrated, with the import content of Canadian exports exceeding 50 percent, followed by machinery, equipment, and electronics at over 40 percent, and textiles, other manufacturing, metals, oil refining, and chemicals exceeding 30 percent. Even food, forestry products, and agriculture exceeded 10 percent (Cross 2002: Figure 2). Economist Glen Hodgson concludes that “trade has evolved beyond the traditional exporting and importing of goods, and has entered the next generation of trade – integrative trade. Integrative trade is driven by foreign investment and places greater weight on elements like the integration of imports into exports, trade in services and sales from foreign affiliates established through foreign investment.” (Hodgson 2004a: 5; see also Hodgson 2004b). Nowhere has this process of integration been more pronounced than between Canada and the United States.

The rise in Canada’s export dependence on the United States in the 1990s was, therefore, to some extent overstated. As a result of double counting, net exports to the United States as a share of GDP only rose to reach 24 percent by 1999, as compared to the 36 percent suggested by the gross numbers (Cross and Cameron). In other ways, however, these numbers may understate the degree of interconnectedness. Canadian merchandise exports as a share of domestic shipments have steadily increased over the past thirty years as Canadian firms have become much more engaged in cross-border and international supply chains. In the 1970s, the value of Canadian merchandise exports was equivalent to about two-thirds of the value-added in the production of goods in Canada. In the opening years of the 21<sup>st</sup> century, merchandise exports now represent about 125 percent of the value added in the goods-producing sectors of the Canadian economy, indicating nearly a doubling in the export intensity of production in Canada over the past thirty years, as well as the increasing role of imported components in that production.<sup>30</sup> Additionally, as a result of increasing cross-border investment, Canadian firms are increasing their presence in the United States through sales by affiliates, particularly in the services sector, just as US-owned affiliates continue to have an important place in the Canadian market place. Canadian-owned affiliates in the United States rang up C\$234 billion in sales in 2001 (Canada 2005b), roughly 60 percent of the value of Canadian-based exports. In the other direction, US-owned affiliates in Canada reported sales of C\$577 billion (US BEA 2003 US dollar data converted to C\$ at Bank of Canada average rate for 2003 of 1.4004).

Deepening integration has allowed Canadian industry to become more specialized and has contributed importantly to the growth of value-added sectors. As Industry Canada economist Surendra Gera and his colleagues explain, “While in the past domestic demand was the dominant factor influencing the growth of industries, trade is now becoming much more important. High-knowledge industries in the tradeable sector seem to have benefited the most from export performance; low-knowledge industries have seen their relative decline hastened by import competition.” (Canada 1997).

The changing intensity and composition of bilateral trade have contributed significantly to making Canadians better off both as consumers and as producers. Canadians employed in export-oriented sectors have consistently been better educated and better paid than the national average. As University of Toronto economists Peter Dungan and Steve Murphy report, “Canada is replacing low-productivity employment with high-productivity employment through expanded international trade, and is thereby made better off.” (Dungan and Murphy 1999) Similarly, greater access to

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<sup>30</sup> Values derived from Statistics Canada, CANSIM Tables 376-0007, 379-0022, 379-0024, and 380-0012 reporting Gross Domestic Product and Balance of Payments data.

internationally competitive goods and services allows Canadians to stretch their earnings further. As Cross and his colleagues point out: “The importance of trade to the economy does not come from an excess of exports over imports: rather, it is from the productivity gains that accrue with increased specialization.” (Cross and Cameron 1999: 3.3). Specialization, in turn, increases, as markets expand in response to the increased openness fostered by trade agreements.

## 2. Emerging Mexico-US-Canada integration

Two key elements explain the emergence of Mexico as an integral part of the North American economy. Until the early 1980s, Mexico was essentially a statist, inward-looking economy, bolstered for a time by oil revenues and international borrowing, but still heavily dependent on government direction and its own resources. The failure of that model and the collapse of the oil market in the early 1980s convinced Mexican leaders to embark on an ambitious reform program centered on reducing the role of the state and opening the economy to international competition. The first focused on regulatory reform, the second was underpinned by joining the GATT, forging a North American Free Trade Agreement with the United States and Canada, and joining the OECD.

Regulatory reform has been a key element in the transformation of the Mexican economy, leading to an economy that is now relatively open and market-based. The rapid pace, broad scope, and depth of regulatory reforms vaulted Mexico ahead of some long-standing OECD members and produced significant benefits for Mexico. As a result of the macroeconomic crises of the late 1990s, however, reform slowed. Sustained attention is now needed to complete reforms aimed at reinforcing vigorous market competition and entry, while strengthening the capacity of the Mexican state to use high quality and transparent regulatory instruments in carrying out public policies. In its 2004 review of Mexico’s progress, the OECD concluded that “Regulatory reform has reinforced Mexico’s approach towards market openness. New institutions and amendments to different laws have enhanced the market orientation and trade and investment-friendliness of the regulatory environment. Domestic regulation and technical standards have improved due to the extension of public consultations and more transparent processes.” (OECD 2004: 10-11).

Negotiating and implementing the NAFTA was the second key element, serving three critical objectives for Mexico:

- Signalling to both Mexican and foreign investors that the reform program was serious and would not be reversed, as had been the case with earlier programs;
- Reinforcing the new openness of the Mexican economy on the basis of contractual obligations to the United States and Canada; and
- Guaranteeing Mexican-based producers open access to a combined market of more than 400 million consumers.

The cumulative impact of the earlier Maquiladora program, regulatory reform and treaty-based openness allowed Mexican-US trade and investment patterns to follow a similar trajectory to that of Canada-US trade and investment. Since implementation of the NAFTA in 1994, two-way merchandise trade between the United States and Mexico has more than tripled, from US\$81.5 billion in 1993 to a high of US \$266.6 billion in 2004. Total Mexican exports of goods and services to the United States reached US\$170.1 billion in 2005, while total US exports to Mexico reached US\$120.4 billion. The United States is Mexico’s most important customer by far, receiving about 87 percent of Mexico’s exports, including petroleum, automobiles, auto parts, electronic goods, apparel and winter vegetables, and providing about 77 percent of Mexico’s imports. Similar to trade between Canada and the United States, intercorporate trade occupies a significant share of the total, and the import content of Mexican exports to the United States is also high. The United States is the source of over 60 percent of foreign investment in Mexico, with FDI inflows valued at about

US\$18.1 billion in 2005, and the primary source of important tourism earnings. Mexico headed the region as the leading foreign direct investor with outflows of US\$6.2 billion in 2005, mainly due to cross-border acquisitions by Cemex, Telmex and América Móvil (CRS 2005, US Census Bureau, UNCTAD 2006).

Trade between Mexico and Canada remains at much lower levels and is concentrated in the participation of Canadian and Mexican plants in US-organized value chains. The expansion of the major auto assemblers and their parts suppliers into Mexico, for example, has provided scope for exchange between Mexico and Canada probably at higher levels than are captured by official statistics. Canada and Mexico are both major suppliers of energy to the United States. Mexico is one of the many sources of Canadian winter fruits and vegetables, some of it organized through US distributors. Between 1993 and 2003, Canadian exports to Mexico increased 25 percent, while Mexican exports to Canada increased 200 percent. Canadian merchandise exports to Mexico reached C\$3.3 billion in 2005 while Mexican merchandise exports to Canada were valued at C\$14.6 billion.

Unlike the widespread benefits from cross-border integration evident in Canada and the United States, the benefits in Mexico are much more concentrated in the north and the large urban areas. As the Independent Task Force on the Future of North America pointed out: “Mexico’s development has failed to prevent deep disparities between different regions of the country, and particularly between remote regions and those better connected to international markets.” (CFR 2005: 5). Thus, while the experiment of integrating a less developed economy into a market dominated by two advanced industrial economies has proven largely successful, there remain significant challenges in ensuring its benefits are more widely shared.

Regulatory cohesiveness and convergence will be critical to the capacity of firms based in North America to develop a strong base at home to compete with European and Asian firms. While many US, Canadian, and Mexican firms have global aspirations, the core of their business strategies continue to be grounded in the reality of their North American base. Their ability to compete with other globally oriented firms, however, will be importantly conditioned by the regulatory regimes that govern their core competencies. US and Canadian regulatory regimes have long been recognized as among the best in the world, in particular because of the more flexible approach to regulations and the capacity to distinguish between outcomes and process. Maintaining this advantage, however, will increasingly require that the three governments develop a North American approach geared towards ensuring a strong home base for their global ambitions. In this, much can be learned from the European experience in developing a more coherent and cohesive, Europe-wide approach to meeting regulatory goals.

## V. The European experience

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The EU has made the greatest progress in implementing mandatory regulatory cooperation and convergence among its member states. Against a background of nearly half a century of depression and war, European governments in the 1950s embarked on an ambitious program of political cooperation and economic integration. Based on the deeply held conviction that countries that trade with each other and have an interest in each others' economic welfare are less likely to go to war or engage in destructive protectionist strategies, European governments pursued policy-induced economic integration.<sup>31</sup> Over the course of the past five decades, the European integration movement has steadily expanded from the original six to now 27 member states, plus association arrangements with neighbours, potential members, and former colonies.

Simultaneous to the widening of the EC/EU, member governments steadily deepened its impact. The 1958 Treaty of Rome committed members to implement the four freedoms: free movement of goods, services, capital, and people. Implementation of the free movement of goods was effected by removing intra-European tariff and non-tariff barriers and by adopting a Common External Tariff and a Common Agricultural Policy. This was accomplished by the original six members by 1968 and became a condition of entry for all subsequent members. The free movement of the other factors of

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<sup>31</sup> Noted Jean Monnet (1978), the father of European integration, in one of the most-quoted passages from his Memoirs "There will be no peace in Europe if States reconstitute themselves on a basis of national sovereignty. ... European States should form themselves into a federation or a 'European entity' which would make them a joint economic unit."

production, however, proved a much more daunting challenge. In effect, it required a high degree of convergence in the regulatory regimes that are at the heart of the modern welfare state and that, either directly or indirectly, operate to segment national markets and frustrate integration.

## 1. From a customs union to a single market

In response to the slow pace in fully implementing all four freedoms – during the era of so-called Eurosclerosis – the European Commission undertook a number of studies leading to a White Paper in 1985 on the operation of the common market and adoption of the Single European Act (SEA) in 1986. In this regard, the Commission surveyed 20,000 businesses to determine their priorities. Technical standards and regulatory and discriminatory barriers ranked at the top, followed by border formalities and tax differences. As Michelle Egan observes “With escalating R&D costs, shortening lead times and product life cycles, European firms perceived that such massive investments could only be recouped by increased standardization ... Barriers to entry created by diverse standards and regulations hindered economies of scale and efficient production structures as European firms were unable to forge a global unit.” (Egan 2001: 50). The SEA identified more than 280 separate initiatives that would need to be pursued in order to create a better functioning, fully integrated market, many of them involving reform of national regulatory regimes and their integration into Europe-wide regimes. The SEA set out a blueprint and a timetable for pursuing these initiatives. In effect, it transformed the center of gravity of the European integration movement from one relying on trade measures to achieve political and security objectives to one using regulatory means to realize commercial and economic ends. While the political and security goals remained important, as demonstrated in the EU’s extension to former Soviet bloc countries, commercial and economic objectives had by the 1980s assumed a much larger role in their own right.

A critical concept underpinning European integration had been recognition of the principle of subsidiarity: regulations should be designed and implemented at the lowest level of government possible. Complementing this principle was the objective of harmonizing regulatory goals across the EU, leaving their design and administration to the local level. Experience by the 1980s, however, indicated that both harmonization and subsidiarity had their limitations: slow progress toward a single market and continued discrimination in promoting national over European interests. A number of spectacular failures in ensuring the safety of the European food supply (Millstone and Van Zwanenburg 2000) added further momentum to the need to take an EU-wide approach to many regulatory regimes, as did a number of decisions by the European Court of Justice (Vogel 1995 and Egan 2001).

Over the past 20 years, the EU has made significant progress in implementing the Single Market program on the basis of a two-pronged strategy: the development of Europe-wide regulations where necessary and much more aggressive use of mutual recognition where they are not. In David Vogel’s words, “the Community thus moved from ‘negative’ harmonization, whose purpose is to remove national obstacles to trade, to ‘positive’ harmonization whose objective is to make the legal systems of the member states consistent with the broader political and social goals of the Community.” (Vogel 1995: 26). Food safety, environmental protection, and competition law are examples of areas subject to EU-wide regulations, developed by the Commission but administered in whole or in part by member states. Professional accreditation, road safety, and public security are examples where national regimes remain pre-eminent but for which Commission Directives increasingly effect mutual recognition and basic norms.

In implementing the SEA, Europe learned that achieving compatibility and equivalence is more than a matter of top-down directives. It required cooperation and coordination covering the full regulatory life-cycle, from policy development and instrument choice, to the assessment of new

or existing regulations, to compliance and enforcement activities, and at the program review and evaluation stages. “The optimal mechanism for this review is suggested to us by the European Union’s 1990 directive (83/189) which requires that whenever a member state considers the adoption of new technical regulations, it provide notification of possible conflicts between EU and national regulations to the concerned bodies of each member state and to the European Union. These bodies, in turn can issue ‘comments,’ which may lead to ‘observations,’ which may lead to ‘detailed opinions’ suggesting EU measures to eliminate conflicts.” (Schmitz 2006: 20). EU and member state officials learned to work together to create Europe-wide compatibility and equivalence at every stage of the regulatory life cycle from adhering to supra-national agreements, to developing legislation, regulations, and especially in the numerous guidelines and procedures employed in the daily operations of regulatory programs, such as conformity assessment procedures. It also involved sustained political leadership and oversight and constant monitoring and review by officials in Brussels.

Significant progress has been made in realizing the objectives of the SEA. At the same time, as former EU Commissioner for the Internal Market, Frits Bolkenstein, has pointed out, much more remains to be done (Bolkenstein 2004). The momentum injected by the SEA in the 1980s had run out of steam by the end of the 1990s. The derailment of the constitutional treaty project by French and Dutch voters in 2005 underlined the extent to which Europe remains a work in progress. As has been the European experience from the start, for every two steps forward in strengthening and deepening integration, there is at least one step slowing it down. The optimism of the SEA has given way to the pessimism of the post-constitution era. Efforts to maintain European commitment to creating a stronger internal market, however, continue.

One of the most challenging initiatives has been to ensure the freedom of movement of people. The ability of workers to live or work in any member state continues to face many obstacles, from professional or technical accreditation to border formalities. The Commission has adopted initiatives encouraging the mobility of workers, notably by recognizing qualifications for professions and technical workers. An important breakthrough came, however, with the negotiation of the Schengen Accord among some members of the EU. Schengen participants have agreed to remove all border formalities, creating a single customs and immigration regime. Under its terms, freedom of movement applies to all, regardless of nationality. Arrangements for tourists, asylum seekers, and legal immigrants from non-member countries are included in the Accord, the main aim of which is to standardize procedures throughout the Schengen area. Police continue to operate on their own national territory, in ports and airports, but closer cooperation on measures to combat terrorism, smuggling, and organized crime have made controls at external borders more effective.

Effective pursuit of the SEA has resulted in the development of an EU-wide regulatory regime to which all member states must adhere. The 2004 and 2007 enlargements, for example, revolved largely around the capacity of the twelve new applicants to fully implement the *acquis communautaire*, the detailed construction of rules that now governs the conduct of affairs within the Union. The task Europeans set for themselves, of course, was considerably more complex than that facing Canadians, Americans, and Mexicans. Market forces and high levels of cross-border cooperation have resulted in much more convergence in North America than was the case in Europe as late as the 1980s, where it was necessary to overcome differences among 27 countries with different histories, institutional structures, legislative styles, and regulatory traditions; the EU now recognizes 23 languages as official. The excessive, even minute, regulation of standards in Europe

is in part the natural result of using regulations to standardize the rules of 27 countries with different histories, traditions, mindsets, constitutions, and polities, rather than letting the market sort it out.<sup>32</sup>

## 2. The EU institutional imperative

Critical to progress in European regulatory convergence has been creative interaction between intergovernmental negotiations and supranational implementation and enforcement. To that end, Europeans have relied on an institution-rich environment to effect their integration objectives. The Treaty of Rome created an intergovernmental Council of Ministers as the supreme decision-making body, but assigned the execution of its decisions to an independent European Commission which, in turn, would be the guardian of the Treaty and the source of much of the Council's legislative activity. An independent European Court of Justice would ensure compliance with the Treaty and resolve conflicts about its interpretation. A European Parliament would assure broad public accountability for European legislation and administration.

As experience was gained in implementing the original treaty, and new obligations were added, the institutional structure was enlarged and made more workable. To the Council of Ministers, the architects added a Council of Europe, in effect the Council meeting at the level of heads of member-state governments. Decisions by the Council evolved from consensus – and its implied veto by any member – to weighted majority voting. To the Court of Justice, they added a Court of First Instance to give EU firms and citizens direct access to European dispute settlement, and a Court of Auditors to oversee the proper management of the EU's financial affairs. To the Commission, they added a European Economic and Social Committee, a Committee of the Regions, a European Ombudsman, a European Investment Bank, and a European Central Bank, each with Europe-wide responsibilities and the resources to carry them out. The Parliament evolved from an appointed body with limited consultative responsibilities to a popularly elected body with oversight and legislative authority. Jean Monnet, one of the chief architects of European integration, noted thirty years ago that, “nothing is possible without men; nothing is lasting without institutions.” (Monnet 1978: 304-5). True to his vision, European leaders have paid considerable attention to his maxim. It is difficult to conceive of the EU's evolution without the large role played by institution building.

The European approach was fully consistent with the economic and security needs identified in the 1940s and 1950s and the reality of more than two dozen fully independent states, many with long traditions of keeping their markets closed to each other and a wide range of ingenious devices to meet this goal. It also reflects the capacity of governments with strong central executives responsible to multi-party parliaments to enter into and manage co-operative strategies. None of the member states is governed on the basis of a much more decentralized, congressional-presidential system with all of its built-in checks and balances. With the exception of Germany, all are unitary states with full authority vested in the national government. When European leaders meet to iron out differences, they are fully competent to enact and implement the results of their discussions. Finally, it reflects the European tradition of giving direct effect in domestic law to international treaties.

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<sup>32</sup> To a US observer, the European experience is comparable to that of the United States in the 19<sup>th</sup> century in developing a single market based on a single polity. The American parallel is instructive, particularly in light of Canada's own more difficult progress in effecting a more integrated market. For Canadians, perhaps the most instructive lesson from Europe does not lie in efforts to create first a customs union and then a single market, but in efforts of the members of the European Free Trade Area (EFTA) first to maintain their separate markets, then to negotiate individual free-trade agreements followed by the EEA arrangement and finally full participation in the single market for most EFTA members. The logic of the market drove decisions about its governance.



## VI. NAFTA and its limitations

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It took more than 30 years and a high level of will, cooperation, and institution-building to create the European *acquis*. This experience is wholly different from that in North America. Rather than the push of government action, North American integration has been driven largely by the pull of market forces: proximity, consumer choice, investment preference, and firm behaviour. Government policy has been largely responsive, motivated by efforts to resolve problems generated by market-driven integration. Rather than seeking deeper integration, governments only gradually accepted the need to facilitate it by addressing problems experienced by private traders and investors. The result is a much more piecemeal and less deliberate approach to rule-making and institution-building. Unlike in Europe, the governmental response in North America has been prompted by commercial and economic considerations and has been at pains to keep geo-political and security considerations at arms' length in forging new rules and arrangements to address deepening economic integration.

### 1. An institutional gap

Both Canada-US and Mexico-US integration have also occurred in the absence of an institutional infrastructure for managing these complex, multifaceted relationships. As former Canadian ambassador to the United States, Allan Gotlieb, observes, “the world’s largest bilateral economic relationship [is] managed without the assistance of bilateral institutions and procedures.” (Gotlieb 2003). There is no

permanent body to provide political or policy oversight, no regular meetings between heads of government or foreign or trade ministers, no formal structure of committees looking at the relationship in a coherent and coordinated manner. Recent practice has included meetings among the three heads of government as well as of a range of ministerial meetings, but only the NAFTA Commission of trade ministers and the CEC ministerial council enjoy any formal status.

The absence of formal structure results from a determined, and largely successful, effort to treat issues in both relationships vertically, rather than horizontally, and to build firewalls to prevent cross linkages. In part, this method of management derives from Canadian and Mexican fears that as the smaller partners, their interests would be overwhelmed in any more formal relationship. As former WTO official Debra Steger points out, “Canadians ... are worried about invasion of our public policy autonomy by the Americans.” In part, it originates in the US system of governance that makes coherence and coordination in both foreign and domestic policies extraordinarily difficult to achieve on a sustained basis. As well, in Steger’s words, “Americans ... fear internationalism in all of its forms.” (Steger 2004: 80).

The institutional gap is filled by inspired ad hocery. The inter-connected natures of the three economies virtually require Canadian, US, and Mexican officials to work closely together to manage and implement a vast array of similar but not identical regulatory regimes from food safety to refugee determinations. In the case of Canada and the United States, officials and, in some cases, ministers have developed a dense network of informal cooperative arrangements. A recent Canadian government survey identified 343 formal treaties and hundreds of informal arrangements between Canadian and US officials at both federal and state and provincial levels (Mouafo, et. al. 2004). Mexico-US networks of cooperation have not yet reached the same stage of development as their Canada-US counterparts, but the need for officials to work with each other is equally clear and pointing in the same direction.

## 2. From free trade to market integration

Discussion of the next stage of regulatory cooperation is more advanced in Canada than in either the United States or Mexico. Initially, some Canadian analysts looked to the emerging bilateral regulatory agenda as a matter of deepening and extending the NAFTA, for example, through its working groups. This was a misperception. The FTA/NAFTA and the WTO represent the culmination of the postwar trade agenda consisting of tariff and non-tariff barriers to trade in goods and the newer issues of services, investment, intellectual property, and temporary movement of skilled personnel. They are essentially liberalization agreements erected upon static rule making.<sup>33</sup> One of the lessons from the European experience is that a regional trade instrument, whether a customs union or free-trade agreement, provides an efficient way to accelerate liberalization and promote integration; reaping the full benefits of integration, however, requires different instruments.

The NAFTA and the WTO have left unresolved a long list of issues from rules of origin to trade remedy regimes and government procurement restrictions, but in neither Canada, the United States, nor Mexico is there any enthusiasm for devoting the political resources necessary to undertake negotiations to deal with such leftovers. Nor is there any pressure from the broad business community to move in this direction, largely because the benefits of classic trade liberalization have now been essentially realized between the three countries. The next stage of negotiations is most likely to be a mix of trilateral and bilateral initiatives and focused on the governance of deepening economic integration and accelerating regulatory convergence. Addressing these issues will require a different lens from the one traditionally used by trade policy

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<sup>33</sup> See Dymond and Hart (2000) for a discussion of the differences between the trade policy of shallow versus deep integration.

practitioners. Doing so successfully, moreover, will ultimately ease dealing with NAFTA's leftovers. While the exact nature of that lens remains to be determined, three of its constituent elements have become clear: crafting a less obtrusive border, promoting greater cross-border regulatory coherence, and enhancing joint decision-making capacity.

A complicating factor in the North American context is the extent of regulatory decentralization. Unlike in Europe where, with the exception of Germany, all member states are governed on the basis of a unitary central government, Canada, the United States, and Mexico have to deal with the reality of three federal governments and more than a hundred state, provincial, and territorial governments, each with regulatory responsibilities and authority. In the United States, the Commerce clause in the Constitution provides a basis for national integration, as does the Agreement on Internal Trade in Canada, although less successfully. The Mexican Constitution provides the federal government with sufficient authority to override any decentralizing efforts by the states. Nevertheless, effective cross-border regulatory cooperation will require strategies that pay due attention to the federal character of the three countries.<sup>34</sup>

Differences between the extent of Canada-US and US-Mexico regulatory cooperation and networking suggests that, at least initially, progress is most likely to be made bilaterally rather than trilaterally. The translation of the two bilateral Smart Border initiatives of 2001 into the 2005 trilateral Security and Prosperity Partnership (SPP) has bolstered the view that the template for regulatory cooperation is trilateral. This view does not stand scrutiny. There is no automatic link between membership in an FTA and the need to address a new range of issues, nor does the SPP require a trilateral approach on all fronts. Indeed, it specifically recognizes the prospect of a two-speed approach to various issues, from security to regulatory cooperation.

Despite rather grand ambitions in the 1990s that the NAFTA would give rise to a three-country North American economy, the reality is quite different. Instead, NAFTA governs two robust bilateral trade and investment relationships; Canada-Mexico trade and investment remains at miniscule levels. Even if Mexico were interested in joining negotiations for new arrangements, the political economy of the negotiating issues in the United States is not the same for Canada and Mexico. Both relationships have long histories and have economic and political importance for the United States but they have followed divergent paths and responded to different imperatives. In sum, the extent to which regulatory issues are pursued trilaterally or bilaterally needs to be approached with an open mind. It is up to each country to demonstrate that it has needs and ambitions similar to those of the other two.<sup>35</sup>

Nevertheless, given the existence of the NAFTA, the SPP, and various trilateral working groups, opportunities for the two parallel efforts to learn from each other and to work toward common goals remain important. The section that follows focuses more heavily on what has been achieved bilaterally between Canada and the United States and what further steps can be taken. The Mexican dimension, however, is flagged wherever there is clear evidence of an opportunity that lends itself either to US-Mexico imitation or to trilateral discussion. Ultimately, all three countries will benefit from a North America in which regulatory barriers have been reduced to a minimum and most businesses can operate on the assumption of one rule and one test to satisfy requirements in all three markets.

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<sup>34</sup> I explore some of the ramifications of the need for federal-provincial cooperation in Hart (1999). The EACSR also devotes a section (26-30) to the need for federal-provincial cooperation and the need to develop a national approach to international regulatory cooperation.

<sup>35</sup> Gary Hufbauer and Jeff Schott (2004 and 2005) offer a different perspective, one increasingly not shared among Canadian and some US analysts. The problems inherent in Canada-Mexico cooperation in addressing issues with the United States are discussed in Goldfarb (2005).

### 3. Next steps

Reaping the full benefits of deepening cross-border economic integration will require that Canada, the United States, and Mexico address fundamental challenges. Three crucial and interrelated challenges addressed in this document are: reducing the impact of the border, accelerating and directing the pace of regulatory convergence, and building the necessary institutional capacity to implement the results of meeting the first two challenges. Each of these will prove difficult and solving the problems associated with either of the first two will prove illusory without addressing the other two.

#### a) Border administration

The first challenge is to address the increasingly dysfunctional impact of border administration. This paper is not the place to discuss in detail the critical role of border administration in frustrating cross-border integration, except to flag its importance and point to the close relationship between border administration and regulatory convergence. With the gradual disappearance of the traditional customs responsibility for collecting revenue, the focus has shifted to ensuring compliance with regulatory requirements and addressing security and immigration concerns.<sup>36</sup> One study estimated that Canadian border officials are responsible for ensuring compliance with nearly a hundred statutory instruments on behalf of several dozen federal departments and agencies. On the US side of the border, officials verify compliance with some 400 statutory instruments. In most instances, domestic commerce in both countries must be equally compliant. In these circumstances, customs administration at the border serves largely as an administrative convenience (Hart and Noble 2003).

Rather than an integrated, single North American market, border administration ensures continuance of three markets with many cross-border ties that remain hostage to the efficiency and reliability of customs clearance, an issue of greater importance to Canadian and Mexican-based than US-based firms. The logic of the market dictates that new or expanded production facilities locate in the larger market and export as desirable to the smaller market. Canadian policy for the past seventy years has been geared to reducing the impact of this logic. Mexico has made similar efforts for the last 25 years. Much progress has been made, but so long as borders separate the three markets, locating in the smaller market starts with a distinct disadvantage.

The intensity of the cross-border relationship is apparent from the 36,000 trucks and 400,000 people who cross the Canada-US border every day. Fewer trucks but many more people cross the US-Mexico border daily. Nevertheless, even after 18 years of “free” trade between Canada and the United States and 13 including Mexico, both borders continue to bristle with uniformed and armed officers determined to ensure that commerce and interaction between Canadians, Americans, and Mexicans complies with an astonishing array of prohibitions, restrictions, and regulations. The list of rules and regulations for which the border remains a convenient, and even primary, enforcement vehicle has grown, rather than diminished, since the implementation of free trade, particular in response to the new security realities created by 9/11 (Robson and Goldfarb 2003).

All three governments seek: 1) a secure border; 2) the rapid movement of legitimate travelers and efficient clearance of freight; and 3) the interdiction of terrorism, illegal drugs, smuggling,

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<sup>36</sup> It may also be useful to keep in mind that zealous border administration are artifacts of the modern welfare state and the ease of modern travel. Customs administration was haphazard until the 20<sup>th</sup> century, and immigration controls were almost non-existent. As settler societies, Canadian and US officials were more interested in attracting migrants than in controlling them until well into the 20<sup>th</sup> century. As Peter Andreas observes about the US-Mexico border: “The popular notion that the US-Mexico border is out of control falsely assumes that there was once a time when it was truly under control. Even though the smuggling of drugs and migrants has received most media and policy attention in recent years, it should be emphasized that these clandestine activities are part of an old and diverse border smuggling economy that thrived long before drugs and migrants were being smuggled.” (Andreas 2000: 29). See also Hart 2004b for discussion of the rise in Canada-US border administration.

illegal migrants, money laundering, and other criminal activities. These goals are broadly shared by the three governments; the differences are matters of detail and emphasis. The clearance of a shipment of goods through Canadian, US, or Mexican customs, for example, requires that officials at the border be satisfied that 1) the goods, 2) the truck, train, plane, or ship, and 3) the driver or operator are all eligible for entry. Eligibility of the goods may involve considerations related to customs (tariffs, rules of origin, and similar issues), health, safety, labeling, government procurement, trade remedies, taxes, environmental concerns, and more. The truck, train, plane, or ship must be certified to meet safety and similar requirements. The driver or operator must satisfy immigration requirements regarding citizenship, visas, criminal records, professional certification, labour regulations, and similar matters. In each case, Canadian, US, and Mexican laws seek to safeguard security, health, safety, and other important policy goals.

Insufficient investment in infrastructure to keep pace with the near tripling in trilateral trade volumes since the mid-1980s has added pressure to the smooth operation of border crossings. In recognition of the extent of their shared objectives, as well as in an effort to reduce costs, facilitate legitimate travel and commerce, and address pressure on infrastructure, Canadian, US, and Mexican officials over the course of the 1990s initiated a series of bilateral programs and dialogues aimed at finding ways to make the two borders more open, effective, and efficient. At the Canada-US border, such programs as CANPASS, FAST, and INSPASS sought to facilitate travel by frequent, low-risk border crossers. Other initiatives – from the Shared Border Accord announced in 1995 to the Canada-US Partnership Forum formed in 1999<sup>37</sup> – tried to make better use of emerging technologies, find ways to streamline implementation of border policies, share information and coordinate activities, and otherwise make existing laws and policies work more effectively.

These initiatives, however, have been limited by the decision to work within the confines of existing legislative mandates and by the lack of an intellectually coherent, strategic framework. Creating such a framework, investing in infrastructure and in technology (both at ports-of-entry and the corridors leading to such ports), and targeting resources toward pre-clearance programs for goods, vehicles, and people are critical components of any comprehensive effort at improving the management of the border and reducing its commercial impact. Ultimately, the objective should be to create a border that is considerably more open and less bureaucratic, within a North America that is more secure. If Canadians, Americans, and Mexicans want a smarter and less intrusive border between them, they will also need to cooperate to create a more secure perimeter. The result should be a more open, more prosperous, and more secure continent.

The scope for tackling these issues on a trilateral basis may be more limited than is the case for other matters. The Canada-US border is relatively open compared to the continued heavy administration apparent on both sides of the US-Mexico border. On normal days, trucks and passenger vehicles can both clear the northern border in less than an hour and often less. While most commercial and personal traffic is concentrated at the ten busiest border crossings, a further 135 crossing points are available along the 5,500 miles border. The shorter (2,000 mile) US-Mexico border offers fewer relief points from the congested principal crossings. While almost twice as much commerce crosses the northern border, nearly twice as many people cross the southern border annually. On the Canadian side of the Canada-US border, Canadian officials have made great progress in simplifying procedures and introducing preclearance facilities. US officials have cooperated in these efforts to the extent possible under US law. The Mexican side of the Mexico-

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<sup>37</sup> Political pressure to be seen to be doing something disposes bureaucrats and ministers to artfully repackage earlier efforts in order to create new “announcables.” Students of this phenomenon would do well, for example, to study the evolution of these four initiatives. Each promised concerted action at the level of the executive branch of government to address a series of border-related problems within existing legislative frameworks. All four shied away from any commitments that might lead to new treaty-level obligations that would require legislative approval. More may not have been politically feasible, but it is unrealistic to expect substantive results without a willingness to invest in more robust projects that might require legislative implementation.

US border, on the other hand, remains a study in frustration, in turn reducing scope for US cooperative efforts. As Peter Andreas observes, “the powerful image effect of [border] policing has brought with it substantial bureaucratic and political rewards – despite generating perverse and unintended consequences that fuel calls for even more law enforcement.” (Andreas 2000: 12). Trucking regulations alone add considerable complexity to moving goods across the border (Canada 2004b). Additionally, illegal migration creates complications at the Mexico-US border on a scale unknown at the northern border. The difference in experience at the two borders alone underlines the reality that the pace of regulatory cooperation between the two sets of partners are at very different levels.

In considering ways and means to address the increasingly dysfunctional economic impact of border administration and remaining trade barriers, it is useful to distinguish between efforts to ensure compliance with a host of regulatory requirements, and efforts to enforce laws and other matters that fall within the ambit of police and security considerations. Most of the requirements administered at the border involve regulatory matters and are secondary to the primary objective of maintaining a secure border. A key aspect of any effort to ensure the more efficient and effective operation of the border, therefore, involves identifying those aspects of the border clearance process that can be satisfied by other procedures away from the border or, as discussed further below, that can be eliminated altogether.

Much of the customs clearance of goods, for example, involves onerous information and reporting requirements that can be satisfied on a basis similar to normal domestic reporting requirements for firms in both economies. Much of this reporting requirement operates as if the three economies are not joined by a free-trade area. Additionally, most customs requirements – for example, origin certificates – involve matters that can easily be eliminated by harmonizing most-favoured-nation tariff levels and similar steps. A well-designed initiative to identify those remaining aspects of border administration that can either be eliminated or addressed away from the border would contribute importantly to making the border function more effectively.

Similarly, virtually all travel across the border involves properly documented and eligible individuals pursuing legitimate objectives, from business to tourism. Much of the activity of immigration officers, therefore, is routine and makes at most a marginal contribution to safety and security. Attempts to cross the border by those who pose potential threats are rare and isolated, particularly relative to the huge number of crossings. Every port-of-entry, of course, is vulnerable to penetration by undesirable elements, but experience indicates that those with serious criminal intent have ample space – and resources – to bypass port-of-entry controls without much effort. Again, a well-designed initiative aimed at identifying how these routine requirements can either be eliminated, be performed away from the border, or be satisfied by relying on more modern technologies would pay handsome dividends in creating a more efficient, effective, and secure border and a better functioning North American economy. The solution to any real threat lies in paying more attention and resources to intelligence gathering, information sharing, and entry by individuals and goods from non-North American points of origin, rather than to increasing routine inspections at the two borders.

More resources at the border seem unlikely to achieve additional results absent extraordinary further investments in human and physical infrastructure. Increasing resources to such an extent, furthermore, risks causing considerable collateral damage to economic interests in an effort to find solutions to a problem that can be handled more effectively and efficiently by other means. Rather, the three governments need to work with each other at every level, institutionalizing contacts, enhancing cooperation, and sharing information on matters small and large. They could make much greater investments in intelligence gathering and gradually focus ever larger parts of that effort at initial entries into North America. They could also make far greater investments in infrastructure and in technology. Both types of investments are critical components of any comprehensive effort

at improving the management of the border. Such investments should not proceed on the basis of current inspection methodologies, but rely much more on risk assessments and random inspections. They should also focus more on targeting resources toward pre-clearance programs for goods, vehicles, and people. Finally, the three governments need to engage in discussions about increasing the level of convergence in policies governing such matters as cargo and passenger pre-clearance programs, law enforcement programs of all types, and immigration and refugee determination procedures.<sup>38</sup>

Reducing border administration will have beneficial effects at three levels: reducing enforcement and administrative costs for governments, reducing compliance costs for industry, and reducing trade and investment disincentives. Various attempts have been made at quantifying the extent of these benefits. As Pierre Martin concludes: “although the total costs are difficult to estimate with precision, they are significant and likely to become higher.” (Martin 2006:15). Perrin Beatty, president of the Canadian Manufacturers and Exporters Association, claims that “border delays alone cost the Canadian and US economies an estimated C\$12.5 billion annually. In the automotive industry alone, it is estimated that the additional reporting, compliance and delay costs translate into an estimated \$800 Canadian per vehicle.” (Beatty 2005). Former Canadian ambassador Michael Kergin suggested that non-tariff border costs added five percent to the invoice costs of most exports, but could be as high as 10-13 percent for trade-sensitive products (Kergin 2002). John Taylor and his colleagues have made the most detailed study of Canada-US border costs and estimate that direct costs add between US\$7.52 and US\$13.2 billion annually to cross-border trade, with a mid-point of US\$10.3 billion (Taylor and Robideaux 2005). Indirect costs are even more difficult to estimate. Automotive industry analysts estimates that “a lost hour of assembly output due to a parts shortage costs approximately US\$60,000 per hour in lost earnings.” (Andrea and Smith 2002: 19). The impact a more open border would have on either direct or indirect costs is equally difficult to estimate. Experience in the EU, however, suggests that the move toward a more open border – the so-called Schengen Agreement – both boosted commerce and reduced direct and indirect costs without any significant negative impact on security and regulatory objectives (Egan 2001).

## **b) Regulatory cooperation**

A key component to trimming border congestion lies in meeting the second challenge: reducing the impact of regulatory differences between Canada and the United States. As the Canadian Council of Chief Executives points out, “most of the administrative costs and delays at the border come not from the need to assess customs duties, but from myriad rules and regulations that are simply convenient for governments to handle at the border.” (CCCE 2001).

As Europeans learned, regulatory cooperation and reducing border formalities are two sides of the same coin. There may be a long tradition of pragmatic, informal problem solving between the regulatory authorities of Canada and the United States, as well as among provincial and state governments, but all now need to ask how much regulatory enforcement needs to be exercised at the border and how much can be exercised behind the border or left to markets. As Mexico and the United States gain greater experience and confidence in bilateral regulatory cooperation, similar questions will emerge. More fundamentally, as regulatory cooperation and convergence proceed, officials in all three countries need to ask whether they are ready to proceed to a more formal, treaty-based process of regulatory cooperation aimed at eliminating to the largest extent possible what has been characterized as the “tyranny of small differences.” By eliminating those differences,

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<sup>38</sup> A good example of the type of policies that need to be pursued with greater urgency and dispatch is provided in a January 12, 2007 announcement by Canada’s Border Services Agenda outlining development of a new program and the required infrastructure, eManifest, that will allow Canadian and US customs officials to assess cargo security risks well before the shipment reaches the border (CBSA 2007).

much of the rationale for border administration disappears, particularly between Canada and the United States.

The default option in addressing regulatory convergence between Canada and the United States has been to stay on the very Canadian path that has gradually emerged: cooperation if necessary but not necessarily cooperation. The results have not been uninteresting: Canadian jurisdictions align their regulatory goals and objectives with those of their US counterparts, work with US regulators in many areas, but maintain sufficient regulatory autonomy to chart their own path. The result is two very similar but autonomous regulatory regimes involving extensive duplication and redundancy. Joelle Schmitz concludes that Canada-US “regulatory co-operation has reached a plateau. Initiatives are plentiful, achievements marginal, and gains ad hoc and inconsistent.” (Schmitz 2006: 8). The extent of regulatory convergence and cooperation is largely determined by bureaucratic agendas and preferences. Broader goals from economic development to regulatory efficiency remain of secondary importance. This default position also avoids confronting the two related issues: the border and institutional capacity.

Canada’s External Advisory Committee on Smart Regulation concluded that this model was inadequate to address Canada’s needs and recommended a proactive approach. It recognized that Canada is “enmeshed in a dense web of international relations,” but wondered “whether the government’s international regulatory activity is well aligned with national priorities and whether resources are being put to best use.” (Canada EACSR 2004: 17). It also questioned the value of maintaining “parallel processes and structures” (20) and the extent of duplication between Canada and the United States. It recommended that the federal government “include international regulatory cooperation as a distinct part of Canadian foreign policy ... and should develop a strategic policy framework for international regulatory cooperation.” (19). Given the extent of Canada-US cooperation and the depth of cross-border integration, it further recommended that “North America should be the primary and immediate focus of the federal government’s international regulatory cooperation efforts.” (22). To that end, it specifically recommended that “the federal government should work to: achieve compatible standards and regulation in areas that would enhance the efficiency of the Canadian economy and provide high levels of protection for human health and the environment; eliminate small regulatory differences and reduce regulatory impediments to an integrated North American market; move toward single review and approval of products and services for all jurisdictions in North America; and put in place integrated regulatory processes to support key integrated North American industries (e.g. energy, agriculture, food) and provide more effective responses to threats to human and animal health and the environment.” (22).

The External Advisory Committee also recognized two analytical traps that continue to appeal to some Canadians:

- Canadians can align their regulations with those in the United States to the extent they collectively judge it to be desirable on their own and do not need to complicate this process by tying it to a bilateral program; and
- Canadians should make a strategic judgment of where they want to be competitively, and then decide whether it is best to achieve that by being the same, being better, or being different.

While there is a superficial appeal to both points, experience suggests a unilateral approach is less likely to yield the desired result: reduce the impact of the border on Canadian trade and investment patterns. This goal will not be achieved in the absence of US confidence that Canada’s regulatory regime is substantively equivalent to its own, a confidence that will require its active engagement. The existence of an agreed bilateral or trilateral program, even one that may require Canada – and Mexico – to adapt and adjust much more than the United States, has the additional clear advantage of bringing political pressure to bear on a process that would otherwise become too



easily captive of bureaucratic agendas. The prime objective of such a program would not be to promote regulatory convergence for its own sake, but to enhance economic performance by reducing barriers to reaping the full benefits of North American integration. In the words of the EACSR, “Canada must take a more deliberate and strategic approach to regulatory cooperation . . . . Otherwise, it may face social, environmental and economic performance well below its potential.” (Canada EACSR 2004: 21).

The Canadian government broadly accepted the recommendations of the EACSR and in the context of the Security and Prosperity Partnership adopted by the Presidents of the United States and Mexico and the Prime Minister of Canada in Waco, Texas in March 2005, took important steps to move the agenda along. It appointed a group in the Privy Council Office (PCO) to pursue the path charted by the EACSR. At their meeting in Cancun, Mexico in March 2006, the three leaders, with Stephen Harper replacing Paul Martin in the Canadian chair, re-committed their governments to the SPP agenda, and took special note of the need to press ahead with regulatory cooperation. Additionally, the federal government’s Policy Research Initiative (PRI) has dedicated resources to considering ways and means to implement the EACSR recommendations. What has emerged to date is a commitment to what might be characterized as accelerated incrementalism. The result is a higher level of awareness of regulatory developments in the United States among Canadian policy makers leading to enhanced opportunities to align Canadian regulatory policy with developments in Washington. What is missing is a strong political commitment to regulatory cooperation and a plan to put it into effect. Not surprisingly, the pace in implementing this program has been glacial.

The current Canadian approach also appeals to American regulators, who have to date exhibited little appetite for more. The US decision-making system is extraordinarily resistant to centralized control and thus a very difficult target for more than piecemeal, regulator-to-regulator cooperation. The US President, for example, may appoint the Commissioners to the Securities and Exchange Commission, but once in office, they act fully independently of his direction. Nevertheless, in both Washington and Ottawa, efforts at regulatory reform and streamlining have gained a growing number of adherents. Congress in 1980 established an Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget (OMB) and successive presidents have, through Executive Orders, set out the basis for OIRA to provide systematic, centralized review and appraisal of all federal regulations. Much of this effort has been coordinated with broader international initiatives, particularly at the OECD. Canadian efforts parallel those in the United States. Since 1978, Canadian federal regulatory activity has been subject to a constant, comprehensive, centralized process of review, housed initially in the Treasury Board and subsequently in the PCO, with a view to eliminating duplication and redundancy and promoting best international practice. The guiding policies developed in both capitals for rule making and review are remarkably similar in tone and intent and reflect the high level of ongoing discussions at the OECD and bilaterally.<sup>39</sup>

For more than a decade the OECD has been engaged in an intense process of study and consultation on the role of regulations in member states, auditing the extent and quality of regulations of each member, considering best practices, and recommending areas for improvement in regulatory process, approach, and outcomes. The result is a mine of useful information as well as a clear indication of the extent to which regulatory goals are very similar across the OECD, while means and outcomes can vary considerably.

Mexico has been one of the most active participants in the OECD process and two major reports prepared by the OECD provide a generally optimistic assessment of the progress Mexico has made in upgrading its regulatory regimes (OECD 1999 and 2004). As in Canada and the United

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<sup>39</sup> See, for example, Canada (1999) and United States.

States, part of that progress was the result of central oversight. In 1989, in Mexico the Salinas administration created the Economic Deregulation Unit (UDE) with a broad mandate to oversee regulatory reform. It was given the authority both to review all new federal regulations and to propose amendments to existing regulations. As it gained experience and confidence, it became bolder in discharging this mandate. Regular consultations with officials in the US, UK, and Canada added to its knowledge and confidence. After a decade of success, it was transformed into the Commission for Regulatory Improvement (COFEMER), and made dependent on advice from a Regulatory Improvement Council comprised of business, labour, agricultural, academic and government representatives. The pace and energy evident in the 1990s was not as evident after 2000, but the broader macro-economic troubles experienced in Mexico contributed to this slowdown in zeal for regulatory reform. Nevertheless, a strong institutional base now exists in Mexico to sustain reform and regulatory cooperation in the long run (Salas and Kikeri 2005).<sup>40</sup>

A sound foundation has, therefore, been created for a more formal program of cross-border regulatory cooperation and even coordination in all three countries. To go to the next level, however, the three governments will need to adopt programs with sufficient scope to provide a basis for ultimately crafting enforceable agreements, and the institutional capacity to make it work.

A critical first step in all three countries will be to develop comprehensive national data bases of federal, state, and provincial regulatory programs that include an approximation of their equivalents in the other two countries and the extent of differences. This is a step that is best undertaken within government and on a cooperative basis. Scholars and analysts in universities and non-governmental institutions command neither the resources nor the access to information required to create comprehensive data bases. Similar to the study organized by the Canada School of Public Service to map the extent of bilateral Canada-US networks (Mouafo, et. al. 2004), the three federal governments need to build such data bases.<sup>41</sup> With such an inventory in hand, it will be possible to select priority sectors and engage officials in the other countries in the next step of designing joint programs – bilateral or trilateral as appropriate – of guided regulatory cooperation in priority sectors.

The academic community can help by developing credible analytical tools capable of assessing the overall costs of regulations in the three societies and the extra costs that result from duplication, overlap, and difference among the regulatory regimes in the three countries. While the case for greater convergence rests on a secure business case of greater efficiency, improved efficacy, reduced costs, and more consistent compliance, the general public is more likely to support the case for convergence on the basis of credible analyses of the costs of divergence and benefits of convergence. Efforts to provide such analysis to date remains insufficiently rigorous and comprehensive (Ndayisenga and Down 2005 and Ndayisenga and Blair 2006). Additionally, well-constructed models assessing costs of divergence and the benefits of convergence should also prove helpful in choosing priority sectors.

A good place to start in enhancing cross-border cooperation and selecting priority sectors is to take advantage of existing reporting requirements and use them as a basis for systematic and mandatory exchanges of information and consultations. In Canada, all federal regulatory authorities are required to prepare an annual report to Parliament on their plans and priorities and responsible ministers must make an annual performance report to Parliament. In the United States, the OMB

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<sup>40</sup> See also the description of the mandate and activities of COFEMER at its website: [www.cofemer.gob.mx](http://www.cofemer.gob.mx).

<sup>41</sup> With support from a number of federal departments, the Centre for Trade Policy and Law initiated an effort to build such a data base in 2002 but concluded that a data base sufficiently comprehensive to meet the needs of both government and independent analysts would require a very high level of access to government documents and resources. The Conference Board of Canada was awarded a contract in 2006 to build an inventory of regulatory issues between Canada and the United States which may shed further light on what is required.

makes an annual Report on the Costs and Benefits of Federal Regulations and OIRA prepares, semi-annually, The Unified Agenda of Federal Regulatory and Deregulatory Actions. In Mexico, the Federal Regulatory Improvements Law requires that all federal agencies provide COFEMER with a biennial plan for improving the quality of their rules and regulations. COFEMER, in turn, presents an annual report to Congress detailing its activities and progress. These regular reporting requirements provide excellent gateways for bilateral and/or trilateral consultations aimed at promoting more systematic regulatory cooperation. Such consultations can strengthen confidence in each other's regulatory regimes and be used to identify areas ripe for efforts to remove differences, move toward mutual recognition, consider joint decision-making, and implement other strategies aimed at creating an approach more consonant with the reality of deepening cross-border economic integration.

Given the extent of regulatory programs in all three countries and the specific nature of each regime, such horizontal efforts will need to be complemented by sector-specific obligations to consult and seek to remove differences and enhance compatibility on a cross-border basis. All three governments already require regulators to ensure that regulations comply with international commitments from the WTO and NAFTA to the FAO, ILO, WHO, WMO, and other international regimes; adding a requirement to ensure cross-border or North American compatibility is not an onerous additional commitment. In all three countries, regulatory developments are also subject to extensive public comment and consultation, offering opportunity for wide public input. Again, without adding any major new burdens, the three governments can require, before regulatory authorities publish a Notice of Proposed Rulemaking in the US Federal Register, similar notifications in the Canada Gazette, and notification and public comment as required by the Federal Regulatory Improvements Law in Mexico, that officials consult with their US, Canadian, and/or Mexican counterparts with a view to ensuring that any new or amended regulations meet their commitment to reduce differences and enhance compatibility.

Some of the more challenging regulatory differences are set out in the detailed policies, processes, and procedures of individual regulatory programs. These often develop over time as officials interpret and implement regulations. In many instances, agreement on goals and benchmarks should provide room for some cross-border differences at this level. Nevertheless, efforts to achieve deeper regulatory convergence will need to pay attention to this dimension. This could involve, for example, a requirement that regulators report on their commitment to reducing difference and enhancing compatibility not just when they introduce new regulations or amend existing ones, but also throughout the regulatory "lifecycle."

As a further step toward promoting convergence and reducing differences at the federal level, both governments can add new decision rules in their regulatory policies. Canada's 1999 Regulatory Policy, for example, requires that regulatory authorities, in developing or changing technical regulations, ensure that they comply with existing international obligations as well as the Agreement on Internal Trade, that the benefits outweigh the costs, and that alternative means to address the problem have been considered. US regulatory policy similarly requires cost-benefit analysis, consideration of alternative means, and due deference to international best practice and obligations. Mexican regulatory policy includes requirements for a regulatory impact analysis of any new regulations, extensive public consultations, and attestation of conformity with international rules and the goals of the Federal Regulatory Improvements Law. It would not be difficult to add an additional decision rule requiring bilateral consultation and a positive determination that any differences with analogous regulations in the other jurisdiction serve an important and unavoidable public purpose. All three countries, for example, could require a mandatory section to this effect within their respective Regulatory Impact Analysis (RIA) statements that are published with each proposed new or amended regulation. As Canada's External Advisory Committee pointed out, "information-sharing and decision-making measures should be designed to help countries build confidence and trust in each other's regulatory and decision-making processes. They should also

help us to recognize that each country's regulatory standards, processes and decisions produce similar results." (Canada EACSR 2004:21). In addition, sector-specific strategies, as described in the next section, can be developed as experience is gained and more detailed appreciations emerge of regulatory differences in these sectors.

Both sets of obligations can be made subject to review by the Auditor General in Canada, the Government Accounting Office in the United States, and COFEMER or the newly created (2003) Auditor General in Mexico. These agencies, in their audit and review functions, regularly audit the effectiveness of existing regulatory regimes in meeting their objectives and in their cost effectiveness. Again, the three governments could agree to give these agencies an additional mandate to include in any such audits and reviews, assessments of cross-border compatibility and efforts to remove the "tyranny of small differences." As Canada's Auditor General put it in a recent report, regulatory co-operation can increase efficiency and reduce regulatory burden by focusing on "those activities that are high priorities and establish international relationships that allow it to benefit from the efforts of other jurisdictions for those activities that are lower priorities." (Canada OAG, 2004: 18).

Initially, the three governments should build confidence and gain experience at the federal level, but given the federal structure of each country, the sooner they engage provincial and state regulatory authorities in a similar process of mandatory information exchange and consultations, the sooner they will arrive at a "North American" approach to meeting their regulatory goals and objectives. Because of the large number of jurisdictions involved, this is an area that will require some creative decision rules as well as institutions to make them work. Fortunately, as at the federal level, extensive regional networks of collaboration already exist between Canadian and US regulators and are developing between Mexican and US state officials. Any successful federal strategy on economic integration and regulatory convergence will need to both complement and take advantage of these existing or emerging cross-border institutions.

Thus, without the need to enter into a massive negotiating process, the three governments can put in place a process that builds on existing cooperation and domestic rule-making requirements and creates a framework within which differences will, over a period of years, become increasingly transparent and, eventually, marginal. In setting up such a framework, they can set a ten-year target at the end of which they will agree to enter into discussions on how to address remaining differences and consider ways and means to effect a more open border.

### **c) Institutional capacity**

Integral to any progress in addressing the governance of deepening integration is the need to build sufficient institutional capacity and procedural frameworks to reduce conflict, and provide a more flexible basis for dynamic rule-making and adaptation for the North American market as a whole. It may well be necessary to consign traditional aversion to bilateral or North American institution building to the dustbin and look creatively to the future. While the European model of a complex supranational infrastructure may not suit North American circumstances, there are lessons Canadians, Americans, and Mexicans can learn from the EU experience.

Rather than seeking to create structures where none is needed, the three governments should focus upon the functions that need to be performed for the efficient governance of deepening integration and create new institutions only where current arrangements are unsuitable. To some extent, these could be met by making creative use of existing cooperative arrangements, by investing officials in agencies in all three countries with new responsibilities, or by building on existing models that have worked well. As described above, much of the enhanced consultation and information exchange suggested can be performed on the basis of existing institutions and informal networks.

The three governments could, for example, stipulate that the Canadian Border Services Agency, the US Customs Service, and Mexican Customs coordinate their efforts to ensure efficient administration of third-country imports. Similarly, an appropriate understanding could be reached requiring the Canadian Department of Transport, the US Department of Transportation, and the Mexican Secretariat of Communications and Transportation to coordinate their efforts to ensure highway safety; before enacting any new rules and regulations, for example, mandatory coordination efforts would focus on ensuring compatible outcomes and mutual recognition of each other's approaches to the same problem. A good basis for this kind of cooperation already exists in both the informal networks among officials, and in the relatively minor differences in regulatory approach. Between the United States and Mexico, the JWC US-Mexico Border Transportation Planning has now had a decade of experience in addressing border issues, while the Canada-United States Transportation Border Working Group has an even longer history.<sup>42</sup> What is missing is an agreed mandate to resolve differences and a more formal institutional framework with authority to ensure mutually beneficial outcomes. Establishing a bilateral commission to supervise efforts to establish a more coordinated and convergent set of regulations governing all customs or transportation matters could prove critical to providing the necessary momentum and political will.

All three governments maintain separate, but similar, approval procedures for therapeutic drugs, reaching almost identical conclusions, albeit within different time frames. The parallel Canadian and US regimes offer a prime example of the External Advisory Committee's view that in some instances, "Canada and the United States should go beyond aligned regulatory frameworks and identify where they could move toward integrated regulatory institutions and processes." (Canada EACSR: 22).<sup>43</sup> Adapting these existing procedures to operate to the benefit of all three countries could involve commitments to more sharing and mutual recognition strategies, reducing duplication and overlap but maintaining the capacity to address unique circumstances that may arise in one country or the other. Adopting a first-to-approve rule as a default position, for example, would lead to constructive regulatory competition, particularly if it includes a safeguard provision for sensitive issues. Establishing a joint commission to supervise the transition to a more integrated regime, and to provide continuing oversight thereafter, would ensure that both governments maintain a voice in the therapeutic drug approval process. Given the extent of already existing Canada-US cooperation, this is an area where the two-speed approach recognized by the SPP might make sense.

Food safety is similarly invested with a high degree of cooperation. The Canadian Food Inspection Agency (CFIA) and Health Canada and the US Animal and Plant Health Inspection Service (APHIS), Food Safety Inspection Service (FSIS), and Food and Drug Administration (FDA) work closely together on the basis of hundreds of agreed protocols and understandings. In Mexico, the Secretary of Health (SH) has primary responsibility for food-related safety issues. Additionally, other federal agencies promote and encourage the development of best practices relating to food. The Secretary of Agriculture, Livestock, Rural Development, Fishery and Food (SALRDFF) maintains zoosanitary control of slaughter houses and meat processing establishments and has delegated responsibility for the control of imported meat and meat products and other animal products. The National Institute of Fishery promotes the establishment of HACCP systems in the fishery. The Secretary of Economy is responsible for the development of mandatory and voluntary standards for the Mexican Accreditation Entities and private third parties such as units for the verification of commercial and sanitary labeling (Flores Luna and Vélez Méndez, 2002). As between Canada and the United States, Mexican regulators work closely with US and Canadian officials to ensure that the \$8 billion plus in Mexican food exports meet US and Canadian

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<sup>42</sup> See their websites at [www.borderplanning.fhwa.dot.gov/mexico.asp](http://www.borderplanning.fhwa.dot.gov/mexico.asp) and [www.thetbwg.org/index\\_e.htm](http://www.thetbwg.org/index_e.htm).

<sup>43</sup> The Committee provides a more detailed assessment of the prospect for greater integration of the drug approval regimes in the two countries in its sectoral annexes (Canada EACSR 2005: 79-88).

requirements. Much of this cooperative activity, however, lacks the status of domestic law or international treaties, and any problems need to be resolved at the level of ministers. Enshrining current levels of cooperation into a North American accord and assigning supervisory responsibility for the continued adaptation of its implementation to a Joint Food Safety Commission would greatly enhance both consumer and producer confidence in the three governments' commitment to governing what is, *de facto*, becoming an integrated North American market (Zahniser 2005).

In all three countries, labour mobility is hampered by provincial and state labour laws and delegated professional accreditation procedures. The NAFTA put in place a modest process to permit temporary entry for business and professional visitors and mutual recognition of professional accreditation. The latter has been hampered by the conflict of interest inherent in a system of self-regulation. As the EU learned, a more centralized approach was required to overcome conflicts of interest and bureaucratic inertia. From architects and accountants to doctors and dentists, there remains considerable scope for enhancing mutual recognition arrangements. An important step toward breaking the logjam would be to appoint a bilateral task force to develop model mutual recognition arrangements for consideration by state and provincial accreditation bodies.<sup>44</sup> The extent of illegal migration to the United States from Mexico suggests that labour mobility will be a much more difficult issue to address on a trilateral basis and is thus a prime candidate for two parallel processes.

Much can be achieved on the basis of existing networks of cooperation, with the addition as necessary of specific joint or bilateral commissions in instances where existing networks are inadequate. More will be achieved, however, if the three governments commit to the establishment of a limited number of trilateral or bilateral institutions with a mandate to provide them with the necessary advice and information to effect a more integrated North American approach to regulation. As noted by the Independent Task Force on the Future of North America, "effective progress will require new institutional structures and arrangements to drive the agenda and manage the deeper relationships that result." (CFR 2005: 30). An independent Canada-US Secretariat with a mandate to drive the agenda and report annually to the two Presidents and Prime Minister on progress could, for example, prove critical to overcoming bureaucratic inertia. Similarly, a Joint Advisory Board to the three leaders could contribute some creative drive to the development of new bilateral initiatives. As numerous studies have demonstrated, regulatory agendas are prone to capture, geared to serving the narrow interests of regulator and regulatee. Initiatives limited to regulatory authorities are unlikely to prove immune from this reality. Regular review by an independent advisory board of progress in implementing a North American program of "guided" regulatory convergence could thus prove a valuable addition in keeping the program focused on broader objectives.

#### **d) Compatibility, not harmonization**

The operating goal of such a program should be to seek greater compatibility and complementarity in goals, design, and outcomes, rather than harmonization, through sharing of information, joint decision-making, strengthened networks, agreed safety valves, greater use of mutual recognition and analogous instruments, development of appropriate machinery and institutions to enhance mutual confidence and facilitate information sharing, and, ultimately, joint decision-making.

Despite populist notions to the contrary, US regulatory requirements are often more stringent than those in Canada. Mexican regulations are of a high order, although there remain problems of enforcement and compliance. More to the point, North American regulatory convergence is more likely to involve adoption of best practices than reliance on the lowest common denominator. As

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<sup>44</sup> I examine the pros, cons, and challenges of greater cross-border labour mobility in Hart (2004b).

David Vogel points out, “the stronger the commitment of nations to coordinate their regulatory policies, the more powerful is the California effect” of promoting a race to the top (Vogel 1995: 8). Furthermore, as noted earlier, differences between the three countries are less a matter of goals and objectives than of ways and means. The challenge is less a matter of agreeing on goals and desirable outcomes than of recognizing mutually acceptable ways of achieving the same outcomes and developing confidence in levels of compliance and enforcement.

To take one politically salient example, US responses to environmental degradation, from carbon emissions to water pollution, are often ahead of Canadian efforts. Notes George Hoberg: “as a result of policy integration through emulation, common science and technology, and shared values and politics, environmental policy in Canada and the United States has witnessed a substantial amount of convergence.” (Hoberg 1997: 384). But, as Nancy Olewiler points out, Canada’s “kinder, gentler route to improving the environment ... also means that Canada may not be moving as fast as it could toward reaching environmental targets.” (Olewiler 2003: 619). A coherent program of cross-border cooperation is thus likely to strengthen Canadian and Mexican regulatory outcomes, even one that will require Canada and Mexico to do much of the heavy lifting and adjustment.





## **VII. Costs, benefits, and further research**

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As already flagged at several points in the analysis, regulatory divergence between countries experiencing increasing market integration imposes costs, including an “inefficiency tax” paid by citizens on virtually everything they purchase. Border administration costs, estimated by some to run into the billions of dollars, can be reduced by removing some of this activity away from the border or eliminating them altogether. Many of the tasks performed at the border are of the belts and suspenders type: they duplicate tasks that are already performed at a domestic level and serve little more than a symbolic purpose. Regulatory regimes that duplicate efforts in all three countries similarly spend taxpayer dollars unwisely. Closer cooperation would reduce the need for some of these funds and make them available for more pressing public policy objectives.

In addition to such direct costs, there are the indirect costs borne by industry resulting from border delays, duplicative efforts, and the need to satisfy multiple authorities. These additional compliance costs undermine international competitiveness and complicate the most efficient deployment of scarce resources. For governments, regulatory divergence increases risk, reduces efficiency, and leads to less than optimum outcomes in achieving regulatory goals.

Finally, regulatory duplication and excessive border administration act as a powerful disincentive to industries to organize their affairs in the most efficient manner possible. As we saw in the

discussion of the disaggregation and re-integration of industrial production along spatially more diverse patterns, both borders and regulatory compliance play a critical role in investment decisions.

Estimates of the full costs borne by governments and society at large from regulatory divergence are at best tentative and incomplete at this stage. As the three economies move further up the integration scale, however, the need for such cost-benefit analysis will increase. It will be difficult to pursue such analysis on a macro or economy-wide basis. The regulatory compliance costs borne by industry vary greatly from sector to sector as do the risks imposed by border administration and potential delays. The automotive sector, for example, the most integrated industry in North America, asserts that unanticipated border delays can run into the millions of dollars as a result of just-in-time production techniques that rely on sophisticated coordination between production of parts at one location and its use in the assembly of a vehicle at another. An extended delay at the border can result in a temporary plant closure.

The extent of these costs were well illustrated during the 2003-05 BSE crisis. In response to the crisis in the UK in the 1980s and 1990s, Canadian, US, and Mexican officials worked closely together to quarantine the North American herd from the BSE scourge, to deal expeditiously with any outbreak in North America, and to safeguard the health of Canadians, Americans, and Mexicans. These efforts resulted in similar and coordinated approaches and worked as intended. However, when a single instance of BSE was identified in Alberta in 2003, followed a year later by a case in Yakima, Washington, all this cooperation was put aside and borders were closed to cross-border trade in beef. Domestic production and distribution, however, continued unabated. It took nearly two years of discussion and rule-making to find a solution that respected the fact that the North American beef industry has become a single, integrated industry; that instances of BSE in North America – 12 in total by the end of 2006 – were rare and isolated; and that the safety of Canadian and US beef products was adequately addressed in each country's national regulatory regimes. Estimates of the damage done to the Canadian beef industry range as high as Cdn \$7 billion. As well, higher prices in the United States resulting from significant shortages in the supply available to US meatpacking facilities added to the cost (Moens 2006 and Caswell and Sparling 2005). In the absence of efforts to ensure that regulatory integration keeps pace with market integration, there will be similar instances of disruption and damage to individual industrial sectors.

Further work, therefore, examining the costs of regulatory duplication and redundancy, of unnecessary border administration, and of frictions flowing from regulatory differences, in a number of specific sectors would add importantly to informed discussion of the costs and benefits of regulatory convergence. Such studies should consider the extent of duplication and overlap in regulatory regimes and the potential for savings flowing from greater convergence. They should also consider the extent to which border administration in specific sectors duplicates tasks already performed at the domestic level and the extent to which officials in one jurisdiction acting without regard for regulatory developments in the other can add to compliance and enforcement costs. They should also explore the extent to which regulatory divergence and border administration acts as a disincentive to the efficient allocation of production facilities. Finally, they should assess the extent to which similar but separate regimes are vulnerable to the kind of disruption and damage sustained by the beef industry.

## **1. The sovereignty dimension**

In recent years, trade and regulatory policy discussions have become cluttered by concerns about sovereignty. It is a sentiment with which many would quickly agree, but which is, in fact, a chimera. In the world in which Canadians, Mexicans, and even Americans now find themselves, they can enhance neither their security nor their prosperity on their own. They need allies and to work with others. The governance of all sovereign states today assumes the benefits that come from

international rules, institutions, agreements, arrangements, and understandings. It is built on the connections and relationships that make a mockery of the 19<sup>th</sup> century concept that links sovereignty with independence and policy autonomy.<sup>45</sup> Canadians and Americans, in particular, should understand the limits of these words. Since the Second World War, no two countries have been more eager to forge commitments and connections with others, geared to ensuring that they are not alone and independent. Each country has entered into thousands of treaties and other arrangements and understandings predicated on pursuing cooperative solutions to common problems.

Exercising sovereignty today is all about forging the relationships needed to advance a country's interests. The University of Toronto's Wendy Dobson also reminds us that modern "sovereignty is not just about what a country gives up but also about what it gains in more efficient production, larger markets, freer flow of investment, swift resolution of disputes, and greater protection of intellectual property, to name but a few of the benefits. ... States are the architects of their own constraints through the decisions they make, ... and through the decisions they avoid by failing to exercise their sovereignty." (Dobson 2002:3). Policy autonomy is not end in itself, but a vital tool of governance. Whether governments achieve their goals and objectives autonomously or co-operatively is less important than their ability to serve the needs and aspirations of their citizens. The reason is simple: co-operative, joint strategies are an efficient way to meet goals and to ensure that others behave in ways that protect and reflect their own citizens' interests and priorities (Doern, Pal, and Tomlin 1996; Banting and Hoberg 1997).

Over the past six decades, successive Canadian and American governments have made the reasonable calculation that their interests are better served if other states are required to behave in a predictable and stable manner, subject to commonly agreed rules and procedures to enforce them. Mexico reached the same conclusion a few decades later. Hence, the instinct to resolve problems through international rules and regimes has been a constant factor throughout the whole range of their foreign policy endeavours. An integral component of this activist diplomacy has been a readiness to accept increasingly more stringent limits on the scope for autonomous decision making, particularly in relations with each other, in return for increased discipline on their foreign partners. The pursuit of more demanding forms of bilateral or trilateral co-operation flows logically from earlier efforts. Deepening North American integration, in particular, challenges the three governments to take further steps down the mutually beneficial road of exercising their sovereignty to achieve important economic, security, and other objectives.<sup>46</sup>

In all three countries, critics of more integrated markets who find their economic arguments to be of little merit, fall back on the defense of sovereignty. They assert, for example, that any deeper integration agreement, such as a customs union, would rob Canada, the United States, and Mexico of the capacity for setting tariffs on trade with third countries. The reality is that all three countries have given up tariff autonomy through the progressive binding of their tariff in the GATT

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<sup>45</sup> Rabkin (2005) explores the complex interrelationships among sovereignty, independence, constitutional government, and international treaty obligations from an American perspective. Most Canadians and Mexicans would probably see the balance among these elements somewhat differently, given the disparity in power and interests between Canada, Mexico, and the United States, but would still find the discussion very informative. See also Wolff (1990) and Krasner (1999) for broad discussions of modern concepts of sovereignty.

<sup>46</sup> What economists call liberalization, political scientists consider the retreat of the state. For many political scientists, the essence of nationhood is the result of policies that discriminated in favour of citizens at the expense of foreigners. For example, they point to Canadian nation-building policies, from railways to banking to communications, as critical to building a Canadian-owned, east-west economy. These policies, however, were gradually undermined by first the Canada-US Reciprocal Trade Agreement of 1935 and then the GATT, and were given a fatal blow by the CUFTA and NAFTA. The result has been a massive re-orientation of the Canadian economy from east-west to north-south, growing dependence on the US market, and less reliance on government programs. McDougall (2004). Nativism, isolationism, and protectionism have their own histories in the United States and Mexico and continue to find echoes in populist policy discussions. One need only think of the current crusade spearheaded by Lou Dobbs in his daily newscasts on CNN.

and WTO negotiations. A variant on this theme is the claim that any new agreement would prevent the pursuit of distinct industrial, energy, immigration, or environmental policies. The scope for industrial and energy initiatives, however, is equally constrained by WTO rules on subsidies in the former and by the NAFTA rules in the latter. As regards issues such as immigration and the environment, it is far from clear how discrimination and eschewing the benefits of economic integration would advance efforts to address these issues.

## VIII. Conclusions

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The security and well-being of its citizens stand at the very pinnacle of any government's responsibilities and regulations affecting everything from food safety to the quality of the environment are central to fulfilling these responsibilities. Governments must think carefully, therefore, about any initiatives that may compromise their ability to discharge them. Canadian, American, and now Mexican experience in negotiating international rules and pursuing regulatory cooperation, both multilaterally and bilaterally, suggests that there is no inherent conflict between these responsibilities and such rule-making and cooperation. Nevertheless, vested interests can mount emotional campaigns questioning the extent to which regulations made jointly with others can respond to national responsibilities. Fortunately, it is not difficult to refute such claims. Canadians, for example, routinely travel in the United States, comfortable in the reliability of US safety regulations. They eat and drink in the United States on the same basis as they do at home. If they are sick, they often can and do rely, at considerable expense, on US medical advice and US-approved drugs. From almost any perspective, Canadians have few if any qualms about the goals and efficacy of US regulations when in the United States. There are few other countries about which Canadians routinely exhibit such confidence. The reason is simple: Canadian and US regulatory regimes are, in almost all respects, closely aligned. The differences are matters of detail that may matter to individual regulators, but have little impact on residents in either country.

The Canadian and US economies have become intertwined in response to demands by Canadians and Americans alike for each

other's products, services, capital, and ideas, creating jobs and wealth across many sectors and accelerating the forces of mutually beneficial integration. Since the early 1990s, this process of cross-border integration has increasingly included Mexico. Whatever the homilies about the value of independence, there is no sentiment that any of the three governments should interfere in private business and investment decisions to change the logic of resources, geography, and private choice that underpin this economic integration. The framework of rules and institutions developed over the past seventy years have worked well to facilitate and govern this process of "silent," market-led integration, but the continued presence of heavily administered borders and of similar but differentiated regulatory regimes continues to undermine the ability of firms and individuals alike to reap the full benefits of deepening integration.

Samuel Krislov, echoing the view of most experts in the field, concludes that the fear of international regulatory cooperation and convergence leading to a boring sameness and loss of sovereignty is not well founded. "The specter of a gray, uniform, and styleless world of mass-produced sameness does not loom large today in the world of standards. By defining parameters for self-standardization in some areas, authorizing and policing standardizers and quality-control testers, and maintaining an intelligent eye on the machinery of standards, standard setters can ensure that the social product serves multiple social purposes." (Krislov 1997: 231). For Canada, the United States and Mexico, several generations of cooperation have demonstrated that the results are both pro-competitive and in the interest of effective regulation.

Operating in small, export-dependent economies next door to the world's most vibrant economy, Canadian and Mexican suppliers and regulators alike have learned the benefits of cross-border regulatory cooperation. The result has been an inexorable drift toward ever-greater convergence. This trend is unlikely to change, but the two smaller countries can take steps to harness it and ensure that it develops in ways that bring greater benefits and more control than is currently the case.

All three governments have committed to developing a framework for regulatory cooperation. Such a framework should, initially, change the current practice of discretionary cooperation at the federal level to a mandatory process of information exchange, consultation, and even coordination with a view to advancing a jointly agreed mandate to improve regulatory outcomes, eliminate duplication and redundancy, reduce regulatory differences between the two countries, and effect a North American approach to regulation. Much of this mandatory cooperation can be implemented on the basis of existing institutions and be focused on priority sectors. Its most critical results will be experience and mutual confidence. Once experience is gained with this framework, the two governments should proceed to negotiating a treaty enshrining the principles of regulatory cooperation and establishing a modest institutional capacity to give it effect. As the Independent Task Force on the Future of North America concludes: "A collaborative approach to regulatory reform could help all three countries expand economic opportunity within North America while strengthening the protection of the environment, health and safety, and other shared objectives of regulatory policy." (CFR 2005:23).

This program of regulatory cooperation should form part of a larger vision implementing a joint commitment to the creation of the necessary legal framework and institutions to govern accelerating cross-border integration and ensure that Canadians, Americans, and Mexican enjoy its benefits. In Allan Gotlieb's words, we need to develop "... a more comprehensive North American community of law. It would create agreed rules and procedures applying to all significant aspects of the movement of people, goods and services across our border. Such a community of law, inspired by the European model, could lead to a full-scale customs union, embracing a common security perimeter, common standards affecting all commerce, joint tribunals to adjudicate disputes, and, in time, complete freedom of movement of people." (Gotlieb 2004: 8).

In the SPP, the three governments committed to developing a regulatory convergence agenda. As the above analysis suggests, an effective agenda could include the following elements:

- The development of comprehensive national data bases cataloguing the extent of differences and similarities in analogous national regulatory regimes.
- The development of analytical tools capable of providing credible assessments of the costs and benefits of regulatory divergence and convergence.
- Identification of priority sectors for intensive discussions aimed at reducing and eliminating nuisance differences.
- Rule changes in national regulatory development systems to embed a default position of compatibility and equivalence at three levels:
  - in annual reporting requirements to legislative bodies;
  - in developing new or amending existing regulatory regimes; and
  - In the general audit functions of national audit officials.
- Development of the necessary institutional capacity to oversee and encourage regulatory convergence and address issues, problems, and conflicts that may arise.
- Establishment of trilateral advisory groups to provide ministers with independent advice on progress and priorities in effecting regulatory convergence.

The result should be a basis for moving from activity to results. In pursuing a more outcomes-oriented approach to North American regulatory cooperation, the three governments should:

- Ensure that regulatory cooperation and convergence is pursued in the public interest. Determining the public interest should be accomplished through an open, transparent and, above all, objective assessment of the costs and benefits of regulatory co-operation. The focus should be on achieving the best possible regulatory outcomes at the lowest possible costs, recognizing that regulatory resources are limited. The public interest would also be served by ensuring accountability for achieving efficient and effective results.
- Ensure that international agreements are followed. This requires effective oversight mechanisms to ensure that regulatory initiatives are designed, and regulatory programs operate, in accordance with all three country's international commitments, from the WTO to the FAO and other arrangements.
- Entrench a presumption in favour of compatibility of the three governments' regulatory approaches. There may be rare cases in which any of the three countries would benefit most from unilateral adoption of regulatory approaches, decisions, or standards of other competent jurisdictions, but this should only happen when there is persuasive evidence that they are absolutely necessary to meet clearly defined national goals.
- Strengthen progress towards regulatory convergence within North America with a goal of creating a North American economic platform. Common sense and basic arithmetic support focusing the efforts of all three countries on engaging each other to the extent appropriate and feasible.
- On the basis of a cooperative North American approach, all three governments should work cooperatively with the European Union and others on the development of international standards wherever feasible.





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## GLOSSARY OF ACRONYMS

AAFC	Agriculture and Agri-food Canada
ANSI	American National Standards Institute
APEC	Asia-Pacific Economic Cooperation
APHIS	Plant Health Inspection Service (US)
APLAC	Asia Pacific Laboratory Accreditation Cooperation
ASME	American Society for Mechanical Engineers
ASTM	American Society for Testing and Materials
CFIA	Canadian Food Inspection Agency
CFIB	Canadian Federation of Independent Business
COFEMER	Federal Regulatory Improvement Commission (Mexico)
CUFTA	Canada-US Free Trade Agreement
DGN	Dirección General de Normas (General Bureau of Standards in Mexico)
EACSR	External Advisory Committee on Smart Regulation (Canada)
EC	European Communities
EEA	European Economic Area
EFTA	European Free Trade Area
EU	European Union
FAO	Food and Agriculture Organization
FDA	Food and Drug Administration (US)
FSIS	Food Safety Inspection Service (US)
GATS	General Agreement on Trade in Services (WTO)
GATT	General Agreement on Tariffs and Trade (WTO)
HACCP	Hazard Analysis Critical Control Point
IAF	International Accreditation Forum, Inc.
IATCA	International Auditor Training and Certification Association
IEC	International Electrotechnical Commission
IEEE	Institute of Electrical and Electronic Engineers
ILAC	International Laboratory Accreditation Cooperation
ISO	International Standards Organization
NACC	North American Calibration Cooperation
NAFTA	North American Free Trade Agreement
NFPA	National Fire Protection Association
OECD	Organization for Economic Cooperation and Development
OIRA	Office of Information and Regulatory Affairs (US)
OMB	Office of Management and Budget (US)
PAC	Pacific Accreditation Cooperation
PCO	Privy Council Office (Canada)
PRI	Policy Research Initiative (Canada)
RIA	Regulatory Impact Analysis
SAE	Society of Automotive Engineers
SALRDF	Secretary of Agriculture, Livestock, Rural Development, Fishery and Food (Mexico)
SCC	Standards Council of Canada
SDO	standards development organization
SEA	Single European Act
SH	Secretary of Health (Mexico)

SPP	Security and Prosperity Partnership (Canada, the United States and Mexico)
SPS	Sanitary and Phytosanitary Agreement of the WTO
TBT	Technical Barriers to Trade Agreement of the WTO
TNC	Transnational Corporation
UDE	Economic Deregulation Unit (Unidad de Desregulación Económica) (Mexico)
UL	Underwriters Laboratory (USA)
USD	US Department of Agriculture
WTO	World Trade Organization



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