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Baggs, J., L. Fung & B. Lapham *"A Theoretical and Empirical Investigation of the Exposure of Canadian Retailers to Cross-Border Shopping"*

SUMMARY

The Model

- A two country model of local retailers and traveling consumers who can shop in both countries
- Retailers are impacted by exchange rate shocks because changes in the value of a country's currency affects the costs of retailers using imported inputs and affects the demand facing retailers as consumers change their purchasing patterns through cross-border shopping.

Empirical Methodology

- A measure of exposure of retailers to exchange rate movements is formulated.
- Measure varies across firms according to their characteristics (such as productivity, location, etc.).
- The model is used to estimate firm-level exposure to exchange rate movements and the quantitative impact of exchange rate movements on retailers sales and profits using comprehensive census level Canadian firm level data and cross-border traveler data from 1986 to 2007.

Results

- Retailer exposure to cross border shopping declines with distance from the closest land border post, decreases with implementation of post 9/11 border control and with relative population to the closest US border county (a proxy of relative market size).
- Retailer exposure increases with Canadian sales taxes and the value of Canadian dollar.
- At the firm level, the firm response to exchange rate movements in terms of sales and profit-sales ratio is augmented by their degree of exposure and mitigated by firm size.

COMMENTS

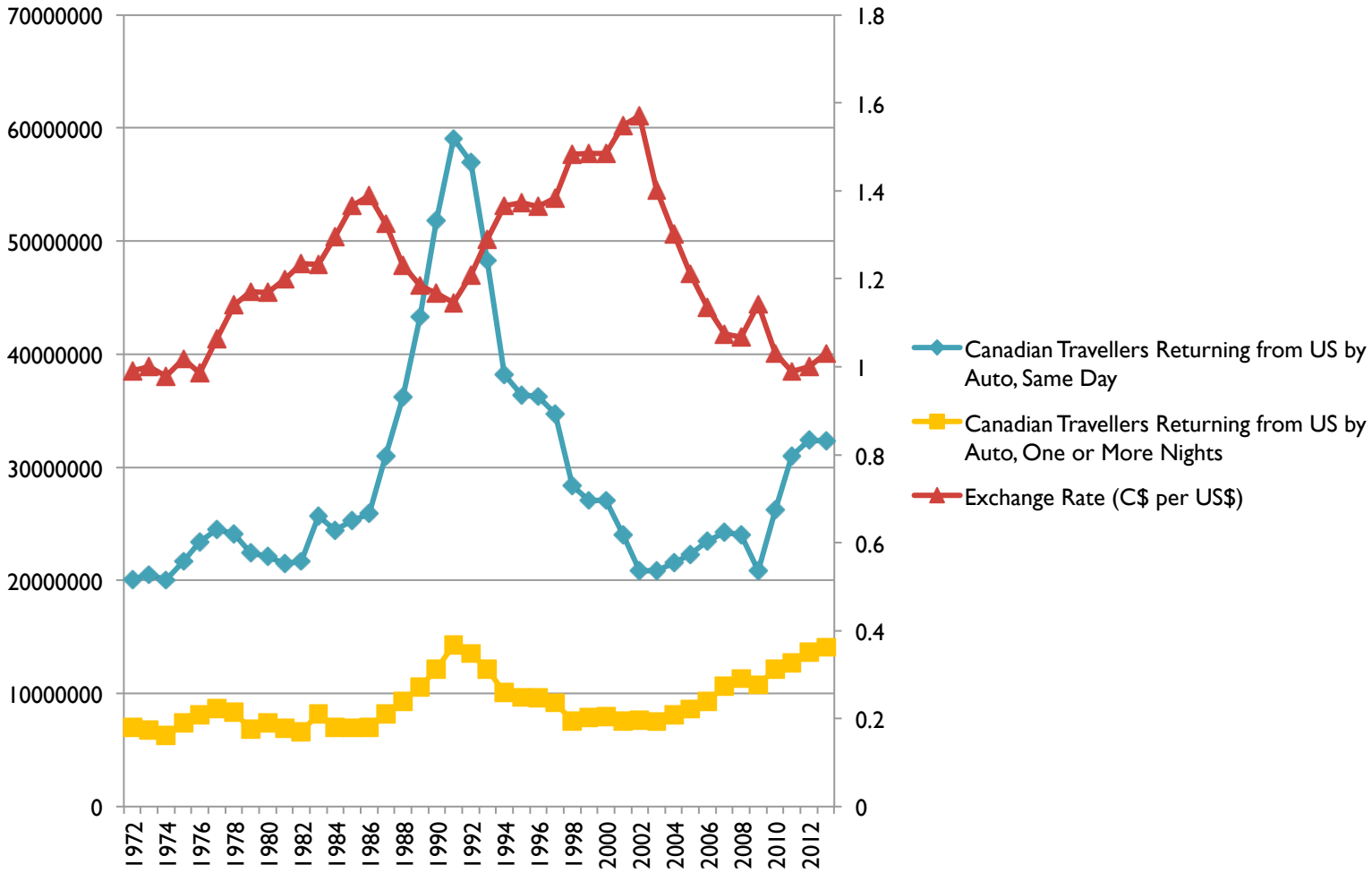
1. Contribution of Paper

- Past studies of cross-border shopping have focused solely on the demand side – as measured by trips across the border.
- Paper combines demand and supply side factors in looking at the effect of exchange rate changes on both firm response and cross-border shopping.
- However, empirical results are done separately for both firms (sales & profits) and shoppers (cross-border trips). Next step would be to introduce some simultaneity between trips and retail response.

2. The Historical Context

- Two key phases to the cross-border shopping saga – pre and post 1990s
- Cross-border shopping peaked in 1991 at 59.1 million SDAT in response to an appreciation of 1.36 CAD per USD in 1985 to 1.15 in 1991.
- SDAT collapsed after 1991reaching a low of 20.8 million by 2003.

Canadian Cross Border Travel & Exchange Rate, 1972-2013



Cross border has declined

- Cross border shopping in Canada (as measured by SDAT) in 2012 about half of that during the peak of the mania in 1991.
- Yet, dollar had reached parity over 2010-2012 period.

Cross-Border Shopping a Much Less Serious Problem Now than Early 1990s

- Why?
  - Structural change in Canadian retailing?
    - Despite a continuing price-gap between goods in Canada and the United States, Canadian retailing has restructured since the early 1990s and Canadian retailers in general are perceived to be somewhat more competitive.
    - Moreover, the arrival of large American retailers into the Canadian market such as Walmart and Target has also made the Canadian shopping experience more akin to the American one.

Question this research can address- Is Canadian retailing more efficient now?

- Have Canadian retail firms become more efficient now?
- Has the supply side response by firms to the exchange rate (firms responding to any cost changes of appreciating $ with efficiencies) begun to dominate the demand side response by consumers (consumers crossing the border to take advantage of appreciating dollar)?

3. Minor Points

- Regression variables on the determinants of SDAT and OMNAT do not include gasoline prices.
- Per capita rather than total trips might be a useful variable specification to explore – the drop in cross-border trips since 1991 even more dramatic when done on a per capita basis due to population growth.