Defining North American Economic Integration: Comments

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Overview

- Very well written, substantively valuable paper
- Particularly useful in enriching our understanding of economic integration through
  - Variety of definitions of economic integration, and
  - Presentation of an interesting set of different measures; specifically, measuring integration through four factors:
    - Product price convergence
    - Factor market integration
    - Volume of trade
    - Breadth of trade

Gains from Integration

- Discussed primarily with reference to international trade; gains from trade
  - Conceptual elements and some reference to empirical studies of benefits of opening up to trade
- Some reasons why *regional trade agreements* may not deliver the expected benefits
  - Trade agreement is necessary but not sufficient
  - Implementation may be incomplete or poorly done
  - Regional trade agreements usually focus on tariff reductions but there are too many NTBs that can remain and frustrate the shift to more open trade

Integration at Less Aggregate Levels

- Gains from integration also exist at regional levels
  - Some discussion in paper of gains accruing to individual farmers or processors
- Also gains from simply integrating markets within a country; aggregate gains from trade have counterparts at commodity or market level, e.g.,
  - Reduced prices to consumers (or quality improvements)
    - Lower costs sources of input supply
  - Gains from specialization, or increasing returns to scale
  - Innovation and introduction of new technologies
  - Increased competition from foreign producers

Integration in Domestic Factor Mkts

- One area where this paper may underplay the importance of market integration is in factor markets
  - More important in domestic mkts than from international trade
- Can be illustrated by looking at distributional effects of government agricultural policies
  - Key issue is Labour market integration between rural, urban areas
  - If they are well integrated, by the measures used in this paper, and if the agricultural sector accounts for a minority of aggregate employment, then
  - supply of L to Ag sector is exogenous (wages determined in urban or industrial sector)
  - Agricultural policies will not affect wage earners, or wage rates, only land owners
  - Example from rice policy and Indonesia; reveals effects on poverty reduction by considering wage rates rather than land price effects

Price Convergence: Canada-US

- Key issue here: making international comparisons when exchange rates may not be adjusting to inflation rate differentials between the two countries being compared
- For Canada-US, Fig 1a: puzzling
  - Shows relatively close correspondence, with some lags, between exchange rate and inflation, except for few periods; not my impression within couple years of event (ok over 5-10 years)
    - Why did Canadian dollar fall from the mid-$0.70s to low 60s three to four years ago when there was little significant difference in inflation?
    - Why did Canadian dollar appreciate so much during 2003 when inflation was if anything higher in Canada?
  - Why use 1986 as base year? To examine levels a base period where a PPP exchange rate holds strikes me as preferable
  - But the longer term *changes* in exchange rate do correspond roughly to changes in inflation rate, as seen in Fig 1a

Price Convergence: Mexico-US

- For Mexico-US exchange rate movements, they correspond less clearly to inflation
  - Much larger differences in inflation, in both levels and variation
  - Two major macro crises complicate comparisons: Debt crisis (1982) and peso crisis (1994)
- For both these reasons, prices in Mexico are moving for different reasons than inflation and exchange rate, making price convergence less evident

Factor Markets: Capital

- Focus on Mexico-US; Canada-US capital movements so large that integration not an issue
- Increased trend of FDI since NAFTA
- Portfolio investment highly volatile
- But what about integration in these capital markets
  - Conceptually, there is the issue of country risk that limits capital flows and therefore capital mkt integration lags, especially in DCs
  - No direct evidence put forward in the paper here
- Exception is Maquiladora sector; here evidence is clear that there is much integration
  - Raises question, how much of Mexican FDI is due to maquiladora sector.
  - Data not presented but would be useful

Factor Markets: Labour

- Focus on Mexico-US; Canada-US labour markt integration not addressed;
  - Limits here across all countries due to immigration regulations
  - Short term mobility is high and fostered by NAFTA (Canada-US)
  - Long term mobility and wage equalization not clear (Canada-US)
- Evidence for Mexico-US not clear nor convincing
  - Fig 8 shows real wage in Mexico rising relative to US wage rate
  - But is this just economic growth in Mexico raising the real wage relative to U.S.? This is what would be expected if Mexican GDP growth rates have exceeded US growth rate over data period (1970-2000)
  - These data also not presented but would be useful
  - No NAFTA effect is claimed, but it too would be clouded by peso crisis of 1994

Factor Markets: Labour II

- Paper makes key point, that the maintenance of border restrictions is holding the cost of migration at high levels, limiting wage rate convergence in levels from occurring
  - Wage rates may move together but no absolute convergence; a limited degree of labour mkt integration
  - Border regions show more integration than regions distant from border
- No influence of NAFTA on wage convergence found, but this could be confounded by stricter border enforcement since NAFTA

Volume of Trade - Canada-US

- Data supportive of increased market integration between Canada and the U.S., particularly on the side of Canadian exports
- But simply comparing before and after NAFTA is to present a too-simple one-variable model of trade movements
  - At least the effect of the exchange rate must be considered, quite apart from other plausible causative variables
  - Specifically the depreciation of the Canadian dollar during the 1990s was dramatic (by roughly one-third) and this coincided closely with the initiation of the Canada-US Trade Agreement, confounding any real effects of the increased trade and lower trade barriers

Volume of Trade - Mexico-US

- Drawing on several data comparisons, story is quite consistent here:
  - Trade is increasing in both imports and exports since NAFTA, in terms of
    - absolute trade flows,
    - import/export shares, and
    - trade levels exceed models of “potential trade”
  - Comparisons again clouded by the peso crisis of 94
- In my view, these data are quite a bit more clear on increased Mexico-US economic integration than looking at factor market or price convergence data

Breadth of Trade

- Very interesting variable to illustrate integration, the range of products traded, data from 1972 to 2001
  - Range of imports into US grew substantially
  - Canada increased as a supplier to US from 4th to 1st in terms of number of products traded
  - Mexico likewise, from 13th to 8th
- Convincing support using this variable that greater economic integration has occurred
- Small literature here, but promising empirical measure; would be nice to see more on this issue

Conclusions

- Economic integration clearly very important issue, leading to more growth and critical distribution effects
- Defining and measuring not easy but this paper helps enlighten us on key elements of this topic
  – Topic is even broader than presented here where focus is pretty much on only trade; domestic market integration also very important
- Price comparisons between Mexico and US difficult due to exchange rate movements, limits what can be concluded
- Factor markets suggest somewhat more integration in capital, not so clear for labour
- Depth, breadth of trade volumes more clear, that Mex/Can-US economic integration occurring; some due to NAFTA