Defining North American Economic Integration

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The Quest for Economic Integration

- Defining Integration
- The Importance of Integration
- Four Measures of Integration
  - Price Convergence
  - Factor Markets
  - Trade Volumes
  - Product Availability
Defining Economic Integration

- Mixing previously separate groups

- “...when product flows between countries are on the same terms and conditions as within countries”
  - Knutson & Ochoa
An Active Definition

- We move towards economic integration by removing barriers to commercial exchange.
- Economic integration is the absence of barriers to commercial exchange.
Three kinds of barriers

- Natural
- Cultural
- Information
- Language
- Preferences
- Political
Why Integration Matters

- People who trade more live better
  - Productivity and Specialization
  - Variety
  - Consumption
- Removing barriers to commercial exchange probably stimulates long-run growth
Measuring Integration with Prices

- Barriers create a wedge between prices
  - Tariffs are added to prices
  - Quotas create shortages that drive price up
  - Transportation costs raise prices
- Price convergence is evidence of integration
- Problems: inflation, exchange rates, and other factors also affect prices
Canada’s currency: relatively flexible
Mexico’s currency: relatively inflexible
Result of inflexibility
Factor Markets: Capital

- Capital flows have increased with NAFTA
- Rising FDI component
- Tied closely to U.S. manufacturing

[Graph showing Log US Manuf. Output and Log Real Maquila Value Added over years from 1980 to 2003]
Factor Markets: Labor

- Large wage differentials persist
- North American labor markets are closely integrated
  - Wage movements in the United States affect wages in Mexico
  - Border region is more closely integrated than the Mexican interior
- Integration has not increased with NAFTA
NAFTA and Factor Markets

- NAFTA changes encouraged capital flows: capital markets are more integrated.
- Unrelated to NAFTA, the United States increased border enforcement that may have neutralized NAFTA’s effects on labor market integration: labor markets are not more integrated.
Trade Volumes

- If barriers restrict trade, trade should rise as barriers fall.
- Trade data are easy to find and analyze.
- Trade as a share of GDP illustrates the relative effects of trade liberalization.
Canada’s Share of U.S. Trade

![Chart showing Canada’s share of U.S. trade from 1985 to 2003. The chart indicates a fluctuating trend with peaks in 1987, 1997, and 1999, and a general decline by 2003.]
Mexico’s Share of U.S. Exports
Mexico’s Share of U.S. Imports

Year

1985
1987
1989
1991
1993
1995
1997
1999
2001
2003

Fitted values

Mexico Share of US Imports
Share of U.S. Trade

- Canadian and Mexican shares of U.S. exports have been rising
- Canadian share of U.S. imports has been falling recently
- Mexican share of U.S. imports has been rising
- Overall, these suggest increasing integration (possible trade diversion)
Product Availability

- Can you get what you want?
- Expanding the *range* of traded products
- Gains from increasing the range can be large (3% increase in estimated United States welfare)
- Fertile topic for future research
Conclusions

- We integrate markets by lowering barriers to commercial exchange
- Economic integration raises welfare on average (in the long run)
- There are several ways to measure economic integration
- Rising trade volumes, capital flows, and product variety suggest NAFTA is contributing to economic integration
- Integration is still incomplete in some markets