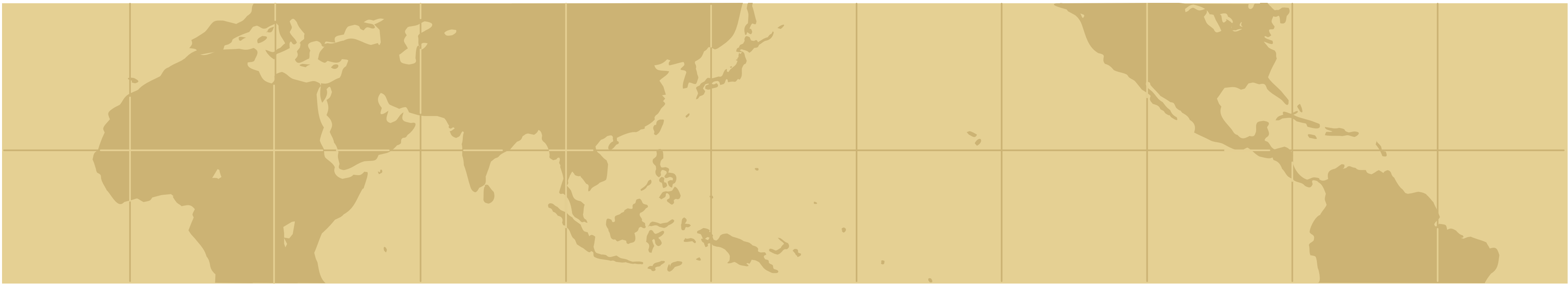

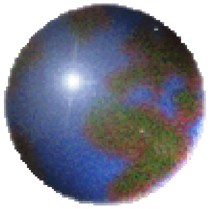

Defining North American Economic Integration

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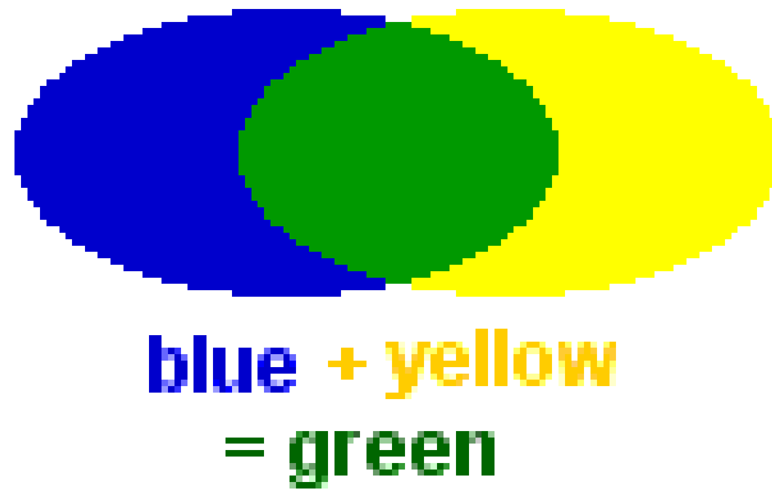
The Quest for Economic Integration

- 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

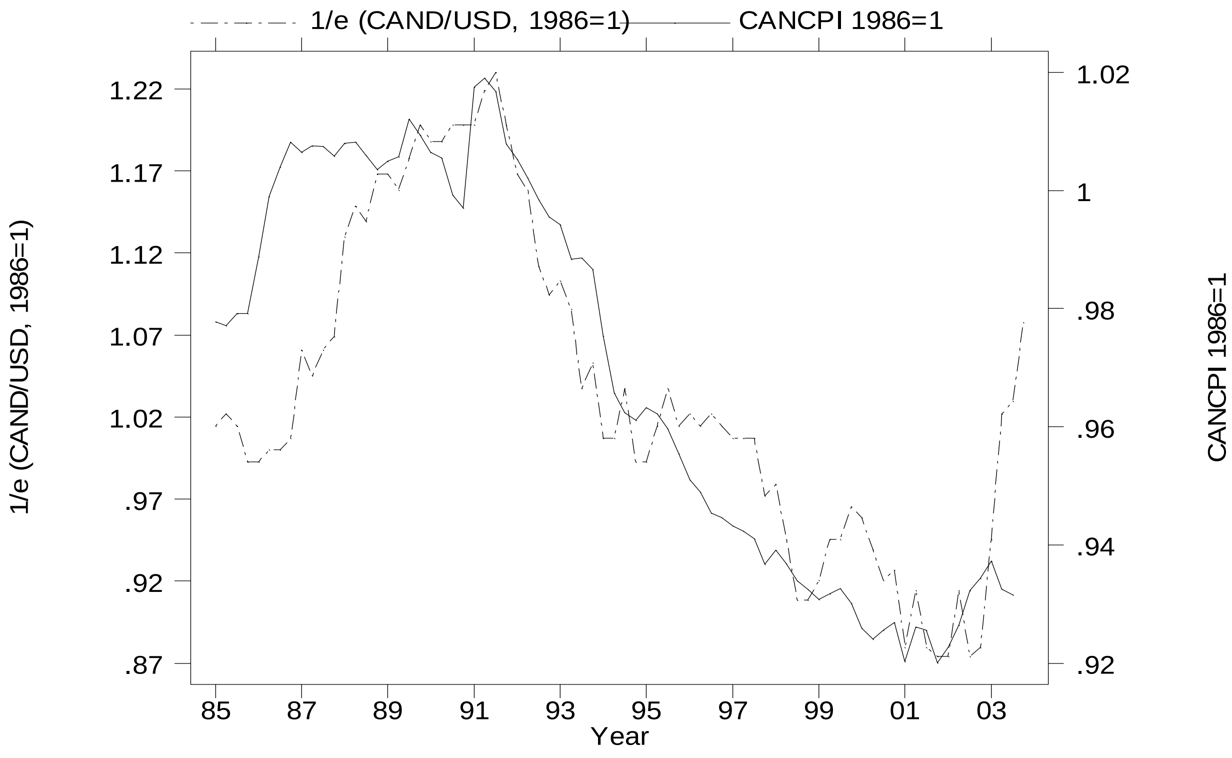
Why Integration Matters

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

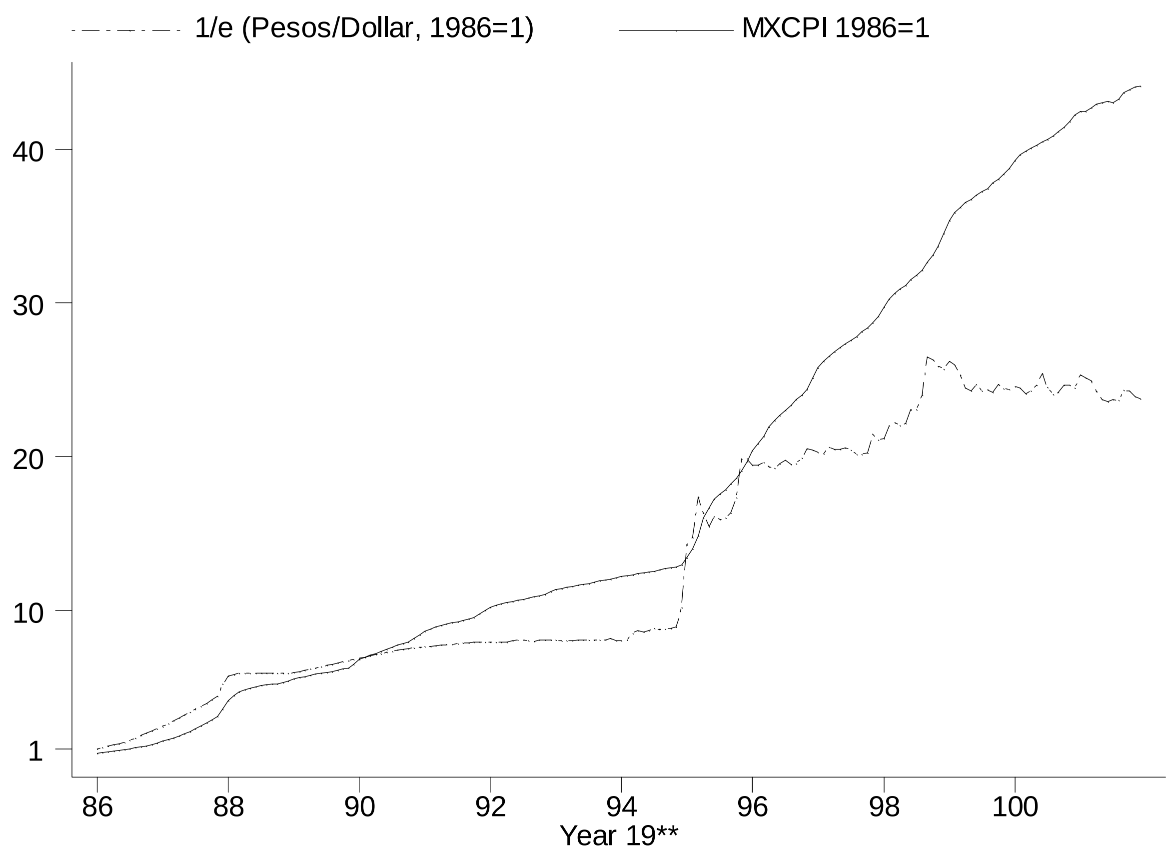
Measuring Integration with Prices

- 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

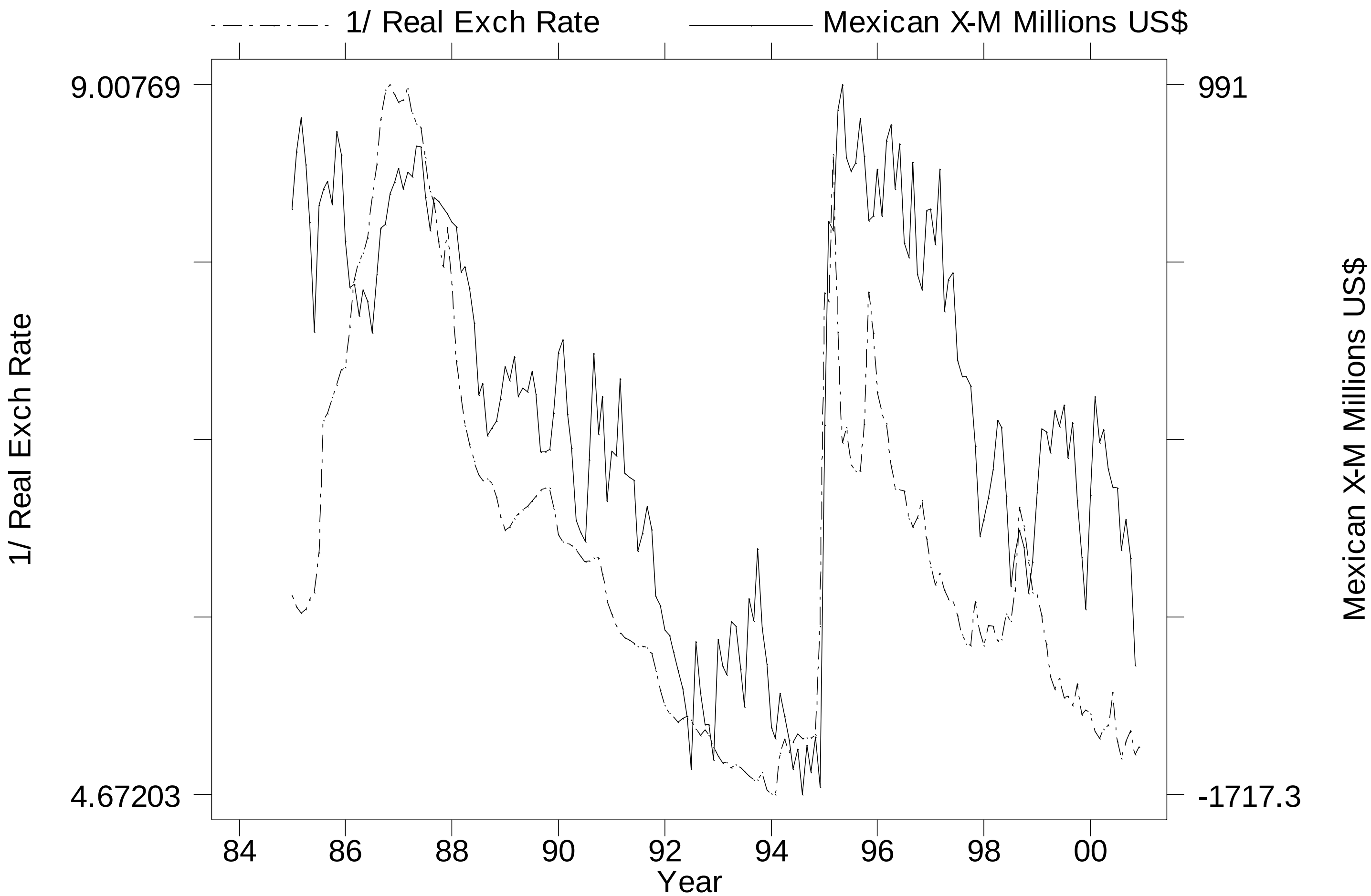
Canada's currency: relatively flexible



Mexico's currency: relatively inflexible

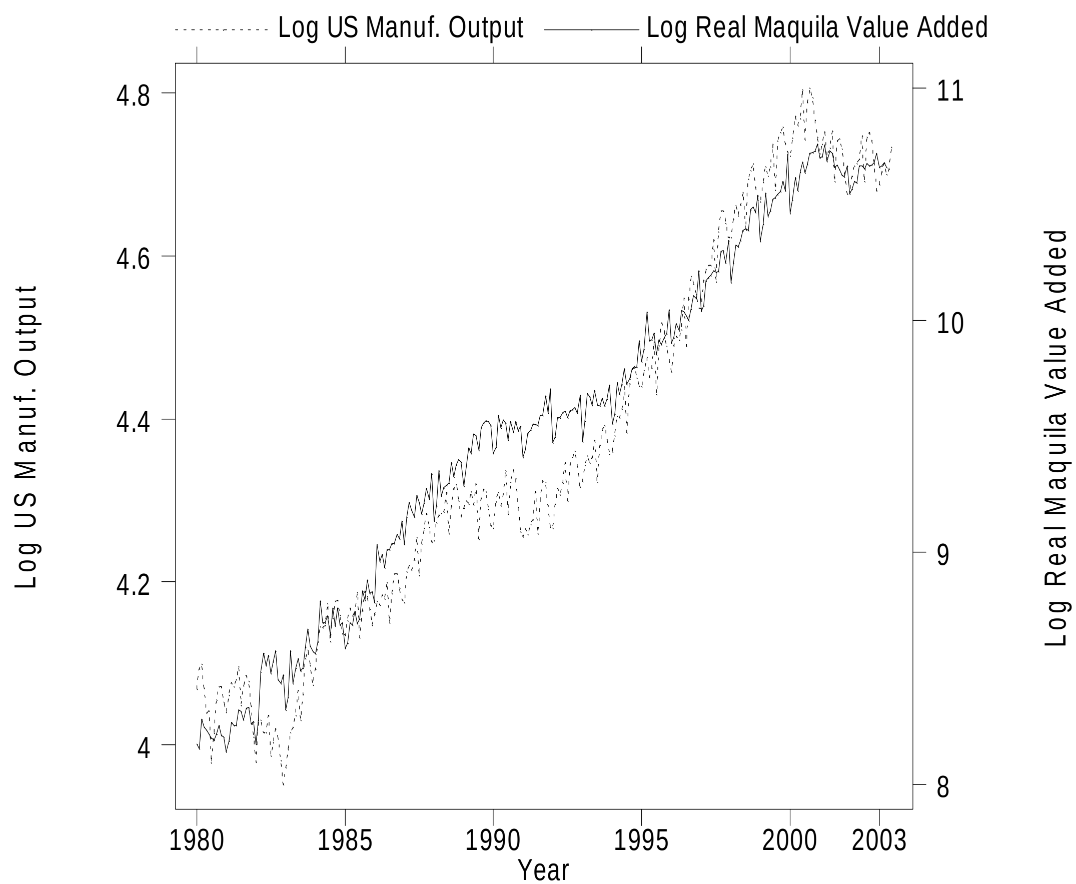


Result of inflexibility



Factor Markets: Capital

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



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

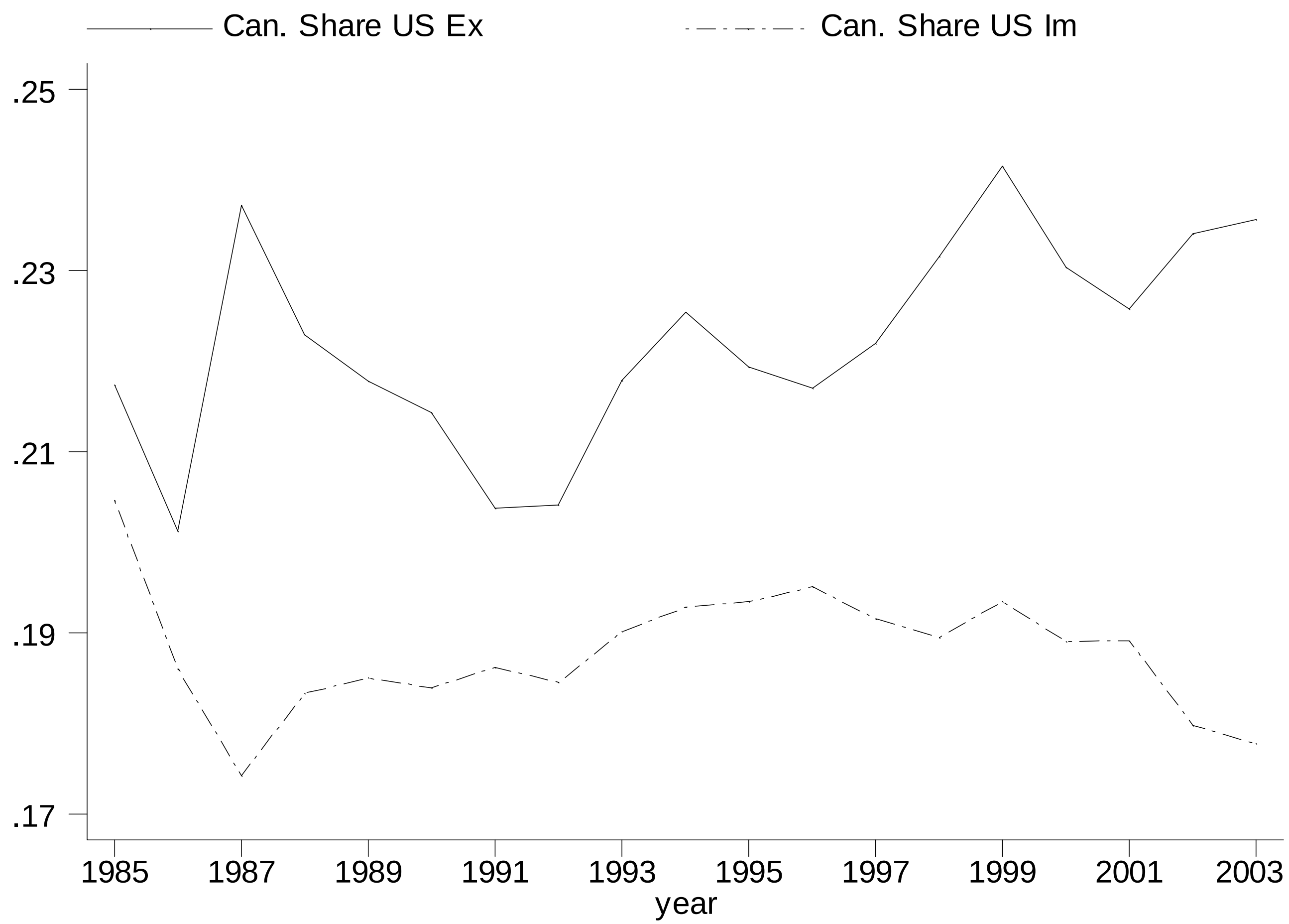
NAFTA and Factor Markets

- 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.

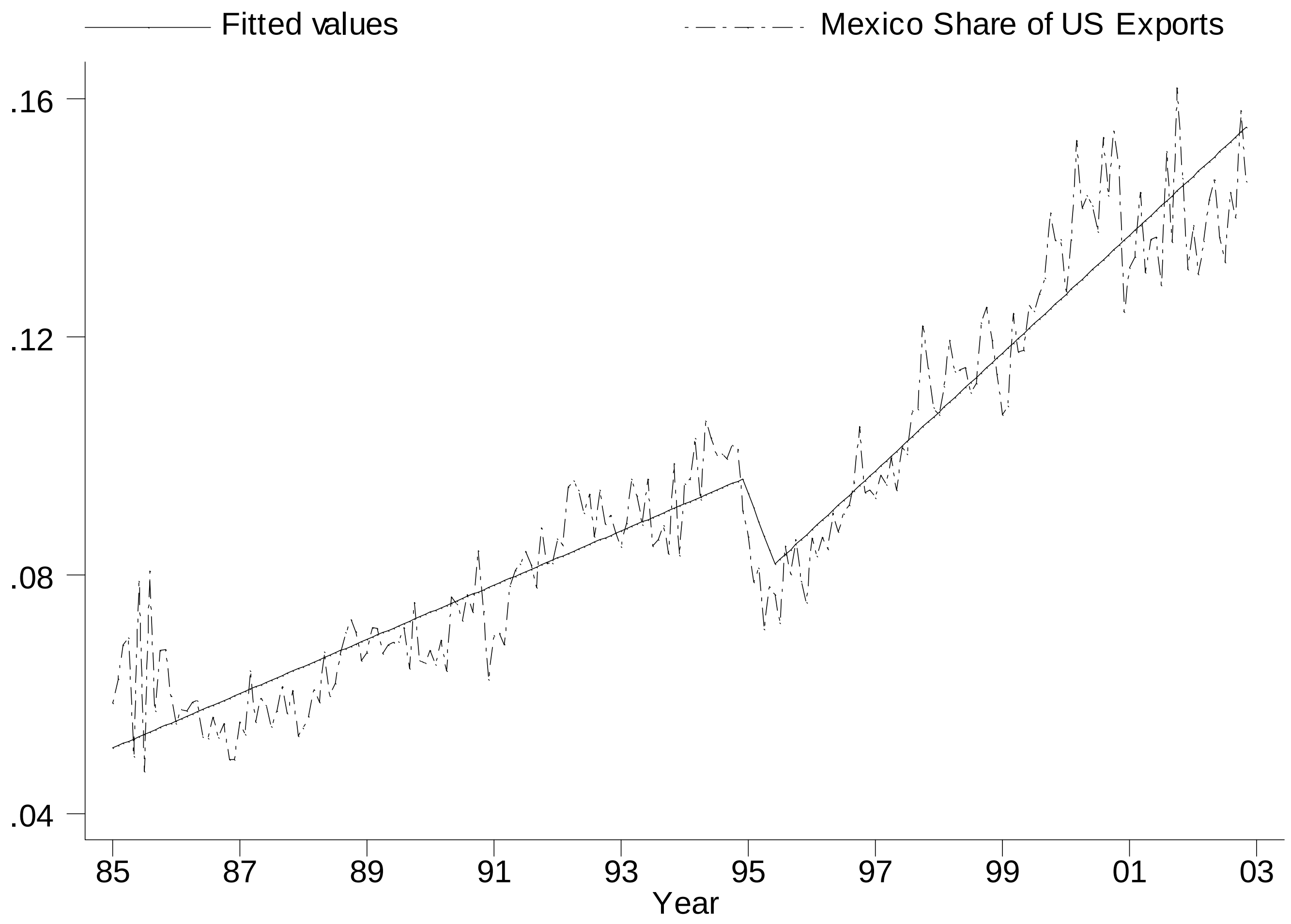
Trade Volumes

- 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

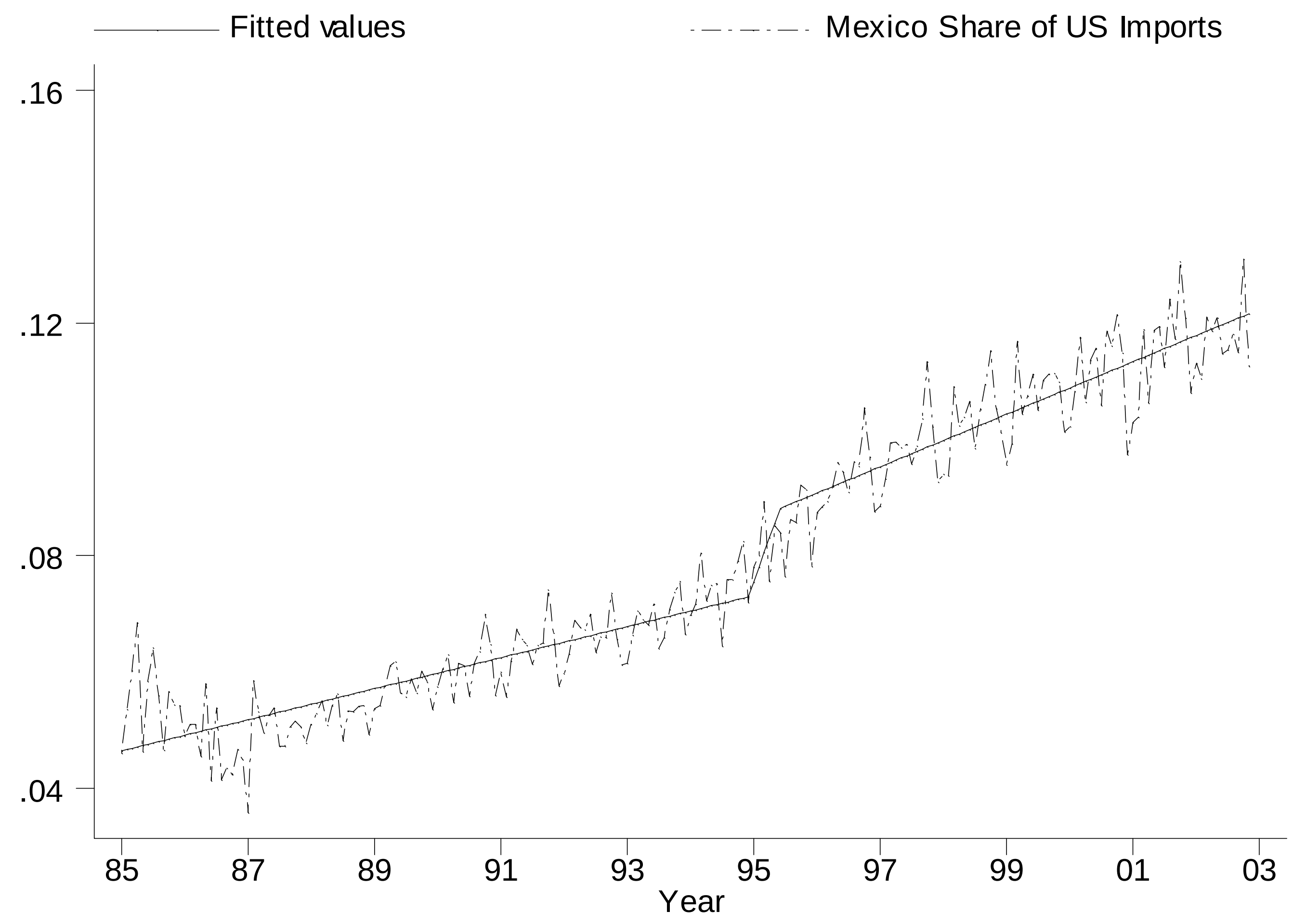
Canada's Share of U.S. Trade



Mexico's Share of U.S. Exports



Mexico's Share of U.S. 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