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# What Will it Take to Build a North American Community?

Gaspare M Genna



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# **North American Integration**

**An Institutional Void in Migration,  
Security and Development**

**Edited by**

**Gaspare M. Genna**

**David A. Mayer-Foulkes**

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## 2 What Will It Take to Build a North American Community?

*Gaspare M. Genna*

### INTRODUCTION

Why is it important to assess North America's integration potential? Regional integration is one method countries use to solve commonly held problems. In North America, many of the issues and problems among the three countries boil down to migration, security, and development. Migration, security, and development are interrelated problems because they have in common the quest for stable economic and political environments where individuals' and states' objectives can be realized. Individuals will choose to exit when they perceive the lack of economic opportunities and/or physical security in their home countries and believe that there are ample quantities of these two items in a neighboring country.<sup>1</sup> Countries seek to control immigration in order to maximize security and development in their countries.<sup>2</sup> Political development also helps in the area of security by reducing the likelihood of civil conflict<sup>3</sup> and external threats.<sup>4</sup> Economic development reduces the likelihood that individuals will seek the exit strategy. It also increases the likelihood that states will experience domestic stability and favorable relations with neighboring countries. Economic development, therefore, becomes the linchpin in solving the associated problems of migration and security. Political leaders can develop policies, laws, and regulations to solve these problems unilaterally. Another approach is to develop solutions in a trilateral manner. The aim of this chapter is to assess the probability of increasing trilateral cooperation.

If the three partners do not view the migration-security-development issue as a common problem, then North America will lack a unified strategy and a set of effective institutions to solve these problems. As was argued in the introduction, North America will persist in having an institutional void. However, the three North American partners can view them as a common problem and thereby conceptualize solutions as collective goods because benefits are spread to all those involved, although not necessarily equally. Collective goods are achieved through collective action, which is often difficult to carry out.<sup>5</sup> What are the main problems for achieving collective action and what form would this action take? Although there are many views

associated with the collective action problem,<sup>6</sup> I will focus on transaction costs and uncertainty with attention on how homogeneity and power asymmetries among countries will lower them.

Transaction costs are costs borne by individuals when they operate in a foreign political and economic environment. Differences between the home and foreign environment increase costs due to the need to adjust in the new environment. In addition to increased transaction costs, individuals have greater uncertainty for success since they will be departing from what is known to what is unknown. Transaction costs and uncertainty can discourage individuals from integrating regionally. The lowering of the levels of these variables can result from homogeneity because of the effect on compatibility. In order to assess North America's current and future state of integration, it is important to examine the compatibility of the three partners in light of transaction costs and uncertainty.

Collective action can take the form of regional integration. Regional integration is the establishment of collective decision making among states for the intention of establishing and regulating market flows.<sup>7</sup> Market flows are the entries and exits of the factors of production (except land), as well as goods and services. The degree of integration refers to the degree of collective decision making. At one end is an intergovernmental arrangement in which states make common decisions but are autonomous in regulating those decisions. If a regional authority does exist, it serves at the pleasure of the individual states. On the opposite end is the supranational arrangement, in which regional institutions do exist and make decisions alongside intergovernmental arrangements or supersede member states' authority.

The possibility of solving the problems of migration, security, and uneven development in North America through regional integration requires us to first discover the general conditions under which integration develops. The optimal conditions, I will argue, are regional leadership and homogeneity. After making the argument and testing if homogeneity and regional leadership do promote integration, I assess North American integration today and then examine what conditions are needed for various levels of integration. The final step is to analyze the likelihood of homogeneity in the North American context.

## CONDITIONS OF REGIONAL INTEGRATION

The literature provides several important variables for explaining the levels of integration. The power theories indicate that an asymmetric distribution of power produces a more favorable condition for integration than a grouping of similarly powerful countries.<sup>8</sup> This is due to the ability of the preponderant power to coordinate efforts and distribute incentives to other members. In other words, the region must include a capable leader.

The coordination of efforts begins with negotiating treaties and continues with treaty implementation and amendments. The attainment of a collective good, like regional integration, requires partners to come together and negotiate terms. Although all actors will recognize the need for the collective good, they may not wish to accept the cost of organizing the negotiations for several reasons. The actor may not have the resources to participate in negotiations and may therefore need a partner to assume the initial cost. In addition, some actors may perceive an asymmetrical distribution of the collective good's potential benefits. With this perception, they may not wish to assume the costs of coordinating the negotiations. Therefore, a regional leader that is willing and capable would overcome these barriers by assuming the initial costs of coordination.

A regional leader's capabilities would also be useful in providing incentives in the bargaining process. These incentives can be directly or indirectly associated with the regional integration negotiations. The direct incentives can include asymmetric concessions during the bargaining process. For example, a regional leader may agree to delay the timing of implementing parts of a treaty in order to alleviate concerns that potential benefits will be asymmetric. The regional leader can do this given its larger economy and therefore its ability to absorb asymmetric treaty implementation. Indirect incentives involve side terms that directly influence the terms of negotiations but are outside the treaty. The regional leader can promise developmental aid in exchange for a concession.

The need for a regional leader is also necessary in treaty implementation and amendment. Free riders may appear in the implementation process. These would be partners that may not be able or, politically, may not want to implement agreements after ratification. A regional leader would be one that would have the resources to effectively prevent or change a free rider's behavior. If the behavior is unintentional, as is often the case, then the leader can provide aid or coordinate efforts among the other partners to provide aid. If the behavior is intentional, the leader can enforce sanctions either on its own or through coordination with other partners. A regional leader's role in amending agreements would follow the same logic as in the production of the initial agreement(s).

Next is the compatibility of countries. Having a powerful regional leader alone cannot help the development of integration if there are wide preferences leading to irresolvable disagreements.<sup>9</sup> Although the powerful country could force preferences on others in the region, the outcome would resemble an empire rather than a voluntary association of countries. In order to form a cohesive unit, political and economic environments must be similar in order to reduce transaction costs<sup>10</sup> and reduce uncertainty. Without compatibility, individuals will assume a cost of having to adjust to new partnerships and have greater uncertainty that the new partnerships will be successful. Therefore, individuals would prefer that regional integration develop between compatible actors so that the costs are low. This explanation follows

theories involving interactions between domestic groups and the interests represented in government policies.<sup>11</sup>

Homogeneity can deepen integration for two reasons. One is the perceived reduction of the costs and uncertainties due to the effects that identity politics has on cooperation. Prior research demonstrates that countries that have a similar political identity also have similar policy preferences.<sup>12</sup> Institutions can be defined as the set of rules and procedures that are deemed appropriate by the political leaders.<sup>13</sup> Given this definition, individuals are assumed to make decisions based on institutionalized values.<sup>14</sup> Since values are closely related to the economic development of a country, research has empirically demonstrated a close association between economic development, values, and institutional preferences.<sup>15</sup> Similar institutions breed ideological similarities since they share a "co-evolutionary process."<sup>16</sup> Norms and institutions reinforce one another, and therefore a country's institutions are viewed as the expected expression of their norms.<sup>17</sup> Similar institutions and levels of development, therefore, will correlate with similar preferences.

The identity factor also provides a decision-making shortcut that would facilitate cooperation because it greatly simplifies a rather complex set of cognitive processes. Research into the dynamics of in-group and out-group behavior has shown that cooperation is easier among those that share an identity than those that do not.<sup>18</sup> Simply being viewed as "one of us" will elicit the type of cooperation that would also include resource allocations.<sup>19</sup> This holds not only for individuals, but for states as well. For example, Werner and Lemke<sup>20</sup> demonstrate that alliances are more likely among similar countries. With a similar identity, actors believe that cooperation is easier due to lower transaction costs.

Another reason that similar institutions can improve the deepening of integration is based on material concerns. Individuals are faced with an important reality: there is one set of factors in life that they can control and then there are those that they cannot. Controllable factors are inward and include only those in their immediate environments. Uncontrollable factors are external. What is and is not controllable varies among individuals, but I assume that issues in the national political and economic realms are outside the control of any one individual. When institutions vary greatly from what an individual is accustomed to, then adjustment costs are needed and uncertainty regarding outcomes increases. Adjustment costs can involve acquiring new information about and adaptation to the new circumstances. Uncertainty about the outcomes can involve the likelihood or degree of success. Also, uncertainty can involve the degree of fair play.

Take the case of entrepreneurs. They have control within their firms and operations. Such factors include personnel, marketing, physical operations, etc. Uncontrollable factors are found outside the firm. These include the political, economic, and social factors of a country. For example, a firm cannot control the economic climate at any given time. Also, it cannot control the

institutional arrangement of a foreign country. There have been examples of large firms influencing regulations, especially in small countries, but most firms in general can at best lobby for their preferences at the margin. They are not assumed to have the ability to produce revolutionary institutional change in a given country. As a result, firms are less likely to demand regional integration with neighbors that do not have similar institutions because needing to adapt to new environments introduces greater costs and uncertainty. Firms instead would either demand regional integration with neighbors that are similar or attempt to change institutions to match their home institutions.

In sum, power preponderance and compatibility are the main conditions associated with the deepening of regional integration. A regional leader is needed for guiding the processes, using available capabilities. Compatibility promotes the idea that states are similar enough in either perceived or material terms not to add additional transaction costs nor increase uncertainty.

## HYPOTHESIS TESTING

I test the hypotheses using a time series linear regression technique that assumes correlated panels. Since such data properties produce inaccurate standard errors, a correction method is used.<sup>21</sup> AR(1) autocorrelation is assumed and the unit of analysis is the regional integration organization during 1975–2004. The time period is bounded by data availability. The variables measuring power preponderance and institutional homogeneity are lagged by five years given the hypothesized direction of association.<sup>22</sup> Five-year lags were chosen in order to reduce endogeneity problems, to work with some data issues (see ahead), and to focus on a long-term examination. Control variables (see ahead) are lagged by one year while regional dummy variables are not lagged. The remainder of this section describes the variables used in the model with the following specifications:

$$\text{Level of Integration}_t = \alpha_1 + \gamma_1 \text{Power Preponderance}_{t-5} + \gamma_2 \text{Homogeneity}_{t-5} + \gamma_n \text{Controls}_{t-1} + \gamma_m \text{Regional Dummies}_t + \varepsilon_t$$

The operationalization of regional integration is a systematic coding so that the analysis can distinguish varying levels while still comparing similar attributes. This is done by using a multidimensional measurement referred to as the integration achievement score (IAS), which was first developed by Hufbauer and Schott<sup>23</sup> and later refined and applied by Efird and Genna.<sup>24</sup> It gauges the level of regional integration by looking at six categories commonly attributable to regionalism: (1) trade in goods and services, (2) degree of capital mobility, (3) degree of labor mobility, (4) level of supranational institution importance, (5) degree of monetary policy coordination, and (6) degree of fiscal policy coordination. Each of the six categories is also



broken down into five levels along a Guttman scale. The measure is an equal weighted average of the six categories. The potential range of the score is from zero to five. Zero represents no formal regional integration in place, and five represents a complete merger of markets, including all economic factors, and political decision making.

Power preponderance is relatively simple to operationalize using GDP data (in constant US dollars) from the World Development Indicators.<sup>25</sup> I calculate the variable by dividing the GDP of the largest economy by the sum of the GDPs of all remaining members.

I operationalize institutional homogeneity two ways. The first uses a measurement of economic institutions, the Economic Freedom of the World (EFW) index.<sup>26</sup> EFW index includes (1) size of government (expenditures, taxes, and enterprises), (2) legal structure and security of property rights, (3) access to sound money, (4) freedom to trade internationally, and (5) regulation of credit, labor, and businesses. Since item four is a proxy for regional integration, it was removed from the index. The data are yearly starting from 2000. Prior to 2000, the data are reported in five-year intervals beginning in 1975. The gaps in time were filled by interpolating averages, but recall that panel error correlation and AR(1) will be used. If a country experienced an extraordinary change in regime or other social, political, and economic instability during the five-year gap, it was coded as missing. I summed the index value for each regional integration organization member and calculated the standard deviation. Since larger standard deviation translates to greater institutional *heterogeneity*, the values were multiplied by negative one. Further, I added one to each value so that the maximum value is one instead of zero, and thereby aiding in the interpretation of the results. The range is -0.566 to 1, with larger values translating to larger levels of institutional homogeneity.

The second homogeneity method uses the Human Development Index (HDI) created by the United Nations Development Programme.<sup>27</sup> HDI measures a country's level of development using indicators of health, education, and living standards. Homogeneity in HDI is an indicator of how similar countries are regarding values and approaches to problems they individually face. The HDI homogeneity measurement is calculated like the measure for EFW homogeneity: the standard deviation of the regional integration organization's HDI values were multiplied by negative one and then added to one in order to create a range in which higher values indicate greater levels of homogeneity. The range for the transformed HDI standard deviation is 0.504 to 0.995.

Table 2.1 displays the values of the integration achievement score and the primary explanatory variables (power preponderance and the two homogeneity variables) for select cases of regional integration organizations in 2004.<sup>28</sup> The Gulf Cooperation Council (GCC; Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates) has the highest integration score among the selected cases, and the Association of Southeast Asian

Nations (ASEAN; Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam) has the lowest score. The GCC integration score is higher because it has formed a customs union (free trade among members and a common external tariff); it allows full capital mobility among its members except for large-scale mergers and acquisitions; citizens of member countries can transfer professional qualifications; the regional institutions gather information and have an advisory role for the organization's principal decision-making body; and they have a formal commitment to maintain a fixed exchange rate system.

Table 2.1 also displays the economic power ratios and transformed EFW index and HDI standard deviations. The North American Free Trade Agreement (NAFTA) is the organization with the largest power asymmetry, since the US economy is approximately seven times larger than Canada's and Mexico's economies combined. The smallest asymmetry is found in ASEAN (Indonesia's economy is approximately half as large as the remaining countries combined). The greatest institutional homogeneity is found among the members of the GCC and the least is found in ASEAN. NAFTA is in the middle with a value close to zero for EFW homogeneity, but higher for HDI homogeneity.

The data analysis also includes the following control variables. The first is the presence of an ongoing crisis between members of the regional integration association. Intuitively, one would suspect that integration would not deepen under such circumstances. The data come from the International Crisis Behavior data set.<sup>29</sup> The variable has a value of zero for the absence

*Table 2.1* Variable Values for Select Cases of Regional Integration Organizations (2004)

Regional integration organization	Integration score	Power reponderance	EFW Index SD (transformed)	HDI SD (transformed)
North American Free Trade Agreement	1.67	6.96	0.008	0.931
Common Market for Eastern and Southern Africa	1.67	0.799	-0.124	0.866
Common Southern Market (MERCOSUR)	1.33	3.75	0.569	0.938
Association of Southeast Asian Nations	0.667	0.491	-0.488	0.876
Gulf Cooperation Council	2.50	1.12	0.846	0.965

of an ongoing crisis and one otherwise. The second control, which is also found in the International Crisis Behavior dataset, is the presence of a new crisis during the year. Like an ongoing crisis, a new crisis may threaten current or future integration efforts. The variable has a value of zero for no new crisis and one otherwise. The age of the regional integration organization is also included because older organizations are more likely to have deeper integration. Integration may deepen due to the political will or persistent effort. The number of members is also included. Larger memberships may encounter greater collective action problems, which makes coordination among member states challenging. Finally, regions could possess specific attributes that may influence the level of integration. I include regional dummy variables for Europe, the Americas,<sup>30</sup> the Middle East, and Africa. Asia is the baseline region.

## RESULTS

The regression model estimates the relationship of regional integration around the world with power asymmetry and homogeneity while controlling for other factors. Overall the results support the hypotheses.

Table 2.2 presents the estimation results using the EFW homogeneity measurement. The model supports the hypothesis that a regional leader and homogeneity among members are positively associated with the level of integration. If the regional leader is *as large as* all other member states combined (a ratio equal to one) then the level of integration is small. At the maximum value of the power preponderance variable found in the data (~11), the effect would be 0.67. At the smallest value of preponderance found in the data (~0.17), the effect would be almost nonexistent (0.0104). EFW homogeneity also has statistically significant explanatory power. From the variable's lowest value to its highest value, the level of integration increases from -0.413 to 0.729.

Table 2.3 presents the estimation results using the HDI homogeneity measurement. We again see support for the hypothesis that a regional leader and homogeneity among members are positively associated with the level of integration. If the regional leader is as large as all other members combined (a ratio equal to one) then the level of integration is small. The effect would be 0.20 at the maximum value of the power preponderance, while it is almost nonexistent (0.0003) at the smallest value of preponderance. From the variable's lowest value to its highest value, the level of integration increases from 0.485 to 0.958.

Among the control variables, the organization's age and membership size as well as its geographic location are consistently significant in explaining the level of the regional integration in the two models. An ongoing crisis is significant in the EFW model, but not the HDI model. A new crisis is not statistically significant in either model.

Table 2.2 Time Series (AR1) Regression with Correlated Panels Corrected Standard Errors

	IAS <sub>t</sub>	Standard error
Power preponderance <sub>t-5</sub>	0.036***	0.009
EFW Index, standard deviation <sub>t-5</sub>	0.126**	0.048
<i>Controls</i>		
ICB on going crisis <sub>t-1</sub>	-0.036*	0.019
ICB new crisis <sub>t-1</sub>	-0.021	0.015
Regional organization age <sub>t-1</sub>	0.027***	0.003
Regional organization membership size <sub>t-1</sub>	-0.014***	0.003
Europe	1.37***	0.108
The Americas	0.879***	0.061
Middle East	0.831***	0.162
Africa	0.449***	0.106
Constant	0.172*	0.076
Observations	390	
R <sup>2</sup>	0.517	

Note: \*\*\* p<0.000; \*\* p<0.01; \* p<0.05; the EFW standard deviation variable was transformed (the negative of the standard deviation plus one) so that the indices now measure institutional homogeneity using the EFW index.

Table 2.3 Time Series (AR1) Regression with Correlated Panels Corrected Standard Errors

	IAS <sub>t</sub>	Standard error
Power preponderance <sub>t-5</sub>	0.018*	0.008
HDI, standard deviation <sub>t-5</sub>	0.963**	0.346
<i>Controls</i>		
ICB ongoing crisis <sub>t-1</sub>	-0.033	0.018
ICB new crisis <sub>t-1</sub>	-0.018	0.013
Regional organization age <sub>t-1</sub>	0.025***	0.003
Regional organization membership size <sub>t-1</sub>	-0.011**	0.003
Europe	1.29***	0.144
The Americas	0.848***	0.099
Middle East	0.748***	0.199
Africa	0.400**	0.141
Constant	-0.616*	0.293
Observations	390	
R <sup>2</sup>	0.416	

Note: \*\*\* p<0.000; \*\* p<0.01; \* p<0.05; the UNDP standard deviation variable was transformed (the negative of the standard deviation plus one) so that the indices now measure institutional homogeneity using the HDI.

## IMPLICATIONS FOR NORTH AMERICAN INTEGRATION

The prior section indicates that the optimal conditions for regional integration to develop are the presence of a preponderant power and homogeneity among the members. The model demonstrates that the larger the GDP ratios (between the regional leader and the sum of all other members), the greater the regional integration score. The necessary condition of homogeneity was also demonstrated by the findings. Recall that these tests demonstrate a *general relationship* and not one that is exclusive to North America. Assuming that North American integration is not unique and is therefore comparable to all other cases, the general results give us an opportunity to see how North America compares with all other cases of regional integration. From this comparison, it becomes possible to make recommendations for deepening integration. The next step is to examine the estimated model in the North American case.

One of the key variables, power asymmetry, is clearly present in the region. The GDP ratio between the United States and Canada during 1989–1993, under the Canada-US Free Trade Agreement, was between 9.8 and 10.8. After the implementation of NAFTA in 1994, the ratio between the United States and the other two partners varies between 6.8 and 8.4 (see Figure 2.1). The data indicates a fairly wide variation in the homogeneity variables. NAFTA's EFW homogeneity values range from  $-0.169$  to  $0.809$ , and the HDI values range from  $0.913$  to  $0.995$  (see Figure 2.1). This section will examine the effect that the two homogeneity variables have on North American cooperation.

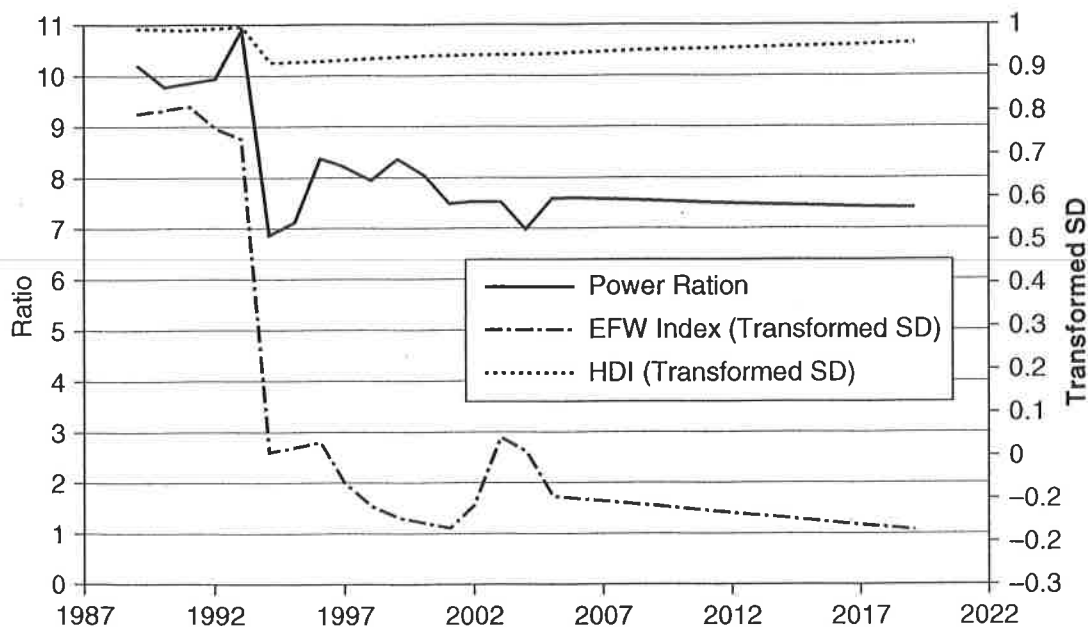


Figure 2.1 North American power ratios and institutional homogeneity.

Table 2.4 North American Integration Scenarios

Scenarios	Integration score
2004 (EFW; HDI)	1.57; 1.49
Low-end Values (EFW; HDI)	1.26; 1.23
High-end Values (EFW; HDI)	1.77; 1.60
Institutional homogeneity (EFW; 25 years)	2.08
Institutional homogeneity (HDI; 25 years)	1.92

Table 2.4 displays calculated North American integration scenarios using varying values of power preponderance and homogeneity indicators. We begin with a baseline examination before discussing potential scenarios that could deepen North American integration. The 2004 estimated value for NAFTA is 1.57 for the EFW model and 1.49 for the HDI model, while the actual value is 1.67. Therefore we will need to keep in mind that the model underestimates the integration score's value when examining future estimated values. The next entry includes North American values at the low end of the range for all the independent variables, while the third entry includes high-end values. Note that these entries represent hypothetical scenarios; the actual data do not have these combinations of values. The point is to determine the bounded values of integration given historical precedence before looking at other scenarios. At the historically lowest values, the predicted integration score is approximately 1.26 (EFW) and 1.23 (HDI). We can use the European Union as a substantive comparison. The EU scored a value of one just before the implementation of the Treaty of Rome (1957). At this time the EU was a partial free-trade area that also allowed foreign capital withdrawal. Regional institutions were limited to information gathering and had advisory roles. At NAFTA's historically highest values, the estimated score is 1.77 (EFW) and 1.60 (HDI). This value represents a substantive change in the level of integration because it requires a one-point increase in at least three categories of composite index. For example, the score increase could represent a change to a full free-trade area, the ability for full access for foreign investment and capital withdrawal (except for national government procurement), and the ability for regional institutions to amend member state proposals.

The next entries in Table 2.4 provide results given improvements to homogeneity between the three countries at different ages of NAFTA. I keep the power ratio at seven and also hold the membership at three. *If* the three achieve perfect EFW homogeneity when NAFTA turns 25 years old, it is estimated that the integration value would be 2.08. *If* the three achieve perfect HDI homogeneity, it is estimated that the value would be 1.92. Recall that the model underestimates the values, so this is a conservative estimate. What

could such a value represent? Let's again use the EU as a comparative example. It achieved this value in 1958 as the members began their earliest integration efforts. The EU was a full free-trade area, provided full access for foreign investment (except for national government procurement), allowed capital withdrawal from member states, labor mobility among nationals of member states, included regional institutions that had the ability to amend proposals, and required member states to consult with each regarding monetary policy. Therefore, a one half-point increase in the integration score represents a great deal of change from NAFTA's 2004 score.

The predicted values all pivot on the notion that homogeneity would take place. However, what are the current differences and what would need to change? In 2004 the three countries' level of EFW homogeneity was 0.008 and HDI homogeneity was 0.931. Recall that the EFW index includes four components. Of these, the three partners display the largest differences in two components: the legal structure and security of property rights and regulation of credit, labor, and business. I will examine each of these components in order to account for the differences.

In the areas of legal structure and security of property, there is a large disparity between Canada and the United States on one side and Mexico on the other. With regard to the judicial system, the northern partners have greater judicial independence than their southern partner. Also, Canada and the United States score high on the impartiality of the courts and integrity of the legal system, while Mexico is coded at the lower end of the scale. Without independence, impartiality, and integrity, cooperation can be hampered by the uncertainty of rulings. This uncertainty is not a moral judgment of the Mexican judicial system, but instead an "unknown" or extra costs for those that come from diverse systems, such as the Canadian or US judicial systems. This uncertainty is a salient concern given the issue of protecting intellectual property, where we see the same pattern: Canada and the United States are higher on this scale than Mexico.

The second highest gap between the partners is in the area of regulation of credit, labor, and business. Of these three subcomponents, the smallest gap is in the area of credit market regulation. While Mexico does score lower than either Canada or the United States, the difference is not very large. The large differences are found in labor and business regulation. Regarding labor, there is a large divergence among all three with respect to flexibility in hiring and firing. The flexibility in this area refers to the mix of government regulation and private contracts. The more a private contract is the source behind these decisions, the higher the score. The United States scores high on this scale, followed by Canada with a value in the mid-range. Mexico scores near the bottom. This divergence introduces risk among firms and therefore uncertainty of success. This also introduces long-term economic uncertainty because labor markets are not competitive. The other large difference is in business regulation. With this indicator, we return to the familiar pattern of greater similarity between Canada and the United States

and a gap between them and the southern partner. The level of regulation in Canada and the United States is very small compared to Mexico. Price controls and high levels of bureaucratic control are prevalent in Mexico as is the need to provide "irregular payments" to government officials.

Like the EFW index, a comparison of the HDI for the three countries indicates a large gap between Canada and the United States on one side and Mexico on the other. The HDI values for Canada and the United States in 2004 were 0.892 and 0.902 respectively, while Mexico was at 0.741. The Canadian and US values are considered very high, while Mexico ranks as high according to the UN Development Programme's *Human Development Report*.<sup>31</sup>

The largest gap between the northern partners and the southern partner is in education and per capita income. Life expectancy among the three does vary, but not to a large degree.<sup>32</sup> Two measures make up the educational component of the HDI: mean years of formal education for individuals aged 25 years and the mean expected number of years for children entering school, with the highest value set at 18. Canada and the United States have similar mean attainment values (16 and 15.7 years, respectively), but Mexico is on the low side with 13 years. The expected educational attainment values for Canada and the United States are also similar (11 and 12.5 years), while Mexico is far behind (7.8 years). The per capita income is the largest gap among the three. Canada and the United States are clearly on the higher end (\$34,380 and \$43,130) while Mexico's is \$12,380.<sup>33</sup>

The foregoing description exposes the problem of North America's compatibility; we see a greater amount of compatibility between Canada and the United States and less so with Mexico. Scores among the northern partnership indicate a high level of homogeneity, while the partnership with Mexico displays less homogeneity. Since North America is a trilateral partnership, the findings lead us to expect that the southern partnership would be the limiting factor when it comes to deepening integration unless we witness homogenization. In other words, most policy recommendations are going to spotlight the changes needed in the southern relationship.

But are such recommendations realistic? What are the trends in the important variables that predict the level of integration? Figure 2.1 plots the trend in power preponderance and the two homogeneity variables. Trends were calculated based on values from 1994–2004. The almost flat trend line of the power ratio indicates that over time the GDP ratio will remain at the same approximate proportion. EFW homogeneity, however, is trending slightly downwards. If the current changes continue, the three will have a value of  $-0.2$  by 2020. This value is smaller than the 2004 value of  $0.008$ . By including these two values, the model predicts the NAFTA integration score to be  $2.09$  in 2025. The HDI homogeneity values are trending upwards and by 2020 we can see a value of  $0.96$ . The predicted value in 2025 is similar to the one calculated by the EFW homogeneity value:  $2.03$ . At a minimum, the years leading to 2025 can introduce *one* of the following changes to North American integration: 1) the creation of a customs union; 2) unrestricted



capital mobility expect for large-scale mergers and acquisitions; 3) full right of movement for all North American workers; 4) the ability for a regional institution to amend proposals; 5) a commitment to a fixed currency exchange rate; or 6) consultations among the three governments regarding fiscal policies. Neither the theory nor the results can predict with any certainty which of the six changes will occur—only that one of these changes is likely to occur.

## CONCLUSION

The literature on regional integration presents various theories and empirical findings. The conditions distilled in this paper are power asymmetry and partner compatibility. First, I evaluated the empirical validity of these conditions and then compared the general model with the North American experience. My goal was to assess North America's potential for deepening integration; does it have the ability to fill the institutional void discussed in the book's introduction? The rationale is that collective action through tri-lateral agreements would be the most effective way to solve the migration-security-development issue.

The general findings confirm that specific conditions are needed. First is the presence of a regional leader. The statistical results show that greater asymmetry is associated with greater levels of integration in general. The presence of the leader was theorized to be necessary in order to solve some problems of collective action (coordinate efforts and distribute incentives). However, valid as this variable is in general, it does not extensively help us to explain North American integration since the United States has been a regional (and global) preponderant power for some time.

The second condition is compatibility of members. The results indicate that homogeneity is a good predictor of integration. It is in this area that we see a good deal of variation among the North American states. Homogeneity is stronger in the northern partnership than the southern partnership, which produces an unbalanced compatibility problem. Therefore, the policy recommendations are geared to improving the compatibility between Mexico and Canada/United States in order to fill the North American institutional void.

The first recommendation is to reduce the differences involving legal structures, the security of property rights, and regulation of labor and business. Regarding the legal structures, the deepening of integration would benefit from the Mexican judiciary becoming more independent and impartial, and increasing its integrity. Also, there will need to be some sort of convergence in the protection of property rights. Regarding the regulation of labor and business, there needs to be a convergence in the regulation of workers' rights regarding hiring and terminating employment. Work also needs to be done in converging business regulations and the reduction of the use of bribes in Mexico.

The second recommendation involves improving Mexico's education and per capita income levels. Education is the backbone of any economy because the human capital developed translates into higher value production. A workforce based mostly on low- or semi-skilled labor can lead to a manufacturing platform for the other partners, but not a dynamic partnership that introduces firm competition. Also, the lack of human capital development in one partner reduces the potential for innovation and discovery through public and private research and development. Income can follow educational attainment, but only if employment opportunities are present. Otherwise Mexico will see either a brain drain to the north and/or dissatisfaction from a growing number of educated individuals.

The two sets of recommendations can be addressed unilaterally, but they can also be addressed trilaterally. Using the theoretical mechanism described earlier, Canada and the United States can help develop changes in Mexico through the development of regional institutions. These institutions can develop plans and strategies and provide pooled funding in order to promote homogeneity and therefore foster greater levels of integration. Unfortunately, North America does not currently have the appropriate conditions that can fill the institutional void. While a power asymmetry is in place, homogeneity, and therefore compatibility, of the three partners is low. But a two-pronged policy of improving homogeneity while increasing integration can very well promote a virtuous cycle that continues to unite the economies and decision making of the three countries. The need to solve problems like the migration-security-development issue requires collective action because unilateral action thus far has proven to be unsuccessful.<sup>34</sup> The limiting factor of the three issues is development, which integration has the potential to solve. By recognizing that the problem is a commonly held one, the three partners can begin to seek out the conditions, and make the appropriate adjustments, for cooperation to develop. Otherwise an institutional void among the three partners cannot be filled.

## NOTES

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11. Genna and Hiroi, "Power Preponderance."
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22. Lagged dependent variables were not used because lagged dependent variables will dominate the results, thereby destroying the effect of other variables when included with heavily trending exogenous variables and disturbances, regardless of whether the lagged dependent variable has any true causal power. In addition, the interest in this study is not in the change or growth in the level of integration, but in the level of integration at a given time period. The lagged independent variables were included to better account for causality. Christopher Achen, "Why Lagged Dependent Variables Can Suppress the Explanatory Power of Other Independent Variables," Center for the Study of Democratic Politics, Princeton University, 2001, <http://www.princeton.edu/csdp/events/Achen121201/achen.pdf>.
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28. There are a total of 36 regional integration organizations in the data set.
29. Michael Brecher and Jonathan Wilkenfeld, *A Study of Crisis* (Ann Arbor: University of Michigan Press, 2000).
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31. United Nations Development Programme, *Human Development Report*, p 21.
32. Canada's is 80.1, the United States' is 77.6, and Mexico's is 75.6 years.
33. The figures are in constant US PPP dollars.
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