

Institutions and Trade: An Examination of the U.S. States and Mexico

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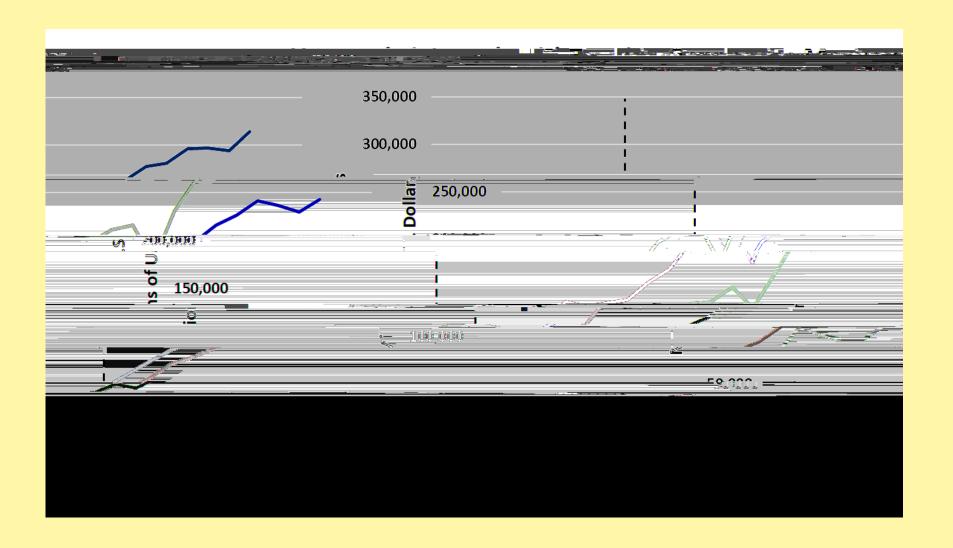
Motivation

Trade between Mexico & the U.S. is "YUGE"!

Mexico was 2nd largest goods export market for U.S. in 2017 (1-Canada) (USTR).

And 2nd largest supplier of goods imports into U.S. (1-China)

U.S. goods exports to Mexico totaled \$243 billion in 2017, almost doubling since the end of the last recession.



Motivation

NAFTA has helped facilitate trade,

Given that context, a better understanding of the character of

Methodology

We examine how differences in institutional quality—across the U.S. states and between the U.S. states and Mexico—affect trade relationships.

Our measure of institutional quality: state

Economic Freedom of North America (EFNA).

Available at www.freetheworld.com

Economic Freedom of the World (EFW), developed about 30 years ago by Nobel Laureate Milton Friedman and others.

property they acquire without the use of force, fraud, or theft is protected from physical invasions by others and they are free to use, exchange, or give their property as long as their actions do not violate the

Most recent *EFW* rankings:

U.S. & Canada: 11th (tied)

Guatemala: 23rd

Panama: 30th

Mexico: 76th

Venezuela: 159th (last place)

Motivation

A large literature has found a positive

and a wide variety of positive economic outcomes (e.g., standard of living, GDP growth, etc.).

volume.

We are the first to investigate this at the state level.

Higher volumes of trade may be one of the channels through which those other better economic outcomes are achieved.

We will also investigate that relationship between trade and broader measures of prosperity.

<u>Methodology</u>

Most research in this area examines trade between nations.

Barriers between nations are higher and vary substantially across countries.

Looking at states allows us better to isolate the impact of economic freedom

Multi-faceted relationships

Preliminary Findings

Unsurprisingly, GDP is positively related to trade

Areas that share a common border are more likely to trade with one another.

Economic freedom is a facilitator of trade

areas with friendlier tax structures and fewer labor market restrictions tend to trade more.

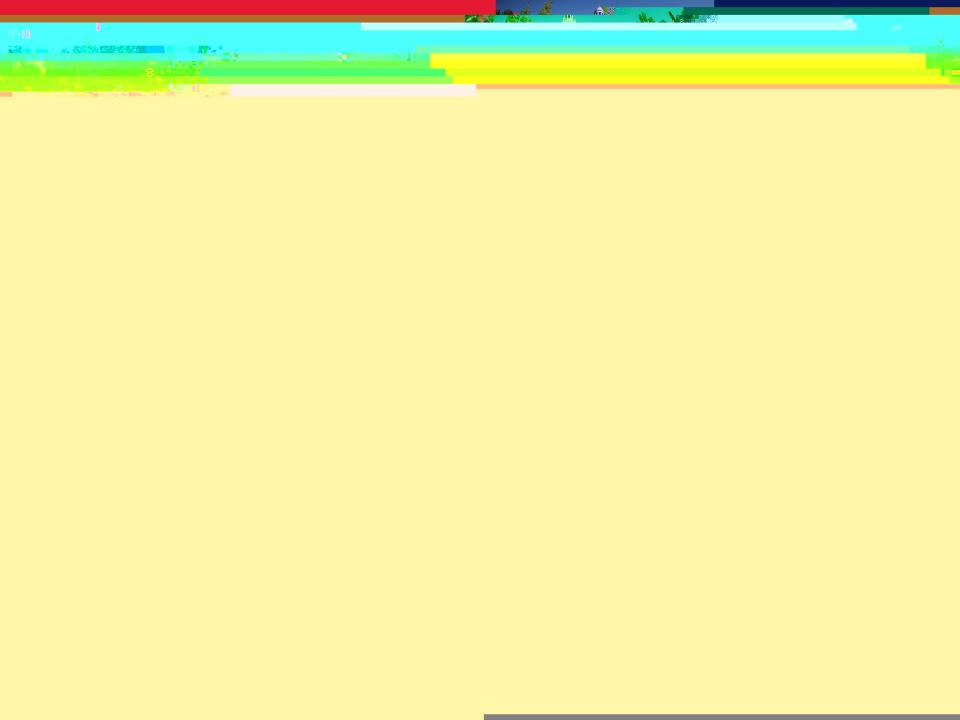
Borders matter even within the US!

Strong border effect for states

Surprisingly, larger border effect for states than for the international border

Implicit barriers might be more important than explicit barriers





Conclusion

States that place fewer restrictions on economic activity tend to produce a higher volume of trade with other jurisdictions.

States that engage in a higher volume of trade tend to have higher levels of GDP, which ultimately means higher standards of living.

Residents in states (and countries) that place restrictions on trade will tend to see lower standards of living, meaning they are poorer than they would otherwise be.



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