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The Economic Integration of California and Mexico

Perhaps the greatest challenge facing Mexican policymakers is to establish a growth path for Mexico that will enable it to become more similar to advanced industrial nations in its institutions, economic structure, income, and quality of life. Economic integration with more advanced countries is essential if Mexico is to accomplish this goal. California, with its large population of Mexican origin, its web of trade and investment relationships with Mexico, and its potential as a major consumer market for Mexican goods, is already playing an important role in this economic integration.

In *The Emerging Integration of the California-Mexico Economies*, Howard Shatz and Luis Felipe López-Calva examine the many ways in which California and Mexico are integrating, focusing in particular on trade and foreign direct investment (FDI), and they suggest a number of policies that can facilitate that integration. They point out, however, that Mexico is still trying to unwind from old political structures and ways of doing business and that a yawning gap lies between that country and the more advanced economies of the world.

California-Mexico Trade

The U.S. and Mexican economies have integrated a great deal since the 1980s and especially since the 1994 North American Free Trade Agreement (NAFTA)—a trade and investment agreement among Canada, Mexico, and the United States. Trade between California and Mexico increased dramatically during the 1990s. Some of it was pass-through trade: Goods were produced elsewhere in the United States and shipped to Mexico through California's ports or border crossings, or goods were shipped from Mexico through California's ports or border crossings and then sent to other destinations in the United States. Much of the increase, however, can be traced back to California producers in the case of exports and California buyers in the case of imports.

Trade links between Mexico and California are deep, in the sense that the total value of traded goods is high, and broad, in the sense that many different types of goods are traded. Exports to Mexico of goods originating in California grew an average of 12.8 percent annually between 1988 and 2002. This was a quicker pace than the growth of exports originating in California to the rest of the world and exports originating in the rest of the United States to Mexico. During these years, Mexico moved up from the third largest destination for California exports to the largest, in 1999. In 2002, Mexico received 17.4 percent of all California exports, almost $16.1 billion.

The majority of California's exports to Mexico consist of two broad commodity classes—machinery, and electrical machinery and equipment. However, California exports to Mexico are more diverse across product classes than California exports to the rest of the world. In addition, they embody less skill than do California exports to the rest of the world, implying that trade with Mexico has provided greater opportunity to production workers—as opposed to executives, administrative assistants, and marketers—than has trade with the rest of the world. Between 2000 and 2002, more than 200,000 California workers each year produced exports to Mexico—17 percent of all export-related jobs in the state.

Although export levels are high, their destinations are concentrated. More than three-quarters of all California-origin exports are shipped to border states, with the vast majority going to Baja California.

Just as exports from California to Mexico have grown dramatically, so have imports from Mexico to California. Imports from Mexico by California-based importers more than doubled between 1995 and 2002, from $9.1 billion to $20.3 billion.

A large part of California-Mexico trade is two-way trade within the same commodity class. This suggests extensive production-sharing, in which components are made in California, assembled or further processed in Mexico, and then shipped back to California. Top commodities for this type of trade include machinery, vehicles, instruments, and electric and electronic equipment.

California-Mexico Foreign Direct Investment

The main driver of global integration in recent years has been the spread of multinational firms through FDI—cross-border investment used to establish or control a business. As reflected in the figure below, available data suggest a large increase in Mexican investment in California in recent years. California investment in Mexico has remained more level.

As with trade, FDI between California and Mexico is in large part a border story, especially from the perspective of Mexican investors. More than 72 percent of Mexican-owned subsidiaries in California are located in Imperial and San Diego Counties, and more than 47 percent of California-owned subsidiaries in Mexico are located in the border states of Baja California, Chihuahua, Nuevo León, Sonora, and Tamaulipas. More than three-quarters of these are located in Baja California.

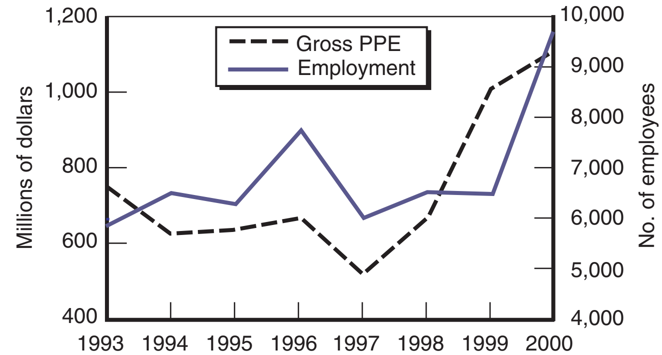
The situation is similar regarding parent companies—the companies that own the subsidiaries in California or Mexico. Most Mexican parents are on the border, and nearly all of those border companies are in Baja California. California parents are less concentrated, but slightly more than a quarter are in the border counties of Imperial and San Diego. Almost 41 percent are in the South Coast counties of Orange, Los Angeles, and Ventura, and another quarter are in the Bay Area.

Many Mexican-owned subsidiaries in California are in wholesale and retail trade, 15 percent are in manufacturing, and 7 percent are in finance. In contrast, 55 percent of California-owned subsidiaries in Mexico are in the manufacturing sector.

Policy Options for an Integrating Region

California faces a number of options in its policy stance toward economic integration with Mexico. First, it must decide whether it even wants closer economic integration. If it does, three policy positions are possible. One position would be to focus on border infrastructure and environment but otherwise let private businesses develop relationships on their own. A second position would be for the state to provide development assistance to Mexico. And a third would be to work with the Mexican and U.S. governments in developing more active policies to increase economic integration, including setting up institutions to encourage more two-way trade and investment.

Mexico's Direct Investment in California, 1993–2000



SOURCES: California Business Investment Services, *Foreign Direct Investment in California*, Sacramento, California, August 2003; and authors' estimates.
NOTE: Property, plant, and equipment (PPE) for 1998 through 2000 is estimated; employment for 1999 and 2000 is estimated.

The value of PPE owned by Mexican companies rose to an estimated $1.1 billion in 2000, and these companies employed an estimated 9,700 California workers.

These policies may bring benefits, but they may also bring sacrifices to California. For example, promoting closer economic integration may require financial resources that might be used for other projects or programs such as closer economic integration with Europe or Asia, or even improvements in California infrastructure, education, or health care facilities. And although imports can have a number of benefits for an economy, they can also force workers out of jobs or result in decreased wages or work hours.

Whatever route the state chooses, devoting more attention to the border area is a worthwhile starting point, because the infrastructure of this region is so strongly affected by—and so strongly affects—the economic interaction of California and Mexico.

This research brief summarizes a report by Howard J. Shatz and Luis Felipe López-Calva, The Emerging Integration of the California-Mexico Economies *(2004, 176 pp., $15.00, ISBN 1-58213-087-6). The report may be ordered by phone at (800) 232-5343 [U.S. mainland] or (415) 291-4400 [Canada, Hawaii, overseas]. A copy of the full text is also available on the Internet (www.ppic.org). The Public Policy Institute of California is a private, nonprofit organization dedicated to independent, objective, nonpartisan research on economic, social, and political issues affecting California.*

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