How Important is the U.S.-Canada Border?

The United States and Canada are each others’ most important trading partner, and the volume of trade between them is greater than that between any two countries in the world. In 1998, Canada imported $137 billion of merchandise from the United States, which was 68% of total Canadian merchandise imports and 22% of total U.S. merchandise exports. During the same year, Canada exported $169.3 billion of merchandise to the United States, which was 84% of total Canadian merchandise exports and 19% of total U.S. merchandise imports. U.S. trade with Canada exceeds its trade with all fifteen countries of the European Union combined, and its trade with Ontario alone exceeds its trade with Japan.

This volume of trade is perhaps not surprising considering that (1) the two countries share many economic and cultural similarities; (2) nearly 90% of the Canadian population lives within 100 miles (161 km) of the U.S. border; and (3) the border between Canada and the 48 contiguous states stretches for almost 4000 miles (over 6400 km). Also, starting with the 1965 Auto Pact, there has been an almost uninterrupted trend towards freer bilateral trade, culminating in the 1988 Canada-U.S. Free Trade Agreement, which was subsequently deepened and broadened by the North American Free Trade Agreement. In principle, the United States and Canada are about as economically integrated as are any two sovereign countries. Because of this, they provide an interesting real-world laboratory for estimating the extent to which international borders still matter in a world that some have declared to have become “borderless.”

Although the volume of trade between the United States and Canada is enormous, it is still small when compared with the level of trade between states or provinces within a country. As an illustration of this, refer to the table, which summarizes the relative volume of trade between British Columbia and six Canadian provinces, and six comparable U.S. states. The left side of the table provides total trade (exports plus imports) between British Columbia and other Canadian provinces as shares of their gross products. The right side provides the same information for six states that are roughly the same distance from British Columbia as are the corresponding provinces. If the two countries were truly integrated, and the international border between them mattered little, then the numbers in the two columns would be roughly the same. Nevertheless, in all cases the province is a far more important trading partner than the corresponding state. For all cases, the relative volume of province-province trade is at least double the province-state trade, and for some cases it is more than ten times higher.

Of course, the remaining barriers to trade between the United States and Canada explain some of these differences, but they are far too low to explain much of it. Also, some of this can be attributed to the foreign exchange costs associated with province-state trade. Nonetheless, one thing is clear: If even the relatively innocuous border between the United States and Canada is such a strong impediment to trade, the world is far from borderless.

—Howard J. Wall

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SOURCES: Statistics Canada, U.S. Department of Commerce
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### Conventions used in this publication:

1. Charts and tables contain data that were current through July 1999. Unless otherwise indicated, data are quarterly.

2. The percent change refers to the percent change from the same period in the previous year. For example, the percent change in $x$ between month $t-12$ and the current month $t$ is: \[\left(\frac{x_t}{x_{t-12}} - 1\right) \times 100.\]

3. All data with significant seasonal patterns are seasonally adjusted.

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**Note:** We are no longer publishing monetary aggregates, short-term interest rates and exchange rates for individual euro area countries. However, the euro area pages have been expanded. A nominal GDP series has also been added. In addition, we have expanded the historical coverage of many of the euro area series.

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We welcome your comments addressed to:

Editor, *International Economic Trends*
Research Division
Federal Reserve Bank of St. Louis
P.O. Box 442
St. Louis, MO 63166

or to:

webmaster@stls.frb.org
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Federal Reserve Bank of St. Louis
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Federal Reserve Bank of St. Louis
Reserve Money Growth

Percent change

Monetary Aggregates

Percent change

Interest Rates

Percent

Stock Exchange Index - Toronto Stock Exchange

1995 = 100
GDP Growth
Percent change

Industrial Production
Percent change

Retail Sales
Percent change

Capacity Utilization
Percent

Federal Reserve Bank of St. Louis
Hourly Earnings and Output per Worker

Percent change

Labor Force Indicators

Percent change

Real Saving and Real Investment

Percent of Real GDP

Government Debt and Budget Surplus or Deficit (-)

Percent of GDP, annual data

Federal Reserve Bank of St. Louis
Hourly Earnings and Output per Worker
Percent change

Labor Force Indicators
Percent change

Real Saving and Real Investment
Percent of Real GDP, annual data

Government Debt and Budget Surplus or Deficit (-)
Percent of GDP, annual data
International Trade - Goods and Services
Percent of GDP

Current Account Balance
Percent of GDP

Foreign Exchange Reserves
Billions of US$

Real Effective Exchange Rate
Index 1995 = 100

Federal Reserve Bank of St. Louis
Adjusted Monetary Base Growth

Monetary Aggregates

Interest Rates

Stock Exchange Index - Tokyo Stock Exchange

1995 = 100
Hourly Earnings and Output per Worker

Labor Force Indicators

Real Saving and Real Investment

Government Debt and Budget Surplus or Deficit (-)
Notes

Euro-area Data – The unit of account for most series is the euro.

Prior to December 1998, euro-area interest rates are calculated on the basis of national government yields weighted by GDP. Starting in 1999 short-term rates are euro interbank offered rates. Long-term rates are calculated on the basis of national government bond yields weighted by the nominal outstanding amounts of government bonds in each maturity band.

Inflation data for the euro area is based on the harmonized index of consumer prices. Data for individual countries in this publication continues to be based on national consumer price indexes.

The euro/dollar exchange rate used in the chart on page 48 is a synthetic rate prior to January 1999. This is constructed by calculating a weighted average of the exchange rates of the 10 euro-area countries against the dollar. The weights are based on 1997 GDP shares.

German Data – As a result of reunification, data for all of Germany are now incorporated in most of the statistical series. The starting periods for unified German data are listed below. Care should be exercised when interpreting the data around these break periods. Data for capacity utilization and hourly earnings remain for western Germany only.

First quarter 1992: employment and output per worker.
First quarter 1993: stock exchange index and unemployment rate.
First quarter 1994: retail sales.

Capacity Utilization covers the manufacturing sector for Canada, France, Japan, the United Kingdom, the United States, and the euro area; manufacturing excluding food, beverage and tobacco for Germany; and mining and manufacturing for Italy.

Consumer Price Index is for all items. The current index is based on goods and services consumed by all individuals for Canada and Italy; all households for France; households with a monthly income of less than 25,000 DM for Germany; all multi-person households excluding those mainly engaged in agriculture, forestry and fisheries for Japan; all households except pensioners dependent on state pension and high income households for the United Kingdom; and all urban households for the United States.

Current Account Balance is the sum of merchandise and service exports and income receipts on domestic assets abroad minus the sum of merchandise and service imports and income payments from foreign assets in the domestic economy plus net unilateral transfers.

Earnings are based on hourly earnings in manufacturing for Canada, France, Germany, the United States, and the euro area; hourly earnings in industry excluding construction for Italy; monthly earnings in manufacturing for Japan; and weekly earnings in manufacturing for the United Kingdom.

The Real Effective Exchange Rate uses normalized unit labor costs in manufacturing. The weighting scheme used to construct the rates, for all except the euro area, is based on disaggregated data for trade among 21 industrial countries in manufactured goods for 1989-91. For the euro area the weights relate to the trade of the euro area with the other countries. The weights reflect the relative importance of a country’s trading partners in its direct bilateral trade relations and competition in third markets.

Normalized unit labor costs in manufacturing are calculated by dividing an index of actual hourly compensation per worker by a five-year moving average index of output per man-hour.

Employment data refer to civilian employment for Canada, Germany, the United States, and the euro area; industrial employment for France; employed persons excluding conscripts for Italy; and total employment for Japan and the United Kingdom.

Fluctuations in the dollar value of Foreign Exchange Reserves occur as a result of changes in reserve holdings and/or changes in the dollar value of the currencies held.

Government Surplus is the difference between general government current receipts and total outlays. Total outlays consist of current expenditures and net capital expenditures. Government Debt incorporates all financial sector bonds of the general government sector. The general government sector consolidates the accounts of the central, state, local and social security sectors.

The Inflation Differential is the difference between the U.S. inflation rate and the foreign inflation rate, as measured by the consumer price index. For the U.S. chart on page 42, the inflation differential is the difference between the U.S. inflation rate and a weighted average of the inflation rates in the 17 countries used in the major currency trade-weighted exchange index. For the euro-area chart on page 48, the inflation differential is the difference between the U.S. inflation rate and a weighted average of the inflation rates in the 11 euro-area countries. The weights are based on 1996 GDP shares.

Industrial Production measures the change in the volume of output in the mining, manufacturing, oil, electricity, gas and water industries.

The Short-Term Interest Rate table on page 4 uses the relevant 3-month interest rate shown in the country pages.

The Long-Term Interest Rate table on page 4 uses the government bond rate. The government bond rate is a composite of yields on Federal government bonds with maturities of more than 10 years for Canada and the United States; long-term public and semi-public sector bonds for France; 7-15 year public sector bonds for Germany; 15-20 year government bonds through 1990, and 10-year government bonds starting in 1991 for Italy; 10-year government bonds for Japan, the United Kingdom, and the euro area.

Investment is gross fixed capital formation and changes in stocks (inventories) of the government and business sectors.

The Reserve Money table on page 4 refers to the adjusted monetary base for Japan and the United States; reserve money for Canada; and M0 for the United Kingdom. Reserve Money is currency in circulation, deposits of the deposit money banks, and demand deposits of other residents (with the exception of the central government) with the monetary authority.

Adjusted Monetary Base
Japan – currency in circulation, reserve requirements and an adjustment for the effects of changes in reserve requirement ratios.
United States – the sum of currency in circulation outside Federal Reserve Banks and the U.S. Treasury, deposits of depository financial institutions at Federal Reserve Banks, and an adjustment for the effects of changes in statutory reserve requirements on the quantity of base money held by depositories.


MZM United States – currency in circulation, travelers’ checks and total publicly-held checkable deposits minus cash items in the process of collection and Federal Reserve float, savings deposits, shares in retail money market mutual funds (funds with initial investments of less than $50,000), net of retirement accounts and institutional money market mutual funds.
M2
Canada – M1 plus all checkable notice deposits and personal term deposits.
United Kingdom – currency in circulation and sterling retail deposits with the UK banks and building societies. In December 1992, the definition of retail deposits was changed, so care should be exercised when making comparisons around this date.
United States – M2M less institutional money market mutual funds plus small denomination (less than $100,000) time deposits.

M2 + CDs
Japan – M1 plus private deposits, public deposits less demand deposits, and certificates of deposit.

M3
Euro area – M1 plus deposits with a maturity up to 2 years, deposits redeemable at notice up to 3 months, repurchase agreements, money market funds and debt securities up to two years.

M4
United Kingdom – M2 plus wholesale deposits with the UK banks and building societies.

Output Per Worker is the ratio of real GDP to employment.

Retail Sales are based on a volume index.

Saving is gross national saving which includes net national saving (receipts less disbursements of households, business and the government) and consumption of fixed capital. Nominal saving is deflated using the investment deflator.

The Stock Market Index refers to all share prices except for the United Kingdom, which excludes financial firms.

The trade-weighted exchange rate, TWEX, is the Board of Governors of the Federal Reserve System’s major currency trade-weighted dollar exchange rate. This is a weighted average of the exchange value of the U.S. dollar relative to the major international currencies of 17 industrial countries.

The Unemployment Rate is the standardized unemployment rate. It is the percentage of the civilian labor force that is unemployed. The unemployed are all persons of working age who are without work, readily available for work and actively seeking work. The standardized rate may differ from the national unemployment rate calculations.

European Central Bank
Monetary aggregates (euro area), stock exchange index (euro area), short and long-term interest rates (euro area)

Eurostat
Consumer price index (euro area), current account balance (euro area), gross domestic product (euro area), industrial production (euro area), retail sales (euro area), unemployment (euro area)

Federal Reserve Bank of St. Louis
Inflation differential (U.S. and euro area), adjusted monetary base (U.S.), M2M (U.S.)

Financial and Economic Research International
Capacity utilization (euro area), budget surplus or deficit (euro area), employment (euro area), government debt (euro area), hourly earnings (euro area), merchandise trade (euro area)

Haver Analytics
Synthetic euro exchange rate

Instituto Centrale di Statistica
Employment (Italy)

International Monetary Fund (IMF)
Foreign exchange reserves, reserve money (Canada), merchandise and service trade (except U.S. and euro area), and real effective exchange rate. For more details on these data see: IMF, International Financial Statistics.

Ministere du Travail et des Affaires Sociales
Employment (France)

Statistics Canada
Employment (Canada)

U.K. Office for National Statistics
Employment (U.K.) and M0 (U.K.)

Sources
Except as noted below, all data are from the Organization for Economic Cooperation and Development (OECD). For more details on these data see: OECD, Main Economic Indicators, Sources and Definitions 1997, July 1997. This publication is available on the Internet at: http://www.oecd.org/std/meta.htm.

Bank of Canada
M1 and M2 (Canada)

Banca D’Italia
Long-term interest rate (Italy)

Bank of Japan
Monetary aggregates (Japan), long-term interest rate (Japan), employment (Japan)

Board of Governors of the Federal Reserve System
Exchange rates, short and long-term interest rates (U.S.), M2 (U.S.), industrial production index (U.S.), capacity utilization (U.S.)

Bundesanstalt Fur Arbeit
Employment (Germany)

Bureau of Economic Analysis (BEA), U.S. Department of Commerce
Gross domestic product (U.S.), current account balance (U.S.), merchandise and service trade (U.S.)

Bureau of Labor Statistics (BLS), U.S. Department of Labor
Employment (U.S.), consumer price index (U.S.)