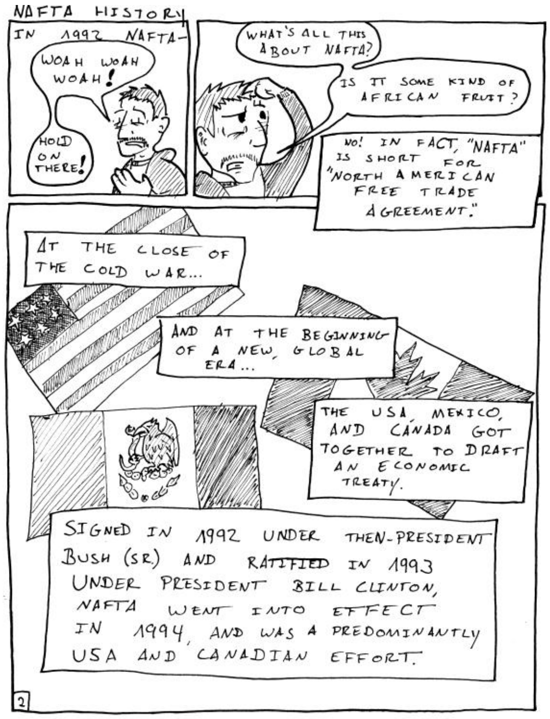

NAFTA: A PARTIAL SOLUTION NOT A SAVIOR TO MEXICO'S ECONOMIC WOES

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NAFTA's impact on the Mexican economy has been positive. The overall economic gains outweigh any short-term shifts in the manufacturing and agricultural sectors. Despite the criticism that NAFTA did not produce a broader and more sweeping transformation, NAFTA has been and remains a part of Mexico's solution to a better economy. Trade liberalization has further opened the door to economic integration, modernization and globalization. However, NAFTA is not enough. A single trade agreement is no substitute for a comprehensive long-term development strategy. Developing a country's economy and, along with its human capital, is an effort that requires a multifaceted approach involving governmental reforms. NAFTA was, and continues to be, a step in the right direction towards convergence with the United States and Canada. It is part of the solution to the problems of Mexico's developing economy, but not all of the solution.

". . . a free trade agreement is not a substitute for a development strategy."
-- World Bank Report on NAFTA [1]

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Introduction

In the early 1990's, Mexican President Carlos Salinas de Gortari was reported to have approached United States President George H. W. Bush with the concept of a trade agreement to help Mexico recover from economic difficulties. In the previous decade, the rise of global interest rates, coupled with falling of oil prices (the country's main export), left Mexico facing high international debt obligation. Mexico was prepared to open its markets with the subsequent high inflation, its undervalued currency, and the majority of its population living below the national poverty line. [2]

Canada and the United States had already entered into their own bilateral trade agreement in 1988 which produced rapid and expansive growth. The addition of Mexico to the trading alliance was an appealing idea. Negotiators in all three countries thought a trilateral free trade agreement would create an investment and production block that would "rival those of Asian and European Union countries." [3] In 1992, the three nations began negotiation for a trilateral trade agreement known as the North American Free Trade Agreement (NAFTA).

The motivation behind Mexico's entrance into a trilateral trade agreement was part of a larger economic strategy to turn the country from an import substitute economy (which emphasizes self-reliance and local production of goods) [4] to one of an open market with trade and finance liberalization. It was a direction Mexico needed to take. By opening its market, Mexico could gain the needed influx of foreign direct investment (FDI) and increase its portfolio investment. It was also a step towards bringing the country closer to economic convergence with its trading partners. [5]

The Agreement: After much controversy, deliberation, and campaigning, NAFTA was ratified in 1992 with additional side agreements signed the following year. According to the agreement, NAFTA's objectives are to eliminate barriers to trade, promote conditions of fair competition in the free trade area, provide adequate and effective protection and enforcement of intellectual property rights, create effective procedures for the implementation and application of the agreement, and establish a framework for further trilateral, regional and multilateral cooperation.[6]

The Hope and Loss of Faith: Of the three nations, Mexico was believed to have the biggest potential gain. Even though the economic structures of the three countries were asymmetrical, Mexican negotiators did not think their weak economy would make them more vulnerable to the dominant economic power of the United States. On the contrary, Mexican economists believed they had an opportunity in NAFTA to restructure the market infrastructure to make their economy more efficient, and by using FDI, to gain technology and international markets. [7] Essentially, NAFTA seemed a winning strategy from the start.

Politicians were quick to jump on the NAFTA public relations campaign. President Salinas promised "Mexicans would gain the jobs Americans lost," and that these job gains "would halt the northward flow of Mexican job seekers." [8] For the average worker, it seemed like a promise for a better life with more jobs and increased wages. It was anticipated NAFTA would fulfill broader social goals such as creating good jobs, reducing illegal immigration, reducing poverty and income inequality, enhancing labor rights, and protecting the environment.[9] In a larger context, NAFTA became a symbol for the way out of economic hardship for millions of Mexicans.

It has been nearly eighteen years since the trade agreement was enforced, and the "promises" of NAFTA seem largely unmet. It has not been the panacea it was sold to be. It seems for all the hopes pinned on it, NAFTA became the whipping boy for all of Mexico's trouble, both economically, and in a broader sense, socially.

Approaching an Assessment: What exactly has been NAFTA's effect on the Mexican economy? The answer is broad, challenging, and complex with several complicating factors. Economic analysts do not always agree on measures of effectiveness. Critics are quick to point out negative statistics and consequences that may or may not have any direct correlation with NAFTA. What remains is a foggy picture of NAFTA's impact on the Mexican economy—one that can be clouded by misplaced faith rather than supported by facts.

To adequately critique the breadth of the trilateral agreement in the context of an entire economic system is clearly beyond the scope of this paper. However, what can be analyzed are the two prevailing narratives which have been raised by critics and supporters in the midst of NAFTA's friction. The first argument is that NAFTA has been a failure and a direct cause of Mexico's inability to rise to the point of economic convergence with Canada and the United States. Critics point to three areas of concern: job, wages and poverty. While this argument sounds plausible on the surface, it falls apart when compared to a macroeconomic viewpoint and statistics that prove otherwise.

The second (and more plausible) argument is that NAFTA has had an overall positive effect on the Mexican economy. Trade liberalization provides the means for the country to compete in global markets, and Mexico has risen to the occasion with a booming and stable economy. Supporters of NAFTA see the real challenge as Mexican domestic policies, which are in need of reform. Without such reforms, the gains of NAFTA may not trickle down to the average worker. In other words, NAFTA has been and continues to be a part of the solution to the Mexican economy, but not its savior.

Blaming NAFTA for Negative Impacts

Manufacturing and Agriculture: Hard Shock to Workers: Not all economists think NAFTA has had positive benefits for the Mexican economy. Critics suggest NAFTA has not been a partial solution at all but rather a direct contributor to problems such as job losses, lower wages, and poverty. Critics point to two major factors where NAFTA has had a seemingly negative impact: the deindustrialization of the manufacturing sector and a decline in the agricultural sector.

First, critics blame NAFTA for tying the Mexican economy to a low wage export strategy. An unintended consequence of increased FDI has been a deindustrialized Mexico through the rise of the maquiladoras. These transnational companies rely on imported parts and supplies exempt from tariffs and assembled in Mexican plants into items such as apparel, machinery, and electronics for export. These companies pay export tariffs on the difference in value. Maquiladoras take advantage of cheap labor and the lack of regulation or enforcement of policies relating to labor conditions and the environment. A low wage export strategy can have a negative effect on jobs and wages since export markets fluctuate in the global arena. As the demand for exports decrease, Mexican manufacturing jobs can also decrease. The fluctuation and instability of a deindustrialized Mexico can be a hard shock to the many maquiladora workers whose employment is tied to the export market.

Second, critics blame NAFTA for losses in the agricultural sector. When the final tariffs on certain staple products like corn were lifted on January 1, 2008, Mexican rural farmers could not compete with falling prices. Agribusinesses in the United States were able to dump their subsidized products at well below Mexican production prices. Consequently, millions of small farmers, mostly in the southern areas, were severely affected.

Jobs, Wages and Poverty: Not Always a Gain in the Short Term: The years following the implementation of NAFTA saw a downward trend in jobs and wages. Critics directly blame trade liberalization as the mechanism which caused these results. For instance, NAFTA related reforms mandated the privatization of certain sectors, including transportation and manufacturing which led to the loss of over a million jobs across Mexico. It was hoped the maquiladora industry would create enough new jobs to stem the tide of unemployment; however, this did not happen as rapidly as critics would have liked. In 2001, the Maquiladora Association reported 1.3 million were employed in over 2000 plants along the border. However, in the following years, over 400,000 of those workers would find themselves unemployed due to an economic recession. [10] Additionally, in this time period, real manufacturing wages were 12% below pre-NAFTA levels, while maquiladora wages only rose by 3%. The lower wages and loss of jobs did not help Mexico decrease poverty levels which fluctuated between 30-40% of Mexican households. [11]

Perhaps the hardest hit sector was agriculture. As previously mentioned, when price supports were removed in 2008, rural farmers who could not compete with cheaper U.S. subsidized products found themselves looking for other means of survival. In 1993 (pre-NAFTA), there were 8.1 million Mexicans employed in the agriculture sector. Once NAFTA was implemented, that figure began a constant downward shift. In 2004, 6.8 million workers remained in the same sector, a decline of over 16%. [12] Consequently, most farmers sought other employment opportunities in the north or began to rely mainly on remittances sent back from family member abroad.

Is NAFTA to blame for these economic factors? Political analysts and economists do not think so. Noted economist, Luis Rubio, director of the Center of Research for Development, a Mexican political/economic think tank, asserts it is a fad among the public and politicians to blame NAFTA of all the ills of the Mexican economy. The reality of the matter, according to Rubio, is that “The only thing that really works in the Mexican economy is the sector linked to NAFTA, which is the modernized, dynamic area that draws investment.” [13] Essentially, without NAFTA, jobs, wages, and poverty would even be worse.

Addressing the Critic

Manufacturing and Agriculture: Shifting Dynamics: As mentioned previously, critics blame NAFTA for tying the country to a low-wage export strategy that affected the manufacturing and agricultural sectors. However, this argument becomes a moot point in the overall context of how and why NAFTA was conceived. It is important to note Mexico’s economic transformation from a largely import substitute, closed economy to an open economy was over four decades in the making. For example, maquiladoras, which are key elements in an overall export strategy, were established in 1965, long before NAFTA.

It was not until the early 1980’s that President Miguel de la Madrid Hurtado instituted several economic reforms, shifting the economy from its traditional state-led development strategy to one focused on trade and financial liberalization, FDI deregulation, and privatization. NAFTA, which came about a decade later, was a logical next step in Mexico’s insertion into the international marketplace. According to noted Mexican economist, Juan Carlos Moreno-Brid, “Within twenty-five years, [Mexico] went from being essentially an oil-exporting country to becoming a major export platform of manufactured goods, including vehicles, auto parts, ready-made clothing and electronic products to the U.S.” [14] Mexico’s economic reforms certainly positioned the country to compete in the global market, but it was not without consequences.

Mexico's shifting strategy brought a rapid change in economic structure. Manufacturing and agriculture were certainly affected. However, economic theory suggests that developing nations adopting a liberal trade and finance strategy will experience a rapid change in economic dynamics (from agriculture to industry, from household production to market production, and so on). Other developing nations such as the Philippines, Thailand, and Vietnam experienced similar changes and also experienced rapid economic growth. Simply put, these shifting strategies with short-term negative effects in manufacturing and agriculture are symptomatic of Mexico's economic growing pains. However, as painful as it may have been/or continues to be for a segment of the overall economy, Mexico is on a more prosperous path than its pre-NAFTA course.

Jobs, Wages and Poverty: Forces Beyond NAFTA

While critics blame NAFTA for loss of jobs, lower wages and poverty, supporters have a different story. The loss of jobs in the first ten years of NAFTA's existence can be attributed to stagnation and increased competition. Economic integration with the United States has linked the Mexican economy closely to its northern neighbor. When the United States experienced its recession and subsequent stagnation in 2001, Mexico was affected. However, since 2001, Mexico's economy has recovered and stabilized.

Another reason for the loss of jobs was the increased competition with other countries. For example, when China entered into the World Trade Organization in 2001, Mexico was faced with a serious competitor in the labor market. Transnational companies found it in their best interest to move their operations where labor costs were lower. To offset this, Mexico expanded its market to Latin America and Asia. While it is true manufacturing jobs were lost early on in the competition with China, this is no longer the case. In recent years, overseas transportation costs and Chinese wages have been on the rise, prompting transnational companies, especially in the automotive and electronics sectors, to move from China to Mexico.[15] Companies such as Mazda, Ford, Hewlett Packard, Sony, and Blackberry now operate maquiladoras in northern Mexico.

In regards to the idea that NAFTA can be blamed for the lowering of wages, analysts provide a different side. Economists indicate there were/are factors which are simply beyond NAFTA that played a part in the lowering of wages. These include the interrelationship between the gross domestic product, productivity, exchange rates, international trade, technology, the differences in skill and unskilled labor, and the cyclical nature of the economy itself. [16]

Another factor that contributed to the lowering of wages is the 1994-1995 pesos crisis. In a comprehensive analysis, the Carnegie Endowment for International Peace concluded the lowering of wages after 1994 was mainly attributed to the devaluation of the Mexican currency, and not to NAFTA itself. [17] In fact, NAFTA helped facilitate the recovery of the Mexican economy from this crisis by obligating the country to follow a textbook recovery program based on fiscal constraint, tight money, and currency devaluation. Additionally, since the United States had a vital interest in a stable Mexican economy, it offered a financial rescue package by offering loans and assistance. [18] Without NAFTA, the Mexican economy may have fared worse in the aftermath of the peso crisis.

With regards to the issue of poverty, NAFTA supporters point out economic asymmetries existed before the free trade agreement was ratified. These asymmetries have only been accentuated as Mexico has had a growth in some areas, while others declined. For example, the northern industrial regions have experienced growth while the southern rural agricultural regions have seen a decline in jobs and wages. In 2008, 12% of the population in the north lived below the poverty line compared to

47% in the south.[19] Economists believe this income disparity existed before NAFTA and has only been accentuated in recent years.[20] However, pre and post NAFTA statistics show an overall improvement in poverty rates. According to the United Nations, the total poverty rate for Mexico went from 53.1% in 1992 to 47% in 2009. [21]

While critics would like to blame NAFTA for the woes of Mexican economy, the reality is that trade liberalization has had an overall positive impact on the country. The team members who drafted NAFTA explain, “We are convinced that the agreement has supported broad social goods including job creation and environmental protection. However, we have always acknowledged that the agreement would not provide an instant and universal remedy to Mexico’s problems.” [22]

NAFTA is Good for Mexico

Economic Progress: Economic analysts can point to growth in Mexico post-NAFTA. According to the World Bank, Mexico is now considered a high middle-class economy. In 2004, at the ten-year mark, the World Bank issued a comprehensive report which concluded NAFTA directly helped Mexico “get closer to the levels of development of its NAFTA partners.” [23] The report suggested without NAFTA, Mexico’s global exports would have been about 25% lower and FDI would have been about 40% less. The report also suggested NAFTA could take “some credit for moderate declines in poverty, and has likely had positive impacts on the number and quality of jobs.” [24]

The Council on Foreign Relations, an independent think tank, reported from 1994 to 2008, Mexico’s gross domestic product increased at an average rate of 2.7%, just under that of the United States (3.3%) and Canada (3.6%). [25] Mexican exports to the United States quadrupled from $60 billion to $280 billion per year. Additionally, American exports to Mexico have more than tripled as the Mexico’s economy has broadly increased. [26] Additionally, prices for Mexican consumers have been dramatically reduced during the same time period. Grupo de Economists y Asociados, a political and economic consulting firm based in Mexico City, cites that the cost of basic household goods in Mexico has been cut in half since NAFTA’s implementation. [27]

From 2008 - 2009, Mexico was hit with a recession. However, in 2010, the Mexican economy showed signs of a rebound as it posted its fastest expansion in ten years while adding 730,000 jobs.[28] According to Finance Minister, Ernesto Cordero, Mexico is Latin America’s second biggest economy and is on track to expand 4% to 5% in 2011. [29] Mexico has, indeed, benefited from trade liberalization. In addition to NAFTA, Mexico has entered into a total of eleven free trade agreements with forty-one countries including Japan, Israel, and the European Union. [30]

The Benefits of Trade Liberalization: In addition to the economic strides Mexico has made since 1994, two other benefits of trade liberalization through NAFTA have been achieved. First, technological innovation and research and development (R&D) have grown. For example, technological advancement in Mexican manufacturing systems has increased at higher rate than pre-NAFTA. The time required for adoption of U.S. technology has been cut in half. [31] There is a positive correlation between maquiladoras, FDI, exposure to industrialized global markets, and innovation which result in a wider range of products, tools, and improvements in processing. [32] The competitive global export market has provided incentive for R&D expansion in Mexico. Pre-NAFTA, only one third of Mexican companies devoted resources to R&D, but in the five years post-NAFTA, that figure grew to one half. [33] The National Science Foundation also reported R&D spending in Mexico jumped from $1.1 billion pre-NAFTA to $2.1 billion in two years post NAFTA. [34]

The second benefit from trade liberalization through NAFTA was a move to a more democratic and open political system. Researchers point to a positive correlation between trade liberalization and democratization of developing nations. Think tank economist, Daniel Griswold, claims, “The economic competition from NAFTA has helped to till the soil in Mexico for a more open and competitive political system. It is no coincidence that a few short years after the enactment of NAFTA, Mexicans were able to end seven decades of one-party rule by electing opposition candidate Vicente Fox as their president.” [35] Trade liberalization and globalization have paved the way for a more democratized Mexico, by opening up new avenues of support for elected officials. [36] With economic prosperity falling to a larger segment of the population, politicians can no longer rely on support from a close circle of oligarchs.

NAFTA is Not Enough

NAFTA has provided overall success on the macroeconomic front. Mexican inflation is under control, the country’s deficit is manageable, there are fiscal and monetary disciples and exports have increased. These indicators suggest NAFTA has been and continues to be a partial solution to Mexico’s economic problem. However, NAFTA is not enough. To ensure economic gains will be sustainable and benefit more than just the small circle of corporations and elite individuals, domestic policy reforms are essential. While there are no easy answers, the following are recommendations.

Incentives for Farmers: One of the provisions of NAFTA was to lift the tariff on agricultural products including corn, sugar beans, and milk after fifteen years of the agreement’s enforcement. The reason for this fifteen year span was to give Canada, the United States, and Mexico time to implement internal governmental reforms to help their farmers absorb the shock of free trade. When price supports were eventually eliminated, Mexico had done very little to help its small farmers modernize their operations. Incentives could have been offered to assist rural farmers to install irrigation or switch to crops more conducive to Mexico’s soil and climate. Jaime Serra Puche, a noted economist and former Mexico Commerce Secretary who helped negotiate NAFTA, asserts, “The government had 15 years to come up with incentives to convince farmers to place broccoli and asparagus, but they didn’t do that.” [37]

Labor Rights: A comprehensive study sponsored by Boston University regarding NAFTA concluded better labor standards in Mexico could result in higher wages of average workers. While production costs may increase, the net result would be a global middle class that would spur the demand for more exports. [38] Additionally, a World Bank regional studies report concluded protecting labor rights, providing unemployment insurance, and practicing ongoing relocation of workers to better job matches could have a positive effect on trade liberalization. In essence, transaction costs would be kept down by avoiding litigious dismissals. [39] This would require more investment in the labor market, which has yet to happen.

The biggest barriers to improving labor rights are the unions and conglomerates that have monopolized industry since privatization in the 1990s. Analysts report there is an institutional bias against facilitating labor rights and enforcing labor policies. This claim can be substantiated by the fact that the side agreement coupled to NAFTA regarding labor cooperation has been largely unenforceable. The government can do a better job enforcing labor standards in order to meet the expectations of the trade agreement and facilitating more growth across the entire labor market.

Managing Corruption: The Transparency International’s Corruption Perception Index for 2010 rates Mexico a 3.1 on a scale of 1 (most corrupt) to 10 (most clean). [40] Corruption provides a barrier to economic, social and political progress. Mexico has had a history of government corruption. Even President Salinas, who helped negotiate NAFTA, fled the country under scrutiny of receiving kickbacks from companies that privatized under the reforms of NAFTA. While corruption may be ingrained within the cultural fabric of Mexican social and political infrastructure, bringing it down to a more manageable level is a goal worth pursuing.

Mexico, like other developing nations, is under the scrutiny of global commerce. It must manage and regulate its internal affairs by guidelines set by lender or aid institutions such as the World Bank and the International Monetary Fund. In order to remain competitive in the international market, Mexico must be attractive, demonstrating low risk and low levels of corruption. [41] By reducing the perception of corruption, Mexico can continue to attract FDI and move closer to reaching economic convergence with its NAFTA trading partners.

Economic Regulations, Institutional Reforms and Infrastructure Enhancement: To sustain the economic growth Mexico experienced post-NAFTA, the government should make comprehensive efforts focusing on tax reform, the deregulation of the telecommunication industry, the reduction of dependence on oil reserves, the generation of investment opportunities in energy sectors, and amending the judicial system to enhance the rule of law. Additionally, economists believe the country must institute a number of reforms affecting a wider spectrum of Mexican society that includes providing more resources for public infrastructures and improving education and human capital development. [42] With these reforms, the country could "attract more skill-intensive industries with greater spillover benefits for the domestic economy—and a greater potential to raise Mexican families' incomes toward U.S. and Canadian levels." [43]

Conclusion

NAFTA's impact on the Mexican economy has been positive. NAFTA's objectives regarding free trade and investment have been achieved. The overall economic gains outweigh any short-term shifts in the manufacturing and agricultural sectors. However, critics hold to a cliché argument that NAFTA was not "sold on these terms," [44] expecting broader and sweeping economic and social transformation. Their argument that NAFTA has failed to fulfill its promises have been largely based on short-term, narrow viewpoints which do not adequately take into account a broader perspective of the economic infrastructure changes that have set Mexico on a new course of trade liberalization.

NAFTA has been and remains a part of Mexico's solution to a better economy. Trade liberalization has further opened the door to economic integration, modernization, and globalization. The transformation of the economy has proven to bring Mexico a step closer to convergence with its trading partners. However, NAFTA is not enough. A single trade agreement is no substitute for a comprehensive long-term development strategy. Developing a country's economy and, along with its human capital, is an effort that requires a multifaceted approach involving governmental reforms. NAFTA was, and continues to be, a step in the right direction towards convergence with the United States and Canada. The journey, however, is a longer road than NAFTA critics are probably willing to admit.

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