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NAFTA'S Institutions An Evaluation Ten Years On

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The North American Free Trade Agreement (NAFTA) is part of the broad process of institutional reforms begun in the 1980s as a result of the country's trade opening. In that sense, the agreement stems from the change in formal institutions effected in those years. At the same time, it is a specific source of institutional change, particularly domestically, where it has been behind modifications in the obligatory nature of Mexico's legal system,

and has spurred important changes in legislation.

When scholars look at the conditions in which Mexico decided to begin the process leading up to NAFTA, they usually concentrate on economic asymmetries with the United States. However, most do not mention Mexico's institutional framework, which corresponded essentially to the "closed" economy model of a corporatist, centralized political system.¹ It had an insufficiently defined system of property rights (particularly with regard to land ownership, the use and extrac-

tion of natural resources and intellectual property rights) and lacked a regulatory framework that could sanction anti-competitive practices and fraud, and a clear legal system without corruption, etc.² In this sense, we can say that Mexico sought NAFTA without the country having an operating institutional framework corresponding to the changes that it would bring. This led to a series of reforms partially oriented to comply with some of the institutional prerequisites implicitly demanded so that our trade partners would approve the treaty, but also as a way to

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strengthen the institutional framework with the massive changes in the economy during the period before the reforms. These changes are rarely explored in research on NAFTA because institutional matters are considered included in the conventional economic analysis.

NAFTA AND THE INSTITUTIONS

In principle—and according to Douglas North³—we know that institutions are the rules of the game in a society and can be formal (legal rules) or informal (conventions or codes of conduct).

In contrast with the European integration process, NAFTA did not give rise directly to a large number of institutions regulated by the treaty itself. This is justified to the extent that NAFTA is an elementary and very limited form of integration.

NAFTA's organizational structure is regulated in a few pages of the official treaty and very generally in its Chapter 20, Section A, and in the environmental and labor side-bar agreements. Its formal bodies are:⁴

- a) The Free Trade Commission (Article 2001): This is NAFTA's central body, made up of cabinet-level representatives from each of the three countries. Its function is to supervise the treaty's implementation and future development. It contributes to resolving conflicts of interpretation and supervises the work of the treaty's other formal institutions. It meets at least once a year.
- b) The Secretariat (Article 2002) is established by the Free Trade Commission and made up of national sections. Its general aim is to facil-

TABLE I
NAFTA COMMITTEES AND WORKING GROUPS

A. Committees	
Committee on Trade in Goods	Art. 316
Committee on Trade in Worn Clothing	Annex 300.B, sec. 9(1)
Committee on Agricultural Trade	Art. 706
Advisory Committee on Resolution of Private	
Commercial Disputes Regarding Agricultural Goods	Art. 707
Committee on Sanitary and Phytosanitary Measures	Art. 722
Committee on Standards-Related Measures	Art. 913
Land Transportation Standards Subcommittee	Art. 913(5)
Telecommunications Standards Subcommittee	Art. 913(5)
Automotive Standards Council	Art. 913(5)
Subcommittee on Labelling of Textile and Apparel Goods	Art. 913(5)
Committee on Small Business	Art. 1021
Committee on Financial Services	Art. 1412
Advisory Committee on Private Commercial Disputes	Art. 2022(4)
B. Working Groups	
Working Group on Rules of Origin	Art. 513
Customs Subgroup	Art. 513(6)
Working Group on Agricultural Subsidies	Art. 705(6)
Bilateral Working Group (Mexico-United States)	Art. 703.2(A)(25)
Bilateral Working Group (Mexico-Canada)	Annex 703.2(B)(13)
Working Group on Trade and Competition	Art. 1504
Temporary Entry Working Group	Art. 1605
C. Other committees and working groups established by the agreement	
Source: <i>Tratado de Libre Comercio de América del Norte. Texto Oficial</i> , vol. 1 (Mexico City: Ed. Porrúa, 1998), and www-tech.mit.edu/Bulletins/nafta.html .	

In contrast with the European integration process, NAFTA did not give rise directly to a large number of institutions regulated by the treaty because it is an elementary, limited form of integration.

- itate the agreement's functioning and, to that end, it must aid the commission and give administrative support to the panels and committees created for the review and resolution of disputes.
- c) The Commission for Environmental Cooperation was created under the parallel North American Agreement on Environmental Cooperation in 1994. The secretariat of the Environmental Commission takes note of the events and facts among the countries in order to report whether environmental legislation is being enforced. Also, in accordance with the side-bar agreement, the parties may convoke an arbitration panel against anyone who has failed to enforce the laws.
- d) The Commission for Labor Cooperation, created by the September

TABLE 2
CASES PRESENTED BEFORE THE NAFTA SECRETARIATS (1994-2000)

Total Cases until August 2000	65
Cases under NAFTA Chapter 19	61
Cases under NAFTA Chapter 20	3
Extraordinary Challenges Committee	1
Source: <i>Libro blanco del TLCAN</i> (Mexico City: Secofi, 2000).	

TABLE 3
REQUESTS FOR NAFTA PANEL REVIEW (1994-2000)

Requests for panel reviews before the Mexican section	11
Country involved: U.S.	6
Country involved: Canada	3
Panel reviews requested by Mexican companies	2
Requests for panel reviews before the U.S. section	33
Country involved: Canada	14
Country involved: Mexico	19
Requests for panel reviews before the Canadian section	17
Country involved: U.S.	12
Country involved: Mexico	5
Source: <i>Libro blanco del TLCAN</i> (Mexico City: Secofi, 2000).	

Mexico has been passive, not taking the initiative to use the institutional dispute framework established by the agreement.

This has led to tension among Mexican producers.

1993 North American Labor Cooperation Accord. This commission does not have the ability to review events and facts as the Environmental Commission does. However, it does have national offices in each country and it can hear complaints pertaining to the violation of labor legislation.

e) Working groups and committees (Appendix 2001.2), created to facilitate investment and trade and ensure the implementation and effec-

tive administration of the treaty. The commissions and working groups are structured by sector and controversial items in the treaty, as Table 1 shows.

f) The North American Development Bank and the Border Ecological Cooperation Commission were created based on a November 1994 agreement between Mexico and the United States. Their aim is to finance environmental infrastructure projects. The

projects funded by the bank must be certified by the commission and linked to drinking water supply, the treatment of waste water or municipal solid waste management, and be located along the border between the two countries.

Even though NAFTA's organizational structure is very simple, it has operated in the context of tremendous changes in the country's formal institutions. Since 1991, the year in which Mexican authorities initiated the negotiation of the free trade agreement with the United States, radical modifications began to be made to Mexico's internal legal system. The aim was to adjust to the changes implicit in the strategy of opening the economy, trade, the financial sector and services to the outside world.

In the period after NAFTA came into effect, important constitutional changes have been made in the electoral system, re-privatizing the banking system, giving the Central Bank autonomy, improving the defense of human rights, opening up the rural property market and, finally, strengthening the fight against drug trafficking.⁵

Numerous changes in federal legislation have also been made; as shown in the graph 1, practically 50 percent of relevant legislation has been changed since 1991.

The new federal legislation passed since NAFTA was a qualitative change with regard to the previous stage; it meant a shift in orientation, putting a priority on the renovation of the legislative framework, mainly vis-à-vis the economy. To comprehend these transformations, suffice it to say that between 1991 and 1996, almost 60 percent of federal legislative changes

dealt with the economy: trade (20.3 percent), communications and transportation (11 percent), natural resources and the environment (9.4 percent), the fiscal system (7.8 percent) and the public administration (7.8 percent).⁶

Once the main institutional changes were established in the context of NAFTA, we can now examine their repercussions. In the first place, we will consider the formal performance of the organizations constituted under NAFTA since, according to Douglas North, they represent the agent of institutional change.⁷

The agreement's so-called "white book" deals with the results of NAFTA's formal bodies' operations, which do not seem to have been very active, particularly in the Mexican case, as can be shown by the following.⁸

Between 1994 and 2000, the NAFTA commission only met six times. Its main agreements dealt with the two rounds to speed up the schedule for eliminating tariffs (This sped up the elimination of 500 mutual tariffs and the United States did the same regarding some chemicals and textiles for Mexico.); the approval of alternative mechanisms for controversy resolution for private trade disputes; and the establishment of a working group on agricultural norms and classification. In this same period, the committees and working groups met 207 times (an average of 30 times a year) and dealt with 65 cases.

From the beginning of the treaty until 2000, 65 cases were presented before the NAFTA secretariats (see Table 2), of which 62 were antidumping and countervailing duty cases. Mexico has been involved in 33 of these (see Table 3). Since NAFTA's inception, 13 investigations have been brought

YEAR	CASE
1994	Import of flat coated steel products originating in and exported from the United States (dumping). Based on a complaint by Industrias Monterrey.
1994	Polystyrene and impact crystal from the United States (dumping).
1995	Seamless line pipe originating in the United States (dumping).
1996	Imports of cold-rolled steel sheet originating in or exported from Canada (dumping).
1996	Imports of rolled steel plate originating in and exported from Canada (dumping).
1996	Imports of hot-rolled steel sheet from Canada (dumping).
1997	Imports of hydrogen peroxide from the United States (countervailing duty).
1998	Imports of high-fructose corn syrup from the United States (dumping).
2000	Imports of urea from the United States (dumping).
2002	Bovine carcasses and half carcasses, fresh or chilled, originating in the United States (countervailing duty).

Source: Data from the *Libro blanco del TLCAN* (Mexico City: Secofi, 2000) and the NAFTA Secretariat.

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against the United States by Mexico. Among the most important are the ones about 42- and 55-grade high-fructose corn syrup and about cattle. Mexico has been passive, not taking the initiative to use the institutional dispute framework established by the agreement. This has led to tension among Mexican producers, like, for example, in the case of farmers who have been demanding the agreement be re-negotiated instead of requesting

an investigation for products around which they think the United States is practicing unfair trade, such as beans and corn.

Table 4 shows that the cases brought by Mexican producers involve sectors in which there are large companies, with information and sufficient organizational capacity to defend their interests. This is the case of steel, petrochemicals, sugar and cattle raising, areas in which companies like Indus-

TABLE 5
GOVERNMENT FACTOR INDEX FROM
THE WORLD COMPETITIVENESS YEARBOOK

COUNTRY	1992	1993	1994	1995	1996	1997	1998	1999	2000
Canada	26	28	29	23	10	9	7	12	15
Mexico	17	16	9	39	38	29	25	28	20
USA	8	8	8	9	7	7	13	15	10
□ Mex-Can	6.4	8.5	14.1	11.3	19.8	14.1	12.7	11.3	3.5
□ Mex-U.S.	6.4	5.7	0.7	21.2	21.9	15.6	8.5	9.2	7.1

□ Standard deviation.

The index orders countries hierarchically from 1 to 47 according to government efficiency in minimizing its participation in business, creating competitive conditions for business, providing predictable social and macroeconomic conditions that minimize external risk for businesses, flexibility in adapting its economic policies to the changing international environment and promoting equality and justice, ensuring social security for the population.

Source: Created by the author using data from the Institute for Management Development, past rankings for government factor, <http://www.imd.ch>

TABLE 6
INTERNATIONAL TRANSPARENCY INDEX FOR THE NAFTA REGION

COUNTRY	1980-85	1988-92	1995	1996	1997	1998	1999	2000
Canada	8.41	8.97	8.87	8.96	9.1	9.2	9.2	9.2
Mexico	1.87	2.23	3.18	3.3	2.66	2.3	3.4	3.3
USA	8.41	7.76	7.79	7.66	7.61	7.5	7.5	7.8
□ Mex-Can	4.6	4.8	4.0	4.0	4.6	4.9	4.1	4.2
□ Mex-U.S.	4.6	3.9	3.3	3.1	3.5	3.7	2.9	3.2

□ Standard deviation.

The corruption index orders countries on a scale from 0 to 10 in which 10 is the cleanest and 0 is the most corrupt. The index is constructed using the perceptions of businessmen, analysts and citizens about the level of corruption of their governments.

Source: Created by the author using information from Transparency International.

trias Monterrey, Altos Hornos de México, Hylsa and Industrias Resistol are among the complainants. This suggests that Mexican producers cannot use NAFTA's dispute resolution mechanisms because they lack information, advisory services and organization.

NAFTA AND PERCEPTIONS OF INSTITUTIONAL PERFORMANCE

For a better appreciation of these institutional changes, the perceptions of economic agents are very useful. Some attempts have been made to measure the institutional factors, basically with the aim of comparing countries to highlight the institutional deficiencies many of them have. World Bank researchers have tried to include institutional performance in the broad concept of governability, defined as the exercise of authority through formal and informal institutions and traditions for the common good.⁹ Different indicators have been developed based on this concept. These indicators come from the official data in the different countries, international bodies and surveys of experts and the public. The following is a review of them vis-à-vis NAFTA:¹⁰

a) The Institute for Management Development, headquartered in Lausanne, Switzerland, has published the *World Competitiveness Yearbook* since 1991. It calculates an indicator called "government factor," constructed for 49 countries using 4,000 surveys and including issues such as government policy transparency, political risk, etc. Table 5 illustrates this indicator's results, emphasizing two basic aspects of the differences among the institutional spheres of

the NAFTA economies. In the first place, the differences in the period prior to NAFTA are not relatively very large. They increased in the first years after the agreement was signed and then began a process of institutional convergence after 1996, reaching slightly lower levels of asymmetry than the ones that existed in the early 1990s.¹¹

b) Transparency International built an index based on the perception of corruption in different countries. Its results can be seen in Table 6. The figures indicate that since NAFTA came into effect, there is certain convergence among the countries vis-à-vis corruption. After 1995, however, the process bogged down, and in 1996, it reversed itself and re-

emerged in the last two years of the period analyzed.

c) Freedom House is a nongovernmental organization headquartered in New York which evaluates political rights and civil liberties in 192 countries. Since its indicator was constructed in 1978, it has the advantage of having one of the longest series of measurements.

Table 7 shows that the variability of the indexes of political rights and civil liberties improved slightly in 1996-1997 and then returned to its historic trend. It was not until 2000 with the National Action Party's presidential win that these indexes became comparable to those of the 1970s. This means that NAFTA does not have a direct, lasting

effect on the convergence of political rights and civil liberties in the region's countries.

In summary, the indicators reviewed do not clearly prove that NAFTA in and of itself has meant a new set-up and hierarchy of institutional forms for Mexico.

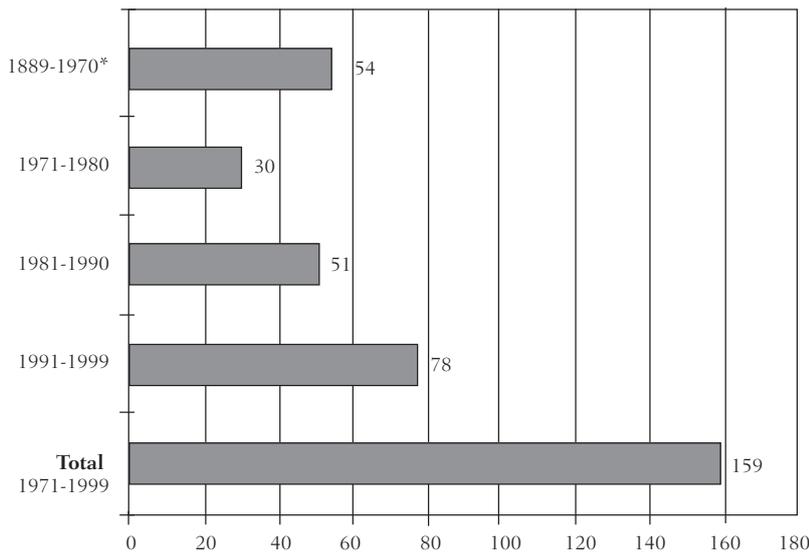
FINAL CONSIDERATIONS

The results of an analysis of institutional change express a problem linked to law enforcement. That is to say, while under NAFTA important changes in the legal system have been made formally, just as we showed in the previous section, in practice, problems persist that affect the quality of the institutions, problems like corruption, low

TABLE 7
FREEDOM HOUSE FREEDOM INDEX IN THE NAFTA REGION

POLITICAL RIGHTS														
COUNTRY	1972-73	1975-76	1980-81	1985-86	1990-91	1991-92	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Canada	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Mexico	5	3	4	4	4	4	4	4	3	4	4	4	3	3
USA	1	1	1	1	1	1	1	1	1	1	1	1	1	1
<input type="checkbox"/> Mex-Can	2.8	1.4	2.1	2.1	2.1	2.1	2.1	2.1	1.4	2.1	2.1	2.1	1.4	1.4
<input type="checkbox"/> Mex-U.S.	2.8	1.4	2.1	2.1	2.1	2.1	2.1	2.1	1.4	2.1	2.1	2.1	1.4	1.4
CIVIL LIBERTIES														
COUNTRY	1972-73	1975-76	1980-81	1985-86	1990-91	1991-92	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Canada	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Mexico	3	3	4	4	4	4	4	4	3	4	4	4	3	3
USA	1	1	1	1	1	1	1	1	1	1	1	1	1	1
<input type="checkbox"/> Mex-Can	1.4	1.4	2.1	2.1	2.1	2.1	2.1	2.1	1.4	2.1	2.1	2.1	1.4	1.4
<input type="checkbox"/> Mex-U.S.	1.4	1.4	2.1	2.1	2.1	2.1	2.1	2.1	1.4	2.1	2.1	2.1	1.4	1.4
<input type="checkbox"/> Standard deviation.														
The index grades freedom in each country: from 1 to 2.5 is considered free; from 3 to 5.5 partially free; and from 5.5 to 7, not free.														
Source: Created by the author with data from Freedom House, http://freedomhouse.org														

FEDERAL LAWS ON ECONOMIC ISSUES STILL IN FORCE (BY YEAR PASSED)



* Of the 54 laws passed, 34 were amended between 1971 and 1999.

Source: Sergio López Ayllón and Héctor Fix Fierro, “¡Tan cerca, tan lejos! Estado de derecho y cambio jurídico en México (1970-1999),” *Boletín Mexicano de Derecho Comparado* new series, no. 97 (Mexico City), 2000.

competitiveness, the informal market, drug trafficking, contraband, poverty, etc. As jurists Sergio López Ayllón and Héctor Fix Fierro say, the positive effects of legal reforms are compensated by negative factors that obstruct and resist change. This means that you can have a legal system without the social support needed for it to function appropriately.¹² Thus, despite the existence of a formal structure of new laws, norms and regulations that have emerged because of NAFTA—even if incomplete and fragmented—they are insufficiently enforceable. Therefore, an important informal structure is maintained that resolves coordination problems in the Mexican economy’s functioning and operation. ■■■

NOTES

¹ Víctor Godínez thinks that the economic reform was carried out without either political or institutional internal counterweights. In this way, the reform was validated via the forms and customs of the old corporatist system. Víctor Godínez, “México: consecuencias económicas del reformismo autoritario,” *Persona y sociedad* vol. 10, no. 2, published by the Instituto Latinoamericano de Doctrina y Estudios Sociales (ILADES) (Santiago, Chile), August 1996.

² Arturo Díaz de León extensively analyzes the historic evolution of property rights over the land and labor rights in Mexico, showing that the main formal regulations are contained in Articles 127 and 123 of the Constitution. He outlines a wide-ranging description of the insufficiencies of the regulatory framework for private, state and communal property in Mexico, showing the negative effects this has on productivity in the countryside as a result of the existence of small holdings and latifundios caused by legislation on land ownership and, finally, the abuses of the most elementary labor rights (low

wages, denial of social protection, child labor, among many others) because labor legislation was not appropriately adjusted. Arturo Díaz de León, “Los derechos de propiedad de la tierra y el trabajo,” Leopoldo Solís, comp., *Los derechos de propiedad en México* (Mexico City: Instituto de Investigación Económica Lucas Alamán, A.C., 2000).

³ Douglas C. North, *Institutions, Institutional Change and Economic Performance. Political Economy of Institutions and Decisions* (Cambridge, Mass.: Cambridge University Press, 1999).

⁴ Douglas North distinguishes between institutions and organizations: institutions are the rules of the game and organizations are the players. Therefore, the structure of NAFTA’s players is very simple and in concordance with the relatively limited degree of integration of a free trade area.

⁵ Javier López Moreno presents a detailed review of each of these constitutional changes. Javier López Moreno, *Reformas constitucionales para la modernización. Una visión de la modernización de México* (Mexico City: Fondo de Cultura Económica, 1993).

⁶ Sergio López Ayllón’s and Héctor Fix Fierro’s work shows that the new orientation of Mexican legislation is characterized by “the acceptance of an open market economy, the reduction of the size and functions of the state (privatization and deregulation, respectively), a new institutional set-up with the objective of greater equilibrium between the executive and the other branches of government (political and judicial reforms), as well as between the federal, state and municipal governments, and, finally, the strengthening of civil and political rights.” Sergio López Ayllón and Héctor Fix Fierro, “¡Tan cerca, tan lejos! Estado de derecho y cambio jurídico en México (1970-1999),” *Boletín Mexicano de Derecho Comparado* new series, year 33, no. 97 (Mexico City), 2000.

⁷ Douglas C. North, op. cit.

⁸ The white book was the log for following up NAFTA activities that the Ministry of Trade kept until 2000.

⁹ World Bank, *The Quality of Growth* (New York: World Bank-Oxford University Press, 2000), p. 137.

¹⁰ We included only indexes with information prior to and after the signing of NAFTA in order to be able to identify and compare the changes due to the treaty.

¹¹ The convergence indicator used is the standard deviation between the countries’ institutional indexes. This measurement is known as the sigma convergence in the specialized literature.

¹² López and Fix, op. cit., pp. 157-158.