Ten Years of NAFTA A Mexican Perspective

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It was 10 years ago, in August 1992, that the North American Free Trade Agreement (NAFTA) negotiations concluded after a final push during a marathon session at the Watergate Hotel.

At the time, some commentators in Mexico feared that the trade agreement would be a "sellout" of Mexico (much as Canadian critics did, when their country negotiated its free trade agreement with the U.S.), especially regarding the sacrosanct oil sector, and that it would wipe out vast segments of Mexican industry. U.S. critics, most notably Ross Perot, expected to hear a "giant sucking sound" as thousands of U.S. jobs moved south of the border.

NAFTA supporters in both the U.S. and Mexico expected a significant number of jobs to be created in both countries and more generally envisaged NAFTA as the driving force of North American economic dynamism, which would allow the three countries to become more competitive in world trade.

Ten years after NAFTA's signing, and almost eight years after its coming into force, it is fair to say that, not surprisingly, it has turned out to be neither a disaster nor a panacea. By some yardsticks, it has performed very well, and by others it has fallen short of expectations; what actually happened could be likened to Sir Arthur Conan Doyle's famous dog that did not bark. And, some of its greatest challenges are still to come.

Large increases in trade and investment flows have translated into a greater reliance on the U.S. economy.

Some Successes

Two recent Mexican books provide an assessment of NAFTA. *¿Socios naturales?* (Natural Partners?), edited by ITAM scholars, and *Para evaluar al TLCAN*, edited by CIDE-ITESM scholars, both conclude that, overall, NAFTA has been a success.[1]

Looking at "the big picture" presents NAFTA in the best light. Take trade flows, for instance. From 1993 to 2000, bilateral trade between Mexico and the U.S. went from U.S.$85 billion to U.S.$263 billion, an increase of 209 percent. Mexico is now the U.S.'s second trading partner, surpassed only by Canada. If the latest available projections are correct, Mexico should become the U.S.'s main trade partner during the current decade.

Thanks in large measure to the impressive growth in Mexico's trade with the U.S. since the onset of NAFTA, it is now, by far, Latin America's main exporter. In fact, for the last several years Mexico's exports have exceeded those of all other Latin American countries combined. As graph 1 shows, in 2000, Mexico's exports easily surpassed those of the other three main exporters in Latin America: Argentina, Chile and Brazil.

The situation regarding foreign direct investment (FDI) is akin to that of trade. The total FDI received by Mexico from 1994 to 2000 was U.S.$466 billion, which translates into an annual inflow of U.S.$7.8 billion, whereas annual inflows from 1989 to 1993 were only U.S.$2.9 billion. The U.S. has accounted for 64 percent of total FDI flows since the NAFTA entered into effect.

Turning from trade and investment flows to institutional questions, NAFTA has also chalked up some noteworthy successes. It represents an institutionalization of economic relations among countries whose economies had become increasingly intertwined and where

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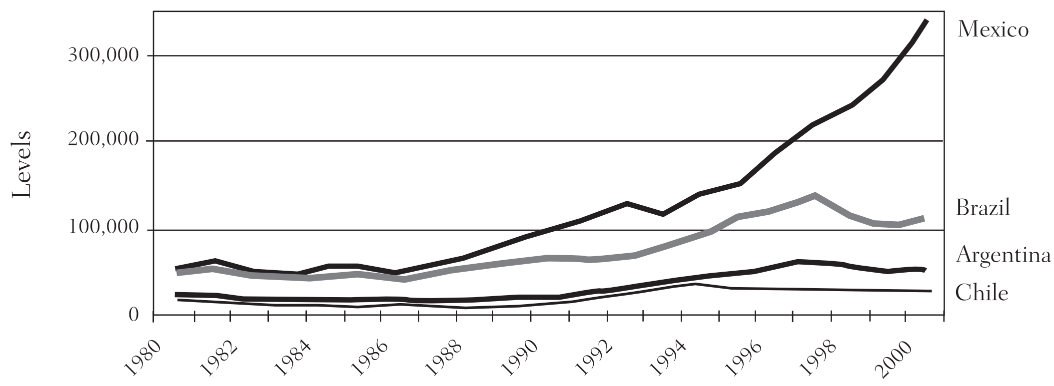
Graph 1

Total Trade: Argentina, Brazil, Chile and Mexico

(millions of U.S. dollars)



Source: World Bank, *World Development Indicators 2001* (Washington, D. C.: World Bank, 2001).

the large partner always had the upper hand over the smaller ones when solving disputes unilaterally. NAFTA has bred certainty and facilitated the impressive growth in trade and investment mentioned above.

A key element in providing certainty has been the dispute settlement mechanisms. For instance, between 1994 and 2001, 79 disputes arose regarding the politically volatile issues of dumping and subsidies, and arbitral panels set up under NAFTA rules have solved the great majority of these cases effectively and fairly. All other Latin American countries would be more than pleased to have access to this dispute settlement mechanism, but so far Mexico is the only Latin American country to have this privilege.

NAFTA has also meant that wide-ranging economic policy swings, which had been prevalent in Mexico and proved devastating (one need only recall the 1982 bank nationalization), have been greatly curtailed. After the December 1994 peso devaluation strong pressure was brought to turn back from trade liberalization, but the costs of doing so under NAFTA would have been very high. Instead, the devaluation, coupled with privileged access to a booming U.S. market, allowed Mexico to turn back from the brink in a relatively short time.

Most critics now take NAFTA for granted, and talk about improving it or modifying it, instead of ditching it altogether. Jorge G. Castañeda, Mexico's current foreign minister, and Adolfo Aguilar Zínser, Mexico's representative in the United Nations Security Council, were two of NAFTA's most vociferous opponents and during its negotiations testified before the U.S. Congress, advising against its approval. Now they no longer question its fundamental principles.

NAFTA is thus a central element in Mexico's economic policy. The country has greatly benefited from privileged access to the world's largest market. It has also helped to attain some continuity in economic policy, which is a prerequisite for sustained economic growth and poverty reduction.

Shortcomings

The obverse sides of some NAFTA successes are also its shortcomings. The large increases in trade and investment flows have also translated into a greater reliance on the U.S. economy. Some commentators see nothing new in this. The usual retort is that Mexican trade has been closely linked to the U.S. market for decades; in the early 1980s approximately 70 percent of Mexico's total trade was with its northern neighbor, and NAFTA merely increased it to 80 percent. This view misses a major transformation: even during the oil boom in the late 1970s and early 1980s, only slightly over 20 percent of the Mexican economy depended on trade, whereas the figure is now close to 70 percent (see graph 2).

Mexican and Canadian trade increased by 199 percent from 1993 to 2000 (just shy of the 209 percent increase in Mexico-U.S. trade), but given the extremely low levels of trade between Mexico and Canada when NAFTA entered into effect, this figure is somewhat misleading. In fact, 95 percent of Mexico's North American trade in 2000 was with the U.S. The fact that only 5 percent of its North American trade was with Canada cannot be fully accounted for by the fact that Canada's economy is smaller than that of the U.S., nor by geographical considerations. What this also shows is that NAFTA is really comprised of two strong bilateral relations (Canada and Mexico with the U.S.) rather than a truly North American one. Mexico now has one of the world's most open economies, and the vast majority of its trade is with the U.S. As the U.S. goes so does Mexico, as became all too painfully evident since the latter entered into a recession in 2001.

NAFTA did not wipe out many Mexican industries, as had been feared. The fact of the matter is that the brunt of trade liberalization was felt during the 1980s, before NAFTA was negotiated. During that decade Mexico undertook a series of far-reaching economic policy reforms as part of macroeconomic stabilization and structural reform efforts, and trade liberalization played a major part.

What is the case is that the benefits of NAFTA have not been shared equally. The Mexican Southeast is one of the country's poorest regions, and it has seen few —-if any— benefits from NAFTA. In fact, those regions may be hard hit as the liberalization of corn imports from the U.S. proceeds apace until full liberalization of trade in corn takes place 15 years after NAFTA's entering into force.

Severe regional disparities are coupled with scant possibilities of participation for small and medium enterprises (SMEs). SMEs account for less than 7 percent of Mexico's exports, while large companies contribute about 50 percent. The rest of exports are accounted for by *maquiladoras* (in-bond processing plants), and of the late it seems that they are more footloose than previously thought. Many of the plants that were in Mexico have moved to Central America and other places and may not return even after a resumption of growth in the U.S. economy and a more competitive Mexican exchange rate, which has appreciated considerably since 2000.

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We thus see some islands of prosperity amidst vast regions that have not prospered and are not connected to the north. How much these regions (and SMEs) can prosper through increased economic interaction with the U.S. (and hopefully also Canada) is open to question. Given that Mexico may soon become the U.S.'s main trade partner, it is not clear how much trade can continue to grow.

There are also some institutional shortcomings. Just as dispute settlement for subsidies and dumping issues has worked quite well, disputes in other areas have not been addressed effectively. Mexico-U.S. disputes over sugar and trucking have festered for years, and the de facto situation is coming perilously close to the bad old days of unilateral solutions.

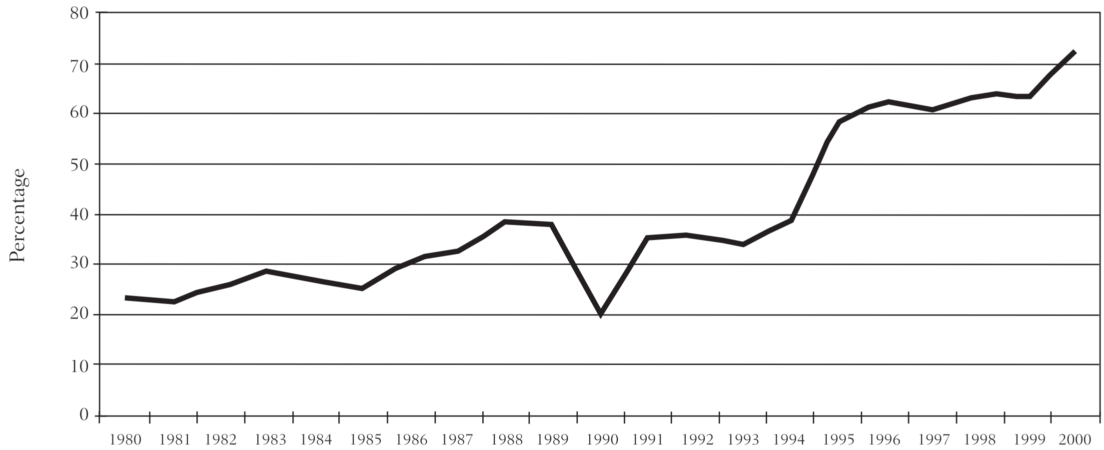
NAFTA is of course not a development strategy: it is merely a very important economic policy instrument that, coupled with a myriad of other measures, may contribute to the reduction of poverty in Mexico via sustained high rates of economic growth. Mexico's developmental problems are not the result of NAFTA, but neither can NAFTA alleviate them. The danger now is that, given that poverty has not decreased notably and income concentration seems to be growing, some groups become desperate and press for radical economic policy changes, doing away with some very positive aspects derived from trade liberalization in general, and NAFTA in particular. Significant challenges still lie ahead if Mexico is to make the most of the opportunities NAFTA offers.

The Challenges Ahead

NAFTA is facing challenges from within and from without.[2] External developments, such as the establishment of the World Trade Organization (WTO) and the launching of a new round of multilateral trade negotiations in November 2001, mean that NAFTA has to keep abreast of multilateral developments if it is to remain relevant. What is more, the Free Trade Area of the Americas (FTAA) negotiations, slated for

Graph 2

Mexico: Exports + Imports/gdp



Source: International Monetary Fund *International Financial Statistics* (Washington, D.C., 2001)

completion by 2004, will also pose a challenge for NAFTA members, and especially for Mexico. The country cannot continue to rely on its privileged and exclusive access to the U.S. market as the main source of economic growth. Once those privileges start to erode, it will face stiff competition in that market.

Another challenge for all three countries, especially salient after the terrorist attacks of September 11, is how to keep fully open borders for legal flows of goods and capital, while closing them off for all illegal flows. Minor adjustments in this regard will not suffice, and the interaction between economic and security needs will have to be addressed head-on, lest focusing on one translates into detrimental effects upon the other.

Internally, Mexico needs to ensure that the benefits from free trade are shared more fairly. This means it will have to implement a series of policies aimed at "making openness work."[3] The Mexican economy must be made less vulnerable to external shocks, for instance, by seriously striving to diversify trade relations and avoid such a high degree of reliance upon the U.S. economy and by providing for a safety net for workers that are displaced by foreign competition, so they can adapt to new circumstances instead of merely trying to survive and pushing for the erection of new trade barriers, which will hurt everyone in the long term.

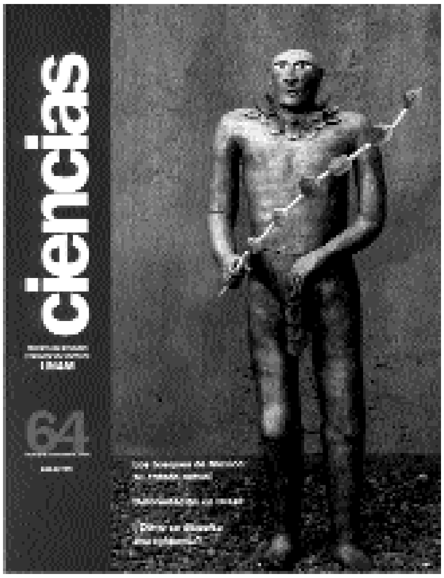
Achieving all this will not be easy. These measures include, among many others, a resumption of financing for SMEs, radical deregulation and simplifications aimed at fostering new businesses and bolstering the social security and educational systems. If these measures are not carried out, in the long term Mexico will bear only the costs of free trade without the many potential benefits it can yield. VM

Notes

[1] Beatriz Leycegui and Rafael Fernández de Castro, eds., *¿Socios Naturales? Cinco años del Tratado de Libre Comercio de América del Norte* (Mexico City: ITAM-Miguel Ángel Porrúa, 2000) and Arturo Borja, comp., *Para evaluar al TLCAN* (México City: ITESM-Miguel Ángel Porrúa, 2001). The ITAM and CIDE are two of the most prestigious in economics theory and analysis in Mexico. [Editor's Note.]

[2] Academics from the three North American countries address these issues in Edward J. Chambers and Peter H. Smith, eds., *NAFTA in the New Millennium* (Edmonton and La Jolla: University of Alberta Press and Center for U.S.-Mexican Studies, 2002).

[3] This expression is borrowed from Dani Rodrik, *The New Global Economy and Developing Countries: Making Openness Work* (Washington, D.C.: Overseas Development Council, 1999).



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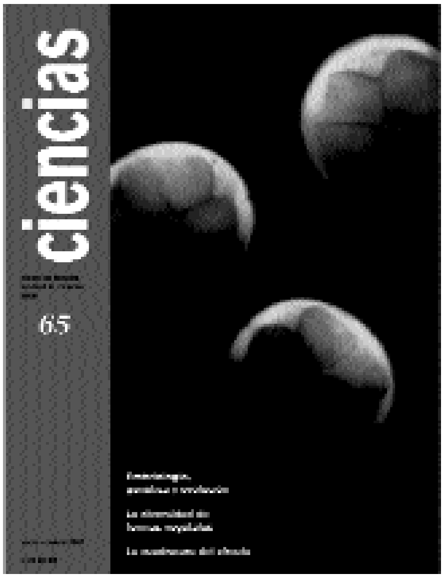

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