

CURRENT HISTORY

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NAFTA at 10: A Plus or a Minus?

JORGE G. CASTAÑEDA

When they drafted the North American Free Trade Agreement 10 years ago, the three parties to the pact—the United States, Mexico, and Canada—agreed to lift trade barriers and create an area where trade, commerce, and investment would take center stage in their relationships. The main purpose of the agreement was to open up borders and ease trade restrictions with the goal of regional commercial integration.

NAFTA was the first trade agreement involving developed and developing countries and it therefore generated great expectations. What would be the effects of this new kind of agreement? Would American products flood Mexican markets and shut down national industries? Would millions of US jobs flee south? Would the agreement raise the number of Mexican immigrants crossing the borders or would it help reduce them? Would it damage the environment through increased industrialization?

From a political perspective, NAFTA meant setting aside many of the national prejudices that Mexican elites and society held regarding the United States. The agreement also meant accepting that Mexico had a real relationship with the United States, leaving aside mistrust and hostility to focus on shared goals and values and embracing cooperation. This was the first time that Mexico reconsidered geographical proximity with the United States and saw it more as an opportunity than a threat. The US perception of its southern neighbor also changed; it no longer viewed Mexico as a constant source of migration and drugs but as a potential business opportunity.

THE WINDOW OF OPPORTUNITY

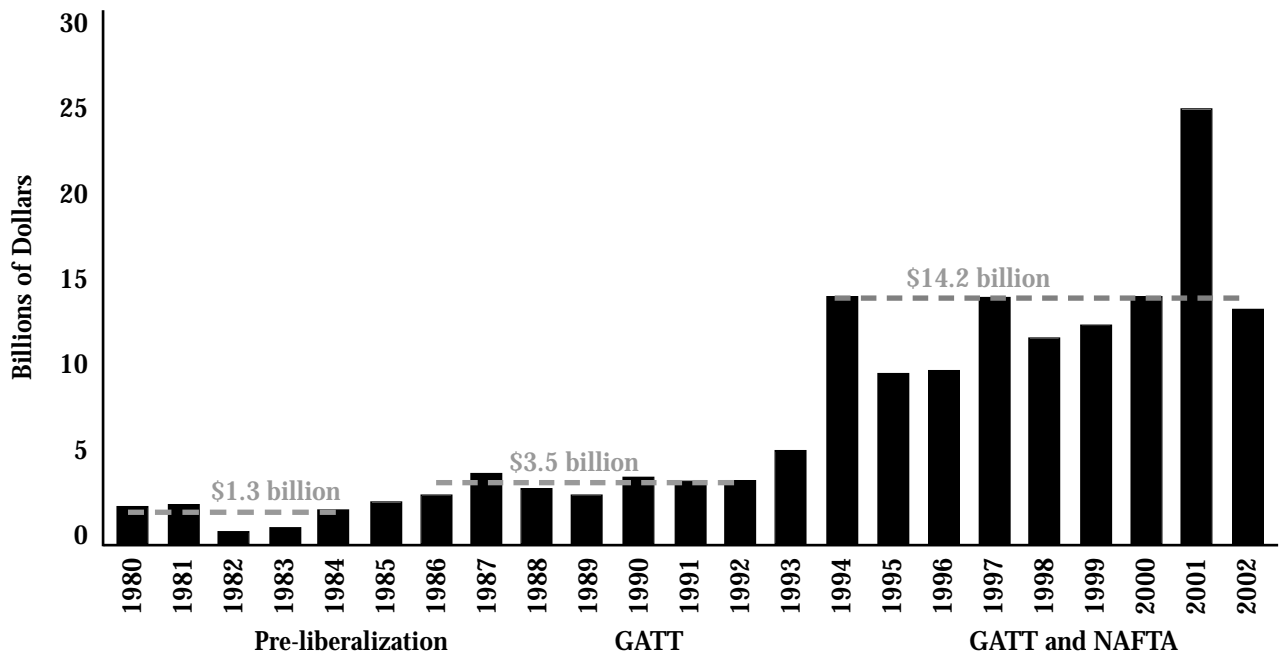
Market liberalization was not unknown to the United States and Canada. The two countries already had a trade agreement (the Canada-United States Free Trade Agreement, or CUFTA, signed in 1988), and they had previously liberalized their economies and already knew the implications of these forms of economic integration. By contrast, Mexico had only just begun to liberalize its economy in the late 1980s. It was attempting aggressive market reforms while coping at the same time with the adverse effects of trade integration.

By the mid-1990s, some observers argued that Mexico would pay the greatest adjustment costs to comply with NAFTA (it had to significantly reduce tariffs), but that in the long term it would benefit the most among the three signatory countries. When the agreement was being drafted, Mexican negotiators believed that NAFTA would cause the Mexican economy to intensify its competitive advantages, resulting in increased efficiency, an expansion of production, and the creation of new sources of employment. At the same time, the agreement guaranteed access for Mexican exports to Canadian and American markets, opening a window of new economic opportunities.

The ratification of NAFTA gave continuity to the economic policies implemented by previous administrations in Mexico and foreclosed the possibility of a generalized regression to an inward-looking model. In this sense, the agreement granted certainty and predictability to the economic policies implemented by the Mexican government, a *sine qua non* for attracting foreign investment. The agreement also established a normative framework for interaction among the three countries. Although

JORGE G. CASTAÑEDA is a professor of politics and Latin American studies at New York University. He was foreign minister of Mexico from 2000 to 2003.

Foreign Direct Investment in Mexico



Source: Economist Jaime Serra Puche, with data from the Mexican trade ministry.

it had deficiencies, it served as a guideline for negotiating complex economic relations.

Through NAFTA, Mexico could guarantee unrivaled access for its agricultural and manufactured products to the United States. This placed Mexico in a privileged position, granting it unparalleled entry to the world's number one market. However, this status turned out to be temporary. The signing of new trade agreements and the enlargement of the World Trade Organization have granted equal access to US markets to other countries, causing Mexico and Canada to lose their privileged position.

There is no doubt that total trade has increased significantly since the agreement's completion. In 1993 trade among Canada, Mexico, and the United States was \$306 billion; by 2002 it had grown to \$621 billion. Indeed, NAFTA has significantly increased the economic relations among the three countries and has had a considerable impact on the three societies. Trade liberalization has generated increased competition between national and international suppliers of goods and services, aiding consumers in the three countries by providing varied options at better prices and improved quality. Producers also have benefited, extending their supply chain by accessing other markets with very low or no tariffs, lowering costs, and increasing productivity.

Before NAFTA's implementation, Mexico had a trade deficit with the United States of \$2.4 billion. Eight years after the agreement went into effect, in

2002, Mexico registered a trade surplus of \$36.5 billion. According to the office of the US trade representative, Mexican exports to the United States in 2002 had increased 232 percent from the levels registered in 1993, reaching \$136.1 billion. US exports to Mexico grew from \$51.1 billion in 1993 to \$107.2 billion in 2002. Mexican exports to Canada also grew substantially, from \$2.9 billion before NAFTA to \$8.8 billion in 2002.

It is difficult to determine whether NAFTA was responsible for generating the export boom that Mexico experienced after 1995. Besides the agreement, two other theses explain the source of the boom: the drastic cheapening of the peso in international markets in late 1994 and the economic boom America experienced during what economist Joseph Stiglitz calls the "roaring nineties."

As economists and trade specialists predicted, NAFTA generated benefits and losses for diverse sectors of society. The agreement contemplated the specialization of each country in the agricultural products where it had competitive advantage. Under these terms, it was predicted that the United States would specialize in crops such as corn or wheat while Mexico could concentrate on the production of fruits and vegetables. Opponents of the agreement have argued that this has brought devastating consequences to some agricultural producers in Mexico.

Research has shown that Mexico's trade deficit in agricultural products with the United States has

grown since NAFTA was implemented—except in 1995, when the peso crisis made American products very expensive and Mexico had a brief agricultural trade surplus with the United States. As for direct foreign investment flows, another essential purpose of NAFTA, the results also are mixed. As seen in the chart on page 52, investment flows in 1993 were around \$5 billion; they jumped to \$14 billion in 1994, but with the exception of \$25 billion in 2001 due to the Citigroup purchase of Banamex, they have never surpassed that level.

The same year that NAFTA went into effect, Mexico suffered a financial crisis—including the devaluation of the peso—that had severe consequences for the country's entire economy. Some authors argue that the peso crisis is attributable to NAFTA. As the agreement attracted greater flows of foreign investment, Mexico received huge inflows of speculative money (the so-called *capitales golondrinos*) that rushed out of the country when political instability emerged. Moreover, these authors argue, in order to get NAFTA approved, Mexican President Carlos Salinas de Gortari had

Increased economic integration has not led to improved standards of living in Mexico.

to overvalue the peso instead of devaluing it; this decision precipitated the eruption of the crisis in 1994. Other authors differ, arguing that the crisis was mainly attributable to internal conditions. Indeed, they believe that the relatively quick stabilization of the Mexican economy through IMF loans occurred because Mexico had become an important US trade partner. NAFTA strengthened bonds between the two countries, generating an increasing interdependence.

PROMISES AND RESULTS

There is a lack of consensus, even among specialists, about the magnitude of the adjustment and the economic gains that have resulted from NAFTA. At the time the agreement took effect in 1994, some believed that NAFTA would increase productivity in the three countries because of more open competition, and that average incomes would rise and so would wages because of the rising productivity. It was also expected that in the future, the gap between wages in the three countries would narrow.

According to the recent report, "NAFTA's Promise and Reality," by the Carnegie Endowment for International Peace, NAFTA's results after 10 years are different from what was expected. Part of the agreement called for reducing tariffs progressively.

The United States cut tariffs on manufactured goods and agricultural products, leaving intact tariffs on one of Mexico's main agricultural products—sugar—and establishing restrictions on seasonal crops. Mexico cut tariffs on US agricultural, manufactured, and livestock products and kept some restrictions on sensitive crops, such as corn and beans. (Although corn will not be liberalized fully until 2008, Mexico has in fact been importing more than stipulated and expected under NAFTA, and the imports have begun to displace peasant corn farmers sooner than foreseen.) The practical results of these tariff cuts were translated into a modification of the overall trade balance. However, the overall trade surplus hides a Mexican agricultural trade deficit with the United States.

One of the major promises of NAFTA was to create jobs in all three countries. This issue has been subject to many interpretations, and results vary extensively depending on the source consulted. The

Carnegie Endowment report affirms that in Mexico's case, "jobs created in export manufacturing have barely kept pace with jobs

lost in agriculture due to imports. There has also been a decline in domestic manufacturing employment, related in part to import competition and perhaps to the substitution of domestic suppliers by foreign ones in assembly operations. About 30 percent of the jobs that were created in maquiladoras in the 1990s have since disappeared."

Although the manufacturing sector registered higher levels of job creation (an increase of 500,000 from 1994 to 2002), it did not contribute to the development of Mexican industry or the domestic market as a whole. The agricultural sector has suffered the most, with a net loss of 1.3 million jobs since 1994. In general, Mexico's growth during this period has been mixed and discontinuous (as can be seen in the chart on page 54). In 1994 the Mexican economy grew by 4.5 percent. Only a year later the economy suffered the effects of the peso crisis and GDP fell by 6.2 percent. In the last 10 years the economy has grown an average of less than 2.3 percent in absolute terms and only 0.6 percent per capita—rates well below the levels needed to achieve the goals NAFTA set. Although bleak, growth has been higher than that achieved during the 1980s, but lower than the rates recorded during the prosperous period between 1940 and 1970.

Year	Annual GDP Growth
1994	4.5
1995	-6.2
1996	5.1
1997	6.8
1998	4.8
1999	3.74
2000	6.57
2001	-0.31
2002	0.9
2003	0.9

The contrast between the northern developed cities and the less developed south has become even more evident, and regional inequality in general has continued to grow year by year. The per capita income gap between the Federal District (which includes Mexico City) and states like Nuevo León, Campeche, Quintana Roo, and Chihuahua versus states like Guerrero, Tlaxcala, Zacatecas, Oaxaca, and Chiapas has not only not diminished with the implementation of NAFTA but has continued to expand. In 2000 the state of Oaxaca had a per capita income of \$2,029 while the state of Nuevo León had an average of \$8,420.

NAFTA has failed to achieve a reasonable distribution of the benefits of economic integration among different geographical regions and social groups. The risk that the gap between sectors favored by NAFTA and those left out will continue to widen is of significant importance, particularly in a country where regional income differences between north and south are deepening. Furthermore, general inequality in incomes has continued to rise. Since NAFTA, the top 10 percent of Mexican households have increased their share of national income while the other 90 percent have seen theirs diminish.

With regard to wages, the Carnegie Endowment report states that real wages for most Mexicans—except for a few groups that were favored by the agreement—have not recorded a significant increase. On the contrary, real salaries are lower today than when NAFTA took effect. Part of the explanation is attributable to the 1994 peso crisis, which had a direct impact in real terms. But it also is the case that productivity growth has been spotty and localized at best; the 2003 OECD *Economic Evaluation of Mexico* indicates that overall productivity has not increased since 1990. Even though NAFTA produced unprecedented gains in trade, attracted portfolio and foreign direct investment, and increased productivity in certain sectors, it did not help the Mexican economy keep pace with new arrivals on the job market of around 1 million a year.

The results found by the Carnegie Endowment report differ from the findings presented by the World Bank in a 2003 draft report. According to the World Bank, NAFTA has generated important economic and social benefits to Mexican society at large, and the country would be worse off had it not signed the agreement. The World Bank says that income inequality in Mexico and even in the United States has diminished thanks to NAFTA. This discrepancy with the Carnegie report perhaps stems from looking at different sets of numbers and placing an emphasis on the counterfactual aspect of what would have happened without NAFTA.

When it comes to migration, NAFTA neither neutralized pressures for migration nor promoted increasing flows of people moving north. Mexican migration to the United States has responded to a diverse series of factors, such as the economic crisis that disrupted the country, the inability to create 1 million jobs a year to satisfy population growth, the disparity between incomes in both countries, the demand for workers in the United States, and the booming US economy—not NAFTA itself.

Indeed, migration to the United States has continued to grow in the past decade, even with increased control at the border since 9-11. Important efforts were undertaken to change the way both countries deal with migration, but the road is still long. If the idea that free trade by itself can control existing migration persists, the results accomplished will be minor. There is no reason to think migration will diminish; more likely it will continue at current levels as economic disparities between the two countries persist.

A NORTH AMERICAN ECONOMIC COMMUNITY

NAFTA has not been the win-win situation some of its supporters said it would be. Nor has it been the catastrophe its critics predicted. NAFTA has, however, definitely linked Mexico's economy ever more closely to the United States, causing Mexico to become much more dependent on the American economy's health. Increased economic integration has, predictably, expanded international trade, but it has not led to improved standards of living in Mexico. Regional integration in North America thus faces two possibilities: deeper integration on political and social issues, or simply continuing along the current path of economic integration.

Those in Mexico who opposed NAFTA at the beginning of the negotiations, like myself, and those who actually negotiated NAFTA, like Jaime Serra Puche, now agree that the next step is to deepen

integration by generating common policies on issues such as migration, economic policy, monetary convergence, joint action on security issues along the border, energy cooperation, and common agricultural policies. Future strategy should be oriented to intensify the links shaped during NAFTA's first decade as well as discussing the possibility of creating a North American economic community by taking advantage of shared needs and values.

One of the necessary adjustments that the agreement requires, debated when NAFTA was initially being negotiated, is the implementation of what is called the principle of compensatory funding. This principle relies on two basic ideas: 1) the adjustment costs of economic integration between three countries of asymmetric development should be compensated; and 2) the least developed country should invest resources in various sectors to compensate for the development differences that exist with its trade partners.

The principle of compensatory funding has been implemented in other economic integration processes. The examples include Spain, Greece, Portugal, Ireland, and now Poland, Hungary, and the Czech Republic, among others, upon entry into what we know today as the European Union. These countries received financial support from other members of the European Union to invest in infrastructure and development projects to attain a more balanced integration process.

NAFTA created an institution to finance projects for the protection of the environment at the border, the North America Development Bank (NADBANK), which adheres to the principle of institutional transfers. However, the scope of the institution is very narrow, which shows why the creation of a fund for North America inside NAFTA is vital. This fund could give assistance to displaced people in Mexico, support unemployed individuals in all three countries, and protect workers directly affected by the agreement. Moreover, this mechanism would correct one of NAFTA's greatest mistakes: the assumption of equal conditions among the members instead of recognition of their asymmetry.

There are two main arguments about the political impact of NAFTA in the Mexican democratic transition. One perspective contends that democratic electoral processes in 1994 and 2000 occurred because of NAFTA. The agreement opened up national events to the scrutiny of international public opinion; therefore, political leaders had to be more cautious about the way politics was carried out in Mexico. Others, including this author,

believe that in 1993 NAFTA perpetuated the authoritarian system for seven or eight more years, allowing the ruling Institutional Revolutionary Party to remain in power longer than it would have otherwise, and thus contributing to a costly delay in Mexico's transition to democracy.

Mexico is passing through a decisive moment, debating whether to continue operating under patterns and structures that worked in the past or embrace changes derived from complex international relations that are moving the country, and the world, in different directions. It is necessary to rethink whether NAFTA is compatible with the traditionally fierce defense of Mexican sovereignty or if the changes occurring in international economic relations do not require a broader transformation of Mexican attitudes, Mexico's relationships with the United States, and many of Mexico's institutions. The main challenge that Mexico faces in relation to NAFTA is how to come to terms with the new economic, cultural, social, and political realities that NAFTA has created with the United States and with the rest of the world. ■

A Current History Snapshot . . .



"[I]n three of the fifteen countries of South America [Peru, Bolivia, and Venezuela], dictatorship and despotism are enthroned. The principle of the 'consent of the governed,' once dominant on this hemisphere, has long been subverted in those three countries; their laws and constitutions have been reduced to scraps of paper, and replaced by imprisonment, the regime of the firing squad, and—merciful by comparison—exile from the fatherland.

How long will the United States give respectful recognition, sympathy and support to such brutal and unconstitutional governments. . . ?"

"Three South American Despots"
Current History, April 1923
 Guillermo Perez [pseud.]