NAFTA in Perspective

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In the last decade, few topics have sparked as broad a discussion as the announcement that a free trade agreement was to be negotiated with the United States. What is more, a guerrilla group picked the day the North American Free Trade Agreement (NAFTA) went into effect, January 1, 1994, to stage an armed insurrection. The head of this group declared, "The compañeros decided to rise up on that day to respond to the death sentence that NAFTA imposes on them (sic)."[1] The political groups, parties and leaders that had opposed the treaty's signing throughout the negotiations magnified the armed uprising with a view to the presidential elections slated for July of the same year. To everyone's surprise, the Institutional Revolutionary Party (PRI) won an undisputed majority of 50.18 percent of the votes and the Party of the Democratic Revolution (PRD), the firmest opponents of NAFTA, only received 17.08 percent. The other opposition party, the National Action Party (PAN), which had not as a block opposed the treaty, was favored with 26.7 percent of the ballots.

These figures were not far from what the public opinion polls said the public's perception and approval rating of NAFTA was. Recognition and support for the treaty grew from 1990 to 1993 and by September 1993, 51 percent of Mexicans approved of the treaty, while only 14 percent disapproved. Of those polled, 21.7 percent declared themselves "indifferent" and 14 percent either did not answer or said they had no opinion.[2]

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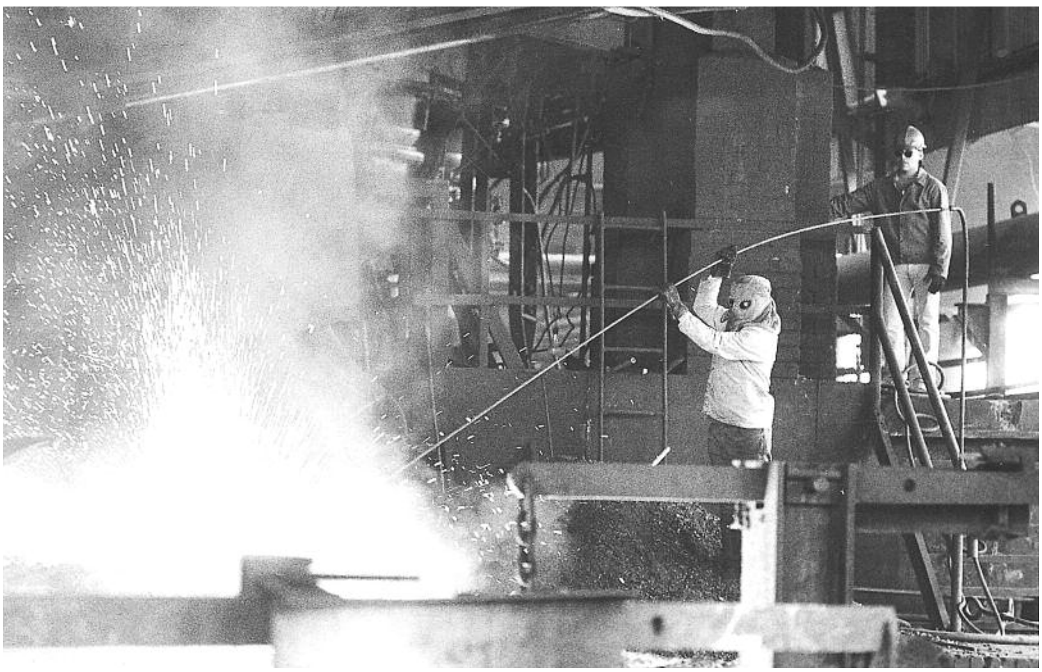

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Six years later, NAFTA was not a campaign issue. Today, it enjoys a broad consensus despite initially having been blamed for the 1995 crisis when, actually, it was what made it possible for the country to get out of that crisis more quickly. These changes in the public's perception of NAFTA deserve to be examined retrospectively.

The Indispensable Opening

Since the end of the 1960s, many voices could be heard warning of the difficulties for the country's continued growth in a closed economy. In May 1971, at a lecture in Austin, Texas, a high, influential government official said that the "inward evolution" characteristic of the previous period had to make way for a more open and competitive model of growth.[3]

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This statement was not made by a technocrat or a neoliberal economist, but by a full-fledged politician, then vice minister of the president's office, Porfirio Muñoz Ledo. He also stated on that occasion, "The increase in export capacity is key to the current economic situation and explains the extraordinary attention that the administration has paid to establishing promotional bodies, tax breaks and financial support. That is why income distribution, educational reform and scientific research and technological adaptability have been spotlighted as strategic factors of development."

Despite the fact that development was properly conceptualized, no viable solutions were proposed, such as Mexico's entry into the General Agreement on Tariffs and Trade (GATT), the deregulation of the economy and negotiating access to other markets. The attempts to promote exports through the now-defunct Mexican Institute of Foreign Trade, created by President Luis Echeverría Alvarez (1970-1976), failed because, as one of its directors said, there was nothing to sell.

Since the economy remained closed, producers did not have access to the low-cost, quality inputs that would have allowed them to compete abroad. What is more, Muñoz Ledo's text itself proposed measures that counterposed the ends being pursued since he also considered it necessary to regulate even further the process of import substitution in order to "more closely tie the production of manufactured goods to the availability of material and human resources." We should not be surprised, therefore, that regulatory measures proliferated during the Echeverría administration that accentuated the Mexican economy's lack of competitiveness. This was the case of foreign investment and the transfer of technology.

In addition to changes on the domestic front to raise competitiveness, in order to promote exports, the importing countries must acquiesce. This obvious thought is relevant because, when negotiations for NAFTA were proposed, some sages proposed signing important treaties with Europe, Japan and the rest of Latin America to "diversify the dependence" on the United States, as though picking trade partners depended only on the will of one of the parties involved.[4]

Muñoz Ledo's lecture contained several messages and one of them, directed at the United States government, was for it to open its markets to Mexican products. The moment was not at all favorable since at that time the U.S. was facing serious balance-of-payments problems that forced it to devalue the dollar and, in August 1971, to impose an additional 10 percent duty on all its imports. Mexican efforts to obtain an exemption based on the two countries' supposed "special relationship" were unsuccessful, as were attempts to gain access to markets of other countries and regions of the world.

To finance his public spending, Echeverría resorted to increasing the country's foreign debt, with well known results. At the same time, the price of oil rose, which gave the Mexican government a breather. But it also delayed the solution to the real problem: the Mexican economy's lack of competitiveness.

For some inexplicable reason, President José López Portillo (1976-1982) refused to take Mexico into the GATT in 1980 as proposed by Finance Ministry economists, headed up by future President Miguel de la Madrid Hurtado (1982-1988). It was not until 1986 that Mexico finally opened its doors to the economic growth that had been limited for 12 years, despite the considerable revenues from oil sales abroad and public and private loans. What is more, these extraordinary revenues had serious repercussions in the country's economy.

Why Free Trade with Canada And the United States?

The first and most obvious answer to this question is that the three governments were willing. But, in addition, in Mexico's case, there were other weighty reasons.

Since the nineteenth century, around 70 percent of Mexican exports and almost 50 percent of its imports had gone to and come from the United States. World War II saw an increase in trade between the two countries and led to the signing of a trade agreement in 1942, although it was abrogated a short time later with the idea of protecting Mexico's incipient industrialization.

Table 1 shows the composition of Mexican exports from 1935 to 1965: the export of mined and extracted raw materials dropped substantially and that of manufactures rose. From the 1970s on, exports of manufactured goods gradually continued to grow: from U.S.$836,400 in 1972, it rose to U.S.$2.4 million in 1977. In the five years from 1978 to 1983, they doubled, jumping from U.S.$3.1 million to U.S.$6.3 million; and from 1983 to 1986, they increased a little over U.S.$2 million, from U.S.$8.2 million to U.S.$10.6 million. By contrast, after Mexico entered GATT, in only two years, exports of manufactured goods rose 70 percent, from U.S.$10.6 million to U.S.$17.4 million.

By 1989, the first year of the administration of Carlos Salinas de Gortari (1988-1994), Mexico was already the third exporter to the United States and its main supplier of television sets, modular sound systems, refrigerators and bathroom fixtures. It was its second supplier of cement, tape recorders and tubing, and its third largest supplier of automobile engines, metal furniture and room fans, among other products.

Mexican exports to the United States came under the Generalized System of Preferences (GSP) created by the U.S. to set up exemptions of duties for all developing countries. This system's benefits were limited: on the one hand, the United States unilaterally decided year after year what products would be included under the GSP. On the other hand, if exports surpassed certain limits, tariff exemptions could be canceled.

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Another Mexican product exported to the United States since World War II has been textiles. Given that this is a very competitive market, in 1973 importing and exporting countries signed what was called the Multifiber Agreement. Two years later, Mexico had to sign another accord on the matter to gain access to the U.S. market, an arrangement which was extended five times, most recently in 1988. Despite the achievements, the agreement restricted the export of woolen suits, pants, skirts, shirts, acrylic thread and cotton fabric, products in which Mexico is highly competitive.

Steel exports also had to be carried out under the terms of the Voluntary Restraint Agreement.

These examples show that the main external problem for increasing Mexican exports to the United States was the lack of a legal framework that would both eliminate tariffs and non-tariff barriers like quotas and create security by establishing norms, procedures and controversy-solving bodies for the frictions that inevitably arose as trade between the two countries grew.

There were sufficient economic reasons, therefore, to seek a legal instrument that would ensure Mexican products access to the U.S. market. As early as President De la Madrid's administration, two "understandings" were signed, one in 1985 and another in 1987; two more were agreed upon during President Salinas' first year

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in office. But neither in his inaugural address nor in the National Plan for Development or the Trade Ministry's Industrial and Foreign Trade Modernization Program of 1990-1994 was mention made of seeking an agreement that went further than these "understandings."[5] The idea was too daring even for a president as audacious as Carlos Salinas.

Everything changed with the 1989 events in Eastern Europe. The breakdown of Marxism made for an ideological vacuum that permitted modernization policies to move forward without any obstacles, and the fall of socialism created a political vacuum that the governments of the European Community rushed to fill. In the February 1990 Davos meeting, Salinas analyzed the prospects and understood the danger of Mexico remaining on the sidelines of the world's political and economic repositioning. Canada and the United States had just signed a free trade agreement in January 1988; Japan and the Asian Tigers were already a de facto bloc difficult to penetrate. And 30 years of good intentions had never blossomed into free trade with Latin America.

A question was planted in an interview with President Salinas in Davos: "What do you think of Mexico becoming part of a North American free trade zone or common market?" The answer was, "We are not thinking of entering into a common market; but, we do want more of a relationship with the United States and Canada." In other words, the president accepted the idea of a free trade zone.

NAFTA's Content

Few people have studied the content of the 1,200-page document itself, and therefore, it is worth summarizing its main chapters before evaluating its initial results.

1. The elimination of quotas and tariffs. Recognizing the differing degree of development of the three countries, it was agreed that more Mexican products would be allowed into the U.S. and Canada without tariffs than U.S. and Canadian products into Mexico. Mexico immediately eliminated tariffs on some goods, mainly those not produced domestically like telecommunications and electronic equipment, airplanes, machinery, etc.

Time frames of 5, 10 and 15 years to totally eliminate all duties on other products were stipulated, a condition that has been gradually implemented, with duties dropping a specified percent each year.

2. Special provisions were made to protect jobs in certain productive sectors, like textiles, which at the time the treaty was signed provided jobs for 800,000 in Mexico, or auto, which at that time employed 450,000 workers.

The quota system was immediately suppressed for textiles and duties eliminated on almost 50 percent of the Mexican textile products exported to the United States. Canada did the same with 19 percent of Mexico's textile exports. Mexico, for its part, immediately eliminated tariffs for 20 percent of its purchases from the United States and 4.7 percent of those from Canada.

In addition, tariffs on Mexican textile exports, which had in some cases gone as high as 65 percent, dropped to 20 percent and have gradually diminished each year and will disappear completely in 2004. This sector, together with the auto industry, is one of those that has expanded the most in the six years since the treaty came into effect.

The United States immediately began to eliminate all duties on automobile exports; export duties on pick-up trucks were eliminated in five years, by 1999, and heavy trucks will be free of all export duties in 2004.

For its part, Mexico eliminated import duties on pick-ups in five years and will levy none on automobiles and heavy trucks after 10. Used vehicles of all kinds will enter Mexico free of tariffs and duties as of 2020. However, reality moves faster than the treaty, as Mexico's illegally imported vehicle problem shows.

3. Mexico has never been an agricultural power. Its mountain ranges and irregular rainfall have rendered it not very competitive in grain production. By contrast, it is competitive in other fields, like the cultivation of flowers, vegetables and fruits, particularly in the wintertime.

Therefore the chapter on agriculture put a priority on the export of Mexican products such as strawberries, flowers and honey and, in the winter, tomatoes, squash, watermelon and eggplant, among others. Since 1994, Mexico has also exported oranges, mangoes, raspberries, blackberries, carrots and canned fruits and vegetables tax free. A similar procedure was followed with exports to Canada.

The United States and Canada benefited from the immediate elimination of Mexican taxes on sorghum, dried fruit, jellies and jams, lentils and Christmas trees, among other things. As of the year 2000, pears, plums, goat meat and vegetable juices are also included. Corn, beans and powdered milk were slated for protection for 15 years. Five years have passed and there is still no clear policy to convince producers in the traditional sector to make use of their comparative advantages in the new market. This is a difficult task because it encompasses economic, cultural and training questions, but it must be the main endeavor of a Ministry of Agriculture.

4. In addition to goods, the three countries exchange services such as transportation, tourism, communications, banking and insurance. All of these were included in the appropriate chapters of the treaty. The recently privatized Mexican banking system had been very protected, which ended up being bad for the country. Very probably, if the country had been open to competition,

TABLE 1
KINDS OF MEXICAN EXPORTS (PERCENTAGES)

	1935	1952	1960	1965
Mining and oil extractive industries	74.5	29.1	17.1	12.5
Agriculture	15.5	39.7	41.8	36.6
Manufacturing	1.0	11.4	12.5	23.3
Tourism and border transactions	9.0	19.8	28.6	27.6
Total	100.0	100.0	100.0	100.0

there would have been no need for the Savings Protection Bank Fund (Fobaproa) and the productive sector would have had access to timely, cheaper credit.

5. Free trade does not imply the total absence of norms, but it does mean that existing norms must be clear and not subject to the whims of one of the parties. Throughout the treaty there are stipulations specifying the rules of the game. For example, it specifies the percentage of parts manufactured outside the North American region that a product may contain to qualify for tariff exemptions. These specifications, known as "rules of origin," are extremely important for the three countries' development.

Also specified are sanitary and phytosanitary measures for the agricultural sector, as well as environmental and technical norms and rules for avoiding dumping and export subsidies. Intellectual property rights were protected and temporary safeguards spelled out.

The growth in exports and changes in their composition have made sales abroad a determining factor in the country's development. The total amount of non-oil exports began to grow significantly because of the economic opening.

Since all these measures can be erroneously interpreted, institutions and procedures for solving controversies were also provided for.

This simple sketch of the treaty's contents provides an idea of the breadth and complexity of the topic that demanded a long, patient negotiation. Many very important interests were at stake since not all the sectors nor all producers were to benefit or be affected equally.

Six Years Later

Since 1990, when the negotiations of the North American Free Trade Agreement were announced, it became the central thrust of government modernization policy. For more than one reason it gave a coherence and political meaning to other measures such as deregulation and the struggle for greater competitiveness. At the same time, NAFTA's economic results have conferred legitimacy on the new model of development. Let us look at the main indicators.

1. *Exports.* The growth in exports and changes in their composition have made sales abroad a determining factor in the country's development.

The total amount of non-oil exports began to grow significantly because of the economic opening. After 1994, the leap was amazing, going from U.S.$40 billion to U.S.$136.703 billion in 1999.

In addition, the composition of sales abroad changed radically. In 1985, oil made up 63 percent of all exports and manufactured products, 30 percent; in 1999, they made up 7 and 90 percent, respectively.

This change has had positive effects on the job market and wages. According to Finance Ministry data, half of the 3 million jobs created since 1995 are linked to exports and employees in those companies earn 33 percent more on the average than employees in non-exporting firms. Companies that export 80 percent or more of their output pay up to 59 percent higher wages than the rest of industry. It should be pointed out that Mexico exports more to the United States than all the rest of Latin America does.

As expected, Mexican imports from the United States increased: from U.S.$27 billion in 1989 to U.S.$142 billion in 1999. The composition of imports is very significant since in 1999 capital goods (machinery, for example) represented 14.4 percent; intermediate goods, 77 percent; and consumer goods, only 8.6 percent. In other words, Mexico imports to produce and produces to export. Although the trade deficit was U.S.$5.36 billion in 1999, this is manageable because there are other sources of income.

2. *Foreign investment.* For many years, dependency theorists saw foreign investment as a threat to the so-called "autonomous development" of less advanced countries. Mexico's Law

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Non-oil exports increased significantly after NAFTA went into effect.

of Foreign Investment, promoted by President Echeverría, was a clear example of this mistrust, since it excessively regulated private capital coming from abroad. Faced with insufficient domestic savings, the government preferred acquiring public debt to private foreign investment.

Changes in the world economy, particularly the internationalization of productive and distribution processes, made dependency theory obsolete, and today, all countries compete to attract capital.

Private foreign investment goes to countries that have greater advantages, not in terms of tax breaks, but in terms of offering skilled labor and above all access to large markets.

In the case of Mexico, the evolution of foreign direct investment (FDI) is very clear: before the economy opened up, between 1980 and 1985, average FDI was only U.S.$1.299 billion annually. From 1986, the year Mexico entered the GATT, to 1993, it rose to an average U.S.$3.468 billion a year, or more than double. Since NAFTA came into effect in January 1994, the yearly average has been U.S.$9.791 billion.

It is very important to look at where FDI goes. Most, 58.5 percent, goes to manufacturing; second, to commerce, with only 13.4 percent; banking, 11.5 percent; transportation and communications, 7.2 percent; other services, 7.1 percent; and construction and other sectors, 1.1 percent.

Thanks to FDI and exports, in a single year Mexico was able to come out of the 1995 crisis, the result of the political problems of the previous year which had led to a loss of confidence and an abrupt flight of capital invested in the stock market. As is common knowledge, President Salinas and his finance minister refused to devalue the peso and left the problem to President Ernesto Zedillo's incoming administration.

> Those responsible for the negotiation and signing of NAFTA always emphasized that it was not a panacea for age-old problems, but rather a unique opportunity to move forward toward their solution. This solution does not lie in the past but in a future based on more education and training.

Final Reflections

Like many others, we must ask ourselves why all this has not meant higher individual incomes.

The first answer is negative, and therefore insufficient. Without the opening of the economy and NAFTA, things would be much worse because Mexico would not have been able to get out of the impasse it had faced since 1970, an impasse in which neither jobs nor wages could grow in a healthy and sustained way because the artificial increase of either led to scarcity or price hikes. Today people have forgotten that wage hikes decreed in that period led immediately to higher prices that canceled out the hikes.

In the second place, we have to take into account that the new development model began to operate in 1986 with Mexico's entry into the GATT and the gradual opening of the economy. After six years, NAFTA is only half way on the road to full opening.

In the 14 years since the new model began to be implemented, it has been necessary to clean up public finances and sell or close hundreds of state companies that depended on heavy subsidies and for the most part were neither strategic nor necessary (like movie theaters, bicycle production, etc.). Also, the generalized subsidies had to be rationalized since, though they did not always benefit those who most needed them, they were a heavy burden on public finances.

In the third place, we must consider that political will on the part of the state is not sufficient to change the development model. The full concert of society is needed, particularly when the new model confers greater responsibilities on the private and social sectors of the economy. The emergence of a new productive culture takes time since it does not imply only training new personnel. It is above all a problem of leadership and entrepreneurial initiative that must be developed by top and medium-level executives and management personnel. Some estimates indicate that no more than 10 percent of Mexico's 150,000 industrial firms export consistently and, as has already been mentioned, wages in these more productive companies are 30 percent higher than average. This means that employees in the remaining firms —that is, the majority— earn less by carrying out tasks that are not very productive. However, Finance Ministry figures indicate that more than 35,000 mostly small and medium-sized industrial companies sell their products abroad.

In the fourth place, demographics must be taken into account, although very few people like to deal with it. If we note that the population of Mexico has quadrupled since 1950, we can see income distribution problems in another light, particularly because no country with scarce resources can create jobs at that rate. In addition, the state was forced to spend enormous amounts of resources on education and health services that would be inaccessible to most of the population if they were in the hands of the private sector. If the state did not have to use such enormous amounts of resources in social spending, it could invest more in scientific research, in the development of technology or in improving transportation infrastructure to increase the country's competitiveness, for example.

On the other hand, the unchecked population growth combined with low levels of schooling and training forces wages down. There are many applicants for even the unskilled jobs available.

Spain, which entered the then-European Common Market late in the game, was able to do it with relative ease since its population growth rate was and is almost nil, and it had an abundance of skilled labor.

Almost all over Mexico, the average population growth rate has dropped, but in Chiapas, for example, it is still around 4 percent.

In the fifth place, we should point out that 1986 was a key year, a dividing line between a protected economy with low productivity and no prospects of growth without inflation, and another economy, competitive and capable of healthy, sustained growth. That moment was also definitive for separating the competitive companies from the ones with low productivity, regardless of their size. It divided the regions and states that knew how to make use of their competitive advantages from those that have not. It also drew a dividing line between productive individuals and those who are not, whether they are professionals, entrepreneurs or management personnel, operators, peasants or medium-level cadre. Today, income is distributed more according to criteria of effectiveness than of privilege. This makes it less difficult to correct, but it will take time. The criterion of effectiveness is, undoubtedly, more democratic than that of privilege.

Conclusions

Modernity has never spread evenly in any country or period in history. The nations considered the most developed, however, are the ones that have been able to extend it throughout their territory by broadening out education, training and culture. The socialist states demonstrated that trying to achieve a more just society without modernizing the productive apparatus —which in turn requires a free market— fails.

Those responsible for the negotiation and signing of NAFTA always emphasized that it was not a panacea for age-old problems, but rather a unique opportunity to move forward toward their solution. This solution does not lie in the past —which was not at all idyllic— but in a future based on more education and training that will grant the majority of the population access to more productive, better paying jobs. This is the only way to close the income distribution gap. VM

Notes

[1] *Perfil,* supplement to *La Jornada* (Mexico City) 19 January 1994.

[2] INDERMEC-Louis Harris poll taken after the approval of NAFTA by the U.S. Congress, published in *El Nacional* (Mexico City), 26 November 1994.

[3] Porfirio Muñoz Ledo, "Apertura política para el desarrollo," a lecture presented at a colloquium organized by the University of Texas Institute for Latin American Studies, published by the Association of University Professors of Mexico, May 30, 1971.

[4] "Las relaciones comerciales de México con el mundo," *Memoria del Foro Nacional de Consulta* (Mexico City: Senado de la República, 1990).

[5] All these documents are included, with their respective sources, in Carlos Arriola, comp., *Documentos básicos del TLC* (Mexico City: Secofi, 1994).