NAFTA and the Future of Integration In North America

Isabel Studer*

The problems of Mexico's countryside have sparked a discussion about reviewing NAFTA.

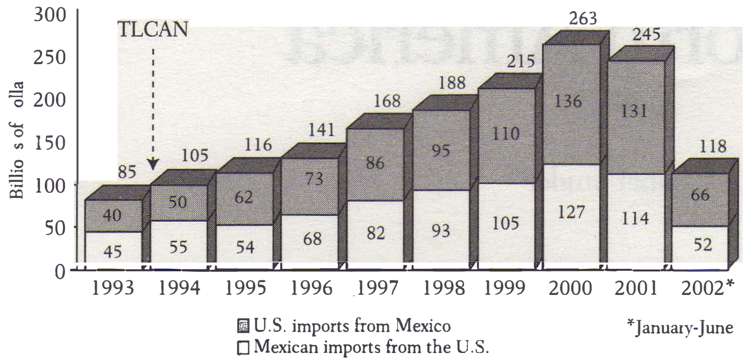
The North American Free Trade Agreement (NAFTA) was a watershed in Mexico's international relations. When it proposed negotiating the treaty, Mexico was recognizing the need to institutionalize its already growing economic integration with the United States, and was willing to develop its until then non-existent links with Canada. Thus, with NAFTA, Mexico tacitly accepted having a common future with its two neighbors to the north.

As soon as he took office, Mexican President Vicente Fox proposed to his counterparts in the United States and Canada to deepen the process of integration in North America. A migratory agreement between Mexico and the United States would establish the basis for a common North American market, adding the free transit of workers throughout the region to the free flow of goods, services and capital. He also requested U.S. and Canadian cooperation to jointly solve the problems of underdevelopment in Mexico and correct the asymmetries among the three North American countries. The terrorist attacks on Washington and New York, however, indefinitely postponed negotiations on these proposals, as well as governmental dialogue about how to advance in North American integration.

The current political situation in Mexico has once again put NAFTA at the center of national public debate because of peasant demands to review and renegotiate its agricultural chapters. If this were to happen, it would set a precedent for reviewing other parts of the treaty, thus opening Pandora's box and most certainly leading to demands by many groups in the three countries, which could mean an end of NAFTA. That scenario would clearly be in detriment to Mexico's interests. In

* Professor and researcher at the Latin American School of Social Sciences (Flacso), Mexico.

GRAPH 1
MÉXICO-U.S. TRADE



Source: Economy Ministry with Bank of Mexico data and USDOC with importing country figures.

order to understand why, it is necessary to explain what NAFTA is, what historic meaning it has for Mexico and what its effects have been on the Mexican economy in the last decade.

WHAT IS NAFTA?

Since Canada and the United States already had a free trade agreement, NAFTA centered on liberalizing trade between Mexico and the other two countries. The reduction of tariffs for a great deal of trade is achieved in a 10-year period, with 15 years for sensitive items like used cars and some agricultural products such as corn. NAFTA also includes the creation of a customs union for computer products, that is, a common tariff for the three countries. With this exception, Canada, Mexico and the United States maintain their own tariffs and trade policies toward third parties, which has made it possible, among other things, for Mexico to negotiate free trade agreements with more than 30 other countries.

NAFTA is not only a free trade agreement, but also introduces innovations that guarantee investors' rights and facilitates the free flow of capital throughout the region. For example, it protects intellectual property rights, impedes distortions in investments, includes the liberalization of financial services and gives national treatment to foreign investors, as well as the possibility for them to appear before supra-national bodies for dispute settlement with any of the governments in North America. It is also the first free trade agreement that includes parallel accords on environmental and labor standards, which aim to prevent lower standards from becoming a competitive advantage for one of the region's countries.

NAFTA'S RESULTS

If measured by trade and investment levels, there is no denying that NAFTA has been positive for Mexico. Its impact on Mexico's trade has been greater than on Canada's and the U.S.'s because Mexico had the highest relative levels of protectionism before the treaty came into effect. Thanks to NAFTA and the more than 30 other free trade agreements Mexico has signed, it has become the world's seventh exporting power and one of the biggest targets for foreign direct investment (FDI). Exports made up more than half the gross domestic product (GDP) growth between 1993 and 2001, reaching 28 percent of GDP in 2001 compared to 15 percent in 1993.

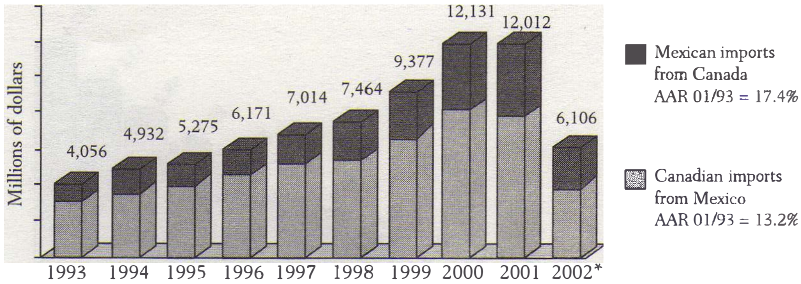
Since the treaty came into effect in 1994, trilateral trade has more than doubled, with a growth of 115 percent, coming to U.S.$622 billion in 2001. In the same period, bilateral trade between Mexico and the United States has almost tripled, making Mexico its northern neighbor's second trade partner, the second largest market for U.S. products and the second largest supplier of goods. Graph 1 shows that in 2001, bilateral trade was over U.S.$245 billion, compared to U.S.$85 billion in 1993. In 2001, Mexican exports to the United States came to almost U.S.$131 billion, 11.5 percent of the value of all U.S. imports, compared to 6.9 percent in 1993. Mexican imports of U.S. products also grew 2.5 times those of 1993 to total U.S.$114 billion in 2001. Although trade between Mexico and Canada continues to be relatively small (about 2 percent of total trilateral trade), it has also grown rapidly, reaching U.S.$12 billion in 2001 (see graph 2).

NAFTA and the many free trade agreements Mexico has signed in the last decade offer certainty to foreign companies in setting up operations in Mexico and in having privileged, guaranteed access for their products to North American markets and those of another 30 countries worldwide. Thus, between 1994 and June 2002, Mexico received U.S.$119 billion in FDI. The United States and Canada are the first and fourth source, respectively, of FDI in Mexico. Between 1994 and December 2001, accumulated U.S. investments came to U.S.$64.7 billion and Canadian investments totaled U.S.$3.8 billion, the vast majority in manufacturing and services. Half of the FDI in North America is intra-regional. These figures indicate the region's level of integration since FDI flows create deeper links between national economies than trade (see graph 3).

While these figures showing a substantial increase in trade and investment are incontrovertible, there is a wide-ranging controversy about the overall impact of NAFTA on the national economy. Some argue correctly that increased trade and investment are not the direct result of the treaty, but rather are trends that already existed from the mid-1980s, a consequence of a series of Mexican government economic measures.

NAFTA's detractors argue that trade and investment figures hide the treaty's effects in terms of distribution. President Fox himself has said that NAFTA is not sufficient to deal with Mexico's development problems and to create enough jobs to stop the continual stream of Mexican workers across our northern border. Critics say that the winners under this treaty, like the electrical, electronics and auto industries —which jointly represent almost half of Mexico's total exports to the United States and which have experienced the country's highest growth rates— are dominated by multinational corporations that tend to sacrifice workers' wages and benefits to maintain their international competitiveness. They also tend to use more technology-intensive than labor-intensive productive processes. According to this more negative viewpoint, this explains why the flow of Mexican workers who emigrate to the United States has not been reversed. However, according to Ministry of the Economy data, companies with FDI have been an important source of better paying jobs in Mexico (in recent years they represent half the jobs created nationwide). In the last analysis, these are jobs that would not have been created without NAFTA.

Graph 2
Mexican-Canadian Trade



Source: Economy Ministry with Bank of Mexico data and Statistics Canada using importing country figures.

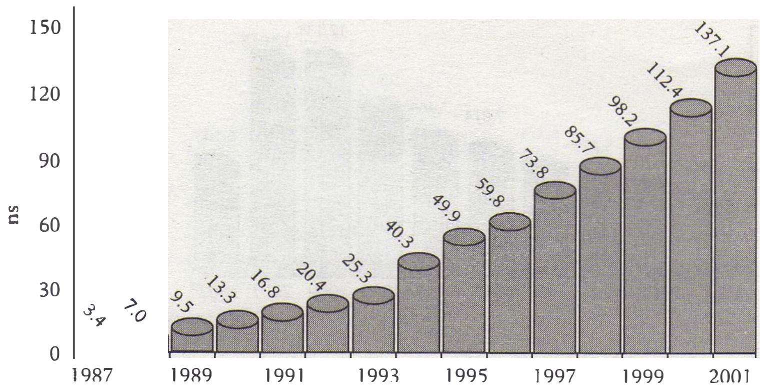
Certainly, the debate between critics and defenders will continue since it is practically impossible to draw up a balance sheet of the global economic impact of the treaty because, on the one hand, economic growth, job creation and industrial performance depend not only on the treaty, but on a wide variety of factors and political and economic decisions made both in Mexico and abroad. In addition, it is difficult to measure other indirect but important consequences of NAFTA.

NAFTA's Significance for Mexico

NAFTA represents Mexico's commitment to continue the process of trade and investment liberalization that began in the 1980s. Through this international treaty, the administration of Carlos Salinas de Gortari sought to anchor the reforms of economic modernization that were introduced in Mexico from the early 1980s, putting an end to statism and the import-substitution model that for almost four decades had restricted both imports and foreign direct investment.

NAFTA was, then, one of the instruments designed by the Mexican government to impose clear rules offering certainty and security to producers, exporters, importers and investors from the region, thus attracting foreign investment to Mexico. This goal had not been achieved with previous trade liberalization measures, particularly with Mexico's entry into the General Agreement on Tariffs and Trade in 1987, and was fundamental for the recovery of the national economy that had crashed with the 1981 financial crisis. NAFTA also had important symbolic value, projecting to the world a radical break with Mexico's past and a new vision of a modern country, ready to face the challenges of globalization and integration with the colossus of the North.

Graph 3
Accummulated FDI



Source: Economy Ministry with Bank of Mexico data.

For some analysts, one of the indirect consequences of NAFTA is having facilitated a rapid economic recovery after the late-1994 financial debacle, as well as macroeconomic and political stability that other Latin American countries have not been able to maintain. This stability has been one of the most important benefits that the United States has gotten out of NAFTA.

For Mexico, the treaty has also meant guaranteed access to the U.S. market, a shield against powerful groups there who can resort to protectionism. Getting that guaranteed access was key during NAFTA negotiations, since the continuance of the late 1980s export success story chalked up by Mexico-U.S. joint industrial production based on the border maquiladora plants depended on it. Investment in this program was endangered by growing opposition from unions and other groups in the United States who opposed sending manufacturing jobs south of the border and the increased Mexican exports that this generated. With NAFTA, Mexican products enjoy preferential access to the U.S. market, although —as can be seen by the U.S. refusal to allow Mexican trucks to cross over into its territory or by the measures to impede the export of Mexican brooms or tomatoes— the treaty's trade dispute settlement mechanisms are not perfect and are still subject to some special interests that manage to use U.S. regulations to protect themselves from foreign competition.

Press reports about these protectionist measures have scarcely helped to increase the already scant popularity of NAFTA among the Mexican and Canadian publics. Neither has it been popular in the United States. From the moment it was proposed, unions and other groups organized to oppose the U.S. government negotiating an agreement with Mexico that did not ensure the improvement of environmental protection standards and the defense of labor and human rights. These demands became an issue in the 1993 U.S. presidential campaign. Independent candidate Ross Perot popularized the idea that Mexico, by exploiting its lower labor and environmental standards, would create a "giant sucking sound," the sound of the massive flight of U.S. investment and jobs. The winning candidate, William Clinton, finally supported NAFTA, but only in exchange for negotiating parallel agreements on environmental and labor questions. These concessions were also necessary for the treaty to be approved by the U.S. Congress itself. From the moment the Mexican government proposed the negotiation of a free trade agreement, it fought an uphill public relations battle to convince certain key sectors in the United States of its importance not only for Mexico, but for the U.S. itself. The Mexican government's lobbying efforts to convince the U.S. Congress to approve NAFTA were enormous. The treaty was approved by 234 votes to 202 in the House of Representatives and 61 votes in favor and 38 against in the Senate, but only after Mexico had made important concessions: these particularly pertained to accepting the parallel environmental and labor agreements, the creation of a North American Development Bank and a Border Environmental Cooperation Commission and adjustments in what had already been negotiated for sugar, some citrus fruits and winter vegetables.

A decade after NAFTA came into effect, it still does not have the staunch, unwavering support of the U.S. public. The current situation, in which Mexico has plummeted on the list of U.S. foreign policy priorities, naturally makes thinking about a more ambitious agenda for integrating North America impossible. But requesting a review of NAFTA could unleash a new political struggle with an uncertain outcome for the treaty itself. Considering the levels of integration of Mexico and the United States reached in the last decade, neither would benefit from dismantling NAFTA. VM