

A Mexican perspective on the FTA agenda

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The shift in Mexico's economic policies

Mexico's decision to seek free trade with the United States and Canada was a result of a number of internal and external factors. Amongst the most important was the opening of the Mexican economy. For over forty years, Mexico's development strategy had emphasized internal growth.

However, the weakness of the world oil market and the scarcity of external funds following Mexico's debt crisis made the Mexican government break with tradition in its import substitution policies, and seek revenues through exports.

In the last five years, Mexico adopted liberalization policies making its economy one of the most open in the developing world. When Mexico joined the General Agreement on Tariffs and Trade (GATT) in 1985, the maximum Mexican tariff fell from a level of 100 per cent to 20 per cent in five years.

Mexican law and enforcement of intellectual property protection is also undergoing changes. Plans to strengthen patent protection and improve the enforcement of trademarks and trade secrets have been

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Gustavo Vega presented the following paper at the Free Trade discussions at the Council on Foreign Relations in New York. This abridged version examines some of the key aspects of the Free Trade Agreement. Well versed in the issues, Vega presents an in depth analysis, using the Canada-U.S. Agreement as a point of reference. He identifies problems and pinpoints areas where Mexico needs to protect its interests.

announced. In May 1989 Mexico made sweeping reforms to its foreign investment regulations, which meant, among other things, allowing up to 100 per cent foreign investment in companies dealing with unclassified activities¹.

¹ This category includes 72.5 per cent of the 754 economic activities within the Mexican economy. Some of the industries are glass, cement, iron, steel and cellulose. For further details, see United States International Trade Commission, *Review of Trade and Liberalization Measures by Mexico and Prospects for Future United States Mexican Relations*. Washington, D.C. USITC Publication 2275, April 1990.

These modifications will make transition to regionalization smoother since the measures required to decrease protectionism in a Free Trade Agreement (FTA) will have a less traumatic effect on the Mexican economy.

Reasons behind the decision to join the Free Trade Agreement

Existing trade between Canada, Mexico and the United States was an important factor in Mexico's decision to join the free trade talks. About 70 per cent of Mexico's trade is with the

United States. Mexico's total trade with Canada (about 2.5 billion) was greater than its trade with all of Latin America. While Canada is the United States' largest trading partner, Mexico is in third place. There is also substantial foreign investment among the three countries.

Mexico's interest in the FTA is partly defensive. Mexico and Canada compete in several export products in the automotive, textile, apparel, furniture, and petrochemical areas. By pursuing the free trade option, Mexico might prevent Canada from gaining a margin of preference through its agreement with the U.S. The consolidation of the European Community in 1992 could also contribute to trade diversion. Thus the FTA becomes an "insurance policy" against U.S. protectionism and a means of insuring access to its largest export market.

The Free Trade Agreement will further open Mexico's borders to imports, forcing Mexican companies to become more competitive. There are two aspects to this issue, and some feel that Mexico will become more vulnerable to U.S. trade policies. Others recognize that as Mexico develops more competitive products, its trade with countries outside the region could become more diversified.

An important added attraction is looking at the FTA as an appropriate precedent for extending free trade throughout the Americas. A single expanding agreement is preferable to a "hub and spoke" system in which the United States signs independent, sequential, bilateral agreements. Although the United States might derive economic benefits from preferences in separate agreements, the technical complications of regulating trade procedures and the resulting increased dominance at the expense of its partners is not in its own best interests.

Options for Mexico-United States-Canada trade talks

There appear to be two basic options for negotiations:

1. Mexico could join the existing Canada-U.S. FTA to form a North American Free Trade Agreement (NAFTA)².
2. An umbrella agreement could be negotiated encompassing Mexico, the U.S. and Canada with the possible addition of a few other countries³.

Pursuing the first course could pose diverse problems that involve specific bilateral needs. Flexibility would be required in dealing with the energy, automotive, service and cultural industries.

A core or umbrella Free Trade Agreement

Article XXIV of the GATT directs that parties to a general agreement eliminate all barriers to almost all trade in goods as a prerequisite to the creation of a valid free-trade area. A Mexico-U.S.-Canada agreement will regulate three types of trade barriers: tariffs, contingent protection measures and non-tariff barriers (NTBs).

The principal tariff issue is the speed with which they are eliminated. Canada and the U.S. agreed to three stages: immediate, in five annual steps, and in ten annual steps. Although the agreement considers safeguards during the transition period (1989-1998) if imports from the other country grow, endangering local producers, no special treatment is

“Mexico, among the most open economies in the developing world”

The essential feature of the core or umbrella option would be "...a common free trade area with common rules for trade in goods among the three economies... [and] a common institutional framework for the North American FTAs⁴."

² See Michael Hart, *A North American Free-Trade Agreement. The Strategic Implications for Canada*. Centre for Trade Policy and Law and the Institute for Research on Public Policy, Ottawa and Halifax, 1990, p. 129.

³ See Richard Lipsey and Murray Smith, "The Canada-U.S. Free Trade Agreement: Special Case or Wave of the Future?" in Jeffrey Schott (ed), *Free Trade Areas and U.S. Trade Policy*. Institute for International Economics, Washington, D.C., 1989. And Richard G. Lipsey, "Canada at the U.S. Free Trade Dance."

⁴ See Murray Smith, "A North American Free Trade Agreement: Agenda and Modalities for the Negotiations." Paper prepared for discussion at a Meeting at the Council of Foreign Relations, New York City, November 5, 1990.

granted to new local industry. The Israel-U.S. Agreement does protect new industries, allowing Israel to introduce and reintroduce ad valorem customs duties, although these will be removed before 1995⁵.

Mexico could take the Canadian approach as opposed to the Israeli, since it is already instituting unilateral tariff liberalization. This position does not take into account massive real exchange rate devaluation and wage reductions (1985-1988) that eased the effects of severe adjustment problems for competing import industries.

However, once the Mexican government implemented the

⁵ See Howard F. Rosen, "The U.S.-Israel Free Trade Agreement" pp. 97-120; also Dennis James Jr., "The Agreement on Establishment of a Free Trade Area between the Government of the U.S. of America and the Government of Israel" pp. 121-130.

Solidarity Pact Program at the end of 1987, the more stable exchange rate did have an effect on competing import industries. Mexico is therefore being pressured to reduce the timetable for phasing out remaining tariffs and easing the adjustment process. Eliminating tariffs over a period of fifteen years (the U.S. and Canada agreed to from seven to ten years) would give Mexican producers better access to the U.S. and Canadian markets while still retaining some temporary protection in the Mexican market⁶.

government procurement practices, quality and safety standards, or quantitative restrictions on agricultural products and similar measures.

Mexico's first and foremost concern regarding contingent protection measures is to obtain free access to markets without the threat of unpredictable political and legal challenges. Mexican industry will be likely to make the necessary adjustments and long-term commitments required to maximize

anticipated. This threat of harassment posed by legal action may deter Mexican investment in new plants and equipment. The Mexican government would need to anticipate potential problems and spell out, as fully as possible, the rules and procedures regulating any bilateral arrangement.

The Mexican government would be well advised to take into account the precedent set by the Canada-U.S. FTA. Canada obtained protection from "side-swiping" in U.S. global safeguard actions (article XIX). The same preferential treatment could be granted to Mexico.

Canada also tried to achieve exemption from U.S. fair trade laws and anti-dumping duties. Although this was unrealistic, the two countries did agree to develop a mutually acceptable set of trade remedy laws within five to seven years. While this is underway (if it is ever accomplished), a "bi-national dispute settlement mechanism" acts as watchdog. It provides for bilateral review of proposed changes in current regulations in either country and calls for specifying the other country explicitly for the law to apply. All changes must be consistent with the GATT and the FTA.

The other function of the bi-national dispute settlement mechanism is supporting a bi-national

“Contingent protectionism is still very much alive”

The low cost structure of Mexican industry is likely to influence the request for extended tariff elimination. A realistic scenario, therefore, might involve eliminating most tariffs over a period of ten, twelve or even fifteen years, providing that each industry is consulted and ready.

Whatever the time frame chosen, I believe that an extensive program of adjustment assistance and global safeguards would be desirable to achieve the benefits of freer trade at the lowest possible cost.

Mexico's exports to the U.S. market are vulnerable to several types of non-tariff barriers. There are two categories:

- Contingent protection measures, such as anti-dumping duties, countervailing duties and safeguard or "escape clause" actions.
- Laws and regulations which, either explicitly or through administrative practice, impose discriminatory burdens on goods of foreign origin through

the economic benefits of free trade only when entrepreneurs and investors are confident of the permanence and effectiveness of the arrangements.

U.S. trade policy is created and applied through decentralized political and legal processes that enhance the influence of relatively small and narrowly based interest groups such as unions and trade associations. The best examples of this power fragmentation are the legal mechanisms that provide producers with contingent protection from import competition.

U.S. producers suffering serious injury from competitive imports have recourse to countervailing duties, anti-dumping duties and emergency protection. The domestic producer doesn't have much to lose when launching a costly lawsuit against foreign rivals, even if the claim is proven groundless.

Since the lawsuits are initiated by private firms, they cannot be

review panel that replaces domestic judicial review. Final decisions are binding on both parties.

It is not likely that the U.S. would agree to exempt Mexican goods from anti-dumping or countervailing duties. Nor is it probable for Mexico and the U.S. to agree on trade remedy laws. The bi-national dispute settlement mechanism would be a better strategy. The success of this system depends on

⁶ See Herminio Blanco, Senate hearings.

“Advantages of a core or umbrella free trade agreement”

the neutrality of a panel from both countries chaired by an impartial person, possibly from a third country.

The second category of NTBs is unquestionably one of the most difficult areas of the U.S.-Mexico trade agreement. It involves the application of phyto-sanitary requirements to agricultural produce and livestock, matters that are currently under negotiation in Geneva.

Other significant NTBs are quantitative restrictions on textiles, steel, apparel and agricultural produce. Mexico made some progress on quotas during the negotiations. Textiles were expanded by 25 per cent; steel doubled. Further, all U.S. quotas will be eliminated by 1992⁷. Even if political pressure extends them, Mexico should be able to increase the present quota levels.

U.S. agricultural quotas are used to restrict trade in poultry, dairy and

⁷ U.S. International Trade Commission, Review of Trade and Liberalization... *Op. Cit.*

meat products. Various subsidies are applied in support of domestic supply management programs. Canada maintains the same restrictions and imposes seasonal tariffs to support farm income. Mexico requires import licenses for sixty agricultural categories (grain, oilseeds, dairy products and others)⁸ as well as establishing quotas for almost all major agricultural commodities.

Intellectual property and foreign investment

Substantial progress has taken place in this area. Major changes in the intellectual property law have been announced which would increase the patent terms to 20 years, protect product and process patents previously unprotected, and strengthen the trade secrets law.

Once the measures have been

“No side-swiping”

The task of harmonizing current agricultural support policies through negotiations is likely to be technically complex and politically difficult. The U.S.-Canada FTA set the reforms in the GATT talks, rather than in a bilateral setting. This same logic could justify deferring free trade for produce.

⁸ U.S. General Accounting Office, *U.S. Mexico Trade: Trends and Impediments in Agricultural Trade*, January 1990.

approved by Congress, Mexico will have instituted greater protection than Canada presently offers. This will facilitate negotiating the point that was one of the most difficult in the U.S.-Canada talks.

The same is true for foreign investment. In May 1989 Mexico liberalized its foreign investment regulations, creating greater transparency, increased potential for foreign participation and more

Highlights of five years of

March 1985

U.S. President Ronald Reagan and Canadian Prime Minister Brian Mulroney met. They agreed to request their respective ministers to explore the possibilities for reducing and eliminating trade barriers.

September 1985

President Reagan and Prime Minister Mulroney exchange letters of resolution to negotiate a Free Trade Agreement (FTA).

October 1987

U.S. and Canadian negotiators sign a draft of the Agreement.

December 1987

The heads of both delegations

ratify the text of the Agreement.

The final version is sent to the U.S. Congress and the Canadian Parliament.

January 1989

The FTA between the U.S. and Canada goes into effect.

March 1990

The Wall Street Journal publishes an article asserting that Mexico and the United States have agreed to initiate negotiations to develop a Free Trade Agreement.

April 1990

The Mexican Senate sets up a forum for consultations on the FTA.

June 1990

The U.S. Senate opens hearings on a "fast track" bill that would allow President George Bush to negotiate directly with President Carlos Salinas. Both Presidents issue a joint communiqué announcing their intention to negotiate a FTA, and instructing their respective trade representatives to explore the possibilities.

August 1990

The Mexican Secretary of Commerce and the U.S. Trade Representative meet and issue a joint recommendation to President George Bush, urging that the U.S. and the Mexican President initiate FTA negotiations.

efficient application procedures. The need for foreign capital will probably accelerate the pace of reforms and reduce the number of exempted sectors.

Problem areas: services and energy

One of the major attractions of the FTA for Mexico is that some sectors can be excluded from bilateral or trilateral negotiations. Article XXIV of the GATT has been interpreted as authorizing the exclusion of up to 20 per cent of the total trade in goods among members of a legitimate free trade area. The Europeans have limited the scope of their agreements to industrial goods. Agriculture, services, transport, insurance and labor are not included⁹.

Although trade in service industries will require special

⁹ See Victoria Curzon Price, *Free Trade Areas, The European Experience, What Lessons for Canadian-U.S. Trade Liberalization*. C.D. Howe Institute, Scarborough, Ontario, 1987, pp. 48 ff.

regulations, it will figure very prominently in the Canada-Mexico-U.S. talks, since all three countries have awarded it a high priority¹⁰. In 1985 services represented 62 per cent of Mexico's gross national product (GNP) and 60 per cent of total employment. Mexico can be considered a service economy¹¹, although service exports only represent about 30 per cent of the total non-factorial receipts. Service imports were about the same 30 per cent.

Even when a country is willing to negotiate, it has to define what to negotiate and how. Services are difficult, first because of insufficient research and therefore little or no

¹⁰ Mexico is one of the few developing countries that supported including this area in the Uruguay Round.

¹¹ See Fernando del Mateo y Françoise Camer, "México frente a las negociaciones de servicios en la Ronda Uruguay" in Blanca Torres (et. al.), *La Adhesión de México al GATT. Repercusiones Internas e Impacto sobre las Relaciones México-Estados Unidos*. México, El Colegio de México, 1989, pp. 359-388.

concrete information. Second, there is no easy way to estimate the effect of liberalizing trade in services. Thirdly, there is still insufficient data on the consequences of existing barriers.

Effective analysis of service trade issues must focus on national regulatory arrangements specific to each service. Government procurement preferences for local suppliers are a major trade impediment in engineering and construction services. However, restrictions and cost increasing regulations on business data transmission are a major irritant to those who trade in financial and business consulting services.

The fact that each particular service industry is affected by regulations that are virtually unique suggests that future negotiations on services should be conducted on a sectoral basis. Mexico has been working on trying to solve this problem. To this effect, a survey was conducted by the Ministry of Trade and Industrial Development in collaboration with the private sector.

free trade negotiations

September 1990

President Carlos Salinas appoints an Advisory Committee for FTA negotiations and informs President George Bush that Mexico intends to sign a Free Trade Agreement. President Bush sends a bill to Congress so negotiations can be initiated. Canada expresses its desire to join the largest trade bloc in the world.

February 1990

President Salinas, President Bush and Prime Minister Mulroney agree to start trilateral negotiations for setting up a North American FTA.

May 1991

The U.S. House of

Representatives votes in favor (231 to 192) of approving the "fast track" for negotiating the FTA with Mexico.

The U.S. Senate also approves the motion (59 to 36) to give President Bush the authority to negotiate.

June 1991

Trilateral negotiations between Canada, Mexico and the U.S. are initiated in Toronto, Canada. The issues discussed include access to markets, trade regulations, investment, technology transfer, services and settlement of disputes.

August 1991

The ministers of commerce

of the three countries meet for a second time in Seattle, Washington. They agree on a gradual reduction of tariffs, to be carried out in three stages, on all products to be imported and exported between the three countries. They resolve to make an in depth analysis of the restrictions on government purchases in the three nations. In addition, a working group is created to strengthen the Mexican assembly plant program. The governors of the fifty U.S. states express their support for the negotiations.

The results indicate that Mexico would be willing to negotiate in 14 service sectors¹². Negotiations would only consider trade in services, not investment flows. The latter would be negotiated independently.

One important point made by all the survey participants was that opening the service sector to outside competition would force local industry to become more efficient and competitive. The areas where Mexico is willing to grant concessions include: tourism, insurance, telecommunications, informatics and engineering services. Mexico would like to receive concessions in engineering, construction and other labor intensive services.

no doubt, be a thorny one, as it was in the U.S.-Canada Agreement.

Another difficult area is energy. This is a sector that calls for a specific bilateral agreement between Mexico and the U.S. The Mexican government insists on excluding the area from negotiations. However, I feel that this does not mean leaving bilateral trade rules out. It is my opinion that Mexico's main concern with natural resources is whether the Free Trade Agreement will restrict our ability to impose production quotas, taxes and export controls for national security and industrial policy purposes. GATT regulations specifically provide for such controls, unless they are discriminatory or

vehement about Mexican involvement. Foremost among their concerns are the issues of wages and environmental controls.

Assembly operations in Mexico take place primarily in *maquiladora* (in-bond) plants. These industries were first established along the Mexico-U.S. border in 1964. American industries were permitted to import components, pay Mexican wages to employees (mostly women) to assemble the product and return it to the U.S. American and Canadian labor leaders stress that the in-bond *maquiladora* plants displace American and Canadian workers. Further, they claim that a serious erosion of Mexican standards of living and human rights is taking place. In effect, these leaders are recommending that any trilateral agreement with Mexico include the acceptance of common standards for workers, social policy and environmental protection.

It is not realistic to expect Mexico to sign a social charter guaranteeing equal wages. It is difficult for developing countries to attract industry without the wage incentive. Let it be said, though, that wage levels at the in-bond *maquiladora* plants are about double those in other places in Mexico.

The nature of the *maquiladora* program is undergoing change. "Second wave" industries are investing substantial amounts of capital in complex technology. They produce more sophisticated products in the automobile related industry and in advanced electronics. The number of male workers¹³ employed has increased from less than 20 per cent

¹³ Jorge Carrillo, "Transformaciones en la Industria Maquiladora de Exportación" in Bernardo González-Aréchiga and Rocío Barajas Escamilla (ed.), *Las Maquiladoras: Ajuste Estructural y Desarrollo Regional*. El Colegio de la Frontera Norte - Fundación Friedrich Ebert, Tijuana, México, 1989, pp.37-54.

“Services, energy, labor and the environment: sensitive areas!”

Sensitive issues

This brings us to what may well be the principal stumbling block in service negotiations between Mexico, the U.S. and Canada. While the two latter countries are likely to focus on areas such as financial services, telecommunication and informatics, they are reluctant to liberalize trade that involves labor displacement or utilization, where Mexico has the advantage.

The disparity in wage levels will certainly arouse concern among industries and workers faced with increased competition, making it difficult for the U.S. and Canada to include this issue in the FTA. However, Mexico's recent reforms in financial services and willingness to provide greater access to its service market may very well put pressure on the U.S. and Canada to accommodate Mexican concerns about trade in labor intensive services themselves. The issue will,

¹² We refer to the Uruguay Round, not specifically the U.S. or Canada.

act as disguised restrictions on international trade.

The United States will probably seek legal assurances of access to future Mexican energy supplies, as in the Canada-U.S. Agreement. Any guarantee to U.S. consumers must recognize Mexico's authority to limit exports to meet anticipated domestic requirements. Article XX(g) of the GATT authorizes signatories to maintain non-discriminatory measures that involve the preservation of non-renewable resources, if the measures are consistent with restrictions on domestic production or consumption. A similar stipulation could be included in any general agreement covering trade in natural resources.

Although the U.S. and Canadian governments, as well as many economists and private enterprise groups favor a NAFTA that includes Mexico, the issue has become a contentious one. Labor movements in both the U.S. and Canada generally opposed the initial Canada-U.S. agreement and are now even more

The Trade Liberalization Process

	Rates	Tariff level	Average tariff	Controlled items (%)	Free items (%)
1982	0-100	16	—	100	0
1983	0-100	13	—	100	0
1984	0-100	16	—	64	35
1985	0-100	10	11.17	10	90
1986	0-45	10	13.49	8	92
1987	0-20	5	10.43	4	96
1988	0-20	5	5.60	8	92
1989-					
1990	0-20	5	11.00	3	97

Trade liberalization started in 1985 when Mexico formally applied to enter GATT, with full membership attained the following year. By the end of 1987, official prices were eliminated as the basis of tariff levies, and substantial tariff reductions were implemented in early 1988 as part of an ambitious, and so far successful, anti-inflation program. Today the average tariff is only 11% and, more importantly, there are now only 5 tariff levels ranging from 0% to a maximum of 20%, down from 16 levels and a maximum levy of 100% in 1983. With regard to non-tariff controls, the reduction was dramatic: nine years ago, 100% of imports were subject to some form of quantitative restriction: by 1989, such barriers applied to only 3% of Mexican purchases abroad.

Source: MEXICO: AN ECONOMY ON THE MOVE, Department of Economic Studies, BANAMEX (Banco Nacional de México).

ten years ago, to about 35 per cent, today. That number is as high as 50 per cent in some sectors, such as transportation equipment¹⁴.

The "new maquiladora" phenomenon is positive for Mexico's

development. While earlier plants generated foreign exchange and jobs, now workers are trained and sophisticated products are assembled with an increasing number of locally produced components (an increase

from 1.7 to 6 per cent). Further, there are now in-bond plants as far south as Guadalajara.

International differences in tolerable levels of environmental risk exist owing to the way that standards in each country tend to vary with income levels. Low income economies recognize environmental and health risks but cannot afford regulation structures such as those in prosperous countries. Mechanisms must be developed to accommodate differences in national priorities originating in economic and cultural realities.

One possibility would be to establish intermediate standards, parallel to the concept of intermediate technologies. This would not mean downgrading U.S. and Canadian regulations but rather upgrading Mexican standards while recognizing that the social cost must be relative to national income.

The fact remains that there is already considerable economic integration among Mexico, the United States and Canada. Mexican liberalization measures have made a North American Free Trade Agreement more feasible today than ever before. Although labor in the U.S. and Canada oppose the agreement, we would hope that negotiations will not cater exclusively to special interest groups, but rather work towards improved benefits and lower costs for all three countries as a unit **M**

¹⁴ Harley Shaiken, *Mexico in the Global Economy: High Technology and Work Organization in Export Industries*. Monograph Series, 33. Center for U.S.-Mexican Studies, UCSD, La Jolla, CA., 1990, p. 12.