

MAQUILADORAS AND FREE TRADE

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Most people think of maquiladoras as precursors to free trade, since they entail tariff exemptions on movements of intermediary goods across borders; some even consider it to be an indicator of what is to come under NAFTA. However, there has also been an important protectionist element in this type of production. I think the worst aspects of maquiladora production are directly related to this protectionism that will disappear under NAFTA. The purpose of this article is to explain briefly how protectionism worked, how it will change, and on that basis, pose the question of how free trade will impact the low wages and the insignificant use of Mexican intermediary goods that have characterized the maquiladora industry from its inception 30 years ago.

Without denying the overriding importance of Mexican protectionism, the United States Harmonized Tariff Schedule 9802.00.80 is the most im-

portant single element that has kept the maquiladoras from evolving beyond the limits of an underpaid assembly industry. This tariff provision deals with intermediary goods of U.S. origin, temporarily exported and then re-imported. It exempts U.S. duties on these goods if, and only if, they are still recognizable when the finished product is returned to U.S. customs territory. Therefore, any industrial process over and above assembly that transformed these goods substantially is precluded because, were they unrecognizable, the Mexican maquiladora would have to pay U.S. tariffs on the value of the U.S. components, even though it had not been instrumental in manufacturing them. Since the vast majority of inter-

mediary goods used in Mexican maquiladoras is of U.S. origin, it has been essential for them not to lose the tariff-free status of U.S. intermediary goods.

Even a small tariff on the total value of maquiladora products would represent a very high rate of protection when calculated on the basis of its value added to the U.S. components. Whereas the nominal rate of protection might be insignificant, the effective rate on value added in Mexico would be prohibitive. For example, a three percent nominal tariff, were it based on the entire value of the maquiladora product, could mean an effective 70 percent rate on the value added by the maquiladora. Therefore, it is not surprising that this tariff has acted as a deterrent to manu-

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facturing beyond assembly. Assembly work, in turn, has generally required an unskilled work force, thereby explaining the fact that, since data began to be collected in 1975, maquiladora workers have seldom made more than a little over 50 percent of the average wage in formal manufacturing establishments.¹

NAFTA offers an alternative to this situation by freeing maquiladora goods from U.S. tariffs if their component parts are of North American origin.

¹ This example is developed in: Monica Gambrell, "La política salarial de las maquiladoras. Mejoras posibles bajo el TLC," in *Comercio Exterior* (Banco Nacional de Comercio Exterior), Volume 44, Number 7, Mexico City, July 1995, pp. 543-549.

So, it will no longer matter whether U.S. intermediary goods remain essentially unchanged by assembly or whether they are totally transformed by a complex manufacturing process. As of January 1, 1994, NAFTA eliminated U.S. import duties on 81 percent of goods previously exported by maquiladoras to the United States; 7 percent were already duty free in the United States before NAFTA came into effect, and the remaining 12 percent was scheduled for gradual removal thereafter.² This rapid liberalization of U.S.

² These figures, as well as data for opening the Canadian market to maquiladora goods, are

tariffs on maquiladora products eliminates a deterrent to upgrading the productive process in maquiladora plants, but the degree to which it will be taken advantage of remains to be seen.

Although this makes us optimistic about the possibility of bettering wages, 1995 data show that two years after NAFTA went into effect, the aver-

presented in Monica Gambrell, "NAFTA and the Mexican Maquiladora Industry: Implications for Canada" in Christos C. Paraskevopoulos, et al. (ed.), *Economic Integration in the Americas*, Edward Elgar, Cheltenham, U.K. and Brookfield, U.S., 1996, pp. 78-87. It should be said in passing that Mexico also permits the sale of maquiladora goods in their market.

age wage in the maquiladora industry was still only 56 percent of the average wage in manufacturing. This is even less than 20 years earlier when, for 1975, wages in the maquiladoras were 59 percent of those in manufacturing as a whole. So, there is no statistically observable improvement in wage levels in maquiladoras. Likewise, when controlling for inflation, real maquiladora wages fell 48 percent between 1976 and 1995, whereas real manufacturing wages fell a bit less, by 45 percent. Undoubtedly it is still too soon to conclude anything definitive about the impact of free trade on wages in the maquiladora industry, but the results to date are worrisome.³

A similar situation exists with respect to the degree to which the maquiladora industry integrates Mexican intermediary goods in their final products. Although one might expect that the elimination of normal U.S. tariffs on Mexican content would lead to their increased use, the immediate reaction to NAFTA has been to reduce the percentage of Mexican intermediary goods to 1.5 percent for both 1994 and 1995, compared to 2 percent in 1992 and 1.8 percent in 1993. The degree of national integration has always hovered around these figures, so, again, nothing final can be concluded on the basis of two years; but it is not encouraging to think that the end result of NAFTA might be to reduce Mexico's relative

participation in supplying the maquiladora industry with intermediary goods even further.

NAFTA opens the Mexican market to maquiladora products, gradually eliminating the non-tariff barriers that had effectively blocked their sale in Mexico while also reducing tariffs. The first year of NAFTA, maquiladoras had the right to sell 55% of their previous year's exports in the domestic market; the second year, 60%; the third year, 65%; and so forth until the eighth year, when there will be no more percentage requirements. NAFTA tariff reduction proceeds simultaneously with this eight-year liberalization of non-tariff barriers on maquila products; during this period almost all tariffs will be eliminated among member countries, thus completing Mexico's opening to free trade.

What will the balance of free trade in maquiladora products be at the end of the road? If there is no major improvement in value added in Mexico, both in terms of wages and the integration of intermediary goods of Mexican origin, the situation could

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Maquiladora workers' wages have not improved under NAFTA.

be significantly worse for Mexico under the influence of free trade; before, at least, a surplus in maquiladora trade was guaranteed. ❧

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³ Calculated on the basis of data from Instituto Nacional de Estadística Geografía e Informática, "Estadística de la Industria Maquiladora de Exportación" and "Estadística Industrial Anual" as well as Banco de México, "Índice de Precios al Consumidor."