Mexico in North America: The Relegated Neighbor?

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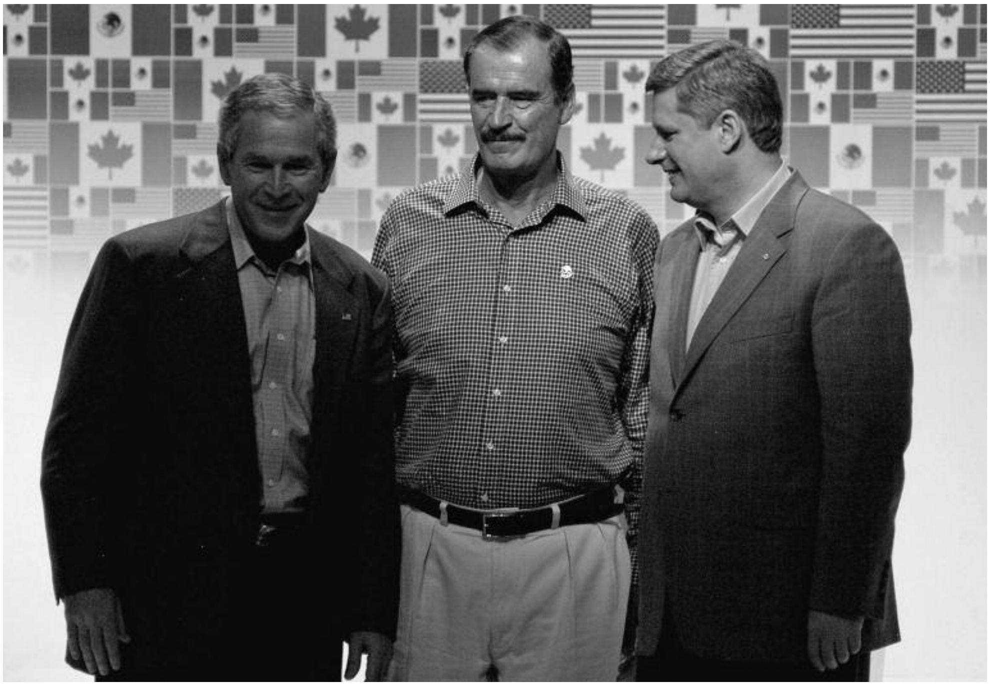
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The three chief executives at the Cancún meeting.

A Region with Growing Gaps[1]

Mexico's economic evolution over the past 20 years reveals many contrasts. On the one hand, remarkable achievements in terms of stability; on the other, meager results overall in growth, social cohesion and convergence of income and development levels. It would seem that Mexico has not fully capitalized on 12 years of NAFTA, macroeconomic stability and the modernization of its electoral system.

Despite progress in combating extreme poverty, the country is increasingly fractured between those who have benefited from two decades of market-oriented policies and those who have not; between those who crave entrenchment and blame current economic policies for every imaginable predicament, and those who suggest that much more has to be done along the same policy lines pursued since the 1980s.

The bottom line is that either Mexico comes up with a new consensus, or failed scripts from the past might again become the roadmap to the future. In the context of rapidly growing competition from the likes of China, the nation needs to refocus and attain a sense of urgency.

Twelve years into NAFTA, both the achievements in economic integration and the failures in convergence coexist. The wage and per capi-

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ta income gaps between Mexico and the United States have not narrowed. Regional integration has not brought about convergence between the countries or within Mexico —the North and the South are increasingly diverging—, and prosperity will not trickle down by virtue of open markets alone. Closing these gaps is by far the main challenge Mexico faces.

As in all trade blocks in the world, North America shows a rapid trend toward regional economic integration. In 1980, a third of the three countries' foreign trade was intra-regional; today it represents close to 60 percent. These internal flows grow at unprecedented rates, and their composition changes substantially along the way.

However, convergence is not simply a by-product of integration. Regardless of whether one thinks of globalization and free trade as necessary conditions for development or not, they are clearly not sufficient. To close income gaps, improve social conditions and foster competitiveness, price stability and trade openness are not enough; additional wide-ranging economic reforms are needed.

DOMESTIC REFORMS

Sadly and paradoxically, comprehensive reforms fall victim to the inexorable failure of partial reforms. Political trends throughout Latin America seem to suggest that economic stability and openness are the culprits for growing inequities and pervasive poverty, generating a rallying cry against further economic reforms.

Partisan politics in Mexico has also created a strident debate around the need for so-called structural reforms.

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But beyond labels, postures and extremes, there is a basic consensus that suggests current conditions are not acceptable. Something needs to change in order to build on a hard-earned platform of stability and connections to the world economy and extend benefits to the bulk of the population.

Assessments conducted annually by organizations like the World Economic Forum and the Institute for Management Development (IMD) capture perceptions on competitiveness. Mexico has consistently ranked very low, but the most disturbing fact is the rapidly sliding trend. This reflects a perception that ultimately diminishes Mexico's allure as a destination for foreign investment, and it depicts the reality of a downward slope in many underlying factors, such as investment in infrastructure. Clearly, Mexico is increasingly uncompetitive in an increasingly competitive world.

Competitiveness calls for objective conditions and the right ethos and attitude. It requires a penchant for excellence and consistent effort.

In Mexico there is a scarcity of clear evaluations and effective plans, and a diminished ability to persuade and create consensus in terms of the reforms required. There is an essential lack of drive and sense of urgency in view of the tremendous dynamism of countries that have embraced competitiveness as a national priority.

Countries as diverse as Spain, Ireland and Chile have widely different development strategies, but also common denominators in terms of improved productivity and competitiveness through better fiscal and labor regimes, quality of education, good governance, solid institutions, investment in basic infrastructure, environmental accountability and the rule of law. This has allowed them to grow and to do so along more egalitarian paths. Few analysts have provided a comparison with these countries that only a few decades ago were poorer than Mexico, elucidating the common factors that explain their success.

Time is of the essence: Mexico's population is not exempt from the aging trends around the world. The demographic bonus from Mexico's age structure will last 20 years at most. That is the timeframe to achieve radical improvements in productivity, through sweeping reforms in education and infrastructure. Mexico will face incremental costs for closing development gaps as the population ages.

CONTRASTS WITH EUROPE

Useful leads for cooperation can be found in the European experience despite its different origin and nature and its marked preference for institutional over market schemes. Clearly, the structural, cohesion and pre-accession funds channeled from rich countries to the poorer regions in Europe have been instrumental in success stories seen in countries like Ireland, Spain and Portugal over the past 25 years. They continue to impact the infrastructure base throughout the continent, narrowing disparities and bolstering integration and competitiveness remarkably.

But for those resources to flow, Spain, Portugal, Ireland and others had to do their homework. Improved governance and modern institutions at all levels, a reformed judicial system as the basis for rule of law, a revamped educational system and a legal framework conducive to broad private sector participation were prerequisites for those countries' notable evolution, and they are a constant in all rapid development processes.

It is very telling that Spain and Mexico had similar levels of gross domestic product per capita 50 years ago; today Spain doubles that of Mexico. For reasons of history, heritage and cultural affinity, Spain's experience should be particularly relevant for Mexico. If better known in Mexico, it would emphasize the requirements and hard work entailed in Spain's accession and integration process with the rest of Europe.

The convergence process in Ireland, Spain and Portugal has been remarkable. Mexico can concoct many excuses for not closing the gap with the United States, but what can be said when compared to Spain or Portugal?

Beyond a huge contrast in demographic growth, how do we explain that sharp difference in development and convergence paths? In essence, thanks to a basic consensus and a political compact with a commitment to pursue and preserve crucial elements of stability, economic openness and a platform to bolster competitiveness, regardless of which party is in power.

The same has been true in every successful democracy in the world, with broad differences in strategy but concurrence in the central elements. It is unfortunate that the huge political capital amassed in Mexico in 2000 was not applied to a broad reform of the state and achieving an agreement on the more relevant societal reforms. Historic opportunities of that nature are few and far between.

Throughout Latin America, the contrast with Europe has been explained by the availability of structural and cohesion funds that have flowed from rich to poor regions in that continent over recent decades. There seems to be a rather naive interpretation of that experience.

No doubt, these funds have played a significant role. But one must take into account the great domestic reform efforts by the countries that have joined the European Union. Far-reaching reforms have preceded and conditioned development assistance funding and have allowed for investments in infrastructure and education to be successful and productive.

In any event, North America is not Europe. The history of two world wars was the backdrop in Europe for a determination to integrate. There is no similar feeling of belonging in North America. The asymmetries among countries at the outset were greater in the context of NAFTA. And there has not been a Schuman, a Monnet or a Delors at hand in North America, with the vision and arguments to surmount domestic resistance to a more profound and equitable integration.

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More importantly, there is a negative reaction in government and political circles in Washington —and to a certain extent in Ottawa— toward anything that resembles supranational institutions. Trust is placed in markets, not institutions that are envisioned as bureaucracies. To be fair, Mexican analysts tend to romanticize the European experience. It is not perfect at all: it is plagued with inefficiencies and squandering of resources. But while Brussels bursts with a cumbersome, profligate and bureaucratic institutional base, North America seems anemic by comparison.

All this does not mean that one cannot take advantage of lessons —both good and bad—provided by the experiences of Spain and other countries close to Mexico by culture and history, both as a reference and a stimulus. A particular challenge that can profit from these experiences is the agenda for cooperation for development.

A Partnership for Development In North America

Despite the huge inflow from oil exports in recent years, Mexico continues to face urgent investment needs in infrastructure and basic services. Many of the vital services for communities —such as water and wastewater— do not have the managerial, political and financial conditions needed to attract private financing and investment. Lags in these sectors will continue to negatively impact development gaps, in detriment to the region's competitiveness.

As reports from the Mexican Institute for Competitiveness and others indicate, public-sector investment in infrastructure as a percentage of GDP has diminished drastically over the past 25 years, and it has not been compensated by the private sector. A decision to leave many of these projects in the hands of the private sector has not been matched with the creation of a legal and contractual environment conducive to an effective private-sector role.

To cater to these lags, some analysts have suggested the creation of development funds for infrastructure and education, with contributions from the U.S. and Canada. Much has been written on the subject.

Several high-level scholarly and business panels —among them, the ones sponsored in the U.S. by the Council on Foreign Relations and the Woodrow Wilson International Center for Scholars— have also debated and published at length on these ideas in recent years, comparing notes with the Europeans along the way.

Based on those discussions, some key considerations for the success of a potential joint agenda for regional development would be:

1. Macroeconomic conditions in the United States that will prevail in the foreseeable future —fiscal and current account deficits— create a particularly difficult environment for the allocation of funds to contribute to Mexico's development. Furthermore, according to recent opinion polls, improving the standard of living of a developing nation is not exactly a priority for the average American.

   An answer must ultimately be found to the most recurrent question in political circles of every stripe in Washington: "What's in it for me?" In order to spur a viable and effective cooperation initiative, Mexico will have to factor in U.S. domestic political imperatives and arguments having to do with security, market expansion, immigration, and competitiveness *vis-à-vis* other regions, as well as Hispanic political agendas.
2. Cooperation has not and will not evolve naturally; it needs to be enhanced. The initiative will have to come from Mexico. It will require a capacity to create consensus and persuade within Mexico and abroad.

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The opportunities and sources of support in the U.S. are not abundant; Mexico must cultivate them. Whether one thinks highly of the results or not, Mexico achieved a significant presence in the U.S. during the negotiation of NAFTA, gaining a voice in government, business, academic and civic circles at different levels. That lobbying capacity —in its broadest connotation— has regrettably dwindled since.

It needs to be rebuilt judiciously. The linchpin for that effort should be the joint gains that could derive from greater cooperation in security, market expansion, energy, regional competitiveness and demographic matters.

The Security and Prosperity Partnership of North America is a positive step and initial framework. It recognizes that infrastructure, transportation, logistics and security are pillars of a competitive North America as a whole. But new initiatives should go beyond simple reorientation and expansion of existing programs. Moreover, sub-regional initiatives that are proliferating mainly among border states and communities in the U.S. and Mexico represent a valuable addition to a bilateral cooperation agenda, based on the increasing decentralization of Mexico's political environment.

3. A clear and detailed idea of the purpose and content of a development fund will be needed: what it would be used for, how it would be applied, the potential sources of funds, their management, the covenants, etc. For it to be palatable in most circles north of the border, it would have to be structured as investment, not as aid.

   An initial portfolio must privilege projects with the greatest potential for success and with clear positive impacts on both sides. It must aim at leveraging resources for infrastructure, education and technical assistance —the latter, mainly to improve good governance and credit capacity at a local level.
4. So far, the only instance of a bilateral fund for infrastructure development in operation in Mexico with U.S. resources is managed by the North American Development Bank (NADBank). To date, it has applied close to $500 million non-reimbursable U.S. dollars to projects on both sides of the border. Despite its limited magnitude and focus —water and wastewater along the border

communities, applied *pari-passu* with Mexican funds— it represents a valuable and effective precedent appreciated by both sides. An important lesson is that these limited funds must be applied in a way that spurs private investment, via seed capital, technical assistance and revolving fund schemes.

5. Only an institutional base trusted by all will allow for further resource transfers and productive interaction. Clearly, political junctures and federal budgets are not propitious for the creation of new institutions; those in existence, such as the NADBank, must be used to their utmost potential.
6. The European experience must be used as an important reference and source of lessons, but should not be framed as a model. Advocating for a European "model" in Washington and Ottawa is a recipe for disaster. Those who have negotiated and managed financial resources on a bilateral basis can attest to that.
7. For historical reasons, regional integration and cooperation for development in Europe were driven more by security concerns than by market interests. A federalist project with common governance elements evolved incrementally. NAFTA emerged in a totally different context. Today, the new foreign affairs paradigm in the U.S. revolves around security. Mexico should frame a proposal for a development fund with that in mind.
8. One must underline that little can be achieved in the absence of improved fiscal, energy, labor, municipal, educational and rule-of-law conditions in Mexico. No foreign assistance would truly be feasible or effective in their absence. A development fund should be construed as an incentive for reforms.
9. A national development strategy cannot depend on uncertain cooperation funds that could possibly come from abroad. Nothing exempts a country in today's world from putting its house in order, call that structural reforms or whatever label one may want.

The Inevitable Vicinity

The U.S.-Mexico relationship is one of historical and current contrasts. Nowhere else in the world do two realities as different as these —and yet so interdependent and mutually influenced— cohabit.

These realities require new ways to manage them that, mindful of history, recognize global economic, social and demographic trends, unimaginable in the recent past. A new vision for North America is clearly needed.

Improving the quality of life and income distribution through productivity and competitiveness should represent the core of such a vision on the Mexican side. It must be the focal point of a new regional partnership. This requires first and foremost rethinking the kind of integration that is evolving, structuring a coherent proposal to submit to Mexican society and present to its northern partners, and advancing domestic conditions that the country —and the partnership— require.

For better or for worse, the United States and Mexico are inextricably bound to each other. Geography is destiny. How do we foster today a "common security-common prosperity" agenda?

To begin with, there is a very low public consciousness of shared "North American" interests. A stronger and more fruitful integration calls for greater awareness and diffusion of the North American experience and its prospects and opportunities, as a basis to articulate a broader vision and to build constituencies to pursue it.

The longest border between the developed and the developing world, where many issues and challenges do not recognize political boundaries, requires a new way for governments at all levels to respond to a reality of complex, varied and far-reaching integration processes taking place. But while a growing proportion of Mexicans not only long for the opportunities available beyond the northern border but actually pursue them there, a substantial portion of the political class has no clear idea of what Mexico aspires to from its North American condition. This must change urgently; otherwise, Mexico will increasingly become the relegated partner.

To close the gaps and to shed the "relegated" condition, cooperation from the U.S. and Canada is clearly desirable. But the challenge for Mexico will continue to be essentially domestic. VM

Notes

[1] This article is an updated version of the author's speech at the Colloquium on the Joint Statement on the Security and Prosperity Partnership of North America (Mexico City: UNAM/Secretaría de Relaciones Exteriores de México/Universidad de las Américas; November 17, 2005); and Raul Rodriguez-Barocio, "América del Norte: ¿Un futuro de integración sin convergencia?" José Luis Machinea and Andras Uthoff, comps., *Integración regional y cohesión social* (Santiago de Chile: United Nations Economic Commission for Latin America and the Caribbean/Secretaría de Relaciones Exteriores de México, October 2005).