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The Unending Campaign against NAFTA

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Cuernavaca, Morelos, Mexico. Many Mexicans and Americans display vague misgivings about the North American Free Trade Agreement; their comments indicate that this is largely because the agreement did not turn out to be a development panacea. As far as I am aware, not a single scholar connected with its conception and launching thought the agreement could stand alone in promoting Mexican development. Neither did the Mexican negotiators. A common view in Mexico is that NAFTA mostly benefited the United States. In the United States it is thought that it mostly benefited Mexico.

A recent publication of the Carnegie Endowment for International Peace ties deficiencies in Mexican economic and structural policies to the existence of NAFTA, even as the article acknowledges that the agreement stimulated substantial increases in Mexico's exports and receipt of foreign direct investment (FDI).[1] The authors fault Mexico's emphasis on tight fiscal policy over exchange rate competitiveness (I take this to mean a recommendation for a little more inflation), weak tax collection, and falling public investment, and then assert the following: "None of these domestic policies was mandated by NAFTA, though they are largely consistent with the model in which NAFTA was a central component." An essential element of the trade model they recommend is that Mexico should pursue a government-mandated industrial policy (Mexico should pick the winners and then subsidize them). The authors are not explicit on what they mean by a "competitive" exchange rate, but references to China imply that they believe the Mexican peso should be undervalued with respect to the U.S. dollar and thereby serve as a stimulus for exports to the United States. I will comment on these recommendations later.

NAFTA was an important agreement for Mexico because it embraced close relations with the United States. It was controversial in the United States because it was the first such agreement with a developing country of consequence whose wages were only about 15 percent of U.S. manufacturing wages. U.S. labor unions were against NAFTA at its birth and continue to oppose it; the labor provisions added in the side agreement to NAFTA were intended to mollify the unions, but did not.

Why did U.S. presidents George H.W. Bush and Bill Clinton support NAFTA—and has their reasoning at the time been proved accurate? Each wished to bring Mexico politically closer to the United States, and this has been accomplished. Intra-industry trade between the two countries has flourished, and not just in simple manufacturing, such as clothing, but in vehicles, computer components, and other sophisticated machinery. Antinarcotic relations changed from mutual recrimination to cooperation. Mexican elections no longer are conducted on the basis of which politician makes nastier comments about the United States, but rather largely on which office-seeker can foster greater cooperation with the United States. Mexican drug dealers are now regularly extradited to the United States. The struggle against money laundering is bilateral. There has been an institutional flowering between the two countries since NAFTA came into effect.

NAFTA had two central objectives—to increase mutual trade and encourage FDI into Mexico in order to stimulate Mexican economic growth. The reasoning was that the richer Mexico becomes, the better this is for U.S. exporters. Mexico is the second largest market for U.S. exports after Canada. The U.S. export level was $132 billion in 2008, three times greater than it was before NAFTA. Mexico´s exports to the United States in 2008 were $216 billion, five times greater than they were before NAFTA.[2] (Trade figures were lower in 2009 because of the recession in both countries caused by the U.S. financial collapse, but trade is increasing in both directions with the recoveries in both countries in 2010.) Not all of this increase was due to NAFTA, but there is ample econometric analysis to show that NAFTA played a large role in augmenting trade in both directions. When the Mexican economy collapsed at the end of 1994, the recovery took only a year because NAFTA had come into existence and allowed Mexico to augment its exports. FDI in the few years before NAFTA amounted to about $3 billion to $4 billion a year and rose to $9 billion a year under NAFTA.

[1] Eduardo Zepeda, Timothy A. Wise, and Kevin P. Gallagher, "Rethinking Trade Policy for Development: Lessons from Mexico under NAFTA," December 2009.

[2] All trade data is derived from the United States International Trade Commission.

Critics of NAFTA also fault Mexico's liberalization of agricultural products in the agreement, particularly of corn, a staple of the Mexican diet. U.S. and Mexican corn are not the same. The substantial increase in corn imports has led critics to assert that trade liberalization triggered a significant exodus from rural to urban areas in Mexico. These critics omit at least two other explanations for the rural exodus: (1) Poverty in Mexico is most severe in rural areas and educational and medical services are inadequate. Consequently, there is no future for smallholders and landless peasants, and their children, if they stay put. Isn't emigration the best option for energetic people under these circumstances? (2) Mexico has a comparative disadvantage vis-à-vis the United States in growing corn, especially in areas that lack irrigation. Why, under these circumstances, should a poor country waste its resources rather than importing the cheaper and higher-quality corn available next door? Mexico has increased its exports of fruits and vegetables to the United States under NAFTA. The bilateral agricultural trade balance under NAFTA, if canned fruits and vegetables are included, favors Mexico—although different farmers are involved, those in the rainfed corn-growing areas of central Mexico and others in the irrigated northwest of the country close to the United States where high-value fruits and vegetables are planted.

The development problems that Mexico has faced since NAFTA came into existence are unrelated to the agreement. Competent analysts who do not have special interests fault the Mexican authorities for failure to take advantage of NAFTA by correcting major structural deficiencies. Mexico does not collect enough taxes to finance the federal government, a situation that continues to this day. The budgetary shortfall was filled by taking funds from the export revenue of Petroleos Mexicanos (PEMEX), the national oil company, making PEMEX unable to function as a normal oil company. The Mexican constitution does not permit joint risk ventures with private companies, and PEMEX has lacked the skill to drill for oil and gas in the promising deep waters of the Gulf of Mexico. The United States, by contrast, gets much of its oil from its portion of the Gulf of Mexico. Mexico's educational system is inadequate, and this needs correction. The power of the education union has been an impediment to progress. Private and government monopolies abound in Mexico, and actions to end these constraints to competition have been meager.[3] Labor laws have led companies to use much part-time and informal (off the books) workers to reduce their costs, setting up a two-tier labor system that does not serve the country well. There is much cronyism and corruption in granting government contracts. Taken together, these structural problems prevent Mexico from growing consistently at a level high enough to fully employ everybody in the labor force—say, 6 to 7 percent GDP growth a year, rather than the 3 percent or less a year (about 1.5 percent a year per capita) that has prevailed for the last 30 years, both pre- and post-NAFTA. The failure to correct these structural problems is best explained today by divided government. Since 1997, the president has faced a legislature in which opposition parties have the majority, and compromises on issues where there are powerful special interests that benefit from the status quo have been impossible.

After NAFTA came into effect in 1994, Mexico enjoyed preferences in the U.S. market not enjoyed by other developing countries. Mexico was thus able to substantially increase its exports to the United States. Over the ensuing 15-plus years, the United States signed many other preferential trade agreements with developing countries, thereby removing the uniqueness of Mexico´s privileges in the U.S. market. In addition, NAFTA became a static agreement and thereby lost its central importance.

The argument of Zepeda, Wise, and Gallagher (ZWG), the authors of the Carnegie Endowment article, is to make Mexico's exports dynamic again. They assume that if Mexico deliberately undervalues its exchange rate as a way of promoting exports, this would be accepted by the United States because a more prosperous Mexico is in the U.S. interest. The acceptance of NAFTA was testimony of the U.S. desire for a wealthier Mexico, but not if this is artificially contrived. If Mexico were to deliberately adopt an undervalued exchange rate—in a replay of the beggar-thy-neighbor policies so damaging during the Great Depression of the 1930s—the United States would almost certainly respond by imposing counteracting impediments to imports from Mexico. Mexico does need a competitive exchange rate, but one designed specifically to penetrate the U.S. market would arouse anger, not cooperation. The ZWG proposal that Mexico should pick winners in the industrial sector and support these choices with temporary tax and other benefits assumes that benefits once granted can later be removed—and assumes also that an all-wise government can actually make the best choices of the industries to support. As a Mexican might say, "Ojalá," best translated in this context as "Get real!"

The core of Mexico´s growth problem, in my view, is political—namely, the inability to deal with structural problems affecting taxes, energy, education, labor markets, monopolies, and self-acting cushions against economic downturns. These failures left the country with little more than trade policy under NAFTA to generate economic growth, and trade policy cannot do the whole job.

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[3] A recent notable exception to the lack of action was the government elimination of a public company, Luz y Fuerza del Centro, that supplied electricity to Mexico City and the area around it, because the costs of maintaining the company had become prohibitive. A larger company, the Commisión Federal de Electricidad, also a public company, now supplies the needed electricity. In doing this, the government also took on the powerful and monopolistic electricity workers union.