NAFTA and the Mexican Economy: A Look Back on a Ten-Year Relationship

Juan Carlos Moreno-Brid,[†] *Pablo Ruiz Nápoles,*[††] *& Juan Carlos Rivas Valdivia*[†††]

I. Introduction[1]

International free trade agreements invoke passionate debates regarding the merits, risks, and shortcomings that are necessarily a part of any such agreement. This is understandable, given that trade liberalization creates both winners and losers, whether viewed from a short-term or long-term perspective. The North American Free Trade Agreement (NAFTA) is no exception. The concerns of NAFTA's opponents that were initially voiced over ten years ago have not been attenuated by the passage of time. Neither has the enthusiasm of its supporters been toned down. Both groups recognize that, indeed, the change in development strategy in favor of state downsizing and trade liberalization implemented since the mid-1980s, culminating with NAFTA, is

---

[†] Regional Adviser, Economic Commission for Latin America and the Caribbean (ECLAC).

[††] Professor, Facultad Latinoamericana de Ciencias Sociales (FLACSO).

[†††] Economist, ECLAC.

[1] The opinions here expressed are the authors' own responsibility and may not necessarily coincide with those of the United Nations Organization or of FLACSO.

the most prominent event in Mexico's economic history in the last five decades.[2] There is a consensus that NAFTA was a key instrument behind the surge of exports and foreign direct investment (FDI) that has taken place in Mexico in the last ten years. The academic and political debates continue, however, regarding NAFTA's effects on the Mexican economy.

Advocates of NAFTA argue that without the agreement in place, Mexico's export and FDI boom would not have occurred. More importantly, they view the agreement as the fundamental reason behind the Mexican economy's prompt recovery after the economic crisis of 1995. Without NAFTA, these advocates argue, the U.S. Treasury would not have so swiftly approved the emergency U.S. $50 billion support loan to Mexico. Following the same line of reasoning, Jaime Serra, Mexico's Minister of Trade when the agreement was signed in 1992, recently stated that NAFTA was highly beneficial to the Mexican economy.[3] In the most recent study published by the World Bank on the topic, the authors conclude that, without NAFTA, by 2002 Mexico's global exports would have been 25% lower, the inflow of FDI 40% lower, and its per capita income 5% lower than the actual levels.[4] While they admit that NAFTA alone cannot guarantee economic convergence in North America, they nevertheless conclude that the trade agreement helped to bring Mexico's level of development closer to that of its trading partners.

On the other hand, NAFTA's opponents claim that the benefits realized from the agreement have been highly concentrated in

---

[2] There is a vast literature on NAFTA, the review of which goes beyond the purposes of this Article. For the most recent contributions that rekindled the debate on assessing the agreement's impact after ten years see J. AUDLEY ET AL., *NAFTA's Promise and Reality: Lessons for the Hemisphere*, CARNEGIE ENDOWMENT FOR PEACE (2003); R. Blecker, *The North American Economies After NAFTA: A Critical. Appraisal*., INT'L J. POL. ECON., (forthcoming 2005); A. TORNELL ET AL., NAFTA AND MEXICO'S LESS-THAN-STELLAR PERFORMANCE (Nat'l Bureau of Econ. Research, Working Paper No. 10289, 2004); D. Lederman et al., *Lessons From NAFTA for Latin American and the Caribbean Countries: A Summary of Research Findings*, World Bank (2004); M. Weisbrot et al., *NAFTA at Ten: The Recount (2004), at* http://www.cepr.net/publications/NAFTA_at_Ten.htm.

[3] Jaime Serra, Hacia la profundizacion de la integracion economica de Mexico en el continente Americano, (2004) (unpublished manuscript, on file with author) *available at* http://cursos.itam.mx/bcondon/NAFTA/integracioneconomica.

[4] Lederman, et al., *supra* note 2.

relatively few firms, activities, and regions, and they were more than compensated by its adverse effects on the overall economy. In a critical review of the econometric work of the World Bank study mentioned above, the authors arrive at the opposite conclusion: NAFTA has reduced the average income per capita growth in Mexico,[5] and its beneficial impact on exports did not compensate for its negative effects. In particular, the authors note the erosion of Mexico's inter-industrial links and the increase in the wage gap between skilled and unskilled labor. The net result was a reduction of Mexico's potential long-term economic growth and a widening gulf between the "haves" and the "have-nots."

It is worth pointing out that such passionately adverse reactions to NAFTA are not isolated to Mexico. A recent report in the *Financial Times* indicates that many of the same views are present today in some groups within the United States:

> The textile state of North Carolina has seen employment in its staple industry collapse from more than 250,000 jobs to just 100,000 since the signing of the North American Free Trade Agreement in 1992. For many, NAFTA is a dirty word and the state's congressmen are skeptical it will fare any better in future free trade deals . . . .[6]

Some commentators have taken a more balanced approach, concluding that, in general, "NAFTA has been neither the disaster its opponents predicted nor the savior hailed by its supporters."[7] It is important to note that when focusing on "its effects on people's lives, livelihoods, and households,"[8] the authors observe a highly adverse impact of NAFTA on rural and vulnerable populations.[9] They add that NAFTA deteriorated Mexico's labor markets and report that from 1994 to 2002, manufacturing employment increased by 500,000 positions, but the agricultural sector lost 1.3 million jobs.[10]

Such divergence in the assessment of NAFTA may be partly

---

[5] Weisbrot et al., *supra* note 2.

[6] Christopher Swann, *Envoys take free trade fight into enemy territory*, FINANCIAL. TIMES, Feb. 23, 2005, at 4.

[7] AUDLEY ET AL., *supra* note 2.

[8] *Id*.

[9] *Id*.

[10] *Id*.

explained by ideological differences. This divergence, however, may also reflect the inherent methodological difficulties that prevail when isolating the impact of NAFTA from the impact of other variables. For example, Mexico implemented radical macroeconomic reforms and policy changes during the same period in order to shift away from its traditional development strategy of import substitution and state-led industrialization. Ten years prior to NAFTA's signing, Mexico began a drastic and unilateral process of trade liberalization. These contradictory assessments of the agreement may be due in part, however, to the differences in the expectations it raised. The official rhetoric on NAFTA identified it as an ambitious step forward in the region's route towards development.[11] As stated in Article 102 of the Agreement, NAFTA's initial objectives were to:

> Eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties; promote conditions of fair competition in the free trade area; increase substantially investment opportunities in the territories of the Parties; provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory; create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.[12]

The Mexican government saw NAFTA as an instrument to achieve three goals. First, the Agreement was thought to have the potential to boost Mexico's trade and FDI flows with the United States and Canada. Second, NAFTA was to induce local and foreign firms (both within and outside of the NAFTA region) to invest in the production of tradable goods in Mexico in order to

---

[11] AUDLEY ET AL., *supra* note 2. "NAFTA fuels economic growth and dynamic trade, stimulates investment …and provides greater job opportunities in North America." *Id*. "The North American Free Trade Agreement (NAFTA) has brought economic growth and rising standards of living for the people of all three member countries [since 1994.]" *Canada and the North American Free Trade Agreement*, Canadian Ministry of International Trade, *at* http://www.dfait.maeci.gc.ca/nafta-Al.ena/menu-en.asp.

[12] North American Free Trade Agreement, Dec. 17, 1992, art. 102, 107 Stat. 2057, 32 I.L.M. 289.

exploit the region's potential as an export platform to the United States. The belief was that such an investment would launch Mexico into a phase of high and sustained economic growth led by exports. The third, and decisively political objective of NAFTA, was to guarantee the lock-in of Mexico's macroeconomic reform process. In this Article, we refrain from attempting to estimate NAFTA's impact on the Mexican economy. Instead, we examine the extent to which the three objectives of the Mexican government have been fulfilled.

Following this introductory section, Part II provides a background of Mexico's road to NAFTA, placing it in the overall context of the radical macroeconomic reform put in place in the last two decades. It focuses on two key aspects, foreign trade and FDI, examining the evolution of exports and imports as well as the overall trade balance performance. Part II closes with a brief assessment of the degree to which the external constraints on the Mexican economy are more binding today. Part III analyzes Mexico's overall growth performance after NAFTA in comparison with other countries in the region. Attention is placed on the evolution of employment and whether there has been a convergence in per capita income with the United States, both aspects that NAFTA and the macroeconomic reforms were supposed to strengthen. Part IV addresses the evolution of liberal reforms since NAFTA. Finally, Part V puts forward our conclusions and policy recommendations.

II. NAFTA, External Trade, and Foreign Investment in Mexico

A. The Road to NAFTA: Unilateral Trade Liberalization and Foreign Investment Deregulation

In the aftermath of the most dramatic balance-of-payments crisis Mexico had faced in decades, the early 1980s was seen by the government as an optimal time for economic reform. President De la Madrid commenced the implementation of this structural reform, designed to shift the economy away from its traditional state-led development and trade protectionist strategy. Important elements of this reform included the deregulation/privatization of public enterprises and the opening of Mexico's domestic market to foreign competition.

In order to encourage foreign competition, the Mexican government began to remove a number of tariff and non-tariff restrictions on imports. A crucial step towards this goal came in 1986 when Mexico became a full member of GATT, which initiated a gradual elimination of some restrictions to foreign investment, particularly in capital and technology intensive industries. By 1988, the coverage of import licenses as well as the average tariff rate had been sharply reduced. In addition, the setting of official prices on imported goods had been completely eliminated. From 1988 to 1994, President Salinas de Gortari's administration worked to accelerate further the economy's structural reforms. In 1989, a new regulatory framework on foreign investment was approved, eliminating restrictions to foreign capital's participation in roughly 75% of all branches of economic activities.[13] December 1993 marked the enactment of a new law governing foreign investment. This law simplified administrative procedures governing foreign investments and eliminated all restrictions on FDI in manufacturing industries with the exception of explosives and basic petrochemicals.[14]

By the time NAFTA's negotiations began in 1990, Mexico was already one of the world's most open developing economies.[15] Two years later, the trilateral agreement among Mexico, the United States, and Canada was signed and slated to go into effect on January 1, 1994. The parties committed themselves not only to the elimination of tariff and non-tariff barriers to intra-regional trade, but also to loosening restrictions on foreign investment over the next ten years.[16] Few trade restrictions were maintained in the agriculture (approximately 7% of the value of imports), oil refining, and transportation equipment industries. For Mexico, the most significant purpose of NAFTA was to institutionalize their

---

[13] Secretaria de comercio y formento industrial (SECOFI), Reglamento de Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera.

[14] F. Clavijo & S. Valdivieso, *La creacion de empleos mediante el comercio exterior, el caso de Mexico*, 50 EL TRIMESTRE ECONOMICO 2, 873-916 (Apr.-Jun. 1983); J.C. Moreno-Brid, *Liberalizacion Comercial. y la Demanda de Importaciones en Mexico*, 240 INVESTIGACION ECONOMICA 13 (2002).

[15] Charles Oman, The Policy Challenges of Globalization and Regionalization (Policy Brief, 29) Organization for Economic Cooperation and Development (OECD) (1996).

[16] SECOFI, *supra* note 13; OECD *supra* note 15.

trade liberalization strategy in an agreement enforced with the United States, its key trading partner and the major player in global trade.[17]

B. Mexico: From Oil to Manufactures

NAFTA greatly facilitated Mexico's trade liberalization goals, allowing Mexico to become a dynamic player in exports of non-oil products and to insert itself into global markets. Table 1 compares the export performance of selected countries, examining their changing shares in world markets from 1985 to 2001. In both periods, China stands at the top of the list, with its share of world (non-oil) exports increasing the most: 3.35% between 1985 and 1994, and an additional 1.93% between 1996 and 2001. During the same time period, Mexico's performance increased substantially, moving from seventh to second place in the rankings.[18]

---

[17] P. Pacheco-Lopez & A. P. Thirlwall, *Trade Liberalisation in Mexico: Rhetoric and Reality*, 229 BANCA NAZIONALE DEL LAVORO Q. REV. 141 (2004); P. Skott & M. Larudee, *Uneven Development and the Liberalization of Trade and capital Flows: The Case of Mexico*, 22 CAMBRIDGE J. ECON. 277-95 (1998); After NAFTA, Mexico signed several more trade agreements, including those with the European Union, Japan and various Latin American countries.

[18] Notice that some of the countries with more change in share market were previously conforming to the USSR, so that they did not have trade transactions with the western world at that time.

Table 1. Changes in Participation of Non-Oil Exports in the World Market (Top 20 Countries), 1985-1994 and 1996-2001 (in percentages)[19]

Rank		1985	1994	Change		1996	2001	Change
1	China	1.53	4.89	3.35	China	5.37	7.30	1.93
2	Russia	0.00	0.81	0.81	México	1.89	2.85	0.96
3	Singapore	0.76	1.57	0.81	Ireland	0.96	1.52	0.56
4	Malaysia	0.87	1.62	0.75	Canada	4.19	4.64	0.45
5	Thailand	0.50	1.12	0.62	S. Korea	2.35	2.72	0.37
6	S. Korea	1.72	2.28	0.56	Philippines	0.52	0.78	0.26
7	Mexico	1.03	1.54	0.51	United States	13.88	14.10	0.22
8	Indonesia	0.38	0.75	0.37	Hungary	0.30	0.50	0.20
9	Spain	1.48	1.83	0.34	Czech Rep.	0.32	0.46	0.14
10	Czech Rep.	0.00	0.29	0.29	Israel	0.42	0.55	0.13
11	United States	13.34	13.56	0.22	Malaysia	1.75	1.88	0.13
12	Ireland	0.69	0.87	0.18	Poland	0.40	0.48	0.08
13	India	0.51	0.67	0.16	Indonesia	0.80	0.86	0.06
14	Slovenia	0.00	0.14	0.14	Thailand	1.19	1.25	0.06
15	Poland	0.24	0.38	0.14	Vietnam	0.13	0.19	0.06
16	Ukraine	0.00	0.11	0.11	Slovakia	0.11	0.15	0.04
17	Turkey	0.30	0.40	0.10	Turkey	0.41	0.46	0.04
18	Vietnam	0.02	0.11	0.09	Romania	0.16	0.19	0.04
19	Slovakia	0.00	0.08	0.08	Costa Rica	0.09	0.13	0.04
20	Croatia	0.00	0.07	0.07	United Arab Emirates	0.11	0.15	0.03

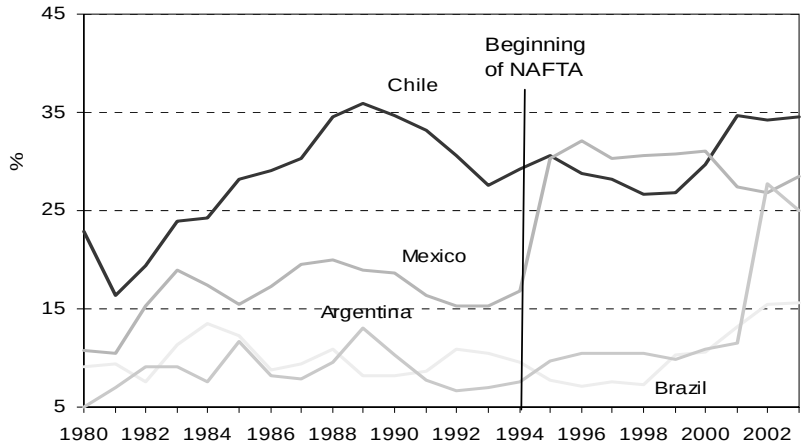
Though not always recognized, Mexico's export drive started nearly ten years before NAFTA's inception, dating back to the country's trade liberalization policies of the early 1980s. Nonetheless, 1994 marked a turning point, as the launch of NAFTA opened an unprecedented window of opportunity to export to the United States, the largest world market. A few years later, exports had increased by approximately 20%, reaching a level of 30% of Mexico's GDP.[20] Such a dynamic shift in exports

[19] Table based on Competitiveness of Analyzed Nations (CAN) 2003 and the Economic Commission for Latin American and the Caribbean (ECLAC).

[20] *See* Table 2. An important part of this change is explained for an increase in the

repositioned Mexico in global trading markets. Having been primarily an oil exporting economy in the early 1980s, 80% of Mexico's total exports are currently manufactured goods. This rapid growth in exports of manufactured goods more than compensated for the decline in foreign sales of oil and agricultural commodities. As shown in Table 3, a key element behind this dynamic performance was the increased presence of *maquiladoras* (in-bond industries) in the Mexican economy.

Table 2. Mexico and Other Selected Countries: Exports of Goods and Services (% GDP), 1980-2003.[21]



It is well recognized that the *maquiladoras* are responsible for approximately half of the manufactured goods exported by Mexico. While the dynamic response of Mexico's manufacturing exports was due in large part to NAFTA, it was also stimulated by a considerable real depreciation of the exchange rate of the peso vis-à-vis the U.S. dollar that took place in 1995.[22] In addition, as

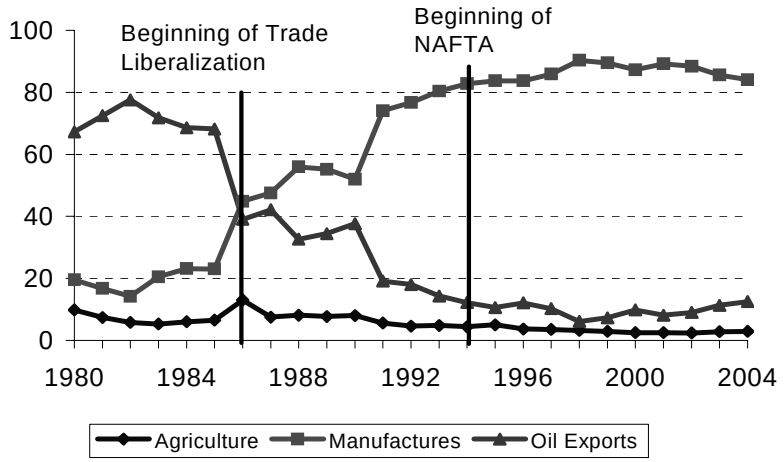
exchange rate of Mexico during the crisis of 1994-1995. The exports as a percentage of GDP measured in constant 1993 Pesos showed an increased from 17 to 24% during 1994-1995.

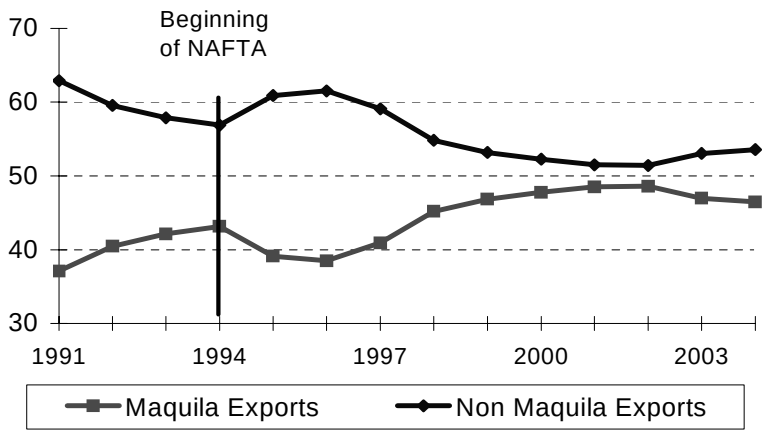
21 World Bank, World Development Indicators (2004).

22 For econometric studies that conclude that NAFTA had no significant impact on Mexican exports, after controlling for the effect of the real exchange rate depreciation, see Blecker, *supra* note 2. *See also*, Pacheco-López, *supra* note 17. *But see* LEDERMAN ET AL., *supra* note 2 (claiming that NAFTA boosted Mexican exports). But, their

the Mexican economy plunged to a recession in the same year (real GDP decreased 6%), local companies were pressed to seek external markets in order to compensate for the collapse of the domestic market.

Table 3. Composition of Mexican Exports, 1980-2004.[23]





econometric specifications failed to adequately capture the effect of the depreciation of the exchange rate.

[23] INEGI, Sistema de Cuentas Nacionales de Mexico (National Accounts System) *at* www.inegi.gob.mx.

The preferential access granted by NAFTA led to a strong increase in Mexico's exports. Key promoters of the overall boost in exports were the various foreign companies that already had strong presence in Mexico, including *maquiladoras*. Additionally, Mexico's export market benefited from the arrival of foreign investment in selected sectors, most of which was motivated by the opportunity or need to use Mexico as an export platform to the United States. Although subject to certain strict limitations, the nation's export drive has been accompanied by an increase in the technological sophistication of Mexican products sold abroad. Traditionally, Mexico's primary exports had been in commodities, such as shrimp, coffee, and tomatoes. By the late 1970s, crude oil was the dominant export item. In the last fifteen years, however, the majority of Mexico's exports consists of manufactured goods, including auto parts, automobiles, computers, and electrical and electronic equipment.

The structure of Mexican exports and their share in (OECD) total imports from 1985 to 2001 is displayed in Table 4, classifying them in three groups: (1) exports directly based on natural resources (agriculture, energy, textile fibers, minerals, and metals); (2) manufactured goods; and (3) other exports. In turn, manufactured goods are also classified in two groups: (1) those that are essentially the result of simple processing of natural resources and (2) everything else. The second part of Table 4 measures the same categories in terms of their contribution to Mexico's total exports. A key point to notice is that Mexico's penetration of the OECD market more than doubled between 1985 and 2001. Equally impressive is the considerable rise in the share of Mexico's manufactured goods in OECD imports (from 1.1% to 3.8%). Also of note is the particularly fast expansion of exports of manufactured goods *not based* on natural resources. While in 1985 they represented 35% of Mexico's total exports, by 1994 their share had mounted to 71% and, in 2001, stood at 78%. Exports of natural resource based goods experienced a mild retraction in the OECD market, and collapsed from 58.6% of total Mexican exports in 1985 to 14.7% in 2001. Passenger vehicles and other manufactured goods related to the automobile and telecommunications industries, stood out among Mexico's main export items during this period.

Table 4. Selected Indicators of Mexican Exports to the OECD, 1985-2001[24]

Mexico	1985	1990	1994	2001
Market Share	**1.78**	**1.52**	**2.03**	**3.62**
Natural Resources	3.08	2.10	1.98	2.65
Agriculture	1.30	1.28	1.37	2.09
Energy	4.60	3.26	2.99	3.29
Textile Fibers, Minerals, and Metal	1.89	1.48	1.57	1.49
Manufactures	1.10	1.29	2.02	3.85
Based on Natural Resources	1.23	0.96	1.03	1.26
Not Based on Natural Resources	1.10	1.33	2.10	4.03
Others	1.61	2.54	2.70	4.12
Structure of Exports	**100**	**100**	**100**	**100**
Natural Resources	58.6	33.6	21.4	14.7
Agriculture	9.7	10.3	8.2	5.1
Energy	45.9	21.0	11.8	9.1
Textile Fibers, Minerals and Metal	3.0	2.3	1.4	0.5
Manufactures	39.1	62.5	74.9	81.4
Based on Natural Resources	3.4	3.4	2.5	1.5
Not Based on Natural Resources	35.0	57.6	70.7	78.1
Others	2.3	3.9	3.7	3.9

The export-driven growth, however, was not felt in all production sectors in Mexico. Since 1994, though some sectors gained an increased presence in the international markets, others retracted. Among those whose exports registered the largest increases in their shares in the U.S. market were machinery and transportation equipment, beverages and tobacco, and

[24] Authors' elaboration based on Competitiveness Analysis of Nations (CAN) and ECLAC, *supra* note 19. References to Agriculture are derived from Sections 0, 1 and 4; Chapters 21, 22, 23, 24, 25 and 29. References to Energy are derived from Section 3. References to Textile Fibers, Minerals and Metals are derived from Chapters 26, 27 and 28. References to Manufactures: Based on Natural Resources are derived from Chapters 61, 63 and 68; groups 661, 662, 663, 667 and 671. References to Manufactures: Not Based on Natural Resources are derived from Sections 5 and 6, sections 7 and 8. References to Manufactures: Others are derived from Section 9.

miscellaneous manufactures. On the other hand, the exports of food and live animals, crude oil and related product, mineral fuels, animal and vegetable oils, and chemical products were unable to maintain their respective market shares. The impact at the micro-level of the firm was very unevenly distributed. According to some authors, the bulk of Mexico's non-oil exports originates in no more than 300 businesses, most of them linked to transnational corporations.[25]

The impressive performance of Mexican exports since NAFTA has been favorably reflected in the country's trade balance with its major partner, the United States. Since 1995, Mexico has run trade surpluses with the United States but not with Canada. Such surpluses have, however, been more than offset by Mexico's mounting trade deficit with the rest of the world. Indeed, except for periods of severe recession, Mexico has systematically registered trade deficits.[26]

Table 5. Trade Balance of Mexico, 1994-2003 (in billions of U.S. Dollars)[27]

	NAFTA Trade			Balance of *Maquiladoras*	NAFTA Balance w/o *Maquiladoras*	Balance of Rest of World	Trade Balance
	Exports	Imports	X-M				
1994	53.4	58.6	-5.2	5.8	-11	-13.3	-18.5
1995	68.5	55.4	13.1	4.9	8.2	-6	7.1
1996	82.8	69.4	13.5	6.4	7.1	-6.9	6.5
1997	96.6	84.1	12.5	8.8	3.6	-11.8	0.6
1998	104.8	95.7	9.1	10.5	-1.4	-17	-7.9
1999	123	108.5	14.5	13.4	1	-20.1	-5.6
2000	151.2	131.8	19.4	17.7	1.7	-27.4	-8
2001	143.6	118.3	25.3	19.3	6	-35.2	-9.9
2002	146.1	111.4	34.7	18.8	15.9	-42.6	-7.9
2003	149.8	110.2	39.7	18.3	21.4	-45.3	-5.6

[25] J. Mattar et al., *Foreign Investment in Mexico after Economic Reform*, *in* Confronting Development: Assessing Mexico's Economic and Social Policy Challenges (2003).

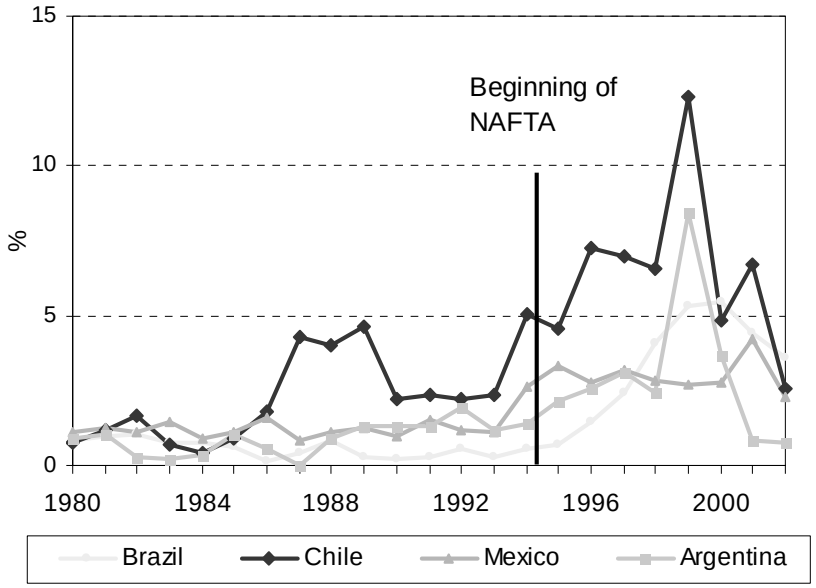
[26] *See infra* Table 5.

[27] Authors' elaboration based on *Estadisticas de Comercio Exterior*, INEGI *supra* note 23.

The other favorable development in Mexico's economic performance, frequently associated with trade liberalization and NAFTA, is the resulting increase in flow of Foreign Direct Investment (FDI). Measured as a percentage of Mexico's GDP, FDI registered an impressive growth since the early 1990s, increasing from levels close to 2% to its peak of 4% in 2001. Nevertheless, it never reached the relative proportions achieved by Chile. Moreover, it has stagnated in the aftermath of the Asian crisis, and has not fully returned to its previous dynamic state.

By 2004, the majority of businesses in Mexico with foreign capital were of U.S. origin.

Table 6. Foreign Direct Investment, Net Inflows (% of GDP), 1980-2002[28]



III. Imports, Trade Balance and Long–Term Economic Growth

In assessing Mexico's trade and FDI performance after NAFTA, it is critical to examine the evolution of its imports and

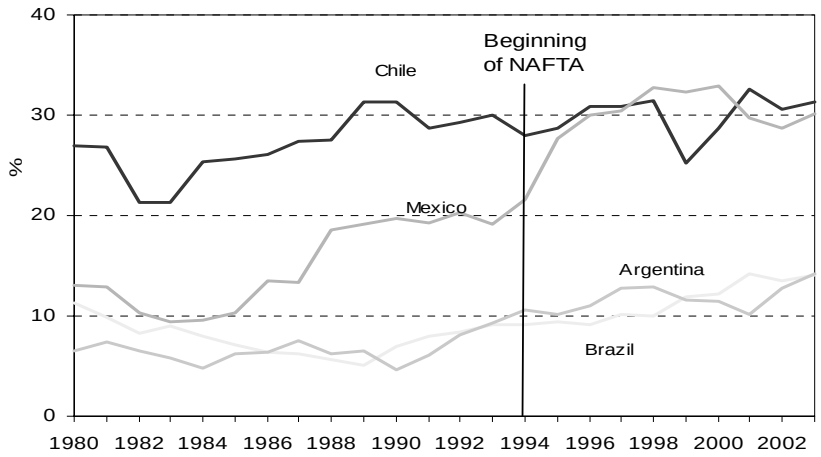
[28] Authors' elaboration based on World Bank, World Development Indicators, *supra* note 21.

its rate of economic expansion. This is particularly important, since a key goal of NAFTA and the accompanying overall macroeconomic reform strategy was to place Mexico onto a path of high and persistent growth. In the last fifteen years, paralleling Mexico's export and FDI boom, trade liberalization has been accompanied by a massive penetration of imports. Given the decades of trade protection marked by high tariffs and strict controls on imports, the elimination of such trade barriers was bound to provoke an intense, although temporary (in principle), flood of imports. It was assumed that once Mexican consumers adjusted to the new "menu" of products made available by trade liberalization, including previously inaccessible foreign goods, purchases of foreign goods would lose momentum. Such a slowdown has, however, not occurred.

The first stages of the trade liberalization process implemented in the late 1980s triggered an explosive increase in imports, expanding at annual rates above 30%. Such a surge of imports to Mexico was unparalleled in the region and dwarfed the increase experienced in both Brazil and Argentina. As a share of GDP, they climbed from 10% in 1982 to more than 30% by the mid 1990s.[29]

[29] Imports as a percentage of GDP, measured in constant 1993 Pesos, showed a decrease from 22% to 20% during 1994-1995. This fall is explained by a depreciation of the exchange rate of Mexico during the economic crisis of 1994-1995.

Table 7. Mexico and Selected Countries: Imports of Goods and Services (% GDP), 1980-2003[30]



The swift pace of Mexican imports since the second half of the 1980s was induced not only by the elimination of non-tariff barriers to foreign trade, but also by the expansion of domestic demand in the context of a persistent appreciation of the real exchange rate. The resumption of facilitated access to external funds also played a role. After decades of highly restricted access, Mexican consumers began to satisfy their pent-up demand for a wide variety of foreign goods and brands. Such import demand, however, also mirrors the increasingly strong relationship between the exporting sector and foreign suppliers to some extent. *Maquiladoras*, the most successful export sector, rely fundamentally on imported inputs and materials, resulting in a limited relationship with local suppliers. Another factor that boosted import penetration to the domestic market, and that cannot be *a priori* ruled out, is the likely breakdown of some internal linkages in Mexico's domestic productive structure; local producers have been put out of business by foreign competition.

On a more technical basis, a number of applied econometric studies reveal that in the last fifteen to twenty years, the Mexican economy has significantly increased its structural dependence on imports. This indicates that the long-term income elasticity of

[30] Authors' elaboration based on World Bank, World Development Indicators, *supra* note 21.

demand for imports has more than doubled in this period.[31] Traditionally, the value stood between 1.2% and 1.5%, but it is currently close to 3%. This means that if Mexico's national income is to grow at an annual average rate of 5%, imports in real terms will have a tendency to expand 15% annually. Sooner or later, such a persistent and rapid increase in imports would put enormous pressure on the economy's exports and other sources of foreign exchange. In fact, to keep the trade deficit from excessively increasing as a proportion of income, Mexican exports would have to expand at rates of at least 15% per year. Such a growth rate is difficult, if not impossible, to sustain. During their most prominent and recent boom, 1988-1999, exports expanded at an average annual rate of 10%, but imports expanded at an even faster rate of 14%.

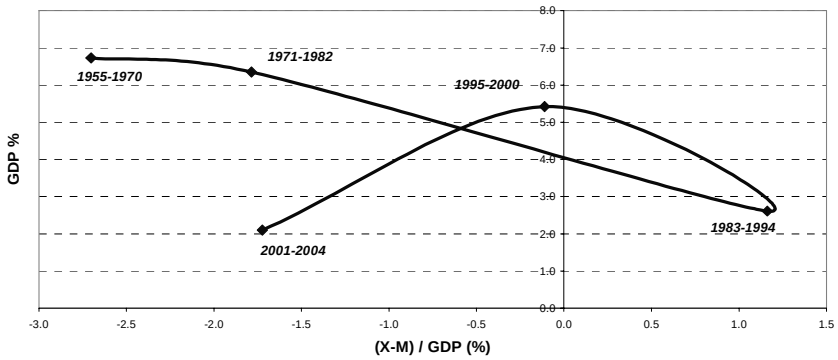
Remarkably, and contrary to the *a priori* expectations, the dynamism of imports has barely subsided. The most recent data, as of January 2005, reports an annual increase of 18% in Mexico's imports, while its real GDP expanded 4.4%. It is unclear whether such an upward shift in the long-term income elasticity of imports will prevail in the future. Most likely, it will decrease somewhat as some of the initial effects of the trade liberalization process on the demand for foreign goods and services subside. But, if the income elasticity remains at its current levels, it will create a major obstacle in Mexico's struggle towards increased economic growth.

Table 8 illustrates how trade liberalization and the process of macroeconomic reforms have not yet been able to insert Mexico onto a path of strong export-led growth. It shows that the relation between trade performance and economic growth has been deteriorating. Between 1955-1970 and 1971-1982, Mexico's real GDP expanded at an annual average rate above 6% and registered a trade deficit of 2.7% and 1.9% of GDP, respectively. The international debt crisis and the collapse of the domestic oil boom forced an economic slowdown in the 1980s that was accompanied by a trade surplus of 1% of GDP. In the first five years after NAFTA, real GDP expand at a 0.5% annual average rate. This recovery was short-lived. The renewed appreciation of the peso eventually slowed down the export boom, and the U.S. economic

[31] The "income-elasticity" of imports is the increase, measured in percentage points that the volume of imports will register for every 1% increase in real income.

recession beginning in 2001 put an end to the dynamism of this period of export-led growth. In 2001-2003, the Mexican economy barely grew (2% annual average rate) and registered a trade deficit of 1.5 - 2% of GDP. Such slow expansion implies that its per capita income fell three years in a row. In 2004, GDP increased 4.4%, better than its performance in recent years but still far below both the pre-1980 rates of expansion and the rates that it needs in order to absorb the vast amount of people entering the labor market. Therefore, with relatively similar amounts of foreign resources as a proportion of GDP as it received in the four decades before the oil collapse, the Mexican economy is now able to grow, on average, at only one-third of the annual rates it experienced between 1950-1980, before macroeconomic reforms were put in place.

Table 8. Trade Balance and Real GDP Growth in Mexico, 1980-2004[32]



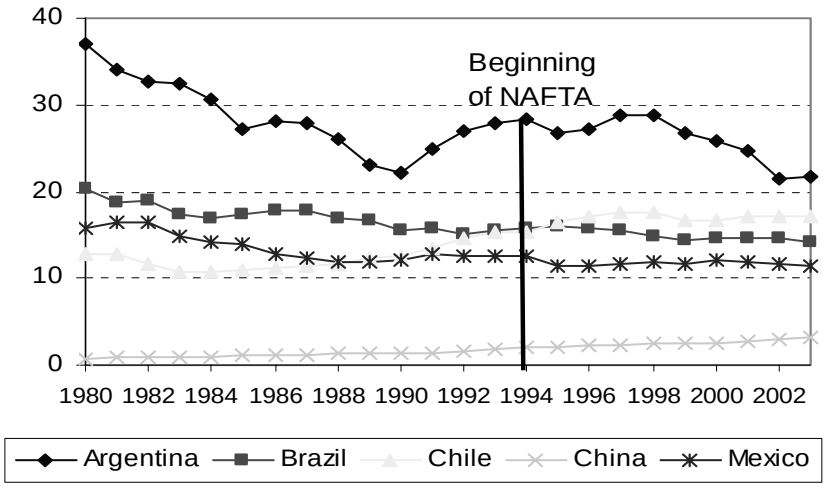
Trade and financial liberalization did result in rapid growth of exports and, though not sustained FDI. But, Mexico's economic growth performance has been disappointing. In fact, instead of closing the gap of its real GDP per capita *vis-à-vis* the United States, it has widened. As shown in Table 9, in the late 1980s, Mexico managed to begin to reduce this gap. This improvement,

---

32 *See* INEGI**,** *supra* note 23. Jesus Santamaria Gonzales, Mexico, crecimiento economico y evolucion de las importaciones, 1960-2002: Una approximacion al analisis de la restriccion externa, (unpublished thesis UNAM Mexico on file with author).

however, was short-lived, as the economic crisis of 1995 widened it once more. Since this time, there has been little change, and the current GDP per capita difference between the United States and Mexico stands at a level comparable to what it was in the 1950s.

Table 9. Mexico and Other Countries: Real GDP Per Capita (Relative to the United States) 1980-2003 (U.S. GDP per capita = 100, measured in constant 1995 U.S. Dollars)[33]



Contrary to the expectations raised by NAFTA, Mexico has yet to see any significant convergence in its average income in real terms with its main regional trade partners.[34] A recent study examining GDP and alternative measures of income concludes that "there is no evidence of any catch-up in average Mexican living standards to U.S. or Canadian levels under NAFTA."[35]

Sustaining long-term economic growth should be a top priority in the national agenda. The Mexican economy needs to expand at average annual rates of at least 5-6%, in real terms, just to create the jobs required to absorb the 2.5% annual increase in its labor force. Economic expansion needs to be even stronger in order to

---

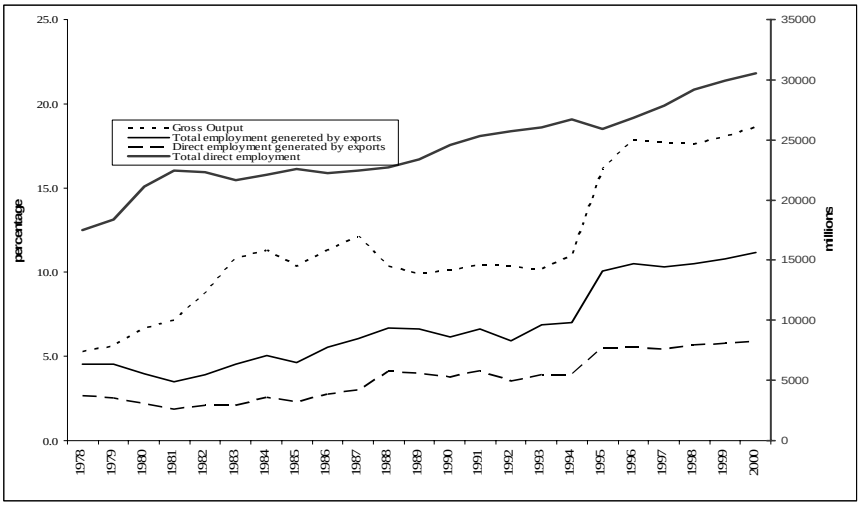
33 World Bank, World Development Indicators, *supra* note 21.

34 Blecker, *supra* note 2.

35 *Id*.

significantly improve the living standards of the more than 13 million Mexicans living in extreme poverty. The evolution of Mexico's labor market after NAFTA has fallen short of the initial favorable expectations. There has been a re-composition in total employment towards export-related activities, but the overall trend of employment has not seen a significant gain.

Table 10. Mexico: GDP and Employment Generated by Exports, 1978-2001 (Share of corresponding total on the left-hand side, and total employed on the right hand side)[36]



More specifically, NAFTA has had adverse effects on employment in the Mexican rural sector. One consequence of this is the increased migration flow to the United States. In 2004, unemployment rates in Mexico reached an all-time high, and the informal market sector has vastly expanded. In addition, the earnings and wage gap between the skilled and unskilled labor force has widened. Unless the economy follows a path of significant and sustained expansion in order to create an adequate number of jobs, the nation's social fabric may be severely damaged. Think-tanks and various international financial organizations forecast an expansion of Mexico's real GDP below 4% in 2005. Mexico clearly needs higher rates of expansion; it

36 INEGI, *supra* note 23.

remains to be seen whether the growth necessary to decrease unemployment rates is both achievable and sustainable.

A remarkable trait of the Mexican transition to trade liberalization was the lack of drastic reallocation processes in capital and labor within the manufacturing industry. To a certain extent, the trade patterns and industrial composition after NAFTA do not radically differ from its previous tendencies. With some exceptions, NAFTA's reallocation processes have extrapolated past trends in trade and industrial patterns with little evidence of a massive restructuring of manufacturing output. Curiously enough, some of the most successful exporting sectors have their roots in the import-substituting era and the sector-specific promotion policies implemented during that time. Mexico's outstanding export performance in manufacturing is a legacy of the import substitution period.

In the economy as a whole, labor productivity has stagnated since the early 1980s. The trade and macroeconomic reforms did not alter this tendency. Although difficult to disentangle from other effects, trade liberalization appears to have had some positive impact on productivity growth in selected manufacturing industries. In the capital goods and heavy intermediates sectors, it has allowed for greater intra-industry (and intra-firm) specialization in foreign trade. In some light industries, such as food processing and parts of the textile industry, less efficient local producers were forced to close or modernize. The net effect of increased exposure to foreign competition on productivity, however, is very small or even negative. To the extent that the productivity gains were based on a tendency to eliminate or displace local producers, the short term social impact could have been adverse. Whether such an impact is positive in the short-term depends on the degree to which the labor surplus successfully makes the transition to gainful employment in the other sectors. Unlike the support policies implemented in the United States, Mexico did not institute any program to ease the transition or to compensate displaced workers affected by the implementation of NAFTA.

IV. Did NAFTA Lock-In the Reform Processes in Mexico?

Finally, it is necessary to examine whether the Mexican government's more politically motivated third objective of

NAFTA was met. There seems to be a consensus that Mexico's trade and financial liberalization strategies are here to stay. To the best of our knowledge, there is simply no relevant political party or organization in Mexico that recommends a return to a generalized system of trade protectionism. In the last four years, however, the liberal reform process has stalled. From their first day in power, President Vicente Fox and his party stated that Mexico needed to implement fiscal, labor market, and energy reforms. To date, however, none of these reforms has been implemented nor is it likely that these reforms will be implemented in the final two years of the Fox administration. A survey conducted by *Latinobarómetro* indicates that there is growing disenchantment in the population with the results obtained in Mexico by privatization and other free market oriented reforms. The three main political parties pay lip-service to the idea of continuing with the macroeconomic reform processes but, in practice, have not formed a working coalition to push forward the pending reforms. In addition, according to the same source, the majority of the Mexican population surveyed is increasingly dissatisfied with the results brought about by these reforms. The dissatisfaction with the new "model based on the free market mechanisms" is evident not only in Mexico but throughout the entire region. In fact, an increasing majority of the surveyed sample by *Latinobarómetro* opposes the idea that the state should not intervene in the allocation of economic resources. In other words, while the majority of the population contends that trade liberalization in Mexico will not be reversed, there is significant consensus that the era of radicalized, liberal macroeconomic reform processes is over.

V. Conclusion

NAFTA, as a part of the package of economic reforms implemented in Mexico, helped to produce an export boom, a rapid and strong increase in manufacturing exports, and an inflow of much needed foreign direct investment accompanied by technology transfers. The fundamental constraints on Mexico's long-term economic growth have not been alleviated, however. Some have actually become more binding. NAFTA's positive impact may have by now reached a point of exhaustion and the Agreement should be revamped. It has not been the success

expected in terms of economic growth or of job generation. The direct impact of exports on domestic output was limited and offset by the rupture of backward linkages brought about by the massive inflow of imported inputs; many of them required for export production.

Mexico is thus at a crossroads. It can no longer base its international competitiveness on low wages. But, at the same time, it has not yet proven itself able to enter international markets based on knowledge-intensive, high value-added processes and products. If Mexico is to succeed in its quest to achieve high and sustained economic growth, there is an urgent need to rethink key elements of its overall strategy. In particular, this may require new policies to promote innovation and technological development, as well as a new wave of public investment to modernize and widen infrastructure. It is also necessary and urgent to implement a policy directed to the generation of jobs in the formal sector of the economy. Without fiscal reform, these initiatives are not feasible.

BIBILIOGRAPHY

S. Alfaro & J. Salas, *Evolución de la Balanza Comercial del Sector Privado en México: Evaluación con un Modelo Econométrico*, 236 EL TRIMESTRE ECONÓMICO 773-97 (1992).

F. Aroche and I. Rupra, *Comercio y empleo: el caso mexicano*, 50 INVESTIGACIÓN ECONÓMICA 21-42. (1991).

P. ASPE, ECONOMIC TRANSFORMATION, THE MEXICAN WAY (1993), The MIT Press.

J. AUDLEY ET AL., NAFTA'S PROMISE AND REALITY: LESSONS FROM MEXICO FOR THE HEMISPHERE, (Carnegie Endowment for Peace 2003).

Banco de México, *Indicadores Económicos y Financieros, at* www.banxico.org.mx (last visited Apr. 4, 2005).

R. Blecker, *NAFTA, the Peso Crisis, and the Contradictions of the Mexican Economic Growth Strategy*, CEPA WORKING PAPER NO. 3 (1996).

R. Blecker, *The North American Economies after NAFTA: A Critical Appraisal*, INTERNATIONAL JOURNAL OF POLITICAL ECONOMY, (forthcoming 2005).

F. Brown & L. Domínguez, *Productivity developments in Post-trade opening in Mexico: a Malmquist approach* (forthcoming) (unpublished manuscript on file with Facultad de Economía, Universidad Nacional Autónoma de México).

Comisión Económica para América Latina y el Caribe (CEPAL), Naciones Unidas. *Análisis de Competitividad de las Naciones 2003*.

F. Clavijo & S. Valdivieso. *La creación de empleos mediante el comercio exterior, el caso de México*, 50 EL TRIMESTRE ECONÓMICO 2, 873-916 (1983).

W. Cornelius, Impacts of NAFTA on Mexico-to-US Migration, *in* NAFTA IN THE NEW MILLENNIUM 287-304 (E.J. Chambers & P. Smith eds., 2002).

R. Dornbusch & A. Werner, *Mexico: Stabilization, Reform and No Growth*, BROOKINGS PAPER ON ECONOMIC ACTIVITY, 1: 253-315 (1994).

W. Easterly et al., *NAFTA and Convergence in North America: High Expectations, Big Events, Little Time*, 4 ECONOMICA (2003).

S. Edwards, *Openness, Trade Liberalisation and Growth in Developing Countries*, 31 J. ECON. LIT. 1358, 1358-93 (1993).

L. Galindo & M. Cardero, *La Demanda de Importaciones en Mexico: Un Enfoque de Elasticidades*, 49 COMERCIO EXTERIOR, 481-87 (1999).

L. Galindo & M. Cardero, *Factories Determinates de la Balanza Comercial de Mexico, 1980-1995*, COMERCIO EXTERIOR, 54: 789-94 (1997).

D. Garces-Diaz, *Was NAFTA Behind the Mexican Export Boom? (1994-2000), in* SSRN WORKING PAPERS (2001).

INEGI, Sistema de Cuentas Nacionales de México (National Accounts System) www.inegi.gob.mx (last visited Apr. 4, 2005).

I. Katz, *Exportaciones y Crecimiento Economico*. *Evidencia para la Industria manufacturera en Mexico*, 46 COMERCIO EXTERIRO 109-19 (1996).

D. Lederman et al., *Lessons From NAFTA for Latin America and the Caribbean Countries: A Summary of Research Findings*, World Bank: Washington, D.C. (2004).

J. Lopez, *Modernization, Heterogeneity and Employment in Mexico*, 16 INT'L REV. APPLIED ECON. 227 (2002).

J. Mattar et al., *Foreign Investment in Mexico after Economic Reform, in* CONFRONTING DEVELOPMENT: ASSESSING MEXICO'S ECONOMIC AND SOCIAL POLICY CHALLENGES (2003).

J.S.L. McCombie & A.P. Thirlwall, *Growth in an International Context: a Post Keynesian View in* FOUNDATIONS OF INTERNATIONAL ECONOMICS: POST KEYNESIAN PERSPECTIVES (1999).

J.C. Moreno-Brid, *Liberalizacion Comercial y la Demanda de Importaciones en Mexico*, 240 INVESTIGACION ECONOMICA 13 (2002).

J. C. Moreno-Brid, Essays on Economic Growth and the Balance-of-Payments Constrain, with Special Reference to the Case of Mexico (2001) (unpublished Ph.D dissertation, Trinity College) (on file with author).

J.C. Moreno-Brid, *Mexico's Economic Growth and the Balance of Payments Constraining: A Cointegration Analysis*, 13 INT'L REV. APPLIED ECON. 149 (1999).

J.C. Moreno-Brid et al., *The Washington Consensus: A Latin American Perspective Fifteen Years Later*, 27 J. POST KEYNESIAN ECON. 345 (2004).

J.C. Moreno-Brid & J. Ros, Mexico's Market Reforms in Historical Perspective (2004) (working paper on file with DRCLAS, Harvard University).

North American Free Trade Agreement, Dec. 17, 1992, 107 Stat. 2057, 32 I.L.M. 289.

P. Pacheco-Lopez, The Impact of Trade Liberalisation on Exports, Imports, the Balance of Payments and Growth: The Case of Mexico (2004) (working paper, on file with the University of Kent).

P. Pacheco-Lopez & A. P. Thirlwall, *Trade Liberalisation in Mexico: Rhetoric and Reality*, 229 BANCA NAZIONALE DEL LAVORO Q. REV. 141 (2004).

P. Ruiz-Nápoles, *Liberalisation, Exports and Growth in Mexico 1978-1994: A Structural Analysis*, 15 INT'L REV. APPLIED ECON. 163 (2001).

P. Ruiz-Napoles, *Export, Growth and Employment in Mexico 1978-2000*, J. POST KEYNESIAN ECON. 105 (2004).

J. Serra, Hacia la profundización de la integración económica de México en el continente americano (2004) (unpublished manuscript on file with the author).

C. Swann, *Envoys Take Fight for Free Trade Deep into Enemy Territory*, FIN. TIMES, Feb. 23, 2005, at 10.

A. Tornell, et al., NAFTA and Mexico's Less-Than-Stellar Performance (2004) (working paper 10289, on file with the National Bureau of Economic Research).

U.N. CONFERENCE ON TRADE AND DEVELOPMENT, TRADE AND DEVELOPMENT REPORT (2002).

M. Weisbrot et al., *NAFTA at Ten: The Recount (2004), at* http://www.cepr.net/publications/NAFTA_at_Ten.htm.

WORLD BANK, WORLD DEVELOPMENT INDICATORS 2004 (2004).