COMENTARIO DE ACTUALIDAD

NAFTA: The Benefits of a Closer Economic Relationship•

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Introduction

In 1990, Mexican President Carlos Salinas de Gortari and the then President of the United States George H. W. Bush, started negotiating a comprehensive bilateral free trade agreement, which Canada joined one year later. The treaty, named the *North American Free Trade Agreement* (NAFTA), was one of the most ample and ambitious free trade agreements that existed at the time, covering the elimination of tariffs on trade, clauses that incorporated foreign direct investment, and mechanisms on the peaceful resolution of disputes, intellectual property and rules of origin. As a one of a kind treaty, many regarded with doubt the effect it would have on the three economies, some opposed it on the basis of job losses due to the disparity of the three economies, and others praised it, viewing it as a key tool for boosting trade, investment, and the overall productivity of the region´s economy.

NAFTA came into effect in 1994, and almost twenty years later, all these perceptions have been proven wrong. The treaty did not cause the adverse effects on the three countries´ economies which its opponents claimed it would, nor did it become the panacea for economic growth in the

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region, especially as one of its main objectives was to eliminate the disparity in income between Mexico, Canada and the United States. The treaty has had more positive than negative effects for the three countries; nonetheless, it has not reached its full potential due to a myriad of variables.

The purpose of this essay is to state the reasons why expanding the economic relationship between the United States and Mexico through NAFTA would benefit both economies.

Three arguments are presented: first, the commonly known factor of interdependence, which means that when one of the countries grows, the other one benefits from this growth; second, reforms, explaining how the application of much needed reforms in Mexico could improve the economic effects of the treaty and expand its benefits; and third, China´s economic expansion and gradual liberalization, explaining how both the United States and Mexico could be better rewarded and could confront the challenge better if they tighten their relationship working as partners rather than as competitors.

Growth of one equals growth of both

Paradigms and common misconceptions sometimes pin the United States and Mexico as competitors more than as partners, and the interdependence between them is regarded as a negative effect on the relationship. The latter is truer in the case of Mexico, which is more vulnerable to changes in United States´ policy and overall productivity. In spite of this, the reality is that there are more positive than negative sides to this close connection between both economies.

Mexico is the second largest destination for United States' exports, its third source of imports, and approximately 6 million jobs in the United States depend on trade with Mexico.[1] On the other hand, Mexican exports to the

[1] Christopher E. Wilson, "Working Together: Economic Ties Between The United States and Mexico", (Washington D.C.: Woodrow Wilson International Center for Scholars , Mexico Institute, 2011) pp. 1.

United States account for approximately 80% of the countries total exports[2]. Studies show that imports from Mexico are 40% of the content produced in the United States, due to vertical specialization, which "occurs when two or more countries share in the manufacturing of a specific good".[3] Therefore, when imports from Mexico rise, not only does this benefit the Mexican industry, it also increases United States´ exports and supports its industry and workers. Each country specializes in a different stage of production, raising their comparative advantage, which results in an increase of regional competitiveness.[4]

Since NAFTA, United States' investment in Mexico and Mexican investment in the United States has grown six times their 1993 level; United States´ investment was, as of 2010, $90 billion, while Mexican investment in the United States was $12.6 billion.[5] Bilateral investment offers benefits to both sides, generating jobs in the host country and generating profits for foreign companies.

With this data in mind, one can see that when one country´s Gross Domestic Product (GDP) rises, along with its imports and investment, the other one benefits from a rise in exports and foreign direct investment (FDI), generating more jobs, increasing production, expanding markets, stimulating trade, augmenting competition, and overall, benefitting consumers in both the United States and Mexico with lower prices and products with greater quality.

Essential reforms

After NAFTA came into effect and started functioning without the expected results in the Mexican economy, meaning job creation, income increase, among others, many blamed this on certain reforms that had not been passed due to the fact that the Mexican Congress is multiparty and as such, it was highly politicized and every initiative of reform was blocked. Politicians and

2 Robert A. Blecker, Gerardo Esquivel, "NAFTA, Trade and Development", Economic Alternatives, (San Diego, CA: Center for US-Mexican Studies, UC San Diego, 2010) pp. 8.
3 Wilson, *Op. Cit.,* pp. 4
4 *Ibid.,* pp. 19.
5 *Ibid.,* pp. 17.

experts in Mexico and abroad often said that Mexico needed reforms in labor, fiscal policy, energy, and education. All of these together could boost the Mexican economy and bring it to its full potential.

The labor reform was approved during ex-President Felipe Calderon´s government which ended in 2012. Now, a series of reforms are taking place during the new government of current President Enrique Peña Nieto. With barely seven months in office, President Peña Nieto has created the political impulse to pass the reforms through his plan called “Pact for Mexico”. The educational reform has been approved, the telecommunication´s reform was published in June, 2012 and is in an interim legislative period of 180 days pending revisions, and fiscal and energy reforms are said to come next. The passing of said reforms would make Mexico more attractive for investment by American companies, which would again be a benefit to both countries. It would enhance investment by; improving individual tax collection, reducing taxes on large companies; modernizing the energy sector making it more profitable and less dependent on government. All of these factors would foster overall competiveness and productivity.

In addition to these passed and proposed reforms, an additional positive factor is that Mexico´s economy, according to the International Monetary Fund, is expected to grow at a steady rate for the next several years. This will in turn increase Mexico´s imports of United States´ products. Data shows that the 5.4% GDP growth of the Mexican economy in 2010 was accompanied by a $34 billion dollar increase in United States´ exports to Mexico[6]. President Barack Obama noted in 2010 that “every $1 billion dollar increase in exports supports more than 6,000 additional jobs.”[7] As Robert Blecker and Gerardo Esquivel, noted international economists, point out, “a

[6] *Ibid.,* pp. 22.

[7] Barack Obama, Speech presented at Export-Import Bank´s Annual Conference, Omni Shoreham Hotel, Washington D.C.: March 11, 2010, available at: http://www.whitehouse.gov/the-press-office/remarks-president-export-import-banks-annual-conference.

growing Mexican economy would be an opportunity for, not a threat to, the United States."[8]

The China Challenge

Since China entered the World Trade Organization in 2001, it displaced Mexico as the number two source of United States' imports. Chinese imports to the United States increased 16.4% annually from 2000 to 2008.[9] Moreover, many Mexican *maquiladoras* shut down and relocated to China due to lower labor costs, affecting many Mexican jobs in the border area. As Blecker and Esquivel note:

> "The penetration of Chinese and other Asian imports not only displaced Mexican exports to the United States, but also displaced U.S. exports of intermediate goods that would otherwise have been shipped into Mexico for assembly."[10]

This means that Mexico did not suffer alone the effects of China´s more open economy; the United States also had something to lose. With time, the Mexican manufacturing sector has been recovering gradually as economic growth in China has caused wages to rise.[11]

In addition, the advantages that Mexico holds *vis-à-vis* China for trade with the United States are many, including lower transportation costs to and from the United States, less time from manufacture to market, easier communication and supervision of production, more transparent government regulation, as well as better protection of intellectual property rights.[12] Also, a wider convergence of trade with Mexico is in the United States´ interest, first,

8 Blecker, Esquivel, *Op. Cit.,* pp. 20
9 *Ibid.,* pp. 7.
10 *Ibid.,* pp. 9.
11 Wilson, *Op. Cit.,* pp. 35.
12 Ralph Watkins, "The China Challenge to Manufacturing in Mexico", Forum on Opportunities in the Economic and Trade Relationship Between China and Mexico in a Latin American Context, (Mexico City: UN Economic Commission for Latin America and the Caribbean, 2006) pp. 5.

because its trade deficit with Mexico is lower than that of its Asian partners;[13] secondly, Mexico is a better consumer of United States´ exports which support more United States' jobs; and finally, as was stated earlier, 40% of the value of Mexican exports to the United States is made from United States´ content, enhancing production and jobs in the United States.[14]

Conclusion

Even though NAFTA did not have the expected positive effects its supporters claimed it would have, it has tightened the relationship between Mexico and the United States through an expansion in trade and investment. Nevertheless, economic integration through NAFTA has not reached its full potential and could still have many benefits for both countries if the countries decide to take full advantage of all of its possibilities.

When Mexico grows, there are positive effects on the American economy, and vice-versa. As Robert Pastor, a foreign affairs analyst, states, "a North American approach needs a vision based on the simple premise that each country benefits from its´ neighbors´ success and each is diminished by their problems or set backs."[15] Working together and cooperating more to enhance each others´ productivity benefits all sides and creates mutual understanding, a greater sense of confidence in each other, and helps to better prepare the region to face together the challenges that the global economy poses.

[13] Blecker, Esquivel, *Op. Cit.,* pp. 21.
[14] Wilson, *Op. Cit.,* pp. 17.
[15] Robert A. Pastor, "The Future of North America", Foreign Affairs, vol. 87, no.4. July-August 2008, pp. 94.

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