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NAFTA: A PARTIAL SOLUTION NOT A SAVIOR TO MEXICO'S ECONOMIC WOES

By

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CDR, CHC, USN

A paper submitted to the Faculty of the Naval War College in partial satisfaction of the requirements of the Department of Joint Military Operations.

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Signature: _____________________

28 October 2011

Contents

Abstract

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NAFTA: A Partial Solution not a Savior to Mexico's Economic Woes

...a free trade agreement is not a substitute for a development strategy.
World Bank Report on NAFTA [1]

Introduction

In the early 1990's, the President of Mexico at the time, Carlos Salinas de Gortari, was reported to have approached then United States President, George H. W. Bush, with the concept of a trade agreement to help Mexico recovery from economic difficulties. In the previous decade, the rise of global interest rates coupled with falling of oil prices (the country's main export), left the country facing high international debt obligation. Mexico was prepared to open its markets with its subsequent high inflation, undervalued currency and the majority of its population living below the national poverty line. [2]

Canada and the United States had already entered into their own bilateral trade agreement in 1988, which saw rapid and expansive growth. The addition of Mexico to the trading alliance was an appealing idea. Negotiators in all three countries thought that a trilateral free trade agreement would create an investment and production block that would "rival those of Asian and European Union countries." [3] In 1992, the three nations began negotiation for a trilateral trade agreement known as, the North American Free Trade Agreement (NAFTA).

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[1] World Bank. "NAFTA is Not Enough." December 2003. http://go.worldbank.org/HIYW5UJD00 (accessed: 6 October 2011).

[2] In 1992, the total population below the national poverty line in Mexico was 53.1%. This figure was derived from the Consejo Nacional de Evaluación de la Política de Desarrollo Social (CONEVAL) which is a government sponsored, decentralized public organization, with autonomy to offer research regarding the social political situation and poverty measurement in Mexico, to allow for better national decision making. CONEVAL developed a methodology for multidimensional poverty measurement in Mexico.
http://data.un.org/Data.aspx?d=MDG&f=seriesRowID%3A581 (accessed: 27 October 2011).

[3] James Cypher. "Mexico Since NAFTA: Elite Delusions and the Reality of Decline." *New Labor Forum (Murphy Institute)* 20, no. 3: 60-69, 2009. *Academic Search Complete,* EBSCO*host* (accessed: 15 September 2011).

The motivation behind Mexico's entrance into trilateral trade agreement was part of a larger economic strategy to turn the country from an import substitute economy (which emphasizes self-reliance and local production of goods) [4] to one of an open market with trade and finance liberalization. It was a direction that Mexico needed to take. By opening its market, Mexico could gain the needed influx of foreign direct investment (FDI), and increase its portfolio investment. It was also a step towards bringing the country closer to economic convergence with its trading partners. [5]

The Agreement

After much controversy, deliberation and campaigning, NAFTA was ratified in 1992 with additional side agreements signed the following year. The trilateral trade agreement was enforced on January 1, 1994, and is still in effect today. According to the agreement, NAFTA's objectives are six fold:

- 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 the agreement, for its joint administration and for the resolution of disputes.

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[4] import substitution. BusinessDictionary.com. WebFinance, Inc. http://www.businessdictionary.com/definition/import-substitution.html (accessed: October 27, 2011).
[5] M. Angeles Villareal. *NAFTA and the Mexican Economy.* Washington DC: Congressional Research Service. June 2010. RL34733. http://www.fas.org/sgp/crs/row/RL34733.pdf (accessed: 15 September 2011).

- Establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement. [6]

The agreement gained global notoriety for a number of reasons. It was the first time that industrialized nations entered into a free trade agreement with a developing nation. It was also the first time that side agreements were attached to a trade liberalization agreement. The North American Agreement on Labor and Cooperation and the North American Agreement on Environmental Cooperation were signed in conjunction with NAFTA. [7] These elements brought a social dimension and heightened expectations to what NAFTA could provide.

The Hope and Loss of Faith

Of the three nations, Mexico was believed to have the biggest potential gain. Mexico had willingly forgone any special considerations during the negotiations regarding its status as a developing nation. Even though the economic structures of the three countries were asymmetrical, Mexican negotiators did not think their weak economy would make them more vulnerable to the dominant economic power of the United States. On the contrary, Mexican economists believed they had an opportunity in NAFTA to restructure the market infrastructure to make the economy more efficient, and by using FDI, to gain technology and international markets. [8] NAFTA also gave Mexico a "credibility anchor" in the international market. By having financial ties to the United States and Canada, the trilateral free trade agreement was seen as a "mechanism that could reduce adverse selection and elimination of potential problems of

[6] The North American Free Trade Agreement. http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/texte/index.aspx?view=d (accessed: 15 September 2011).
[7] Carol Wise. "NAFTA and Mexico: Sorting Out the Facts." *Insights on Law & Society* 9, no. 3: 10-27. 2009. *Academic Search Complete*, EBSCO*host* (accessed: 15 September 2011).
[8] Maxwell A. Cameron, and Brian W. Tomlin. 2002. *The Making of NAFTA: How the Deal Was Done*. New York: Cornell University Press, page 227.

time-inconsistency with respect to the Mexican reform process." [9] Essentially, NAFTA seemed a winning strategy from the start.

Politicians were quick to jump on the NAFTA public relations campaign. President Salinas promised that, "Mexicans would gain the jobs Americans lost," and that these job gains "would halt the northward flow of Mexican job seekers." [10] For the average worker, it seemed like a promise for a better life with more jobs and increased wages. It was believed that NAFTA would lift the country's status from a developing nation to one that would have economic convergence with its trading partners.

Through the politicizing and socializing of NAFTA, it became more than a free trade agreement. It represented the people's hope for transformation. It was anticipated that NAFTA would fulfill broader social goals such as: creating good jobs, reducing illegal immigration, reducing poverty and income inequality, enhancing labor rights, and protecting the environment.[11] In a larger context, NAFTA became a symbol for the way out of economic hardship for millions of Mexicans.

It has been nearly eighteen years since the trade agreement was enforced and the "promises" of NAFTA seem largely unmet. It has not been the panacea that it was sold to be. Critics are quick to point out that the expectations for increased jobs and increased wages have been unfulfilled. For example, at the fifteen-year mark, critics cite that under NAFTA the Mexican economy could not keep up with demands for new jobs. The economy at that time experienced

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[9] Jorge Blazquez and Javier Santiso. "Mexico: Is it an Ex-Emerging Market." *Journal of Latin American Studies*, vol. 36, no. 2, May 2004, pp. 297-318 http://www.jstor.org/stable/3875617 (accessed: 27 October 2011).
[10] David Bacon, "NAFTA's Legacy – Profits and Poverty," *San Francisco Chronicle*, January 14, 2004. http://www.commondreams.org/views04/0114-04.htm (accessed: 15 September 2011).
[11] John Cavanagh, Sarah Anderson, Jaime Serra and J. Enrique Espinosa. "Debate: Happily Ever NAFTA?" *Foreign Policy,* no. 132, Sep.-Oct. 2002, pp. 58-65.

marginal growth and was inadequate to provide jobs for the million young adults who entered the workforce and the millions who barely scraped by. [12] Additionally, when poverty rates did not significantly improve, critics had lost faith in NAFTA as a potential solution to Mexico's economic troubles. It seems for all the hopes pinned on it, NAFTA became the whipping boy for all of Mexico's trouble, both economically, and even in a broader sense, socially. Critics point out the disconnection between what politicians promised and what has been actually achieved.

Approaching an Assessment

What exactly has been NAFTA's effect on the Mexican economy? The answer is broad, challenging and complex. There are several factors that complicate matters. Economic analysts do not always agree on measures of effectiveness. Critics may be quick to point out negative statistics and negative consequences that may or may not have any direct correlation with NAFTA. Politicians, in support of the free trade agreement, may be passionate and have difficulty separating facts from rhetoric. What remains is a foggy picture of NAFTA's impact on the Mexican economy– one that can be clouded by misplaced faith rather than supported by facts.

To adequately critique the breadth of the trilateral agreement in the context of an entire economic system is clearly beyond the scope of this paper. However, what can be analyzed are the two prevailing narratives, which have been raised by critics and supporters in the midst of NAFTA's friction. The first argument is that NAFTA has been a failure and a direct cause of Mexico's inability to rise to the point of economic convergence with Canada and the United

[12] Elisabeth Malkin. "Nafta's Promise, Unfulfilled," *The New York Times*, March 24, 2009, http://www.nytimes.com/2009/03/24/business/worldbusiness/24peso.html (accessed 15 September 2011).

States. Critics point to three areas of concern: job, wages and poverty. While this argument sounds plausible on the surface, it does not hold weight compared to a macroeconomic viewpoint and statistics that prove otherwise.

The second (and more plausible) argument is that NAFTA has had an overall positive effect on the Mexican economy. Trade liberalization provides the means for the country to compete in global markets, and Mexico has risen to the occasion with a booming and stable economy. Supporters of NAFTA see the real challenge as Mexican domestic policies, which are in need of reform. Without such reforms, the gains of NAFTA may not trickle down to the average worker. In other words, NAFTA has been and continues to be a part of the solution to the Mexican economy, but not its savior.

Key Assumptions

In order to provide a framework for analyzing the dual narratives of NAFTA's impact on the Mexican economy, certain key assumptions must be pointed out.

- First, a trade agreement is a means not an end. It provides an opportunity for countries to achieve economic gain. NAFTA is a limited document. It was not drafted to solve all the ills of Mexican society, despite the inflated promises of politicians who touted it as an instant and cure-all solution.

- Second, as with any trade agreement, there will be winners and losers. It is unreasonable to assume that a trade policy will benefit every economic sector of a nation. Economic transformation suggests that while one sector will grow, another can potentially be reduced. Mexico's diverse economy is no exception. In other words, instead of focusing on the decline of a particular sector, it is imperative to take a larger perspective of the overall gains.

- Third, there is difficulty in assessing the precise impact of NAFTA on the Mexican economy. Statistics and exact data figures are approximate at best. Arguments made in this paper reflect general conclusions based on authoritative research and scholarship.

- Fourth, the unintended consequences of an impoverished population such as, the rise in migration and illegal trade cannot be directly attributed to NAFTA. Research in this area concludes that there is no causal link between the implementation of NAFTA and these kinds of issues. It is important to highlight this fact, since these unintended consequences can cloud an impassionate assessment.

- Fifth, the importance of assessing the overall effectiveness of NAFTA is invaluable at a time when the U.S. Congress has just approved free trade negotiations with Korea, Panama, and Columbia. Economic integration and globalization are an important aspect of U.S. international relations and can affect foreign policy and national security.

This paper is divided into six sections. The first section offers background information on the agreement. The second section highlights the counterargument to NAFTA's success and argues that NAFTA is a problem -- not a solution. The next section addresses the key arguments of critics and offers an alternative broader viewpoint of NAFTA's overall achievements. This is followed by a discussion of the benefits of trade liberalization and reforms the government can make to further bolster the gains achieved through NAFTA. Finally, the paper concludes that NAFTA, while not drafted to solve all the ills of the Mexican economy or society, has led the country to a path of prosperity. It is, indeed, part of the solution to the problems of Mexico's developing economy, but not all of the solution.

Blaming NAFTA for Negative Impacts

Manufacturing and Agriculture: Hard Shock to Workers

Not all economists think NAFTA has had positive benefits for the Mexican economy. Critics suggest that NAFTA has not been a partial solution at all, but a direct contributor to problems such as job losses, lower wages and poverty. Critics point to two major factors where NAFTA has had a seemingly negative impact: the deindustrialization of the manufacturing sector and a decline in the agricultural sector.

First, critics blame NAFTA for tying the Mexican economy to a low wage export strategy. An unintended consequence of increased FDI has been a deindustrialized Mexico through the rise of the maquiladoras. These transnational companies rely on imported parts and supplies that are exempt from tariffs and then assembled in Mexican plants into such items as apparel, machinery and electronics for export. These companies pay export tariffs on the difference in value. Maquiladoras take advantage of cheap labor, and the lack of regulation or enforcement of policies relating to labor conditions and the environment. A low wage export strategy can have a negative effect on jobs and wages, since export markets fluctuate in the global arena. As the demand for exports decrease, Mexican manufacturing jobs can also decrease. The fluctuation and instability of a deindustrialized Mexico can be a hard shock to the many maquiladora workers whose employment is tied to the export market.

Second, critics blame NAFTA for losses in the agricultural sector. When the final tariffs on certain staple products, like corn, were lifted on January 1, 2008, Mexican rural farmers could not compete with falling prices. Agribusinesses in the U.S. were able to dump their subsidized products at well below Mexican production prices. Consequently, millions of small farmers, mostly in the southern areas, were severely affected.

Jobs, Wages and Poverty: Not Always a Gain in the Short Term

The years following the implementation of NAFTA saw a downward trend in jobs and wages. Critics directly blame trade liberalization, as the mechanism that caused these results. For instance, NAFTA related reforms mandated the privatization of the certain sectors, including transportation (airlines, railroads) and manufacturing. This led to the loss of over a million jobs across Mexico. It was hoped that the maquiladora industry would create enough new jobs to stem the tide of unemployment. However, this did not happen as rapidly as critics would have liked. In 2001, the Maquiladora Association reported that 1.3 million were employed in over 2000 plants along the border. However, in following years, over 400,000 of those workers would find themselves unemployed, due to an economic recession. [13] Additionally, in this time period, real manufacturing wages were 12% below pre-NAFTA levels, while maquiladora wages only rose by 3%. The lower wages and loss of jobs did not help Mexico decrease poverty levels, which fluctuated between 30-40% of Mexican households. [14]

Perhaps, the hardest hit sector was agriculture. As previously mentioned, when price supports were removed in 2008, rural farmers who could not compete with cheaper U.S. subsidized products found themselves looking for other means of survival. It is estimated that in 1993 (pre-NAFTA) there were 8.1 million Mexicans employed in the agriculture sector. Once NAFTA was implemented, that figure began a constant downward shift. In 2004, it was reported that 6.8 million workers in the same sector – a decline of over 16%. [15] Consequently, most farmers sought other employment opportunities in the north, or began to rely mainly on remittances sent back from family member abroad.

Is NAFTA to blame for these economic factors? Political analysts and economists do not think so. Noted economist, Luis Rubio, director of the Center of Research for Development, a Mexican political/economic think tank, asserts that it is a fad among the public and politicians to blame NAFTA of all the ills of the Mexican economy. The reality of the matter, according to Rubio, is that "the only thing that really works in the Mexican economy is the sector linked to

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[13] Bacon.
[14] John J. Aduley, Demetrios G. Papdemetriou, Sandra Polaski and Scott Vaughan. *NAFTA's Promise and Reality: Lessons from Mexico for the Hemisphere.* The Carnegie Endowment for International Peace. 2004, page 26. http://carnegieendowment.org/2003/11/09/nafta-s-promise-and-reality-lessons-from-mexico-for-hemishphere/3ge (accessed: 15 September, 2011).
[15] Carlos Salas. "Between Unemployment and Insecurity in Mexico: NAFTA Enters its Second Decade." *Economic Policy Institute*. Economic Briefing Paper 173, 28 September 2006, page 42.

NAFTA, which is the modernized, dynamic area that draws investment." [16] Essentially, without NAFTA, jobs, wages and poverty would even be worse. Economic integration and globalization has had a transformative effect, which will continue to benefit Mexico in the long run.

Addressing the Critics

Manufacturing and Agriculture: Shifting Dynamics

As mentioned previously, critics blame NAFTA for tying the country to a low-wage export strategy that affected both the manufacturing and agricultural sectors. However, this argument becomes a moot point in the overall context of how and why NAFTA was conceived. It is important to note that Mexico's economic transformation from a largely import substitute, closed economy to an open economy was over four decades in the making. For instance, maquiladoras, which are key elements in an overall export strategy, were established in 1965, long before NAFTA.

It wasn't until the early 1980's that then president, Miguel de la Madrid Hurtado, instituted several economic reforms that would shift the economy from its traditional state-led development strategy to one that was focused on trade and financial liberalization, FDI deregulation and privatization. NAFTA, which came about a decade later, was a logical next step in Mexico's insertion into the international marketplace. It was a step in the right direction. According to noted Mexican economist, Juan Carlos Moreno-Brid, "Within twenty-five years, [Mexico] went from being essentially an oil-exporting country to becoming a major export platform of manufactured goods, including vehicles, auto parts, ready-made clothing and

[16] Marcela Valente. "The Lessons of NAFTA: How Mexico Has Fared" *Interpress Service.* Rome. 20 April 2001. http://www.worldpress.org/Americas/148.cfm (accessed: 15 September 2011).

electronic products to the U.S.” [17] Mexico’s economic reforms certainly positioned the country to compete in the global market, but it was not without consequences.

Mexico’s shifting strategy brought a rapid change in economic structure. Manufacturing and agriculture were certainly affected. However, economic theory suggests that, in general, developing nations, that adopt a liberal trade and finance strategy, will experience a rapid change in economic dynamics (from agriculture to industry, from household production to market production, etc.…). Other developing nations such as the Philippines, Thailand and Vietnam experienced similar changes and also experience rapid economic growth. Simply put, these shifting strategies with short-term negative effects in manufacturing and agriculture are symptomatic of Mexico’s economic growing pains. However, as painful as it may have been/or continues to be for a segment of the overall economy, Mexico is on a more prosperous path than its pre-NAFTA course.

Jobs, Wages and Poverty: Forces Beyond NAFTA

While critics directly blame NAFTA for loss of jobs, lower wages and poverty, supporters have a different story. The loss of jobs that occurred in the first ten years of NAFTA’s existence can be attributed to stagnation and increased competition – and not to NAFTA. Economic integration with the United States has linked the Mexican economy closely to that of its northern neighbor. When the United States experienced its recession and subsequent stagnation in 2001,

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[17] Moreno-Brid, Juan Carlos, Jesús Santamaría, and Juan Carlos Rivas Valdivia. "Industrialization and Economic Growth in Mexico after NAFTA: The Road Travelled." *Development & Change* 36, no. 6, November 2005, pp. 1095-1119. *Academic Search Complete*, EBSCO*host* (accessed: 20 October 2011).

Mexico was no doubt affected. However, since 2001, Mexico's economy has recovered and stabilized in recent years.

Another reason for the loss of jobs during that time was the increased competition with other countries. For example, when China entered into the World Trade Organization in 2001, Mexico was faced with a serious competitor in the labor market. Transnational companies found it in their best interest to move their operations where labor costs were lower. To offset this, Mexico expanded its market to Latin America and Asia. While it is true that manufacturing jobs were lost early on in the competition with China, this is no longer the case. In recent years, overseas transportation costs and Chinese wages have been on the rise, prompting transnational companies, especially in the automotive and electronics sectors, to move from China to Mexico.[18] Companies such as: Mazda, Ford, Hewlett Packard, Sony and Blackberry operate maquiladoras in northern Mexico.

In regards to the idea that NAFTA can be blamed for the lowering of wages, analysts provide a different side. Economists indicate that there were/are factors which are simply beyond NAFTA that played a part in the lowering of wages. These include the interrelationship between the GDP, productivity, exchange rates, international trade, technology, the differences in skill and unskilled labor, and the cyclical nature of the economy, itself. [19]

Another factor that contributed to the lowering of wages is the 1994-1995 pesos crisis. In a comprehensive analysis, the Carnegie Endowment for International Peace concluded that the lowering of wages after 1994 was mainly attributed to the devaluation of the Mexican currency,

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[18] Quincy Yu. "Foreign Firms Say China Losing Competitive Edge." *Epoch Times.* February 3, 2001. http://epoch-archive.com/a1/en/sg/nnn/2011/02%20February_2011/Issue%20350_15%20February_2011/350_A5.pdf (accessed: 20 October 2011).

[19] Villareal.

and not to NAFTA, itself. [20] In fact, NAFTA helped facilitate the recovery of the Mexican economy from this crisis. It did this by obligating the country to follow a textbook recovery program based on fiscal constraint, tight money and currency devaluation. Additionally, since the United States had a vital interest in a stable Mexican economy, it offered a financial rescue package by offering loans and assistance. [21] Without NAFTA, the Mexican economy may have fared worse in the aftermath of the peso crisis.

With regards to the issue of poverty, NAFTA supporters point out that economic asymmetries existed before the free trade agreement was ratified. These asymmetries have only been accentuated as Mexico has had a growth in some areas, while others declined. For instance, the northern industrial regions near the border have experienced growth while the southern rural agricultural regions have seen a decline in jobs and wages. In 2008, it was reported that 12% of population in the north lived below the poverty line compared to 47% in the south.[22] Economists believe that this income disparity existed before NAFTA, and has only been accentuated in recent years.[23] However, pre and post NAFTA statistics do show an overall improvement in poverty rates. According to the United Nations, the total poverty rate for Mexico went from 53.1% in 1992 to 47% in 2009. [24]

[20] Aduley, page 33.
[21] Gary Clyde Hufbauer, and Jeffrey J. Schott. *NAFTA Revisited: Achievements and Challenges.* Washington, DC: Institute for International Economics. 2005, page 11.
[22] Elizabeth Burgess. "Still Unclear if NAFTA Has Reduced Poverty, Inequality in Mexico." *Inter-American Dialogue.* 2008. http://www.thedialogue.org/page.cfm?pageID=32&pubID=1195 (accessed: 15 September, 2011).
[23] Burgess.
[24] The United Nations data statistics included here are from the Consejo Nacional de Evaluación de la Política de Desarrollo Social. http://data.un.org/Data.aspx?q=mexico+poverty+&d=MDG&f=seriesRowID%3a581%3bcountryID%3a484 (accessed: 27 October 2011).

While critics would like to blame NAFTA for the woes of Mexican economy, the reality is that trade liberalization has had an overall positive impact on the country. The team members who drafted NAFTA explain, "We are convinced that the agreement has supported broad social goods including job creation and environmental protection. However, we have always acknowledged that the agreement would not provide an instant and universal remedy to Mexico's problems." [25]

NAFTA is Good for Mexico

Economic Progress

Economic analysts can point to growth in Mexico post NAFTA. According to the World Bank, Mexico is now considered a high middle class economy. In 2004, at the ten-year mark, the World Bank issued a comprehensive 346-page report, which concluded that NAFTA directly helped Mexico "get closer to the levels of development of its NAFTA partners." [26] The report suggested that without NAFTA, Mexico's global exports would have been about 25% lower, and foreign direct investment (FDI) would have been about 40% less. The report also suggested that NAFTA could take "some credit for moderate declines in poverty, and has likely had positive impacts on the number and quality of jobs." [27]

The Council on Foreign Relations, an independent think tank, reported that from 1994 to 2008, Mexico's gross domestic product has increased at an average rate of 2.7%, just under that

[25] Cavanaugh.
[26] Daniel Lederman, William F. Maloney, and Luis Severn. *Lessons from NAFTA for Latin America and Caribbean Countries: A Summary of Research Findings.* World Bank. 2003. http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/EXTLACOFFICEOFCE/0,,contentMDK:20393778~pagePK:64168445~piPK:64168309~theSitePK:870893,00.html (accessed: 15 September 2011).
[27] Lederman.

of the United States (3.3%) and Canada (3.6%). [28] Mexican exports to the United States have quadrupled from $60 billion to $280 billion per year. Additionally, American exports to Mexico have more than tripled as the Mexico's economy has broadly increased. [29] It has also reported that prices for Mexican consumers have been dramatically reduced during the same time period. Grupo de Economists y Asociados, a political and economic consulting firm based in Mexico City, cites that the cost of basic household goods in Mexico has been lowered in half, since NAFTA's implementation. [30]

From 2008-2009, Mexico was hit with a recession. However, in 2010, the Mexican economy showed signs of rebound, as it posted its fastest expansion in ten years, while adding 730,000 jobs.[31] According to Finance Minister, Ernesto Cordero, Mexico is Latin America's second biggest economy and is on track to expand 4% to 5% in 2011. [32] Mexico has, indeed, benefited from trade liberalization. In addition to NAFTA, Mexico has entered into a total of eleven free trade agreements with forty-one countries including Japan, Israel and the European Union. [33]

The Benefits of Trade Liberalization

In addition to the economic strides Mexico has made since 1994, two other benefits of trade liberalization through NAFTA have been achieved. First, technological innovation and research

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[28] Council on Foreign Relations. "NAFTA's Economic Impact." http://www.cfr.org/economics/naftas-economic-impact/p15790 (accessed: 15 September 2011).
[29] Council on Foreign Relations.
[30] Council on Foreign Relations.
[31] Laura Price and Thomas Black. "Codero Says Mexico's 2011 GDP May Expand up to 5% on Domestic Consumption." Bloomberg News. 22 March, 2011. http://www.bloomberg.com/news/2011-09-01/cordero-says-data-point-to-slower-mexico-2011-gdp-growth-1-.html (accessed: 13 October 2011).
[32] Price.
[33] M. Angeles Villareal. *Mexico's Free Trade Agreements.* Washington, DC: Congressional Research Service. 7-5700 R40784 July 12, 2010. http://www.fas.org/sgp/crs/row/R40784.pdf (accessed: 14 October 2011).

and development (R&D) have grown. For example, technological advancement in Mexican manufacturing systems has increased at higher rate than pre-NAFTA. The time required for adoption of U.S. technology has been cut in half. [34] There is a positive correlation between maquiladoras, FDI, exposure to industrialized global markets and innovation which result in a wider range of products, tools and improvements in processing. [35] The competitive global export market has provided incentive for R&D expansion in Mexico. Pre-NAFTA only one third of Mexican companies devoted resources to R&D, but in five years post-NAFTA , that figure grew to one half. [36] The National Science Foundation also reported that R&D spending in Mexico jumped from $1.1 billion pre-NAFTA to $2.1 billion in two years post NAFTA. [37]

The second benefit from trade liberalization through NAFTA, was a move to a more democratic and open political system. Researchers point to a positive correlation between trade liberalization and democratization of developing nations. Think tank economist, Daniel Griswold, claims, "The economic competition from NAFTA has helped to till the soil in Mexico for a more open and competitive political system. It is no coincidence that a few short years after the enactment of NAFTA, Mexicans were able to end seven decades of one-party rule by

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[34] Lederman.
[35] Roberto Alvarez and Raymond Robertson. *Exposure to Foreign Markets and Firm-level Innovation: Evidence from Chile and Mexico.* Asociación de Economía de América Latina y el Caribe (LACEA) Conference, Montevideo, Urguay, 2001. http://www.lacea.org/meeting2001/Robertson.pdf (accessed: 28 October 2011).
[36] Liliana Meza González and Ana Belén Mora Yague. "Trade and Private R&D in Mexico." *Economia Mexicana.* 15 January 2004. http://www.economiamexicana.cide.edu/num_anteriores/XIV-2/LILIANA_MEZA.pdf (accessed: 28 October 2011).
[37] The National Science Foundation. "Latin America: R&D spending jumps by Brazil, Mexico and Costa Rica." http://www.nsf.gov/statistics/nsf00316/secta.htm#summary (accessed: 28 October 2011).

electing opposition candidate Vicente Fox as their president." [38] Trade liberalization and globalization have paved the way for a more democratized Mexico, by opening up new avenues of support for elected officials. [39] With economic prosperity falling to a larger segment of the population, politicians can no longer rely on support from a close circle of oligarchs.

NAFTA is Not Enough

NAFTA has provided overall success on the macroeconomic front. Mexican inflation is under control, the country's deficit is manageable, there are fiscal and monetary disciples and exports have increased. These indicators suggest NAFTA has been and continues to be a partial solution to Mexico's economic problem. However, NAFTA is not enough. In order to ensure that the country's economic gains will be sustainable and benefit more than just the small circle of corporations and elite individuals, domestic policy reforms are essential. While there are no easy answers, the following are recommendations.

Incentives for Farmers

One of the provisions of NAFTA was to lift the tariff on agricultural products including, corn, sugar beans and milk after fifteen years of the agreement's enforcement. The reason for this fifteen year span was to give Canada, United States and Mexico the time to implement internal governmental reforms to help their farmers absorb the shock of free trade. When price supports were eventually eliminated, Mexico had done very little to help its small farmers

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[38] Griswold, Daniel. "NAFTA Benefits Arizona." July 2, 2003. http://www.cato.org/pub_display.php?pub_id=3149 (accessed: 27 October 2011).
[39] Helen V. Milner and Keiko Kubota. "Why the Move to Free Trade? Democracy and Trade Policy in the Developing Countries." *International Organization*, vol. 59, no. 1, Winter, 2005, pp. 107-143 http://www.jstor.org/stable/3877880 (accessed: 25 October 2011).

modernize their operations. Incentives could have been offered to assist rural farmers to install irrigation or switch to crops more conducive to Mexico's soil and climate. Jaime Serra Puche, a noted economist and former Mexico Commerce Secretary who helped negotiate NAFTA, asserts, "The government had 15 years to come up with incentives to convince farmers to place broccoli and asparagus, but they didn't do that." [40]

Unless the government changes its agricultural policies for small farmers, the picture remains bleak for this segment of agricultural workers. It is estimated that 80% of them continue to work non-irrigated fields of 25 acres or less producing a single crop when enough rain falls. According to the Agriculture Ministry, only 6% of these rural farmers can export anything, otherwise, they are basically subsistence farmers barely scraping out a living. [41] The government must undertake an incentive program for modernization, or this sector will continue to marginalize, while the rest of the country continues along the road to economic integration, and globalization.

Distribution of Agriculture Subsidies

Perhaps, the largest setback post-NAFTA for the roughly three million rural Mexican farmers has been the government's failure to distribute agricultural subsidies in a fair manner. [42] Because the majority of subsidies are passed on to large confederations and food conglomerates, funds hardly, if ever, trickle down to the individual farmer. In 2008, Mexico's federal farm subsidies for the year totaled over $22 billion. According to Luis de la Calle, former Undersecretary for International Trade Negotiations, while rural farmers living in poverty have protested in the

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[40] Geri Smith. "NAFTA: Two Mexicos, Two Outcomes." *BusinessWeek Online*. 2009. *Academic Search Complete*. EBSCO. Web. (accessed: 2 September, 2011).
[41] Smith.
[42] Smith.

capital every year, the subsidies always go to the union organizers or to large farmers that are politically connected. [43] Government policy can be reformed to ensure that millions of peasant farmers will receive enough government support to keep above poverty levels.

Labor Rights

A comprehensive study sponsored by Boston University regarding NAFTA concluded that better labor standards in Mexico could result in higher wages of average workers. While production costs may increase, the net result would be a global middle class that would spur the demand for more exports. [44] Additionally, a World Bank regional studies report concluded that protecting labor rights, providing unemployment insurance, and practicing ongoing relocation of workers to better job matches could have a positive effect on trade liberalization. In essence, transaction costs would be kept down by avoiding litigious dismissals. [45] This would require more investment in the labor market, which has yet to happen.

The biggest barriers to improving labor rights are the unions and conglomerates that have monopolized industry since privatization in the 1990s. Analysts report that there is an institutional bias against facilitating labor rights and enforcing labor policies. This claim can be substantiated by the fact that the side agreement coupled to NAFTA regarding labor cooperation has been largely unenforceable. The government can do a better job enforcing labor standards, in order to meet the expectations of the trade agreement and facilitating more growth across the entire labor market.

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[43] Smith.
[44] Pardee Center Task Force Report. *The Future of North American Trade Policy: Lessons from NAFTA.* Boston University. 2009. http://www.bu.edu/pardee/task-force-report-nafta/ (accessed: 15 September, 2011).
[45] Lederman.

Managing Corruption

The Transparency International's Corruption Perception Index for 2010, rates Mexico a 3.1 on a scale of 1 (most corrupt) to 10 (most clean). [46] Corruption provides a barrier to further economic, social and political progress. Mexico has had a history of government corruption. Even President Salinas, who helped negotiate NAFTA, fled the country under scrutiny of receiving kickbacks from companies that privatized under the reforms of NAFTA. While corruption maybe ingrained within the cultural fabric of Mexican social and political infrastructure, bringing it down to a more manageable level is a goal worth pursuing.

Mexico, like other developing nations, is under the scrutiny of global commerce. It must manage and regulate its internal affairs by guidelines set by lender or aid institutions such as, the World Bank and the International Monetary Fund. In order to remain competitive in the international arena, it must be attractive, demonstrating low risk and low levels of corruption. [47] By reducing the perception of corruption, Mexico can continue to attract FDI and move closer to reaching economic convergence with its NAFTA trading partners.

Economic Regulations, Institutional Reforms and Infrastructure Enhancement

In order to sustain the economic growth that Mexico experienced post-NAFTA, the government should make comprehensive efforts focusing on tax reform, the deregulation of the telecommunication industry, the reduction of dependence on oil reserves, the generation of investment opportunities in energy sectors, and amending the judicial system to enhance the rule

[46] Transparency International. *Corruption Perceptions Index Report 2010.* http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results (accessed: 14 October, 2011).
[47] Gabriela Coronado. "Discourses of Anti-corruption in Mexico: Culture of Corruption or Corruption of Culture?" *PORTAL: Journal of Multidisciplinary International Studies* 5, no. 1, January 2008: 1-23. *Academic Search Complete*, EBSCO*host* (accessed 20 October 2011).

of law. Additionally, economists believe that the country must institute a number of reforms affecting a wider spectrum of Mexican society that include providing more resources for public infrastructures, and improving education and human capital development. [48] With these reforms, the country could "attract more skill-intensive industries with greater spillover benefits for the domestic economy—and a greater potential to raise Mexican families' incomes toward U.S. and Canadian levels." [49]

Conclusion

NAFTA's impact on the Mexican economy has been positive. NAFTA's objectives regarding free trade and investment have been achieved. The overall economic gains outweigh any short-term shifts in the manufacturing and agricultural sectors. However, critics hold to a cliché argument that NAFTA was not "sold on these terms," [50] expecting broader and sweeping economic and social transformation. Their argument that NAFTA has failed to fulfill its promises, have been largely based on short-term, narrow viewpoints which do not adequately take into account a broader perspective of the economic infrastructure changes that have set Mexico on a new course of trade liberalization.

NAFTA has been and remains a part of Mexico's solution to a better economy. Trade liberalization has further opened the door to economic integration, modernization and globalization. The transformation of the economy has proven to bring Mexico a step closer to

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[48] M. Ayhan Kose, Guy M. Meredith, and Christopher M. Towe. "How Has NAFTA Affected the Mexican Economy? Review and Evidence." International Monetary Fund Working Paper. IMF: 2004. http://www.imf.org/external/pubs/ft/wp/2004/wp0459.pdf (accessed: 27 October 2011).
[49] Robert Blecker. "The North American Economies After NAFTA: A Critical Appraisal." *International Journal of Political Economy,* vol. 33, no. 3, Fall 2003, pp. 5–27. http://nw08.american.edu/~blecker/research/01Blecker.pdf (accessed: 27 October 2011).
[50] Lederman.

convergence with its trading partners. However, NAFTA is not enough. A single trade agreement is no substitute for a comprehensive long-term development strategy. Developing a country's economy and, along with its human capital, is an effort that requires a multifaceted approach involving governmental reforms. NAFTA was, and continues to be, a step in the right direction towards convergence with the United States and Canada. The journey, however, is longer road than NAFTA critics are probably willing to admit.

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