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NAFTA's Mixed Record

The View From Mexico

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When the North American Free Trade Agreement was proposed, it set off a vigorous debate across the continent about its benefits and drawbacks. Today, 20 years after it came into effect, perhaps the only thing everyone can agree on is that all sides greatly exaggerated: NAFTA brought neither the huge gains its proponents promised nor the dramatic losses its adversaries warned of. Everything else is debatable. Mexico, in particular, is a very different place today -- a multiparty democracy with a broad middle class and a competitive export economy -- and its people are far better off than ever before, but finding the source of the vast changes that have swept the country is a challenging task. It would be overly simplistic to credit NAFTA for Mexico's many transformations, just as it would be to blame NAFTA for Mexico's many failings.

The truth lies somewhere in between. Viewed exclusively as a trade deal, NAFTA has been an undeniable success story for Mexico, ushering in a dramatic surge in exports. But if the purpose of the agreement was to spur economic growth, create jobs, boost productivity, lift wages, and discourage emigration, then the results have been less clear-cut.

PLUSES AND MINUSES

Without a doubt, NAFTA has drastically expanded Mexican trade. Although exports began increasing several years before the treaty was finalized, when President Miguel de la Madrid brought the country into the General Agreement on Tariffs and Trade (the predecessor of the World Trade Organization) in 1985, NAFTA accelerated the trend. Mexico's exports leapt from about $60 billion in 1994 (the year NAFTA went into force) to nearly $400 billion in 2013. Manufactured goods, such as cars, cell phones, and refrigerators, compose a large share of these exports, and some of Mexico's largest firms are major players abroad. Moreover, the corollary of that export boom -- an explosion of imports -- has driven down the price of consumer goods, from shoes to televisions to beef. Thanks to this "Walmart effect," millions of Mexicans can now buy products that were once reserved for a middle class that was less than a third of the population, and those products are now of far superior quality. If Mexico has become a middle-class society, as many now argue, it is largely due to this transformation, especially considering that Mexicans' aggregate incomes have not risen much, in real terms, since NAFTA entered into force.

NAFTA also locked in the macroeconomic policies that have encouraged, or at least allowed, these gains for the Mexican consumer and the country. Although the Mexican government made undeniable economic policy mistakes in 1994 (when it froze the exchange rate and loosened credit), in 2001 (when it failed to pump-prime modestly), and again in 2009 (when it underestimated the magnitude of the contraction), over the long run, the authorities have kept in place sound public finances, low inflation, liberal trade policies, and a currency that has been unpegged and, since 1994, never overvalued.

This package has not been without its costs, but it has fostered a remarkable period of financial stability, bringing down interest rates and providing credit for myriad Mexicans. Over five million new homes -- albeit often ugly, small, and far removed from workplaces -- have been constructed and sold over the past 15 years, largely because families now have access to low, fixed-rate mortgages in pesos. Although no clause in NAFTA explicitly mandated orthodox economic management, the agreement ended up straitjacketing a government accustomed to overspending, overpromising, and underachieving. It prevented Mexico from returning to the old days of protectionism and large-scale nationalizations and caused the prices of tradable goods on both sides of the border to converge. As a result, NAFTA made Mexico's traditional gargantuan deficits no longer viable, since they were now generators of currency crises, as in late 1994.

NAFTA's political effects on Mexico are harder to assess. Many of those who disagreed with the deal, like me, opposed it because it looked like a last-minute propping up of the authoritarian political system, which had been devised in the late 1920s and was on its last legs in the mid-1990s. And indeed, to the dismay of those who believed that 1994 was the right time for Mexico to leave the Institutional Revolutionary Party (PRI) behind and move on to a full-fledged representative democracy, NAFTA did provide life support to what the writer Mario Vargas Llosa famously called "the perfect dictatorship," which otherwise might have succumbed to the democratic wave sweeping Latin America, eastern Europe, Africa, and Asia at the time. But many other Mexicans with equally valid democratic credentials consider NAFTA directly responsible for the PRI's loss of power in 2000. Without the trade deal, the logic goes, U.S. President Bill Clinton would never have agreed to the $50 billion U.S. bailout of Mexico in 1995, which some believe he made conditional on President Ernesto Zedillo's acceptance of free and fair elections five years later, regardless of who won.

Both cases are difficult to prove. Multiple crises befell Mexico in 1994: the Zapatista rebel uprising in the state of Chiapas broke out; the PRI's presidential candidate, Luis Donaldo Colosio, was assassinated; and the economy overheated, leading to a financial crisis in December of that year. Had NAFTA been rejected in late 1993, the PRI might well have lost the 1994 elections, since it would have suffered a tremendous setback and would have been unable to undertake the spending spree that ratification allowed. Conversely, one could argue that by committing any Mexican president to prudent economic policies and ever-closer relations with the United States, NAFTA helped speed the end of the PRI era by guaranteeing that no government could stray far from the policies that the Mexican business sector and Washington preferred. Politically, then, NAFTA either contributed to Mexico's democratic transition or postponed it by six years; although the former assessment is understandable, the latter is more plausible.

Whatever the case, NAFTA helped open Mexicans' minds. Mexican society had begun a process of modernization well before the 1990s, but by increasing all types of cross-border exchanges, the treaty accelerated the shift toward an attitude that has stressed Mexico's victimization less and been less introspective and history-obsessed. Although the change has yet to cause a permanent retooling of Mexico's foreign policy, everyday Mexicans' views of the world, and of the United States in particular, have evolved thanks in large part to the trade agreement.

GROWING FLAT

Despite the real benefits NAFTA has wrought for Mexico, the economic growth so many of the treaty's advocates imagined would ensue has remained elusive. Since 1994, the nation has been governed by five presidents from two parties, and the world has lived through the longest expansion in modern U.S. economic history, the worst recession since the Great Depression, and a commodity boom fueled by insatiable Chinese and Indian demand. That period was long and eventful enough to cancel out any aberrations. During this time, Mexico experienced two years of major economic contraction (1995 and 2009), two years of zero growth (2001 and 2013), and four years of high performance (1997, 2000, 2006, and 2010). But the country has averaged only 2.6 percent annual GDP growth.

Meanwhile, Mexico's per capita income rose slowly during the past two decades, from $6,932 in 1994 to $8,397 in 2012, in constant U.S. dollars, according to the World Bank -- an average yearly rate of just 1.2 percent. Over the same period, Brazil, Chile, Colombia, Peru, and Uruguay experienced far greater growth in per capita GDP. And as a percentage of the United States' per capita income, Mexico's has barely budged, drifting from 17 percent in 1994 to 19 percent today. Real GDP per hours of work has increased by a meager 1.7 percent, meaning that productivity has remained flat, although there has been some improvement in the automobile sector (which was already doing well in the early 1990s), in the aeronautic sector (which did not yet exist), and in a number of so-called maquiladoras, factories in free-trade zones, in the north. Accordingly, real incomes in the manufacturing sector and the rest of the formal economy have remained stagnant, even if the fall in the price of some goods has softened the blow for workers.

One important reason for these disappointing results is Mexico's failure to develop at home enough of what economists call "backward linkages": connections to upstream industries that produce the materials for assembly further down the supply chain. In 1994, 73 percent of Mexico's exports were composed of imported inputs; by 2013, the number had actually risen, to 75 percent. As a result, employment in the manufacturing sector has stayed unchanged, and so have salaries. Not even the tourism industry, Mexico's largest employer, has performed that well. The number of Americans visiting Mexico today is twice what it was two decades ago, but Mexico's market share of U.S. tourism has stayed flat, and the sector is growing at the same rate as before. Similarly, the maquiladoras created only about 700,000 jobs over the past 20 years, or, on average, 35,000 per year.

During this period, roughly one million Mexicans entered the job market every year, and the country's population rose from approximately 90 million to 116 million, which explains why the average wage differential between U.S. and Mexican workers has not shrunk.

It should come as no surprise, then, that the number of Mexican-born people living in the United States, legally and otherwise, jumped from 6.2 million in 1994 to almost 12 million in 2013. (And that second number takes into account the temporary slowdown in Mexican immigration to the United States between 2008 and 2012 and the nearly one million deportations of Mexicans from there between 2009 and 2013.) Thus, NAFTA has also failed to achieve its goal of discouraging emigration: as Mexican President Carlos Salinas said when the treaty was up for debate, "we want to export goods, not people."

The absence of backward linkages in Mexico's export sector stems from foreigners' unwillingness to invest in Mexico, a problem that dates back to the 1980s. That decade, the country's economy collapsed, mainly as a result of the excessive debt incurred by the earlier administrations of President Luis Echeverría and President José López Portillo. In 1989, Salinas was able to bring down the country's foreign debt burden, but only at the cost of renouncing virtually any new foreign borrowing. The only alternative was to dramatically boost foreign direct investment, chiefly from the United States. And the only avenue for that was NAFTA: an agreement that would lock in sound economic policies and access to the U.S. market, providing investors with the certainty they required. Through NAFTA, Mexico sought to increase its foreign direct investment as a percentage of GDP to as much as five percent, far above what it had ever been before.

That didn't happen. In 1993, the last year before NAFTA took effect, foreign direct investment in Mexico stood at $4.4 billion, or 1.1 percent of GDP. In 1994, the number leapt to $11 billion, or about 2.5 percent of GDP. But it remained stuck around there until 2001, when it rose to 4.8 percent, and then began a steady decline. If one takes the average of foreign direct investment for 2012 (a very bad year) and 2013 (a very good year), one finds that Mexico now receives only around $22 billion annually in foreign direct investment -- slightly less than two percent of GDP, well below the figures for Brazil, Chile, Colombia, Costa Rica, and Peru.

Foreign investors have proved particularly unwilling to channel capital into export-industry supply chains. Because domestic investment, public and private, has moved remarkably little since 1994, neither has the overall level of capital formation, which has averaged about 20 percent of GDP since the mid-1990s. At that rate, Mexico can attain only the mediocre growth it has known for 20 years. In other words, despite impressive trade numbers, NAFTA has delivered on practically none of its economic promises.

THE PATHS NOT TAKEN

A relevant question, however, is how the Mexican economy would have performed without NAFTA. It is difficult to see why it would have fared much worse. For one thing, growth was greater in other Latin American countries that did not have free-trade agreements with the United States for all of the 1990s and much of the next decade, including Brazil, Chile, Colombia, Peru, and Uruguay. Moreover, Mexico grew faster in per capita terms from 1940 to 1980, and the population was rising then at a faster rate than it is now. Had the Mexican government attempted to revive the unsustainable economic policies it pursued in the 1970s, things probably would have been worse. But it had already abandoned most of them by the mid-1980s, and many other countries have managed to adopt free-market policies without the benefit of a free-trade agreement. Thus, there is little reason to believe that in the absence of NAFTA, Mexico’s productivity, attractiveness for foreign investment, employment levels, and wages over the past 20 years would have been systematically lower, unless the government had attempted a return to the policies of the 1970s and early 1980s -- an improbable scenario.

There are other counterfactuals worth considering. Perhaps a different NAFTA would have worked better for Mexico. Many, including me, favored a more comprehensive, EU-style agreement. Such a treaty would have allowed for greater labor mobility and included the energy sector. And it would have offered various forms of resource transfers from the wealthy United States and Canada to poorer Mexico, akin to those that helped Italy in the 1960s, Ireland in the 1970s, Spain and Portugal in the 1980s and 1990s, and Poland more recently. Such changes still may not have helped, but Mexico’s low investment and productivity figures are partly a consequence of its shabby infrastructure, which could have been improved with U.S. and Canadian money. One could also argue that had Mexico opened up its oil industry to foreign investment just after the Gulf War, the decision would have sparked an investment boom (like the one some expect today) and would have convinced Washington to contemplate some type of immigration reform in exchange. There is no way to prove that different choices would have led to different outcomes, but in light of the picture today, they might have been worth trying.

As for the road ahead, some believe that President Enrique Peña Nieto’s energy, education, tax, and banking reforms will, by themselves, finally generate the five percent annual growth that has escaped Mexico since 1981. But that assessment looks too optimistic, absent other measures. Although it is conceivable that the gap between Mexico and the United States might finally narrow on its own, the better option for Mexico would be to embrace proactive policies and ideas. Indeed, perhaps this realization explains why the notion of North American integration, taken up by President Vicente Fox in 2001 and then left by the wayside, has begun to gain traction again. Whether in books or task forces in the United States and, to a lesser degree, Mexico, there is a growing sense that it is time to take new steps toward North American economic integration. Only Mexico can drive such a process, and for now, its government is shying away from bold foreign policy endeavors. That reluctance could change, however, if the current reforms are rejected or passed in such a diluted form that they fail to stimulate growth.

Instead of traveling down the same road for another 20 years, policymakers should consider a more ambitious path. They need not attempt to replicate the European model of integration, but they should include many of the items left off the table in 1994, such as energy, immigration, infrastructure, education, and security. In other words, despite the treaty’s disappointing results, maybe Mexico needs more NAFTA, not less.

CORRECTION APPENDED (January 24, 2014)

This article has been revised to address errors in the original version regarding Mexico's per capita income between 1994 and 2012.