THE MEXICAN ECONOMY AFTER OF NAFTA[1]

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Abstract: *The paper examines to what extent the key goals that Mexico aimed to reach with the implementation of the North America Free Trade Agreement (NAFTA) have been achieved by 2005, more than ten years after it was put in place. The analysis of the statistical information show that NAFTA's capacity to impact Mexico's overall path of economic development -as well as that of the whole package of macroeconomic reforms implemented- was overestimated. Certainly, NAFTA helped to produce an export boom and an inflow of much needed foreign investment to Mexico. But, it failed to alleviate the fundamental constraints on Mexico's long-term economic growth and job generation. Neither did it ensure that the macroeconomic reform process will be deepened. It concludes by stating that NAFTA's positive impact has likely reached a point of exhaustion, and it is due time for Mexico to rethink key elements of its overall development strategy.*
Keywords: *NAFTA / Exports / Foreign investment / Technology transfers / Economic growth / Employment / Development strategy.*

LA ECONOMÍA MEXICANA DESPUÉS DEL TLCAN

Resumen: *El artículo examina en qué medida la economía mexicana ha alcanzado las metas clave que se querían lograr con la implementación del Acuerdo de Libre Comercio de Norteamérica (TLCAN) antes del año 2005, más de diez años después de que fuera puesto en marcha. Del análisis de la información estadística se desprende que la capacidad de impacto del TLCAN sobre la trayectoria de desarrollo económico de México –así como la del paquete de reformas macroeconómicas implementado– fue sobreestimada. Ciertamente, el TLCAN ayudó a producir un auge de la exportación y una afluencia de inversión extranjera muy necesaria para México. Pero, no pudo aliviar las urgencias fundamentales para el desarrollo económico de México y para la generación de empleo en el largo plazo. Tampoco se aseguró que el proceso macroeconómico de la reforma fuera profundo. El artículo concluye indicando que el impacto del TLCAN alcanzó probablemente un punto de agotamiento, por lo que ahora México debe repensar los elementos fundamentales de su estrategia de desarrollo.*
Palabras clave: *TLCAN / Exportaciones / Inversión extranjera / Transferencia de tecnología / Crecimiento económico / Empleo / Estrategia de desarrollo.*

1. INTRODUCTION AND BACKGROUND

The debate on the merits, risks and shortcomings of free trade draws passions. Understandably so, given that trade liberalization creates in the short and in the long term big winners and heavy losers. The North American Free Trade Agreement (NAFTA), though not really a free trade initiative, is no exception. But, contrary to other passions, the ones it gave rise to more than ten years ago have not been attenuated by the passage of time. Indeed, the change in development strategy

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in favor of State downsizing and trade liberalization implemented since the mid 1980s –culminating with NAFTA– is the most prominent event in Mexico's economic history in the last five decades[2]. There is consensus that NAFTA was a key instrument behind the surge of exports and direct foreign investment that has taken place in Mexico in the last ten years. However, there is a strong academic and political debate still going on what have been its effects on the Mexican economy.

Its advocates argue that without NAFTA Mexico's export and FDI boom would not have occurred. More importantly, they view this agreement as the fundamental reason behind the Mexican economy's prompt recovery after the acute financial crisis it suffered in 1995. If it had not been signed, they argue, the US Treasury would not have so swiftly approved the emergency US $50 billion support loan to Mexico. Following this same line of argument, 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 (Serra, 2004). In the most recent study published by the World Bank on this topic, Lederman *et al.* (2004) conclude that without NAFTA by 2002 Mexico's global exports would have been 25% lower, the inflow of FDI 40% smaller and its per capita income 5% lower than what they actually were. They admit that NAFTA by itself cannot guarantee economic convergence in North America but, nevertheless, they conclude that the trade agreement helped to bring Mexico's level of development closer to its trading partners.

Its opponents claim that NAFTA's benefits have been highly concentrated –on relatively few firms, activities and even regions– and they were more than compensated by its adverse impacts on the overall economy. Weisbrot *et al.* (2004), in their critical review of the econometric work of the World Bank's study mentioned above, arrive at the opposite conclusion: NAFTA has reduced the average income per capita growth in Mexico. They argue that its beneficial impact on exports did not compensate its negative effects, in particular, 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 a prerogative of Mexico.

A more balanced view is put forward by Audley *et al.* (2003), who conclude that for Mexico in general: "NAFTA has been neither the disaster its opponents predicted nor the savior hailed by its supporters". Note however that when focusing on "its effects on people's lives, livelihoods, and households", they observe a highly adverse impact of NAFTA on the rural and the vulnerable population. They add too that NAFTA deteriorated Mexico's labor markets, and report that from 1994 to 2002 manufacturing employment increased in 500,000, but the agricultural sector lost 1.3 million jobs.

[2] There is a vast literature on NAFTA, and reviewing it 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 Audley et al (2003), Tornell *et al.* (2004), Lederman et al (2004), Weisbrot *et al*. (2004) and Blecker (2005).

Such divergence in the assessment of NAFTA may be partly explained by ideological differences. But it may also reflect the methodological difficulties that prevail in isolating the impact of NAFTA from the impact of other variables, in particular, the radical macroeconomic reforms, and policy changes that Mexico implemented during the same period to shift away from its traditional development strategy of import substitution and State-led industrialization. Indeed, as it is well known, already in the second half of the 1980s –ten years before NAFTA- Mexico started a drastic, fast and unilateral process of trade liberalization. But also, the contradictory assessments of NAFTA may be partly due to 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. [3] Its objectives, formally stated in Article 102 of the Agreement, were: "*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*"[4].

The Mexican government saw NAFTA as an instrument to achieve three goals. The first one was to boost its trade and FDI flows with the United States and Canada. A second and related one was to induce local and foreign firms (both within and outside of the NAFTA region) to invest in Mexico in the production of tradable goods in order to exploit its potential as an export platform to the United States. Such investment, it was believed, would launch Mexico into a phase of high and sustained economic growth led by exports. Finally a third, decisively political objective of NAFTA was to guarantee the lock-in of Mexico's macroeconomic reform process. In the present paper we refrain from attempting to estimate NAFTA's impact on the Mexican economy, but instead we concentrate in examining the extent to which the three objectives above mentioned have been fulfilled.

Our work is organized as follows. After this introduction, the following section gives 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 in detail, as well as of imports and the overall trade balance performance. The section closes with a brief assessment of the degree to which the external constraint on the

[3] See for example the declaration signed by the three Governments of the region: "*...NAFTA fuels economic growth and dynamic trade, stimulates investment ...and provides greater job opportunities in North America*" (quoted by Audley *et al.*, 2003). Or see the introductory sentence to NAFTA in the Canadian Ministry of International Trade's web page: "*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*".

[4] Article 102 of The North American Free Trade Agreement, The Governments of Canada, Mexico and the United States.

Mexican economy is more binding today, after NAFTA. The subsequent section 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; aspects that NAFTA –and the macroeconomic reforms– were supposed to strengthen. The paper closes with the conclusions and some policy recommendations.

2. NAFTA, EXTERNAL TRADE AND FOREIGN INVESTMENT IN MEXICO

2.1. THE ROAD TO NAFTA: UNILATERAL TRADE LIBERALIZATION AND FOREIGN INVESTMENT DEREGULATION

In the early 1980s, in the aftermath of the most dramatic balance of payments crisis that Mexico had faced in decades, President De la Madrid started to put in place a structural reform to shift away the economy from its traditional State-led development growth path and trade protectionist strategy. Important elements of this reform were the deregulation/privatization of public enterprises and the opening of Mexico's domestic market to foreign competition.

As regards the latter, in 1984 the government began to remove a number of tariff and non-tariff restrictions on imports. In 1986 a crucial step in this direction was taken by becoming full member of GATT, and initiating a gradual elimination of some restrictions to foreign investment particularly in capital or technologically intensive industries. By 1988 the coverage of import licenses as well as the average tariff rate had been sharply reduced. And official prices on imported goods had been totally cancelled. President Salinas de Gortari's administration (1988-94) accelerated the economy's structural reforms. In 1989 a new regulatory framework on foreign investment was approved to eliminate restrictions to foreign capital's participation in about 75% of all branches of economic activities[5]. In December 1993, a new Law of Foreign Investment was enacted, simplifying its the administrative procedures, and eliminating all restrictions on FDI in manufacturing except in the production of explosives and basic petrochemicals (Clavijo and Valdivieso, 2000; Moreno-Brid, 1999b).

NAFTA negotiations started in 1990, and by then Mexico was already one of the world's most open developing economies (OECD, 1996). The tri-lateral agreement was signed two years later between Mexico, the United States and Canada and went into effect on January 1, 1994 with the commitment to eliminate over the next ten years tariff and non-tariff barriers to most intra-regional trade and to ease restrictions on foreign investment (SECOFI, 1994; OECD, 1996). Few trade restrictions were maintained (equivalent to close to 7% of the value of imports) in

[5] See SECOFI, Reglamento de Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera).

agriculture –particularly in corn production–, oil refinery and transportation equipment industry. In any case NAFTA's relevance was to formally institutionalize Mexico's trade liberalization strategy in an agreement enforced with the United States, its key trading partner and the main player in the global trade scene (Pacheco-López, 2004)[6].

2.2. MEXICO: FROM OIL TO MANUFACTURES

Mexico's trade liberalization, crowned by NAFTA, has been accompanied by a radical shift in its insertion in the global markets, becoming a dynamic player in exports of non-oil products. Table 1 compares the export performance of selected countries, examining their changing shares in the world markets from 1985 to 2001.

Table 1.- Changes in Participation of Exports in the World Market of Selected Countries, 1985-1994-2001

	WITH PETROLEIUM AND ITS DERIVATIVES				WITHOUT PETROLEUM AND ITS DERIVATIVES			
	1985-1994	Rank	1994-2001	Rank	1985-1994	Rank	1994-2001	Rank
China	3,02	1	2,06	1	5,10	1	2,80	1
United States	1,24	2	0,15	4	0,57	6	0,92	3
Singapore	0,71	3	-0,18	11	1,62	2	-0,29	12
Malaysia	0,63	4	0,21	3	1,05	3	0,59	4
Thailand	0,62	5	0,11	5	0,79	4	0,27	5
Japan	0,48	6	-2,17	14	-1,31	13	-0,44	13
Chile	0,08	7	0,01	8	0,08	9	0,14	7
Hong-Kong	0,06	8	-0,27	12	0,21	8	-0,11	11
Mexico	0,03	9	1,20	2	0,61	5	1,77	2
Argentina	0,02	10	0,04	7	0,03	10	0,03	9
Korea	0,00	11	-0,01	9	0,02	11	0,00	10
Indonesia	-0,09	12	0,05	6	0,40	7	0,23	6
Brazil	-0,33	13	-0,07	10	-0,20	12	0,13	8
Germany	-0,80	14	-1,41	13	-1,79	14	-1,57	14

SOURCES: Authors' elaboration based on CAN 2003, CEPAL.

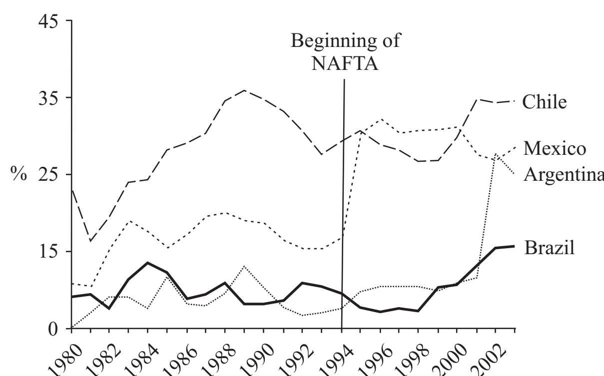
In both periods here examined, China stands at the top of the list, as its share in world (non-oil) exports increased the most: 5.01 percentage points in 1985-1994, and 2.8 additional points in 1994-2001. Mexico's performance is very good. Excluding sales of petroleum and derivatives, during 1994-2001 it is ranked in second place, just behind China.

Though not always recognized, Mexico's exports drive started nearly ten years before NAFTA was put in place. Its origin is usually traced back to the trade libera-

[6] After NAFTA, Mexico signed many more trade agreements *inter alia* with the European Union, Japan and various Latin American countries.

lization processes that began in 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 augmented approximately 20 percentage points as a proportion of Mexico's GDP, reaching a level of 30%. Their dynamism repositioned Mexico in world trade. Having started in the early 1980s as a fundamentally oil-exporting economy, twenty years later more than 80% of its total exports were manufactures. The fast growth in exports of manufactured goods more than compensated for the decline in foreign sales of oil and agricultural commodities. As shown in Figure 2, a key element behind this dynamic performance was the in-bond industries (*maquiladoras*).

Figure 1.- Mexico and Other Selected Countries: Exports of Goods and Services (% GDP), 1980-2003

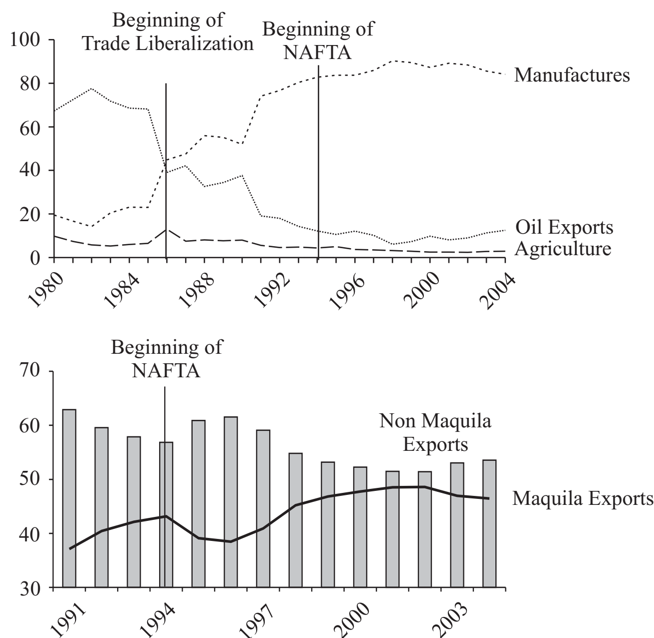


SOURCE: Authors' elaboration based on World Bank (2004).

Indeed it has become a standard fact of the Mexican economy that maquiladoras are responsible for about half of its exports of manufactures. The dynamic response of Mexico's manufacturing exports was helped by NAFTA but, to an important degree, it was stimulated by a considerable real depreciation of the exchange rate of the peso vis-á-vis the US dollar that took place in 1995[7]. In addition, as the Mexican economy plunged in a recession that year (real GDP decreased 6%), local companies were pressed to seek external markets in order to compensate for the collapse of the domestic market.

[7] 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 (2005), Krueger (1999) and Pacheco-López (2005). Lederman et al (2003) argue otherwise, and claim that NAFTA boosted Mexican exports. But, apparently, their econometric specifications failed to adequately capture the effect of the depreciation of the exchange rate.

Figure 2.- Composition of Mexican Exports, 1980-2004



SOURCE: Authors' own elaboration based on INEGI.

The preferential access –granted by NAFTA– led to a strong increase in Mexico's exports, among them in garment topping for many years other international competitors in the US market, including China. Key promoters of the overall boost in exports were the various foreign companies that already had strong presence in Mexico (including maquiladoras). The arrival of foreign investment in selected sectors motivated by the opportunity or need to use Mexico as an export platform to the United States, also helped. The export drive has been accompanied, within strict limits, by an increased technological sophistication of Mexican products sold abroad. Traditionally they were mainly primary commodities (shrimp, coffee, cotton, and tomatoes). By the late 1970s, crude oil was the dominant export item. Today, as in the last fifteen years, the major proportion of Mexico's sales abroad consists of manufactures; *inter alia* auto parts, automobiles, computers, and electrical and electronic equipment.

Table 2 presents the structure of Mexican exports and their share in OECD's total imports from 1985 to 2001, classifying them in three groups: i) Exports directly based on natural resources (agriculture, energy, textile fibers, minerals and metals), ii) Manufactures and iii) Other exports. In turn manufactured goods are also classified in two groups, those that are essentially the result of simple processing of natural resources and the rest. The second part of the table registers the same categories, but measured in terms of their contribution to Mexico's total exports. Finally, in its bottom part it lists the ten main exports. A key point to notice is that Mexi-

co's penetration of the OECD market more than doubled during 1985-2001. Equally impressive is the considerable rise in the share of Mexico's manufactures in OECD imports (from 1.1% to 3.8%). In this respect, note too the particularly fast expansion of exports of manufactures *not based* on natural resources. Indeed, while in 1985 they represented 35% of Mexico's total exports by 1994 their share had mounted to 71% and in 2001 at stood at 78%. Exports of natural resource based goods experienced a mild retraction in the OECD market, and saw their proportion of total Mexican exports collapse from 58.6% in 1985 to 14.7% in 2001. Among its main export items in this period, stand out passenger vehicles, and other manufactured goods liked to the auto industry or the telecommunications sector.

Table 2.- Selected Indicators of Mexican Exports to the OECD: 1985-2001

MEXICO	1985	1990	1994	2001
MARKET SHARE	*1,78*	*1,62*	*2,03*	*3,62*
Natural Resources	3,08	2,10	1,98	2,65
Agriculture (1)	1,30	1,28	1,37	2,09
Energy (2)	4,60	3,26	2,99	3,29
Textile Fibers, Minerals and metal (3)	1,89	1,48	1,57	1,49
Manufactures	1,10	1,29	2,02	3,85
Based on Natural Resources (4)	1,23	0,96	1,03	1,26
Not Based on Natural Resources (5)	1,10	1,33	2,10	4,03
Others (6)	1,61	2,54	2,70	4,12
STRUCTURE OF EXPORTS	100,0	100,0	100,0	100,0
Natural Resources	58,6	33,6	21,4	14,7
Agriculture (1)	9,7	10,3	8,2	5,1
Energy (2)	45,9	21,0	11,8	9,1
Textile Fibers, Minerals and metal (3)	3,0	2,3	1,4	0,5
Manufactures	39,1	62,5	74,9	81,4
Based on Natural Resources (4)	3,4	3,4	2,5	1,5
Not Based on Natural Resources (5)	35,0	57,6	70,7	78,1
Others (6)	2,3	3,9	3,7	3,9
10. PRINCIPAL EXPORTS	56,3	48,9	47,0	53,4
781 Passenger motor cars (excl. public service type)	0,9	0,0	8,7	11,6
333 Petroleum oils, crude, also from bituminous minerals	42,0	19,9	10,9	8,5
764 Telecommunications equipment, n.e.s.	3,4	3,1	3,6	6,6
752 Automatic data processing machines, units thereof	0,1	1,7	1,8	5,6
782 Motor vehicles for the transport of goods/materials	0,5	0,5	1,9	4,0
931 Special transactions and commodities not class.	2,2	3,6	3,5	3,9
773 Equipment for distributing electricity	2,5	4,6	5,2	3,8
784 Parts and accessories, n.e.s. of the motor vehicles	2,6	4,3	4,7	3,5
761 Television receivers	0,5	2,5	3,7	3,3
772 Elec. apparatus for making and breaking elect. circuits	1,6	2,6	2,9	2,6

(1) Sections 0, 1 and 4; Chapters 21, 22, 23, 24, 25 and 29. (2): Section 3. (3) Chapters 26, 27 and 28. (4): Chapters 61, 63 and 68; Groups 661, 662, 663, 667 and 671. (5) Sections 5 and 6 (less chapters included in (4)), sections 7 and 8. (6) Section 9.

SOURCES: Authors' elaboration based on CAN (2003), CEPAL.

However, the export-driven growth was not felt on all productive activities in Mexico. Indeed, since 1994, though some sectors gained an increased presence in the international markets, others retreated. Among those whose exports registered the largest increases in their shares in the US market are Machinery and transportation equipment, Beverages and tobacco and 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 shares. The impact at the micro-level of the firm is very unevenly distributed. According to some authors, the bulk of Mexico's non-oil exports is originated in no more than 300 businesses, most of them linked to transnational corporations (See Máttar *et al.*, 2003; Dussel, 2000).

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. Indeed since 1995 Mexico has run trade surpluses with the US, but not with Canada. However, such surplus has been more than offset by its mounting trade deficit with the rest of the world. Indeed, except for periods of severe recession, Mexico has systematically registered trade deficits (see Table 3).

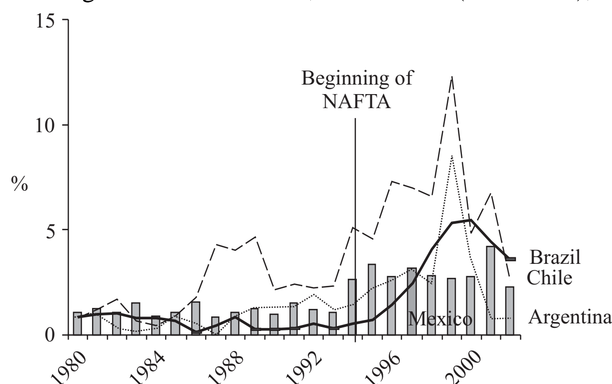
Table 3.- Trade Balance of Mexico, 1994-2003 (Billions of US Dollars)

	NAFTA TRADE			BALANCE OF MAQUILADORAS	NAFTA BALANCE WITHOUT MAQUILA	BALANCE OF REST OF WORLD	TRADE BALANCE
	Exports	Imports	X-M				
1994	53,4	58,6	-5,2	5,8	-11,0	-13,3	-18,5
1995	68,5	55,4	13,1	4,9	8,2	-6,0	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	-17,0	-7,9
1999	123,0	108,5	14,5	13,4	1,0	-20,1	-5,6
2000	151,2	131,8	19,4	17,7	1,7	-27,4	-8,0
2001	143,6	118,3	25,3	19,3	6,0	-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

SOURCE: Authors' own elaboration based on INEGI.

The other favorable development in Mexico's economic performance, frequently associated with trade liberalization and NAFTA, is the vast inflow of Foreign Direct Investment it has received. FDI, measured as a percentage of Mexico's GDP, registered an impressive growth since the early 1990s. From levels close to 2%, it rapidly increased to reach its peak of 4% in 2001. Note that, however, it never reached the relative proportions achieved by Chile. And, moreover it has stagnated in the aftermath of the Asian crisis, and has not really recovered its previous dynamism.

Figure 3.- Foreign Direct Investment, Net Inflows (% of GDP), 1980-2002



SOURCE: Authors' elaboration based on World Bank (2004).

By 2004, the majority of businesses in Mexico that had foreign capital were of US origin.

3. IMPORTS, TRADE BALANCE AND LONG–TERM ECONOMIC GROWTH

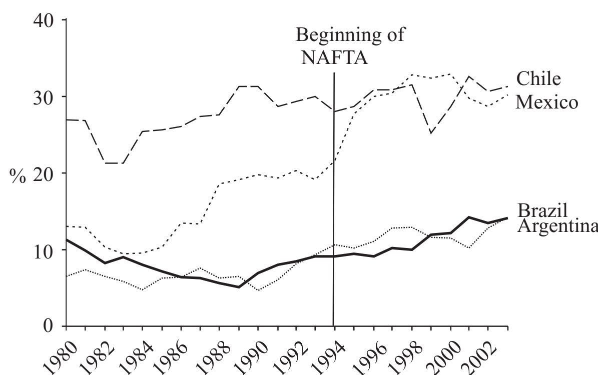
To complete this, so far, favorable assessment on Mexico's trade and FDI performance after NAFTA it is indispensable to examine the evolution of its imports and its rate of economic expansion. After all, a key goal of NAFTA and the overall macroeconomic reform strategy was to insert Mexico in a path of high and persistent growth. Parallel to the export and FDI boom that Mexico experienced, in the last 15 years 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 but in principle temporary flood of imports. It was assumed that once Mexican consumers got adjusted to the new "menu" made available by trade liberalization that included the, until then, inaccessible foreign goods purchases of imported goods would lose momentum. Such slowdown has, however, not occurred.

The first stages of such trade liberalization process implemented in the late 1980s triggered an explosive increase of imports, expanding at annual rates over and above 30 per cent. Such surge of imports in Mexico had no parallel in the region, and dwarfed the increase that they had in Brazil or Argentina. As a share of GDP, they climbed from 10% in 1982 to more than 30% by the mid 1990s.

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 a context of a persistent appreciation of the real exchange rate. The resumption of a facilitated access to external funds also played a role. Mexican consumers began to eagerly satisfy their pent-up demand

for a wide variety of foreign goods and brands, after decades of a tightly restricted access to them. But, such import demand also mirrors to some extent the increasingly strong relation that an important part of the exporting sector has with foreign suppliers. *Maquiladoras*, the most successful export sector, rely fundamentally on imported inputs and materials, having scant relation 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, as local producers have been put out of business by foreign competition.

Figure 4.- Mexico and Selected Countries: Imports of Goods and Services (% GDP), 1980-2003



SOURCE: Authors' elaboration based on World Bank (2004).

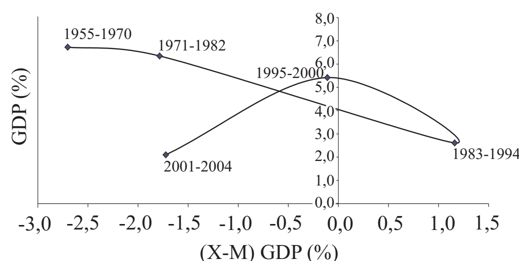
On a more technical basis, applied econometric studies reveal that in the last fifteen to twenty years the Mexican economy has significantly increased its structural dependence on imports. These results indicate that the long-term "income-elasticity" of demand for imports has more than doubled in this period[8]. Traditionally its value stood between 1.2 and 1.5, but currently is at levels close to 3.0. 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 annually expand 15%! Such persistent and rapid increase in imports would puts, sooner or later, 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 dynamic behavior is not easy to sustain. During their most prominent and recent boom, 1988-1999, they expanded at an average annual rate of 10%, but imports expanded even faster (14%).

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

Remarkably, and contrary to the a priori expectations, the dynamism of imports has barely subsided. The most recent data, January 2005, reports an annualized increase of 18% in Mexico's imports, while its real GDP expanded 4.4%. It is unclear whether such upward shift in the long-run income elasticity of imports will prevail in the future. Most likely, it will decrease somewhat as some once-and-for-all effects of the trade liberalization process on the demand for foreign goods and services wear off. But, if it remains at high levels, the external sector will keep being a major obstacle in Mexico's struggle to enter a path of high economic growth, away from recurrent balance of payments crisis.

Figure 5 illustrates how trade liberalization and the process of macroeconomic reforms have not yet been able to insert Mexico in a path of strong export-led growth. It shows that the relation between trade performance and economic growth has been deteriorating. Indeed, during 1955-70 and 1971-82, its 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 oil boom forced an economic slowdown in the 1980s concomitant with a trade surplus of 1% of GDP. The first five years after NAFTA saw real GDP expand at a 5% annual average rate. This recovery was short-lived. The renewed appreciation of the peso eventually slowed down the export boom, and the recession of the US economy starting in 2001 put an end to the dynamism of this short period of export led growth. In 2001-03, the Mexican economy barely been grew (2% annual average rate) and registered a trade deficit of once again of 1-5%-2% of GDP. Such slow expansion, most alarmingly, implied that its income per capita fell for three years in a row. In 2004, GDP augmented 4.4%, better than its performance in the recent previous but still way below the rates of expansion that it used to experience pre-1980s and that it needs in order to absorb the vast amount of people entering its labor market. In other words, 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 in 1950-80; before macroeconomic reforms were put in place.

Figure 5.- Trade Balance and Real GDP Growth in Mexico, 1980-2004



SOURCE: Authors' elaboration based on INEGI and Santamaría (2004).

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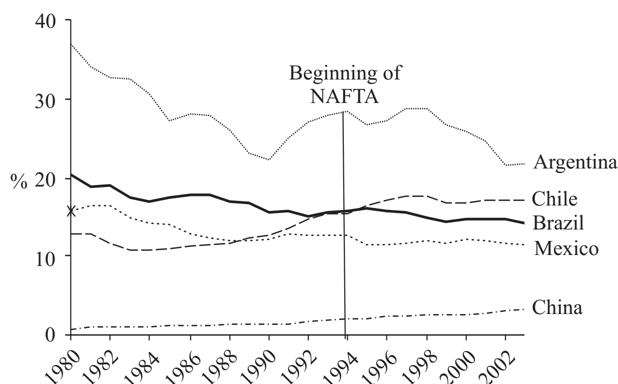
In other words, trade and financial liberalization did result in a fast growth of exports and, though not sustained, of FDI. But its economic growth performance has been disappointing. In fact, instead of closing the gap of its real GDP per capita vis-à-vis the United States, it has widened it. As figure 6 shows, in the late 1980s Mexico managed to begin to moderately reduce such gap. However, the economic crisis suffered in 1995 widened it once more. And since then it has remained with minor changes. Its gap with the US currently stands at a level comparable to what it was in the 1950s!

Figure 6.- 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 US$)

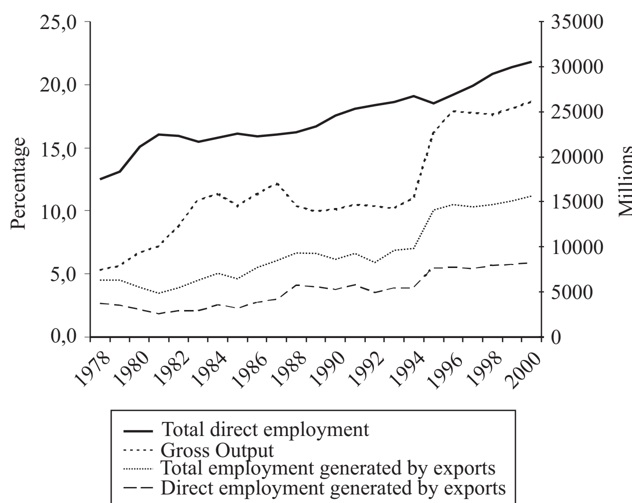


SOURCE: Authors' elaboration based on World Bank (2004).

Thus and 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. Blecker (2004), examining not only GDP but also alternative measures of income concludes: "*...There is no evidence of any catch-up in average Mexican living standards to U.S. or Canadian levels under NAFTA*".

Sustaining high long-term economic growth should be a top priority in the national agenda. The Mexican economy needs to expand at least at average annual rates of 5-6% in real terms, just to create the jobs required to absorb the 2.5% annual increase in its labor force. Its economic expansion needs to be even stronger in order to significantly improve the living standards of the more than 13 million Mexicans that live in extreme poverty conditions. The evolution of Mexico's labor market after NAFTA has been far from meeting the favorable expectations it generated. There has been a re-composition in total employment towards export-related activities, but the overall trend of employment has not gained any significant impulse (See Figure 7).

Figure 7.- 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)



SOURCE: Authors' own elaboration based on INEGI.

NAFTA's effects on employment in the Mexican rural sector have been adverse. Partly as a consequence of this, migration flows to the US have actually increased. In 2004, open unemployment in Mexico reached its historical maximum, and the informal sector has vastly expanded. In addition the earnings and wage gap between the qualified and the unqualified labor force has widened. If the economy does not enter in the medium term a path of high and sustained expansion, able to create sufficient number of jobs, the nation's social fabric may be severely damaged. Think tanks and various international financial organizations forecast for 2005 an expansion of Mexico's real GDP close to 4%. Mexico clearly needs higher rates of expansion. Whether this growth is actually achieved and sustained in the medium term remains to be seen.

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 does not radically differ from its previous tendencies. With some exceptions NAFTA's reallocation processes have extrapolated past trends in trade and industrial patterns, with scant 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 sectoral promotion policies then implemented. Mexico's outstanding export performance in manufactures is, to a certain extent, a legacy of the import substitution period.

In the economy as a whole, labor productivity 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 –but not all- manufacturing industries. In the capital goods and heavy intermediates sector it allowed for greater intra-industry (and intra-firm) specialization in foreign trade. In some light industries -food processing and parts of the textile industry- it shook out or forced to modernize less efficient local producers. But the overall net effect of increased exposure to foreign competition on productivity performance is either too small or perhaps negative. To the extent that the productivity gains were based on a tendency to eliminate or displace local producers, its short term social impact could have been adverse. Whether in the medium term such impact is positive depends on the degree to which the thus redundant labor successfully makes the transition to be gainfully employed in the dynamic sectors. However, and contrary to the support policies implemented in the United States, Mexico did not any program to ease such transition or to compensate displaced workers for the harm done by NAFTA.

3.1. DID NAFTA LOCK-IN THE REFORM PROCESSES IN MEXICO?

Before closing this section, it is necessary to examine whether the third -and definitely political- objective of NAFTA was met. There is a consensus that Mexico's trade and financial liberalization strategies are here to stay. Indeed, to the best of our knowledge, there is simply no relevant political party or organization as well as no business sector in Mexico that recommends a return to trade protection policies. However, having said so, in the last four years the reform process has simply stalled. Although the Executive −and his party now in power− stated from their first days in power that Mexico had to soon implement a fiscal reform, a labor market reform and an energy reform, none of these reforms has been implemented so far. Moreover there is consensus in the national and international press, as well as among political analysts, that none of these reforms will be implemented in 2005-06, the last two years of the Presidency of Mr. Vicente Fox. Moreover, the surveys carried out by Latinobarómetro indicate that there is growing disenchantment in the population with the results obtained in Mexico by privatization and by other market 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 these reforms. The dissatisfaction with the new "model based on market mechanisms" is evident not only in Mexico but in many more countries in the region. In fact, an increasing majority of the surveyed sample by Latinobarómetro is against the idea that the State should not intervene in

the allocation of economic resources. In other words, although the population at large considers that trade liberalization will not be reversed in Mexico; the consensus is that the era of radical macroeconomic reform processes is over.

4. FINAL REFLECTIONS

It is true that NAFTA as part of the package of economic reforms implemented in Mexico, helped to produce an export boom, a rapid and strong increase in manufacturing exports, an inflow of much needed foreign investment and with it technology transfers. However, it did not alleviate the fundamental constraints on Mexico's long-term economic growth. Some of these constraints may have actually become more binding with the reforms put in practice. Certainly, NAFTA was not the success expected neither in terms of economic growth nor of job generation. Its direct impact through on exports was very limited and was even offset by the rupture of internal economic linkages due to the pressure of imported goods from abroad at competitive prices. There is consensus that NAFTA's positive impact may most likely have reached a point of exhaustion. Many analysts and political agents consider that it should be revamped.

Mexico is at a crossroads. It can not further base its international competitiveness on low wages. But, at the same time, it has not yet proved itself able to successfully enter the international markets based on knowledge intensive, high value added processes and products. If the country is to succeed in its so far failed quest to achieve high and sustained economic growth, there is 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. Without a fiscal reform these initiatives are not feasible.

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