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Mexico Twelve Years After the Implementation of the NAFTA*

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Abstract

Today, twelve years after the North American Free Trade Agreement came into effect; we evaluate Mexico's major objectives with the ones accomplished within its relationship with the United States and Canada in the context of the Agreement. We carry out a reflexion on the central problems of said relationship: competitivity, growth, employment, prices, and wages; the expected (but not achieved) direct economic effects; what Mexican industry and agriculture took advantage of, or did not, from the Agreement, emphasizing the role of Mexican Government policies. We also consider some issues that need to be incorporated into the Agreement (migration), and renegotiated (environmental matters, and the arbitration of controversies) in order to obtain larger and better benefits from it. Finally, Mexico's perspectives, in relation to the commercial agreement are expressed in a possible future agenda, and tasks still to be done.

Key words: NAFTA, Commercial Policy, FDI, Foreign Trade.
JEL Clasification: F53, F13, F15, F21.

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Introduction

During the last decades of the 20th century, Mexico went through a process of structural changes within its Foreign Sector as a fundamental axis for economic growth. In order to obtain Mexico's gradual integration in the conditions of the world market, the commercial policies were adapted to the new circumstances. The incorporation to the General Agreement on Trade and Tariffs (GATT) in 1986 represented the very first step towards Mexico's openness, but it was the signing of the North American Free Trade Agreement (NAFTA) that determined the structural change that has occurred in the nation. Today, over twelve years since it came into effect, it becomes pertinent to revise its outcomes and compare them with the proposed objectives.

With this purpose in mind, this paper is organized in six parts. The first one describes the characteristics of the development pattern prior to the opening of Mexico's economy, while the second exposes the first steps that Mexico took in order to the open it up. Next, the most relevant issues concerning the NAFTA negotiation are commented in the third part. The fourth section presents the outcomes in foreign trade and the effects on the Primary Sector, as well that on foreign direct investment. The penultimate part contains a summary of NAFTA's outcomes and its relationship with economic growth. The sixth part deals with the problems and the outstanding agenda concerning the Agreement. Finally, some lessons associated with NAFTA are presented.

1. Background

The immediate references, which are directly related with the current problems of Mexico's economy, are the ending of an era of industrialization based upon import substitution (ISI, in its Spanish abbreviation), and the economy's petrolization towards the end of the 70's. The first one derived in a highly protected industry, oriented towards the domestic market, and whose growth was at the expense of the agriculture (net currency generator until the mid 60's). As a result of the economy's petrolization, Mexico's currency incomes were only based on one activity. A third reference is the enormous external debt acquired simultaneously with the petrolization of its economy, which Mexico confidently expected to pay back with the petroleum resources located in the Southeast of the country.

During the 60's, Mexico's commercial policies were oriented towards the promotion of the substitution of intermediate goods in the manufacturing industry, as a means for the vertical integration of the domestic Industrial Sector.

Meanwhile, a great effort was made to promote the export of semi-processed products by taxing agricultural goods and non-processed mineral exports.

At the beginning of the 80's the price structure was clearly distorted in this context of commercial protectionism. Particularly, the generalized use of non-tariff barriers (import permits and official prices) increased the distortions of market signs. And as a result of the exchange terms weakening, during 1981-1982, the authorities responded with an increase in the nominal protection rates, raising the average to nearly 100%.

The ISI policy diminished the economy's competitive pressures and the extent of the productivity increases by intensive goods and services intensive in technology. Hence, imports substitution reduced exporters' competitivity and led to a decrease of exports participation in long term Gross Domestic Product (GDP). By the early 80's, the composition of Mexican exports was characterized by a strong component of primary goods, especially petroleum, whilst manufactures, including maquila (in bond industry), only represented a relatively small percentage of total exports.[1]

In this way, the Payment Balance crisis at the beginning of the decade, and the corresponding external debt crisis, originated the biggest commercial protection that Mexico had lived since World War II. Imports were slowed down and exports promoted so as to achieve a commercial surplus in order to pay for the external debt. Such protection, reinforced by an active devaluation of the exchange rate, resulted in a strategy, incompatible with long term development of the economy, and made it impossible for the productive plant to stock up with quality intakes at competitive international prices. Also, it restricted a sustained increase of the available currency, and, at the same time, the continuous depreciation of the Mexican peso contributed to domestic inflation.[2]

2. The Opening Process

Previous to the opening up process, Mexico had to face several fundamental challenges: the stabilization of its economy, above all contain the inflationary process and stabilize the exchange rate; recover the economy's growth; promote non-petroleum exports in order to increase the employment in the Manufacturing Sector; increase foreign direct investment (FDI) to complement internal savings that were insufficient for financing for the economy's growth.

[1] A summary of this period can be viewed in Clavijo and Valdivieso (2000).
[2] Espinosa and Serra (2004).

In this context the important opening up process initiated during the 80's (precisely through 1985-1988),[3] allowed Mexico to become a member of the GATT in 1986. The process advanced in 1987 when a new stabilization policy, known as the *Pacto de Estabilidad Económica* (Economic Stability Pact), was adopted, setting a maximum tariff of 20% and increasing the opening up rate.[4] The relation that measures the opening up rate is:

$$\frac{Exports + Imports}{GDP}$$

The rate went from 22% in 1980-1985 to 30% in 1994, year in which the NAFTA came into effect.

Those measures partially balanced the prices between exportable and importable goods, and, also partially, eliminated the anti-exporting slant from the excessive protectionism period. However, the non-petroleum exports didn't grow sufficiently.

Despite the measures taken, there were still two obstacles. One was the weakening of the Generalized Preference System (SGP in its Spanish abbreviation) that the United States (US) granted to Mexico; under this system, Mexican exporters were afraid to loose their preferences if they exceeded the established quotas, so many firms preferred to close before the end of the year to avoid accumulating inventories. The second was the uncertainty caused by the continous sectorial negotiations, because Mexico's exporters never exactly knew the amount of the tariffs in relation to the quotas, and so the entrepreneurs carried out minimum investments. This environment made it necessary to change the commercial relationship with the US.

These obstacles disappeared with the NAFTA. The SGP was consolidated: the quotas were eliminated without altering preferences, and tariff discounts, and the result was an accelerated tax relief on the part of the US market. The annual negotiations of the different sectors were suppressed, so the uncertainty concerning access to that market ended, and Mexico's exports to the US increased significantly.

As to the necessity of increasing FDI, whilst the average annual flows during the years of protecting the Mexican economy were of US $1,300 million; once Mexico was a member of the GATT, such resources ascended up to US $3.000 million.

[3] During this period, the process was unilateral.
[4] Aspe (1993).

Unlike the NAFTA, the GATT did not incorporate investment requirements; so the result was insignificant in this area. But NAFTA included measures that contributed to regaining competitivity, and attracted FDI for two reasons. Firstly, Mexico was incorporated into one of the world's mayor markets with preferences for those who invested and produced in Mexico. Secondly, NAFTA's Chapter XI established rules that substantially diminished the Mexican investment risk.

3. The Negotiation

The Treaty's agenda did not consider mayor issues for one or more of the countries involved: migration meant for the US compromising the internal agreement required for the negotiation; private investment in Mexico's Energy Sector, was declared non-negotiable due to its own constitutional restrictions, and therefore declined to guarantee the provision of petroleum to the other Parties: something that Canada had accepted to do in its Free Trade Agreement with the US.

For some authors the agenda was ambitious, because it included practically all the issues being considered at that moment by GATT's Uruguayan Round, as well as some others.[5]

3.1 Certain NAFTA's Chapters

3.1.1 Market Access

One of the purposes of NAFTA was to ensure the least restricted access possible to goods and services for all three countries, eliminating tariffs and other commercial restrictions for North America (as GATT's Article XXIV established for any regional Free Trade Agreement). However, the Parties accepted that certain sectors, such as agriculture, the automobile industry and the textile-dress chain, required special agreements.

3.1.2 Economic complementarity

It was important to define rules of origin in order to address such issues as efficient specialization within the region; the comparative advantages of each country; and the necessity to bringing up to date the technology of Mexico's productive plant, the most backward of the Parties.

[5] Espinosa and Serra (2004).

3.1.3 Increasing of Foreign Investment

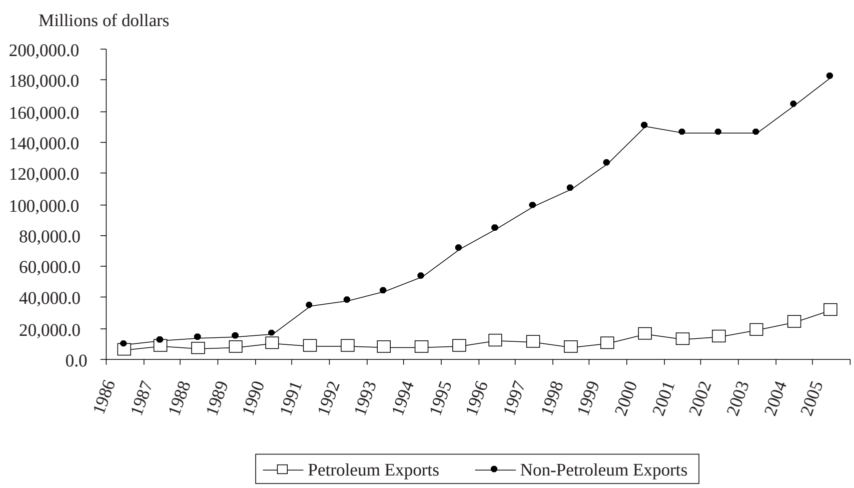
Mexico's possibilities were now greater, both preferences and complementation (promoted by rules of origin) gave it a unique opportunity faced with the possible competition risks from the Eastern European countries that had recently adopted market economy policies and were beginning to incorporate themselves to international markets.

The establishment of procedures for solving controversies was very important in view of the upcoming, ample and intense trade.

4. Foreign Trade Outcomes

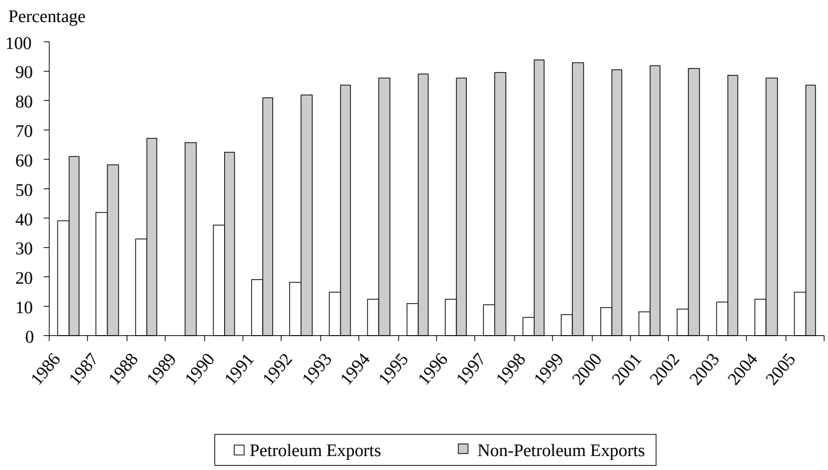
Since Mexico entered the GATT (1986), the exporting capability of its productive plant improved. But when the NAFTA came into effect, not only did Mexican exports increase, but they also changed in composition: petroleum ceased to be Mexico's main currency source, and manufactures generated the major currency flows (see Figures 1 and 2). Also, since NAFTA, trade between Mexico and the US has been favourable to Mexico.

Figure 1
Mexico: Petroleum and Non-Petroleum Exports, 1986-2005



Source: Banco de México.

Figure 2
Mexico: Exports structure, 1986-2005



Source: Banco de México.

Nevertheless, since NAFTA came into effect 50% of non-petroleum exports are from maquila assembly plants mainly located in Mexico's Northern region, precisely at its border with the US. This fact has resulted in strong differences with the other regions in the rest of Mexico,[6] and at the same time as these differences have caused several problems in the Northern region.[7]

4.1 Agricultural Sector

Mexico's Agricultural Sector received special treatment during the negotiation both as to the calendarization period and tax relief. Indeed 61% of the sector's exports to the US when the negotiations began, immediately became tax free as soon as NAFTA

[6] There is no evidence of a reduction of economic differences in the long term between the border economies of Northern Mexico and Southern US, although the gap isn't growing for the moment.

NAFTA hasn't been a referent for convergence in the border region, even though it has stimulated the economic development of Mexico's Northern border, particularly the states of Baja California and Chihuahua. Nevertheless, this process has promoted a regional specialization pattern oriented towards the maquila activities reducing the relative size of the local manufacturing activities; in this sense, this pattern is a strong reason not to be optimistic in the near future. Even if this pattern has increased the employment, it has also been a factor for breaking up the local production chains, diminishing the multiplier effects of new investments (Ocegueda and Plascencia, 2004).

[7] NAFTA and migration to the Northern border have resulted in an increase of the non-formal employment (Mendoza, 2003).

came into effect (Calendar A). For its part, Mexico only granted such treatment to 36% of its imports from the US. The contrary situation occurred under the calendar in which the tax relief would be gradual and will be complemented in ten years (Calendar C). The US only conceded that 28% of its imports from Mexico, would qualify for these regime, whilst Mexico granted the same conditions to 42% of its imports from the US. Certain products although representing a small percentage of its trade for each country, were incorporated under the longest calendar (Calendar D, 15 years) because of their being particularly sensitive for a variety of reasons.[8]

As for Mexico, it was agreed that all the restrictions to imports on some agricultural products (mainly grains and basic products, such as corn and beans) would be converted into initial taxes that represented an equivalent protection (215% for corn and 139% for beans); and then a gradual tax relief of 15 years would take place. In addition, it was agreed that during the first six years the relief would be quite slow, accelerating through the last nine. Taking into account that Mexico might need to import such goods to fulfil its domestic demand, non-taxed import quotas were agreed.

In this way, the established taxes were the starting point for the tax relief: the taxes were determined to ensure that the domestic prices of some relevant products were higher than the international price. For corn it could be triple, and for beans more than double. A significant protection of sensitive products was thus guaranteed. The term for eliminating the taxes of agricultural products was exceptionally long (15 years) compared with that agreed for most of the ones traded between the Parties. The transition period established was supposedly long enough to plan the adjustment of Mexico's Agricultural Sector to the new opening conditions, either by increasing the competitivity of its products, when it was possible, or by changing to crops that could take advantage of the preference conditions to the US market established by the NAFTA.

The establishment of non-taxed import quotas recognized a certain reality: Mexico's domestic production was often insufficient to satisfy its own demand, mainly due to climatic conditions. It was therefore reasonable that in order to cover its demand, Mexico could purchase from the other NAFTA Parties and at the lowest possible price (non-taxed). The quotas' size was small, so the imports that Mexico has faced since the coming into effect of the NAFTA has been more than such quotas stipulated.

Another issue is the extent of NAFTA's negative impact on basic agricultural products. During the period 1994-2000, the tax reduction on corn coincided with

[8] Espinosa and Serra (2004).

fluctuating, although relatively stable productions; the corn production has increased in the last years, just when the tax relief accelerated. As for beans, the situation is quite similar to that of corn. During the same period its production showed a decreasing tendency but in more recent years has had a significant increase; also coinciding with the acceleration of tax relief. With NAFTA, Mexico became the main supplier of these products for the US, as also the country that has derived most benefits from the US market.

The agreed terms gave Mexico a certain flexibility to adopt appropriate adjustment measures. But the issue is, in the end, if the period allowed was enough to adjust its Agricultural Sector to the opening process. It is also important to make clear to what extent the Mexican government took the necessary steps. The sector had been going through a severe crisis for many years, which has raised the question of whether it would be possible to renegotiate NAFTA's Agriculture Chapter, or if Mexico was wrong to assume that their producers could compete with those of the US.

What is clear is that the period allowed for complete liberalization of the Agricultural Sector wasn't sufficient for strengthening it, and at the same time it suffered drastic changes: going from the production of grains and pulses to fruit and vegetables.[9] This new structure now faces an unfair trade due to subsides and disloyal practices by the US.

Nevertheless, NAFTA is not the only cause of the agriculture's crisis; indeed there are several factors which explain this. Amongst the most important, is the sector's duality; the concentration of the land whose Gini coefficient is almost 62%; agriculture's productivity is lower than the national average due to its inability to generate added value, which worsened with the peso appreciation during 1954-1976; the average agricultural wage has decreased more than in other activities. The limited proportion of land used to produce fruits and vegetables has diminished the labour demand per product unit in the agricultural activities, which has had a negative impact on rural wages.

The low dynamism of the rest of the economy reduces the hiring of those who emigrate from rural zones, thus promoting under-employment, and the migration of workers and small producers to urban zones, and to the US. The grain and vegetable oil producers are the ones affected, on not receiving enough governmental support. The lower Mexican agricultural productivity is at a disadvantage with respect to international trade. Mexico's added value per worker is nearly 7 times less than that of the US, a country which not only is highly efficient

[9] Yúnes-Naude and Barceinas (2004).

in global terms, and is a world grain exporter, but also has a highly subsidized agriculture. This productivity gap existed prior to NAFTA, and has increased since it came into effect, despite Mexico's advances in terms of yields and production volume of the majority of the marketable products, including basic grains.

As in the case of so many other non-industrialized countries, Mexican agriculture faces other adverse situations, such as the fall of international prices for agricultural products during the last few years, partially due to the larger support that industrialized countries grant to their own agricultural sectors. Developed countries also invest in research and development, which results in higher productivity and a larger supply (pushing down prices) in the context of facing a demand that does not grow in the same proportion. The fall of domestic prices affected producers, but also benefitted consumers. The peso appreciation made both Mexican agricultural exports and Mexican producers who competed with similar inputs less competitive, and this situation magnified the reduction of international prices in relation to the domestic ones. Without the necessary financing, for decades the rural sector has accumulated an investment deficit, representing more than 5% of Mexico's GDP, and receiving less than 1% of total investment; a proportion not corresponding to its high occupation levels.

Agricultural and alimentary exports increased significantly in terms of volume and value, but imports grew at a higher rate; the result is a commercial deficit since the NAFTA came into effect.

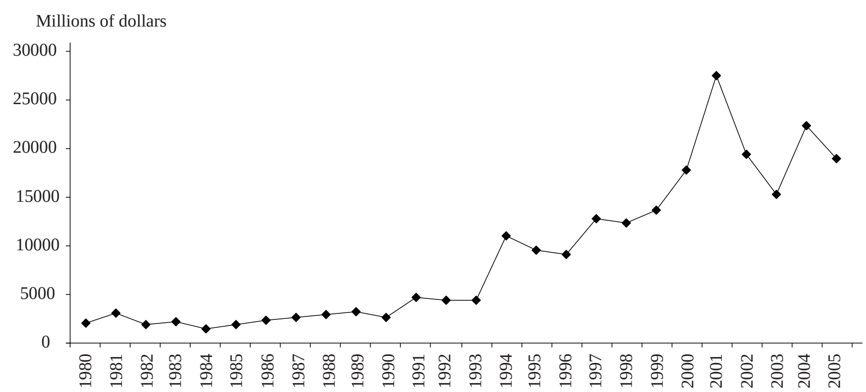
The export structure became less concentrated due to less production of tomato and coffee, and the growth of agroindustrial exports. The loss of market share on total imports (per US product) in some of the mayor products in the Mexican export structure, such as tomato and many vegetables, deserves special attention. Among the main causes of this situation are to be found the real appreciation of the peso, and the fact that the US also granted tariff preferences to other developing countries. Also, the imports' structure concentrated on basic grains and beef; in fact twelve products represent more than 50% of total agro-alimentary imports.

Since NAFTA came into effect, the Mexican government implemented several aid programs for the Agricultural Sector, such as *Alianza*, *PROCAMPO*, and *Apoyos al Ingreso Objetivo/Comercialización*. But by concentrating on commercially oriented producers, their common problem is that none covers all the producers, and they generate regressive effects on income distribution. All of them require: restructuring in order to to eliminate the mentioned effects, and to increase productivity, as also a long term approach.

4.2 Outcomes in terms of FDI

The trade opening initiated in 1985 and extended by Mexico's incorporation to GATT, and thereafter with NAFTA, registered increasing flows of FDI. This tendency is shown in the next figure:

Figure 3
Mexico: FDI, 1980-2004
(Million of dollars)



Source: Banco de México.

The average annual flow of these investments (during selected periods) is: 1980-1985, US $1,300 millions (prior to the trade opening); 1986-1993, US $3,486 millions (after incorporation in the GATT); 1994-2003, US $14,251 millions (since NAFTA).

The greater part of FDI comes from North America (68%), and nearly a quarter from the European Union (22%). It is worth mentioning that in some years, FDI was attracted by the privatizations that took place, as well as by fusions and merges. The larger part of the investment went to the Manufacturing Sector, though both commerce and services represented a similar portion (43%) to that sector. Mexico is attractive to investors because of its stabilization scenario, its financial status due to the debt renegotiation under the Brady Plan, and its active depreciation of the peso since the 1994-1995 devaluation.

4.3 Mexico's dependence on the US

As we have seen, in terms of FDI Mexico's dependence on the US is evident, and this is also true in terms of its commerce, although this has its own specific features, such as the higher participation of Mexico and the US in relation to acquisitions, strengthening their relationships.

US imports from Mexico grew from US $39.9 billion to US $138 billion, during the period 1993-2003, significantly more than those from other Latin American countries during those years (35.5 to US $138.1 billion); which means that 64 out of every 100 dollars of US imports from Latin American correspond to Mexican products. As for Mexican imports from the US. In the same period they showed a greater increase than those from Latin America.

During the period 1993-1999, US participation in Mexican trade rose from 75% to 81%; since 2000, it has decreased from 81% in 1999 to 75% in 2003. The Agreement also significantly increased Mexico's global economic insertion. Mexico's trade volume in NAFTA is the largest percentagewise but not that which is growing most: Mexican participation in US total imports only grew from 6% to 12% between 1994-2004.

5. Synthesis of results since NAFTA's implementation

NAFTA, together with the 1994-1995 peso crisis, derived in the following outcomes for the Mexican economy: an outstanding increase of exports;[10] a significant change in the exports structure (diversification); preeminence of the manufacturing industry; reduction of petroleum dependency; higher FDI flows;[11] an increasing connection with the international economic cycle, and especially with the US economy, which can result in vulnerability.

This last aspect, also known as convergence, implies that Mexico's economic growth path has strengthened its correlation with the US economy. Prior to 1993 both economies showed a modest relationship, even divergent in some years (1989-1993). Since 1994, they have shown a joint tendency, particularly as far as industrial production is concerned. Firms of all three NAFTA countries have relocated their productive processes in the country that offers the best possibility of

[10] The Northern Border has experimented changes that has allowed this zone a greater growth than other regions in Mexico. It's proximity with the US implies localization advantages for the export industry, and has stimulated the development of a, constantly more integrated, bilateral border region (Mendoza, 2003: 1088). See also Salazar and Varella (2004), Salazar Cantú, José de Jesús and André Varella Mollick (2004).

[11] NAFTA has promoted commerce and investment in Mexico (Mendoza, 2003: 1088).

lowering costs, which means an intensification of intra-industry commerce, and frequently within subsidiaries and accessories of a single corporation.[12]

The close synchrony between the Mexican and US economies, its dominant weight in the Mexican Commercial Balance, and the increasing importance of the intra-industrial commerce are three factors that have given an important stability to the Current Account of the Mexican Payments Balance. In fact, prior to NAFTA any reactivation of Mexico's growth tended to be a lessening of its trade balance with the US (1991, and 1993). Since 1994, Mexican exports to the US, and Mexico's imports from the latter, show parallel paths, which has contributed to a decrease in the exchange rate volatility.[13]

Exchange rate stability, along with disciplined fiscal and monetary policies, has been a factor for controlling inflation. Although this stability, of both exchange rate, and therefore of inflation in Mexico, has had a high cost. To date it has been supported by a large amount of reserves (near to US $60 billions at present).

The growth rate of Mexican consumer prices shows a rapid convergence towards the prices of the other two member countries. Low inflation, and exchange stability have led to a lowering of funding costs in the Mexican financial market, down to levels that until recently seemed impossible to achieve. The short term interest rate of the Cetes (that's to say *Certificados de la Tesorería del Gobierno Federal*, or Mexican Treasury Bonds) have shown a tendency to decrease and clearly are converging to similar levels of the rates of similar financial instruments in the other two countries.

The stability of the exchange rate and prices has restored the possibility of longer term loans: whilst in 1995 it was almost impossible to issue instruments in pesos with terms longer than 90 days, by the end of 2002 the Mexican financial market was able to issue instruments for periods of 10 years, or even longer, at a reasonable cost. The convergence of Mexico's major macroeconomic indicators with those of the US and Canada has opened the possibility of financing, in pesos, projects that require long terms for their repayment. Nevertheless, these favourable conditions have not yet had a considerable impact on the availability of loans for the Mexican firms, especially the medium size and small ones. The financial margin is high, and has been since the commercial bank was privatized.[14]

[12] The NAFTA period has had two constants that establish a marked contrast with the immediate past: Mexican and US business cycles follow a common path, and the Mexican Commercial Balance follows it as well –both exports and imports move jointly and respond to the same impulse: external demand– (Luna and González, 2004).

[13] The Agreement allowed a faster recovery for the Mexican economy since 1996 (Díaz-Bautista, 2003).

[14] Bonturi (2002) and Sánchez (2004).

Normally, the NAFTA is assessed in terms of the commercial advances and investments, leaving out the consequences of improvement in welfare.[15] The Agreement has reduced employment in the Manufacturing Industry and is one of the causes of the serious employment decline in the Agricultural Sector (8.1 millions in 1993 *versus* 6.8 millions in 2002). Although the total demand for employment went from 32.3 millions in 1993 to 40.2 millions in 2002, the number of workers in non-maquila manufactures in 2004 was below the 1994 level (1.3 millions *versus* 1.4 millions), whilst maquila employment increased by 550,000 jobs during the same period, after suffering a 30% reduction due to the re-localization in Asia. This situation is explained by several factors: the low aggregate value of maquila exports (only 3% is done in Mexico); the displacement of national industries by imports; the reduction in trained labour; and the diminished advantage derived from the access preferences to the US market. A similar scene can be observed for real wages, that are now lower than when NAFTA came to effect.

It is believed that NAFTA has contributed to an important increase in illegal migration. This is not correct, although NAFTA does not include a chapter on migration and only allows the mobility of 63 highly qualified professional categories, it's incorrect to think that commercial agreements could solve this problem.

There is little evidence that NAFTA has had a significant direct impact on the environment, except for corn, whose associated industries opened up rapidly causing damage. For that matter, there are other consequences in this sector which derive from the US policy of subsidies; the bankruptcy of Mexican small firms and the excessive use of fertilizers.

6. Problems and upcoming agenda

6.1 Problems

Despite the fact that the macroeconomic stability achieved single digit inflation, the Mexican economy faces a stagnation of its GDP, it's growth having been below the expected and that which would have been desirable. During the period 1994-2003 the domestic component of the aggregate demand has grown at a considerably lower rat than that of the external component.

There is evidence that the manufacturing firms whose exports have increased fastest, tend to also be the ones that have created more jobs and pay higher wages.[16]

[15] Audley, Papademetriou, Polaski and Vaughan (2003).

[16] According to Casares (2004), the Industrial Sector which has exported most since NAFTA increased the employment in the whole of the Manufacturing Sector.

At least in the Manufacturing Sector, export growth has contributed to an increase in employment, but the opening up has also forced many small and medium firms to close. However; the insufficient creation of jobs (and of market growth) is also due to factors other than the commercial opening up carried out in recent years.

A fundamental cause of the low growth of the domestic market is the significant fall in bank credit: from 39% of GDP in 1994 to 17% in 2003. The highest dependency on bank credit is to be found in the small and medium sized firms, for whom this credit is the main source for financing labour capital, and eventually for new productive capacity investments. Since large firms are the principal contributors to export growth, they attract the greater part of the increasing FDI flows that Mexico receives since NAFTA came into effect.

The incapacity to expand its basic infrastructure (especially in transports and communications), as well as to promote investments in strategic sectors, above all in energy, is another factor that has kept back Mexico's growth. Weak Public Finances, increasing Current Account compromises, and deficient regulation of the privatized sectors have inhibited private investments. Substantial resources have been used for several aspects of the Federal Budget instead of using them to ensure a sufficient energy supply at competitive costs.

The shrinkage of Mexico's share in US trade, associated with China's increasing participation in global commerce, and particularly in relation to the US market, has also contributed to Mexico's poor economic performance.

The country has also faced difficulties for attracting FDI due to several causes that are widely accepted throughout the world as obstructing FDI flows: such as countries' national policies, the quantity, pertinence, and quality of a country's institutions, the legal system and property rights, promotion of systemic competitivity –such as innovation systems, diversified production chains and quality infrastructure services–, educational systems, and standards for the preservation and rational exploitation of the environment. Almost all these elements are missing in Mexico, and therefore, in recent years, the country has faced difficulties for attracting FDI.

Another factor that hinders FDI flows to Mexico is the competition with China, in particular in relation to US FDI. Mexico is in an ongoing process of losing both export competitivity and increasing FDI flows. For example, many maquila firms have emigrated from Mexico due to several causes; one major cause being the better conditions that China offers to this kind of firm, and which makes China's FDI attraction even bigger.

It is important to point out that it is the globalization process, and not necessarily that of NAFTA, that has caused the aforementioned problems to the Mexican economy. Globalization, and the tendency to reduce the role of the State in all aspects of national life implies adverse situations for improving general welfare. There have been Government expenditure cuts, tax cuts, less political support to redistributive measures, and the generalized implementation of market liberalization without adequately estimating the economic and social consequences.

The deep structural changes that have occurred in the world have significantly affected the role of institutional structures that had made growth possible and, above all, the setting up of generalized mechanisms for the economic coordination normally accepted between countries. But only a few nations have benefitted, and new institutions are necessary to face up to the necessary changes.[17]

The incomplete economic and institutional reforms in Mexico and the obvious stagnation of the reform process (before taking total advantage of the opportunities originated by NAFTA), emerge as fundamental problems, as negative incentives that inhibit US and Canadian interest for a more profound entailment with Mexico.

There are other major problems that act in the same way: the simulation of a true state of law, insufficient and poor infrastructure, the lack of social and human capital, the inexistence of local production of sophisticated industrial intakes, production duality, enormous inequality, a weak domestic market, low rural productivity, little democratic participation, lesser coverage and quality of public goods, a solid and omnipresent culture corruption, security problems and drug trafficking.

The important economic, political, and military asymmetry between the three NAFTA members constitutes an adverse factor for the integration of the region, as also the US policies on migration, terrorism, and drug trafficking. Mexico and Canada seem to have integrated with the US (which is the core of their commercial and investment relationships), but each one by itself.

Even though rural problems increased it is not possible to affirm that the sector's crisis was originated by NAFTA since the Rural Sector problems can be traced back as far as to the ISI era.

A migration chapter, presently not included in NAFTA, seems impossible to incorporate. There's little or non political interest on the part of the US, and even from the Mexican Government, to lessen the difficulties that Mexicans face when looking for jobs in the US, or even already work there, despite their contribution to currency flows derived from the remittances to their families. The amount being comparable to that of the petroleum exports.

[17] Novelo (2004).

Proliferation of free trade agreements between the US and other Latin American countries, and China's entrance into the World Trade Organization, are phenomena that have also affected the relative advantages that Mexico obtained with the implementation of NAFTA.

The Mexican fiscal regime is not competitive: there are high rates for direct taxes but the deficient collection of these does not allow the Government to invest in infrastructure which would lower the costs of transporting exports. It is also the result of a regressive tax structure on Mexicans' incomes.

Mexico's energy prices are higher than those of its principal competitors, and even those of its main commercial partners, due to insufficient investment, and monopoly incomes in the sector. Transportation costs, adjusted for quality and efficiency, are also higher.

Since the events of September 11th, border security requirements have also become an obstacle for free trade.

6.2 Upcoming Agenda

The necessary deepening of the Agreement, but by way of a gradual process of integration, which would imply strengthening NAFTA's institutions that at present do not ensure certainty in relation to the rules governing the regional economic operation. They should also be a more severe application, and sense of commitment for resolving disputes.

The macroeconomic convergence of all Parties could be the basis for negotiating the coordination of policies that grant continuity to stability, as well as reduce risks associated with the regional economic activity.

As for the Agricultural Sector, it is imperative not to postpone the reforms that would allow a larger participation of this sector in the GDP, and increase its productivity, efficiency, and competitivity, combined with the creation of rural jobs in non-agricultural activities. This would generate jobs and additional incomes in rural areas, and would stimulate the demand for industrial goods, construction and services that would stimulate the domestic market and urban employment. Also, it could slow the fall of wages throughout the whole of Mexico's economy and reduce informal work in urban zones. The three countries could take advantage of the several complementarities that they have in agricultural issues.

The situation is similar in matters of energy. North America has the possibility of generating comparative advantages by way of a rational exploitation of energy resources in the region. Whilst others countries, such as China, are already facing bottlenecks in this sector.

Mexico has a natural advantage over China and other countries to access the US market as far as transportation costs are concerned. Unfortunately, today it does not collect the benefits that derive from its proximity due to the dispute between the trailers of both countries to access Mexico, or the US, significantly reducing the region's competitivity.[18]

Although the Agreement has facilitated the migration both of non-qualified workers and professionals, free labour mobility is necessary in the context of NAFTA. Even so, the loss of human capital has had serious consequences for the Mexican economy. In reference to non-qualified workers, the consequences have been positive; especially for the remittances sent to Mexico which increase currency flows and families' income.[19] Nevertheless, the workers separation from the country, its culture and family ties is a negative side of migration.

A new industrial policy that allows the coherent articulation and integration of regional development strategies with the commercial and macroeconomic policies is required. This should be directed towards the industrial conglomerates and the small and medium firms, and must aim to correct both market imperfections and faulty State intervention. Also, it must stimulate a better integration of Mexico´s Northern Border Region to national economic development as a whole, by proposing an integral industrialization model that facilitates hub settlement of firms, as well as to promote the proliferation of small and medium industry and other activities, such as industrialized agriculture and services. There should also be a selective policy for attracting new maquila firms which develop manufacturing processes that use new technologies.[20]

Finally, the coordination of several Government spheres is necessary in order to discover the operative design for both fiscal organization and collection so as to comply with the demand for public services and the necessary infrastructure for the population, and productive activities.[21]

[18] US non-fulfillment of NAFTA's Chapter XII in reference to the transportation opening up with Mexico, has increased the costs of this service (Mendoza and Díaz, 2003).

Sobrazo and Pla (2004) consider that NAFTA's potential advantages will not be fully capitalized if the productivity in the commercial and transportation sectors is not increased.

[19] Zárate-Hoyos and Spencer (2003).

[20] Calderón y Martínez (2004).

[21] Aguilar and Flores (2004).

Learnt lessons

Free trade must not be visualized as an end in itself. It isn't enough just to open markets to foreign competition in order to make domestic producers competitive.

It is important to distinguish the objectives, outcomes and effects for a country when signing a free trade agreement, from the implications (both positives and negatives) derived from a government's economic policy, such as in the case of Mexico.

A free trade agreement between poor and rich countries has to consider the asymmetries existing between the Parties concerned.

Any country with a backward economy, as that of Mexico, cannot afford to overlook the weaker economic sectors and population groups when making a free trade agreement; the terms of grace for the opening up to international competition must be well justified, and must guarantee aid, and reorganization measures that prepare them to face the new phase; the developed countries have done this, and continue doing, this. Non-exclusion must be a major premise, which means the celebration of fair agreements on crucial issues for the more backward country; migration as in Mexico's case.

It is also necessary to negotiate lengthier calendarizations for the tariff liberalization of richer countries' agricultural products.

Taking into account the experience of developed countries' practices, it is also necessary to negotiate special treatments in order to prevent the dumping of subsidized products.

It is also important to put into practice policies that stimulate employment, and allow for a better distribution of the commercial benefits.

Finally, it is fundamental that cooperation mechanisms be established for the adoption of the new price and production structure; generally dominated by the more developed economy.

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