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NAFTA'S Effects on the U.S.-Mexico Relationship

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Introduction

The North American Free Trade Agreement was a watershed event in U.S.-Mexican relations—perhaps the most important agreement between the two countries in the 20th century. The United States already had a free-trade agreement with Canada that went into effect six years earlier, in 1988, but the inclusion of Canada in NAFTA started what is already proving to be a significant process of North American integration.

NAFTA, when it was conceived, did not have the grand long-term goal of leading to economic and political union that was the explicit objective from the outset of what today is the European Union. Neither was NAFTA based on the premise that deepened economic interaction would eliminate the likelihood of war among the member nations; the probability of war between the United States and its two land neighbors has been nil, or close to it, for the better part of a century.

NAFTA, however, did not lack political motivation. Political issues were part of the thinking from the outset, but with less grandiose aspirations than those that motivated European pioneers like Jean Monnet and Robert Schuman. President George Bush (the father) would have been derelict had he not accepted the offer made by Mexico's president, Carlos Salinas de

Gortari—which was a proposal for free trade and, perhaps even more important, for a more cooperative political relationship between the two countries than had existed for more than a century. The Salinas offer was for the two countries to become less "distant neighbors" (to use the title of the book by Riding, 1985). The argument I made in a book published before Salinas made his proposal was that U.S.-Mexico free trade would have the important political consequence of enhancing government and business consultation and make the movement of capital and labor freer than it had been (Weintraub, 1984, p. 31).

The discussion that follows deals with these themes. NAFTA has led to sharp increases in U.S.-Mexico trade and investment, and this will be shown in the next section. This, however, is by now a well-known story. Greater attention will be given in the subsequent section to noneconomic outcomes since NAFTA's creation in 1994. The paper will close with some speculation about how NAFTA will develop in the years ahead.

Economic Outcomes

U.S. trade with Mexico and Canada, which has long been substantial, took off spectacularly after NAFTA came into effect. This can be seen in figure 1 (U.S. Trade with Mexico, 1990-2000) and figure 2 (U.S. Trade with Canada, 1990-2000). During the 1990s as a whole, U.S. merchandise exports to Mexico rose at an annual rate of almost 30 percent, and to Canada at an annual rate of 14 percent. As a point of comparison, U.S. merchandise exports to the rest of the world over these years increased at an annual rate of less than 7 percent. The increase in U.S. merchandise imports tells a similar story over the decade: an annual average increase of 33 percent in imports from Mexico, 16 percent from Canada, and slightly less than 10 percent from the rest of the world. At the beginning of the 1990s, Canada and Mexico together took roughly 28 percent of U.S. exports; in 2001, the two together took 36 percent of U.S. exports. (These percentages are based on merchandise trade data from the U.S. Census Bureau; the percentage changes would be similar if goods and services data were used.)

The economic rationale for NAFTA was not just to increase trade in North America, but also to stimulate direct investment. This, too, has succeeded, as can be seen in figure 3 (U.S. Direct Investment Position in Mexico, 1990-2000) and figure 4 (U.S. Direct Investment Position in Canada, 1990-2000). Other countries also are direct investors in Mexico and Canada, but the United States dominates the annual flows as well as the cumulative stock. There is considerable investment in the United States from the other two NAFTA members, but the expectation when NAFTA was negotiated was that the direction would be outward from the United States.

To persons immersed in economic integration theory, the promise was that NAFTA would lead to a division of labor and that investment would be directed to similar sectors in the three countries, with the consequence that there would be much intra-industry as well as intra-firm trade. There is not much purpose in integrating economies which have little commodity competition. If there is no competition among them, import barriers should be low to start with. The evidence is quite clear that a division of labor is taking place in North America. Each of the three countries ships more automobiles and auto parts to the other two than they do products in any other sector. The products, however, are differentiated. Mexico has focused much on the production of smaller autos, Canada on special utility vehicles, and the United States on mid-sized and larger cars and trucks. Electrical machinery, data processing equipment, and telecommunications equipment are among the sectors in which intra-industry trade has flourished. More than half of the exports from Canada and Mexico to the United States is to a related party, such as from a subsidiary to a parent company or to a strategic partner. The trade, increasingly, is in intermediate goods that serve as inputs to final products, which fits the expectation of a division of labor.

There have been expressions of concern in Canada that if the trade trends of the last decade continue, Mexico, in a relatively short time, would replace Canada as the number one U.S. trading partner. This, of course, could happen, but Mexico's large percentage increases in exports—starting from a lower base than those from Canada—almost surely will not continue indefinitely. U.S. exports to Canada still exceeded those to Mexico— the number two U.S. export market—by $62 billion in 2001, and U.S. imports from Canada were larger by $86 billion in 2001.

NAFTA still has its vociferous opponents. The discussion above starts from the premise that the large trade increases stimulated by NAFTA are a plus for the member countries, but much opposition to NAFTA focuses instead on the large U.S. trade deficits with Mexico and Canada. (These are shown in figures 1 and 2.) The argument is then made that this has led to jobs losses in the United States (Scott, 2001). This was an empty argument during the high-growth years in the United States, between 1992 and 1999— when the U.S. economy was operating at full employment—but may have more resonance today when U.S. growth is less robust. At its core, however, this is an anti-trade argument, that U.S. trade is desirable only with countries with which the United States has trade surpluses.

The Political Dimension

NAFTA differs from the EU not only in the basis for its conception and, consequently, the goals of its founders, but also in the nature of its country composition. NAFTA has one overwhelmingly dominant country, one developed but relatively small country, and one populous developing country. The EU, by contrast, started with many developed countries, of varying sizes to be sure, but much less disparate in their economic sizes. Mexico, at the outset of NAFTA, was about one-twentieth the size of the United States in GDP terms and Canada one-tenth. The EU did not have to deal with differences of this magnitude, certainly not at the outset; and even today, as the EU contemplates further enlargement, the problems that must be addressed because of economic disparities are complicating the negotiations.

NAFTA, although that was not its intent, was much more experimental in embarking on an integration arrangement between the world's largest economy and a poor neighbor. It was this economic difference that made NAFTA so controversial from the outset. The concern then, which remains to this day, is that competing on a free-trade basis with a country where manufacturing wages were about one-tenth those in the United States would erase many low-skill jobs in the United States and would lead to investment to exploit low-wage production in Mexico. The geographic reality that production sharing was particularly convenient with a neighbor was amply demonstrated by the growth of Mexican *maquiladora* plants along the border. (The idea of the maquiladora was for the United States to ship partially finished products to Mexico, finish them with low-wage labor, and then reship the final product back to the United States.) There is no other place in the world where two countries so disparate in their economic structures and sizes share such a long (2,000 mile) and porous common border.

The combination of proximity and poverty in Mexico created its own problems, such as the attraction of the United States for undocumented migrants. There was little stomach in the United States for an armed border to keep out unwanted immigrants, although unsuccessful efforts have been made to do precisely this. NAFTA, in part was promoted in the United States as a way to slow down unwanted immigration by creating better job opportunities in Mexico. Migration from Mexico has not slowed, but NAFTA is still less than nine years of age. The combination of lower fertility and higher economic growth in Mexico still holds the best promise for dealing with the migration issue—just as emigration from Italy and Spain and Ireland lost their attraction after those economies grew sufficiently. It is also grotesque to see such stark disparities by merely walking across a bridge or walkway between the two countries and the hope was that increased trade and investment stemming from NAFTA would help to reduce the economic difference.

Apart from this desire for a more prosperous neighbor—on humanitarian as well as market grounds—NAFTA was a way to deal with a conflictive binational history. Even though it was more than 150 years ago when Mexico was forced to give up half its territory to the United States, the history is part of the cultural upbringing of Mexicans. There were subsequent incidents of U.S. incursions into Mexico well into the 20th century. It was not really until the administration of Franklin D Roosevelt, after Mexico expropriated U.S. and British oil properties in 1938 without incurring counter-military action from the United States, that the current era of peaceful relations the "good neighbor" policy can be said to have begun. The relations were peaceful, but not warm or deep.

Mexican foreign policy, as a result of country's experiences, was long typified by obligatory declarations about sovereignty and non-interference in the affairs of other countries. These perennial invocations were directed primarily at the United States. Distrust of the United States was deeply embedded in Mexico's social culture and was the basis for Mexico keeping its distance in the relationship. Salinas' proposal for free trade with the United States confronted this sentiment head-on—or almost head-on, because the ratification process for NAFTA was kept limited to the Mexican Senate, where the government's control was overwhelming. Elements of keeping its distance remain in Mexico. For example, public opinion in Mexico did not support the U.S. anti-terrorist action after September 11, 2001—and this public opposition was a factor in President Vicente Fox's reluctance at first to declare his full support for the United States.

It is not a trivial accomplishment, therefore, that NAFTA is altering many political and social relationships between the Mexican and U.S. governments and their populations. French and the Germans may still not feel warmly toward each other, but they work together closely, thanks to the EU. Something similar is taking place in the much younger NAFTA. Examples of this follow.

Governmental liaison. Pre-NAFTA relations between officials of the two governments were formal. Most business was conducted through the two foreign ministries, via the embassies, rather than in less formal contacts between action officers. The Mexican embassy made little effort to directly approach members of the U.S. Congress responsible for dealing with issues concerning Mexico; the Mexican approaches, when made, generally were through the State Department. The State Department was the usual intermediary even for Mexican embassy dealings with other parts of the U.S. government.

This has largely changed. Action officers now pick up the telephone or send e-mail messages to their counterparts in the other government. Intermediation of the State Department or the External Relations Department of the Mexican government is largely superfluous when dealing with other agencies or the respective legislators. Officials now know each other from the NAFTA negotiations and the many working groups set up for dealing with specific issues. Such informal contacts are routine—they have long been so between U.S. and Canadian officials – but were not earlier between U.S. and Mexican officials.

A small thing? Yes, but not inconsequential. NAFTA is not rich in institutions, deliberately so. One reason for this was to downplay any formal political aspects of the agreement. The free-trade area format was chosen precisely because it was felt that a customs union—and a common external tariff and common commercial policy—would add an unwanted degree of political commitment. A common market involving free movement of labor was out of the question in light of the economic disparities. The simplicity of the institutional structure is the theme of a book by Robert Pastor, who uses the EU model as an example of how NAFTA might develop (Pastor, 2001). The institutional structure of NAFTA undoubtedly will become more extensive over time, but the paucity of overarching decision-making institutions has not resulted in a lack of contacts between working-level officials of the two governments.

Business links. Links between businesspersons from the two countries have developed naturally. This is inevitable now that two-way trade approaches $700 million a day. The fact that much of this trade is between related parties adds to the development of personal links. So, too, does the nature of production when many producers in either country can function only by receiving intermediate products from producers in the other.

Non-governmental organizations. While more business linkages are expected as trade increases, there was nothing inevitable about the growing connections between non-governmental organizations (NGOs). This is taking place across-the-board—for dealing with the environment, human rights, education, regional development, treatment of labor, migration, and health care. Cross-border NGO cooperation often works in opposition to national groupings in either country in such fields as protecting the environment and promoting human rights.

Environment. This issue merits special mention because President Clinton insisted on a side agreement dealing with this issue before he felt able to submit NAFTA to the Congress for approval. The Mexican government agreed, but more because of U.S. coercion than willing consent. What has happened since is that the nascent environmental movement in Mexico grew in size and became more aggressive in dealing with urban pollution, seeking sewage systems, protecting and conserving water resources, and handling hazardous waste. The driving force behind the supplemental environmental agreement was that Mexico would not take strong measures to protect its environment, particularly at the border where pollution would not respect the boundary, and that a threat of adverse publicity and potential trade punishment would be necessary. There can be little question but that a home-based environmental lobby in Mexico is far more effective than an outside threat. The links between NGOs in this field is a societal triumph—one that NAFTA abetted.

Labor. Something similar, but much less dramatic, has occurred in the labor field. A second supplemental agreement on which the United States insisted was to protect basic labor rights in Mexico. The problem in Mexico was not with its labor legislation, but rather enforcement; and a second problem was the near monopoly of the Institutional Revolutionary Party (PRI) over labor unions and the country's large labor confederation. The large U.S. labor confederation, the AFL-CIO, opposed NAFTA on these grounds and mocked the labor side agreement. The labor movement in Mexico has since changed, not so much because of NAFTA, but from the loss of the PRI's overwhelming power in running the government. Many U.S. labor unions now work with their Mexican counterparts, whereas the attitude before was mostly disdain. The change has not been as dramatic as in the environmental area because organized U.S. labor still fights NAFTA. Organized U.S. labor has made clear that it opposes low-wage imports more than it supports improved working conditions in Mexico.

Education. The tone of elementary school textbooks in Mexico has long been anti-*yanqui*, stemming from the history of the 19^{th} century. This is still true, but there are now Mexican voices critical of this inculcation in young minds of distrust of a neighbor. At the university level, there was little sophisticated study of the United States, either at the undergraduate or graduate level. This has changed; there are now U.S. and North American study centers throughout Mexico. The same is true today in the United States, and even Canada is catching up. Many Mexicans who live near the border study in U.S. colleges and universities and, indeed, need pay only in-state tuition in some states—such as The University of Texas. The cross-border ignorance of each other is slowly, but methodically, being corrected in both Mexico and the United States.

Migration. The Mexican government, for many years, had an explicit policy not to discuss migration matters with the United States; or, to put this differently, there was a policy not to have a policy (*Binational Study*, 1998, p. 448). This approach was of the same genre as that calling for noninterference in the domestic affairs of other countries. This began to change in the late 1980s and then shifted completely after NAFTA. Under President Vicente Fox, Mexico developed an initiative formula called "post-NAFTA," and the principal issue emphasized under this rubric was migration. Mexico, in fact, insisted on discussion of regularization of undocumented Mexican immigrants living in the United States, improving security for Mexicans crossing the border, establishing a temporary worker program, and even looking toward free movement of labor as per capita incomes in the two countries converged.

The U.S. government was receptive to this approach, but the momentum to move ahead was lost after September 11. However, it is an issue certain to be revived in the context of the annual binational meetings now held between cabinet-level officials of the two governments. These cabinet-level meetings are themselves an outgrowth of NAFTA. Migration, once a taboo issue for bilateral discussion—for the United States, because it was a domestic matter; and for Mexico, because it did not wish to interfere in U.S. domestic affairs—is now a regular part of the post-NAFTA bilateral agenda.

Narcotics. Like migration, control over the movement of narcotics from and through Mexico into the United States was not discussed except in terms of charges and counter-charges hurled at each other. Each year, the U.S. Congress deliberated whether to certify Mexico as a country collaborating in the control of narcotics trade, and the Mexicans retorted that the problem was the demand in the United States that attracted the supply of cocaine, heroin, marijuana, and other drugs. There is much cooperative discussion of this issue today and even the U.S. Congress has temporarily suspended its certification process. Discussion does not assure solution; that still requires effective substantive action by both parties. Nevertheless, there is considerably more civility in the binational treatment of this issue.

Sovereignty. Given the history of Mexico-U.S. relations, the pre-NAFTA expectation was that Mexico would invoke its concern over sovereignty in dealing with sensitive issues. This was indeed the case in the NAFTA negotiation, when Mexico made no commitment on foreign investment in the petroleum sector and few on trade in petroleum products. Mexico, for example, refused to assure normal oil supply to the United States in an emergency, a commitment that Canada gave in its free-trade agreement with the United States and carried over into NAFTA. Yet, the reality in the post-NAFTA period is that the United States has raised issues of defensive sovereignty much more than Mexico. Some examples are dealing with anti-dumping issues and permitting Mexican trucks to operate in the United States (as provided for in NAFTA). Mexico, by contrast, consented to extradite Mexican nationals wanted for criminal acts in the United States, an action that would have been inconceivable in the pre-NAFTA period. There are now high-level discussions among officials of the three NAFTA governments on creating a cooperative North American energy market.

Sovereignty is still an important issue in both countries; one need only listen to politicians in each of them to understand this. (As an aside, anti-U.S. rhetoric that was normal in Mexico pre-NAFTA, is now rare. Intemperate and condescending statements about Mexico are still made by U.S. politicians, but are no longer commonplace.) But there are few issues where sovereignty is invoked to cut off binational discussion. This is a major accomplishment.

Democracy. Mexico changed gradually from an authoritarian government that held elections whose outcomes were known in advance (a "perfect dictatorship," as Mario Vargas Llosa called it) to what is now a legitimate democracy. The election of Vicente Fox as president in 2000, overturning a 71-year period of PRI control, was the culmination of this process. This shift toward democracy began before NAFTA and there were partial openings, starting largely after the slayings during the 1968 student demonstrations. NAFTA, however, encouraged this shift. The reduction of the role of the government as the *rector* (director, manager, controller, are good translations) of the economy, the dispersion of economic decision-making authority into private hands, and the open market that NAFTA provided, were all contributory factors. Fox may or may not turn out to be an effective president; the PRI may or may not return to power—but the principle of alternation in power has now been established. This is a most powerful element bringing Mexico and the United States closer together.

Security. September 11 brought on the challenge of securing U.S. borders while, at the same time, permitting the smooth flow of goods, services, capital, and people. This requires cooperation in such fields as customs, migration, transportation, finance, and police operations. These would have been controversial areas before NAFTA; they will still be difficult, because competing objectives must be reconciled, but the focus can now be on the substance and not national antipathy.

NAFTA has changed much in the U.S.-Mexico relationship. It has, as well, in U.S.-Canada matters, but the habits of cooperation were extensive before the their free-trade agreement and before NAFTA. Canada, for its part, has now discovered Mexico which, before NAFTA, was sort of hidden below the United States. NAFTA is a young agreement, one that is still far from reaching its potential in economic, political and social spheres. But it has made a major difference in bringing Mexico and the United States closer together—and it is this relationship that has been emphasized in this paper.

Should a Free Trade Area of the Americas (FTAA) be negotiated, this would alter NAFTA in some respects, but not necessarily in others. The FTAA would be separate from NAFTA—and separate, as well, from other economic integration arrangements in the Western

Hemisphere—but would have the effect of gradually extending the tariff preferences the three NAFTA countries enjoy in each other's markets to all the members of the hemispheric agreement. NAFTA, in that case, would have to deepen in other areas if it is to remain viable apart from the FTAA. The assumption made here is that this, in fact, is what will occur.

Looking Ahead

For the United States, NAFTA is an agreement with two neighboring countries and this geographic reality makes it different from other potential economic integration agreements. Proximity, as noted earlier, facilitates production sharing and just-in-time inventory control. The security arrangements at the two extensive U.S. borders must be more stringent post-September 11 than with more distant countries, such as those in the southern cone of the South America. The large Mexican-origin population in the United States makes relations with Mexico different from those with other hemispheric countries. This has been evident in the many financial rescue operations the U.S. government mounted in Mexico over the years, even when there was reluctance to do the same for other countries in the hemisphere. There are solid reasons why Mexico and Canada are special cases for the United States.

1. As one looks ahead, therefore—and especially if the FTAA comes into existence—it will be imperative to speed the movement of goods back and forth across the border. This will involve more efficient customs procedures, much pre-clearance of containers coming from Mexico, perhaps stationing U.S. customs and agricultural officials at Mexican ports of departure, and setting up special lanes for trucks with pre-cleared cargo. U.S. goods moving to Mexico are burdened by the need for clearance by private customs brokers, which both slows the crossing and adds to the expense of moving goods. These sound like mundane requirements, but they have not been resolved so far.

Even more than for the FTAA, NAFTA—because of the greater amount of production sharing—requires working out similar, compatible, and mutually recognized standards for intermediate and final products and the provision of services. The security measures must be more stringent at the two borders because, together, there are close to two million legal border crossings of people each day. Immigration laws and procedures require more consistency among the three NAFTA countries than they do for Latin America and the Caribbean as a whole.

Stated simply, the details of moving goods, services, and people, while simultaneously looking to border security, are more complex for the NAFTA countries than they would be for the totality of FTAA countries. The task of working out these arrangements have already begun and should change the nature of border crossing in the future.

2. Perhaps the major task for improving U.S.-Mexico relations in the years ahead is to further diminish the distrust that still exists in the two countries. The reality of this distrust emerged most clearly after September 11. This is a gradual process and will require more education at all levels in each of the countries about the other. Problem-solving will require avoidance of deprecatory comments and insults from responsible officials in the two countries. Mistrust need not be replaced by admiration—this may demand too much—but by a sense that each country is making its best effort to solve difficulties. This is already taking place, but the effort will require intensification in the future. This will become more likely as Mexican democracy is solidified, and as the various branches of the Mexican government learn how to work together more cooperatively than is now the case.

3. The most sensitive—and perhaps the most important—area for future cooperation is probably migration. There are solid arguments in favor of regularizing undocumented Mexicans who have been working for years in the United States: They are unlikely to be deported en masse in any event; will raise their children in the United States; will earn more if legalized; will enable

competitive workers to earn more if they are not played off against cheaper illegal immigrant workers.

But there are also strong arguments against such regularization: Such an action will encourage more Mexicans and others to enter the United States illegally; over time, they will want other family members to join them in the United States; if Mexican undocumented immigrants are regularized, it will be necessary to do the same for those from other countries in the same position; and the totality of persons who will be affected would likely be in the tens of millions. The United States will want Mexico to protect its southern border so that Mexico does not become a gateway for illegal entry into the United States of other nationals.

In sum, migration is not an issue for glib solutions, but rather for discussion and a demonstration of ingenuity.

4. Financial relations may deepen in the future. From time to time, there are proposals from influential Mexicans in favor of adopting the dollar as Mexico's legal currency. Mexico is already largely dollarized in terms of prices quoted for a wide variety of goods, services, contracts, and the like, but the formal adoption of the dollar would eliminate an independent monetary policy, and would be costly in terms of lost seignorage. There is no urgency for Mexico to take this step now, and perhaps not at all in the foreseeable future. The issue will return to prominence, however, if Mexico has another financial collapse, such as the one that afflicted the country at the end of 1994.

5. As U.S.-Mexico relations deepen in the future, there may be a need for new binational institutions (or trinational, to include Canada, if the institutions are explicitly NAFTA-related). This is not a pressing issue because the structure is working reasonably well. The inability to reach agreement on complex issues like migration, the combination of border security and

facilitation of commerce, and narcotics control is not the result of an institutional lack, but stems from the inherent complexity of these issues.

One final point deserves mention. The Latino population of the United States is 12.5 percent of the total U.S. population, and the Mexico component alone is 7.3 percent (U.S. Census Bureau 2000). This reality, in and of itself, makes the U.S.-Mexican relationship different from all others.

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