A Critique on the Conflicting Evaluations of NAFTA Effects in Mexico

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NAFTA, at five years of age, has brought a tremendous change in Mexico's economy and society. There are conflicting cases for NAFTA and against NAFTA in terms of its performance and impact. Arguments in the positive side are that first, NAFTA has contributed to transforming Mexico in one of the major traders in the world. Secondly, NAFTA paved the way for the U.S. prompt assistance to Mexico when it fell into a financial crisis at the end of 1994. Thirdly, NAFTA provided attractive investment environments in Mexico for foreign investors, and foreign direct investments increased from $4.4 billion in 1993 to $12.5 billion in 1997 and $10.2 billion in 1998. Trade expansion and investments surge absorb labor. Others in the negative side, however, argue that Mexico's socioeconomic situation runs far short of improvement. First, the continuous readjustments in the manufacturing sector produced low-skilled unemployment only to be absorbed by the informal sector, which actually disturbs the statistics on jobs, and worse labor conditions. Second, the Mexican economy is further exposed to external shocks. Third, the gap between the rich and the poor has widened, and it serves as a critical momentum for increased sociopolitical instability.

The timing of NAFTA establishment overlapped with Mexico's ongoing unilateral trade liberalization and the sharp devaluation of the Mexican peso amid financial crisis. It further complicates an objective evaluation of

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NAFTA effects in Mexico. Many of the "positive" effects largely resulted also from trade liberalization and the peso devaluation. On the other hand, most of the "negative" effects had occurred even before NAFTA or would have happened without NAFTA under the ongoing liberalization and globalization environments. Both sides' evaluations of NAFTA tend to be exaggerated due to the politicization of the NAFTA issue and to practical difficulty to distinguish NAFTA effects from those by other factors.

Introduction

Since late 1980s, Mexico had undertaken aggressive economic reforms under the leadership of President Carlos Salinas de Gortari (1988-1994). His reformist initiatives included major public-enterprise privatization, and deregulation as well as trade liberalization. President Salinas himself proposed a free trade with the United States when he met President George Bush in Washington on June 10th, 1990. Canada joined the talks later as it already was implementing free trade with the U.S. since 1989. Within the framework of Salinas' grand scheme for national development, Mexico's free trade with its neighbors to the north meant a final touch on a series of market-oriented economic reforms. Through the North American Free Trade Agreement (NAFTA), Salinas envisioned an improved status of Mexico as major recipient of foreign direct investments, which would absorb Mexico's ever-increasing labor force and enable it to catch up with advanced technologies. He also wanted a policy framework in which an international arrangement might perpetuate the reformed economic structure.

On the other hand, NAFTA is considered a new model as a regional trade arrangement between industrial and developing countries. Integrating with the United States and Canadian economies, two of major economies in the world, Mexico became an interesting case to test the effectiveness of an economic integration with much larger economies as a development strategy. With NAFTA being implemented for more than five years, the performance of the agreement in Mexico is quite mixed with positive as well as negative impacts on Mexico's economy and society. Export increase, foreign investment inflows, and rapid economic recovery from the peso crisis and higher-rate economic growth afterwards may be seen in the bright side while the national manufacturing sector's bankruptcies and widening gap between rich and poor may be observed at the dark side.

This paper attempts to explore the outcomes of NAFTA for Mexico's economy and society for the first five years of its effect. In doing this, some statistical data will be convoked, and also some convincing arguments will be examined although many of these arguments are qualitative rather than quantitative. As a matter of fact, NAFTA is still controversial in Mexico. What political stance you take determines how and from what perspective you evaluate its performance. Thus, the evaluation of its performance has been quite politicized throughout its implementation in Mexico. Although solid discussion on this political interaction will be beyond this paper, it should be relevant to mention the practical difficulties in evaluating economic and social effects of NAFTA, which accelerates the politicization of the NAFTA debate in Mexico.

Mexico's economy before NAFTA

By early 1990s Mexico went through a long road to change its development model since it came to find itself trapped in model crisis in as early as late 1960s. Since the Great Depression, when Mexico's exports to the United States and other industrial countries were substantially reduced and Mexico lacked foreign exchange to buy manufactured goods, Mexico undertook an import-substitution industrialization (ISI) development strategy. This inward-looking development strategy faced a dilemma beginning in late 1960s with current account deficits and accumulated foreign debts. The debt crisis in early 1980s, triggered by the hike of international interest rates and the plunge of international oil prices, set a crucial constraint on the regime's capacity to mobilize the financial resources needed to sustain its legitimacy. The earlier expansionist policy, largely motivated by populist political consideration under the Luis Echeverría administration (1970-76) and the José López Portillo administration (1976-82), had to give way to severe adjustment. The ensued economic austerity for the rest of the 1980s slowed the economic growth of the nation, and economic stability was a target never reached. As shown in Table 1, ever-increasing inflation and exchange rates clearly told the story. This definitely affected labor and middle sectors, and although it was justified in terms of a "national emergency and defense of the nation," its political repercussions were immense, as demonstrated in the 1988 presidential election. The ruling party candidate, Salinas de Gortari, won the election by a record narrow margin. Indeed, the election was the regime's greatest crisis.

In this situation, the mandate for Salinas was to create an environment for sustainable growth. Major policy consideration had to focus on the new development strategy. The debt crisis actually terminated the cause for ISI as development strategy. Mexico's earlier outward strategists failed in 1981 in joining the General Agreement on Tariff and Trade (GATT) because of opposition by industrialists, who largely had depended on the government's protection from international competition.[1] Joining the GATT in 1986, however, was the milestone to signal Mexico's official abandonment of the formerly protectionist ISI development strategy. The next year Mexico unilaterally began to cut down the import tariffs and

1) For Mexico' postponement of joining the GATT, see Dale Story, *Industria, estado y política en México: Los empresarios y el poder* (Mexico: Grijalbo, 1990), pp. 188-193.

eliminated importation permits, etc., and the Salinas Administration liberalized Mexican markets further. Once this meant a change of development strategy from inward to outward orientation, Mexico needed to enhance international competitiveness and penetration of international markets.

Table 1. Mexico's Major Economic Indicators, 1981-1994

	1981	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
Growth of GDP (%)	8.77	-0.62	-4.20	3.61	2.59	-3.74	1.86	1.24
Inflation (%)	28.0	58.9	101.9	65.4	57.7	86.2	131.8	114.2
Trade Balance /GDP (%)	-1.5	4.0	9.2	7.4	3.9	2.9	5.1	0.2
Current Account Balance/GDP (%)	-6.4	-3.6	3.6	2.4	0.2	-1.4	2.7	-1.7
Exchange Rate (peso/USD)	24.51	57.44	120.17	167.77	256.96	611.35	1366.72	2550.28
Total External Debt/GNP (%)	31.9	52.5	66.4	57.1	55.2	82.6	82.3	60.9

Source: WEFA, *World Economic Service Historical Data,* 1995.6.

Salinas' economic reforms were rather revolutionary as compared with his predecessor Miguel de la Madrid's moderate ones. He liberalized further Mexico's trade regime, privatized major public enterprises including blue-chip companies like Teléfonos de México (TELMEX), and aggressively deregulated including reducing restraints against foreign investments. His neoliberal reform envisioned the leading role of the private sector rather than the *rectoría* or directorship of the state even though Mexico's business and labor sector might not be mature enough to directly face global competitive environments. Mexico's economy began to be reactivated, though not accelerated, under the Salinas administration.

Especially, economic stabilization was achieved due to annual social pacts among the government, business, labor and peasant sectors since late 1987 (See Table 2).

Table 2. Mexico's Major Economic Indicators, 1988-1994

	1988	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*
Growth of GDP (%)	1.2	3.3	4.4	3.6	2.8	0.4	3.1
Inflation (%)	114.2	20.0	26.7	22.7	15.5	9.8	7.0
Trade Balance/GDP (%)	0.2	-1.3	-1.8	-3.9	-6.3	-5.3	-6.3
Current Account Balance /GDP (%)	-1.7	-2.9	-2.9	-4.8	-7.5	-6.4	-8.3
Exchange Rate (Peso/USD)[1)]	2550.3	2453.2	2807.3	3017.9	3094.4	3.11	3.37
Total External Debt (US$ billion)	101.8	95.3	104.3	116.6	117.6	131.9	142.6
International Reserves (US$ billion)	-	-	9.9	17.7	18.9	25.1	6.3

Note: 1) Mexican peso was changed to new peso in 1993 (1 new peso=1000 peso). The new peso began to be called again peso as of January 1, 1996.
Source: WEFA, *World Economic Service Historical Data*, 1995. 6.

From Salinas policymaking perspective, a free trade with the U.S. and later on with Canada would serve to three major goals. First, as the U.S. is the largest economy of the world and the largest export market of Mexico, a free trade with the U.S. would facilitate Mexico's new export-oriented development strategy. Secondly, as a free trade regime would secure access to the U.S. market, international investors would consider Mexico as the most attractive country for their businesses. This should combine with Mexico's geographic closeness to the U.S. market, and abundant local cheap labor. Thirdly, a free trade agreement as international treaty would enhance Mexico's reformist policy consistency and international confidence on it. As a matter of fact, under Mexican policymaking environments, his reforms would change anytime for political pragmatism in the future. With Mexico's *sexenio* rule, or a six-year presidential term and the principle of no reelection, a new president came into office with a new team and usually initiated a different set of policy reforms to overcome neglected problems from the previous administration.[2] Salinas wanted to change this practice. A free trade with the U.S. was to serve as a "binding force" to make his market-oriented reforms irrevocable, and to make believe in seriousness and consistency in Mexico's economic policymaking.

The "positive" side of NAFTA in Mexico[3]

With NAFTA, average tariffs of the U.S. for Mexican products fell from 3.3% to 1.1% vis-à-vis 5.7% to 4.3% for most-favored nations' products.

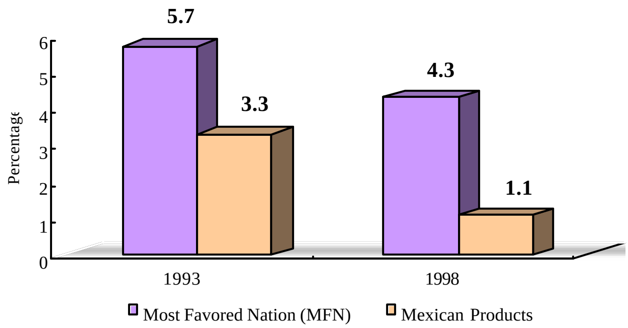
Increase of Exports

2) The present author interprets Mexican pendulum politics in terms of regime crisis management in his doctoral dissertation, "The Mexican Regime's Political Strategy in Implementing Economic Reform in Comparative Perspective: A Case Study of the Privatization of the Telephone Industry," University of Texas at Austin, December 1992. Dale Story proposes spending cycle of Mexican governments in his critique of the pendulum theory. See his "Policy Cycles in Mexican Presidential Politics," *Latin American Research Review*, 20: 3 (1985), pp. 139-161.

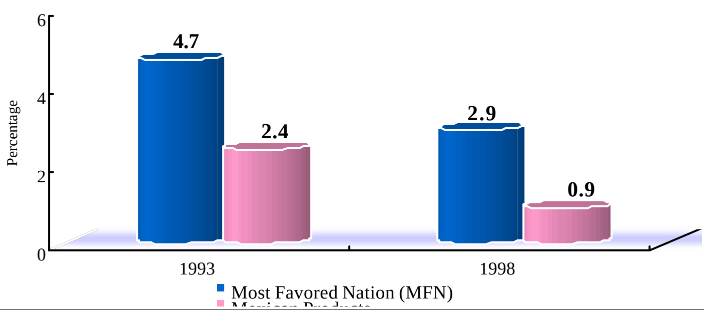
3) If not indicated otherwise, data in this section depended on the following materials: SECOFI (Secretaría de Comercio y Fomento Industrial), *Relaciones Comericales de México con el Mundo*, 1999; and SECOFI, *Mexico Exporta*, Mayo de 1999.

Canadian markets are further open to Mexican products, with average tariffs falling from 2.4% to 0.9% (See Graph 1 and 2). Especially, tariffs of imported manufactured goods entering the U.S. have been reduced from an overall 5.8% to 1%. This further enhanced Mexican products' competitiveness in the U.S. market against extraregional traders. Meanwhile, Mexico's import tariffs have been reduced from an overall 11% before NAFTA to 5%.

<Graph 1> U.S. Average Tariffs



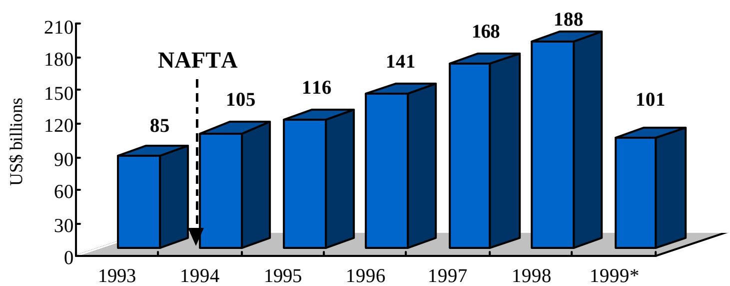
<Graph 2> Canada's Average Tariffs



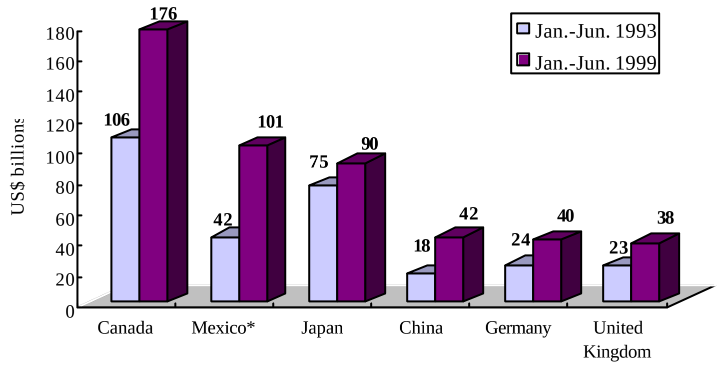
As a result, Mexican exports to the U.S. increased from US$39.9 billion in 1993 to US$94.7 billion in 1998 by 137% and at an annual average rate of 17% while exports to Canada reached US$5.1 billion at an annual growth rate of 12% during the same period. Mexico's total exports increased from US$51.8 billion in 1993 to US$117.5 billion in 1998 by 127% and at an annual rate of 18%. This is contrasted to slower growth of Mexico's exports at an annual rate of 13% during the period 1986-1993. As Mexico's exports to the U.S. and Canada account for 84.9% of its total, it is no denying that NAFTA paved way for Mexico's dynamism as exporter. Mexico became the tenth largest exporter in the world, and the first in Latin America.

Meanwhile, Mexico's imports from the U.S. and Canada grew at an annual average rate of 14.5%. Trade between Mexico and the U.S. has soared from US$ 85 billion in 1993 to US$ 188 billion in 1998, while trade between Mexico and Canada increased from US$4.1 billion to US$7.5 billion during the same period. Mexico had a surplus in its trade with the U.S. of US$ 11.5 billion and US$ 8 billion in 1997 and 1998, respectively. In September 1998, Mexico surged as the U.S. second largest trading partner (export destination), a position once occupied by Japan (See Graph 3 through 8).

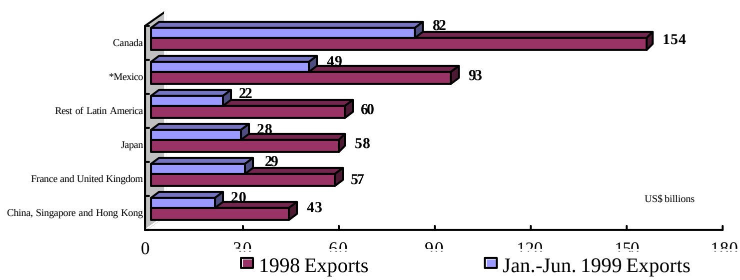
<Graph 3>
Total Trade between Mexico and the United States



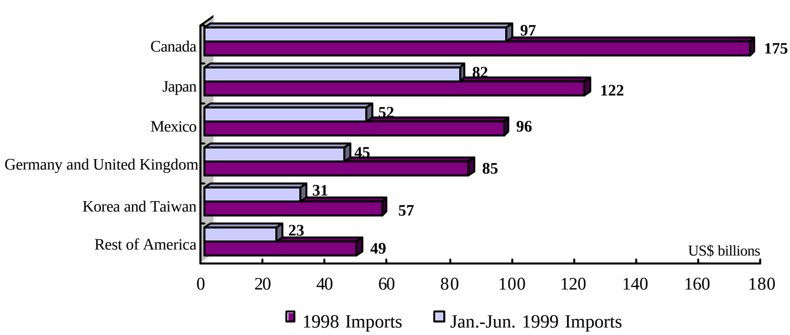
<Graph 4> Major U.S. Trade Partners



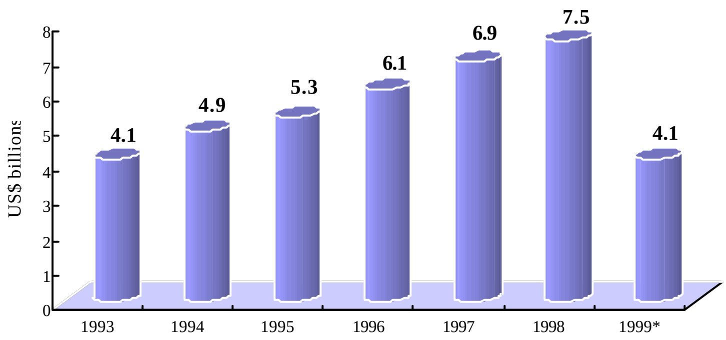
<Graph 5> U.S. Export Destinations



<Graph 6> U.S. Import Sources

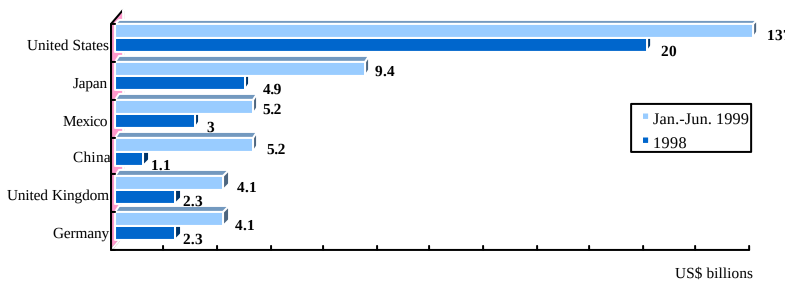


<Graph 7> Total Trade between Mexico and Canada



Note: (*) January -June 1999.

<Graph 8> Canada's Import Sources

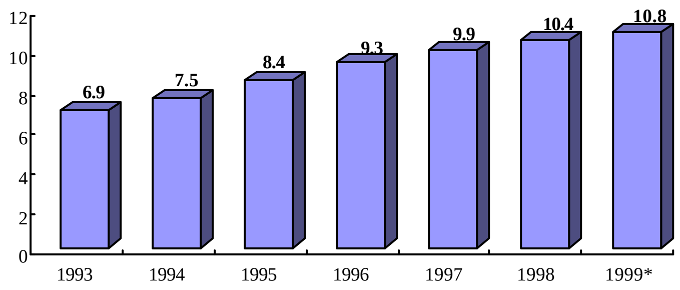


Meanwhile, due to NAFTA's discrimination of offshore countries, labor cost, and geographic distance, trade relations between the U.S. and Asia in the textile and automobile industry have experienced a trade diversion effect, accelerated by investment diversion. In 1996, Mexico overtook China as the largest supplier of textiles and garments to the U.S.[4] Also the

4) Now, Mexico is going a step further by producing not only garments but also high-quality textiles, and U.S. mills are rushing to invest. IBM's Guadalajara plant

important portion of textile trade between the U.S. and Central America/the Caribbean has been transferred to the U.S.- Mexico trade. NAFTA allows Mexican-made apparel to enter the U.S. duty-free and quota-free, as long as the clothing is manufactured with fabric knitted or woven in the U.S. This gives Mexico a major competitive advantage over Asia or Central America/the Caribbean because goods entering the U.S. from those regions are subject to quotas and, sometimes, duties.[5] Trade diversion was indispensable, and this has resulted in Mexico's enhanced share in the U.S. import markets (See Graph 9). When it comes to increased competitiveness of Mexican products, however, the effect of the peso devaluation since the end of 1994 cannot be overlooked as another decisive factor beyond the elimination of some tariffs between the U.S. and Mexico.

<Graph 9>
Share of Mexican Products in U.S. Total Imports



Note: (*) January -June 1999.

houses more than 7,000 employees of its own and its subcontractors. The parts used to be made in Singapore, Taiwan, and Malaysia. See Jeremiah Spencer, "Five years after NAFTA, Mexico turning into an industrial power," *Business Week*, May 16, 1999.
5) *The Miami Herald* (International Edition), "NAFTA paving way for Mexican apparel industry, U.S. firms," April 9, 1997.

Foreign Direct Investments

One of the major policy reform areas under the Salinas administration involved foreign direct investment (FDI) inducement. In May 1989 and December 1993, the Mexican government expanded sectors eligible for FDI and largely liberalized related regulations, which was the cornerstone of Mexico's FDI policy. The NAFTA itself further enhanced investors' legal status while its Chapter 11 provides the settlement mechanism for disputes between investor and host state established in U.S. bilateral investment treaties signed with some Latin American countries but that Mexico traditionally refused to sign. The Mexican Constitution still inserts a Calvo clause under its Chapter 27, requiring foreign investors to be treated as nationals and, when they are involved in a dispute, they have to submit claims under local tribunals. Though controversial, however, Mexico actually accepts through Chapter 11 of the NAFTA that foreign arbitration could substitute for national tribunals in conflicts arising with foreign firms.[6] This fundamentally improved FDI environments in Mexico.

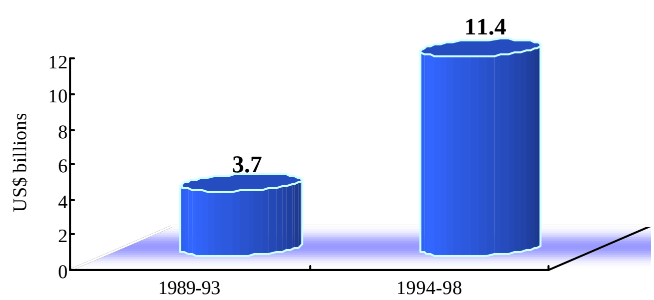
Better access to the U.S. and Canadian markets, guaranteed through political and legal systems, placed Mexico in the global arena as a highly attractive production site, not only to U.S. and Canadian investors but also to European and Asian multinational corporations. Since the beginning of the NAFTA negotiations in 1991, Mexico had seen a rapid increase in FDI reaching US$12.4 billion in 1994, an almost double figure over that of 1993. The subsequent peso crisis discouraged foreign investors to the

6) Isidro Morales, "NAFTA: The Governance of Economic Openness," *The Annals of the American Academy of Political and Social Science*, 565 (September 1999), pp. 48-52.

effect that FDI flows lost some momentum and that the level of 1994 was not recovered until 1997.

However, it is very hard to say that FDI has become stronger in Mexico after NAFTA. Although the average annual FDI amounted to US$11.4 billion during 1994-98 as contrasted to US$3.7 billion during 1989-93 (See Graph 10), Mexico's importance in Latin America as FDI recipient has shrunken with some South American countries emerging as alternatives. As shown in Table 3, Mexico accounted for more than a third out of the total FDI in Latin America up to 1994, but it came down to the level of one-third in 1995, one-fourth in 1996, and less than one-fifth in 1997 and 1998. In 1999, Mexico only received US$10 billion out of the regional record US$75.4 billion. Particularly, Argentina surpassed Mexico as ranked second with US$21 billion in which the sale of the Argentine Oil company YPF to the Spanish firm Repsol was the principal incidence.[7]

<Graph 10> Annual Average FDI to Mexico



7) El Mercurio, "América Latina Anota Récord de Inversión Extranjera," 19 de enero de 2000.

Of course, this should not mean that Mexico is no longer attractive, but that Mexico is not uniquely attractive. Liberalization, privatization, and regional integration among Brazil and the Southern Cone countries have diversified investors' attention. Rather it can be argued that without NAFTA, loss of Mexico's privilege as the attractive site for FDI would have been more serious. Yet the constant flow of FDI into Mexico is not solely due to the simple existence of NAFTA. There exist other reasons such as sustained economic reform and the outcome of the peso crisis.

Stable economic growth from the early 1990s until before the economic crisis of 1994, and sharp economic recovery since late 1995 contributed to an increase in domestic consumption, which also came to be another attractiveness for foreign investments.

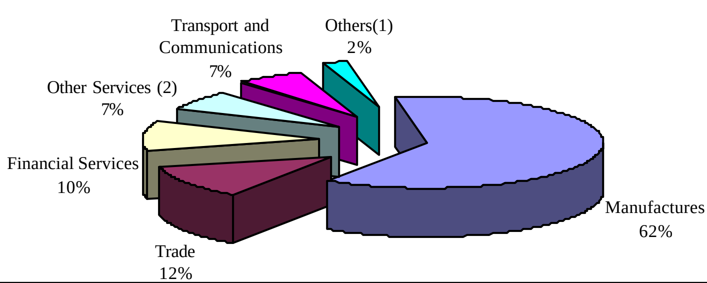
Table 3. Net FDI flows in Latin America, 1990~ 1998 (US$ million)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Argentina	1 836	2 439	4 012	2 763	3 432	5 279	6 513	8 094	5 697
Bolivia	67	93	122	124	130	374	474	731	872
Brazil	989	1 103	2 061	1 294	2 589	5 475	10 496	18 745	28 718
Chile	661	822	935	1 034	2 583	2 977	4 724	5 417	4 792
Colombia	501	457	729	950	1 444	2 968	3 123	5 701	2 983
Ecuador	126	160	178	469	531	470	491	695	830
Mexico	2 549	4 742	4 393	6 715	12 362	9 526	9 186	12 831	10 238
Paraguay	76	84	137	75	138	156	106	240	195
Peru	41	-7	136	687	3 084	2 056	3 226	1 786	1 930
Uruguay	0	32	58	102	155	157	137	126	164
Venezuela	451	1 916	629	372	813	985	2 183	5 087	3 737
Total	7 297	11 841	13 390	14 585	27 279	30 423	40 659	59 453	60 156

Source: UNCTAD, *World Investment Report*, 1999.

NAFTA transformed Mexico as a stable base of parts and components manufacturing for U.S. and Canadian corporations. Post-NAFTA FDIs have mainly concentrated in regions such as the states of Yucatan, Oaxaca, Tlaxcala, and Puebla which possess the advantage of cheap labor, and are characterized by a high concentration of the population. Particularly, sewing industry has crowded in those states.[8] On the other hand, the concentration of FDI on manufacturing sector has led to concentration of exports, more than 90%, on the same industry as compared with 25% in 1982, and 77% in 1993 (See Graph 11 and 13).

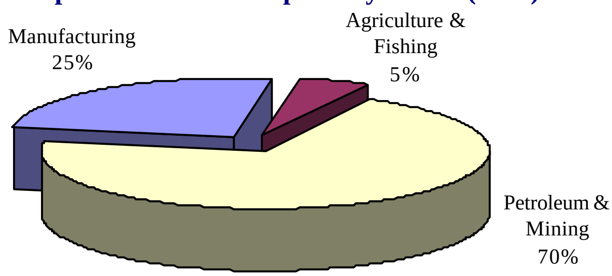
<Graph 11> FDI in Mexico by Sector, 1994-1998 Jun.



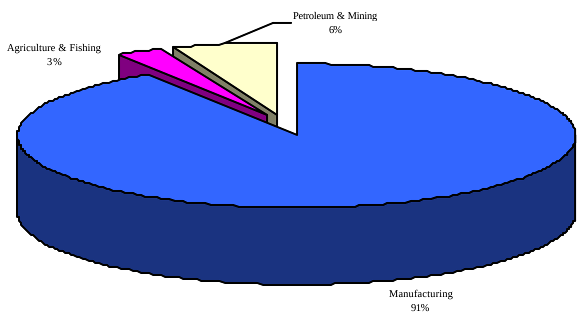
Note: (1) Agriculture & Fishing, Extraction, Construction, Electricity and Water
(2) Communal and social services: hotels and restaurants, professional, technical and personal services.

8) Luis Rubio, "El TLC: Sin lagrimas ni risas," *Nexos* (Septiembre 1999), pp. 40-41.

<Graph 12> Mexico's Exports by Sector (1982)



<Graph 13>
Mexico's Exports by Sector (Jan.-Jun. 1999)



Job Creation through Exports

The number of companies in the *maquiladora* or in-bond industry rose from 2,000 in 1993 to 4,300 in September 1998. As a result, the number of employees hired in this industry increased from 100,000 to 300,000. Mexico's open unemployment rate dropped to 2.3% in July 1999, the lowest since the end of 1992. It is also argued that some states such as Aguascalientes, Chihuahua, Jalisco, Queretaro and Guanajuato enjoy almost full employment owing to NAFTA.[9] The maquiladora industry, however, demands non-skilled labor which is paid only half of the manufacturing average wage.[10] This means that job creation was concentrated on lower wage ones.

Productivity and Welfare Effect

In the past, the economic isolationism of ISI generated low productivity through public expenditure and government subsidy, and protection of the domestic market, which, in turn, maintained a tendency to produce low quality products. Open market theorists often argue that the introduction of a new economic system of deregulation and liberalization along with NAFTA have led to an increase in domestic industrial productivity under the more competitive environment. Improvement in Mexico's manufacturing productivity since the late 1980s trade liberalization is widely known (See Table 4). Under the international pressures to increase efficiency, productivity increased quickly, averaging 6.6% per year between 1988 and 1993. Although compatible data is quite limited for that recent case, one's best guess is that NAFTA has served as additional momentum for such productivity improvement trend to persist.

Neoliberal theorists also argue that further trade liberalization and rapid increase of FDI provide Mexican consumers with a wide variety of high-quality, low-price, domestic and foreign products widening their

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9) *Ibid.*
10) See Manuel Pastor Jr. and Carol Wise, "Mexican-Style Neoliberalism, " in Carol Wise, ed., *The Post-NAFTA Political Economy: Mexico and the Western Hemisphere* (University Park: The Pennsylvania State University Press, 1998), p. 57.

scope of choices as compared with the past monopolistic domestic companies producing low-quality, high-price products. This would signal a welfare effect for the population at large. That should be the case as far as the liberal trading regime serves well to stabilize the macroeconomy, and a bigger economic pie means for the majority of the population. However, the actual widening gap between rich and poor in Mexico's liberalization context will not promise the same positive welfare effect for the whole population.[11]

Table 4. Mexico's Manufacturing Productivity (1980=100)

Year	*Productivity index*	*Mexico/US Productivity Ratio*
1985	106.7	87%
1986	104.3	83%
1987	107.1	82%
1988	110.9	82%
1989	118.7	86%
1990	126.2	88%
1991	133.4	92%
1992	141.0	96%
1993	152.7	99%

Source: Jonathan Heath, "The Impact of Mexico's Trade Liberalization: Jobs, Productivity, and Structural Change," in Carol Wise, ed., *The Post-NAFTA Political Economy: Mexico and the Western Hemisphere* (University Park: The Pennsylvania State University Press, 1998), pp. 189-190.

The "negative" effects of NAFTA

Job Loss in Manufacturing Sector

11) *Ibid.*

As reviewed above Mexico's average productivity increased fast, particularly in the manufacturing sector. Contrary to the common logic, increase in productivity did not lead to job generation. Companies rather focused on increasing productivity, or output per labor unit by reducing labor, and subsequently job market conditions deteriorated: less job generation, and worsened wage levels. There is a quite convincing case that productivity gain was in inverse proportion to job generation in the Mexican context. Jonathan Heath argues:

"As an open border increases the pressure on firms to become more efficient and competitive, they struggle immediately to reduce costs and increase productivity. For firms established under a highly protectionist economy, the easiest cost to reduce is labor… In the initial period of trade reform, competitiveness is usually increased through productivity gains as firms struggle to decrease costs, especially by reducing labor overhead."[12]

While Mexican workers' productivity is up 36.4% during the first five years of NAFTA, wages have dropped by 29%.[13] As shown in Table 5, employment in the manufacturing sector registered a steady decrease in the early liberalizing context. Just before and after the establishment of NAFTA when the necessity for structural adjustment and reengineering was imperative, and impact on small and medium companies was quite devastating, the rate of employment kept falling drastically.[14] The only reason the unemployment rate does not reflect this situation is because the expansion of the large informal sector blindly distorts the reality.

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12) See Jonathan Heath, "The Impact of Mexico's Trade Liberalization: Jobs, Productivity, and Structural Change," in Carol Wise, ed., *op. cit.*, pp. 179-182.
13) Lori Wallach and Michelle Sforza, "NAFTA at 5," *The Nation*, January 25, 1999. Some Mexican and the U.S. researchers argue that under five-year-old NAFTA, maquiladora workers' wages have fallen 23%. See *Mexican Labor News and Analysis*, "Maquiladora Wages Drop 23% in Last Five Years," September 2, 1999.
14) See Jonathan Heath, *op. cit.*

NAFTA caused unbalanced distribution of benefits among companies and workers. For many small Mexican companies, high borrowing costs are a barrier to upgrading technology. "Big corporations with access to cheaper foreign financing have reaped the lion's share of the benefits of Mexico's industrial surge." The top 50 companies account for one-half of Mexican exports and for the bulk of recent export growth.[15] Furthermore, the gap between export sector income and non-export sector income is quite large as shown in Graph 14.[16] In short, trade liberalization and NAFTA induced losses of formal jobs and unbalanced income distribution among workers. The same table, however, indicates that the period of net-job-loss was over after the mid-1996, five years since intensive liberalization. This means that one saw an increase of companies' efficiency and the increase of output, which began to expand employment.

Table 5. Employment Growth Rate in Manufacturing Sector (%)

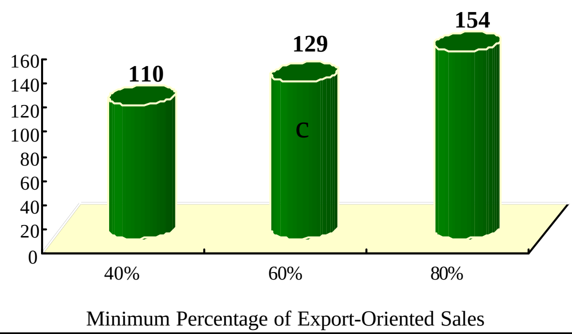
	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Jan	0.9	-0.4	-2.3	-5.9	-7.7	-2.0	-4.9	4.3	4.0	1.7
Feb	0.9	-0.9	-2.6	-6.1	-7.1	-4.5	-2.3	4.0	3.6	1.4
Mar	1.2	-1.6	-2.7	-6.4	-6.9	-5.3	-1.4	5.6	3.8	1.0
Apr	0.5	-1.1	-3.6	-6.4	-6.3	-6.6	0.6	5.56	3.5	0.7
May	0.5	-2.3	-3.0	-6.5	-6.0	-7.6	1.9	5.65	3.4	0.7
Jun	-0.3	-2.0	-3.0	-7.1	-5.0	-9.1	2.9	5.25	3.9	0.0
Jul	-0.3	-2.2	-3.8	-7.7	-4.4	-9.6	3.8	5.48	3.4	0.9
Aug	0.0	-2.4	-4.1	-7.6	-4.1	-9.7	4.7	5.46	3.1	1.3
Sep	-0.4	-2.0	-4.5	-8.3	-3.3	-9.3	4.9	5.32	3.0	
Oct	-0.3	-1.7	-5.2	-8.4	-2.4	-9.0	5.5	5.26	2.5	
Nov	-0.5	-1.8	-5.3	-8.3	-2.0	-7.6	4.3	-	2.0	

15) Spencer, *op. cit.*
16) Interestingly, export jobs in the U.S. also pay higher salaries, about 10% to 15% higher, than jobs unrelated to foreign trade. See Sidney Weintraub, "NAFTA: A Politically Unpopular Success Story," *Los Angeles Times*, February 7, 1999.

Dec	-0.5	-2.3	-5.2	-7.9	-1.7	-6.6	4.8	-	1.3

Source: INEGI.

<Graph 14> Comparison of Wages in the Non-Maquiladora Manufacturing Industry (1998) (100=average salary in non-maquila manufacturing sector)



Increased Vulnerability from External Shocks

Due to the strong dependency on the U.S. economy, which grew from 70s of percentage up to 80s, the Mexican export economy gets extremely vulnerable to the effects of domestic cycles in the U.S. economy. Not only U.S. consumers' tendency but also the fluctuation of U.S. interest rates may further affect Mexico's exports and speculation in the capital market as the two economies and business communities become more and more integrated. Controversy over the loss of sovereignty in economic policymaking exacerbates sociopolitical instability to be described below.

Sociopolitical Instability

While NAFTA served as the "locking-in" mechanism of Mexico's neoliberal reforms,[17] this has narrowed political leverage of the government to listen to the have-nots. As NAFTA constituted the final touch of the "neoliberalism" that had been pursued by the Salinas administration, many blamed any economic and social misfortunes including the peso crisis on the creation of NAFTA, demonstrating an increased disintegration of the political social structure. Uprising on the backdrop of NAFTA on January 1st, 1994, the Zapatista Liberation Army (EZLN) from the state of Chiapas regarded themselves as playing the role of the opposition, and have utilized NAFTA as a political excuse or justification. Under the politicization of the situation, successive political murders resulted in the increased levels of concern within country, which caused rapid capital flight and the peso crisis. Mexico's ruling party, Institutional Revolutionary Party (PRI), lost its majority base in the Congress in 1997 for the first time in its history of almost seventy years.

All these political incidents would have been sufficient to justify policy changes in the traditional PRI regime. The outgoing Salinas Administration and the new Zedillo Administration, however, did not follow the past practice of political pragmatism. They attempted to keep consistency in their reform projects. This constantly exacerbates the potential threat to the sociopolitical instability by the discontent.

The peso crisis and early recovery

In evaluating the NAFTA effects on Mexico's economy, the peso crisis in

17) "NAFTA has locked in fundamental economic reforms in Mexico and, under President Zedillo, these reforms are being widened and deepened." See U.S.-Mexico Chamber of Commerce, "NAFTA at Four Years: What It Means for the U.S. and Mexico," NAFTA Forum Series, June 1998.

December 1994 takes an important meaning. The Mexican economy suffered from the severe financial crisis. Major reasons for the crisis can be traced to overvaluation of the peso, current account imbalance, short-term foreign debts, especially dollar-denominated ones, and sociopolitical instability, which accelerated speculation and capital flights.[18]

However, the crisis, under the NAFTA framework of policymaking, took some peculiar implications for international cooperation for crisis management, and effects on the economy, especially on exports and investments. As a NAFTA member, the U.S. was more prompt in responding to the Mexican crisis than before. President Clinton immediately authorized the assistance to Mexico through Exchange Stabilization Fund (ESF) when he met a rather hostile response to a Mexico bailout bill from the Congress. The U.S. immediate response also swiftly led to the international bailout scheme led by the International Monetary Fund (IMF).

With the international financial support, the Mexican economy recovered from the peso crisis within a short period, registering a -6.2% in 1995, 5.2% in 1996, and 7.0% in 1997 (See Table 6). The economic growth in 1998 decelerated to 4.8%, mainly due to the post-Asia crisis stagnation of the oil industry and the decrease of domestic consumption. Pre-peso crisis GDP level was recovered as early as the beginning of the 1997. Mexico's rapid recovery from the peso crisis is compared to the prolongation of recession during the financial crisis of 1976 and 1982. During the debt crisis in 1982, it took seven years to return to the international financial market as compared to only seven months in recovering from the peso crisis in 1995. NAFTA supporters emphasize that the crisis would have persisted, and the Mexican economy would have been characterized by

18) Won-Ho Kim et al., "A Study of IMF Bailout Programs: The Cases of Mexico, Thailand and Indonesia." Working Papers 97-09, KIEP, December 1997.

high levels of poverty and unemployment if it had not been for NAFTA. Particularly, the Mexican government argues that NAFTA member countries' prosperity helped "mitigate economic repercussions of the financial crisis and evade recession in other parts of the world."[19]

The peso devaluation of December 1994 and further depreciation later on prompted the recuperation of competitiveness of Mexican products. Particularly, the adoption of free-floating exchange system in December 1994 was "the key in Mexico's success in manufacturing industry, and in smoother adjustment to the Asian and Brazilian crisis."[20] Mexico's exports experienced an impressive hike on the wake of the peso crisis. As the U.S. has been Mexico's traditional export market, the recovery of competitiveness was immediately reflected in Mexico's strong exports to the U.S. At this point, it is technically difficult to tell the extent to which the devaluation and better access to the U.S. market through NAFTA contributed to export increase respectively.

Table 6. Mexico's Major Economic Indicators Since NAFTA

	1994	*1995*	*1996*	*1997*	*1998*
Nominal GDP (US$ billion)	420.2	286.3	334.8	402.4	406.0
GDP per capita[1)] (US$)	3,449	3,179	3,281	3,450	3,589
Nominal GDP growth (%)	3.5	-6.2	5.2	7.0	4.8
Unemployment Rate[2)] (%)	3.6	6.3	5.5	3.7	3.2
Inflation[2)] (%)	7.1	52.0	27.7	15.7	18.6

19) Garza Limón, "Evaluación general del TLCAN: situación actual y perspectivas," Conferencia Internacional sobre la Integración Económica en el Hemisferio Occidental, Academia China de Ciencias Sociales, Beijing, 15-19 de noviembre, 1999.
20) Rogelio Ramirez de la O., "Una perspectiva mexicana sorbre cinco años del TLC: resultados hasta la fecha y perspectivas a futuro," International conference on U.S.-Mexico Relations Approaching 2000: Looking Back to Look Ahead, Georgetown University, April 4, 1999.

Fiscal size/GDP	22.8	22.8	22.8	22.9	9.9[4)]
Fiscal Balance /GDP	-0.1	0.0	0.0	-0.8	0.18[5)]
Government Debt [5)] (US$ billion)	85.4	100.9	98.2	88.3	92.2
Exports (US$ billion)	60.9	79.5	96.0	110.4	117.5
Imports (US$ billion)	79.4	72.5	89.5	109.8	125.1
Trade Balance (US$ billion)	-18.5	7.0	6.5	0.6	-7.6
Current Account Balance/GDP	-7.0	-0.5	-0.6	-1.8	-3.9
Foreign Reserves [3)] (US$ billion)	6.15	15.74	17.51	28.18	30.14
Total Loans[3)] (US$ billion)	139.8	164.2	157.1	149.0	161.2
Exchange Rate[2)] (peso/dollar)	3.38	6.42	7.60	7.92	9.1357

Notes: 1) Based on WEFA, 2) Annual average, 3) Based on year's end, 4) Based on June's end, 5) based on public loans.

Sources: Central Bank of Mexico/ Ministry of Statistics/ Ministry of Finance; WEFA, *World Economic Outlook: Developing and Eurasia*, April, 1998.

As a matter of fact, the peso crisis, along with trade liberalization since 1986 make evaluation of the NAFTA performance in Mexico even more difficult. The impact of early trade liberalization on Mexico's economy was minimal because Mexico still suffered high inflation and low consumer demand. In the 1990s, however, the impact was more real in parallel with the stabilization and reactivation of the Mexican economy. This implies that the time lag between the general trade liberalization and NAFTA is so short that it is technically difficult to tell which was the effect of the former and that of the latter. In most cases, the two effects came together. Such limitation in analyzing the NAFTA evaluation in Mexico reinforces the politicization of the debate on the performance of NAFTA among political groups.

Conclusion

NAFTA, at five years of age, has brought a tremendous change in

Mexico's economy and society. It is partly positive, and also partly negative. First, NAFTA has contributed to transforming Mexico in one of the major traders, the 8th leading exporter, in the world.[21] As oil is now less than 7% of exports, down from 22% in 1993, NAFTA has helped protect Mexico from both the recent "plunge in oil prices and the fallout from the global emerging-markets crisis."[22] Secondly, NAFTA provided attractive investment environments in Mexico for foreign investors. Thirdly, NAFTA enhanced international crisis cooperation by paving the way for the U.S. prompt assistance to Mexico when it fell into a financial crisis at the end of 1994. Additionally, NAFTA has strengthened deregulation and transparency in Mexico's policymaking.

On the other hand, Mexico's socioeconomic situation runs far short of improvement. First, the continuous readjustments in the manufacturing sector produced low-skilled unemployment only to be absorbed by the informal sector, which actually disturbs the statistics on jobs. Whether increased FDI contributed to improving labor quality or not is unclear.[23] Second, the gap between the rich and the poor has widened, and it serves as a critical momentum for increased sociopolitical instability.

Moreover, the timing of NAFTA establishment overlapped with

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21) In the early 1980s, Mexico ranked 30th as exporter worldwide. See SHCP (Secretaría de Hacienda y Crédito Público), *Mexico's Bimonthly Economic News*, November 1, 1999.

22) Spencer, *op. cit.*

23) Spencer, *op. cit.*, reports that "NAFTA has nurtured an elite new class of skilled Mexican workers who earn up to two-thirds more than the average US$13 per day for Mexican factory workers." Olaf Carrera also reports that in order to achieve the goals of increased productivity and total quality management, companies took advantage of the synergies created by NAFTA as in the case of ICA-Reichmann, a joint venture between a major Mexican construction firm and the renowned Canadian developer, and others such as Cifra-Wal-Mart, Cuauhtemoc-Moctezuma brewery and Canada's John Labatt, and tobacco giants Philip Morris and Cigata, etc. See his, "NAFTA at five," *Business Mexico*, February 1999. Yet all this hardly proves a broad labor quality upgrade.

Mexico's ongoing unilateral trade liberalization and the sharp devaluation of the Mexican peso amid financial crisis. It further complicates an objective evaluation of NAFTA effects in Mexico. Although NAFTA supporters convoke export increase, FDI influx, productivity gains, and job creation as NAFTA's positive gains, many of them largely resulted also from trade liberalization and the peso devaluation. On the other hand, although NAFTA opponents argue the negative effects of NAFTA such as job loss and company bankruptcies in the manufacturing sector, increased vulnerability and sociopolitical instability, most of them had occurred even before NAFTA or would have happened without NAFTA under the ongoing liberalization and globalization environments.

Both sides' evaluations of NAFTA tend to be exaggerated due to the politicization of the NAFTA issue and to practical difficulty to distinguish NAFTA effects from those by other factors. The current debate on NAFTA's effects in Mexico has been chronically politicized, and it tends to blindly cover "the urgent policy agenda for Mexico to take care of" while it is in a privileged position as the only developing country in the current NAFTA framework. Such policy agenda may include education, infrastructure, financial sector, deregulation, technology transfer, etc., which may promise a more secured base for a competitive Mexico in the longer term.[24]

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[24] Luis Rubio, *op. cit.*, p. 47.

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