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FROM TRADE LIBERALIZATION TO ECONOMIC INTEGRATION: THE CASE OF MEXICO

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ABSTRACT

This paper reviews Mexico's economic situation before 1982. It outlines the evolution of Mexico's inward-oriented strategy and its experience with trade liberalization since 1985, highlighting the causes of the structural crisis manifested in 1982. Sections II and III examine the reform policies of the de la Madrid administration (1982-1988) and the more radical approach under the current Salinas administration. These sections also explore the implications for Mexico of changing international conditions from the 1980s onwards and the potential of its current development strategy. Finally, the paper examines the conditions and implications for Mexican development of the North American Free Trade Agreement. The paper concludes with a prospective analysis of the Mexican economy.

RESUMEN

Este trabajo analiza la situación económica de México anterior a 1982. Describe la evolución de la estrategia 'hacia adentro' de México y su experiencia con la liberalización económica desde 1985, enfatizando las causas de la crisis estructural que se manifestó en 1982. Secciones II y III examinan las políticas reformistas de la administración de de la Madrid (1982-1988) y el proyecto más radical bajo la administración de Salinas de Gortari. Estas secciones además examinan las implicaciones de las actuales condiciones internacionales desde los 1980s y las posibilidades de la estrategia de desarrollo actual. Por último, el trabajo desarrolla las condiciones e implicaciones del Tratado de Libre Comercio para el desarrollo de México. El trabajo concluye con un análisis en perspectiva de la economía mexicana.

The 1970s saw a general crisis of the accumulation model in Mexico which was exacerbated by the government's incapacity to service its external debt payments throughout the 1980s. In consequence, the Mexican government since 1983 and more conspicuously in the second half of the 1980s has shifted from inward-looking, protective policies to a neoliberal strategy. The new strategy had an impact not only on the economic structure but also on the corporatist character of the Mexican state. It redefined the government's instrumentalization of unions and weakened the traditional roles of unions and political parties, including the Partido Revolucionario Institucional (PRI). The new direction for Mexico's economy is its integration to global markets, in particular to the US market. After joining the GATT in 1986, Mexico entered into negotiation for a free-trade agreement with the US and Canada.

Mexico, at present, faces an enormous task of regaining macroeconomic stability and of restructuring the economy. Trade liberalization and privatization and subsequent economic integration are key elements in Mexico's neoliberal development strategy. This paper assesses Mexico's recent policies in making the transition to a more market-oriented and outward-looking economic system. From this perspective, it attempts to identify and examine the problems and challenges facing the country. The other side of trade liberalization—the need to maintain cheap energy and cheap labor power, possibly by heightening political repression—will also be considered.

Section I reviews Mexico's economic situation before 1982. It outlines the evolution of Mexico's inward-oriented strategy and its experience with macroeconomic performances, highlighting the causes of the structural crisis manifested in 1982. Section II examines the subsequent reform policies of the de la Madrid administration (1982-1988) and the more radical approach under the Salinas administration. This section also explores the implications for Mexico of the changing international conditions with the decline of US economic hegemony from the 1980s onwards. Section III examines the conditions and implications for Mexican development of the North American Free Trade Agreement (NAFTA). The paper concludes with prospective analysis of the Mexican economy.

I. INWARD-ORIENTED DEVELOPMENT (1940-1982)

I.1. The Mexican Miracle (1940-1970)?

Mexico's development strategy before 1980 led to structural contradictions, as reflected by persistent financial and balance of payments crises. The inward-oriented strategy made the Mexican economy increasingly vulnerable to external forces such as transnational corporations

(TNCs), change in internation oil prices, foreign debt, and foreign direct investment (FDI). Despite massive subsidies and tariff and nontariff barriers, neither the domestic private sector nor TNCs generated the conditions for competitive capitalist industrialization or built an adequate technological and financial base. On the contrary, TNCs transferred a high share of their profits to abroad, as we will show below. This was a primary reason for the huge current account deficits and foreign indebtedness since the late 1960s. In this context, the long-term challenge facing the present administration, in addition to the problem of distributional equity in Mexican society, is the legacy of 40 years of low productivity and lack of international competitiveness, tax evasion, and rent-seeking attitudes in a hitherto protected economy.

The government of Lázaro Cárdenas (1934-1940) established the foundations for a corporatist society in which import substitution, based on surpluses and labor power transferred from agriculture to industry, played a central role in development. The import substitution strategy promoted domestic production of consumer goods, shielding it from external competition through selective import barriers. Policies to selectively import capital and intermediate goods were also instituted.[1] The industrial sector made impressive gains as a result: while GDP per capita in the period 1940-1970 increased by 2.9 percent annually, the share of the secondary sector rose from 28 percent of GDP in 1938 to 35 percent in 1974. During this period, Mexico has been under a stable authoritarian regime equipped with a selective repression apparatus (Meyer and Reyna 1989).

The success of the accumulation model in the 1940s critically depended on external financial resources and the implementation and diversification of technologies introduced by TNCs.[2] FDI and trade surpluses in the nonmanufacturing sectors (primarily agriculture and tourism) financed import substitution. Such policy, however, quickly led to strong dependency on external resources, resulting in increased current-account deficits in the 1960s, and in agricultural and consumer price increases with budgetary deficits (Ruiz Durán 1991b). TNCs contributed to Mexico's import-substitution industrialization.[3] Taking advantage of their market power, the TNCs began to dominate in such protected and fast-growing sectors as transport equipment, electrical and nonelectrical machinery, chemicals, rubber products, and modern consumer goods. A seemingly 'peaceful coexistence' evolved: while state-owned enterprises (paraestatales) and national private companies continued to provide the infrastructure, producing

[1] An important index of import substitution policy is the foreign trade ratio (imports + exports/GDP), which fell from 31.1 percent in 1951-1960 to 19.7 percent in 1971-1980, and rose during the 1980s to 32.3 percent in 1987 (Peres Núñez 1990b).

[2] For a detailed discussion of the accumulation strategy and the different phases of the import substitution policy see Huerta (1985); Kate and Wallace (1980); Kim (1986); Villareal (1988).

[3] Up to 1982 TNCs accumulated a little over $27 billion in FDI, nearly 20 percent of Mexico's GDP (Peres Núñez 1990a).

basic consumer goods and intermediate goods, TNCs, with higher total factor productivity (TFP)[4] and profit rates (Casar 1990), concentrated their activities in relatively more advanced manufacturing branches.[5] According to Péres Núñez (1990a), TNCs contributed to the rise in import coefficients and trade deficits, accounting for 48.9 percent and 115 percent of Mexico's trade deficit in 1970 and 1980, respectively.

Beginning in the early 1950s, trade policy emerged as an important instrument for Mexico's industrialization and for fiscal revenue. Tariffs, official import reference prices and, most importantly, import licenses, generated around 30 percent of the total fiscal revenue in 1940-1955, but their share has since declined. These trade restrictions—under which 60 percent of all imports were subject to trade barriers in 1960—protected producers of final consumption goods, while imports of capital and intermediate goods continued to grow. Import licenses continued to thrive during the 1960s, covering 65 percent of all imports in 1969.[6] The overvaluation of the exchange rate and the consequent balance of payment difficulties forced the Mexican government to continue to extend import restrictions. During the era of inward-orientation, Mexico's trade policy changed drastically depending on movements of the balance of payments. Frequent policy changes made it difficult for producers to flexibly adjust to changing market conditions (Haneine 1987; Kate and Wallace 1980; Pérez Motta 1989; Peres Núñez 1990b).

The composition of Mexico's trade during the 1950-70 period reveals structural characteristics of the economy. While the cumulative current account deficit reached $7.7 billion and was rising, the private sector's trade deficit, at five-fold the public sector's in the period 1960-1970, accounted for 78.6 percent and 80 percent of the total exports and imports.[7] Mexico depended heavily on the US for trade during 1940-1970: 70 percent of its exports went to the US and 79.3 percent of its imports came from the US.[8] Low productivity[9] in agriculture and basic manufacturing contributed to Mexico's balance of payment crisis (Table 1).

As the agricultural and tourist sectors failed to generate sufficient revenue, the government had to find alternative financial resources. It is worth noting that the agricultural sector

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4 According to Blomstrom and Wolff (1989), in 1970 labor productivity of local (public and private) and transnational corporations accounted for 0.79 and 1.88 respectively.

5 In 1980, 63 percent of all manufacturing firms in Mexico were foreign subsidiaries and accounted for 71.2 percent of the manufacturing production value of all foreign firms (Peres Núñez 1990a).

6 For different aspects of protection and its instruments in 1940-1970 see Kate and Wallace (1980).

7 Private and public sector's cumulative trade balance deficit amounted in 1960-1970 to $4.8 billion and $0.96 billion respectively. See Table 1.

8 The United State's share in Mexico's total exports accounted for 90 percent during the World War II and decreased to 70.9 percent by 1970. Table 2.

9 In 1970 TNCs' and local firms' TFP accounted for 93 and 69 percent of the average TFP in the US, whereas labor productivity in Mexican firms averaged only 39 percent of the US (Blomstrom and Wolff 1989; Hernández and Velasco 1990).

was not accorded the same level of effective protection as the industrial sector. This undermined the long-run reproduction and financing capacities of the primary sector and shifted the structure of production toward importables and nontradables (Kate and Wallace 1980; Zabludovsky 1990). Also, the inability of the Mexican economy to "deepen" its industrial structure, with TNCs showing higher capital-labor ratios and import and export coefficients than local firms, led to rising propensities to import, revealing progressive contradiction between growth and balance-of-payments equilibrium. Moreover, Mexico's development strategy gave rise to greater income inequalities: the income share of the poorest 40 percent of the population fell from 13.1 percent to 11.8 percent in the period of 1950-1970 (Barkin 1991).

The first signs of Mexico's developmental crisis emerged in the late 1960s, as the agricultural sector—the main source of financing the strategy—could no longer remain viable with its declining production and increased imports.[10] Oil revenues and foreign borrowing[11] replaced it as the pillars of Mexican development throughout the 1970s.

I.2. Structural Crisis and Reforms (1970-1982)

Toward the end of the 1960s, the Mexican government was facing a dual crisis: its own accumulation crisis and the crisis of the capitalist world market which had been progressing since the late 1960s (Glyn 1989). The exhaustion of financing resources and social turmoils at the end of the 1960s reflected the the crisis of Mexico's accumulation model: Mexico had the option of either departing from the capitalist development model it had been pursuing or prolonging the structural crisis that its industrialization strategy had created. The latter option would call for massive infusion of new capital through external financing and/or a shift to an export-oriented economy.

External conditions during this period also adversely affected Mexico. The oil shock in 1973 widened Mexico's current-account deficits, while providing incentives to explore and invest in the oil and petrochemical industries. The collapse of the Bretton Woods System and inflation in the US directly affected Mexico, destabilizing its exchange rate. The crisis of US hegemony and of the OECD countries created the need to lend money-capital even prior to the first oil shock in 1973 and the possibility of international borrowing, either by private corporations or nation-states (Dussel Peters 1993; Schubert 1985). By 1970 Mexico's external debt amounted to $5.97 billion with the private sector accounting for 61 percent of the total.

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[10] The productivity of the increasingly modernized primary sector by worker increased sharply since 1940 in relation to the secondary and tertiary sectors (Barkin 1991).

[11] Villareal (1988) points out that even in the 1960s FDI significantly reduced its share of the current account deficit. In the period 1939-1958, FDI and foreign debt accumulated $1.1 billion and $0.5 billion respectively, which reversed in 1959-1970 to $2.2 billion and 3.4 billion.

Internally, the Lopez Portillo administration (1977-1982), in an effort to resuscitate the stagnant economy it inherited from the previous administration, implemented an expansionary policy to stimulate aggregate demand, with the anticipation that increased production and imports could hold down inflation. Expansionary government spending, subsidized prices for energy and other basic goods, and sector-oriented policies promoting private investments in leading sectors provided incentives for industrial expansion (Kim 1986).

At the same time, Mexico continued to implement gradual reforms and restructure the import substitution model in order to overcome external structural instabilities and to develop the nation to a "middle-sized industrial nation." The requirements for restructuring included that:

1) The development of the manufacturing sector continue to proceed under an import substitution regime supported by public investments, direct or indirect subsidies[12] and a favorable tax system.[13]

2) A more selective import protection of Mexico's industry be designed, in which selected branches of the manufacturing sector, primarily the automobile and maquiladora industries, generate export revenue necessary for balancing the external trade.

3) Oil revenues, cheap labor and energy, and foreign borrowing should be the main financing resources for the future development.

Throughout the 1970s, TNCs continued to perform significantly better than national firms in terms of profit rates, growth rate of product, and labor productivity.[14] However, TNC's trade and current account deficit bursted in 1971-1982, which reached $28.4 billion and $16.4 billion, respectively. Repatriated profits and the net contribution to Mexico's balance of payments amounted to -$3.6 billion and -$14.2 billion, respectively. The share of intra-industry trade reached 51.4 percent and 30.6 percent of the total exports and imports, revealing the specialization of TNCs in sectors in which Mexico does not have traditional comparative

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[12] Intermediate goods and a few capital goods industries had an average effective subsidy rate of about 25 percent and 79 percent respectively, contrasting with a negative rate for the food-processing industry. Similarly, subsidies in the form of credits for financing exports, and for small- and medium-sized firms since the 1950s, and various forms of tax devolution were the common instruments for enhancing Mexico's industrialization (Kim 1986; Trejo 1989).

[13] In 1975 import tariffs were reduced to a maximum of 75 percent (with the exception of automobiles), and a more selective policy was established. However, in August 1975 all imports were once more subject to quantitative restrictions. Public investment increased in the period 1970-1975 from 6.8 percent of GDP to 10.9 percent, accounting for 56 percent of total investments (Villareal 1988; Solís 1988).

[14] Several authors, in spite of different methodologies and important quantitative differences, agree that Mexico's (TNCs and local firms) difference in TFP narrowed during the 1970s, widening again in the 1980s (Blomstrom and Wolff 1989; Ros 1991a). However, and this is not considered by these authors, the US's TFP was significantly lower compared to the OECD countries, which might partly explain Mexico's economic alignment with the US (Hernández and Velasco 1990).

advantage.[15] These industries are characterized by economies of scale and favorable access to US and world markets (Peres Núñez 1990a; Ros 1987a, 1991a).

Despite temporary gains in TFP, Mexico's balance of trade soon collapsed because of adverse international conditions and inappropriate economic policies over the period of 1970-1981. Current account and trade balance in 1970-1981 reached an accumulated deficit of $52.1 billion and $28 billion, respectively; the performance of Mexico's private sector was particularly tenuous as it contributed to a trade deficit of $34 billion.[16]

Mounting trade deficits not only led to inflation during this period but also generated an environment of uncertainty, provoking speculation[17] and capital flight. There were pressures on the overvalued domestic currency.[18] As a result, government policy began to shift somewhat toward export promotion. In 1971, the Special Certificates for Devolution of Taxes (CEDIS) were established (abolished in 1976), which restituted to domestic producers all indirect taxes on products and inputs for five years as long as exports were increased by 20 percent in the first two years (Haneine 1987). The explosive growth in the maquiladora industry in the late 1970s can also be attributed to Mexico's policy shift. From 1970 to 1981, employment in the maquiladora industry increased from 20,327 to 130,973 workers, with value added rising from $0.1 billion to $0.98 billion.[19] After 1986 as the Mexican government began to consolidate the scheme for export-oriented industrialization, the maquiladora industry began to play a more important role in the economy (Barajas Escamilla 1987; Carrillo 1986; González-Aréchiga 1989a, 1990).

This period also saw increased concentration in Mexico's industry, especially with the development of industrial "grupos." For instance, the share of the 100 largest firms in total sales rose from 32.8 percent of GDP in 1973 to 48 percent in 1981 while that of TNCs fell from 35.4 percent to 25.2 percent.[20] Moreover, the effects of massive investments in the oil and petrochemical sectors, which accounted for around a half of the total public investments and 30

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[15] TNCs tended to export more technology-intensive goods than national firms and there was a correlation between TNCs' 'high-tech' and trade balance deficits (Peres Núñez 1990a; Ruiz Durán 1991a).

[16] During the same period, the private sector's share in exports decreased from 83.6 percent to 21.1 percent, while its import share remained relatively constant at 70 percent (Table 1).

[17] Especially during the administration of Echeverría (1970-1976), the private business sector in Mexico engaged in "economic terrorism" and was unable, after exhausting the existent profitable projects during the first import substitution decades, to create new leading sectors. For the first time since the 1940s, productive investments accounted for considerably less than 50 percent for the period 1970-1978 (Cypher 1990; Tello 1976).

[18] The margin of overvaluation in the Mexican peso reached 32.3 percent in 1975 with a rising trend (Villareal 1988).

[19] The maquiladora industry, however, does not have significant linkages with the rest of the Mexican economy. On average, over 97 percent of its material inputs were imported between 1975-1981.

[20] The sales of paraestatales remained relatively constant, accounting for 15.5 percent of GDP in 1973 and 16.8 percent in 1981 (Cypher 1990).

percent of Mexico's external debt, began to be felt in the economy toward the late 1970s. Oil exports generated as much as $31.9 billion in 1977-1981, accounting for 72.5 percent of the total exports in 1981. But the strategy to export primarily low value added, unrefined petroleum products, led to dependency on international oil prices, and failed to strengthen the industrial potential for oil refinery. As a result, linkage between the oil sector and the rest of the economy remained relatively tenuous with vast quantities of natural gas consumed for the export of oil.

Under the Lopez Portillo administration, the distribution of income further deteriorated. Over the period 1976-1981, inflation averaged 37.3 percent annually with real minimum wages falling by 10 percent over the period 1976-1981. While public investments were targeted on the oil industry, private investments were concentrated on services and trade. As a result, the manufacturing sector experienced a set-back; its share in the total exports fell from 44.8 percent in 1977 to 16.7 percent in 1981 although the total exports increased modestly from $2.1 billion to $3.4 billion.[21]

There was further liberalization of imports in the period from 1976 to 1978; the system of import licenses was replaced by tariffs. More tolerant measures for import licenses resulted in increased imports from $5.7 billion in 1977 to $23.9 billion in 1981.[22] Basic goods were exempt from governmental price controls. The new price and tariff structures were introduced to promote the development of domestic manufacturing industry, while the EPRs for agricultural products remained negative or relatively low.[23] For similar purposes, CEDIS were reinstalled in 1977. After 1977 new measures were introduced to reduce import dependency and to expand exports and trade in the border regions (Villareal 1988; Haneine 1987). The current account deficit reached $16.5 billion in 1981, and the external debt rose from $5.97 billion in 1970 to $78.22 billion in 1981.[24] While facing the problem of increasing social and political unrest and worsened distribution of income, the government was unable to improve the balance of payments problem. The two-fold increase in oil prices in 1979-1980, however, restored an overwhelming confidence in Mexico's capacity to service its foreign debt. Despite the sharp rise in international interest

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[21] Casar (1989) concludes for this period that intra-industry trade, which took a significant share of total external trade primarily concentrated on economics of scale and technical requirements according to the necessities of TNCs.

[22] The US's share in Mexico's trade declined from 70.9 percent in 1970 to 53.9 percent in 1981, primarily because of the diversification of oil exports to Japan and Western Europe (Table 2).

[23] Ros (1991a) asserts that the average nominal protection declined moderately. The effective protection rate for manufacturing goods, while remaining positive, declined continuously since 1960. Consumer goods' EPR declined from 40.1 percent in 1960 to 5.2 percent in 1980, while heavy intermediate and investment goods increased, the latter from 85.2 percent to 108.9 percent. However, in trying to achieve alimentary self-sufficiency, the agricultural sector's EPR, negative in 1970 and positive in 1980, shifted significantly. See also Kate (1980).

[24] In 1979-1981, Mexico's total external debt increased by $35.5 billion to $78.22 billion, of which $24.9 billion was short-term debt (World Bank 1990).

rates, the Mexican government based its development strategy on high oil prices and foreign borrowing.

Mounting fiscal deficit and unreliable oil revenues—which only partly covered imports payments and made external borrowing necessary—paved the way to the breakdown of four decades of Mexico's import substitution industrialization.

II. NEOLIBERALISM AND GLOBAL INTEGRATION (1982-1992)

II.1. An Overview

The year 1982 is significant not only because of the international debt crisis triggered by Mexico's financial impasse but also because of the collapse of Mexico's development model of the prior four decades. The agricultural sector, the oil industry, and international loans had already been exhausted as financing sources. Coupled with the decline in agricultural output, falling oil prices in 1982 and 1986 resulted in sharp trade deficits (Table 1). Most state-owned industries incurred deficits and external debts, following the policy of socializing losses and privatizing profits.[25] As the private sector and TNCs failed to create an efficient and competitive industrial sector, a general ambience of uncertainty, fueled by increasing capital flight of around $20 billion in 1981-82, contributed to balance of payments difficulties.

Since then, Mexico has shifted its economic policy drastically. Salinas de Gortari, Mexico's present president and one of the architects of de la Madrid's economic policy, pursued a strict schedule to open the economy. Assuming a relief of the external debt service and increasing repatriation of capital flight, the neoliberal project presents four essential pillars: 1) low inflation rates, drastic reduction of public spending and of the public financial deficit; 2) the privatization of state-owned industries and a central role for the private sector; 3) increasing foreign direct investment (FDI) and nonoil manufacturing exports in the context of a general liberalization of trade and investment; and 4) the government's commitment to national and foreign investors to guarantee Mexico's historical 'comparative cots advantages', i.e. primarily the exploitation of cheap labor power and energy. The NAFTA proposed in 1990 can then be understood as the logical and necessary step to make Salinas' neoliberal project feasible. Neoliberal policies were implemented through privatization of state-owned industries, trade liberalization and joining the GATT in 1986, "Pactos Económicos" after 1987, which contributed to a fall of the fiscal deficit, low inflation rates, and decreasing real wages.

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[25] An important element of this policy was the nationalization of the private banks and their external debt. The Mexican government acquired around $10 billion of their foreign debt through several programs in 1982. Later, in 1984 and in 1991, these banks were privatized once more, however without their external liabilities (Rojas 1984; Tello 1984).

Mexico has faced increased political instability reflected by the emergence of the opposition parties (PAN and PRD) and the growing divisions within the ruling party (PRI) itself (Cornelius 1990; Meyer 1991; Reding 1991). At the same time, the traditionally held corporatist political system has begun to erode: corrupt but strong political fractions and unions could still threaten Salinas' strategy.

The remainder of this section examines the initial reforms undertaken by the de la Madrid administration in the early 1980s. We will then examine the motives of Mexico's new initiative to join a NAFTA and the possible consequences on Mexico's future development.

II.2. Managing The Crisis (1982-1985)

> *The most important good of the Nation is its population: 75 million inhabitants, of whom 70 percent are younger than 30; in them lie the extraordinary power and energy of development.*
>
> Miguel de la Madrid,
> *Plan Nacional de Desarrollo 1983-1988*

As already mentioned, the structural crisis after 1982 must not be viewed as a simple solvency or liquidity problem caused by declining oil prices and rising interest rates or the earthquake disaster in 1985. More importantly, it manifested the structural fragility of the Mexican economy. President de la Madrid's Plan Nacional de Desarrollo (1983-1988) focused on a set of measures to bring down inflation, restore fiscal and exchange rate stability, improve the current-account balance, and service the debt. At the same time, the decline in industrial production, primarily in manufacturing, was to be reversed by gradual rationalization of protection and promotion of export sectors. The measures called for privatization of paraestatales, a selectively open policy in regard to FDI,[26] and a progressive liberalization of international trade.

The PND and the National Programme for Promoting Industry and Foreign Trade contained specific goals for industrial and foreign trade policies and manifested the increasing linkages between them. The general guidelines of industrialization stipulated the goals of increasing the production of consumer goods, decentralizing the economy through new technological developments, and establishing a stable mixed economy. The key element of trade policies in 1982-1990 consisted of rationalization of the protection regime and support of export industries; import licenses were gradually to be replaced by tariffs, followed by reductions in the

[26] As a first step, a decree passed in 1983 stated that national and foreign firms were to equilibrate the balance of payments and their preformance in technology transfer in order to obtain tax-deductable imports and to sell up to 20 percent of their production on Mexican territory (Peres Núñez 1990a).

dispersion and levels of tariffs.[27] The export sector was to be supported through maintenance of an undervalued peso. Moreover, the government was to support expansion of Mexico's Northern border, maquiladora activities, and to promote domestic production of intermediate and capital goods.

In the early '80s, the undervaluation of the peso and the decreasing domestic demand led to a drastic decline in imports. Real wages also fell by a substantial margin. At the same time, the fiscal deficit of the public sector, on account of drastic cutbacks on investment and current expenditure, fell from 16.9 percent of GDP in 1982 to 8.5 percent in 1985 (Table 4). These measures produced a current-account surplus of $35.2 billion for 1983-1985 and made the increasing net transfer of resources possible (Ros 1991a; Villareal 1988; Table 4).

The economic and social costs of these apparent successes were high, however: during 1983 Mexico's GDP declined by 4.2 percent, industrial production by 8.1 percent, manufacturing by 18.1 percent, and public investments by 30 percent, which seriously affected Mexico's productive infrastructure (Kim 1986). As real wages fell by over 20 percent in the early 1980s, the living standards of Mexico's working class were severely affected, which was exacerbated by unprecedented levels of inflation, averaging 75.7 percent in 1982-1985.[28]

After a modest recovery in 1984, unfavorable external developments soon forced the government to take a more radical orientation in economic policy. Mexico had continuing problems with servicing the debt, as the Baker Initiative for debt relief fell through in 1985 and oil prices collapsed in 1986. The private sector continued to incur current-account deficits and failed to diversify its export activities. The precarious prospects of inflation and the speculative behavior of the private sector led to increased capital flight and falling FDI.

Under these circumstances, the government introduced a trade liberalization program in which import licensing requirements and official price controls were removed and an equivalent amount of protection was to be maintained through tariff rates (Bravo 1989; Zabludovsky 1990). The government simplified the tariff system by reducing the number of tariff rates (Table 5). Reforms were further carried out through the Programa Nacional de Fomento Industrial y Comercio Exterior (Pronafice) in 1984-1988 and the Programa de Aliento y Crecimiento (PAC) and the Law of Foreign Trade in 1986. With the third rescheduling of its debt, the government accumulated international reserves by $6.7 in 1986 and $13.7 billion in 1987. The way was now open to implement a neoliberal development strategy at an accelerated pace.

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[27] The share of the import value subject to licensing declined from 83 percent in 1983 to 37 percent in 1985, primarily for intermediate and some capital goods (Peres Núñez 1990b; Pérez Motta 1989).

[28] Lustig and Ros (1990) note the increasing importance of the informal sector which partly compensated for the decline in real wages.

II.3. Enterprise For The Americas Initiative

As already mentioned, stagnation in the Mexican economy during the early '80s was caused by drastic reductions in international oil prices and by the difficulty of continuing with debt payment. As the US, a major creditor of many Latin American countries, became a net importer of capital in 1981 for the first time since the WWII era, the highly indebted countries like Mexico were forced to search for new financing sources and a new development strategy. Mexico already had a considerable reverse transfer of resources amounting to 6.3 percent of its GDP annually from 1983-1987 (ECLAC 1990a).[29]

The crisis of US hegemony since the end of 1960s—manifested in the decline in productivity and profit rates since the 1950s—implied that the US in the 1980s was no longer able to pay the costs of financial stability in the capitalist world economy as it had been in the 1950s and 1960s. However, countries such as Mexico, Chile, Costa Rica, and the Philippines, given their geopolitical situation, were still heavily favored for assistance by the US government and multilateral agencies.

The importance of Mexico to the US was shown by frequent debt reschedulings. Mexico was one of the main beneficiaries of the Baker Initiative in 1985; it was allowed to have an "exit-bonds" system in 1987. In the 1989 rescheduling of Mexican debt multilateral agencies provided 20 percent of their total funds as conceded by the Brady Initiative. They rescued Mexico from total financial bankruptcy. Even under these favorable terms, the actual reduction in Mexico's debt service was modest; the Brady Initiative achieved a reduction of less than 15 percent of Mexico's annual interest payments during 1983-1988 (Dussel Peters 1993).

President Bush's Enterprise for the Americas Initiative, announced in June 1990, was targeted for countries like Mexico that had faithfully pursued a neoliberal strategy for structural adjustment, emphasizing the above-mentioned selection process.[30] Taking for granted that import substitution and protection policies in Latin America would "stifle progress and free markets breed prosperity," the initiative focused on a bilateral framework for free trade and investment. Moreover, it offered $100 million for a new investment fund for the Americas and not yet specified

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[29] Total disbursed external debt as a percentage of exports increased from 222 percent in 1980 to 337 percent in 1982 and reached its highest level at 459 percent in 1986. Similarly, total interest due as a percentage of exports accounted for 30.2 percent in 1980 and reached 47.6 percent in 1982 (Table 4).

[30] "I'm announcing today that the US stands ready to enter into free trade agreements with other markets in Latin America and the Caribbean, particularly with groups of countries that have associated for purposes of trade liberalization. And the first step in this process is the now-announced free trade agreement with Mexico" (Bush 1990). Similarly, the conditionality for these funds depends on an existing economic program with the IMF or the World Bank, an economic program including the liberalization of investments and an agreement with private creditor banks (Bouzas 1991).

debt reduction schemes. Although the initiative is relatively insignificant in economic terms in the short run, it presents an apparent new political and economic long-run development setting for Latin America.

In 1988 the US market accounted for 36.1 percent of the total Latin American exports and 37.6 percent of the region's imports came from the US (ECLAC 1990c, 1991a). Thus, Bush's initiative can have far-reaching economic implications for the continent as a whole, in particular for countries with high trade linkages with the US—Mexico, Venezuela, Brazil, and Chile[31]—and will presumably enhance increasing competition among these countries to impose the most radical neoliberal policies to attract foreign investments and bilateral agreements with the US (Orme 1991). For the US, since exports have been accounting for an important share of contribution to its economic growth,[32] securing adequate access to Latin America's market will become a policy priority during the 1990s. The trilateral North American free-trade negotiations currently underway must be seen in this light.

II.4. Industrial and Trade Policies (1985-1990)

In general, the strategy adopted after 1985 can be seen as a desperate move of the government to prevent economic bankruptcy of the nation. The failure of gradual reforms since 1982 and mounting uncertainty, which reached a climax in 1985-1986,[33] left the Mexican government with no other alternatives but to rely more heavily on the US economy. Furthermore, the period of 1986-1987 was one of strong multilateral conditionality; new loans were disbursed only if specific trade liberalization measures were implemented.[34] The Mexican government continued with the measures already initiated in 1983, which consisted of cutbacks in public spending, privatization of paraestatales, exchange rate adjustment, and reorientation of the generalized subsidy scheme to promote the export-oriented private sector. Thus, the Mexican government had to replace the import substitution model with a drastic 'marketization program.'

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[31] This preliminary assessment is confirmed by the study of Erzan and Yeats (1992), which estimates that the effect of an exclusive free trade agreement of eleven Latin American countries with the US would be minimal. Furthermore, Mexico's exports under a free trade agreement with the US exceeds that for all other countries combined, and Mexico and Brazil together account for almost 90 percent of the total gains.

[32] Huerta (1991) emphasizes that exports contributed 40 percent of US's economic growth in 1986, and increased in 1990 to 88 percent.

[33] Cornelius (1986) states that a "widening rupture" between the public and private sector in 1985-1986 was manifested in intensifying pressure from big businessmen to dismantle the state sector more rapidly, the surge of PAN in the elections of 1986, decreasing private investment, the lag in attracting new FDI, and increasing capital flight, the latter accounting in 1977-1984 for $33.2 billion and $5-6 billion in 1986. See also Millán (1988).

[34] In 1987-1988, $7.7 billion were granted under these conditions by the multilateral agencies (Schatan 1991).

Successful implementation of new trade policies and their effects on the balance of payments was then viewed as the key to increasing industry's efficiency and productivity. The role of the domestic market was ambivalent: it provided the basis for export promotion and yet proved incapable of providing the necessary basis for developing a competitive capitalist economic structure.

Behind the new initiative, intensified in 1986 and again in 1989-1990, was the recognition by the government that Mexico's strategy now relied exclusively on one pillar: the exploitation of abundant labor power—85 million Mexicans—since other financing resources had already been exhausted. Complete liberalization of the economy would require massive domestic and foreign private investments to stabilize the balance of payments and gain access to the world market—in Mexico's case almost exclusively to the US market. It is in the context of the international conditions examined above and the severe constraints imposed on the Mexican government that liberalization of trade and investment took place in the late 1980s.

Mexico's unilateral trade liberalization initiated in 1986[35] called for reciprocal concessions by other nations. The liberalization undertaken before 1986, consisting of tariffs, import licenses, and import reference prices, meant that few additional industrial and trade reforms were necessary in order to join the GATT (Toro 1989; Zabludosvky 1990). The pace of liberalization was accelerated after 1986. The average tariff weighted by the value of imports declined from 13.3 percent in 1985 to 5.6 percent in 1987. Similarly, the "official importation prices," widely used in prior decades, were removed completely in 1987-1988. In summary, the most important measures regarding selective trade liberalization were as follows:

1. Import tariffs were reduced to five categories of lower rates (0 percent, 5 percent, 10 percent, 15 percent, and 20 percent) in 1987.

2. In 1989 the import-weighted average tariff increased to 10 percent to make effective protection more uniform and to address concerns about increasing consumer goods imports.

3. Part of the agricultural, pharmaceutical, automobile, and microcomputer industries have been exempted from trade liberalization through several development programs and subsidies equivalent to 100 percent of their imports for components and finished goods. TNCs are the largest producers and exporters in these sectors.[36]

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[35] The percentage of total import value subject to licensing dropped from 83 percent in 1984 to 31 percent in 1986 and 90 percent of dutiable imports were subject to three rates, 10 percent, 22.5 percent, and 37 percent.

[36] The government protects these sectors by imposing the highest tariffs on imports. However, the producers, mainly TNCs, have to meet strict conditions regarding domestic content, import/export coefficients, and reinvestment of profits. For the automobile industry a gradual trade liberalization was implemented from November 1990. Similarly, the agricultural goods, wood, and pharmaceutical industries still require import licenses (Peres Núñez 1990b; INFORUM 1991).

4. The 1973 Law to Promote Mexican Investment and to Regulate Foreign Investment has not been changed since then, but was reinterpreted and amended through several decrees, allowing in 1984 up to 100 percent foreign ownership in specific sectors authorized by the Mexican government (National Commission of Foreign Investments, NCFI). Similarly, the decree of May 1989, primarily addressed to small- and medium-sized firms, permitted an automatic 100 percent share of foreign capital if foreign-financed investments of less than $100 million can show a balance in their current account, and guarantee employment and abide by environmental protection laws.

5. Legislation in December 1989 and June 1990 stipulated that foreign capital of up to 49 percent in the financial sector and 34 percent in commercial banks will be allowed if authorized by the NCFI.

6. Technology transfer and the use of patents, trademarks and intellectual property rights were similarly changed in 1987, 1990, and 1991, establishing unconditional imports of technology and unlimited royalty payments.

In addition, the government concluded several agreements with the US after 1985, which led to broader cooperation on subsidies, trade, and investment. Particularly important is the 1987 Framework of Understanding and later sectoral accords on steel, alcoholic beverages, textiles, and apparel, in which the US accepted a sectoral approach for trade and investment relations, as reiterated in the Trade and Investment Facilitation Talks (TIFTs) in October 1989. Both agreements conceded market access to the US in exchange for Mexico's FDI liberalization. Nevertheless, the announcement and later ratification by US Congress that negotiations on a future NAFTA would begin through the "fast track" procedures overshadowed the prior accords, as we shall see below.

The effects of these measures are ambiguous and raise serious concerns for Mexico's future. Although FDI rose substantially since 1986, reaching around $4.6 billion in 1990, it can only partly offset the trade deficit.[37] The debt-equity swaps with discounts close to 14 percent and other mechanisms to substitute public foreign debt accounted for 50 percent of all authorized FDI. As in the period 1970-1981, in 1985-1990 FDI was concentrated in the manufacturing industry. The US was the main source with about 63 percent of total FDI until 1990.[38] TNC exports—mainly by in-bond industries and the automobile sector—were most dynamic in 1985-1990.[39] They now account for more than 50 percent of nonoil exports and are responsible for an

[37] As Peres Núñez (1990b) stresses, FDI figures have to be interpreted cautiously, as long as they correspond to projects lasting several years that have already been authorized or registered.

[38] Despite high expectations for the 1980s, Japanese FDI has been moderate—accounting for only 0.5 percent and 0.6 percent in 1989 and 1990 respectively—and concentrated in transport equipment and mining during the 1980s, reaching a 70.3 percent share in these sectors for 1990 (Nacional Financiera 1991; Székely 1991).

[39] Thirty-five percent of the increase of total nonoil exports came from the high-technology and capital-intensive automobile industry in 1982-1988. For a detailed analysis on the specialization of TNCs and the automobile and microcomputer industries see Peres Núñez (1990a), Carrillo (1990a) and Weintraub (1991).

improvement in Mexico's balance of payments. TNCs in Mexico have already repaid $9.7 billion or 45 percent of total private debt from retained profits, internal debt, and swap transactions.

Peres Núñez (1990a) notes, however, that the existing installations in TNCs in Mexico have not been adequately modernized, although TNCs have been a leading sector in exports and the transfer of technologies. Since TNC trade is characterized by intra-industry transactions to the US, it has had limited intersectoral linkages within the domestic economy. These considerations plus the sector's increasing dependency on international factors, especially on the US, leave the future of TNCs' activities for a competitive accumulation strategy uncertain.

As for the domestic manufacturing sector, its performance has not been impressive. Although Mexico's manufacturing during the 1970s succeeded in catching up in TFP with the US (but with increasing disparities vis-à-vis Japan and Germany), in the period of 1979-1985 TFP in Mexico decreased by 0.5 percent annually. Hernández and Velasco (1990) point out that the gap in TFP between Mexico and the US widened throughout the 1980s, taking into account the fact that TFP increases in Mexico have been attained mainly through undervaluation of the domestic factors, in particular labor power.

Although trade liberalization has focused on changes in the import regime, such export promotional measures as maintenance of an undervalued peso, simplification of export permits, and bilateral agreements for tariff reductions have substantially changed the composition of exports. While total exports increased from $5 billion in 1985 to $13.9 billion in 1990, during the period 1985-1989 exports of textiles, basic metallic industries, and metallic goods experienced the most dynamic growth.[40] Chemicals, oil-derived products, and lumber products slightly declined. On the import side, consumer goods registered the largest increase; their share in total imports surging from 8.2 percent in 1985 to 17 percent in 1990. The share of intermediate and capital goods declined (Table 3).[41] During the same period, foreign trade in manufactured goods showed increasing concentration. Chemicals, oil-derivatives, and metallic products, machinery, and equipment accounted for 57 percent of exports and 73 percent of imports (Nacional Financiera 1990). It is important to note that during 1991, despite the impressive growth in manufactured exports, trade liberalization led to a surge in imports in consumer goods as well as in intermediate goods.

Trade liberalization was a factor contributing not only to the recovery in economic growth but also to increased concentration in industry. Worth noting in this context is that in Mexico,

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[40] Ros (1990a) emphasizes that industrial rationalization and productivity growth in the period 1985-1990 were mainly achieved in the investment goods sector (primarily the automotive industry), basic metals, and food processing

[41] As *Business Latin America* (11 May 1992) highlights, the figures on intermediate and capital goods are skewed because of flaws in the classification system. According to other estimates, consumer goods would account for 35 percent-40 percent of all imports and not 14.8 percent as reported for 1991.

unlike East Asia's newly industrializing countries, exportable goods have a low domestic content and are more capital-intensive in production than import substitutes (Kim 1990). Thus, benefits from exports tend to concentrate in a small proportion of the economically active population. Moreover, the rapid growth in trade in the second half of the 1980s was attributable to increased intra-industry and intra-firm specialization (Ros 1990a). Unless the trend of increased concentration in foreign trade and limited intersectoral linkages is checked, the distributional implications of trade liberalization can be questioned.[42]

Even higher has been the US's share in manufacturing exports in 1986-1990, around 90 percent, significantly lower than the US's 65 percent share in total exports. Mexico has become the world's fastest growing market for US exports between 1986-1991, increasing by 168 percent.[43]

There have been, of course, variations in performance from industry to industry. In addition to the computer and automobile industries, the cement, steel products, beer, glass, and chemical industries have registered market pace of expansion in 1982-1990. Some of the "grupos industriales"—primarily Vitro and Cemex[44]—consolidated in the domestic market and are competing directly in the US market. Large-scale, multiplant-based production, take-overs of US firms by Mexican "grupos" in the late 1980s, and redefinition of competitive strategy indicate new dimensions of restructuring strategy in a few Mexican "grupos," although the majority of them will probably continue predominantly in traditional and intermediate goods industries.[45] The performance of the small and medium industries (SMI) has not been widely investigated yet. In Mexico they tend to be concentrated in food, metals, apparel and processed textile goods, printing and publishing, and footwear. The studies by Ruiz Durán (1991a) and Casar et al. (1990) show that a moderate turnaround occurred in this sector during the 1980s. Due to the flexibility of the SMI sector to adjust to the export-oriented strategy, however, partial recovery took place in the second half of the 1980s; it increased its production and employment share to 43.5 percent and 50 percent in 1990, although they were still below the 1970s levels. The future development

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42 The immiserating effect of the 1980s—more than half of all Mexicans are considered to be living in poverty—manifests itself in the percentage of the population receiving up to 2 minimum wages. This group increased from 46.9 percent in 1981 to 58.6 percent in 1987. Twenty percent of the middle income groups (those earning between 2 and 14 times the minimum wage), also fell to the category of the "poor" by 1987 (Kim 1990).

43 Mexico's increasing foreign trade concentration has been substantial during the 1980s: the US's share in exports rose from 54 percent to 69 percent in 1989, while Western Europe's and Japan's changed from 18 percent to 13 percent, and from 5 percent to 6 percent respectively (*Mexico News Update* 5(1), 1992; Peres Núñez 1990b).

44 CEMEX produces 70 percent of the domestic cement production and exports more than 90 percent of cement exports (*El Financiero*, December 20, 1991).

45 These conditions are reinforced by the fact that only a few of the "grupos" will have the possibility of massive foreign borrowing and bond positioning in international markets, as Vitro's case demonstrates.

of Mexico's manufacturing sector will critically depend on the growth potential of SMIs. Existing surveys, however, reveal that SMIs—especially manufacturing producers—are not expected to perform well in the immediate future.[46]

Towards the end of 1987, controlling inflation, which had reached 159 percent, and fiscal policy became the major economic priorities of the Mexican government. The stabilization package consisted of reductions of public expenditures, the depreciation of the exchange rate by 22 percent, increases in prices of goods and services produced by the public sector, an increase in domestic interest rates, and privatization of state-owned enterprises. However, the essence of the project were several Economic Solidarity Pacts (PSE), the first announced at the end of 1987, which redistributed the costs of the strategy primarily among wage-earners. After allowing initial price increases in the "basic commodities basket"—especially in oil (85 percent), electricity (89 percent), and consumption goods—price-fixing on basic goods and overall wage-freezing were put into practice. This resulted in a drastic fall in real wages.[47] The exchange rate was similarly controlled. It was through this set of measures that toward the beginning of 1988 inflation came down substantially.[48]

The "disincorporation" of the paraestatales set in motion since 1982, in conjunction with the "reconversión industrial" initiated since 1986, reduced the role of state-owned enterprises to providing only basic consumer and capital goods. As of 1990, only 310 out of 1155 state enterprises were left. Virtually all paraestatales, with the possible exception of PEMEX and CFE, will be the targets for privatization. The share of state-owned enterprises in manufacturing goods fell from 18.8 percent in 1981 to 10.6 percent in 1985 (Casar and Péres 1988; USITC 1991). Essential to note in this context is that privatization of the paraestatales actually raised the level of industry concentration for domestic as well as for TNCs in Mexico. According to Gasca (1989), for the most part domestic monopolies and foreign firms purchased paraestatales that already produced in the same sector or the same good. The revenue intake of privatization in 1989-1990—equivalent to around $4 billion—and FDI during the same period were the main sources to support the overvaluation of the exchange rate and the increasing trade balance deficit.[49]

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[46] On the other hand, the same firms point out that the low domestic demand and trade liberalization are the main limitations on their economic activity. See *Expansión*, 20 February 1991.

[47] Real wages decreased constantly since 1980, accounting in 1990 for 44.3 percent of real wages of 1980. See Table 4.

[48] The Pact for Stability and Economic Growth (PECE) established at the beginning of 1989 was similar to PSE, but lengthened the period over which the set of measures were to be implemented. For an analysis of the measures and effects of PSE and PECE see Navarrete (1990).

[49] Primarily the revenues of the privatization of paraestatales and public banks in 1990-1991 have been assigned for a "Contingency Fund" created in December 1990, totalling close to $16 billion at the beginning of 1992 (*Mexico Service*, 12 February 1992). The development of the period 1991-1992 will be analyzed in the next section.

One consequence of trade liberalization in the late 1980s has been the rapid growth in the maquiladoras in northern Mexico. They have evolved into the most dynamic sector in terms of employment and have become the second largest source of foreign exchange earnings. The maquiladoras have been the major beneficiary under the US General System of Preferences (GSP) and Harmonized Tariff Schedule of the US (HTS).[50] Maquiladora exports in 1986-1990 totalled $48.6 billions, and accounted for an accumulated added value balance of $11.6 billion. Employment in this sector—primarily in the Northern regions—registered growth rates between 10 percent and 20 percent in 1986-1990. In 1991 almost half a million Mexicans worked in the maquiladora industry (Banco de México 1991). The maquiladora activities, however, are concentrated in a few industrial branches: three subsectors[51] accounted for 70 percent of total added value in 1985-1990, and their import (70 percent) and export (80 percent) shares were even greater. The local content of this sector has been very low: less than 4 percent of inputs have been secured from Mexican sources. The enclave character of the industry will likely persist throughout the 1990s. Moreover, growth in Mexico's most dynamic sector has depended almost exclusively on US investment; in 1990 the US, Mexican, Japanese, and European share of investments in maquiladoras were 68 percent, 25 percent, 4 percent, and 2 percent respectively. The diversification in the sources of investment for Mexico has in the past been made difficult by US trade policy (Carrasco and Hernández 1991).[52] The US government's unilateral implementation of the GSP and HTS[53] has further strengthened Mexico's structural dependency on the US. Despite the new legal framework for maquiladoras[54] and expected positive effects in employment and investment,[55] the predominance of US interest is not likely to be challenged.

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[50] These items allow part of US's exports to re-enter the US free of duty (Grundwald and Flamm 1985).

[51] Transport equipment, machinery and electrical products, and electronic materials (Nacional Financiera 1990).

[52] The "rules of origin," essential for the Japanese and European maquiladoras, in particular might exclude market access to third countries by establishing tariffs for products exceeding a certain import level (Kerber and Ocaranza Fernández 1990; Székely 1991).

[53] Also important is the Trade Remedy Legislation, used increasingly during the 1980s, which can be applied unilaterally by the US to counteract unfair commercial methods, creating an important uncertainty for countries like Mexico.

[54] The Special Regime implemented in the US in 1988 increased the maximum fraction of imports of a particular item that can be made within foreign nations to 63 percent on average. This directly affected the maquiladora industry. In December 1989 a "Decree for Promotion and Operation of the Exporting Maquiladora Industry" was established in Mexico, which allows sales up to 33 percent of maquiladora production to the domestic market and enables them to sell their imports to domestic firms through transfer operations, requiring a prior governmental authorization (Gambrill 1990; INFORUM 1991).

[55] González-Aréchiga and Ramírez (1989a) estimate that for the maquiladora industry, assuming the same growth rates as in 1980-1985, total employment could account for 1.7-2.25 million, FDI for $14-$21 billion, and an added value for around $8 billion for the year 2000.

There are important structural limitations with Mexico's in-bond operation. First, the important maquila sectors are automobiles and electronics which are reflected by the product of a quasi-monopolist transnational structure. Governmental policies, i.e. tariff and nontariff barriers and export promotion, will have limited impact on creating a competitive and efficient industrial structure (González-Aréchiga and Ramírez 1989b). Second, unprecedented population concentration and industrial growth due to the maquiladoras in the Northern border has disclosed the infrastructural and ecological limitations of the region. Further economic growth, at least in the form of the last decades, is no longer possible in cities like Tijuana, Nogales, and Ciudad Juárez, nor indeed in San Diego and the rest of Southern California (Gaventa 1989; Pastor 1992).[56] Third, increases in investment in this capital-intensive sector will hardly generate more than 12 percent of the required employment in the next decade, even considering a relative increase in its labor share. Although new capital-intensive management strategies have improved the productivity of the maquiladora industry, they have failed to increase the supply of foreign exchange and to generate an equivalent growth in employment and wages (González-Aréchiga and Ramírez 1989a and 1990; Solís de Alba 1991).

In summary, the ongoing process of trade liberalization in Mexico has not yet produced diversification in the directions of trade; it has strengthened the presence of US influence in Mexico.[57] Mexico achieved a relative catch-up with the US in productivity growth rates, but has increased its gap with other OECD countries. The liberalization of investment and trade policies did not cause diversification. On the contrary, it strengthened the role of the TNCs and the "grupos" in Mexico. Similarly, trade liberalization since 1986 boosted Mexico's trade and current account deficits, which will only in part be covered by FDI, and might lead to a situation similar to the crisis of 1982.

Finally, it is well to note that the probable consequence of the neoliberal strategy, at least in the short term, is the worsening of income distribution, reduction in real wages, and deterioration of living standards for the masses of the Mexican population. This process goes hand in hand with the increased profit margins, which has been happening since 1987. To attract FDI and continue with liberalization, Mexico would need to continue to provide cheap labor and political stability. The repressive response of government will likely remain a key element in the

[56] This relates directly to the question of the potential of the "maquilización of Mexico." Higher productivities and profits of the maquiladora sector are not 'transferred' to Mexico. How was it possible that the Northern border presented such impressive economic growth? The public sector was primarily in charge of this development, transferring resources either through public investment and direct subsidies or through tax reductions (Zepeda 1991).

[57] Similarly, Mexico's trade with the US averaged above 65 percent during the 1980s, while US trade with Mexico was around 6 percent. An instance of this "disproportional significance for Mexico" (INFORUM 1991) is that no US industrial sector exports more than 15 percent of its production to Mexico, while for various goods manufactured in Mexico, exports to the US exceed 90 percent.

new strategy. Corporatist-centered unions in Mexico, frequently under a corrupt leadership, form an alliance with the government. The government, in turn, has tended to suppress movements of independent-minded unions which demand higher wages and better working conditions. The case of Ford Motor Co., one of the main automobile producers and exporters in Mexico, is illustrative of these repressive tendencies (Bensurán 1991; Mendiola 1991). This traditional cooperation between corporatist unions and the administration in charge hinders essential worker rights. These unions, with the aid of the state, have often attempted to impede the creation of independent worker unions. Gambrill (1990) concludes that corporatist unions in maquiladoras ("sindicatos blancos") have responded effectively to the government policy to maintain low unit-labor costs in in-bond operation.[58]

[58] For a detailed analysis of the development of labor's role and the possible response to current conditions, see Middlebrook (1989, 1991).

III. FROM LIBERALIZATION TO REGIONALIZATION: MEXICO'S RESPONSE

The negotiations for a free trade agreement among the three countries are still in progress; only some preliminary results have sporadically been made known. It is not possible at present to assess the full implications of a NAFTA for the Mexican economy. Nonetheless, on the basis of the agenda initially agreed on, this section attempts to outline Mexico's position in the negotiations, exploring its prospective implications. We start with the recent macroeconomic situation in Mexico leading to the current negotiations for a NAFTA.

Mexico's current position is to continue to pursue neoliberal policies implemented since 1986. The goals of the Salinas administration consist of trade and investment liberalization, selective removal of trade barriers—mainly of import licensing—which accounted for about 7 percent of US exports to Mexico in 1989, development of the export-oriented manufacturing sector, increased foreign investments to "modernize" the economy, stabilization of the balance of payments, and acquisition of a more favorable treatment from the US under the GSP.[59] US tariff and nontariff barriers (import quota system and "voluntary export restraints") have restrained Mexican exports, particularly in textiles, apparel, shoes and leather, and steel.[60] Mexico's efforts to geographically diversify trade and investment relations, as evidenced by Salinas' trip to Europe in March 1990, failed to materialize. Japan's cautious approach to Mexico's reforms, and the events in Eastern Europe, which dampened possibilities of capital inflow from both Western Europe and multilateral agencies, left Mexico with virtually no option but to concentrate on the US market. Also, uncertain prospects of the GATT prompted the government to desire to have closer linkages with the US. Thus, the success of Mexico's neoliberal strategy is based on prospective access to the US market and FDI. Mexico wants the US to remove antidumping, countervailing duties, and emergency protection for US producers. However, as pointed out by Schatan (1991), the bargaining position is more disadvantageous for Mexico after 1985, as trade liberalization since 1987 has gone far beyond the targets set by the GATT.

From the US perspective, a NAFTA is an important step to reinforce neoliberal strategies in Latin America, consistent with the Enterprise for the Americas Initiative. The US expects to reinforce Mexico's (and Latin America's) neoliberal models while securing US's export markets[61]

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[59] "Today, trade opening by itself does not guarantee a successful insertion into the rest of the world; we have to fight on all external fronts to gain access to markets" (Salinas 1990, author's translation).

[60] In 1991, 44 percent of Mexican exports entered the US duty free, which might increase to around 60 percent in the next years (Rawlings 1992).

[61] Assuming a one-time investment increase of $25 billion in Mexico, as a result of FDI and repatriated capital, Rawlings (1992) estimates $18 billion in demand for exports from the US.

and enhancing US productivity. Possible restructuring of US TNCs in the wake of the conclusions of a NAFTA could also result in specialization and increased productivity, a step necessary to catch up with other OECD nations.

Without any preceding national discussion and consensus, Presidents Bush and Salinas announced their intentions to negotiate for a free trade agreement by December 1990. In the US, Bush requested Congress to allow the "fast-track" procedure in negotiations with Mexico, which was authorized in May 1991. In Mexico neither the elected houses nor its populations, under the constitutional rights of the Executive, participated in the sole decision of Salinas.

Both governments agreed to negotiate on six at least areas—market access, trade rules, services, investment, intellectual property, and dispute settlement[62]—as summarized below:

1. Harmonization and gradual elimination of tariff[63] and nontariff barriers among Canada, Mexico, and the US for respective market access. The abolishment of nontariff barriers will be difficult, although it is the most important issue in the negotiation. Mexico is likely to ask for concessions (by means of quotas, concessions under GSP, allowance for subsidies, etc.) in the export of such products as textiles, apparel, iron, steel, and glass. On the other hand, the US will probably press Mexico to further liberalize its FDI laws, especially in the politically sensitive agricultural and petrochemical sectors. Mexico's practice since 1987 of subsidizing the automobile, computer, and pharmaceutical sectors will be another important area for negotiation. Negotiations in the services sector and on intellectual property rights are particularly complicated by the different controls and regulations in each of the three negotiating countries.

2. The rules of origin. Mexico is interested in obtaining low percentages in the rule of origin, since it prefers diversification of FDI, especially in the maquiladora industry and automobile sector. The Canada-US agreement, however, accorded free-trade status only to products with more than 50 percent of their value added originating in the FTA nations.

3. Trade disputes. Mexico will insist on fair and adequate mechanisms in resolving future trade disputes. Both the US and Canada will likely resist the idea of disputes' being settled under the Mexican legal system.

The most important issue in US-Mexico relations—labor immigration—will be excluded.[64] The environment, salary disparities, and general competitive conditions of the respective

[62] See Salinas 1991.

[63] Tariffs are 18.3 percent for apparel, 10 percent for shoes and leather, 10.1 percent for textiles, 6.9 percent for stone, clay and glass, 4.4 percent for ferrous metals, and about 10 percent-20 percent for about 600 other products. Analogously, Mexico's tariffs affected about 7 percent of the value of US exports in 1989 (Schatan 1991; INFORUM 1991).

[64] However, Salinas suggests that "sooner or later we will have to sit down and look at labor mobility. The sooner the better. I am for the free movement of labor" *Los Angeles Times*, 25 November 1990. Furthermore, Pastor (1992) points out that in a free trade area, "any domestic policy that confers a discriminatory advantage on a country's exports or a disadvantage on imports is legitimately a trade issue... Moreover, if a country's laws require that imported products be produced according to certain safety, labor, or environmental standards, then a nontrade item can become a trade issue."

industries will not enter the negotiations.[65] Due to demands from opposition groups in the respective countries, a parallel negotiation track ("Action Plan") was installed.[66] However, these issues will not be part of the formal negotiation agenda. The Mexican negotiating team will be under heavy pressure, since the only concessions the US is likely to make are tariff and nontariff restrictions. The remaining issues involve liberalization of several sectors of Mexico's economy, which necessitates changes in the Mexican Constitution (Aguilar Zinser 1991).

The conclusion of these negotiations, initially expected by the end of 1991, has been rescheduled for 1993. Added to the difficulties in coming to an agreement in the areas mentioned, the "recession" and the electoral debates in the US have clouded the possibilities of reaching an earlier agreement.

Evidently, a free trade agreement between US and Mexico cannot be a simple extension of the previous agreement between Canada and the US. Will the time schedule for the reduction in tariffs be the same? Can the Mexican economy sustain the removal of all trade restrictions in US and Canadian agricultural and automobile imports, as Canada agreed to in 1989 with the US? Will Mexico's government permit direct foreign investment, foreign ownership, and interferences in price setting and export quotas in the energy sector?[67] Will the rules of origin be 50 percent, as in the Canada-US agreement, or will they be increased, as suggested by US automakers?[68] Will the maquiladora and automobile industries be an exception? And, will a NAFTA be an open institution for Latin American nations or will it be a counterpart to "fortress Europe"? There are several other issues difficult to be resolved. Will Mexico's agricultural sector, especially ejidos, and the energy sector be 'negotiated'? And finally, will the respective administrations face a popular debate and participation on an issue that will profoundly affect the future of their society?

Finally, what will be the probable macroeconomic and social effects of a NAFTA on Mexico? It is yet too early to determine the outcomes of the negotiations. However, several studies have simulated possible results under alternative scenarios.

In general, these studies[69] show that the impact of a NAFTA on both countries will reinforce the macroeconomic tendencies that have existed in Mexico and the US since the mid-

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[65] See Pastor (1992).

[66] The "Plan Integral Ambiental Fronterizo," in which Mexico will invest $460 million in the northern border of Mexico, can be viewed as a result of these pressures.

[67] Canada agreed that its energy export to the US can only decrease proportionally with a decline in the domestic market (Castro Martínez 1989).

[68] Nicholas Scheele, Ford Motor Co.'s general director in Mexico, suggested that regional content levels be set at 75 percent, well above the 50 percent standard in the free trade agreement among Canada and the US (*Business Latin America*, 16 September 1991).

[69] This section is based on Erzan and Yeats (1992), Rawlings (1992), US Department of Labor (1991) and USITC (1991), who do not consider the impact of new FDI in Mexico.

1980s.[70] Countries of different sizes and degrees of development have different benefits to gain. The impact will be much greater on Mexico since it is the smaller economy.[71]

According to Erzan and Yeats (1992), a free trade agreement for the whole American continent would have insignificant effects on trade among the respective countries. The projected expansion under an exclusive free trade agreement for eleven Latin American exporting countries accounts for $2.925 billions, Mexico exceeding that for all other countries combined (56 percent).[72] This study also stresses that the potential of such a free trade agreement would also be reduced if the Uruguay Round of negotiations are brought to a successful conclusion.

Furthermore, the development of FDI and repatriation of capital flight will be one of the key issues for the short- and medium-run strategy of the Mexican government to secure debt service payments, rising current-account deficits, and the exchange rate (Dornbusch 1992; Lustig and Ros 1990).

For the US, USITC projections show that under a NAFTA higher Mexican growth rates and attendant US exports to Mexico will increase the US's GDP by 0.26 percent by 1995. However, the US is expected to secure most of these benefits even without a NAFTA.[73] As for Mexico, being a much smaller economy, the impact is expected to loom much larger, especially in investment and trade balance. Although movements of foreign capital are still uncertain, Mexico's trade deficit is estimated to rise drastically. INFORUM (1991)[74] projections indicate that US exports to Mexico would increase between $3.1-$5 billion in 1995, while increases in Mexican exports to the US would range between $1.1 and $1.6 billion:[75] Mexican exports will increase at

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[70] Tariff and nontariff barriers are already low and crude petroleum trade will not be affected by the NAFTA. The trade-weighted average US tariff rate was 3.4 percent in 1989, and a significant share of Mexican imports were considered under the GSP and HTS, as presented above, while Mexico's trade-weighted average represented 9.8 percent, highly concentrated in a few sectors (INFORUM (1991); USITC 1991; Table 5).

[71] The 1990 GNP of the US was over $5 trillion, whereas in Mexico it was about $200 billion; per capita GNP has been less than 1/10 of US's; around 70 percent of exports go to the US and about 65 percent of its imports are from the US. In the US trade balance, Mexico represents between 5 percent and 6 percent of total imports and exports.

[72] Emphasizing this potential development, Mexico's rate of return for US investors has been the highest in Latin America in 1989-90 (*Business Latin America*, 28 October 1991).

[73] USITC's (1991) partial equilibrium analysis includes Canada, Mexico, and the US and assumes, first, that the rules of origin for NAFTA will be similar to those under the US-Canada FTA and, second, that the effective rate of duty on US imports from Mexico and the increase in the value-added of these imports will account for a large amount of trade between Mexico and the US under the Generalized System of Preferences.

[74] The "Tariffs Only" scenario assumes that tariffs effective in 1990 will be removed, while the "Tariffs and Barriers" scenario additionally assumes a gradual lifting of US restrictions on imports of apparel from the maquiladora industry and a gradual elimination of Mexico's import licensing on agricultural products, computers, and automobiles. See Table 6.

[75] This study also estimates that in 1995 total US imports will increase by $0.6-$1.2 billion, lower than the increase in imports from Mexico, showing some trade diversion from other suppliers.

an annual rate of 3 percent-4.4 percent, mainly in apparel, TV sets, radios, and phonographs, while its imports will rise by an annual rate of 10 percent-20 percent, mainly in agriculture, motor vehicles, and computers.[76]

Moreover, the US is shown to gain slightly in industrial employment while in Mexico moderate real-wage adjustments will take place, which would narrow the existing 9 to 1 wage gap between the two countries. According to USITC (1991) estimates, a NAFTA will accelerate the shift from unskilled to skilled labor, a process that has been taking place in the US. For Mexico, apparel, leather and footwear, horticultural products, textiles, cement (CEMEX), services, construction, and glass (Vitro) will expand moderately. On the other hand, machinery producers and agriculture might lose some 200,000 jobs by 1995,[77] profoundly impacting on Mexico's employment structure (Table 6).

In contrast to the previous models, Prestowitz et al. (1991) stress the role of new investments in Mexico. They assume that FDI in Mexico will have the same output-to-capital ratio as their counterparts in the US, that FDI will increase between $25 billion and $46 billion for 1992-1999, and that 70 percent of new Mexican production in these industries will create increased US imports. The results show a similar initial trade balance impact as the previous simulations. However, production and exports to the US through FDI are expected to rise: Mexico's trade deficit vis-à-vis the US will disappear by 1996/97, turning to a $13.5-$30 billion surplus by 1999. Outflow of US capital will, on the other hand, displace more than 900,000 jobs in the US. US auto parts, radio and television, and telecommunications will be especially affected.[78]

Although the commercial link-up with the US and Canada should help the Mexican economy to regain economic growth, available projections indicate modest negative changes in real GDP, investment and employment (Table 6). On the other hand, a trade agreement is not going to easily resolve Mexico's long-standing structural economic problems. The distribution of income is seen as becoming worse under a NAFTA. The Mexican government's unilateral trade liberalization since 1986 has already hurt important sectors of the economy, in particular the farming sector. As import demands are expected to continue to boom with the country's liberalization, the disparity in growth between imports and exports will grow. There will be moderate increases in exports to the US. Much of the credit for increased exports will, however,

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[76] USITC (1991) presents the likely impact of the NAFTA on automotive products, chemicals, and electronic equipment, which would result in a negligible increase in US imports while a moderate export increase would take place in the medium term. See also Table 6.

[77] About 20 million peasants and day-working laborers, particularly ejido farmers, could be directly affected by slashing tariff and nontariff barriers. See also *The Economist*, 24 March 1991.

[78] For a more detailed discussion on different NAFTA models, see Ros (1992), Schoepfle (1991), and Weintraub (1992).

go to the improved economic performance of the TNCs and "grupos." It is doubtful that their expansion can serve as an engine of growth for the Mexican economy.

Thus, these studies show that Mexico will need in the immediate future to continue to finance the growing current-account deficits. Pursuit of a neoliberal strategy will be based on cheap labor, massive FDI, and an overvalued exchange rate, which could turn out to be difficult to finance. In this context, the simulations show that the commercial gains for Mexico—as distinct from investment impact—are insignificant. However, as Ros (1992) stresses, uncertain movements of capital flows and FDI could crucially affect Mexico's growth in output, employment, and trade.

Mexican consumers are expected to benefit from cheaper and better quality of imported goods, especially foodstuffs, but only if there are substantial increases in imports. Because of locational proximity, Mexico's border regions will be the main beneficiaries. Here, the share of imported goods consumed ranged from 9 percent in Mexicali to 39 percent in Nogales, while Mexico's national average was 5.2 percent (Zepeda 1991).

The expected increase in US-Mexico trade can adversely affect Canada, as Canadian exports to the US are largely substitutable for those of Mexico, especially in the energy and automobile sectors. There will also be some trade diversion to nonmember countries of Latin America; US trade with other Latin American nations could diminish as a result of free trade between Mexico and the US. Many Latin American nations have, however, already been the beneficiaries of US tariff preference schemes, including the GSP. In this regard, trade diversion may turn out to be inconsequential (Lustig 1991; USITC 1991). On the other hand, the prospect of participation in NAFTA by other nations—including Chile, Central America, Venezuela, Argentina, and Brazil—could undermine Mexico's favorable position, adversely affecting FDI in Mexico. In this sense, it is doubtful that the Enterprise for the Americas Initiative is compatible with the NAFTA.

Since the proposal of a NAFTA was initially made, significant economic changes have occurred in Mexico. Although a euphoric atmosphere began to prevail within governmental circles, there have been serious concerns over the latest developments. Improved performance of the private sector, despite positive signs in the manufacturing sector, has yet to be shown, and its increasing trade deficits put in question its capacity under trade liberalization. There are no 'automatic linkages' between current-account deficits and capital-account surplus, as the government tries to claim about the current-account deficits in the early 1990s. Finally, it has yet to be proved that new private investments will lead to increased productivity, employment, and exports throughout the 1990s.

The inflation rate declined to 18.8 percent in 1991, which will have to be reduced even further (to US inflation rate levels), or it will exacerbate the trade deficit and undermine the almost fixed exchange rate. Privatization revenues have registered $16 billion for the period 1988-1991, which have bolstered the “Contingency Fund” to around $18 billion in 1992. The privatization of paraestatales and several banks in 1990-1991 generated 80 percent of these revenues, and selloffs in 1992 are expected to peak to $10 billion. However, these revenues will decline drastically beginning in 1993, when most of the paraestatales and banks, with the exception of PEMEX, will have already been sold.[79]

Especially impressive was the growing capital-account surplus of $20.2 billion in 1991, which indicates the private sector’s increasing propensity to invest. However, more than 70 percent of FDI in 1991 was portfolio investment—against 40 percent in 1990—which also manifests the increasingly speculative character of foreign capital and accentuates the risks and uncertainty of the neoliberal project. Moreover, FDI was highly concentrated: communication and transport sectors absorbed 68.9 percent of total FDI. Finally, the Mexican stock market has risen by almost one-third in 1992 to $24.5 billion, concentrated in a few companies.

On the other hand, the trade deficit increased in 1991-1992, and the current account deficit accounted for $13.3 billion in 1991 and is estimated to increase to around $16 billion in 1992. The performance of the private sector gives rise to special concern, although manufacturing exports reached almost 60 percent of total exports (Table 1). It is yet uncertain whether the sharp increase of consumer goods purchased abroad in 1991, 43 percent, will slow down in the next years. From 1991 to the beginning of 1992, the trade balance deficit increased by 110.5 percent.

The NAFTA negotiations appear to have made substantial progress up to mid-1992. A final agreement will probably be reached in 1993. In March of 1992 a draft of the agreements was leaked to the press. The text referred to some of the remaining controversial issues: the market share of foreign financial institutions, antidumping regulations, Mexico’s 1973 Foreign Investment Law, and the energy sector. The latest negotiations seem to reflect the Mexican government’s desperate need for a final agreement, as it is willing to accept crucial provisions.[80]

The development during 1991-1992 reveals the commitment of the Mexican government to support an overvalued exchange rate in order to decrease inflation and interest rates. However, reduction in public investments and massive privatization will reduce the government’s ability to regulate the economy in future. Moreover, foreign and domestic investments seem to be correlated with massive privatization and speculative investments, which will depend on the outcome of the NAFTA negotiations. The overvaluation of the exchange rate will have to

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[79] Data for 1991-92 are taken from *Business Latin America*, *El Financiero*, *Mexico Service*, and *Proceso*.

[80] *Business Week* (25 May 1992) indicates that, for example, Mexico has accepted a 60 percent labor content in the automobile industry concerning the rules of content, up from 50 percent initially proposed by the Mexican government and as agreed in the US-Canada FTA.

continue to reduce real wages and public spending, thereby worsening the distribution of income. Cheap labor power and an overvalued exchange rate appear to serve as the foundation for Salinas' strategy.[81] The economic costs of continuing with this process could undermine the feasibility of Mexico's neoliberal strategy. A new "vicious circle" (Lomelín 1992) has been initiated since 1991, in which imports and the exchange rates can only be supported through massive foreign investment, foreign borrowing,[82] and privatization of revenues to guarantee the macroeconomic stability.

IV. CONCLUDING REFLECTIONS

Mexico's import-substitution during the period of 1940-70 was characterized by protectionist rules. As the domestic and foreign financing resources necessary for continuation of import substitution diminished, restructuring of the economy began toward the mid-1970s. Mexico's earlier experience shows, not surprisingly, that economic growth by itself was not enough to eradicate poverty and build a productive infrastructure adequate for competing in the capitalist world market. The decades of the 1960s and 1970s saw an increasing tension between growth and external stability. Import substitution had only partially been attained in durable consumer, intermediate, and capital goods. This failure to produce capital goods domestically led to Mexico's continued dependency on their imports. The sudden shift to trade liberalization in the mid-1980s boosted consumer and intermediate goods imports, also increasing economic risk and uncertainty. Along with rapid growth in the maquiladora industry, the impact of the transition has so far been confined to TNC intra-industry and intrafirm trade with the US and to a few "grupos industriales."

As trade liberalization and the "disincorporation" of state activities have became the government's principal measures to promote economic growth during the 1980s, the transition toward a competitive industrial structure is proving difficult. Mexico's import substitution and subsequent export push had previously been advanced by strong state intervention that included massive subsidies and public investments. The sudden withdrawal of government activities is not only weakening Mexico's productive infrastructure but is also leaving an environment of uncertainty for domestic producers. The declining investment/GNP ratio since 1982 and the rising share of portfolio investments partly reflect this development. The government's support of the maquiladora industry further reflects its attempt to take advantage of

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[81] Whalen (1992) suggests that "Mr. Salinas's political faith is tied to the peso, and he will say and do almost anything before enduring the humiliation of a devaluation."

[82] Private and public sectors borrowed around $10 billion in the international capital markets in 1991, which is estimated to reach around $7 billion in 1992. In this sense, Mexico has borrowed and sold equity for more than $27 billion since 1988 (*Mexico Service*, 8 April 1992; Whalen 1992).

Mexico's last financing resource, cheap labor power. As the government, lacking a clear industrial strategy, increasingly relies on TNCs and "grupos industriales" to resuscitate the economy, the role of small and medium firms will likely be diminished in the neoliberal policy.

Undoubtedly, macroeconomic policies have achieved a certain degree of success during the 1980s. Inflation, fiscal deficit, and increasing economic growth rates since the late 1980s have adjusted adequately, and privatization and prospects of a NAFTA resulted in impressive foreign investments for 1989-1991. Furthermore, the Mexican government has succeeded in preventing social turmoil, unlike in other Latin American nations. However, economic and social costs have been high.

Mexico's "silent integration" to the North American market became known to the public in 1990. The conclusion of the Canada-US free trade agreement in 1989, consolidation of the European Common Market in 1992, and possible emergence of regional trade blocs with uncertain prospects of the GATT have left the Mexican government with virtually no options but to concentrate on the US market to continue its neoliberal policy. However, the NAFTA is likely to serve as a necessary but not as a sufficient condition for economic revitalization in Mexico.[83] The question still remains: could Mexico's development strategy rely solely on cheap labor and assembling operations with low value added and low wages?

Deterioration of Mexico's physical infrastructure, import explosion, and underemployment will likely persist at least in the short and medium term. The fragile development strategy proposed by the government and its identification with US interest may likely be questioned in the next years. Furthermore, to gain international competitiveness and to promote foreign investments the government may have to continue to resort to repressive labor policy, as it has done since 1986. Despite the government's ability to suppress the growing popular discontent during the 1980s, these policies, under the circumstances of an increasingly uneven distribution of income and deteriorating living conditions,[84] may eventually fuel social unrest and economic uncertainty. The adverse impact of a NAFTA on Mexican peasants could aggravate Mexico's employment situation. Finally, the lack of participation of Mexico's population, of its Congress and of the political parties in opposition, and of its civil society in general, could risk the political legitimacy of the accord.

Moreover, the emerging free trade agreement among the three North American countries could end up with limited possibilities for economic cooperation. Given the structural nature of

[83] INFORUM (1991) emphasizes that economic integration among countries has to be accompanied by complementary economic policies, as the Spanish and Greek experiences in the European Community show.

[84] According to the Centro de Análisis e Investigación Económica (1991), nine out of 10 Mexicans are born in poverty. In the period 1981-1987, the poor population increased from 32.1 to 41.2 millions, while 17 millions live under extreme poverty, concentrated in rural regions.

Mexico's balance of payments disequilibrium, long-run development of a NAFTA will be possible only if member states can agree to establish a common funding scheme to design exchange rate policies for settling the disparities among the members. An "only trade and investment" approach is unlikely to succeed even in the short run, as was the case of the Central American Common Market. The experience of Canada, even with its closer historical, economic and political linkages to the US, tells us that the initial results of a free trade agreement can be far from all positive. Increased imports and unemployment accompanied by uncertain economic and political environment might very well be the short- and medium-term outcome of such an agreement.

The significant level of international reserves recently acquired through the privatization program and FDI can help the government to tide over short-term macroeconomic adjustment with some ease. The Mexican government needs to formulate clear industrial policies, supported by these international reserves, instead of subsidizing importers through an overvalued exchange rate. If there is a NAFTA at all, the agenda for negotiations must include not only nontariff barriers and dispute settlements but also enforcement mechanisms to ensure compliance with regulations for a safe ecology and worker rights. For sustained development of the region as a whole, perhaps much broader and more comprehensive forms of integration, including labor immigration and the sharing of energy and other social costs in adjustment, would have to be negotiated: unless this is done, both the US and Canada may end up in the position of, as said in Mexico, "tapar el sol con el dedo" [covering the sun with your finger].

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