

WORKING PAPER

Regional Governance

Great Expectations: Mexico's Short-lived Convergence under NAFTA

CAROL WISE

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Working Paper No.15

January 2007

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* A revised version of this paper will appear as a chapter in the forthcoming volume by participants in the CIGI conference, *Global Governance and the Contours of Domestic Politics in the Americas*, Waterloo, ON, 3-5 November 2006.

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John English

Author Biography

Carol Wise is Associate Professor in the School of International Relations at the University of Southern California. Holding a PhD in political science from Columbia University, she specializes in political economy issues as they relate to the development process in Latin America. In 2005 Dr. Wise held the Fulbright Chair in North American Studies at Carleton University, Canada; a Fulbright-Hays Senior Faculty Award in the Department of International Relations and Political Science at the Universidad de las Americas in Puebla, Mexico; and, a Public Policy Scholarship in the Canada Institute at the Woodrow Wilson International Center for Scholars in Washington, DC.

Dr. Wise has authored numerous articles on Latin American political economy and has produced the following books: *Requiem or Revival? The Promise of North American Integration* (co-ed. Brookings, 2007); *Reinventing the State: Economic Strategy and Institutional Change in Peru* (University of Michigan Press, 2003); *Post-Stabilization Politics in Latin America* (co-ed. Brookings, 2003), *Exchange Rate Politics in Latin America* (co-ed. Brookings, 2000); and, *The Post-NAFTA Political Economy: Mexico and the Western Hemisphere* (ed., Penn State Press, 1998). She is currently completing a co-authored book on *The Politics of Economic Transformation in Mexico*.

Abstract

Upon Mexico's entry into the North American Free Trade Agreement (NAFTA), neo-classical trade theory assumed, first, that it had the greatest potential for higher rates of growth, productivity and overall welfare gains due to its relatively underdeveloped status; and second, that Mexico's adjustment to an integrated, liberal economy would be the most painful but also the most beneficial. It was envisioned that the blending of Mexico's endowment factors - cheap labour, natural resources, and proximity to the US market - with the abundant capital and advanced technology of Canada and the US would maximize on NAFTA's competitive potential over the long-term. However, these expectations have yet to fully materialize. This paper reviews the convergence/divergence debate with regard to NAFTA and Mexico, and analyzes the empirical data that have been used to tout both the benefits and the costs of asymmetrical integration. In light of the standstill in Mexico's per capita growth since 2001, this paper concludes with a critique of the potential role of NAFTA as a development tool and argues that the steep regional asymmetries call for a more proactive continental strategy.

1. Introduction

While it is estimated that around 230 sub-regional integration schemes have cropped up across Asia, Africa, the Middle East, and the Western Hemisphere since 1990,¹ this paper is concerned with one of the more unique features to have emerged within the current generation of regional trade agreements (RTAs): the sweeping elimination of economic barriers between the less developed countries and those of the developed country bloc. Ireland, Greece, Spain, and Portugal first made this leap when joining the European Economic Community (EEC) between 1973 and 1986, and Mexico, the focus of this analysis, later followed with its entry into the North American Free Trade Agreement (NAFTA) with Canada and the United States in January 1994.

By definition, these more recent North-South deals - all of which involve shorter liberalization timelines and much higher levels of asymmetry and heterogeneity - invoke a more development-oriented set of questions and concerns.² First, because today's underdeveloped RTA members are poorer than their European predecessors were at the time of accession. In the latter cases, all but Portugal registered at least double the levels of per capita income prior to joining the EEC/European Union (EU) than did Mexico on the eve of NAFTA.³ The EU, moreover, coupled mutual market access for these poorer entrants with development assistance, the free movement of labour within the EU bloc, and other measures meant to compensate for the steep

¹ World Bank, *Global Economic Prospects: Trade, Regionalism, and Development* (Washington, DC: World Bank, 2005), 30.

² Paolo Giordano et al, eds, *Asymmetries in Regional Integration and Local Development* (Washington, DC: Inter-American Development Bank, 2005).

³ Werner Baer and Larry Neal, "Introduction," *The Quarterly Review of Economics and Finance*, vol. 43, no. 5 (Winter 2003): 714.

asymmetries at hand.⁴ Not so under NAFTA, which means that any bridging of the huge gap between Mexico and its NAFTA partners, or for that matter between the US and any number of its newest RTA partners (e.g., the Central Andean or Central American blocs), has fallen to market forces.

Second, along with the *laissez-faire* ethos that has underpinned this latest wave of North-South integration, the accompanying discourse both within Mexico and between the three NAFTA partners raised great expectations for rapid development gains. From the start, neo-classical theories of trade and growth held sway, arguing that a country like Mexico - the least developed and most protected member of the RTA - would be expected to undergo a more painful adjustment, but would also reap disproportionate gains in the way of higher growth, productivity and overall welfare.⁵ In the short-run, it was expected that the elimination of barriers to the free flow of goods, capital, and services within the RTA would enable all three countries - but especially Mexico - to better capture the benefits of regionalism (scale economies related to greater specialization, increased technological capabilities, and a more rapid and efficient deployment of those endowment factors for which Mexico has a comparative advantage), and trigger a dynamic process of income convergence between the three members.⁶

⁴ For a full discussion of the differences between NAFTA and the EU see Robert Pastor, *Toward a North American Community: Lessons from the Old World to the New* (Washington, DC: Institute for International Economics, 2001).

⁵ For a good overview of these neo-classical assumptions see Timothy J. Kehoe, "Assessing the Economic Impact of North American Free Trade" in M. Delal Baer and Sidney Weintraub, eds, *The NAFTA Debate: Grappling with Unconventional Trade Issues* (Boulder, CO: Lynne Rienner Publishers, 1994), 3-29.

⁶ Jeffrey Sachs and Andrew Warner, "Economic Convergence and Economic Policies," *NBER Working Paper*, no. 5039 (February 1995); and, Sebastian Edwards, "Openness, Productivity and Growth: What Do We Really Know?" *Economic Journal*, vol. 108, no. 447 (March 1998): 383-89.

It was also envisioned that NAFTA's competitive potential in the long-run would rest in the dynamic blending of Mexico's abundant factors (natural resources, comparatively cheap labour, and proximity to the US market) with the abundance of capital, technology and know-how that Canada and the US brought to the table. Yet, from the start, there were doubters, both concerning NAFTA's impacts on labour and the environment, and with regard to the plausibility of this neo-classical economic scenario. For example, because Mexico had already unilaterally liberalized the bulk of its tariff lines prior to joining the General Agreement on Tariffs and Trade (GATT) in 1986, a slew of technical estimates prior to the approval of NAFTA cautioned that the overall impact of North American integration on Mexico would amount at most to 5-8 per cent of Mexico's "steady state" gross domestic product (GDP).⁷

Hindsight has thus borne out some of the earlier predictions, but not others. However, none of the forecasters fully captured the essence of what has come to pass: Mexico's short-lived surge under NAFTA and the uneven pattern of "convergence" between Mexico and its NAFTA partners, and within Mexico itself.⁸ Whether measured in absolute (growth) or relative (distribution) terms, or by comparing macro- versus micro-economic indicators, the expectations for higher sustainable growth and dynamic gains have yet to fully materialize. In particular, Mexico has struggled to compete effectively with China since its forceful entrance into US markets upon accession to the World Trade Organization (WTO) in 2001.⁹ Granted, theories of growth and development

⁷ These pre-NAFTA estimates are summarized in Aaron Tornell and Gerardo Esquivel, "The Political Economy of Mexico's Entry into NAFTA" in Takatoshi Ito and Anne O. Krueger, eds, *Regionalism versus Multilateral Trade Arrangements* (Chicago, IL: University of Chicago Press, 1997), 25-55.

⁸ Enrique Dussel Peters, *Polarizing Mexico: The Impact of Liberalization Strategy* (Boulder, CO: Lynne Rienner Publishers, 2000).

⁹ Enrique Dussel Peters, *Economic Opportunities and Challenges Posed by China for Mexico and Central America* (Bonn: German Development Institute, 2005).

have yet to fully come to grips with the rapid and remarkable ascendance of China in the world economy. Yet, many of these same theories held that Mexico, by virtue of its privileged access to the US market since 1994, should be able to hold its own against such incursions.

Despite a growing and dynamic literature that debates both the impetus and the obstacles to convergence, these insights take us just so far in explaining Mexico's inability to fully exploit its unique status as a member of NAFTA.¹⁰ What's missing is a broader political explanation, one that probes the interests, ideologies and choice of policies that have underpinned the process of North American integration from both a regional and a domestic standpoint. I begin here with a brief examination of the institutional design of NAFTA and note how the agreement itself intentionally overlooks Mexico's less economically advanced status and the steep asymmetries that distinguished it from the outset. The following section reviews the convergence/divergence debate with regard to NAFTA and Mexico, and analyzes the empirical data that have been used to tout both the benefits and the costs of asymmetrical integration. The final sections of the paper critique the potential role of NAFTA as a development tool, and argue that the steep asymmetries call for a more proactive regional strategy.

2. NAFTA in Perspective: Anglo-Saxon Regionalism

Although I began by noting some basic distinctions between NAFTA and the EU in terms of regional integration strategies, the prominence of the latter has weighed in on US integration

¹⁰ M. Ayhan Kose, Guy M. Meredith, and Christopher M. Towe, "How Has NAFTA Affected the Mexican Economy? Review and Evidence," *IMF Working Paper* (April 2004), Washington, DC: International Monetary Fund, Research Department and Western Hemisphere Department.

debates since the onset of the NAFTA negotiations in 1991. This is so in the sense that a majority bloc of US policymakers, legislators, and public opinion shapers have sought to define EU integration strategies in terms of how *not* to proceed. At least from the standpoint of Washington, the main areas of contention with the EU model concern the thick web of supranational institutions (or "Brussels bureaucracy") that govern political and economic integration in Europe, the equating of the EU's extensive harmonization and standardization measures with a misguided industrial policy, and the strong role that public policy has played in the provision of social and infrastructure funds to smooth the adjustment costs of EU entry for weaker members and regions.¹¹

Thus, while in principle NAFTA and the EU may embrace similar goals in the promotion of growth, productivity, and overall welfare gains, the shadow of the past has shaped markedly different policy choices. The EU approach to integration reflects the ideological and pragmatic concerns that gave rise to the European social welfare state in the wake of the Second World War;¹² in the US, historical preferences have similarly prevailed, but in favour of a laissez-faire integration strategy that casts responsibility for overall welfare in individualistic terms.¹³ At least in the Washington lexicon, the EU's supranational institutions overly impinge on state sovereignty, and public policy is too interventionist and solicitous of the less developed members of the EU.

¹¹ Pastor, *Toward a North American Community*, 28-39; and, Philippe C. Schmitter, "Neo-functionalism," in Antje Wiener and Thomas Dietz, eds., *European Integration Theory* (Oxford: Oxford University Press, 2004), 47.

¹² A comprehensive analysis of these distinctions can be found in Peter Hall and David Soskice, eds., *Varieties of Capitalism* (New York, NY: Oxford University Press, 2001).

¹³ Bernard Silberman, *Cages of Reason: The Rise of Rational States in France, Japan, the United States, and Great Britain* (Chicago, IL: University of Chicago Press, 1993).

To frame these differences in terms of the four-stage taxonomy used in the literature on regionalism,¹⁴ since 1957 the EEC/EU has evolved from a six-member free trade area (where barriers to trade in goods are eliminated but each member maintains independent tariffs with non-members); to a customs union (which sets a common external tariff on all trade between members and non-members); to a 27-member common market (which deepens the customs union by allowing for the free flow of labour and capital); to a full economic union where a majority of members share a common currency and seek to coordinate macro-economic policies. Within this scheme, NAFTA remains a free trade area in which the flow of goods, capital, and services has been liberalized over a 15-year time schedule. It is the dominant preference of US and Canadian policymakers, as well as vested interests in North America, which this arrangement remains at the level of a free trade area that warrants the label 'Anglo-Saxon regionalism.'¹⁵

Other features of NAFTA further justify this classification, including the primarily private sector impetus for its negotiation and the anti-institutional biases inherent in the agreement. On the role of the private sector in lobbying for NAFTA, Kerry Chase argues convincingly that it was the high pre-existing levels of intra-industry trade and production sharing across borders in intermediate goods, as well as the possibilities for exploiting economies of scale, that prompted producers in NAFTA's key sectors (autos, computers, office equipment, electronics, machinery and parts) to push for regional liberalization; "Because barriers to regional trade and investment restrict opportunities

¹⁴ Jeffrey A. Frankel, Ernesto Stein, and Shang-Jin Wei, *Regional Trading Blocs in the World Economic System* (Washington, DC: Institute for International Economics, 1997), and, World Bank, *Global Economic Prospects*, 28.

¹⁵ Also see Stephanie Golob, "Beyond the Policy Frontier: Canada, Mexico, and the Ideological Origins of NAFTA," *World Politics*, vol. 55, no. 3 (April 2003): 361-98.

to take advantage of differences between countries in wages, skills, or capital costs, firms seek regional arrangements if they can redeploy intermediate production between labor-rich and labor-scarce areas."¹⁶ With Mexico and Canada accounting for 60.5 per cent of US intra-firm trade in 1989, regional liberalization clearly offered producers the opportunity to reduce manufacturing costs and realize higher profit margins.

Because each of the three members maintained its own independent trade relationship with non-members, NAFTA included detailed rules of origin in key sectors to prevent imports from third countries from entering the free trade area through the member country with the lowest tariffs. To deter outsiders from free riding, the 'Big Three' North American auto producers, blue chip computer companies such as Hewlett-Packard and IBM, and the leading textile firms, among others, sought and won guarantees that competitors from Asia and the EU, in particular, would contribute to their own restructuring costs by paying North American content duties as high as 62.5 per cent. Under the GATT/WTO, these stiff entry requirements in the form of rules of origin are permitted conditionally within RTAs, but not at the multilateral level.

None of these explanatory factors takes away from the well-told narrative that has developed with regard to the choice and design of NAFTA. As this parallel story goes, all three countries

¹⁶ Kerry Chase, "Economic Interests and Regional Trading Arrangements," *International Organization*, vol. 57, no. 1 (Winter 2003): 141. This argument was developed earlier by Paul Krugman, "Intra-Industry Specialization and the Gains from Trade," *Journal of Political Economy*, vol. 89, no. 5 (1981): 959-73; Gene Grossman and Elhanan Helpman, "The Politics of Free-Trade Agreements," *American Economic Review*, vol. 85, no. 4 (September 1995): 667-90; and Helen Milner, "Industries, Governments, and Regional Trade Blocs" in Edward Mansfield and Helen Milner, eds, *The Political Economy of Regionalism* (New York, NY: Columbia University Press, 1997), 77-106.

were reeling from the global economic shocks of the 1970s and the international recession of the early 1980s. As noted above, bilateral trade and cross-border production with US companies was of increasing importance for both Canada and Mexico, although one main US response to the rising debts and deficits of the mid-1980s was an increase in protectionism. Of necessity, Canada and Mexico had each begun a gradual process of economic liberalization and macro-economic restructuring to address the cumulative shortcomings of decades of high protectionism, but these respective reform strategies could only be "locked-in" domestically via secure access to US markets.¹⁷ As the Uruguay Round negotiations were clearly lagging, US policymakers conceded, first, to negotiate a bilateral Canada-US Free Trade Agreement (CUSFTA) implemented in 1989, and then the trilateral NAFTA launched in 1994.

Apart from offering its own brand of protectionism-cum-industrial policy (i.e. the breathing room afforded to cross-border producers in North America as they restructured behind high content rules), NAFTA also facilitated certain liberalization inroads that had been heretofore blocked in the multilateral arena. Such was the case with the liberalization of services and investment, provisions for strengthening intellectual property rights, and the design of dispute settlement mechanisms for trade and investment conflicts. From the US viewpoint, the creation of dispute settlement mechanisms and a rotating NAFTA secretariat sufficed in terms of an institutional foundation for NAFTA. Given the huge disparities within North America, both Canada and Mexico correctly perceived

¹⁷ See, for example, Carol Wise, "Introduction: NAFTA, Mexico, and the Western Hemisphere," in Carol Wise, ed., *The Post-NAFTA Political Economy* (University Park, PA: The Pennsylvania State University Press, 1998), 1-37; Pastor, *Toward a North American Community*, 23-25; and, Gary Hufbauer and Jeffrey Schott, *NAFTA Revisited* (Washington, DC: Institute for International Economics, 2005), 1-8.

that the design of supranational institutions would require each to concede sovereignty to the US in ways that reached beyond their respective political comfort zones. Thus, all three countries colluded in favour of a minimalist institutional framework.¹⁸

In the interim between the completion of the NAFTA negotiations by the outgoing Bush administration in 1992 and the inauguration of the Clinton administration in January 1993, grass roots opposition to this minimalist institutional approach swelled in the US. Domestic civic constituencies demanded additional institutional guarantees in terms of environmental protection and labour rights as a quid pro quo for their support of the proposed agreement. Civil society was highly successful in politicizing the debate over NAFTA and thereby winning institutional concessions in the form of side agreements for labour and the environment, and the creation of a new North American Development Bank (NADBank). Unfortunately, the resulting institutions - the North American Commissions on Labor Cooperation and on Environmental Cooperation and the NADBank - "were left with such minimal mandates and meager funding that they barely meet original expectations."¹⁹

Through a kind of *ad hoc* intergovernmental consensus, ruling elites in all three countries have certainly avoided the programmatic redundancy and bureaucratic creep that also characterizes the EU. However, the adamancy against institutionalizing NAFTA has been such that there is no central headquarters or tri-national staff to coordinate the work of the NAFTA secretariat. Dispute settlement procedures are thus decentralized and panel members are chosen

¹⁸ Louis Bélanger, "An Unsustainable Institutional Design: Incompleteness and Delegation Deficit in NAFTA," Paper presented at the conference NAFTA and the Future of Trade Governance, Woodrow Wilson International Center for Scholars, Washington, DC, March 13, 2006.

¹⁹ Hufbauer and Schott, *NAFTA Revisited*, 62.

on a revolving basis. At most, the labour and environmental side agreements obligate each member to uphold and implement their own national laws, and play mainly a consultative role in this process. As the following section will argue, this insistence that NAFTA remain a free trade area in the absence of sound institutional moorings has limited its success to the narrow parameters by which it has been defined.

3. Convergence/Divergence: The Debate and the Data

The tenth anniversary of NAFTA in 2004 was met with a spate of assessments, most of which judged its success or failure according to the growth of intra-bloc trade and investment flows, the net employment effects on each member country, and the accompanying distributional impacts.²⁰ In brief, these analyses found that total intra-bloc merchandise trade had grown by more than 200 per cent and that the stock of FDI in Mexico had increased five-fold from its pre-NAFTA levels.²¹ On the downside, labour markets and wage trends had turned increasingly volatile and distribution had somewhat worsened across North America. Perhaps most troubling was the World Bank's finding that Mexico's "FDI performance in the post-NAFTA period was not significantly above the Latin America norm;"²² neither were its aggregate or per capita growth rates.

²⁰ See, for example, John Audley, et al, *NAFTA's Promise and Reality* (Washington, DC: Carnegie Endowment for International Peace, 2003); Hufbauer and Schott, *NAFTA Revisited*; Daniel Lederman, William F. Mahoney and Luis Servén, *Lessons from NAFTA for Latin America and the Caribbean* (Palo Alto, CA and Washington, DC: Stanford University Press and the World Bank, 2005); Miguel D. Ramirez, "Mexico under NAFTA: A Critical Assessment," *The Quarterly Review of Economics and Finance*, vol. 43, no. 5 (December 2003): 863-92; and, Sidney Weintraub, "Trade, Investment, and Economic Growth" in Sidney Weintraub, ed., *NAFTA's Impact on North America* (Washington, DC: Center for Strategic and International Studies, 2004), 3-20.

²¹ Hufbauer and Schott, *NAFTA Revisited*, 22-36.

²² Lederman, Mahoney and Servén, *Lessons from NAFTA*, 18.

When analyzed from these vantage points, NAFTA's reviews ranged from deleterious to mildly favourable.²³

The continued lack of enthusiasm or consensus over NAFTA's purpose and impacts reflects the gulf between the wishful theoretical thinking and the concrete empirical asymmetries that underpinned its launching back in the early 1990s. As the guiding principle for North American integration, neo-classical theory assumed a state of perfect competition and constant returns to scale under an RTA such as NAFTA. As mentioned earlier, it was expected that over time the elimination of barriers to the free flow of goods, capital, and services within the RTA would enable all three countries - but especially Mexico - to better capture the benefits of regionalism (scale economies related to greater specialization, increased technological capabilities, and a more rapid and efficient deployment of those endowment factors for which Mexico has a comparative advantage), and trigger a dynamic process of income convergence between the three members.²⁴

The fact that NAFTA has yet to measure up to this scenario of buoyant dynamism and steady convergence between the three countries in many respects vindicates the earlier doubters of neo-classical trade theory,²⁵ who are still quick to note the impediments to realizing these conventional assumptions. The obstacles would include, for example, the institutional weaknesses, deeply

²³ On the deleterious side see Audley et al, *NAFTA's Promise and Reality*; and Jeff Faux, *The Global Class War* (New York: Wiley, 2006); for a more favourable assessment see the essays in Weintraub, ed., *NAFTA's Impact on North America*.

²⁴ Sachs and Warner, "Economic Convergence"; and, Edwards, "Openness, Productivity and Growth."







²⁵ Paul Mosley, "Globalisation, Economic Policy, and Convergence," *World Economy*, vol. 23, no. 5 (May 2000): 613-34; Marcus Noland, "Chasing Phantoms: The Political Economy of USTR," *International Organization*, vol. 51, no. 3 (Summer 1997): 365-87; and, Robert Wade, "Is Globalization Reducing Poverty and Inequality?" *World Development*, vol. 32, no. 4 (April 2004): 567-89.

engrained barriers to competition, and sizeable skill and technology deficits that typically characterize a developing economy like Mexico's. Yet even Canada, with its leg-up as a G8 country, has lagged in this regard. For example, although Canadian income distribution is the most equitable in North America, Canada's purchasing power per capita remains about 74 per cent of that of the US and productivity and investment ratios are similarly trailing.

The data do lend equivocal support to the champions of neo-classical analysis in that both Canada and Mexico have converged toward the more highly developed US standard in terms of broad macro-economic performance - inflation, interest rates, aggregate growth, and exchange rate stability - even if the micro-economic track record has been uneven. This micro-economic point is driven home in Table 1, which shows a respectable upward convergence of GDP growth rates between the three NAFTA countries, but a troubling lag in the rise of per capita incomes. After doubling its per capita growth performance between 1995 and 2000, the rise of real income in Mexico has hit a virtual plateau. And, while Mexico's average aggregate growth rate of 2-3 per cent during the NAFTA era is respectable and in step with Canada and the US, this is well below the average growth rate for other Latin American emerging markets like Argentina, Chile, and Peru.

The indisputable successes in the macro-economic realm include Mexico's ability to radically reduce inflation and interest rates to levels already achieved by Canada and the US. As Tables 2 and 3 show, both of these indicators are now running in the single-digit range, after a prolonged period of double-digit inflation and high interest rates following the country's 1994 financial meltdown. Given Canada's tighter pre-existing pattern of integration with the US and its G8 status at the outset of NAFTA, its macro-economic performance has been even more impressive. While some of Canada's uninterrupted growth has

Table 1.

| Year | Annual Percent Growth of GDP | | | GDP per capita, U.S. Dollars | | |
|------|---|---|---|---|---|---|
| |  |  |  |  |  |  |
| 1980 | (0.2) | 1.3 | 9.2 | 21,000 | 16,539 | 3,282 |
| 1990 | 1.7 | 0.2 | 5.1 | 26,141 | 19,229 | 3,187 |
| 1995 | 2.7 | 2.8 | (6.2) | 27,404 | 20,117 | 2,637 |
| 1997 | 4.5 | 4.2 | 6.8 | 30,096 | 21,287 | 4,165 |
| 1998 | 4.3 | 4.1 | 5.0 | 31,357 | 20,402 | 4,068 |
| 1999 | 4.1 | 5.5 | 3.6 | 32,870 | 21,677 | 4,958 |
| 2000 | 4.2 | 4.6 | 6.6 | 34,445 | 23,537 | 5,799 |
| 2001 | 0.3 | 1.5 | (0.3) | 35,163 | 23,048 | 6,326 |
| 2002 | 3.5 | 4.3 | 0.7 | 36,033 | 23,535 | 5,956 |
| 2003 | 4.9 | 5.2 | 1.3 | 37,423 | 27,403 | 5,878 |
| 2004 | 0.7 | 6.5 | 4.4 | 39,722 | 31,030 | 6,478 |
| 2005 | 3.6 | 3.0 | 3.0 | | | |

Source: International Financial Statistics (IFS), Washington, D.C.

been due to the luck of high commodity prices since 2001, it is also policy-induced.

As the country's longstanding mercantilist policies had virtually imploded by the late 1980s, Canadian policymakers met the challenge of heightened competition from the US market by executing major fiscal cuts and deep structural reforms through the 1990s. Although these bold moves were politically anathema to most Canadians at the time, they have paid off in spades. Since 1997 Canada has been the fastest growing G8 economy, registering a fiscal surplus for seven consecutive years; net public debt has been reduced by nearly 30 per cent of GDP and the public pension and healthcare systems are on sound fiscal footing.

The current gap between Canada's sound macro performance and its less dynamic micro returns is reflected in Table 4, where Canada continues to fall behind the US on all five of the competitiveness indicators listed in the table. A 2005 report from the Government of Ontario-funded Institute for Competitiveness & Prosperity notes some complacency in this respect, stating that Canadians have simply not been "as successful as their US counterparts in creating value from our labor, intellectual, physical, and natural resources."²⁶ The tackling of this tenacious gap (i.e.,

Table 2. Inflation: Changes in Consumer Prices

| Year |  |  |  |
|------|---|---|---|
| 1995 | 2.81 | 2.17 | 35.00 |
| 1996 | 2.93 | 1.58 | 34.38 |
| 1997 | 2.34 | 1.62 | 20.63 |
| 1998 | 1.55 | 0.99 | 15.93 |
| 1999 | 2.19 | 1.72 | 16.59 |
| 2000 | 3.38 | 2.75 | 9.50 |
| 2001 | 2.83 | 2.53 | 6.36 |
| 2002 | 1.59 | 2.25 | 5.03 |
| 2003 | 2.27 | 2.77 | 4.55 |
| 2004 | 2.68 | 1.83 | 4.69 |

Source: International Financial Statistics (IFS), Washington, D.C.




Table 3. Interest Rates (Percentage)

| Year |  |  |  |
|------|---|---|---|
| 1993 | 6.00 | 4.11 | 22.04 |
| 1994 | 7.14 | 7.43 | 20.38 |
| 1995 | 8.83 | 5.79 | 59.43 |
| 1996 | 8.27 | 3.25 | 36.39 |
| 1997 | 8.44 | 4.50 | 22.14 |
| 1998 | 8.35 | 5.25 | 26.36 |
| 1999 | 7.99 | 5.00 | 23.74 |
| 2000 | 9.23 | 6.00 | 16.93 |
| 2001 | 6.92 | 2.50 | 12.80 |
| 2002 | 4.68 | 3.00 | 8.20 |
| 2003 | 4.12 | 3.00 | 6.91 |
| 2004 | 4.33 | 2.75 | 7.22 |
| 2005 | 6.18 | 3.50 | 9.90 |

Source: International Financial Statistics (IFS), Washington, D.C.

²⁶ Roger L. Martin, "Foreword and Acknowledgements," in Institute for Competitiveness & Prosperity, *Realizing Canada's Prosperity Potential*, Report presented at the 2005 Annual Meeting of the World Economic Forum, Davos, Switzerland, January 2005, 5.

Table 4. Competitive Inroads

| | |  |  |  |
|----------------------------|------|---|---|---|
| High Tech Exports % GDP | 1990 | 33% | 13% | 8.2% |
| | 2000 | 33% | 18.6% | 22% |
| R&D % GDP | 1996 | 2.5% | 1.7% | 0.3% |
| | 2001 | 2.8% | 2.1% | 0.3% |
| Patents Granted | 1999 | 153,487 | 13,778 | 3,899 |
| | 2000 | 157,496 | 12,125 | 5,519 |
| | 2001 | 166,038 | 12,019 | 5,479 |
| Internet users per 1,000 | 1994 | 49 | 25 | 0.4 |
| | 2001 | 551 | 512 | 36 |
| Productivity (output/hour) | 1994 | 100 | 100 | 100 |
| Index 1990=100 | 2001 | 146.1 | 124.2 | 177.8 |

Sources: World Trade Organization (WTO), Geneva, Switzerland;
International Labor Organization (ILO), Geneva, Switzerland.



tax incentives that spur rather than deter investment; increased ties between research and development [R&D], universities, and private initiative; and the application of more advanced technology to the production of goods) emerged as one of the policy commitments made by the winning conservative candidate, Stephen Harper, in Canada's January 2006 federal election.

A main puzzle here concerns Mexico's micro-economic progress in Table 4, which is notable, although the inroads recorded defy the rapid trend toward its displacement by China in the US market as reflected in Tables 5 and 6. As Table 4 shows, the proportion of high-tech exports as a percentage of GDP nearly tripled for Mexico, outpacing Canada's improvement, and with no change at all on this count for the US. The number of patents granted to Mexico increased at a faster rate than did those of

the US, while Canadian patents actually decreased. Moreover, Mexican productivity easily out-gained both the US and Canada in the post-NAFTA years. While Mexico trailed in the growth rate of internet users and the ratio of R&D to GDP, this too supports the assumptions of neo-classical trade theory: Mexico did better at increasing productivity than increasing R&D because its comparative advantage is in labour, not science, and not in the capital required for fast internet expansion.

As estimated by Daniel Lederman and his colleagues at the World Bank's Latin America and Caribbean Division, "Mexico's global exports would have been about 50 per cent lower and foreign direct investment (FDI) would have been about 40 per cent less without NAFTA. Also, the amount of time required for

Table 5: Exports to U.S.

| (US dollars) | | | | |
|--------------|---|---------|---|---------|
| |  | |  | |
| Year | Total \$ | %Change | Total \$ | %Change |
| 1995 | 45,555,431,841 | 17.5% | 61,704,998,446 | 24.7% |
| 1996 | 51,495,276,148 | 13.0% | 72,963,189,408 | 18.2% |
| 1997 | 62,551,934,280 | 21.5% | 85,872,344,740 | 17.7% |
| 1998 | 71,155,860,423 | 13.8% | 94,708,666,043 | 10.3% |
| 1999 | 81,785,929,599 | 14.9% | 109,706,486,039 | 15.8% |
| 2000 | 100,062,958,084 | 22.3% | 135,910,533,679 | 23.9% |
| 2001 | 102,280,483,580 | 2.2% | 131,432,956,779 | -3.3% |
| 2002 | 125,167,885,954 | 22.4% | 134,732,185,087 | 2.5% |
| 2003 | 152,379,235,541 | 21.7% | 138,073,296,952 | 2.5% |
| 2004 | 196,698,977,367 | 29.1% | 155,843,010,915 | 12.9% |

Sources: World Trade Organization (WTO), Geneva, Switzerland;
International Labor Organization (ILO), Geneva, Switzerland.

Table 6: U.S. Imports from Mexico vis-à-vis China (top 10 Commodities)

| |  2004  | |
|------|--|-----------------------------------|
| Rank | Commodities* | \$ Total % of Total |
| 1 | 85 – Electric Machinery, etc.; Sound Equip; TV Equip; Parts | 37,407,929,040 24.00% |
| 2 | 87 – Vehicles; except Railways or Tramway; and Parts, etc. | 26,143,233,067 16.78% |
| 3 | 84 – Nuclear Reactors; Boilers; Machinery, etc.; Parts | 20,035,665,705 12.86% |
| 4 | 27 – Mineral Fuel; Oil, etc.; Bitumen Subst.; Mineral Wax | 713,990,841 12.65% |
| 5 | 90 – Optic; Photo, etc.; Medic or Surgical Instruments, etc. | 6,040,570,961 3.88% |
| 6 | 94 – Furniture; Bedding, etc.; Lamps Nesoi, etc.; Prefab Bd | 5,146,712,865 3.30% |
| 7 | 98 – Special Classification Provisions; Nesoi | 4,681,261,978 3.00% |
| 8 | 62 – Apparel Articles and Accessories; not Knit, etc. | 4,137,043,077 2.65% |
| 9 | 61 – Apparel Articles and Accessories; Knit or Crochet | 2,708,184,889 1.74% |
| 10 | 07 – Edible Vegetables and Certain Roots and Tubers | 2,400,584,578 1.54% |
| | All other | 27,427,833,914 17.60% |
| | Total | 155,843,010,915 100.00% |

*Lines 1,3,6,8,9, are bolded to represent those sectors where Chinese exports to the U.S. are now outpacing those of Mexico.

Source: International Trade Administration (ITA), TradeStats. Washington, D.C.

Mexican manufacturers to adopt US technological innovations was cut in half...NAFTA made Mexico richer by about 4 per cent of its gross domestic product (GDP) per capita."²⁷ Mexico, moreover, has leveraged its NAFTA membership to effectively shift away from a heavy dependence on oil exports and toward a more diversified mix of higher value-added goods. In light of these gains, what accounts for the bottleneck in Mexico's growth rate of both aggregate and per capita GDP? How is it that China has so readily cut into Mexico's supposed long-touted advantage

²⁷ Lederman, Mahoney and Servén, *Lessons from NAFTA*, 2.

in the US market? And, why would nearly half of the electorate support a presidential candidate in 2006 that vowed to backtrack on many of the country's commitments to a NAFTA-style development model?

4. Mexico: The Politics of Divergence

Back in the early 1990s, the eagerness of Mexican policy-makers to close the NAFTA deal was such that former President Carlos Salinas vowed to forgo Mexico's developing country status at the NAFTA negotiating table. While a similar elite-level decision would have been unthinkable in more democratic polities like those of Argentina or Brazil, in Mexico the peculiarities of hegemonic single-party politics basically rendered the country's entry into NAFTA a *fait accompli*. At the same time, the US made it clear from the start that this North American project would remain distinct from the EU; a free trade agreement that had no aspirations toward the creation of a fully integrated political and economic union. True to its Anglo-Saxon roots, the goal set for NAFTA was mainly an economic one, this in itself a political decision that was cast in apolitical terms by executive leaders in all three countries.

Thus, according to these minimalist criteria of trade and investment expansion, NAFTA clearly measures up to the narrow standards imposed by its creators. In short, although Mexico may arguably have been worse off had it not joined NAFTA, counterfactual analysis (i.e. comparisons of Mexico with other Latin American emerging markets that did not join NAFTA), and the post-2000 growth trap that appears in Table 1 suggest a pattern of underperformance. Or, to put this differently, although impressive in and of themselves, Mexico's competitive inroads displayed in Table 4 have still not been buoyant enough to trigger the kind of development leap envisioned by NAFTA's architects.

NAFTA's critics have been quick to lay blame on the agreement itself,²⁸ but Mexico's own reform record suggests that the roots of divergence lie just as much in the frailties of domestic politics, institutions and policymaking.

The remainder of this section focuses on three main factors that have contributed to Mexico's underperformance within NAFTA: the use of an RTA as a tool to lock in incipient market reforms without prior adequate preparation; the unexpected difficulties of managing economic liberalization in the context of a hegemonic single-party system; and, a miscalculation concerning the benefits to be gained from Mexico's close geographic proximity to the US market.

The limits to Mexico's liberalization-cum-integration approach. In contrast to the reform preparation and adjustment assistance afforded to less developed entrants into the EU prior to their accession, Mexico's own market restructuring program was still gathering steam when NAFTA was launched in 1994. As the country's political and economic elite seized NAFTA entry as a way to permanently lock-in a liberal development strategy, the risks inherent in this liberalization-cum-integration approach were quickly made evident by the December 1994 peso crash. While clearly a well-told story, it would be difficult to exaggerate the adverse effects of this financial crisis over the longer-term.²⁹ To this day, the distributional fall-out and lingering risk adversity have partially deterred Mexico from achieving the higher growth,

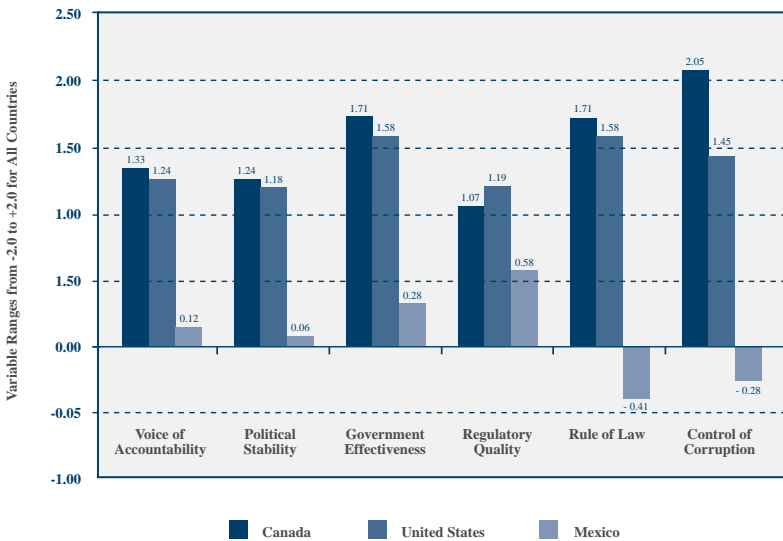
²⁸ Audley et al, *NAFTA's Promise and Reality*.

²⁹ The economic team at that time had closely pegged the peso to the US dollar as a main way to combat inflation; however, the simultaneous opening of the trade and capital accounts in the late 1980s, and a massive inward flow of US portfolio investment attracted by Mexico's higher interest rates (see Table 3), had placed upward pressure on the exchange rate. Investors fled, as Mexico's economic fundamentals in late 1994 indicated an inevitable need for a sizeable downward adjustment in the peso.

and per capita gains that have pushed EU developers like Ireland and Spain closer to the front of the global pack.

As Tables 2 and 3 show, it has taken Mexico nearly a decade since the peso debacle to stabilize inflation and join step with its NAFTA partners in terms of macro-economic performance. This long-fought victory has not come cheaply, as it has tied policymakers to a tight monetary and fiscal regime that works directly against job creation and improvements in per capita growth.³⁰ The battle for macro-economic stability has also

Table 7: Mexico's Institutional Gap with Respect to Canada and the U.S.



Source: Daniel Lederman, William F. Maloney, and Luis Servén, *Lessons from NAFTA* (Washington, DC and Palo Alto, CA: World Bank and Stanford University Press, 2005), 41.

³⁰ Celso Garrido, "Mexico's Financial System and Economic Development," in Kevin Middlebrook and Eduardo Zepeda, eds, *Confronting Development* (Palo Alto, CA: Stanford University Press, 2003), 89-122.

distracted resources and policymaking talent away from the pressing competitive tasks that stand out in Table 7, including the kinds of institutional modernization that will be required to support a meaningful competition policy. However, despite the real or imagined confines of Anglo-Saxon regionalism and its simplistic penchant for *laissez-faire*, nothing in this doctrine has stood in the way of those institutional reforms needed to better complement and bolster Mexico's gains from NAFTA. Rather, the country's growth bottleneck appears to be home grown, and deeply engrained in domestic politics.

Divided government and the reform backlog. For Mexico, NAFTA entry catalyzed a long overdue process of political liberalization that culminated in 2000 in the first opposition presidential victory that the country had seen since the installation of the heavy-handed Institutional Revolutionary Party (PRI) back in 1929. When elected to the presidency in 2000, National Action Party (PAN) candidate Vicente Fox inherited a formidable list of reform tasks, but also a democratic dividend that seemed to promise high levels of political support for tackling the reform agenda. At the top of this list was the dire need for: energy sector modernization and improvement of the country's transportation and communications infrastructure; a fiscal restructuring to raise tax revenues as a per cent of GDP; technical support and credit for those small and medium-sized firms that provide the bulk of Mexican employment; greater labour market mobility; and a deepening and expansion of human capital investments in education and health.

Candidate Fox had aptly identified this cluster of reform tasks as the prime source of sluggish growth, lagging international competitiveness, and wage stagnation, and he had vowed to address these challenges accordingly. Unfortunately, the country's

much acclaimed 2000 democratic transition fell short of a cohesive majority coalition to usher Fox's reform agenda through the legislature, the result being that the executive was immobilized early on. Those PRI technocrats responsible for negotiating Mexico's entry into NAFTA some fifteen years ago were no doubt looking to lock in single-party hegemony along with the new liberal economic model;³¹ however, the subsequent interaction between political and economic liberalization in Mexico has been anything but static, and the failure of the President's party to capture a majority bloc in the legislature was just one of several indicators in terms of Mexico's dramatic political transformation in the NAFTA era.

With the advent of minority government, there has been a concomitant shift from a seemingly omnipotent executive to a weakening presidency and from a hegemonic party system to a multiparty and increasingly fractionalized one. The Mexican Congress, moreover, has evolved from a mere rubber stamp to a more independent and active legislative body. This heightened party competition and congressional coming of age has greatly diminished the Mexican executive's constitutional authority over the legislative process. In other words, gone are the days of strictly elite-level consultation and autocratic implementation of major economic initiatives, including something as fundamental as the country's entry into NAFTA.

This situation, while effectively thwarting Fox's reform agenda, need not prove fatal in itself. But it does mean "that future presidents will have to be very effective coalition builders

³¹ Maxwell Cameron and Carol Wise, "The Political Impact of NAFTA on Mexico: Reflections on the Political Economy of Democratization," *Canadian Journal of Political Science*, vol. 37, no. 2 (June 2004): 301-23.

given the country's institutional tendencies toward separation of purpose and the dearth of legislative powers."³² This point has become increasingly important for Mexico, as minority governments could prevail indefinitely given the similar outcome in the 2006 presidential elections.

Recent research suggests that the difference in legislative success rates for executives operating within presidential systems under the constraints of minority government over the post-Second World War period were not all that different from those who led majority governments: a 61 per cent success rate for the former, versus a 72 per cent success rate for the latter.³³ But this spectre of indefinite minority government in Mexico has placed a steep premium on the skills of statecraft: the executive's ability to negotiate, compromise, build alliances, and forge majority coalitions that can advance the reform agenda.

On this count, the Fox administration folded like a bad suit, and the resulting reform delays are readily reflected in Table 7. The challenge for Mexico will be to break out of the costly collective action gridlock that held policymakers hostage for Fox's entire six-year term, to further modernize the country's political and economic institutions, and to orchestrate a more integrated proactive strategy that links the various macro- and micro-economic variables discussed here in ways that directly tap the country's full competitive potential. Earlier on, PRI technocrats held up NAFTA membership as a shortcut of sorts for achieving

³² Matthew Shugart and Stephan Haggard, "Institutions and Public Policy in Presidential Systems," in Stephan Haggard and Mathew D. McCubbins, eds, *Presidents, Parliaments, and Policy* (Cambridge: Cambridge University Press, 2001), 99.

³³ This unpublished study was conducted by Sebastian Saiegh at New York University's Department of Political Science and cited in Gerardo Munck, "Democratic Politics in Latin America: New Debates and Research Frontiers," *Annual Review of Political Science*, no. 7 (2004): 443.

these goals. Now, the electorate and those politicians and policy-makers who represent it, still face many of the same reform tasks that awaited them at the outset of NAFTA.³⁴ The lesson: privileged access to the US market cannot substitute for the kinds of deep structural reform that Mexico still requires in order to fully compete and prosper from an RTA.

The chimera of geographical advantage. Certainly there were doubters within the Mexican business community that questioned their own ability to survive the prospect of heightened competition from US and Canadian imports under an RTA. Yet, NAFTA's architects were able to quell these fears by holding up Mexico's enviable geographical advantages - its proximity to the US market and incredibly rich factors of endowment - as the country's sure bet for success. Even today, when faced with solid evidence that the combined effects of trade integration and geographical proximity have failed to high sustainable growth, prominent business representatives in Mexico continue to express hope that geography will pay off once the country's pending list of structural reforms is completed.³⁵

This wishful thinking flies in the face of the historic gains that China has made in terms of per capita income growth and penetration of the US market - and in the absence of geographical advantages or the kinds of privileged access that Mexico has enjoyed for more than a decade under NAFTA. Again, Tables 5 and 6 show some of the gains that China that has made at Mexico's expense, both in terms of the dollar amount of exports to the

³⁴ Manuel Pastor and Carol Wise, "The Lost *Sexenio*: Vicente Fox and the 'New' Politics of Economic Reform in Mexico," *Latin American Politics and Society*, vol. 47, no. 4 (Winter 2005): 135-60.

³⁵ This is the case, for example, with Luis Gutiérrez, President of Grupo Acción, which is the largest infrastructure provider to companies operating in Mexico's export processing zones. Author's interview, Mexico City, November 2005.

US and to the extent that China has outpaced Mexico in sectors once considered core to NAFTA. These include, for example, a broad range of machinery and parts, which accounted for nearly 23 per cent of US imports from China in 2004, versus just 3 per cent in 1990. The runner-up in 2004 was the category of electronics, including telecom, computer peripherals, and sound and television equipment, which accounted for some 20 per cent of Chinese exports to the US market, versus 13 per cent in 1990.

A first attempt at explaining China's rapid advances over Mexico would be to compare the broader mix of policies that underpins China's growing presence alongside Mexico in the US market: lower costs for utility inputs to industrial production; greater labour market mobility; more conducive tax incentives, and an education system that is turning out some 600,000 engineers and thousands of other qualified professionals each year.³⁶ But there is also a deeper institutional story to be told here, one that begins with the counter-productive role played by Mexico's political institutions, as discussed above. The recent literature on the economics of growth has probed the broader institutional sources of economic divergence within the international system,³⁷ and the more compelling arguments point toward the range of institutional measures in Table 7 as a more complete explanation for the drag on Mexican growth and international competitiveness.³⁸

³⁶ For an examination of China's outpacing of economic development in Latin America and the Caribbean, see Nicola Phillips, "Consequences of an Emerging China: Is Development Space Disappearing for Latin America and the Caribbean?" *CIGI Working Paper*, no. 14 (January 2007).

³⁷ Daron Acemoglu, Simon Johnson, and James Robinson, "Reversal of Fortune: Geography and Institutions in the Making of the Modern World," *Quarterly Journal of Economics*, vol. 117, no. 4 (November 2002): 1231-94; Dani Rodrik, A. Subramanian, and F. Trebbi, "Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development," *Journal of Economic Growth*, vol. 9, no. 2 (June 2004): 131-65; and, Dani Rodrik, ed., *In Search of Prosperity: Analytical Narratives on Economic Growth* (Princeton, NJ: Princeton University Press, 2003).

³⁸ Lederman, Mahoney and Servén, *Lessons from NAFTA*, 41-49.

Has China made more convincing progress on these politico-institutional variables? Perhaps not, but as Yingyi Qian argues, Chinese policymakers have pursued institutional reforms that directly address their designated economic goals - what he calls "transitional institutions," designed with an eye toward improving economic efficiency within the range of what's politically feasible.³⁹ Some examples include: dual-track reform, under which some prices have been liberalized at the margins but without entirely departing from the central planning model, and similar strategies involving private asset ownership with built-in incentives to dissuade the state from expropriating these assets. Although a far cry from the kinds of state-of-the-art practices that have been held up as a benchmark for emerging market reformers by the international financial institutions (IFIs), China's decidedly more heterodox approach to institutional reform has served it well.

Ironically, in the name of orthodoxy, and given the high ratio of political costs associated with the completion of the kinds of reforms mandated by the international financial institutions (IFIs) laid out in Table 7, Mexico has lost its way in achieving any sort of institutional reform at all. Insights from the literature on economic growth confirm that institutional innovation can help even the most geographically disadvantaged countries (i.e., Botswana, Chile, Mauritius) overcome this handicap and succeed in raising per capita GDP.⁴⁰ Thus, in the absence of institutional creativity, the supposed benefits of Mexico's proximity to the US market have proved ephemeral. Even under the most successful domestic reform scenario, Mexico will still require considerable

³⁹ Yingyi Qian, "How Reform Worked in China," in Rodrik, ed., *In Search of Prosperity*, 297-333. Also see Chaohua Wang, ed., *One China, Many Paths* (London: Verso, 2003); and, Minxin Pei, *China's Trapped Transition: The Limits of Developmental Autocracy* (Cambridge, MA: Harvard University Press, 2006).

⁴⁰ See, for example, Dani Rodrik, "Introduction," in Rodrik, ed., *In Search of Prosperity*, 1-19.

technological guidance and development assistance from its NAFTA partners to rise to this occasion. Given that the very design of NAFTA works against any such helping hand, Mexican policymakers are faced with the hard reality that they are basically on their own with regard to engineering a full-blown economic transformation.

5. NAFTA as a Development Tool?

The dilemma for an increasingly integrated North American political economy is that those markets at risk in Table 6 are not just Mexico's to lose. The North American auto sector is a pressing case in point, where tightly linked patterns of cross-border production and intra-firm trade have helped to retain regional market share in the face of rising Chinese competition, even though this sector still lacks an explicit continental strategy. Mexico, in particular, has yet to fully integrate its productive clusters in autos and transport equipment. Here, and even within the narrow confines of Anglo-Saxon regionalism, the kinds of "dual-track" endeavours identified by Yingyi Qian, such as measures that improve economic competitiveness without raising the usual political hackles, could help preserve North American market advantage. For starters, and this is just one of any number of examples, the three NAFTA governments could coordinate in the setting of much stricter fuel efficiency standards that would deter the production of gas-guzzling autos and sports utility vehicles, a move the Chinese government is now taking.

Would a dual-track approach help to whittle down the asymmetries that appear in Tables 1 and 4, or jump-start Mexico's domestic reform effort? Probably not, although some Chinese-style tinkering at the margins of the NAFTA model could perhaps slow the outflow of jobs and investments in those sectors that face displacement. Big-think policy debates have dominated in

this realm,⁴¹ for instance non-governmental proposals for the launching of a "NAFTA-plus" that updates the RTA in ways that more directly address the profound changes that have occurred since 1994 (i.e., security concerns related to the 9/11 attacks, China's formidable rise as a global trader, intense migratory pressures along the US-Mexico border). Yet, no one member government or cross-border coalition seems able or willing to put forth the political capital to lead such an endeavour.

In fact, despite the concrete demand for regional public goods - regulatory reform, regional infrastructure, a more orderly and humane immigration framework, and the design of cohesive policies to enhance competition - those vested interests in all three countries that originally lobbied for NAFTA have been remarkably disengaged. Thus, any impetus for change has taken the shape of a series of bi-lateral development accords over the past decade, including a security-oriented Smart Border Declaration between the US and Canada, the more development-based Mexico-US Partnership for Prosperity, and the Mexico-Canada Alliance.⁴² In its own way, each of these initiatives is meant to compensate for NAFTA's shortcomings. Recall that the initial justification for the negotiation of NAFTA was to lower transaction costs via the harmonization of regulatory standards and the regionalization of infrastructure networks; jobs, growth, and income gains were expected to increase across North America as a result of these synergies.

Yet, in the post-9/11 era, NAFTA's laissez-faire approach to lowering these barriers and capitalizing on these economies of

⁴¹ Council on Foreign Relations, *Building a North American Community*, Report of an Independent Task Force, no. 53 (New York, NY: Council on Foreign Relations, 2005), 6-8.

⁴² Marcela Celorio, "The North American 'Security and Prosperity Partnership': An Evaluation," *Working Paper*, Center for North American Studies (Washington, DC: American University, March 2006), 6-7.

scale has been exhausted. The explosion of intra-bloc trade has swamped regional transport systems, and this, along with heightened security concerns and divergent regulatory standards has lengthened, not shortened, delays at the border. Contrary to the vision of NAFTA as a magnet for job growth within Mexico, put forth originally by NAFTA's proponents, illicit labour flows from Mexico to the US job market have increased exponentially. The question thus remains as to how the original rationale for NAFTA - the realization of higher productivity gains and greater international market share based on the merging of Mexico's plentiful supply of cheap labour with the abundance of capital, technology and know-how on the part of Canada and the US - can be reinvigorated.

The most recent attempt to address these unpleasant realities was the creation of a Security and Prosperity Partnership of North America (SPP), announced in Waco, Texas, by the leaders of all three countries in March 2005. The SPP represents the first trilateral endeavour undertaken since the creation of the North American Environmental Cooperation Commission in 1993, and the first trilateral executive-level meeting since 2001. Of interest here is the 'prosperity' side of this venture, whereby trilateral working groups have been appointed to promote regional competitiveness across nine designated areas ranging from transportation to financial services to information and communication technologies.⁴³ But already SPP appears to be just more of the same: it mirrors rather than deepens NAFTA and offers no new institutional innovations or major commitment of funds with which to promote North American competitiveness.

⁴³ SPP report submitted to leaders by the Ministers and Secretaries of the Economic, Security, and Foreign Policy areas of Canada, Mexico, and the US, June 2005. Available Online; <http://www.spp.gov/report_to_leaders>.

A March 2006 follow-up SPP meeting held in Cancún, Mexico, did create a North American Competitiveness Council, which was assigned a private-public consultative role meant to bolster sectors most at risk (i.e., autos and transportation, steel, manufacturing, and services). However, this follow-up gesture similarly piles on tasks with no new organizational mechanisms or significant financial allotments for implementing them. The possibilities for enhancing North American competitiveness by reaching creatively across borders, and in ways that respect WTO guidelines, are immense. But in the NAFTA case, the specific menu of policy development tools is not the issue;⁴⁴ be it production-related grants to promote the cross-border clustering of small entrepreneurial companies, or any range of horizontal incentives to link regional firms in the realm of tax rebates, interest rate concessions or technology transfer, in North America the barriers to a competition policy proper are political and ideological.

In the end, then, SPP and all of the other above-mentioned initiatives are mainly window dressing for NAFTA - Canada and Mexico will continue to work bilaterally with the US on competitive measures and the facilitation of cross-border trade and investment, and each of the three members will continue to rely on its own domestic legal and institutional backdrop.⁴⁵ In this vein, some ad hoc advances have been made, most notably the lowering of rules of origin since 2003 for 15-20 product lines that account for around US\$20 billion in annual trilateral trade.⁴⁶ This matters for at least two reasons; first, because these content rules have slowed the flow of business to the extent that eligible

⁴⁴ Marcelo de Paiva Abreu, "Which 'Industrial Policies' are Meaningful for Latin America?" *SITI Working Paper*, no. 11 (Buenos Aires: IDB-INTAL, January 2006).

⁴⁵ Celorio, "The North American 'Security and Prosperity Partnership': An Evaluation," 8.

⁴⁶ Hufbauer and Schott, *NAFTA Revisited*, 60-61.

producers are willing to forgo their tariff exemptions in order to avoid further delays at the border; and second, they have deterred privileged sectors like autos and textiles from adapting to changing market conditions and done little to halt the loss of market share in North America, as demonstrated in Tables 5 and 6. A more plausible alternative to these content rules would be to establish a common import tariff at most-favoured-nation rates,⁴⁷ although this debate is nowhere in sight.

Hence, policy change within NAFTA is moving at a glacial pace, especially in light of the swiftness with which China is conquering key North American markets. Given China's cost advantages in North America, the most immediate task will be for Mexico to move further up the industrial learning curve into higher value-added activities that are at once more complementary and competitive with the lower-end market niches increasingly occupied by China. At a minimum, this would mean tackling the abysmal indicators on Mexican competitiveness that appear in Table 4. The problem is how to get from here to there, as all three NAFTA members continue to eschew the design of institutions to properly focus the integration process or an assistance fund to finance a truly trilateral competition policy. Within Mexico, important work on the country's competitive potential has been undertaken within select agencies that span the federal government, the Senate, academia, and the private sector, although little of these insights made it onto the campaign platform of the three major presidential candidates in 2006.

Certainly NAFTA could provide a forum for pursuing dual-track kinds of measures where the economic benefits would be expected to greatly outweigh the political costs; for example, in the modernization of border infrastructure and the harmonization of regulatory norms across the three countries. Even when the

⁴⁷ Council on Foreign Relations, "Building a North American Community," 35.

political costs are relatively high, as in the case of somehow coming to terms with volatile immigration pressures on the US-Mexico border, NAFTA should ostensibly be part of the solution. For some Washington policymakers, dual-track reforms will no doubt resonate too closely with the EU approach to integration; and, the use of NAFTA as a venue for immigration reform would clearly stoke longstanding fears about national sovereignty. But these worries skirt the main point, which is the urgent need to increase the provision of public goods under NAFTA and the viability of infusing just a tinge of heterodoxy into its otherwise orthodox parameters.

6. Conclusion

This paper offers up three main conclusions. The first concerns some insights on how NAFTA has differentially benefited Canada and Mexico, the so-called spokes to the US hub. Canada, obviously, enjoyed a more level playing field at the outset, and inductive analysis of its economic performance since entering into an RTA with the US confirms that G8 membership has been more conducive to convergence in GDP growth and per capita income gains. Despite the clear imperative for Canada to ramp up its efforts on the competitive front, this analysis also emphasized the ways in which Canada has used its privileged access to the US market as an opportunity to restructure the economy and to introduce sweeping changes to its historically mercantilist trade strategy. Mexico, in contrast, seized NAFTA membership as a way of locking in a new market-oriented reform model, one for which there has been insufficient preparation or follow-up. The data presented here hint at the one-shot nature of Mexico's gains under NAFTA, and confirm that since 2000 Mexico seems to have squandered its preferential access to the US market.

As tempting as it has been for policymakers in both Canada and Mexico to point the finger at the US (and at NAFTA itself)

as the main perpetrator of economic divergence in the region, a rich literature on economic growth seems to toss the roots of divergence back into the home court. To questionable avail, Mexico placed almost blind faith in neo-classical trade dictums and the power of geographical advantage to trigger higher sustainable growth and lift its population out of poverty. Although China's eventual displacement of Mexico in certain North American sectors was just a remote possibility at the time of NAFTA's negotiation, the quick culmination of China's structural shift is testimony to the importance of domestic institutional reform and experimentation. While the EU has established built-in incentives and requirements for institutional reform for its less developed members, all three NAFTA countries have eschewed this strategy as too interventionist. Thus, despite clear evidence of its shortcomings, Anglo-Saxon regionalism seems to prevail by default, with all three members stuck in a classic collective-action stalemate.

My final point concerns the future of North American integration. As innovative as NAFTA was at the time of its 1994 implementation, it may well have peaked in terms of its original goal of maximizing trade and investment ties between the three member countries. And, while NAFTA helped trigger innovative breakthroughs in the liberalization of services, investment, and the strengthening of intellectual property rights, these 'new trade issues' are now firmly embedded in the multilateral trade agenda. With China now looming over Canada and Mexico in the US market, NAFTA seems to have lost its way as a regional project. A revival of NAFTA would require that regional leaders agree to a continental strategy that taps labour markets across the three borders, tackles the huge asymmetries that continue to divide Mexico from its partners, and invests more vigorously in infra-structure and technology transfer. Otherwise, NAFTA's very divergence will continue to eat away at this particular brand of regionalism.

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