TOWARDS A NORTH AMERICAN FREE TRADE AGREEMENT : MEXICO'S INITIATIVES AND THEIR IMPLICATIONS

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CERTIFICATE

Certified that the dissertation entitled **"TOWARDS A NORTH AMERICAN FREE TRADE AGREEMENT : MEXICO'S INITIATIVES AND THEIR IMPLICATIONS"** by MALINI in partial fulfilment for the award of the Degree of Master of Philosophy has not been previously submitted for any other degree of this or any other University. To the best of our knowledge this is a bonafide work.

We recommend that this dissertation be placed before the examiner for evaluation.

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PREFACE

Tri-lateral negotiations on a north American free trade agreement currently in progress between Canada, Mexico and the United States, it is claimed, will permanently alter the face of the Western Hemisphere. Beyond providing a new "economic constitution for North America", as US President Ronald Reagan described, the accord, it is argued, will set a pattern for a new relationship between the three continental-sized countries and define a new vision for North America's collective future.

Canada-United States Free Trade Agreement signed in 1988 and already in force seems to form the core of the new North American Free Trade Agreement (NAFTA). While proponents celebrate the virtues of free trade as the prime engine of economic growth, opponents insist that NAFTA will reinforce the subordinate position of Canada and Mexico in the continental affairs. Both views have basis. Yet, each masks the complexity of NAFTA's implications for a variety of issues such as importantly immigration patterns, environmental policy, flow of resources and goods across borders, security structures and power relationships between the countries and social classes -- none of which can be clearly foreseen.

Neverthless Mexico's integration into NAFTA appears inevitable. Mexico's ruling party, Institutional

Revolutionary Party (PRI), under Carlos Salinas de Gortari in what is described as a "radical about-face in development policy" has already launched negotiations with both Canada and the United States. Beginning the negotiations with the US following his meeting with President George Bush in Washington in June 1990, Salinas in February last year had declared that the negotiations will include Canada as a full participant.

The three parties were to sign the agreement by the end of the year leading to NAFTA's formal adoption at the beginning of 1993. However, for a variety of reasons, the finalization of the agreement has been delayed beyond 1992.

What is of interest to the proposed study is the decision of Mexico to pursue a free trade agreement with Canada and the US. It is undoubtedly an extremely bold political act and testifies the complete hold of the ruling PRI over various domestic constituencies. After a long period of political uncertainty, the ruling party has been able to regain the support of big business and a consumerist middle class while forcing the captive organized labour to acquiesce to government's decision. While the main right wing National Action Party (PAN), the traditional advocate of free trade policies, has been preempted, the leftist and nationalist forces rallying around the Democratic Revolutionary Party (PRD), through coercive measures, has been made to climb down from outright opposition to modified support for the free trade agreement. Opposition to NAFTA is now in the hands of a small group of intellectuals, environmentalists and some independent trade unions and peasant associations.

Politics has so often determined economic decisions and policies that the sudden shift of the Salinas administration on the issue of free trade leads one to question whether the decision is motivated by economic compulsions or political considerations ?

As Mexico's negotiations for the conclusion of NAFTA are in progress, differing perceptions and opinions are being expressed regarding Mexico's motivations and the implications of NAFTA for Mexican economy and politics. What has been attempted in the present monograph is a descriptive survey of Mexico's initiatives towards the proposed North American Free Trade Agreement and their implications for Mexico. To begin with, a brief introduction attempts to survey various US initiatives that have been made in the past for liberalising trade with Mexico and Mexico's responses. Into this introduction, the Canada-US Free Trade Agreement of 1988, which is a precursor to the NAFTA negotiations, has also been examined. This is followed by, in a separate chapter, an analysis of Mexico's various initiatives and participation in movements such as Latin American Free Trade Area (LAFTA) and Latin American

Economic System (SELA) while resisting various US moves and initiatives. A scrutiny of the economic policies and pronouncements of the Salinas administration in support of the free trade decision could establish the rationale and expectations Mexico has of NAFTA. Therefore, the development strategy that Mexico pursued since the 1940s and the economic crisis that broke out in the 1980s have been discussed in the last chapter itself. There is no gainsaying that NAFTA has far-reaching implications for Mexico. Chapter three in this context discusses the viewpoints of the proponents who argue that FTA will revive and refurbish Mexican economy. While government expects increasing inflow of foreign capital, private business and industry seeks to take advantage of an access to a secure export market. Of specific interest would be to examine the role of the <u>maquiladoras</u>, that is, the assembly plants situated in the Mexican-US border. A separate fourth chapter focussing on the other interest groups opposed to the agreement highlights the likely negative consequences of NAFTA for Mexico. Objections ranging from environmental concerns over Mexico's pollution control standards, prospects of lay-off, low wages and exploitation of labour to nationalist fears of US hegemony, loss of national cultural lidentity and the dilution of Mexican revolutionary goals have been treated separately. The concluding chapter before attempting a balance sheet of the costs and benefits of NAFTA for Mexico, seeks to identify the issues involved

and the progress made in the negotiations so far.

I wish to thank my supervisor, Dr. Abdul Nafey, for guiding me through this work and for his invaluable suggestions. Needless to say, the responsibility for any errors is entirely mine.

Many thanks to all my dear friends -- Niti, Poonam, Uma, Bhaswati, Jaya, Manila, Savita, Shubra, Suddu -- for having helped me at different stages in different ways.

And finally, my heartfelt gratitude to my family. To Uday -- for being a constant source of inspiration and to my parents -- for their love and support.

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CHAPTER I

INTRODUCTION

The United States and Mexico have a long tradition of interdependence and rivalry, of conflict and cooperation. This is because of the differing national interests of the two countries arising out of different experiences and perceptions on a multitude of bilateral issues. The United States and Mexico, by geographical happenstance, share an extensive 3,000 kilometer border. This has given rise to a myriad of problems not uncommon between neighbours. The problems of narco-trafficking, illegal migration and of sharing water resources, as well as, of preserving the environment in the border areas have besides trade-related matters led to various conflicts in the past.

The root of the contradictions between Mexico and the United States is largely the result of an unbalanced power structure. The United States has represented a perceived security threat to Mexico since the beginning of last century. The Mexico looked at the US as the "colossus of the north." This constant imbalance of power, combined with the geographical proximity of the United States to Mexico had translated itself into real and potential threat to Mexico's sovereignty since the beginning of the last century. With this background one can understand Mexican dictator Porfirio Diaz's (1876-1910) oft-repeated cliche "Poor Mexico! So far from God and so near the United

States".

The original threat that Mexico faced from the United States was to its territorial integrity and sovereignty. Since the time the two nations established diplomatic relations in 1823 till today they have been separated by differing cultures. Historically, they were separated by the idea of 'manifest destiny', a national pursuit that was used to justify the expansion of the United States southward. Another stumbling block to good relations between the two countries was the intervention of the United States government in Mexico which began virtually at the commencement of relations between the two countries.[1]

The Mexicans were also apprehensive of economic domination by the United States. In the nineteenth century, the US investors took the lead in the exploitation of Mexico's natural resources and certainly 'anti-gringoism' became one of the major planks of the Mexican Revolution of 1910. Article 27 of the Mexican Constitution established Mexican supremacy over all Mexican soil and subsoil resources. It prohibited foreigners from owning property or any type of real estate within 50 kilometers of the coast reflecting the deep-rooted fear that Mexico had of foreign investors. Nationalist and anti-US sentiments grew very

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1 See Lorenzo Meyer, "The United States and Mexico : The Historical Structure of Their Conflict," Journal of International Affairs (New York), vol. 43, no. 2, winter 1990, p.259.

strong during the Lazaro Cardenas era. Cardenas's presidency was marked by the nationalization of foreign owned industries and petroleum companies. The foreign investment laws of this period reflected the government's attitude of distrust and its insistence to assert sovereign control over foreign investments.

After the Second World War, the Mexican government consciously adopted a strategy of import-substitution industrialization. This model was propounded by Raul Prebisch when he was the head of the UN Economic Commission for Latin America. The levy of tariffs and other protectionist measures resulted in insulating the Mexican economy. Additional steps were implemented to stimulate the country's infant industries, including indirect subsidies and tax incentives. As a result of these measures, the Mexican industrial sector grew, and the level of economic growth outstripped population increases by nearly 3 percent a year.[2]

However, as a result of all the protectionism, the domestic producers became oriented exclusively towards the domestic market and lost their competitive edge. Further, import substitution did not come about in the intermediate goods category like production of steel and copper wires. The 'Mexican miracle' lasted till 1965. Between the Second

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2 Michael J. Dziedzic, "Mexico : Converging Challenges", Adelphi Papers (London), no. 242, autumn 1989, p. 10.

World War and 1965, the agricultural sector grew at a 7.6 per cent on an average whereas the overall economy experienced an average growth rate of 6.1 per cent. [3] So, much of the credit for the Mexican economic 'miracle' actually belonged to agriculture. However,in the mid-1960s, the agricultural sector too began to stagnate like the rest of the economy. When Luis Echeverria assumed the presidency of Mexico in 1970, the 'Mexican miracle' was nearly over.

Echeverria (1970-76) tried to overcome the problem by massive increases in state-sponsored investment in capital-intensive projects like the development of intermediate and capital goods. During the period, therefore, the public sector grew tremendously. But since investment decisions always emanated from the state, decisions were not necessarily driven by the economic criteria. To finance these investments and to make ends meet, Echeverria resorted to foreign borrowings. The amount of foreign debt owed by the public sector increased from $4.2 billion in 1970 to $19.6 billion in 1976.[4]

As a result of the governments' deficit spending inflationary forces were unleashed and the consumer price index that had averaged 3.5 percent per annum (1957-70) burgeoned to 27 per cent by the end of Echeverria's term.[5]

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3 Ibid., p.11

4 Ibid., p.12

5 Ibid.

Jose Lopez Portillo (1976-82) followed Echeverria with the same model of development. Oil reserves were discovered in 1976 and this resulted in an increase in the government's revenues as well as, an increase in the country's foreign borrowings from international banks. The discovery of oil gave some hope that Mexico would be able to wriggle out of increasing debt burden, inflation and a devalued peso. The oil bubble soon burst, however, on account of various external and internal factors such as the fall in oil prices, increase in international interest rates, recessionary conditions in the US and other industrialized countries and growth in domestic money supply which created conditions of profound economic crisis.[6] By 1982, the country was nearly bankrupt and unable to service its huge external debt. During Portillo's last year of office, the economy contracted by 0.5 per cent, the federal budget deficit amounted to almost one-fifth of GDP, and inflation soared nearly to triple digits. [7]

Thus economic reform was born of necessity as President Miguel de la Madrid Hurtado (1982-88) began in a marked shift from previous development policies by trimming deficits (from one-fifth of GDP in 1982 to 8.5 per cent of GDP in 1983 and to 7.6 per cent the next year), reducing

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6 Ibid., p.13

7 Ibid., p. 14

inflation (to 65 per cent by 1984) and cutting down imports.[8]

De la Madrid began a programme of 'reconversion' that abandoned two major aspects of the previous economic policy. Mexico's long-standing refusal to join the General Agreements on Tariffs and Trade (GATT) came to an end, and steady growth in the number of state-owned corporations was reversed through a process of privatization and liquidation. Mexico entered GATT in 1986 and by December 1987, it had reduced its highest tariff rate from the 100 per cent level prevailing in 1984 to 20 per cent. The number of imports for which entry permits were required had also been substantially reduced.[9] And the number of state-owned corporations which were over 1,100 in 1982 were trimmed down to 500 by April 1988.[10]

Apart from these two measures, the De la Madrid administration sought to stimulate export-led growth by promoting the maquiladora, that is the border industrialization programme and by adopting a somewhat more positive stance towards foreign investment. This flexibility was reflected in allowing exemptions up to 100 per cent to foreign ownership in areas deemed vital for economic

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8 Ibid., P. 14

9 Ibid., p. 18

10 Ibid., p. 19

expansion, that is those that would promote exports, job creation or technology transfer.

Mexican exports shifted from oil to manufactures. Manufactured goods soared to 55 per cent of all exports in 1989 from 14 per cent in 1982.[11] And with 85 per cent of its manufactured exports destined for its northern neighbour, secure access to US markets became increasingly important. The move towards free trade thus began in the 1980s, when Mexico signed a series of agreements to guard against potential US protectionism, including one on subsidies and another on a framework for investment and trade.[12] Thus, President Miguel de la Madrid laid the foundation for changes in the economic orientation and structures of Mexico.

President Carlos Salinas de Gortari (1988 -) picked up from where De la Madrid left and brought in sweeping economic changes in Mexico. These changes, as discussed subsequently, paved the way for negotiating the creation of a free trade area in North America. A free trade agreement with the United States will ostensibly deepen the economic relations between the two countries and, as claimed by the government, bring more short- and long-term benefits to Mexico.

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11 M. Delal Baer, "North American Free Trade", Foreign Affairs (New York, NY), vol. 70, no.4, fall 1991, p. 133.

12 Ibid.

However, what is contemplated in the next section is a survey of the various US initiatives towards free trade in the past.Into this, the Canada - US Free Trade Agreement of 1988 will also be examined to be followed by a section on the impending US - Mexico free trade agreement.

U.S. INITIATIVES

The US has traditionally deemed and projected a "special relationship" with Mexico. This exists because of geography and history as neighbours. President John F. Kennedy is said to have remarked once that geography has made the US and Mexico neighbours, tradition has made them friends, and economics had made then partners.[13] This specialness in their relationship was more symbolic than anything else and signified that despite vast asymmetry, mutual dependence could enable Mexico to become strong and independent or weak and dependent. In the 1970s, the US had shown interest in establishing firm economic relations with Mexico. This may have been guided by the US interest in Mexico's energy resources. It was way back in 1974 that the US President endorsed Section 612 of the US Trade Act calling for negotiations on a free trade pact with Canada; this was subsequently complemented by Section 1104 of the

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13 David Ronfeldt and Caesar Sereseres, "The Management of US-Mexico Interdependence : Drift Toward Failure?", in Carlos Vasquez, and Manuel Garcia y Griego, Mexican-US Relations : Conflict and Convergence (Los Angeles, 1983), p.68.

1979 Trade Agreement Act supporting a study of new trading arrangements with Canada and Mexico.[14]

Section 1104 had made an amendment to the Section 612 of the Trade Act of 1974 and this reads as follows :

"The President shall study the desirability of entering into trade agreement's with countries in the northern position of the Western hemispheres to promote the economic growth of the US and such countries and the mutual expansion of market opportunities and report of the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate his findings and conclusions within two years after the date of enactment of this Act. The study shall include an examination of competitive opportunities and conditions of competition between such countries and the US in agricultural, energy and other appropriate sectors."[15]

The much-publicized North American Accord idea was promoted by the administration of President Ronald Reagan (1980-88) and by some prominent US legislators. But the idea was initially for a resource-based or energy common market and at that time had not been welcomed by Mexico. In the Report on North American Agreements transmitted to Congress by the then US President Ronald Reagan in 1981, the administration supported free trade with Canada and Mexico on a gradual and investment basis, stating that there were

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14 A.J. Sarna, "The Impact of a Canada -US Free Trade Area", Journal of Common Market Studies (Oxford), vol. 23, no. 4, June 1985, p. 311.

15 United States Statutes at Large Containing the Laws and Concurrent Resolutions Enacted During the First Session of the Ninety - Sixth Congress of the United States of America, 1979 and Reorganization Plans and Proclamations (Washington D.C. : Government Printing Office, 1981).

many near-term opportunities for reduction of tariff and non-tariff barriers.[16] With respect to Canada, the Report noted the high degree of trade integration already existing with the US as a result of the Multilateral Trade Negotiations, the Auto Pact and the extensive prevalent network of business arrangements and corporate linkages.[17] It therefore concluded that "further opportunities to rationalize industries through freer trade should be explored on both sides". This would lay a foundation for the more ambitions undertaking than the authors of Section 1104 envisioned.

These proposals however were never explicitly stated. At that time the rhetoric of interdependence was very strong in the US and reference to a "North American interdependence" was seen as a potential component of the rationalization of a new special relationship that would resolve some of the differences between the two countries. These proposals covered a wide variety of alternatives too. One specific example limited its focus to the labour market, while others postulated the supposed benefits of a North American Common Market. Thus, the rhetoric of interdependence was an integral element in the formulation of policy proposals which stressed a future relationship of "community".

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16 Sarna, n. 3, p. 311

17 The Auto Pact provided for duty-free trade in cars, trucks, buses, and automobile parts.

Arguments that favoured such proposals were made by groups representing practically every section in the U.S. political spectrum. Examples ranged from the then Republican majority leader in the Senate, Howard Baker, the then President Ronald Reagan, to the former Democratic governor of California, Edmund G. Brown, Jr., the Senate Finance Committee, and the Energy and Natural Resources Committee.[18]

A greater economic integration between "major trading partners isolated on a continent", characterized by Pete Domenici, former Republican senator from New Mexico, was proposed as a mechanism for the resolution of conflicts between the participating countries. The president of the Dow Chemical Company, Paul Oreffice, made explicit the possible ingredients of a Mexico - Canada - US free trade agreement :

> " ...a recognition of the problem faced by the United States may lead to a flow of oil and gas from its neighbours... a recognition of Mexico's problems may lead to the free flow of the needed Mexican labour into the United States (and) recognition of Mexican agricultural problems may lead to (a) better market for US and Canadian agricultural products".[19]

The Mexican attitude to such US overtures remained restrained and full of reservations. It has, due to historical reasons, been skeptical about evolving closer

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18 Carlos Rico F., "The Future of Mexican-U.S. Relations and the Limits of the Rhetoric of 'Interdependence'", in Carlos Vasquez, and Manuel Garcia y Griego, Mexican-US Relations: Conflict and Convergence, p. 137.

19 Ibid., p. 138.

economic ties with the US. Mexicans have also been apprehensive about US domination and its intervention in the internal affairs of Mexico. Rather than viewing these proposals as a general package of cooperation, Mexican observers saw them as vehicles for the US to obtain access primarily to Mexican energy resources. Some Mexicans like Jesus Puente Leyva, then chairman of the Commission de Energeticos felt that the proposal was a "sophisticated provocation of Mexico".[20] The idea of a common market, it was felt was a first step towards making Mexico a part rather than a partner of the United States. It was also felt that those versions of the proposal which emphasize the exchange of goods and services were actually mechanisms to "recycle" Mexican "petro-pesos". Mexico would be given constant encouragement to increase imports which could be detrimental to its economic health. The theory of comparative advantages under such conditions could lead Mexico to specialize in those products that it had sought to escape from. There would be no free mobility of factors of production and there would be no "complementarity" of interests between the US and Mexico. Thus, while the United States advocated a north American common market to further its interests in the Western Hemisphere, Mexico was guarded in its reaction and refused to accept such an idea. The Mexicans considered it as yet another plot by the US to keep

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20 Ibid., P. 138

Mexico subjugated. Lopez Portillo had declared to the Canadian Parliament in May 1980 that "proposals (along these lines) one incompatible with the objectives of Mexico's social and economic development, in view of the great differences between the development levels of the three countries". [21] What then brought about a sudden change in the Mexican development strategy after Carlos Salinas de Gortari assumed the office of the president?

Before that is dealt with, however, it would be pertinent to examine the US-Canada Free Trade Agreement of 1988, which is regarded as a precursor to the US-Mexico free trade negotiations.

US-CANADA FREE TRADE AGREEMENT

Debate on trade policy has been a recurrent phenomenon in Canada. Successive Canadian regimes have considered whether they should seek a preferential trade arrangement with the United States? This theme was central to the reciprocity treaty of 1854 and arose again when the US rejected a new reciprocity treaty in 1874, and once again became an element in the national debate in the electoral campaigns of 1891 and 1911.[22] By that time though Canada

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21 Cited in Robert H. McBride, ed., Mexico and the United States (New Jersey, 1981), p.19.

22 Sidney Weintraub, "US-Canada Free Trade : What's in it for the US? " Journal of Interamerican Studies and World Affairs (Coral Gables, FL), vol. 26, no. 2, May 1984, p. 226.

had adopted a policy of protectionism, the issue of increased economic collaboration with the United States was far from dead.

The 'third - option' policy of 1972 was intended as a way to diversify Canada's economy through internal development and extensive external relations, and in the process to reduce the Canadian vulnerability.[23] Its main proponent was Michael Sharp, the then Secretary of State for External Affairs, who wrote at the time that free-trade arrangement with the United States was not rejected on economic grounds but because it was judged to be inconsistent with Canada's desire to preserve a maximum degree of independence. This concern about becoming an appendage of the United States had prevailed up until the recent decision was taken. So until the late 1980s, diversification of trading partners was the strategy. However, no trade agreements were signed with any of the European Countries and all through the 1970s the value of Canada's exports to the United States ranged anywhere from 60 to 70 per cent of the total, in 1984 it was more than 75 per cent a percentage which persisted in 1985.[24] So over the period, the reliance on US market has grown.

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23 Sidney Weintraub, "Canada Acts on Free Trade", Journal of Interamerican Studies and World Affairs, vol. 28, no. 2, summer 1986, p. 103.

24 Ibid., p. 104

The Economic Council of Canada made some recommendations in 1975 which called for a multilateral reduction of tariffs rather than to seek some type of an arrangement within the North American bloc.[25] Since, the likelihood of reaching world free trade through negotiations in the General Agreement on Tariffs and Trade (GATT) appeared remote, the next best solution was to practise free trade with a group of developed countries, particularly including the United States and the European Community. Again, assessing the probabilities, the 'third best' solution was deemed to be a US-Canada Free Trade Agreement. But this report was rejected by Canada's leaders as politically unrealistic. This, however, did not end the debate. After extensive hearings spanning the better part of a decade and reported in the three volumes of 1975, 1978 and 1982, the Standing Committee of the Senate on Foreign Affairs (1982) advocated a bilateral free-trade agreement with the United States.[26] This was the same as the Economic Council's 'third best' solution of 1975. The Standing Committee of the Senate concluded, however, that "a bilateral free trade approach is preferable to a multilateral approach" and its reasoning was that bilateral free trade might more realistically be achieved. However,

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25 Their recommendation was to speed up trade liberalization and may have each influenced the significant trade liberalization undertaken by Canada in the Tokyo round of GATT negotiations.

26 Weintraub, n. 10, p. 226.

the recommendations of the Senate Standing Committee was not given much attention.

The Economic Council again issued a report in 1975 explaining that a Canada - US Free Trade Agreement would not result in massive dislocation and job displacement since the changes would be carried out gradually. The report concluded that Canadian industry and workers would almost certainly benefit from a bilateral free trade agreement though adjustment within industries could be difficult.[27]

In 1983 and later in 1985, the Department of External Affairs of Canada reviewed the arguments for and against a Canada-US Free Trade Agreement.[28]

However, by mid-1980s Canada changed its policy. Prime Minister Brain Mulroney, who was elected in 1984, recognized that Canada could not afford a nationalist industrial policy, both for financial reasons and because it needed tó preserve good relations with the United States. He reversed the national energy policy proclaimed by his predecessor, Prime Minister Trudeau, greatly curtailed subsidies, and sought a free trade agreement with the United States.[29] It was on 26 September 1985 that Prime Minister

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27 Weintraub, n. 11, p. 106

28 Ibid., pp. 106-107.

29 For details on Trudeau's industrial policy see Peter Morici, "Making the Transition to Free Trade", Current History (Philadelphia, Pa), vol. 90, no. 560, December, 1991, p.429.

Brian Mulroney requested the opening of trade talks with the US. In the 1980s, Canada had begun to get increasingly concerned about its ability to compete with the newly industrialized countries of Asia. There was an apprehension about the growing inward focus in Europe and the subsidy battles over agriculture and increasing signs of protectionism in the US due to the large trade deficit -- all these began to shape the attitude of the policy makers. Thus the idea of free trade was born out of necessity and the Canadian government went in for it expecting access to export markets in the US and also expecting to attract foreign investments into Canada.

On 11 December 1988, the Government of Canada tabled the Canada - US Free Trade Agreement (FTA) in the House of Commons. This FTA is to be phased over 10 years and is planned to develop a barrier and secure market of 265 million consumers. The Agreement became operative on 1 January 1989.

The FTA is a trade liberalizing agreement and is to remove almost all barriers to trade in goods eventually between US and Canada. The FTA has also liberalized Canadian foreign direct investment controls while seeking to provide some flexibility for national interests. The Agreement also provides for a code of conduct for the governments in their regulation of both private firm behaviour and for their own economic policies. The most extensive obligations cover trade in goods and include obligations regarding rules of origin: tariff quotas, and customs procedures; national treatment, technical barriers; safeguards; government procurement and unfair trade remedies. The rights and obligations in all the articles dealing with trade in goods are based on those of the GATT and are generally consistent with the rules set out in GATT Article XXIV for the establishment of free-trade areas.[30] The FTA also removes all restrictions on trade in energy and determines that energy must be shared proportionally between the two countries. Changes have been made in the Auto Pact. The FTA has also established a dispute settlement mechanism.[31]

The FTA has since then been operational. In the past two years, the Canadian economy has gone through a deep recession, with substantial declines in employment, output and, in certain sectors, new capital investment. Between April 1990 and March 1991, employment in Canada declined by 305,000.[32] The critics of the Canada - U.S. FTA have been

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30 For details of the US-Canada FTA see Donald Simpson, "Integrated North American Market: Trade Prospects for Developing Countries for the 1990s", in <u>International Trade Strategies for Developing Countries for the 1990s: Proceedings and Papers of a Commonwealth Roundtable</u> (London, 1991) p. 200.

31 See Joseph A. McKinney, "Dispute Settlement Under the US-Canada Free Trade Agreement", <u>Journal of World Trade</u> (Geneva), vol. 25, no. 6, December 1991, pp. 117-130.

32 Gordon Ritche, "Beyond the Volcano Canadian Perspectives on Trilateral Free Trade", <u>Columbia Journal of World Business</u> (New York), vol. 26, no. 2, summer 1991,p. 85.

quick to blame the FTA as directly contributing to the length and depth of the recession.

When Canada joined the U.S. and Mexico to begin tri-lateral negotiations towards a North American Free Trade Agreement (NAFTA) in February 1991, Canadian critics felt that Canadian signature on NAFTA would compound the original error. Trilateral free trade is viewed by some Canadian critics as encouraging the movement of Canadian industry and jobs to Mexican locations where wage and benefit costs one much lower. Other critics focus on the potential for Canadian plant closures and job losses resulting from increased import competition or rationalization of production facilities.

The Canadian government's policy on its participation in the trilateral negotiations has been increasingly shaped by the continuing debate over the Canada-U.S. FTA. The Canadian government repeatedly warned the U.S. negotiators to respect the final negotiating position of Canada in the Canada - U.S. FTA. When Bush and Salinas decided on 11 June 1990 to seek a comprehensive free trade agreement, Bush informed the Canadian Prime Minister Mulroney of the U.S. interest in pursuing talks with Mexico and of his intention to keep Mulroney informed throughout the process. But Canada felt that neither the US nor Mexico has given great thought to the question of Canadian participation.[33]

While all three parties are now committed to a trilateral agreement, there may be issues of an exclusively bilateral nature for which bilateral arrangements may be more appropriate.

Doubts have appeared in Canadian minds about the benefits that NAFTA would accrue to Canada. For one, Canada and Mexico do not interact much in terms of trade. The total value of Canadian exports to Mexico in 1990 was under US $ 600 million and under 1 per cent of the total value of Canadian exports. On the import side, Mexico sold US $ 1.6 billion in goods and services to Canada in 1990, or just over 1 per cent of the total value of Canadian imports.[34]

Most of Canada - Mexico trade is already free. Approximately 80 per cent of Mexican imports to Canada already enter duty free. Also, direct investment ties between Canada and Mexico are weak. Canadian direct investment in Mexico was U.S. $ 361 million in 1989, less than 1.5 per cent of total foreign direct investment in Mexico. This stands in contrast to Canadian direct investment in the US ($52 billion in 1990). Mexican direct investment in Canada was only $ 400 million in 1989.

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33 Ibid., p.88

34 Ibid.

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In the initial stages of the debate on Canadian participation in the NAFTA, great attention was paid to the dangers posed by the potential emergence of a "hub and spoke" arrangement. This situation could emerge in the absence of a full fledged NAFTA and consist of the U.S. as the hub with Canada and Mexico as two spokes attached through the Canada - U.S. FTA and a Mexico - U.S. FTA. Some argue that such an arrangement would lead to investors putting their money in the U.S. economy knowing this would grant them access to Mexico and Canada also.

US Interest Given the successful completion of the US-Canada FTA, an important question is whether such an arrangement can serve as a model for U.S. - Mexico free trade pact? There are many similarities and differences in the two arrangements. For many issues in the US - Mexico negotiations, the US - Canada FTA can serve as a useful case. Canada and the U.S. have implemented a binational panel to review disputes arising out of subsidies and countervailing duties. Like Canada, Mexico has been frequently frustrated with US anti-dumping and countervailing duties -- the US has been using these as protectionist devises. Between 1982-85 there were 26 Mexican petitions, 18 of which went in favour of US producers.[35]

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35 Terry Wu and Neil Longley, "The US-Canada Free Trade Agreement : A Model for US Mexico Free Trade Pact? ", Columbia Journal of World Business, vol. 26, no. 2, summer 1991, p. 65

Thus, as with the Canadian negotiations, a binational panel may be an effective instrument to settle this issue.

Both Canada and Mexico have restricted foreign investments in their countries to limit US economic influence. In the US - Canada FTA, the US was successful in substantially reducing the investment barriers. The investment provisions in the U.S. - Canada FTA can provide the framework for the US - Mexico case. In case of services trade too, the US - Canada FTA can form a model. U.S Interest

Despite the many similarities between the two situations, there are many differences too. While Canada and US are similar -- culturally, economically and politically-- Mexico is very different. The Mexican economy is labour - intensive, while Canada and US are capital-intensive. The dominant -party political system of Mexico is very different from the party based representative system of the other two North American countries. Thus, a US - Mexico FTA might need a longer phase - in period as compared to the US - Canada FTA.

US Interest

MEXICO - US FREE TRADE AGREEMENT

Mexico is now the third largest trading partner of the US. Imports from Mexico account for 5.3 per cent of total US imports, while US exports to Mexico represent about 6.4 per cent of total US exports. Thus, like the U.S. - Canada FTA, an FTA with Mexico would impact a very significant percentage of total US trade. This is more time in the case of Mexico which for over 70 per cent of its trade is dependent on US.

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The US motivations in championing a North American trading bloc are apparently many : a response to the strengthening of trading blocs in Europe and elsewhere; growing dissatisfaction with the slow progress of GATT negotiations; also by signing an FTA with Mexico, the US would gain access to Mexico's energy resources; and a US - Mexico FTA would also provide strategic benefits for US foreign policy. Political stability in Mexico is deemed an important US foreign policy objective.

3rd

From the Mexican perspective, a FTA would be the extention of domestic economic reforms. Salinas was also said to have been influenced by the growing globalization of the world economy. With the recent events in East Europe, German investments would probably be channeled to Europe. A FTA with US might attract European investments into Mexico.

3rd

Mexicans are also concerned about the trade diversion resulting from the US - Canada FTA. A major concern of Mexico is the possible threat of trade diversion to Canada of products in which Mexico has a comparative advantage. For example, Mexico could lose the huge U.S. market to Canada in energy and motor vehicle parts as a consequence of the US - Canada FTA. Thus, it is argued, it is in Mexico's own interest to be a part of the North American trading bloc. It is also expected that trade disputes with the U.S. will lessen if Mexico negotiates a bilateral FTA. Mexico also fears that U.S. protectionist policies would increase if the two countries were not joined by the FTA. The FTA with the US would enable Mexico to finance the foreign debt by increasing trade flow and thus increasing foreign exchange earnings. Yet another inspiration for Mexico to initiate a free trade pact with the US is the emergence of trading blocs all over the world.

In June 1990, Salinas and Bush issued a joint statement in support of negotiation of a free trade agreement. The statement called for a gradual and comprehensive elimination of trade barriers including : full 3rd phased elimination of tariffs; elimination or fullest possible reduction of nontariff trade barriers, such as import quotas, licenses and technical barriers to trade; protection for intellectual property rights; fair and expeditions dispute settlement procedures; and improvement and expansion of the flow of goods, services, and investment between the United States and Mexico.[36]

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On 12 June 1991, trade representatives from the US, Canada and Mexico met in Toronto and formally began negotiations on the North American Free Trade Agreement.

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36 "North American Free Trade Agreement", Congressional Digest (Washington, D.C.), February 1992.

Negotiations are now being conducted under six broad categories, some of which are divided further. The working groups on all of these issues are meeting regularly. The categories are as follows : market access (tariff / non-tariff barriers; rules of origin; government procurement; agriculture; automobiles; other industrial sectors); trade rules (safeguards; subsidies/trade remedies; sanitary/ phytosanitary, health/environment and industry standards; services (principles; financial; insurance; land transportation; telecommunications; other services); investments (principles and restrictions); intellectual property rights; and dispute settlement.[37] 3rd

The negotiations began quickly, but several difficult issues have apparently slowed down the pace of the talks. There is no gainsaying there is a mutuality of interests on very wide - ranging subjects between ~~Mx~~ Mexico and United States. However, there is an asymmetry in this relationship with Mexico depending heavily for its imports and exports on United States. This is not to suggest that Mexico is not deemed important in the strategic, political and economic calculations of the United States. It was essentially to insulate the Mexican economy from foreign domination and influence that the post-revolutionary regimes especially after the Second World War had chosen an inward-looking import substitution strategy of development. Such a

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37 Ibid.

strategy performed 'miracles' for a while but soon exhausted itself demanding greater inflow of foreign capital and technology for its revival, successive regimes beginning with the Echeverria presidency instead of adopting harsh ameliorating measures continued to pursue the same development strategy with the help of heavy external borrowings, deficit financing and an 'expansive' state propelled by huge hydrocarbon resources. The strategy continued to work for a while in the 1970s. However, on account of various domestic and external factors such as the fall in oil prices in the international market and the extreme bureaucratic strangle- hold over the economy, Mexico found itself in the midst of a severe economic crisis in the early 1980s. The redefinition and restructuring of the chosen strategy of development soon impelled President Miguel de la Madrid to accept and introduce various adjustment programmes prescribed by the international lending agencies. The crisis of the 1980s thus aided the process of liberalization and dismantling of both tariff and non-tariff barriers.

It is under these circumstance that the regime of Salinas de Gortari, after some initial hesitations, began evincing interest in the proposal of free trade with the United States. Successive US administrations particularly the Reagan administration had undertaken feasibility studies and made various overtures to Mexico regarding free trade, common market in energy or at least substantial reduction in trade barriers. On its part, Mexico on account of its historical experiences and development policies had remained skeptical even somewhat apprehensive of evolving more close economic ties with United States.

Whatever may have been the factors -- commonly cited among which include the global trend towards building regional trading blocs and prospects of competition for foreign investments after the events in Eastern Europe and the erstwhile Soviet Union, Mexico was also influenced by the conclusion of the US - Canada Free Trade Agreement (FTA) in 1988. The US - Canada FTA had the potential of adversely affecting Mexican trade with US at a time when ever increasing exports including that of manufactures and the need to attract US investments were deemed essential by Mexico.

Thus many factors guided the initiation of free trade negotiation with US. In a sense, it was the culmination of the asymmetrical trade relationship Mexico enjoyed with the US and the structural changes that were introduced during the 1980s.

As negotiations continue to finalize the North American Free Trade Agreement, contentious issues have emerged between the three countries. Of specific interest to Mexico are issues pertaining to, among others, the petroleum sector and flow of Mexican labour into the United States.

Also from Mexican viewpoint the US - Canada FTA is likely to give rise to various other contentious issues. On its part, Canada also seems to be doubting the benefits that the NAFTA would bring to it. Thus as a comprehensive FTA between the three countries is being worked out, differing perceptions and interests are cropping up which have already delayed the finalization of the agreement beyond the date that had been envisaged earlier.

Before examining some of these issues in detail it is however pertinent to describe and analyze Mexico's own initiatives and motivations in seeking a NAFTA. The about turn in Mexican foreign policy is an much the admission of trade realities between the two countries as the conviction of Mexico's ruling elite to transform the economy and make it in tune with the larger and dominant US economy.

The next chapter therefore deals with Mexico's attitude towards free trade with United States and the Latin American countries. In this context, the focus is on Mexican participation in the Latin American Free Trade Area in the 1960s and recently its overtures to the Central American Common Market and the Caribbean Community and Common Market. With this background, Salinas's initiatives towards NAFTA has been examined in a separate section. Issues that are under consideration at present under NAFTA negotiations have been examined separately.

CHAPTER II

MEXICO'S INITIATIVES

Mexico's thoughts and actions were all through its history since independence coloured by its deep suspicion and apprehension of US motives. However, in the 1940s and 1950s, when the Organization of American States had begun to prosper, Mexico was one of the strongest advocates of inter-American cooperation and perceived it as its main line of defence against the US. The Mexican foreign minister Ezequiel Padilla had in 1943 proposed a Western Hemispheric economic union.[1] This is particularly relevant as at the present moment, Mexico and US are negotiating towards the creation of a North American free trade bloc.

It was under the leadership of President Luis Echeverria (1970-76) that Mexican foreign policy undertook some major changes by abandoning the purely defensive and isolationist strategies of the past in favour of a more active and involved relationship with the world. Echeverria's strategies for a new foreign policy came at a time when the economic health of the country was poor and the ruling Institutional Revolutionary Party (PRI) had lost considerably its legitimacy and popular support.

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1 L. Ronald Scheman, "Rhetoric and Reality : The Inter-American System's Second Century", <u>Journal of Interamerican Studies and World Affairs</u> (Coral Gables, FL), vol. 29, no.3 fall 1987, p. 9.

Echeverria's foreign policy was a response to the crisis of the political system. Confidence in and even the stability of the political system were shaken during the protests surrounding the 1968 Olympics and culminating in the massacre at Tlatelolco in Mexico city. Having been alleged of personal involvement in the repression of the protests, Echeverria, when he became president, sought to make overtures toward the deeply disaffected groups among the left and among the young. He aligned himself to popular progressive causes such as the support to Salvador Allende of Chile and Fidel Castro of Cuba.

When Echeverria assumed the presidency, not only was the political system of the country being questioned but also the economic policies of successive PRI regimes. The strategy of import substitution industrialization, protectionism by the state and the developmental model was suspect as it had not delivered its goods specially to the downtrodden. The manifestations of failure were internal as well as external : unemployment, underemployment, price stability, maldistribution of income, lagging exports, a lack of comprehensive advantage, denationalization of the manufacturing sector, negative balance of payments, growing deficits in the balance of trade, and a balooning external public debt.[2]

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2 Guy Poitras, "Mexico's Foreign Policy in an Age of Interdependence", in Elizabeth G. Ferris, and Jennie K. Lincoln, eds., Latin American Foreign Policies; Global and Regional Dimensions (Boulder, 1981), p. 105.

Echeverria also perceived that Mexico's developmental difficulties were the result of an unjust and hegemonic world order. Mexico had become very dependent upon a asymmetrical relationship with the United States. The Mexicans needed the US far more than the US needed Mexico.

To obtain some measure of leverage with regards to the US and to bolster the popular support for PRI, Mexico oriented itself towards the Third World and Latin America in the 1970s. And Third World activism did gain some new political prestige for Mexico in Latin America, in the Third World and other multilateral forums.

The reasons for Echeverria's foray's into the third world can be understood in the light of this background. Since Mexico's dilemmas were internationally and to a lesser extent domestically generated, foreign policy had to move from the relatively unpoliticized "commercial diplomacy" of his first few years in office to a highly politicized political activism.[3] By the middle of his regime, Echverria had evolved a leftist, activist foreign policy devoted to global change.[4]

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3 Ibid., p. 107

4 William H. Hamilton, "Maxico's 'New' Foreign Policy: A Reexamination", Inter-American Economic Affairs (Washington, D.C), vol. 29, no. 3, winter 1975, p. 51-58.

Along with Venezuelan president Carlos Andres Perez, Echeverria led in the creation of the Latin American Economic System (SELA). Echeverria also proposed the Charter of the Economic Rights and Duties of State.[5] He also stepped up Mexico's participation in such established forms as key international banking institutions while ignoring membership in the United Nations Security Council and avoiding the Organisation of American States, both of which represented, in his view, big power interest. He chose forums or created forums where the United States was not predominant or where big power interests were only equally weighted.[6]

Echeverria felt that a Third World solidarity was necessary to overcome the hegemony of the big industrialized countries, especially the United States. The Charter of Rights and Duties was one such initiative. During the United Nations Conference on Trade and Development (UNCTAD) meeting of 1972 in Chile, Echeverria proposed the charter as an initial effort to reform the world order in the light of the needs of the weak and dependent nations.[7] It was brought up in the General Assembly in 1974 and again in 1975

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5 Yoram Shapira, "Mexico's Foreign Policy Under Echeverria: A Retrospect", Inter-American Economic Affairs, vol. 31, no. 4, spring 1978, p. 30.

6 Poitras, n. 2, p. 107.

7 Guy Poitras, "Mexico's 'New' Foreign Policy", Inter-American Economic Affairs, vol. 28, no. 3, winter 1974,p. 66.

suggesting resolutions and codes of conduct in relations between the North and the South.

The (SELA) was of a political-economic nature which began formal operations after a ministerial conference of Latin American countries in Caracas during June 1975. The aim of SELA was to pursue more unity against industrial powers with respect to obtaining better trading terms for primary and industrial goods and a membership that excluded the US.[8] It sought to enhance sectoral planning through heavy state involvement in several areas such as energy, agriculture, and fertilizer.

Among others, the NAMUCAR (Caribbean Multinational Shipping) venture was initiated by a SELA Work group based on regional membership and including Cuba but not the United States. NAMUCAR was established to compete with the shipping services that were being dominated by U.S. and European countries. So at least at the internal level, the Echeverria government was trying to extricate Mexico from its position of growing dependence on the US and at the same time advocating strongly free trade among the countries of Latin America. Echeverria had said :

> "The Latin American Economic System and later (...) the Caribbean Multinational shipping line ...as well as the various associations for promoting raw materials which have begun to reorganize, evidenced the beginning of truly Latin American economic cooperation without metropolitan inclusions or advice".[9]

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8 Hamilton, n. 4, p. 55.

9 Shapira, n. 5, p. 41.

Earlier in 1960 Mexico had joined the LAFTA which came up as a result of the recommendations of the UN Economic Commission for Latin America (ECLA). The then president of Mexico Lopez Mateos had tried to promote the idea of regional integration to the business community in Mexico but was not well received.[10] Though Mexico became one of the most "conservative" members of LAFTA, still it was able to achieve its immediate objectives of expanding trade even without the full scale achievement of a common market. While the object was to expedite the creation of a common market, the very success of Mexican export drive in Latin America, and the surplus enjoyed by the country soon led to a sense of complacency both at the government and private sector level. Moreover, some sectors of the Mexican economy strongly opposed the lowering of trade barriers. The presence of foreign capital in Mexico which had a tendency to take the main benefit from regional integration, and the fact that import substitution at a national level had not adequately exhausted itself, contrary to ECLA's claims, were other factors which discouraged Mexico from taking a strong stand in support of integration.[11]

Between 1960-75 Mexico's trade with LAFTA did increase but the country in overall terms continued to rely

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10 Vasant Kumar Bawa, Latin American Integration: An Asian View (New Delhi: Radiant Publishers, 1980), p.139.

11 Ibid.

on industrialized countries essentially for its imports. Though Mexican exports also remained diverted towards the developed countries, however, significant gains were made under LAFTA as far as exports to the Latin American countries were concerned. It, therefore, with the exception of 1974-75 continued to have a surplus trade with the LAFTA region. Liberalization of trade under LAFTA and the stimulation of development process in LAFTA member countries were largely responsible for rising Mexican exports between 1961-73. A substantial part of this export consisted of manufactured products. Despite the exhaustion of domestic market Mexico primarily due to its continued exports to LAFTA region continued to pursue import substitution industrialization strategy in certain key sectors. However, due to the slowing down of domestic manufacturing sector itself from the mid - 1960s onwards, Mexican trade with LAFTA became erratic.

Coming back to Echeverria's nationalist policy against the conspicuous presence of US direct foreign investment in the economy especially the manufacturing sector, the government enacted a foreign investment law which provided for a more selective screening and regulation of foreign investment.[12]

Although at a rhetorical level, Echeverria spoke of diminishing Mexico's dependence on the US : in practice,

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12 Poitras, n. 7, p. 67.

his economic policies accentuated the dependence. Echeverria's economic policies of deficit financing and external borrowings to finance social welfare programmes and increasing role of the public sector resulted in the accumulation of foreign debt. These policies caused increase in imports of technology, capital goods and food which exceeded the exports of agricultural products, manufactured goods, and oil, leading to a massive deficit in the balance of trade.

Lopez Portillo (1976-82) further exacerbated the situation by carrying on in the same way as his predecessor. The discovery of oil in the mid - 1970s lead to a dramatic increase in the country's foreign borrowings. And when there was a glut in the oil market and international interest rates began soaring, as has been discussed in the previous chapter, a crisis prevailed over Mexico. The Portillo regime had used oil as a collateral to finance the development of the oil industry and to raise the ceiling for its foreign indebtedness. Any by 1982, when Miguel de la Madrid became the President, he was left with no other choice but to change the growth strategy followed by Echeverria and Portillo. De la Madrid brought structural changes in the Mexican economy by opening it to the US and other countries.

At least since the 1940s the PRI regimes have emphasized development of the Mexican economy by keeping foreign competition out and subsidizing domestic producers. That model was developed in large part to prevent Mexico and its economy from being swallowed by US interests whose extensive acquisition of mines, railroads, oil companies and ranches had helped detonate the Revolution in 1910. The inward-looking, import substitution policy was largely given up in the 1980s. Thus when Salinas came to power in 1988 the time was ripe to seriously consider afresh the idea of a free trade with the US. It was as early as in July 1988 that George Bush, who was then the Republican presidential candidate, hinted at the possibility of a free trade agreement with Mexico. In November 1988 the two Presidents Salinas and Bush met creating what is know as the "Spirit of Houston". The two presidents agreed in principle to a new bilateral agenda promoting free trade between their two countries.[13]

In an interview in January 1988, Salinas had, however, stated that he was not in favour of any free trade or common market plans between the US and Mexico because of the disparate level of economic development of the two countries.[14]

What then brought the sudden change in Salinas' perception when he asked Bush in June 1990 for a free trade

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13 <u>Daily Report: Latin America</u> (Washington D.C. : Foreign Broadcast Information Service), 22 May 1992.

14 <u>New York Times</u>, 29 March 1990.

between the two countries ? When Salinas came to power in December 1988, the legitimacy of the PRI was at its lowest ebb. The 1988 elections had all the dimensions of a fraud.[15] The opposition forces from both the left and the right had challenged the results of the elections. To bolster his own position politically and revive the economy, the Salinas regime resorted to drastic economic changes at the domestic level. These changes in their wake strengthened the process of integration with the US economy.

SALINAS' INITIATIVE TOWARDS NAFTA

One of the first attempts of Salinas was to try to increase the level of foreign investment in Mexico. In order to do so, the government sought to attract external resources through direct foreign investment. The foreign investment law of 1973 was changed just 6 months after the new president assumed office. In May 1989, many impediments to investment were removed. Accordingly, foreign investors are new allowed to own 100 per cent of a venture without obtaining prior approval of the National Foreign Investment Commission with exceptions in the oil and gas transportation and forestry industries.[16]

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15 For details see Andrew Reding, "Mexico at a Crossroad: The 1988 Election and Beyond", World Policy Journal (New York), vol.5, no.4, fall 1988, pp. 615-649.

16 Management Review(Saranac Lake, NY), September 1989, p. 50.

Accordingly, foreign investments registered a \$ 5 billion increase from May 1989, when the new rule was approved, to November 1990.[17] However, this was below expectations. Apparently, developments in Eastern Europe and elsewhere at the end of 1989 may have diverted the interest of potential investors to those regions despite the efforts of Salinas to promote European investment during his trip there in the end of January 1990. Because of economic restructuring, capital that had been stashed abroad returned to Mexico as is evidenced by the increase in foreign investment in Mexico from a total of \$ 4 billion in 1990 to more than double that amount by the first half of 1991.[18] Within foreign investments, IMF statistics show that portfolio investment in the first half of 1991 amounted to \$ 5.6 billion which a year earlier had been negative. Meanwhile, direct investment increased from \$ 826 million in the first half of 1990 to \$ 1.37 billion in the same period last year.[19] And as regards the foreign investment that entered Mexico through the stock exchange, which for the past couple of years has overtaken foreign direct

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17 Jorge Chabat, "Maxico's Foreign Policy in the 1990s : Electoral Sovereignty and Integration with the United States", Journal of Intermerican Studies and World Affairs, vol. 33, no. 4, winter 1991, p.3.

18 Susan Kaufman Purcell, "Mexico's New Economic Vitality", Current History (Philadelphia, Pa), vol. 91, no. 562, February 1992, p. 55.

19 Mexico: Country Report (London : The Economic Intelligence Unit), no. 1, 1992, p. 22.

investment, it was "selective and low-risk oriented" and came mainly from the US. In February 1992 32 per cent of the foreign investment in shares went to the ten largest companies ; 20 per cent of foreign portfolio investment was placed in government securities, and of this more than half in the treasury bills.[20]

And if most of the capital that has entered the country is devoted to portfolio rather than direct investment, it means that it could quickly leave the country in the event of the emergence of any economic or political problems in Mexico.

Salinas has gradually opened up the economy. The average tariff is now 10 per cent, one of the lowest in the world.[21] Import permits, which were required to import certain items have essentially been eliminated. Salinas followed his decision to look northward with efforts to reduce trade barriers between Mexico and its Latin American neighbours. He offered the countries of Central America duty-free access to the Mexican market and signed a free-trade agreement with Chile in 1991. The groundwork for a free trade agreement with Colombia and Venezuela has also been laid. Salinas hinted at the possibility of a free trade agreement with Guatemala during his visit to that

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20 Latin American Weekly Report (London), 11 June 1992.

21 Purcell, n. 18, p. 55.

country in February 1992.[22] Also, Mexico has made entry into the English-speaking Caribbean region by successfully seeking observer status in the Caribbean Community and Common Market.

On the economic front the regime has tried its hand at controlling inflation by adopting some anti-inflationary measures like renewing a series of wage and price control agreements among business, organized labour, and the government. It has reduced taxes while simultaneously expanding the tax base.[23] The annual inflation rate which was 150 per cent when Salinas took power was reduced to 19.3 per cent by 1991. However, this was still higher than the governments targeted inflation rate of 14 per cent of 1991.[24]

Another major change brought out by Salinas was the privatization of state firms including politically sensitive areas such as telephones, steel and the huge Cananea copper mines. The government had cut the number of state run companies from 1,155 in 1988 to fewer than 750 by 1990.[25] The most dramatic privatization occurred in May

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22 Daily Report : Latin America, 27 February 1992, p. 11, and Latin American Weekly Report, 9 January 1992.

23 Purcell, n. 18, p. 55.

24 Latin American Weekly Report, 9 January 1992.

25 George W. Grayson, "Mexico Moves Towards Modernization", Current History (Philadelphia, pa), vol. 90, no. 554, March 1991, p. 110.

1990, when Mexico's Congress approved a constitutional amendment that returned to private hands two-thirds of the equity in 18 banks nationalized eight years earlier. The sale of these banks is estimated to bring in funds and should help promote private-sector investment in Mexico. Salinas has also used the cash generated by the privatization programme to fund 'Solidarity'--a self-help public works programme for the poor--and to retire substantial portions of Mexico's internal debt, thereby reducing future interest payments and reinforcing Mexico's efforts at economic stabilization.

In 1990, an agreement was signed to restructure the debt that had been negotiated back in mid- 1989. According to the agreement, about 500 participating creditor banks (holder of about 50 per cent of Mexico's total debt) chose one of the three options offered to them as a way to reduce the country's debt: to forgive the principal; to reduce the interest; or to lend new money.[26] As a result, the debt under consideration (US $48.5 billion) was reduced by $20.5 billion through a combination of forgiving part of the principal amount (some 43 per cent of the debt under negotiation) and lowering of interest rates (accounting for another 47 per cent).[27]

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26 Chabat, n. 17, p.3.

27 Ibid., p.4.

The economic growth after 1988 was, more positive compared to the early 1980s, as the growth rate exceeded the population growth by 2 per cent in 1991. Revised figures show that the real GDP growth increased from 1.3 per cent in 1988 to 3.3 per cent in 1989 to a healthy 4.5 per cent in 1990. In 1991, the growth rate was 3.5 per cent. For the entire period 1988-91, the GDP grew by 13.1 per cent.[28] The main engine of this rapid growth was private investment which increased by 25 per cent in the period and now accounts, in real terms, for 80 per cent of all investment in Mexico.[29] Particularly notable was the growth in he agricultural output (by 6 per cent) and the increase in commerce (by 4.7 per cent).[30] This spectacular growth in the agricultural sector hints at the increase in investment in agribusiness and the food processing industries.

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Salinas brought out sweeping changes in the agricultural sector of Mexico. In November 1991, he submitted to the congress a bill to reform Article 27 of the Constitution which proposed to do away with land reforms and the ejidos system.[31] Under Article 27 of the Constitution, ejidos were accorded constitutional status as a form of communal property and distinguished between ejidos that had

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28 Latin American Weekly Report, 11 June 1992.

29 Latin American Weekly Report, 9 January 1992.

30 Ibid.

31 Daily Report ; Latin America, 21 February 1992, and Purcell, no. 18, p. 57.

been awarded as human settlements and those that are productive assets for individual use. The amended article proposed to end land redistribution by repealing all of the constitutional provisions upholding it, to allow *ejido* members to alienate their lands if they so wish; to facilitate the various forms of partnership between *ejido* members and investors by allowing corporations to own land and invest in the countryside; to open up agriculture to foreign investment; and to retain the current limits on the various forms of small landholdings. In spite of the widespread support for giving the *ejidos* members ownership rights, it is feared that this could foster a concentration of land Some also feel that these reforms would erode the PRI's peasant support base. [32]

Critics of Salinas' reform charge that Salinas has brought out *perestroika* (restructuring) without *glasnost* (openness). [33] In other words, Salinas has attempted economic reforms without any meaningful political reforms. But Salinas has defended this by saying that the Soviet President Gorbachev's policy of *Glasnost* destroyed the central political authority that was subsequently needed to

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32 Purcell, n. 18, p. 57.

33 Sidney Weintraub, and M. Delal Baer, "The Interplay Between Economic and Political Opening : The Sequence in Mexico", *The Washington Quarterly* (Cambridge, MA), vol. 15, no. 2, p. 187, and Cuauhtemoc Cardenas, "Misunderstanding Mexico", *Foreign Policy* (Washington, D.C.), no. 78, spring 1990, p. 115.

implement his economic policy. To avoid the replay of these developments in Mexico, Salinas is using the power and authority of Mexico's mildly reformed authoritarian political system.

The regime has justified its economic policies and thinking as 'social liberalism'.[34] In his speech while presenting the tenets of 'social liberalism' on 5 March 1992, Salinas has stated that more economic interaction with US would not be allowed to include political integration.

Be that as it may, Salinas' policy is undoubtedly a high-risk strategy. Whether Salinas' moves result in delivering the goods to the Mexican people or not remains to be seen. But whatever be the final denouement of these changes, these are irrversible. There seems to be only one path for Mexico--to see to the logical conclusion of the North American Free Trade Agreement. Success however depends on ironing out the many differences. What are the issues that have been placed on the negotiating table ? How are these differences likely to be resolved ? The next section discusses briefly the negotiations towards a free trade agreement.

ISSUES UNDER NEGOTIATION

Negotiations between Mexico and the US followed Salinas' meeting with President George Bush in Washington in

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34 See Daily Report : Latin America, 20 March 1992, and Latin American Weekly Report, 19 March 1992.

June 1990. It was in February 1991 that the negotiations became tri-lateral with the inclusion of Canada. Presently negotiations between the three countries are in progress. If the negotiations move smoothly, the three countries will be joined together in a market of more than 360 million people and an annual economy of US$6 billion.

Of interest is the question of opening Mexico's energy sector, which was nationalized in 1938 and is protected as part of the national patrimony by the Constitution. But oil will be the last bastion of Mexican sovereignty as it has traditionally been a symbol of nationalism. Hence, the outright ownership by foreign oil companies of Mexican crude oil fields was ruled out by the Mexican authorities even before formal NAFTA negotiations began. At the same time US has demanded that migration of labour should be kept out of the agreement.[35] Salinas has often reiterated that the Mexican sovereignty over its oil resources would be left untouched by a free trade agreement. Mexico, though, has already allowed foreign drilling companies to operate under contract to Pemex, while Mexican crude already enters the US without tariffs.[36] However, most observers feel that some amount of opening of the oil industry to foreign investment may become necessary if the

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35 Latin American Weekly Report, 20 February 1992.

36 Ibid.

US is to approve the Treaty. Indications are that Salinas will open up the industry to some extent at least after making some constitutional amendments. Salinas regime has already ordered a restructuring of Pemex in May 1992 in a move to separate oil-related ancillary sector outside the purview of Pemex.[37]

Apart from the process of restricting Pemex into eight different divisions, the government has also agreed to reclassify a number of petroleum products (in addition to those reclassified earlier) from 'basic' to 'secondary' thus allowing foreign investment with the so called secondary products.[38] Mexico is lured by the idea that private investment will enable the oil sector to make a more positive contribution to the balance of payments situation than it does at present.

Progress in the negotiations is said to have been made towards agreement on product standards, temporary entry across boundaries for business, safeguard against surges of imports, customs procedures and rules of origin.[39] However disagreements still persist over many important subjects including the time table for tariff liberalization, rules of origin, investment protection, levels of farm subsidies and

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37 Daily Report : Latin America, 21 May 1992.

38 Latin American Weekly Report, 20 February 1992.

39 USIS Public Diplomacy Query Index and Dext Database, 9 April 1992.

dispute settlement mechanisms. Others areas left undecided include auto parts, energy, financial services and copyrights.[40] Differences over the phase-out period also persists. An example of this is in the banking and financial services markets which the US wants Mexico to open within a 3 to 10 years adjustment period. Mexico contends that such a time frame is too short to give its industries enough time to become competitive. Positions are reversed in textiles and glass where the US wants a 20 years period of adjustment -- much longer than what Mexico wants.[41] Protectionist barriers against the importation of Mexico's textiles seem to be causing some problem too. While Mexico only applies a maximum duty of 20 per cent on import of textiles, US imposes as high as 57 per cent and Canada upto 30 per cent.[42]

Mexico is opposed to the opening of its maize market for it will have very serious impact on small and 3rd
marginal farmers, while the US and Canada want restrictions on Mexico's automobile exports.[43]

Motor vehicles are the single most important product traded among the three countries. The main problem 3rd
with motor vehicles is the local content rules. The US,

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40 *The Observer* (New Delhi), 2 June 1992.

41 *New York Times*, 22 February 1992.

42 *Latin American Weekly Report*, 23 January 1992.

43 *Latin American Weekly Report*, 13 February 1992.

spurred by its three automakers, is pushing for a 75 per cent minimum in order to deem vehicles 'North American'. Mexico, which has recently attracted foreign investment from Mercedes Benz and is seeking investment from Japanese companies, is pushing for a 60 per cent local content minimum.[44] As far as Canadian vehicles are concerned, the Canadian assembled vehicles previously exempt from US import duties have presently been reclassified as eligible for duty. Ambiguity in the rules of origin under the existing US-Canada Free Trade Agreement led to considerable differences between the two countries when US Customs Service determined that Honda autos assembled in Canada do not qualify for duty-free treatment in the US because it failed to meet the 50 per cent North American content--threshold required for duty-free access to US under the Canada-US Free Trade Agreement.[45] This has sent warning signals to Mexico as the US decision against Canadian made Hondas seems harsh and arbitrary. It seems that the US administration is to take into account the pressures exerted by the domestic auto industry.

A number of disputes have arisen in the Canada-US Free Trade Agreement. The wheat lobbyists in the US Congress are now protesting that Canadian wheat is entering

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44 Latin American Weekly Report, 20 February 1992.

45 The Observer, 2 June, 1992, and USIS Public Diplomacy Query Index and Text Database, 9 April 1992, and The New York Times, 9 April 1992.

US under unfair condition. Similar complaints have been made in the areas of hog and beer trade, and lumber trade.

Despite all the technicalities,the negotiations are going on. The US Trade Department has been negotiating under a 'fast track' authority which was granted to the president (under a 'fast track' authority the congress has to accept the free trade agreement without any amendments or reject it in full). But conclusion of NAFTA seems unlikely before the 1992 US presidential elections. There are various reasons to support such an argument. The US will go 3Rd
to polls later this year. And within the US the opposition to NAFTA is increasing as the economy continues to reel under recessionary conditions. As the industrial wage level in Mexico is only one-twentieth that of wage levels in the US, the US labour has come down heavily against the signing of an FTA with Mexico as it would lead to the displacement of American workers.

The fear exists that the labour opposition could turn into a serious political liability for the Republican Party particularly when opponents within the Republican Party itself like Pat Buchanan do not lose the opportunity to talk of the disadvantages of a free trade area.[46] The non-party presidential candidate Ross Perot is against the FTA too. So discussing of support for NAFTA in the election

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46 Latin American Weekly Report, 6 February 1992.

year is unwise and dilatory tactics to prolong the finalization of the treaty till the elections are over may end up in an indefinite postponement of NAFTA. Even the Democratic Party is wary of mentioning NAFTA in its electioneering. As of now Bush's popularity seems to be very low going by various reports.[47] In the Pennsylvania senate elections, Harris Wafford, a Democrat gathered anti-NAFTA support and was declared winner. After the December 1991 meeting between Bush and Salinas the statement issued only mentioned that the FTA would be concluded as early as possible, and a date was studiously avoided. The absence of any mention of NAFTA in the emergency economic programme which Bush announced in January 1992 is yet another signal that the Bush administration is unlikely to play up the issue just now, and might delay it indefinitely if the perceived dividends of the NAFTA are not forthcoming immediately. Besides, Canada will go in for elections sometime in 1993 and the Brian Mulroney government in terms of its popular rating is at its lowest. Salinas himself is half way through his sexenio and from now his hold over the ruling party and government will only decline if the search for the next presidential candidate intensifies. A stalled NAFTA may even become a liability for the next PRI presidential candidate if the domestic situation does not get quickly adjusted to structuring changes.

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47 Mexico : Country Report, no. 1, 1992, pp 8-9.

In sum, both economic and political factors are impinging on the process of negotiations aside from considerations of the three countries which at time may be at variance with each other. Many points of contentions and differences are cropping up at the negotiation stage itself. Though the salinas regime had expected long and protracted negotiations, the inability of all the three countries to negotiate the finalization of the treaty is giving rise to misgivings about the early signing of the agreement. However, as the next chapter describes, Mexican regime and groups championing the free trade agreement are becoming more open in their support and propagating the virtues of NAFTA.

CHAPTER III

IMPLICATIONS OF NAFTA FOR MEXICO

The idea of a North American free trade area is not new. As has been discussed earlier, the Section 1104 of the 1979 Trade Agreement had made an amendment to the Section 612 of the Trade Act of 1974, supporting a study of new trading arrangements with Canada and Mexico. The Reagan administration in the US had promoted the idea of a North American free trade area again in the 1980s. But Mexican response to such US initiatives had been repeatedly negative till the late 1980s, predominantly because Mexico had been apprehensive of being swept over by the US. It was only with the economic restructuring of Mexico by De la Madrid and later by Salinas, that Mexico began a process of integration with the US. The initiatives taken by Salinas to integrate the Mexican economy into the US economy have been discussed in the previous chapter. Integration will undoubtedly have for-reaching implications for Mexico. The present chapter intends to analyze the implications of a NAFTA for Mexico as seen by the government and other advocates of free trade. In other words, this chapter will highlight the proponents views. The proponents of the agreement celebrate the virtues of free trade as the prime engine of economic growth.

One of the main advocates of NAFTA has been the government of Mexico itself. The government of Salinas has justified the changes and reforms which have taken place in Mexico in the last decade to conform to the tenets of "social liberalism". The proclaimed aims of the state of Mexico are to bring in a better democracy, more social justice, growth, employment and prosperity. The principle of sovereignty is fundamental to Salinas' concept of "social liberalism".[1] So greater economic integration would not include political integration. The concept of social justice under "social liberalism" rejects paternalism and populism. Salinas has defended the reforms in Mexico's agrarian sector by saying that it confirms to the regime's goal of justice and liberty in the farm sector. "Social liberalism", according to Salinas, is different from "statism" and "neo-liberalism" as it is totally relevant to Mexico's past and its future and will steer Mexico towards the path of modernization. President Salinas has justified his policy of looking northwards :

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> "Integration is a fact of the modern world. Look at the blocs that are being created: Europe in 1992, the Pacific Basin countries, the US and Canada. I don't want to be left out. We, by geographical happenstance, are neighbours. But by political will we want to get the best from that relationship. We want to participate much more in the biggest market in the world. If we give our investors the certainty of access to the US. market, investment in Mexico will grow substantially. That's why I place so much emphasis on the trade agreement.[2]

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1 Daily Report : Latin America (Washington, D.C. : Foreign Information Broadcasting Service), 20 March 1992.

2 Adolfo Gilly, "The Mexican Regime in its Dilemma", Journal of International Affairs (New York), vol. 43, no. 2, winter 1990, p. 285.

For Salinas an agreement with US would strengthen his market-oriented reforms. An accord, it is expected, would draw in investments from North America, Europe and Latin America. From a long-range perspective, secure access to the U.S. market could make Mexico an attractive investment location relative to its competitors in Asia. The mere prospect of a free trade would testify confidence and investment in the Mexican industrial sector. Some intellectuals like Aguilar Camin have also come out strongly in support of the economic and political changes in Mexico.[3] The "new paradigm" depicts a modernization thoroughly opposed to the institutional system that Mexico created in its post revolutionary era starting in the 1920s. According to Camin, the countries which do not respond to the globalization of the world economy will pay for it in terms of the well being of its people. Camin has justified the reforms that are taking place in the agrarian sector, like the abolition of ejidos, through an amendment of Article 27.

INDUSTRIAL AND BUSINESS SECTOR

From Mexico's perspective, the US is by far its most important trading partner since three-fourths of its trade is with the United States. From Mexican point of view, therefore, trade with the US is critical to its economic health. The industrial and the business sector

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3 Daily Report: Latin America, 20 April 1992.

have welcomed the Free Trade Agreement as it would lead to increased trade between the US and Mexico. The changes that take place through economic integration would have a direct impact on the corporate world. For the businessman, issues of competitiveness have a lot of significance. It is argued that the globalization of the Mexican economy will make Mexican industries more internationally competitive. The Salinas government embarked on a process of structural changes by opening its borders to international trade, privatizing state-owned industry and deregulating some of the most important of its economic sectors. According to 1990 national statistics, G.D.P. grew by 3.9 per cent, with industrial production rising at the rate of 5.4 percent. Investment as a percentage of G.D.P. reached its highest level in five years, standing at 18.9 per cent.[4] According to recent surveys conducted in the international banking community, Mexico's credit rating has been raised by 5.4 points, one of the highest rises ever recorded.[5] The international business community has responded to this upsurge in the Mexican economy. New foreign investment reached US $4.6 billion in 1990 over half of which was in direct investments.[6] Through cross-border alliances,

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4 Raul de la Sierra, "Revitalization of the Mexican Economy : Investment for the 90s", Columbia Journal of World Business (New York), vol. 26, no. 2, summer 1991, p.105.

5 Ibid., p.105

6 Ibid., p.106

acquisitions, technology transfers and portfolio investments, foreign business have further strengthened their participation in the Mexican market and demonstrated their confidence in its stability.

Major U.S. corporations such as the Detroit "Big Three", Eastman Kodak, General Electric, IBM, Pepsico, Du Pont and Phelps Dodge have long been involved in the Mexican market, and are now expanding their manufacturing facilities to take advantage of increased local demand, raising productivity levels and export potential. For companies such as these, the benefits of Mexico's competitive labour costs, natural resources and regional contiguity have translated into significant gains in productivity. The strengthening of Mexico's consumer market --traditionally focused towards the US -- has resulted in an important increase in the imports of all items from the US, particularly capital goods. Additional integration of the two economies can only further enhance these gains.

Deregulation and procedural simplification have created alternative forms of investment in Mexico. Buy-outs, joint ventures, trusts, share ownership, neutral stock options, and venture capital funds all present viable investment mechanisms for the foreign businessman.

There are three industrial sectors in Mexico that would be covered in the negotiation towards the FTA.[7] In the first category are those industries which are already integrated to a high degree, by means of investment, trade or technology, with the US market. In the second category are included sectors with a limited amount of integration, but in which it will be relatively easy to increase integration given the existence of the appropriate framework and terms. The third category includes sectors in which integration will be extremely difficult, for reason specific to the industry or for political considerations.

The automotive industry and the maquiladoras fall into the first category. The role of the maquiladoras has been discussed in a separate section later. The principal effect of the free trade agreement in these sectors would be the guarantee of a long term legal framework which would ensure not only access to the US market, but also alter the permanent structure of the Mexican foreign trade policy. This could translate into greater flows of investment into Mexico, leading to an increase in the sales of production and, in this manner, strengthening the specialization in the production of certain goods.

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7 Gabriel Szekely and Oscar Vera, "What Mexico Brings to the Table: Negotiating Free Trade with the US", Columbia Journal of World Business, vol. 26, no. 2, p.105.

A large number of firms in these industries are owned by foreign corporations, particularly from the U.S. Consequently, these firms will often respond more readily to pressures for globaliztion of their investments, markets and technology. Only in a few cases Mexican capital prepared to develop industries of this type, as is already the case with the cement and glass industry. However, some would argue that in today's globalized economy, the importance of the national origin of capital has been greatly diminished. These industries will have to adjust themselves to the global conditions of the market place. This will mean the closing and relocation of firms as new competitors displace investment towards other countries for reasons of available natural resources, lower costs, or other considerations.

In the second category are included those industries where it will be possible to reach full integration with relative ease, such as petrochemicals, textiles and auto parts. In the short term, these could become the industries which most greatly benefit from the accord, and in addition to new investment flows aimed at increasing plant scales, one can expect the integral development of new production lines and of the corresponding access to the US market. In this case there will be more firms in which Mexican capital predominates.

Some of the industries with little possibility of becoming more closely tied with the US economy, like machinery, tools and heavy transport, will suffer economic setbacks because they lack specific government support for their development.

Over the past decade, the Mexican financial sector has taken important steps towards restructuring and modernizing its operations. First there was a strong movement towards consolidation, with the number of banking institutions reduced from 60 to just 18.[8] Second, there was a rapid rise in alternate financial intermediaries such as brokerage houses, fund managers and leasing operations. Many of the large commercial banks began operating as multipurpose institutions, offering their clients a broad range of services from investment funds, factoring real estate investment and trusts. Banco National de Mexico (Bananex), Mexico's largest commercial bank, bought the Los-Angeles based California Commerce Bank in order to have a toe-hold in the important Southern California market and offer services to the maquiladoras industry.[9] In May 1990, the Mexican government announced it's intention to re-privatize the entire banking system. In order to strengthen the competitive position of this industry, financial holding companies are being formed by the Mexican business community in order to offer the services of banks, insurance

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8 Sierra, n. 4, p.106

9 Ibid.

companies, currency brokers and fund managers, a process which should help to accelerate their capitalization. Already, there are some Mexican banks that are better capitalized than their US counterparts.

The advent of a free trade agreement between the two countries and its implications for Mexico's still underdeveloped financial sector demand that new technology, modern system operations and tailored services be rapidly assimilated and implemented if the Mexican banks are to compete on comparable terms when and if giants such as Citicorp (already operating in Mexico), J.P. Morgan and Bank of America enter the market.

As regards the Mexican businessmen, they are more interested in free trade in agriculture, textiles and automobiles. They are keen for an opening in the US markets to currently prohibited fruits and vegetables. Mexico grows more avocados than any other country in the world, for example, but sells more in the US, because of US protective rules favouring Californian growers and allegations that Mexican advocates are infested with worms.[10] Similarly, the orange growers of Florida fear the removal of protectionist barriers by the US government, in the event of a free trade agreement, as Mexican orange producers will displace them.

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10 Business Week (New York, NY), 12 November 1990.

Mexicans are eager to open US markets to more of their fruits, vegetables and processed foods.

The Mexican agribusiness sector have encountered a series of obstacles when attempting to gain access to the markets of its northern neighbour. The US government (citing principally health reasons) has frequently limited access to Mexican exporters. In addition, due to low levels of Mexican output, US products such as chicken and eggs have been dumped in the Mexican marketplace.

The advantages of an agreement for the Mexican agribusiness sector would be significant. For example, estimates prepared by Mexico's trade Ministry indicate that while the average tariff for agricultural products entering the US is close to 4 per cent, melons coming from Mexico pay 35 per cent, and squash pay 26 per cent.[11] However, success will depend on avoiding the adoption by the US authorities of openly protectionist measures in response to particular special interest groups, such as Florida and California farmers.

The practical way to achieve this goal is to negotiate access quotas, as has been done in the cases of steel and textiles. With these quotas the discretion of the authorities will be reduced and clear rules will prevail. In

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11 Szekely and Vera, n. 7, p.32.

the US, the farmers receive an extraordinary quantity of subsidies and these have resulted in an excess production of numerous products. Mexico should avoid converting itself into a market to which the US exports highly - subsidized products, although in the short term these might be attractive, in the long term it could constitute a serious error. Although one could argue that in the long run the beneficiary of such subsidies would be the Mexican consumer, national production would be deflated even further. In the long run the level of dependence on outside sources for food would increase.

In some cases, Mexico will be able to attract capital for profitable projects in aquaculture, flower cultivation, and other agricultural areas. This will favor the rehabilitation of the countryside and will open new opportunities within the US market.

ROLE OF THE MAQUILADORAS

An analysis of the role of the maquiladoras in Mexico will explain further the perceived benefits of signing an agreement with the US. One of the more remarkable areas of growth in manufacturing has been in-bond or maquiladoras plants. These are off-shore activities, permitted to import raw materials or parts without restriction or duties for processing in Mexico, provided all or part of the output is exported. Such activity in the past has been closely related to US imports under tariff schedules 806 and 807.[12] The output of the *maquiladora* industry is important not for reasons of its size, but because changes accurately reflect external demand without intermediation of government (except in the management of the currency and provision of infrastructure). *Maquiladoras* are regulated by a special regime under which various aspects of free trade already operate. In particular, they can import inputs and machinery from the US market without paying taxes in Mexico; and the finished goods sent to the US market pay tariffs based only on the value added in Mexico. This preferential treatment -- the access to low-cost and relatively qualified labour, the proximity to the world's largest market, and the easy access to the technology and modernization infrastructure of the US -- explains the growing success of the *maquiladoras*.

The *maquiladora* sector began in the 1960s, initially along Mexico's northern border, but now has expended to many other regions. They began, as the East and South-East Asian 'miracle' economies had done by exporting traditional manufactures, produced by a labour force, the chief advantage of which was its cheapness. Unlike the case of Asian country, with the exception of Singapore, the companies concerned were foreign owned -- most of them

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12 Nigel Harris, "Manufactured Exports and Newly Industrialising Countries : Mexican Trade and Mexico - US Economic Relations", *Economic and Political Weekly* (Bombay), vol. 26, nos. 11 & 12, March 1991, p.663.

registered in the US. Initially, operations were concentrated in the border region which was made a free trade zone. Growth since 1965 has usually fluctuated on a rising trend, most strongly affected by the level of the peso-dollar exchange rate. From 1982, with a radical depression of the peso (the currency remained undervalued upto 1987, with the exception of a short period in 1985), unemployment in maquiladoras expanded with remarkable speed -- from 119,546 people in 1980 to 123,000 in 1982 to a whopping 450,000 people in August 1989. Currently there are about 1900 maquiladora plants near the U.S. - Mexican border and employing about 500,000 Mexicans.[13] The average annual growth rate in the same sector between 1980 to 1988 was 13.4. per cent[14] Of the inputs consumed by these enterprises, only 2.3% were produced in Mexico, the rest entered Mexico duty free since the final products were destined for export.[15] The companies in these sectors are thus more integrated with the US economy than with Mexico.

By the late 1980s, the maquiladora sector was said to be producing about a quarter of the value of Mexico's manufactured exports (although providing only about a fifth of Mexico's manufactured output.[16]

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13 Robert E. Batres, "A Mexican View of the North American Free Trade Agreement", Columbia Journal of World Business, vol. 26, no.2, summer 1991, p.79.

14 Ibid.

15 Gilly, n. 2, p. 285.

16 Harris, n. 12, p.663.

Simultaneously, the growth of employment and output has gone along with the rapid change in the composition. They began as small, poorly organized plants, belonging to relatively small US-registered companies, often from states in the border area employing a high proportion of unskilled or semi-skilled workers on very low wages. Since the 1970s, the average size of plant has increased, many of them owned now by the major international companies including a growing number of firms registered in Japan, Federal Republic to Germany and even South Korea. Capital and skill intensities have also risen considerably resulting in a decline in the proportion of employed especially women.

Border locations as well as the bias in tariff schedules 806 and 807 encourage maquiladora plants to import most of their inputs from the US, of the inputs consumed by these enterprises only 2.3 per cent are produced in Mexico; the rest enter Mexico duty free since the final product is destined for export.[17] However, at times this is decreasingly true. The closer the plant to Mexican sources of inputs the higher is the percentage -- 17 per cent of the final value derives from Mexican inputs in Nuevo Leon state with its strong manufacturing base in Monterrey.[18]

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17 Gilly, n.2, p. 285.

18 Harris, n. 12, p. 663.

Import substitution policies in the past perhaps encouraged the location of plants to supply the domestic market in the central Valley, liberalization in the 1980s is still too new to affect significantly territorial distributions, but it is presumed that in the future, just as _maquiladora_ activity moves south towards central valley, so increasingly Mexican companies will move to supply them both there and in the border region.

There are three ways to become involved in a _maquiladora_ : subcontract, shelter, or full ownership. [19] In a subcontract operation, the US company makes a deal with an operator to produce a certain product for an agreed-upon price. If the product is a garment, for example, the US company will then ship the fabric, machines and other tools to the subcontractor who sews the garment and ships it back to the US. The company pays duty on the labour and markets the garment.[20]

In a shelter operation, the Mexican operator provides the building and workers ; and the US company provides raw materials, machinery and production supervision. US managers oversee production and the administrative work is left to the shelter operator --

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19 _Management Review_ (Saranac Lake, NY), September 1989, p.51

20 Ibid.

finding the building, hiring the workers, dealing with the Mexican unions and so forth. Shelter Operations are generally temporary in nature. Most U.S. maquiladoras are Mexican companies that are 100 percent owned by the parent company and they operate like any other plant with the exception of cheap labour. The U.S. facility sends raw materials to the maquila plant; there, it is assembled into product and shipped back or exported for sale elsewhere.

The maquiladora sector has been the source of much controversy on both sides of the border, Fears are frequently expressed in Mexico that such activities are particularly subject to economic fluctuations in the North American economy.[21] In the 1974 US downturn, however, maquiladora plants were significantly more stable than control groups of plants in both Mexico and the US. And, protectionism in the north could pose particular problems for Mexico. But Mexico has an important advantage over South Korea and Taiwan in its maquiladora sector as much of the maquiladora production is in the lands of important US-registered companies which are likely to exercise considerable influence to prevent the restriction of their intracompany flows across the border. Furthermore, the US administration is not unaware that maquiladora output plays

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21 Harris, n. 12, p.665.

a role in maintaining the competitiveness of US-based production relative to Mexico. Thus what has hitherto been seen as a disadvantage by Mexicans, the ownership of part of Mexican industrial assets by US-registered companies, restricting the stimulation of Mexico component suppliers, might be a strength in combating American protectionism.

The maquiladora sector is closely linked with the manufacturing processes of the economy of the north. In the US and Mexico there has been much discussion as to which country gains from the arrangement. In the US, there is a feeling among some trade unions that Americans are losing out on jobs to Mexico due to plants relocating southwards due to the availability of cheaper Mexican labour. Another question which is being raised is whether imports in general decrease employment and domestic output, or, through providing cheap inputs, increase both?

Doubts have been expressed on the future of the maquiladora sector. It is feared that the maquiladora sector, the forerunner of the free trade between the US and Mexico could become one of the victims of the agreement. However, all the possible scenarios do not include the eventual disappearance of the regime, that regulates the maquiladoras. While it is true that in the eventuality of FTA, the majority of both the US and the Mexican economies will be full of obstacles to trade, however the majority of the conditions that favour investment in the maquiladoras will continue to exist. These conditions not only include the low cost of labour and the proximity to the US, but also given the fact that these plants operate only as the centres of production, the profits are reported in the US, where tax rates are lower and fiscal exemptions are more favourable.

If indeed the maquiladoras will no longer enjoy relative protection, they will be compensated by the fact that the horizon of their operations will be significantly amplified upon signing a free trade agreement. Eventually, they will not have to concern themselves with restrictions on the proportion of sales that they can realize in Mexico, with the inefficiencies of customs, nor with various other factors that diminish their productivity.

One of the major deficiencies of Mexico while trying to orient itself to the international markets is the inadequate communications and transportation infrastructures in the interior of the country. Many cities of the interior would be formidable competitors to the border cities if these shortcomings were to be resolved, as the problems experienced by the latter in the areas of basic infrastructure, housing, public services, and a high turnover rate amongst its labourers do not exist in cities in the interior.

The question of inputs imported for maquiladora from certain markets will be the subject of special negotiations. Between the two countries the target of U.S.

criticism has been the Japanese firms for their pronounced tendency to purchase inputs made in their own country and in East Asia, to the detriment of US products. For Mexico, the problem is even greater as it faces extremely low sales of domestic inputs -- 2 per cent of total demand. In the context of greater integration, the small and medium - sized Mexican firms could be among the greatest beneficiaries of establishing productive links with the large maquiladoras. This is important because these firms, by any other means, will have few chances to insert themselves into the international economy.

It is in Mexico's interest to maintain the maquiladora regime in order to continue to attract certain types of investment. But an attempt has to be made to upgrade the conditions of labour in these plants-wages should be in consonance with actual work, social security, occupational safety and hazard regulations. As part of this effort maquiladora workers should be encouraged to unionize and open up an active dialogue with American unions in the same industries. The goal would be to devise compatible negotiation strategies on both sides of the border. The gap in wages and fringe benefits between the US and Mexican labour has to be narrowed down. If in addition one considers Mexico's geographical advantage, it is obvious that there is room for better working conditions, higher wages, and growth in the industries. In the meantime, the maquiladoras can be stimulated to integrate themselves into the Mexican economy, to spread to other regions, and to establish downstream links with other domestic industries and markets. This would provide for more consistent transfer of technology, as well as for the development of other productive activities and other regions.

This chapter has outlined the arguments of the proponents for forging a free trade area in North America. While the government expects an FTA to usher in growth, employment and prosperity, the industrial and business sector expect an inflow of capital. However, opinion on FTA is divided in the industrial and business sector. The small businesses are opposed to the FTA as they expect it to displace them since they will not be able to withstand the pressures of international competition. The industrial sector, by and large, is optimistic about an FTA as they feel it would enable them to gain access to the northern markets. An FTA is also expected to bring into Mexico new techniques of production. The Mexican agribusiness too would have a lot to gain under a NAFTA.

As regards the <u>maquiladoras</u> - which is already integrated to the US economy - an FTA would increase employment for the Mexican labour. Benefits are also expected to accrue in the form of US investments and technology transfers.

CHAPTER IV

OPPONENTS OF NAFTA

The last three chapters have traced the evolution of the concept of free trade in the Western Hemisphere; the compulsions that drove Mexico to accept the idea of a North American Free Trade Agreement and the initiatives taken by Mexico in this direction. Beginning with a brief description of the Mexican development strategy after the end of the Second World War, further attempt has been made to explain the gradual downslide of the Mexican economy from mid-1960s onwards, once hailed for its 'miraculous' performance. It was the economic crisis of 1982, when Mexico found itself enmeshed in the problems of foreign debt, runaway inflation and a glut in the oil market, that resulted in the De la Madrid's government to look at alternative strategies of development. The isolationist policy of Mexico ended and the strategy of export-led growth began. President Salinas has continued with De la Madrid's economic policies, and even went a step further by requesting for negotiations to create a North American free trade area. This decision of Salinas has invoked mixed responses. While the proponents of NAFTA celebrate the virtues of a free trade agreement, there are groups opposed to such an arrangement. The proponents feel the agreement would give an impetus to foreign investments and enable the government to ameliorate the condition of the people. Free trade would act as a panacea for the economic ills of Mexico. The decision to pursue a free trade agreement is undoubtedly a bold political act and testifies the complete hold of the PRI over various domestic constituencies. After a long period of political uncertainty, the ruling party has been able to regain the support of big business and a consumerist middle class while forcing the captive organized labour to acquiesce to the governments decision. While the main right wing National Action Party (PAN), the traditional advocate of free trade policies, has been preempted, the leftist and nationalist forces rallying around the Democratic Revolutionary Party (PRD), through coercive measures, has been made to climb down from outright opposition to modified support for the free trade agreement. Opposition to NAFTA is thus now in the hands of a small group of intellectuals, environmentalists and some peasant groups and independent trade unions. Objections now range from environmental concerns over Mexico's pollution control standards, prospects of lay-off, low wages and exploitation of labour and displacement of small and marginal peasants to nationalist fears of U.S. hegemony, loss of national cultural identity and dilution of Mexican revolutionary goals.[25]

ENVIRONMENTAL CONCERNS

From the past five decades, the amount and variety of goods and services traded between the United States and

Mexico has increased tremendously. The two countries are now on a path of economic integration. Once the free trade agreement is finalised some of the industries like the automobile manufacturing sector which is already in the process of integration would become fully integrated with U.S. market. A free trade agreement between the two countries would further intensify the process of economic integration in various sectors between the two countries.

A number of important environmental issues are linked to increased economic integration between the two countries. In the South Western U.S. and in Northern Mexico, the effects of rapid development are already evident. The U.S. - Mexican border infrastructure, which has not developed concomitantly with increased industrialization, is strained beyond its capacity. The consequences of this has been raw sewage and toxic wastes, posing hazards to this desert region's scarce water resources, air pollution in border cities and an inadequate supply of livable housing. The negative effects of Mexican industrialization has been visible to the U.S. border residents. Mexican border and water pollution would affect the U.S. citizens on the other side, if industrialization picks up after the signing of a free trade agreement.

Thus free trade between an industrialized country like the U.S. and a newly-industrialized country such as Mexico needs to be approached with the greatest of caution.

It is imperative that the environmental impact of increased economic integration must be studied. The official position of the U.S.-Mexico free trade agreement negotiators remain that environmental issues are not on the agenda.[1] Important issues that need be included are the impending water shortages on both sides of the border, then to govern the environmental performance of the increasing member of U.S. corporations expected to operate in Mexico under the FTA and the means by which the two countries can provide the physical and regulatory infrastructure necessary to absorb increased industrial and agricultural activity that is expected with unrestrained trade. Failure to recognize these issues can only lead to further degradation of the environment and public health. Thus, there should be, what the environmentalists call, a sustainable economic development.

The environmentalists argue that the removal of trade barriers and government controls would no doubt spur economic development in the two countries. However, if this economic development were to be based on short term economic goals, the future generations could suffer greatly. If the resulting development is located in areas already burdened by resource shortages and infrastructure problems, the new

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1 Mary E. Kelly and others, "U.S. - Mexico Free Trade Negotiations and the Environment: Exploring the issues", "Columbia Journal of World Business (New York), Vol.26, no.2, summer 1991, p.42.

development could create more problems than it solves. Thus free trade has to recognize the externalities. The need for government controls and restrictions can be understood now.[2] There are legitimate areas for government control that must not be overlooked in the search for economic development and integration of the economies of the U.S. and Mexico. Important areas of control include many of the environmental and health issues.

Due to increasing industrialization without attention being paid to the need for comprehensive sustainable development policies, the natural resources and environment of the U.S. - Mexico border area and Mexico's three largest cities -- Mexico City, Monterrey and Guadalajara -- are already greatly strained. President Salinas has made directed development his top priority.[3] Accordingly, the government plans to redirect development

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2 Government controls have to be exercised in those areas where it is difficult to fix the liability for the damages caused. For example, air pollution control regulations protect public health, since the industry does not voluntarily include the costs associated with damage to public health in its production costs. And there are government restrictions to protect resources with no readily determinable monetary value, but which are nontheless important, like endangered species and historic sites. Governments at times have to control the type, location or rate of development to assure sustainability.

3 Kelly, and others, n.1, p.44.

way from its primary and most polluted industrial centers -- Mexico City, Guadalajara and Monterrey -- towards cities that can better absorb the effects of industrial development.

Keeping in mind the above policy, although Mexico's recent deregulation has opened all unclassified and a significant portion of classified sectors of the economy to free foreign ownership, current Mexican policy prohibits this in companies established in Guadalajara or Monterrey without special permission. The policy is aimed at alleviating the strain on infrastructure and water supplies in overburdened Mexican cities.

Pro-free trade circles argue that incentives or limitations for directional development and other sustainable development controls in Mexico could potentially be challenged as non-tariff barriers to free trade, and if the agreement does not expressly preserve such rights to the counteracting countries, it could become an issue of friction between the two countries.

The U.S. does not have a directed development policy either to direct development away from areas where natural resources are over-exploited or towards areas where unemployment is high. Unplanned development has adversely affected the U.S. border areas water quality, water supply, air quality and other natural resources as well. For example, industrial and vehicular pollution in the rapidly growing El Paso / Ciudad Juarez area have combined to cause serious air contamination; the common ground water aquifer serving Nogales, Mexico and Nogales, Arizona has been contaminated with industrial solvents as a result of unsound industrial practices (the vast majority of industry in Nogales, Mexico is maquiladora); the quality of the Rio Grande / Rio Bravo in Texas is threatened by untreated or poorly treated sewage and agricultural run-off from both sides of the border. While sewage problems in Tijuana, San Diego and Nogales have persisted for a number of years; habitat for endangered and threatened species is disappearing in both countries at an alarming rate.[4] One option environmentalists argue, could be that the FTA could include an agreement for binational cooperation in pursuing sustainable development policies by establishing mechanism for resource conservation.

Some Mexican and American policymakers feel the need to create a new agency to oversee the enforcement of binational environmental agreements. Alberto Szekely, legal advisor to the Mexican Foreign Ministry, supports such a measuré, but Sergio Reyes Lujan, Subsecretary for the Environment of the SEDUE (Secretariat of Urban Development and Ecology) has expressed his confidence in the current relationship between the SEDUE and Environmental Protection

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4 Ibid., p.45

Agency of U.S.A.[5] However, the smooth functioning of the relationship between the EPA and SEDUE has been troubled by bilateral issues between the two countries like the war on drugs and sovereignty issues. Another major impediment is the financial constraints that SEDUE has had to face. To overcome these shortcomings a new binational agency with more enforcement powers could be created as part of an FTA or as a separate agreement. Such a commission would then have to be accountable to both the countries. Several such attempts have been made in the past but have not been able to gather enough support.[6] The other issue is of hazardous wastes and its regulation and management in the U.S.-Mexico border area. Mexican law prohibits the import of hazardous wastes into Mexico for disposal. Even <u>maquiladoras</u> operating in Mexico must return the hazardous waste to the country that supplied the raw products for the manufacturing, unless the wastes can be "recycled" into usable products.[7] In addition, under current law and accords, foreign industry

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5 Ibid.

6 One such environmental agreement is the La Paz Agreement of 1983 which provided a general framework to address certain environmental problems within hundred kilometers of the international boundary including accords on industrial pollution, such as from <u>maquiladroas</u> or smelters. Despite a few success stories, the La Paz Agreement process has not been effective. Disadvantages include the unenforceable nature of the agreement, the lack of opportunity for public participation from either the U.S. or Mexico and insufficient financial and other resources devoted to making the agreement work well.

7 Kelly, n.1, p.47

that is not maquiladora is not required to return wastes to the country of origin. The question about the capacity of the Mexican waste industry to handle the rapidly growing quantity of wastes generated becomes significant. For example, there are currently no commercial hazardous waste disposal sites in the immediate Texas - Mexico border area -- the closest is a landfill in Corpus Christi, Texas. Also, in Hermosillo, Sonora, the industrial waste dump is located less than half a mile from the city's drinking water supply, and the question of future risk and liability is inevitable. The FTA or a separate environmental accord would have to deal with the problem of limited hazardous waste disposal capacity.

Another aspect causing worry to the environmentalists is the depletion of water resources. With increased industrialization and development under prospects of a free trade, water shortages have occurred especially in the border areas such as in Nogales, Arizona, Sonora and Agua Prieta. The supply for Ciudad Juarez/El Paso is sufficient only for immediate needs and rapid pumping is creating salinity problems. In various areas along the border, cities are pumping groundwater at a rate twenty times faster than aquifers can recharge.

Surface water supplies have also been threatened. Some predict that before the end of the century, the U.S. will have real difficulties in delivering to Mexico the water allocations outlined in the 1944 Colorado River Treaty.[8] Already, the levels of salinity in the water the U.S. is obligated to deliver to Mexico are causing problems for Mexican agriculture. Federally - subsidized water use in the U.S. has been identified as a root cause of the increased salinity in deliveries to Mexico.

A possible solution, would be to have a separate groundwater treaty.[9] Groundwater users in the northern Mexico and South Western U.S. states would have to give up or limit their rights to pump unilaterally, without regard to the effect on supply for other users.

Water quality has also deteriorated as a result of overdevelopment. Both in groundwater and surface water, pollution has been on the increase. This is mainly due to inadequate sewage treatment systems which causes the flow of pollutants into the rivers and thereby poses serious health problems.[10] So there's an urgent need for sewage collection and treatment facilities along the Mexican border communities. According to a <u>New York Times</u> Report, the

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8 Ibid., p.51

9 Ibid.

10 The Council on Scientific Affairs of the American Medical Association has concluded that 46 million litres of raw sewage flow each day into the Tijuana River in Baja, California; 76 million into the New River at Calexico-Mexicali on the California border; and 84 million into the Rio Grande between Texas and Mexico.

recreational use of the Rio Grande below Laredo, Texas, has long been considered unsafe because its sister city in Mexico, Nuevo Laredo, dumps about 25 million gallons of untreated sewage into the river everyday.[11]

Another matter of grave concern for the environmentalists has been the trans-boundary pollution from border manufacturing and assembly plants or the maquiladoras. As discussed in the previous chapter, much of the growth and development along the border came as a result of the 1965 agreement between the two countries that allowed U.S. companies to set up operations on the Mexican side. The U.S. factories and asssembly plants import all raw materials and export almost all products virtually exempt from tariffs and other trade restrictions. Due to the unprecedented boom in the maquiladora plants, pollution along the border has increased alongwith increased development. An investigation by the National Toxics Campaign Fund of U.S. found "widespread and serious contamination by U.S.-owned firms operating along Mexico's border".[12]

The New York Times has reported that "the contamination along the border runs the gamut from raw

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11 New York Times, 31 March, 1991.

12 Thomas R. Donahue, "The case Against a North American Free Trade Agreement,"Columbia Journal of World Busines, vol.26, no.2, summer 1991, p.94.

sewage to wood smoke to highly toxic industrial chemicals".[13] An American Medical Association report last year said that the maquiladora region is "a virtual cesspool and breeding ground for infectious disease .... Uncontrolled air and water pollution is rapidly deteriorating and seriously affecting the health and future economic vitality on both sides of the border."[14]

Some environmental groups have called for stronger environmental laws in Mexico. But as New York Times and others have observed, most regulations there are as strict as those in the U.S. The problem is the lack of enforcement by the government. More than a thousand U.S.- owned plants generate hazardous waste, but only 30 per cent of those have complied with Mexican legal requirements to file information on how such wastes are handled. Moreover, as a SEDUE report has pointed out only 19 per cent of the plants using toxic materials could show that they had disposed off wastes properly.[15] In November 1990, SEDUE estimated that 52 per cent of the nations 1,963 maquiladoras generate hazardous wastes.[16] Of those, 307 have complied with federal

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13 New York Times, n. 11.

14 U.S. News & World Report (Washington, D.C.), 6 May 1991.

15 New York Times, n.11.

16 Kelly, n.1, p.52.

regulations to provide SEDUE with information on the volume and characteristics of the wastes they generate. About 19 per cent, or 195 maquiladoras, are returning their waste to their country of origin, or recycling their waste in compliance with Mexican law. SEDUE estimates that another 150 maquiladoras return their waste without filling out all the necessary paperwork. This leaves 578 maquiladoras that have not accounted for their wastes, by SEDUE estimates. Environmentalists have suggested that the U.S. and Mexican governments take a complete inventory of border industries and industrial hazardous waste produced by those industries so that the extent and nature of the problems become evident and could possibly determine the system's resources needed to combat the problem. The FTA or a separate agreement could also possibly provide for a binational water and air monitoring network, financed by a combination of government funds, multilateral development bank loans and contributions from industry through user fees or other mechanisms.

Mexican fishermen have expressed their concern over the FTA between the U.S. and Mexico. Mexican funa fishermen have complained about the provisions of the U.S. Marine Mammal Act, which forbids the sale of tuna in the U.S. if a certain number of dolphins are killed in the tuna catch. Mexican fishermen argue that these provisions are unnecessary and a disguise for economic protection of the

U.S. tuna industry.[17] The environmentalists have voices their concern that some of the fishing grounds of the U.S. and Mexico are polluted with lead, mercury, cadmium, and other chemicals. The FTA could include provisions for joint certification of U.S. and Mexican fishing grounds to overcome this problem.

The mining industry of Mexico would also be affected by an FTA. Mexico has significant reserves of gold and copper. Liberalization of foreign investment restrictions has already increased copper and gold mining in northern Mexico. But mining activites need water-use and create significant pollution problems. An example is the copper mining at Cananea in northern Mexico. In previous years, spills from the mine tailings ponds were contaminating an 80 mile stretch of the San Pedro river, the last 40 miles of which are in the U.S. The ponds have since been reinforced, but spills will now flow south into Mexico's Rio Sonora.[18] Smelter operations result in air pollution problems (as evidenced in the border regions of Arizona, Sonora, New Mexico and El Paso, Texas). There are also increased risks associated with transport of toxic process chemicals associated with mining operations. The La Paz Agreement does contain some provisions regarding binational action on sulfur dioxide pollution problems from

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17 Christian Science Monitor(Boston), 7 November 1990.

18 Kelly, n.1, p.55.

specific copper smelters in the border region. The FTA or a separate agreement could enforce strict environmental controls on mining operations especially those which are likely to cause transboundary pollution problems.

Another pertinent question to ask is how the FTA would affect Mexico's dwindling forests. According to a World Bank report, Mexico loses more than 2500 square kilometers of forests each year to cultivation, overgrazing and fire.[19] Loss of forests has threatened or endangered 47 species of native animals and 241 species of plants unique to tropical forests.

Multilateral lending for forestry development projects already appears to be unduly exploiting those forests remaining. For example, in August, 1989 the World Bank approved a $ 45.5 million loan to Mexico to help finance a $90 million forestry development project in the Sierra Madre within the Mexican states of Chihuahua and Durango -- home to one-third of the remaining coniferous forests in Mexico. The project aimed to increase economic activity and to provide development to benefit the indigenous communities in these areas. However, four months before World Bank approval of the project, the Bank staff warned that the project carried a number of environmental risks.[20]

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19 Cited in Kelly, n.1, p.55.

20 Ibid, p.55

In a November 1990 evaluation of the project, the Texas Center for Policy Studies, Austin concluded that the project poses a serious risk to an area suffering from severe erosion, with several threatened species.[21] Future development could adversely impact the watershed of the Rio Conchos, the largest tributary of the Rio Grande/Rio Bravo below El Paso, Texas. Another fear is that with free trade rules, there could be an increase in the razing of Mexican forests for cattle operations particularly in the Montes Azules biosphere reserve in the Lacadon forest area in southern Mexico. So in this area, a special study is deemed absolutely imperative.

A related problem is that of wildlife. How would a free trade agreement affect the endangered species? Both Mexico and the U.S. are struggling to conserve wildlife species as their natural habitats become developed. In Mexico, home to a number of threatened, endangered species, the issue often centers on controlling the illegal trafficking of these species, but others are also working over habitat conservation. Mexico is, however, severely handicapped in terms of the personnel, resources and developmental priorities.[22]

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21 Ibid.

22 SEDUE, charged with policing 63 protected areas, has only 4 to 5 personnel per state to do so. Overall, SEDUE has only about 300 vigilance and protection personnel for all environmental issues in Mexico.

Air pollution has increased with automotive emissions causing concern to the environmentalists. Automotive emission standards vary greatly between Mexico and the U.S. The Mexican government has announced its intention to match all U.S. requirements by 1993, but the ability of the automotive sector to do so is doubtful. The oil industry of Mexico has to be examined here. Oil has been a traditional symbol of nationalism for Mexico. Salinas has repeatedly desired the opening of Mexican oil resources to U.S. investment. In his annual state of the nation address on November 1, 1990 Salinas had told the lawmakers that Mexican sovereignty over its oil resources -- written into the national constitution -- would be left untouched by an FTA.

However, in their meeting on 26-27 November, 1990, Presidents Bush and Salinas did agree that U.S. oil drilling companies would be allowed access to oil fields to help the efforts of the Mexican owners. If Mexico were to allow US investment in its petroleum sector, the potential for rapid depletion of a finite natural resource would increase.[23] This would lead to an increase in the potential for pollution attendant with all oil and gas production.

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23 There may be indirect avenues of opening up the oil and gas industry in Mexico to U.S. investment, such as restructuring of the PEMEX, the government-controlled oil company, into a holding company and allowing U.S. investment in subsidiaries responsible for exploration and production.

In order to absorb all the effects concomitant with economic integration, the question of infrastructure financing becomes very important. The Mexican economy, debilitated after the economic crisis of the 1980s has little funds to finance infrastructure or other environmental projects. Economic stability would presumably enhance Mexico's ability to obtain loans and grants from multilateral lending institutions. However, Mexico is already deeply in debt to such institutions, which poses an obstacle to future borrowing.

Other than the problem of infrastructure financing, the three main areeas of concern regarding environmental, public health and worker safety norms are pre-emption, harmonization and resource exploitation restrictions. The pre-emption issue involves the question of whether or not a binational trade agreement would pre-empt state and local governments in either country from setting stringent environmental, public health or worker protection standards.

The harmonization issue involves the question of whether environmental, public health and worker protection standards should be the same in one country as in the other, and whether lower standards may actually function as indirect subsidies.

The resource restriction issue involves the right of a country to restrict the rate at which finite natural resources, such as timber, oil, gas or fish are developed and exploited and not have these restrictions challenged as non-tariff trade barriers under an FTA.

This section has provided an overview of the environmental and other related issues associated with increased economic integration between the two countries. Solutions for many of the problems have to be worked out before the two countries establish a free trade area in the continent. These solutions could be a part of FTA or could be treated separately.

INTELLECTUAL AND POLITICAL OPPOSITION 3rd C

Many intellectuals have also spoken against an FTA between the U.S. and Mexico. Jagdish Bhagwati, an economist and one of the staunchest and most eminent defenders of free trade, raises a subtle concern.[24] A free trade area or customs union, Bhagwati contends, is defensible as an exception to multilateral free trade only to the extent that it is evolving towards a political union that will eventually have similar social and economic policies -- the best current example being the European Community. Otherwise, it is pure discrimination and an affront to free trade. By opting for regional free trade deals, argues

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24 Business Week (New York, NY), 6 May 1991.

Bhagwati, the administration virtually invites its critics to demand that Mexico and the U.S. "harmonize" labour social and environmental policies. This could logically lead to further demands that harmonization of social policies become a precondition for all trade.

While the world-wide free-trade system, represented by GATT is committed to the principle of nondiscriminatory, multilateral and universal free trade, some feel that the impending U.S. - Mexico FTA like the U.S. - Canada FTA is bilateral, preferential, regional and hence discriminatory against countries not a party to it. Other intellectuals opine that regional integration in the Americas would not threaten multilateralism. Regional integration would carry with it some trade diversion but it would not increase external barriers.[25] On the contrary it may even be the first stage to multilateral opening since all tariffs are GATT bound. This is evident in the European economic integration.

The former Finance Minister of Mexico Jesus Silva Herzog, novelist Carlos Fuentes, and others have also condemned the continental FTA based on low wages in Mexico. They have written that "Low wages cannot be a permanent feature of North American economic relationships. That comparative advantage is too costly for everybody involved:

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25 Rudiger Dornbusch, "North America Free Trade: What it means,"Columbia Journal of World Business, vol.26, no.2, summer 1991, p.75.

too humiliating and unproductive for Mexican dignity and economic development; too costly in jobs and welfare for American and Canadian workers; too destructive for our common environment and civilization."[26]

According to Thomas R. Donahue the Secretary - Treasurer of American Federation for Labour and Congress of Industrial Organizations and the Chairman of the U.S. Special Trade Representative's Labour Advisory Committee, the NAFTA is not as human and progressive as the EC's 1992 Single Market Plan. This is so because the EC 1992 has a Social Charter which sets out rights to a minimum wage, social assistance, collective bargaining, vocational training, and health and safety protection in each of the member countries and they have developed a series of initiatives to implement these principles. The EC has established a Regional Development Fund of at least $ 68 billion to finance economic development in the poorest areas and to bridge the gap between the poorest and the richest countries of the EC.[27] The NAFTA negotiations on the contrary have not adopted any of the social and environmental protection principles that are a part of EC 1992.

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26 Cited in Donahue, no.9, p.95.

27 Ibid., p.95.

The U.S. - Mexico FTA has also been charged of being an unfair and an unequal agreement. While the U.S. capital has free access to Mexican markets, the Mexican labour in return has no access to U.S. markets. It has also been pointed out that in the thick of Latin America's 'lost decade' of the 1980s, trade with the US had expanded enormously without the aid of any free trade agreements. Latin America's exports to the United States, had in the 1980s, grown by more than 70 per cent, and its imports from the U.S. by 45 per cent.[28] Critics have therefore questioned the current trend towards the formation of free trade areas in Latin America.

The small Mexican businesses fear free trade with U.S. since their products would not be able to compete with the U.S. products.[29]

A lot of attention has also been paid to the dangers posed by the potential emergence of a "hub and spoke" arrangement.[30] There is fear that the US would be the hub with Canada and Mexico as the two spokes drawn together by the U.S. - Canada FTA and a U.S.- Mexico FTA. Such a "hub and spoke" arrangement, it is feared would lead

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28 Latin American Special Reports (London), June 1992.

29 Newsweek (New York, NY), 23 March 1992.

30 Gordon Ritchie, "Beyond the Volcano: Canadian Perspectives on Trilateral Free Trade", Columbia Journal of World Busines, vol.26, no.2, summer 1991, p.89.

investors to put their money in the U.S., knowing that they would thereby also get access to both Mexico and Canada.

The major political party opposed to Salinas's policy of pursuing an FTA with the U.S. is the Democratic Revolutionary Party (PRD) led by Cuauhtemoc Cardenas. Cardenas is of the opinion that economic modernization cannot be carried out without political reform.[31] The recent events in Eastern Europe and the erstwhile Soviet Union reveal that economic reforms cannot be introduced successfully without political liberalization. The modernization of Mexico and its integration with the U.S. according to Cardenas, implies an internal process that will deprive a large portion of the population of the fruits of development. It would lead to a fear of economic disintegration as wealth is further concentrated in large and few conglomerations and a small segment of the population benefits disproportionately. Economic reforms, Cardenas has argued, should not be carried out at the expense of social justice. The division of labour would not only degrade Mexican workers in both U.S. and Mexico, but would also threaten the welfare of many American workers, whose jobs one lost through sharp drops in U.S. exports to Mexico brought out by Mexican economic stagnation over the last decade.[32] Cardenas has also expressed concern over the

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31 Cuauhtemoc Cardenas, "Misunderstanding Mexico", Foreign Policy (Washington, D.C.), no.78, spring 1990, p.116.

32 Ibid., p.118

environmental damage caused by the <u>maquiladoras</u>. Also, Mexico offers U.S. corporations an opportunity to evade strict regulations enforced in the U.S. itself.

The trade liberalization policy started off by Miguel de la Madrid -- full maintenance of payments on the foreign debt, the trade and foreign investment opening, privatization, subsidy cuts, and wage containment -- has been criticized by Cardenas.[33] This has resulted in a drop of more than 50 per cent in real wages and in unemployment or underdevelopment for more than half of the labour force. Cardenas charges that this liberalization promotes an international division of labour as it returns Mexico to its nineteenth century status as a supplier of raw materials and cheap labour and a purchaser of imported consumer products.

Mexico s (Yet another flaw is then in Mexico's trying to join with North America, it will have to sooner or later abandon its foreign policy moorings; for instance, its involvement in the peace process in Central America. Cardenas and his supporters would prefer that Mexican foreign policy look at the south towards Latin America than to the North.[34])

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33 Ibid.,p. 124.

34 Susan Kaufman Purcell, "U.S.-Mexico Relations: An Optimistic View", <u>Journal of International Affairs</u> (New York), vol.43, no.2, winter 1990, p.429.

Cardenas is said to have remarked that "Salinas is destroying the laws and institutions of the revolution one by one".[35] The regime has brought changes in those areas which were considered the symbols of the Revolution like the privatizing of the Cananea copper mine (where a Key strike of the Revolution had occurred) to exploring relations with the Vatican (the Revolution had a strong anti-clerical thrust).

However, in the last four years, the P.R.D. has lost considerable ground to the P.R.I.. The P.R.D. has been stung by high-level desertions, by lack of grass-root organizations and a clear political-ideological platform. So the P.R.D. has been unable to turn the popular discontent of 1988 into a political movement. Consequently, those sections of the organized and unorganized labour that had deserted P.R.I. in 1988 in favour of P.R.D. have remained unorganized and incoherent in their opposition to a free trade agreement. On the contrary, the P.R.I. has been able to regroup and draw up support from its affiliated labour unions. The anti-government independent Federation of Agricultural Workers and Peasants (CIOAC) has rejected the governments proposal on the Free Trade Agreement.[36] It has

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35 The Nation (New York, NY), 24 June 1991.

36 Daily Report : Latin America (Washington:D.C., Foreign Broadcast Information Service), 28 May 1992.

also denounced the amendment of Article 27 of the Constitution. The government allied Confederation of Mexican Workers (CTM) has come out strongly in support of the FTA as it believes that FTA would bring new factories, new jobs and better salaries.

Though Cardenas opposes Salinas's social policies, he has had to modify his position on the FTA from outright opposition to modified suport. He now says he would back a treaty as long as it is a part of a social contract that includes immigration reforms, guarantees of investment in Mexican infrastructure and compensation for disparate workers.[37]

Meanwhile, the right-of center National Action Party (PAN) has been largely neutralized by Salinas by taking over most of its political programmes. The PAN has strong regional support, but represents little threat to the PRI on a national level.

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This chapter has discussed the viewpoints of the opponents of NAFTA. A major group opposed to NAFTA are the environmentalists. The concern of the environmentalists is that a NAFTA will lead to trans-boundary pollution and to a degradation of the Mexican environment due to increased levels of air and water pollution associated with industrialization. The environmental impact of a NAFTA on

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37 The Nation, n.35.

border, industrialization programme is particularly a cause for concern as it would damage the environment along the Mexican - U.S. border. The depletion of forest reserves, effects of increasing mining activity are another reason for the skepticism of the environmentalists to doubt the virtues of NAFTA.

Other than the environmental concerns, various intellectuals and political parties have voiced their concern and expressed doubts that a NAFTA would lead to an asymmetrical relations between U.S. and Mexico.

CHAPTER V

SUMMARY AND CONCLUSIONS

In attempting to assess and analyze the implications of a NAFTA for Mexico, the monograph has by way of an introduction discussed the various US initiatives in the past and Mexico's response to such overtures. Mexico had always been apprehensive about economic and political domination from the US. This arose because of an unbalanced power structure between the two countries as a result of which the US had intervened in Mexico's internal affairs right from the beginning of the nineteenth century. Article 27 of Mexico's Constitution reflects the deep-rooted fear that Mexico had of foreign investors from the north. Mexico's import-substitution industrialization strategy had reflected this fear too, since till the end of the 1960's the Mexicans had followed an inward -looking, protectionist, state -led and subsidized development policy. Import substitution industrialization was expected to result in growth, and till the end of the 1960s, the economy did experience an average growth rate of 6.1 per cent. As the ISI Phase neared its exhaustion, and needed drastic reforms, President Luis Echeverria (1970-76) instead resorted to foreign borrowings and deficit financing to continue to pursue the old development strategy. During the period, the public sector grew tremendously. And because of the government's policy of deficit spending, inflationary forces were unleashed. President Lopez Portillo (1976-82) further reinforced Echeverria's model. Portillo was spurred to increase the level of borrowings even further after the discovery of oil in the mid-1970s. When Miguel de la Madrid took office in 1982, Portillo had left behind a legacy of a huge foreign debt and a glut in the oil market, all creating a profound economic crisis. De la Madrid was forced to embark on a process of economic reforms beginning with reform packages prescribed by the IMF and World Bank. Mexico abandoned its isolationist policy by joining the GATT in 1986 and began a process of privatization. De la Madrid paved the way for Salinas to make further changes in the economy to the extent of requesting free trade negotiations with the US.

Chapter 1 has also discussed the US - Canada Free Trade Agreement, which is regarded as the precursor of NAFTA. As an introduction to this section, the US overtures towards Canada in the past, to forge in bilateral free trade between the two countries, has been mentioned. The relevant question here is whether the US - Canada Free Trade Agreement can serve as a model for a U.S. - Mexico free trade pact ? There are many similarities and differences in these two cases that have been enumerated in Chapter 1. In case of agreements on investment and dispute settlement the US - Canada FTA can serve as a model. But there are many differences in the two cases, primarily because the Mexican political system is very different from the other two countries as also the level of economic development in Mexico is much lower than Canada and US.

The US - Mexico FTA, if signed, will lead to a gradual and comprehensive elimination of trade barriers including elimination of tariffs, reduction of non - tariff trade barriers, protection for intellectual property rights and an improvement in the expansion of the flow of goods, services and investment between the US and Mexico.

Chapter 2 deals with Mexico's initiatives and, particularly, Salinas's initiatives towards NAFTA. Mexico's attitude towards free trade and its participation in movements such as SELA and LAFTA have been discussed briefly. This assumes importance because while Mexico had long supported the idea of the formation of free trade areas with other Latin American countries, it had repeatedly spurned US overtures in the past. Mexico played a leading role in the Latin American Free Trade Area in the 1960s and a pioneering role in the formation of the Latin American Economic System. LAFTA brought some tangible benefits as Mexican export of manufactures to LAFTA region increased though its imports continued from the developed industrialized countries. Mexico had since the 1940s emphasized the development of the Mexican economy by keeping foreign competition out and subsidizing domestic producers. That model was developed largely to prevent Mexico and its economy from being swallowed primarily by US interests. Its ability to forge closer economic relations were limited by the nature of the domestic industrialization process and also as its overwhelming dependence on US for trade and investment persisted.

Salinas brought in an economic restructuring of Mexico. The foreign investment laws were changed to encourage foreign investors, tariff rates were lowered and state firms were privatized. The Salinas government tried to negotiate the foreign debt with the US. In the agricultural sector, too, there have been many changes with the amendment of Article 27 and the subsequent abandoning of land reforms and the ejidos system. Under the garb of his policy of "social liberalism", Salinas has brought in all these changes.

As negotiations are on towards the creation of a NAFTA, of great interest is the issues which are under negotiation. Progress in the negotiations is said to have been made toward agreement on product standards, temporary entry across boundaries for business, safeguard against surges of imports, customs procedures and rules of origin. There are many issues on which an agreement has not yet taken place like in auto parts, petroleum, financial services and copyrights. Differences also persist on the phase-out period.

While negotiations are still going on, many have been writing about the virtues of a free trade agreement. That an FTA will have far-reaching implications for Mexico is beyond doubt. Chapter three discusses the implications of NAFTA for Mexico. So this chapter has taken into consideration the proponents viewpoints. One of the main advocates of free trade, is the Mexican administration itself. An FTA is expected to bring in much needed US capital into Mexico at a time when the industrialized countries of West Europe are pre-occupied with Eastern Europe and the erstwhile Soviet Union. The industrial sector in Mexico has welcomed the FTA as it would lead to increased economic activity in Mexico and this would result in the inflow of much-needed capital and new technologies. Also, an FTA would guarantee an access to the American markets. The <u>maquiladoras</u> , that is, the in-bond plants along the US-Mexican border have responded positively to an FTA between US and Mexico. Already with talks of the possible signing of an FTA, many US companies have shifted south. With increased industrialization, employment along these border areas will increase. As such, Mexican wages are very low in comparison to the US wage structures. Again the <u>maquiladoras</u> expect an FTA to bring in new technologies and investment, particularly American.

The viewpoints of the interest groups opposed to NAFTA is mentioned in chapter 4. Among the opponents of NAFTA, a major group are the environmentalists. The environmentalists expect NAFTA to cause trans-boundary pollution, air and water pollution in the industrial centres and a depletion of Mexican forest reserves and other natural resources--all concomitant with increased industrialization.

There are other intellectual and political groups opposed to NAFTA. While some intellectuals charge that NAFTA would not have a social charter, unlike the European community, others feel that an economic integration would be meaningless without a measure of political integration. It is also feared that NAFTA would subordinate Mexico's position in the Western Hemisphere. Some believe that it will give rise to a "hub and spoke" arrangement with the maximum benefits accruing to the 'hub', which in this case is the United States.

One of the opposition leaders, who has denounced Salinas' policy of seeking economic integration with the United States is Cuauhtemoc Cardenas. Cardenas has argued that economic reforms cannot be successful unless it is accompanied by political reforms. He has also voiced his concern over Mexico making itself more vulnerable to US domination. Many fear that once the US gets Mexican oil, it might dump Mexico like "garbage" and retreat. Alternatively, the other scenario projected is what if US itself eventually loses interest in FTA because of domestic, political or economic considerations ? Already delayed, the fresh dates for finalizing the agreement have not been fixed. While the Bush Administration has delayed the conclusion of the NAFTA beyond 1992 and has studiously avoided making it an electoral issue, the Democratic presidential candidate, Bill Clinton, though theoretically supporting NAFTA, has expressed no definite views on the subject.[1]

Some other critics of NAFTA agree that foreign investments are lagging behind the expectations. Moreover, foreign capital is mostly of portfolio type and is likely to escape if it finds conditions unfavourable in Mexico. Also, it is pointed out that despite increased inflow of capital and growth in exports Mexico continues to have an unfavourable balance of trade with US. And if the present period of transition prologs, situation may become more difficult for Mexico. For instance, if rate of inflation, that was around 19 per cent in 1991, goes up further, it could create extremely adverse conditions for the government. The success of FTA depends so much on continuous economic growth. It is all the more necessary in view of high unemployment rates, rapid growth in labour force, and -- as a consequence of abolition of land reforms and modernization of argiculture-- the potential rural-urban migration. Prospects of growth rate slowing down because of the "over-heating" of the economy and resurgence

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1. New York Times, 9 April 1992.

of inflation are already issues that are creating widespread concerns in the official circles.[2]) 5

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(Noticeably absent from the NAFTA agenda is the issue of labour migration, and particularly that of illegal migration. Also, the issue of opening the petroleum sector -- the last bastion of Mexican Sovereignty -- would prove a critical and long-drawn affair between the two countries. On their part many small and medium-sized companies fear that they will be wiped out in the process of trade liberalization. The government has often presented a picture of high growth rates, increased wages and more employment in the wake of NAFTA. However, it is feared that new jobs may not be many; at least they will not be enough for the 18 million Mexicans who are presently unemployed or underemployed.

3

5\The number could substantially go up if the FTA opens Mexico to US or Canadian wheat and maize exports at the cost of small or marginal producers. Many US companies and corporate executives have expressed openly their reservation about the high tax rate in Mexico. Washington Post reports that about 20 new US projects, or plant expansions in Mexico are on hold because of taxation difficulties.[3] All these cumulatively may have an anti-FTA

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2. Latin American Weekly Report (London), 9 January 1992.

3. Washington Post, 25 March 1992.

effect on Mexico. Long sheltered and benefitting from a protected market Mexican business still harbours protectionist sentiments.

Salinas, with only two-and-a half years of his term left, will only loose his control in the government and the party from now onwards. As the speculation on finding his successor gains momentum, politics and not economics will hold the centre-stage in Mexico. This may become even more true if the economic growth rate shows an adverse trend in 1992 and beyond. Besides, many PRI bosses feel uncomfortable with the demand of greater political liberalization which are, in the euphoria of free trade, often receiving support and sympathy of various groups in the US. All in all, NAFTA, though initially promising may, if concluded, prove extremely challenging to the PRI leaders. It proved easier for Salinas to take the initiatives but the implications of NAFTA may be very varied and contrary to current hopes and promises.

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