



BRIEF ANALYSIS

The Economic Benefits of NAFTA to the United States and Mexico

by Heidi Sommer

Prior to the 1980s, high import tariffs and quotas characterized Mexico's international trade policy, along with restrictions on foreign investment and ownership. But following a severe economic crisis in the early 1980s, the country began liberalizing its protectionist policies. In the years since, Mexico has implemented 11 free trade agreements — with the European Union, countries in South and Central America, Japan and, most importantly, the United States and Canada. The 1994 North American Free Trade Agreement (NAFTA) between Mexico and its two northern neighbors eliminated the majority of taxes on products traded among the countries, and called for a gradual phase-out of other tariffs. Although there have been calls to renegotiate or suspend NAFTA, after nearly 14 years under the treaty it is clear that both Mexico and the United States have benefitted from more open trade.

More Exports. The Mexican economy is the world's 13th largest. Yet it is the United States' third-largest trading partner and the second-largest market for U.S. exports.

This partnership owes much to NAFTA; two-way trade between Mexico and the United States has more than quadrupled since the agreement was implemented (see the figure):

- The value of Mexican goods exported to the United States grew from \$39.9 billion in 1993 to \$210.8 billion in 2007, an increase of 437 percent.
- The United States exported \$136.5 billion worth of goods to Mexico in 2007, up 242 percent since 1993.

Over that period, gross domestic product (GDP) grew 50 percent in the United States and 46 percent in Mexico.

More Investment. The United States is the largest source of foreign direct investment (FDI) in Mexico, accounting for over half of the \$19 billion invested there in 2006. In addition, U.S. companies contribute around 50 percent of the investment funds for Mexico's maquiladoras — factories that assemble products (such as apparel, auto parts and electronic goods) from imported U. S. components for export back to the United States. These firms account for almost half of Mexican exports and over \$41 billion in annual sales.

Investment in Mexico has helped increase the efficiency of U.S. domestic production. Many manufacturing companies are able to reduce costs by shifting assembly of their products to the maquiladoras. This has helped boost U.S. manufacturing output, which rose by almost 60 percent from 1993 to 2006. By contrast, output increased only 42 percent in the 13 years before NAFTA.

More Jobs. The greatest opposition to NAFTA (and free trade in general) comes from the belief that foreign competition hurts U.S. employment. This misconception stems from the fact that while the greater benefits of free trade are often dispersed relatively evenly across an



economy, losses tend to be concentrated in a few sectors or industries. But job losses are balanced by other jobs created in more productive sectors of the economy, and the new jobs usually pay more than the lost ones. For instance:

- U.S. employment rose from 110.8 million in 1993 to 137.6 million in 2007, an increase of 24 percent.
- The U.S. unemployment rate averaged 5.1 percent for the first 13 years after NAFTA, compared to 7.1 percent during the 13 years prior to the agreement.

Moreover, increased openness to trade has been accompanied by a more rapid rise in wages. For example, from 1979 to 1993 U.S. business-sector real hourly compensation rose at an annual rate of 0.7 percent each year, or 11 percent over the entire period. Between 1993 and 2007, however, real wages rose 1.5 percent annually, for a total of 23.6 percent.

Mexican employment levels have been more volatile since the implementation of NAFTA. But, as of 2005, the Mexican affiliates of U.S. companies employed nearly 840,000 people who contributed 3.3 percent to Mexico's GDP. Wages for Mexican workers have grown steadily since the 1994 peso crisis (reaching precrisis levels in 1997) and increasing each year since. In addition, Mexican industries that export goods or are located in regions with a high level of foreign investment also pay higher wages. According to Mexico's Secretariat of Economy, exporting companies pay salaries 37 percent higher than those that don't export.

Unfinished Business: Energy Industry Liberalization. Mexico is the world's sixth-largest producer of crude oil, and the second largest supplier of oil to the United States. Yet, despite the high price of petroleum, the state-owned oil monopoly, PEMEX, is in dire financial condition and its production is declining. Without significant domestic or foreign investment, Mexico may be unable to tap large reserves deep beneath the waters of the Gulf of Mexico.

Turning PEMEX in the right direction, however, could be quite difficult. Mexicans have traditionally feared that foreign ownership and control of their natural resources would lead to a loss of sovereignty. But PEMEX needs greater autonomy to utilize private investment so that it can be managed more efficiently. While it may prove politically difficult to achieve this goal while simultane-

ously allowing the Mexican government to maintain its control, it is economically necessary if PEMEX is to remain viable.

Unfinished Business: Trucking Industry Liberalization. Another important issue is the liberalization of transportation. NAFTA is supposed to allow qualified American and Mexican truckers to make deliveries across the border. Currently, federal policy requires Mexican trucks carrying goods destined for the United States to unload their cargo into warehouses in commercial zones within 25 miles of the border, only to have them reloaded onto short-haul vehicles and then onto domestic trucks for final delivery.

Liberalization of trucking has been delayed, ostensibly due to safety concerns, but more likely for political reasons. Because 80 percent of trade with Mexico travels by truck, the need to resolve the situation is of utmost importance. Currently, the delay in opening U.S. markets to Mexican truckers costs Americans \$200 million to \$400 million each year in higher transportation costs.

Conclusion. Trucking and PEMEX's financial straits are not the only problems facing U.S.-Mexican trade. In the United States, opposition to NAFTA in its entirety — and to trade agreements in general — has become more vocal recently, with mounting calls for suspension or renegotiation of the treaty. Doing so would be a mistake. Protectionism hurts America's status as a preferred trading partner and proponent of global growth. Moreover, withdrawing from the international trading system would allow the European Union and fast-growing Asian countries to take the lead in trade negotiations, which would put U.S. goods and services at a competitive disadvantage.

Economic liberalization under NAFTA has been a slow process, and is still incomplete. Moving forward, both the United States and Mexico will undoubtedly face more challenges to free trade. Overcoming these challenges is paramount. With an open environment for foreign trade and investment, and a large and growing domestic market, Mexico will become an ever-more attractive destination for foreign investment. In the United States, convincing trade protectionists that free trade provides a net benefit to the economy will help ensure economic growth and a dynamic economy well into the future.

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