



*Beyond Free Trade?*  
**Regional Integration and Economic  
 Development in the Iberian  
 Peninsula and Mexico**

**"The U.S. and Mexico: Are We Still  
 Connected?"**  
 Houston Branch of the Federal Reserve  
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<b>Regional Integration in Iberia and Mexico</b>	
<b>1974-78</b>	<b>Transitions to Democracy</b>
<b>1986</b>	<b>Spain and Portugal join the EC</b>
<b>1989</b>	<b>Spain joins ERM-EMS</b>
<b>1992</b>	<b>Portugal joins ERM-EMS</b>
<b>1992</b>	<b>Single Market</b>
<b>1999</b>	<b>Spain and Portugal join EMU</b>
<b>2004</b>	<b>New Enlargement</b>
<b>1994</b>	<b>North American Free Trade Agreement</b>

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## Political Consequences for Iberia

- **Decided on the basis of political considerations**
- **European integration and democratization intertwined**
  - Democratization pre-requisite: decision to proceed
  - Demonstrative and symbolic influence: identification with liberal democracy and freedom
  - Influence on domestic policies and policy direction
  - Involvement of political and economic elites in European institutions and networks
  - Indirect levers during negotiations: economic incentives
- **Democratic consolidation (Pridham 2002):**
  - Improved economic conditions
  - Influenced public opinion
  - *Acquis Communautaire* reinforced democratic practices and pushed for administrative reforms and decentralization
  - Promoted elite socialization
  - Institutional reforms
- **But no direct intervention instruments**
  - Role of domestic politics

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## Political Consequences for Mexico

### 2 Views:

- Open markets can be a positive force for political change. Fox's election in 2000:
  - Contribution to the surge of the export sector and accelerating growth has tilted the balance of political power toward the internal forces that favored growth over the defenders of the status quo
  - Trade and FDI has made types of official and social behavior less acceptable: economic and social consequences
  - Free trade encouraged the formation of watchdog citizen groups to oversight government activities
- NAFTA ignored the issue of democracy:
  - Excluded from the negotiating agenda
  - Avoid direct criticism of the Mexican political regime

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## Economic Consequences for Iberia

*-Catalyst for the conversion of the Iberian economies into modern Western-type economies*

*- Acquis Communautaire: custom union, VAT, CAP, Single Market, ERM, and EMU*

**The end of economic isolation**  
**Institutional reforms**  
**Tax harmonization**  
**Openness of the Iberian economies**  
**Nominal convergence**  
**Capital infrastructure effort**  
**Financial liberalization**  
**Central Bank independence**  
**Privatization**  
**FDI in Iberia**  
**Labour market reform**  
**Reduction in Government Subsidies**

**Increasing competition**  
**Industrial restructuring**  
**Capital Flow Liberalization**  
**Deregulation**  
**Lower inflation**  
**Fiscal Consolidation**  
**Cohesion Policies**  
**Lower nominal interest rates**  
**Internationalization**  
**Higher efficiency**  
**Deregulation**  
**Economic growth**

## EU Economic Consequences: Nominal Convergence

**Compliance of the EMU Convergence Criteria, 1986-2004**

		Spain				Portugal			
		1986	1996	1997	2004	1986	1996	1997	2004
Inflation	%	11.6	3.6	1.9	3.3	13.1	2.9	1.9	2.6
Government Deficit	% GDP	5.3	4.6	2.6	0.3	6.4	3.2	2.5	6.7
Government Gross Debt	% GDP	55	70.1	68.8	62.6	68	65.0	61.4	58.6
Long-term Interest Rates	%	11.7	8.7	6.4	3.64	19.5	8.6	6.4	3.64

*Source: Commission and EMU Reports.*

## EU Economic Consequences: Real Convergence

### Convergence of GDP per Capita 1980-2004

	1980	1985	1990	2000	2004
EU Totals	100.0%	100.0%	100.0%	100.0%	100.0%
Spain	74.2	72.5	77.8	84.0	98.0
Portugal	55.0	52.0	55.7	74.0	73.0

*Source: European Union.*

#### Reasons:

- Productivity
- Unemployment
- Demographic factors
- Participation rate

**At 0.75%  
Spain > 2025  
Portugal > 2046**

#### STRUCTURAL AND COHESION FUNDS

	Greece	Ireland	Spain	Portugal
GDP %				
1989-93	2,6	2,5	0,7	3,0
1994-99	3,0	1,9	1,5	3,3
2000-06	2,8	0,6	1,3	2,9
% on Gross Fixed Capital Formation				
1989-93	11,8	15,0	2,9	12,4
1994-99	14,6	9,6	6,7	14,2
2000-06	12,3	2,6	5,5	11,4

*Data from: European Commission. Estimates based on Eurostat data and forecast for 2000-2006.*

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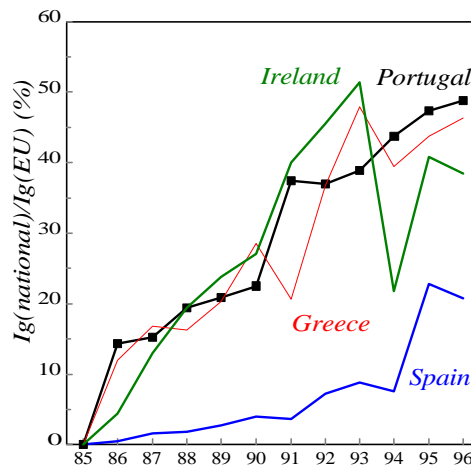
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## CONSEQUENCES OF EU INTEGRATION

### Percentage of public sector investment financed with EU funds:

**EU Aid accounted for:**  
- 1.5% of GDP in Spain  
- 3.3% in Portugal

**Public sector investment:**  
- Over 15% in Spain  
- 42% in Portugal



*Source: Sebastian, 2001*

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## Economic Consequences of NAFTA Integration

- **Supporters: It has strengthened Mexico economically and politically**
  - **It has increased trade and FDI:**
    - Mexican trade with NAFTA countries has increased by 225% since 1993
    - Mexico's exports nearly double those of the rest of LA
    - FDI has averaged over \$13bn since 1994 (before the highest was \$5bn)
    - Second most successful country in capturing FDI
  - **It has improved wages and labor conditions:**
    - Almost 1m jobs created in manufacturing sector
    - More than 1.7m jobs since 1995 export related
    - Companies with FDI paid wages almost 50% higher
    - Wages have increased since 1996 (2001 95% of pre-NAFTA value).
    - Blue collar low-skilled wages closing the gap. Less income inequality
  - **Environmental and agricultural problems not a result of NAFTA**
  - **Establishment of new patterns of industrial organization,**
    - Resulting in lower costs and the exploitation of complementary elements
    - Forcing Mexican producers to adopt foreign stds. and business practices
    - Technology transfers, industrial modernization, access to foreign markets
    - Facilitated infrastructure development, increased training and skills for workers
  - **More prosperous and stable Mexico**

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## Economic Consequences of NAFTA Integration

- **Opponents: Negative effects on workers, communities and the environment.**
- **Failure to promote sustainable development in Mexico and social goals**
  - Need to maintain social cohesion, to avoid environmental damage, and to promote sound governance
- **Trade tricks: Only 3.2% come from Mexican inputs**
- **Adjustment costs and constraints on development policies**
- **Disappointing performance of wages and employment**
  - 50% of nonagricultural jobs in microbusinesses.
  - Real wages declined 11% between 1994 and 2001 and remain lower than in 1981
  - Significantly lower in the *maquila* plants (\$1.74 vs. \$2.12)
- **Income disparities have widened and rising income inequality:**
  - Mexican in poverty increased from 51% in 1995 to 58% in 1998
- **It has intensified environmental problems**
- **Growing geographical and sectoral polarization of investment, income, and employment. Exacerbating the regionalization of core economic activities**
- **Swapped oil dependency for exports to the U.S. (87%) from a very limited number of industries**
- **Devastating the agricultural sector. Poverty rate up to 82%**
- **Inadequate functioning of the National Administrative Office**

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## MEXICO: ECONOMIC DATA

MEXICO (Table 1)				
INDICATOR	1990	1994	2000	2004
Central government debt, total (% of GDP)	46.37	35.32	23.22	N/A
GDP growth (annual %)	5.18	4.46	6.60	4.36
GDP per capita, PPP (current international \$)	6239.97	7353.60	9058.91	9774.19
GNI per capita, Atlas method (current US\$)	2810	4600	5110	6770
GNI per capita, PPP (current international \$)	6030	7130	8830	9590
Inflation, consumer prices (annual %)	26.65	6.97	9.50	4.69
Inflation, GDP deflator (annual %)	28.20	8.47	12.10	6.10
Unemployment, total (% of total labor force)	N/A	4.20	2.20	N/A
Real interest rate (%)	N/A	9.98	4.30	1.06
Foreign direct investment, net (BoP, current US\$)	2.63E+09	1.10E+10	1.68E+10	1.44E+10
Foreign direct investment, net inflows (% of GDP)	0.98	2.60	2.85	N/A
Gross foreign direct investment (% of GDP)	1.00	2.61	2.86	N/A

Source: World Bank databases: World Development Indicators, and Global Development Finance [www.worldbank.org](http://www.worldbank.org)

## LESSONS

*Economic motivations vs. political ones*

*The democratic pre-requirement for membership was a powerful incentive for democratization.*

*Limits of peer pressure.*

*Economic success drives public opinion.*

*Migration patterns can be reversed: Net inflow of immigrants (by 1995 100,000 less Spaniards and less 110,000 Portuguese living in the EU)*

*Real Economic Convergence is a slow process.*

*Macroeconomic reform per se will not produce the necessary institutional reforms in other areas.*

## LESSONS

*Cases of success (Ireland and Spain) and failure (Portugal? and Greece)*

*The key role of structural and cohesion funds: 1.5% of GDP in Spain and 3.3% in Portugal.*

***But Structural Funds are not enough:***

- *Ireland received larger transfer per head than the other 3. Yet Ireland's GDP per head grew from 52% of French levels to 60% in 1990. Then in 2000 it passed France. Why two decades?*
- *Greece experienced more than a decade of decline after accession. Until 1986 it had higher GDP per head than Ireland, and until 1987 than Portugal. Now poorest country.*
- *Portugal: From 1986-01 GDP per head from 53 to 68% of French levels*

***Success contingent on good use of regional projects and structural funds (i.e. transport projects).***

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## LESSONS

***Success is not automatic.***

***Determined by how countries exploit advantages of membership: access to EU markets, and free movement of labor and capital:***

*-Between 1985 and 2002 the ratio of the stock of inward FDI to GDP grew in Spain from 5 to 33%; Portugal from 19 to 36%; Greece it fell from 20 to 9%.*

***Access to markets important but membership is not enough.***

***Also needed: fiscal and monetary discipline, planning, as well as reforms.***

- *Stability influences rate of growth.*
- *Fiscal discipline: Greece ran fiscal deficits close to 10% until to 1996, and public debt increased from 48% of GDP in 1986 to 111% in 1996. Ireland: debt fell from 112% in 1987 to 38% by 2000.*

***Models***

- *Ireland: investment in education (technical colleges), low corporate taxes, and flexible industrial relations.*
- *Finland: innovation.*

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## Conclusions

- *A convergence of integration models is highly unlikely*
- *Integration brings challenges and opportunities.*
- *Success is not automatic. There are no guarantees.*
- *It helps those prepared to help themselves.*