Executive Summary:
NAFTA at 20: Effects on the North American Market

Justino De La Cruz[1]

On June 5–6, 2014, the Federal Reserve Bank of Dallas held a conference, "NAFTA at 20: Effects on the North American Market," at its Houston Branch. The conference was sponsored by the Dallas Fed, the U.S. International Trade Commission, Canadian Department of Foreign Affairs, Trade and Development (DFATD), Mexico's Instituto Nacional de Estadística y Geografía, and the Colegio de México. The two-day conference aimed to review the impact of the agreement on the North American economy. Experts from academia, government, and multilateral institutions discussed a wide range of NAFTA-related topics, including growth, trade and welfare, foreign direct investment (FDI) and supply chains, wages and employment, external shocks and trade liberalization, rules of origin, the U.S.-Mexico border region, and the future of NAFTA. The conference began with a discussion on the challenges of predicting the effect of NAFTA using applied general equilibrium models.

Predicting the Effects of NAFTA: Can We Do Better Now?[2]

In his keynote address, **Timothy J. Kehoe** noted that the applied general equilibrium models built to predict the impact of NAFTA failed to foresee the agreement's impact on trade by industry. Kehoe commented, "If we look at the correlations of what we predicted with what happened, they average about zero." Addressing the question of how to improve these types of predictions, Kehoe indicated that those earlier models were based on the Armington elasticities of substitution. They, thus, did not take into account the extensive margin after an agreement entered into force—the huge increase in trade in new goods, or in goods that traded only in small amounts before the agreement.

Kehoe reported that he was able to significantly improve the trade predictions using a model that takes the margin into account. But "this model is atheoretical," he emphasized. To improve this model, Kehoe noted his intention to modify the Eaton-Kortum model to allow flexible comparative advantage and to apply the estimation methodology developed by Berry, Levinsohn, and Pakes (1995), which could

[1] The views in this article are solely the opinions of the author and should not be interpreted as reflecting the views of the Board of Governors of the Federal Reserve System; Federal Reserve Bank of Dallas; Federal Reserve Bank of Minneapolis; U.S. Department of Agriculture; U.S. International Trade Commission or any of its Commissioners; Inter-American Development Bank; Canadian Department of Foreign Affairs, Trade and Development (DFATD); and Mexico's Instituto Nacional de Estadística y Geografía.
[2] Computable general equilibrium (CGE) models make comparative static estimates, not forecasts; although they are different from predictions, simulation estimates should be aligned with future changes in trade to the extent that changes due to trade liberalization are not overwhelmed by other macroeconomic developments.

generate very different cross-elasticities. He explained that this method of estimation allows the productivity of an exporter's factors of production to vary across products due to deterministic differences in their suitability for a particular product. Examples would include the characteristics of an export firm's land and climate, which affect the set of agricultural products in which it has a comparative advantage, or the education and skills of the workforce, which affect the set of manufactured products in which it has a comparative advantage. This will be addressed in Kehoe's forthcoming work with Kari Heerman.

Serge Shikher agreed with Kehoe that the pre-NAFTA forecasts based on computable general equilibrium (CGE) models did a poor job of forecasting the effects of NAFTA, and he proposed an alternative model to improve the predictions. While earlier models used the Armington assumption to explain two-way trade between countries, Shikher's CGE model relies on the Eaton-Kortum framework at the industry level. Within each industry, the model assumes there is a continuum of goods with different productivities. Since heterogeneous producers and perfect competition are the defining characteristics of this model, Shikher calls it the HPPC model.

Shikher used this model to predict changes in post-NAFTA trade flows from the vantage point of 1989. He then compared the performance of the new HPPC model with that of pre-NAFTA models, and analyzed the differences in the forecasts. Shikher's main conclusion is that the new HPPC model is able to predict the effects of NAFTA noticeably better than previous models. He further noted that newly available methods of creating ad valorem tariff equivalents from nontariff barriers also significantly improve the quality of trade forecasts.

U.S. Wages, Employment, and North American Welfare

The two conference presentations dealing with NAFTA's effects on the North American labor markets were in general consistent with the literature: Overall NAFTA has had small but positive effects on wages and welfare in the member countries, while trade has increased substantially, especially for Mexico. In the first presentation, "The Impact of NAFTA on U.S. Labor Markets," **Justino De La Cruz** discussed collaborative research in which he and David Riker asked the question: What would happen to real wages and employment in the United States if U.S. imports from Mexico were imported not at NAFTA rates but rather at most-favored-nation (MFN) rates?

After documenting the decline in NAFTA preference margins (the difference between NAFTA rates and MFN rates), De La Cruz and Riker incorporated these data into a CGE model from the Global Trade Analysis Project (GTAP). Their model simulation results indicate that the NAFTA preference margins increase real wages in the United States of both skilled workers, by 0.008 percent, and unskilled workers, by 0.003 percent. These real wage effects were smaller than the estimates recently obtained by Caliendo

and Parro, discussed next, for at least two reasons. First, De La Cruz and Riker only modeled the NAFTA tariff preference margins on U.S. NAFTA imports from Mexico, which have declined due to the reductions in tariff rates on non-NAFTA imports. Second, De La Cruz and Riker did not model the effect of NAFTA-mandated reductions in the tariffs on U.S. exports to Mexico. Thus, their estimates include the potentially negative shocks to U.S. labor demand due to U.S. imports from relatively labor-abundant Mexico but do not include many of the likely positive shocks to U.S. labor demand (the reductions in tariffs on U.S. exports to Mexico and Canada). The model estimated that the largest positive employment effects were in the nonferrous metal, iron and steel, and machinery sectors (0.4, 0.2, and 0.2 percent increases, respectively), while the largest negative employment effects were in the sugar and apparel sectors (0.7 and 0.3 percent declines, respectively).

In the second presentation, **Fernando Parro** discussed "Estimates of the Trade and Welfare Effects of NAFTA," a paper jointly written with Lorenzo Caliendo. He focused on the effects of reducing NAFTA members' tariffs on trade flows and on welfare changes. In their 2015 paper, Caliendo and Parro used a stochastic Ricardian model with intersectoral linkages to estimate the trade and welfare effects of tariff reductions between 1993 and 2005. The authors estimated sector-level trade elasticities and then used the elasticities to calculate trade and real wage effects of the NAFTA tariff reductions. Their model takes into account intermediate goods in production and input-output linkages.

The authors estimated that NAFTA tariff reductions led to a 10 to 11 percent increase in Mexico's imports and exports, a 4 percent increase in Canada's imports and exports, and a 1 percent increase in U.S. imports and exports. They estimated that NAFTA tariff reductions increased real wages by 1.30 percent in Mexico, by 0.96 percent in Canada, and by 0.17 percent in the United States. They also found that in all three countries, a substantial share of trade effects due to tariff reductions from all sources can be attributed to NAFTA—for the United States, 55 percent; for Canada, 58 percent; and for Mexico, 93 percent.

Peyton Ferrier also discussed the effects of NAFTA on welfare changes, specifically the producer welfare effects of trade liberalization when goods are perishable and habit-forming—for example, in the case of asparagus. Ferrier and his co-author, Chen Zhen, analyzed the effects of lowering or ending tariffs on asparagus in the United States under NAFTA and ATPA (the Andean Trade Preference Act). Their model results for asparagus suggest that when both ATPA and NAFTA were put in place, the effect on U.S. producer welfare ranged from -0.36 percent without the habit effect to positive 0.04 percent with it. Here, the "habit effect" is the tendency of consumers to develop a taste for off-season asparagus once it becomes available at reasonable prices. In this case, once the "habit effects" are factored in, the welfare losses to U.S. asparagus producers decrease or vanish.

NAFTA and Growth in the United States and Mexico

In their presentation, **Peter B. Dixon and Maureen T. Rimmer** discussed their paper "Identifying the Effects of NAFTA on the U.S. Economy between 1992 and 1998: A Decomposition Analysis." Using the USAGE model—a detailed dynamic CGE model of the U.S. economy that has proven effective in analyzing a wide range of policies—they decomposed movements in U.S. macroeconomic and industry-level variables from 1992 to 1998 into the contributions of NAFTA factors and other factors. Dixon and Rimmer estimated that during this period, U.S. GDP grew by 24.40 percent, of which 0.19 percent is attributable to NAFTA factors. They added that growth in U.S. trade greatly exceeded growth in GDP. Their results show that NAFTA factors made a minor but useful contribution to aggregate U.S. economic welfare. They attribute an increase of about 0.4 percent in private and public consumption from 1992 to 1998 to NAFTA factors. In present-day terms, this is an annual welfare gain of about $50 billion.

At the industry level, Dixon and Rimmer focused on whether there were structural adjustment problems in the U.S. economy that developed between 1992 and 1998 and should be attributed to NAFTA. Still working with the USAGE model, which breaks U.S. production down into 502 different industries, they did not find such problems. For industries that suffered negative growth during this period, they found that the major cause in most cases was poor performance in non-NAFTA export markets or in competition with non-NAFTA imports in the U.S. market. For some industries, they found that NAFTA factors mitigated a potential structural adjustment problem by easing access to NAFTA markets in a situation in which there was strong competition in non-NAFTA markets.

José Romero's discussion focused on the effects of FDI on economic growth in Mexico between 1940 and 2013. Romero addressed the question of how FDI affected productivity in Mexico over this time period. He used an aggregate production function that relates aggregate production to labor and to three types of capital: private domestic, foreign, and government. The study divided the analysis into two periods—1940–79 and 1984–2013, excluding the 1982–83 debt crisis and the years immediately preceding it. Using time series analysis, Romero found that in the first period (1940–79), Mexico's growth was led mainly by government investment, and that the impact of foreign investment on labor productivity outweighed that of private domestic investment. However, in the second period (1984–2013), growth was predominantly led by domestic private investment, with foreign capital playing only a secondary role due to the limited spillover effect that foreign capital created in the economy.

In examining the reason for this change, Romero noted that NAFTA helped develop the vertically integrated production network in North America, with its fragmentation of productive processes, and that this significantly altered the composition of FDI. FDI shifted from a focus on internal markets to a focus

on Mexico's export potential and therefore became directed at labor-intensive stages of fragmented production. This process created few linkages to the rest of the economy and few spillover effects, hence limiting the effect of foreign capital on the growth of the Mexican economy.

NAFTA and North American Integration

Peter B. Dixon, Maureen T. Rimmer, Shenjie Chen, and Catherine Milot discussed the North American Integration model (NAIM) that they are developing. They noted that the aim of the NAIM is to give the Canadian Department of Foreign Affairs, Trade and Development (DFATD) a quantitative analytical tool for assessing the effects of changes in trade policies on Canada and its North American trade partners. These policies include proposed efforts such as further streamlining the passage of goods among the NAFTA partner countries and harmonizing the partners' quality and safety standards for sales of goods and services. Their presentation discussed how the NAIM model was constructed and explained challenges that the authors have encountered, along with promising solutions.

After building CANAGE, a one-country model of the Canadian economy whose theoretical structure is identical to the USAGE model for the United States, the authors combined USAGE and CANAGE into a single model. To this model they added equations that allow U.S. exports to Canada to be driven by Canadian demands for imports from the United States and allow Canadian exports to the United States to be driven by U.S. demands for imports from Canada. Then they conducted two simulations: first they imposed a 1 percent increase in U.S. absorption via a stimulatory macro policy. The second simulation was the same as the first, except that the stimulatory policy was carried out in Canada rather than in the United States. Dixon et al. found that Canada had a greater sensitivity to improved absorption in the United States than the United States did to improved absorption in Canada. This was the result they expected, given the relative sizes of the two economies.

Addressing the integration of energy markets in North America, **Kenneth B. Medlock III** discussed shifts in energy production in Canada, Mexico, and the United States as well as worldwide over the past 20 years, particularly the development of shale crude oil and natural gas. He also described the obstacles holding back energy sector development and the conditions needed for robust growth in the sector. Medlock's main conclusion was that, despite large shale endowments in the NAFTA countries and the fast-paced development of the industry in the United States, all three member economies still need to undertake reforms to boost production, market development, and energy security in North America.

NAFTA and the Border Region

James Gerber discussed "Income in the Border Region, 1993–2010." His presentation cited his 2008 book, *Fifty Years of Change on the U.S.-Mexico Border: Growth, Development, and the Quality of Life*, co-authored with Joan Anderson. He focused his presentation on trends in income levels and growth rates in the U.S. and Mexican border region over the two decades following NAFTA's entry into force. After examining income levels between neighboring U.S. and Mexican cities and between the two countries at the national levels, Gerber discussed multiple reasons for the income divergence between the two countries.

Gerber's first conclusion is that besides the popular explanation—the differences between the institutions of the two countries—there are political, socioeconomic, and macroeconomic factors behind the marked increase in the income gap between the United States and Mexico in the 2000s. Since many of these factors are largely determined by national-level policies (as opposed to local ones), Gerber's second conclusion suggests that those policies—for instance, vulnerability to U.S. economic cycles and China's entrance into the WTO—could also have an extractive[3] effect on Mexican border municipalities.

André Varella Mollick discussed his research with René Cabral on wage convergence in Mexico. They tried to determine if the increase in the economic integration of Mexico and the United States led to quicker wage convergence at the regional level. To quantify NAFTA's effects on Mexican wages, they analyzed the increase in capital and labor mobility in Mexico as a result of NAFTA. They found that greater integration with the United States has led not only to growth of output in Mexico but also to changes in the supply of labor across regions as well as the regional distribution in Mexican wages. Their analysis indicated that states closer to the U.S.-Mexican border experienced quicker wage convergence than non-border states and that migration appears to be an important factor in this convergence.

NAFTA and Mexican Industry

In his presentation, "NAFTA and Mexican Industrial Development," **Eric A. Verhoogen** discussed the role that NAFTA and international integration have played in Mexico's economic growth. He noted that Mexico's recent performance has been mediocre relative to other middle-income countries, and offered what he called an "old-fashioned idea" as a partial explanation for Mexico's disappointing performance. He argued that integration into the international economy in 1998–2008 led Mexico to specialize in less capital- and skill-intensive activities, which tended to be less innovative. Trade liberalization may not

[3] In this context, the term "extractive" refers to policies that affect one region negatively to the benefit of other regions. For example, a U.S. immigration policy of increased border enforcement could be beneficial to the security of U.S. citizens and residents far from the U.S. border with Mexico, but it could also have adverse effects on Mexican border cities whose economies are oriented toward the U.S. marketplace.

bring about sustained economic growth if it leads to specialization in sectors with little innovation. “This argument relies on the idea that innovation generates positive externalities,” added Verhoogen.

Focusing on the Mexican maquiladora industry facing competition from China, **Luis Bernardo Torres Ruiz** discussed the results of his joint research with Hale Utar. Their study addressed the question of how intensified competition from China in the period 1990–2006 affected Mexican export assembly plants, or maquiladoras—their entry, growth, productivity, and exit. They conclude that all responded negatively to Chinese competition. Torres also noted that Chinese competition led to downsizing or exit of firms in low-skill, labor-intensive sectors, leading their former employees to find work in other sectors. But Torres also pointed out that there is strong evidence that heightened competition from China improved maquiladoras’ within-plant productivity.

NAFTA and the Transformation of Canadian Patterns of Trade and Specialization

Richard Harris and Nicolas Schmitt reviewed a variety of evidence on the changes in Canadian merchandise trade patterns in the pre- and post-NAFTA periods. They noted that Canada’s integration into a common North American market occurred in two steps: first as a result of the 1988 Canada-U.S. free trade agreement (FTA), and then with the implementation of NAFTA in 1994, which also covered Mexico.

Harris and Schmitt noted that the 1990–2000 decade is referred to as the NAFTA decade, since this was the period in which the full impact of the two trade agreements on the Canadian economy would have been realized. Overall, Harris and Schmitt found that NAFTA led to substantially higher volumes of trade in all types of goods during this period. Canada’s integration with the United States and Mexico increased, but so did its trade with non-NAFTA trading partners. Canada’s NAFTA trade generally showed less specialization, with more trade in primary commodities and intermediate goods. By contrast, Canada’s non-NAFTA trade showed increased specialization, especially in imports of finished goods. At the sector level, Canada’s trade volume rose across almost all sectors under NAFTA, with very large increases in the transportation and electrical machinery sectors. Generally, the changes observed in the NAFTA decade essentially accelerated many of the trade patterns that were evolving from 1965 to 1990.

However, the decade 2000–2012 led to a strong reversal in many of these trends. Notably, Harris and Schmitt found that Canada’s trade in manufactured goods with its NAFTA partners declined relative to GDP. In the same period, resource exports—particularly energy—increased, in tandem with significant increases in resource prices, driven by growth in developing countries such as China. The authors examined several possible explanations for the NAFTA trade reversal. Of these, two stand out as leading candidates. First, the large real exchange rate appreciation which occurred in 2000–2012 is consistent

with the observed decline in manufacturing exports and increase in resource exports. The second explanation often given is that increased competition from China and other low-cost exporters is pushing Canada out of its NAFTA partners' markets for manufactured goods. Harris and Schmitt found some evidence of such a trend when viewed in the appropriate context.

Remaining Barriers and Greenhouse Gas Emissions

Border Crossing for Trucks

Pilar Londoño-Kent and Alan K. Fox explained that, despite the liberalization achieved by NAFTA as well as substantial investments in infrastructure, technology, and equipment, significant barriers to efficient truck transport remain between the United States and Mexico. They also discussed the practical and economic implications of changes to the NAFTA border crossing system put in place after the terrorist events of September 11, 2001, and described the border procedures in place today. They concluded that the new security measures have "thickened" NAFTA's borders, increasing costs and delays associated with border crossings.

Londoño-Kent and Fox presented the institutional context in which barriers exist and border authorities' rationale for establishing new barriers or continuing preexisting ones. Using this information and the time and costs associated with cross-border freight movements, they used a CGE framework to estimate the welfare effect of these measures on the NAFTA economies. Their counterfactual assumes the implementation of a "seamless freight flow" system similar to Europe's *transport international routier* (international road transport) system, and they calculated the time and cost differentials between such a system and the border status quo. They estimated that the annual welfare gains for Mexico and the United States accruing from a seamless cross-border processing system would be about $8 billion for each country.

NAFTA Rules of Origin: Adaptation in North America and Emulation Abroad

In his presentation, "NAFTA Rules of Origin: Adaptation in North America and Emulation Abroad," **Jeremy T. Harris** discussed his and Antoni Estevadeodal's research findings that NAFTA set the default "template" for the product-specific rules of origin (PSROs) of subsequent FTAs of NAFTA partners, and also heavily influenced other FTAs globally. He noted that NAFTA has introduced a new model for designing, negotiating, and implementing rules of origin. In his joint research with Estevadeordal, Harris has addressed the question of how the rules of origin in NAFTA have become more flexible and how this flexibility has affected the trade flows between the United States, Canada, and Mexico. In closing, Harris stated that NAFTA's institutional mechanisms for adapting PSROs to evolving market structures have had a small but significant positive effect on regional trade.

Designing a Greenhouse Emission Market for Mexico

Jaime Sempere presented "Designing a Greenhouse Gas Emission Market for Mexico," a paper written with David Cantala and Stephen McKnight. Sempere focused on the creation of a cap-and-trade system that would allow "a cap on greenhouse gases emissions for a set of firms" to be divided into permits and then traded among firms. He also discusses the potential integration of this system with other similar North American programs. The main conclusion of this paper is that while cap-and-trade systems are effective in reducing greenhouse gas emissions, they are complicated to design. In the case of Mexico, Sempere suggested that the government work with other NAFTA members to agree on homogeneous environmental regulations and proper regional integration to foster efficient design, proper implementation, and ultimately effective greenhouse gas reduction.

NAFTA: Retrospect and Prospect

Anne O. Krueger began her presentation by outlining three topics she would examine: (1) the debates over NAFTA at the time of its formation; (2) the current state of NAFTA affairs; and (3) key issues for NAFTA's next 20 years. She noted that her discussion would be mainly from the U.S. point of view. Krueger highlighted some lessons we can learn from the NAFTA experiment moving forward: (1) preferential trade agreements (PTAs) are susceptible to lobbying and other third-party pressures; (2) to succeed, future PTAs must operate under the multilateral trade system or the World Trade Organization (WTO), given the growth in importance of global value chains; and (3) NAFTA needs to be strengthened by enabling faster transit of goods, facilitating great labor mobility, increasing regulatory uniformity, and adopting policies for energy and agriculture. Energy and agriculture are areas with huge potential gains. The main conclusion that she drew from her examination was that, while NAFTA's effects are very hard to isolate and measure, initial estimates of these effects seem to have been pessimistic as a whole, overstating NAFTA's negative consequences while understating its benefits.

The Future of NAFTA: A Policy Perspective

In the final session of the conference, a panel of economists that included Justino De La Cruz, Alan V. Deardorff, Richard G. Harris, Timothy J. Kehoe, and José Romero discussed its views on the future of NAFTA.

Justino De La Cruz noted that his comments, built around two points, would be from Mexico's perspective. The first point regards Mexico's trade policy: De La Cruz suggested that for Mexico, NAFTA's primary objectives were to promote and encourage trade and FDI with Canada and the United States. The second point is that NAFTA is only one growth-promoting policy instrument among many at Mexico's disposal. Thus, if Mexico's goals are to achieve high rates of economic growth, employment,

real wages, and productivity, as well as balance of payments equilibrium and low rates of inflation, policymakers must use several policy instruments, not just NAFTA. Returning to his first point, De La Cruz observed that since NAFTA's implementation, trade flows and FDI between Mexico, the United States, and Canada have grown substantially. In that sense, NAFTA has successfully achieved Mexico's objectives for it.

As to the future: First, efforts by NAFTA's Free Trade Commission to facilitate trade and investment will likely continue to encourage trade and investment expansion, supported by the eventual successful completion and implementation of the Trans-Pacific Partnership (TPP) agreement and the Trans-Atlantic Trade and Investment Partnership (TTIP). However, Mexico's gains from these agreements will be limited, given that the country has already free trade agreements with Japan and the European Union. Given the second point—that trade is only one among many instruments available in the policy toolbox—one may consider that for Mexico to promote its own development, it could undertake other policy initiatives as well. For example, there are the reforms that Mexico is currently adopting—education reform, energy reform, and others. These will certainly help trade and investment, but more importantly, they will support development of the entire Mexican economy. However, one reform that is essential for development but is missing is the "strengthening of the rule of law." De La Cruz concluded that the future of NAFTA will be affected indirectly by what happens with the other policy reforms Mexico has been undertaking. But, even if there were a super NAFTA, Mexico will not develop without the rule of law.

Alan Deardorff said he feels that if the TPP is agreed upon and enacted in what appears to be its current form, it would simply replace NAFTA. If, however, the TPP were to include some provisions that are weaker than those of NAFTA, then the NAFTA countries would still be obliged to follow the NAFTA rules, and the TPP would not replace it. But this would seem to be the less likely outcome: Apparently, the negotiations for the TPP are aimed at making the TPP stronger than NAFTA in many ways. If that were the case, then the future of NAFTA, in some sense, could turn out to be whatever the TPP does. Deardorff noted that there are some features of the TPP that he is concerned about, including the TPP rules of origin, the closed nature of the TPP, NAFTA's Chapter 11 and its equivalent under the TPP, and the stronger versions of NAFTA's labor and environment agreements.

Richard G. Harris noted that his comments would focus on issues other than trade, with an emphasis on the Canadian perspective. To begin, he noted that border issues are and will continue to be at the front and center of the agenda in all three countries. Second, an issue of enormous importance is the lack of regulatory harmonization. For instance, in two of the biggest sectors, services and telecom, there has been absolutely no progress toward free trade and integration. A third issue involves labor mobility, specifically the temporary visas offered under NAFTA. Harris noted that the program has been very

successful and that some companies are in favor of further liberalization of the NAFTA labor provisions, but there has been little progress in this area. Finally, Chapter 11, the dispute settlement mechanism under NAFTA, is problematic for both Canada and the United States.

Harris commented in conclusion that all these examples are about economic integration and asked the question: is North America going to become more deeply integrated economically? The answer is yes, he said—that is going to happen. But it is unlikely that NAFTA will be the mechanism by which this will be carried out. Harris believes that, as outlined by Deardorff, the future of NAFTA will be subject to the future of the TPP.

Timothy J. Kehoe focused his comments on the future of Mexico. He stated that the United States has grown at about 2 percent per year on a per capita basis—it has done so for the past 113 years, with the exception of the Great Depression and its aftermath. Kehoe said he believed that every country could grow 2 percent per year by just following the United States. “When you are behind, though, you can play catch-up,” said Kehoe, “and that’s what Mexico was doing in the fifties, sixties, and seventies, with high-growth policies that eventually caused the later problems. But then you get to a point in the development of a country in which institutions matter.”

At this point Kehoe’s remarks turned to institutions in Mexico. “What are the barriers to growth to Mexico?” he asked. In Mexico, he said, the big monopolies and the bureaucracy are holding the economy back. The financial institutions in Mexico could function more efficiently as well, while contract enforcement, the rule of law, and labor markets are all in need of reform. Mexico has to start growing again. And while reforms of the financial institutions, labor markets, and rule of law are all difficult, he is hopeful that Mexico can get rid of these inefficiencies.

In the final presentation of the panel and of the conference, **José Romero** addressed the current state of Mexico’s economy and its policies of liberalizing trade and fully opening its capital markets. Romero first stated that the predicted convergence of U.S. and Mexican per capita GDP has not happened: Mexico’s per capita GDP is about 33 percent of U.S. per capita GDP. Second, Mexico’s export growth strategy has not produced economic growth in rural areas. Romero added that full opening of the Mexican capital markets also made monetary policy ineffective at promoting growth, since interest rates in Mexico and the United States are practically the same. Similarly, the exchange rate cannot be used to make the economy more competitive. Thus, according to Romero, Mexico lacks effectiveness in its trade policy, industrial policy, fiscal policy, monetary policy, and exchange rate policy. “We are in a canoe without any control, going into rapids,” Romero stated.

Romero went on to state that looking at industrial production trends, we see that Mexico's index almost mimics that of the United States. That means that the only source of growth for Mexico now is the United States economy. "What worries me the most," Romero concluded, "is that NAFTA does not have a broad strategy as a bloc." He explained that the United States has its own growth strategy that does not include Mexico or Canada.