

The Political and Economic Transformation of Mexico Since NAFTA

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Mexico Before NAFTA

Circa 1974, 20 years before NAFTA, Mexico was characterized by:

- Autarky (closed to trade and FDI)
- Financial Repression
- Low Levels of Public Goods Provision
- Minimal Taxation
- Widespread Poverty
- Authoritarian Government
- These features were not independent of each other; they were part of a general equilibrium.

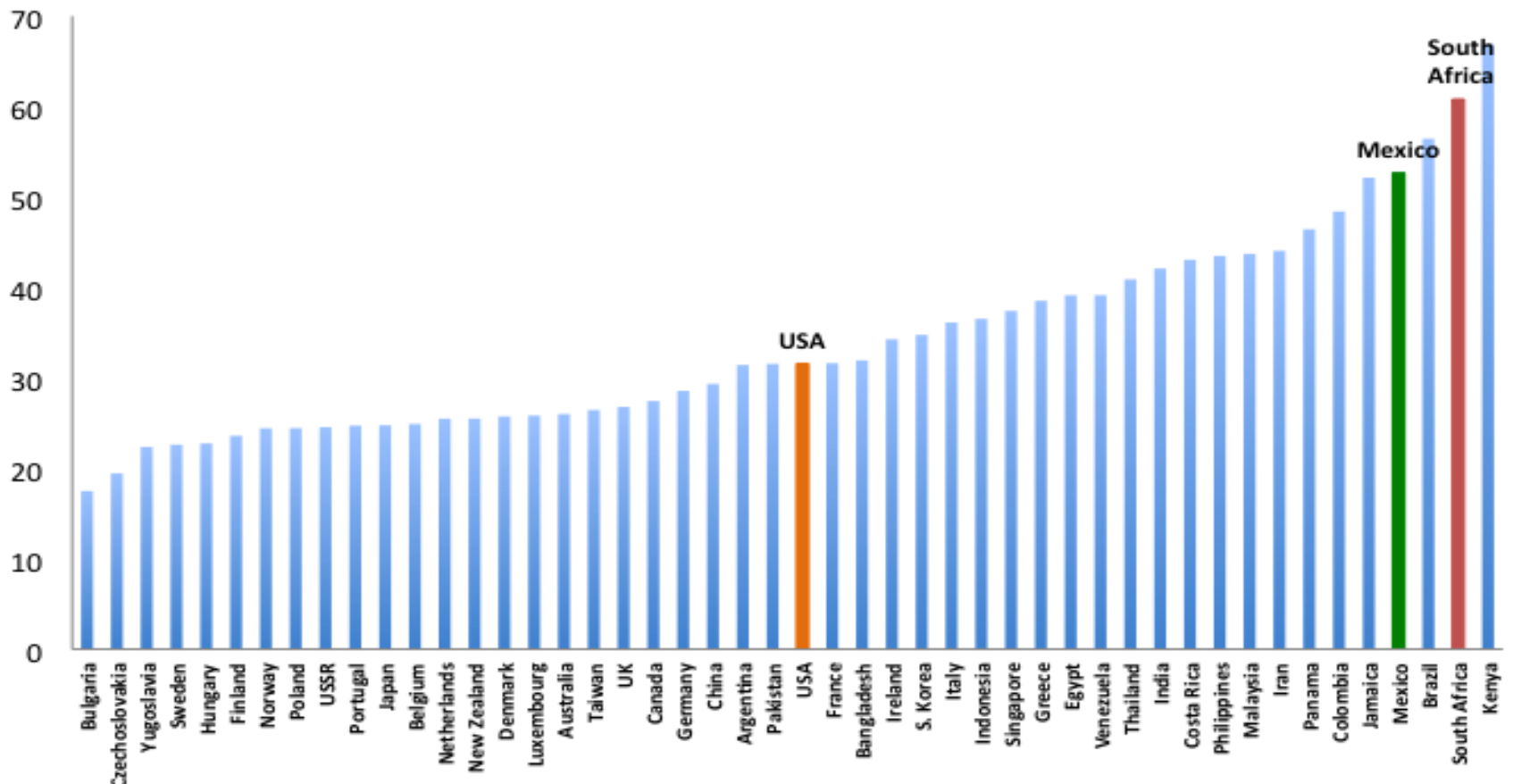
How do you encourage investment when property rights are insecure?

Raise rates of return as compensation for expropriation risk

1. Access to capital as a barrier to entry.
2. Import licenses as barriers to entry.
3. Tax capital at low rates.
4. Share some of the rents with organized labor groups affiliated with the PRI.
5. Do very little for everyone else.

The paradox: a country ruled by a “revolutionary government” with the income distribution of South Africa

Estimates of the Gini Coefficient, net of taxes and transfers, in 1974
(From Solt, SWIID Database)



Mexico Since NAFTA

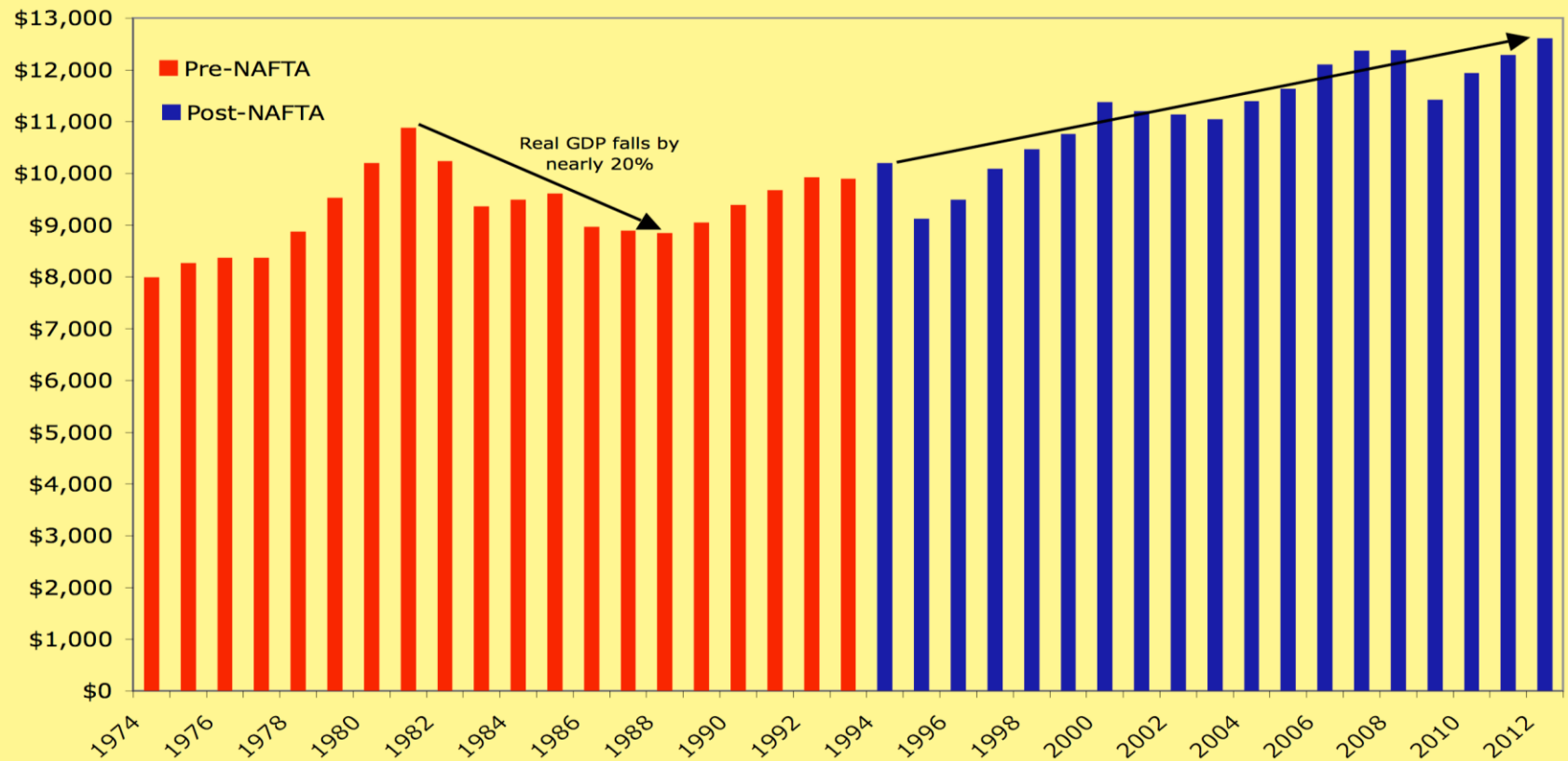
- 20 years after NAFTA, Mexico is characterized by: :
- An open, export-driven economy
- Openness to FDI
- Sustained (but not breakneck) growth
- Financial openness
- Increasing levels of public goods provision
- Falling poverty levels
- Less corruption (although starting from a high base)
- A multiparty democracy
- These features are also not independent of each other: they are part of a general equilibrium

Let's be careful about causation

- The fact that NAFTA occurred in between 1974 and 2014 does not mean that NAFTA “caused” the shift in equilibria in the narrow sense of the word
- But...NAFTA was an important part of a larger process that brought about that shift in equilibria, and that larger process was about political survival. NAFTA was part of a larger gamble by the Salinas government.
- That gamble set in motion a process that became difficult to control. It was not trade and investment that were rerouted, the equilibrium path of development was shifted.

Why the Mexican Government Abandoned Autarky in One Slide

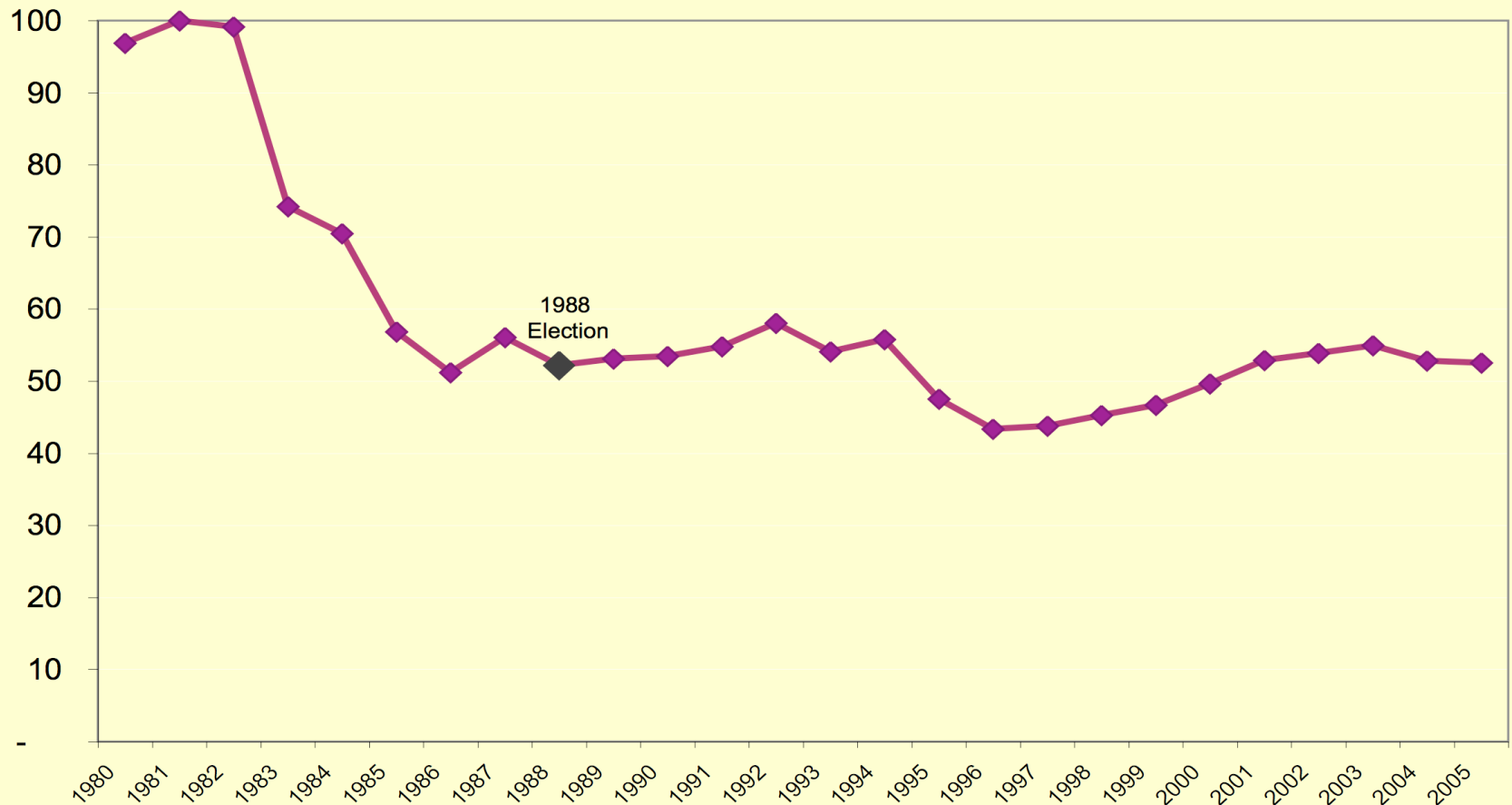
Mexican Real GDP Per Capita, 2005 PPP\$, 1974 to 2012



Source: Penn World Tables 7.1 and WBDI 2013

Wages fell even faster than GDP-- undermining the PRI's coalition

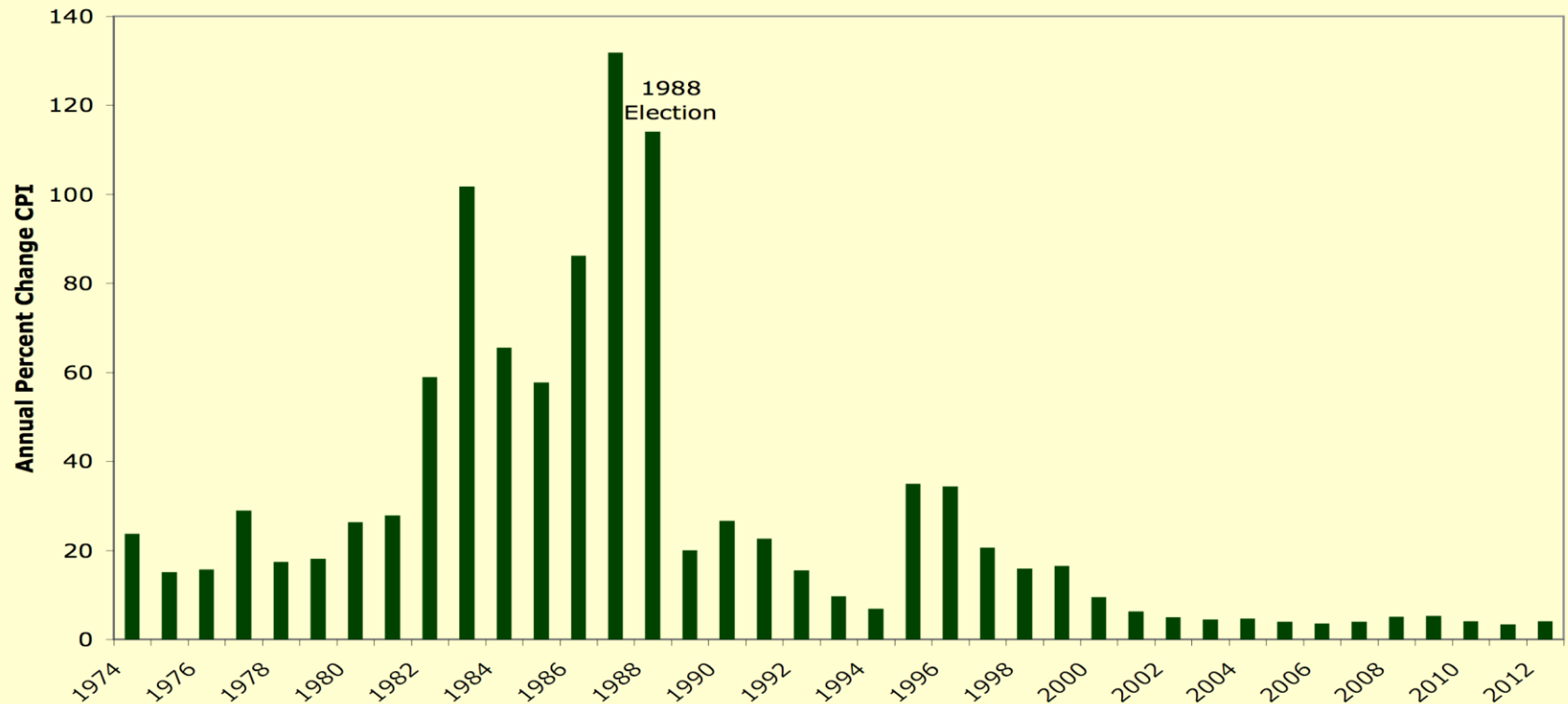
Index of Real Mexican Manufacturing Wages, 1981=100



Source: Haber et. al, Mexico Since 1980.

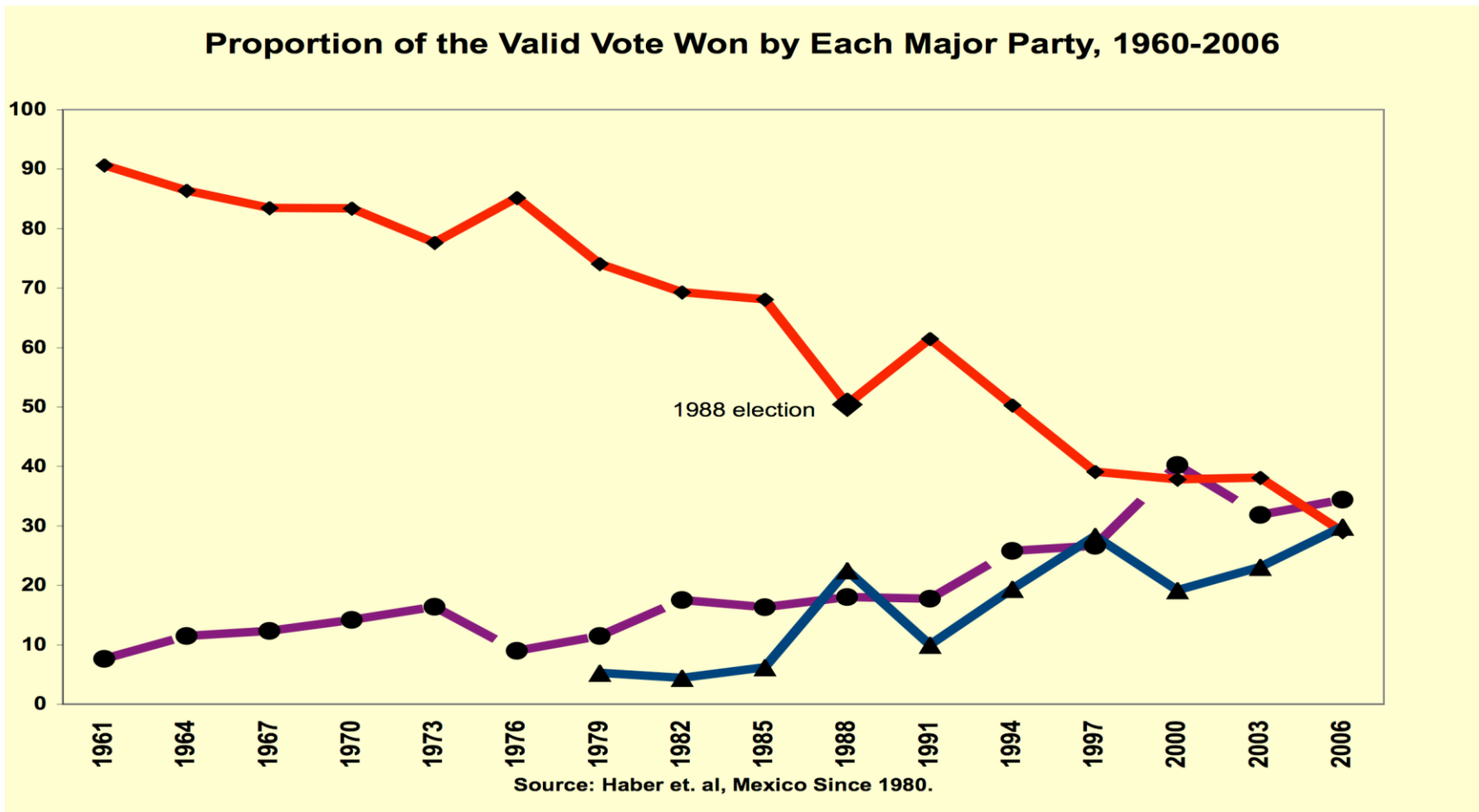
Real wages fell fast, because the government financed itself through an unpopular inflation tax

Inflation in Mexico, 1974-2012

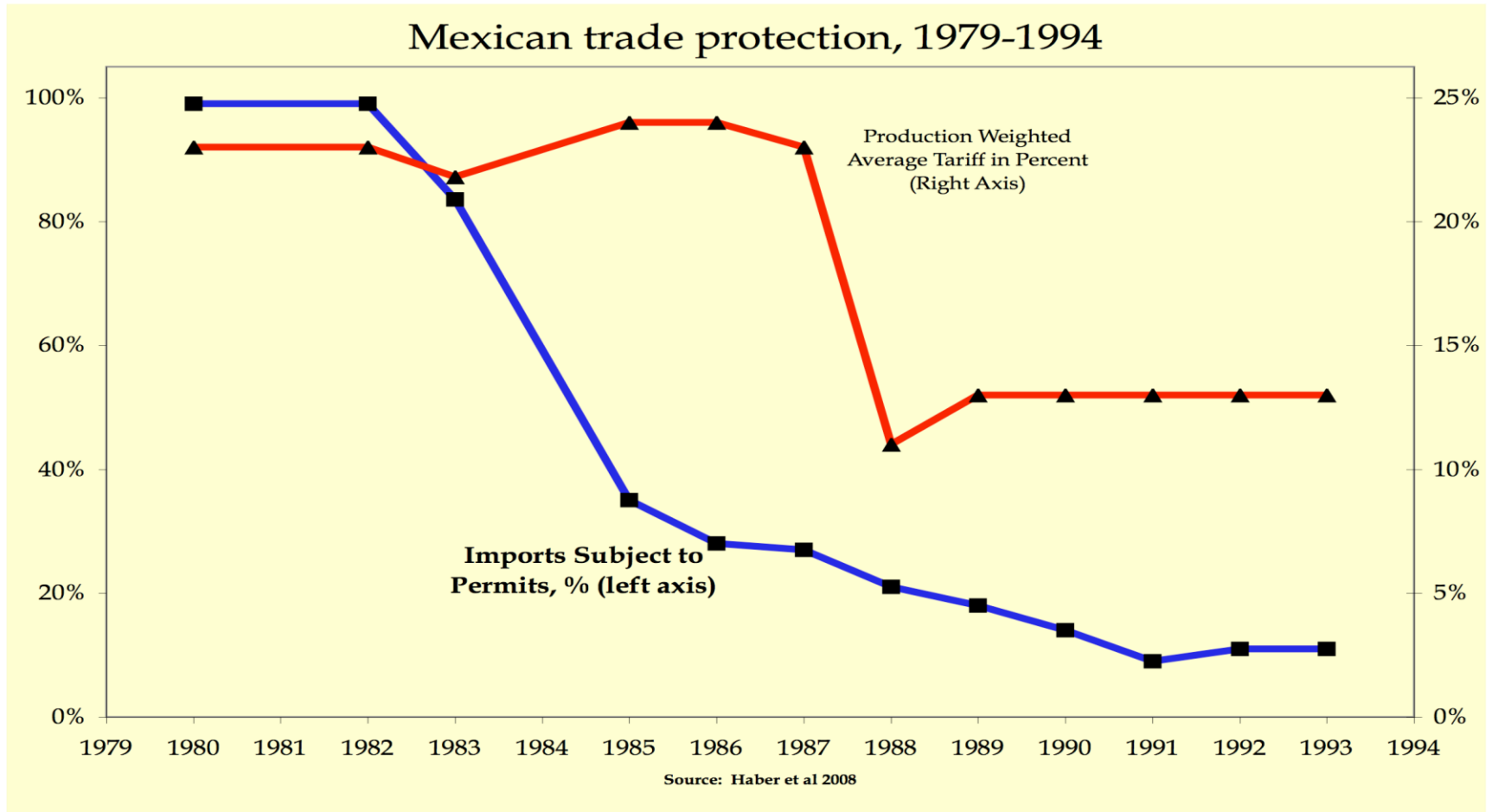


Source: World Bank WDI 2013 Update

In short, the fate of the PRI was in Carlos Salinas' hands



Salinas gambled on trade, FDI, and privatization as a fix for the economy--and hence as a fix for the PRI



NAFTA was not just about trade

NAFTA established mechanisms protecting the property rights of U.S. and Canadian investors. Mexico could no longer:

- Treat U.S. and Canadian companies differently from Mexican firms.
- Require U.S or Canadian-owned manufacturing plants to purchase a share of production inputs from Mexican sources
- Require them to export a greater value of goods than they imported.
- Prevent them from repatriating profits.
- Expropriate foreign firms and arbitrarily determine the level of compensation (NAFTA tribunals established).

The other part of Salinas' gamble was the privatization of SOEs

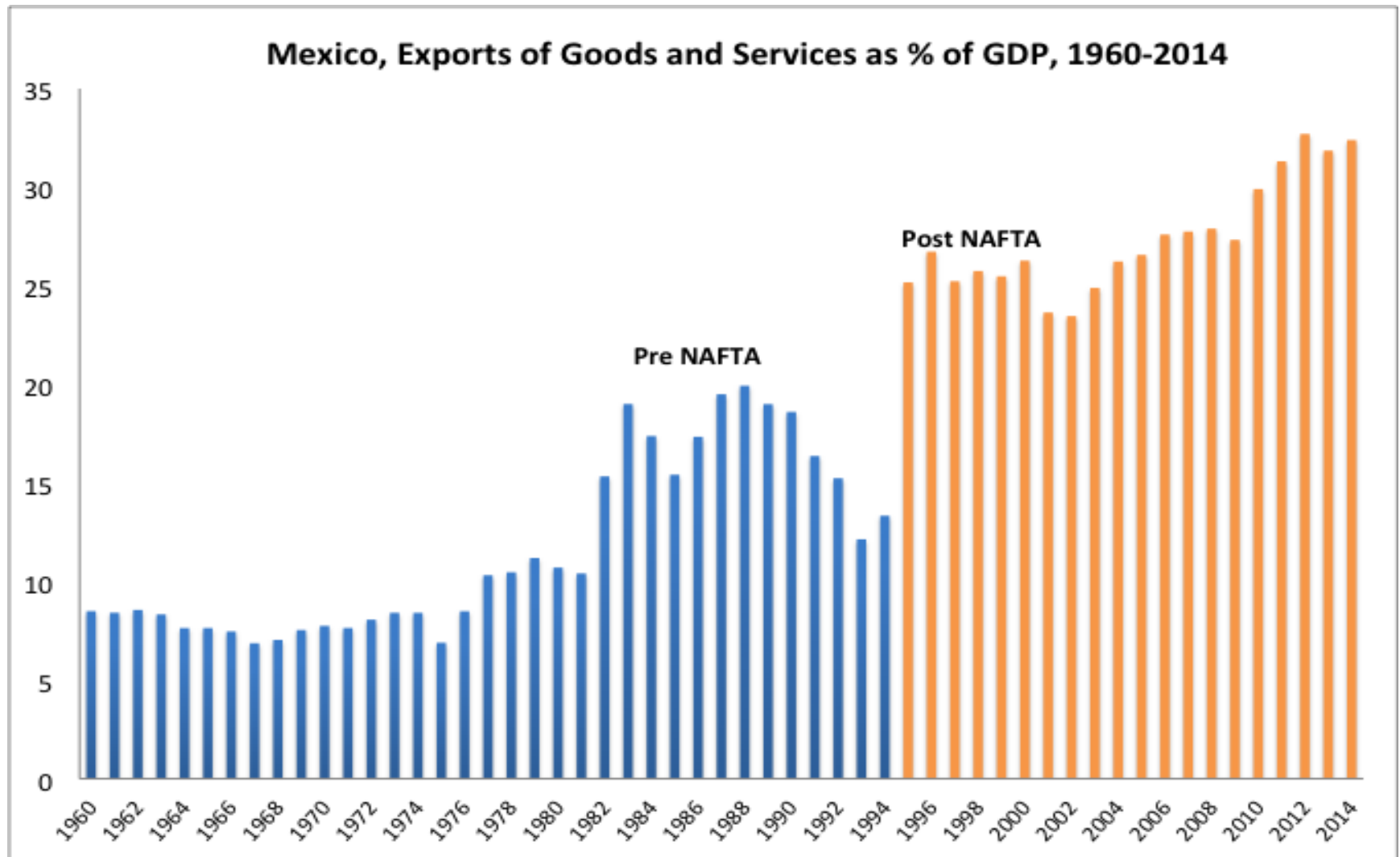
The sale of SOEs provided one-time injections of cash and moved perennial money losers off the budget.

The two crown jewels:

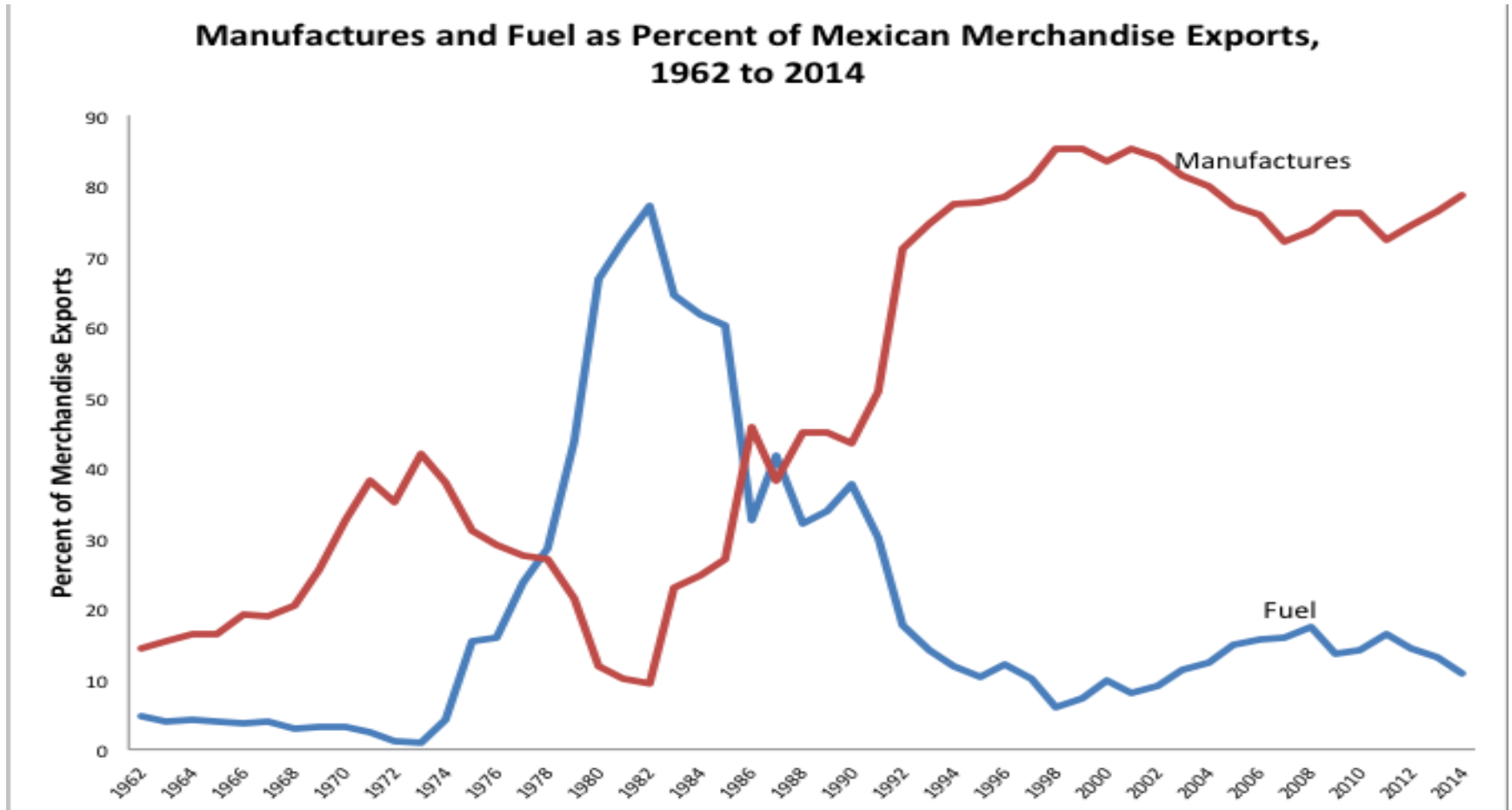
Banks

Telecoms

Part of Salinas' gamble paid off



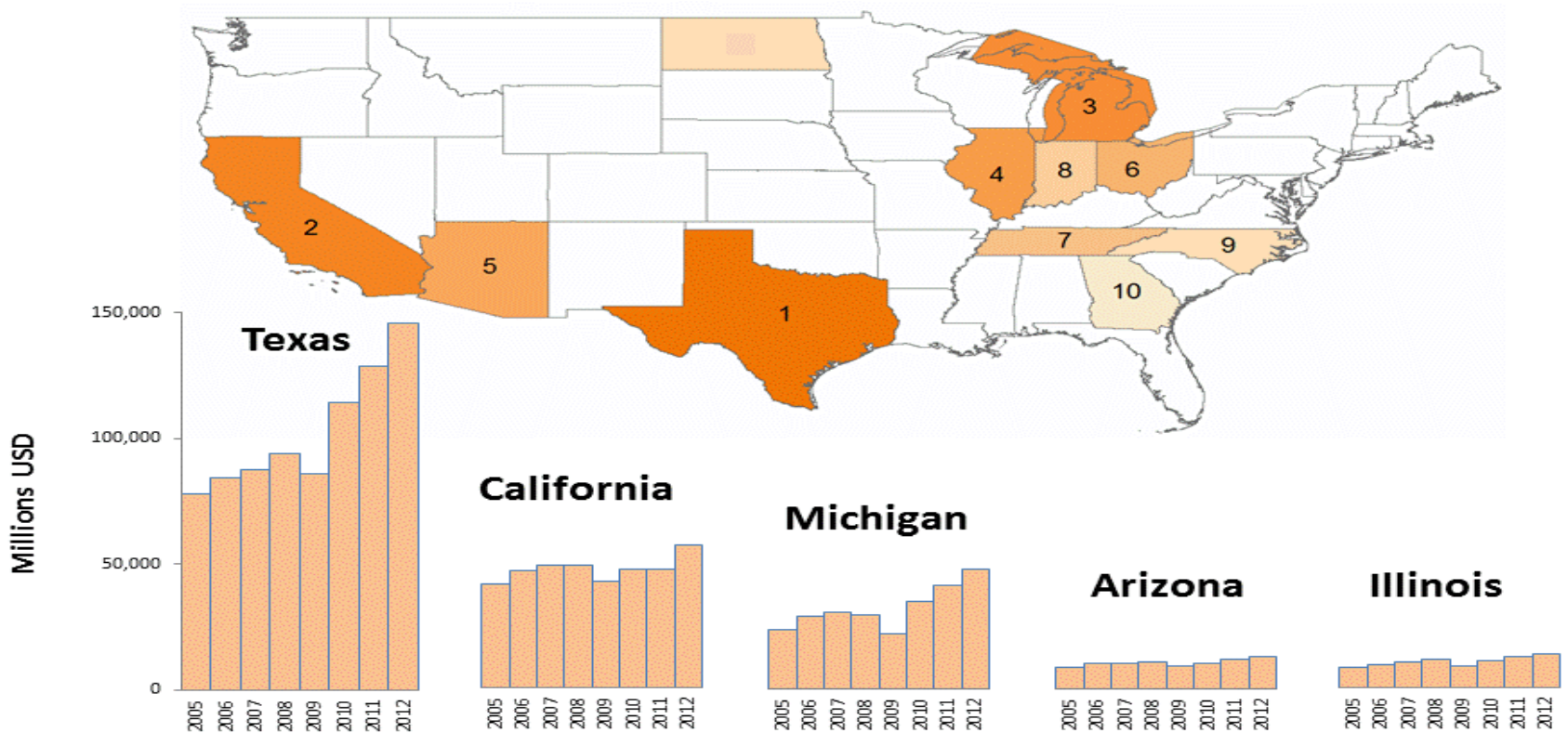
Mexico became a manufacturing platform for the U.S.



Texas was a beneficiary of this jump in trade

Surface Trade of US States with Mexico

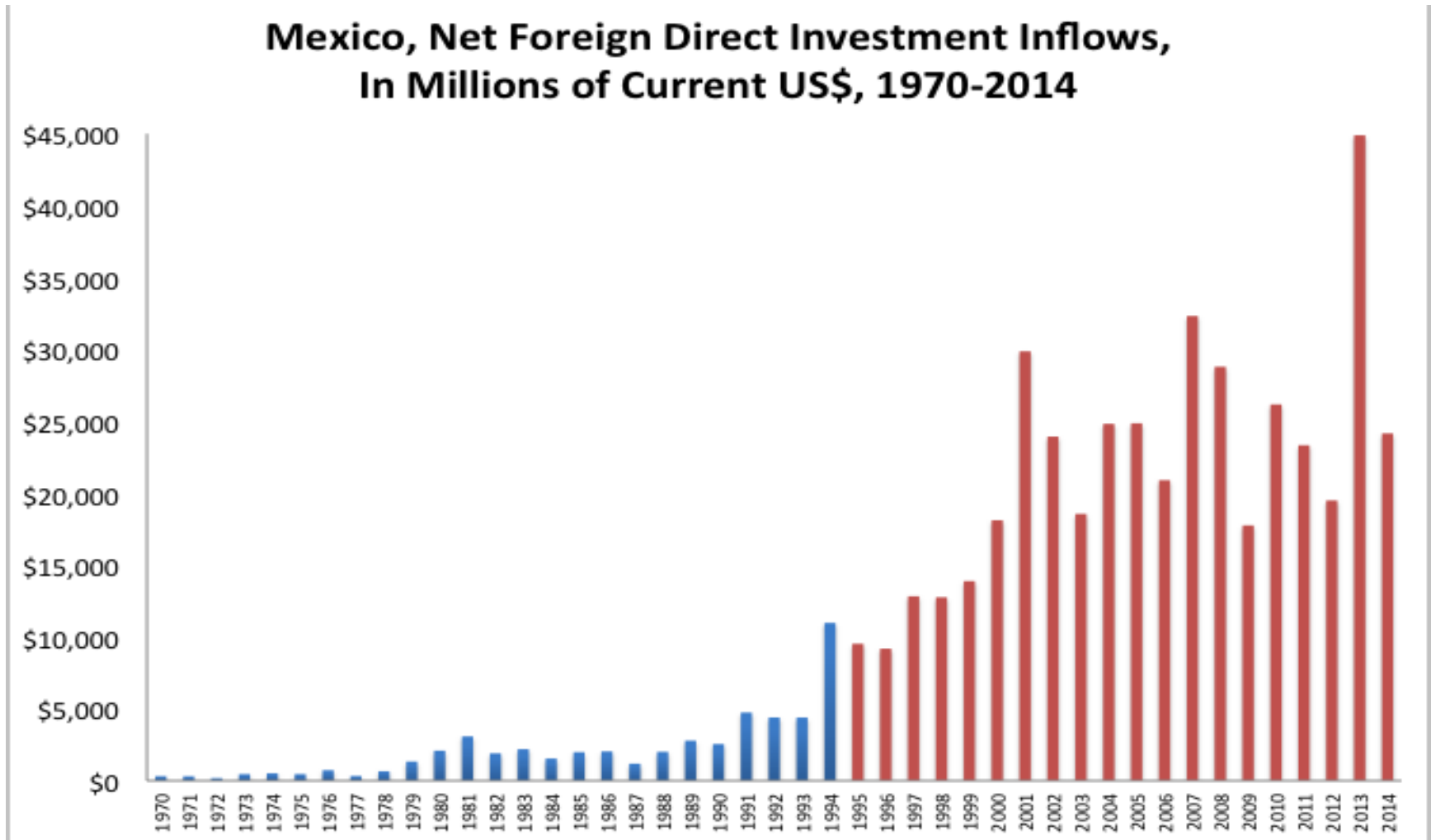
States Ranked Based on Value of Traded Goods (2005-2012)



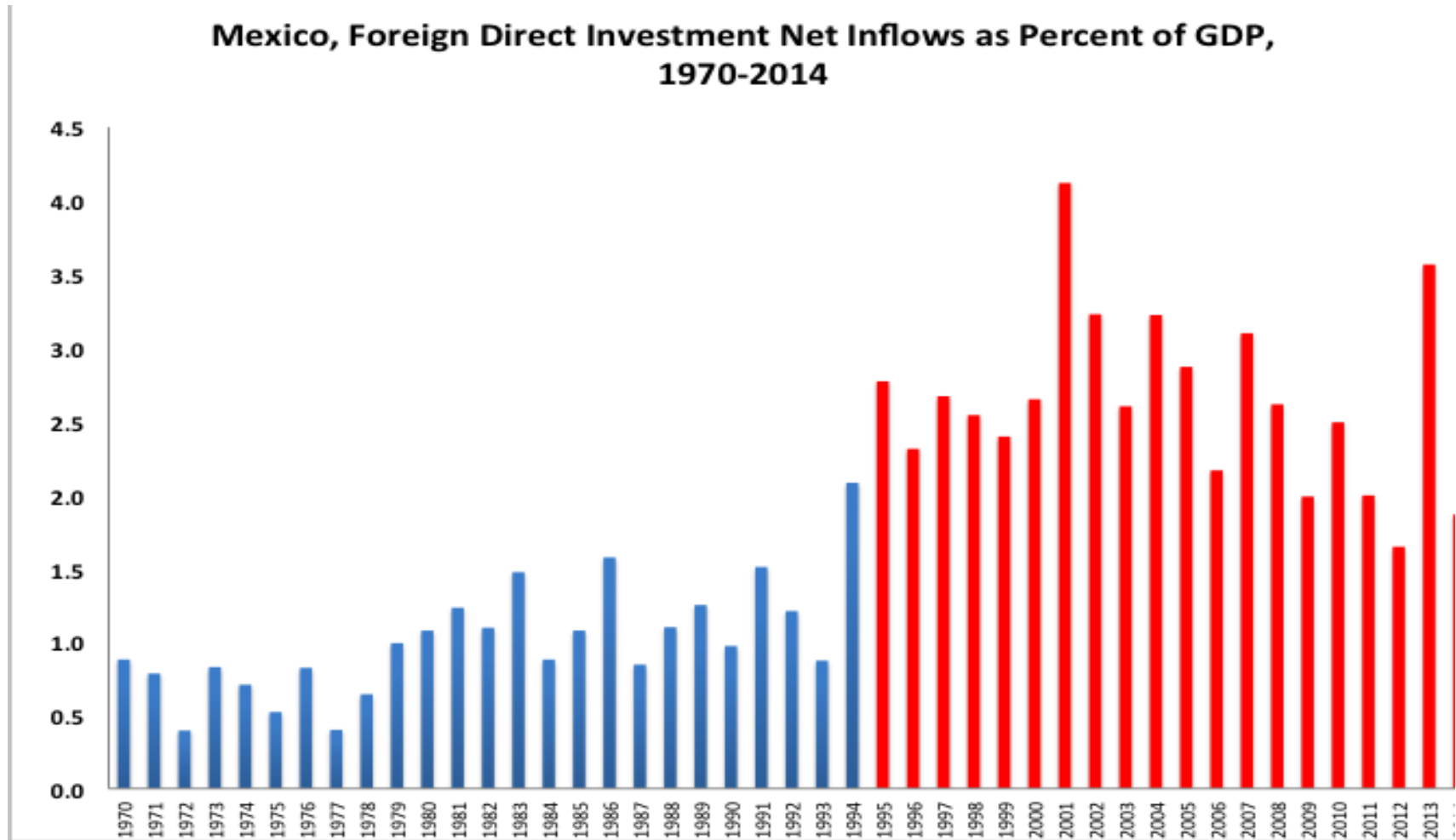
Data and Image From
Texas A&M
Transportation Institute

FDI also Increased as a result of NAFTA

**Mexico, Net Foreign Direct Investment Inflows,
In Millions of Current US\$, 1970-2014**

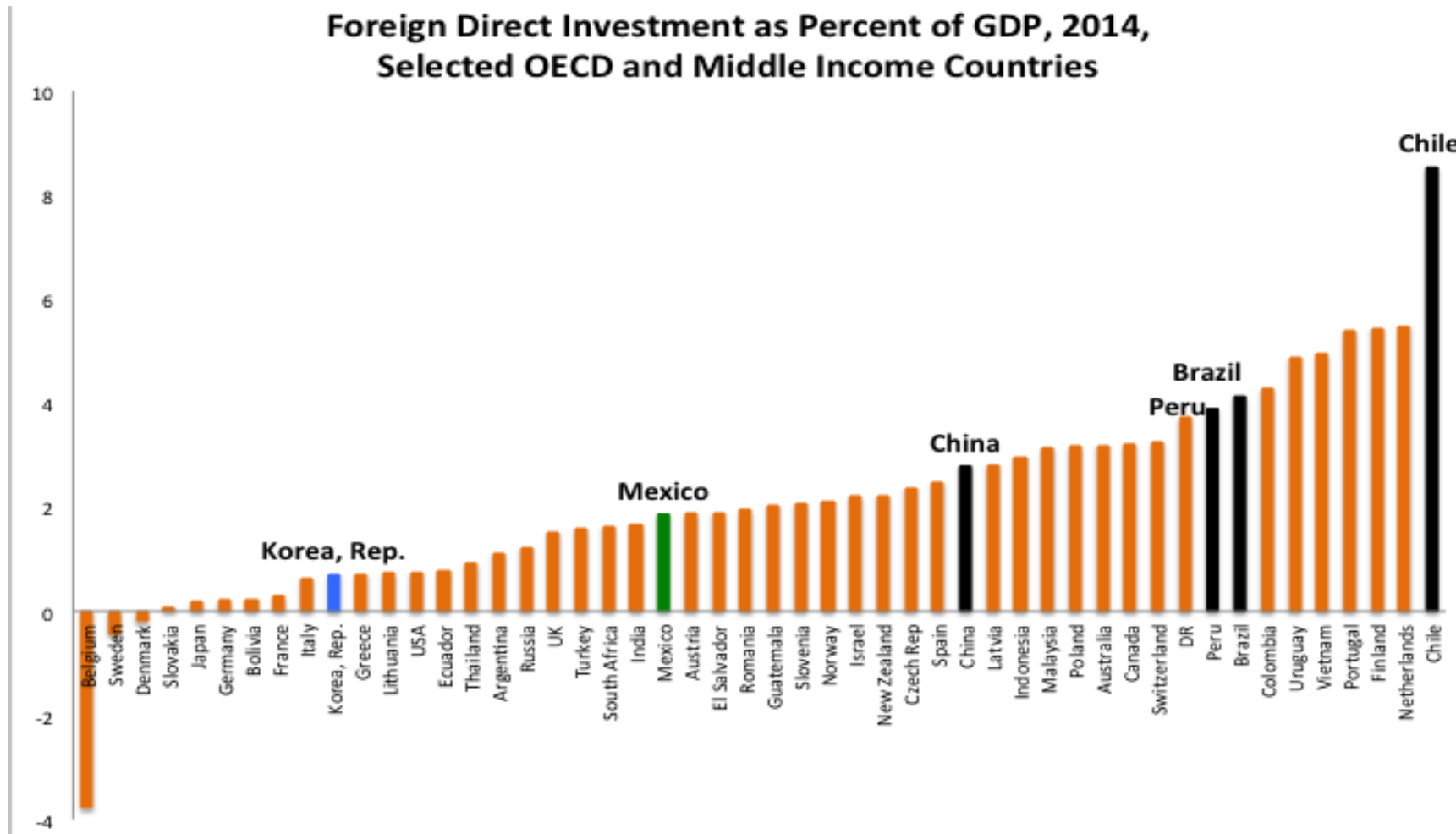


But FDI increased modestly relative to the size of the Mexican economy



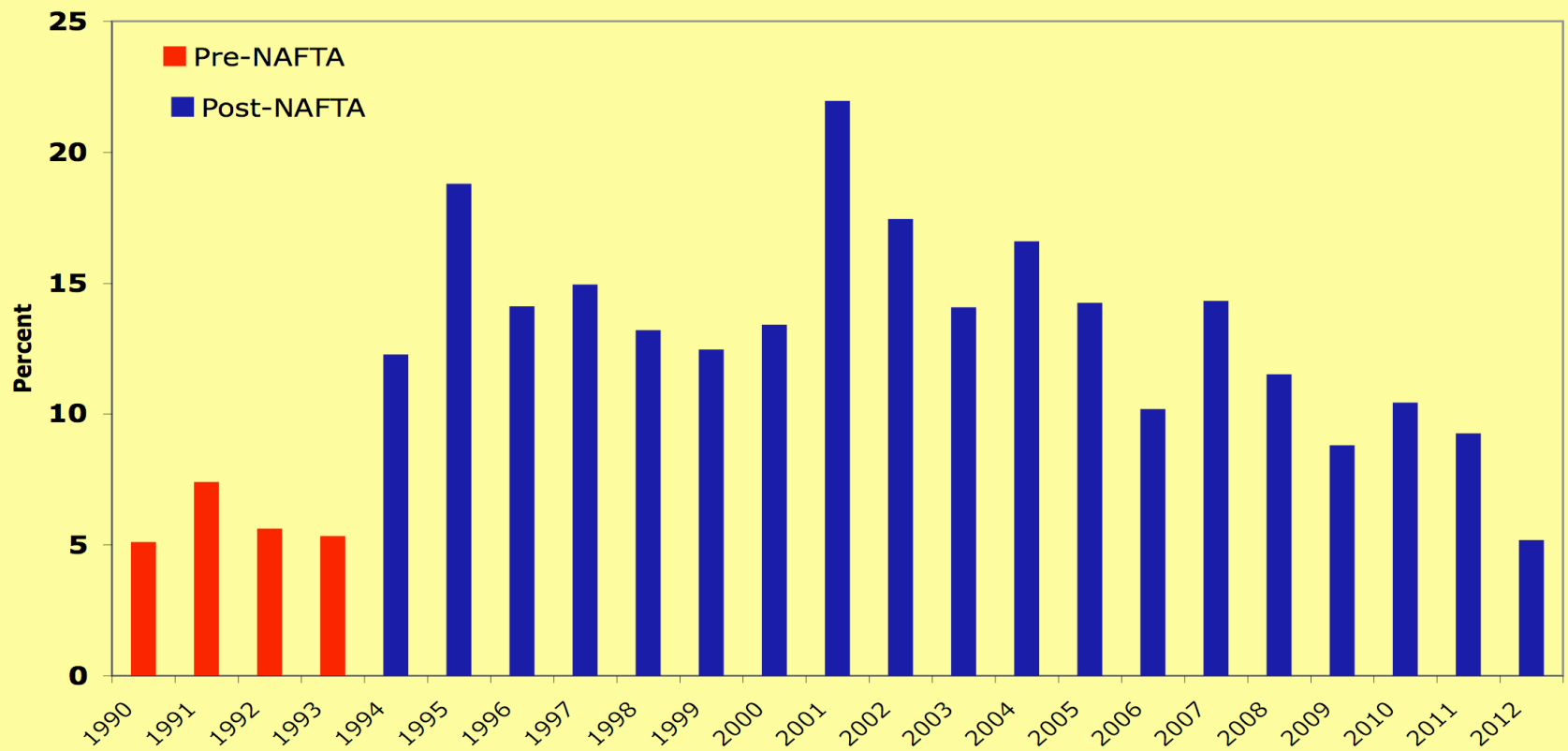
So, FDI into Mexico is modest by international standards

Foreign Direct Investment as Percent of GDP, 2014, Selected OECD and Middle Income Countries



Thus, part of Salinas' gamble did not pay off quite as expected

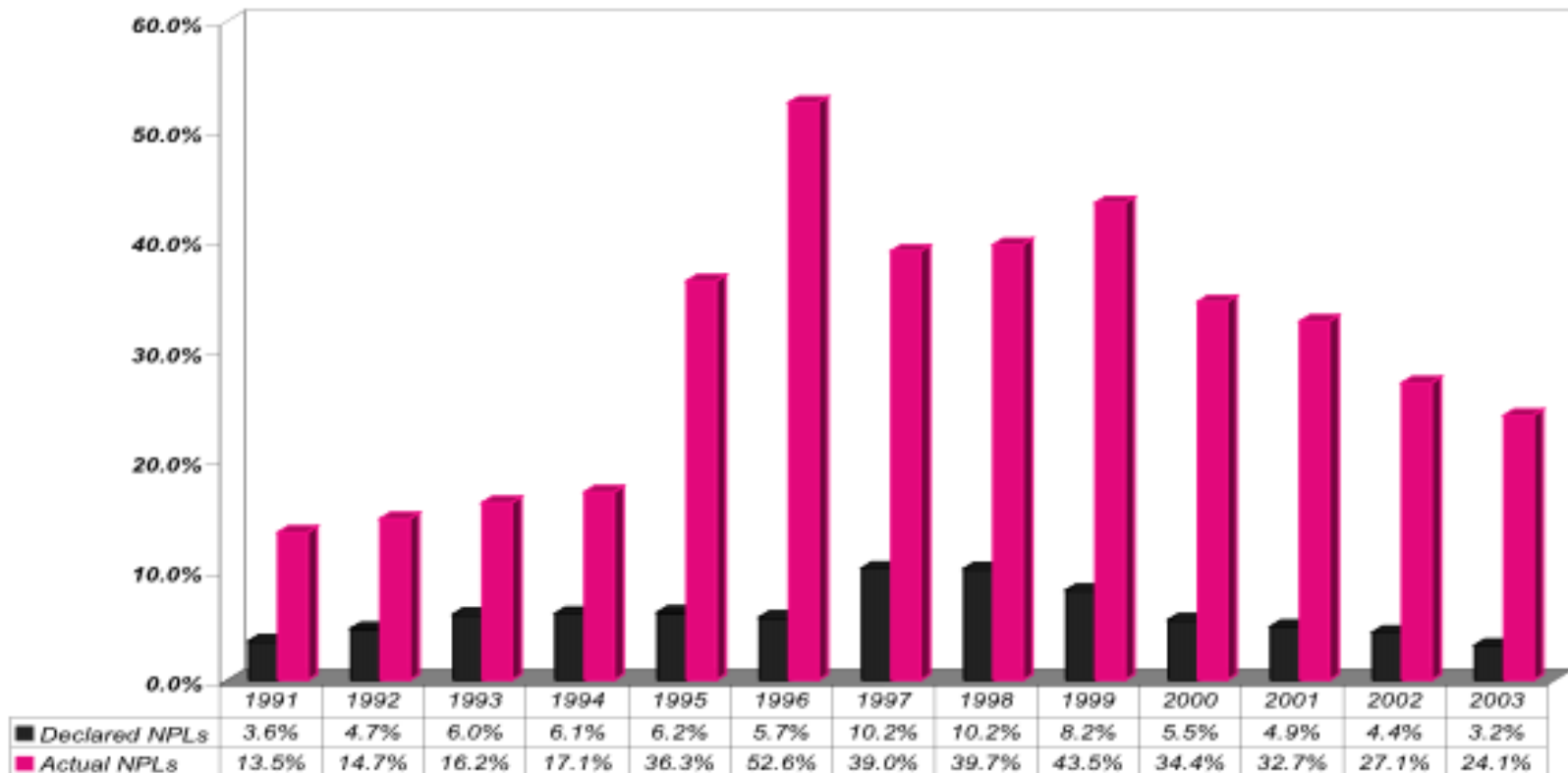
FDI Inflows as Percentage of Gross Fixed Capital Formation, Mexico, 1990-2012



Source: UNCTAD, World Investment Report 2013.

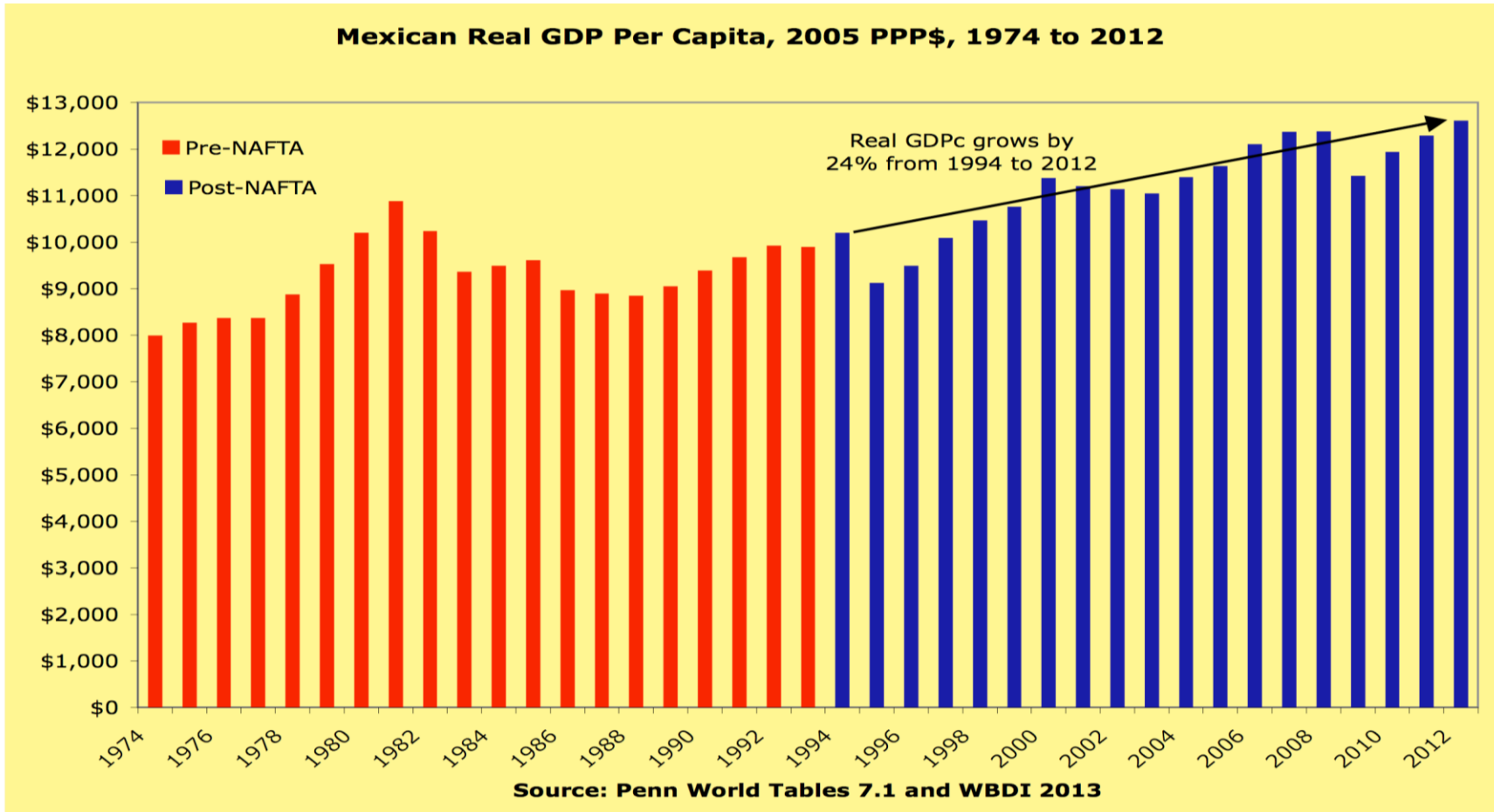
The third part of Salinas' gamble was a loser: privatization resulted in a banking crisis

Declared and Actual NPLs, Mexican Commercial Banks, 1991-2003



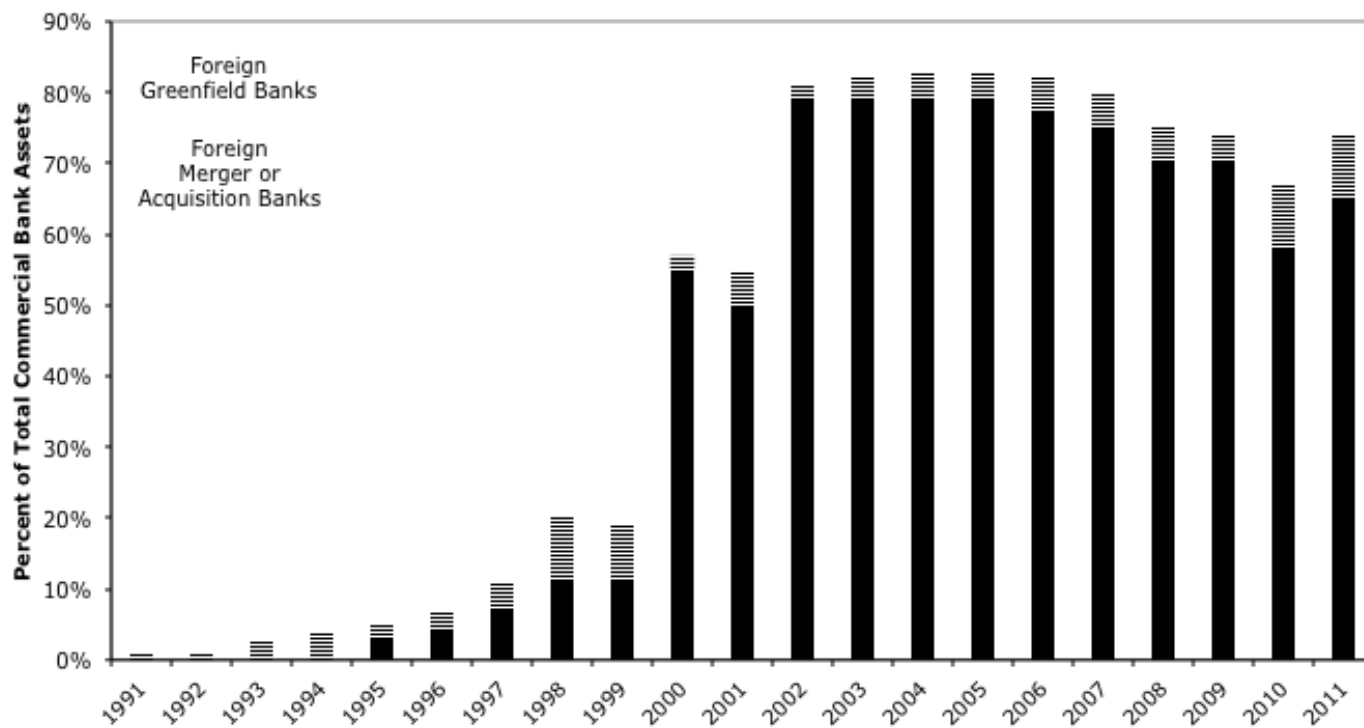
Source: Haber and Musacchio 2012.

The Mexican economy grew, but by only 1.1% per year in per capita terms—and 1995 and 1996 were disastrous



An unanticipated outcome: Foreign Bank Entry

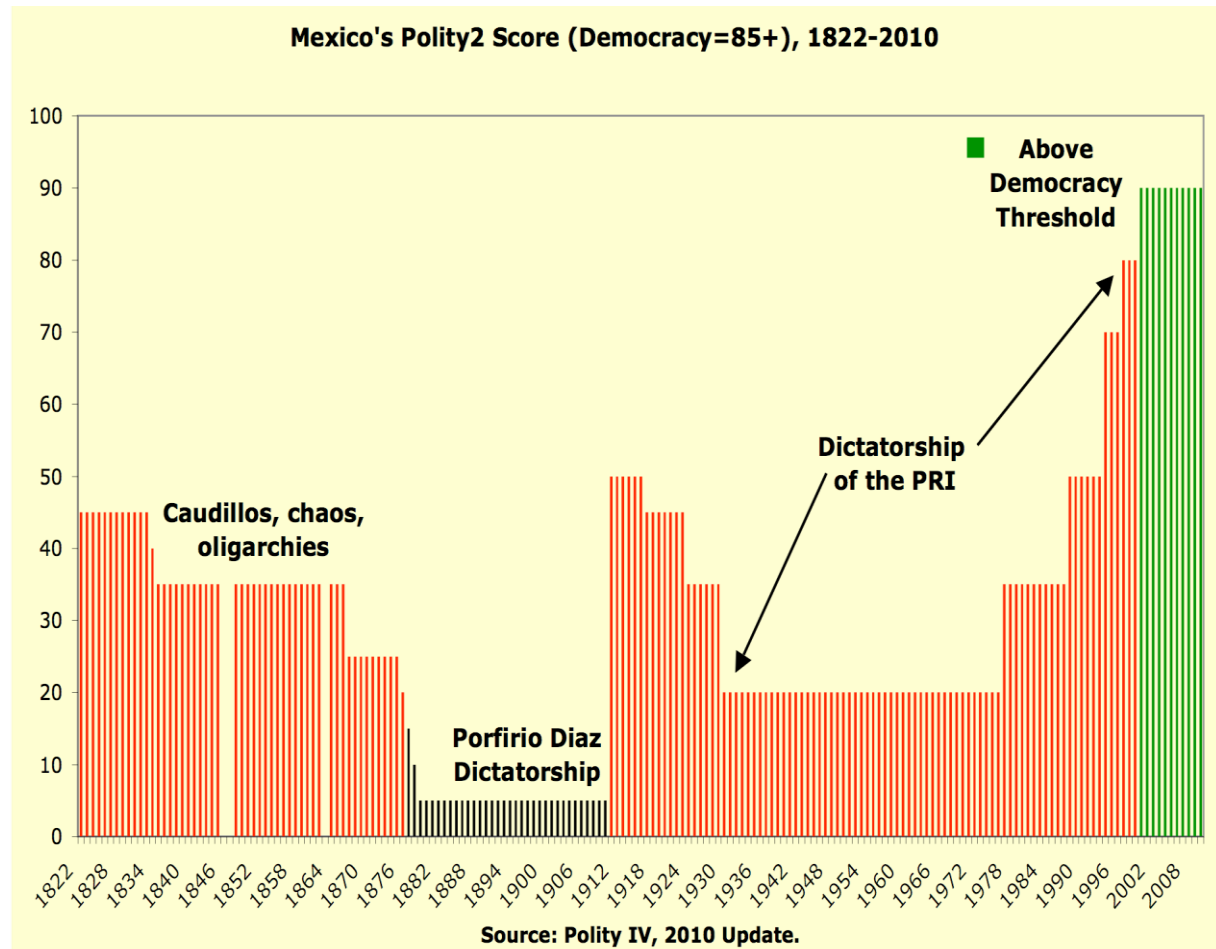
Figure 1
Foreign Banks' Share of the Mexican Market
(As Percent of Assets), 1991-2011



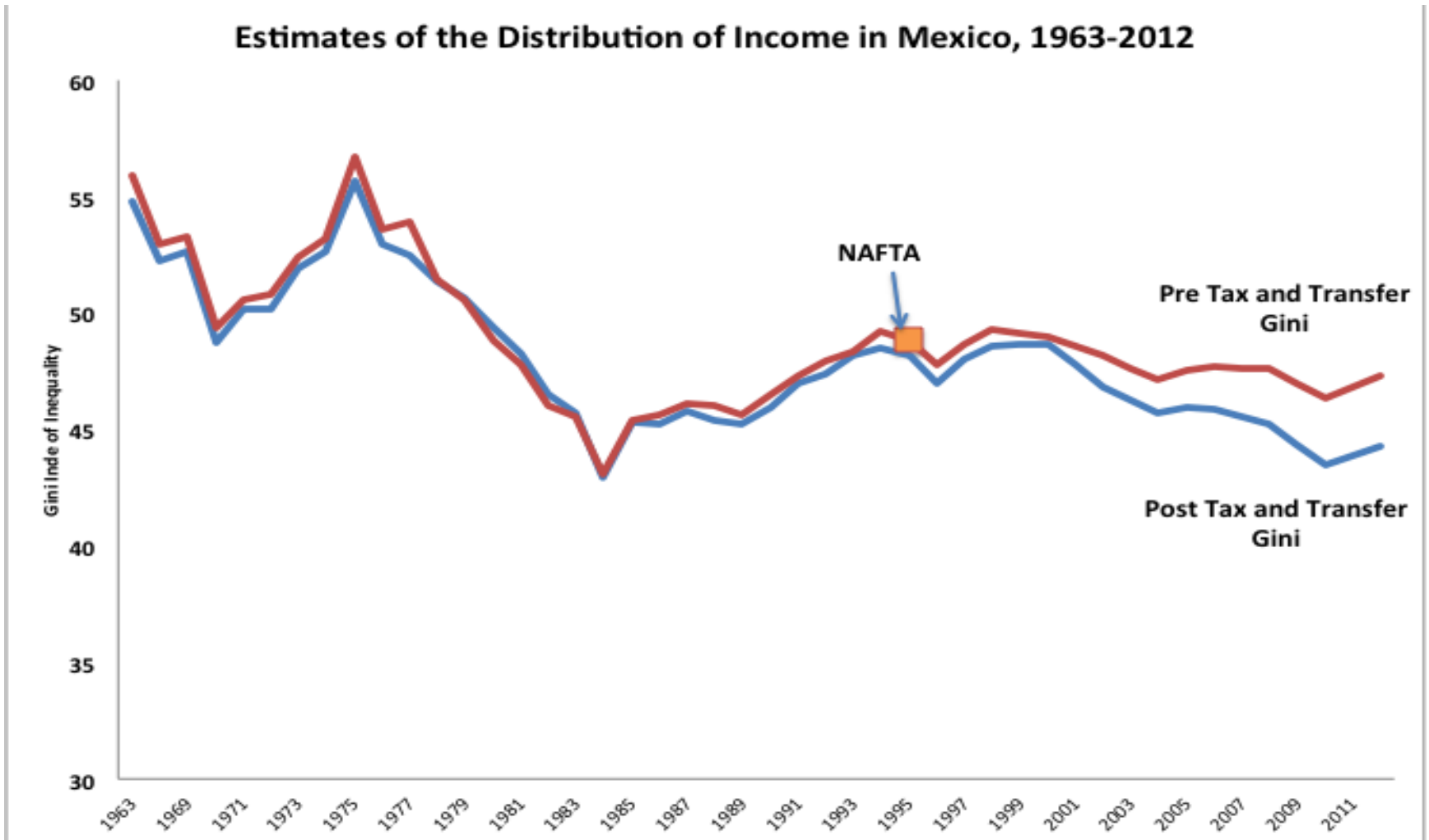
Source: See Table 1

An even more unanticipated outcome: Mexico democratized

Opening up the economy was disruptive. It hurt the PRI's traditional coalition partners, while failing to generate fast enough growth to create new partners that could sustain one party rule.



The gains from NAFTA in Mexico were not all captured by elites



Conclusion: Mexico's new equilibrium

- An open, export-driven economy
- Financial openness
- Increasing levels of public goods provision
- Falling poverty levels
- A multiparty democracy