the Southwest ECONOMY

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Texas' Border: On the Front Line of Change

Laredo's long lines of cars and trucks backed up at bridges to Nuevo Laredo, Mexico, were replaced in January by long lines of displaced workers at the unemployment office. For Laredo and other border communities, 1994 was a year of sweeping change, first as the North American Free Trade Agreement, or NAFTA, took effect and then as the peso's value plummeted. And 1995 promises even more change. Dozens of border retailers, heavily dependent on Mexican shoppers, have closed their doors. Export firms, truckers and customs brokers whose businesses were bustling throughout 1994 now wait for the peso to stabilize.

Despite current economic stress, long-run prospects for the Mexican economy are bright. The border remains an important distribution center to northern Mexico and will continue to grow, but the changes of 1994 will influence the region's economy well into the future.

Economic setbacks that could overwhelm many cities are not new to border communities. In 1982, the peso devalued 121 percent against the dollar in real terms.[1] The current devaluation—55 percent from November 1994 through February 1995—probably won't be as severe as the 1982 crisis. As NAFTA's new trade rules take effect and consumers' disposable incomes fluctuate with the peso's value, industries along the border will adjust to meet new demands.

The Texas–Mexico border stretches along the Rio Grande for 1,248 miles—from El Paso to the lower Rio Grande Valley. Border counties are home to more than 1.5 million people, or about 9.2 percent of Texas' population, and about 6.4 percent of the state's total employment. The border has a relatively large share, 11.5 percent, of Texas' jobs in nondurable manufacturing, in part because of El Paso's concentration of apparel and textile factories. Another important border industry is wholesale and retail trade, which contributes 27 percent of all border jobs, compared with 24 percent statewide.

Heavy immigration to border cities keeps unemployment rates higher than the state's 1994 average of 6.4 percent. Last year, the unemployment rate averaged 9 percent in Laredo, 9.9 percent in El Paso, 11.5 percent in Brownsville–Harlingen–San Benito and 16.5 percent in McAllen–Edinburg–Mission. Even so, the border's employment growth has surpassed the state's average in nine of the past 10 years. Despite their brisk growth, border counties' incomes are among the lowest in the nation; their 1992 per capita income averaged $10,933, about 59 percent of the state average of $18,437.

NAFTA's New Rules of the Game

While being a major benefactor of freer trade, the border also benefits from barriers to trade. For many years, cities along the border have thrived selling goods and services to Mexican visitors and helping the influx of importers and exporters comply with international rules and regulations. In 1994, NAFTA changed the demand for these services, and some businesses profited while others suffered.

By lowering trade restrictions, NAFTA made it easier for U.S. companies to set up shop in Mexico, which reduced the demand for some border retail services, particularly to Mexican wholesalers who export U.S. goods to resell at home. With more U.S. outlets in Mexico, fewer Mexicans need to cross the border to purchase U.S. goods.

Changing regulations under NAFTA lowered the cost of exporting U.S. goods and reduced the demand for services that help traders accommodate previous regulations.

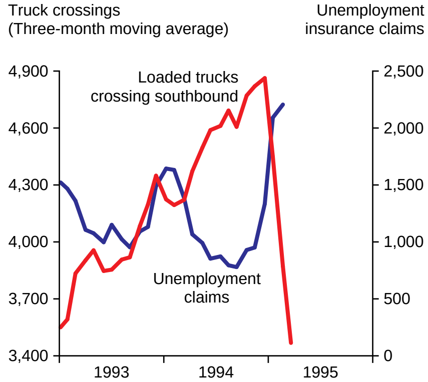
At the same time, NAFTA's new rules and restrictions boosted cross-border trade traffic and demand for other services. Rising trade volume—accompanied by new tariff rates, rules of origin and labeling requirements—helped border customs brokers, import and export firms, and warehouses.

The Peso Is Devalued

After a year of sharply rising trade, Mexico's December peso devaluation once again altered the demand for border industries' products and services. The number of loaded trucks crossing the Laredo Bridge System southbound into Mexico increased 15 percent in 1994 and then plummeted to pre-NAFTA levels following the devaluation. January claims for unemployment insurance doubled (*Chart 1*). Retail sales dropped over the holiday shopping season, typically stores' busiest period of the year. Retailers quickly cut back on inventories and employees and many stores eventually closed. Sagging demand also led to layoffs in other border service industries—including warehousing, transportation, customs brokerage and freight forwarding.

The peso's changing value means U.S. border residents must be mindful of daily peso–dollar exchange rate movements. For nearly a decade, Mexican policy provided a relatively predictable exchange rate for currency transactions. During the mid-1980s, Mexico targeted the peso's value relative to the dollar. Mexico began allowing the peso's value to float within a widening band in 1991. After the December devaluation, however, Mexico abandoned the band and allowed the exchange rate to float freely. Now, the peso is far less likely to show large reductions in value, but frequent small movements are more likely.

Chart 1
Laredo Unemployment Claims Up, Border Traffic Down



The effects of Mexico's new exchange rate policy are becoming evident. Since the devaluation, currency exchange houses report an increase in business. For now, U.S. stores that once accepted pesos or dollars are accepting only dollars to avoid the risk of day-to-day exchange rate shifts, or are accepting pesos at deep discounts from market value. Day-to-day uncertainty has increased for Mexican shoppers and businesses purchasing supplies in the United States because exchange rates must be a consideration in every purchase.

The peso devaluation was not entirely negative for border communities. The devaluation lowered the cost of labor and other inputs for maquiladoras because most operate on dollar-denominated budgets with costs in pesos.[2] The peso's drop has sparked renewed interest in the Mexican border as a low-cost off-shore manufacturing site. The benefits maquiladoras derive from the peso's devaluation boost economic activity, especially among U.S. legal, accounting, warehousing and transportation firms. The border also benefits from maquiladoras' expanding demand for goods and services from U.S. suppliers. Although most of these suppliers are located outside the border region, more of them are either opening operations on the border or relocating there to lower transportation costs and help maintain "just-in-time" inventories.[3]

A Bright Long-Run Outlook

Uncertainty over the Mexican economy and the peso will bring continued change to border communities in the near term. Analysts who initially thought the situation would improve in six to eight months have extended their estimates to a year or longer. Still, with economic fundamentals strong in Mexico, long-run prospects for the border remain bright. Major construction and infrastructure expansion plans continue unabated, including those for a new hospital, hotels and freeways. Large retailers are continuing with expansion plans based on the positive long-term prospects for the region. In February, Foley's announced plans to add stores in Brownsville, McAllen and Laredo, and in March, JCPenney and Mervyn's opened new stores in Laredo. Ultimately, the devaluation and its aftermath may amount to nothing more than a speed bump along the region's highway to prosperity.

—Fiona Sigalla

Notes

1. The real value of the dollar against the peso, according to the Dallas Fed's Trade-Weighted Value of the Dollar Index, went from 71.5 to 157.7 from January 1982 to September 1982.
2. Maquiladoras assemble goods in Mexico, importing inputs duty-free as long as a percentage of the final product is exported from Mexico. NAFTA phases in new rules for Mexican sales by maquiladoras during 1994–2000, greatly liberalizing maquiladoras' access to domestic markets. In 1994, the allowance of domestic sales as a share of the previous year's export production was raised to 55 percent. This allowance will increase annually from 1994 to 2000 in 5-percent increments. See Lucinda Vargas, "The Changing Dynamics of the Maquiladora Industry, Part 2" Federal Reserve Bank of Dallas, El Paso Branch *Business Frontier*, November/December 1994.
3. See Lucinda Vargas, "Border Economic Integration: The Case of the Maquiladora Industry" (Speech presented at the Fourth International Conference on the Quality of Life on the Border) University of Texas at El Paso, El Paso, Texas, March 17, 1994.