NAFTA at 20: Shortcomings Suggest Trade Agreement Alone Isn't Enough

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The North American Free Trade Agreement (NAFTA), binding Canada, Mexico and the United States, turned 20 this year. Its objectives were clear: to increase trade and investment by eliminating tariffs, remove nontariff barriers, facilitate cross-border movement and provide a framework for dispute resolution.

The results have been impressive. Mexico–U.S. trade—exports plus imports—has grown 286 percent in inflation-adjusted terms since implementation, Jan. 1, 1994. U.S. exports to Mexico reached $226 billion in 2013, up from $67 billion in 1993, and imports from Mexico climbed to $281 billion, up 336 percent. U.S. trade with Canada is larger in volume than trade with Mexico but grew more slowly, with exports to Canada and imports from Canada rising about 85 percent in real (inflation-adjusted) terms from1993 to 2013.

NAFTA foreign direct investment (FDI) grew even more. U.S. FDI in Mexico averaged $1.5 billion per year before the agreement and $8.3 billion after implementation.[1]

Major U.S. corporations have a large presence in Mexico in most sectors, including manufacturing, banking and retail. U.S. FDI in Canada similarly vaulted from an average $4.2 billion before NAFTA to $19.6 billion post-NAFTA.

Meanwhile, Mexico and Canada FDI in the U.S. rose more than fourfold in the post-NAFTA period. Well-known Mexican companies that have entered the U.S. market include food giants keen on the growing Hispanic food market, such as Grupo Bimbo (which bought Texas-based Mrs Baird's Bakeries), Grupo Herdez and Gruma.

NAFTA's successes based on its stated objectives have been the most far-reaching for Mexico, particularly in the manufacturing sector. The country supplies a variety of consumer goods such as televisions and top-of-the-line refrigerators. Mexico is a world-class producer of automobiles and auto parts; every major global car company operates a production facility there. Mexico is the top auto parts supplier to the U.S. and ranks second after Canada in auto vehicle exports to the U.S.

Mexico's Living Standards

Despite such successes, some say that NAFTA has failed, given broader data on Mexican living standards. There has been no overall convergence between Mexico and its NAFTA partners. The per capita income gap between Mexico and the U.S. in 2012 remained as large as it was in 1994—about 70 percent in purchasing-power-adjusted terms (*Chart*).

Mexico has made giant strides in the last two decades in macroeconomic stability, fiscal discipline and openness to trade. But external shocks and domestic structural problems continue to blunt progress.

Even as NAFTA took effect, the financial and banking sector collapse known as the Tequila Crisis rocked the Mexican economy in 1994. Domestic credit markets still have not recovered. Private sector credit amounted to a paltry 28 percent of gross domestic product in 2013, compared with 69 percent in Brazil and 73 percent in Chile. More shocks followed: China's entry into the World Trade Organization in 2000 created new competition and led to manufacturing job losses. Since then, Mexico has contended with drug-related violence, declining oil production and two U.S. recessions.

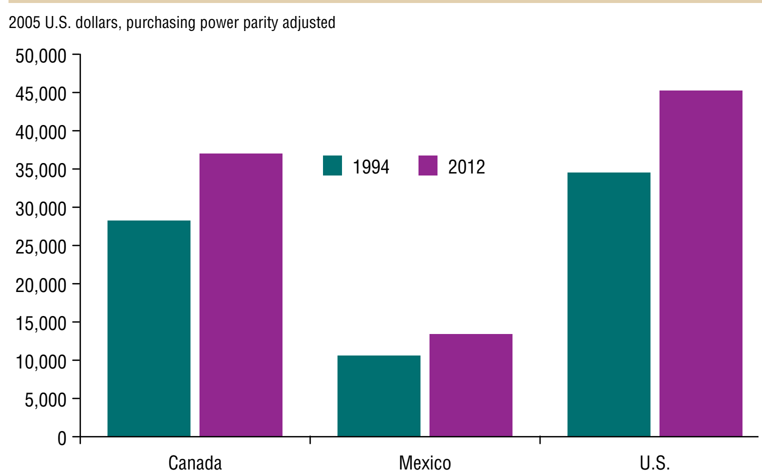
NAFTA successfully changed the tradables sector in Mexico. Other sectors have lagged. Promising reforms taking root in Mexico would similarly alter the nontradables (service) sector as well as the energy industry, opening them up to further competition and investment, which would in turn raise productivity and innovation.

After 20 years, it's likely that the problem has not been too much NAFTA, but rather too little.

Note

[1] The pre-NAFTA period spans 1982–93; the post-NAFTA period is 1994–2013.

North American Trading Partners Still Unequal
(Gross domestic product per capita)



SOURCE: Organization for Economic Cooperation and Development.