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**Regional Integration and Economic Development in the Iberian  
Peninsula and Mexico**

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## **Abstract**

Since the last century, the obsession of Mexican, Spanish and Portuguese reformists has been to make up the lost ground with modernized countries. This paper compares the experiences of Spain and Portugal in the European Union (EU) and of Mexico in NAFTA to study how integration has affected their economic structures and economic performance. It examines the relationship between regional integration, economic growth, and democratic consolidation in these three countries, and draws some lessons based on their regional integration experiences.

**Keywords:** European integration, economic development, democratic consolidation, NAFTA, Mexico, Portugal, Spain

## **Resumo**

Desde o século passado, a obsessão dos reformistas Mexicanos, Espanhóis e Portugueses tem sido a de recuperar o terreno perdido face aos países modernizados. Este artigo compara as experiências de Espanha e Portugal na União Europeia (UE) e do México na Associação de Livre Comércio da América do Norte (TLCAN) para avaliar como a integração afectou as suas estruturas e desempenho económicos. Estuda também a relação entre integração regional, crescimento económico e consolidação democrática nestes três países, e tira algumas lições baseadas nas suas estratégias de integração regional.

**Palavras-chave:** integração europeia, desenvolvimento económico, consolidação democrática, TLCAN, México, Portugal, Espanha

## INTRODUCTION<sup>1</sup>

This paper examines the integration process of Spain and Portugal in the European Union (EU) and of Mexico in the North American Free Trade Agreement (NAFTA). It reviews the relationship between regional integration, economic growth, and democratic consolidation. Among other concerns, it asks how membership has impacted economic performance and democracy in the three countries. What is the relationship between economic growth and political citizenship? Are these separate entities, or connected in fundamental ways?

The issue of membership in the EU and NAFTA raises at least three important issues. First, it is important to keep in mind that the post-war construction of the European Union was first an economic reality (in the 1950s and 1960s) then a political one (in the 1970s and 1980s), and only now perhaps is becoming a cultural one (since the 1990s). NAFTA so far has been essentially an economic treaty. Second, the political dimension of the EU (born in the aftermath of WWII), which is based on the principle of solidarity, has been instrumental in the development of solidaristic policies that have been critical in the process of economic and social convergence. This dimension is largely absent in NAFTA. Third, the EU includes free movement of people among member countries, as well as the notion of European citizenship (established in the Maastricht Treaty), as two of its cores. The inclusion of substantive immigration provisions in NAFTA (or at the bare minimum in a bilateral agreement with the United States) is still one of the key ambitions of Mexican governments.

## THE EU INTEGRATION PROCESS FOR PORTUGAL AND SPAIN

After a long and winding negotiation process that lasted for almost eight years, on 1 January 1986 Spain and Portugal joined the EU. Portugal applied for EEC membership in March 1977, Spain in July of the same year. Formal negotiations to enlarge the EC began with Portugal in October 1978 and Spain in February 1979. Spain and Portugal were poor countries and as in the case of the Central and Eastern European countries a decade later, these negotiations drove a wedge between rhetoric and reality. The prospect of Iberian membership filled many EC members with dread. Portugal, fully aware that EC countries feared the economic and social consequences of Spanish membership, sought to have its application considered separately. Consequently, the EC negotiated separately with each country. In reality, however, both applications were interrelated. [2]

Enlargement negotiations proved to be slow and protracted. For Portugal the most controversial bargaining issues affected textiles (which represented over 40 percent of the country's industrial output and 33 percent of its exports), agriculture, and migrant workers. During the negotiations Portugal and the EC signed a pre-accession agreement that revised pre-existing agreements and provided for assistance to Portugal. This agreement that came into force on 1 January 1981 sought to modernize the Portuguese

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<sup>1</sup> This paper was first delivered at the 2003 Meeting of the *Latin American Studies Association* (LASA). Dallas, Texas, March 27-29, 2003.

<sup>2</sup> This section draws from: D. Dinan (1999) *Ever Closer Union: An Introduction to European Integration*, Boulder, CO: Lynne Rienner Publishers, p. 104-09 and F. Nicholson and R. East (1987) *From the Six to the Twelve: The Enlargement of the European Community*, Chicago: St. James Press. For a detailed analysis of the impact of integration see: Jose da Silva Lopes, ed., *Portugal and EC Membership Evaluated*, New York: St Martin's Press, 1994 and Amparo Almarcha Barbado and Carl-Christoph Schweitzer, eds., *Spain and EC Membership Evaluated*, New York: St. Martin's Press, 1993.

economy to facilitate the country's eventual integration into the EC. By that time, however, the enlargement process was the subject of political controversy all over Europe with opposition led by the French government, which was immersed in a close presidential campaign, and thus viewed with dread the prospect of enlargement to the South.

The EC, particularly the French, had misgivings about southern enlargement that were focused more on Spain than on Portugal. Agriculture, textiles, fisheries, and the free movement of labour proved to be the most contentious issues throughout the negotiations. Agricultural policy within the EC has been the subject of historic disputes and clashes on interests. The proposed Spanish membership in the EC was framed within the debate of its presumed impact on the EC agricultural policy as well as the ongoing budgetary crisis and attempted reform of the Common Agriculture Policy. In this regard, it was estimated that Spain's accession would increase the EC agricultural area by 30 percent. At the same time, France and Spain would compete directly in the production of fruits, olive oil, and vegetables—hence, French misgivings. While the French and Italian governments wanted to protect domestic growers, the German, British, and Dutch governments supported the Spanish accession. Germany, however, placed the ongoing negotiations within the discussion about CAP reform and the settlement of budgetary issues.

Fisheries were also a very controversial issue. Since Spain's fishing fleet was larger than the entire EC fleet combined, there was also strong interest in limiting the access of the Spanish fleet to the Common Fisheries Policy. This dispute intensified throughout 1984 when French and Spanish fisherman attacked each other. At the same time, the French government, with presidential elections less than a year away, pandered to French farmers, a powerful constituency. For instance, in a 1980 speech to French farmer leaders in Paris, the French president, Valéry Giscard d'Estaing, declared that in view of the ongoing disputes over the British budgetary contribution, the EC should resolve that issue before undertaking another enlargement. This declaration provoked an outrage in both Spain and Portugal. France's opposition, however, failed to receive strong support from the other EC members. Britain, a historical ally of Portugal, supported Portuguese accession and the British Prime Minister, Margaret Thatcher, went as far to declare in 1981 that Portugal and Spain did not need to join simultaneously and that Portugal could join by January 1984. Despite repeated attempts on the part of Portugal to decouple the accession negotiations, the fate of Spanish and Portuguese negotiations became increasingly linked. Negotiations between the Iberian countries and the EC progressed throughout 1981 and 1982 over a wide range of less controversial issues including capital movement, regional policy, transport, and services.

François Mitterrand's victory in the 1981 French presidential election did not change France's opposition to enlargement. The new French government sought an acceptable arrangement for Mediterranean agriculture. Despite French opposition and Iberian rhetoric, however, the fault for the lack of progress in the enlargement negotiations did not lie entirely with the EC. For instance, the Spanish government was reluctant to introduce a value-added tax, as well as to curtail subsidies and end protectionism. This recalcitrance prompted the European Council in 1981 to stress the need of the applicant countries to introduce the necessary reforms and prepare their countries for accession.

The Iberian countries' application was strengthened in the early 1980s by the formation of stable administrations in both countries. The overwhelming victory of the Spanish Socialist party, led by its young and charismatic leader Felipe González, in the

October 1982 general election, and the subsequent election in June 1983 of Mario Soares, leader of the Portuguese Socialist party, as Prime Minister, gave new impetus to the enlargement process. Both leaders were passionate Europhiles, and one of their primary political objectives was to bring their countries into the EC. They embarked on a series of visits to EC capitals to make the case for Iberian accession. In the domestic front both new leaders implemented ambitious economic agendas to modernize the outdated economic and social structures of their countries. In Portugal the new Socialist government reached an agreement with the International Monetary Fund to restructure its economy and reduce the country's foreign debt. In Spain the new Socialist government left aside demand-oriented policies and embarked on a supply-oriented restructuring stride that sought to address the imbalances of the Spanish economic structure. These reformist agendas illustrated both countries' determination to become model member states. The new leaders also used their personal contacts and ideological affinity with their European counterparts to make the case for their countries' accession.

Despite progress in the negotiations, the European Council and the EC Commission concurred on the need for the Community to get its house in order before any Iberian expansion could occur. At the 1983 Council of Ministers' summit in Stuttgart, the heads of state of the ten member countries outlined the general conditions for southern enlargement. This summit stressed the need to solve the EC budgetary problems and reform the CAP before Spain and Portugal could join the Community. In addition, it linked French demands over Community policy on fruits and vegetables to the expansion. The budgetary crisis of the Community dated back to the 1970s and became a serious obstacle when Margaret Thatcher became British Prime Minister and began exasperating her EC colleagues by aggressively pursuing Britain's budgetary claims. In order to mollify British concerns, the European Commission issued in 1983 a Green paper on EC finances that proposed mechanisms to raise additional funds. The subsequent European Council summit that took place in Athens in December of 1983 failed to resolve the financial issues. This summit, however, brought into the open the issues that required resolution. This debate led to the development of a normative framework that became a new agenda of cohesion. German leadership in budgetary matters, and the country's decision to act as 'paymaster' for the enlargement, paved the way for the resolution of standing conflicts. During the 1984 winter summit of the Council of Ministers at Dublin, the EC Ten reached an agreement on Mediterranean agricultural production.

The Fontainebleau summit six months later (July 1984) resolved the standing EC budgetary issues, set 1 January 1986 as the agreed date for Spain and Portugal entry into the EC, and called for an end to negotiations by 30 September 1984. This date proved too ambitious. In December 1984 the European Council reached an agreement on fruits, fish, wine, and vegetables that was accepted by the Spanish government. The formation of a new European Commission in Brussels led by the energetic and influential Jacques Delors in January 1985 gave a final impetus to the negotiations. Delors threw himself into the negotiations and assumed personal responsibility over the last roadblock, namely, the Integrated Mediterranean Program (IMPs), a Greek demand that sought to provide EC financial assistance to Greece to compensate for enlargement. In the first half of 1985, the EC foreign ministers agreed on a five-year enlargement-linked program of structural aid to farmers, and resolved the remaining problems over fisheries, the applicants' budgetary contributions, and the free movement of labour in the EC. Finally, based on a new Commission proposal, the European Council of Brussels approved a seven-year program of 6.6 billion ECUs for grants and loans to assist the existing EC

Mediterranean regions. These agreements resolved the final obstacles for Southern enlargement. Spain and Portugal joined the EC on 1 January 1986.

## CONSEQUENCES OF EU INTEGRATION

### Political and Sociological Consequences

The EC played a significant role in the success of Portugal and Spain's democratization processes. It exercised a key demonstrative and symbolic influence based on its association with democracy and freedoms. During the early phases of the democratization processes, the most important lever was, obviously, the democratic precondition for EC entry. Brussels defined explicitly the institutional conditions that would satisfy this requirement, and European leaders made them very specific to the Iberian ones. Indeed, the EC had important indirect levers, particularly during the negotiations for accession, to influence the direction of events and the decisions of policymakers and economic actors (i.e., economic incentives). The decision to proceed with negotiations was the ultimate lever in the hands of the EC to push for democratization in both countries. [3]

EC membership has also contributed to the consolidation of the Iberian democratic regimes. Pridham (2002) has argued that membership has had the following impact: First, it helped link 'enhanced national self-image with possible feelings for democracy'. In addition, financial contributions from the EC budget as well as the economic benefits of membership (i.e., FDI) helped improve economic conditions and mitigated some of the negative effects of liberalization and modernization of the outdated economic structures of both countries. Improved economic conditions and better prospects for social and political stability, in turn, influenced public opinion and helped legitimize the new system and strengthen support for democracy. Membership also forced the Iberian countries to align their institutions to the *acquis communautaire*, which reinforced democratic practices and induced democratic governments to push for administrative reforms and decentralization (for instance, Portugal reformed its Constitution in 1989 to allow for privatization of companies that had been nationalized during the revolution). Finally, membership also promoted elite socialization and the development of transnational networks, which proved vital for the strengthening of interest groups and political parties (such as the Spanish and Portuguese Socialist parties, which received substantive support from their European counterparts). The development of economic interests and networks at the European level also strengthened the support of economic actors for democracy. [4]

The EC, however, lacked the direct intervention instruments (such as armed intervention) that could have had a systemic effect on the Iberian democratization processes. Hence, the chapters in this volume look at interactions between the international environment and domestic politics. The actors involved in the transition had the powers to influence events and, hence, they were the ones that ultimately determined the final outcomes. Domestic dynamics are thus, critical. The process of European integration interacted with a wide variety of domestic social, political, and economic factors that shaped the new democracies. In Spain a radical and unparalleled process of devolution to the autonomous regions has led to a decentralized state that has

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<sup>3</sup> Pridham 2002, pp. 188–89 and Pridham 1991, pp. 234–35.

<sup>4</sup> Pridham 2002, pp. 194–205.

culminated with the development of the State of Autonomies. [<sup>5</sup>] In Portugal, following the collapse of the revolutionary attempt, the state also undertook a systemic process of modernization. The two transitions were substantially different, however. In Portugal the road to democracy started with a clear break, the coup of 25 April 1974. In Spain, on the contrary, the transition was more consensus-oriented. These two paths to democracy (among other factors) have resulted in enduring differences in the two Iberian democracies in terms of institutional developments (i.e., in Portugal a decentralization attempt was defeated in a referendum), economic performance (i.e., Spain has experienced higher levels of unemployment), and collective life (i.e., support for unions and political parties is higher in Portugal than Spain, or differences exist in labor participation rates). Indeed, European integration has not eliminated major differences between the Iberian countries. Also, integration cannot explain the broader patterns of political transformation with its clearly identifiable underpinnings in the two countries. These enduring differences illustrate the limitations of research attempts that have sought to causally link the Iberian democratic transitions to internationally rooted and domestically supported pressures for European integration. In the end, as it has been correctly stated by Fishman (2001:8), ‘the political motivations guiding their assessment of Europe during the crucial years leading up to EC membership were strongly shaped by the Iberian-held attitudes toward democracy and regime transition, attitudes formed within the context of the distinctive political experience of each case’.

From a sociological standpoint EU membership has also resulted in attitudinal changes that have influenced the political culture of both countries. From the beginning there was strong support from public opinion and elites for the integration of both countries into Europe as a means of consolidating the new democratic regimes. They viewed democratization and European integration as part of the same process. Hence, successive governments in Portugal and Spain associated European integration with the modernization of their countries. This association helped shift public opinion toward their governments and democracy. In addition, other scholars have noted that by allowing for the active involvements of both countries in European institutions, European integration helped change the ‘isolationist-fatalist attitude’ of the political classes. [<sup>6</sup>] Public opinion surveys from *Eurobarometer* and Madrid’s *Centro de Investigaciones Sociológicas* have showed a sustained increase in positive ratings effects for the functioning of democracy. Furthermore, support for the relationship between the Iberian countries and the EU has been widespread in both countries since 1986 despite fluctuations. This almost unanimous consensus in favor of integration into Europe seems to be the consequence of Portugal and Spain’s need to overcome their historical isolation from the rest of Europe since the nineteenth century until the end of the authoritarian regimes in 1970s. This development contributed to the legitimating of the new democratic system (and thus the consolidation of democracy).

The greatest consensus elicited toward the EU is instrumental (particularly in Spain), however, with levels of diffuse affective support for the EU being low, although high in comparative perspective. Approval of Europe seems therefore to coincide with the

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<sup>5</sup> Supporters of decentralization and the regionalist parties viewed the process of European integration as a model of decentralization, and saw EC integration as an instrument to ensure the decentralization of the Spanish political system. See Alvarez-Miranda 1996 and Magone 2002, p.229.

<sup>6</sup> Magone 2002, p. 225.

economic cycles: low during economic recessions and high during periods of economic growth.

Finally, it is important to stress that in terms of political behavior, EU membership has not transformed activism or political participation in Portugal or Spain. Levels of support for democracy as a legitimate political regime, preferably to any other alternative, have usually remained high (around 80% of the responses in surveys), and Portuguese and Spaniards declare themselves satisfied with the functioning of democracy. Political cynicism continues, however, to be a major component of political attitudes and the political behavior of Portuguese and Spanish citizens. These countries still have the lowest levels of participation of Western Europe, and membership in political and civic associations remains very low. At the same time, citizens do not have a feeling of political influence and express a strong sense of ambivalence toward political parties and the political class, which is translated into a rather low interest in politics. [7]

### Economic and Social Consequences

EC integration was a catalyst for the final conversion of the Iberian countries into modern Western-type economies. It led the political and economic actors to adopt economic policies and business strategies consistent with membership and the *acquis communautaire* (which at the time included the custom union, the VAT, the Common Agriculture and Fisheries Policies, and the external trade agreements). This is not to say, however, that membership was the only reason for this development. The economic liberalization, trade integration, and modernization of these economies started in the 1950s and 1960s, and both countries became increasingly prosperous over the two decades prior to EU accession.

EU membership, however, facilitated the micro- and macroeconomic reforms that successive Iberian governments undertook throughout the 1980s and 1990s. Indeed, in a context of strong support among Iberian citizens for integration, membership became a facilitating mechanism that allowed the Iberian governments to prioritize economic rather than social modernization and hence, to pursue difficult economic and social policies (i.e., to reform their labor and financial markets), with short-term painful effects. Moreover, in the 1990s the decision to comply with the EMU Maastricht Treaty criteria led to the implementation of macro- and microeconomic policies that resulted in fiscal consolidation, central bank independence, and wage moderation. [8]

Since 1986 the Portuguese and Spanish economies have undergone profound economic changes. For instance, EU membership has led to policy and institutional reforms in the following economic areas: monetary and exchange rate policies (first independent coordination, followed by accession to the ERM, and finally EMU membership); reform of the tax system (i.e., the introduction of the VAT, and reduction

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<sup>7</sup> Pérez-Díaz 2002, pp. 280–84 and Magone 2002, p. 232.

<sup>8</sup> See Tovias 2002. EU pressures have contributed to the implementation of policies and rules for the sound management of the economy. This influence has been explicitly acknowledged by Iberian policy-makers. The Portuguese Prime Minister, José Durao Barroso, reflecting on the impact of the Stability Pact has recognized that “the Portuguese usually respond best when they face an external challenge. Some of the reforms we have implemented—such as setting limits on local government debt—would not even have been accepted by members of my own party if there had not been this pressure from the outside.” See “Portugal learns to love stability pact,” in *Financial Times*, January 29, 2003, p.4.



of import duties); and a fiscal consolidation process. These changes have led to deep processes of structural reforms aimed at macroeconomic stability and the strengthening of competitiveness of the productive sector. On the supply side these reforms sought the development of well-functioning capital markets, the promotion of efficiency in public services, and the enhancement of flexibility in the labor market. As a result, markets and prices for a number of goods and services have been deregulated and liberalized; the labor market has been the subject of limited deregulatory reforms; a privatization program was started in the 1980s to roll back the presence of the government in the economies of both countries and to increase the overall efficiency of the system; and competition policy was adapted to EU regulations.

In terms of *static effects*, EU accession has resulted in trade creation in the manufacturing sector, but also in more competition for Iberian manufacturers. The intensity of the adjustment, however, has been mitigated by the behavior of exchange rates (prior to EMU) and a dramatic increase in the levels of investment in these two countries. In agriculture the main source of adjustment problems has been trade creation because greater import penetration led to a contraction in domestic production. Indeed, the fears of trade diversion materialized after accession (in favor of other EU members such as Italy or France), which contributed to increasing migration from rural areas to the cities. Finally, for Spain one of the main challenges of accession has been the result of the regional diversity of its agriculture. It has not been easy for farmers affected by the CAP to switch to other products given the differences in the environment, weather, and fertility conditions. [9]

In sum, from an economic standpoint the combined impetuses of European integration and economic modernization have resulted in the following outcomes:

### **The Iberian Economic Transformation**

- **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**

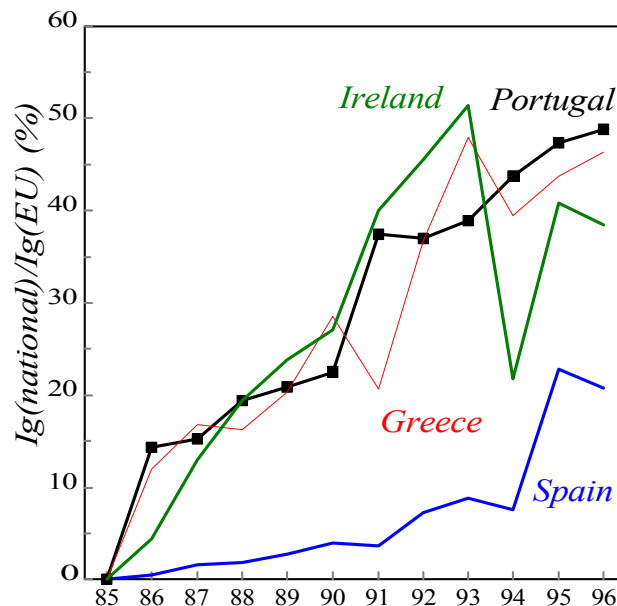
- **Increasing competition**
- **Industrial restructuring**
- **Capital Flow Liberalization**
- **Deregulation**
- **Lower inflation**
- **Fiscal Consolidation**
- **Cohesion Policies**
- **Lower nominal interest rates**
- **Internationalization**
- **Higher efficiency**
- **Deregulation**
- **Economic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

<sup>9</sup> Hine 1989, pp. 16–18.

A critical factor to determine the positive outcome of integration was based on *dynamics effects*. Spain and Portugal had a number of attractions as a production base, including good infrastructure, an educated and cheap labor force, and access to markets with a growing potential. In addition, EC entry would add the incentive of further access to the EC countries for non-EC Iberian investors, namely, Japan or the United States. As expected, one of the key outcomes of integration has been a dramatic increase in foreign direct investment, from less than 2 percent to more than 6 percent of GDP over the last decade. This development has been the result of the following processes: economic integration, larger potential growth, lower exchange rate risk, lower economic uncertainty, and institutional reforms. Another significant dynamic effect has been the strengthening of Iberian firms' competitive position. Indeed, as a result of changes to the production structure and in the structure of exports, the indicators of the degree of competitiveness of the Portuguese and Spanish economies (i.e., in terms of human capital skills, stock of capital, technological capital) shows important improvements, although significant differences remain in comparison to the leading developed economies.

The EU contributed significantly to this development. During 1994–99 EU aid accounted for 1.5 percent of GDP in Spain and 3.3 percent in Portugal. EU funding has allowed rates of public investment to remain relatively stable since the mid-1980s. As a result major infrastructural shortcomings have been addressed, and road and telecommunication networks have improved dramatically both in quantity and quality. In addition, increasing spending on education and training have contributed to the upgrading of the labor force. In sum, these funds have played a prominent role in developing the factors that improve the competitiveness and determine the potential growth of the least developed regions of both countries. [10]

**Figure 1: Percentage of public sector investment financed with EU funds**



Source: Sebastian 2001.

<sup>10</sup> See Sebastian 2001, pp. 25–26.

Nominal convergence, however, has advanced at a faster pace than real convergence. Indeed, 'fifteen years have not been long enough'. Portugal and Spain's European integration has revealed convergence and divergence, nominal and real. Since 1997 inflation in Spain has exceeded the EU average every year. In Portugal real convergence has been slowing down each year since 1998, actually turning negative in 2000, and with both real and nominal divergence expected to increase until 2003. Per capita GDP has experienced a cyclical evolution in the Iberian countries with significant increases during periods of economic expansion and sharp decreases during economic recessions. Since Spain joined the EU in 1986, per capita income has increased 'only' 11.5 percent and Portugal's has increased 14.2 percent. Ireland's, in contrast, has increased 38 percent. Only Greece, with an increase of 6.8 percent, has had a lower real convergence than Spain and Portugal. According to observers, a possible explanation for this development has been the fact that whereas Spain has grown an average of 2.1 percent between 1990 and 1998, Portugal has grown 2.5 percent, and Ireland 7.3 percent over the same period. This growth differential explains the divergences in real convergence. Other explanations include: the higher level of unemployment (15.4 percent in Spain); the low rate of labor participation (i.e., active population over total population, which stands at 50%, which means that expanding the Spanish labor participation rate to the EU average would increase per capita income to 98.2% of the EU average); the inadequate education of the labor force (i.e., only 28% of the Spanish potential labor force has at least a high school diploma, in contrast with the EU average of 56%); low investment in R&D and information technology (the lowest in the EU); and inadequate infrastructures (i.e., road mile per 1000 inhabitants in Spain is 47% of the EU average and railroads' 73%). The inadequate structure of the labor market with high dismissal costs, a relatively centralized collective bargaining system, and a system of unemployment benefits (particularly in Spain) that guarantees income instead of fostering job search have also hindered the convergence process. [11]

From a social standpoint, this was a decade and a half of political stability, associated with an overall strengthening of the State's financial and budgetary capacity, and with a significant increase in social expenditures. The overall architecture of the system has been maintained, but there was a substantive growth of the amount of benefits, with a consequent upgrade of social standards. There has also been a movement toward the institutionalization of social dialogue, with the signature of social pacts. For instance, in 1980 expenditure on social protection was 18.1 percent of GDP in Spain and 12.8 percent of GDP in Portugal, much lower levels than the EU average at that time (24.3%) and only higher than that of Greece (9.7%). Since EU accession, despite an increase of 3.4 percent of the resources dedicated to social protection in Spain (the Spanish welfare state grew significantly in size during this period and expenditures on social protection over GDP increased by 50%), the differential with the EU average has not been reduced. Instead, it has increased from 6.2 points in 1980 to 6.8 points in 1997. Portugal, starting from lower levels of social protection, has been more successful in reducing the differential with the EU average by 50 percent. Spain, however, continues to show a higher intensity of protection (per capita expenditure on social protection) than that of Portugal. In the end, the Portuguese and Spanish welfare states have undergone a deep process of change in qualitative terms, entailing both the introduction of several universal policies and a broader extension of tax-funded non-contributory benefits and services. At the same time, the need to transpose the EC's regulatory framework, the

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<sup>11</sup> From 'La Convergencia Real a Paso Lento', in *El País*. Monday, 14 February 2000.

*acquis communautaire* (i.e., in the fields of labor and working conditions, equality of treatment for women and men, free movement of workers and health, and safety at work), and the role the structural funds play have contributed widely to this development.

## THE NAFTA INTEGRATION PROCESS FOR MEXICO

On June 1990 President Salinas de Gortari of Mexico visited Washington and proposed the creation of a free trade agreement with the U.S. President Bush asked Congress for fast-track authority to negotiate NAFTA. This proposal precipitated a national debate revealing that the U.S. has reservations about the idea. Some of the controversial issues included: concerns about the environment, the risk of job losses in the U.S., fears about the competitiveness of some manufacturing sectors and farmers, as well as concerns about Mexico's politics and the social consequences of such an agreement. Bush assured Democratic leaders in Congress that these issues would be discussed in the negotiations, and on May 24, 1991, Congress gave him fast-track authority to negotiate it. Three weeks later, in Toronto, the trade negotiators from the U.S., Canada—which had also showed its interest in such an agreement—and Mexico officially launched the NAFTA negotiations.[<sup>12</sup>]

These negotiations concluded on August 12, 1992, when the representatives of the United States, Mexico and Canada formally announced a comprehensive plan for free trade across North America. This pact was initialed in a symbolic ceremony held in Texas, attended by presidents Bush and Salinas de Gortari, and Prime Minister Mulroney. The three leaders in their respective countries signed the Treaty on December 17. Following the negotiations of new side agreements with the Clinton administration involving environmental protection, worker rights, and imports surges, NAFTA came into force in January 1<sup>st</sup> 1994.

The main objective of the Treaty is to give consumers of all three nations a wider variety of goods at lower prices and to make North American industry more competitive by enlarging its markets. It is also intended to enrich the Mexican economy and to give Canadian products access to Mexican markets while protecting Canada's free trade agreement with the U.S.[<sup>13</sup>] This agreement has created a trade area extending from the Yukon to the Yucatan Peninsula with a combined GDP of more \$11 trillion and a market of 416 million consumers. NAFTA is a complex agreement that encompasses not only financial services, investment, intellectual property, and of course commerce, but also dispute-resolution mechanisms, banking, transport, services, agriculture, computers and electronics, energy and petrochemicals, textiles and apparel, and transportation.

At the same time, it is important to stress that NAFTA does not involve total free trade between the U.S., Mexico and Canada, but instead provides preferential tariff treatment for goods which are considered North American. The treaty establishes rules of origin to determine which goods will receive that preferential treatment. Such rules require a specific percentage of North American content for products—i.e., in the case of

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<sup>12</sup> Pastor, 1992. p. 259.

<sup>13</sup> See: *Description of the Proposed North American Free Trade Agreement*. Prepared by the Governments of Canada, The United Mexican States and the United States of America. August 12, 1992. Preamble and Objectives and Other Opening Provisions, p. 1. For a description and analysis of NAFTA's content see: VanGrassteck and Vega, 1992, pp. 157-76.

automotive products--or the “*minimis*” rule, which establishes that if a good fails to meet the content test and non-North American parts constitute no more than 7% of the price of total cost of the product, it is still considered to be North American for NAFTA free trade purposes. The tariffs on virtually all these goods have either been eliminated or are being phased out (over a 10-15 year period). According to NAFTA provisions tariffs on most goods crossing the border will reach zero in both directions by 2009. However, the tariff-abolition schedule contained in the 1988 U.S. Canada Free Trade Agreement remained in place. Prior to NAFTA U.S. imports from Mexico averaged less than 4% while Mexican tariffs on shipments from the U.S. averaged 10%. Of course, tariffs remain in force on imports from countries outside the trade block, giving North American products a competitive advantage.

### Objectives of the Signatories

The political reforms launched by President Salinas were dependent on maintaining economic growth.<sup>[14]</sup> Hence, Mexico’s primary objective was to secure access to the larger U.S. market in order to attract new capital and to expand exports. <sup>[15]</sup> Moreover, according to the treaty supporters, free trade would be the best way to encourage economic and political progress in Mexico while providing assurances to investors who might have been afraid of the future of Salinas reforms after his departure from office in 1994.<sup>[16]</sup> Furthermore, Mexico was concerned about the possibility that the U.S. would increase its trade barriers in the future if the escalation of the worldwide trade problems continued, prior to the conclusion of the Uruguay Round and the establishment of the WTO. In the early 1990s, Mexico’s objectives were to secure access to the U.S. market before: a) increases in such barriers materialized; and b) other countries entered into negotiations with the U.S., thus leading the world toward the further evolution of regional groupings. <sup>[17]</sup> Finally, NAFTA, which was President Salinas’ team initiative, derived from his conviction that the world was moving towards a system of trading blocks, and that Mexicans could not avoid reliance on America because it could not get the capital it needs to grow from Europe and Japan—both focusing in their respective areas.<sup>[18]</sup>

Canada was guided by many of the same reasons that motivated Mexico to go along with the agreement, i.e. to guarantee access to the U.S. market for their products as well as to preempt a potential increase of trade barriers in the U.S. Moreover, Canada had always been a strong defendant of the GATT process, but in the early 1990s the leaders

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<sup>14</sup> Mexico’s workforce is expanding by 3% a year. More than a third of the population is under 15 years old and more than 80% are under 40 years old. Mexico has to create more than 1 million jobs a year. See *The Economist*, “Into the Spotlight: A Survey of Mexico” February 13<sup>th</sup>-19<sup>th</sup>, 1993, p. 6.

<sup>15</sup> Whalley 1992, pp. 137-138. See also, Morici 1992, p. 89-90.

<sup>16</sup> Morici 1992, p. 91. According to this analysis Mexico’s saving rate of 19% is not enough to finance the 5-6% sustained growth that Mr. Salinas thinks Mexico needs. Capital inflows from foreign investors are needed to finance a rising current-account deficit. Foreign Investment during the administration of Mr. Salinas reached \$24 billion at the end of September 1992. See *The Economist*, “Into the Spotlight: A Survey of Mexico” February 13<sup>th</sup>-19<sup>th</sup>, 1993, pp. 6-7.

<sup>17</sup> Hurrell, 1992, pp. 121-139. See also, Whalley, pp. 125-126.

<sup>18</sup> *The Economist*, “Into the Spotlight: A Survey of Mexico” February 13<sup>th</sup>-19<sup>th</sup>, 1993, p. 4-5.

of the country became increasingly frustrated over the stagnation of the Uruguay Round and decided that given the 80% of Canada's transactions were with the U.S., the country would advance faster by negotiating directly with the U.S.<sup>[19]</sup> Finally, Canada was interested in NAFTA as a way to gain access to the Mexican market.

The U.S. acted out of concerns about the growing trend towards exclusive regionalism demonstrated by Europe in 1992, as well as the increasing competitive stance of Japan.<sup>[20]</sup> Moreover, these concerns were reinforced by the stagnation of the GATT process in the first half of the 1990s. Indeed, at the time, the failure of the Uruguay Round to resolve the outstanding disputes between the U.S.-Japan and the European Community forced the U.S. to look for other alternatives.<sup>[21]</sup> In addition, the United States needed to develop a more assertive regional policy given the increasing interrelation among issues such as drugs, immigration and the environment.<sup>[22]</sup> Furthermore, there were forces in the United States that supported further integration in the Hemisphere. These forces alleged that the United States had the moral duty to uphold the values of democracy and economic liberalism in Latin America.<sup>[23]</sup> Other objectives included: <sup>[24]</sup>

- (1) The establishment of obstacles to prevent Asian and European companies from bypassing U.S. tariffs by shipping goods through Mexico.
- (2) The elimination of custom duties on thousands of products.
- (3) The creation of multilateral panels to resolve commercial environmental disputes.
- (4) The opening of Mexico's banking insurance and securities industries
- (5) The increase of exports to Mexico and Latin America, i.e., the enormous growth of U.S exports to L.A between 1989 and 1991 from \$44 billion to \$59 billion was a major indicator of the long-term potential of a Free Trade Zone

## CONSEQUENCES OF NAFTA

Over the last decade there has been an intense debate between those who support free trade and those who oppose it, favoring protectionist policies. Lately, this debate has been very prominent in the developing countries, as the economic recession has lingered with no end in sight. In this context, NAFTA has sparked intense academic and political debate and it has provided a springboard to showcase the cost and benefits of free trade. Looking back on its nine years of existence, has NAFTA fulfilled expectations or has it been a disappointment? The answer to this question hinges to a large extent in the definition of its objectives. Was NAFTA intended to support broad social goals,

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<sup>19</sup> Langhammer 1992, pp. 136-137.

<sup>20</sup> Hurrell 1992, pp. 130-132. Pastor 1992, pp. 108-109.

<sup>21</sup> Langhammer 1992, pp. 226-227. Pastor 1992, pp. 107-108.

<sup>22</sup> In 1992 the American border patrol arrested 1.2 million people attempting to cross illegally. No one knows how many trips are successful. See *The Economist*, "Into the Spotlight: A Survey of Mexico" February 13<sup>th</sup>-19<sup>th</sup>, 1993, p. 6. See Pastor 1992, p. 109-110 and Hurrell 1992, pp. 132-133.

<sup>23</sup> Pastor 1992, p. 125.

<sup>24</sup> Whalley 1992, pp. 137-139.

including job creation and environmental protection, or just to increase trade and investment?

### Positive Outcomes

The major argument for NAFTA was that it was the best alternative to assist Mexico in becoming democratic and prosperous, and hence, the United States had a strategic interest in trying to help Mexico's political and economic development.

According to NAFTA supporters, the treaty has strengthened Mexico both economically and politically and, contrary to all dire predictions, it has not hurt the United States. Indeed, the fundamental objectives of the treaty, as a free trade and investment pact, have been fulfilled. NAFTA has increased trade and investment flows. From 1991 to 2001 Canadian merchandise exports to Mexico and the United States grew from \$117 billion to \$229 billion. Mexico exported \$139 billion to its NAFTA partners in 2001, a 225% increase from 1993, and U.S. exports to Canada and Mexico grew from \$142 billion in 1993 to \$265 billion in 2001. <sup>[25]</sup> Mexico's exports to the U.S. have increased 140% since the implementation of NAFTA and almost 94% of Mexican exports were to the NAFTA region by 1998: 87.5% to the United States and 6.3% to Canada. Indeed, a comparison in the evolution of Mexican exports to the United States with the rest of Latin American exports to the U.S. shows that while ten years ago they were about equal, today Mexico's exports nearly double those of the rest of Latin American countries put together. Exports to the United States and Canada grew at an annual average of 16% between 1990 and 1998. For instance, between 1993 and 1997 Mexico's automotive exports increased 134%, and Mexico has become the third largest US provider and its second largest market for automotive goods. In agriculture, while the US still has a favorable trade balance, Mexican exports have increased 67%, and textiles and apparel exports to the U.S grew 167%. Finally, Mexican exports are not only low-tech and labor intensive. On the contrary, more than 20% of all Mexican exports are capital goods.

Foreign Direct Investment (FDI) has also increased dramatically averaging over \$13 billion since 1994 (prior to NAFTA the highest yearly figure was less than \$5 billion, a figure that doubled to \$10 billion after NAFTA's enactment in 1994, and reached \$14 billion in 1997). Mexico has become the world's second most successful country in capturing FDI after China. Between 1994 and 1998, Mexico received 57.2 billion dollars of FDI and almost 60% came from the U.S. and 4.2% from Canada. In 2002 U.S. and Canadian FDI accounted for 73.3% of the total (down from 81.8% in 2001), and EU investment grew to 17.8% (up from 14.9%). FDI continued to increase in Mexico in 2002 despite a sluggish economy and the economic turmoil in Latin America, reaching \$13.6 billion, up 10.9% from 2001, and the governments expects \$12-14bn in 2003. Since 1994 over 62% of FDI went to the manufacturing sector, 1% to the construction industry, 1.1% to other industry, 6.9% to services, 10% to banking, 12% to commerce, and another 6% to transportation and telecommunications industries (despite investment restrictions). This data confirms that Mexico is becoming less dependent on the *maquiladora* sector, which attracted only \$2bn in FDI in 2002 (down from \$3bn in 2001). NAFTA has contributed to this development in four main ways: it has given more credibility and permanence to Mexico's reforms, thus helping to bolster investor

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<sup>25</sup> See "NAFTA's Nuts and Bolts," in *Foreign Policy*, Sept/Oct 2002, Issue 132, p. 61.

confidence [26] Second, it has provided guaranteed access to the United States' market. Third, it confirmed investors' expectations that the government was willing to heed their preferences. Finally, it contributed to restore Mexico's creditworthiness to investors.[27]

In addition, NAFTA supporters claim that the implementation of the treaty has also improved wages and labor conditions for Mexican workers. Between 1993 and 1998 967,000 jobs were created in the manufacturing sector, led by the textile and clothing sector (contributing to 380,000 new jobs), followed by machinery and equipment, and the food industry. In addition, about half a million jobs have been created in the *maquila* industry. More than half of 1.7 million jobs that have been created in Mexico since August 1995 have been export related and by 1998 one of every five workers registered in the Social Security system had a job in a company with FDI in Mexico. In this regard, it is important to note that companies with FDI paid wages that were almost 50% higher than the rest of the economy. As a result of this development, the urban unemployment rate, which was 6% in 1992 and rose to 8.5% in 1995, was in 2000 less than 4%.

NAFTA also had a positive impact in wages, according to these analyses. Average real hourly wages fell in Mexican manufacturing 20% between 1993 and 1996 as a result of the rebound of inflation and the subsequent massive devaluation of the peso in late 1994 and 1995. However, according to the Mexico's INEGI (the National Institute of Statistics, Geography and Information) average wages have increased every year since 1996, and by 2001 they have recovered 95% of their pre-NAFTA value. From 1994 to 1996 Mexican exporting firms (i.e. those that exported more than 80% of their total sales) paid between 58% and 67% higher wages than the average wage rate. Furthermore, they claim that blue-collar wages and jobs have responded in a more positive way to free trade than white-collar ones. While wages in the *maquiladora* export plants also decreased between 1993 and 1996 and are lower than in Mexico's manufacturing industry, by 2001 they showed an 8.4% gain and closed the gap with the manufacturing industry by nearly 25%. Hence these developments show that low-skilled workers have benefited from NAFTA even more than high skilled workers and this has helped narrow Mexico's income inequality. These scholars contend that the income distribution problem is a secular problem in Mexico and should be explained by educational and cultural factors, not alluding to specific trade regimes (particularly NAFTA, which has only been in place for nine years). [28]

NAFTA advocates have also argued that the agricultural and environmental problems that Mexico is facing cannot be attributed to NAFTA. In agriculture, the sector will not be fully liberalized until 2008, and although imported agricultural products from the U.S. have increased (exceeding in many cases, such as corn, the quota system established by NAFTA) with a devastating effect on Mexican small farmers, this has been the result of internal supply shortages and cannot be considered a NAFTA effect. These scholars stress that the real problem has been the reluctance of Mexican farmers to adapt to the new open market and move into more profitable, labor intensive crops such as tomatoes and eggplants, instead of corn and beans. They point out that the businesses that invested in modernizing are thriving and that agricultural exports have gone up under NAFTA. In the case of pork, NAFTA advocates blame the problems to the inability of the industry to

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<sup>26</sup> See Rodrik 1989, pp. 1-16

<sup>27</sup> See Thacker 1999, p. 73.

<sup>28</sup> See Serra and Espinosa 2002a, p. 60.



protect itself against animal disease (only two states, Sonora and Yucatan, are allowed to export pork). They stress the need to balance the benefits to consumers against the costs incurred by producers and highlight the benefits that these agricultural imports bring to poor Mexican consumers with no land of their own and farmers that use corn as an input. Some even contend that NAFTA negotiators intended for the sector to shrink in order to force Mexican farmers to seek manufacturing jobs (i.e. Canada left a chunk of agriculture excluded). [29]

Furthermore, while NAFTA advocates acknowledge that there has been declining investment in environmental protection, they claim that this has been the result of budgetary constraints and the lack of availability of funds, not NAFTA, and stress that trade liberalization has increased per capita income, and thus created better chances to address environmental problems. [30]

According to these analyses, these benefits have even accrued to traditional areas and firms (including the *maquiladoras*) of low-wage, low-value-added production. Over 4,000 *maquiladora* factories employ nearly 1m workers in Mexico, making goods whose value added worth is over \$7 billion a year, second only to oil in the Mexican economy. Under NAFTA provisions *maquiladoras* have now to buy 60-80% of their raw materials and parts inside NAFTA's borders, or face import duties.[31] Hence, in order to remain competitive most of them have been moving to a more developed form of industrialization. As a consequence, low-wage operations have been drifting off to the poorer states of Mexico and other Latin American countries such as Guatemala. In the areas in which *maquiladoras* are established (mostly in the northern and border states) unemployment is just over 1% (compared with a 4.5% for Mexico as a whole), and labor turnover exceeds 15%, which is helping to push wages upward (which range from \$1.60 to \$2.20 an hour depending on location-including benefits such as health care, attendance bonuses, and a housing tax), although wage competition between companies still mainly takes the form of fringe benefits. Consequently, as we have seen, while far below prevailing rates in the United States, *maquiladora* wages are now comparable with equivalent manufacturing sectors in Mexico.[32] Furthermore, many of these *maquiladoras* are moving toward second-generation manufacturing with technical capabilities including research and design. This development combined with the increasing automation in these factories require more qualified workers, and for instance,

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29 See Serra and Espinosa 2002a, p. 60, and Serra and Espinosa 2002b, p. 63. See also "Plowed by NAFTA," in *The Boston Globe*, Saturday November 30, 2002.

30 See Serra and Espinosa 2002a, p. 60, and Serra and Espinosa 2002b, p. 63.

31 The *maquila* program started in 1965 but in the first 6 years of NAFTA the number of plants increased 80% to over 3,600 plants drawn by Mexico's proximity to the U.S., high productivity, and low labor costs. Under article 303 of NAFTA tariff breaks formerly given on all import parts, supplies, equipment, and machinery used by the *maquilas* in Mexico now apply only to such inputs from Canada, Mexico and the United States, and *maquilas* have to document the origin of the inputs. The seven-year grace period granted in the treaty to allow official time to write new regulations has now expired. As a result, Mexico has imposed duties on non-NAFTA inputs and introduced and increase existing taxes and the consequence has been an exodus of operators who are moving out of Mexico or threatening to do so in the near future. Since *maquila* exports account for half of Mexico's sales abroad and 80% of the exchange with the United States, this is a very worrisome development, and to counter this "maquila flight" Mexico is developing "sectoral promotion programs" with low tariff rates for vital production areas. Currently only 3/2% of inputs come from Mexico. See Lindquist 2001, p.23.

32 See MacLachlan and Aguilar 1998, pp. 315-31.

more than 12% of the workers in Baja California are now classified as technicians.[<sup>33</sup>] As a consequence more benefits will accrue from their operations including “technology transfer, stimulus of domestic development, infrastructure creation, added tax revenue, and more jobs and foreign exchange.”[<sup>34</sup>]

Free trade advocates also contend that by encouraging greater investment NAFTA has raised Mexico’s economic growth rate, thereby increasing the benefits to the U.S. [<sup>35</sup>] Between 1996 and 2000 real GDP in Mexico has grown at 5.5% per year (3.8% since NAFTA’s ratification even with the 1995 peso crisis).

According to these supporters, over the last nine years it has been confirmed that when tariff and non-tariff barriers—which were already low—have been eliminated, Mexican goods have gained a larger share of the U.S. market. Despite the hundreds of U.S. owned factories across the border before 1995, Mexico only accounted for 6% of American imports. This has meant that the effects of a Free Trade Area (FTA) were bound to be much larger for Mexico than the U.S. Modernizing Mexico’s economy requires a great deal of equipment, and most of it is coming from the U.S. Indeed, the trade agreement has opened the Mexican market to American goods. Economic reforms in Mexico have spurred both economic growth and a rise in imports, most of which – 70%—come from the U.S. Although United States workers have been facing the competition of low-wage Mexican workers, plants in Mexico have been buying components from U.S. factories—it has been estimated that 50% of the components incorporated into the final products of labor-intensive facilities that have moved to Mexico, are sourced in the U.S.[<sup>36</sup>]

The so-called “giant sucking sound of 5 million jobs” moving to Mexico voiced by Ross Perot and others in the early 1990s has not materialized. The Mexican economy was always too small to have a significant macroeconomic effect on the United States. In addition, wages account for a much smaller percentage of the cost of manufacturing than they used to. Furthermore, experts claim that for every \$1 billion in exports, 40,000 jobs are created. [<sup>37</sup>] This means that since 1987 more than 520,000 jobs were created in the

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<sup>33</sup> See “The Tijuana Triangle,” in *The Economist*, 6/20/1998, Vol. 347, Issue 8073, p. 13.

<sup>34</sup> Lindquist 2001, p.23.

<sup>35</sup> *Report of the Administration on the NAFTA and Actions Taken in Fulfillment of the May 1, 1991 Commitments*, U.S. Government Printing Office. September 18, 1992, pp.17-33. This report describes the benefits of the accord and the actions the Administration has taken in fulfillment of the President’s May 1, 1991 commitments to Congress on worker adjustment, labor rights, environmental protections, and thorough consultation. Some of the economic studies on the free trade agreement include: U.S. International Trade Commission “The Likely Impact on the United States of a Free Trade Agreement with Mexico;” Institute for International Economics “North American Free Trade: Issues and Recommendations;” U.S. Department of Commerce “U.S. Jobs supported by Merchandise Exports to Mexico.” All these reports stress the potential benefits of NAFTA and the benefits for the U.S. economy.

<sup>36</sup> Economist Intelligence Unit 1991, pp. 2-3.

<sup>37</sup> For an empirical effect study of an U.S.-Latin America FTA see: Erzan and Yeats 1992, pp. 117-146. The authors conclude that the potential impact for many Latin American and Caribbean countries to expand their exports through FTAs with the U.S. may be smaller than expected (8.8%) because most exports already face zero or low barriers. On the contrary, they argue that a FTAs induced expansion of U.S. exports to Latin America appears larger. The reason is that their protection levels are significantly greater than those in the U.S. They recommend that L.A. countries should assign greater importance to multilateral efforts within the GATT. Also, for the strategic advantages that free-trade zones offer to corporations that want to compete globally see Befus 1983, pp. 285-286..

U.S. Moreover, many of the jobs created in the U.S. over the second half of the 1990s have been in the high-skill-technology sector, whereas the new positions created in Mexico have been primarily low-skill ones.<sup>[38]</sup> In the end, American jobs that have been displaced because of increased imports amount to less than 2% of job elimination (i.e. the sum of those who lose their jobs and those who leave their jobs). In addition, in the auto and auto parts sectors employment in the United States has grown by more than 20%. Finally contrary to predictions of falling wages, hourly earnings of American automotive workers have actually increased since NAFTA came into force. <sup>[39]</sup> After all, NAFTA has resulted in the creation of jobs in the U.S. in certain sectors (and in any case fewer jobs have been lost under NAFTA than if production were transferred to the Far East).

In addition, NAFTA is forcing Mexican producers to adopt foreign standards and foreign business practices. To a large extent NAFTA has had a greater impact on some industries and companies than it has had on the economy of the three countries involved. Particularly companies in autoparts, telecommunications equipment, financial services and parts of the agricultural industry have benefited from the removal of specific trade and investment barriers. In addition, the strengthening of Mexico's intellectual property laws and the access to a pool of relatively cheap labor have allowed companies in these sectors to increase investments in Mexico in labor-intensive operation.<sup>[40]</sup> One of the sectors that has benefited the most has been the financial sector, particularly financial services linked to the production and commercialization of exports, as well as microbusinesses (with less than five employees), which account for about 50% of the non-agricultural jobs in Mexico. Mexican financial services attracted the most interest in FDI in 2002, with two deals in excess of \$1bn.

In deciding where to establish a factory companies have two main objectives in mind, they seek the lowest possible labor costs, and also to be close enough to their markets to respond to them swiftly. Hence, NAFTA has provided an unprecedented opportunity for North American firms to gain a competitive edge over the European Union and Japan by allowing them to combine modern technology from the U.S. and Canada with Mexico's cheap labor. At the same time, the treaty has promoted the establishment of a new pattern of industrial organization clustered around the global firms and its linkages with outward-oriented domestic ones. This has resulted in the lowering of production costs and an exploitation of the complementary elements of the U.S., Canadian, and Mexican economies. For instance, in the automotive industry the low-cost, high-quality products assembled in Mexico and re-exported to the U.S. have permitted American companies to compete with Japanese imports by producing niche vehicles that would otherwise have been much more costly, and in textiles, United States workers perform the high-tech weaving and spinning while Mexican workers handled the low-tech cutting and sewing. <sup>[41]</sup> Furthermore, NAFTA has allowed each member country to specialize and become more efficient in developing its products, thereby increasing world economic output. Rising intra-industry trade has led to a greater degree of specialization and a finer division of labor in industries.

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<sup>38</sup> Economist Intelligence Unit 1991, pp. 2-3.

<sup>39</sup> Deong, 2000, p. 10.

<sup>40</sup> Economist Intelligence Unit 1991, pp. 1-2.

<sup>41</sup> Economist Intelligence Unit 1991, p. 3.

An additional benefit, according to supporters of the treaty, has been that NAFTA has offered an alternative to the multilateral trade system, thus forcing other countries to seek an agreement with the U.S. out of fear of being excluded from that market, and hence providing an additional leverage to the U.S. in closing the Uruguay Round negotiations in the 1990s, because the EC and Japan were afraid of being left out of the North American market. This contributed to the conclusion of the Uruguay Round, and the establishment of the WTO. It is also spurring other Latin American countries to negotiate a FTA with the U.S.-Chile has just reached such an agreement, and the U.S. is planning to conclude in 2003 another FTA with five countries in Central America: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. Mexico, for its part, has been signing trade treaties with countries all over the world and currently trades at reduced or zero tariff with over 60% of the world, measured by GDP, and it is one of the very few countries that has a free trade treaty with the United States and the European Union.

In the political realm NAFTA advocates contend that President Fox's election in 2000 was a vindication of the principle that open markets can be a positive force for political change, because NAFTA contributed to alter the political landscape in Mexico. According to this interpretation, by contributing to the dramatic surge of the export sector and accelerating growth NAFTA has tilted the balance of political power toward the internal forces that favored growth and modernization rather than the ones that had a vested interest in the status quo. In addition, trade and foreign investment made certain types of official and social behavior, associated with government crime and corruption, seem less acceptable now because they would not only have personal consequences but economic ones as well, as companies would refuse to invest in a country perceived as dangerous or corrupt. [42] In this regard, it has been argued that the "free-trade agreement began a process of opening Mexico to global influences and encouraged formation of watchdog citizen groups to evaluate social, labor, and environmental aspects of Mexico's economic shift...the emergence of international human rights standards has worked in a similar way to create interest in government-oversight activities." Consequently the number of Mexicans satisfied with the way that democracy is working in the country increased from 29% in October 1999, to 51% in November of 2000, with large increases in confidence in institutions such as the federal election agency, the federal government, and even NAFTA. [43] In sum, increasing economic integration brought pressures for increasing political integration and the result has been the first peaceful transfer of power to an opposition candidate in Mexico in more than a 70 years.

In the end, NAFTA supporters claim that one of the main benefits of the treaty has come from having a more prosperous and stable neighbor. This benefit, according to NAFTA advocates, will pay political and economic dividends for decades to come. President Carlos Salinas de Gortari and Ernesto Zedillo, for example, have taken radical steps in Mexico. A free-trade pact has supported their policies by drawing new investment, and ensuring that their successors won't undo these reforms. [44] NAFTA has given many of Salinas' and Zedillo's reforms the status of law because under

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42 See "Mexico: Open Markets, Open Politics," in *Business Week*, 7/17/2000, Issue 3690, p. 164.

43 See "People Power grows in Mexico," in *Christian Science Monitor*, 11/8/2000, Vol. 92, issue 243, p.6.

44 Morici, 1992, pp. 90-98. *The New York Times* "Mexico's Leader Cautiously Backs some Big Changes." Monday, November 2, 1992, p. A2.

Mexican Law an international treaty has the equivalent status of Mexican federal laws issued by Congress, and any federal law conflicting with NAFTA has been overridden. Furthermore, the provisions of the treaty cannot be amended without the consent of the three countries involved, which assures a level of permanence and continuity that could not be achieved solely through national legislation, providing further assurance to foreign investors. Without this guarantee few exporters would have dared to develop the strong links between the three member countries. Therefore, NAFTA has locked Mexico's economy into the economies of its trading partners, making it impossible for the country to revert to the disastrous protectionist policies of the past. Indeed, the benefits of a FTA must be viewed not simply as those resulting from the elimination of trade tariffs, but instead as a continuation of a process of integration between the three economies that has intensified since NAFTA came into force. NAFTA has furthered this integration and has placed it within a legal framework, hence supporting the market reforms pursued by successive Mexican administrations.[45]

In sum, NAFTA advocated claim that the implementation of the treaty has strengthened and deepened economic and political reforms; fostered industrial modernization as well as greater access to foreign markets; promoted technology transfers; increased foreign investment, facilitated infrastructure development; enhanced employment prospects; increased training and skills for Mexican workers; and finally it has raised wages and income, and hence improved standards of living.

### Shortcomings

On the opposite side of the debate about NAFTA's effects, the Treaty's opponents have argued that while NAFTA has boosted trade, investment, and international competition, thus fueling a dramatic productivity spurt in Mexico and the United States, its implementation has also resulted in deleterious effects on workers, communities and the environment. According to its opponents, the central objective of NAFTA is to reduce the cost of trade and financial transactions and to enforce firms' property rights. Hence NAFTA is failing to promote sustainable development in Mexico, defined not merely by economic performance, but also by the need to maintain social cohesion, to avoid environmental damage, and to promote sound governance. On the contrary, as a result of NAFTA "state resources and capabilities have been eroded by the empowerment of market actors and market-oriented policies." [46] In addition, according to this interpretation, NAFTA has failed to promote the broader social goals (including job creation, higher wages and standards of living, and environmental cleaning and protection) under which it was sold to the public. The root of the problem, according to this analyses lies at the inequality at the heart of the treaty, both among the signatory countries and within the countries.

First, opponents of the treaty contend that the impressive rise in exports is the result of an accounting trick: the adding up of the total value of goods transformed in the *maquila* process as though they were real exports, when in reality this is not the case because only 3.2% of inputs come from Mexico and in many cases the *maquila* firm pays nothing for them to its corporate headquarters. The only money that remains in

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<sup>45</sup> Economist Intelligence Unit 1991, p. 1.

<sup>46</sup> Morales 1999, 992.

Mexico is the value added, i.e. wages, benefits and small additions to the production system. [47]

They also claim, as an additional criticism, that the quality of employment and the performance of wages' have also been quite disappointing. While new jobs have been created, about 50% of the non-agricultural jobs are currently in microbusinesses, which are essentially activities of self-employment that represent a form of survival. In addition, real manufacturing wages declined 11% between 1994 and 2001, and the overall wage decrease between 1994 and 2000 is on the order of 21%, despite the fact that real wages grew between 1999 and 2000 by just 1%. [48] Manufacturing wages showed some improvement in 2000 and 2001, yet they remain lower than in 1994 and considerably lower than in 1981. In addition, the claim that export-oriented firms pay higher wages, is disputed by the fact that according to the U.S. labor department data, wages in the *maquiladora* export plants (\$1.74) are significantly lower than in Mexican manufacturing as whole (\$2.12).

As a consequence of the scarce creation of new jobs and the absence of significant wage increases and new well-paid jobs, Mexico's income disparities have widened and the parallel increase in income at the top has also contributed to raising income inequality (in 2000 it was higher than in any year since the mid 1980s). The share of Mexicans living in poverty rose from 51% in 1995 (NAFTA's first year) to more than 58% in 1998 according to the World Bank. Until 1984, before the implementation of neoliberal policies, measures of income distribution showed convergence toward greater equality as a result of redistributive policies, but this movement has stagnated since 1984. Opponents also argue that NAFTA has intensified environmental problems as the U.S.-Mexico border faces increasing environmental hazards, at a time in which the Mexican government investment in environmental protection has declined by about 45% in real terms since 1994 and the contribution from the trinational commission established under NAFTA amounted to just 43 million per year. This problem has been aggravated by the threat of expensive lawsuits allowed to investors under NAFTA rules to sue governments directly to protect the value of their investment. [49]

NAFTA has also resulted in job losses in certain U.S. economic sectors (particularly in labor intensive ones such as footwear, household glassware, textiles and apparel, some types of autoparts, and fruits and vegetables). During the approval process some politicians went as far as to predict that NAFTA could cost 550,000 jobs over the next decade.[50]. As we have seen, however, these predictions have not materialized and the

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47 See Salas 2002, p. 32.

48 See Salas 2002, p. 32.

49 See Cavanagh and Anderson 2002a, p. 58; and Cavanagh and Anderson 2002b, p. 62.

50 The debate about NAFTA's consequences was very intense and spirited from the outset. See, Senator Howard M. Metzenbaum in *The New York Times* Monday, October 5, 1992, p. A16. Jeff Faux, the President of the Economic Policy Institute estimated that the pact would cause the loss of 500,000 jobs in the U.S. within 10 years, based this figure on the assumption that American exports of factory equipment would have a much more immediate effect on Mexican industrial production. See *Business Week* "A Noose Around NAFTA" February 22, 1993, pg. 37; and *The New York Times*. "Study Says Trade Pact will Aid U.S. Economy." Wednesday, February 3, 1993, pp. D1 & D14. The International Trade Commission, an independent U.S. Federal Agency, issued a comprehensive assessment of NAFTA stating that the pact would help overall American economic output and employment slightly, while producing job losses in the auto, household appliance and apparel manufacturing industries. The report concluded that if the U.S. Congress approved NAFTA, employment would eventually drop by up to 5% in the automotive and

economic boom of the second half of the 1990s helped to keep unemployment at records low in the United States.

At the same time, NAFTA critics argue that the effects of the implementation of the treaty have fallen unevenly in the member countries. In the United States, states such as Texas and California have benefited far more than other states in the Midwest. For instance, in 1996 53% of US exports to Mexico originated in the Southern States (with California accounting for 16% and Texas with 32%, while Illinois, Indiana and Michigan together only accounted for 19%). In Mexico, NAFTA is also provoking a new regional concentration of core economic activities and exacerbating regional inequalities that existed in the country even before the implementation of economic reforms. Economic growth is unevenly spread and while the export sector has been growing by an average of 10.9% a year over the last two decades, output of the domestic market has been expanding by an average of only 3.5%. [51]

According to its opponents, NAFTA has also resulted in a growing geographical and sectoral polarization of investment, income and employment. Most of Mexico was not ready for the implementation of the treaty and Mexican people and states were left to work it out for themselves with little help from the government. The best location place for a factory producing for re-export (i.e. a *maquila*) is near the border across which the goods are to be re-exported, therefore most of the jobs that have been created in the *maquilas* (which have grown from 546,000 jobs when NAFTA came into force to 1.3m jobs) are in the north of the country. In addition, since companies seek to take advantage of the mobility of productive factors, and in Mexico companies and population with mobile assets (such as financial capital, skills, and training) are located in central and northern Mexican states, this region has been the one that has gained the most from NAFTA and, hence most successful export-oriented industries are located in Mexico's NAFTA core: Mexamerica (the strip running along the Mexican border), the Northern high-tech states (Baja California, Sonora, Chihuahua, Coahuila, Nuevo León, Durango, Nayarit, Zacatecas and Tamaulipas) and the Central high-tech core (Jalisco, Veracruz, Guanajuato, Quétaro, San Luís Potosí, Hidalgo, Tlaxcala, the state of Mexico, Puebla

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apparel industries and up to 15% in the major household appliance, glass and ceramic tile industries. The report attributed the job losses to additional competition from Mexican imports and the establishment of new factories in that country. The study also estimated that compared with forecasted employment without the agreement, total employment with NAFTA would gradually rise by up to eight-hundredths of a percentage point in the U.S., up to six-tenths of a percentage point in Canada, and up to 6.6% in Mexico. The American auto parts, computer, industrial machinery and textile industries would gain jobs. The commission report also projected that the long-term effect would be to increase annual economic output by up to three-tenths of 1 percent in the U.S. and by 16.2% in Mexico. It has also advanced that the pact would have its greatest effect in Mexico because its economy is only one-twentieth of the size of the U.S. economy, and because Mexico already relies heavily on trade with the U.S. The report concludes that NAFTA will prove a mild boon to the U.S. economy, slightly boosting exports to Mexico and creating a net gain of 35,000 to 95,000 jobs by 1995. Other studies stated different conclusions. These gains ignored projections that stated that allowing NAFTA to come into effect would cause American companies to shed as many as 170,000 jobs. Two senior fellows at the Institute for International Economics, Gary C. Hufbauer and Jeffrey J. Schott, whose forecasts of short term job gains were cited by the Bush Administration at Congressional hearings, forecasted that the pact would produce a net gain of about 175,000 jobs in the U.S. by 1995. However, they have also concluded that any net increase in jobs gains would evaporate after 15-20 years. *The New York Times* "Trade Pact Job Gains Discounted." Monday, February 22, 1993, pp. D1-D2.

<sup>51</sup> The country's economic crises have also been unevenly spread, for instance in 1995 the economy contracted by 6.2%, but leaving exports out the shrinkage was 13.1%. See "If not for NAFTA, When?" in *Economist*, 10/28/2000, Vol. 357, Issue 8194, Special Section, p.7.

and Mexico City). [52] In particular, this development is having a very negative effect in the Southern states, which are the least endowed with mobile assets—such as capital, technology, and knowledge. This region from Michoacan to Chiapas (including Oaxaca and Guerrero), above the Mexican border with Guatemala, is dominated by a poor agriculture-based economy and encompasses three of the poorest states in Mexico, with GDP per capita below 60% of the national average. Manufacturing production in these states is far below the national average (20%), the agricultural sector is far above (6.75%), and this region is the locus of ethnic cleavages with 43.5% of illiterate indigenous-speaking adults living in this area. [53]. Data from the INEGI shows that “the polarization and concentration of poverty in poor states has grown and that the number of states with high levels of marginalization has also grown.” [54] It is not surprising, therefore, that since 1994, when NAFTA came into force, this region has become as the center of guerrilla uprisings (particularly in Chiapas). It is worth noting, however, that over the past five years there has been a growing movement of *maquilas* to the south of the country, particularly in the clothing industry, which is now establishing in a few areas of Oaxaca and Puebla (i.e. the city of Tehuacan has tripled the number of its *maquila* factories over the past five years).

At the same time, economic openness is aggravating some local problems that market mechanisms cannot manage in a satisfactory way. As a result, the country’s social cohesion is at stake. While this development is not only provoked by the implementation of NAFTA, the treaty is exacerbating this regionalization of core economic activities and showcasing that market mechanisms are not sufficient to address social and regional cohesion imbalances. [55] Moreover, NAFTA has also resulted in lower safety and health standards. In the end, increasing regionalization demands for a reinforcement of supranational institutions and processes to deal with common problems. NAFTA has not responded to this challenge.

Not only has NAFTA widened economic differences within the region (i.e., annual per capita incomes equal approximately \$28,900-Canada, \$9,000-Mexico, and \$35,900—the United States) but it has also increased dramatically Mexico’s dependence on the United States. This link with the U.S. economy was consolidated, not created by NAFTA, but Mexico has swapped oil dependence (in the early 1980s two-thirds of Mexican exports were oil), for exports to the US (with nearly nine-tenths of exports coming to the United States). Almost 94% of Mexican exports were to the NAFTA region in 1998: 87.5% to the United States and 6.3% to Canada. It is not surprising that the current economic crisis north of the border is having significant implications for Mexico, with estimates that Mexico’s growth will be close to zero (down from initial predictions of 7% growth). In addition, while half of the country’s manufacturing exports are *maquila* exports, the non-*maquila* ones come from a very limited number of industries (i.e. 31% come from the automotive industry) and in many cases they take the

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52 See Morales, 1999 982-93. According to him, Nuevo León, turns out 16% of Mexico’s output in primary and fabricated metals, 15% of machinery and electric equipment, 6.9% of all chemical and petrochemical output, 7% of textiles and clothing and 3% of the national output in the transportation and automotive sector. In these regions per capita income is close to or above the national average and this is the most homogeneous region in Mexico.

53 See Morales 1999.

54 See Salas 2002, p. 32.

55 See Morales 1999.



form of intra-firm trade concentrated in a segment of firms who rely in outside suppliers with very loose links with the domestic economy.<sup>[56]</sup> Finally, NAFTA has also led to the purchase by foreigners of existing productive facilities, particularly in the textile industry and the non-*maquila* production of food with greater presence of foreign capital in the production destined to the domestic market.

The scholars that oppose NAFTA argue that the failure to reduce poverty or increase wages is related to the increasing power of capital in a globalized economy in which employers to fight unions and restraint wages use the 'exit threat' more frequently. In particular, they point at the failure of NAFTA labor side agreements to protect workers rights (with more than 20 complaints being filed in the National Administrative Office, the agency set up under NAFTA labor side agreement, and not a single case of success), which has been a major factor in the meager level of wage growth in both Mexico and the United States. Furthermore, the strategy of low wages to attract FDI is short-lived as other countries (such as China or other Central American countries) can offer even lower labor costs. Hence it is not surprising that in 2001 almost 500 *maquilas* closed their doors and in many cases relocated to Asia.

In agriculture, they claim that the sharp increase of cheap U.S. corn imports has devastated small farmers and increased rural poverty rate, which increased from 79% in 1994 to 82% in 1998 according to the World Bank. While land reform after the Revolution contributed to address the secular challenge of land concentration, most of the poor 3.5m peasant families who now have a plot and live in *ejidos* (i.e. collective communities where they have usufruct rights over the land, but do not own it<sup>[57]</sup>) are unable to compete with American farmers using high technology processes, high-quality seeds, and high-value subsidies from the U.S. government (i.e. in May 2002, president Bush signed the Farm Bill, which will pump \$190 billion into U.S. agriculture over the next 10 years giving U.S. farmers an unfair advantage). Hence Mexico has been flooded with cheaper agricultural imports (particularly corn). The financial crisis of 1994-95 intensified this problem because it made it even more difficult for these peasants to borrow money to buy new equipment and seeds. On January 1<sup>st</sup> 2002 most remaining agricultural tariffs were lifted under NAFTA rules, a development which will have devastating consequences for small Mexican farmers. On November 18<sup>th</sup> president Fox announced a \$10.6 billion farm program for 2003 to increase financial aid to farmers and boost enforcement of NAFTA quotas. This package pales compared with the one approved by the U. S. government. This has led Mexican farmers to stage demonstrations in Mexico City to demand a renegotiation of NAFTA to exclude agriculture, or at least delay the end of tariff by 3 years. The U.S has refused to make concessions and president Fox has confirmed that Mexico will not renegotiate NAFTA believing that it could leave Mexico worse off. In response to the main farmers' union threat to stage a national strike, the Mexican government has banned imports of poultry from 8 U.S. states on health and safety grounds in 2003.

Small business have also faced their own challenges, not only lack of credit, but also labor bottlenecks caused by insufficient labor with proper education and training, which makes the supply of middle managers and supervisors scarce. While the government has

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<sup>56</sup> See Salas 2002, p. 32.

<sup>57</sup> In 1992 the government passed a reform giving *ejido* dwellers the option of owning and selling their land, but the reform have been hampered by the granting of parcels as many of them have been assigned to several different people. As a consequence the government is still certifying who owns which plot

been focusing on macroeconomic issues, it has paid scant attention to microeconomic ones, and beyond the promotion of *maquiladoras* Mexico lacks an industrial policy that can satisfy the needs of small and medium enterprises and respond to their pressing needs. It is also worth stressing that while *maquila* products are made in Mexico only 2.8% of their input is locally produced. Consequently the export boom is not having a dramatic impact in the economy. [58]

An additional major criticism that has been raised against the treaty has been the fact that it ignored the issue of democracy. This subject was explicitly excluded for the agenda for the NAFTA negotiations at the Bush-Salinas Monterrey summit in November 1990 and it played a minor role in the debate over the approval of the treaty. While president Salinas was pushing for limited political reforms [59], democracy in Mexico was not fully institutionalized when the treaty has ratified [60]. U.S. officers in the Clinton administration “emphasized that they talked privately to the Mexicans about democratic reform,” but their public stance and the response from the U.S. administration to the Chiapas rebellion (which epitomized the democratic demands of Mexican indigenous people) “largely reflected the traditional U.S. approach of avoiding any direct criticism of the Mexican political regime.” [61] Even if this is an internal issue of a sovereign nation, many critics of NAFTA highlighted this situation and voiced their disapproval.[62] This approach stands in stark contrast with the democratic prerequisite

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58 See “If not for NAFTA, When?” in *Economist*, 10/28/2000, Vol. 357, Issue 8194, Special Section, p.7.

59 *The New York Times*, “Mexico’s Leader Cautiously Backs Some Big Changes” Monday, November 2, 1992. p. A3 and *The Economist*. “Into the Spotlight: A Survey of Mexico,” 1993, pp.8-12. Both articles addressed the political changes endorsed by Mr. Salinas to open the Mexican political system, but also highlighted that those reforms were limited and insufficient. For a broader analysis see: Davis 1992, pp. 655-671. The author offers a historical perspective of Mexican trade policies, and examines the changes implemented by President Salinas in order to renegotiate NAFTA. She raises questions about the uncertain support of the popular middle classes to the treaty.

60 *Business Week* “A Tear In Mexico’s Curtain of Democracy.” March 22, 1993, p. 47. This article shows that Salinas was under intense pressure to show that he is not just another authoritarian leader, and ruled “from above.” Among other scandals that have appeared in the international press, see: *El País* “El Líder de la Oposición Acusa al Presidente Mexicano de Estar Implicado en “Negocios Sucios” (The opposition leader accuses the Mexican president of being involved in dirty business). Monday, February 22, 1993, p. 8. See also *The Boston Sunday Globe*, “Continental Trade Pact Puts Focus on Mexico’s Problems” March 7, 1993, p. 18. This article addressed Mexico’s antidemocratic traditions, history of political repression, labor abuses, rigged elections and human rights violations that have been brought to the spotlight in the U.S. as a consequence of the NAFTA debate. See also, *The New York Times*, “First Hat in Ring for Mexico’s Vote.” Saturday, February 6, 1993, p. A1. This article addressed the announcement of the candidacy of Cuauhtémoc Cardenas and offer examples of some electoral scandals that happened in previous elections.

61 Mazza 2001, p. 105, Carranza 2002, p. 152.

62 Among other articles that appeared in the press see: *Business Week* “A Tear in Mexico’s Curtain of Democracy.” cit., p. 47. Representative John LaFalce (D-N.Y.) has stated that he “expects Mexico to look more democratic as a precondition for free trade.” *The New York Times* “Mexican Leader Asks Executives to Give Party \$25 Million Each.” Tuesday March 9, 1993. pp. A1 & A8. *The Boston Globe*. “Mexico Party Puts Cap on Donations.” Wednesday, March 10, 1993, p. 3. *The New York Times* “Salinas endorses party Gift Limits.” Wednesday March 10, 1993, p.3. these articles addressed an incident that illustrates the political situation in Mexico and the effect this situation had in the U.S. The fiasco shows that Salinas and his administration suffered from the arrogance that had characterized the PRI for decades. Mexican officials became increasingly worried that American Congressional support for the agreement would be weaker than they have thought, and they were especially anxious to keep critics of their policies on Capitol Hill from gaining greater influence in the trade debate.

for membership to the EU, which prevented Greece, Spain and Portugal, from joining the Union until they became democratic, thus offering a powerful incentive for democratization.

There is also considerable dispute over the influence that NAFTA had in the 1994 peso crisis of 1994-95. While NAFTA supporters argue that the crisis cannot be attributed to NAFTA because the treaty came into force in 1994, and point out that the peso crisis was similar to the other financial crises experienced by Asian and Latin American countries, which are not part of such a treaty, its opponents contend that NAFTA intensified existing trends by allowing Mexico to sustain its current account deficit longer and delay and intensify the eventual devaluation.<sup>[63]</sup>

Finally, labor activists and trade unions have also criticized the functioning of the National Administrative Office (NAO) of the U.S. Department of Labor (and its “sister” institutions in Canada and Mexico), which is the enforcement mechanism in the United States for the North American Agreement on Labor Cooperation (NAFTA’s labor side agreement), in charge of hearing allegations that Canada or Mexico are not enforcing their own labor-protection laws. Overall, more than 20 complaints have been filled in all 3 NAFTA countries regarding alleged violations, but not a single case has resulted in more than a little publicity.<sup>[64]</sup>

In sum, some of the negative consequences of the implementation of the agreement include: (1) Adjustment costs: Mexico has faced enormous adjustment problems as they liberalized its economy and the cost to adjust to a new FTA has been an additional strain. (2) Dynamic Effects: the free market system has accentuated the problems of areas on economic periphery. Indeed, the dynamic gains to overall growth have not been able to outweigh the redistributive effects as activities are transferred from the center to the periphery. <sup>[65]</sup> (3) Constraints of Development Policy: The Integration in a FTA has limited the adoption of certain economic policies that would be critical for the development of the Mexican economy.<sup>[66]</sup>

Overall while NAFTA’s supporters contend that it has increased trade and investment, its opponents claim that it has failed to support social objectives such as job creation, or environmental protection. However, it is important to stress that NAFTA has intensified processes that were already underway since the 1970s (including less state intervention in the economy, regulatory changes in favor of businesses, the opening to world trade, the turn toward an export based model of economic growth, the closer link with the United States, and a weaker state) and, therefore, it is not possible to attribute recent changes to the Mexican economy exclusively to NAFTA. At the same time, it is necessary to acknowledge that NAFTA per se cannot provide an instant remedy to Mexico’s secular problems. Mexico’s problems remain daunting. The political democracy is still fragile, income distribution is deteriorating, the financing of education

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<sup>63</sup> See Weintraub, 1997; and Dropsy 1995.

<sup>64</sup> See Cavanagh and Anderson 2002, p. 58; and “Testing NAFTA’s Labor Side Agreement,” in *NACLA Report on the Americas*, May/June 1998, Vol. 31, Issue 6, p.6. See also “Expensive Trade-Offs of Free Trade,” in *Christina Science Monitor*, 6/1/1998, Vol. 90, Issue 129, p. B5.

<sup>65</sup> See Lipsey 1992, pp. 99-104.

<sup>66</sup> Lipsey 1992, pp. 103-104.

and infrastructure are still insufficient, and demographic prospects remain challenging.<sup>[67]</sup> In addition, Mexico's social welfare system is still very inadequate and is plagued by overwhelming financing and bureaucratic problems. NAFTA has not (and will not) address these challenges. Improvements will require a shift from low-tech low-productivity processes (particularly in agriculture) toward urban occupations, but this will require substantive funding from the government to support this migration.

## LESSONS

Let me suggest some lessons based on information from the preceding sections.

### Lesson One: The Integration of Mexico in NAFTA, and of Portugal and Spain in the European Union Contains Both Global and Particular Elements

The integration process of these 3 countries was *particular* in that the focus was on the nation-state, and *global* in that decision-makers were concerned with modernizing the economies of their countries to compete in the global markets.

### Lesson Two: While Political Considerations Were the Main Motivation behind Portugal and Spain's Application to Join the European Community, Economic Motivations led Mexico's decision to Negotiate NAFTA

Portugal and Spain both wanted to strengthen their new democratic regimes, and they both held the desire to end the relative isolation they had experienced during the authoritarian years. These were critical political factors behind their decision to join the European Community. The EC democratic precondition for entry was a powerful incentive for democratisation. Mexico, for its part, sought to institutionalize privileged access to the US market to attract investment into the country and anchor the process of economic reforms.

### Lesson Three: Economic Success Can Improve Political Ties. EU Integration Has Brought Portugal and Spain Together and NAFTA has intensified the relationship between Canada, the U.S. and Mexico

Despite significant tensions between Spain and Portugal over the centuries European integration has brought Spain and Portugal together. By 1990 Spain traded more with Portugal than with all of its Latin American trading partners, and Spanish imports from Portugal are rising faster than those from any other country. Direct Spanish investment in Portugal and Portuguese investment in Spain has soared, and Spain has emerged as the largest investor in Portugal. By 2000 there were more than 3,000 Spanish firms in Portugal, compared with fewer than 400 in 1989, and the Portuguese own more than 400 firms in Spain

Mexico's economy has also become deeply integrated with the United States and Canada ones. As we have seen, Mexico exported \$139 billion to its NAFTA partners in 2001, a 225% increase from 1993.

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<sup>67</sup> See Deong 2000, p. 10.

#### Lesson Four: Economic Success Drives Public Opinion

The decision to join the European Union in both Portugal and Spain was supported by most of the political parties in each country. Furthermore, according to a recent *Eurobarometer* study (see Table 1), the overwhelming majority of the population understood the importance and significance of this step and supported the decision. EC membership would increase economic growth, thus increasing the standards of living of the Iberian people.

**TABLE 1**  
**SUPPORT FOR EU MEMBERSHIP AND EMU**  
*It Is a Good Thing*                      *It Is a Bad Thing*

	<i>It Is a Good Thing</i>	<i>It Is a Bad Thing</i>
<b>Portugal</b>	56	45
<b>Spain</b>	53	61

*Source: Eurobarometer, no. 48, October–November 1998.*

The polls conducted by European and Iberian institutions show that the opinions and attitudes of Iberian citizens toward the process of European integration are in general favourable. It is important to stress, however that *Eurobarometer* data show that one of the key factors to account for the attitude of Portuguese and Spaniards toward European integration has been the perception about the personal and collective benefits derived from membership. Iberian citizens have a very utilitarian concept of the European Union—that is, they evaluate the consequences of membership over issues such as living costs, infrastructures, job opportunities, wages, and so on, and in function of this cost/benefit analysis, they adopt a position in favour of or against European integration.[68]

#### Lesson Five: EU Membership Has Altered the Mexican and Iberian Roles in the World

EU membership put an end to the relative isolationism of both Iberian countries, which had been a key cause of their economic, cultural, and social backwardness. At the same time, over the last few years Mexico has also opened up and become more assertive in international affairs. After years of backwardness and isolation, Mexico, Spain and Portugal have become players in the world again.

#### Lesson Six: EU and NAFTA Membership Have Given Mexico Spain and Portugal a Better Competitive Position

NAFTA and EU integration has provided the 3 countries with markets for their products Mexican, Spanish and Portuguese producers now have access not only to their national markets but also to the North American and European ones respectively. At the same time, in order to compete in the new expanded market, these countries had to speed up the reform of their productive and economic structures to increase the productivity of their labour force. This fact offered incentives for investment, specialization, and for the development of economies of scale, which in turn has resulted in more competitive products and processes. Finally, regional integration has promoted the establishment of a

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67 See *CIS: Opiniones y actitudes de los españoles ante el proceso de integración europea*. Madrid: 1999, pp. 131–32.

new pattern of industrial organization clustered around the global firms and its linkages with outward-oriented domestic ones

### Lesson Seven: Real Economic Convergence Is a Slow Process

More than three years ago, on 1 January 1999, Spain and Portugal became founding members of the European Monetary Union. At the end both countries, which as late as 1997 were considered outside candidates for joining the Euro-zone, fulfilled the inflation, interest rate, debt, exchange rate, and public deficit requirements established in the Maastricht Treaty. This development confirmed the nominal convergence of both countries with the rest of the European Union. The Iberian integration in the European Union has allowed these economies to become integrated internationally and to modernize, thus securing convergence in nominal terms with Europe. Nominal economic convergence vis-à-vis the European average, however, has advanced at a faster pace than real convergence. While there is significant controversy over the definition of real convergence, most scholars agree that a per capita GDP is a valid reference to measure the living standards of a country. This variable, however, has experienced a cyclical evolution in the Iberian countries with significant increases during periods of economic expansion and sharp decreases during economic recessions. Since the adhesion of Spain to the EU in 1986 per capita income has increased "only" 11.5 percent and Portugal's 14.2 percent. Ireland's, in contrast, has increased 38 percent. Therefore these economies still have to achieve convergence in real terms, reconciling convergence in productivity with the creation of employment. In terms of convergence and growth in the long run, while contributing to important progress, fifteen years have not been long enough. GDP per head in Mexico is only \$5,500 a year, compared with \$36,000 in the United States.

For the Iberian countries and Mexico to increase their living standards it is necessary that their economies grow faster than the other countries. This will require further liberalization of their labour and service markets and better utilization of their productive resources. In addition, convergence will also demand institutional reforms in R&D policies, in education, and in civil infrastructures, as well as further innovation, an increase in business capabilities, more investment in information technology, and better and more efficient training systems. Finally, a successful convergence policy will also demand a debate about the role of public investment and welfare programs in these countries. In the Iberian countries increases in public expenditures to develop their welfare state have caused imbalances in their national accounts. Both countries still spend significantly less in this area than their European neighbours, however (e.g., Spain spends 6.3 points less on welfare policies than the EMU average). Effective real convergence would demand not only effective strategies and policies, but also a strong commitment on the part of Mexican, Spanish and Portuguese citizens to this objective. [69]

### Lesson Eight: Integration Has Both Benefits and Costs

Regional integration n has so far brought many advantages to Mexico and the Iberian countries. Portugal and Spain have benefited extensively from the European Union's cohesion funds, which have contributed to improving the physical infrastructure and

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<sup>69</sup> See 'La Convergencia Real a Paso Lento', in *El País*. Monday, 14 February 2000.

capital stock of both countries. At the same time Mexico, Portugal and Spain's trade with their partners has expanded dramatically over the past fifteen years, and foreign investment has greatly increased. For the Iberian countries, one of the main consequences of these developments has been a reduction in the economic differentials that separated both countries from the European average. For instance, since 1986 Portugal's average per capita income has grown from 56 percent of the EU average to about 74 percent, while Spain's has grown to 83 percent. The culmination of this process was the (largely unexpected) participation of both countries as original founders of the European Monetary Union in 1999.

From a social and cultural standpoint, the effects of integration are also significant. As part of their democratic transitions, both Iberian countries embarked on new processes of self-discovery. They have begun to come to terms with their own identities, while addressing issues such as culture, nationality, citizenship, ethnicity, and politics. The process of integration into Europe has greatly influenced these developments. At the dawn of the new millennium, it would not be an exaggeration to say that the Spaniards and the Portuguese have become 'mainstream Europeans', and that many of the cultural differences that separated these two countries from their European counterparts have faded as a consequence of the integration process.

The process of integration, however, has also brought significant costs in terms of economic adjustment, loss of sovereignty, and cultural homogenization. For Mexico, given the asymmetrical nature of the relationship with the U.S., these costs have been particularly high, as we have seen. Regional integration has had, and will continue to have for the foreseeable future, a profound effect on both countries' societies. It has had an impact on issues such as national identity, the sustainability of welfare institutions, and the adjustment of political and economic structures.

The experience of these three countries with regional integration illustrates that such a process requires a set of measures including: increased competition, privatization of public enterprises, industrial restructuring, and deregulation. These measures have translated into efficiency gains, which have been reinforced by a more stable macroeconomic framework. At the same time, lower inflation and fiscal consolidation have led to lower real (and nominal) interest rates, which, in turn, have resulted in a higher sustainable growth.

#### Lesson Nine: Structural and Cohesion Funds Play a Key Role

As we previously indicated, the role of European Structural and Cohesion Funds has been crucial in the success of the Iberian countries since they became EU members. The structural and cohesion funds are the instruments designed by the European Union to develop social and cohesion policies within the European Union (see Table 2). These allow for the construction of public infrastructure vital for private sector productivity and real convergence. The cohesion funds were established in the Maastricht Treaty in order to compensate for the efforts countries with the lowest per capita income (Ireland, Greece, Portugal, and Spain) relative to the European Union would need to make to comply with the nominal convergence criteria. These funds, which amount to just over one-third of the EU budget, have contributed significantly to reducing regional disparities and fostering convergence within the European Union. At the same time, they

have played a prominent role in developing the factors that improve the competitiveness and determine the potential growth of the least developed regions. [70]

**TABLE 2**  
**STRUCTURAL AND COHESION FUNDS**

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

*Source:* Sebastian 2001: 25. Data from: European Commission. Estimates based on *Eurostat* data and forecast for 2000–2006.

During 1994–99, EU aid accounted for 1.5 percent of GDP in Spain and 3.3 percent in Portugal. [71] EU funding has allowed rates of public investment to remain relatively stable since the mid-1980s. The percentage of public investment financed by EU funds has been rising since 1985, to reach average values of 42 percent for Portugal and 15 percent for Spain. It has been estimated that the impact of these funds on the ratio of public investment in the Spanish economy in the past few years has been 0.5 percent higher as a consequence of EU funding, which in turn had a positive effect on private investment and per capita income in the long run. [72] Moreover, the European Commission has estimated that the impact of EU structural funds on GDP growth and employment has been significant: GDP rose in 1999 by 9.9 percent in Portugal and 3.1 percent in Spain. In the absence of these funds, economic integration in the Americas is bound to be far slower and more unbalanced.

NAFTA does not include such provisions. When he came to power in 2000 Mexico's president Vicente Fox, developed two main proposal when he came to office. First he wanted to develop a modest version of the regional structural and cohesion funds that allowed Spain and Portugal to catch up so quickly with the richer members of the EU. Specifically, he proposed beefing up a small bilateral credit agency for border-area environmental improvements and turn it into a full-blown development bank to fund infrastructure and anti-poverty measures in Mexico. Second, he wanted a new agreement that would allow for an increase in legal migration of Mexicans to the United States as a forerunner to eventual EU-style free movement of labor. These limited proposals, however, have not moved forward. Both Canada and the United States were dismissive

<sup>69</sup> See Sebastián 2001, pp. 25–26.

<sup>70</sup> As Sebastián 2001, (pp. 25–26) indicates, 'this is set to fall slightly in the period 2000-2006, to 1.3% of GDP. The decline reflects, on the one hand, a reduction in structural funds over the new programming horizon (structural funds will represent around 0.3% of EU GDP in 2006, compared with 0.45% in 1999) and, on the other hand, the impact of enlargement (accession aid). This fall-off in funding will clearly affect the long-term growth of the Iberian economies'.

<sup>71</sup> Sebastián 2001, p 26.



of the first one because they would have to come up with the funds to finance such a bank. The second one was buried by the U.S. government in the aftermath of September 11<sup>th</sup> with the changing environment toward immigration. [73]

#### Lesson Ten: Financial and Trade Institutional Reform Will Not Produce the Necessary Institutional Reforms in Other Areas

Trade and financial institutional reforms have not forced institutional changes in other areas (i.e., the labour market or fiscal policies). The peso crisis of 1994-95 and the virtual collapse of the European Monetary System in 1982, showed the limits of financial and monetary instruments to impose institutional reforms in other areas and the difficulties trying to balance domestic and external economic objectives. This is a potential danger. Institutional reforms require action on the part of the governments that are willing to pay the short-term political price for unpopular policies.

#### Lesson Eleven: The Democratic Pre-Requirement for Membership Is a Powerful Incentive for Democratization

As we have seen, long-standing authoritarian regimes prevented Spain and Portugal from joining European organizations and kept both countries on the fringe of the integration process that began in Europe after World War II. The emergence of democratic regimes in both Spain and Portugal in the second half of the 1970s paved the way for the successful consideration of these countries' applications for membership in the European Community. This was a prerequisite. As long as the political setting of these countries remained authoritarian, membership was not feasible. This was a powerful incentive for democratization and also for the consolidation of democratic institutions (i.e., the failure of the 1981 *coup d'état* in Spain and the revolutionary attempt in Portugal). Whereas other agreements (i.e., the North American Free Trade Agreement—NAFTA) have left aside such a precondition, including it would provide a powerful incentive for Eastern European and Latin American countries to consolidate their democratic processes and avoid authoritarian temptations.

#### Lesson Twelve: A Convergence of Integration Models is Highly Unlikely

Some scholars have argued that NAFTA needs to establish common institutions in order to deal with common problems. [74] However, there are significant obstacles to the creation of EU-like supranational institutions in NAFTA. First, it has been noted that one of the central problems inherent to NAFTA is that the “asymmetry of power in favor of the United States is an obstacle because the United States will always be tempted toward unilateral solutions to common problems—such as immigration and drug trafficking.” [75] Indeed, GDP per head in Mexico is only \$5,500 a year, compared with \$36,000 in the United States.

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<sup>73</sup> See “Breaking Foreign Policy Taboos,” in *The Economist*, 8/26/2000, Vol. 356, Issue 8185, p. 25.

<sup>74</sup> See Pastor 2001.

<sup>75</sup> Carranza 2002, p. 154.

In addition, a Western Hemisphere Community, similar to the European Union, is very unlikely to occur due to the following realities: (1) the divergent interests and objectives that each country pursues; (2) the lack of interest in the U.S. to integrate further with these countries beyond free trade; (3) Latin American concerns over sovereignty and autonomy; and (4) the absence of geopolitical interests for such an agreement. Indeed, the extreme heterogeneity of the region poses a critical challenge to hemispheric free trade.<sup>[76]</sup> The disparate interest of each partner, as well as the vast differences between the U.S and Latin American countries (and even within the countries themselves) in terms of size, level of development productivity and mutual importance as trade partners, makes impossible the developments of a FTA among equals. These inequalities will require the development of mechanisms that will ensure that the result of such a FTA is not an unacceptable skewed distribution of benefits in favor of the more developed countries. It will be critical that these complementary policies will be adopted in order to build a truly free trade area between partners of different stages of development. Minimizing these differences will be the major challenge of the Western hemisphere FTA. Doing so, however, will likely lengthen the process of integration until these countries reach the minimum levels set to integrate in the FTA.

Furthermore, the strategic dimension of trade arrangements in this region is completely different from the European one.<sup>[77]</sup> In the case of Europe, European countries had to rebuild their nations from scratch after World War II. The fear of communism and the Cold War also acted as glue. Moreover, the region had a very high geopolitical value for the U.S and received all its support. In the case of the Western Hemisphere, Latin American countries will seek trade arrangements with the U.S., but their motivations will be driven largely by fears about the impact of the preferential treatment currently given to Mexican products, and over potential future increases in U.S barriers. The most feasible alternative would be a model based on a strong intergovernmental structure combined with small supranational institutions.<sup>[78]</sup>

#### Lesson Thirteen: Is NAFTA the right model for hemispheric integration?

NAFTA opponents contend that Free trade competition allows a race to the bottom. The EU illustrates that trade should also support social goals. It includes a social protocol and the channeling of resources into the poorer nations to facilitate adjustment and accelerate the convergence process. Free trade per se cannot accomplish this (at least in the short term). Needed: protection for small farmers as well as water and the environment, limits to financial speculation, debt cancellation, measures to protect workers and the environment, and measures to address increasing inequalities. Like in the EU, closing the social gap between the two countries would be accelerated under a social program funded by the richer partners.

#### Lesson Fourteen: Migration patterns can be reversed

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<sup>75</sup> Salazar-Xirinaches and Lizano 1992, p. 91

<sup>76</sup> Whalley 1992, p.139

<sup>77</sup> See Bulmer-Thomas 2001.

The Iberian integration in the EU illustrates that patterns of migration can be reversed. Both Spain and Portugal were made to wait for accession in the 1980s, partly over immigration fears that did never materialize. Hence, the accession treaties established a transition period of 7 years. However, fears of uncontrolled migration were not substantiated after 1986, (or even after the 7 years transition period). On the contrary, as a consequence of improved economic conditions in Iberia, one of the key results of EU accession has been that by 1995 there were 100,000 fewer Spaniards and 110,000 Portuguese living in other EU member states than before enlargement. Furthermore, the reverse process took place when thousands of Europeans (particularly from Germany and Britain) migrated to Spain.

## CONCLUSION

In this paper, we have analyzed the main political and economic factors that motivated the accession to the European Community and NAFTA. We have showed that political considerations were the main motivation behind Portugal and Spain's application to join the European Community, while economic ones led Mexico. The wish of the Iberian countries to strengthen the new democratic regimes, coupled with their desire to put an end to the relative isolation that they had suffered during the authoritarian years, were critical factors behind their desire to join the European Community. The economic implications of European integration were also very profound, however, and played an important role in Spain and Portugal's application for membership. For all three countries the asymmetry of trade barriers before integration indicated a strong possibility of trade creation. This asymmetry was translated into adjustment problems for many Iberian and Mexican manufacturing and agricultural companies that were not ready for competition. Particularly for Portugal and Spain, the advantages and benefits that have accrued from EU membership have offset the disadvantages

1. Regional integration has contributed to the termination of secular isolationism of the Iberian countries, which had been one of the roots of these countries' economic, cultural, and social backwardness.
2. Integration has allowed them to confront the international economic recessions of the 1980s-90s from a stronger position. Without EU/NAFTA integration these countries would have never attracted as much investment as they did after 1986 (Portugal and Spain) and 1994 (Mexico), and there was the real possibility, given the intensity of the economic crises, that they would have fallen into third-world economic levels.
3. Portugal and Spain have taken part in the process of European integration and Mexico in the process of regional integration of the Americas. They have become significant players and have been able to influence important decisions.
4. The EU/NAFTA framework has better prepared Spain, Portugal, and Mexico to compete in the global market against colossi such as Japan and the United States.
5. Spain and Portugal had traditionally been countries of emigrants. In 1986 there were more than 600,000 Spanish emigrants throughout Europe. EU membership has contributed to better economic performance, which has provided better opportunities for Iberian citizens, and this helped to reverse this historical pattern. In addition, EC/EU membership has made Spanish and Portuguese

citizens European citizens, thus ending some of the discrimination that those emigrants had suffered in the past. This can be an important lesson for Mexico.

6. Membership has given the Mexican, Spanish and Portuguese agricultural and industrial products, and services access to the North American and European markets respectively.
7. EU/NAFTA membership has forced Spain, Portugal, and Spain to speed up the reform of their productive and economic structures in order to increase the productivity of their labour force.
8. EU accession helped consolidate new democratic institutions and NAFTA contributed to the democratization of Mexico.
9. Finally, EU membership has increased economic growth, thus improving the standard of living of the Iberian and Mexican people. As we have seen, after Portugal and Spain joined the Community and Mexico NAFTA GDP rose faster, investment soared, unemployment decreased, inflation was kept under control, and the deficit in the current accounts' balance was sharply reduced (an helved in the case of Mexico). The Iberian and Mexican governments' actions to liberalize their economies and open their countries to the European Union/NAFTA contributed to this remarkable turnaround. As expected, much of the expansion was financed from abroad. The flow of foreign direct investment into Spain doubled over the first two years of membership and reached \$80 billion in the period 1986–91.<sup>79</sup> Between 1970 and 1998 foreign investment in Spain grew from 1 percent of GDP to more than 6 percent. In Mexico, FDI has averaged over \$13 billion since 1994.

No matter how impressive these results might seem, Mexico, Spain and Portugal still have a long way to go to reach the average wealth of their richer partners. The Iberian countries have benefited far more than Mexico from their membership because of the cohesion policies and the immigration benefits of the EU. The path toward 'convergence' has been (and will be in the foreseeable future) long and winding. Over the last two decades, Iberian and Mexican governments have been forced to reform their pension and welfare systems, namely, by freezing health spending, cutting subsidies, and setting restrictions on the entitlement to unemployment pay. They also have had to privatize most public companies to more efficiently enforce the laws to stop unemployment fraud—which is still rampant—and to cut excessive bureaucracy. All of these measures led to social problems because the unions did not accept these reforms easily. Some of these processes remain unfinished.

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<sup>79</sup> "After the Fiesta," in *The Economist*, April 25th-May 1st, 1992, p. 3; and Hine 1989, p. 23.

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