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## ■ AQ FEATURE

# NAFTA @20: Where We Go From Here

BY [Ernesto Zedillo Ponce de León](#)

**The North American Free Trade Agreement created more jobs for Mexicans, but it was only a start.**

[Read NAFTA @20: The Perils of Partisanship by Thomas F. McLarty III here.](#)

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Has the North American Free Trade Agreement (NAFTA) fulfilled its promise? I believe it has.

NAFTA was conceived first and foremost as an instrument to promote trade and investment integration among Mexico, Canada and the United States—on the premise that integration would enhance growth, employment and competitiveness in the three countries.

On that front, NAFTA certainly has led to more intense and closer integration. Annual trade among the three partners has increased fourfold, and intraregional investment almost fivefold since NAFTA came into effect in 1994. The NAFTA countries trade within the region more than with the rest of the world; in fact, their exports to Asia and to Europe are, respectively, one-half and one-third of their total intraregional exports. The goods traded within NAFTA are more value-added than those traded with any other countries. For example, 40 percent of U.S. imports from Mexico consist of goods that were partly assembled or produced in the U.S., employing U.S. workers. In contrast, U.S. imports from China have only 4 percent U.S. content.



Then-President Bill Clinton welcomes then-President Ernesto Zedillo to the White House in October 1995. Photo: Dennis Cook/AP

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Of course, determining unequivocally whether NAFTA has meant more growth and jobs to all three member economies is, technically, a harder question to answer. The generation of economic opportunities is influenced by many factors, not just international trade and investment. Fortunately, in the case of Mexico, there have been serious attempts to measure the impact of NAFTA once the influence of all the other pertinent variables is properly taken into account—or controlled for, in statistical jargon. All of the serious analyses I have seen indicate that NAFTA has meant for my country more growth, more jobs—and better paid ones—than otherwise would have happened.

As for the other partners, at the very least, the “giant sucking sound” of American jobs flowing to Mexico was never heard. Of course, nothing like this was ever feared, nor happened, in the case of Canada. On

balance, NAFTA has been good for the U.S. and Canada.

## Addressing the Critics

Despite the evidence, NAFTA continues to have its detractors. There are, of course, those who dislike globalization no matter what and, consequently, anything that embraces the concept. And there are those who disavow NAFTA on the grounds that it has failed to deliver on its promise. But the promise they have in mind is one that was never put forward by its original promoters: that NAFTA would solve every one of Mexico's challenges.

The more sophisticated detractors point to the unquestionable fact that Mexico has failed to close the gap between its GDP per capita and that of its NAFTA partners. They argue that, in reality, that gap has slightly widened; that productivity growth continues to be disappointing; that poverty is still pervasive; and that income distribution worsened after the introduction of NAFTA and has only started to improve in recent years.

The response is simple. NAFTA was never supposed to be the magic wand or the silver bullet to accelerate Mexico's development. It was clear from the outset that opening the economy to trade and foreign investment was one instrument among many reforms that were needed in the pursuit of faster and more equitable economic growth.

## Deepening the Opportunity of NAFTA

Unarguably, my country has made enormous progress in making the reforms necessary to take advantage of the free trade union. But it is also true that the pace of reform slowed down significantly in the 15 years prior to 2013, and more remains to be done to really seize the opportunity presented by NAFTA.

The successive political reforms that culminated in the creation of an independent and fair electoral system in 1996 have given Mexico a vibrant, highly competitive, multiparty democracy. However, and perhaps as an inescapable consequence of the country's political diversity, our democracy has delivered a divided government since the federal congressional elections of 1997. It has taken time for our political plurality to mature to the point where our parties can establish the consensus around the additional reforms that are indispensable to achieving faster growth and to improving social policies.

Fortunately that point of political maturity seems to be arriving at last. The current Mexican Congress, where still no single party has control of either chamber, has been able to establish multipartisan majorities to approve important reforms, including not only those requiring changes in the laws but also constitutional amendments. This has also included significant reforms in traditionally sensitive areas such as labor relations, telecommunications, breaking up monopolies, regulating the financial system and improving education. Remarkably, the Mexican Congress has also approved a truly transformative reform of the hydrocarbons and energy sectors.

Most of these reforms have been initiated under the framework provided by the *Pacto por México* (Pact for Mexico) embraced by the three major political parties (PAN, PRD and the governing PRI) and President Enrique Peña Nieto.

For the *Pacto* to be meaningful to the well-being of the Mexican population, it is essential that the reforms already passed by the Mexican Congress be effectively executed. It is also essential that the momentum for reform not flag. Much more must be done to meet the conditions that are necessary to put the Mexican economy on a path to faster growth, well beyond what we are experiencing today. This challenge has been

magnified, not reduced, by the recent evolution and prospects of the global economy.

## **Where We Go Now**

Although the worst of the 2008–2009 global economic crisis seems to have passed, it is reasonable to expect that in the coming years both the rich countries and the most dynamic emerging economies will grow at a slower pace than they did in the decade prior to the crisis. And eventually—likely sooner rather than later—conditions in international capital markets will tighten up for countries like Mexico.

It would be a serious mistake to bet on a global economy buoyant enough to compensate for the structural deficiencies that the Mexican economy still has. To continue its growth and broaden its benefits, Mexico needs a higher rate of investment. Given the volatility of external capital flows, the only way it can ensure this is through higher domestic savings. Expanding national savings will require further changes in the areas of taxation, pensions and financial institutions.

For higher growth, not only must the stock of human capital be expanded, but also its quality. Achieving this objective requires a rigorous implementation of the educational reform already enacted into law. But the reform only addresses basic education up to ninth grade. In the preparatory, technical and higher levels of education, there remain serious gaps in quality and access, demanding urgent and comprehensive reform.

A larger investment in the physical and human capital of the country must be complemented with policies that increase productivity. Greater competition and flexibility in the domestic markets for goods and services will dramatically improve labor productivity and competitiveness.

Very important: the policy-induced distortions that continue to foster the informal sector of the Mexican economy need to be corrected once and for all. Sixty percent of the country's labor force works in the informal sector, with all the severe limits on productivity that implies.

But if we are to shift employment from the informal sector to the more productive and socially rewarding activities of the formal sector, we need to ease investment in formal enterprises and reduce incentives for employment in the informal sector. As long as employment in the formal sector is heavily taxed and employment in the informal sector is significantly subsidized (through not paying taxes), there remains a gap in the cost of labor between the two sectors—by some estimates up to 30 percent. Addressing this will require additional taxes and social security and labor reforms to nudge employment and enterprise from the informal sector to the formal sector. But doing so requires implementing all these changes in a simultaneous and coherent way.

By far, however, strengthening the rule of law is the most important reform to accelerate Mexico's development. Unfortunately, this has proved to be the greatest challenge. All the Mexican institutions that work on and defend this critical area consistently fail to guarantee to all citizens true equality before the law or to effectively protect their personal security and patrimony. Nor do these institutions enforce another component of the rule of law: citizen obligations before the law.

The three branches of the federal government and Mexican civil society and all political forces, along with state and municipal governments, must embark in an unprecedented intellectual, economic, social, and political effort to make Mexico a country where justice is the rule and not the exception. Postponing this crucial endeavor will undermine all the other indispensable steps that have been taken in the pursuit of our nation's prosperity and social justice.

But if that were to happen, please don't blame NAFTA!

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