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THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) THREE YEARS AFTER IMPLEMENTATION *

* This document was prepared by Patricia Rich, an officer of the International Trade Unit of the International Trade, Finance and Transport Division. The views expressed herein are those of the author and do not necessarily coincide with those of the Organization.

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Abstract

The North American Free Trade Agreement (NAFTA) has aroused the interest of governments, academics, business people and the public around the world. It has also sparked controversy and debate about its expected future benefits. Evaluations carried out by non-governmental bodies are both critical and favourable, while the official verdict tends in general to be favourable. The results produced by the Agreement to date were one of the major arguments against renewing "fast track" provisions when these were put to the vote in the United States Congress in November last year. For Latin America, the Agreement is of particular interest because it includes a country in the region, one that is also involved in the creation of the Free Trade Area of the Americas (FTAA).

Three years after the Agreement was first implemented, specialists in the subject agree that the benefits promised during the campaign to secure its approval were somewhat exaggerated. Its effects on the economy of the United States, which is much bigger than the Mexican economy, would prove to be modest, besides which the two economies were already integrated to a substantial degree before the Agreement came into effect. As regards Mexico, the political and economic difficulties that this country had to cope with at exactly the same time as the Agreement came into effect cancelled out any immediate gains. The effects of this crisis also led to some scepticism, particularly in the United States, about the benefits attaching to integration. The question now being raised is rather what would have happened during these three years had NAFTA not existed. Finally, it needs to be borne in mind that a great many of the tariffs due to be abolished are still in place, which implies that the process is a long-term one.

The most striking thing about the Agreement is the dynamism it has generated and the gradual relocation of production activities towards the frontier zone that has taken place. Right from the beginning we have seen increases both in the number of assembly plants and in employment in this zone. At the same time, there have been substantial increases in foreign direct investment, especially in the case of investment from the Asian countries, and it is partly thanks to this that, among developing countries, Mexico is second only to China as a recipient of such investment.

The trade figures for the last three years do not clearly identify which country is the exporter or importer of a given product, due to factors related to assembly plant production and the role of transnationals. The Agreement introduced greater transparency and reduced investment risk, thereby encouraging a larger number of United States firms to produce in Mexico for the local market and for export. Trade has increased in the automobile and textile and clothing sectors, the destination market for exports being the United States. In clothing, Mexico has succeeded in outstripping China in growth rates, although this does not mean that the country has a guaranteed market, as in some cases the products of Central American countries have been preferred to Mexican ones even since the Agreement was implemented, despite the fact that the

Central American countries do not enjoy the kind of preferential tariffs that are provided for by NAFTA. In the final analysis, quality control, design, price and good management are factors of more critical importance than trade agreements alone in determining whether producers can maintain and increase their access to markets.

INTRODUCTION

Few recent issues have attracted so much public attention as the North American Free Trade Agreement (NAFTA). In Canada, as in the United States and Mexico, practically a majority of people have heard of it and a great many approve of it and regard it as beneficial for their economies. Furthermore, it is novel, because this is the first time the economies of two industrialized countries have been integrated with that of a developing country. For the member countries, it also entails a commitment to meeting some rigorous requirements.

This agreement, which was signed on 17 December 1992 and came into effect on 1 January 1994, is a strategic response to the globalization of production, the challenges posed by the European Single Market, and the formation of free trade areas in the Pacific Basin, among other things. For the three countries, it opens up the long-term prospect of improved market access and investment opportunities, and it is contributing to greater cooperation between companies and to improved information flows. These are vital factors, since free trade has become one of the most important parameters for evaluating the effectiveness of the different governments in managing the economy.

Given the international political structure now existing, with there being only one competitor, the main challenge for developing countries is to find a way of influencing the agenda in respect of the new global issues, since whoever sets the agenda also sets the terms of negotiation to a great degree. Latin America needs to participate and to make its views heard when these agreements are being formulated. The countries of the region need to focus their efforts on an in-depth examination of the contents of these and the repercussions they will have for their economies, in order to maximize the benefits and minimize the costs of this process, since we live in a world where, for the time being, regionalism is a fact. This was one of the main reasons why Mexico elected to sign up to an agreement of this nature with its northern neighbours.

This type of agreement, which is regarded as a "new generation" agreement since it covers a wider field than trade in goods alone, has provided an essential point of reference for the agreements subsequently signed up to by Mexico with the Group of Three, and by Chile in its own bilateral agreements. It also fits into the pattern of new schemes for international rapprochement, such as FTAA.

The existing literature includes attempts to evaluate the effects of the Agreement, and the widely differing conclusions that have been reached about its real benefits have given rise to debate and controversy. This is because any attempt to produce a conclusive analysis or schematic interpretation of an Agreement of this kind is at present premature, for a number of reasons:

1) The agreement has only been in operation for three years; 2) the Canadian and United States economies were already highly integrated, and so too to a lesser extent was the Mexican economy, which dilutes the effects of NAFTA; 3) the Mexican peso crisis, although it cannot be

ascribed to the Agreement, indirectly obscured the effects that this might have had if no crisis of such magnitude had occurred; and 4) a great many of the tariff reductions have yet to be implemented, which means that the repercussions of the agreement on the economies of these countries have not yet made themselves fully felt.

Bearing these observations and limitations in mind, what has to be asked is whether any study on NAFTA can be worthwhile, given all the impediments that currently exist. Perhaps the best thing might be to carry out a strictly retrospective study, confining ourselves to examining the results that we are acquainted with, such as the degree of tariff reduction that has been achieved to date and the effects of this, and the way complaints submitted to the mechanism for resolving disputes have been dealt with, and to indicating which products the rules of origin have been applied to.

There is an alternative approach that can contribute to the debate on this issue in the region, and this is to examine where NAFTA appears to be heading. What changes are taking place in a globalized world in which intra-company activities are making it harder to interpret trade flows? Will NAFTA be enough to meet the needs of Mexico? What guarantees does entry into an agreement of this type provide in relation to protectionist practices? The second approach has been opted for in this document, which draws on the opinions of experts in the subject, trade figures, sectoral studies and the author's own well-documented analysis. This examination sets out from a knowledge of the current trade and integration policy of the United States and, for greater regional interest, concentrates on the Mexican point of view. A novel aspect of this document is that it does not contain any hard and fast answers or absolute certainties about the results of the Agreement; but then, where NAFTA is concerned, such certainties are nowhere to be found.

With this end in view, the document is divided into five parts:

The <u>first part</u> examines the main provisions of the Agreement as a starting point for further analysis later in the document, tying them in with specific cases of current relevance. The mechanism for resolving disputes, the most novel aspect of the Agreement and one that has been adopted in other bilateral accords, is analyzed in relation to its performance right from the beginning, with particular attention begin paid to Mexico as the most recent member. Canada and the United States already used a mechanism of this type before signing NAFTA.

The <u>second part</u> analyses the expectations and objectives of the Agreement, paying special attention to the Mexican standpoint in view of that country's political and historical background in relation to the United States, and the fact that it is a Latin American country. Existing publications, whether produced by governments, academics or international bodies, do not deal with the case of Canada, as this has been thoroughly analyzed in relation to the pre-NAFTA Free Trade Agreement between Canada and the United States. The new factor is the entry of Mexico, since in a way this represents an extension of that same Agreement. The trade policy of the United States and its reasons for entering into an integration arrangement of this type are subjects that have been thoroughly studied in another document produced by the Economic Commission for Latin America and the Caribbean (ECLAC), and will therefore be alluded to only in relation to the Agreement.

The third part covers the peso crisis, which is examined in terms of the conduct of Mexico in matters of trade by comparison with earlier crises, such as those of 1976 and 1982, by contrast with 1995 when the Agreement was in force. It is not the intention to analyze this crisis in depth in this document, since a great deal has been written about the subject that bears no relation to the Agreement and deals with a domestic aspect of the Mexican economy.

The fourth part deals with the zone adjoining the border between the United States and Mexico, which is where the most dynamic effects of the Agreement have hitherto been seen. Existing benefits, risks and costs are examined, with a view to carrying out a more thorough field study on this important and growing zone, whose dynamism can be attributed directly to the Agreement.

The fifth part examines two sectors, automobiles and textiles, with the objective of obtaining an additional tool to enable analytical work to be undertaken more effectively. It would be advisable to carry out further sectoral studies on this issue in future. This document concludes with a synthesis of the most important points of the Agreement, remarks on the role of transnationals and the production practices of the assembly industry in relation to the current significance of trade figures, and comments on the way in which NAFTA influences the decision-making processes of businesses when they make plans for production and investment in these sectors.

I. MAIN PROVISIONS AND THE WAY THEY OPERATE

The Agreement embraces the largest free trade area in the world, currently with a population of around 387 million people and output of more than 8 trillion dollars' worth of goods and services each year. NAFTA not only provides for the removal of barriers to trade, such as tariffs and quotas, but also covers other aspects, among them being services and the protection of intellectual property rights. Again, legislative and institutional changes will be required if it is to be applied more fully, and its consequences for the political and cultural spheres will be, and in some cases already have been, substantial. It addresses less traditional matters, such as the environment, labour regulations and human rights issues, and it includes a clause covering membership by other countries.

Table 1
ECONOMIC INDICATORS, 1996

Variable	Mexico	Canada	United States
Land area (thousands of Km^2)	1,973.0	9,976.0	9,373.0
Population (millions of inhabitants)	91.3	31	264
GDP per head	2,862	18,374	28,020.2

Source: ECLAC, on the basis of information provided by the Bank of Mexico, the Ministry of Finance and Public Credit, the National Institute of Statistics, Geography and Informatics (INEGI), and Statistics Canada and Canadian Outlook, various issues.

Among the most important provisions that will now be examined are: a) the removal of tariffs, with some exceptions; b) rules of origin; c) safeguard measures and d) a sophisticated mechanism for resolving disputes. Since this is not a customs union, there is no common external tariff.

A. REMOVAL OF TARIFFS

Generally speaking, the tariff reduction programme of NAFTA is compatible with the terms of the General Agreement on Tariffs and Trade (GATT). These reductions apply to most trade, although there are restrictions, with special transition periods for agriculture, textiles and the automobile industry. There is no new protection against third countries and a large part of the programme will be implemented within 10 years, the period being extended to 15 years for certain categories. A timetable for the removal of tariffs was laid down on the basis of the tariffs applying in July 1991, the objective being to arrive at tariff-free trade between the three countries by the end of the transition period, in 2010. The pace of tariff reduction is more gradual in the case of Mexico, given its lower level of development.

Table 2
INSTITUTIONAL CHARACTERISTICS OF THE FREE TRADE AGREEMENT

Trade agreement	Timetable for removal of tariffs	List of exceptions	Common external tariff	Rules of origin	Safeguards	Mechanisms for resolving disputes
NAFTA 1 January, 1994	Zero tariff 4 groups -immediate -5 years 10 years -15 years	-Automobile ind. -agriculture -energy -textile and clothing -petrochemical industry	Not applicable	Tariff jump and value added rule (50% or 60% regional content)	Bilateral safeguards (With global safeguards and compensation)	-Consultation -trade commission -arbitral panel

Source: ECLAC, on the basis of the North American Free Trade Agreement.

Examination of the most important aspects of the tariff removal process provided for by the Agreement gives rise to the following observations:

1. Since the Mexican economy was more closed than the United States economy before the agreement was signed, the tariff concessions granted by Mexico were greater than those offered by the United States, and the same is true of the abolition of quotas, permits, and other barriers to imports. Before the signing of NAFTA, the average tariff applied in Mexico to products originating from the United States was 10%, whereas in the United states the average was 2.1%, and half of all imports already entered the country free of tariffs under the Generalized System of Preferences (GSP). Mexico reduced its tariffs by 7.1%, as against 1.4% in the case of the United States; i.e., Mexico lowered its tariffs by approximately 5 times more than the United States did. The same could occur in the case of other Latin American countries wishing to join the Agreement.

2. As the process of tariff reduction has been carried forward, Mexico has been imposing more severe tariffs and quotas on third countries in a number of categories, as part of the adjustment measures adopted to cope with the 1995 economic crisis. These increases have not applied to the NAFTA member countries, which means that the margin of preference for the North American market has widened still further.

3. In the agricultural sector, the time limits for tariff removal have been more extended. Instead of a tripartite agreement, three bilateral agreements were signed in which the interests of the three countries were taken into account. In particular, for especially sensitive products such as maize and kidney beans in the case of Mexico and orange juice and sugar in the case of the United States, tariffs are to be maintained for a period of 10-15 years. The same thing could happen if other countries in the region join the agreement, with Canada and the United States continuing to apply the rules laid down in the bilateral agreement signed previously.

4. As regards domestic subsidies or support programmes, Mexico was not considered to be a developing country and consequently had to discontinue these programmes, although under GATT/WTO these are regarded as valid for these countries. Again, it was agreed that regulations providing for sanitary and phytosanitary measures would not be used to impede access for Mexican products, this being the most important achievement of Mexico in the negotiations.1/

B. RULES OF ORIGIN

As non-tariff barriers have increased in international trade, rules of origin have come to take on greater importance, and these are now an essential component of preferential agreements. Rules of origin in NAFTA are complex, the most vital factor being the production process. They are among the most restrictive in the region, as they limit the use of inputs from countries that belong to the agreement. This is due to the method chosen for deciding the level of national content, value added or degree of processing required for a product to receive the treatment provided for by NAFTA.2/

The NAFTA rules of origin have been a cause of irritation and concern for third countries, since one effect of them can be that trade and investment are diverted away from more competitive countries. The more restrictive the rules of origin, the higher production costs will be. Consequently, these rules need to be interpreted in the least complex and most transparent way possible, and the number of criteria involved in determining origin needs to be low. These rules as applied in NAFTA may be divided into four categories. They are of particular importance in the automobile and textile and clothing industries.

1/ For an interesting appraisal of this issue, see Corder (1996).

2/ There are two types of rules of origin currently used in the region: the NAFTA rules, and the rules applying to trade among the Group of Three and between Mexico and Costa Rica. Under the NAFTA rules, two or three basic qualification criteria need to be met: changes in tariff classification, regional content, and technical requirements. Generally speaking, the rules of the Latin American Free Trade Association (LAIA), and to a lesser extent those of the Southern Common Market (MERCOSUR), are based on the tariff classification criterion only. See Silver (1996, p.54).

Table 3
MAIN RULES OF ORIGIN LAID DOWN IN THE FREE TRADE AGREEMENT

Categories of goods
1. Goods produced in one of the member countries that contain natural resources like minerals and agricultural products.
2. The tariff classification of inputs used in the production process that do not originate from member countries must be changed, and this must have taken place in one of the member countries.
3. Products whose regional value added must represent a minimum of 50-60%; in the case of the automobile sector, this content must be 62.5%.
4. Textiles, for which double production processing is required; garments, for which triple production processing is required; all this must be carried out in member countries.

Source: ECLAC, on the basis of the North American Free Trade Agreement.

C. ANTIDUMPING AND SAFEGUARD MEASURES

When bilateral and multilateral market expansion agreements are negotiated, efforts are made to protect the domestic market against countries that are considered to follow "unfair trade" practices. This situation is corrected by using trade laws covering a number of areas, among them being antidumping provisions and safeguard clauses.

Recently, the measures most used to restrict exports in trade have been antidumping provisions. These have become an important instrument of United States trade policy, and it is unlikely that this situation will change given the current political climate.3/ In relation to antidumping measures, the following observations may be made:

1. Trade should not be subject to any kind of antidumping legislation. Rather, progress should be made towards resolving discrepancies on the basis of the Uruguay Round results, since it is very unlikely that countries acting individually because of domestic pressures will be impartial.

2. It would be best to do away with all antidumping measures and replace them with normal anti-monopoly laws.4/

3/ For a more thorough discussion of this issue, see Rich (1997a, pp.94-97).

4/ In relation to trade correction measures and solutions, see Destler (1995, pp.240-244) and Finger (1987, pp.144-150).

3. When considering the possible entry of Chile into NAFTA, it must be borne in mind that this agreement, like the previous one between the United States and Canada, contains provision for laws relating to dumping and safeguard clauses to be applied to another member country. Thus, joining NAFTA would not help to discourage the future use of antidumping measures against Chile (Rich, 1997b).

4. The most recent antidumping case to capture political and public attention in Chile was submitted by the organization Fair Atlantic Salmon Trade (FAST) of the United States against Chilean salmon, on 12 June 1997. This group maintains that the United States industry is being seriously affected by dumping practices. Furthermore, they claim that this industry is heavily subsidized in Chile, and that it is this that enables Chilean salmon to be sold in the United States market at an average price that is 40% lower than the sales price of the domestic product. These accusations have produced the most serious trade conflict between the two countries since 1989, when the entry of Chilean grapes into the United States was suspended. At present, there is concern in the United States over increasing market penetration by Chilean wood, and also wine.

Safeguard clauses are less popular, since they lapse after a specified period of time and it is more difficult to renew them. Two types of safeguard measures are provided for in NAFTA: temporary bilateral measures, and global measures. The former can be used during the period of transition and are applied when imports from another member country increase; the latter are applied when there is an increase in imports from the rest of the world. In this case the GATT/WTO rules apply, whereas in the other differences are settled using the mechanism for resolving disputes provided for in section XIX of NAFTA. The same procedure applies in respect of antidumping measures.

D. MECHANISM FOR RESOLVING DISPUTES

The mechanism for resolving disputes basically covers three aspects: a) general issues; b) investments and c) safeguard measures and cases where antidumping duties are used. Hitherto, the greatest activity in relation to the provisions of chapter XIX of NAFTA has centred around aspects relating to the application of safeguard and antidumping measures. Section XX contains provisions for ensuring that the Agreement works properly, and also covers political issues, so that the importance of the mechanism will increase as NAFTA matures.5/

Between January 1994 and May 1997, 26 cases were presented by countries or groups of countries under section XIX, of which three were submitted by organizations from the United States, seven by Canadian bodies, and seven by Mexican ones. So far, eight politically sensitive cases have been submitted under chapter XX, and in relation to some of these consultations were

5/ Drawing on comments made by the dispute resolution expert James R. Holbein, United States Secretary at the NAFTA Secretariat, United States Department of Commerce, in conversations with the author.

carried out to resolve discrepancies with the so-called Helms-Burton Law, the provisions applying to Mexican trucks and the imposition of import quotas on tomatoes originating from Mexico.

The Secretariat of NAFTA was set up alongside this mechanism to give support to the Panel of experts when a complaint is submitted. Before NAFTA existed, there was a Binational Secretariat with offices in Washington and Ottawa, the participants being the United States and Canada; with the arrival of Mexico, the number of offices was increased to three, the third being opened in Mexico City. Those staffing these offices work as a team, visiting and consulting with one another frequently in order to provide advice to those firms that wish to take advantage of the Agreement.

Now that three years have passed since the Agreement was implemented, some consider that the mechanism for resolving disputes has worked well, while others believe that the process has become politicized. What does seem to be the case is that the participants have had to learn on the job. The results achieved have been substantial enough to ensure that the Agreement has been able to continue operating without any real upsets. This does not mean that there have not been difficulties in relation to some of the negotiating methods used by the member countries, as these are the result of past practice and of cultural peculiarities in each country. Nonetheless, as their economies become more integrated, these differences will tend to disappear. The really important thing to note is that although at the outset there was concern that the Mexicans could be at a disadvantage because they did not have the same amount of experience as the other countries –and this was undoubtedly the case at the beginning– they have adapted quickly and successfully to the negotiating process.

Table 4
MECHANISM FOR RESOLVING DISPUTES

Section	Purpose	Composition of the panel	Time limits	Right of appeal	Compliance
XIX	The mechanism operates with the objective of determining whether there has been dumping, subsidization or prejudice in relation to a country's exports to the detriment of the importing country. The Panel examines whether or not this decision is in accordance with antidumping or safeguard laws applying in the importing country.	The panel is made up of five experts, who must be nationals of the countries of the accused and affected parties. Each party appoints two experts from out of 25 panelists in each member country, most of whom must be magistrates. Once four experts have been chosen, the fifth is designated by mutual agreement.	The ruling of the Panel must be issued within 315 days from the start of the proceedings, and no extensions are allowed.	The procedure for cases to determine whether the provisions of the agreement have been properly complied with is the same as would apply in a local court. Once a decision has been taken, there is no right of appeal.	The liable party must compensate the injured party. Nonetheless, if the ruling is considered inadequate, proof being required for this, an "extraordinary" Committee of three judges is set up to arrive at a final ruling.
XX	All types of complaint are resolved by consultations between experts from the affected parties. If no solution is reached, the case is taken to the Free Trade Committee. If it is not resolved here, a Panel is convened immediately.	The Panel consists of two experts representing the accused party and two representing the affected party. The fifth is selected by mutual agreement. They do not have to be citizens of a NAFTA country, and most of them must be magistrates.	The final ruling must be issued within a maximum of 150 days from the time the Panel is convened, or 220 days from when the complaint was initiated.	None.	The recommendation must be complied with, failing which the injured party may suspend benefits for an amount equivalent to the amount of the damage.

Source: Collen S. Morton (ed.), Outlook for Free Trade in the Americas. Report on the Hemispheric Policy Forum, Washington D.C., February 1996, p. 70.

II. EXPECTATIONS AND OBJECTIVES OF NAFTA

A. CONCEPTUAL BACKGROUND

NAFTA was created for a variety of purposes. For the United States, the inclusion of Mexico meant better prospects in an export market that was already growing. There was also a foreign policy dimension: the agreement was a method of ensuring that the democratic and economic reforms undertaken by Mexico would be irreversible. The stability of its southern neighbour is of strategic importance for the United States, considering that Mexican emigration to that country has been growing in importance as a political issue. Indeed, this factor weighed heavily in favour of NAFTA ratification in the United States.

For Canada, it meant an improved degree of preferential access to the Mexican market in key sectors such as financial services, automobiles and government procurement. Again, it would secure access to the rest of Latin America by providing Canada with the means to strengthen trade and investment, and would serve to counteract the predominance of the United States as the most vigorous economy in the hemisphere. While the United States ponders whether membership of NAFTA should be extended to other Latin American countries, Canada has already signed a bilateral agreement with Chile and begun consultations about a commercial agreement with Mercosur.

For Mexico, there were a number of reasons for signing up to an agreement of this nature, among them:

1. A strong sense of its vulnerability in terms of trade with the United States, given how much of its trade is with that country. Becoming a signatory to an Agreement of this type was a way of dealing with this vulnerability by basing the relationship on clear rules that could be established by agreement, rather than imposed (SECOFI, 1997, pp. 18-19 and p. 151; García and Hernández, 1994). Thus, Mexico would be a participant and not just an observer.

2. The United States is Mexico's geographical neighbour, and the two countries share a long border. Since the United States is also the world's largest market, it made sense to take advantage of the opportunities offered by it, particularly given the difficulties Mexico has had in diversifying its exports over the past decades.

3. A stronger Mexican economy would also help to forestall potential emigration by increasing employment and strengthening social order and political stability (Vega, 1994).

4. Since the middle of the 1970s, the countries of South-East Asia have dominated the sectors that might naturally be expected to offer the best potential for increased exports from Mexico, such as textiles and clothing, and shoes (SECOFI, Industrial Policy and External Trade Programme, 1997, pp.16-18). As a late entrant, Mexico needed to conclude a further-reaching integration agreement, like NAFTA.

5. Mexican competitiveness would improve, since the fact that all sectors have been opened up for trade means that the incentives are the same for all branches of the economy. It should be noted that these arguments formed part of the strategy employed by the United States government to increase exports while the process of obtaining support for ratification of the Agreement in that country was underway.6/

B. INSTITUTIONAL BACKGROUND

The Mexican market began to open up unilaterally and to seek foreign direct investment long before the Agreement was signed, and the high degree of social and economic linkage between Mexico and the United States that has resulted likewise long predates the Agreement. By opening up to the outside, the country found itself obliged to transform certain of the ways in which industry and the economy in general operated, from the simplest to the most complex aspects. In this respect, the Agreement was the culmination of a process of economic reform that began in 1985, when Mexico entered GATT.

At present, too, Mexico is undergoing a great many changes, since the collective process of reflection on the economic and political situation of the country that began with the debate about the Agreement is still continuing. The consultation process that was initiated at that time to canvass views on whether NAFTA entry was right for the country was massive in scale, multi-faceted, and representative of all sectors of society, involving the participation of industry, companies and labour and professional organizations. This process of political liberalization has continued, as was demonstrated in the legislative elections held on 6 July 1997, which were among the most open and transparent in recent Mexican history. At the same time, there is concern that the peso crisis, political problems and recent difficulties with the certification process relating to drug trafficking have affected the country's commercial and political relationship with the United States. Consequently, the priority at present is to consolidate and safeguard the Agreement.

In the United States, not only was the debate on NAFTA that took place before ratification one of the most hotly contested in the country's history, but this debate is still open. The degree of controversy is still so great that it could be more feasible for Chile now to sign

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6/ In the sense that it is beneficial for the United States to integrate with Mexico and the other countries of Latin America because it is with these countries, among the emerging economies, that the United States has a trade surplus, in contrast to its trade position with the countries of South-East Asia.

a bilateral agreement with the United States than to secure support in Congress for entry into NAFTA. The report submitted by the Executive to Congress on 11 July 1997, which scrutinized the performance of the Agreement, did not contain any great surprises, in that it showed that the Agreement has been beneficial for the United States and for exports and that, had it not existed, the crisis would have lasted longer and affected United States exports more severely. Nonetheless, this report by and large was not very enthusiastic.

In the meantime, groups opposed to the agreement in the United States became active again, presenting Congress with their own negative interpretation of the way NAFTA has operated. According to information provided by the Federation of Labor, since NAFTA came into effect more than 420,000 people have lost their jobs, and both real wages and benefits have deteriorated for those in work.7/ Many of these views were shared by Richard Gephardt, the leader of the Democratic minority in the House of Representatives and an aspiring presidential candidate, who affirms that many North American companies are taking advantage of the opportunity to relocate to Mexico as a way of holding down wages in the United States.

This argument has been making headway, despite the fact that the economy is healthy, unemployment is at very low levels with labour shortages in many areas, the inflation rate is low, the level of consumer confidence is very high, trade between the two countries picked up in 1996 and the loss of jobs is attributable mainly to the restructuring process going on in the domestic economy, which is driven by technological change, and to the globalization of production.8/ The United States public has also shown a degree of scepticism about trade agreements. According to a survey carried out by the Bank of Boston in November 1996, one in every two people in the United States is convinced that free trade agreements do more to increase imports than to stimulate exports.

This scepticism was clearly apparent when the Executive put the bill for renewal of fast track authority to the vote in Congress, then had to withdraw it because they were unable to secure the majority needed to approve it. On this occasion, NAFTA had a direct bearing on the renewal of these provisions. The arguments against NAFTA were once again put forward under the auspices of labour groupings and with the support of Richard Gephardt, creating a major split in the Democratic party between centrists, who support NAFTA and trade agreements, and those opposed to the Agreement and to the integration process. Members of the United States Congress believe that there are no votes in international trade issues, since these are not among the issues that are most prominent on the political agenda, but that they do have political costs for them.

7/ According to statements made in March 1997 by Ron Carey, President of the International Brotherhood of Teamsters, affiliated to the American Federation of Labor - Congress of Industrial Organizations (AFL-CIO), before the International Relations Committee of the United States Congress, in relation to the subject "A Report Card on NAFTA".

8/ For an interesting analysis of the relationship between increased trade and falling wages, see The Economist, (1997c).

For this reason, it is unlikely that the fast track provisions will be put to the vote again this year, since there are legislative elections due.

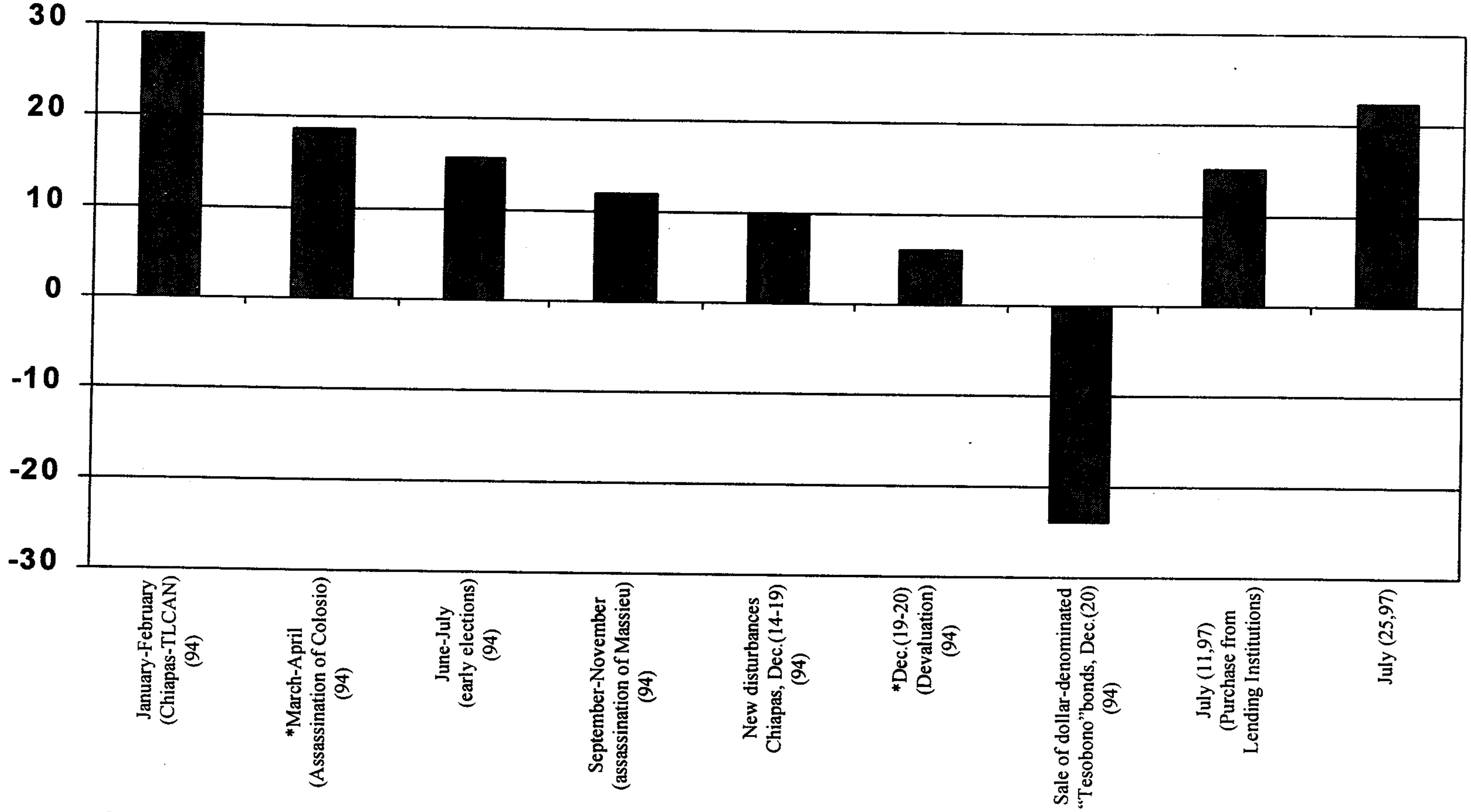
III. THE CRISIS IN THE MEXICAN ECONOMY

A. STATE OF THE ECONOMY IN 1994-1995

It was after 1994, when the Agreement began to be implemented amid general optimism, that the economic crisis occurred in Mexico. Some people in that country concluded that it was partly attributable to NAFTA, since it began a few months after implementation, and as a result they believed that the contents of the Agreement needed to be radically revised (Calva, 1996). For different reasons, certain groups in the United States shared the view that revision was needed, and others argued, more drastically, that the Agreement should be abandoned altogether. It is clear that the Mexican economic crisis was brought about by domestic problems of economic management and not by NAFTA, and it is highly probable that without the Agreement its effects would have been more severe and prolonged. Unquestionably, the factor that did most to bring about the crisis was the country's inability to finance its large current account deficit which, financed by short-term capital, had been building up over a number of years.

Historically, it might be said that increasing foreign investment in Mexico was one of the achievements of the administration of President Salinas de Gortari during 1988-1994. At that time, most investment came from the United States, the remainder being from other regions and countries. Short-term capital was a major component, and became the primary source of financing for the current account deficit. At the beginning of 1994, the situation changed as the result of a series of domestic events of both a political and an economic nature (see figure 1), which led to a withdrawal first of Mexican capital, then of foreign capital. As it corrected its balance of payments, the country found it was obliged to take restrictive monetary and fiscal measures, including the decision to devalue the peso which was announced on 19 December, and which exacerbated the flight of capital still further. The result was that by the beginning of 1995, the country not only had a current account deficit of around 28 billion dollars, or 8% of GDP, but it was no longer receiving foreign capital, and domestic savings were not sufficient to finance a deficit of these proportions.

Figure 1
INTERNATIONAL RESERVES OF MEXICO a/
(Billions of dollars b/)



Source: Bank of Mexico, The Mexican Economy, 1997. Mexico City, 1997.
a/ Period falling between to December 1994 and july 1997.
b/ Approximations.

B. IMPACT OF THE CRISIS IN RELATION TO THE FREE TRADE AGREEMENT

The influence of NAFTA becomes manifest when we compare the effects of the latest crisis in Mexico with the crisis of 1982-1983. By contrast to what happened in 1982, the balance of payments was adjusted mainly by means of increased exports (31%), and only to a lesser extent (9%) by a contraction in imports. Mexico used restrictive macroeconomic tools, which meant that production fell by some 20% and investment by some 30%, while consumer prices rose by 52%. The recession that the Mexican domestic market went through during 1995 and 1996, due to the effects of the crisis on purchasing power and to devaluation, forced producers to turn to the export sector, and this tendency has persisted right up to the present, as domestic demand is still cautious.

The United States was a beneficiary of the way in which Mexico handled its balance of payments situation, since imports from that country were hardly affected at all (5%), the brunt being borne by countries that are not members of the Agreement, in Latin America (24%) and the European Union (25%). This was due to the fact that Mexico was restricted in its ability to raise tariffs and other trade barriers against the other member countries, as this would have been a breach of the Agreement. This contrasts sharply with what happened during the 1982 crisis, when imports from the United States dropped by 40%. As the economy has continued to recover, imports from other countries are picking up again (see tables 7 and 8).

To help Mexico extricate itself from one of the worst crises in its history and enter the international financial system, the country was granted credits amounting to over 50 billion dollars. Although the United States would have put together a package of rescue measures in any case, as it did in the 1976 and 1982 crises, there can be no doubt at all that NAFTA influenced its actions. It should be noted that Mexico paid off the entirety of the loan granted by the Department of the Treasury, which in fact did not exceed 12,500 million dollars, in January 1997, earlier than agreed, having paid 500 million dollars in interest (Chrisholm, 1996).

As regards foreign direct investment (FDI), this increased substantially in anticipation of the Agreement being signed. It is interesting to note that, contrary to expectations, large investments were made by countries as diverse as Germany, India, Japan, the Netherlands and the Republic of Korea, whereas those of the United States increased only slightly, as can be seen from the following table, although investment did fall after the crisis. As the country has continued to recover and the confidence of investors has grown, Mexico has increased its international reserves, so that in July 1997 they stood at around 22,400 million dollars, although FDI has not yet recovered completely.

Table 5
MEXICAN TRADE BY REGIONS, 1992-1996
(Millions of dollars)

Region	1992			1993			1994			1995			1996		
	Exp.	Imp.	Balance	Exp.	Imp.	Balance	Exp.	Imp.	Balance	Exp.	Imp.	Balance	Exp.	Imp.	Balance
TOTAL	46 196	62 130	-15 934	51 886	65 367	-13 481	60 882	79 346	-18 464	79 542	72 453	7 089	95 987	89 458	6 529
North America	38 419	45 269	-6 850	44 609	47 628	-3 019	53 325	58 513	-5 188	68 315	55 180	13 135	82 711	59 178	23 533
-United States	37 419	44 217	-679	43 068	46 465	-3 387	51 855	56 913	-5 058	66 336	53 806	7 530	80 541	57 435	23 106
-Canada	1 000	1 052	-52	1 541	1 163	378	1 470	1 600	-130	1 979	1 374	605	2 170	1 743	427
Latin America	2 693	2 353	340	3 009	2 471	538	2 929	2 584	345	4 862	1 962	2 900	6 217	2 260	3 957
-Chile	152	96	56	194	130	64	203	228	-25	490	498	-8	688	402	286
-Costa Rica	107	15	92	99	22	77	95	28	67	137	16	121	188	58	130
-Colombia	219	72	147	236	83	153	304	121	183	453	97	356	438	97	341
-Venezuela	199	207	-8	227	227	0	174	297	-123	380	214	166	423	234	189
European Union	3 301	7 154	482	2 601	7 289	73	2 746	8 951	42	3 383	6 724	-3 341	3 555	7 733	-3 341
-Germany	491	2 477	-1 986	427	2 832	-2 405	393	3 088	-2 695	516	2 687	2 171	641	3 174	-2 533
-Spain	1 235	875	360	874	1 152	-278	851	1 333	-482	779	694	85	920	629	291
Asia Pacific	1 114	5 239	-4 125	1 136	6 258	-5 122	1 402	7 386	-5 984	1 888	7 293	-5 405	2 404	8 747	-6 343
-Hong-Kong	62	403	-341	62	317	-255	135	250	-115	506	159	347	433	129	304
-Japan	793	3 041	-2 248	700	3 369	-2 669	988	3 811	-2 823	928	3 604	-2 676	1 363	3 901	-2 538
-Chinese province of Taiwan	43	543	-500	21	658	-637	23	865	-842	44	716	-672	42	891	-849
-Republic of Korea	41	617	-576	26	662	-636	38	734	-696	89	974	-887	188	1 177	-989
-Singapore	103	104	-1	131	158	-27	67	213	-146	173	289	-116	235	383	-148
Others	669	2 115	-1 446	531	1 721	-1 190	480	1 192	-1 432	1 094	3 256	-2 162	1 100	11 540	-10 440

Source: Information supplied by the Ministry of Foreign Affairs, Department of Economic Affairs with Asia Pacific and North America, August 1997.

Table 6
MEXICAN TRADE BY REGIONS, 1993-1996
(Annual rate of change)

Region	1993		1994		1995		1996	
	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.
TOTAL	12.3	5.2	17.3	21.4	30.6	-8.7	20.7	23.5
North America	16.1	5.2	19.5	22.9	28.1	-5.7	21.1	7.2
-United States	15.1	5.1	20.4	22.5	27.9	-5.1	21.4	6.7
-Canada	54.1	10.6	-4.6	37.6	34.6	-14.1	9.7	26.9
Latin America	11.7	5.0	-2.7	4.6	66.0	-24.1	27.9	15.2
-Chile	27.6	35.4	4.6	75.4	141.4	118.4	40.4	-19.3
-Costa Rica	-7.4	46.7	-4.0	27.3	44.2	-42.9	37.2	262.5
-Colombia	7.8	15.3	28.8	45.8	49.0	-19.8	-3.3	0.0
-Venezuela	14.1	9.7	-23.3	30.8	118.4	-27.9	11.3	9.3
European Union	-21.2	1.9	5.6	22.8	23.2	-24.9	5.1	15.0
-Germany	-13.0	14.3	-8.0	9.0	31.3	-13.0	24.2	18.1
-Spain	-29.2	31.7	-2.6	15.8	-8.5	-47.9	18.1	-9.4
Asia Pacific	2.0	19.5	23.4	18.0	34.7	-1.3	27.3	19.9
-Hong-Kong	0.0	-21.3	117.7	-21.1	274.8	-36.4	-14.4	-18.9
-Japan	-11.7	10.8	41.1	13.1	-6.1	-5.4	46.9	8.2
-Chinese province of Taiwan	-51.2	21.2	9.5	31.5	91.3	-17.2	-4.5	24.4
-Republic of Korea	-36.6	7.3	46.2	10.9	134.2	32.7	111.2	20.8
-Singapore	27.2	51.9	-48.9	34.8	158.2	35.7	35.8	32.5
Others	-20.6	-18.6	-9.6	-30.7	127.9	173.2	0.5	254.4

Source: Information supplied by the Ministry of Foreign Affairs, Department of Economic Affairs with Asia Pacific and North America, August 1997.

The Agreement undoubtedly stimulated trade between the two countries and led to growth in FDI, which was already rising. In the light of previous crises, the country opted to increase its exports and to limit imports to a moderate degree, in contrast with the approach that was taken during the 1976 and 1982 crises. The countries it trades with, in particular, were less affected by comparison with other regions.

Finally, although the governments of both countries support the Agreement, neither the United States nor Mexico wish to see the border disappear. A single market to improve the quality of life, yes, but full integration, no (Fuentes, 1994, p.152). Nonetheless, a certain degree of cultural integration is inevitable as the economies of the two countries continue to move together. We are living in a world characterized by a new international division of labour, and transnational companies have become indispensable units of global integration, as is proved by the frontier strip between the United States and Mexico, which is where the effects of the Agreement have hitherto been mainly felt.

Table 7
FOREIGN DIRECT INVESTMENT IN MEXICO, BY COUNTRIES AND ECONOMIC BLOCS a/
(Millions of dollars)

Countries and blocs	1994		1995		1996		1997	Total 1994-1997
	Value	% share	Value	% share	Value	% share	Value	Value
TOTAL	10 158.8	100.0	7 614.3	100.0	5 646.1	100.0	716.7	24 134.9
North America	5 260.8	51.8	4 977.7	65.4	4 217.1	74.7	538.6	14 994.2
-Canada	735.5	7.2	160.3	2.1	493.2	8.7	39.5	1 428.5
-United States	4 525.3	44.5	4 817.4	63.3	3 723.9	66.0	499.1	13 565.7
European Union	1 894.4	18.6	1 749.8	23.0	753.3	13.3	47.7	4 440.2
-Germany	304.8	3.0	543.7	7.1	162.7	2.9	7.1	1 017.7
-Spain	141.5	1.4	39.2	0.5	40.4	0.7	0.7	221.8
-France	89.3	0.9	116.4	1.5	69.8	1.2	1.0	276.5
-Netherlands	727.2	7.2	690.7	9.1	325.0	5.8	29.4	1 773.0
-United Kingdom	589.2	5.8	206.9	2.7	59.2	1.0	2.0	857.3
-Sweden	9.3	0.1	61.1	0.8	60.2	1.1	6.0	136.6
Selected countries	2 958.7	29.1	848.0	11.1	654.7	11.6	126.8	4 588.2
-Netherlands Antilles	467.1	4.6	68.5	0.9	59.8	1.1	0.0	595.4
-Cayman Islands	95.0	0.9	25.0	0.3	24.3	0.4	1.4	145.7
-India	1 218.7	12.0	50.5	0.7	285.7	5.1	0.0	1 554.9
-Japan	628.3	6.2	159.4	2.1	94.7	1.7	22.9	905.3
-Republic of Korea	11.9	0.1	175.7	2.3	52.2	0.9	98.0	337.8
-Panama	353.2	3.5	60.9	0.8	14.7	0.3	0.1	428.9
-Switzerland	53.6	0.5	200.1	2.6	66.8	1.2	0.1	320.6
Other countries	48.9	0.5	38.8	0.5	21.0	0.4	3.6	112.3

Source: Information supplied by the Ministry of Foreign Affairs, Department of Economic Affairs with Asia Pacific and North America, August 1997.

a/ Comprises investment movements notified to the National Registry of Foreign Investment, plus imports of fixed assets by assembly plants. Does not include reinvested profits or accounts between companies, as information on the distribution of these by country is not available.

IV. THE BORDER ZONE

One of the effects of the new exporting opportunities that have opened up has been the gradual relocation of production activities, which have moved away from the more traditional economic centres such as Mexico City, Guadalajara and Monterrey to the border zone, something that has been made easier by the deregulation and privatization process (SECOFI, 1997, p.26). This zone attracts direct foreign and Mexican investment in production plants, taking advantage of its geographical proximity to the United States market and of falling (in dollar terms) labour costs and prices for various local inputs, brought about by the depreciation of the Mexican peso.

In consequence, the border zone, which is 210 kilometres wide, with a population of 11 million and output of around 150 billion dollars (Business Week, 1997, pp.32-34), is one of the fastest growing regions in North America and one of the most dynamic areas in the world.

Table 8
ECONOMIC INDICATORS FOR THE BORDER STRIP

Geographical size of the region	3,380 km. long 210 km. wide
Population	6.1 million a/ 5.1 million b/
Annual population growth	3.1% a/ 4.0% b/
Regional GDP	150 billion dollars
Per capita income	3,700 dollars a/ 14,000 dollars b/
Average hourly wage	7.71 dollars c/ 1.36 dollars
Assembly plant exports (1996)	36,800 million dollars
Annual border traffic	250 million dollars

Source: Business Week, "The Border", 12 May 1997.
a/ On Mexican territory.
b/ On United States territory.
c/ Assembly worker in El Paso; in other plants in the assembly industry the average is from 5 to 7 dollars.

Specifically, the assembly industry experienced substantial growth after the implementation of NAFTA, with the number of assembly plants rising from 2,143 at the end of 1993 to 2,500 in 1996. The aggregate value of their exports rose by 70% in the same period, and the number of workers by 46% (Larios, 1997, p.7). It is interesting to note that average employment growth in the border states during 1985-1994 was more than 8%, while in the rest of the country the figure was just over 1% (SECOFI, 1997, p.24).

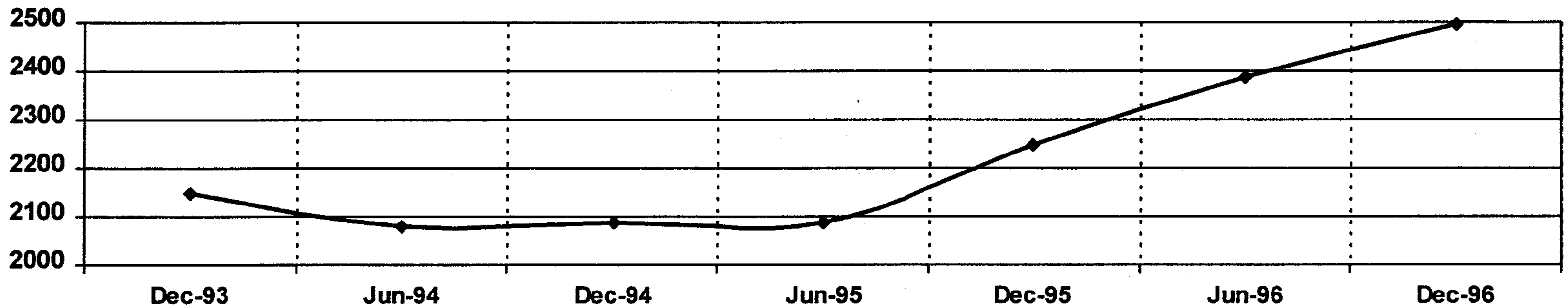
United States investment has also grown, but more surprising still are the very substantial increases recorded for investment from Asia and Europe, due in part to the fact that assembly firms will be able to place their products in the Mexican market without restrictions from 2001 onwards. Manufacturing plants have been set up in Tijuana, Mexicali and Matamoros in particular, and this has assisted the recovery of the Mexican economy. According to a special report on recent developments in the economic situation within the border zone (Business Week, 1997, p.37), this is comparable with the province of Guandong in China.

Specifically, Japanese firms like Sony and Sanyo, and the Korean Daewoo Corporation, have been attracted by the relatively low costs of production, although the most crucial factor has been the opportunity to take advantage of the benefits of the tariff and non-tariff reductions provided for by NAFTA. These firms have helped to change the production structure of Mexican industry by investing large sums in Tijuana and Mexicali, the bulk of these going into the establishment of electronics plants. Of developing countries, Mexico is now second only to China as the preferred option for investors. New businesses, generally Mexican, have also risen up to act as intermediaries in the handling of negotiations between Asians, Mexicans and North Americans (Business Week, 1997, p.32).

The high level of integration between the United States and Mexico at the frontier is clear and manifest, and is still increasing. The population of Tijuana grew by 6% between 1990 and 1995, and is expected to double in the next 14 years. Ciudad Juárez, with a current population of 1.2 million, has 235 assembly plants, while Laredo and Nuevo Laredo are the most important transport hubs, with more than 4,000 trucks crossing the border at these points each day.

Nonetheless, economic and social problems have also arisen, and these merit a separate study. Due to the increase in population, the residents are faced with serious problems in relation to drainage, drinking water and rubbish collection, informal economies have flourished, and crime and drug trafficking have increased. Women make up a large proportion of the labour force in the assembly plants, and this has created conflicts within families. The concentration of activity in this region has also brought income distribution problems. While some Mexicans have benefited enormously from the frontier boom, others have been marginalized, and for this reason the process of migration in search of a better life in the United States continues (Dussel, 1995).

Figure 2
NUMBER OF ESTABLISHMENTS IN THE ASSEMBLY INDUSTRY



Source: ECLAC, on the basis of data provided by the Mexican National Institute of Statistics, Geography and Informatics.

V. EXAMINATION BY SECTOR

Sectoral examinations are very useful for obtaining a clearer idea about which direction a free trade agreement is heading in. Nonetheless, although these are a useful tool of analysis, it should be borne in mind that not all sectors are the same, and the differences between them mean that it is impossible to generalize. Two of the most important industries are automobiles and textiles, and of all the sectors included in the agreement these were among those that were subject to the most intense negotiations, and that have aroused the greatest interest in the United States and Mexico. Consequently, it is these that will now be examined.

The automobile sector is particularly sensitive to changes in economic growth and to the income elasticity of demand. In both countries, there are certain groups that have blamed operational difficulties on the Agreement. The textiles sector also arouses great social and political interest, since the industry is a labour-intensive one and, consequently, an important provider of jobs.

A. AUTOMOBILES

The automobile industry is the most important one for bilateral trade between the United States and Mexico, due to the large number of jobs it generates and the substantial contribution it makes to gross domestic product. It is also the sector in which integration between the three economies is proceeding at the fastest pace. This industry is now undergoing far-reaching structural changes, and NAFTA has provided one of the means for introducing new forms of management in a great many sectors. The automobile industries of the United States and Canada were already highly integrated due to the "Autopact" agreement of 1965. This agreement was the starting point for more far-reaching integration between these two neighbouring countries in terms of intra-company cooperation and integration.

In Mexico, the cuts in tariffs for all vehicles were very sharp, since before the agreement Mexican tariffs were much higher (20%) than those of the United States and Canada (2.5% for cars, 8.5% for trucks and 25% for light trucks), which would indicate that these countries derived greater benefits, although the tariff liberalization schedule was more gradual for Mexico. Mexico immediately did away with import quotas for automobiles and trucks, this being regarded as one of the greatest benefits secured by the United States.

Table 9
AUTOMOBILE SECTOR: TARIFF LIBERALIZATION PROGRAMME
(With effect from 1 January 1994)

	By Mexico	By the United States
Automobiles	Immediate reduction from 20% to 10%. Gradual reduction from 10% to zero over 10 years.	Immediate reduction from 2.5% to 0%.
Light trucks	Immediate reduction from 20-10%; phasing out over more than 5 years, 20% a year.	Immediate reduction from 25-10%; phasing out over more than 5 years, 20% a year.
Heavy trucks, tractors, buses and specialized vehicles a/	Gradual reduction 20-10% over 10 years.	Gradual reduction from 25%-4% over 10 years. For those benefiting under the GSP b/, 0% immediately.
Engines, transmissions	Most removed immediately, others over 5 years.	3.1% removed immediately. For those benefiting under the GSP b/, 0% immediately.
Parts	10-15% average tariff, 75% of the 1990 value, eliminated in 5 years (4% immediately, 71% in 5 years, 25% in 10 years).	3-6% average tariff. In accordance with the GSP b/, abolition is immediate for most of them, with some exceptions, for which a period of 5 to 10 years applies.

Source: Information supplied in May 1997 by the Office of Automotive Affairs, Auto Parts and Suppliers at the United States Department of Commerce.

a/ The tariffs that are scheduled to be eliminated in 5-10 years will in practice be removed in 4 years, since the timetable of reductions begins to apply on the first day of the fifth and tenth years.

b/ Generalized System of Preferences.

Before the implementation of NAFTA, Mexico had already taken some important liberalization measures under the 1989 Automobile Decree. At that time, the importation of cars was permitted for manufacturers operating in that country, provided that a "trade balance" was maintained – each dollar's worth of imports had to be matched by 2.5 dollars' worth of exports. By 1994, the ratio had fallen to 1.75 dollars for each dollar's worth of imports. The Agreement was instrumental in ensuring that there would continue to be reductions, and thus there was a reduction to 71 cents for each dollar's worth imported in 1997, the target being 0 by 2004. The same Decree also changed the rules for national value added, which was reduced from 60% to 35%. As a result of the Agreement, the Mexican value added requirement fell to 34% between 1994 and 1998, and will continue to drop gradually until it disappears altogether in 2004.9/

Table 10
REQUIREMENTS FOR MAINTENANCE OF TRADE BALANCE

Automobile Decree, 1989	Phasing out under NAFTA a/
1990-1991: 2.5 dollars' worth of exports for each dollar required to import a vehicle.	1994: 80 cents' worth of exports for each dollar's worth of imports.
1992 and 1993: 2.0 dollars' worth of exports for each dollar required to import a vehicle.	1995: 77.2 cents' worth of exports for each dollar's worth of imports.
1994: 1.75 dollars' worth of exports for each dollar required to import a vehicle.	2000: 66.3 cents.
1.00 dollar's worth of exports for each dollar required to import parts for an assembly plant. Summary: firms are obliged to produce vehicles in Mexico in order to be able to import other vehicles.	2004: no exports required to be able to import.

Source: Information supplied in May 1997 by the Office of Automotive Affairs, Auto Parts and Suppliers of the United States Department of Commerce.

a/ All the requirements laid down by the 1989 Automobile Decree will be totally eliminated from 1 January 2004.

To sum up, the most important changes relating to Mexican value added and the trade balance were made in 1989, but the Agreement has underpinned the liberalization process and ensured that it will be a continuous one until it is completed in 2004. The removal of tariffs, the elimination of quotas, and the changes required in the trade balance law were the most important of the Mexican liberalization measures that worked in favour of exports from the United States.

9/ According to information supplied in May 1997 by the Office of Automotive Affairs, Auto Parts and Suppliers of the United States Department of Commerce.

1. Trade flows from the United States

When studying the trade figures of the three member countries, it needs to be borne in mind that due to the increasing degree of integration between them in respect of the production activities of the assembly industry and the role of transnationals, the export figures do not in themselves distinguish re-exports of the same product with greater value added. It is becoming more and more difficult to decide what definition to use to establish whether a product is "made in Canada, in the United States, or in Mexico".

It is also important to note that there are only three Mexican automobile producers: Diesel Nacional S.A. (DINA), Trailers de Monterrey and Mexicana de Automóviles, and these have a low market share. The rest is accounted for by the traditional American companies, like General Motors, Ford and Chrysler, to which may be added Nissan (Japanese) and Volkswagen (German). Canada is the most important market for United States exports in the automobile sector, as most of this trade consists of intra-company consignments between General Motors, Ford and Chrysler, with a high percentage of United States components.

Examination of trade flows and the structure of the automobile sector following the signing of the Agreement brings the following facts to light:

1. Total vehicle exports from the United States to Mexico stood at 683 million dollars in 1994, falling to an estimated 394 million dollars in 1995 and, as the Mexican economy recovered, rising to over 1,265 million in 1996.

2. Although exports of parts increased in 1994, they did not reach pre-crisis levels. This is due to two factors: a) a large part of the portion of output coming from the assembly industry can now be sold directly in the Mexican market, without having to be sent to the United States and then re-exported to Mexico; and b) there was an immediate increase in domestic demand for parts in the automobile sector of the United States (see tables 11 and 12).

3. Although the 1989 Automobile Decree had already raised the maximum for foreign investment participation to 100%, this measure was not in conformity with the provisions of the Mexican law on foreign investment, approval being discretionary. Under NAFTA, this measure was formalized, and this led to greater transparency and lower investment risk, which benefited foreign transnationals and led to an increase in the number of United States firms producing in Mexico for the domestic market and for export. In short, in a globalized and integrated world like the one the automobile sector operates in, trade flows do not determine which countries are the beneficiaries. In the case of Mexico, it would be necessary to examine the repatriation of profits in the case of transnationals, and the actual participation of Mexican companies.

Table 11
UNITED STATES EXPORTS TO MEXICO: AUTOMOBILE SECTOR
(Millions of dollars)

	1992	1993	1994	1995	1996
Motor vehicles	278	195	683	394	1,265
- Passenger vehicles	80	90	569	290	835
- New trucks	87	24	48	57	361
Parts	6,515	7,317	7,662	6,717	7,058
TOTAL	6,793	7,512	8,346	7,111	8,323

Source: Information supplied in May 1997 by the Office of Automotive Affairs, Auto Parts and Suppliers of the United States Department of Commerce.

Table 12
CHANGES IN RESTRICTIONS ON SALES BY THE ASSEMBLY INDUSTRY AFTER IMPLEMENTATION OF THE FREE TRADE AGREEMENT

Restriction on sales by assembly firms before the implementation of NAFTA	Phasing out of the restriction on sales by assembly firms	
Firms operating under the terms of the decree applying to assembly companies may sell no more than 50% of the total value of their previous year's exports in the Mexican domestic market	1995	60% of their previous year's export total
	1996	65%
	1997	70%
	1998	75%
	1999	80%
	2000	85%
	2001	Sales by assembly firms are free of restrictions in the Mexican market

Source: Information supplied in May 1997 by the Office of Automotive Affairs, Auto Parts and Suppliers of the United States Department of Commerce.

2. Trade flows from Mexico

Mexican exports to the United States had increased even before the signing of the Agreement, which then gave them a fresh impetus. Considering that a large proportion of Mexican exports already entered the United States tariff-free by virtue of the Generalized System of Preferences (GSP), which means that the tariff benefits for Mexico were not as significant as they were for the United States, we need to ask why exports to the United States should have increased substantially after the implementation of the Agreement. This comes down to two reasons that have no connection with the Agreement:

1. As the Mexican economy shrank (7%), domestic demand for automobiles dropped by 70%.10/ To survive the collapse in domestic demand and place their excess production, Mexican and American producers sought to expand their exports both to the United States and to other countries in the region.

Table 13
UNITED STATES IMPORTS FROM MEXICO: AUTOMOBILE SECTOR
(Millions of dollars)

	1992	1993	1994	1995	1996
Motor vehicles a/	3,109	3,727	4,787	7,829	11,305
- Passenger vehicles	2,591	3,084	3,943	5,815	7,899
- New trucks	442	543	643	1,773	3,055
Parts	6,203	7,354	9,702	10,501	11,645
TOTAL	9,312	11,081	14,489	18,331	22,950

Source: Information supplied in May 1997 by the Office of Automotive Affairs, Auto Parts and Suppliers of the United States Department of Commerce.

a/ Includes cars, trucks, buses, used vehicles, chassis with engines.

2. The devaluation of the Mexican peso gave an impetus to exports, but a more crucial factor was the excess of domestic demand by American manufacturers in the United States, which can be indirectly attributed to the favourable economic climate in the United States, low interest

10/ According to information supplied in May 1997 by the Office of Automotive Affairs, Auto Parts and Suppliers of the United States Department of Commerce.

and inflation rates, rising income and high levels of employment, independently of the Agreement.11/

The Agreement, however, has produced dynamic effects, which will reveal themselves more clearly in the medium to long term. A study on the automobile market (United States Department of Commerce, 1997a, p.6) states that both the United States and Mexico are planning to export to Chile, Colombia and Venezuela, taking advantage of existing bilateral agreements. Already, the United States company Navistar International has contracted Trailers de Monterrey to assemble trucks and school buses, and in June 1996 it opened a distribution centre in the Mexican capital to export to other Latin American countries.12/ Specifically, General Motors exported 12,000 Cavalier cars to Chile via Mexico, taking advantage of the bilateral agreement between the two countries, by virtue of which trucks from Mexico enter tariff-free. (United States Department of Commerce, 1997a, p.6).

B. TEXTILES

The textiles and clothing sector is a very important one, due to the considerable political repercussions that developments within it can have in relation to employment issues. This is clearly illustrated by the resistance of certain pressure groups in the United States to the idea of liberalizing imports and, in the past, by their efforts to keep the Multifibre Arrangement (MFA) in force. Although the MFA will expire at the end of 2005 as a result of the agreement adopted by GATT in 1994, import quotas are still applied both in the United States and in other countries, whereas under NAFTA these were eliminated immediately. Mexico benefited directly by the replacement of the MFA rules with Appendix 300B of the Agreement. There was no change in the trade between Canada and the United States, as they were not part of the MFA.13/

1. Phasing out of textile sector tariffs

In the textiles sector, two schemes were negotiated separately, one for the final product and the other for inputs, as follows:

11/ Ibid.

12/ In response to NAFTA, Honda began production of the Accord sedan in November 1995 to supply the Mexican market and subsequently export to other Latin American countries. BMW, which has facilities in Mexico capable of producing 3,000 units, has already begun to assemble the BMW 325 model; in the same plant, Porsche of Germany is producing 75 units of the Porsche 911 model. Mercedes-Benz is now assembling its model C in Mexico, and has begun to assemble the model E sedan. See United States Department of Commerce (1997b, p.9).

13/ If a conflict arises with the provisions of other agreements or treaties, the rules of NAFTA will prevail, although the transition clauses of NAFTA expire before those of the MFA. For a detailed analysis of the MFA, the results achieved in the World Trade Organization (WTO) and access for Latin American textiles, see Kouzmine (1997).

1. For products manufactured in North America that comply with the rules of origin, tariffs will be phased out within a period of no more than 10 years. Of exports from the United States to Mexico, 20% were freed from tariffs immediately, and the plan is to eliminate tariffs for the remaining 80% within 6 years at most. In addition, quotas were abolished immediately for all textile and garment items, although safeguard measures can be introduced if necessary.

2. For a product to be considered "domestic", the fabric, the yarn and the fibre must be from a NAFTA member country. If the fabric does not originate from a NAFTA member country, clothing made up with it is subject to quotas and tariffs. This limits the options of member countries in terms of purchasing lower cost or better quality inputs from other countries, and the result is a distortion of trade. This measure affected Canada in its trade with the Asian countries, since Canada was an importer of fabrics from these countries for use in the garment industry. The Agreement provides for the workings of the rules of origin to be appraised in January 1999.

3. The removal of tariffs between Mexico and the United States was fairly reciprocal, but Mexico benefited most from article 807A of the Agreement (United States Department of Commerce, 1997b, p.26). This article is similar to the one applying to trade between the United States and certain countries of Latin America by virtue of article 807,14/ but has wider application; it stipulates that exports from Mexico may enter free of tariffs, quotas and the application of safeguard measures, provided that the final product contains fabric sewn and produced using yarn from the United States. Products made with Mexican cloth that is cut in the United States are subject to tariffs on the value added in Mexico. If the cloth is not Mexican, but is cut in the United States, they are subject to quotas.

2. Mexican exports to the United States market

As the Agreement continues to operate, article 807A has come to take on more and more significance in the trade between the United States and Mexico. After it came into effect, United States imports of clothing from Mexico increased from 2,813 dollars in 1995 to 3,778 million in 1996, which placed Mexico among the world's leading exporters. The United States, for its part, has seen substantial increases in its trade in fabrics and yarn and, to a lesser extent, Canadian trade in yarn has also grown. Nonetheless, it is important to note that some of the United States imports from Mexico are products that have been semi-manufactured in the United States, exported to Mexico, and then re-exported to the United States as in the case of the automobile industry, analyzed earlier.

In May 1997, Mexican exports to the United States market were 45% higher than in the same period in 1996, a growth rate that was higher than that of China (37%), although in absolute terms Mexico still lags behind that country, as well as the countries participating in the

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14/ Colombia, Costa Rica, El Salvador, Philippines, Haiti, Mexico and the Dominican Republic have taken advantage of this benefit since 1976. See an analysis of the subject in Morawetz (1981, p.29).

Caribbean Basin Initiative, others in the Caribbean, and certain Asian countries (see tables 14 and 15). The countries of the Caribbean Basin have expressed an interest in obtaining similar treatment to that given to NAFTA members, since although they receive preferential treatment from the United States, they have to pay tariffs and are subject to the application of safeguard measures. This is one of the proposals that have received support and attention from the United States Administration, but it was not approved when it was put to the vote in Congress in November 1997.

3. NAFTA and assured competitiveness

Although Mexican trade with the United States in clothing, yarn and fabrics has increased substantially, this does not necessarily imply that the United States market is automatically assured. According to a representative of the United States Chamber of Commerce,15/ when the Agreement was first implemented Mexican clothing imports were inferior in quality to those of that country's competitors, and although Mexico enjoyed better preferential treatment, United States firms went back to purchasing from the Central American countries, forcing Mexico to improve quality and output. The same could happen as regards preferences for Asian products. It must be remembered that Hong Kong, the Chinese province of Taiwan and other Asian countries are traditional suppliers of clothing to the United States. The likelihood of a garment on sale in a store in the United States having been made in one of these countries is 8 in 10.

The remarks made in the previous paragraph bring to mind the much-quoted study that appeared in 1981 in the World Bank publication, "Why the Emperor's new clothes are not made in Colombia". This book, which is still relevant to Latin America, analyses the reasons why the percentage of United States imports from Colombia dropped by comparison with other countries, which at that time were its competitors like Hong Kong, the Chinese province of Taiwan and the Republic of Korea. In 1961, Colombia exported twice as much clothing to the United States as Taiwan and Korea combined (Morawetz, 1981, pp.11 and 23).

As is now the case with Mexico, Colombia initially benefited from a devaluation of the peso in real terms that made its products more competitive abroad, but then lost market share to the higher productivity and better quality of the Asian countries. This is demonstrated in the men's clothing segment; the Colombian industry adapted to circumstances by improving productivity and quality, and thus succeeded in maintaining a substantial share of the United States market, alongside firms from Europe.16/ Although Colombian clothes have improved, world competition has also increased substantially, making it harder and harder for the country to maintain its market share.

15/ Information provided to the author at a March 1997 meeting with David Hirschmann, Director of the United States Chamber of Commerce in Washington, D.C.

16/ Other countries have also had difficulties in penetrating the United States market, examples being Greece, Portugal and the former Yugoslavia, among others.

If we look at the figures for imports into the United States, the gap between China and the other countries, with the exception of Mexico, can be seen to be widening all the time. The surprising and impressive thing about China is the way that country, which does not enjoy the benefits of a trade agreement like the one between Mexico and the United States, has managed to penetrate the United States market and place such a volume of products so rapidly, despite being a late entrant. This shows that signing trade agreements is not in itself enough to guarantee markets, and that quality control, price, design and good administration also play a vital role. All of these components are mutually reinforcing. For these reasons, as happened in the case of Colombia, if Mexico does not adapt quickly, with or without an Agreement, the emperor's new clothes could well end up being made in China.17/

17/ Los Angeles, California, has also become a centre of the textile industry, and is now the biggest in the United States, generating annual sales of over 100,000 million dollars. This is being achieved by using low-cost labour from Latin America, China and the Republic of Korea, The Economist (1997b, p.25).

Table 14
COMMERCIAL REPORT ON TEXTILES AND CLOTHING PRODUCTS:
UNITED STATES IMPORTS
(Millions of dollars)

Country CUCI Rev.3	1995	1996	January-May 1996	January-May 1997	Percentage change May 96-97
WORLD					
Yarns	870	956	367	457	24.52
Fabrics	4 991	5 159	2 025	2 405	18.81
Miscellaneous	4 619	4 593	1 773	2 049	15.60
Garments	36 794	38 666	13 930	16 056	15.26
Total	47 274	49 373	18 095	20 968	15.88
CANADA					
Yarns	182	221	80	108	34.11
Fabrics	534	632	250	301	20.38
Miscellaneous	224	257	108	114	5.13
Garments	789	965	363	466	28.41
Total	1 728	2 076	801	988	23.33
CHINA					
Yarns	15	15	8	8	5.43
Fabrics	253	265	76	182	140.02
Miscellaneous	1 484	1 382	530	611	15.29
Garments	4 807	5 205	1 602	2 193	36.87
Total	6 560	6 866	2 215	2 993	35.13
HONG KONG					
Yarns	2	2	1	1	-34.20
Fabrics	152	144	63	55	-12.96
Miscellaneous	56	35	18	10	-48.47
Garments	4 285	3 943	1 349	1 141	-15.44
Total	4 495	4 124	1 432	1 206	-15.77
MEXICO					
Yarns	99	110	44	54	23.08
Fabrics	204	307	113	159	40.15
Miscellaneous	425	469	171	220	28.47
Garments	2 813	3 778	1 314	1 899	44.48
Total	3 541	4 664	1 643	2 332	41.94
CARIBBEAN BASIN COUNTRIES					
Yarns	12	9	4	2	-49.45
Fabrics	23	16	6	6	-6.40
Miscellaneous	83	92	41	46	10.32
Garments	5 475	6 058	2 162	2 767	28.00
Total	5 593	6 175	2 214	2 821	27.43
CHINESE PROVINCE OF TAIWAN					
Yarns	17	15	7	6	-10.71
Fabrics	401	457	166	213	28.64
Miscellaneous	224	228	74	90	21.27
Garments	2 060	1 982	691	723	4.59
Total	2 703	2 681	938	1 032	10.04
REPUBLIC OF KOREA					
Yarns	13	12	5	3	-32.54
Fabrics	491	539	212	253	19.31
Miscellaneous	133	105	49	64	30.64
Garments	1 689	1 449	528	512	-3.04
Total	2 327	2 105	794	832	4.84
ASEAN a/					
Yarns	52	61	21	37	78.03
Fabrics	283	260	109	132	20.74
Miscellaneous	251	264	97	103	6.15
Garments	4 940	4 946	1 919	2 003	4.35
Total	5 526	5 531	2 146	2 274	5.98

Source: Compiled from the official statistics of the United States Department of Commerce, Office of Textiles and Apparel, July 1997.
a/ Association of South-East Asian Nations.

Table 15
COMMERCIAL REPORT ON TEXTILE AND CLOTHING GOODS:
UNITED STATES EXPORTS
(Millions of dollars)

Country CUCI Rev.3	1995	1996	January-May 1996	January-May 1997	Percentage change May 96-97
WORLD					
Yarns	987	1 079	443	490	10.56
Fabrics	4 431	4 725	1 940	2 234	15.17
Miscellaneous	1 492	1 673	663	763	14.98
Garments	6 180	7 042	2 801	3 291	17.49
Total	13 090	14 520	5 848	6 778	15.91
CANADA					
Yarns	321	363	149	171	14.59
Fabrics	1 186	1 270	517	613	18.67
Miscellaneous	498	568	214	269	25.39
Garments	513	533	220	254	15.66
Total	2 518	2 734	1 100	1 307	18.82
CHINA					
Yarns	7	3	1	1	20.45
Fabrics	28	28	13	12	-7.34
Miscellaneous	20	15	8	5	-31.16
Garments	9	7	4	2	-34.16
Total	63	53	25	21	-17.44
HONG KONG					
Yarns	15	14	4	7	53.15
Fabrics	164	171	76	89	16.36
Miscellaneous	46	49	20	24	18.00
Garments	42	41	18	19	6.84
Total	267	274	119	138	16.55
MEXICO					
Yarns	89	141	51	68	33.49
Fabrics	686	839	331	391	18.23
Miscellaneous	145	197	76	97	27.72
Garments	1 324	1 656	633	817	29.13
Total	2 244	2 833	1 090	1 373	25.93
CARIBBEAN BASIN COUNTRIES					
Yarns	67	90	31	43	38.03
Fabrics	419	457	173	221	27.94
Miscellaneous	76	78	31	38	25.31
Garments	2 502	2 930	1 103	1 457	32.10
Total	3 065	3 554	1 338	1 759	31.54
CHINESE PROVINCE OF TAIWAN					
Yarns	17	9	4	6	44.06
Fabrics	49	49	22	23	4.90
Miscellaneous	13	15	6	5	-14.81
Garments	14	14	6	7	22.10
Total	93	86	38	41	8.39
REPUBLIC OF KOREA					
Yarns	10	15	5	4	-34.25
Fabrics	87	80	33	33	1.56
Miscellaneous	21	22	9	10	19.15
Garments	19	37	14	16	13.65
Total	136	154	61	63	3.57
ASEAN					
Yarns	13	19	9	9	7.65
Fabrics	119	139	60	62	3.41
Miscellaneous	63	73	27	30	9.05
Garments	48	56	26	18	-28.60
Total	242	287	121	119	-1.85

Source: United States Department of Commerce, Office of Textiles and Apparel, July 1997.

V. CONCLUSIONS

The North American Free Trade Agreement has been debated and commented upon more than almost any other issue in the recent history of the United States and Mexico. One of the greatest difficulties in evaluating NAFTA derives from the exaggerated optimism with which, in both the United States and Mexico, the potential benefits of this Agreement were anticipated in 1993. This was a defensive reaction to the criticisms of protectionist groups and opponents of the Agreement, who organized among themselves at that time to discredit it.

The effects of the Mexican crisis were devastating for that country's economy and affected the results that had been expected from NAFTA in the short term. On the one hand, though, the peso crisis is unconnected to the Agreement, being rather an internal process, and to some extent the Agreement made it possible to overcome it more quickly than would have been the case had it not existed. Again, it did influence the way in which Mexico handled this crisis by comparison with previous ones. The country opted to follow a restrictive macroeconomic policy to correct its balance of payments, rather than restricting imports.

To sum up, we may conclude that although the effects of NAFTA have been modest for the United States, due to the difference in the economic level of the two countries (the U.S. economy is 23 times larger than the Mexican economy), the political results have been significant. Part of the United States public believes that the Agreement is not beneficial, because during the debate over its approval people lost sight of what could be expected from an Agreement like this one. Its opponents have continued their campaign against it and maintain that, among other effects, and contrary to what was promised in 1993, the Agreement appears if anything to have been a contributory factor in lowering wages in the three countries and weakening the negotiating power of workers, while failing to relieve the pressure of migration into the United States.

The report evaluating the Agreement which was submitted to the United States Congress in July 1997 was not very enthusiastic. It was taken as a reference point when the proposal to renew fast track authority was put to the vote in November last year, and this had to be withdrawn because it was not supported by enough votes to pass it. The Mexican crisis also cooled parliamentary support for NAFTA in the United States, and raised concerns about the speed at which it was prudent to carry out the process of integration.

The Agreement cannot be evaluated in the short term, because its costs and benefits can only be appreciated over a period longer than three years. The implementation and monitoring mechanisms established by it need to be given substance. There has undoubtedly been an increase in trade between the countries, but it is not clear what effect this is having on employment, given that so far there have been no major changes in the composition of exports. The automobile sector is the most important one as far as NAFTA is concerned, and it is in this sector that integration is proceeding the fastest. In the process of liberalizing the automobile sector, the United States was benefited by the reduction of tariffs and quotas, since before the agreement tariffs and quantitative restrictions were more severe in Mexico, and a large proportion of Mexican exports were already entering tariff-free by virtue of the Generalized System of Preferences. On the other hand, Mexico benefited in the textiles sector when the rules of the Multifibre Arrangement were replaced by Appendix 300B of the Agreement.

It should be borne in mind that NAFTA needs to be regarded as a means towards growth and not as an end. If it fails to improve its technology, innovate and update its system of production, Mexico could well lose market advantages. In the case of the textiles sector, the case of China is a particularly noteworthy one, since this country, which was a late entrant into the market and does not enjoy the benefits of NAFTA membership, has nonetheless succeeded in penetrating the North American market and achieving very rapid growth there. It is also important to consider the role of transnationals in order to establish which country or countries are benefiting from the increase in trade and investment. Every day the distinction between what is "made in Canada, the United States or Mexico" is becoming more tenuous, as can be appreciated from an appraisal of the automobile sector. The repatriation of profits and the origin of capital need to be analyzed more thoroughly.

Neither of the two parties wishes to see the border disappear; they are looking for market and investment integration, without going any further. Both parties agree that NAFTA is necessary given the already rising level of integration between the two markets, the fact that they share a long border, and the migratory problems between the two countries. It is in fact in the border zone between the two countries that the effects of NAFTA have hitherto been mainly felt, turning this into one of the most dynamic areas in the world. Not only has United States investment increased there, but so has Asian and European investment, and this has contributed to changes in the production structure of the Mexican economy, to increased employment and to growth in bilateral trade.

Will NAFTA be enough? Although the Agreement is an opportunity for Mexico, the economy can only become stronger if income redistribution is speeded up, education is improved and favourable conditions are maintained through macroeconomic and financial stability. The Agreement has helped to democratize the country politically, something that was reflected in the recent Mexican elections, which were the most open and transparent in recent Mexican history.

For historical, social and geographical reasons, Mexico and the United States are natural partners. As the Mexican economy recovers, consolidating and safeguarding the Agreement is the top priority for many groups in the country. In the United States, there is also a degree of conviction about the need to make cautious progress, consolidate the Agreement and examine the results more closely, before extending membership to other countries.18/ In the final analysis,

18/ Based on statements made in March 1997 by Richard Gephardt to the International Relations Committee of the United States Congress, in relation to the subject "A Report Card on Nafta".

it will be the United States that determines the form NAFTA will take in future, as it is the dominant economy among the three.

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