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Dealing with Neighbors

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Quite apart from the fact that the United States profits overall from the North American Free Trade Agreement (NAFTA), an important consideration lost in the bad-mouthing of the agreement by Senators Barack Obama and Hillary Clinton is that we are fortunate in our two land neighbors. Canada and Mexico are peaceful countries and troops are not needed on either side of the two U.S. borders for purposes of keeping the peace.¹ Neither of the two countries is politically extreme. Both are democracies, and NAFTA gave a push toward reaching this outcome peacefully in Mexico. Comparing North America with other regions of the world brings out this fortuitous situation; it is the antithesis of the enmity, and often bloodshed, that prevailed between Germany and France for centuries, between India and Pakistan, Russia and China, and Venezuela and Colombia today.

The United States has much trade with Canada and Mexico. The United States is the first export market of both countries, and they are the first and second foreign markets for U.S. goods. Consequently, it is not surprising that trade frictions arise. The United States has long put limits on imports of softwood lumber from Canada; the two countries periodically reach an agreement on the amount that should be sent until a new push for restriction arises and a successor agreement is concluded. For many years, the United States imposed high antidumping duties on cement imports from Mexico and removed them only a few years ago in the aftermath of Hurricane Katrina when more cement was needed. Canada restricts imports of cultural material, such as some English-language magazines. Recently, there was a mammoth demonstration of many tens of thousands in the *zocalo*, the large central square in Mexico City, against U.S. imports of corn. However, the free movement of goods in North America far outweighs the restrictive measures. In 2007, \$1.5 billion of goods were traded each day between Canada and the United States and \$940 million a day between Mexico and the United States.

There must be some merit in the argument that Lawrence Harrison espouses: that differences in economic development

¹ The United States does have some troops to work with the border patrol, which seeks to control the entry of undocumented immigrants, and Mexico recently placed troops on the border to combat the violence caused by competing groups of narcotraffickers.

among countries can be traced to culture. Mexico's inheritance is Spanish, superimposed on a large body of indigenous people, whereas that of the United States is British. The two Anglo-Saxon countries in North America are developed whereas Mexico is underdeveloped by comparison. Mexico's transformation from an authoritarian society to a democracy is recent. Mexico's strivings are focused on economic development, and the perennial problems that arise in Mexico-U.S. relations are primarily a consequence of the large disparity in income and wealth.

Migration is primarily an economic problem stemming from the push of low earnings in Mexico and the pull of much higher paying employment in the United States. The ratio of hourly manufacturing earnings in the two countries is about 10 to 1. Poverty is rampant in Mexico's rural areas, and the rational incentive of adventurous young men and women is to move to urban areas in Mexico and then across the border into the United States. The number of people born in Mexico now living in the United States is about 12 million, or about 10 percent of the total Mexican population. This provides both a safety valve for social order in Mexico and leads to some \$25 billion in remittances sent back to Mexico. The main complaint against Mexican immigrants is that about 6 million are in the United States without authorization. On the other hand, they are hard working and law abiding once in the United States. Migration of ambitious young people is a natural phenomenon and is unlikely to cease despite restrictive U.S. legislation and fence building until Mexico is able to raise its own job creation and wage levels. The desperation of the unauthorized migrants is evident in the risks they knowingly take; 3,346 died between 2000 and 2006 trying to cross arid and dangerous areas in the United States.

It gets tiresome to hear politicians who advocate draconian punishment of persons in the United States without authorization state that their parents or grandparents were immigrants—but came legally to the United States. Of course they did—there was no need to come without proper documents in the nineteenth and much of the twentieth century because entry papers were readily available.

U.S. merchandise exports to Mexico in 2007 amounted to \$1,282 for each Mexican, whereas the exports to Canada were \$7,542 for each Canadian. Proximity, plus largely open

markets, makes both countries attractive destinations for U.S. goods. However, the Mexican market could be six times greater if per capita income were at the Canadian level. The United States has a rich neighbor and a poor neighbor, and rich is better. The benefit to the United States would be substantial if Mexico were able to resolve the problems holding back more rapid economic growth. One way to judge the merits of NAFTA for the United States is to ask whether the agreement has helped the Mexican economy grow. The U.S. gross domestic product is some 20 times larger than that of Mexico, and it was logical to assume that NAFTA would provide a greater opportunity for economic growth in Mexico than in the United States. Mexico also took a greater risk of damage to its smaller economy than did the United States by entering into NAFTA.

Mexico's economic growth has been mediocre since the creation of NAFTA. However, Mexico's export growth to the United States has been spectacular, growing from \$81 billion in 1993, the year before NAFTA came into effect, to \$347 billion in 2007. U.S. exports to Mexico and Canada also grew by more than they did to the rest of the world, but not by as much in absolute or percentage terms as Mexico's exports. Critics of the agreement have noted that economic growth in Mexico has been inadequate and then contend that this means that NAFTA has failed. Essentially this logic implies that Mexico's export expansion reduced its overall growth—and this can't be. The growth problem in Mexico must lie somewhere else—in the country's structural shortcomings and the political inability to correct them. I will return to this theme.

Mexico's entry into NAFTA signified a recognition by the Mexican authorities that its long-standing political-economic strategies were not optimal. As captured in the title of Alan Riding's book, *Distant Neighbors: A Portrait of the Mexicans* (Knopf, 1985), Mexico had long aimed to minimize its relations with the United States, in large part because of the history of lost territory. In the political arena this was captured by constant repetition of the need to protect Mexican sovereignty, and in the economic sphere by import restrictions and limits on foreign direct investment. These policies broke down with the debt crisis of 1982 and the subsequent lost economic decade. Mexico's trade policy shifted from restricting imports to promoting exports; and this, in turn, led to greater political interaction with the United States, the logical market for Mexican goods. Instead of being a misfortune, as a well-known cliché puts it, being a neighbor of the United States became a blessing.

In at least one respect, being a neighbor of the United States has its downside. How dare Mexico put itself on the direct route from Latin America to the largest narcotics market in the world? This was the attitude in the years when the Congress insisted that the U.S. president punish other countries, including Mexico, for not doing enough to impede the flow of narcotics to the United States. Mexico pays a heavy price for U.S. narcotics policy: the illegality of narcotics trade coupled

with large U.S. usage pushes up the rents that traffickers obtain. This has led to horrible criminality in Mexico, open warfare among the different narcotics families to capture the spoils, and insecurity and murders on the Mexican side of the border.

The decisions necessary to improve Mexican economic growth must of course be taken primarily by Mexicans. U.S. politicians who promise never to raise taxes should admire the Mexican model. Federal tax collections in Mexico are about 11 percent of GDP compared with about 18 percent of GDP in the United States! Because Mexico's tax take does not provide enough revenue to run social and other programs of the federal government, another 6 percent or so of GDP is taken from the national oil company's revenue. Consequently, the oil company (Pemex) lacks revenue in most years to carry out oil and natural gas exploration in the promising deep waters of the Gulf of Mexico. The social security system has deep financial problems. The cost to fire workers, done ostensibly in the name of protecting employment, leads private companies not to hire full-time employees. This, in turn, leads to a large informal labor force that pays little taxes. Primary and secondary education is deficient, especially in rural areas, and this impedes upgrading industry's capital equipment, reducing the country's competitiveness. Justice is not equal. Paying bribes to obtain official services is commonplace.

Taken together, these interrelated structural deficiencies hold back growth. The political parties have thus far failed to make the painful decisions to correct these problems. Democracy in Mexico to a large extent is one of presidential-congressional stalemate. The main counter to these problems in recent years has been the growth of exports—NAFTA's contribution. The most important contribution the United States can make to stimulate Mexican economic growth is to keep its market open to competitive Mexican products, and for the most part this is being done. But this would not continue if the NAFTA critics have their way. The United States would benefit enormously if Mexico were to grow at 6 percent to 7 percent a year, rather than the roughly 3 percent that has prevailed for so long. It would pay high dividends for the United States to be a good neighbor.

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