REVIEW ESSAYS

MEXICAN TRADE LIBERALIZATION AND NAFTA

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DISTORTED DEVELOPMENT: MEXICO IN THE WORLD ECONOMY. By David Barkin. (Boulder, Colo.: Westview, 1990. Pp. 162. $25.00 paper.)

TOWARD A NORTH AMERICAN COMMON MARKET. Edited by Charles F. Bonser. (Boulder, Colo.: Westview, 1991. Pp. 125. $22.50 paper.)

THE UNCERTAIN CONNECTION: FREE TRADE AND MEXICO-U.S. MIGRATION. By Wayne A. Cornelius and Philip L. Martin. (La Jolla: Center for U.S.-Mexican Studies, University of California, San Diego, 1993. Pp. 40. $7.50 paper.)

THE POLITICAL ECONOMY OF NORTH AMERICAN FREE TRADE. Edited by Ricardo Grinspun and Maxwell A. Cameron. (New York: St. Martin's, 1993. Pp. 348. $55.00 cloth, $19.95 paper.)

NORTH AMERICAN FREE TRADE: ISSUES AND RECOMMENDATIONS. By Gary Clyde Hufbauer and Jeffrey J. Schott. (Washington, D.C.: Institute for International Economics, 1992. Pp. 369. $35.00 cloth, $25.00 paper.)

NAFTA: AN ASSESSMENT. By Gary Clyde Hufbauer and Jeffrey J. Schott. (Washington, D.C.: Institute for International Economics, 1993. Pp. 164. $21.95 paper.)

THE PARADOX OF CONTINENTAL PRODUCTION: NATIONAL INVESTMENT POLICIES IN NORTH AMERICA. By Barbara Jenkins. (Ithaca, N.Y.: Cornell University Press, 1992. Pp. 234. $28.50 cloth.)

MEXICO: THE REMAKING OF AN ECONOMY. By Nora Lustig. (Washington, D.C.: Brookings Institute, 1992. Pp. 186. $11.95 paper.)

NORTH AMERICAN FREE TRADE: ASSESSING THE IMPACT. Edited by Nora Lustig, Barry P. Bosworth, and Robert Z. Lawrence. (Washington, D.C.: Brookings Institute, 1992. Pp. 274. $31.95 cloth, $12.95 paper.)

IMPLICATIONS OF A NORTH AMERICAN FREE TRADE REGION: MULTI-DISCIPLINARY PERSPECTIVES. Edited by Joseph A. McKinney and M. Rebecca Sharpless. (Waco, Tex.: Program for Regional Studies, Baylor University, 1992. Pp. 215. $25.00 cloth.)

THE NEW NORTH AMERICAN ORDER: A WIN-WIN STRATEGY FOR U.S.-MEXICO TRADE. By Clyde V. Prestowitz, Jr., and Robert B. Cohen, with Peter Morici and Alan Tonelson. (Washington, D.C.: Economic Strategy Institute, 1991. Pp. 122. $42.00 cloth, $15.50 paper.)

THE DYNAMICS OF NORTH AMERICAN TRADE AND INVESTMENT: CANADA, MEXICO, AND THE UNITED STATES. Edited by Clark W. Reynolds, Leonard Waverman, and Gerardo Bueno. (Stanford, Calif.: Stanford University Press, 1991. Pp. 281. $39.50.)

THE PREMISE AND THE PROMISE: FREE TRADE IN THE AMERICAS. By Silvia Saborio and contributors. (Washington, D.C.: Overseas Development Council, 1992. Pp. 282. $29.95 cloth, $15.95 paper.)

ASSEMBLING FOR DEVELOPMENT: THE MAQUILA INDUSTRY IN MEXICO AND THE UNITED STATES. By Leslie Sklair. (La Jolla: Center for U.S.-Mexican Studies, University of California, San Diego, 1993. Pp. 287. $39.95 cloth, $18.95 paper.)

U.S.-MEXICAN INDUSTRIAL INTEGRATION: THE ROAD TO FREE TRADE. Edited by Sidney Weintraub, with Luis Rubio F. and Alan D. Jones. (Boulder, Colo.: Westview, 1991. Pp. 342. $32.00 paper.)

Academic research on Latin American economics, like the economies themselves, seems to proceed in cycles or waves. At the beginning of the 1980s, a flurry of books and articles grappled with the origins and consequences of the emerging debt crisis, their topics ranging from game-theory approaches to borrower-lender dynamics (e.g., Eaton and Gersovitz 1981) to econometric analyses of the fundamental causes of debt accumulation and payment difficulties (e.g., Berg and Sachs 1988). This research boomlet gave way to a virtual cottage industry of analyses comparing East Asia and Latin America, with most of the studies insisting on the virtues of the former and the defects of the latter (e.g., Sachs 1985, 1987). As Latin American economies stagnated, inflation rose, and some Latin American countries started to experiment with "unorthodox" approaches to stabilization, a new body of research tackled the problems of hyperinflation (e.g., Dornbusch, Sturzenegger, and Wolf 1990), the underlying reasons and consequences of delayed stabilization (e.g., Alesina and Drazen 1991; Rodrik 1991), and the relative merits of the new heterodox strategies (e.g., Taylor 1988; Pastor 1992).[1]

The newest wave of research is now upon us, and like the previous ones, it is connected to ongoing events and policy debates in the region. In this case, the topic is trade liberalization, the place is Mexico, and the policy issue is the North American Free Trade Agreement (NAFTA). As with past fads in Latin American economics, academic production on NAFTA-related topics has been extraordinary in quantity but uneven in quality. This pattern makes the task of evaluating the literature both harder and easier. On the one hand, the reviewer has to read far more than usual, sometimes wading through works that seem hastily finished by authors hoping to win the "race" to the academic or policy-making marketplace. On the other hand, the sheer volume of the new literature allows one to exclude from the ultimately discussed pieces those that make only minor contributions.

In this essay, I will review fifteen recent books on the Mexican economy, the liberalization process, and NAFTA itself. Although flaws can be found in several of the works, most of them constitute building blocks for constructing a full analysis of the contemporary Mexican economy and the prospects for North American economic integration. The individual pieces of this new literature fall into—or should have fallen into—three categories: general reviews of the Mexican economy that help contextualize NAFTA; analyses and projections of the consequences of NAFTA on the participating economies; and in-depth political-economy analyses of why NAFTA emerged at all. The existing literature in the last category is the most seriously deficient, leaving space for another and perhaps more interesting wave of research on Mexico and NAFTA.

Contextualizing NAFTA

Although negotiations surrounding a North American free trade pact have dominated the public debate, it is important to remember that the thrust toward Mexican trade liberalization has been only one part of a larger restructuring of the Mexican economy. Observers who have been tracking the Mexican situation have long been aware of the "neoliberal" drift that began under President Miguel de la Madrid (1982–1988) and accelerated under President Carlos Salinas de Gortari (1988–). Those less familiar with the process would do well to begin by consulting four books dealing with changes in Mexican economic policy and the industrial (or real-sector) context.

The best of the four is Nora Lustig's *Mexico: The Remaking of an*

1. The relevant reviews of research on these trends published in previous issues of *LARR* include Conway (1992), Golub (1991), Edwards (1989), and Sheahan (1989).

Economy. Lustig begins by examining the roots of the crisis that erupted in 1982. After reviewing briefly the late 1950s and the period of so-called stabilizing development, she jumps quickly into considering the macroeconomic crises of the late 1970s and early 1980s. The crux of Lustig's argument is that the percolating Mexican crisis resulted less from the structural inefficiencies of the import-substitution industrialization (ISI) model than from the usual problem of poor macromanagement. As she notes, postwar Mexican growth was relatively healthy, and some of the sectors now positioned best for trade success (particularly autos and auto parts) grew up under strict protectionist policies and "onerous" regulation of foreign investors.[2]

Sticking with this macroeconomic focus, Lustig blames the ultimate 1982 collapse on excessive optimism about oil prices (on the part of Mexican policymakers as well as foreign lenders) and the inconsistencies and fragility of "public-expenditure-led growth." She covers the subsequent adjustment efforts in the 1980s blow by blow and does much to dismiss the popular image of a steady Mexican march to orthodox economic tunes. Conflicts arose within policy-making circles between those eager to engage in structural reforms (like privatization) and those more interested in simply taming the government deficit and inflation. Not until after 1985 did both "policy currents" conveniently converge in the Pacto de Solidaridad Económica, a stabilization-cum-trade opening. Although launched by the de la Madrid administration, the Pacto was essentially designed by a team directed by Salinas as Secretario de Programación y Presupuesto under de la Madrid, and it has been maintained by Salinas since he became president.[3]

The tortuous path leading to the Pacto also belies any myth of orthodox effectiveness. As Lustig details, the first International Monetary Fund (IMF) programs adopted by Mexico after 1982 failed to come anywhere near their original anti-inflationary goals. When the problems subsequently induced by the decline in oil prices of 1986 were doctored with the standard devaluation medicine, inflation soared to nearly 160 percent and the stock market crashed. Hence in December 1987, Mexican authorities finally took a page from the new heterodox approaches and imposed controls on the movements of prices, wages,

2. Lustig's account is a healthy corrective to those who dismiss ISI as a total disaster and attribute the mid-1980s liberalization shift to a fundamental problem of microeconomic misallocation of resources. As will be argued in this review essay, much of the rationale for the rapid trade opening after 1987 was connected to the imperatives of macrostabilization and not microefficiency.

3. The Pacto was initially called the Pacto de Solidaridad Económica, then the Pacto para la Estabilidad y el Crecimiento Económico, and now the Pacto para la Estabilidad, la Competitividad y el Empleo. Despite the name changes, its essential quasi-heterodox features—wage-price controls, a nearly fixed exchange rate, and fiscal austerity—have remained unchanged.

and the exchange rate. They also made a firm commitment to fiscal retrenchment, the crucial element lacking in the Argentine, Brazilian, and Peruvian heterodox strategies (p. 52).

An essential component of this "quasi-heterodox" approach was acceleration of trade liberalization: the coupling of increased import competition and a rigid exchange rate helped provide another level of price controls. The trade opening, considered the "most controversial measure of the package," restrained inflation but at the cost of a massive import boom (p. 53). This outcome in turn produced a ten-billion-dollar decline in international reserves, forcing the Mexican government to maintain high real interest rates (to entice the return of flight capital) as well as to devise new ways to foster capital inflows. These means included privatization, relaxation of foreign investment regulations, and finally in August 1990, the tantalizing announcement (for investors) that Mexico would attempt to negotiate a free trade pact with the United States.

The theoretical points underlying *Mexico: The Remaking of an Economy* are straightforward but perhaps surprising. First, liberalization has been driven less by microeconomic worries than by macroeconomic necessities. The accelerated opening, for example, was staged more to check domestic prices than to induce sectoral reshuffling toward Mexico's areas of comparative advantage. Second, while the public emphasis has been on trade, the key concern all along has been the need to attract the capital flows necessary to maintain the peso and hence preserve the hard-won macroeconomic victory against inflation.[4] Thus any political economy analysis of Mexico's initiation of NAFTA should center on what may seem to be less than obvious starting points.

Lustig offers more focused chapters on the impacts of the economic events of the 1980s on poverty levels and the distribution of income, the restructuring of the public sector and financial systems, and the ongoing reforms regarding trade and foreign investment. The last is the issue of most interest here. Lustig modifies her earlier linking of trade liberalization with the 1987 macroeconomic package and discusses the earlier debates and actions about joining the General Agreement on Tariffs and Trade (GATT). She also covers topics found in many of the books reviewed here, including foreign investment laws, respect for intellectual property rights, and other issues. Each chapter is comprehensive and analytical, and the entire book benefits from Lustig's excellent amassing of consistent and meaningful data from a wide variety of national sources. Although more history, more politics, and more sectoral discussion would have been helpful in filling remaining gaps, *Mexico: The Remaking of an*

4. In fact, Mexico first tried to meet its financing needs by attracting the interest of European and Japanese investors. Unfortunately, Europeans seemed only mildly interested, partly because of more interesting opportunities in the former socialist nations, and thus the attention of Mexican policymakers turned to the United States and NAFTA.

Economy will be essential reading for any researcher examining the contemporary Mexican experience.

David Barkin's *Distorted Development: Mexico in the World Economy* also makes an important contribution, but it is at times a frustrating read. Like Lustig, Barkin seeks to detail how "Mexico's economy has literally been turned inside out" (p. 1). But in contrast with Lustig and her dispassionate but mildly critical tone, Barkin is clearly appalled by the liberalization trends now underway in Mexico. This perspective should make his book of particular interest, given that a voice of criticism in a sea of orthodox contentment usually rates a special listen. Unfortunately, however, Barkin's text seems to jump from topic to topic (partly reflecting the fact that the book was built on disparate essays), and the quality is uneven.

The best chapter of *Distorted Development* focuses on agriculture and food production. An acknowledged expert on these issues, Barkin seems overly enthusiastic about food self-sufficiency and the Sistema Alimentario Mexicano (SAM) of the late 1970s, but his critique of the impacts of Mexican policy and the internationalization of food markets on poor farmers serves as a useful counterweight to World Bank nostrums. After this discussion, however, *Distorted Development* drifts. The chapter on the environment seems more anecdotal than analytical, and although Barkin's review of capital flight offers useful numbers (mostly because he adds estimates of trade misinvoicing to the usual approaches), his discussion of the determinants of such flight is limited to brief references to the impact of social conflict on investor confidence. Barkin's chapter on Mexican macropolicy offers adequate coverage until 1987 but then fails to capture the significance of the shift signaled by the adoption of the Pacto de Solidaridad Económica (a point that became evident early in the program).

What Barkin emphasizes, and often powerfully, is the social polarization that has accompanied Mexican development. Particularly left out (and likely to be hit once again by NAFTA) have been small rural producers. To repair the damage, Barkin suggests a "war economy" strategy that borrows heavily from Irma Adelman's (1984) concept of industrialization led by agricultural demand. The key to Barkin's program is a mandated increase in wages and grain prices, the idea being that the consequent redistribution would spur aggregate demand and allow Mexico to grow its way out of the crisis. A variant of this approach was tried in Peru under Alan García in the mid-1980s, and the unhappy results could be even worse in Mexico, particularly given the latter's long history of maintaining few restrictions on capital outflow (Maxfield 1990) and the resulting ability of capital to protest changes in policy via exit. Moreover, it is hard to believe that the Mexican political system could produce the sort of progressive nationalist alliance, complete with modest business support, that Barkin is recommending.[5] Thus the "war economy" strategy is unlikely to solve the problem noted by Barkin that "the organized opposition offers no real alternative to the official reorganization" of the economy" (p. 4).[6]

Before discussing NAFTA, it is worthwhile to mention two other books that help supply the context for trade liberalization. The first is Sidney Weintraub's edited volume, *U.S.-Mexican Industrial Integration: The Road to Free Trade*. Most of this book consists of already dated and slightly dull reviews of industrial sectors in Mexico and the United States. An essay on the U.S. textile industry is followed by a review of the Mexican textile industry and so forth, with the focus in each case on the binational industrial complementarities and conflicts. The reviews of autos and pharmaceuticals are especially interesting and still useful, even though they were written before NAFTA was firmly on the horizon.

The introductory sections are the real stars in this collection. Rogelio Ramírez de la O's review of the Mexican macroeconomy rightly emphasizes the importance of intra-industry trade and is absolutely prescient in its view that the stabilization strategy after the Pacto was destined to generate the now-apparent problem with the current account. Luis Rubio's essay is also forward-looking in arguing that in abandoning the interventionist tools of the past, Mexico has lost its capability to engage in a serious industrial policy. This trend is rapidly becoming clear to Mexican officials, who are quietly worried about the beating Mexican industry has taken since the liberalization speedup of 1987. For those less enthused about plodding through the industry-level studies, Weintraub's summary (which is oddly enough the third article) nicely characterizes the various contributions, although his broader review of industrial effects in Lustig, Bosworth, and Lawrence's *North American Free Trade: Assessing the Impact* is actually of more general use.

One other starting point is *Assembling for Development: The Maquila Industry in Mexico and the United States* by Leslie Sklair. This updated version of Sklair's 1989 book with a similar title is a cautionary tale of Mexico's previous attempt at "export-led industrialization fueled by foreign investment and technology"—the *maquiladora* industry. Sklair is critical, arguing that the *maquilas* have largely failed to establish links to local business via transferring technology or improving the conditions of labor.

5. In a manner reminiscent of Alan García, Barkin argues that "the powerful industrialist and merchant classes also benefit substantially from the increase in well-being of urban workers and small rural farmers, as the initial stimuli increases production and sales throughout the economy" (p. 123). Perhaps more likely is a negative business response to perceived populism, particularly because the political bases for Barkin's program would be created through "popular mobilization" (p. 123).

6. Social polarization and widening inequalities may be negative consequences of Mexico's historic and current policies, but such economic injustice has not, contrary to Barkin's argument, posed a "limit to capitalist development." Attacking distributional issues is crucial, but this task is also likely to be postponed and to require different strategies.

Although he accepts the maquilas' ability to generate foreign exchange, he also points out the leakages from the cross-border spending of maquila workers and the contradictory effects of devaluation on domestic value added in the maquila industry.

Most relevant for this review is Sklair's last chapter (added for this edition) on the likely impacts of NAFTA itself. On the one hand, overall trade liberalization means the end of maquilas per se for two reasons: these firms will now lose their special status as duty-free importers and transformers of intermediate goods, and they will also be allowed to sell their end products in the domestic market. On the other, the trade and investment opening may bring the "maquilization" of Mexico, whereby the country's manufacturing will become tightly integrated into a North American–dominated productive structure. Sklair's central but ambiguous conclusion is that NAFTA may make "the maquila industry as such redundant" (p. 255), although the locational advantage of border plants should keep many existing firms competitive (p. 262).

Despite attention to detail that is sometimes excessive and a little too much dependency-style pessimism, Sklair's *Assembling for Development* provides a useful base for projecting the impacts of NAFTA and understanding the international and class alliances that have formed in favor of binational economic integration. The central questions of NAFTA's economic effects and political support are the focus of the majority of the texts reviewed in the following section.

Evaluating NAFTA

One industry whose growth was immediately triggered by the possibility of NAFTA was publishing, as presses rushed into print academic (and not-so-academic) studies on NAFTA's likely impacts. Most of these works were written to influence U.S. policymakers' views of what to ask for and what to settle for. Although some authors also hint at what the Mexicans should have requested, few observers believed that the insulated inner circle negotiating on behalf of Mexico was open to critical research on NAFTA given that Mexico had initiated the effort and Salinas was hardly likely to back off. Thus recommendations for Mexican bargaining strategy have been fewer.[7] Despite the frequent focus on the U.S. side, many of the books under review include analyses of Mexico, if only

7. One book focusing on free trade from the Mexican angle is *Hacia un tratado de libre comercio en América del Norte*, edited by Miguel Angel Porrúa and the Grupo Editorial (Mexico City: Grupo Editorial, 1991). It includes an introduction by Jaime Serra Pucha, head of the Secretaría de Comercio y Fomento Industrial (SECOFI). Despite its boosteristic and one-sided tone, this book influenced the limited debate occurring within Mexico. A more critical Mexican perspective is offered in *La integración comercial de México a Estados Unidos y Canadá*, a collection put together at the Universidad Nacional Autónoma de México (UNAM) (Mexico City: Siglo Veintiuno, 1990).

to determine how the likely effects of further liberalization within Mexico will influence the U.S. economy.

In evaluating the evaluations, it is important to note some of the issues associated with free trade agreements, a task taken up in *The Dynamics of North American Trade and Investment*, a somewhat dated but well-executed collection edited by Clark Reynolds, Leonard Waverman, and Gerardo Bueno.[8] First, the distinction between inter-industry and intra-industry trade must be understood. The former is the stuff of comparative advantage: Mexico is "better" at producing one product, the United States at another, and according to the traditional theory, each country should specialize and trade those products. Increasingly important to world and U.S.-Mexican trade is intra-industry trade, in which both countries produce products within the same industry, often with similar ratios of capital to labor, and wind up specializing (for example, in auto engines in one country versus assembled cars in the other) in order to gain the economies of scale possible when one country's companies can dominate one subsection of the market in both countries.[9] At the risk of exaggerating the distinctions, it could be said that increased inter-industry trade generates the static (or onetime) efficiency gains associated with comparative advantage while increased intra-industry trade generates the dynamic (or growth) gains associated with the competitive advantage of capturing a large share of the market.

In both comparative and competitive advantages, the presumption is that a small country opening up to a large country will gain more than its trading partner: efficiency gains in the small country will be relatively larger (that is, the small country will tend to specialize more and hence gain from shedding a wider range of less productive activities) and the enhancements in the potential scale of production are naturally greater for the smaller partner who is gaining access to the larger market. This theoretical precept is one reason why so many analysts have assumed that Mexico will benefit and have thus focused the policy debate on the costs and benefits to the United States. From the other side, the implication of the small country scenario is that the net effects of NAFTA will be insignificant for the United States while the induced transformations in Mexico will be large and profound.

Underlying the industrial effects is the labor market. The traditional presumption has been that trade-induced specialization in prod-

8. Although *The Dynamics of North American Trade and Investment* focuses mostly on the U.S.-Canada relationship and many of its essays are too technical for a general audience, the collection clearly lays out the theoretical issues raised by a free trade area, particularly in the excellent contributions by Richard Caves and by Morley Gunderson and Daniel Hamermesh.

9. Rogelio Ramírez de la O's piece in *U.S.-Mexican Industrial Integration* disaggregates Mexican industries and notes certain sectors with high rates of growth in imports from and exports to the United States, suggesting the growing importance of such binational intra-industry trade. See also Ros (1991).

ucts will also reflect relative endowments of capital and labor: with freer trade, Mexico will concentrate on labor-intensive products and processes while the United States will shift to high-technology and capital-intensive production techniques. This prospect implies that labor demand and incomes will rise in Mexico and fall in the United States, yielding distributional consequences that appear frightening to U.S. workers. NAFTA apologists insist, however, that any such negative effects on U.S. labor will be small because the larger economy will be less affected for the reasons outlined above. According to this perspective, U.S. workers will gain as consumers, and job creation at the high end will make up for any losses at the low end.

But it is not clear that those obtaining the new "good jobs" induced by trade will be the same workers who lost the old "bad jobs" (particularly given unemployment and the absence of job-training programs and other supportive public policy in the United States). Moreover, as Morley Gunderson and Daniel Hamermesh point out in their contribution to the Reynolds, Waverman, and Bueno collection, those already disadvantaged in the labor market (older, female, and minority workers) are more likely to be the transitional victims of such a trade opening. In an intriguing study of the labor-market impact of U.S.-Mexico integration (not included in any of the books under review), Edward Leamer has developed a model dealing with capital and two types of labor (high-skilled and low-skilled). He concludes that NAFTA is likely to increase wages at the higher skill levels but significantly reduce the annual wages of the average low-skilled worker in the United States (Leamer 1992). Clearly, the labor-market effects are more complex than depicted in simple models, and it may be more useful to think of U.S.-Mexican integration as a coupling of two sets of segmented labor markets in which trade liberalization induces a "widening divide" according to class within each country (see the upcoming discussion of the essay by Raúl Hinojosa-Ojeda and Sherman Robinson).

A final theoretical issue is that of trade creation versus trade diversion. First, however, observers must understand what a free trade agreement is and what it is not. Although such an agreement involves a commitment to reducing tariffs and quotas between two partners, it does not explicitly involve the harmonization of macroeconomic policy and social standards (as in a common market like the European Community) or an agreed-upon "external" tariff for products from all countries not part of the agreement (as in a customs union). Despite the lack of a common external tariff, any free trade agreement is likely not only to create new trade (due to specialization and effects of scale) but also to divert trade (as, for example, when the United States suddenly finds Mexican products cheaper than Caribbean-produced alternatives). Concern about trade diversion has made other Latin American countries anxious observers of the NAFTA negotiations, particularly with regard to whether NAFTA would include an "accession clause" for future members.

While not a theoretical issue per se, it should be reemphasized that the NAFTA proposal has been as much about investment as about trade. As Lustig argues, Mexico's central rationale for negotiating a free trade arrangement has been the hope that it would attract foreign investors by "freezing" the open economy reforms already in place while enlarging market access from a Mexican production base. Assumptions about the actual investment response to NAFTA vary widely and generate divergent economic projections. If one believes that the effect is a pure investment diversion from the United States to Mexico, then U.S. job loss will be significant (see Koechlin and Larudee 1992). Other analysts are more optimistic, arguing that U.S. and Mexican investment will be complementary. This issue has not been studied sufficiently, however, and many models purporting to gauge the effects of NAFTA assume capital immobility, hardly the correct view given the intent of Mexico to stimulate interest in investing across the border.

The actual results of the NAFTA negotiations (minus the recent "side agreements") are conveniently summarized in *NAFTA: An Assessment* by Gary Hufbauer and Jeffrey Schott. This book follows up on their influential *North American Free Trade: Issues and Recommendations*, which helped shape Washington policymakers' views during the negotiations with Mexico. Although this continuity is a strength, it also leads to a sometimes annoying grading of NAFTA against the authors' previous suggestions. Even so, *NAFTA: An Assessment* is essential reading and makes clear the dramatic progress achieved in reducing trinational tariffs, liberalizing Mexico's foreign investment regime (including guaranteeing "national treatment" of foreign investors, relaxing performance requirements on foreign-exchange generation, and other matters), and enhancing intellectual property rights (through improving patents and copyright protection).

As in their earlier analysis, Hufbauer and Schott argue that the likely scenario under NAFTA is quite rosy. Rejecting what they term the "pauper labor argument"—that "imports by a rich country from a poor country must inevitably reduce the standard of living in the rich country"—they note that high wages in the United States will persist if high productivity also persists (p. 11). They project that NAFTA will produce a net increase of 170,000 U.S. jobs in the "foreseeable future" (p. 12). Although Hufbauer and Schott acknowledge that some jobs will be lost, they argue (against others like Leamer) that there is "no overall tendency for . . . U.S. imports from Mexico to displace low-skilled U.S. jobs" (p. 21). As Faux (1993) points out, this view is problematic. For example, Hufbauer and Schott's estimates of NAFTA-induced jobs include those that have already been created by Mexico's unilateral trade liberalization, making it difficult to gauge the impact of NAFTA per se.[10] In addition, U.S. job gains may deteriorate in the future as Mexico finishes its current binge of importing capital goods and uses its newly installed productive capacity to export consumer and other goods to the United States. Finally, as some economists and almost all business executives acknowledge, many Mexican plants are operating at levels of productivity similar to those in the United States, weakening the argument that U.S. firms face roughly equivalent labor costs after they are adjusted for productivity in both countries.

Turning to the consumer side, Hufbauer and Schott argue that the United States will experience a gain of 1.9 billion dollars in static efficiency (from specializing according to comparative advantage). As Faux notes, this increase amounts to about two cents a day for the average U.S. citizen, swelling to fifteen cents a day if one counts the dynamic gains from growth. Clearly, the crux is not the total effects but rather the gains and losses by sector, class, and skill level. Thus it is important to disaggregate effects not only for policymaking but also for understanding the particular sources of resistance to free trade on both sides of the border.

On the sectoral front, Hufbauer and Schott note that transnational firms in the Mexican auto industry will find their domestic-content and foreign-exchange requirements relaxed. At the same time, the relatively high level of NAFTA-wide "rules of origin" for autos suggests a reconcentration and reorganization of production across Mexico, the United States, and Canada, which means that Mexico is likely to remain a prime site for investment despite the already mentioned weakening of regulations on domestic content. Oil remains largely off-limits to foreign firms, as expected, but Mexico will allow performance contracts (for exploration) and transnational production of various basic and secondary petrochemicals. Agricultural trade will be significantly liberalized, albeit with long transition periods and various safeguards against import surges. Financial services in Mexico will be opened to foreigners, again with long transition periods (to protect the new owners of the recently privatized banking system) as well as temporary and permanent "safeguards."[11]

10. As Hufbauer and Schott make clear in *North American Free Trade: Issues and Recommendations*, their baseline projections are founded on a scenario of "collapsed liberalization" (p. 53) and a total cutoff of net capital flows. Few other observers believed that Mexico would have turned wholly to old-style state intervention if NAFTA had been rejected by the U.S. Congress. Projecting a total investment shutdown therefore seems excessive. Given this pessimistic base, it is little wonder that their model "suggests the possibility for larger trade gains in both directions than any of the CGE [computable general equilibrium] or econometric models" of other researchers. It is useful to recall that this optimistic "outlier" was very influential in shaping the views of policymakers in the Bush administration.

11. The most significant of these financial-sector safeguards is a 4 percent market share limit on any individual foreign bank's acquisition, a feature that "effectively protects the largest banks from foreign takeovers" (p. 62). This limitation reflects Mexican national concerns but also suggests the influence wielded by large financial interests in the negotiat-

Perhaps the most striking feature of NAFTA is its permanent liberalization of rules governing U.S. and Canadian investment in Mexico. As Hufbauer and Schott observe, "NAFTA marks the first time that a developing country has accorded to foreign investors from the developed countries the more favorable of either national or MFN (most-favored nation) treatment, has adopted rigorous dispute settlement procedures, and has accepted comprehensive constraints on its use of performance requirements" (p. 84). Dramatic progress on this front again illustrates that this treaty is primarily aimed at attracting new foreign investment.

To get a sense of the likely impacts of the treaty, it is useful to go beyond Hufbauer and Schott's optimistic predictions to other key studies of the likely effects. Here, the crucial work is the volume edited by Nora Lustig, Barry Bosworth, and Robert Lawrence, *North American Free Trade: Assessing the Impact*. The most significant contributions are those by Drusilla Brown, Sidney Weintraub, and Raúl Hinojosa-Ojeda and Sherman Robinson. Brown's piece is a bit technical but will delight practicing economists. She reviews the range of models of applied general equilibrium (AGE) used to estimate the effects of NAFTA and details how different authors' assumptions and methodology lead to different predictions.[12] Weintraub updates *U.S.-Mexican Industrial Integration* (his collection already assessed here) by covering the full range of industrial effects reviewed either by AGE models or by sectoral studies. This useful summary of the research to date highlights an unsettling point: most economists are estimating that NAFTA will produce only small gains in social welfare or well-being even as they understate the labor adjustment and other transition issues.

The real gem in the Lustig, Bosworth, and Lawrence collection is Hinojosa-Ojeda and Robinson's piece on the labor issues raised by NAFTA. They begin by surveying a large number of studies on this question and then highlight their own AGE model. It employs a crucially modified assumption: the possibility of rural-urban migration as free trade in agriculture (particularly in corn) disrupts and displaces traditional producers (see also Hinojosa-Ojeda and Robinson 1991; and Hinojosa-Ojeda and McCleery 1992). This possibility, also noted by Levy and van Wijnbergen (1992), implies a continuing labor surplus that will dampen any expected

ing process. The "bankers' alliance" described in Maxfield (1990) is apparently alive and well.

12. The most important conclusion Brown draws regarding the various AGE models is that the largest positive effects occur when capital flows to Mexico are included in the estimation (for positive impacts, NAFTA has to be primarily an investment enhancer) or when productivity enhancement (perhaps through technology transfer) is assumed. She also notes that the biggest limit on most AGE models is that they assume full employment and balanced markets in real goods (in order to "balance" equations and "close" the system) and therefore cannot account easily for such macroeconomic phenomena as unemployment, trade imbalance, and shifts in the nominal exchange rate (p. 57).

wage growth in Mexico and probably swell the emigration of workers to the United States, thus exacerbating the already negative impact of open trade on low-wage workers north of the border. Although Hinojosa-Ojeda and Robinson do not fully explore their recommendations in this essay, they have employed the same results to argue elsewhere for several measures: long transition periods for agriculture as well as creation of a North American development bank and adjustment fund (which was eventually approved by the U.S. Congress) for easing the adjustment process, investing in rural infrastructure, and forestalling immigration flows. The point is that accounting realistically for possible movements in labor supply dramatically alters the results, suggesting a certain fragility in the seemingly precise econometric estimations used to justify NAFTA.

Because the Hinojosa-Ojeda and Robinson findings have been so challenging, particularly to the insistence of Mexican officials that the country wants to "export products, not people," it is no surprise to find a thin but important rejoinder. *The Uncertain Connection: Free Trade and U.S.-Mexican Integration*, by Wayne Cornelius and Philip Martin, argues that the "job displacement" thesis argued by Hinojosa-Ojeda and Robinson and also by Levy and van Wijnbergen is overstated because rural producers have income from sources other than maize (p. 7). Cornelius and Martin also predict that migration will stop long before wages are equalized because "international labor migration is far more than a simple response to wage differentials" (p. 18). In reality, what matters is the direction of wages, and the authors' assumption of a trend toward binational wage equalization leads them to forecast a slowdown in rural outmigration.

Other authors, however, assume that the displacement of rural producers will worsen wages at the lower end of the labor market. Moreover, as Cornelius and Martin rightly note, "transnational migrant networks" formed by previous labor flows encourage a "culture of outmigration" in which Mexican residents have contacts who can provide information and connections to U.S. labor markets. Migration, in short, is a historically cumulative phenomenon, and given that Cornelius and Martin admit that NAFTA will cause an immediate increase (which they suggest is merely a change in the timing of exit), one worries about their final graph showing an unmeasured decline in immigration to the United States over an unspecified period of time.

A slew of other books and writings discuss NAFTA's likely effects, usually adding arguments about what negotiators should ask for (or should have asked for). A major instance is *The New North American Order: A Win-Win Strategy for U.S.-Mexico Trade.* This commentary by Clyde Prestowitz, Robert Cohen, Peter Morici, and Alan Tonelson of the Economic Strategy Institute questions the wisdom of free trade and argues for a more managed approach by the United States. Much of their caution is based on a suspicion that the Mexican commitment to liberalization is not sincere. Noting that old habits of bureaucratic control tend to persist, especially in Mexico's authoritarian political system, the authors seem worried that Mexico is secretly committed to an industrial policy in the style of Japan and more recently Korea, one that will "take advantage" of the United States. Many other observers wish Mexican policy really were that coherent. In fact, Mexican decision makers are only now realizing that they are about to integrate with the world's largest industrial economy without any planned program to steer domestic resources to the likely winners under NAFTA.

The authors of *The New North American Order* nonetheless provide an interesting analytical contribution. Their model assumes that foreign investment will enter Mexico not in a broad-based fashion (across all industries) but rather will be targeted toward export industries. This twist generates an increasing U.S. trade deficit with Mexico and hence a pessimistic scenario for U.S. workers and producers. To counter this outcome, Prestowitz, Cohen et al. suggest that U.S. investors work to transform Mexico into a platform for reexport not just to the United States but to the rest of the world.[13] Unfortunately, this intriguing insight gives way to recommendations not unlike the more "liberal" ones made by Hufbauer and Schott. What both these analyses lack is an explicit call for a rational industrial policy in both countries.

Such a call is a central theme of Barbara Jenkins's *The Paradox of Continental Production: National Investment Policies in North America*. This book is a welcome find in that its truly trinational approach focuses appropriately on investment flows. Her key argument hinges on rejecting a "globalist" view that individual countries have little policy latitude vis-à-vis transnational investors because any restrictions they may place will only chase away foreign capital. Jenkins argues instead that the ebbs and flows of investment have to do more with business cycle conditions than with regulatory practices, and she opens up theoretical room for state intervention by suggesting that governments may play a significant role in "creating [a] web of informal relationships" or business alliances and in coordinating the subsequent "quest for competitive advantage" (p. 23). In the Mexican case, Jenkins hangs her case for state intervention partly on the example of the auto industry, a sector where "restrictive decrees" have not repelled foreign manufacturers and may well have helped transform the industry into a pro-trade export platform and one of the assumed winners of the current opening to U.S. markets.

On the policy side, Jenkins argues for government "softening" of

13. Prestowitz and Cohen use as an example the relationship between Japan and Thailand, arguing that "Japan has been able to use its sizable and growing foreign investments to turn its low-wage neighbor into an export platform to the rest of the world for Japanese companies' products, thereby improving the competitiveness of both countries" (p. 53).

the ill effects of free trade: "Minus a prominent state role for adjustment and ensuring the competitiveness of individual firms, the practice of free trade is threatened. . . . [By] ignoring the need to cushion threatened actors, economic liberals in effect sabotage their own projects by guaranteeing that they will not be politically acceptable" (pp. 28, 35). Toward the end of *The Paradox of Continental Production*, Jenkins considers NAFTA directly and finds it lacking in social safety nets and any strategy for steering investments in industry. Perhaps surprisingly, the lack of an industrial policy framework has become the whispered worry in Mexican policy circles, particularly as Mexican firms lose out in the competitive battle and the new streams of foreign investment turn out to be mostly portfolio-type purchases in the stock market rather than direct creation of plant and equipment.

A few other books evaluating NAFTA merit a brief mention. *Toward a North American Common Market*, edited by Charles Bonser, focuses on why world trends like the consolidation of the European Community and the failure of the Uruguay round of the GATT talks have caused North American players, particularly the United States, to consider turning away from traditional multilateral efforts. The best of the contributions for Mexicanists is that by Randall Baker and Joseph Miller, who review the changes in the Mexican economy and make an "advocacy case" for a free trade agreement based on the assumption that regional blocs are inevitable. Hufbauer and Schott's contribution is also good, but their views are better elaborated and updated in their own books. The rest of *Toward a North American Common Market* is competently argued, but the reader finds an uncomfortable sameness of opinion and is left rather unenlightened about the details of NAFTA itself.

Definitely not required for Latin Americanists is *Implications of a North American Free Trade Region: Multidisciplinary Perspectives*, edited by Joseph McKinney and Rebecca Sharpless. This rather stiffly organized volume focuses primarily on the earlier U.S.-Canada trade pact. Each section has a U.S. perspective and a Canadian perspective, followed by a few pages commenting on the earlier pieces from a Mexican perspective. Only some pieces incorporate Mexican concerns: Peter Morici discusses why the United States and Canada should seek agreements with Latin America; Earl Fry comments on Mexican assimilation into the U.S.-Canada accord; and the contributions focusing on legal aspects of free trade directly tackle Mexico's incorporation into mechanisms for resolving disputes. Nonetheless, the volume's structure, which allows only brief space for the "Mexican perspective," makes the collection of limited utility for most Latin Americanists.

The Premise and the Promise: Free Trade in the Americas, by Sylvia Saborio and the other contributors, fills one more niche in the literature in being the only book under review to concentrate on NAFTA's meaning for and effects on the rest of Latin America. Published in 1992 (presumably before the U.S. presidential elections), the book focuses on the hemispheric free trade areas at the core of President George Bush's Enterprise for the Americas Initiative. Despite this link to an outdated policy, the question of NAFTA's impact on the rest of Americans as well as the possibilities of other countries' accession to NAFTA remain relevant.

Saborio's introductory essay suggests that the benefits of individual free trade arrangements between the United States and countries other than Mexico are marginal at best, all the more so because the rest of Latin America accounts for only 6 percent of the U.S. export market—less than Mexico alone (p. 12). Projections by contributors Refik Erzan and Alexander Yeats suggest that the "potential (static) trade gains from a preferential removal of U.S. barriers to Latin American exports appear to be relatively small and unevenly distributed," with 80 percent of the gains accruing to Mexico and Brazil (pp. 25–26). Despite this possibility, some pressure is building in other Latin American countries to pursue free trade agreements with the United States, partly out of fear of the trade diversion that will occur in NAFTA's wake.

In opening up NAFTA to other countries, the contributors to *The Premise and the Promise* suggest a number of key considerations and concerns. Morici, for example, makes an eloquent argument that NAFTA-style arrangements, in integrating Latin American countries with the world's strongest proponent of "atomistic capitalism" (the United States), could exclude the possibility of the kind of market-supporting industrial policies embodied in Japan's "syndicate capitalism" (pp. 65–66).[14] José Manuel Salazar-Xirinachs and Eduardo Lizano argue for "asymmetric liberalization" in order to give Latin American countries access to the U.S. market and more time for domestic adjustment (p. 88). Richard Lipsey argues strongly that there should be one hemispheric agreement (to which countries can accede) rather than "a series of bilateral arrangements, with the United States at the hub, and single Latin American countries at the other end of each spoke," an arrangement that would give unfair advantage to the United States and create trade diversion from each of the "spoke" partners (p. 106). Erzan and Yeats worry that even without a hub-and-spoke arrangement, U.S. manufactured and capital goods could displace intra–Latin American trade in these products and hence prevent industrial diversification.

In any case, it appears unlikely that NAFTA will be expanded in the near future. As Hufbauer and Schott note, NAFTA's accession or "docking" clause "suffers from several flaws." Examples are industry provisions (as with autos) that are a poor fit for other countries, unclear

14. This concern that free trade arrangements will hinder industrial policy is also stressed by Lipsey in *The Premise and the Promise* (pp. 103–4).

application procedures, no limits that would constrain accession to Latin American trading partners only, and a built-in "one-country veto" of new members (pp. 114–15). Apparently, U.S. enthusiasm for hemispheric free trade waned as the concept moved from rhetoric to reality in the course of negotiating NAFTA. Equally likely is that Mexican officials realized the veracity of arguments made by various contributors to Saborio's volume: Mexico would gain less from a multicountry free trade arrangement and may enjoy certain advantages if it can serve as its own "hub" between the United States and Latin America. In short, the region will probably have to "digest" NAFTA before moving on to a hemisphere-wide agreement.

Why NAFTA?

Amidst the sound and fury created by the NAFTA negotiations, two central questions seem to have fallen by the wayside: why has the Mexican liberalization occurred, and why now?[15] There are two simple but contradictory answers: either the Mexicans, after a long lapse from orthodox sanity, have finally "awakened" to the virtues of comparative advantage, or the debt crisis has allowed the imperialist North to impose its will on a weakened neighbor.

Neither view is sufficient. Disputing the "imperialist" view, it was Mexico that orchestrated a unilateral opening beyond anything demanded by the IMF or GATT and then initiated the call for NAFTA negotiations. This move actually came as a surprise to U.S. administration officials, who had not really believed that any Latin lenders would take up the free-trade agenda suggested by former President Bush when he announced the 1990 Enterprise for the Americas Initiative. As for the "wake-up" view, it assumes that free trade was "right" all along, a notion that ignores the utility of ISI and other restrictions in constructing Mexico's industrial base and generally fails to explain exactly what has occurred institutionally and politically that has allowed neoliberal policymakers to dominate the Mexican scene.

Of the books reviewed here, only one purports to explain (at least in part) the "why" of NAFTA. Ricardo Grinspun's and Maxwell Cam-

15. Another equally compelling and underresearched question concerns the macroeconomic sustainability of the Mexican reforms. While the Mexican case may be usefully contrasted with other liberalization episodes (the method used by Hufbauer and Schott to generate their optimistic projections), it may be just as fruitful to restrict comparison to only those cases in which relatively fixed and overvalued exchange rates were a key policy feature. By this benchmark, one might worry whether Mexico's quadrupling of imports since 1987, the concurrent worsening of the current account by nearly 9 percent of the gross domestic product, and the resulting dependence on portfolio and short-term capital flows are signals of an impending financial explosion like that witnessed in Chile and Argentina in the early 1980s. Few researchers have focused on this aspect to date, suggesting an avenue for future work.

eron's edited collection, *The Political Economy of North American Trade*, bears a hopeful title. The editors' introduction and the excellent contribution by Gerald Helleiner (replete with a game-theory analysis of trade bargaining) consider explicitly the deeper reasons for Mexican liberalization. The collection also contains other useful pieces. Daniel Drache's article takes Jenkins's argument one step further in insisting that the momentum toward hemispheric free trade is part of a neoconservative program to impede structurally the possibility of formulating progressive industrial and social policies. Judith Hellman contributes a fascinating study of how asymmetric access to information has helped produce support for NAFTA among likely Mexican winners and a sort of confused neutrality among likely losers. She also shows how some support is based almost purely on ideology, noting the enthusiasm of small business owners who are pleased to see the state in retreat but are apparently unaware that they may be crushed in the ensuing competition. Finally, Judith Teichman's piece focuses on how monopolization and privatization have swelled the constituency for trade liberalization, while Adolfo Aguilar Zinser's contribution reminds readers of the important role of authoritarianism in squelching open debate and maintaining the informational asymmetries documented by Hellman.[16]

Unfortunately, *The Political Economy of North American Trade* strays afield from these topics. Its general call for a social democratic approach to trade relations echoes Jenkins and others, but this political project gives the book two sometimes competing goals: a rigorous analysis of the political economy of NAFTA and an alternative set of policy prescriptions and critiques of orthodoxy. The latter category includes several contributions that are analytically weak and overly ideological (an important exception being the piece by Jeff Faux and Thea Lee). Nonetheless, this book represents an important step toward explaining NAFTA and should be an integral part of any complete set of references on the subject.

Serious analysis of the emergence of NAFTA is a crucial task, particularly because it will provide insight into the political and economic requirements not only for NAFTA's sustainability but also for other trade reform efforts underway in Latin America and elsewhere. Strands of such an overall analysis can be found in many of the books reviewed, especially in Lustig's focus on the macroeconomic and investment rationales, Barkin's radical view of Mexican restructuring, and Jenkins's study of foreign investment. Explanatory efforts are also available in a number of published and unpublished articles that make good use of the tools of modern political economy, including game theory and formal modeling

16. As Aguilar Zinser notes, "The Mexican government has given NAFTA negotiations the equivalent status of a national security affair, keeping information almost a state secret . . . and transmitting only general propaganda messages to the public" (p. 207).

(for examples, see Blecker 1993; Cameron 1992; and Rodrik 1992a, 1992b). Nonetheless, we still have only incomplete answers to what is really a prior question—under what conditions does trade reform take place? Addressing this issue is likely to produce yet another flurry of academic research.

While the uncertainty over NAFTA's approval by the U.S. Congress is now ended, trinational conflicts over its meaning and consequences will continue. In spite of continuing debates, the processes of economic integration codified by NAFTA will go forward, binding together the lives and destinies of the U.S., Canadian, and Mexican peoples. Whether this integration will bring North America bounty or misery will depend not on abstract economic models but rather on serious policy attention to the needs of low-wage workers and rural producers accompanied by a hard-nosed view of exactly what is possible in today's highly globalized economies. The works reviewed here provide a set of starting points for understanding Mexico's role in these changing realities, but the research agenda on these topics is far from exhausted.

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