The Political and Economic Transformation of Mexico Since NAFTA

Stephen Haber
Stanford University
Presented at Federal Reserve Bank of Dallas, April 8, 2016
Mexico Before NAFTA

Circa 1974, 20 years before NAFTA, Mexico was characterized by:

- Autarky (closed to trade and FDI)
- Financial Repression
- Low Levels of Public Goods Provision
- Minimal Taxation
- Widespread Poverty
- Authoritarian Government
- These features were not independent of each other; they were part of a general equilibrium.
How do you encourage investment when property rights are insecure?

Raise rates of return as compensation for expropriation risk

1. Access to capital as a barrier to entry.
2. Import licenses as barriers to entry.
3. Tax capital at low rates.
4. Share some of the rents with organized labor groups affiliated with the PRI.
5. Do very little for everyone else.
The paradox: a country ruled by a “revolutionary government” with the income distribution of South Africa
Mexico Since NAFTA

- 20 years after NAFTA, Mexico is characterized by:
  - An open, export-driven economy
  - Openness to FDI
  - Sustained (but not breakneck) growth
  - Financial openness
  - Increasing levels of public goods provision
  - Falling poverty levels
  - Less corruption (although starting from a high base)
  - A multiparty democracy
  - These features are also not independent of each other: they are part of a general equilibrium
Let’s be careful about causation

• The fact that NAFTA occurred in between 1974 and 2014 does not mean that NAFTA “caused” the shift in equilibria in the narrow sense of the word.

• But…NAFTA was an important part of a larger process that brought about that shift in equilibria, and that larger process was about political survival. NAFTA was part of a larger gamble by the Salinas government.

• That gamble set in motion a process that became difficult to control. It was not trade and investment that were rerouted, the equilibrium path of development was shifted.
Why the Mexican Government Abandoned Autarky in One Slide

![Graph showing Mexican Real GDP Per Capita, 2005 PPP$, 1974 to 2012. The graph compares Pre-NAFTA and Post-NAFTA periods, highlighting a significant increase in GDP post-NAFTA.](source: Penn World Tables 7.1 and WBDI 2013)
Wages fell even faster than GDP--undermining the PRI’s coalition

Index of Real Mexican Manufacturing Wages, 1981=100

Source: Haber et. al, Mexico Since 1980.
Real wages fell fast, because the government financed itself through an unpopular inflation tax.
In short, the fate of the PRI was in Carlos Salinas’ hands.
Salinas gambled on trade, FDI, and privatization as a fix for the economy--and hence as a fix for the PRI.
NAFTA was not just about trade

NAFTA established mechanisms protecting the property rights of U.S. and Canadian investors. Mexico could no longer:

- Treat U.S. and Canadian companies differently from Mexican firms.
- Require U.S or Canadian-owned manufacturing plants to purchase a share of production inputs from Mexican sources
- Require them to export a greater value of goods than they imported.
- Prevent them from repatriating profits.
- Expropriate foreign firms and arbitrarily determine the level of compensation (NAFTA tribunals established).
The other part of Salinas’ gamble was the privatization of SOEs

The sale of SOEs provided one-time injections of cash and moved perennial money losers off the budget.

The two crown jewels:

Banks

Telecoms
Part of Salinas’ gamble paid off
Mexico became a manufacturing platform for the U.S.
Texas was a beneficiary of this jump in trade.
FDI also Increased as a result of NAFTA
But FDI increased modestly relative to the size of the Mexican economy.
So, FDI into Mexico is modest by international standards.
Thus, part of Salinas’ gamble did not pay off quite as expected
The third part of Salinas’ gamble was a loser: privatization resulted in a banking crisis
The Mexican economy grew, but by only 1.1% per year in per capita terms—and 1995 and 1996 were disastrous.

Source: Penn World Tables 7.1 and WBDI 2013
An unanticipated outcome:  
Foreign Bank Entry
An even more unanticipated outcome: Mexico democratized

Opening up the economy was disruptive. It hurt the PRI’s traditional coalition partners, while failing to generate fast enough growth to create new partners that could sustain one party rule.
The gains from NAFTA in Mexico were not all captured by elites
Conclusion: Mexico’s new equilibrium

• An open, export-driven economy
• Financial openness
• Increasing levels of public goods provision
• Falling poverty levels
• A multiparty democracy