Lessons from NAFTA for Latin American and Caribbean Countries

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Presentation outline

- **NAFTA’S RESULTS FOR MEXICO**
  - Trade
  - Foreign Investment
  - Productivity
  - Labor Market
  - Income per capita convergence with the U.S.A.
  - Regional divergence

- **KEY NEGOTIATION ISSUES**
  - Preparation and strategy
  - Rules of origin
  - Administered protection (antidumping, counter-vailing duties)
  - Agriculture
Results: Is an FTA with the U.S. worth it? The Mexican experience: Yes!

- Source of opportunities for development
  - Economic convergence with North America
  - GDP per capita, wages
  - Industrial productivity

- Effect on trade and foreign and domestic investment

- Demand for additional reforms, mainly related to institutions and technological innovation

- Challenges before, during, and after the negotiations: Benefits are not necessarily automatic, but they depend on complementary policies
Free Trade Agreements (FTA) versus Unilateral Liberalization

- Guaranteed market access
  - Effect on exports and investment
- Effect on trade policy credibility and the reforms
  - The more uncertainty there is at the beginning of negotiations, the more important
  - The more developed and large is the counterpart’s market, the more important
- FTA is more than trade in goods and services
  - It requires institutional reforms: intellectual property, investors protection, and others caused by indirect pressure
- The Mexican case: NAFTA immediately after the unilateral reforms ... different from LAC
Results: Trade increased (% of GDP)
Results: Effect of NAFTA on FDI? FDI per worker before and after NAFTA

Pre-NAFTA, 1983-1993
Post-NAFTA, 1994-1999

Origin of FDI

- Mexico
- Costa Rica
- Dominican Republic
- Chile
- Colombia
Results: Effect of NAFTA on FDI - effects by country on the FDI from the U.S. per capita, 1994-2000 (econometric evidence)
Results: Effect of NAFTA on FDI per capita relative to other LCR countries – notable but temporary?

Mexico country effects on Real FDI per capita
Results: NAFTA accelerated convergence in industrial productivity (econometric evidence)
**Results:** Aggregate TFP growth increased in Mexico, but it is still low. Chile is ahead.

![Bar chart showing TFP growth by country/region](image-url)

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<tbody>
<tr>
<td>Mexico</td>
<td>-1.62</td>
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<td>Chile</td>
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<tr>
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<td>OECD</td>
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<tr>
<td>East Asia</td>
<td></td>
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<td>1.00</td>
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Source: Loayza, Fajnzylber, Calderón (2002)
Results: Positive effects on wages and employment before and after the 1995 crisis

![Graph showing positive effects on wages and employment before and after the 1995 crisis.](image-url)
**Results:** Wages (and formality) are higher in sectors that are more exposed to trade.

Note: Non agricultural workers. Conditional on human capital.
Results: Influence of NAFTA and trade liberalization on wages across States (econometric evidence)

- Real wages increased more in States with higher:
  - Labor force education
  - FDI/GDP
  - Imports/GDP
  - Percentage of population that migrated to the U.S.A.
Results: Formal employment increases after the 1995 crisis

Formal employment increases after NAFTA/Tequilla

Formal employment decreases in Colombia—slowdown, real minimum wage, and overvaluation.
Results: After 1995, greater convergence of income per capita with the U.S. than other LAC countries (econometric evidence)
Results: Incomplete convergence of income per capita (ppp) between U.S. and Mexico after NAFTA

• Additional exercise: Convergence up to a point – reaching 50% of U.S. income per capita – after NAFTA
Results: Institutional gaps constrain the reduction of the income per capita gap between the U.S.A. and Mexico.
Problem: Institutional gaps limit the reduction of the income per capita gap of Mexico with respect to the U.S.A.

Index Range: between -2 and +2 for all countries

Fuente: Kaufmann and Kraay (2002a)
Results: Institutional gap (with respect to the U.S.) declined after NAFTA. But it declined more in other LAC countries ...

(Composite ICRG Index minus U.S. Index)

<table>
<thead>
<tr>
<th>COUNTRY/GROUP</th>
<th>BEFORE-NAFTA</th>
<th>AFTER-NAFTA</th>
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<td>-0.11</td>
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<td>0.09</td>
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<tr>
<td>CENTRAL AMERICA</td>
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<td>-1.61</td>
<td>0.90</td>
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<td>ANDEAN COUNTRIES</td>
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<td>-1.60</td>
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<tr>
<td>LAC</td>
<td>-1.83</td>
<td>-1.53</td>
<td>0.30</td>
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</tbody>
</table>
**Problem:** Secondary education deficit – Net enrollment ratio vs. income per capita

[Graph showing correlation between secondary net enrollment ratio and GDP per capita for various countries.]
Problem: Tertiary education deficit - Enrollment ratio vs income per capita
Problem: Education deficit -- Quality

Student performance and national income

Relationship between average performance across the combined reading, mathematical and scientific literacy scales and GDP per capita, in US$, converted using purchasing power parities (PPPs)

- OECD countries
- Non-OECD countries

GDP per capita (US$ converted using PPPs)
Results: Innovation activity increased, but not enough ... (patents per worker)

Caution! Mexico, Chile, Colombia, and LAC region are multiplied by 100. East Asia is multiplied by 10.
Problem: R&D gap in Mexico, post-NAFTA recovery ...
Problem: Innovation results gap in Mexico (residuals with respect to similar countries, patents)
Problem: Inefficiencies in the innovation system remain ...

Patenting Efficiency of R&D Expenditures, 1985-2000: Mexico and Selected Countries

(% deviation from OECD average)
Problem: Sub-national divergence (with respect to D.F.)
Problem: Causes of sub-regional divergence in Mexico (econometric evidence)

- Initial education (illiteracy and years of education of adult population)
- Infrastructure: access to telecommunications
- Possibly political instability and bad institutions
- “Conditional convergence” – if poor States had the same education, institutions, and infrastructure, they would have grown more than the rich ones
Before negotiations: Important topics for other LAC countries

- Sequence of negotiations and unilateral measures
  - Simultaneous Negotiations (FTAA, DOHA)? Examples: Chile, Central America, DR
  - FTAA and DOHA complementarity? Agriculture: tariff reduction in FTAA (or bilateral) and subsidies in DOHA
  - Unilateral Liberalization: Initial protection does not improve negotiation results in North-South versus North-North agreements (Freund 2002). Examples: Mexico, Chile

- Public and private sector technical groups

- How much to spend in lobbying in the U.S.
  - Mexico spent a lot: 35m dollars in 1990
  - Private sector investment in lobbying seems to be highly “effective” (Lee, Olarreaga, Silva 2002)
During the negotiations: Rules of origin -- Gains from switching from CBI/ATPA to NAFTA-type ROOs?
During: Rules of origin -- Utilization rates of apparel preferences, CBI versus NAFTA

<table>
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<tr>
<th></th>
<th>2001</th>
<th>Jan-Nov 2002</th>
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<tr>
<td><strong>Mexico</strong> (NAFTA)</td>
<td>68%</td>
<td>74%</td>
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<tr>
<td><strong>Costa Rica</strong> (CBI)</td>
<td>53%</td>
<td>65%</td>
</tr>
<tr>
<td><strong>El Salvador</strong> (CBI)</td>
<td>57%</td>
<td>63%</td>
</tr>
<tr>
<td><strong>Honduras</strong> (CBI)</td>
<td>62%</td>
<td>73%</td>
</tr>
<tr>
<td><strong>Nicaragua</strong> (CBI)</td>
<td>21%</td>
<td>29%</td>
</tr>
<tr>
<td><strong>Jamaica</strong> (CBI)</td>
<td>59%</td>
<td>88%</td>
</tr>
<tr>
<td><strong>Dominican Rep.</strong> (CBI)</td>
<td>68%</td>
<td>83%</td>
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During: Apparel – No diversion against Central America & Caribbean; but against Asia and Colombia?

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<tbody>
<tr>
<td>Mexico</td>
<td>3.74%</td>
<td>10.77%</td>
</tr>
<tr>
<td>Colombia</td>
<td>0.92%</td>
<td>0.70%</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>1.79%</td>
<td>1.50%</td>
</tr>
<tr>
<td>Central America and the Caribbean</td>
<td>10.06%</td>
<td>13.97%</td>
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<tr>
<td>China</td>
<td>15.44%</td>
<td>11.71%</td>
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<tr>
<td>Hong Kong</td>
<td>14.54%</td>
<td>8.82%</td>
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<tr>
<td>Asia</td>
<td>54.89%</td>
<td>40.47%</td>
</tr>
<tr>
<td>Africa (AGOA)</td>
<td>0.69%</td>
<td>0.94%</td>
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During: Rules of origin and apparel – Looking ahead ...

- Elimination of MFA Quotas by 2005
  - Threat of Asian apparel imports (China)?
- In general, apparel protection in the U.S. will continue to be eliminated as this sector continues to lose economic/political importance
- Therefore, preferences (in both FTA and ATPA/CBI) will be less and less important
- Challenge: to compete based on innovation and low transportation / logistics costs ... importance of complementary policies
**Econometric Evidence (Blonigen 2002):**
- Chapter 19 of NAFTA **has not had** a significant effect
- Canada – significant effect of accumulated “remands”
- Mexican cases are moving slowly
- CAUTION: Chile decided not to sign NAFTA-type procedures

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<tbody>
<tr>
<td>Canada</td>
<td>3.9</td>
<td>4.3</td>
<td>1.6</td>
</tr>
<tr>
<td>Mexico</td>
<td>1.1</td>
<td>3.8</td>
<td>1.7</td>
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<tr>
<td>Japan</td>
<td>7.6</td>
<td>6.3</td>
<td>3.3</td>
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<td>European Union</td>
<td>32.7</td>
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<td>Latin America</td>
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<tr>
<td>Asia</td>
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<td>22.3</td>
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<tr>
<td>Rest of the world</td>
<td>14.1</td>
<td>11.5</td>
<td>9.1</td>
</tr>
</tbody>
</table>
During: There have not been devastating effects for the Mexican countryside.
During: Mexican agriculture -- Imports and production of traditional agricultural products
Results: Agricultural land yields (productivity; tons/Ha) before and after NAFTA
Results: Mexican agriculture – Exports and production of fruits before and after NAFTA
### Results: Did NAFTA significantly change trends in agricultural trade? (econometric evidence)

**EXPORTS**
- Agricultural products
- Tomato
- Fresh vegetables
- Melon and watermelon
- Other fruits

**IMPORTS**
- Agriculture products
- Corn
- Other oleaginous
- Sorghum
- Soy
- Wheat

**STRUCTURAL CHANGE**
- December 1994
- December 1994
- November 1994
- September 1994
- June 1995

Results: Why didn’t Mexican agriculture suffer as much as expected?

- Demand growth in Mexico & U.S. in 1995-2000
- Productivity growth, mainly in agriculture with irrigation
- PROCAMPO and Alianza para el Campo
  - Subsidies to producers’ income; date from CONASUPO time
  - Are they efficient?
    - Mostly delinked from current and future production (PROCAMPO)
    - Programs managed by local authorities are less efficient (Alianza para el Campo)
During: Structure of traditional agricultural producer support in Mexico before and after NAFTA

During: Agriculture – Focus on market access (partial equilibrium estimates)

- Costa Rica: 28.4
- El Salvador: 0.1
- Guatemala: 3.6
- Honduras: 1.9
- Nicaragua: 1.3
- Mexico: -0.5

Change in income per capita (USD$)

Source: Hoekman, Ng, Olarreaga (2002, Appendix, Table 2).

Source: Hoekman et al. (2002)
During: The Mexican countryside and recent protests – the goal of productive transformation

- Protests caused by the NAFTA liberalization of January 1st 2003: chickens, turkeys, and pigs ...
- A grave political problem for the government, even though it is not an economic problem of great magnitude
- PROCAMPO, Alianza para el Campo, new policies have not succeeded in ameliorating social pressures
  - Recent policies: reduction of electricity fee for irrigation, diesel subsidies, safeguards for chicken parts
- Looking to the future: incentives in favor of productive transformation – feasible within NAFTA framework
Mexico: Challenges for agricultural transformation

- Macroeconomic stability
- *Ex post* pressures from groups affected by the liberalization
- Productive transformation and technological change:
  - Policies to aid structural change (PROCAMPO)
  - Education in the countryside
  - Credit (New Capitalization Law)
- Rural poverty (CONTIGO)
- Creation of non agriculture income sources for poor farmers
Lessons for LAC countries

- FTA with the U.S. is desirable (exports and FDI, faster growth of industrial productivity), but not enough for sustainable development and convergence
- Challenging complementary domestic agenda:
  - **Institutions**: fight corruption and improve the rule of law
  - **Education**: to reduce secondary, tertiary, and quality gaps
  - **National innovation policy!**: passive technology transfer is not enough
  - **Infrastructure**, especially in less developed regions
  - **Macro**: ensure debt sustainability
- FTA would be especially useful if it facilitates national consensus in favor of this agenda: Convergence of institutions and policies
Lessons for LAC countries

- Key negotiation issues for LAC countries: rules of origin, agriculture, administered protection
- Simultaneous bilateral, FTAA, and DOHA negotiations?
- Intensify private sector lobbying in Washington?