

Economics of the 2013-2014 Debate Topic: U.S. Economic Engagement Toward Cuba, Mexico or Venezuela

Debate Backgrounder No. 7

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“Resolved: The United States federal government should substantially increase its economic engagement toward Cuba, Mexico or Venezuela.”



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Economics is the branch of human knowledge concerned with the satisfaction of human wants through the production of goods and services, and the exchange of those goods and services between two or more individuals. Thus, economics encompasses human activities from simple barter between two individuals to international trade between firms or governments. Many of these economic activities are regulated by government, and some are outlawed. Trade and other economic activities that cross national borders — such as sales of goods and services, travel, migration or transfers of money — are regulated by both the government of the originating country and the government of the destination country. The government itself could be an economic actor, buying and selling from other governments or firms in other countries; or the government could regulate the private economic activities of individuals and firms.

Economic engagement between or among countries can take many forms, but this document will focus on government-to-government engagement through 1) international trade agreements designed to lower barriers to trade; and 2) government foreign aid; next, we will contrast government-to-government economic engagement with private economic engagement through 3) international investment, called foreign direct investment; and 4) remittances and migration by individuals. All of these areas are important with respect to the countries mentioned in the debate resolution; however, when discussing economic engagement by the U.S. federal government, some issues are more important with respect to some countries than to others.

International Trade

Countries trade with each other because the activity typically makes them better off. Imagine a country that has decided to isolate itself economically from the rest of the world. In order to survive, the citizens of this country would need to grow their own food, make their own clothes and build their own houses. However, if

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this country decided to open its border to trade, its citizens would specialize in the activities they do best and enjoy a greater variety of goods and services, even at a lower cost.

Absolute Advantage and Comparative Advantage. With respect to international trade, countries are usually grouped together under two categories: absolute advantage and comparative advantage.

The term **absolute advantage** refers to the ability of a country to produce some things cheaper or better than another. For example, some tropical countries have absolute advantages over the United States in the production of bananas. This fruit can be grown much more cheaply in the tropics than in places where greenhouses and other artificial means of maintaining warmth would be necessary. This does not mean that the United States is completely incapable of growing bananas; rather, that it would require many more resources to grow them here, when bananas can be purchased from Caribbean countries at a lower cost. Foreigners who buy that country's products benefit from the lower costs, while the country itself obviously benefits from the larger market for its products or services.

Consider a country that is capable of producing anything more cheaply than a neighboring country. Would this country be still willing to trade with its neighbor? The answer is yes. Because, as

Thomas Sowell states in *Basic Economics*, "being able to produce anything more cheaply is not the same as being able to produce everything more cheaply." Let us take Sowell's example to explain the real driving force behind international trade: **comparative advantage**.

A fundamental principle of economics holds that when a country produces more of one product, it will create less of some other product. This trade-off occurs because resources are scarce and societies want to get the maximum benefit from them. The central question in international trade is not how much it costs, in either money or resources, to produce, for instance, T-shirts or computers, in one country compared to another country. The question is how many T-shirts it costs to produce a computer when resources are shifted from producing one product to another. The country that can produce more computers by, say, forgoing production of 1,000 T-shirts can benefit from trading with the country that gets fewer computers in return for not producing 1,000 T-shirts.

An Example of Gains from Trade: T-shirts versus Computers. Assume that the average American worker produces 500 T-shirts a month, while the average Chinese worker produces 450 in the same period of time. Similarly, assume that the average American worker produces 200 computers a month while the average Chinese

Table I

T-Shirts versus Computers: The Absolute Advantage of the United States over China

Products	United States		China	
	Workers	Output	Workers	Output
T-shirts	200	100,000	200	90,000
Computers	300	60,000	300	30,000

worker produces 100. In terms of absolute advantage, the United States produces both goods more efficiently, meaning that it produces more output with the same amount of inputs. However, if the countries trade with each other they would specialize in the activities they do best, and both countries would increase their consumption of both goods at lower prices.

Assuming a total of 500 workers in each economy — 200 producing T-shirts and 300 producing computers — the total output in each country is 190,000 T-shirts and 90,000 computers, as shown in Table I.

Who is more likely to sell what to whom? To understand this we first need to ask how many T-shirts it costs in each country to produce a computer. If the United States decides to produce computers, each one of the 200 workers would, on average, stop producing 500 T-shirts per month and produce 200 computers

instead. Thus, each additional computer would cost 2.5 T-shirts. Similarly, if China decides to produce computers, each one of the 300 workers would stop producing 450 T-shirts per month, on average, to produce instead 100 computers, which means that each additional computer would cost 4.5 T-shirts. Therefore, China must give up a greater number of T-shirts to produce computers, and the United States has a comparative advantage over China in producing computers.

Thus, in order to gain from trade with China, the United States will specialize in the production of computers. If we recreate the same exercise for T-shirts, we realize that China has a comparative advantage over the United States in producing T-shirts; therefore, China should specialize in T-shirt production.

Now that specialization has taken place, with the very same

output per worker, each country can produce a larger grand total of the two products from the same thousand workers, as shown in Table II. Americans can sell 35,000 computers to China, a greater number than the 30,000 computers China used to have in isolation. The United States can keep 65,000 computers for domestic consumption, a greater number than the 60,000 computers they had in isolation. Similarly, China can sell 125,000 T-shirts to the United States, a greater number than the 100,000 T-shirts it had in isolation, and the Chinese now have access to 100,000 T-shirts, a greater number than the 90,000 it had in isolation.

Another way to look at the gains from trade is in terms of the price that each party pays the other. China gets 35,000 computers from the United States in exchange for 125,000 T-shirts. In other words, citizens in China buy each computer for a price of 3.5 T-shirts. This price

Table II

T-Shirts versus Computers: The Comparative Advantage of China over the United States

Products	United States		China	
	Workers	Output	Workers	Output
T-shirts	0	0	500	225,000
Computers	500	100,000	0	0

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of a computer is lower than the cost of 4.5 T-shirts per computer the Chinese had to pay during isolation. Similarly, Americans can buy more T-shirts for fewer computers than before.

The benefits of comparative advantage are particularly important to poorer countries. In Thomas Sowell's *Basic Economics*, he quotes an unattributed statement: "Comparative advantage means there is a place under the free-trade sun for every nation, no matter how poor, because people of every nation can produce some products relatively more efficiently than they produce other products."

Barriers to Trade. Though there are many advantages to international trade for both the entire world and for individual countries — and despite offsetting economic gains that typically far outweigh the losses — it is almost inevitable that loud calls will be made for government protection from foreign competition through various restrictions on imports. **Tariffs** are taxes on imports that serve to raise the prices of those imports, and thus enable domestic producers to charge higher prices for competing products than they could in the face of cheaper foreign competition. Import quotas are limits on how much of a good can be imported. Like tariffs, these quotas keep foreign companies from competing on even terms with domestic producers.

There is only one difference between these two trade restriction: A tariff raises revenue for the government, whereas an import quota creates surplus for the domestic firms that obtain the import licenses (as the word license implies, one must obtain a license to import certain products). The license holder's profit is the difference between the domestic price (at which he sells the imported good) and the world price (at which he buys it).

Trade Agreements

International trade without barriers, such as tariffs or quotas, is called **free trade**. In theory, free trade requires no governmental action; it simply requires governments not to discriminate against producers from other countries. However, in practice, because of **protectionist** (pro-tariff) sentiments and the political clout of domestic producers (usually constituents of the country with trade barriers), trade liberalization has required government-to-government agreements: either multilateral agreements among several countries or bilateral agreements between two countries. The North American Free Trade Agreement (NAFTA) which includes the United States, Mexico and Canada is one such multilateral agreement; another is the Central American Free Trade Agreement (CAFTA) includes the United States and six other countries, as are the agreements governing the

World Trade Organization (WTO), an organization of 159 countries designed to foster trade and provide an institutional framework for resolving trade disputes between countries. The United States, Cuba, Mexico and Venezuela are all WTO members. Examples of bilateral agreements with Mexico include 2006 agreements on trade in tequila, sweeteners and cement.

Citizens of countries that embrace free trade are better off than citizens of countries that do not. However, some special interest groups — the ones that aim at protect local producers — often complain that "unfair" foreign competition increases the **trade deficit** and destroys jobs at home. Specifically, in the United States, the **trade deficit** (surplus of imports over exports) and the unemployment rate usually have an inverse relationship: When the trade deficit decreases, the unemployment rate increases, and vice versa. For example, in 2009, the U.S. trade deficit shrank 46 percent, and the unemployment rate increased 60 percent. Additionally, many critics of trade deals, such as NAFTA and the WTO agreement, argue that free trade benefits big multinational corporations and "the rich" at the expense of everyone else. However, poverty rates are much lower in countries with low trade barriers than in those where trade is restricted.

Trade freedom is one of the indicators in the *Index of Economic Freedom* that

the Heritage Foundation has published every year since 1995, in partnership with the *Wall Street Journal*. The trade freedom index takes into account tariff and nontariff barriers that affect imports and exports of goods and services. The index shows that countries with the lowest barriers to trade enjoy more economic prosperity, lower poverty rates and cleaner environments.

The United States ranks 37th out of 181 countries in terms of trade freedom, which means that U.S. citizens experience some restrictions when purchasing items from overseas, but the countries we analyze in this paper are worse off. Mexico ranks 68, Cuba ranks 152 and Venezuela falls to 163.

Foreign Aid

Foreign aid refers to the transfer of wealth from foreign governmental organizations, as well as international agencies, to the governments of less developed countries. Because it is a transfer of wealth to governments, as distinguished from investments in private enterprises, foreign aid has not always provided genuine assistance, such as food and housing, to recipient countries. Unfortunately, foreign aid has sometimes encouraged countries to set up government-run enterprises that create palaces, plazas or other things meant to impress rather than produce. The term aid assumes that such transfers will in fact aid the

recipient countries to develop. Sometimes foreign aid reaches those intended to receive it, but in many cases this intrinsic good has simply enabled those in power to enrich themselves through graft and to dispense largess in politically strategic ways to those who help to keep them in power.

Perhaps the most famous foreign aid program was the **Marshall Plan**, which transferred wealth from the United States to various countries in Western Europe after World War II. It was far more successful than many later attempts by the United States to imitate it by sending foreign aid to less developed countries. Western Europe's economic distress was caused by the physical devastations of the war. Once the people were fed and the infrastructure rebuilt, Western Europe simply resumed the industrial way of life they had achieved — indeed, pioneered — before the war. That was very different than the United States' more recent efforts to create industrial and economic infrastructures that are nonexistent in poorer, nonindustrial nations. While, Europe needed physical capital, third world countries need human capital. The latter goal has proved harder to accomplish, just as the vast array of skills needed in a modern economy took centuries to develop in Europe.

The vast sums of money dispensed by multilateral

foreign aid agencies, such as the International Monetary Fund and the World Bank, give the officials of these agencies enormous influence on the governments of aid-recipient nations, regardless of the success or failure of the programs they suggest or impose as preconditions for receiving money.

Direct government-to-government grants of money, shipments of free food, and loans are also made available on terms more lenient than those available in financial markets. Government-to-government loans are periodically “forgiven,” allowed to default, or “rolled over” by being repaid from the proceeds of new and larger loans. Foreign aid is often a disguised subsidy to domestic manufacturing firms or farms. The Export-Import Bank of the United States, for example, loans money to foreign governments to purchase U.S. goods. Other developed countries have similar agencies.

Beneficial results of foreign aid are more likely to be publicized by the national or international agencies that finance it, while failures are more likely to be publicized by critics, so the net effect is not immediately obvious. One of the leading development economists of his time, the late Professor Peter Bauer of the London School of Economics, argued that, on the whole, “official aid is more likely to retard development than to promote it.”

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The Untapped Wealth of Poor Countries. Many poor countries have already created substantial physical wealth that is not legally recognized, due to a lack of secure titles to property, including undeveloped land, the minerals that may lie beneath, or buildings and houses on the land. The insecurity of titles may be due to corruption, the inefficiency and inaccessibility of courts where property titles could be protected, or the possibility of government confiscation or redistribution through land reform. This wealth cannot be used as collateral for loans from banks or other lenders and investors.

Financing the development of a piece of property is difficult if there are doubts, disputes or potential claims regarding ownership. In nations with better functioning property rights systems, existing physical wealth can be used to build more wealth-creating enterprises. An adequate property rights system has not been made as accessible to ordinary people in poor countries as it has been to ordinary people in the United States. An American bank unwilling to invest in a small business may nevertheless be willing to lend money to its owner in exchange for a mortgage on his home — but the home must first be legally recognized as the property of the person seeking the loan. If the business becomes a major success, other strangers may lend money on its growing assets or

invest directly as stockholders. But this process hinges on a system of dependable and accessible property rights, which could mobilize far more wealth, even in a poor country, than is ever likely to be transferred from other nations or from international agencies like the World Bank or the International Monetary Fund.

Nongovernmental Aid. An estimated 90 percent of the wealth transfers to poorer nations from the United States takes the form of private philanthropic donations, business investments or remittances from ex-patriot citizens living in the United States [see the discussion of remittances under Foreign Direct Investment, below]. People who measure a donor nation's contributions to poorer countries solely by the amount of official "foreign aid" sometimes point out that, although "foreign aid" from the United States is the largest in the world, it is also among the smallest as a percentage of Americans' income. But that calculation ignores the vastly larger amount of American transfers of wealth to poor countries in non-governmental forms.

A much larger question is: To what extent do these international transfers of hundreds of billions of dollars actually benefit the countries receiving them? That question is much harder to answer. However, given the differing incentives of those sending wealth in different forms, official "foreign aid" may

have the fewest incentives to ensure that the wealth received will be used to raise the standard of living in recipient nations.

Foreign Direct Investment

Another way countries engage economically is through the transfer of wealth. Specifically, individuals and businesses in one country may transfer wealth to another country by investing in its business enterprises; this kind of wealth transfer is called **foreign direct investment**.

In 2011 the United States received a flow of foreign direct investment of nearly \$227 billion, and Americans invested directly abroad almost \$400 billion. The United States alone is both the source and the recipient of more foreign direct investment than any other country in the world. In a similar way, citizens of a given country may also put their money in another country's banks, which will in turn make loans to individuals and enterprises; this method, too, is indirect foreign investment. Yet another option is to buy bonds issued by a foreign government. At the end of 2012, people in other countries held 48 percent of the bonds issued publicly by the United States.

Barriers in Developing Countries Against Foreign Investment. Individuals and businesses invest in other countries because they can obtain more benefits abroad than inside their own countries. In this sense, scarcity plays a big role.

Theoretically, investments might be expected to flow from where capital is abundant to where it is in short supply. In a perfect world, wealthy nations would invest much of their capital in poorer nations, where capital is scarcer and would therefore offer a higher rate of return. However, rich countries typically invest in other rich countries. Why? Because investors are reluctant to invest in poor countries with unstable governments, where they may never recoup their investment. Constant changes of personnel or policies create risks that the conditions under which the investment was made can change — the most drastic change being outright confiscation by the government, or **nationalization**, as it is called politically.

Widespread **corruption** is another deterrent to investment, as it is to economic activity in general. Countries that rank high on the international index of corruption, compiled by Transparency International, are unlikely to attract international investments on a scale that their natural resources or economic potential might otherwise justify. Aside from confiscation and corruption, many poorer countries impose controls on the flow of capital in and/or out of the country, called **capital controls**. When capital cannot get out easily, it is less likely to go in. Poverty does not deter investment in these countries; rather, their structural problems and policies inhibit interest from

foreign investors.

The Heritage Foundation's *Index of Economic Freedom* states: "A free and open investment environment provides maximum entrepreneurial opportunities and incentives for expanded economic activity, greater productivity, and job creation. The benefits of such an environment flow not only to the individual companies that take the entrepreneurial risk in expectation of greater return, but also to society as a whole. An effective investment framework will be characterized by transparency and equity, supporting all types of firms — local and foreign — rather than just large or strategically important companies (sometimes state-owned), and will encourage rather than discourage innovation and competition."

Investment freedom, which is also part of the *Index of Economic Freedom*, evaluates a variety of restrictions typically imposed on investment. Some countries have different rules for foreign and domestic investment; some restrict access to foreign exchange; some impose restrictions on payments, transfers and capital transactions. Labor regulations, corruption, red tape, weak infrastructure, and political and security conditions can also affect the freedom that investors have in a market.

In this sense, with a score of 70 out of an ideal 100 in the index of investment freedom, the United States and Mexico are

catalogued as countries where foreign investment has some restrictions, mainly in particular industries, but the overall level of investor protection is relatively high. However, this is not the case for Venezuela; its score of 5 rates it as a country where threats of expropriation and hostility to foreign investment are permanent. Cuba receives a score of 0 because its government is the only one allowed to invest in the country.

The entire oil industry in Mexico and Venezuela is off limits to foreign investors. In both countries, state-owned enterprises are responsible for producing and exporting oil, and they resist foreign investment. Their policies have had a clear consequence: a diminishing volume of oil production in both countries in recent years. The United States limits ownership by foreign investors in the airline industry to 25 percent, and foreigners are completely banned from owning TV stations. Several factors helped grow the United States from a small agricultural nation to an industrial giant, but one or the most important factor was an inflow of capital from Western Europe in general and from Britain in particular. These vast resources enabled the United States to build canals, factories and transcontinental railroads to tie the country together economically. As of the 1890s, for example, foreign investors owned about one-fifth of the stock of the Baltimore & Ohio

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Railroad, more than one-third of the stock of the New York Central, more than half the stock of the Pennsylvania Railroad, and nearly two-thirds of the stock of the Illinois Central.

Everyone wins when investments create a growing economy. Despite fears in some countries that foreign investors would carry off much of their national wealth, leaving the local population poorer, there is probably no country in history from which foreigners have carried away more wealth than the United States. By that reasoning, Americans ought to be some of the poorest people in the world, rather than consistently maintaining one of the world's highest standards of living. Why? Because have we achieved that prosperity? Economic transactions and trade are not a zero-sum activity, they create wealth.

Remittances and Migration

Individuals have international economic effects when they, or their money, crosses national borders. Immigrant workers, who are often from developing countries, are important to developed countries with rising wage rates and labor shortages. Money sent by migrants back to “the old country” is an important source of income in developing countries.

Migrant Workers Wire Money Home. Emigrants working in foreign countries

often send money back to their families to support them. As of 2007, “migrants from poor countries send home about \$300 billion a year,” according to the New York Times. That figure was more than three times as much as total, formal foreign aid globally, making **remittances** the main source of outside money flowing to the developing world. According to the World Bank, in 2011 the global inflow of remittances was \$514 billion. For some countries, remittances represent an important part of their economy. In Tajikistan, a Central Asian country, remittances represent 47 percent of its total economy. The United States is the only country where most of the remittances are sent abroad. In 2011, immigrants in the United States sent out more than \$51 billion, representing more than 15 percent of all outflows of remittances that year.

At one time, Chinese citizens living in Malaysia, Indonesia and other Southeast Asian nations were noted for sending money back to their families in China. Politicians and journalists in these countries often whipped up hostility against the overseas Chinese by claiming that such remittances were impoverishing their countries for the benefit of China. In reality, the Chinese created many of the enterprises — and sometimes whole industries — in these Southeast Asian nations. What they sent back to China was a fraction of the wealth they had created, and added to the wealth of the

countries where they were now living. Sometimes the hostility generated against such groups has led to their leaving these countries or being expelled, often followed by economic declines in the countries they left.

Migration of Workers.

Immigrant workers have created whole industries and transformed entire economies. Indeed, the numerous immigrant groups who settled in Britain and later, the United States, were vital sources of the skills and entrepreneurship that made these countries both industrial and commercial leaders among world nations. Perhaps to an even greater degree than the United States, Latin American countries have depended on immigrants, especially those from countries other than the conquering nations of Spain and Portugal.

Some countries have exported **human capital** on a large scale; for example, educated young people often emigrate because other countries offer better opportunities. *The Economist*, a respected British magazine, reported that more than 60 percent of the college or university graduates in Fiji, Trinidad and Tobago, Haiti, Jamaica and Guyana have gone to live in developed countries. Although it is difficult to quantify human capital, emigration of educated people on this scale represents a serious loss of national wealth.

It would be misleading, however, to assess the economic

impact of immigration solely in terms of its positive contributions. In earlier times, immigrants also brought diseases, crime, internal strife and terrorism. Nor should we lump all immigrants together. There are similar disparities in crime rates and other factors, both negative and positive, that immigrants bring to the United States and to other countries in other parts of the world.

Labor migration has been and is a major issue with respect to United States relations with Mexico and other Latin American countries.

Economic Engagement with Cuba, Mexico or Venezuela

Let us apply the concepts discussed above to the specific circumstances of United States' relations with Cuba, Mexico and Venezuela.

Cuba. Cuba is a one-party Communist state. A Communist country works on the premise that government officials are in the best position to determine the allocation of scarce economic resources. Government central planners decide what goods and services are produced, how much is produced, and who produces and consumes these goods and services. The theory behind central planning is that only a centralized government can organize economic activity in a way that promotes well-being for the country as a whole. Even though this system has rarely

delivered even the most basic, decent living standards, a few countries in the world remain under a communist regime. Cuba is one of them.

In 1960, a year after the Cuban Revolution led by Fidel Castro, his brother Raul, and Argentine Ernesto "Che" Guevara overthrew dictator Fulgencio Batista, the new regime reformed the country along communist lines, nationalizing even the property of United States' citizens and corporations. President Kennedy decided to establish prohibitions on commerce and trade to Cuba, known as **the embargo**. An embargo is a strong diplomatic measure taken by the country imposing it to elicit a given national-interest result from the recipient country. Embargoes are similar to economic sanctions and are generally considered legal barriers to trade.

The U.S. embargo policy toward Cuba remains in place to this day, but some restrictions have been relaxed. For example, in 2009 the federal government loosened restrictions on family travel and remittances to Cuba. In 2011, the United States announced changes that might increase purposeful travel including religious, cultural, educational, and people-to-people travel; expand the individuals and groups eligible to send and receive remittances; and allow all U.S. international airports to apply to provide charter services to Cuba.

In the 1960s, the U.S. federal government strongly believed that sanctioning Cuba would weaken the regime, given the absolute control government officials had over the economy, and the economic cost of the embargo would pressure Cuban rulers to allow free elections, freedom of expression, freedom of association for civil society, private enterprise and so on. But today, opponents in the United States say the embargo is not fulfilling its objective, even with more flexible parameters, and is actually hurting the United States by denying access to a geographically convenient market. In one way or another, for decades Cubans have been deprived of the better quality of life that comes from free markets and democracy.

Still, over the last 50 years, the Cuban regime has encountered ideologically allied governments that have helped maintain its power. During the second half of the 20th century the former Soviet Union became Cuba's major trade partner. Now, more than 20 percent of Cuba's imports come from China, and more than 25 percent of its exports go to China. Cuba relies on China for machinery, boilers, electrical and electronic equipment, iron and steel. On the other hand, Cuban exports to China are mostly nickel and articles made of nickel, sugar and ores, slag and ash.

In other words, Cuba imports technological and capital goods from its most important trade

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partner; while the island country sells natural resources and food back to China. Here, once again, comparative advantages play a big role. Even though China can probably extract minerals and produce sugar cheaper than in Cuba, both countries still benefit from trade. Thus, no matter how poor a country is, international trade can make almost every country better off. Poorer countries especially benefit, because people of every nation can produce some products more efficiently than they produce other products.

The United States sends medicine and food to Cuba for humanitarian purposes and has become the second largest food supplier to the island, according to the U.S. State Department. Should the two countries restart trading, we would probably see the same pattern. The United States would sell technological and manufactured goods, as well as food, to Cuba, and Cuba would in turn sell natural resources and some basic foods to the United States. The specific goods would depend on the output per input ratio for that good in each country.

Foreign direct investment (FDI) in Cuba is minimal, but that is not due to the U.S. embargo. Most countries (other than the United States) have few or no restrictions on trade with Cuba. Even so, the United Nations Conference on Trade and Development (UNCTAD) estimates the inflow of FDI to Cuba in 2011 was only \$110

million, one of the lowest amounts of FDI of any country in the world. It is impossible to say what country the FDI comes from, since Cuban regime's statistics stopped being credible long ago. Meanwhile, the U.S. foreign aid agency (USAID) designated \$20 million last year for Humanitarian Support to Political Prisoners and their Families, Human Rights and Democracy Promotion and Facilitating the Free Flow of Information in Cuba.

The U.S. embargo includes restrictions on U.S. residents' travel and remittances to Cuba. The Pew Hispanic Center calculated the Cuban immigrant population in the United States for 2004 at more than 1.5 million, of which only one-third were native-born. Given the restrictions on sending remittances to the island, no official data can verify how much money Cubans send to their relatives.

Mexico. The U.S. Department of State provides a brief summary of U.S.-Mexico relations: "It entails extensive commercial, cultural, and educational ties, with more than \$1.35 billion worth of two-way trade and roughly one million legal border crossings each day. In addition, a million American citizens live in Mexico, and approximately 10 million Americans visit Mexico every year. More than 18,000 companies with U.S. investment have operations in Mexico, and U.S. companies have invested

\$145 billion in Mexico since 2000."

Mexico and the United States, along with Canada, signed the North American Free Trade Agreement (NAFTA), which came into force on January 1, 1994. NAFTA has served as an example of how trade liberalization can improve the living standards of all people in all countries. Before the NAFTA went into effect, opponents made dire predictions that jobs would be sucked out of the United States to Mexico because of Mexico's lower wage rates. But low wage rates generally indicate relatively low productivity (output per worker); they do not necessarily confer any advantage on the low-wage country compared to a relatively high wage country, where average workers may be more productive. In reality, the number of American jobs increased after the agreement and the unemployment rate in the United States fell over the next seven years from more than seven percent down to four percent, the lowest level seen in decades. In Canada, the unemployment rate fell from 11 percent to 7 percent over the same seven years.

The United States is Mexico's most important trade partner. It is the third most important country in terms of imports, and the second most important in terms of exports for the United States. Clearly, the economic ties between Mexico and the United States are very strong. Comparative advantage also

seems to work here. According to the U.S.-Mexico Chamber of Commerce, due to NAFTA Mexico now has a comparative advantage in vegetables, fruits and beverages, and the United States has a comparative advantage in grain production, animals and animal products, and oilseeds.

Historically, the United States has been the main source of FDI in Mexico. In the first nine months of 2012, U.S. investors accounted for 49 percent of all FDI in Mexico. In 2011, Mexico received a flow of \$19.5 billion from U.S. investment. Mexico receives the second largest amount of FDI in the whole Latin American region. The industries that receive the largest amount of FDI are food, beverage and tobacco production; finance; wholesale and retail trade; business activities; and construction.

The U.S. foreign aid agency, USAID, is working with Mexican public and private-sector institutions to improve the security and well-being of its citizens. USAID programs support Mexican leadership in specific technical areas that are high priorities for both the United States and Mexican governments, including: development and testing of models to mitigate the impact of community crime and violence; implementation of criminal justice constitutional reforms that protect citizens' rights; Mexico's commitment to reduce

greenhouse gas emissions; and economic competitiveness to improve its citizens' lives.

In 2011, Mexico received an inflow of \$22.4 billion in remittances, mostly from the United States. Mexico receives the largest amount of remittances in Latin America, but in terms of the size of its economy, remittances to Mexico are among the smallest share of any Latin American economy. In Haiti, for example, remittances represent more than 21 percent of the economy.

Venezuela. Since 1999, when the late socialist Hugo Chavez became president, the foundation of Venezuela's economy has been severely weakened and the country now has extensive structural and institutional problems as well as rampant inflation and currency instability. Venezuela's judicial system has become increasingly vulnerable to political interference, corruption is prevalent, and the rule of law is weak. The nationalization of industry has significantly increased the state's presence in economic activity. Heavily dependent on the oil sector, the economy suffers from a lack of dynamism. Inefficient and non-transparent regulatory and judicial frameworks obstruct prospects for long-term development. The lack of rule of law precludes entrepreneurial growth, and the investment regime lacks transparency and remains under tight state control.

The United States is

Venezuela's most important trading partner. U.S. exports to Venezuela include machinery, organic chemicals, agricultural products, optical and medical instruments, autos and auto parts. Oil dominates U.S. imports from Venezuela, one of the top four suppliers of foreign oil to the United States. About 500 U.S. companies still operate in Venezuela. Political and economic uncertainty, state intervention in the economy, and a volatile legal and regulatory framework make Venezuela a difficult climate for foreign investors. Foreign direct investment in Venezuela is concentrated largely in the petroleum, manufacturing and finance sectors. In 2011 the inflow of foreign direct investment in Venezuela was \$5.3 billion, with American businesses representing a large part of this amount.

Venezuela's late President Hugo Chavez, and now Nicolas Maduro, have defined themselves in opposition to the United States, criticizing the U.S. government and U.S. relations with Latin America. Despite tensions in the relationship, both countries have had limited bilateral counter-narcotics cooperation. In 2011, the U.S. Secretary of State imposed sanctions on Venezuela's state oil company (PDVSA) for delivering at least three cargoes of reformate, a blending component for gasoline, to Iran between December 2010 and March 2011. The sanctions

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prohibit PDVSA from competing for U.S. government contracts, securing financing from the Export-Import Bank of the United States, and obtaining export licenses.

Conclusion

Theoretically, countries that trade with one another are better off, both enjoy a greater variety of goods and services, people specialize on the things they do best, and even the price of these goods and services are lower. A country gains from international trade regardless of whether it is big or small, close to the equator or to the poles, Christian or not, cold or hot. Every country will benefit from trade because every nation can produce some products relatively more efficiently than they produce other products. Similarly, the transfer of wealth between countries through investment and remittances reflects the fact that everyone can win when the economy grows.

At a first glance, it seems obvious that public policies in all countries should be focused on creating **free trade zones** and allowing capital to flow from one country to another without

prohibitions. However, some of these policies are more important for one country than other; and this is not precisely the case in the three countries that we have briefly analyzed in terms of their economic engagement toward the United States.

Should the United States federal government increase its economic engagement with Mexico, Cuba or Venezuela? Any argument either in favor or against should probably ask, who among these countries seem more proactive for a free trade policy that would benefit both countries?

About the Author

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