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The North American Free Trade Agreement and Mexican Monopolies

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Supporters of the North American Free Trade Agreement (NAFTA) among Canada, the United States and Mexico predicted the pact would boost Mexico's economic growth and raise the living standards of its people.

Dallas Headquarters:
14180 Dallas Parkway, Suite 350
Dallas, TX 75254
972.386.6272

www.ncpa.org

Washington Office:
202.830.0177
governmentrelations@ncpa.org

However, though the agreement became effective January 1, 1994, the promised economic benefits have not been fully realized — despite the fact that the NAFTA economies make up one of the largest trading blocs in the world, with a combined annual gross domestic product of more than $19 trillion.[1]

The negotiations leading to NAFTA focused on opening up the manufacturing sector rather than the service industries. In fact, the agreement excluded opening other sectors — such as telecommunications, media, transportation and energy. This allowed Mexican conglomerates to continue profiting from closed markets.[2] Thus, economic liberalization under NAFTA has been a gradual process and is still incomplete. For instance, until 2015, Mexican commercial trucks were not allowed to make long-haul trips in the United States.[3]

The Effects of NAFTA. Foreign direct investment in Mexico, coming mainly from the United States, rose sharply after NAFTA took effect [see Figure I]. As a result, the country grew into a major automobile assembler, its economy became more diversified and the quality of manufactured consumer goods increased and prices declined.[4] But economic growth rates have remained weak, averaging 2.47 percent over the past 20 years [see Figure II].[5] Analysts at the research group *México ¿Cómo vamos?* estimate that Mexico would need to generate 1.2 million jobs per year to absorb its growing labor force.[6] Yet in 2014, a better-than-average year, it created only 714,000 new full-time jobs.[7] Many experts attribute this meager growth to the persistence of lucrative monopolies and oligopolies that hold back Mexico's economic growth.[8]

The Impact of Monopolies. From the very beginning, the NAFTA negotiations excluded discussion of the state-owned oil (Pemex) and electricity (CFE) monopolies as well as the banking and telecommunications sectors. These services are essential inputs for other industries, and for many years Mexican consumers have had to pay for poor and overpriced products.[9] Some of the best known monopolies, such as Telmex, were former state-owned enterprises that were privatized during the 1990s. In a protected market they have been able to extract large economic

Figure I
Foreign Direct Investment in Mexico
(billions of dollars)

Source: Secretariat of Economy, Mexico.

rents but have had few incentives to invest and increase productivity.[10]

There are other monopolistic entities, such as labor unions and political parties. These interest groups have formed a "sturdy political equilibrium" that perpetuates a rent-seeking environment and have blocked reforms that would make the economy more efficient and productive.[11] Their aim is to preserve privileges built up over decades under Mexico's closed economy and one-party state.[12] In doing so, they monopolize access to power, employment, public services, opportunities and financing, among other things. Mexico's recent democratic transition to a multiparty system with more transparent elections has done little to change this. Its democracy is plagued with a crony capitalism nexus where exclusionary policies and institutions remain.[13]

The persistence of a high level of inequity impedes stronger economic growth. The close relationship between the economic and political elites often leads to situations in which the norm is favoritism and the application of law is subject to negotiation.[14] The effects of this inequitable system are felt by the poor but also by potential entrepreneurs and investors, including American companies, which are discouraged from entering the market.[15]

Mexico was governed by a single party, the *Partido Revolucionario Institucional* (PRI), for more than 70 years. The ruling coalition's control of key economic sectors, labor and the body politic is evident in international rankings.[16] For example:

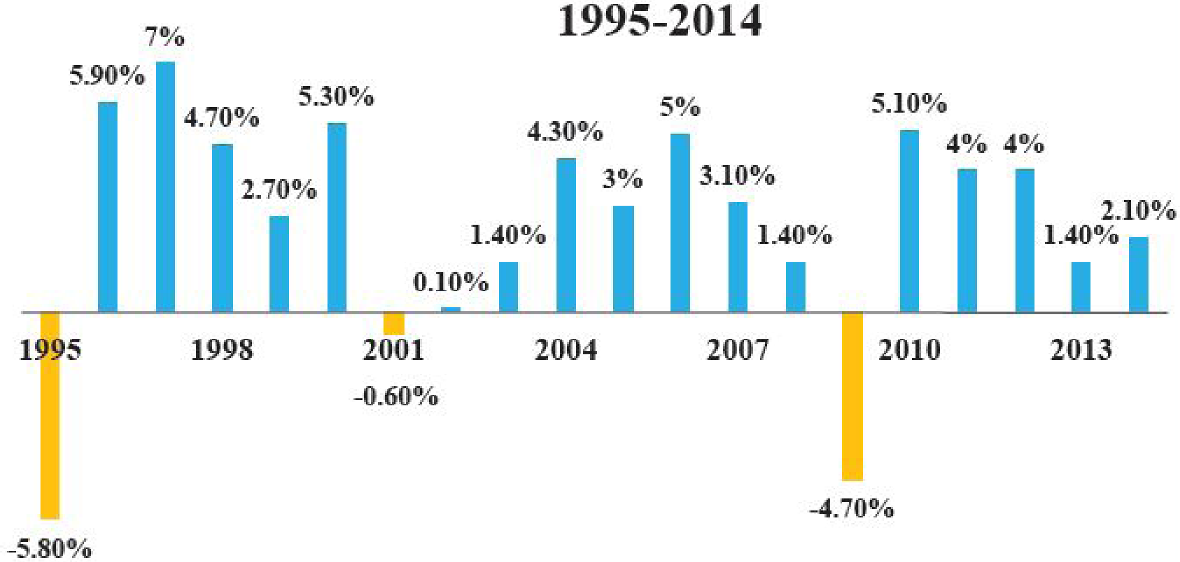
- The *2015 Index of Economic Freedom* classifies Mexico as only a "moderately free" country, ranking 59 out of 186 countries.[17]
- Mexico has improved its position in economic freedom indices by opening its economy to international trade, but corruption; inefficient government, insecure property rights and lack of financing are factors that adversely affect its economic freedom.[18]
- Thus, in the World Economic Forum's 2015-2016 Competitiveness Report, Mexico attained spot 57, trailing other emerging economies, such as Chile (35), Turkey (51) and especially China (28); moreover, Mexican institutions were rated "very poor."[19]

Recent Reforms. Lately there has been some progress. Mexico has pursued a better monetary policy and reined in inflation.[20] New rules have strengthened the telecom and broadcasting regulatory authority, granted autonomy to the antitrust agency and produced measures to expand the availability of credit to businesses.[21]

The most significant development of recent years has been the energy reforms of 2013 and 2014, which let private investors access the energy sector. The nation's vast oil resources, including offshore and unconventional fields, will be opened to foreign firms and the industry will benefit from the technological expertise and financial resources of international oil companies.[22]

Similarly, reform of the electric power sector allows private participation in all areas for the first time. Ultimately, this will enable expanding and modernizing the grid, lower the cost of electricity to users and prevent industrial electricity demand from outstripping supply.[23]

Figure II
Gross Domestic Product Growth in Mexico, 1995-2014



Source: World Bank.

These reforms should eventually lead to a more competitive business environment.

Further Opening. As North America becomes a more integrated economic bloc within the global system, the United States should seek to revise old NAFTA provisions to include those sectors originally excluded.[24]

In the last two decades Mexico has become a more democratic country, but the implementation of economic and political reforms has been slow. Thus, in its foreign policy the United States should support Mexico in its efforts to solidify democracy and develop more inclusive institutions.[25] This is an aspect of bilateral relations the United States should prioritize: assuring that Mexico overcomes its legacy of inefficiency and inequity — the latter defined as inequality of opportunity.[26]

Nevertheless, the United States should continue putting pressure on the Mexican government to end its institutionalized monopolistic practices that unfairly favor powerful groups. It should also seek to persuade Mexico to increase its transparency and accountability, strengthen the rule of law and enforce property rights, including intellectual property rights. Only then will global and domestic investors feel confident to venture into other sectors of the Mexican economy and consequently the economy will grow at a faster pace.

Conclusion. For the United States, the benefits of a more prosperous Mexico would be enormous. Mexico is already the United States' third most important trading partner, and bilateral trade between the two nations is larger than U.S. trade with Japan and Germany combined.[27] Wealthier Mexican consumers would mean more demand for U.S. products and higher exports for American manufacturers. A more dynamic economy would represent more opportunities for U.S. companies seeking to expand in the Mexican market.

A more efficient government, more jobs, higher wages and better social services would translate into improved living standards in Mexico and, therefore, fewer unauthorized migrants coming to the United States. Lastly, a stronger, more dynamic and resilient North American continental base will increase U.S. power globally.[28]

Hector Colon is a research associate with the National Center for Policy Analysis.

Notes

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