

## On the future of trade in North America

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## **On the future of trade in North America\***

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I would like to thank the Faculty of Law of the University of Ottawa for this kind invitation. I think this conference is a good opportunity first to examine Mexico's recent economic performance and to exchange views on the prospects of a stronger economic and cultural relationship between our two countries. Secondly, it shall allow us to analyze the future of trade in North America. These are extremely important subjects at present since both Mexicans and Canadians know far too little about each other.

Mexico and Canada have united on many subjects and many occasions, but often these encounters have not lived up to their potential. Our similar geopolitical positions have given us a wealth of experience which could be exploited to our mutual advantage. It is almost imperative that there be a deeper, shared knowledge and a clear pledge to unify resources and take advantage of the arising new opportunities.

Mexico has made important economic and political changes in order to become more integrated into the emerging new world order. The byword in Mexico today is "modernization". In this endeavor, my country sees in Canada an important partner and a country that offers a rich source of possibilities across the board. There is enormous potential, yet to be explored, for the exchange of goods and services, for cooperation in the fields of technological development, education and culture, in hemispheric matters and in the strengthening of our political relationships.

The world is experiencing an unprecedented shift in history, a change that calls for economies to be restructured and political practices modified, in keeping with the new and more intense interdependence among nations. The globalization of the world economy and the emergence of economic blocs is shaping a new multipolar system, is a process that Mexico and Canada cannot ignore. This is why Mexico, with the leadership of President Salinas, has embarked on the full modernization of the country to take advantage of the new international environment, and based on our own efforts, to improve the living standards of our population. Today, there are 85 million Mexicans

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\* Notes for a speech given at the University of Ottawa January 29th, 1991.

and we grow by 1.5 million every year; a modern and diversified society exists side by side with poverty. It is essential to ensure economic recovery and sustained stable growth.

Until 1982, Mexico had one of the most closed economies in the world. A protective industrial policy had been the centerpiece of economic development for more than 60 years, and indeed, contributed to a substantial increase in the industry's share of Mexico's GDP and transformed it into one of the most dynamic sources of employment and well-being. In those six decades, import substitution and government-led strategies transformed the country's basically rural economy into an industrial one.

In the seventies, some defects of the strategy became apparent with high costs, inferior quality standards, lags in technology and inefficient allocation of resources, all of which limited the economy's capacity for growth. The oil boom registered in that decade increased Mexico's income and made it possible to postpone economic reform, but the sharp reduction in oil and other commodities' prices as well as the debt crisis brought matters to a climax.

Mexico entered a period of economic shock requiring hard therapy to solve the crisis itself and to pave the way for structural change and, eventually, to attain progress again. But a growth-oriented program requires price stability, with inflation rates similar to those of Mexico's principal trading partners. High inflation adversely affects confidence, giving raise to uncertainty, while it promotes unproductive speculation and affects mostly those who have the least. Mexico came close to hyper inflation. Therefore we established in 1987 a comprehensive, anti-inflationary and growth program known as the *Pacto de Solidaridad Económica*, which is in fact a consensus strategy among laborers, businesses, farmers and the government to introduce all the necessary measures to defeat inflation. It is based on, among other factors, strict fiscal discipline, the renegotiation of the foreign debt and an open economy.

Mexico, through serious and painful adjustment, has been able to achieve a significant improvement in its public finances. In the early eighties the borrowing requirements of the public sector were in excess of 16 % of our GDP. After a steep reduction in expenditures and an increase in revenues, the borrowing requirements of the public sector were estimated to be just over 1 % of the GDP for 1990.

A significant part in the improvement in the finances of the public sector has been the privatization of a large number of state-run enterprises. Public enterprises have been an important policy instrument of the state. Some were acquired as a deliberate policy; others, more by default than by design. The resources and the management required to expand or modernize most of them could not be provided without diminishing those assigned under the fundamental responsibilities of the government. A clear policy has been adopted to sell or liquidate non-strategic, state-owned corporations.

The number of publicly-owned enterprises has dropped from close to 1200 in 1982, to just over 200 in 1990, and will further decrease in the future. The Mexican government has privatized airlines, hotels, mines and

steel mills, and is about to complete telephone privatization and is in the process of divesting itself of the banking system, among others. The resources obtained will be channeled mainly to solve pressing social needs and to reduce the public debt.

The debt reduction agreement between Mexico and its foreign creditors was the first of its kind by a major debtor country. Because of this, the Mexican economy will enjoy direct savings which will reduce the external debt service by over 4 % of the GDP. An immediate impact has been the reduction of internal interest rates by over 30 points and a reflow of capital.

The results of the *Pacto* are clear today. From inflation rates, which reached more than 160 % in 1987, last year the consumer price index rose less than 30 %, the second lowest rate in 11 years. Price stability is a condition for growth, while economic efficiency is necessary to increase productivity and improve overall economic progress. But it is also necessary to compete in international markets.

Exports are one of the main forces of our growth. To achieve this, trade reforms have been implemented in the last five years, which makes Mexico one of the most open economies in the world. Producers are moving along the production frontiers from importable to exportable goods. They have access to imports at competitive prices and consumers benefit from lower protection.

Trade restrictions of all kinds have been eased, tariffs have declined from over 100 % in 1982 to a maximum of 20 %, with a weighted average of less than 9 % in 1990. Non tariff barriers, which covered all imports in 1982, today apply to less than 20 % of the total.

Mexico has traditionally been a country with a high savings rate. However, it will require resources from abroad to achieve adequate growth rates. Foreign investment is a natural complement of domestic savings and of our new trade policy. The combination of these factors provides a financial base for private sector projects and it enhances our export capacity. The objectives of increased exports and foreign investment are the same.

Mexico today welcomes foreign investment. The new by-laws, issued in May of 1989, provide a general framework. Case by case authorizations are limited to exceptional instances. The new regulations put the rules in black and white with clear, neutral and permanent procedures that give certainty to foreign investors.

The new framework provides ways for foreigners to invest, with full ownership, in almost all areas of the economy. Certain sectors that were previously excluded from majority foreign ownership because of administrative restrictions, such as glass, cement, iron, steel and cellulose, are now fully open to foreign investors.

Investors demand a competitive tax system and clear and consistent regulations regarding the treatment of foreign investment. Mexico has moved rapidly to adjust its fiscal and regulatory framework to make them compatible with these demands.

With respect to tax policy, effective tax rates have been reduced and are now comparable to those of most industrialized countries. The recent changes to the income tax code, which also includes a permanent incentive to invest, have served this purpose. Tax rates in Mexico are now competitive with average rates in Canada or the U.S. There are no limitations to dividend transfers and no withholding tax on already taxed income.

A corner stone of Mexico's economic program is the promotion of technological innovation. A new policy was designed so that domestic entities can adopt the technologies best suited for the competitive advantage of each sector.

Technological policy has shifted towards a demand-oriented approach: industries shall work together with research and development centers in such a way that a domestic market for innovation can develop under the principles of fair competition and efficiency, given an appropriate protection of intellectual property rights. The new regulations on the technology transfers facilitate the necessary changes by letting firms freely choose their own technology.

The Mexican Government has moved aggressively to give adequate protection to intellectual property. It is the government's intention to submit an initiative to Congress that will modify the legal framework that protects intellectual property, in order to offer similar protection to that of more developed nations. New legislation shall be implemented this year.

With a comprehensive package, based on an effective linkage between the demand and supply of technology and an adequate protection of intellectual property, we are in an optimal position to fully benefit from foreign and domestic technological innovations.

Another element in this change process is economic deregulation. Deregulation eliminates barriers to entry that promote monopolistic behavior and damage the ability of domestic producers to compete abroad. As long as an economy remains overregulated, it cannot reach the full benefits of trade liberalization.

In the first year of President Salinas' administration, the Mexican Government initiated a national deregulation program designed to eliminate obsolete regulatory bottlenecks that increased costs excessively and, thus, damage the competitiveness of our economy.

One important sector that has been substantially deregulated, for example, is the petrochemical sector. This has been achieved by reducing the number of products whose production is reserved to the state, while dramatically increasing the rest, whose production is now open to foreign investment.

Special emphasis has also been placed on the transportation and telecommunications sectors, which are crucial for export promotion. We estimate, for example, that the annual consumer loss in Mexico due to previous licensing requirements in the freight trucking sector, was about 0,5 per cent of GDP. Today, this sector has been completely deregulated, rates have declined

up to 35 per cent, and free competition in freight transportation is benefitting producers and consumers alike.

Finally, one of the key elements of our modernization and development program is export promotion. In an open trading regime, resource allocation benefits the exportable-goods sector and production plans are rationalized so that industries can fully exploit their economies of scale. This, in itself, provides a solid support for the expansion of exports.

In Mexico, the trade reforms have had a positive effect on our trade balance. In 1982, about 70 per cent of earnings came from oil exports, whereas today about 70 per cent are due to non-oil exports. This change is a result of the outward orientation of economic policy. The pace and sweep of Mexico's economic changes is comparable to anything that has occurred thus far in Eastern Europe and has made my country one of the most open economies today.

The world is undergoing a process of critical change, largely as a result of advances in scientific knowledge and technological innovation. These changes have forced the majority of countries to review not only their strategies for growth but also many of the foundations they had considered certain. New models of economic growth have led nations to specialize in the production of those goods where they have shown comparative and competitive advantages.

Neither Mexico nor Canada can afford to remain aloof from this transformation. Open trade will bring about the maximization of our advantages. There are many points of convergence between us; the political, economic and intellectual dialogue between our countries has expanded substantially. Notwithstanding, a deeper knowledge between both countries is needed as well as a clear will to take advantage of the opportunities that are arising.

Mexico, like Canada and others, gave the Uruguay Round of GATT the highest priority. Free trade will lead to sustained economic growth, with the creation of needed employment, particularly in developing countries like Mexico. However, the emergence of economic blocs is a fact of life. Mexico wants to trade with all countries. In order to build on whatever results of the Uruguay Round, we have decided to embark on negotiations to achieve a North American, free trade area.

Mexico and Canada assign particular importance to relations with our common neighbor. Sixty-four per cent of Mexican exports, and seventy-five per cent of Canadian ones find their way to the United States. These facts enhance the necessity for our two countries to increase their bilateral exchanges.

Also, our two countries have had long bilateral experiences with our common neighbor. The asymmetry among the three North-American nations is well-known and understood. There are differences in history, culture, and economic development. We should exchange our experiences, learn mutually from the existing interdependence and create, manage, and take full advantage of all opportunities.

The Mexican government has gradually approached trade relations. We signed several sectorial agreements both with the U.S.A. and Canada. We strongly supported multilateral and bilateral trade negotiations and have promoted and attracted foreign investment from all over the world. Nevertheless, capital is a scarce resource and competition is acute. As well, trading blocs are naturally considered by countries in regards to their neighbors than to other regions: Eastern Europe for the EEC and southeast Asia for Japan. In the same manner, Mexico is becoming attractive to our neighbors in North America and therefore a free-trade agreement has been envisioned.

At the request of President Carlos Salinas, the Senate in Mexico held hearings in May, 1990, throughout the country on the future of our trade policy. Their recommendations were clearly in favor of free trade, particularly for a free-trade area in North America. To that end, Mexico and the United States decided to initiate the process of signing a free-trade agreement.

In 1990, Canada approached Mexico and the USA expressing its desire to participate in the free-trade negotiations with a view to establishing a North American Free-Trade Area. We enthusiastically welcomed this initiative and agreed to start consultations between the Canadian, U.S., and Mexican Governments to explore the modalities and mechanisms to achieve such an agreement. We believe that this decision will transform the ability of the region to compete with the rest of the world. A decision on this topic has been reached by the three governments and we are quite optimistic about it.

There are various reasons in support of a North American Free-Trade Area. The countries involved are complementary to each other; there is geographical proximity, we have common business practices, ample natural resources, a significant market potential, and a need for an effective strategy to face competition from other trade blocs.

As far as complementarities are concerned, free trade between the three countries would improve the relative factor endowment, leading to better technological choices and a more efficient system of production.

Labor, with appropriate age and growth structures, provides a most valuable asset of human wealth. The capital resources of the region are adequate, with complementary technological know-how based on our own needs and characteristics. We have complementary climates, with seasonal production patterns that support each other.

Secondly, there exists geographical proximity which leads to relatively low transportation costs. Communications are adequate but they can be improved substantially. All three countries have ports in both oceans, and an interconnected system of railways and roads. In the area of telecommunications, we have linked networks and common use of satellites. We can have an expanded use of pipelines and an improved air transportation system.

Thirdly, there is large market potential. In sheer size we have close to 370 million people, 10 % more than that expected of Europe in 1992. The purchasing power of the area would amount to around 5,500 billion U.S.

dollars; again, almost 19 % higher than that expected of Europe in 92. This is coupled with a welcome diversity in the patterns of consumption.

Fourthly, competition will increase in the future and we will have to face the other trade blocs more effectively. These developments are, and will be, leading to trade diversion by increasing flows within blocs, therefore reducing their growth with the rest of the world. A North American area would, by itself, create trade within, giving stability to such flows and strengthening our position to fight against unfair trade practices from other areas.

Fifth, we have common business practices. They are based on the fact that our economies are market-oriented and have today similar fiscal regimes. There is in Mexico, as in Canada and the United States, a legal system of protection of property rights and contracts, and we have compatibility of business institutions, including production, marketing, and financial practices.

All of the above, point to the fact that there are advantages to free trade in North America given the three countries complementarity, market potential and geographical proximity. We can all benefit from economies of scale, economies of scope, transfer of technology, capital mobility, increased trade, more efficient allocation and use of resources, a more competitive environment and specialization.

The aim of all of us is, of course, to achieve a better level of welfare and growth to benefit our population. Canada and Mexico today have a close and friendly relationship. Trade and investment flows are small but we must not only look at what we have, but what we can achieve and work to that end.

Canada should see an excellent market potential in Mexico and this consideration should outweigh any other argument. Fear for dilution of the Canada-U.S. FTA's benefits, valid as a circumstance, should not limit the discussions on the possible gains. If Canadians want Canada to be on the bargaining table only to protect the existing agreement, Mexicans may conclude that Canada is not an asset but a liability in the negotiations.

Some of the opponents of the FTA argue against the North American prospect, and although some of their arguments may indeed be valid, they have important shortcomings. They argue that differences in wages would erase Canada from the surface of the earth, without taking into account that Mexicans have lower wages because they have a lower productivity rate. Even if this were the case, low tariffs would provide little relief, proving that Canadian workers are more productive and competitive than what those critics acknowledge. Unit labor costs are the ones that determine where an industry may be established. Also, new techniques in manufacturing have reduced the importance of labor, which today represents anywhere between 5 to 25 % of the products cost.

Opponents to a North American FTA also assert that social and environmental issues should be included, or Mexico would not comply with the same standards of a developed country. That may be true in the sense



that Mexico is still a developing country and the lack of resources is what makes enforcement of regulations more difficult. Nonetheless, Mexico, in this category, among the developing world, is probably the most advanced due to firm legislation. One of the benefits of the NAFTA will be a better position as trade expands and wages and other conditions improve.

This session is intended to promote a dialogue on the question of Mexican-Canadian economic relations in the coming years. This is a process that has to be viewed as one of interdependence. Our historical experiences have been different and we are currently in different stages of development *vis à vis* the United States. This situation makes it important for us to share points of view and calls on us to join in expanding trade between Mexico and Canada in order to take full advantage of the points of natural complementarity between our two economies.

The Free Trade Agreement is just one aspect of the complex issues that should be carefully analyzed. Mexico and Canada should learn mutually from their relationship with the U.S.A. They should make it profitable for each of them; not, as the saying goes, that Canada and Mexico have a common problem between them but as a partnership that shall bring broad opportunities.

Mexico would like to see an increase in our bilateral trade. It does not reflect the importance of both countries on the international scene nor the fact that we both form part of North America. Our volume of trade, as I stated earlier, is very small, almost non-existent, relative to the size of our respective economies and to the potential of our markets and productive plants.

People in both countries have recognized this for almost a century, but for many reasons it has been easier to acknowledge it than to do something about it. It seems to be that one of the reasons has been that neither nation has had the ability to talk frankly to the other. We, Mexicans and Canadians, have been more concerned with our own self-interest, rather than the willingness to take action in order to obtain important developments on a wider scale.

The recent initiatives for a North-American Free-Trade Area indicate that Mexico and Canada shall soon increase their interaction and hopefully improve their past record.