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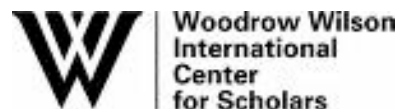
The U.S.-Mexico Relationship: Towards a New Era?

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Mexico and the United States: Confronting the Twenty-First Century

This working paper is part of a project seeking to provide an up-to-date assessment of key issues in the U.S.-Mexican relationship, identify points of convergence and divergence in respective national interests, and analyze likely consequences of potential policy approaches.

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The U.S.-Mexico Relationship: Towards a New Era?

David R. Mares & Gustavo Vega Cánovas

The U.S. and Mexico have been neighbors for more than two centuries and within that relationship there is one important constant. Despite intermittent attempts by Mexico to distance itself from the US out of a concern of US protectionism and its political, cultural and economic hegemony, a process of progressive economic and social integration has taken place among the two countries which expresses itself in high levels of trade, financial and labor flows.

Mexico is currently the US' third largest trading partner, after Canada and China, accounting for approximately 8.4 percent of US exports and imports. The United States, on the other hand, is Mexico's dominant trading partner, accounting for two-thirds of both exports and imports and far outdistancing Mexico's trade with Europe, Japan, and with the rest of Latin America and Canada. The United States is also the major source of foreign investment flows in the Mexican economy, accounting for close to 65 percent of the total. Labor market integration is also very high, with at least 10 percent of the growth of the US labor supply since World War II accounted for by Mexican migration.ⁱ Mexicans who work in the US represent close to one-fifth of the Mexican work force and their remittances in 2008 were close to 21 billions dollars, representing the first source of foreign exchange surpassing oil and tourism.

NAFTA, the latest chapter in this process, accelerated the economic and social integration of both economies to unprecedented levels. By 2001 some analysts and think tanks believed that sufficient progress had been achieved to propose a greater intensification of economic and social relations and even the creation of a North American Community.ⁱⁱ

Multiple factors, however, have combined to dramatically transform the context of the relationship. The US and Mexico face a critical juncture in their economic, security, and social relations created by the US embarkation on a global War on International Terrorism after September 11, 2001, a sudden increase in levels of drug trade-related violence in Mexico, the US financial crisis stimulated by the collapse of the subprime mortgage market, challenges thrown up by the dramatic reach of the economic globalization process, failed efforts to integrate the Western Hemisphere, and the need to incorporate new social forces as a result of the beginning of democratization in Mexico and its further development in the U.S. Will the policies adopted by each country to address these challenges lead to further cooperation and deepening of economic and social integration or is the progress previously achieved likely to derail?

This chapter begins by briefly characterizing the most recent period of US-Mexico relations, the NAFTA era since 1994. We trace the origins, purposes, and the impact of NAFTA in the two economies and societies. A second section lays out the parameters of a new era in the bilateral relationship, paying particular attention to the challenges to both countries raised by the processes of globalization and democratization. Globalization's impact on the relationship is best captured in the rise of China and consequent displacement of Mexico in trade relations with the US. Democratization complicates policy responses but improves the likelihood that policy will have some consistency over time. The inadequate manner in which the two countries have responded up to now to these challenges is highlighted. A third section discusses the essence of any appropriate response to these challenges: economic integration. The failure of integration at a regional level is discussed, but we note that Mexico's long border with the US means that the options open to Brazil, Argentina and Chile in diversifying their economic relations simply are not viable for Mexico. A fourth section evaluates the current relationship and offers suggestions

to improve the two countries' abilities to respond effectively to today's challenges. Whether Mexico or the US like it or not, they are destined to walk together if they want to be successful in this globalized economy. The conclusion speculates on whether the countries will move towards a more collaborative or distant relationship, thus helping to set the context for the in-depth discussions in subsequent chapters.

The NAFTA Era

The US-Mexico relationship underwent a major shift in 1994 with the approval of the North American Free Trade Agreement (NAFTA). A unipolar moment after the end of the Cold War and a Mexican perception that its economic restructuring needed an international boost that Europe could not provide given its preoccupation with incorporating European nations recently freed from the Soviet bloc created the context for the agreement. The debate in both countries concerning NAFTA never died, and as NAFTA is fully implemented the debate is rekindled in discussions of post-NAFTA possibilities (e.g., the SPP).

NAFTA helped stabilize the Mexican economy after the crises of the 1990s and prevented negative shocks from spreading to the US border states. NAFTA also made Mexico an important contributor to US economic well being. By 2008 Mexico was the second most important export market for US goods, representing 12 percent of their total exports. Most US States have seen their exports to Mexico triple since NAFTA came into being. Additionally, about 45 percent of Mexico's exports are composed of goods previously imported from the United States. The US is the largest foreign investor in Mexico and the most popular foreign destination for Mexican investment as well as for Mexican tourists. .

The goal of NAFTA was to eliminate economic barriers – tariffs and quotas – at the two borders. Apart from agricultural trade between Canada and its partners, and a handful of sensitive products in U.S.-Mexico trade, economic barriers have largely disappeared. For example, progress has been made in addressing agricultural sanitary standards – relocating inspection and certification activity away from the border to farms and plants where agricultural produce is grown or processed. U.S. meat inspectors routinely visit Canadian packing plants; U.S. agricultural inspectors are posted at Mexican avocado orchards. It's harder to inspect a packed and refrigerated container truck than an open field or processing plant, so the payoff is a faster trip across the border and better compliance with standards. Nevertheless, the provisions permitting Mexican truckers to operate freely in the US side await implementation.

The NAFTA era also saw some coordination between government agencies across the border. For example, the Border Liaison Mechanism, managed by Mexican consulates in ten U.S. border towns and U.S. consulates in five Mexican border towns, convenes a set of ad hoc meetings on border issues. Other cooperative efforts include the U.S.-Mexico Mutual Legal Assistance Treaty; the Financial Information Exchange Agreement (FIEA) and the Memorandum of Understanding (MOU) for the exchange of information on the cross-border movement of currency and monetary instruments; and the U.S. Department of Homeland Security - Mexican Public Safety Secretariat operation *Armas Cruzadas*.

Increasing concern over immigration and the drug trade made security on the border an issue for government and public opinion on both sides of the border prior to 9/11. The U.S. Border Patrol budget approximately tripled from 1993 to 2000.ⁱⁱⁱ Following 9/11 the escalatory rhetoric that developed in the US as all issues became subordinate to defending against another

attack (a process labeled the “securitization” of issues) changed the political dynamics of debate about the border.

The historic degree of cooperation under NAFTA was predicated on long-term mutual benefit. The promise of NAFTA was initially undermined by both poor implementation (especially of the side agreements) and the dramatic rise of China as a manufacturer of goods for the U.S. market. Securitization of the border since 9/11 has undercut it further. Hence the NAFTA era may now be over.

A New Era for the 21st Century?

As we come to the end of the first decade of the 21st Century, the U.S.-Mexico relationship is facing new challenges and opportunities. The new challenges have been thrown up by the dramatic reach of the economic globalization process, failed efforts to integrate the Western Hemisphere as well as the limits to NAFTA integration, and the need to incorporate new social forces as a result of the beginning of democratization in Mexico and its further development in the U.S. The issues of transnational crime (including the drug trade and terrorism) as well as the illegal flow of labor are the manifestations of an informal integration pushed by the process of globalization. These challenges cannot be ignored, and if dealt with poorly, the results will be detrimental to both. Neither country can deal effectively with these challenges unilaterally; unilateral policies may give each the patina of ‘sovereignty defended’ but that very sovereignty will be undermined as the inefficient unilateral responses sap the country’s resources and create resentments internally that obstruct necessary reforms.

In this section we examine how globalization affects the two countries, and summarize how the democratization processes in both countries impacts policymaking.

Globalization

Globalization is an economic process that seeks to determine the allocation of land, capital and labor on a world-wide basis. This process attempts to mold countries and incorporate them into an exchange process determined by the logic of a global market. All countries resist that process to some degree, depending largely upon their endowments of natural resources, capital and skilled labor. In and of itself, globalization is a process that produces both positive and negative results; how those results are dealt with is influenced, but not determined by the globalization process. The challenge for countries is to develop policies that will mitigate the adjustment costs and facilitate the movement of capital and labor into productive and competitive enterprises. No country, including the U.S., is immune from these challenges. National responses will have their domestic and international components, and making these two interconnected spheres work together can be difficult.

Economic integration is one potential response by countries to the globalization process. Integration is built upon national policies that facilitate and promote the complementarities of national economies; de facto integration by the pull of market forces can never go far enough on its own to generate the level of integration that is advantageous in competing with extra-regional forces. There are competing paths to sub-global integration, but each have the common goal of dealing with globalization in a manner that promotes and defends the interests of the nations involved in that particular integration scheme. The globalization process has its own dynamic but is ultimately dependent on the major consuming countries and providers of capital adopting policies that keep barriers to the process low.

The U.S. needs to develop a strategy to deal with its continued movement out of manufacturing enterprises, a falling dollar, the economic rise of China, growing demands on energy that result in price increases, and the violent backlash against globalization which targets the U.S. as its chief promoter. The U.S. undoubtedly still retains sufficient advantages to bungle its way through the short term but an adjustment that will sustain the country's standard of living over the medium term will require important decisions concerning the relative incentives facing investors and the social infrastructure undergirding the development of human capital. The US has to rationalize its demand for energy in order to stay on the cutting edge of industrial technology and to divert national income from purchasing ever increasing quantities of oil and gas towards investing in the nation's productivity.

In this revised national strategy Mexico and Canada will play important roles. The US must remember that NAFTA not only helped to prevent negative shocks from spreading to the US border states but also made Mexico an important contributor to US economic well being. A similar response at the present time can assist both countries in surmounting their domestic crises while helping the Mexican government to win its battle against organized crime.

With appropriate policies in the US stimulating development in Mexico, the latter, with its 108 million people, could also contribute a growing market for US goods and services as well as provide skilled labor. But the U.S. must not only want Mexico to play a more significant role in North America, Mexico itself must want to and adopt the appropriate responses to promote that development.

The biggest challenge that Mexico faces for recovering, maintaining and improving its participation in the US market is Chinese competition. Since acceding to the WTO and receiving Most Favored Nation treatment, China has rapidly captured the US market, particularly in labor

intensive products. For example, Mexican textile and apparel exports to the US in 2006 fell to US\$6.8 billion from US\$14 billion in the year 2000, when, thanks to NAFTA, it had been the main supplier, a position China now holds.

Ideally, Mexico will confront Chinese and other Asian countries competition by taking advantage of its geographic proximity to the US to produce higher value added products, such as advanced technology products (ATP). Since 2002 Mexico has signed free trade agreements with European, Asian and Latin American countries and attracted new investments in this sector. Mexico has already benefited, with ATP exports to the US rising 149% between 2002 and 2008, to US\$40 billion (see Table 1).

Table 1 US Imports of advanced technology products from Mexico

(Millions of dollars)

	2002	2005	2006	2007	2008	% growth (2002-2008)
Biotechnology	11.5	20.3	24.9	20.4	18	56%
Life Science	1,112.9	1,830.8	2,233.3	2586.1	2,786	150.3%
Opto-Electronics	431.9	4,957.1	10,164.5	14,146.9	14,623.1	3285.7%
Information and Communications	12,513.3	15,222.4	16,387.0	16380.3	20,592.9	64%
Electronics	1,117.2	991.8	1,131.6	1,170.5	1023.5	-8.3%
Flexible Manufacturing	581.3	527.9	456.1	432.6	438.7	-24.5%
Aeroespace	183.1	245.5	305.3	342	525.7	187.1%
Advanced Materials	60.6	311.6	185.9	187.7	183.6	-18%
Weapons	55.9	55.9	71.4	56.6	55.6	-.5%
Nuclear Technology	0.0	0.0	0.1	.02	.8	-----
Total	16,196.2	23,990.7	30,887.2	35322	40319.9	410%

Source : US Census Bureau for data up to 2006; ^{iv} Foreign Trade Statistics, U.S. Census Bureau for data of 2007- 2008.

Mexico sells more ATP goods to the US than Japan, more than Korea and Taiwan combined, and more than France and Germany combined. It ships ten times more than the rest of Latin America as a whole. The only country that supplies the US with more ATP goods than Mexico is, predictably, China. However, geographic proximity and proper policies, can provide Mexico an edge in this growing market and even aspire to overcome China for first place.

Mexico needs to respond to the challenges globalization represents by looking forward rather than seeking refuge in failed economic policies of the past. Although some analysts look wistfully at the level of trade diversification of the Southern Cone countries of Latin America, gravity models of trade clearly indicate that the U.S. market will have an overwhelming impact on Mexico simply due to geography.

In order for Mexico to effectively increase its ability to get more out of its relationship with the U.S., Mexico will need to make the domestic choices that develop its human capital and infrastructure and attract productive investment. One of the most important and highly controversial challenges facing Mexico is the management of the energy sector. Oil production fell 5% in 2007 and 9% in 2008. The biggest vulnerability posed by declining oil production lies with government revenue. Total oil-related revenue equaled just over one-third of total government revenue in 2007. Fiscal revenues from the oil sector exceeded 8% of GDP in 2007, almost equaling the 9% of GDP that comes from income tax and value-added tax. Total tax revenues from the non-oil sectors of the economy were below 11% of GDP in 2007, low by regional standards. The failure to build a stronger non-oil tax base has led Mexican governments

to depend heavily on PEMEX's resources, thereby depleting the company's ability to modernize and undertake more exploration and production. ^v

Petroleum can't be a bludgeon to rework the relationship with the US because the country doesn't have sufficient reserves with which to threaten. Mexico has become an importer of natural gas from both the US and around the world, and, unless it dramatically alters its energy policies, is on its way to facing similar prospects in petroleum. It is ironic that even Hugo Chávez' government exports petroleum to the US and permits foreign and domestic private investment in exploration and production but Mexico fears exporting to the US and won't permit Venezuelan-type conditions to attract private investment. If Mexico is going to continue supplying its domestic market and generating export revenues, the country will have to at least become more Chávez-like in its energy policy rather than continue asserting the uniqueness of the Mexican Revolution.

Another major challenge facing Mexico is that macro-economic stability has not generated rapid economic growth. Poor micro-economic foundations and the lack of flexibility in key sectors of the economy prevent Mexico from advancing more rapidly. The Mexican economy grew at an average annual rate of only 3.3% during 2003-2007, a period of much faster growth in the world economy and in Latin America as a whole. The relatively modest growth rate helped to reduce poverty and improve human development indicators, but the pace of change has been disappointing for most Mexicans.

What explains the lack of a solid and robust economic growth in Mexico? The answer is not hard to find. The level of domestic competition in Mexico is lower than in most industrialized countries. Some sectors of the Mexican economy are competitive and dynamic, thanks to impressive reforms in recent decades to open them to trade and investment. Other

sectors, however, suffer from poor competitiveness, due in large part to the country's legacy from a 'corporatist' economic and political model for much of the 20th century. The extent of "dualism" in the economy is higher than in most countries at Mexico's level of wealth, given the contrast in productivity between competitive, export-oriented sectors like autos and protected sectors like corn, oil, gas and electricity. According to the OECD, Mexico could aspire to reach annual growth levels of 6% if it improved the quality and productivity of its infrastructure and electricity sectors.^{vi}

In sum, Mexico cannot postpone important reforms, especially if it wants to recover sustainable and robust economic growth and take advantage of its proximity to the US. Only in this way could Mexico become a leader in favor of seeking effective and beneficial participation in the globalization process and adopt a foreign policy that promotes regional integration. Of course, Mexico cannot play this role if the Mexican economy falters and if the U.S. attempts to push an inordinate share of its own adjustments costs onto Mexico. In short, the two can fail separately, but they cannot separately adjust successfully.

Globalization and Crime. After the terrorist attacks of September 11, 2001 U.S. policy towards not only Mexico but the rest of the world, has prioritized protecting its homeland from a further terrorist act. However, the conceptualization of protection has been narrowly defined, ignoring its impact on the relationship with its immediate neighbor to the south. Mexico has had to understand its new relationship with the U.S. in light of this drastically heightened preoccupation with national security. At the same time, Mexico itself is entering a new stage of confrontation with ruthless drug traffickers. Thus Mexican policymakers are becoming sensitized to the challenges of fighting unconventional threats.

Mexico is also facing a conceptual challenge. Mexico had historically been reticent to think about the northern border in terms of security. Clearly, there is little Mexico can do to be secure *from* the US in traditional terms, so to think about the security of its northern border meant buying into a US view that Mexico represented a threat. So for most of their joint history, Mexico has not systematically attempted to patrol its side of the border. The country has no border patrol and the military is deployed only in crisis periods and at specific points. It is now in Mexico's own national interest to develop a systematic plan for dealing with illegal flows of goods and people across its borders. Ideally, it would not reproduce the high profile but little effective militarization strategy that the US has for its border with Mexico.

The onslaught of violence by Mexican criminal organizations is not just a result of the drug trade. The development of vast new means of laundering money in the global financial networks and the ready availability of high powered weaponry in a global market that includes the US has made drug gangs that existed for decades into newly powerful threats to public safety and order. Human trafficking and kidnapping have become extremely lucrative enterprises as well. The criminal organizations have extremely effective intelligence gathering, brutal intimidation tactics, and deep pockets for bribery.

We need to be clear that the illicit drug market itself is not the sufficient cause of the large scale violence wracking Mexico today; the value of cocaine and heroin is higher in the US than in Mexico and the US was a major producer of methamphetamine for years without reaching the level of violence in Mexico today. At the height of US drug related violence in the early 1990s there were 5.7 deaths per million; in Mexico in 2007 the rate was 24.9 per million and the rate went up in 2008 and 2009.^{vii} The drug trade is also quite lucrative in Western Europe and yet their levels of violence are also significantly lower than Mexico's. Rather than focusing

on the drug trade itself, therefore, we should be targeting the institutional deficiencies, low levels of economic development, and the cartels' local monopolies to understand and combat the level of violence in Mexico today.

We also have to recognize that the proximity of the U.S. is a serious liability for Mexico since it is the world's largest market for drugs and —despite an estimated \$30 billion in annual U.S. counter-narcotics spending— has been unsuccessful in reducing domestic drug consumption to the point that drug traffickers would look elsewhere. The latest National Survey on Drug Use and Health of the U.S. Department of Health and Human Services notes “The overall rate of current illicit drug use among persons aged 12 or older in 2007 (8.0 percent) was similar to the rate in 2006 (8.3 percent) and has remained stable since 2002 (8.3 percent).”^{viii}

Meanwhile, the United States serves as the primary source for Mexican organized crime to acquire illegal weapons. According to the State Department's International Narcotics Control Strategy Report for 2009, 95% of the drug related killings were carried out with U.S.-purchased or stolen firearms (guns are illegal in Mexico).^{ix} “An estimated 6,700 gun shops can be found along the U.S.-Mexico border alone, making it possible for Mexican criminal organizations to access high-powered weaponry and ammunition with relative ease; while the region has an estimated 16,000 U.S. border patrol agents, there are only 100 U.S. firearms agents and 35 gun inspectors.”^x The U.S. and Mexico are collaborating on this issue (the eTrace program of the Bureau of Alcohol, Tobacco, Firearms and Explosives was made available last year to trace the origins of weapons seized) but the goal should be to stop the flow of arms before they are used in crime in Mexico.

In other words, the US and Mexico are in this struggle against crime together. The public in both countries demand that the border be better secured in both directions against the drugs,

money, weapons and individuals feeding this crime. Despite the frustrations many on the US side feel as they read sensationalist press accounts, there is no way of ‘fixing’ the border that can provide security for the US without also providing it for Mexico. The expectation by some that the US can ‘seal the border’ against illicit entry of goods and individuals is simply impossible. Even making significant progress toward it would impose economic and social costs on Mexico that would create an even more desperate situation south of the border, thereby producing even greater threats to US national security. The two countries can either address these demands for security in a more effective manner (and that means doing many things differently) or divert significant human and capital resources from meeting the economic challenges of globalization into an ineffective search for security from crime. Although the levels of violence have declined in 2009 their continuation at historically high levels indicates that the level of trans-national cooperation between the Mexican and the United States governments is not optimal in this area.

Given the magnitude of the violence issue, professionalizing the police and reforming the judicial system are necessary but insufficient responses. Ultimately the penal system should not simply take criminals off the streets, but deter crime. The US model of dealing with crime after the fact is too expensive (manpower, court time, jail cells and parole infrastructure) and the severely negative underlying social and economic conditions in Mexico can generate a never-ending supply of criminals to overwhelm whatever judicial and police reforms the country adopts.

Mexico attempted to deal with the drug trade a few years ago by pursuing the European route of decriminalization of consumption in order to focus on trafficking and production. But pressure from the Bush Administration kept President Vicente Fox from signing the bill after Congress passed it. Fortunately, the Obama administration and the new Congress have decided

not to oppose Mexico on this issue. In 2009 Mexico returned to the issue and President Calderón signed the bill decriminalizing consumption of any illegal drug

Another major reform was passed in March 2008 when the Mexican Congress approved changes that will move Mexico away from its traditional inquisitorial model of criminal procedure, and toward an accusatory model where cases are presented to a neutral judge by opposing counsel, with greater opportunities for plea bargaining, pretrial release, and alternative sentencing. These reforms have also allowed major changes to the structure and function of domestic law enforcement institutions, including the blending of investigative and preventive police agencies under the same umbrella, a shift that may increase the efficiency and effectiveness of criminal investigations.

The Mexican Congress and President Calderón recognize both the weakness of their judicial system and the contribution that the US can make to the fight against organized crime. Although Mexico will still not extradite criminal suspects who would be subject to the death penalty (there is no death sentence in Mexico), it will now consider extradition in cases in which life imprisonment is a possibility. Under Calderón's administration Mexico has extradited more than 150 criminal suspects.

The Merida Initiative is another important effort aimed at fostering collaboration between Mexico and the US to fight organized crime and to defend human and civil rights in the process. Both governments would be extremely short-sighted to believe that the fight against organized crime required temporarily ignoring the human and civil rights costs of policy. Insisting that the current security situation requires and justifies putting human and civil rights on the back burner will create a backlash against US-Mexican cooperation that would further contribute to the polarization of a Mexico already confronting armed rebellion in Chiapas,

Guerrero and Oaxaca. Now that Mexico is a democracy what citizens think about their government matters. The party (PRD) whose candidate (AMLO) narrowly lost the last presidential election is ideologically inclined to be extremely skeptical of close collaboration with the US. The US already has poor relations with Venezuela, Bolivia, Ecuador and Nicaragua; it would be poor policy for the current US and Mexican administrations to push the next Mexican government into that camp.

Democratization

Globalization is significantly affected by politics and hence, the process of democratization. As a country democratizes it incorporates new actors into the decision making process and increases its level of transparency. The combination of more interests and more information inevitably stimulates controversy. On the one hand, the discussion can become overly politicized, which then feeds on itself to undermine the ability of decision makers to craft an effective policy to the challenges generated by the globalization process. On the other hand, by incorporating more interests and shedding light on the distribution of costs and benefits, democratization can also increase the likelihood that globalization will benefit the nation and thus that the country will promote it.

Democratization is an on-going process that is never completed because society is constantly evolving, interests change and new political coalitions develop, and the world within which a political system exists generates stresses within existing political arrangements. Consequently, which groups have influence and who is mobilized in opposition fundamentally affects politics and policymaking in general, and particularly in response to globalization.

The democratization process in Mexico responds largely to its own internal dynamics. Seventy years of rule by a single party (PRI) and a history of electoral manipulation, corruption and selective repression are the dominant factors that help us understand much of the challenges posed to the democratizing political system by the PRD party and anti-systemic forces in Chiapas and Oaxaca. The anti-market advocates have political and social standing in the political system, on the streets and in the mountains. Consequently, they need to be addressed through engagement and their followers have to have social and economic reasons to abandon them. That means that the consequences of market reforms have to improve their lives now, not through the promise of trickle down benefits for future generations.

Congress plays a major role in reforming policy. With three major parties and a number of minor ones, the Mexican Congress is quite diverse. That broad spectrum of political views increases the representativeness of the Mexican Congress, but it complicates policy making.

The country's political arena is now filled with debate on key issues, such as education, health, environment, and competition policy. The Mexican Congress held exhaustive debates during 2008 on President Felipe Calderón's proposals to reform the energy sector, seeking to strengthen Pemex financially and managerially, and to modestly enlarge the role of the private sector in the oil business. Such trends augur well for the country's ability to modernize and prosper, albeit slowly.

Mexico is likely to move in a centrist direction after the PRI's 2009 Congressional victories and the demise of the PRD. Since PRI has the potential of regaining the presidency in 2012 after twelve years, one should expect the Party to support reforms now so that the new president can enjoy its fruits. Supporting reform doesn't mean abandoning nationalism, but it

should mean creating more incentives for private foreign investment because neither Mexico itself, the “South”, China, nor Russia can provide the capital required for economic recovery.

Calderón has an important opportunity to decrease the nationalist tenor of responses to globalization and look for closer relations with the US. But this success will only come at the expense of his own party’s likely future in the next elections because PRI controls the reform process in Congress and will only approve reforms for which it can take credit. It cannot alienate the nationalists and win in 2012, but it will also want a more effective set of national development policies if it wins in 2012; hence, PRI should seek further reforms in the key sectors of the economy, including energy. Calderón has already demonstrated his innovative nature in working with Congress to pass important, though still limited, reforms in the pension, fiscal and judicial sectors;^{xi} now he has to take the risk of putting his historical legacy ahead of his party’s chances in the next presidential election.

Mexico will try to get closer to the US, but can the US reciprocate? The answer depends in part on how democratization influences US politics.

In the case of the U.S., democratic politics became more complicated in the 1980s and 1990s as the Republican Party mobilized a new conservative and religious grass roots base of support and swept into power in both the Executive and Legislative branches of government. The incorporation of this group upset the political spectrum in the US and polarized it. The sole Democrat to win the presidency between 1980 and 2008, Bill Clinton, was constrained by that shift most vividly in the failure of his health care reforms at the beginning of his first term in office and by the exceedingly moderate characteristics of his Supreme Court nominees. The culmination of this dramatic shift to the right was the unilateral and radical right-wing tenure of the Bush-Cheney presidency, 2000-2008.

The shift rightward in US politics meant that the challenges which globalization was thrusting upon the U.S. in the period 1980-present, and the efforts to develop an integrated response across North America and the Western Hemisphere, were interpreted and responded to in a manner that emphasized relatively unrestrained market incentives. While the economy adjusted successfully in this period, everyone benefitted; the rich more so than the poor and the US more so than Mexico. But as the US economy faced newer challenges spurred by its growing trade deficit (which earlier had been seen as a sign of success) and weakening dollar (partly due to the costs of the Iraq war but also affected by the collapse of the wild financial schemes that fuelled the housing market and through it, consumer spending), new and more difficult adjustment choices have forced themselves upon the U.S..

Barak Obama was able to tap into an underlying sense of unhappiness with 'politics as usual' by those who had ignored their necessary role in generating sustainable and broad based development in favor of shopping. Unfortunately, now that these people see themselves as losers in the globalization process they are seeking to defend against it rather than to develop positive adjustment strategies. Thus NAFTA is under attack and the low-skill, low-wage labor needed by the economy is threatened. The challenge for President Obama and the Democrats in Congress is to incorporate the younger generation that seeks positive change into a coalition with the current losers that will support policies that make the best use of North American potential.

North American economic Integration: The Only Way Forward

Economic integration is the optimal response to globalization and meeting the needs of a citizenry empowered by democratization. The integration of the Western Hemisphere became a perhaps too easily identified goal after the end of the Cold War and the return of democracy in most of the region. Economic integration became the cure-all for economic crisis, interstate

rivalries, and democratization. The logic was on the one hand, typically liberal: what people most cared about was their economic well-being and by creating larger markets (via the integration of the 30+ national markets in the Western Hemisphere) the factors of production (land, labor and capital) could be used more efficiently, thereby creating sustainable growth. The fact that the Washington Consensus failed to benefit significant portions of the Latin American population should not detract from the expectation that a more socially focused economic integration (a la Europe) could successfully address international challenges without undermining social and economic progress across the region.

Capitalists are not the only ones attracted to integration as a response to globalization. Hugo Chavez' has articulated an alternative to the US-led liberal integration which would be developing country-centered. The Banco del Sur is expected to provide the capital to facilitate South American integration beyond Mercosur and the Comunidad Andina (CAN). The Bolivarian Alternative for the Americas (ALBA) is a direct competitor to the U.S.-espoused Free Trade Area of the Americas (FTAA); ultimately, Chavez' global version includes the integration of China, Russia, Iran and any other 'anti-imperialist' nations. The logic here is not one of market efficiencies but rather one of state-directed economic activity for the generation of social welfare, or what he calls, "Socialism of the 21st Century." The likelihood of Chavez' alternatives becoming a significant means of addressing the challenges of globalization are virtually nil. But that alone does not mean that NAFTA, or any 'post-NAFTA' programs will be effective responses.

A European style socially-focused economic integration could successfully address international challenges without undermining social and economic progress across the two borders. Yet the current political moods in the two countries suggests that this is unlikely to

garner sufficient political support to guide the two countries. A more realistic option for building a long term partnership is to focus on the most urgent problems while trying to mitigate the accompanying social dislocations.

The Security and Prosperity Partnership of North America (SPP) is often referred to as the project to take the region ‘beyond NAFTA.’ Unfortunately, the SPP reflects U.S. phobia with national security more than a blueprint for a coordinated and integrated response to the challenges of globalization. But poor responses to globalization contribute to terrorism, diverting resources from defeating the underlying sources of terrorism. Inappropriate responses that myoptically focus on a highly unlikely major attack against the U.S. ‘homeland’ also create obstacles to developing appropriate political-economic responses in North America and will more likely produce a weakening ability of North America to compete effectively in the globalization process than deter such a major attack.

Where Are We, and Where Should We Go?

The most useful place to discern the future of the bilateral relationship is on the U.S.-Mexican border (3,326 kilometers) since improving its management is the most likely path to progress toward a closer economic partnership. We divide the border management question into two parts, the inspection of agricultural products, and the inspection of all other products.

An indication of drifting apart comes from customs inspections along the border. After September 11, 2001 new security measures were implemented that cause delays and complicate the process of inspection. In order to facilitate and prevent future disruption of cross-border trade, the three countries negotiated in 2001- 2002 new agreements on “smart borders” aimed: to secure the infrastructure and the flow of people and goods at the North American borders As

part of the Smart Border accords, they created the Free and Secure Trade (FAST) Programs to permit the rapid and secure passage of legitimate commerce through the North American Borders. However, so far only a minimum proportion of North American firms on the Mexican side have registered into this program.

Importers and exporters everywhere regard customs services as an irritation especially now that most provisions of NAFTA have been implemented. One study estimates that a border crossing can take as much as between 7 and 17 hours and the total costs for a border crossing may reach as much as between 10 to 20% of total transportation costs.^{xii} According to a 2007 study by the American Transportation Research Institute

...inefficiencies at the [US Canadian border] have increased costs by 10 to 15 percent...The main costs impacts derive from border delays, either real or anticipated. ...[and] the cost of duties, broker fees, custom administration...[amounting] to total costs representing 2.7 percent of merchandise trade totaling US \$ 382 billion in 2001 (Kergin and Matthiesen, 2008,).

Virtually all the truck traffic between Canada, Mexico and the United States crosses fewer than 10 ports of entry, and these were totally congested even before September 11. It is simply not feasible to expand the inspection lanes and holding areas at these 10 ports adequately to cope with the needs of just in time deliveries across borders and security inspections.

Customs experts recognize that to really improve border management security inspections must be moved back from the border to the plants where shipments originate, and one must ensure continuous surveillance from origination to destination. NAFTA partners have already taken the first step in addressing agricultural sanitary standards. What has already been

accomplished in agriculture should be implemented in other segments of merchandise trade. This will require a host of low-tech and high-tech innovations: audited security built into production lines, akin to ISO 9000; sealed and tamper-proof containers; and continuous tracking of containers (using GPS) from origin to border to destination.

The United States and Canada demonstrate the possibilities for a productive customs relationship to proceed even under the heightened security conditions of today. The two countries have developed a program to inspect, at the Canadian port of entry, shipping containers destined for the United States that arrive from Europe at Halifax and from Asia at Vancouver. Although only a start, (the program does not address the far larger volume of traffic originating in U.S., Canadian, or Mexican plants), it demonstrates that the technology exists for inspection and surveillance from point of origin to point of destination. While it may be costly to implement, especially for small firms, the bigger obstacle is gaining political assent from each North American partner for intrusive practices that entail the presence of foreign customs officials. Until that assent is forthcoming and new systems are put in place, North American commerce will be clouded by periodic episodes of border strangulation, as happened after September 11 or prevented from regaining momentum by the inefficiencies referred above.^{xiii}

Beyond mutual inspection on land, there is the problem of interception at sea. Within the framework of new and closer economic and security partnership, the NAFTA coast guard services would need to work closely – and even interchangeably – to intercept smugglers. All three countries have long coastlines with unpopulated stretches, vulnerable to smuggling of human and merchandise cargo. High-tech means, involving specially equipped aircraft and tethered surveillance balloons, may be appropriate in some areas. Again, the problem is not so much technical frontiers as political assent from the three partners.

Deepening regional trade policy

Another way to regain momentum and increase trade and investment among the three partners would consist of eliminating the remaining barriers that exist to regional trade through the creation of a customs union with a common external tariff (CET)^{xiv}. That approach was pioneered by the Treaty of Rome (1957) for the European Economic Community, and copied for numerous economic unions since then. While a CET has many attractions, in our opinion the three countries could not currently agree on a formula for choosing tariff rates for a CET. Equally difficult would be the problem of coordinating NAFTA tariff offers in the context of the WTO, or bilateral or regional trade negotiations. None of the NAFTA members would want to concede its own freedom of maneuver to the prior approval of its partners. Even less acceptable would be delegation of negotiating authority to a supranational body, modeled after DG-1 in the European Commission.

It should be possible, nonetheless, to achieve many of the practical benefits of a common external tariff. The NAFTA partners could set a long-term goal of reducing their respective MFN tariffs to the lowest MFN level applied by Mexico, Canada or the United States, while each NAFTA partner would retain complete freedom to negotiate its rates in the WTO, or regionally or bilaterally. Rules of origin would be waived for tariff-free trade *within* NAFTA, provided that the exporting country did not import a significant quantity of the affected inputs at tariff rates more than (say) one percentage point lower than the MFN rates applied by the importing country. The waiver procedure could be invoked on an annual basis by each importing firm.

As a package, these reforms would not add up to a customs union. There would be no attempt to harmonize quotas. Individual NAFTA partners could still invoke antidumping and

countervailing duties. External MFN tariff schedules would converge only gradually. Rules of origin would linger for many years. Nevertheless, from the vantage point of firms investing and trading within North America, these changes would go far towards eradicating the residual *commercial* borders that still separate Canada, Mexico and the United States.

Improving migration flows

Another way to compete effectively in the globalization process and a necessary step in the economic integration of North America is the liberalization of migration flows in North America.

Liberalization of migration flows remains, without doubt the toughest issue within North America. Whenever North American integration is debated, migration questions attract the spotlight, especially as they pertain to Mexico and the United States. Before tackling the most difficult migration questions, however, we believe that progress can be achieved on several lesser questions

First, Mexico and the US can make quick progress on a subject where they share common interests, namely the creation of a more efficient system for the free flow of legitimate travelers among the two countries. The smart border concept negotiated between Canada and the United States and Mexico and the US contains two useful ideas: high-tech identity cards for permanent residents, using biometric identifiers; and pre-clearance programs for frequent travelers. Border crossings will be faster for these persons; meanwhile, the immigration authorities can focus their attention on unknown travelers.

Second, the US and Mexico can make it easier for their citizens to retire anywhere in North America. NAFTA retirement visas should be readily available, as a companion to the TN visas used by firms to relocate their employees within North America. More important,

Medicare and similar health benefits should be made portable within North America. An American retired in Guadalajara should be able to spend her Medicare benefits at an approved clinic in that city. The same principle should apply to a Canadian retired in West Palm Beach, or a Mexican retired in Vancouver.

Finally, and most difficult between Mexico and the United States, is the looming issue of undocumented Mexican workers. Within this category are two groups: those who already reside in the United States, a group whose number reached between 4.5 and 5 million in the last decade and those who will, in the future, come to the United States to work. While important distinctions can be made between the two groups (a point we discuss later) the whole issue of unauthorized immigration is highly charged.

On the Mexican side, the government considers the legalization of immigrant workers a matter of human rights and social justice – and a necessary step in the economic integration of North America. In terms of economic benefits, legalization will help ensure that the Mexican economy receives a growing flow of worker remittances (now running about \$20 billion a year). The legalization of millions of Mexicans working in the United States will moreover improve their economic prospects, and enable many to return to Mexico as successful entrepreneurs.

On the United States side, feelings are equally strong. Some Americans flat out oppose any increase in immigration. More immediately, the attack on September 11 and the subsequent deterioration of the U.S. economy damped discussions of a “Grand Bargain” that started in the Administration and Congress in the fall of 2001. The recession and rising unemployment gave fresh impetus to groups that oppose the opening of the border to migrant workers.

What does this imply for a new policy on immigration?

Public debate and policy in the US are deadlocked over how to balance the objectives of ending unauthorized flows, resolving the status of undocumented residents, enhancing immigrant integration and providing for labor needs – in addition to setting desirable levels of legal immigration and the criteria for admission.

On the other hand, widespread agreement exists along the border that some type of formal worker registration program is necessary. The current state of affairs forces hard working persons to face the uncertainties of a north-of-the-border “informal underground labor market,” which is at best, an inefficient arrangement. Since the benefits of illegal migration are nationally distributed, federal financial support to county and municipal agencies facing excess expenditures due to non-resident social service provision would be appropriate.

One way to tackle the migration issue is to start with an expanded number of legal visas, say 300,000 persons from Mexico annually. Additional visas should be issued on a work skill basis (including unskilled workers), not on a family reunification basis (the dominant test for current visas). However – and this is where security is underlined – to obtain a temporary work permit, the Mexican applicant will have to undergo a background check designed to avert security threats. Once inside the United States, temporary permit holders would need periodically to inform the Immigration and Naturalization Service electronically of their address and place of employment. Permit holders could renew their permits as long as they were employed a certain number of months (say eight months) in each rolling twelve-month period, had no felony convictions, and reported regularly to the INS. They could apply for residency after a certain number of years (say a cumulative five years as temporary permit holders). In the meantime, they should accumulate public Social Security and Medicare rights, as well as any private health or pension benefits.

Coupled with this substantial, but closely regulated, increase in temporary work permits, the United States and Mexico should embark on a joint border patrol program to reduce the flow of illegal crossings. The program should include features such as enhanced use of electronic surveillance, and ineligibility for a temporary work permit for three years after an illegal crossing. No border patrol program will eliminate illegal crossings, but a joint program, coupled with a substantial temporary work permit initiative, could reduce the flow.

That leaves the very difficult question of perhaps 5 million undocumented Mexicans living and working in the United States. We do not have a magic solution. The foundation for our tentative suggestions is the proposition that nearly all these people have made permanent homes in the United States and they are not going to pick up their lives and return to Mexico. Under a set of appropriate circumstances, therefore, they should be granted residence permits with eligibility for citizenship. The appropriate circumstances we envisage have two components – a threshold relating to illegal crossings, and standards for individual applicants.

- The resident permit program would be launched when the Presidents of the United States and Mexico could jointly certify that the annual rate of illegal crossings does not exceed 200,000 persons. This would entail a reduction of close than two-thirds in illegal crossings estimated in recent years. The resident permit program would be suspended in years when the Presidents could not make this certification.
- Individual eligibility would require evidence that the person resided in the United States prior to the *announcement* of the program. Otherwise, eligibility standards would parallel those for temporary work permits (discussed earlier).

- An applicant for a residence permit who could provide satisfactory evidence of residence in the United States prior to the announcement of the program would not be subject to deportation (whether or not he met other eligibility requirements) so long as he periodically reported a place of residence to the INS, and committed no felony after the issuance of the residence permit.
- Holders of residence permits would be immediately eligible for public Social Security and Medicare benefits, as well as private health and pension benefits. They could apply for citizenship after five years.

Conclusion: Tied Together, Whether they Like it Or Not

This context of globalization, integration and democratization is the one within which the US-Mexico relationship plays out. The challenges are relatively clear, but the responses are not. The most appropriate policies are not likely to be politically viable. The policies that are likely to be the easiest to sell politically are unlikely to be particularly appropriate economic responses. We need, therefore, to take a step back from short term thinking powered by hysteria and engage in a fundamental re-examination of the common interests and mutual benefits that will place those challenges in their proper context and build a societal consensus that we are in this boat together, like it or not.

Therefore, in order to improve the relationship through which both countries can assist each other to surmount their domestic crisis, they will have to adopt a new and ambitious project that addresses new border and supply line inspections, but also cooperative policies in two other fronts: regional trade policy and migration.

To succeed, the new project should be ambitious enough to evoke visionary leadership, but ambiguous enough to accommodate the political realities of the three countries. In a sense, the new project, which could be called a North American Economic Space (NAES), should be the analogue of the 1980s concept of a European Economic Space – designed to link the European Economic Community and the European Free Trade Area. Until the European Union came into being with the Maastricht Treaty, and absorbed most of EFTA, the final destination of the European Economic Space remained a work in progress. Similarly, the NAES should be a work in progress for at least a decade, to foster the closer integration of North America, while preserving the essential sovereignty of each partner.

ⁱ Hinojosa-Ojeda, and Robinson. "Labor Issues in a North American Free Trade Area".

ⁱⁱ Pastor, *Toward a North American Community*; Council on Foreign Relations, 2005 pp. 7-32.

ⁱⁱⁱ Bronk, Christopher and Tony Payan, "Managing the U.S.-Mexico Border: Human Security and Technology".

^{iv} Quoted in Mexico Watch, 2007.

^v Despite the negative trends in oil production, the Mexican economy is much more flexible in macro-economic terms today. In contrast with the situation facing Mexico in 1994 during the 'Tequila' financial crisis, the country does not have to defend an exchange rate with its foreign exchange reserves. The combination of an autonomous central bank, floating exchange rate, and inflation-targeting, monetary policy has given Mexico more capacity to absorb the kind of external shock that typically led to a crisis in previous decades. The government has much greater flexibility to fund its debt, reducing the risk of depending upon volatile international financial markets.

^{vi} OCDE *Economic Surveys: Mexico*.

^{vii} Figures cited in Neuhaus Schaan, Joan “Security in the U.S. – Mexico Border Lands: The Crisis, the Forces at Work, and the Need for Honest Assessments and Action”.

^{viii} National Survey on Drug Use and Health of the U.S. Department of Health and Human Services. Proximity to the United States and the proliferation of local trafficking networks (*narcomenudeo*) has also contributed to increasing drug consumption in Mexico. But we need to keep the size of the two markets in perspective: in 2008 one survey with slightly less than national coverage indicated that 4.5 million Mexicans had tried an illegal drug at some point in their lives, while the US government’s 2007 National Survey on Drug Use and Health found that 114 million people in the US had done so.

^{ix} U.S. Department of State, “International Narcotics Control Strategy Report for 2009: Country Report for Mexico”.

^x Shirk, “Developing the US-Mexico Border Region for a Secure and Prosperous Relationship. pp. 22-23.

^{xi} Mexico passed a tax reform in 2007, widening the corporate income tax base. The reform was done from a position of strength, while oil revenues were high, increasing Mexico’s fiscal flexibility before a potential fall in oil prices. The government also reformed the pension system for federal civil servants last year, leading to the creation of more pension funds that will boost the size of the local capital market.

^{xii} Haralambides and Londoño-Kent, Supply Chain Bottlenecks.

^{xiii} On the negative side, the NAFTA provision for Mexican truckers to transit the US has confronted a number of political and legal challenges and has not been implemented. The most recent instance of an attempt to solve this quagmire was the Pilot Program which allowed a

limited number of companies to cross the border north and south and which showed a great potential to become the final solution, was left without funding in March in the US and was practically killed. According to reports, both governments are negotiating its restoration and they are close to finding a solution. This should be done soon as a way to restore the dynamism of trade flows.

^{xiv} Council on Foreign Relations; Dobson, *Shaping the Future of the North American Economic Space*, p.33-35.

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