TRADE FLOWS IN THE CONTEXT OF THE NORTH AMERICAN FREE TRADE AGREEMENT

By Arturo Guillén R.*

1. Introduction

The objective of this paper is to analyze trade flows between the United States, Canada and Mexico from 1980-1998. I would like to evaluate changes to the size and structure of these trade flows, since the application of policies focused on opening up trade in Canada and Mexico in the 1980s and, specifically, since the North American Free Trade Agreement (**NAFTA**) went into effect in 1994. Furthermore, I would like to analyze the impact of economic opening and the **NAFTA** on economic development and the wellbeing of its populations, particularly in the case of Mexico.

2. Main Hypotheses

a) International trade is not a subject among equal partners, exchanging goods or services according to comparative advantages or the endowment of productive factors, but a relationship between unequal States and economic agents.

   Economic firms from each country and within the region are different in their size, bargaining power and in the very relationship they maintain with their respective States (Perroux, 1961) [1].
   According to a new theory of international trade (Krugman, 1979) [2], trade flows are not determined by the comparative advantages of production costs but by the increasing profits enjoyed by transnational companies. These profits are derived from ***internal economies of scale*** (determined by the firm's size) and from **external economies of scale** (dependent on agglomeration processes in the sector they operate in), where the role of the State is vital in several forms.

b) The driving forces behind **NAFTA**, defining the terms of the agreement, were highly globalized capital fractions from the United States and Canada, as well as the larger Mexican groups and transnational companies that operated in its domestic market.

c) In the international arena, **NAFTA** was not negotiated between equal partners, but by one single nation, the United States—not only dominant on a regional scale, but also a hegemonic on a global one—with 1) Canada, a developed nation, but still dependent on the United States; and with 2) Mexico, an underdeveloped nation, historically dependent on this hegemony's power and in a situation of structural crisis since the 1970s.

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[1] Francois Perroux (1961).**L' Economie du XXe siécle**.Grenoble, 1991, Presses Universitaires de Grenoble. 814p.
[2] Paul Krugman (1979). ***Increasing Returns, Monopolistic Competition and International Trade.*** Journal of International Economics.

d) Mexico, Canada and the United States constitute, in Krugman's own words (1991) [3], *a natural economic space*, that is to say an area within which intra-regional trade is more intense than trade with the rest of the world. Mexico and Canada's commercial and financial dependency on the United States is nothing new. The **NAFTA**—as the US-Canada Free Trade Agreement (**FTA**)—only constituted a legal instrument, through which the integration process was formalized. For geographic, strategic and historical reasons, these countries became the preferred areas of US power.

e) **NAFTA** is not a classic free trade agreement, since it incorporates a set of rules for the operation of globalized capital (national treatment to direct foreign investment, the elimination of performance requirements to this investment, the opening up of services, property rights, and unrestricted opening up of capital account), which the United States and globalized capital have attempted to promote in other forums and instances, such as the World Trade Organization (**WTO**), the Organization for Economic Cooperation and Development (**OECD**), etc. (Weintraub, 1997; McDougall, 2000) [4].

3. The Extent of Economic Opening in the North American Countries

The opening up of the American continent's economies over the last two decades has been a generalized phenomenon. From 1990-1996 exports from Latin America increased by 73%, with imports increasing more rapidly at 127%. These figures represented 20% of the GDP, when in 1990, they barely amounted to 10% of the GDP (Devlin and French Davis, 1999) [5].

In North America's case, the opening up of its economies has been a general process, but not a uniform one. The opening up of Canada's economy began in the 1970s. In 1970, foreign trade was only 11.7% of the GDP, but in 1980, it had reached the same levels as the European Union and went on to hit 53.3% in 1981. During the 1980s, the level of opening remained relatively stable, nonetheless, during the 1990s, after signing of a bilateral trade agreement with the United States in 1989 and the **NAFTA** in 1994, this indicator registered a sharp increase reaching 83.5% in 1999 (table 1).

In Mexico's case the degree of opening remained low during the entire period of import substitution; in 1970 it was only 11.4% of the GDP. However, during the 1970s, opening increased as a result of increased crude oil exports and mainly because of the growth of imports feeding by foreign debt. By 1980 foreign trade had reached 23.3% of GDP.

As a consequence of the foreign debt crisis of 1982, a radical change occurred in the economic strategy [6]. The opening up process began to take effect in 1985. At the end of the 1980s, the degree of opening had reached 38.3%, 15 percentage points higher than in 1981

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[3] Paul Krugman (1991). ***Geography and Trade***. Cambridge, Mass, MIT Press. p.142.

[4] Sydney Weintraub (1997). ***The North American Free Trade Agreement*** in Ali M. El-Agraa ed**.** ***Economic Integration Worldwide***. London, Macmillan Press. p. 203-229. John McDougall. ***National Differences and the NAFTA***. International Journal. Vol. LV.No. 2, Ontario, Spring 2000. p.281-290.

[5] Roberto Devlin and Ricardo French Davis (1998). ***Hacia una evaluación de la integración de América Latina***. Revista Comercio Exterior. Vol. 49. No. 11. Mexico, BANCOMEXT, November 1998. p. 955-956.

[6] For economic reform in Mexico, see author's ***Mexico hacia elSiglo XXI: crisis y modelo económico alternativo.*** Mexico, 2000, Plaza y Valdés ed.-UAMI. 319p.

[7]. This level remained constant until the **NAFTA** came into force. From this point an unprecedented increase was registered on this indicator. In 1999 it had reached 62.8%, almost double the figures registered before the **NAFTA** went into effect (table 1).

The United States has historically been a relatively closed economy. At the end of the Second World War, foreign trade barely represented 10% of the GDP (Perroux, 1954) [8]. During the period under analysis, the extent of North American economic aperture progressed slowly, despite globalization, which proves the importance and strength of its domestic market. During the 1980s this indicator stood practically still, but in the 1990s it increased almost four percentage points, from 20.6%, in 1989, to 24%, in 1999. This change responded not only to increasing exports from new trade agreements and progress made at the General Agreement on Tariffs and Trade (**GATT**) Uruguay Round, but was also due to the growing dependency of the North American economy on imports that were driven up by a strong dollar and by increased capital flows.

4. The Recent Development of Trilateral Trade

Trade between Mexico, Canada and the United States increased sharply over the last two decades. From 1981-1998 trilateral trade between the three North American nations almost quadrupled, increasing from 133.6 billion dollars to 518 billion dollars (see table 2 and figure 1).

The rapid growth of foreign trade in the region over the last two decades was the result of the global tendency to project productive systems internationally. This came as a result of a structural crisis that began at the end of the 1960s, at the end of the lengthy economic boom after the Second World War. Globalization became a crisis “exit” strategy for the most powerful and internationalized transnational companies. From 1993-1998, trade between its members increased by 70.5%. As a percentage of world exports, regional exports increased from 5.7%, in 1981, to 6.6%, in 1990 reaching 9.7%, in 1998.

5. Intra-Regional Trade Vs Trade with the Rest of the World

The North American tendencies to form a regional bloc have a long history. However, since the **FTA** with Canada and subsequently since the **NAFTA** came into effect, regionalization has strengthened as never before. In effect, intra-regional trade increased from 184.9 billion dollars, in 1988, to 518 billion dollars, in 1998, representing 180% growth during this period. Inversely, even though trade with the rest of the world also increased in absolute terms, from 661.1 billion dollars, in 1988, to 1,106.8 billion dollars, in 1998, this only meant it increased by 67.4%. As a proportion of the area’s global trade, intra-regional trade increased more than 7 percentage points, from 21.9% of the total, in 1988, to 29.3%, in 1998. In the mean time, trade with the rest of the world decreased from 78.1% to 70.7% (see table 3 and figure 2).

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[7] The extent of opening of the Mexican economy is overvalued, as figures include assembly plant or *maquiladora* imports and exports. *Maquiladoras* perform the simple function of transforming imported goods, and as exports should only be considered, as the Bank of Mexico did before, added value.

[8] Francois Perroux. (1954). ***L’Europe sans Rivages***. Grenoble, 1990, Presses Universitaires de France, p. 99

It is true that the percentage of North American intra-regional trade is lower than that of other regions of the world, such as the European Union or Asia, (Guillén, 1994) [9]. However, it is undeniable that North America's tendencies to regionalize are very pronounced and that this process is moving forward at a fast pace. This should not be surprising, as apart from being the expected outcome of any non-multilateral economic integration agreement; it was also the intentional objective of US trade policy. The **FTA** and the **NAFTA** were signed with the intention of creating a regional trade bloc faced with the European and Asia Pacific trade blocs.

In triggering the onset of regionalization, the **NAFTA** has generated a trade diversion away from other areas of the world, owed to the raising of trade barriers within the region and other mechanisms such as the *rules of origin.* Nevertheless, it is also true, at least for the moment, that there is no danger of the **NAFTA** constituting an exclusive economic bloc. It is a process of *open regionalism* (to use a slightly ambiguous term used for the first time by the Asia Pacific Economic Cooperation (**APEC**) and popularized by the Economic Commission for Latin America and the Caribbean (**CEPAL**), that is to say –a process that is not opposed to globalization.

The regional concentration of North American trade is demonstrated clearly in an analysis of each country of the zone. This is more so in the dominated economies (Canada and Mexico) than in the United States.

Canada and Mexico carry out over three-quarters of their foreign trade with North America. The ratio of intra-regional trade is as high as levels reached by countries of the European Union. In Canada's case, this ratio increased from 69% of the total, in 1988, to 81.8%, in 1998. In Mexico's case, intra-regional trade that last year was 75.7% of the total.

In the case of the United States, intra-regional trade also increased consistently with the rest of the region: increasing over 7 percentage points from 23.8%, in 1989, to 31.9%, in 1998. However, trade with the rest of the world continues to play a very important role, representing 68.1% of the total this last year.

Changes in sector orientation and regions to trade flows respond to changes in productive system configuration. The determining factors have been the movements of foreign direct investment and of portfolio capital.

6. Regional Integration, National Disintegration

It is irrefutable that **NAFTA** has been an important instrument of foreign trade expansion in North America; however, this analysis cannot focus solely on this facet of the agreement. Integration is not an objective in itself, but only an instrument used by countries that follow this path to achieve higher levels of economic development and social wellbeing.

[9] Arturo Guillén R. (1994). ***Bloques regionales y la globalización de la economía.*** Revista Comercio Exterior. Vol.44.No.5. BANCOMEXT, May 1994. p. 379-386.

In order to create an objective balance of the effects of integration, it is firstly necessary to answer questions set forth by Francois Perroux (1961*) who integrated whom?* And *who is benefiting from integration*?

NAFTA implied a commitment between governments and economic forces that saw the agreement as an important lever for integration to expand markets and areas of operation and influence, as well as to maximize upon its benefits. Fundamentally, the most globalized groups and US financial capital companies, as well as the most powerful groups of Canada and Mexico promoted this commitment.

North America's most globalized financial capital, that is the capital that operates with a world market logic, saw the **NAFTA** as an instrument to raise levels of competition in relation to other regions of the world (mainly Europe and Asia) and to put into practice a series of rules (intellectual property, services, etc.) that the US government promoted in multilateral forums and attempted to apply on a global scale. Large Canadian and Mexican companies were looking to modify their strategies and redirect their companies towards the foreign market, in order to insert them into a growing global world economy.

If US transnational companies and large Canadian and Mexican groups and companies were those who promoted the agreement and defined integration, with the support of the respective governments, then it is not surprising that these are the main beneficiaries of the **NAFTA**.

Transnational companies carry out the majority of foreign trade in North America. Around 70% of Canadian exports are tied to transnational operations. Of this total, 40% is intra- firm trade between signatory nations and 30% is derived from the strategic licenses or alliances of Canadian corporations with foreign corporations. In the case of the United States, around 50% of its manufactured exports to Canada is intra-firm trade. In Mexico's case, in 1992, 40% of foreign trade was intra-firm trade and this percentage has increased substantially with NAFTA (Weintraub, 1997) [10].

The strategy of transnational companies in Latin America over the last two decades has been to focus on establishing assembly plants in the region in order to construct an export platform to the United States and the world market. This strategy has been particularly successful in Mexico, in the case of the automotive, auto part, plastics, electronics, clothing and manufacturing industries. Assembly plants in the clothing and manufacturing industries have also sprouted up in the countries of the Caribbean Basin (Mortimore, 2000) [11].

As a result of The **NAFTA** being an agreement between countries with asymmetric productive systems, the strengthening of economic integration between the three nations has triggered an intense process of restructuring—disarticulation –destruction of its productive systems.

In Canada and Mexico, the restructuring process has implied the rupture of productive chains of former productive systems that operated in their respective domestic markets. With the

[10] Sydney Weintraub (1997)**.** p. 206.

[11] Michael Mortimore (2000). **Corporate Strategies for FDI in the Context of Latin America's New Economic Model.** World Development. Vol. 28. No. 9. Great Britain. p. 1611-1626.

onset of economic aperture, the relative price structure of the predominant economy imposed itself on the integrated markets. This caused all kinds of distortions to productive systems due to lower levels of development and productivity of the integrated economies.

The breaking up and restructuring of "national" productive chains coincided with the creation of new regional chains (in North America) in the exporting sector. Transnational companies are central to these new "supranational" chains that operate within the economic space of **NAFTA**. These chains and the financial capital that circulates around them cause concentration and agglomeration phenomena. In the spaces that regionalized companies operate (many of which—the most powerful –have a world market logic), forces of "attraction" and "brake" are developed at the same time. On one hand they stimulate integration processes, as well as the creation and/or reinforcement of development poles, however they also cause the destructuring and /or destruction of other companies and activities oriented towards the domestic market and that have not connected to this new regional economic space.

In Mexico's case, **NAFTA**, and in more general terms of external opening, it has accentuated the heterogeneous structure of the productive system and social structure. This has in turn provoked marginalization, social exclusion and decomposition and cultural disintegration. Regional differences within the country are now more pronounced: the "rich" north has distanced itself further from the "poor" south that is isolated from global integration.

Instead of diminishing, the old problem of structural dualism, typical of underdevelopment has worsened, in addition to becoming more complex. Along side the manufacturing *maquilador* exporting sector, which has become a dynamic axis in the system, there coexists the former modern sector created during the import substitution era, that is largely separated from this and anchored in the domestic market, as well as the backward sectors such as: 1) old traditional activities of an urban and rural nature and 2) the ever increasing informal economy.

Technical progress made in the exporting sector is not transmitted to the whole productive system. Progress concentrates itself, as in the times of the pre-war agrarian-export model, in the economy's dynamic sector and only shifts minimally to other activities.

The reorganization of the productive system, as a result of the neoliberal model, accentuated the structural tendencies of trade deficit, with increased dependency on imports. The ratio of imports, that is the participation of imports on global supply, increased sharply as a consequence of commercial aperture and the **NAFTA**.

Greater dependency on imports is a sign of the rupture of domestic production chains and substitution with regional chains, which reflect the increased importance of intra-firm trade and new forms of articulation between the globalized capitals and their suppliers and distributors. It also reveals, the major tendency to import, stemming from higher levels of income and the possibility of acquiring luxury consumer goods with greater facility through eliminating trade barriers.

It was hoped that **NAFTA** would promote manufactured food exports from Mexico and reduce the weight of *maquiladoras* in the economy, by causing the industrial structure to modernize. In reality, it has done the opposite. Instead of the "industrialization" of assembly plants, Mexico is undergoing a process of "*maquilización*" of industry. More and more assembly plants are being constructed, not only on the northern border, but also within the country itself.

The free entry of agricultural goods from abroad has deeply affected traditional farming in Mexico. The idea outlined by promoters of the Treaty was that the agreement's implementation would reduce immigration to the United States, but this does not correspond to the facts. The deterioration of the farming sector, together with recurrent economic crises in Mexico has accelerated migratory flows.

The fragility of the productive system in Mexico goes hand in hand with financial fragility. The new accumulation model increased foreign sector restrictions, instead of reducing them. When the economy grows, the trade balance deficit increases faster than during the period of import substitution. Faced with the impossibility of moderating this process, its financing depends on the entry of foreign private capital flows, whose volatility, after the 1994-1995 Mexican economic crisis and the Asian crisis of 1997-1998, is well known.

In order to keep attracting foreign capital, monetary and fiscal restrictive policies are applied, which have recessive affects on the "real economy" and increase the fragility of the banking system and domestic financing. The entry of foreign capital, on the other hand, overvalues the national currency, which contributes to an increased current account deficit.

The financial logic of the new accumulation model is a source of instability and of recurrent financial crisis.

7. Conclusions

The results obtained from research show increasing integration between Canada, the United States and Mexico over the last two decades, especially since **NAFTA** went into effect. This has led to reinforced tendencies to create a future North American regional bloc, under the hegemony of the United States.

In other words, **NAFTA** has been an important lever to create trade in the region, although, at the same time it has also put in to motion a process of trade deviation away from other regions of the world (Latin America, Europe and Asia). This can be seen specifically in the automotive, auto parts, electronics, textiles and clothing industries.

Greater economic opening of the region's economies has triggered the clear restructuring of domestic productive systems. This has meant the rupture of national productive chains, which took shape during a previous stage of development, and their substitution by regional chains in activities and/or leading companies that are a motoring force in the creation of *development poles*. These companies and activities also have an important influence on the globalization and regionalization processes of the world economy.

In Mexico's case, regionalization has allowed for the modernization of the economy's exporting sector, but the price has been to marginalize the rest of the productive system, which continues to be dependent on national and local markets. The heterogeneous structure of the productive system has become more pronounced than ever, leaving several sectors and social groups on the margins of the benefits of globalization.

As the new economic model works on a base of low real wages on the periphery and the restricted direct participation of the State in the economy, the domestic market has stagnated instead of expanding, seriously affecting the majority of companies and activities that depend on it. Contractionalist affects on economic activity strengthened in virtue of the financial fragility of the new model. As foreign sector imbalances has become more pronounced instead of reducing, the continuity of accumulation lies in attracting highly volatile and speculative foreign capital flows, which increase the possibility of recurrent crises.

The main beneficiaries of integration have been transnational companies and large private groups that operate in the foreign market. Social inequalities between the three signatory nations and domestically have increased. Profits, in terms of employment related to exports have not compensated for job loses in relocated sectors, nor for loses registered by disassembling national production chains. Wage differences between the three nations have increased instead of decreasing. The decreasing tendency of real wages in Mexico has not declined with integration.

To put commercial and economic integration at the service of the population is not something that can be left to market laws, as has been the case in Mexico, where the State abandons its responsibilities and becomes merely the active agent of external globalizing forces. On the contrary, the State is needed to moderate regional imbalances and to take action to diminish social inequalities.

TABLE1
DEGREE OF OPENING OF NAFTA'S ECONOMIES
% Total trade / GDP

YEAR	***MEXICO ****	***CANADA***	***U.S.A.***
1981	23.3	53.3	19.9
1982	25.7	47.8	18.1
1983	28.4	47.6	17.2
1984	27.0	53.2	18.1
1985	25.9	54.0	17.2
1986	30.9	53.7	17.5
1987	32.9	51.8	18.6
1988	38.5	52.1	19.8
1989	38.1	50.8	20.2
1990	38.3	50.8	20.6
1991	35.6	49.9	20.7
1992	35.5	52.7	21.0
1993	34.4	58.2	20.7
1994	38.5	64.8	21.8
1995	58.2	70.8	23.3
1996	62.8	73.0	23.5
1997	60.7	77.2	24.0
1998	64.5	81.3	23.7
1999	62.8	83.5	24.0

SOURCE: IMF. **International Financial Statistics.**

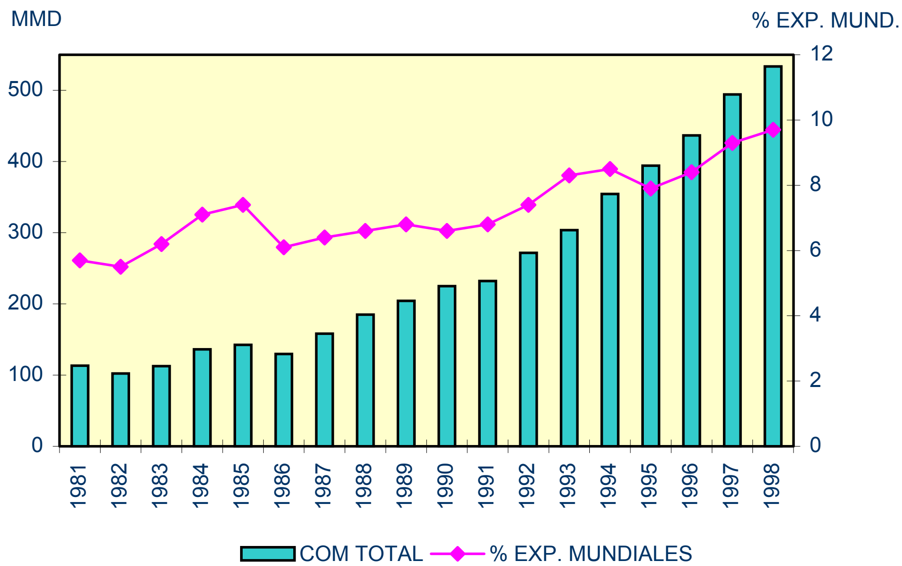
TABLE 2
NAFTA: TRILATERAL TRADE
Billions of dollars

1 YEAR	2 TOTAL TRADE	3 WORLD EXPORTS	4 (2/3) % OF WORLD EXPORTS
1981	113.2	1976.3	5.7
1982	102.2	1857.5	5.5
1983	112.5	1817.9	6.2
1984	136.1	1921.3	7.1
1985	142.5	1921.0	7.4
1986	129.8	2120.6	6.1
1987	158.2	2485.2	6.4
1988	184.9	2814.1	6.6
1989	204.2	3022.8	6.8
1990	225.0	3425.0	6.6
1991	232.1	3418.0	6.8
1992	271.8	3661.4	7.4
1993	303.7	3652.0	8.3
1994	354.4	4169.1	8.5
1995	394.3	4970.0	7.9
1996	436.8	5173.2	8.4
1997	494.2	5337.1	9.3
1998	518.0	5,337.1	9.7

SOURCE: United Nations. **Yearbook of International Trade Statistics**. Varios años

Gráfica 1

COMERCIO TRILATERAL DEL TLCAN



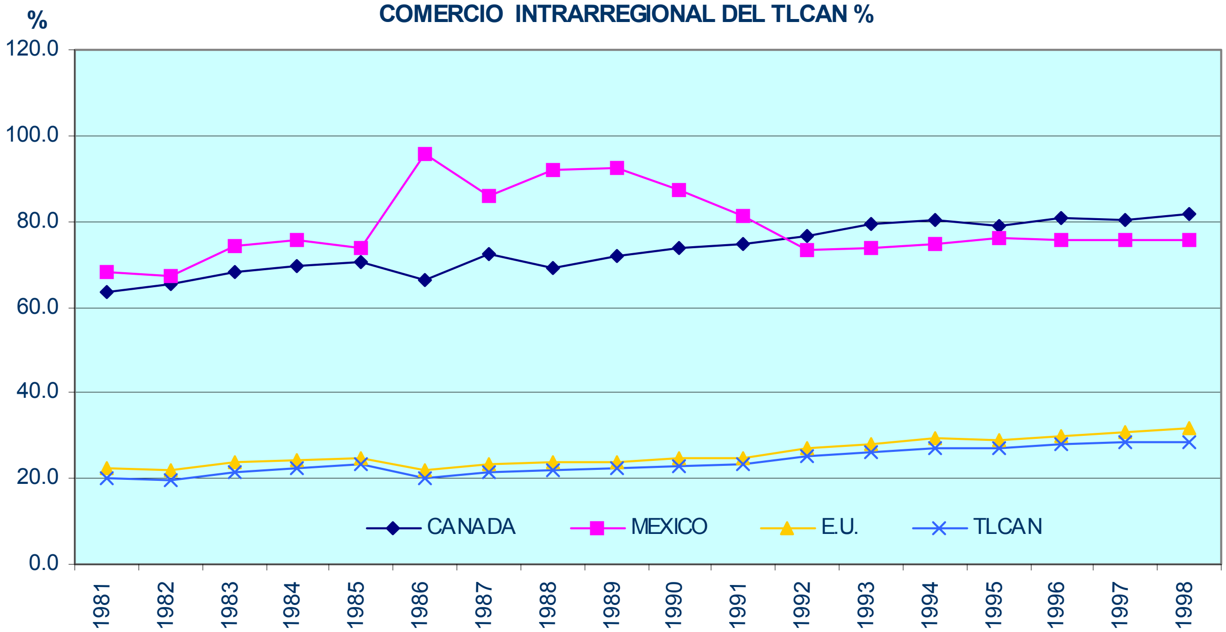
Fuente: ONU, Yearbook of International Trade Statistics. FMI, Estadísticas Financieras Internacionales, Varios Números

TABLE 3
TRADE OF NORTH AMERICA'S COUNTRIES
Billions of dollars

YEAR	1 TOTAL TRADE	2 INTRA-REGIONAL TRADE	3 TRADE OTHER COUNTRIES	4 (2/1 x 100) % INTRAR	5 (3/1 x 100) % OTHER COUNTRIES
1981	565.3	113.2	452.1	20.0	80.0
1982	518.4	102.2	416.2	19.7	80.3
1983	518.4	112.5	405.9	21.7	78.3
1984	611.6	136.1	475.5	22.3	77.7
1985	611.3	142.5	468.8	23.3	76.7
1986	649.5	129.8	519.7	20.0	80.0
1987	729.8	158.2	571.6	21.7	78.3
1988	845.9	184.9	661.0	21.9	78.1
1989	920.8	204.2	716.6	22.2	77.8
1990	976.2	225.0	751.2	23.0	77.0
1991	1000.7	232.1	768.6	23.2	76.8
1992	1085.1	271.8	813.3	25.0	75.0
1993	1157.5	303.7	853.8	26.2	73.8
1994	1301.2	354.4	946.8	27.2	72.8
1995	1467.9	394.3	1073.6	26.9	73.1
1996	1561.2	436.8	1124.4	28.0	72.0
1997	1723.2	494.2	1229.0	28.7	71.3
1998	1624.8	518.0	1106.8	31.9	68.1

Source: United Nations. Yearbook of International Trade Statistics.

Gráfica 2
COMERCIO INTRARREGIONAL DEL TLCAN %



Fuente: ONU, Yearbook of International Trade Statistics. FMI, Estadísticas Financieras Internacionales, varios números.