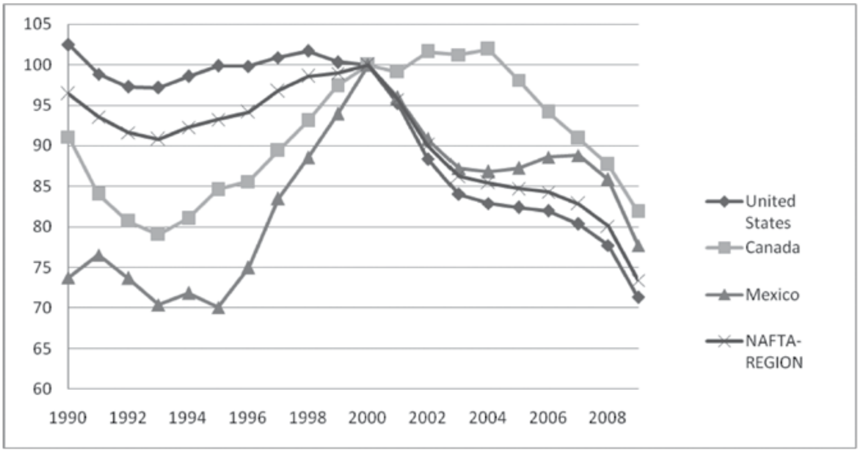
2. Manufacturing Competitiveness: Toward a Regional Development Agenda

Enrique Dussel Peters

One of the Mexican government's goals in signing NAFTA was to expand its manufacturing sector by stimulating exports. In the early years following implementation, Mexico succeeded in attracting foreign investment and increasing manufacturing exports, with notable expansion in automotive, apparel, and electronics, among others. Yet this apparent success masks fundamental weaknesses, as the three NAFTA countries together have been losing their ability to compete in manufacturing in the global market. This suggests the need for a more proactive and long-term regional response.

Figure 1. Manufacturing Employment, NAFTA Region: 1990–2009/03 (2000=100)



Source: Department of Labor (United States); Statistics Canada (CANSIM); and Secretaría del Trabajo y Previsión Social (Mexico).

Even before the recent global financial and economic crisis[1], the manufacturing sectors in the NAFTA-region were under similarly extreme pressures. The share of manufacturing in terms of GDP and employment has been falling in the three NAFTA countries, particularly since 2000 (See Figure 1). Contrary to the period 1994–2000, which saw increasing regional integration in a highly competitive global market, from 2000–2009 (March) the NAFTA region together lost 6.3 million jobs in manufacturing, or 27 percent of total employment in the sector.[2]

This suggests that in general, and in particular since 2000, the process of regional integration has deteriorated; in fact, an increasing process of "disintegration" has been taking place since then. These tendencies have only deepened since the second half of 2008 with the global crisis. In recent years, the original NAFTA integration agenda among the NAFTA countries has given way to one focused on security topics, with little sustained attention to socioeconomic, infrastructure, and other regional development issues.

Manufacturing is of particular relevance to both regional and NAFTA-specific discussions. According to a wide variety of modeling and debates during 1991–1993, if a sector in Mexico's economy was going to benefit through economic integration, it was manufacturing.[3]

This brief analysis is divided into three parts. Beginning with a brief analysis of the current conditions of Mexico's manufacturing sector, this chapter moves on to discuss overarching principles and goals for an agenda toward competitiveness and development in the NAFTA region. The final section proposes specific instruments and policies to achieve those goals.

I. CURRENT CONDITIONS IN MEXICO'S MANUFACTURING SECTOR

Mexico´s economy has faced severe limitations to growth since the 1980s, both in comparison with its own historical experience in the 1940–1970 period, as well as from an international comparison. From 1980 to 2007, for example, Mexico´s per capita GDP growth rate was one-tenth that of China. Manufacturing, more than any other sector, has experienced the impacts of these growth limitations. Four key issues stand out as we seek to understand the current conditions of Mexico's manufacturing sector.[4]

Falling Manufacturing

First, Mexico´s manufacturing share in GDP has fallen constantly since the end of the 1980s, from levels above 23 percent to levels below 19 percent in the last quarter of 2008 (and since 2001). In terms of formal permanent employment, the conditions have been harsher: from 1994 to March 2009 manufacturing's share of total formal and permanent employment fell from 33 to 26 percent. Since its peak in October 2000, the sector lost 1.04 million permanent jobs through March 2009—or 25 percent. In the recent economic crisis, manufacturing has been hit particularly hard, suffering 59 percent of the country's total employment losses from October 2008 to March 2009.

Weakening Integration

Second, the integration process within NAFTA, and concretely between Mexico and the United States, has been weakening steadily since 2000. From a Mexican perspective, the share of trade with the United States fell from levels above 86 percent in the 1990s to 73 percent in 2008. In manufacturing the fall has been more substantial, with Mexico's share of U.S. manufacturing imports dropping from levels above 80 percent in the 1990s to 45 percent in November 2008. Similarly, as measured by the Grubel-Lloyd Index that calculates the percent of trade that is within industries, intra-industry trade (at the four-digit level of the Harmonized Tariff System) reached its highest level in 1998 with 48 percent and fell since then to levels below 43 percent. This trend is a clear indicator of declining economic integration between Mexico and the United States.

Dependence on the U.S.

Third, these tendencies have been evident in value chains that are of particular regional importance—yarn-textile-garments, electronics, and auto parts-automobiles. The current global crisis has taken a heavy toll on these industries. In automobiles, for example, it is very possible that only one or two of the Big Three U.S. auto companies—GM, Chrysler and Ford—will survive the crisis. Mexico's auto parts-automobile industry is highly dependent on these three firms, since they account for almost 60 percent of total auto parts and automobile production.

New Competitiveness

Finally, it is worth remembering that during the period 1994–2000, the implementation of NAFTA helped the auto parts-automobiles, electronics, and yarn-textile-garments industries restructure. In both the United States and Mexico, this increasing integration contributed to new competitiveness in North America to better compete with Asia.

Causes and Effects

A number of factors contribute to these trends. NAFTA made the auto, electronics, and garment industries more dynamic. Yet the dynamism was largely cut off from the broader economy because the firms in this sector tended to ignore Mexico as a source of inputs or markets, preferring to import the majority of its inputs and export the majority of its output. Thus, much of Mexico's domestic manufacturing sector was hollowed out. This was a result of certain preferential programs in Mexico that favored importing inputs, a persistently overvalued exchange rate due to Mexico's tight monetary policy, and low tariffs under NAFTA. NAFTA's investment and intellectual property rules also made it difficult to pursue East Asian-like policies to enhance industrial competitiveness (though it is not clear the Mexican government would have used such policies if they had the space to do so).

China's accession to the WTO accentuated these forces. Mexico's exchange rate became even more overvalued relative to competitors (China) in the U.S. market. These factors, in addition to the preference toward imports in national programs and in NAFTA, made importing all more important. More importantly, those sectors that experienced dynamism from 1994 to 2000 began to lose competitiveness in the U.S. market with respect to China.[5]

Manufacturing sectors in all three NAFTA countries are in a deep crisis, a crisis which has been growing since the end of the 1990s. More worrisome than the short term is probably the medium- and long-term state of the sector in terms of its competitiveness in Mexico and in the U.S. market, particularly in comparison with China and the rest of Asia.

II. OVERARCHING PRINCIPLES FOR A COMPETITIVENESS AND DEVELOPMENT AGENDA IN THE NAFTA REGION

To face these challenges, Mexico, Canada, and the United States should start a new framework—either within NAFTA or beyond it—to allow for a new development agenda to improve regional competitiveness, with an emphasis on the region´s manufacturing sector. Having this goal in mind, regional leaders need to come together to address several specific issues:

- The region´s weak internal dynamism since 2000 in terms of overall socioeconomic integration, including trade, investment, migration, and regional patterns within the three NAFTA countries.

- The challenges facing priority value chains such as energy, yarn-textile-garments, electronics, infrastructure, telecommunications, transportation, agriculture, automobile-auto parts, and the financial and banking sector, among others.

- Each country's priority sectors, which vary significantly. From a Mexican perspective, for example, issues such as agriculture, transportation, and migration are critical.

- The competitiveness of the three countries with other regions, and specifically with Asia and China. The three NAFTA countries today have similar socioeconomic challenges with Asia and in particular with China, not just in terms of increasing Asian trade and investment, but also regarding massive current account deficits. Thus, the NAFTA countries should envision a new North American regional relationship with Asia and China.

III. SPECIFIC INSTRUMENTS AND POLICIES

The general framework for instruments and policies from a regional and NAFTA perspective should be one that accepts the legacy of NAFTA and focuses on the need to update, reframe, or go beyond NAFTA after 15 years. In addition to creating the policy space under the investment, intellectual property, and other parts of NAFTA itself discussed in this report, this is, in effect a proposal for a new integration and development agenda in the NAFTA region. Within this framework, socioeconomic topics and the issue of manufacturing's competitiveness are of critical importance. They should be considered in the context of the first NAFTA-period (1994–2000) in which specific value chains survived and restructured through NAFTA.

Having this general spirit in mind, the "Development and Competitiveness Agenda for NAFTA´s Manufacturing Sector" should include at least the following policies, provisions, and instruments:

NAFTA Development Commission

The three NAFTA countries should engage in negotiations to establish a Development Commission that defines the depth and breadth of specific NAFTA reforms, much as the countries negotiated between 1991 and 1993. This NAFTA-Commission should, in a few weeks, outline the future of regional reforms and delegate most of the concrete policies and provisions for the future of the development agenda to various sub-committees. The Commission should include not only officials of the public and private sectors, but also non-governmental organizations, academics, and experts in the respective fields.

One of the sub-committees should address the "Competitiveness Agenda of Manufacturing in the NAFTA Region" by creating panels for priority value chains, as discussed earlier, for example, in yarn-textiles-garments, electronics, infrastructure, telecommunications, transportation, agriculture, automobile-auto parts and the financial and banking sectors. Another panel should specifically discuss the new proposed relationship with Asia, and in particular with China.

Rules of Origin Evaluation

One of the main results of regional integration and negotiations during 1991–1993 were the rules of origin, i.e., the value-added that was created in the NAFTA region so that the commodity was considered from the region. A strict evaluation of the rules of origin in manufacturing is required. This should consider increases or decreases in the negotiated levels in the current legal framework of NAFTA. For example, in the automotive sector the rules of origin have been important to regional development but the levels are now routinely ignored.

"Buy North American"

Similarly, the three countries have engaged in formal and informal programs of "Buy American, Buy Canadian, and Buy Mexican" during the current economic crisis. From a regional perspective, a "Buy North American" program could respond better to regional challenges and spur regional competitiveness.

Development Financing

One of the main weaknesses of the NAFTA framework was its lack of regional development financing. The original NADBANK proposals called for a regional development bank that could address the asymmetries among the NAFTA countries and fund regional integration projects. The institution still exists, but its mandate has been significantly reduced. It should be revitalized and recapitalized, as others in this group have urged. Part of its broadened mandate should include stimulating competitiveness in North American manufacturing through initiatives such as support for small- and medium-sized industries, financing of joint venture projects, financing technological transfer, export promotion, and expanding domestic markets, research and development, and innovation, as well as public infrastructure projects.

All three NAFTA countries face competition issues in their manufacturing sectors. If any of them is going to emerge from the current economic crisis with a strong manufacturing base, together they will need to devise a regional development strategy that can reestablish the competitiveness of the sector in global markets that are now quite different than they were when NAFTA was negotiated. It is time for a new phase of regional cooperation to achieve a more competitive manufacturing sector, which is vital to all three countries' futures.

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1 Nevertheless, the current global crisis is also a regional—NAFTA—issue, since the three countries have been particularly hard hit in terms of employment, GDP, and in manufacturing, and much deeper than other countries in Asia and Europe, for example.

2 In the period 1994–2000 all three countries increased employment in manufacturing, by 8.4% in the region, 1.4 percent in the U.S., 23.4 percent in Canada, and 39.2 percent in Mexico.

3 For a full discussion, see: United States International Trade Commission (USITC) (1992). Economy-wide modeling of the economic implications of a FTA with Mexico and a NAFTA with Canada and Mexico. *Report 332–316.* Washington, D.C.: USITC.

4 For a full analysis see: Dussel, Enrique (2009). La manufactura Mexicana: ¿opciones de recuperación? *Monitor de la Manufactura Mexicano: proyecto conjunto de la UNAM y CANACINTRA.* Mexico City: Facultad de Economía de UNAM. Available at: www.dusselpeters.com/40.pdf.

5 For comprehensive treatment of these factors see the following books I have coordinated or authored: Ruiz Durán, Clemente and Enrique Dussel Peters (1999). *Dinámica regional y competitividad industrial.* México: Universidad Nacional Autónoma de México; Díaz, Fernando (2001). *Claroscuros: Integracion Exitosa de las Pequenas y Medianas Empresas en Mexico.* Enrique Dussel Peters (ed.), Mexico City: CANACINTRA-JUS-CEPAL; Dussel, Enrique (2000), *Polarizing Mexico: The Impacto f Liberalization Strategy.* Boulder, CO: Lynne Rienner Publishers; and Dussel Peters, Enrique (ed.) (2007). *Oportunidades en la relacion economica y comercial entre China y Mexico.* CEPAL.

This chapter is part of a Boston University Pardee Center Task Force report on reforming NAFTA and U.S. trade agreements. For more information on the project, and to find links to the full report and to Spanish language content, visit:
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