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U.S.-Mexico Economic Relations: Trends, Issues, and Implications

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U.S.-Mexico Economic Relations: Trends, Issues, and Implications

Summary

Mexico has a population of about 109 million people making it the most populous Spanish-speaking country in the world and the third most populous country in the Western Hemisphere. Based on a gross domestic product (GDP) of $893 billion in 2007 (about 6% of U.S. GDP), Mexico has a free market economy with a strong export sector. Economic conditions in Mexico are important to the United States because of the proximity of Mexico to the United States, the close trade and investment interactions, and other social and political issues that are affected by the economic relationship between the two countries.

The United States and Mexico have strong economic ties. An important feature of the relationship is the North American Free Trade Agreement (NAFTA), which has been in effect since 1994. In terms of total trade, Mexico is the United States' third largest trading partner, while the United States ranks first among Mexico's trading partners. In U.S. imports, Mexico ranks third among U.S. trading partners, after China and Canada, while in exports Mexico ranks second, after Canada. The United States is the largest source of foreign direct investment (FDI) in Mexico. These links are critical to many U.S. industries and border communities.

In 2007, about 11% of total U.S. merchandise exports were destined for Mexico and 11% of U.S. merchandise imports came from Mexico. In the same year U.S. exports to Mexico increased almost 4%, while imports from Mexico increased about 7%. For Mexico, the United States is a much more significant trading partner. About 82% of Mexico's exports go to the United States and 50% of Mexico's imports come from the United States. FDI forms another part of the economic relationship between the United States and Mexico. The United States is the largest source of FDI in Mexico. U.S. FDI in Mexico totaled $84.7 billion in 2006. The overall effect of NAFTA on the U.S. economy has been relatively small, primarily because two-way trade with Mexico amounts to less than three percent of U.S. GDP. Major trade issues between Mexico and the United States have involved the access of Mexican trucks to the United States; the access of Mexican sugar, tuna, and avocados to the U.S. market; and the access of U.S. sweeteners to the Mexican market.

Over the last decade, the economic relationship between the United States and Mexico has strengthened significantly. The two countries continue to cooperate on issues of mutual concern. On March 23, 2005, President Bush met with the leaders of Mexico and Canada to discuss issues related to North American trade, immigration and defense. After the meeting, the three leaders announced the Security and Prosperity Partnership of North America (SPP), an initiative that is intended to increase cooperation and information sharing in an effort to increase and enhance prosperity in the United States, Canada, and Mexico. In April 2008, the three countries agreed to advance the SPP agenda by focusing on five priority areas. This report will be updated as events warrant.

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Mexico has a population of slightly over 107 million people making it the most populous Spanish-speaking country in the world and the third most populous country in the Western Hemisphere (after the United States and Brazil). The bilateral economic relationship with Mexico is among the most important for the United States because of Mexico's proximity and because of the large amount of trade and investment interactions. The most significant feature of the relationship is the North American Free Trade Agreement (NAFTA), through which the United States, Mexico, and Canada form the world's largest free trade area, with about one-third the world's total gross domestic product (GDP).

The United States and Mexico share common interests and are closely tied in areas not directly related to trade and investment. The two countries share a 2,000 mile border and have extensive interconnections through the Gulf of Mexico. There are links through migration and tourism, environment and health concerns, and family and cultural relationships. President George W. Bush and former Mexican President Vicente Fox made efforts to strengthen the relationship between the two countries. The Bush Administration anticipates continued strong relations under President Felipe Calderón.[1]

The economic relationship with Mexico is important to U.S. national interests and to the U.S. Congress for many reasons. As the United States considers free trade initiatives with other Latin American countries, the effects of NAFTA may provide policymakers some indication of how these initiatives might affect conditions in the overall U.S. economy. In the 110th Congress, issues of concern are related mostly to the issue of Mexican migrant workers in the United States, but may also include economic conditions in Mexico and the possible effect of NAFTA on the United States and Mexico. This report provides an overview of U.S.-Mexico economic trends, background information on the Mexican economy, the effects of NAFTA on the U.S.-Mexico economic relationship, and major trade issues between the United States and Mexico. This report will be updated as events warrant.

U.S.-Mexico Economic Trends

The United States and Mexico have strong economic ties. The United States is, by far, Mexico's most important partner in trade and investment, while Mexico is the United States third largest trade partner after China and Canada. Many economists

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[1] See CRS Report RL32724, *Mexico-U.S. Relations: Issues for Congress*, by Colleen W. Cook.

have focused much attention on the on-going transformation of Mexico into a manufacturing-for-export nation since the late 1980s and the importance of exports to its economy. Exports represent 33% of Mexico's GDP, up from 10% twenty years ago. After oil and gas, most of these exports are manufactured goods. Over 80% of Mexico's exports are headed to the United States. Mexico's reliance on the United States as a trade partner appears to be diminishing, although slightly. Between 2004 and 2007, the U.S. share of Mexico's total imports decreased from 56% to 50%, while the share of total Mexican exports going to the United States decreased from 89% to 82%. Although Mexican exports to the United States are steadily increasing, Mexico's share of the U.S. market has lost ground since 2002. In 2003, China surpassed Mexico as a supplier of U.S. imports, and Mexico now ranks third, after China and Canada, as a source of U.S. imports.

Mexico's economy is relatively small compared to the U.S. economy. Mexico's gross domestic product (GDP) in 2007 was $893 billion, about six percent of U.S. GDP (see **Table 1**). Mexico's exports as a percent of GDP amounted to 33% in 2007. Because over 80% of Mexico's exports are destined for the United States, any change in U.S. demand can have strong economic consequences in Mexican industrial sectors.

The immigration issue has received much attention by political leaders in recent years and it is one that can be linked to the economic situation in Mexico, although it has social and political aspects as well. Approximately 11.5 to 12 million unauthorized immigrants resided in the United States in 2006, with 56% from Mexico.[2] Economic conditions in Mexico and other countries, such as poverty and unemployment, are a major factor related to the migration issue. These workers often send money to their families in Mexico to help provide food and shelter. Worker remittances to Mexico, which increased from $13.4 billion in 2003 to $26 billion in 2006,[3] are an important source of income for the Mexican economy. Remittances to Mexico rank second after oil as a foreign-exchange generator for Mexico.[4]

U.S.-Mexico Merchandise Trade

Mexico ranks second among U.S. export markets and is the United States' third largest trading partner in terms of total trade. In 2007, about 11% of total U.S. merchandise exports were destined for Mexico and 11% of U.S. merchandise imports came from Mexico. In the same year U.S. exports to Mexico increased 4% while imports from Mexico increased about 7%. For Mexico, the United States is a much more significant trading partner. About 82% of Mexico's exports go to the United States and 50% of Mexico's imports come from the United States. Mexico's second

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[2] Pew Hispanic Center, *The Size and Characteristics of the Unauthorized Migrant Population in the U.S. Estimates Based on the March 2005 Current Population Survey*, March 7, 2006.

[3] Pew Hispanic Center, Fact Sheet, *Indicators of Recent Migration Flows from Mexico,* May 30, 2007, p. 10.

[4] Federal Reserve Bank of Dallas, *Southwest Economy*, "Explaining the Increase in Remittances to Mexico," by Jesus Cañas, Roberto Coronado and Pia M. Orrenius.

largest trading partner is China, accounting for approximately 6% of Mexico's exports and imports.[5]

Table 1. Key Economic Indicators for Mexico and the United States

	Mexico		United States	
	1997	2007	1997	2007
Population (millions)	96	109[a]	273	302
Nominal GDP ($US billions)[b]	401	893	8,304	13,841
GDP, PPP[c] Basis ($US billions)	784	1,346[a]	8,304	13,841
Per Capita GDP ($US)	4,187	8,220[a]	30,429	45,820
Per Capita GDP in $PPPs	8,174	12,380[a]	30,429	45,820
Total Merchandise Exports (US$ billions)	110	272	689	1,163
Exports as % of GDP[d]	30%	33%	12%	12%
Total Merchandise Imports (US$billions)	110	283	870	1953
Imports as % of GDP[d]	30%	34%	13%	17%
Public Debt/GDP	37%	20%[a]	n.a.	n.a.

Source: Compiled by CRS based on data from Economist Intelligence Unit (EIU) on-line database.

a. Estimated amount.
b. PPP Nominal GDP is calculated by EIU based on figures from World Bank and World Development Indicators.
c. PPP refers to purchasing power parity, which reflects the purchasing power of foreign currencies in U.S. dollars.
d. Exports and Imports as % of GDP derived by EIU.

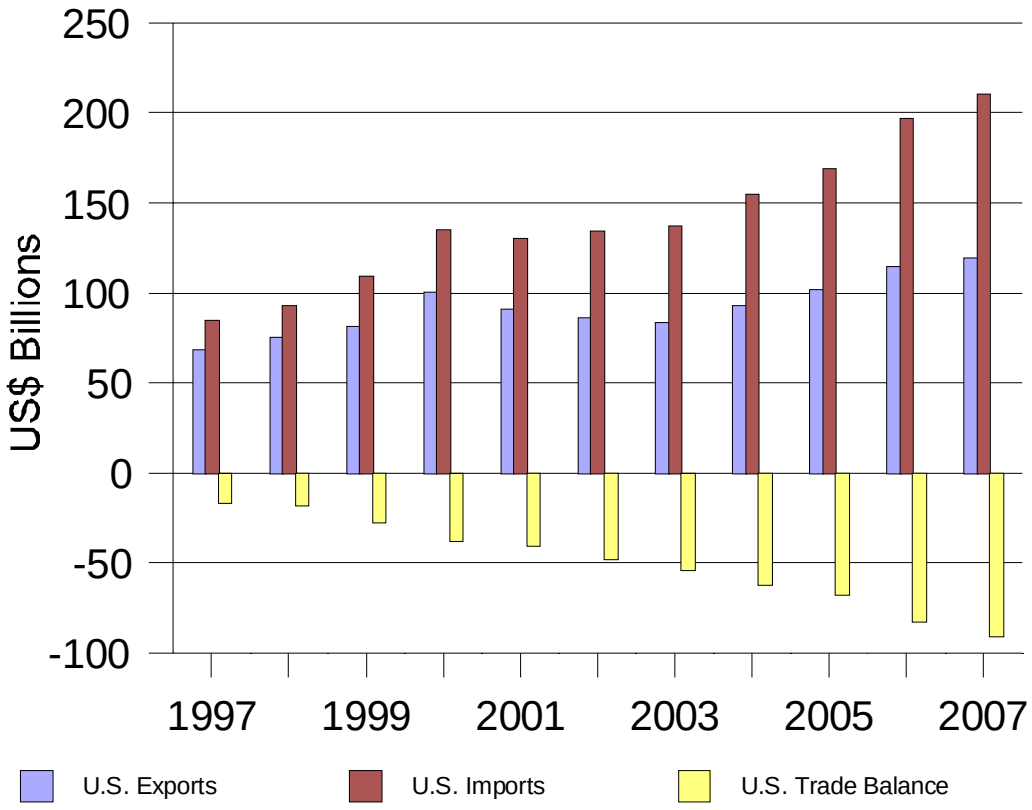
U.S. merchandise trade with Mexico has grown considerably over the last ten years (see **Figure 1**). Although some of the increase in trade could be attributable to NAFTA, there are other variables that affect trade, such as exchange rates and economic conditions. Mexico's currency crisis of 1995 limited the purchasing power of the Mexican people in the following years and also made products from Mexico less expensive for the U.S. market. Economic factors such as these played a role in the increasing U.S. trade deficit with Mexico which went from a $1.4 billion surplus in 1994 to a $90.8 billion deficit in 2007.

[5] Data compiled by CRS using Global Trade Atlas database.

U.S. imports from Mexico increased from $85.0 billion in 1997 to $210.2 billion in 2007, while U.S. exports to Mexico increased from $68.4 billion in 1997 to $119.4 billion in 2007. The downturn in the U.S. economy in 2001 caused a slowdown in trade, with a temporary decrease in both U.S. imports from and exports to Mexico. As a result, Mexico's economy followed U.S. economic trends and also experienced a period of slow growth after 2001. In 2004, as economic conditions improved, trade with Mexico increased. Since 1997, the U.S. trade deficit with Mexico has increased steadily to $90.8 billion in 2007 (see **Table 2**).

Several studies between 2003 and 2004 on the effects of NAFTA found that trade deficits were largely driven by macroeconomic trends, and, in the case of U.S.-Mexico trade, caused by the respective business cycles in Mexico and the United States.[6] Strong U.S. growth in the 1990s combined with Mexico's deep recession in 1995 were the main factors cited for the large deficits. None of the studies attributed the peso crisis to NAFTA, but to structural misalignments in the Mexican economy combined with political events.[7]

Figure 1. U.S. Merchandise Trade with Mexico



Source: United States International Trade Commission, Interactive Tariff and Trade Data Web [http://dataweb.usitc.gov]. Compiled by CRS.

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[6] See CRS Report RS21737, *NAFTA at Ten: Lessons from Recent Studies*, by J.F. Hornbeck.

[7] Ibid.

The leading U.S. import item from Mexico in 2007 was oil and gas, which amounted to $30.27 billion, or 14.4% of U.S. imports from Mexico (see **Table 2)**. The next leading import items were motor vehicles ($23.08 billion or 11.0% of total); motor vehicle parts ($22.65 or 10.8% of total); audio and video equipment ($17.06 billion or 8.1% of total); and communications equipment ($13.06 billion or 6.2% of total). The leading U.S. export item to Mexico in 2007 was motor vehicle parts, which amounted to $9.40 billion, or 7.9% of total exports to Mexico (see **Table 3).** The next leading export items were basic chemicals ($6.50 billion or 5.4% of total); petroleum & coal products ($5.66 billion or 4.7% of total); resin, synthetic rubber and products ($5.43 billion or 4.5% of total; and semiconductors and electronic components ($5.77 billion or 4.8% of total). The U.S. industries with the highest volume of trade (imports and exports) with Mexico are the automotive, chemical and allied products, and computer equipment industries.

Table 2. U.S. Imports from Mexico: 1997-2007

($ Billions)[a]

Leading Items (NAIC 4-digit)	1997	1999	2001	2003	2005	2007	Change
Oil and Gas	6.87	5.52	8.16	13.67	22.48	30.27	341%
Motor Vehicles	12.25	15.77	21.30	19.03	18.36	23.08	88%
Motor Vehicle Parts	10.12	12.53	13.22	15.99	19.33	22.65	124%
Audio/Video Equipment	5.35	7.05	7.71	6.91	9.87	17.06	219%
Communications Equipment	1.97	4.08	6.27	5.98	7.34	13.06	563%
Other	48.44	64.07	73.85	75.62	91.84	104.04	115%
Total	**85.00**	**109.02**	**130.51**	**137.20**	**169.22**	**210.16**	**147%**

Source: Compiled by CRS using USITC Interactive Tariff and Trade DataWeb at [http://dataweb.usitc.gov]: NAIC4-digit level.

a. Nominal U.S. dollars.

Table 3. U.S. Exports to Mexico: 1997-2007

($ Billions)[a]

Leading Items (NAIC 4-digit)	1997	1999	2001	2003	2005	2007	Change
Motor Vehicle Parts	7.59	6.93	8.79	7.11	7.39	9.40	24%
Basic Chemicals	2.40	2.48	2.74	3.35	5.01	6.50	171%
Petroleum & Coal Products	1.53	1.86	2.67	2.31	4.73	5.66	270%
Resin, Synthetic Rubber & Other Products	1.94	2.18	2.52	2.94	4.51	5.43	180%
Semiconductors and Other Electronic Components	7.45	8.86	12.02	7.40	6.56	5.77	-23%
Other	47.48	59.07	61.8	60	73.47	86.62	82%
Total	**68.39**	**81.38**	**90.54**	**83.11**	**101.67**	**119.38**	**75%**

Source: Compiled by CRS using USITC Interactive Tariff and Trade DataWeb at [http://dataweb.usitc.gov]: NAIC4-digit level.
a. Nominal U.S. dollars.

Mexico-U.S. Bilateral Foreign Direct Investment

Foreign direct investment (FDI) forms another part of the economic relationship between the United States and Mexico. FDI consists of investments in real estate, manufacturing plants, and retail facilities, in which the foreign investor owns 10% or more of the entity. The United States is the largest source of FDI in Mexico. U.S. FDI on a historical cost basis in Mexico increased from $17 billion in 1994 to $84.7 billion in 2006, nearly a 400% increase (see **Table 4**).

Mexican FDI in the United States is much lower than U.S. investment in Mexico, with levels of Mexican FDI fluctuating over the last ten years. In 2005, Mexican FDI in the United States totaled $8.7 billion, representing an increase of over 300% since 1994, as shown in **Table 4**.

Table 4. U.S.-Mexican Foreign Direct Investment Positions: 1994-2006

Historical Cost Basis
(US$Millions)

	Mexican FDI in the U.S.	U.S. FDI in Mexico
1994	2,069	16,968
1995	1,850	16,873
1996	1,641	19,351
1997	3,100	24,050
1998	2,055	26,657
1999	1,999	37,151
2000	7,462	39,352
2001	6,645	52,544
2002	7,483	55,724
2003	6,680	61,526
2004	8,167	63,502
2005	8,653	71,423
2006	6,075	84,699

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

The sharp rise in U.S. investment in Mexico since NAFTA implementation is also a result of the liberalization of Mexico's restrictions on foreign investment in the late 1980s and the early 1990s. Prior to the mid-1980s, Mexico had a very protective policy that restricted foreign investment and controlled the exchange rate to encourage domestic growth, affecting the entire industrial sector. Mexico's trade liberalization measures and economic reform in the late 1980s represented a sharp shift in policy and helped bring in a steady increase of FDI flows into Mexico. NAFTA provisions on foreign investment helped to lock in the reforms and increase investor confidence. Under NAFTA, Mexico gave U.S. and Canadian investors nondiscriminatory treatment of their investments in Mexico as well as investor protection. NAFTA may have encouraged U.S. FDI in Mexico by increasing investor confidence, but much of the growth may have occurred anyway because Mexico likely would have continued to liberalize its foreign investment laws with or without NAFTA.

Nearly half of total FDI investment in Mexico is in the manufacturing industry of which the maquiladora industry forms a major part. (See section on Mexico's Export-Oriented Assembly Plants below.) Mexico's maquiladora industry is important to the economic relationship of the United States and Mexico in several ways. In Mexico, the industry has helped attract investment from countries such as the United States that have a relatively large amount of capital. Therefore, Mexico is able to attract some of the foreign direct investment it was seeking when it liberalized trade and investment barriers. For the United States, the industry is important because U.S. companies are able to locate their labor-intensive operations in Mexico and lower their labor costs in the overall production process. Many economists believe that maquiladoras are an important part of U.S. corporate strategy in achieving competitively priced goods in the world marketplace.[8] Other analysts are concerned that the industry has caused U.S. companies to move their manufacturing facilities to Mexico at the expense of U.S. workers.

Mexico's Export-Oriented Assembly Plants[9]

Mexico's export-oriented assembly plants are closely linked to U.S.-Mexico trade in various labor-intensive industries such as auto parts and electronic goods. These export-oriented plants generate a large amount of trade with the United States and a majority of the plants have U.S. parent companies. Foreign-owned assembly plants, commonly called *maquiladoras,* account for a substantial share of Mexico's imports and about half of its exports. The largest maquiladora operation, Delphi Automotive Systems, headquartered in the United States, has 51 plants with 66,000 employees in Mexico.[10] Most maquiladora plants are located along the U.S.-Mexico border. The Mexican metropolitan areas with the highest maquiladora activity as of December 2006 were the Mexican border cities of Tijuana, Baja California, 568

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[8] Federal Reserve Bank of Dallas, "The Binational Importance of the Maquiladora Industry," *Southwest Economy,* Issue 6, November/December 1999.

[9] Mexico's export-oriented industries began with the maquiladora program established in the 1960s by the Mexican government, which allowed foreign-owned businesses to set up assembly plants in Mexico to produce for export. Maquiladoras could import intermediate materials duty-free with the condition that 20% of the final product be exported. The percentage of sales allowed to the domestic market increased over time as Mexico liberalized its trade regime. U.S. tariff treatment of maquiladora imports played a significant role in the industry. Under HTS provisions 9802.00.60 and 9802.00.80, the portion of an imported good that was of U.S.-origin entered the United States duty-free. Duties were assessed only on the value added abroad. After NAFTA, North American rules of origin determine duty-free status. Recent changes in Mexican regulations on export-oriented industries merged the maquiladora industry and Mexican domestic assembly-for-export plants into one program called the maquiladora Manufacturing Industry and Export Services (IMMEX).

[10] Data from Mexico's *Instituto Nacional de Estadística Geografía e Informática* (INEGI), provided by Global Insight, Inc, at the LIX Maquiladora Industry Outlook Meeting on June 8, 2007 in El Paso, Texas.

maquiladoras with 164,900 employees, and Cd. Juárez, Chihuahua, 279 maquiladoras with 283,300 employees.[11]

Private industry groups have stated that these operations help U.S. companies remain competitive in the world marketplace by producing goods at competitive prices. In addition, the proximity of Mexico to the United States allows production to have a high degree of U.S. content in the final product, which could help sustain jobs in the United States. Critics of these types of operations argue that they have a negative effect on the economy because they take jobs from the United States and help depress the wages of low-skilled U.S. workers.

After NAFTA, Mexico's regulations governing the maquiladora industry changed significantly. Beginning in 2001, the North American rules of origin determined the duty-free status for a given import and replace the previous special tariff provisions that applied only to maquiladora operations. The initial program ceased to exist and the same trade rules applied to all assembly operations in Mexico and not just those in the maquiladora program.[12] NAFTA rules for the maquiladora industry were implemented in two phases, with the first phase covering the period 1994-2000, and the second phase starting in 2001. During the initial phase, NAFTA regulations continued to allow the maquiladora industry to import products duty-free into Mexico, regardless of the country of origin of the products. This phase also allowed maquiladora operations to increase maquiladora sales into the domestic market. Phase II made a significant change to the industry in that the new North American rules of origin determined duty-free status for U.S. and Canadian products exported to Mexico for maquiladoras. The elimination of duty-free imports by maquiladoras from non-NAFTA countries under NAFTA caused some initial uncertainty for the companies with maquiladora operations. Maquiladoras that were importing from third countries, such as Japan or China, would have to pay applicable tariffs on those goods under the new rules.

Mexico had another program for export-oriented assembly plants called the Program for Temporary Imports to Promote Exports (PITEX) that was established in 1990 to allow qualifying domestic producers to compete with maquiladoras. PITEX plants are usually in areas located in central and southern Mexico while maquiladoras are more common in states along the U.S.-Mexico border. In recent years, the differences in the customs status of maquiladoras and PITEX plants diminished and the Mexican government decided to merge the two export-oriented programs. In 2007, the Mexican government announced a new set of regulations on export-oriented industries. These new rules merge the maquiladora industry and PITEX plants into the Maquiladora Manufacturing Industry and Export Services, or IMMEX. In 2008, maquiladora industry data will be included in Mexican manufacturing reports, without a distinction for maquiladora plants.[13] Prior to

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[11] Ibid.

[12] Vargas, Lucinda, "NAFTA, the U.S. Economy, and Maquiladoras," *El Paso Business Frontier*, 2001.

[13] Federal Reserve Bank of Dallas, *Southwest Economy*, Issue 3, "Spotlight: Maquiladora (continued...)

NAFTA, a maquiladora was limited to selling up to 50% of the previous year's export production to the domestic market. By 2000, maquiladoras were allowed to sell up to 85% of the previous year's export production to the Mexican market. Most maquiladoras, however, continue to export the majority of their production to the U.S. market.

The maquiladora industry expanded rapidly in the 1990s. The number of plants grew from 1,920 at the end of 1990 to 3,590 in 2000. After 2000, the number of maquiladoras fell to 2,860 in 2003. Since 2004, the number of plants has stayed at approximately the same levels, totaling 2,819 in 2007.[14] Some observers believe that the correlation in maquiladora growth after 1993 is directly due to NAFTA, but in reality it is a combination of factors that has contributed to growth in this sector. Trade liberalization, wages, and economic conditions, both in the United States and Mexico, have all contributed to the growth of Mexican export-oriented assembly plants. Although some provisions in NAFTA may have encouraged maquiladora growth in certain sectors, maquiladora activity is more influenced by the strength of the U.S. economy and relative wages in Mexico. Maquiladora operations usually increase during periods of economic expansion in the United States. A drop in Mexican wages may also be an incentive for U.S. companies to shift production to Mexico.

Between 1993 and 1996, relative wages in Mexico fell considerably due to the peso devaluation. Since 1997, however, Mexican labor costs have risen, and some manufacturers have closed their Mexican plants and shifted production to other low-wage countries. In 2001, maquiladora employment levels fell for the first time since 1982. Between 2000 and 2004, maquiladora employment levels fell from 1.30 million workers to 1.12 million workers. Approximately 176,000 jobs were lost and 780 plants were shut down nationwide during this time. Since 2004, employment has risen to about 1.23 million.[15]

Worker Remittances to Mexico

Remittances from workers abroad play a strong role in the Mexican economy and form an important aspect of the U.S.-Mexico economic relationship.[16] Worker remittances account for about 3% of Mexico's GDP and are the second-largest source of foreign currency inflows behind oil exports. Mexico was one of the top three recipients of remittances worldwide in 2007. After high levels of growth rates since 2002, the rate of growth of remittances to Mexico has dropped markedly in the past two years. In 2004, Mexico received a record $16.6 billion in remittances,

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[13] (...continued)
Data, Mexican Reform Clouds View of Key Industry," May/June 2007.

[14] Based on data from INEGI.

[15] Ibid.

[16] For information on remittances to Latin America see CRS Report RL31659, *Foreign Remittances to Latin America*, by Walter W. Eubanks and Pauline Smale.

representing a 24% increase over 2003.[17] Remittances from the United States to Mexico reached a peak of $6.2 billion in mid-2006 and have been decreasing since. In 2007, remittances grew by only 1%, after years of high growth. In January 2008, remittances to Mexico were down nearly 6%, the biggest drop in 13 years.[18] The decline in the level of remittances is due to a combination of factors. The slowdown in the U.S. economy, the weakening job market in the construction sector, tighter border controls, and increased anti-immigration sentiment in the United States may all be factors in the reduced number of seasonal migrants in the United States and their ability to send remittances to Mexico.[19]

Worker remittance flows to Mexico have an important impact on the Mexican economy, in some regions more than others. Some studies on remittance flows to Mexico report that in southern Mexican states, remittances mostly or completely cover general consumption and/or housing. One study estimates that 80% of the money received by households goes for food, clothing, health care, and other household expenses. Another study estimates that remittances in Mexico are responsible for about 27%, and up to 40% in some cases, of the capital invested in microenterprises throughout urban Mexico.[20] The economic impact of remittance flows is concentrated in the poorer states of Mexico. The government has sponsored programs to channel the funds directly to infrastructure and investment rather than consumption.[21]

Security and Prosperity Partnership of North America

The Security and Prosperity Partnership of North America (SPP) is a trilateral initiative, launched in March 2005, that is intended to increase cooperation and information sharing in an effort to increase and enhance prosperity in the United States, Canada, and Mexico. The SPP is a government initiative that was endorsed by the leaders of the three countries, but it is not a signed agreement or treaty and, therefore, contains no legally binding commitments or obligations. It can, at best, be characterized as an endeavor by the three countries to facilitate communication and cooperation across several key policy areas of mutual interest. Although the SPP builds upon the existing trade and economic relationship of the three countries, it is not a free trade agreement and is distinct from the existing North American Free Trade Agreement (NAFTA). Some key issues for Congress regarding the SPP concern possible implications related to national sovereignty, transportation

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[17] EIU ViewsWire, "Mexico Economy: Remittances Home Hit a Record US$16.6 Billion in 2004," February 9, 2005.

[18] *The Dallas Morning News*, "Remittances to Mexico See Biggest Drop in 13 Years," March 7, 2008.

[19] The World Bank, *Remittance Trends 2007*, by Dilip Ratha, Sanket Mohapatra, K.M. Vijayalakshmi, and Zhimei Xu, November 29, 2007.

[20] The Federal Reserve Bank of Dallas report "Workers' Remittances to Mexico," (2004) evaluated the economic impact of worker remittances to Mexico and cites a number of reports by the World Bank and the Mexican government.

[21] Ibid, p. 4.

corridors, cargo security, and border security. These issues are discussed in various sections of the report.

Since 2005, the SPP working groups have made annual recommendations to the North American leaders on how to accomplish the goals of the SPP. In 2008, the working groups agreed to continue to advance the agenda of the SPP by identifying and focusing on a set of high priority initiatives. They decided to: 1) increase the competitiveness of North American businesses and economies through more compatible regulations; 2) make borders smarter and more secure by coordinating long-term infrastructure plans, enhancing services, and reducing bottlenecks and congestion at major border crossings; 3) strengthen energy security and protect the environment by developing a framework for harmonization of energy efficiency standards and sharing technical information; 4) improve access to safe food, and health and consumer products by increasing cooperation and information sharing on the safety of food and products; and 5) improve North American response to emergencies by updating bilateral agreements to enable government authorities from the three countries help each other more quickly and efficiently during times of crisis.[22]

Goals of the SPP in the area of prosperity are to increase cooperation and sharing of information in order to improve productivity, reduce the costs of trade, and enhance the quality of life. Leaders from the three countries have highlighted the need to enhance North American competitiveness through compatible regulations and standards that would help the three countries protect health, safety and the environment, as well as to facilitate trade in goods and services across their borders. In the 2008 joint statement, the leaders highlighted the need for the three countries to implement compatible fuel efficiency regimes and high safety standards to protect human health and the environment, and to reduce the costs of producing cars and trucks for the North American market. They also emphasized their efforts to advance intellectual property rights protection in North America through the Intellectual Property Action Strategy.

The SPP is not a form of economic integration, and goes only as far as leading to some measure of regulatory harmonization among the United States, Canada, and Mexico. The SPP working groups are not contemplating further market integration in North America. Such a move would require a government approval process within each of the three countries. In the United States, such an agreement would require the approval of the U.S. Congress.

Some observers state that the SPP is an important step forward in the relationship of the United States with Mexico, and also Canada, in view of the distancing that occurred after the terrorist attacks of September 11, 2001.[23] However, other analysts believe that the SPP and any subsequent trade-facilitating measures

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[22] Joint statement by President Bush, President Calderon, Prime Minister Harper, April 22, 2008.

[23] "U.S., Mexico, Canada Agree to Increase Cooperation," *The Washington Post*, March 24, 2005, p. A4.

may fall short of any grander vision of further economic integration.[24] Critics of the SPP contend that it may ultimately lead to a so-called "NAFTA Superhighway" that would link the United States, Canada, and Mexico with a 'super-corridor'.[25] However, if the United States were to potentially consider the formation of a customs union or common market with its North American neighbors, it would require approval by the U.S. Congress.

The Mexican Economy

Mexico has a free market economy with a strong export sector, but this has not always been the case. The transformation of Mexico into an export-based economy began in the late 1980s when the government started to liberalize its trade policy and adopt economic reform measures. One of the more distinctive aspects of the Mexican economy is its strong ties to the economic cycle of the United States, making it very sensitive to economic developments in the United States. The state of the Mexican economy is important to the United States because of the close trade and investment ties between the two countries, and because of other social and political issues that could be affected by economic conditions, particularly those related to immigration.

Economic Reform and the 1995 Currency Crisis

In the late 1980s and early into the 1990s, the Mexican government implemented a series of measures to restructure the economy that included steps toward trade liberalization. For many years, Mexico had protectionist trade policies to encourage industrial growth in the domestic economy. The 1980s were marked by inflation and a declining standard of living. Repercussions of the 1982 debt crisis in which the Mexican government was unable to meet its foreign debt obligations were a primary cause of the economic challenges the country faced in the early to mid-1980's. Much of the government's effort in addressing the challenges was placed on privatizing state industries and moving toward trade liberalization. Efforts included privatization of sea ports, railroads, telecommunications, electricity, natural gas distribution and airports. The negotiation and implementation of NAFTA played a major role in Mexico's changing economic policy in the early 1990s.

Mexico's economic reforms initially attracted a large amount of private foreign investment, but by 1993 the inflow of foreign capital began to slow down. The combination of macroeconomic policies at the time, which led to an overvalued exchange rate, and domestic political uncertainty helped drive down the flow of capital into the country. The decrease in capital inflows and the low levels of

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[24] "Neighbors Who Are not Always Friends: Bush's Summit with Mexican and Canadian Leaders Will Probably Take Small Steps Toward Bolder Integration," *The Christian Science Monitor,* March 23, 2005, p. 2.

[25] See for example, Corsi, Jerome R., *The Plan to Replace the Dollar with the 'Amero',* May 22, 2006; Corsi, Jerome, *I-69: Yet Another NAFTA Superhighway,* September 12, 2006*;* or Schlafly, Phyllis, *The NAFTA Superhighway,* August 23, 2006.

international reserves held by the Mexican government led to a peso devaluation in March 1994. Later that year, foreign exchange reserves continued to fall, domestic government debt increased, and the Mexican central bank had limited dollar reserves to support the current peso rate.

By the end of 1994, Mexico faced a currency crisis, putting pressure on the government to abandon its previous fixed exchange rate policy and adopt a floating exchange rate regime. As a result, Mexico's currency plunged by around 50% within six months, sending the country into a deep recession.[26] Several factors influenced the decision to float the peso: overspending in the economy had generated a significant current account deficit; the Mexican government had accumulated large levels of debt with insufficient reserves; and the banking system was facing a crisis due to overexposure.[27] Mexico's finance minister at the time, Guillermo Ortiz, stated later that Mexico had "no choice" but to float the peso because the government had run out of reserves.[28]

In the aftermath of the 1994 devaluation, Mexican President Ernesto Zedillo took several steps to restructure the economy and lessen the impact of the currency crisis among the more disadvantaged sectors of the economy. The goal was to create conditions for economic activity so that the economy could adjust in the shortest time possible. The United States and the IMF assisted the Mexican government by putting together an emergency financial support package of up to $50 billion, with most of the money coming from the U.S. Treasury. The Zedillo Administration wanted to demonstrate its commitment to fulfill all its financial obligations without a default on its debt by adopting tight monetary and fiscal policies to reduce inflation and absorb some of the costs of the banking sector crisis. The austerity plan included an increase in the value-added tax, budget cuts, increases in electricity and gasoline prices to decrease demand and government subsidies, and tighter monetary policy.[29]

Following the lead of former President Ernesto Zedillo, former President Vicente Fox continued efforts to liberalize trade, privatize government enterprises, and deregulate the economy. Through tighter monetary and fiscal policies, the Fox Administration was able to decrease the fiscal deficit, control inflation, and help economic growth.

The peso steadily depreciated through the end of the 1990s, which led to greater exports and helped the country's exporting industries. However, the peso devaluation also resulted in a decline in real income, hurting the poorest segments of the population and also the newly emerging middle class. NAFTA and the change

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[26] EIU, "Mexico Finance: The Peso Crisis, Ten Years On," January 3, 2005.

[27] Banco de Mexico, "Mexico's Monetary Policy Framework Under a Floating Exchange Rate Regime," by Agustín G. Carstens y Alejandro M. Werner, May 1999.

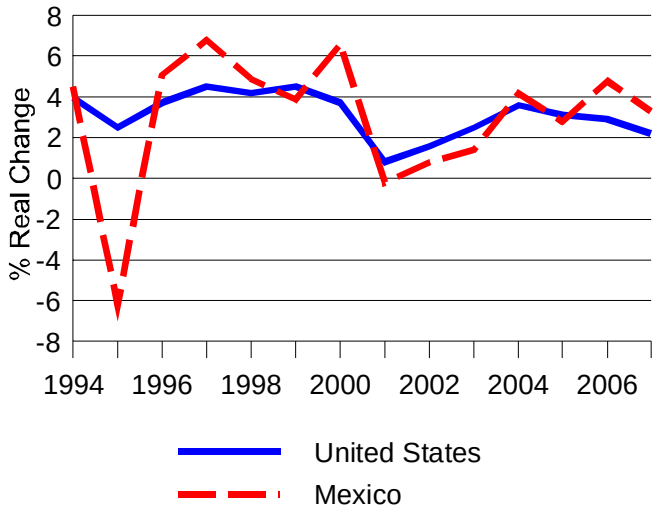
[28] EIU, "Mexico Economy: Mexico Begins to See Benefits of Free-Floating Peso," December 20, 2004.

[29] Joachim Zietz, "Why Did the Peso Collapse? Implications for American Trade," *Global Commerce*, by , Volume 1, No. 1, Summer 1995.

in the Mexican economy to an export-based economy helped to soften the impact of the currency devaluation.

After a real decline in GDP of 6.22% in 1995, the Mexican economy managed to grow 5%-6% in each of the three years to 1998. The combination of a stronger peso and the slowdown in the U.S. economy in 2001, which worsened after the September 11 terrorist attacks, hit Mexico's economy hard. Real GDP growth dropped from 6.2% in 2000 to -0.16% in 2001. Improving economic conditions in the United States helped Mexico's economy improve as well. Real GDP growth in 2004 was 4.37%, up from 1.41% in 2003 and 0.81% in 2002 (see **Figure 2**). In 2006, GDP growth was 4.8% and decreased to 3.3% in 2007.

Figure 2. GDP Growth



Source: Economist Intelligence Unit.

Current Economic Conditions

Real GDP growth in Mexico in 2007 was 3.3%, down from 4.8% in 2006. Major factors contributing to Mexican economic growth since 2004 have been an increase in exports stimulated by U.S. demand and an increase in private consumption. Mexico's dependence on exports and on the economic cycle in the United States is reflected in the economic cycles of the two countries depicted in **Figure 2**. Slower growth is anticipated for 2008 due to declining demand in the United States, declining oil production, and slow growth in remittances sent by Mexicans abroad.[30] After a weakening by an estimated 5% in 2004 and 13% in 2003, the Mexican peso strengthened in 2005 and in 2006. In 2007, the peso remained

[30] EIU, *Country Report: Mexico*, May 2008.

relatively stable. Forecasts show that the currency is likely to remain sensitive to developments in the United States.[31]

Poverty is one of the more serious and pressing economic problems facing Mexico. Former President Fox considered the problem of poverty one of Mexico's principal challenges and stated that the highest priority of his administration was to combat poverty. He also said that Mexico was a long way from a situation of economic equality since 41% of the country's income was concentrated in the hands of only 10% of the population.[32] According to a 2004 World Bank Study,[33] the Mexican government had made progress in its poverty reduction efforts, but poverty continues to be a basic challenge for the country's development. The authors of the study note that poverty is often associated with social exclusion, especially of indigenous groups of people who comprise 20% of those who live in extreme poverty.[34] In 2002, over half of the population lived in poverty. According to World Bank estimates, the percentage of people living in extreme poverty, or on less than $1 per day, fell from 24.2% of the population in 2000, to 20.3% in 2002, and 18% in 2005. Those living in moderate poverty, or on about $10 a day, fell from 53.7% in 2000 to 51.7% of the population in 2002 and 45% in 2005. Mexico's continuing problem of poverty is especially widespread in rural areas and remains at the Latin American average.[35]

Mexico's main program to reduce the effects of poverty is the *Oportunidades* program (formerly known as Progresa). The program began under former President Zedillo and expanded under former President Fox to benefit five million families throughout Mexico. The program seeks to not only alleviate the immediate oeffects of poverty through cash and in-kind transfers, but to break the cycle of poverty by improving nutrition and health standards among poor families and increasing educational attainment. This program provides cash transfers to families in poverty who demonstrate that they regularly attend medical appointments and can certify that children are attending school. The government provides educational cash transfers to participating families. The program also provides nutrition support to pregnant and nursing woman and malnourished children. Monthly benefits are a minimum of $15 with a cap of about $150. The majority of households receiving *Oportunidades* benefits are in Mexico's six poorest states: Chiapas, Mexico State, Puebla, Veracruz, Oaxaca, and Guerrero.[36]

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[31] Global Insight, *Global Risk Service: Highlights, Mexico,* March 28, 2008.

[32] Associated Press, "Poverty Level Down, But Still Big Challenge for Mexico," July 28, 2004

[33] The World Bank Group, *Mexico Makes Progress and Faces Challenges in Poverty Reduction Efforts,* June 2004.

[34] The World Bank Group Press Release, "Mexico Makes Progress and Faces Challenges in Poverty Reduction Efforts," July 2004.

[35] Ibid.

[36] Santiago Levy, *Progress Against Poverty,* Brookings Institution, 2006.

Mexico's Regional Free Trade Agreements

Since the early 1990s, Mexico has had a growing commitment to trade liberalization and its trade policy is among the most open in the world. Mexico has pursued free trade agreements (FTAs) with other countries as a way to bring benefits to the economy and also to reduce its economic dependence on the United States. By early 2006, Mexico had entered into a total of 12 FTAs involving 42 countries. The Mexican government has negotiated bilateral or multilateral trade agreements with most countries in the Western Hemisphere including the United States and Canada, Chile, Bolivia, Costa Rica, Nicaragua, Uruguay, Colombia, Guatemala, El Salvador, and Honduras.[37]

Mexico has ventured out of the hemisphere in negotiating FTAs, and, in July 2000, entered into agreements with Israel and the European Union. Mexico became the first Latin American country to have preferred access to these two markets. Mexico has also completed an FTA with the European Free Trade Association (EFTA) of Iceland, Liechtenstein, Norway, and Switzerland. The Mexican government has continued to look for potential free trade partners, and expanded its outreach to Asia in 2000 by entering into negotiations with Singapore, Korea and Japan.[38] In 2004, Japan and Mexico signed an Economic Partnership Agreement. It was the first comprehensive trade agreement that Japan signed with any country.[39] Mexico's negotiations on FTAs with Korea and Singapore are stalled.

In addition to the bilateral and multilateral free trade agreements, Mexico is a member of the WTO,[40] the Asia-Pacific Economic Cooperation forum, and the OECD.[41] In September 2003, Mexico hosted the WTO Ministerial Meeting in Cancun.

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[37] Organization of American States, Foreign Trade Information System (SICE), see [http://www.sice.oas.org].

[38] *The Asahi Shimbun,* "Mexico: Loving Free Trade Ever Since NAFTA," March 2002. See [http://www.facilitycity.com].

[39] *The Asahi Shimbun,* "Japan: Free Trade with Mexico," *The Asahi Shimbun,* March 12, 2004.

[40] The WTO allows member countries to form regional trade agreements, but under strict rules. The position of the WTO is that regional trade agreements can often support the WTO's multilateral trading system by allowing groups of countries to negotiate rules and commitments that go beyond what was possible at the time under the WTO. The WTO has a committee on regional trade agreements that examines regional groups and assesses whether they are consistent with WTO rules. See The World Trade Organization, "Understanding the WTO: Cross-Cutting and New Issues, Regionalism: Friends or Rivals?" [http://www.wto.org].

[41] U.S. Commercial Service, *Country Commercial Guide: Mexico,* August 13, 2004, p. 6.

NAFTA and the U.S.-Mexico Economic Relationship

The North American Free Trade Agreement (NAFTA) has been in effect since January 1994. There are numerous indications that NAFTA has achieved many of the intended trade and economic benefits as well as incurred adjustment costs. This has been in keeping with what most economists maintain, that trade liberalization promotes overall economic growth among trading partners, but that there are significant adjustment costs.

Most of the trade effects in the United States related to NAFTA are due to changes in U.S. trade and investment patterns with Mexico. At the time of NAFTA implementation, the U.S.-Canada Free Trade Agreement already had been in effect for five years, and some industries in the United States and Canada were already highly integrated. Mexico, on the other hand, had followed an aggressive import-substitution policy for many years prior to NAFTA in which it had sought to develop certain domestic industries through trade protection. One example is the Mexican automotive industry which had been regulated by a series of five decrees issued by the Mexican government between 1962 and 1989. The decrees established import tariffs as high as 25% on automotive goods and had high restrictions on foreign auto production in Mexico. Under NAFTA, Mexico agreed to eliminate these restrictive trade policies.

Not all changes in trade and investment patterns between the United States and Mexico since 1994 can be attributed to NAFTA because trade was also affected by other unrelated economic factors such as economic growth in the United States and Mexico, and currency fluctuations. Also, trade-related job gains and losses since NAFTA may have accelerated trends that were ongoing prior to NAFTA and may not be totally attributable to the trade agreement. Overall, Mexico has experienced a slight shift in the composition of trade with the United States since the late 1980s from oil to non-oil exports. In 1987, crude oil and natural gas comprised 17% of Mexico's exports to the United States. The percentage of oil and natural gas exports had declined to 10.6% in 2004, but increased to 14.4% in 2007 due to higher oil prices.

Effects on the U.S. Economy

The overall effect of NAFTA on the U.S. economy has been relatively small, primarily because two-way trade with Mexico amounts to less than three percent of U.S. GDP. Thus, any changes in trade patterns with Mexico would not be expected to be significant in relation to the overall U.S. economy. In some sectors, however, trade-related effects could be more significant, especially in those industries that were more exposed to the removal of tariff and non-tariff trade barriers, such as the textile and apparel, and automotive industries.

Since NAFTA, the automotive, textile, and apparel industries have experienced some of the more noteworthy changes in trading patterns, which may also have affected U.S. employment in these industries. U.S. trade with Mexico has increased considerably more than U.S. trade with other countries, and Mexico has become a

more significant trading partner with the United States since NAFTA implementation.

In the automotive industry, the industry comprising the most U.S. trade with Mexico, NAFTA provisions consisted of a phased elimination of tariffs, the gradual removal of many non-tariff barriers to trade including rules of origin provisions, enhanced protection of intellectual property rights, less restrictive government procurement practices, and the elimination of performance requirements on investors from other NAFTA countries. These provisions may have accelerated the on-going trade patterns between the United States and Mexico. Because the United States and Canada were already highly integrated, most of the trade impacts on the U.S. automotive industry relate to trade liberalization with Mexico. Prior to NAFTA Mexico had a series of government decrees protecting the domestic auto sector by reserving the domestic automobile market for domestically produced parts and vehicles. NAFTA established the removal of Mexico's restrictive trade and investment policies and the elimination of U.S. tariffs on autos and auto parts. By 2006, the automotive industry has had the highest dollar increase ($41 billion) in total U.S. trade with Mexico since NAFTA passage.

The main NAFTA provisions related to textiles and apparel consisted of eliminating tariffs and quotas for goods coming from Mexico and eliminating Mexican tariffs on U.S. textile and apparel products. To benefit from the free trade provision, goods were required to meet the rules of origin provision which assured that apparel products that were traded among the three NAFTA partners were made of yarn and fabric made within the free trade area. The strict rules of origin provisions were meant to ensure that U.S. textiles producers would continue to supply U.S. apparel companies that moved to Mexico. Without a rules of origin provision, apparel companies would have been able to import low-cost fabrics from countries such as China and export the final product to the United States under the free trade provision.[42]

While some U.S. industries may have benefitted from increased demand for U.S. products in Mexico, creating new jobs, other industries have experienced job losses. Data on the effects of trade liberalization with Mexico are limited and the effect on specific sectors of the U.S. economy is difficult to quantify. Trade-related job gains and losses since NAFTA may have accelerated trends that were ongoing prior to NAFTA and may not be totally attributable to the trade agreement.[43] Quantifying these effects is challenging because of the other economic factors that influence trade and employment levels. The devaluation of the Mexican peso in 1995 resulted in lower Mexican wages, which likely provided an incentive for U.S. companies to move to lower their production costs. Trade-related employment effects following NAFTA could have also resulted from the lowering of trade barriers, and from the economic conditions in Mexico and the United States influencing investment decisions and the demand for goods.

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[42] For more information on textile and apparel trade, see CRS Report RL31723, *Textile and Apparel Trade Issues*, by Bernard A. Gelb.

[43] CRS Report 98-783, *NAFTA: Estimates of Job Effects and Industry Trade Trends after 5½ Years*, by Mary Jane Bolle.

Effects on the Mexican Economy

At the time that NAFTA went into effect, a number of economic studies predicted that the trade agreement would have a positive overall effect on the Mexican economy, narrowing the U.S.-Mexico gap in prices of goods and services, and the differential in real wages. Most studies after NAFTA have found that the effects on the Mexican economy tend to be modest at most.[44] A World Bank economic study states that there have been periods of positive growth and negative growth in Mexico after NAFTA, and that some of the benefits Mexico experienced after NAFTA really began in the late 1980s when Mexico began trade liberalization measures. Overall the study finds that NAFTA has brought economic and social benefits to the Mexican economy, but that the agreement does not suffice to ensure economic convergence in North America.[45]

It is challenging to isolate the economic effects of NAFTA from other economic or political factors. For example, Mexico has experienced at least two major events outside of NAFTA that had economic consequences. Mexico's unilateral trade liberalization measures between 1985 and 1988 and the currency crisis of 1995 both affected economic growth, per capita GDP, and real wages in Mexico. Other challenges in evaluating the effects of NAFTA on the U.S. and Mexican economies relate to the time element, or being able to compare sufficiently long time-frames to separate trends before and after the agreement went into effect and across countries to provide relative measures of any observed effects.[46]

The World Bank study on NAFTA found that the benefits of NAFTA, and of trade in general, have been unequal across regions and sectors in Mexico. While trade liberalization may narrow disparities in income levels with other countries, it may indirectly lead to larger disparities in income levels within a country. The study estimates that had NAFTA not gone into effect, Mexico's per capita GDP would have been about four to five percent lower; Mexican global exports would have been roughly 25% lower; and foreign direct investment in Mexico would have been roughly 40% lower. The authors of the study also reported the following: NAFTA caused Mexican productivity to increase; Mexican wages are higher in sectors experiencing increases in trade; and poorer states in the south grew more slowly due to low levels of education, infrastructure, and quality of local institutions. One of the study's key findings on the regional effects of NAFTA is that initial conditions in a region determined which Mexican states experienced stronger economic growth. Telecommunications infrastructure and human capital were especially important in determining the economic performance of individual states. States with more

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[44] See CRS Report RS21737, *NAFTA at Ten: Lessons from Recent Studies*, by J.F. Hornbeck.

[45] The World Bank, *Lessons from NAFTA for Latin America and the Caribbean*, by Daniel Lederman, William F. Maloney, and Luis Servén, 2005.

[46] Ibid.

telephone service and a higher skilled labor force experienced more positive impacts.[47]

Other studies on NAFTA have also found that NAFTA's investment and trade liberalization worked together to reduce risk and improve profitability in Mexico, and observed that NAFTA helped to increase total investment flows to Mexico.[48] On the issue of Mexico's demographic patterns, one study found that NAFTA has had a minor role in Mexico's rural-urban migration. The study argues that the observed trend of migration from rural areas of Mexico to urban centers is directly the result of agricultural liberalization linked to NAFTA. However, the study also argues that these migration patterns have been in place since 1960. Some economists have argued that rural-urban migration trends are common in the development process of most countries.[49]

Major Issues in U.S.-Mexico Trade Relations[50]

Major trade disputes between Mexico and the United States involve the access of Mexican trucks to the United States; the access of Mexican sugar, tuna, and avocados to the U.S. market; and the access of U.S. sweeteners to the Mexican market.

A major U.S.-Mexico trade issue relates to the implementation of NAFTA trucking provisions. Under NAFTA, Mexican commercial trucks were to have been given full access to four U.S. border states in 1995 and full access throughout the United States in 2000. Citing safety concerns, the United States refused implementation of NAFTA's trucking provisions. Congress addressed the safety concerns in the FY2002 Department of Transportation Appropriations Act (P.L. 107-87), which set 22 safety-related preconditions for opening the border to long-haul Mexican trucks. In November 2002, the Secretary of Transportation announced that all the preconditions had been met and directed the Federal Motor Carrier Safety Administration (FMCSA) to act on the Mexican applications. In January 2003, however, the Ninth Circuit Court of Appeals delayed implementation. In June 2004, the U.S. Supreme Court reversed the decision of the Ninth Circuit Court and ruled that Mexican trucks could operate in the United States.[51]

Since the ruling, the U.S. and Mexican Administrations worked on resolving the trucking issues, and the two countries engaged in talks regarding a number of safety

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[47] Ibid.

[48] See CRS Report RS21737, *NAFTA at Ten: Lessons from Recent Studies*, by J.F. Hornbeck.

[49] Ibid.

[50] See CRS Report RL32724, *Mexico-U.S. Relations: Issues for Congress,* by Colleen W. Cook.

[51] See CRS Report RL31738, *North American Free Trade Agreement (NAFTA) Implementation: The Future of Commercial Trucking Across the Mexican Border,* by Robert S. Kirk and John F. Frittelli.

and operational issues that needed to be resolved before Mexican commercial trucks were granted authority to operate in the United States. In February 2007, the Administration announced a pilot project to grant Mexican trucks from 100 transportation companies full access to U.S. highways. The Administration announced a delay in the program in April 2007, likely in response to critics who contend that Mexican trucks do not meet U.S. standards. In September 2007, the Department of Transportation launched the pilot program.

The United States and Mexico resolved a long-standing trade dispute in 2006 involving sugar and high fructose corn syrup. Mexico argued that the sugar side letter negotiated under NAFTA entitled it to ship net sugar surplus to the United States duty-free under NAFTA, while the United States argued that the sugar side letter limited Mexican shipments of sugar. Mexico also complained that imports of high fructose corn syrup (HFCS) sweeteners from the United States constituted dumping, and it imposed anti-dumping duties for some time, until NAFTA and WTO dispute resolution panels upheld U.S. claims that the Mexican government colluded with the Mexican sugar and sweetener industries to restrict HFCS imports from the United States.

In late 2001, the Mexican Congress imposed a 20% tax on soft drinks made with corn syrup sweeteners to aid the ailing domestic cane sugar industry, and subsequently extended the tax annually despite U.S. objections. In 2004, the United States Trade Representative (USTR) initiated WTO dispute settlement proceedings against Mexico's HFCS tax, and following interim decisions, the WTO panel issued a final decision on October 7, 2005, essentially supporting the U.S. position. Mexico appealed this decision, and in March 2006, the WTO Appellate Body upheld its October 2005 ruling. In July 2006, the United States and Mexico agreed that Mexico would eliminate its tax on soft drinks made with corn sweeteners no later than January 31, 2007. The tax was repealed, effective January 1, 2007.

The United States and Mexico reached a sweetener agreement in August 2006. Under the agreement, Mexico can export 500,000 metric tons of sugar duty-free to the United States from October 1, 2006, to December 31, 2007. The United States can export the same amount of HFCS duty-free to Mexico during that time. NAFTA provides for the free trade of sweeteners beginning January 1, 2008. The House and Senate sugar caucuses expressed objections to the agreement, questioning the Bush Administration's determination that Mexico is a net-surplus sugar producer to allow Mexican sugar duty-free access to the U.S. market.[52]

On tuna issues, the Clinton Administration lifted the embargo on Mexican tuna in April 2000 under relaxed standards for a dolphin-safe label in accordance with internationally agreed procedures, and U.S. legislation passed in 1997 that encouraged the unharmed release of dolphins from nets. However, a federal judge

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[52] "Bush Administration Defends Sugar Deal to Congress," *Inside U.S. Trade*, November 3, 2006; "Grassley, U.S. Industry Welcome Agreement with Mexico on Sugar, HFCS," *International Trade Reporter*, August 3, 2006; and, "U.S., Mexico Reach Agreement on WTO Soft Drink Dispute Compliance Deadline," *International Trade Reporter*, July 13, 2006.

in San Francisco ruled that the standards of the law had not been met, and the Federal Appeals Court in San Francisco sustained the ruling in July 2001. Under the Bush Administration, the Commerce Department ruled on December 31, 2002, that the dolphin-safe label may be applied if qualified observers certify that no dolphins were killed or seriously injured in the netting process, but Earth Island Institute and other environmental groups filed suit to block the modification. On April 10, 2003, the U.S. District Court for the Northern District of California enjoined the Commerce Department from modifying the standards for the dolphin-safe label. On August 9, 2004, the federal district court ruled against the Bush Administration's modification of the dolphin-safe standards and reinstated the original standards in the 1990 Dolphin Protection Consumer Information Act. That decision was appealed to the U.S. Ninth Circuit Court of Appeals, which ruled against the Administration in April 2007, finding that the Department of Commerce did not base its determination on scientific studies of the effects of Mexican tuna fishing on dolphins.

In February 2007, the U.S. Department of Agriculture (USDA) authorized the importation of Mexican avocados. The California Avocado Commission (CAC) disagrees with this decision. In April 2007, the California Avocado Commission (CAC) sued the U.S. Department of Agriculture for allowing the importation of Mexican avocados containing armored scaled insects. The CAC is reportedly preparing a motion to request a preliminary injunction on imports of Mexican avocados. The lawsuit has reportedly deterred shipment of avocados from Mexico because growers there are concerned about future market access.

On other issues, in early October 2002, the U.S.-Mexico working group on agriculture dealt with major agricultural issues, including Mexico's anti-dumping decisions on apples, rice, swine, and beef, and safeguard actions on potatoes. In January 2003, the countries agreed to permit Mexican safeguard measures against U.S. imports of chicken legs and thighs, and in July 2003, these safeguard measures were extended until 2008, with tariffs declining each year. In September 2006, Mexico revoked anti-dumping duties imposed on U.S. rice imports in 2002 following rulings by the WTO and WTO Appellate Body in 2005, which found that the duties were contrary to WTO rules. Mexico banned beef imports from the United States in December 2003 following the discovery of one cow infected with mad cow disease in Washington State. Mexico resumed importation of boneless beef in early March 2004, and bone-in beef in February 2006, in response to improved beef cattle screening.

Policy Issues

The United States economic relationship with Mexico has strengthened significantly over the last decade and is of mutual importance. Up to this point, the discussion in the report has focused on the background and surrounding issues of the economic relationship, which leads to the issue of policy considerations. First, there is the question of whether to further economic integration with Mexico in view of the increasing trends in regional trade agreements throughout the world. The close economic relationship between the United States and Mexico that was strengthened by NAFTA is likely to continue but there may be challenges in coming years as the

influence of China and other low-wage countries increases. According to a recent study on economic integration in North America, a major shift is under way in trade patterns among NAFTA partners with exports among NAFTA economies growing more slowly than their exports with the rest of the world, reversing the previous 10-year trend. The report finds that lower-cost suppliers, primarily China and India, are displacing North American imports and could weaken North American integration. The report states that furthering continental integration would require "renewed efforts at resolving long-standing trade disputes, new liberalization initiatives, or greater policy harmonization in areas such as border security, labor mobility, or corporate taxation."[53]

If the United States continues to deepen economic integration with Mexico, one area that may need more attention is the issue of the difference in income levels between the two countries. The economic relationship with Mexico is unique because of Mexico's proximity to the United States, but also because of the wide differences in levels of economic development between the two countries. Mexico is the first developing country with which the United States entered into a free trade agreement. In Mexico, NAFTA has had an uneven effect in different parts of the country and it has not been a solution to the problem of poverty and unemployment. Mexico's problem with poverty cannot be attributed directly to NAFTA because it was in existence prior to the agreement. At the time of NAFTA there was hope that Mexico's economy would grow sufficiently to create jobs in urban areas and help alleviate poverty in rural areas. However, the economy did not expand as expected and the problem of poverty continues.

Another issue is whether trade agreements are enough, or are the appropriate policy instrument, to resolve income disparities among trading partners or even within a developing country. The World Bank study on the effects of NAFTA on Mexico concludes that NAFTA has helped to improve economic conditions in Mexico but it has not been enough to narrow the economic disparities with the United States. The authors of the study state, among other things, that Mexico needs to invest more in education, infrastructure, and institutional strengthening to benefit more fully from freer trade.[54] A possible consideration for policymakers is whether to help Mexico improve the quality of education and strengthen its national institutions through foreign aid programs or other mechanisms.

The economic hardship in certain sectors and regions of Mexico has been a major reason behind unauthorized Mexican migration to the United States. Mexican President Felipe Calderón made his first official visit to the United States as President-elect in early November 2006, after first visiting Canada and several Latin American countries. During his visit, Calderón criticized the recent authorization of 700 miles of fencing along the U.S.-Mexico border and noted that it complicated U.S.-Mexico relations. He asserted that job-creation and increased investment in Mexico would be more effective in reducing illegal migration from Mexico than a

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[53] ITR, "North American Integration Slipping Due to China's Strong Growth, Report Says," Volume 22, Number 8, February 24, 2005.

[54] The World Bank, *Lessons from NAFTA for Latin America and the Caribbean*, by Daniel Lederman, William F. Maloney, and Luis Servén, 2005.

border fence. Calderón signaled a shift in Mexican foreign policy when he noted that while immigration is an important issue in the bilateral relationship, it is not the only issue, as trade and economic development are also important.

Under the Fox Administration, Mexico voiced concern about alleged abuses suffered by Mexican workers in the United States and for the loss of life and hardships suffered by Mexican migrants as they use increasingly dangerous methods to cross into the United States. The Fox Administration held the view that the migrants are "undocumented workers" and that because the U.S. market attracts and provides employment for the migrants, it bears some responsibility. During his administration, former Mexican President Vicente Fox pressed proposals for legalizing undocumented Mexican workers in the United States through amnesty or guest worker arrangements as a way of protecting their human rights. In 2004, President Bush proposed an overhaul of the U.S. immigration system to permit the matching of willing foreign workers with willing U.S. employers when no U.S. documented workers could be found to fill the jobs.

The U.S. Senate began consideration of comprehensive immigration reform in May 2007. Mexico had long lobbied for immigration reform in the United States and cautiously watched the debate in 2007 on this measure. Legal immigration reform has stalled in the 110th Congress. A bipartisan compromise proposal for comprehensive immigration reform negotiated with the Bush Administration was introduced in the Senate on May 21, 2007, as S.Amdt. 1150 to S. 1348. A modified version of that compromise (S. 1639) came to the Senate floor the week of June 26, 2007, but a key cloture vote did not pass.[55] It is unclear whether the 110th Congress will again tackle comprehensive immigration reform. It may, however, consider legislation on selected immigration reform issues, such as foreign workers. Additional border security measures may also be considered.

[55] For more details, see CRS Report RL32235, *U.S. Immigration Policy on Permanent Admissions*, by Ruth Ellen Wasem.