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

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Summary

The bilateral economic and trade relationship with Mexico is of interest to U.S. policymakers because of Mexico's proximity to the United States, the high level of bilateral trade, and the strong cultural and economic ties that connect the two countries. Also, it is of national interest for the United States to have a prosperous and democratic Mexico as a neighboring country. Mexico is the United States' third-largest trading partner, while the United States is, by far, Mexico's largest trading partner. Mexico ranks third as a source of U.S. imports, after China and Canada, and second, after Canada, as an export market for U.S. goods and services. The United States is the largest source of foreign direct investment (FDI) in Mexico. The 112th Congress will likely maintain an active interest in Mexico on issues related to cross-border trade between the two countries, the implementation of NAFTA trucking provisions, economic conditions in Mexico, migration, counternarcotics, and border issues.

The United States and Mexico have strong economic ties through the North American Free Trade Agreement (NAFTA), which has been in effect since 1994. Prior to NAFTA, Mexico had followed a strong protectionist policy for decades until it began to unilaterally liberalize its trade regime in the late 1980s. Not all trade-related job gains and losses since NAFTA can be entirely attributed to the agreement because of the numerous factors that affect trade, such as Mexico's trade liberalization efforts, economic conditions, and currency fluctuations. NAFTA may have accelerated the ongoing trade and investment trends that were already taking place at the time. Most studies show that the net economic effects of NAFTA on both countries have been small but positive, though there have been adjustment costs to some sectors within both countries.

The trade issue of most concern to Members of Congress over the past several years involves NAFTA trucking provisions. Under NAFTA, Mexican commercial trucks were to have been given full access throughout the United States by 2000 but the United States did not implement these provisions due to alleged safety concerns. Mexico objected and a NAFTA dispute resolution panel supported Mexico's position in 2001. In 2009, the Mexican government began imposing retaliatory tariffs on certain U.S. products with a value of $2.4 billion in exports to Mexico. On July 6, 2011, the United States and Mexico signed a Memorandum of Understanding to resolve the dispute and a new pilot program was announced by the Federal Motor Carrier Safety Administration. Mexico eliminated 50% of the retaliatory tariffs in July 2011 and the remaining 50% in October 2011

Also of interest to many policymakers is the economic disparity between the two countries and migration issues. The United States and Mexico have been involved in ongoing efforts to address economic prosperity and regulatory economic cooperation. In 2009, President Barack Obama met with Mexican President Felipe Calderón and Canadian Prime Minister Stephen Harper in Guadalajara Mexico to discuss issues of prosperity and security in North America. In May 2010, Mexican President Calderón made a state visit to the United States in which he emphasized the need for increased cooperation in North America to increase the competitiveness of the region. In a meeting hosted by President Obama, the two leaders reaffirmed their shared values and the need for focusing on economic growth. They vowed to enhance and reinforce efforts to create jobs, promote economic recovery and expansion, and encourage prosperity across all levels of society in both countries. President Obama underscored his commitment to comprehensive immigration reform in the United States while President Calderón stated that his administration was committed to creating more job and educational opportunities in Mexico.

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Introduction

The bilateral economic relationship with Mexico is of key interest to the United States because of Mexico's proximity, the high volume of trade with Mexico, and the strong cultural and economic ties between the two countries. Mexico is one of the United States' key trading partners, ranking second among U.S. export markets and third in total U.S. trade (imports plus exports). Under the North American Free Trade Agreement (NAFTA), the United States and Mexico have developed significant economic ties. Trade between the two countries more than tripled since the agreement was implemented in 1994. Through NAFTA, 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). Mexico has a population of 114 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 United States and Mexico share many common interests related to trade, investment, and regulatory cooperation. The two countries share a 2,000 mile border and have extensive interconnections through the Gulf of Mexico. There are also links through migration, tourism, environmental issues, health concerns, and family and cultural relationships.[1] The 112th Congress will likely maintain an active interest in Mexico on issues related to cross-border trade between the two countries, the implementation of NAFTA trucking provisions, economic conditions in Mexico, migration, counternarcotics, and border issues. This report provides an overview of U.S.-Mexico trade and economic trends, the Mexican economy, the effects of NAFTA, and major trade issues between the United States and Mexico.

U.S.-Mexico Economic Trends

Mexico's gross domestic product (GDP) was an estimated $1.1 trillion in 2011, about 7% of U.S. GDP of $15.0 trillion. Mexico's economy was hit harder than most Latin American countries during the global recession of 2009 but has recovered since then. In 2009, Mexico's the percent change in Mexico's real GDP growth was -6.1%, while that of the United States was -2.6%. In 2010, Mexico's economy experienced a higher than expected growth rate of 5.0%, while the U.S. economy experienced a somewhat lower growth rate of 2.8%.[2] In 2011, GDP grew at an estimated 3.9%.[3]

The immigration issue that has been the focus of much attention by lawmakers and the public in recent years is linked to the economic situation in Mexico, although it has social and political aspects as well. In March 2008, there were approximately 12 million unauthorized immigrants living in the United States, with 59% from Mexico.[4] Economic conditions in Mexico, as well as in other countries, such as poverty and unemployment, contribute to the migration issue. Per capita income in Mexico is significantly lower in Mexico than in the United States. In 2011,

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[1] For more information on issues related to Mexico, see CRS Report RL32724, *Mexico: Issues for Congress*, by Clare Ribando Seelke

[2] The Economist Intelligence Unit (EIU), "Mexico Economy: Better outlook, with caveats," February 9, 2011.

[3] EIU, *Mexico: Country Report,* January 2012.

[4] Pew Hispanic Center, *Trends in Unauthorized Immigration: Undocumented Inflow Now Trails Legal Inflow,* October 2, 2008.

Mexico's per capita GDP in purchasing power parity[5] was $17,040, or 64% lower than U.S. per capita GDP of $47,190. Ten years earlier, in 2001, Mexico's per capita GDP in purchasing power parity was $10,653, or 70% lower than the U.S. amount of $36,082. Although there is a notable income disparity with the United States, Mexico's per capita GDP is relatively high by global standards and falls within the World Bank's upper-middle income category.[6]

Mexico's economy relies heavily on the United States as an export market. Exports accounted for 32% of Mexico's GDP in 2010 and over 80% of Mexico's exports are headed to the United States (see **Table 1**). The United States is, by far, Mexico's leading partner in trade and investment, while Mexico is the United States' third-largest trade partner after China and Canada. Many economists and other observers have focused much attention on the ongoing transformation of Mexico into a manufacturing-for-export nation since the late 1980s and the importance of exports to its economy. After oil and gas, most of Mexico's exports are manufactured goods. Over 80% of Mexico's exports are headed to the United States.

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

	Mexico		United States	
	2001	**2011[a]**	**2001**	**2011[a]**
Population (millions)	101	114	285	313
Nominal GDP (US$ billions)[b]	710	1,113	10,286	15,006
Nominal GDP, PPP[c] Basis (US$ billions)	1,079	1,939	10,286	15,006
Per Capita GDP (US$)	7,012	9,950	36,082	47,190
Per Capita GDP in $PPPs	10,653	17,040	36,082	47,190
Total Exports of Goods and Services (US$ billions)	159	342	731	1,499
Exports as % of GDP[d]	24%	34%	10%	14%
Total Imports of Goods and Services (US$ billions)	168	350	1,153	2,230
Imports as % of GDP[d]	26%	35%	14%	19%

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

a. Most figures for 2011 are estimates.

b. 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.

[5] Purchasing power parity (PPP) reflects the purchasing power of foreign currencies in their own markets in U.S. dollars.

[6] The World Bank utilizes a method for classifying world economies based on gross national product (GNP). Mexico is one of 48 economies classified as upper-middle-income, or countries which have a per capita GNP of $3,946 to $12,195 per year. The United States is one of 69 economies classified as a high-income, or countries which have a per capita GNP of more than $12,195 per year.

Mexico's reliance on the United States as a trade partner appears to be diminishing, although slightly. Between 2004 and 2009, the U.S. share of Mexico's total imports decreased from 56% to 48%, while the share of total Mexican exports going to the United States decreased from 89% to 81%.[7] Mexico's share of the U.S. market has lost ground since 2002. In 2003, China surpassed Mexico as a top supplier of U.S. imports, and Mexico now ranks third, after China and Canada, as a source of U.S. imports. 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.

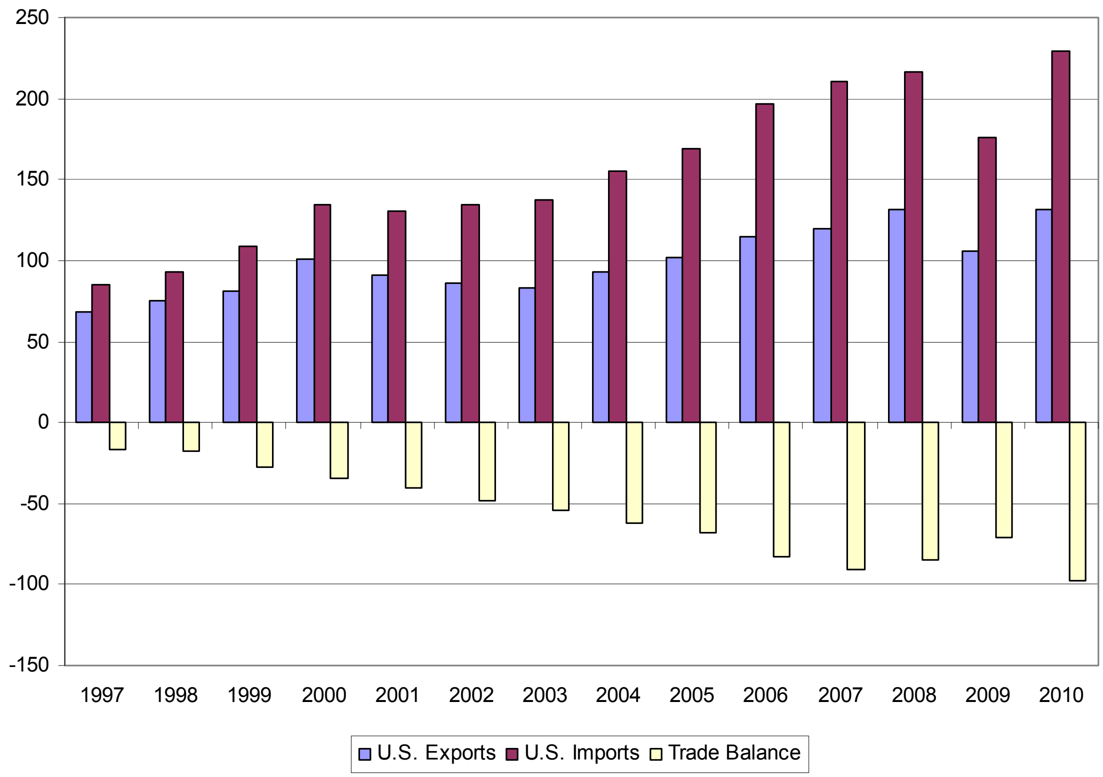
In 2010, 12% of total U.S. merchandise exports were destined for Mexico and 12% of U.S. merchandise imports came from Mexico. After the significant decrease in trade in 2009 that resulted from the global economic downturn, U.S.-Mexico trade increased considerably in 2010. U.S. exports to Mexico increased 25% in 2010 from $105.7 billion to $131.6 billion. U.S. imports from Mexico increased 40% in 2010, from $176.3 billion to $228.8 billion. In 2009, U.S. exports to Mexico decreased by 19.6%, while imports from Mexico decreased by 18.5%. Mexico's second-largest trading partner is China, accounting for approximately 6% of Mexico's exports and imports.

Although some of the increase in U.S.-Mexico trade since the 1990s 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 years that followed 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 $97.2 billion deficit in 2010 (see **Figure 1**). U.S. imports from Mexico increased from $85.0 billion in 1997 to $216.3 billion in 2008, and then decreased to $176.3 billion in 2009 before increasing to $228.8 billion in 2010. U.S. exports to Mexico increased from $68.4 billion in 1997 to $131.5 billion in 2008, and then decreased to $105.7 billion in 2009 before increasing to $131.6 billion in 2010.

[7] Data compiled by CRS using Global Trade Atlas database. Mexican direction of trade data were not available for 2010 at the time of this report update.

Figure 1. U.S. Merchandise Trade with Mexico

(U.S. $ in billions)



Source: Compiled by CRS using USITC Interactive Tariff and Trade data.

Several studies between 2003 and 2004 on the effects of NAFTA found that U.S. trade deficits with Mexico 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.[8] 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.[9]

The leading U.S. imports from Mexico in 2010 were oil and gas imports, which amounted to $29.3 billion, or 13% of total U.S. imports from Mexico (see **Table 2**). These imports decreased sharply in 2009 (44% decline), but increased by 38% in 2010. The next leading import items in 2010 were motor vehicles ($27.5 billion); motor vehicle parts ($23.4 billion); audio/video equipment ($16.5 billion); and communications equipment ($14.0 billion). After sharp decreases in 2009, all leading imports from Mexico increased in 2010. The highest increase was in motor vehicles parts (52%) and motor vehicles (49%).

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

[9] Ibid.

Table 2. U.S. Imports from Mexico: 2004-2010

(U.S. $ in billions)

Leading Items (NAIC 4-digit)	2004	2005	2006	2007	2008	2009	2010	% Change 2009-2010
Oil and Gas	17.2	22.5	29.4	30.3	37.9	21.2	29.3	38%
Motor Vehicles	18.8	18.4	23.2	23.1	22.0	18.4	27.5	49%
Motor Vehicle Parts	17.8	19.3	20.8	22.7	20.6	15.4	23.4	52%
Audio/Video Equipment	8.2	9.9	13.9	17.1	17.8	15.6	16.5	6%
Communications Equipment	7.5	7.3	8.7	13.1	13.0	12.8	14.0	8%
Other	85.5	91.8	101.0	104.0	105.0	92.9	118.2	38%
Total	155.0	169.2	197.1	210.2	216.3	176.3	228.8	30%

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

Note: Nominal U.S. dollars.

Table 3. U.S. Exports to Mexico: 2004-2010

(US$ Billions)

Leading Items (NAIC 4-digit)	2004	2005	2006	2007	2008	2009	2010	% Change 2009-2010
Motor vehicle parts	7.6	7.4	8.6	9.4	10.1	8.8	12.6	43%
Petroleum and coal products	2.8	4.7	5.0	5.7	9.6	6.6	11.9	81%
Basic chemicals	4.4	5.0	5.7	6.5	7.2	6.2	7.0	14%
Resin, synthetic rubbers and related products	3.6	4.5	5.4	5.4	6.0	4.9	6.2	26%
Oilseeds and grains	2.6	2.5	3.1	4.0	5.9	4.2	4.5	8%
Other	72.1	77.5	86.8	88.4	92.8	75.1	89.1	24%
Total	93.0	101.7	114.6	119.4	131.5	105.7	131.6	25%

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

Note: Nominal U.S. dollars.

The leading U.S. export item to Mexico in 2010 was motor vehicle parts (10% of total U.S. exports), as shown in **Table 3**. After a 13% decrease in 2009, U.S. exports to Mexico in 2010 in motor vehicle parts increased by 43% to $12.6 billion. The next leading U.S. export items in 2010 were petroleum and coal products ($11.9 billion); basic chemicals ($7.0 billion); resin, synthetic rubber and related products ($6.2 billion); and oilseeds and grains ($4.5 billion). All leading exports to Mexico decreased markedly in 2009, but then recovered in 2010, as shown in **Table 3**. The highest increase was in petroleum and coal products (81% increase). Total U.S. exports to Mexico increased 25% in 2010.

Mexico-U.S. Bilateral Foreign Direct Investment

Foreign direct investment (FDI) has been an integral part of the economic relationship between the United States and Mexico since NAFTA implementation. 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. The stock of U.S. FDI increased from $17.0 billion in 1994 to $90.3 billion in 2010, a 430% 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 10 years. In 2010, Mexican FDI in the United States totaled $12.6 billion (see **Table 4**).

The sharp rise in U.S. investment in Mexico since NAFTA 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 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 the agreement.

Nearly half of total FDI investment in Mexico is in the manufacturing industry of which the maquiladora industry forms a major part. (See "Mexico's Export-Oriented Assembly Plants" below.) In Mexico, the industry has helped attract investment from countries such as the United States that have a relatively large amount of capital. 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.

Table 4. U.S.- Mexican Foreign Direct Investment Positions: 1994-2010 Historical Cost Basis

(U.S. $ in millions)

Year	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	7,829	56,303
2003	9,022	56,851
2004	7,592	63,384
2005	3,595	73,687
2006	5,310	82,965
2007	8,478	91,046
2008	8,420	87,443
2009	11,492	89,419
2010	12,591	90,304

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

Mexico's Export-Oriented Assembly Plants

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 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, which originated under Mexico's *maquiladora* program in the 1960s,[10] account for a substantial share of Mexico's trade with the United States. The border region with the United States has the highest concentration of assembly plants and workers. The Mexican cities with the highest manufacturing activity as of December 2009 were the Mexican border cities of Tijuana, Baja California, 590 plants with 136,957 employees, and Cd. Juárez,

[10] 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).

Chihuahua, 339 plants with 168,011 employees.[11] Prior to NAFTA, a maquiladora was limited to selling up to 50% of the previous year's export production to the domestic market. Most maquiladoras currently export the majority of their production to the U.S. market.

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.

Some observers believe that the correlation in maquiladora growth after 1993 is directly due to NAFTA, but in reality it was a combination of factors that contributed to growth. Trade liberalization, wages, and economic conditions, both in the United States and Mexico, all affected the growth of Mexican export-oriented assembly plants. Although some provisions in NAFTA may have encouraged growth in certain sectors, manufacturing activity has been more influenced by the strength of the U.S. economy and relative wages in Mexico.

Mexico's Regulations for Manufacturing Plants

Changes in Mexican regulations on export-oriented industries after NAFTA merged the maquiladora industry and Mexican domestic assembly-for-export plants into one program called the Maquiladora Manufacturing Industry and Export Services (IMMEX). In 2001, the North American rules of origin determined the duty-free status for a given import and replaced the previous special tariff provisions that applied only to maquiladora operations. The initial maquiladora program ceased to exist and the same trade rules applied to all assembly operations in Mexico.

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. In 2007, a new set of government regulations on export-oriented industries merged the maquiladora industry and PITEX plants into the Maquiladora Manufacturing Industry and Export Services, or IMMEX. Industry data regarding

[11] Data from Mexico's Instituto Nacional de Estadística y Geografía (INEGI).

Mexico's export-oriented assembly plants no longer distinguish maquiladora plants from other Mexican manufacturing plants.[12]

Plants and Employment Levels

The number of maquiladora plants expanded rapidly in the 1990s after NAFTA implementation. Plants increased from 1,920 at the end of 1990 to 3,590 in 2000, and then fell to 2,860 in 2003. Between 2004 and 2007, the last year maquiladoras were classified as such by the Mexican government, the number of plants stayed at approximately the same level, about 2,819.[13] After July 2007, the Mexican government published statistics for all manufacturing plants in Mexico under the IMMEX program (which combined maquiladora data with other manufacturing).

The 2009 downturn in the Mexican economy, combined with the increased violence along the U.S.-Mexico border, hurt the manufacturing industry, and many IMMEX plants shut down as a result. In Cd. Juárez, Chihuahua, the city with the highest number of jobs in export assembly plants, IMMEX employment decreased from 214,272 in July 2007 to 168,011 in December 2009, a loss of 46,261 jobs (22% decrease). In Tijuana, Baja California, employment decreased from 174,105 in July 2007 to 136,957 in December 2009, a loss of 37,148 jobs (21% decrease). The total number of IMMEX plants in Mexico increased from 5,083 in July 2007 to 5,245 in December 2009. However, employment decreased from 1,910,112 million in July 2007 to 1,641,465 in December 2009, a loss of 268,647 jobs (14% decrease).[14] Estimates for 2010 show that the manufacturing plants may be on the rebound. In Cd. Juarez, maquiladoras reportedly added about 26,000 new jobs from July 2009 through August 2010.[15]

Worker Remittances to Mexico

Remittances are the second-highest source of foreign currency for Mexico, after oil and tourism. Most worker remittances to Mexico come from workers in the United States who send money back to their relatives in Mexico. Mexico receives the largest amount of remittances in Latin America and the third-largest in the world, after India and China. After a decline in remittances following the global financial crisis, remittances increased by one percent in 2010. Preliminary reports from Mexico's Central Bank show that remittances increased by an estimated 8% in 2011 over 2010.[16] On January 27, 2010, Mexico's Central Bank reported that remittance inflows fell 16.0% in 2009 to $21.1 billion. The decline was at least partially due to the global financial crisis and the slowdown in the U.S. economy as the jobless rate took a toll on Mexican immigrants in the United States. The housing and services were particularly negatively affected. Approximately 239,000 immigrant Hispanics lost their jobs in 2008, with almost 100,000 of these jobs in the construction industry, according to one estimate.[17]

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[12] Federal Reserve Bank of Dallas, "Spotlight: Maquiladora Data, Mexican Reform Clouds View of Key Industry," *Southwest Economy*, Issue 3, May/June 2007.

[13] Based on data from INEGI, at http://www.inegi.org.mx.

[14] Ibid.

[15] Will Weissert, "Juarez maquiladoras recovering despite bloodshed," *Miami Herald,* January 23, 2011.

[16] Ricardo Lopez, "Mexican immigrants living in the U.S. sent an estimated 8% more money back to relatives last year compared with 2020, thanks to an improving U.S. job market," *Chicagotribune.com,* January 11, 2012.

[17] Joel Millman, "Remittances to Mexico Fall More than Forecast," *Wall Street Journal,* January 28, 2009, p. A3.

For a number of years, remittances were considered a stable financial flow for Mexico as workers in the United States made efforts to send money to family members, especially to regions of the country experiencing economic crises or natural disasters. Annual remittances to Mexico grew substantially between 2001 and 2008, from $8.9 billion to $25.1 billion, an increase of 182.0%. The annual growth rate reached a high of 26.3% in 2003, then continued at a slower rate until 2009 when they fell by 16% (see **Table 5**). Although the relationship between GDP growth and the level or remittances is not very clear, the Mexican government attributed the 2009 decline to the global financial crisis.[18]

Table 5. Percent Changes in Remittances to Mexico

(U.S. $ in billions)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Amount	8.9	10.5	13.3	16.6	20.0	23.7	24.0	25.1	21.1	21.3
% Change	—	18.5%	26.3%	25.2%	20.6%	18.5%	1.0%	4.9%	-16.0%	0.9%

Source: Compiled by CRS using data from the Inter-American Development Bank, The Multilateral Investment Fund.

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.[19] 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.[20]

Economic Regulatory Cooperation

The United States, Canada, and Mexico have made efforts since 2005 to increase cooperation on security and economic issues through trilateral summit meetings and through the former initiative under the Bush Administration called the Security and Prosperity Partnership of North America (SPP). The most recent trilateral summit took place at the North American Leaders' Summit in August 2009 in Guadalajara, Mexico. President Barack Obama, Canadian Prime Minister Stephen Harper, and Mexican President Felipe Calderón met to discuss issues related to prosperity and security in North America. The first North American Leaders' Summit took place on March 23, 2005, in Waco, TX; this was followed by several trilateral summits in Mexico, Canada, and the United States. One of the outcomes of the 2005 summit was the trilateral SPP initiative. The main goal was to increase and enhance prosperity in the region through regulatory cooperation. The

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[18] E. Eduardo Castillo, "Mexico Sees Record 15.7 percent Annual Drop in Money Sent Home by Migrants," Associated Press, January 27, 2010.

[19] 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.

[20] Ibid., p. 4.

SPP was endorsed by all three countries, but it was not a signed agreement or treaty and, therefore, contained no legally binding commitments or obligations. Although the SPP built upon the existing trade and economic relationship of the three countries, it was not a trade integration agreement as many critics claimed, and distinct from the existing North American Free Trade Agreement (NAFTA).

The United States continues to cooperate with Canada and Mexico on security and prosperity. Since the last trilateral summit that was held in Mexico in August 2009, President Obama has met separately with Prime Minister Stephen Harper and Mexican President Felipe Calderón on various occasions. These meetings have included discussions on increasing security as well as economic competitiveness, job creation, and prosperity.

Efforts to increase regulatory cooperation generally have followed the recommendations of special working groups. Some recommendations have included (1) increasing the competitiveness of North American businesses and economies through more compatible regulations; (2) making borders smarter and more secure by coordinating long-term infrastructure plans, enhancing services, and reducing bottlenecks and congestion at major border crossings; (3) strengthening energy security and protecting the environment by developing a framework for harmonization of energy efficiency standards and sharing technical information; (4) improving access to safe food and health and consumer products by increasing cooperation and information sharing on the safety of food and products; and (5) improving the North American response to emergencies by updating bilateral agreements to enable government authorities from the three countries to help each other more quickly and efficiently during times of crisis.

On economic issues, North American cooperation efforts have focused on increasing information sharing, harmonization of standards, productivity improvement, reductions in the costs of trade, and enhancement of the quality of life. The three countries have also addressed the need to enhance North American competitiveness through compatible regulations and standards that would help them protect health, safety and the environment, as well as to facilitate trade in goods and services across borders.

Some critics of North American cooperation efforts contend that it has been an attempt to create a common market or economic union in North America. Proponents of North American competitiveness and security cooperation view the initiatives as constructive to addressing issues of mutual interest and benefit for all three countries. Business groups generally support increased North American cooperation and believe that it is necessary to enhance the competitiveness of U.S. businesses in the global market.

The Mexican Economy

Mexico has an open market economy, but this has not always been the case. The transformation of Mexico began in the late 1980s when the government started to liberalize its trade policy and adopt economic reform measures.

History of Economic Reforms

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, but the policies did not have the expected positive results on industrial growth. The 1980s in Mexico were marked by inflation and a declining standard of living. After the 1982 debt crisis in which the Mexican government was unable to meet its foreign debt obligations, the country began experiencing a number of economic challenges. 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. 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.[21] 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.[22] 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.[23]

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 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.[24]

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

[21] The Economist Intelligence Unit (EIU), "Mexico Finance: The Peso Crisis, Ten Years On," January 3, 2005.

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

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

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

emerging middle class. NAFTA and the change 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**). Real GDP went from a 4.8% growth rate in 2006 to a contraction of 6.9% in 2009.

Current Economic Conditions

Mexico's economic growth has recovered since the 2009 downturn. The global financial crisis, and the subsequent downturn in the U.S. economy, resulted in the sharpest economic contraction in the Mexican economy in twenty years. It is estimated to have contracted by 6.6% in 2009, as shown in **Table 1,** while the Mexican peso depreciated against the dollar by 25%.[25] In 2010, GDP grew by 5%, higher than the expected growth rates of 3% to 4%. Estimates for 2011 show GDP growth of 3.9.%.[26] However, the partial recovery of the economy in 2010 was mostly due to an increase in external demand, which has driven up manufacturing exports, rather than from internal demand.[27]

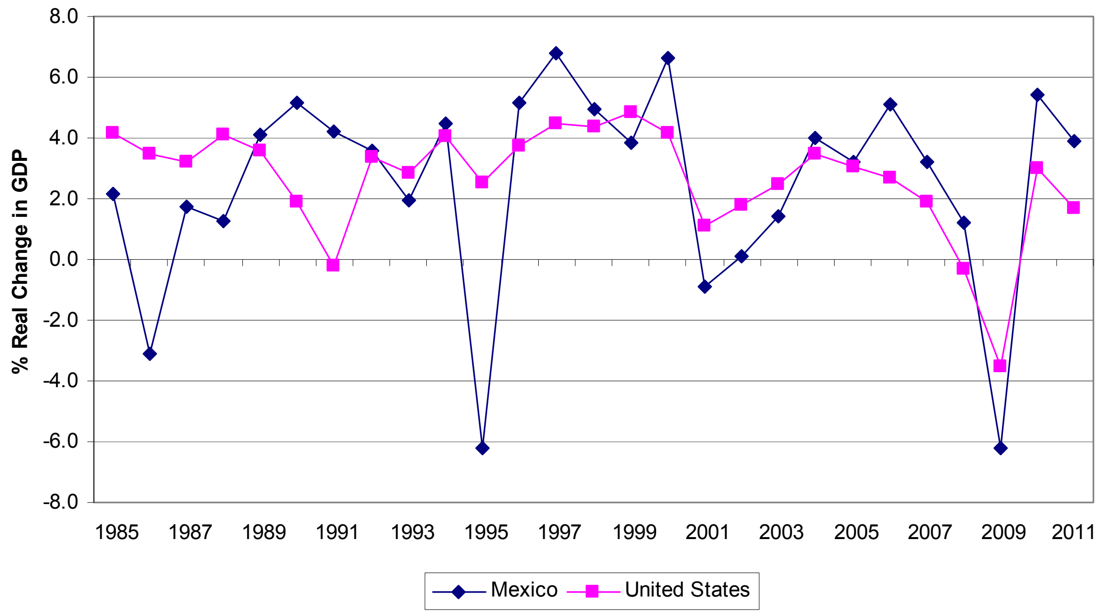
Mexico experienced the deepest recession in the Latin America region following the crisis. This is largely due to its high dependence on manufacturing exports to the United States, though other factors have also contributed. Other Latin American countries experienced negative economic consequences from the global financial crisis, but to a lesser extent. In Central America, the economy of Honduras was the most affected, with a contraction of 4.4%. Economic growth in most South American countries was affected by the crisis, but because most of these countries were experiencing high levels of growth prior to the crisis, the effect was not as severe. Paraguay was the country most adversely affected in South America, with a -3.8% change in real GDP.

[25] International Monetary Fund (IMF), "IMF Executive Board Concludes 2010 Article IV Consultation with Mexico," Public Information Notice (PIN) No. 10/39, March 16, 2010, p. 2.

[26] EIU, *Country Report: Mexico,* January 2012.

[27] EIU, "Mexico economy: Better outlook, with caveats," February 9, 2011.

Figure 2. GDP Growth Rates for the United States and Mexico



Source: Economist Intelligence Unit.

President Calderón implemented a number of measures to help cushion the economy from the fallout of the global economic crisis. These policy measures and Mexico's prior economic performance helped the economy begin to recover and the exchange rate to improve.[28] Mexico's Central Bank made substantial interventions to stabilize conditions in the foreign exchange market and secured lines of credit through the U.S. Federal Reserve swap line and the International Monetary Fund (IMF) to improve confidence in the economy. The IMF set up flexible credit lines to help countries deal with the effects of the global recession and provided a credit line of $48 billion for Mexico in 2009, which was renewed in March 2010. In early 2011, Mexico secured a new flexible line of credit from the IMF for $72 billion, the largest credit line that the IMF has ever extended to protect Mexico from possible external shocks.[29] Mexico has indicated that it does not intend to draw on the resources, but sought the renewal to provide confidence to investors and financial markets in the event that global conditions were to deteriorate.[30]

Mexico has also taken a series of additional economic measures to strengthen the economy. The FY2010 budget included a substantive tax reform that was designed to offset the revenue losses from lower oil production. Mexico's requirements on corporate disclosure of derivative exposures have been tightened. In addition the government has made structural reforms to enhance growth

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[28] IMF, "IMF Executive Board Concludes 2010 Article IV Consultation with Mexico," PIN No. 10/39, March 16, 2010.

[29] Ibid.

[30] IMF, "Mexico Recovering, but Crisis Spotlights Challenges, says IMF," *Survey Magazine: In the News,* March 16, 2010.

potential, most recently in the electricity sector, and announced plans to gradually increase foreign exchange reserves.[31] However, the dependence on falling oil revenues and weak prospects for reforming the oil industry may continue Mexico's vulnerability to future external shocks.[32]

Poverty in Mexico

Poverty has been one of Mexico's more serious and pressing economic problems for many years. The government has made progress in its poverty reduction efforts over the last ten years, but poverty continues to be a basic challenge for the country's development. The authors of a World Bank 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.[33] 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.[34]

The alleviation of poverty has been a high priority for the Mexican government. Mexico's main program to reduce the effects of poverty is the *Oportunidades* program (formerly known as Progresa). The program seeks to not only alleviate the immediate effects 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.[35]

Mexico's Regional Free Trade Agreements

Since the early 1990s, Mexico has had a growing commitment to trade liberalization; 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

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[31] IMF, "IMF Executive Board Concludes 2010 Article IV Consultation with Mexico," PIN No. 10/39, March 16, 2010, p. 2.

[32] EIU, *Country Report: Mexico*, March 2010.

[33] The World Bank Group, "Mexico Makes Progress and Faces Challenges in Poverty Reduction Efforts," press release, July 2004.

[34] Ibid.

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

Canada, Chile, Bolivia, Costa Rica, Nicaragua, Uruguay, Colombia, Guatemala, El Salvador, and Honduras.[36]

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. Mexico and Japan signed a free trade agreement, formally called an Economic Partnership Agreement (EPA) in September 2004. The EPA was Japan's second free trade agreement, but its most comprehensive bilateral agreement at that time.[37] 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,[38] the Asia-Pacific Economic Cooperation (APEC) forum, and the OECD.[39] Mexico has also expressed interest to participate in the Trans-Pacific Partnership (TPP) negotiations and is engaging in consultations with the current participants to gain their support for joining the negotiations. Mexico, Canada and Japan expressed an interest in joining the TPP talks at the November APEC meeting.[40]

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

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

[37] "Japan, Mexico Ink Landmark Accord," *The Asahi Shumbun,* September 20, 2004.

[38] 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.

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

[40] *World Trade Online, "*Mexico Holds Formal Consultations with U.S., Asian Partners On TPP," January 20, 2012.

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 11% in 2004, increased to 14% in 2007 due to higher oil prices, and went back down to 12% in 2009.

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 3% 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 ongoing 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.[41]

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.[42] 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.

Effects on the Mexican Economy

A number of studies have found that NAFTA has brought economic and social benefits to the Mexican economy as a whole, but that the benefits have not been evenly distributed throughout the country. Most studies after NAFTA have found that the effects on the Mexican economy tended to be modest at most.[43] While there have been periods of positive growth and negative growth in Mexico after the agreement was implemented, much of the increase in trade began in the late 1980s when the country began trade liberalization measures. Though its net economic effects may have been positive, NAFTA itself has not been enough to lower income disparities within Mexico, or between Mexico and the United States or Canada.

A 2005 World Bank study assessing some of the economic impacts from NAFTA on Mexico concluded that NAFTA helped Mexico get closer to the levels of development in the United States and Canada. The study states that NAFTA helped Mexican manufacturers to adopt to U.S. technological innovations more quickly and likely had positive impacts on the number and quality of jobs. Another finding was that since NAFTA went into effect, the overall macroeconomic volatility, or wide variations in the GDP growth rate, has declined in Mexico. Business cycles in Mexico, the United States, and Canada have had higher levels of synchronicity since NAFTA, and NAFTA has reinforced the high sensitivity of Mexican economic sectors to economic developments in the United States.[44]

Several economists have noted that it is likely that NAFTA contributed to Mexico's economic recovery directly and indirectly after the 1995 currency crisis. Mexico responded to the crisis by implementing a strong economic adjustment program but also by fully adhering to its NAFTA obligations to liberalize trade with the United States and Canada. NAFTA may have supported the resolve of the Mexican government to continue with the course of market-based economic

[41] See CRS Report RL31723, *Textile and Apparel Trade Issues*, by Bernard A. Gelb.

[42] See CRS Report 98-783, *NAFTA: Estimates of Job Effects and Industry Trade Trends After 5 1/2 Years*, by Mary Jane Bolle.

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

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

reforms, resulting in increasing investor confidence in Mexico. The World Bank study estimates that FDI in Mexico would have been approximately 40% lower without NAFTA.[45]

One of the main arguments in favor of NAFTA at the time it was being proposed by policymakers was that the agreement would improve economic conditions in Mexico and narrow the income gap between Mexico and the United States. Studies that have addressed the issue of economic convergence[46] have noted that economic convergence in North America might not materialize under free trade as long as "fundamental differences" in initial conditions persist over time. One study argues that NAFTA is not enough to help narrow the disparities in economic conditions between Mexico and the United States and that Mexico needs to invest more in education; innovation and infrastructure; and in the quality of national institutions. The study states that income convergence between a Latin American country and the United States is limited by the wide differences in the quality of domestic institutions, in the innovation dynamics of domestic firms, and in the skills of the labor force.[47] Another study also notes that the ability of Mexico to improve economic conditions depends on its capacity to improve its national institutions, adding that Mexican institutions did not improve significantly more than those of other Latin American countries during the post-NAFTA period.[48]

Mexican wages rose steadily from the early 1980s until the mid-1990s, when the currency crisis hit. After a drop in average real wages in 1996 of 15.5%, real wages increased steadily until 2000, when the average rate of growth was 11.8%. Since then the average rate of growth has only varied slightly. Mexico's trade liberalization measures may have affected the ratio between skilled and non-skilled workers in Mexico. In 1988, the real average wage of skilled workers in Mexico's manufacturing industry was 2.25 times larger than that of non-skilled workers. This ratio increased until 1996, when it was about 2.9, but then remained stable until 2000.[49] The World Bank study found that NAFTA brought economic and social benefits to the Mexican economy, but that the agreement in itself was not sufficient to ensure a narrowing of the wage gap between Mexico and the United States. The study states that NAFTA had a positive effect on wages and employment in some Mexican states, but that the wage differential within the country increased as a result of trade liberalization.[50]

Mexican Trucking Issue

U.S. implementation of NAFTA trucking provisions has been a major trade issue between the United States and Mexico for several years. Under NAFTA, Mexican commercial trucks were to

[45] Ibid.

[46] Economic convergence can be broadly defined as a narrowing of the disparities in the economic levels and the manufacturing performances of particular countries or their regions. The goal of the theory of economic convergence is to research and analyze the factors influencing the rates of economic growth and real per capita income in countries.

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

[48] William Easterly, Norbert Fiess, and Daniel Lederman, "NAFTA and Convergence in North America: High Expectations, Big Events, Little Time," *Economia,* Fall 2003.

[49] Esquivel, Gerardo, and José Antonio Rodríguez-López, "Technology, trade, and wage inequality in Mexico before and after NAFTA," *Journal of Development Economics*, 2003.

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

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, however, the United States refused to implement NAFTA's trucking provisions. The Mexican government objected and claimed that U.S. actions were a violation of U.S. commitments under NAFTA. A NAFTA dispute resolution panel supported Mexico's position in February 2001. President Bush indicated a willingness to implement the provision, but the U.S. Congress required additional safety provisions in the FY2002 Department of Transportation Appropriations Act (P.L. 107-87). Since then, the United States and Mexico have worked to resolve the issue and have engaged in numerous talks regarding safety and operational issues.

Bush Administration Pilot Program for Mexican Trucks

On November 27, 2002, with safety inspectors and procedures in place, the Bush Administration announced that it would begin the process that would open U.S. highways to Mexican truckers and buses. However, environmental and labor groups went to court in early December to block the action. On January 16, 2003, the U.S. Court of Appeals for the Ninth Circuit ruled that full environmental impact statements were required for Mexican trucks to be allowed to operate on U.S. highways. The U.S. Supreme Court reversed that decision on June 7, 2004.

In February 2007, the Bush Administration announced a pilot project to grant Mexican trucks from 100 transportation companies full access to U.S. highways. In September 2007, the Department of Transportation (DOT) launched a one-year pilot program to allow approved Mexican carriers beyond the 25-mile commercial zone in the border region, with a similar program allowing U.S. trucks to travel beyond Mexico's border and commercial zone. Over the 18 months that the program existed, 29 motor carriers from Mexico were granted operating authority in the United States. Two of these carriers dropped out of the program shortly after being accepted, while two others never sent trucks across the border. In total, 103 Mexican trucks were used by the carriers as part of the program.[51]

In the FY2008 Consolidated Appropriations Act (P.L. 110-161), signed into law in December 2007, Congress included a provision prohibiting the use of FY2008 funding for the establishment of the pilot program. However, the DOT determined that it could continue with the pilot program because it had already been established. In March 2008, the DOT issued an interim report on the cross-border trucking demonstration project to the Senate Committee on Commerce, Science, and Transportation. The report made three key observations: (1) the Federal Motor Carrier Safety Administration (FMCSA) planned to check every participating truck each time it crossed the border to ensure that it met safety standards; (2) there was less participation in the project than was expected; and (3) the FMCSA implemented methods to assess possible adverse safety impacts of the project and to enforce and monitor safety guidelines.[52]

In early August 2008, DOT announced that it would be extending the pilot program for an additional two years. In opposition to this action, the House approved on September 9, 2008 (by a vote of 396 to 128) H.R. 6630, a bill that would have prohibited DOT from granting Mexican trucks access to U.S. highways beyond the border and commercial zone. The bill also would have

[51] Ibid.

[52] Department of Transportation, "Cross-Border Trucking Demonstration Project," March 11, 2008.

prohibited DOT from renewing such a program unless expressly authorized by Congress. No action was taken by the Senate on the measure.

On March 11, 2009, the FY2009 Omnibus Appropriations Act (P.L. 111-8) terminated the pilot program. The FY2010 Consolidated Appropriations Act, passed in December 2009 (P.L. 111-117), did not preclude funds from being spent on a long-haul Mexican truck pilot program, provided that certain terms and conditions were satisfied. Numerous Members of Congress urged President Obama to find a resolution to the dispute in light of the effects that Mexico's retaliatory tariffs were having on U.S. producers (see section below).

A truck safety statistic on "out-of-service" rates indicates that Mexican trucks operating in the United States are now safer than they were a decade ago. The data indicate that Mexican trucks and drivers have a comparable safety record to U.S. truckers. Another study indicates that the truck driver is usually the more critical factor in causing accidents than a safety defect with the truck itself. Service characteristics of long-haul trucking suggest that substandard carriers would likely not succeed in this market.[53]

Mexico's Retaliatory Tariffs

In response to the abrupt end of the pilot program, the Mexican government announced in March 2009 that it would retaliate by increasing duties on 90 U.S. products with a value of $2.4 billion in exports to Mexico. Mexico began imposing tariffs in March 2009 and, after reaching an understanding with the United States, eliminated them in two stages in 2011. The retaliatory tariffs, effective as of March 19, 2009, ranged from 10% to 45% and covered a range of products that included fruit, vegetables, home appliances, consumer products, and paper.[54] Subsequently, a group of 56 Members of the House of Representatives wrote to United States Trade Representative Ron Kirk and DOT Secretary Ray LaHood requesting the Administration to resolve the trucking issue.[55] The bipartisan group of Members stated that they wanted the issue to be resolved soon because the higher Mexican tariffs were having a "devastating" impact on local industries, especially in agriculture, and area economies in some states. One reported estimate stated that U.S. potato exports to Mexico had fallen 50% by value since the tariffs were imposed and that U.S. exporters were losing market share to Canada.[56]

On August 16, 2010, the Mexican government announced a new list of retaliatory tariffs on imports from the United States. The new list added 26 products to and removed 16 products from the original list of 89, bringing the new total to 99 products from 43 states with a total export value of $2.6 billion. Products that were added to the list included several types of pork products, several types of cheeses, sweet corn, pistachios, oranges, grapefruits, apples, oats and grains, chewing gum, ketchup, and other products. The largest in terms of value were two categories of pork products, which had an estimated export value of $438 million in 2009. Products that were

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

[54] Rosella Brevetti, "Key GOP House Members Urge Obama to Develop New Mexico Truck Program," *International Trade Reporter,* March 26, 2009.

[55] Amy Tsui, "Plan to Resolve Mexican Trucking Dispute 'Very Near,' DOT's LaHood Tells Lawmakers," *International Trade Reporter,* March 11, 2010.

[56] Ibid.

removed from the list included peanuts, dental floss, locks, and other products. [57] The new retaliatory tariffs were lower than the original tariffs and ranged from 5% to 25%. Mexico rotated the list of products to put more pressure on the United States to seek a settlement for the trucking dispute.[58] U.S. producers of fruits, pork, cheese, and other products that were bearing the cost of the retaliatory tariffs reacted strongly at the lack of progress in resolving the trucking issue and argued, both to the Obama Administration and to numerous Members of Congress, that they were potentially losing millions of dollars in sales as a result of this dispute.

The Mexican government indicated it was willing to resolve the ongoing dispute with the Obama Administration. In March 2011, President Obama and Mexican President Calderón announced that they had agreed on a way to move forward to resolving the dispute. Mexico stated that once a final agreement was reached, it would suspend retaliatory tariffs in stages, beginning with reducing tariffs by 50% at the signing of an agreement and suspending the remaining 50% when the first Mexican carrier was granted operating authority under the program.[59]

U.S. Concept Document for Long Haul Trucking

In January 2011, the Obama Administration presented an "initial concept document" to Congress and the Mexican government for a new long-haul trucking program with numerous safety inspection requirements for Mexican carriers. The concept document would put in place a new inspection and monitoring regime in which Mexican carriers would have to apply for long-haul operating authority. The proposed project would include several thousand trucks and eventually bring as many vehicles as are needed into the United States. [60] A DOT press release from January 6, 2011 stated that a formal proposal on which the public would have the opportunity to comment would be released in the coming months.[61] The Mexican government responded positively to the initiative, stating that it would not continue rotating the list of retaliatory tariffs, but that it would keep the current tariffs in place until a final accord was reached.[62]

The U.S. concept document outlined a proposed program with three sets of elements. The first set of elements, pre-operations elements, included an application process for Mexican carriers interested in applying for long-haul operations in the United States; a vetting process by the U.S. Department of Homeland Security and the Department of Justice; a safety audit of Mexican carriers applying for the program; documentation of Mexican commercial driver's license process to demonstrate comparability to the U.S. process; and evidence of financial responsibility (insurance) of the applicant. The second set of elements, operations elements, included the following: monitoring procedures that included regular inspections and electronic monitoring of long-haul vehicles and drivers; a follow-up review (first review) to ensure continued safe operation; a compliance review (second review) upon which a participating carrier would be

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[57] *Inside U.S. Trade's World Trade Online,* "Pork, Cheeses, Fruits to Face new Tariffs Due to Mexico Trucks Dispute," August 17, 2010.

[58] *Inside U.S. Trade's World Trade Online,* "New Mexican Retaliatory Tariffs in Trucks Dispute Designed to Spur U.S.," September 3, 2010.

[59] *Washington Trade Daily,* "A Trucking Breakthrough," Volume 20, No. 45, March 4, 2011.

[60] Rosella Brevetti and Nacha Cattan, "DOT's LaHood Presents 'Concept' Paper on Resolving NAFTA Mexico Truck Dispute," January 13, 2011.

[61] U.S. Department of Transportation Press Release, "U.S. Cross-Border Trucking Effort Emphasizes Safety and Efficiency," January 6, 2011.

[62] Josh Mitchell, "U.S. Jump-Starts Bid to End Truck Dispute with Mexico," *The Wall Street Journal,* January 7, 2011.

eligible for full operation authority; and a Federal Motor Carrier Safety Administration (FMCSA) review that included insurance monitoring and drug and alcohol collection and testing facilities. The third set of elements, transparency elements, would require Federal Register notices by the FMCSA; a publically accessible website that provides information on participating carriers; the establishment of a Federal Advisory Committee with representation from a diverse group of stakeholders; periodic reports to Congress; and requirements for DOT Office of the Inspector General reports to Congress.[63]

Pilot Program on NAFTA Long-Haul Trucking Provisions

On July 6, 2011, the two countries signed a Memorandum of Understanding (MOU) to resolve the dispute over long-haul cross-border trucking.[64] Within ten days after signing of the MOU, Mexico suspended 50% of the retaliatory tariffs. Mexico agreed to suspend the remainder of the tariffs within five days of the first Mexican trucking company receiving its U.S. operating authority.[65]

The new program was announced by the DOT Federal Motor Carrier Safety Administration (FMCSA). DOT Secretary LaHood stressed that roadway safety would be a priority in the program.[66] The program came as a result of numerous meetings between Secretary LaHood, other Obama Administration officials, lawmakers, safety advocates, industry representatives and others to address concerns. According to the FMCSA, the final text of the program addresses recommendations of over 2,000 commenters to the proposal issued in April 2011.[67] Under the program, trucks will be required to comply with all Federal Motor Vehicle Safety Standards and must have electronic monitoring systems to track hours-of-service compliance. In addition, DOT is to review the complete driving record of each driver in addition to having drug testing requirements for all drivers. Other requirements include an assessment of abilities to understand the English language and U.S. traffic signs.[68] Under the new agreement, Mexico will provide reciprocal authority for U.S. carriers to engage in cross-border long-haul operations in Mexico.

On October 14, 2011, the FMCSA granted the first permit to provide international long-haul cargo services to Monterrey-based trucking firm Transportes Olympic. The company successfully completed a pre-authorization safety audit and had been a participant in the Bush Administration's 2007 pilot program. On October 21, 2011, Mexico suspended the remaining retaliatory tariffs.[69]

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[63] U.S. Department of Transportation, *Concept Document: Phased U.S.-Mexico Cross-Border Long Haul Trucking Proposal,* January 6, 2011, at http://www.fmcsa.dot.gov.

[64] Federal Motor Carrier Safety Administration (FMCSA), *News Release*, "United States and Mexico Announce Safe, Secure Cross-Border Trucking Program: U.S.-Mexico Agreements Will Lift Tariffs and Put Safety First," July 6, 2011.

[65] *NAFTA Works,* "The United States and Mexico Sign a Memorandum of Understanding on Long-Hayl Cross-Border Trucking," Volume 3, Alert 18, July 2011.

[66] FMCSA, *News Release*, "United States and Mexico Announce Safe, Secure Cross-Border Trucking Program: U.S.-Mexico Agreements Will Lift Tariffs and Put Safety First," July 6, 2011.

[67] Ibid.

[68] Ibid.

[69] Rosella Brevetti, "Mexico Suspends Tariffs as Trucking Program is Launched," *International Trade Reporter,* October 27, 2011.

The International Brotherhood of Teamsters strongly opposes the pilot program and, together with Public Citizen and the Sierra Club, filed an amended petition on November 23, 2011 with the U.S. Court of Appeals for the District of Columbia Circuit to block the program. The suit was initially filed on September 2, 2011 in the U.S. Court of Appeals for the Ninth Circuit by the Teamsters and Public Citizen on the grounds that the program put public safety and U.S. jobs at risk. The Sierra Club joined in amending the suit in November, adding an environmental claim that was not in the initial filing.[70]

Other Trade Issues

Dolphin-Safe Tuna Labeling Dispute

The United States and Mexico are involved in a trade dispute regarding U.S. dolphin-safe labeling provisions and tuna imports from Mexico. U.S. labeling provisions establish conditions under which tuna products may voluntarily be labeled as "dolphin-safe." These products may not be labeled as dolphin-safe if the tuna is caught by intentionally encircling dolphins with nets. According to the Office of the United States Trade Representative (USTR), some Mexican fishing vessels use this method when fishing for tuna. Mexico asserts that U.S. tuna labeling provisions deny Mexican tuna effective access to the U.S. market.[71]

In October 2008, Mexico filed a request for World Trade Organization (WTO) dispute settlement consultations with the United States regarding U.S. provisions on voluntary dolphin-safe labeling on tuna products. The United States requested that Mexico refrain from proceeding in the WTO and that the case be moved to the NAFTA dispute resolution mechanism. According to the USTR, however, Mexico "blocked that process for settling this dispute."[72] In September 2011, a WTO panel that was established in April 2009 circulated its final report to other WTO Members and the public. This report found that the objectives of U.S. voluntary tuna labeling provisions are legitimate and that any adverse effects felt by Mexican tuna producers are the result of choices made by Mexico's own fishing fleet and canners. However, the panel also found U.S. labeling provisions to be "more restrictive than necessary to achieve the objectives of the measures."[73] The Obama Administration is appealing the WTO ruling. Mexico's economy ministry said that it plans to file a counter-appeal.[74]

The government of Mexico wants the United States to broaden its dolphin-safe rules to include Mexico's longstanding tuna fishing technique. It cites statistics showing that modern equipment has greatly reduced dolphin mortality from its height in the 1960s and that its ships carry independent observers who can verify dolphin safety.[75] However, some environmental groups that

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[70] [70] *International Trade Reporter,* "Suit to Block Program that Opens Border to Mexican Trucks Amended in D.C. Circuit," December 1, 2011.

[71] Office of the United States Trade Representative (USTR), "U.S. Appeal in WTO Dolphin-Safe Tuna Labeling Dispute with Mexico," January 23, 2012, available at http://www.ustr.gov.

[72] Ibid.

[73] Ibid. For more information, see the USTR website at http://www.ustr.gov.

[74] Eric Martin, "U.S. Appeals WTO Ruling in Mexico Dolphin-Safe Tuna Dispute, *Bloomberg Businessweek,* January 20, 2012.

[75] Tim Carman, "Tuna, meat labeling disputes highlight WTO control," *The Washington Post,* January 10, 2012.

monitor the tuna industry dispute claims by the Mexican government, stating that even if no dolphins are killed during the chasing and netting, some are wounded and later die. In other cases, they argue, young dolphin calves may not be able to keep pace and are separated from their mothers and later die. These groups contend that if the United States changes its labeling requirements, cans of Mexican tuna could be labeled as "dolphin-safe" when it is not.[76] However, an industry spokesperson representing three major tuna processors in the United States contends that U.S. companies would probably not buy Mexican tuna even if it is labeled as dolphin-safe because these companies "would not be in the market for tuna that is not caught in the dolphin-safe manner."[77]

The tuna labeling dispute began over ten years ago. In April 2000, the Clinton Administration lifted an embargo on Mexican tuna under relaxed standards for a dolphin-safe label. This was 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 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. Environmental groups, however, filed a 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 late October 2008, Mexico initiated World Trade Organization dispute proceedings against the United States, maintaining that U.S. requirements for Mexican tuna exporters prevents them from using the U.S. "dolphin-safe" label for its products.[78]

2006 Sugar Dispute

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

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[76] Ibid.

[77] Ibid.

[78] Daniel Pruzin, "Mexico Initiates WTO Dispute Proceeding Against U.S. 'Dolphin-Safe' Label for Tuna," *International Trade Reporter,* October 30, 2008.

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.[79]

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[79] See "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.