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

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Summary

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. Based on a gross domestic product (GDP) of $840 billion in 2006 (about 6% of U.S. GDP), Mexico has a free market economy with a strong export sector that is very sensitive to changes in the U.S. economy. Mexico's economy is relatively small compared to the U.S. economy. Economic conditions in Mexico are important to the United States because of the close trade and investment interactions, and because of other social and political issues that are affected by economic conditions, such as immigration.

The bilateral economic relationship with Mexico is among the most important for the United States. The most significant feature of the relationship is the North American Free Trade Agreement (NAFTA), which has been in effect since 1994. In bilateral trade, Mexico is the United States' second most important trading partner, while the United States is Mexico's most important trading partner. In U.S. imports, Mexico ranks third among U.S. trading partners, after Canada and China, 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 2006, about 13% 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 12%, while imports from Mexico increased about 17%. For Mexico, the United States is a much more significant trading partner. Almost 85% of Mexico's exports go to the United States and 51% 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 $71.4 billion in 2005. 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. The most significant trade issues that the United States and Mexico are focusing on in 2005 involve the following: access of Mexican trucks to the United States; the access of Mexican sugar, tuna, 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) in which they seek to establish a cooperative approach to advance their common security and prosperity; develop a common security strategy; and promote economic growth, competitiveness, and quality of life. This report will be updated as events warrant.

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

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 second most important trade partner after 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 transformation of Mexico into a manufacturing-for-export nation since the late 1980s and the importance of exports to its economy. Exports represent 30% of Mexico's GDP, up from 10% twenty years ago. Most of these exports are manufactured goods, with 85% of total exports headed to the United States. Mexico's reliance on the United States as a trade partner appears to be diminishing. Between 2004 and 2006, 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 85%. Although Mexican exports to the United States increased 12% in 2006, Mexico's share of the U.S. market has lost ground since 2002. In 2003, China replaced Mexico as the second-highest source of U.S. imports.

Mexico's economy is relatively small compared to the U.S. economy. Mexico's gross domestic product (GDP) in 2006 was $840 billion, about six percent of U.S. GDP (see **Table 1**). The value of Mexico's exports is 32% of GDP and 85% of Mexico's exports are destined for the United States. Thus, any change in U.S. demand can have strong economic consequences in Mexican industrial sectors.

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

	Mexico		United States	
	1996	2006	1996	2006
Population (millions)	94	107*	270	299
Nominal GDP ($US billions)	333	840	7,817	13,247
GDP, PPP** Basis ($US billions)	682	1,162*	7,817	13,247
Per Capita GDP ($US)	3,527	7,820*	28,987	44,244
Per Capita GDP in $PPPs	7,224	10,820*	28,987	44,244
Total Merchandise Exports (US$ billions)	96	250	625	1,037
Exports as % of GDP	32%	32%	11%	11%
Total Merchandise Imports (US$billions)	89	256	795	1855
Imports as % of GDP	30%	33%	12%	164%
Public Debt/GDP	47%	20%*	n.a.	n.a.

Source: Economist Intelligence Unit.

*Estimated amount.

**PPP refers to purchasing power parity, which reflect the purchasing power of foreign currencies in U.S. dollars.

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 million unauthorized immigrants resided in the United States in 2005, with 56% from Mexico.[2] Economic conditions in Mexico such as poverty and unemployment are a principal cause of the migration problem. These workers often send money to their families in Mexico to help provide food and shelter. Worker remittances to Mexico, which reached a record $26 billion in 2006, are an important source of income for the Mexican economy.

U.S.-Mexico Merchandise Trade

In 2006, about 13% 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 12% while imports from Mexico increased about 17%. For Mexico, the United States is a much more significant trading partner. Almost 85% of Mexico's exports go to the United States and 51% of Mexico's imports come from the United States. Mexico's second largest trading partner is Canada, accounting for approximately 2% of Mexico's exports and imports.[3]

U.S. merchandise trade with Mexico has grown considerably over the last ten years (see **Figure 1**). Much of the increase in trade could be attributable to NAFTA, but 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 $62.9 billion deficit in 2006.

U.S. imports from Mexico increased from $73.0 billion in 1996 to $197.1 billion in 2006, while U.S. exports to Mexico increased from $56.8 billion in 1996 to $134.2 billion. 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.

Several studies on the effects of NAFTA found that trade deficits are 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. 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,

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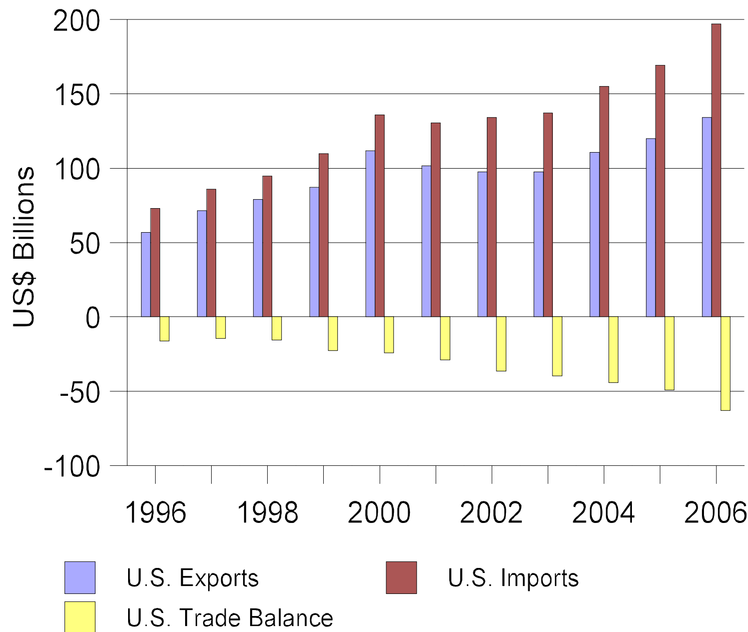
[2] CRS Report RL33874, *Unauthorized Aliens Residing in the United States: Estimates Since 1986*, by Ruth Ellen Wassem.

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

but to structural misalignments in the Mexican economy combined with political events.[4]

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.

Major industry trade between the United States and Mexico from 1996 and 2006 increased considerably (see **Table 2**). 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. The automotive industry accounts for 18% of total trade with Mexico and had the highest dollar increase ($24.2 billion) in trade volume with Mexico from 1996 to 2006. The U.S. trade deficit with Mexico in automotive goods increased from $12.2 billion in 1996 to $30.6 billion in 2006.

The textiles and apparel industries were among the industries more sensitive to the removal of trade barriers. The U.S. trade deficit with Mexico in textiles and apparel increased from $0.8 billion in 1994 to $4.1 billion in 2002, but then decreased to $2.5 billion in 2006 (see **Table 2**). After 2000, U.S. imports from Mexico have decreased steadily, suggesting that imports from Mexico are being replaced by imports from other countries, such as China. U.S. textile and apparel imports from China rose by 42% in 2005 and by 16% in 2006.

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

Table 2. Trade Flows Between the United States and Mexico: 1996-2006

($ Billions)[a]

	1996	1998	2000	2002	2004	2006	$Change 1996-2006[b]
Automotive							
U.S. Exports	$6.5	$10.0	$13.9	$12.8	$12.5	$14.0	$6.0
U.S. Imports	$18.7	$24.2	$35.0	$36.0	$36.9	$44.5	$18.2
Trade Volume[c]	$25.2	$34.3	$48.9	$48.8	$49.4	$58.5	$24.2
Trade Balance	($12.2)	($14.2)	($21.2)	($23.2)	($24.5)	($30.6)	($12.3)
Computer Equipment							
U.S. Exports	$3.9	$3.1	$4.8	$5.7	$8.4	$7.8	$4.5
U.S. Imports	$4.6	$6.1	$10.6	$10.4	$9.7	$8.8	$5.1
Trade Volume[c]	$8.5	$9.2	$15.4	$16.1	$18.1	$16.7	$9.6
Trade Balance	($0.7)	($3.0)	($5.8)	($4.6)	($1.3)	($1.0)	($0.6)
Microelectronics							
U.S. Exports	$6.0	$8.1	$15.6	$10.9	$11.2	$10.8	$5.2
U.S. Imports	$3.2	$3.5	$5.3	$3.6	$3.7	$4.1	$0.5
Trade Volume[c]	$9.2	$11.7	$20.9	$14.5	$14.9	$14.9	$5.7
Trade Balance	$2.8	$4.6	$10.2	$7.4	$7.5	$6.8	$4.7
Chemicals and Allied Products							
U.S. Exports	$4.6	$6.4	$8.3	$8.2	$11.3	$15.3	$6.7
U.S. Imports	$1.4	$1.7	$2.2	$2.6	$3.2	$4.1	$1.8
Trade Volume[c]	$6.0	$8.1	$10.5	$10.7	$14.5	$19.4	$8.5
Trade Balance	$3.2	$4.7	$6.1	$5.6	$8.1	$11.2	$4.9
Textiles and Apparel							
U.S. Exports	$3.0	$4.4	$6.0	$4.9	$4.7	$4.3	$1.7
U.S. Imports	$5.2	$7.8	$10.0	$9.1	$8.2	$6.8	$3.1
Trade Volume[c]	$8.2	$12.2	$16.1	$14.0	$12.9	$11.2	$4.7
Trade Balance	($2.1)	($3.4)	($4.0)	($4.1)	($3.5)	($2.5)	($1.4)
TOTAL							
U.S. Exports	$56.8	$79.0	$111.7	$97.5	$110.8	$134.2	$54.0
U.S. Imports	$73.0	$94.7	$135.9	$134.1	$154.9	$197.1	$81.9
Trade Volume[c]	$129.7	$173.7	$247.6	$231.6	$265.7	$331.2	$136.0
Trade Balance	($16.2)	($15.7)	($24.2)	($36.6)	($44.1)	($62.9)	($27.9)

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

a. Nominal U.S. dollars.
b. Figures may not add up due to rounding.
c. Trade volume denotes exports plus imports.

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 $71.4 billion in 2005, a 320% increase (see **Table 3**). In 1995, the level of U.S. FDI in Mexico decreased somewhat because of the Mexican currency crisis, but after 1996, the FDI inflows continued.

Table 3. U.S.-Mexican Foreign Direct Investment Positions, 1994-2005

Historical Cost Basis
(Millions of Dollars)

	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

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

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 3**.

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 traditionally 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 Maquiladora Industry 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.[5] Other analysts believe that the industry has caused U.S. companies to move their manufacturing facilities to Mexico at the expense of U.S. workers.

Maquiladora Industry Production[6]

Mexico's maquiladora industry is closely linked to U.S.-Mexico trade in various labor-intensive industries such as auto parts and electronic goods. The maquiladora industry is important to the U.S. economy because of the amount of trade it generates with the United States and because the majority of the plants have U.S. parent companies. Maquiladoras account for a substantial share of Mexico's imports and about half of it's exports. A large number of maquiladora operations in Mexico have U.S. parent companies. The largest maquiladora operation, Delphi Automotive Systems, headquartered in the United States, has 51 plants with 66,000 employees

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

[6] Mexico's maquiladora program was established in the 1960s by the Mexican government, allowing 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.

in Mexico.[7] The majority of maquiladora plants are located along the U.S.-Mexico border. The states with the highest maquiladora activity as of October 2006 were the Mexican border states of Baja California, 903 maquiladoras with 254,173 employees, and Chihuahua, 397 maquiladoras with 310,195 employees.[8]

Private industry groups have stated that these operations are important to the United States because they 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, however, argue that they have a negative effect on the economy because it takes away jobs from the United States to other countries.

After NAFTA, Mexico's regulations governing the maquiladora industry changed in a very significant way. Beginning in 2001, the North American rules of origin determine the duty-free status for a given import and replace the previous special tariff provisions that applied only to maquiladora operations. The initial program has ceased to exist and the same trade rules now apply to all assembly operations in Mexico and not just those in the maquiladora program.[9] 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 currently determine duty-free status for maquiladora imports. As long as the source of maquiladora inputs is either the United States or Canada, no duties are assessed. 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. Some companies were concerned about their ability to remain competitive because of the possible increase in cost, and raised these concerns to the Mexican government. In response, the Mexican government passed a decree in December 2000, creating 20 Sectorial Promotion Programs, one for each industrial sector with maquiladora operations. The sectorial programs were formed to help guarantee and enhance the efficiency and competitiveness of manufacturing operations in Mexico, whether or not they exported their goods. The programs allow maquiladora and non-maquiladora companies to apply for reduced tariffs of 0% to 5% for the promotion program in which they are registered.

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[7] Maquila Portal, "100 Top Maquilas," see [http://www.maquilaportal.com].

[8] "Maquila Scoreboard," *Twin Plant News,* see [http://www.twinplantnews.com].

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

Prior to 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. Part of the reason for this is that sales into Mexico would require the assessment of duties on imported components because duty-free status on imported components is allowed only as long as 100% of the production is exported. Selling directly to the Mexican market would entail additional costs such as applicable tariffs and administrative costs. For this reason, companies wishing to sell to the Mexican market usually export their product to the United States, and then re-export it back to Mexico.

The maquiladora industry expanded rapidly in the 1990s. The number of plants grew from 1,789 at the end of 1990 to 3,655 in 2000.[10] After 2000, the number of maquiladoras fell to 2,860 in 2003. In 2004 and 2005, the number of plants stayed at approximately the same levels. Some observers believe that the correlation in maquiladora growth after 1993 is directly due to NAFTA, but in reality it is unclear whether maquiladora growth is more related to trade liberalization, or to economic conditions in the United States.

Although some provisions in NAFTA may have encouraged maquiladora growth in certain sectors, maquiladora activity is also 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 Asian countries. In 2001, maquiladora employment levels fell for the first time since 1982. Between 2000 and 2003, maquiladora employment levels fell from 1.29 million workers to 1.07 million workers. Approximately 220,000 jobs were lost and 855 plants were shut down nationwide during this time. In 2004, the employment level rose to 1.14 million workers and is expected to reach 1.19 million workers by the end of 2005.[11] The change in the number of plants and jobs could be partially a result of the relative labor costs in Mexico, but as previously mentioned, it is also tied to the slowdown and recovery in the U.S. economy.

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[10] Gruben, William C. and Sherry L. Kiser, *NAFTA and Maquiladoras,* Federal Reserve Bank of Dallas, June 2001.

[11] Maquila Portal, *Maquila Overview,* see [http://www.maquilaportal.com].

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.[12] According to a publication by the Federal Bank of Dallas, Mexico received the most remittances of any country in the world in 2002, accounting for about 15% of all remittances received by developing countries.[13] Workers in the United States are the leading source for worker's remittances worldwide. In 2004, Mexico received a record $16.6 billion in remittances, representing a 24% increase over 2003.[14] Remittances reached a peak of $6.2 billion in mid-2006 and have been decreasing since. In the first quarter of 2007, remittances to Mexico dropped 3.4%. Worker remittances account for about 2% of Mexico's GDP and are a major source of foreign earnings.

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.[15] 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.[16] Remittances from migrant workers overseas, mainly in the United States, are expected to remain steady and support moderate growth of private consumption.[17]

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. Although the SPP builds upon the existing trade and economic relationship of the three countries, it is not a trade agreement and is

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

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

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

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

[16] Ibid, p. 4.

[17] EIU, *Country Outlook: Mexico*, January 2005.

separate from NAFTA.[18] The SPP is a government initiative that was endorsed by the leaders of the three countries, but it is not a signed document or treaty. It can be characterized as an endeavor by the three countries to facilitate communication and cooperation, and has no legally binding commitments.

On March 23, 2005, President Bush met with Prime Minister Martin of Canada and President Fox of Mexico in Waco, Texas to discuss a number of issues including trade and economic collaboration. A major outcome of the summit was the announcement of the SPP. The government fact sheet on the SPP states that the SPP "energizes other aspects of our cooperative relations, such as the protection of our environment, our food supply, and our public health."[19] The initial plan for the SPP was to establish a number of security and prosperity working groups in those two separate categories. The security working groups would be chaired by the Secretary of the Department of Homeland Security, and the prosperity working groups would be chaired by the Secretary of the Department of Commerce.

In the area of "prosperity," goals of the SPP are to increase cooperation and information sharing to improve productivity, reduce the costs of trade, and enhance the quality of life. The three countries agreed to establish a series of working groups to "consult with stakeholders; set specific, measurable, and achievable goals and implementation dates; and identify concrete steps the governments can take to achieve these goals." The Prosperity working grous were established to cover the following range of issue areas: (1) Manufactured Goods and Sectoral and Regional Competitiveness, (2) Movement of Goods, (3) Energy, (4) Environment, (5) E-Commerce & Information Communications Technologies, (6) Financial Services, (7) Business Facilitation, (8) Food and Agriculture, (9) Transportation, and (10) Health.[20]

To reduce the costs of trade, the leaders pledged to promote more efficient movement of goods and people in the region by developing standardized rules for screening people and cargo in North America, regardless of which country is the first point of entry. Other possible measures would consist of rationalizing differences in external tariffs consistent with multilateral negotiation strategies; facilitating the movement of business persons within North America; and discussing ways to reduce taxes and other charges residents face when returning from other North American countries.[21]

In June 2005, the SPP working groups offered their initial proposals to the North American leaders. In their report, the working groups announced the completion of several collaborative initiatives and proposed a number of other initiatives to improve certain sectors of the economy and develop higher standards of safety and health and joint stewardship of the environment. The completed initiatives related to trade and

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[18] Any changes to NAFTA would require congressional approval.

[19] See Security and Prosperity Partnership of North America (SPP) website [http://www.spp.gov/].

[20] SPP.GOV: A North American Partnership, "Prosperity Working Groups: Security and Prosperity Partnership of North America," [http://www.spp.gov].

[21] Ibid.

commerce include a signed Framework of Common Principles for Electronic Commerce; liberalization of Rules of Origin; a Memorandum of Understanding between Canada and the United States to exchange of information and cooperate on activities on consumer product safety and health; harmonization of the use of care symbols on textiles and apparel labeling requirements; and a trilateral document to clarify each country's domestic procedures for temporary work entry of professionals that will serve as a mechanism for more temporary work permits under NAFTA.[22]

In March 2006, the three countries agreed to advance the agenda of the SPP by focusing on five high priority initiatives: (1) increasing private sector engagement in the SPP through the North American Competitiveness Council, (2) advancing cooperation on avian and pandemic influenza management, (3) ensuring a secure and sustainable energy supply through the North American Energy Security Initiative, (4) developing a common approach to emergency management in all three countries, and (5) contributing to smart and secure borders by increasing collaboration on standards and processes.

Some analysts note 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 and the war with Iraq.[23] However, other analysts believe that the SPP and any subsequent trade-facilitating measures may fall short of any grander vision of further economic integration. They believe that the political and economic situations among the three neighbors would not facilitate bold steps toward further integration.[24]

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 such as immigration.

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[22] Security and Prosperity Partnership of North America (SPP), *Report to Leaders,* June 2005.

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

[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.

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, railroad, 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 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.[25] 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.[26] 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.[27]

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

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

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

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

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.[28]

Following the lead of former President Ernesto Zedillo, 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 been 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 in the Mexican economy to an export-based economy helped to soften the impact of the currency devaluation. While Mexico's economy as a whole has since recovered, the country has experienced little economic expansion on a per capita basis. Real wages and per capita GDP fell considerably after the crisis and only began to recover to their old level in 2004.[29]

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% in 2004, up from 1.41% in 2003 and 0.81% in 2002 (see **Figure 2**). In 2005, GDP growth was 2.8% and increased to 4.8% in 2006.

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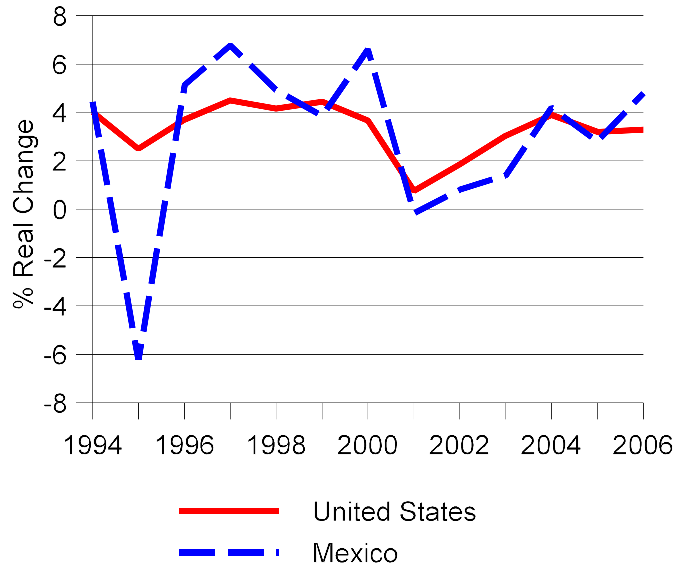
[28] Joachim Zietz, "Why Did the Peso Collapse? Implications for American Trade," *Global Commerce*, by , Volume 1, No. 1, Summer 1995.

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

Figure 2. GDP Growth



Source: Economist Intelligence Unit.

Current Economic Conditions

The major factors contributing to Mexican economic growth since 2004 were 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**.

The Mexican peso weakened by an estimated 5% in 2004, following a real depreciation of around 13% in 2003. Forecasts show that the peso may continue to depreciate further against the US dollar. However, Mexico's strong reserves, higher interest rates than in the United States, firm oil prices, steady inflows of foreign direct investment and access to foreign financing will likely help the value of the peso from declining further.[30]

Poverty is one of the more serious and pressing economic problems facing Mexico. Former President Fox made public statements saying that the principal challenge and 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.[31]

[30] Ibid.

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

According to a World Bank Study,[32] the Mexican government has made progress in its poverty reduction efforts, but poverty continues to be a basic challenge for the country's development. In 2002, over half of the population lived in poverty. 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. Those living in moderate poverty, or on about $10 a day, fell from 53.7% to 51.7% of the population. 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.[33]

The Mexican government program *Oportunidades,* which provides financial assistance for the extremely poor, has been noted by the World Bank and other studies as a reason for the recent reduction in poverty levels. Other factors that may have helped with the recent decline in poverty include a growing amount of remittances from workers abroad, economic growth, and social programs for housing and assistance for small and medium businesses. Poverty continues to remain a problem, however. It is especially widespread in rural areas and remains at the Latin American average and pre-crisis levels.[34]

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 been actively pursuing 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. Beginning in 1995, Mexico had entered into a total of 11 FTAs involving 42 countries by early 2006. 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, Venezuela, Guatemala, El Salvador, and Honduras.

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

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

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

[34] Ibid.

Japan.[35] In 2004, Japan and Mexico signed an Economic Partnership Agreement. It was the first comprehensive trade agreement that Japan signed with any country.[36]

In addition to the bilateral and multilateral free trade agreements, Mexico is a member of the WTO,[37] the Asia-Pacific Economic Cooperation forum, and the OECD.[38] Mexico is an active and constructive participant in the WTO. In September 2003, Mexico hosted the WTO Ministerial Meeting in Cancun.

NAFTA and the U.S.-Mexico Economic Relationship

The North American Free Trade Agreement (NAFTA) has been in effect since January 1994. After 12 years of implementation, the full effects of NAFTA on the U.S. and Mexican economies are still unfolding. 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 understand, 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.

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

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

[37] 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].

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

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 notable 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. By 2004, the percentage of oil exports had declined to 10.6% of all exports to the United States.

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. The automotive industry has had the highest dollar increase ($31.6 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.[39]

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.[40] 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

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.[41] 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.[42]

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

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

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

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

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

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.[43]

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 telephone service and a higher skilled labor force experienced more positive impacts.[44]

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.[45] 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.[46]

Major Issues in U.S.-Mexico Trade Relations

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. In May 2007, Mexico's Ambassador to the United States, Arturo Sarukhan, stated that U.S. objections to Mexican trucks, tuna, and avocados will make it harder

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[43] Ibid.

[44] Ibid.

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

[46] Ibid.

for President Calderón to justify full implementation of NAFTA on January 1, 2008. President Calderón is under pressure to resist fully opening Mexico's agricultural market, particularly in corn and beans.

Another 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 has stalled 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.[47]

Since the ruling, the U.S. and Mexican Administrations worked on resolving the trucking issues, and the two countries are engaged in talks regarding a number of safety 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. The Iraq War Supplemental (P.L. 110-28), enacted May 25, 2007, mandates that any pilot program to give Mexican trucks access beyond the border region cannot begin until U.S. trucks have similar access to Mexico. Before a pilot project can begin, the Department of Transportation (DOT) must meet certain reporting and public notice requirements. The DOT's Inspector General must prepare a report to Congress to verify that the DOT has established mechanisms to ensure that Mexican trucks comply with U.S. federal motor carrier safety laws. The report must also verify that Mexican trucks meet the safety provisions of P.L. 107-87, mentioned above. The DOT must also publish a *Federal Register* notice and allow for public comment on pre-audit inspection data and plans to protect the health and safety of Americans.

The United States and Mexico recently resolved a long-standing trade dispute 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

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[47] 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.

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.[48]

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 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.

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[48] "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 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 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 recent 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 cow 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."[49]

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

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 yet been a solution to the problem of poverty and unemployment. Mexico's problem with poverty cannot be attributed directly to NAFTA because it was already 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 to consider 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 that, among other things, Mexico needs to invest more in education, infrastructure, and institutional strengthening to benefit more fully from freer trade.[50] 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 economic sectors and regions of Mexico has been a major reason behind unauthorized Mexican migration to the United States. 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. Mexico holds 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. The Comprehensive Immigration Reform Act of 2007 (S. 1348) would improve border security, establish a temporary worker program, and normalize the status of most illegal immigrants in the United States. Mexico has long lobbied for such reforms and is cautiously watching debate on this measure. Immigration reform

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

legislation was introduced in the House of Representatives in March 2007, but debate has not been scheduled. The House measure, the Security Through Regularized Immigration and Vibrant Economy Act of 2007 (H.R. 1645), sets border and document security benchmarks that must be met before normalizing the status of illegal immigrant or the creation of a guest worker program.[51]

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[51] For more details, see CRS Report RL32724, *Mexico-U.S. Relations: Issues for Congress*, by Colleen W. Cook.