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**The Future of Mexican-U.S. Economic Relations:
Is the EU a Model for North America?**

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**The Future of Mexican-U.S. Economic Relations:
Is the EU a Model for North America?**

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The Future of Mexican-U.S. Economic Relations: Is the EU a Model for North America?

Introduction

In the last few years some analysts and observers of North American integration in Mexico but also in the United States, have been proposing the need for a deepening of North American trade and investment liberalization toward higher levels of integration covering social and immigration policies. In these proposals normally one finds references to the European Union (EU) as a model of integration that North America should follow.¹

In this paper I will address two questions. First, to what extent is the EU a useful model for the near future integration efforts in the North American region. Second, what is the likely future evolution of North American integration? In order to answer these two questions, first, I will compare the experiences of the North American Free Trade Agreement (NAFTA) and the EU and will try to demonstrate that although NAFTA and the EU share important commonalities in terms of extent and depth of integration, they are also very different in terms of origins, goals, scope, degree of institutionalization and centralization and because of this, one important lesson one can draw from the EU experience is that higher convergence in the social field is not likely at least in the short term in North America. However, in the second part of the paper, I will argue that September 11th opens in my opinion a possibility to advance the process of integration in the trade and migration fronts. In order for this to happen a Schengen type of agreement would have to be negotiated between Mexico and the United States.

Economic and Political Models which account for Processes of Integration

Economists as well as political scientists have formulated models useful to understand processes of integration. These models normally entail categories that try to account for the nature and extent of integration, both economic, social and political. For instance, in economics there is a model which is normally used to account for regional processes of integration which departs from the assumption that integration can be explained on the basis of a continuum which starts from a basic "negative" form of integration, (which entails the removal of discrimination and of restrictions on the free movement of goods and factors of production between countries), and a more advanced "positive" form, which requires the development of common institutions and policies to enable the integrated market to function effectively and to promote collective political and economic objectives.² Bela Balassa's classic model, for instance, formulates economic integration

¹ A clear example of this approach is found in Robert Pastor's book *Toward a North American Community?* (Washington, D.C.: Institute for International Economics, 2000).

² Peter Robson, *The Economics of International Integration*. (London: Allen and Unwin, 1987), 1.

as a process in which three cumulative stages of negative or market integration (free trade area, customs union, and common market) are superseded by two stages of positive or policy integration (economic union and total economic integration).³ In principle, each stage incorporates all features of the preceding one, plus a new element.

From this perspective, we can situate integration arrangements like the Asian-Pacific Economic Cooperation forum (APEC), or the former European Free Trade Area (EFTA) and go through arrangements like NAFTA, the Southern cone Common Market (MERCOSUR), and reach the EU which from this perspective, is the most advanced example of deep positive integration.

Political scientists, like Peter Smith from the University of San Diego, have also proposed models, aimed at comparing integration arrangements according to dimensions of *scope*, *depth*, *institutionalization*, and *centralization*.⁴ The advantages of these categories are that they account not only for the extent of economic integration but also for the level of political, social and legal integration among countries.

What one realizes when applying these categories is that among all integration arrangements existing at the present time throughout the world, the EU is the most ambitious and complete undertaking. The EU covers a broader range of economic, political and social issues, involves deeper policy coordination, is more institutionalized and has resulted in more centralized decision-making. But where in this continuum can we place North American integration? In order to answer this question, we will use Smith's categories of depth, scope, institutionalization and centralization.

The European Union and NAFTA compared

When one reviews the process of integration that is taking place in North America using the variable of scope, one has to recognize that the three countries of North America do enjoy a relationship nearly as wide as those of the EU countries. The NAFTA is clearly a result of a long-term trend towards integration of trade and investment in the North American economy. More than 80 percent of Mexican and Canadian trade is with the United States and between 33 and 35 of United States trade is with Canada and Mexico. Canada is the largest trading partner of the United States while Mexico in 2004 was the third largest. There are also substantial U.S. Mexican and U.S. Canadian foreign investment flows. Labor market integration between the Mexican and the US economies is also very high. Mexican migrant labor has had a large impact on the US economy by increasing the labor supply an effect probably greater than that arising from increased

³ Bela Balassa, *The Theory of Economic Integration* (London: Allen and Unwin, 1962).

⁴ Peter Smith, "The Politics of Integration: Concepts and Themes" in *The Challenge of Integration. Europe and the Americas* ed. Peter H. Smith (New Brunswick and London: Transaction Publishers 1993), 5 and ff. *Scope* is defined as the range of issues and transactions falling under the purview of the integration scheme; *Depth* as the extent of policy coordination or harmonization; *Institutionalization* as the degree to which accommodation and decision making take place in organized and predictable ways; and *centralization* the extent to which there exists a central supranational decision-making apparatus to establish common policy.

U.S.- Mexican commodity trade, direct foreign investment, or financial transactions. At least 10 percent of the growth of the U.S. labor supply since world war two is due to Mexican migrants. Besides all of the above, NAFTA itself as a free trade agreement is without doubt the most profound economic integration arrangement short of a common market.⁵ But here is where similarities end between NAFTA and the EU. Despite the obvious affinities, the EU as a model provide for deeper integration than does NAFTA.

The same explanatory variable of *scope* is extremely useful in highlighting the differences between the two arrangements. To begin with, the EU has had uniform custom policy since January 1, 1993. In fact, most if not all of the EU nations have already eliminated customs checkpoints along their borders. This, however, is not the case in North America where each country in NAFTA retains its own regulations and have not contemplated a common custom policy. Next, the treaties governing the EU provide for the free movement of persons among member nations. Students and laborers are particularly attended to, with European youth eligible for up to a year of education at another country's national university and uniform labor protection laws covering the entire continent. In this dimension NAFTA is also much less ambitious since migration provisions only apply to professionals, business persons and investors all of whom have the right to transfer temporarily for work in member states. The Maastricht Treaty also covers trade policy (the Council of Ministers makes decisions applied to all members) , consumer protection, and defense none of which are addressed in the NAFTA agreement.

Institutionalization as criteria for comparison points to further striking differences. The EU has implemented coordinated policies regarding: a) trade agreements with non-member nations (trade agreements are agreed to by the Union, not individual countries), b) macroeconomic policy (member states may not permit run-away inflation nor unilaterally devalue their currencies), c) social security, d) tax legislation, e) health programs, f) competition and quality issues, and consumer protection. NAFTA countries are free to pursue their own policies on all these issues. Furthermore, the EU has established a common currency, an instrument which is not likely in the future in North America though it is only used for large inter-member transfers and each country continues to maintain its own legal tender.

Considering the fact that both arrangements exist in the form of a diplomatic treaty, it may be unfair to say that one is more institutionalized than the other. Nonetheless, the EU allows decision making to take place in more organized and predictable ways than NAFTA does. For this reason, I would contend that NAFTA is not as formal an organization as the EU. This fact, notwithstanding, the very legal nature of both organizations provides for institutionalization far more thorough than APEC, the Andean Pact, with the exception of MERCOSUR.

The argument for *centralization* is not as ambiguous. The EU clearly has a much more advanced central decision-making process: The European Commission draws up proposals that are binding on all members. No such body exists under the terms of

⁵ Gary Hufbauer and Jeffrey Schott, *NAFTA an Assessment* (Washington, D.C.: Institute for International Economics 1994), 1.

NAFTA. In fact, changes to the treaty are negotiated on an ad-hoc basis. Dispute resolution does go to a central trade commission, but its decisions are not binding (though one country may retaliate against another that continues with policies that have been deemed unfair by a binational panel). The North American Free Trade Area also lacks institutions correlate to the European Council, Court of Justice or Court of Auditors. Another aspect of EU policymaking glaringly missing from NAFTA is the existence of a democratically-elected body to assist in its administration.

Despite the similarities, it is clear, then, that the EU and NAFTA are two very different arrangements. Even when one steps away from Smith's explanatory variables the differences are clear. In NAFTA one country (the United States) is able to overpower the other two through pure economic might and a disparately large population. Such is not the case in Europe, where the largest country (Germany) contains less than a quarter of the group's people and earns less than 35 percent of its gross product. Further, the wage and GNP per capita disparities among EU nations (which measure about 3:1, Germany: Spain) are much smaller than those in NAFTA (where a 10:1 disparity exists between the United States and Mexico).

The question then arises, why are the two arrangements so different? After all, both are integration schemes that involve western countries with a long tradition of market-based economic policy. One obvious explanation is that the EU is simply much older than NAFTA. Although founded in 1957, the EC did not even reach the point of free trade until 1968. If this is taken as a guide, it might be assumed that in thirty years the North American Continent will be as integrated as the European.

This explanation only goes so far, however. The two treaties rose out of very different historical environments. It is perhaps foolish to assume a post-Cold War economic pact will develop in the same way one did that was founded during the Marshall Plan era. The differing surrounding elements do offer a compelling explanation, however. The needs of the European countries in the 1950's were markedly different from those of North America in the 1990s. Perhaps the most pressing reason for unification in the 1950s was the need to strengthen Western Europe to such an extent that it could resist a Soviet-led invasion. Clearly, North America faces no such threat today. Further, factories in post-World War II Europe needed to find economies of scale if they were to successfully rebuild. The productive plants of Canada, Mexico and the Unites States have not faced similar destruction since the Mexican Revolution in the 1920s.

NAFTA was implemented for a unique set of reasons. To begin, with, Mexico was saddled with such high debt payments that it had no choice than to seek outside capital if it were to develop. It, therefore, sought a trade and investment agreement with the most powerful economy in the world. From a northern perspective, The United States wanted to help stabilize Mexico's economy in order to prevent the negative shocks that would transfer to the States of Texas and California if their southern neighbor were to continue experiencing economic and political difficulty. Canada simply wished to prevent the United States both from granting better trade and financial treatment to Mexico and from positioning itself as the only viable conduit to trade in the Americas.

This being the case, it is perhaps inappropriate to expect the EU and NAFTA to be overly similar. They grew out of different eras with different needs and for different reasons. In fact, in direct contravention of NAFTA, the EU has always been considered a political union first and an economic union second. The two treaties were never meant to be considered equal.

Spill over in North America?

There is a long standing debate in the literature about the political and economic impacts of economic integration in the countries involved. The question is whether once the process of integration is initiated at the lower level, there is a tendency to move more or less automatically from one stage to the next. Political theories of integration have often asserted such logic, while pure economic theory remains more skeptical.⁶ Taking the EU example one could argue that indeed there is an inexorable logic to economic integration, even though the reactions of the Danish, French and English electorates to deeper stages of integration clearly prove that the progress beyond the customs union is unlikely to be smooth.

However, if one takes other examples like the free trade agreements forged on an individual basis between what at that time was the EC and members of the European Free Trade Association (EFTA) (Iceland, Norway, Sweden, Finland, Austria and Switzerland) one could reasonably argue that free trade areas can achieve stable equilibrium at levels that do not entail significant elements of supranationality, that is, that economic integration can be managed and contained at an early stage at least for a long time as the case of EFTA countries show.⁷

In principle, it is clear that NAFTA countries have intentionally chosen the EFTA rather than the EU route, but what is the likelihood of the NAFTA following, albeit over some time the EU path of positive deepening integration? In my opinion, this will not happen for the near future. No country in North America would accept the erosion of sovereignty involved in the EU model.

In clear contrast to the EU whose members have been willing to surrender their sovereignty in order to achieve common purposes, Mexico, Canada and the United States have guarded their sovereignty with great zeal. Mexico is extremely sensitive over key economic areas such as petroleum and over its autonomy in foreign affairs. Canada's

⁶ Robson, 59-61.

⁷ Victoria Curzon Price has aptly demonstrated that the free trade technique very successfully managed the relationship between the EC and the EFTA countries where these latter group of countries "had no stomach for the highly intensive form of economic integration on which the EC was prepared to embark" and wanted "to keep a free hand not only in trade policy but in ...industrial policy." See her *Free Trade Areas, The European experience. What Lessons for Canadian-US Trade Liberalization*. Observation no. 31 (Toronto: C.D. Howe Institute, 1987). Of course, the recent adhesion of most of EFTA countries to the EU would seem to support the idea for the inexorable logic of economic integration. However, the fact that it took such a long time would support the notion that free trade areas can be contained at least for a good number of years.

views are shaped by some of the same forces: cultural industries and water resources are to Ottawa what oil is to Mexico, while its sensitivity to autonomy in at least foreign economic policy is equally strong.⁸ For instance, both Mexico and Canada have expressed opposition to an integration arrangement in the form of a customs union or a common market in the North American context because a customs union or a common market require that a uniform set of trade and commercial policies be applied to all non-members. Mexico and Canada have given clear signs that they do not wish to follow U.S. initiatives on trade with the outside world. Both countries have maintained trade relations with Cuba after the United States ceased to do so.⁹ In other words, Canadian and Mexican strategic elites believe that if they are to preserve their autonomy in foreign economic policy, they cannot accept a common market's legal restriction on its capacity for independent action.¹⁰

In the case of the United States, it is clear too that U.S. leaders are as unwilling to share or surrender sovereignty as its North American counterparts are. As an author has said: "The first impulse of great powers when faced with threats to the effectiveness of national policy is often to try to reinforce unilateral control by asserting extraterritorial jurisdiction, as the United States has sought to do."¹¹ There are many examples of this U.S. impulse like the October 1992 "Cuban Democracy Act" i.e.: the Torricelly Law in the trade field, or the Helms Burton Law.

A second important factor that will prevent NAFTA from following the pattern of Europe in the social field soon is the wide income disparities prevalent among the three NAFTA countries. These large income disparities would make the process of deepening integration very difficult and augment adjustment problems. As Hufbauer and Schott have pointed out, the European Community (EC) spanned a wide divide when it incorporated Spain and Portugal, countries whose per capita GNP levels at the time of accession (January 1986) were \$4860 and \$2,250, or 40 percent and 19 percent, respectively, of West German per capita GNP. By comparison, Mexico's per capita GNP was in 2004 only 12 percent that of the United States and Canada combined.¹² Moreover, there were fewer people to accommodate at the lower income levels in the EC case, thus limiting the adjustment burden and simplifying the task of paying for adjustment assistance.

⁸ The contrast between the United States and Canada is, of course, narrowed considerably by a shared Anglo-Saxon origin, similar economic level of development, a federal political structure, North Atlantic Treaty Organization (NATO) membership, and an alliance during two world wars.

⁹ Let us remember that in the past Mexico also maintained trade and economic relations with Nicaragua during the Sandinista regime despite strong opposition from the United States.

¹⁰ Mexico, for instance, has continued in the last few years to pursue trade initiatives with other regions. It has signed free trade agreements with 42 countries in Latin America, Europe, Asia and the Middle East. Canada also has shown a strong interest in increasing its trade ties with other countries in Latin America and Europe.

¹¹ Robert Keohane, *Sovereignty, Interdependence and International Institutions (Working Paper No. 1, Working Paper Series, Cambridge, Mass.: Centre for International Studies, 1991).*

¹² Gary Hufbauer and Jeffrey Schott, *North American Free Trade. Issues and Recommendations.* (Washington, D.C. Institute for International Economics 1992), 7-8.

In consequence, if these important factors seem to preclude that NAFTA may in the near future follow the European pattern in terms of social integration, what is the likely future evolution of it? ¹³ In order to answer this question, I think it is important to present a picture of what impact NAFTA has had for Mexico since it entered into force in January, 1994. Is it achieving the purposes for which it was negotiated? Can the European experience offer any lessons to improve the integration process in North America? In the next section, I offer answers to these questions.

Structural change in Mexico since the 1980s

One way to appreciate the impact of NAFTA on the Mexican economy is by showing the strong process of structural change that the Mexican economy has experienced since the opening of the economy and especially since NAFTA went into effect. The following table shows the performance of the economy during successive periods, from the administration of President Miguel de la Madrid, who initiated the opening of the economy (1983-88). This was followed by President Salinas (1989-94), the crisis of 1995, and the successful stabilization and growth during the period of President Ernesto Zedillo (1995-2000).

¹³ The difficulties present in North America to follow the EU route should not preclude the possibility that North American integration may take an unprecedented form in which elements of policy integration were instituted before lower levels of integration were complete. In fact, as we will argue in the following section, September 11th opened the door for this to happen in the migration field.

Table I**Economic Performance by Periods 1983-2001**

(\$ million)

	1983-88	1989-94	1995	1996-2000	2001
GDP (annual growth %)	1.1	3.9	-6.2	5.5	-0.3
GDP in manufacturing (annual growth %)	2.3	3.5	-4.8	6.4	-3.9
Manufacturing employment (annual growth %)	0.9	-1.2	-8.9	2.5	-4.3
Trade balance (\$bn annual ave)	7.0	-12.2	7.1	-2.9	-9.9
Exports (annual growth %)	16.7	12.2	30.6	16.0	-4.8
Imports (annual growth %)	12.0	19.1	-8.7	19.3	-3.5
Manufactured exports (\$bn annual ave)	7.3	33.3	66.6	109.7	141.3
Current account balance (\$bn annual ave)	1.8	-10.7	-1.6	-11.6	-17.4
Foreign direct investment (\$bn annual ave)	2.3	4.6	9.5	11.8	27.7
US GDP (annual growth %)	4.4	2.4	2.7	4.1	1.2
Foreign debt, end of period (\$bn)	101.8	153.6	176.5	173.7	172.2

Source: INEGI, US Department of Commerce, and Ecanal

Macroeconomic overview

The changes in the economy from before the NAFTA to after can be easily seen. Although Mexico suffered a devaluation and financial crisis in 1995, only one year after the NAFTA went into effect, this crisis was not caused by free trade. The high current account deficit, which reached \$29.7 billion in 1994, or 6.8 percent of GDP, was caused by heavy overvaluation of the peso exchange rate, as the currency had been used since 1989 as an anchor to bring inflation down. The NAFTA undoubtedly accelerated trade growth in 1994 and thus indirectly helped to precipitate the balance-of-payments crisis. But such a crisis would have occurred in any event, as the economy had accumulated considerable distortions from the overvalued peso.

Free trade was, however, key for Mexico to recover quickly after 1995, as the table shows. With high import growth in 1994 having caused the external deficit to rise from -\$23.4 billion to -\$29.7 billion, when the peso adjusted down the deficit fell dramatically. There was unprecedented growth in exports, from \$51.9 billion in 1993 to \$166.4 billion in 2000, which helped overcome this crisis within a short period. The current account deficit fell to -\$1.6 billion in 1995 and rose only to -\$2.3 billion in 1996.

Thus, for the first time in more than 30 years Mexico saw a reduction in the external current account deficit even in the presence of high import growth, which was on

average 19.3 percent per year from 1996 to 2000. The current account deficit was only -\$11.6 billion on average and never exceeded -\$18 billion, including in 2001, when exports to the United States fell -5 percent. The low current account deficit meant that the economy could grow faster than before without suffering balance-of-payments crises, as had been the case from the 1970s through 1994.

Exports of goods and services jumped from 19.4 percent of GDP in 1985 to 32.8 percent in 2000. Employment in manufacturing, not having grown for 15 years, grew 2.5 percent per year, only interrupted in 2001 by the U.S. recession. Another significant change was that as Mexico became more integrated with North America, in 2001 its economy adjusted downwards following the U.S. recession, avoiding an expansion of domestic demand when exports were flat.

Since 1995, Mexico has had a floating exchange rate, which became validated as the appropriate regime, for it allowed Mexico to adjust smoothly to external shocks from the Asian and Russian crises of 1997-98. The floating exchange rate has been responsible for much of the success of Mexican exports and for the control of the trade deficit within manageable limits.

Privatization was another important change in the macro economy, for Mexico had a very large and inefficient state-owned sector engaged in steel, fertilizers, hotels, banks, insurance, telephones, and many stakes in manufacturing industry. From all of these industries, the state withdrew. Privatization was a sound policy, as it reduced the size of the state and budgetary transfers. But clearly one problem was that many privatizations during the term of Salinas lacked transparency and ended up in bankruptcies after the peso devaluation in 1995.

New privatization projects are now focused on electricity, gas, and a new regime for toll roads. President Vicente Fox, however, with the bad experience of the 1990s and especially because of the high cost of rescuing the banks that had been privatized, must assure the Congress and public opinion that they will not repeat past mistakes and vices before obtaining broad support for privatizations.

Foreign direct investment

Table I above shows that FDI has jumped after the NAFTA, which has led to major changes in ownership across sectors, transforming Mexican companies into more efficiently run firms and changing the way in which management operates. FDI was an average of \$4.6 billion per year during 1989-94, almost trebled to \$11.8 billion during 1996-2000, and reached a peak of \$27.7 billion in 2001.

Apart from the greater flows of capital and technology, FDI has led to qualitative improvements in corporate governance, an area until recently ignored by Mexican

regulators. That is, for the first time regulations were issued in 2001 establishing rules for the conduct of boards of directors and for the protection of minority rights.¹⁴

The NAFTA has been instrumental in making Mexico more attractive and secure for foreign investors, especially because they know that the free trade regime is permanent, therefore removing a possible cause for uncertainty. It also amplified the size of the potential market to investors operating in any of the three countries.

The NAFTA contained a precept guaranteeing national treatment status to any investor from the region investing in any of the three countries. Moreover, in practice it helped create a climate more propitious to relaxing restrictions, as foreign investment was more notorious across economic activities and the public gradually saw in this an opportunity for more jobs and higher incomes. In 1995, the first foreign banks were permitted to increase their equity shares in Mexican banks to acquire control, and gas distribution was open to private investors. Later on most of the banks were acquired by foreign investors.

The positive effects of FDI have become clear across sectors of activity. Modernization of management and work standards has been visible in all banks acquired by foreigners. The contribution of foreign partners to modernize management of family-owned businesses has also been substantial. In many of the largest public firms, professional managers are now more prominent than they were in the early 1990s, while boards of directors are much more active. Investors, for their part, demand greater information on the companies' operations.

Under NAFTA foreign capital flows to Mexico have revitalized older sectors and created new ones. Foreign investment has contributed to the establishment of state-of-the-art plants that are internationally competitive. Three industrial sectors that stand out -- automobiles, electronics and textiles, which represent core sectors from traditional, heavy and high technology industries -- have become more dynamic and competitive since the agreement became effective in 1994.

Other sectors that have not enjoyed the same kind of capital inflows have not enjoyed the same kind of success. For example, Mexico's agriculture sector has shown mixed results under NAFTA. A dynamic export-oriented agribusiness sector coexists with a traditional self-subsistence agriculture sector. The uneven performance of agriculture reveals what NAFTA really is -- an agreement to reduce tariff barriers and promote trade and investment flows -- and the limits to what it can deliver. NAFTA is only an instrument that creates opportunities for growth in certain economic sectors, not a solution for transforming the entire economy.

Labor markets

The NAFTA caused an increase in industrial and services employment, offsetting losses of jobs in farming. In those sectors where employment has increased, output has

¹⁴ "Ley del Mercado de Valores," *Diario Oficial de la Federación*, June 1, 2001.

increased at a faster rate, so that productivity is considerably higher than it was before the NAFTA. This explains that there has been a steady increase in real wages, which continue to catch up with higher levels of wages in North America.

Nevertheless, wages have increased from very low levels after major macro crises wiped out almost one half of their purchasing power in the early 1980s. In the more recent period of 1998 to 2001, wages have shown a steady upward trend despite fluctuations in output and employment.¹⁵

Labor productivity in the manufacturing industry, measured crudely as the ratio of output to employment, grew 38 percent during the 1980s up until 1990, that is, by 3.3 percent per year. From 1990 to 1993, this growth accelerated to 6.4 percent and from that year to 2001 it slowed down to 4.8 percent.¹⁶

The NAFTA has been a major catalyst of the increase in productivity, which has been highly correlated with exports.¹⁷ (But even with such growth in productivity, labor markets in Mexico are still much less flexible than in North America. Workers continue to enjoy heavy protection against shedding or relocation; collective labor contracts contain a myriad of uneconomic conditions for companies; and measures to reduce employment are in practice extremely difficult to implement. In 2001, the combination of the U.S. recession and a strong peso exchange rate led some multinational firms in manufacturing to close down operations for the first time in many years, blaming high labor costs.¹⁸ In fact, this is one cause for the fall in manufacturing employment of -3.9 last year.

Sectoral developments of NAFTA

Table II shows the dramatic increase in exports from Mexico, from \$41 billion in 1990 to \$51.9 billion in 1993 (8.1 percent per year) and \$166.4 billion in 2000 (15 percent per year from 1990 and 18.1 percent from 1993). On this measure, the post-NAFTA period recorded most of the growth in exports.

¹⁵ Instituto Nacional de Estadística Geografía e Informática (INEGI), various years, various statistics, at <http://www.inegi.gob.mx/>

¹⁶ Rogelio Ramírez De la O., *What Has Changed in the Performance of Employment and Wages in Mexico after NAFTA? Incomes and Productivity in North America* (Papers from the 2000 Seminar of the Commission for Labor Cooperation, 2000)

¹⁷ Ramírez De la O., Rogelio, "The Impact of NAFTA in the Auto Industry in México" in *The North American Auto Industry under NAFTA*, Sidney Weintraub and Christopher Sands eds. (Washington, D.C.: Center for Strategic and International Studies, 1998).

¹⁸ Luhnnow 2002.

Table II
Total Exports of Mexico and selected manufactures
(\$ Million)

	1990	1993	2000
Exports	41,046	51,886	166,424
Crude Oil	8,921	6,485	14,884
Manufactures	29,062	42,500	146,439
Textiles	1,291	2,770	12,512
Chemicals	1,830	2,558	5,971
Glass	258	673	1,561
Steel	938	1,399	2,983
Transport Equipment	12,876	14,514	51,143
Electrical, Electronics	7,022	14,032	49,156

Source: Bank of Mexico, 'Indicadores del Sector Externo', various years

Table III shows that imports recorded a similarly high increase, so that the link between export and import growth became accentuated.

Table III
Total Imports of Mexico and selected products
(\$ Million)

	1990	1993	2000
Imports	41,579	65,367	174,480
Agriculture	2,265	2,393	4,855
Manufactures	28,341	61,568	165,221
Textiles	1,706	3,525	10,035
Chemicals	2,929	4,855	11,425
Plastics	785	3,404	9,277
Steel	1,628	3,312	7,653
Transport equipment	13,821	16,770	44,497
Electrical, electronics	7,265	12,511	44,744

Source: Bank of Mexico, "Indicadores del Sector Externo", various years

The auto sector

The auto sector has been the most dynamic sector in the NAFTA. Mexico's exports, in the table, included as transport equipment, jumped from \$12.8 billion in 1990 to \$14.5 billion in 1993 and \$51.1 billion in 2000. Mexico's export drive started before the NAFTA, but it did not go for enough as after the NAFTA.

The automotive industry plays a crucial role in the economies of Mexico, Canada and the United States in terms of exports, employment generation, and technological and industrial development. The sector is not only the largest exporter and importer of manufactured goods. Thus it is not surprising that the automotive sector was singled out as particularly sensitive during NAFTA negotiations. From the Mexican perspective it is also a prime example of the kind of intra industry trade NAFTA was designed to boost. Free trade allows firms that sell in the entire North American market to relocate their production facilities among NAFTA countries to minimize costs and take full advantage of specialization and economies of scale.

The auto industry in Mexico has taken full advantage of trade and investment policies established under NAFTA.¹⁹ It has gone through a restructuring process that has enabled it to increase competitiveness and to successfully integrate into the North American and the world auto market.

The automotive industry has contributed to growth and job creation. Although the 1995 peso crisis had a devastating effect on Mexican auto production with domestic sales falling 80 percent, NAFTA made it possible for the industry to recover with remarkable speed. Vehicle and auto parts production represents 2 percent of Mexico's GDP and more than 11 percent of Mexico's manufacturing GDP. The auto industry accounts for 20 percent of Mexico's total exports and 22 percent of total manufacture exports.

Production jumped from 1.055 million units of cars and trucks in 1993 to 1.854 million in 2001, an annual growth of 7.3 percent. Exports were 493,194 and 1.382 million respectively, i.e. a growth of 13.8 percent per year. Domestic sales of vehicles jumped from 576,025 to 918,835 units, growing 6 percent per year despite the deep recession in 1995 when sales plummeted -69 percent followed by only a mild recovery.

Employment in manufacturing in the auto industry reached 313,157 workers in 1993, rising to 432,733 in 2001, i.e. by 4.1 percent per year. Comparing this figure with that of output growth, we can infer that there was an annual increase in productivity per worker of 3.1 percent per year. While employment in vehicle producers only rose mildly from 1993 to 2001, employment in auto parts increased by 4.8 percent per year, significantly higher than the increase of 2.6 percent per year recorded for the whole manufacturing sector, as was shown in Table I.

¹⁹ NAFTA provisions were fully implemented this year and the specific levels of local content and export requirements for manufacturers of autos in Mexico, and the conditions for importing foreign vehicles based on sales in the Mexican market as provided in the 1989 Auto Decree were eliminated.

Under NAFTA the Mexican auto industry has become highly integrated with its Canadian and U.S. counterparts, and vehicles made in Mexico have a high United States and Canadian content. Trade in automotive products has consequently exploded. U.S.-Mexico trade in vehicles and auto parts expanded from \$14.6 billion to \$47.1 billion between 1993 and 2000. Almost 25 percent of U.S. auto parts imports come from Mexico.²⁰ Around 90 percent of Mexico's vehicle exports are sold in the U.S. market, 6 percent in Canada, and 3 percent in Germany. Mexico has become the second largest export market, after Canada, for both U.S. vehicles and auto parts. In 2000, U.S. car exports to Mexico totaled \$4.3 billion.

Mexico, largely as a result of the NAFTA, is now the eighth largest global producer of cars and fifth in trucks. The good performance of the industry makes it key for future integration with North America. Moreover, the government is keen to create conditions to attract more FDI and is in close consultation with the industry regarding taxes and other factors that affect costs and prices. In the next few years we will see greater commitments by the government to facilitate expansion and productivity growth in this industry.

The textile and clothing industry

A major goal for Mexico in the NAFTA negotiation was to gain improved access to the U.S. market for its textile and clothing products through full elimination of tariffs and Multilateral Fiber Agreement (MFA) quotas. Prior to NAFTA, the so-called Special Regime enabled Mexican apparel assembled from U.S. fabric to benefit from flexible quotas and the application of U.S. tariffs only on the non-U.S. value added (in other words, "round trip" U.S. fabric was free from duty). Intensive utilization of the Special Regime by Mexican exporters established the basis for a fast growing garment industry and jobs for low skilled workers. Under NAFTA, immediate elimination of MFA quotas, coupled with substantial cuts on exceptionally high tariffs as NAFTA entered into force, extended the gains achieved under the Special Regime. Benefits were also extended to Mexican fabric producers, who became qualifying suppliers under the complex NAFTA rules of origin²¹

After almost a decade under NAFTA, performance of the Mexican textile and clothing industry bears out the initial expectations. In 1995, the Mexican industry suffered from the collapse of the domestic economy. Like the auto industry, it was able

²⁰ Among the main auto parts that the United States buys from Mexico are wire harnesses, auto stereos, auto body parts, speedometers, engines and air conditioning parts. For its part, Mexico buys from the United States engines, wheels, seat parts, and auto stereos. A similar type of integration has occurred between the Mexican and Canadian automotive sectors.

²¹ NAFTA stipulates that no new quotas in the textile and clothing sector may be imposed except under specific safeguard provisions. Moreover, some products that do not meet the NAFTA rules of origin may still qualify for preferential treatment up to a "tariff preference level," or up to a specified import level, which is negotiated among the three countries (Hufbauer and Schott 1993).

to export its way to recovery thanks to preferential market access. After a sharp 6 percent decline in 1995, the industry grew 15 percent, 10 percent, and 5 percent in 1996, 1997, and 1998, respectively.

In 2000, Mexico's textile and clothing industry exported \$11 billion, contributing more than 6.5 percent of Mexico's total exports. Two-way Mexico-U.S. trade in textiles and clothing increased from \$4.1 billion in 1993 to \$15.3 billion in 2000.²² In 1998, Mexico became the leading supplier of textile and clothing products to the United States, displacing China.²³ Significantly, Mexico has also become the largest market for U.S. textile products.²⁴ Today Mexico's textile and clothing industry includes almost 1,200 *maquiladora* plants, employing close to 286,000 workers.

The electronics industry

The electronics industry, in a fashion similar to the automotive and textile/clothing sectors, became a major export player for Mexico as a result of trade and investment opening promoted by the NAFTA. Mexico established itself as the main trading partner for the United States in electronics, surpassing such key players as Japan, Canada, Taiwan, Korea and Singapore. In 2000, both Mexican exports of electronics to the United States and U.S. exports to Mexico amounted to about \$34 billion in each direction. Electronics trade between Mexico and Canada rose from \$210 million in 1993 to \$773 million in 2000. Zero tariffs and a stable investment climate are behind these trade statistics.

NAFTA has encouraged Mexican production of sophisticated electronic products that go beyond mere assembly, with significant research and development now conducted in Mexico.²⁵ The 1970s stereotype of low cost, labor intensive assembly no longer characterizes the new generation of electronics production.²⁶

Some 570 *maquiladora* plants now operate in the electrical and electronics sectors, representing almost 12 percent of the total number of *maquiladora* plants in Mexico. In 2000, these firms employed approximately 350,000 workers, an increase of 80 percent over 1993 levels.

²² Sistema de Informacion Empresarial Mexicano, *NAFTA Works: For the Textiles and Apparel Industry. Sectoral Fact Sheet* (2000) available at <http://www.naftaworks.org/Publications/Industrial/industrial.html>.

²³ Mexico's main textile and clothing exports to the United States are denim products, knit fabric, synthetic fabric, trousers, T-shirts, sweaters and underwear.

²⁴ Approximately 75 percent of Mexico's clothing production incorporates U.S. fabric. Kurt Salmon Associates Capital Advisors, "Textile Transactions and Trends: Perspectives on Mergers and Acquisitions," *Textile Industry Newsletter* (Summer, 1999).

²⁵ Jorge Carrillo and Alfredo Hualde, "Third Generation In-Bond Assembly Plants. The Case of Delphi-General Motors," *Comercio Exterior* 47 no. 9 (1997): 747-58.

²⁶ Nichola Lowe and Martin Kenney, "Foreign Investment and Global Geography of Production: Why the Mexican Consumer Electronics Industry Failed," *World Development* 27, no. 8 (1999): 1427-43.

The trade and investment story for electronics, as for autos and textiles and clothing, finds firms repositioning themselves through mergers, acquisitions and greenfield investments, and restructuring their chains of supply. The result is far deeper integration of the North American economies. The reward has been higher productivity in favored sectors, a strengthened position in the world economy, and booming intra-industry trade.

The agriculture sector

Unlike the manufacturing sector, however, NAFTA has had very different effects over a two-tier agriculture sector where a booming agribusiness sector coexists with a self subsistence, backward and traditional sector. While the first has been able to increase its exports as a result of improved market access into the United States and Canada, the latter has been unable to take advantage of the benefits that NAFTA has provided in terms of investment and increased production.

Agriculture accounts for less than 5 percent of Mexico-U.S. trade. While trade in this sector has grown, export dynamism is concentrated among fruit and vegetable producers in northern and western Mexico who have access to credit and have traditionally been quite competitive. These producers do not engage in traditional Mexican subsistence agriculture, which is heavily concentrated in the central and southern parts of Mexico. The dichotomy between subsistence ejido-type production and export-led agriculture pushed the government to introduce a variety of domestic support policies that side-step NAFTA to sustain the livelihood of Mexican peasantry.²⁷

Regional effects of NAFTA

Exports and investment have been the leading forces of growth in Mexico for the past five years. Both of them are closely linked to the NAFTA, but for the same reason their effects have been uneven across regions.

The main driver for exports and manufacturing activity has been the northern region and especially the border. South of the border, the industrial area north of Mexico City, Guadalajara, Monterrey, and Aguascalientes have all seen growth in industrial activity and in exports. These regions are all located in the northern corridor from the center of Mexico to the north east and in the western region of Guadalajara, where foreign firms in electronics have proliferated for the past years.

But regional disparities have increased after the NAFTA, for the south of Mexico has not attracted as much activity as the north. This problem has been aggravated by budget constraints, preventing the Government from investing in infrastructure and social services. Lack of opportunities in the south while there are growing exports and activity

²⁷ This is the case of the Program for Direct Support for Mexican Producers which delivers cash payments to guarantee a minimum income for 2.9 million farmers who sow 14 million hectares of basic crops.

in the north, results in large flows of migrants from southern states to the northern border and eventually illegally into the United States.

The relatively high growth in the north has added pressure on public infrastructure and social services, leading in some instances, to extremely poor environmental conditions, lack of water, and other public services in northern cities. With this in mind, President Fox's government announced an ambitious plan (Plan Puebla-Panama) to invest in infrastructure and connect Mexico with Central America through more roads, telecommunications and seaports. This plan, however, depends entirely on the successful integration of Mexico to North America. But can successful integration with North America be maintained and enhanced in light of recent events in the United States and particularly the attacks of September 11th?

The "Grand Bargain"

As we mentioned before, NAFTA's success in achieving the aims for which it was negotiated, led some academics and public officials including president Fox himself, to propose in early 2001 that North America should advance towards deeper levels of integration very much in the European style. The proposal was bold to the extent that it did not argue in favor of what in classic integration theory would be considered a natural second or third steps, namely, a customs union or a common market but it went even further to propose a North American Community or "grand Bargain". The main idea of the "Grand Bargain" was that NAFTA had achieved everything that could be accomplished through a process of free trade in goods and investment and what was required next was the liberalization of labor flows and a recognition that the more developed economies, i.e., the United States and Canada, have a responsibility to provide financial support to the less developed economy, namely, Mexico to tackle some of the problems that NAFTA had accelerated like the regional polarization of the economy or the lack of infrastructure in the southern states of Mexico and infra-structural decay in the northern border.

This proposal, to say the least, was received with skepticism in Canada and the United States but in the latter country the government of President Bush decided to initiate talks to explore new ways to strengthen the U.S-Mexican economic and migratory relationship. According to some observers and participants in the negotiations, the talks basically were centering in a possible migratory agreement through which an important amount of Mexican workers would be allowed to come temporarily to work in the United States. Mexico in turn was insisting that the agreement should also include provisions to legalize the 3 to 4 million of Mexican undocumented workers that are residing in the U.S. This Mexican proposal was made famous by the Mexican Foreign Relations Minister, Jorge Castañeda as "the whole Enchilada approach." Apparently, the Bush administration was not persuaded of the legalization proposal but had not rejected it either. But then came September 11th. What has been the impact of the September 11th attacks on the Mexican-U.S. relations? In the next section, I discuss the significance of the September 11th attacks for the future of Mexico-U.S. economic relations.

September 11th and the need for secure but open borders

History shows that stunning events can force a new perception of the world and a new set of policies. In 1941, Japan's attack on Pearl Harbor forced the American public to follow President Franklin Roosevelt's lead, abandon the entrenched post First World War policy of isolationism, and adopt a new policy of active engagement in world turmoil. In 2003, the tragic events of September 11th are still being debated in the United States. President George W. Bush has called for a global war on terrorism based on a new doctrine of preemptive strikes and the creation of a new Department of Homeland Security with extensive powers. How these initiatives will play out remains to be seen. But the same openness that fosters economic integration is evidently a great source of vulnerability. The United States has thus begun to adopt an array of new policies to make its domestic territory and its borders more secure.

For Canada and Mexico the new security policies had immediate and shocking implications. On September 11, 2001, the U.S. authorities took a number of immediate measures at its borders north and south. U.S. Customs went to a high level of alert which still exists (Level One: sustained and intense inspection). Automobile traffic was delayed for several hours and commercial traffic for up to 12 to 15 hours for several days thereafter. Just-in-time manufacturers, particularly auto companies and Mexican goods exporters, were in crisis. By some estimates, unexpected shutdowns due to part shortages cost auto makers up to \$25,000 a minute in lost production. Cross-border retail shopping and tourism plunged. The U.S. Customs Service beefed up its staffing along the border and introduced legislation to triple the number of agents. The Immigration and Naturalization Service (INS) announced plans to introduce an entry/exit system by 2003 at airports and seaports and by 2004 at the 50 largest land entry points. This system would require visitors, including those from Mexico, to have their names recorded every time they enter and leave the country.

As these measures were adopted, Mexico's choices seemed to narrow: either take a leap towards deeper integration and be "inside the U.S. tent" or see the bilateral border re-erected and be left outside. Debates about deeper integration predated September 11th as did work to negotiate a new initiative to allow more Mexican migrant workers into the United States and legalize the workers already living in the United States, but the range of possibilities changed that day. Deeper integration became a matter of national security: if Mexico wanted to preserve openness it had to pay more attention to security.

Longer term, the impact of a permanent increase in border transaction costs acts like a tariff, particularly on Mexican and Canadian goods entering the United States. The higher cost of exports causes U.S. customers to switch to cheaper domestic and alternative foreign suppliers. Mexico's exchange rate depreciates as the demand for Mexican pesos declines. More expensive imports undermine Mexican living standards. Higher costs of moving people, goods and services also erode Mexico's productivity performance. The other longer term impact could be the reconsideration of the plans to invest in Mexico by countries like Japan and those in the EU. Increasingly, they can be expected to head for the United States with new investments. Why invest in Mexico or

Canada if border delays are to be a permanent factor in the other North American markets? Diversion of such investment would also undermine Mexico's productivity growth.

Mexico is not alone in its dilemma. Increased border security raises transaction costs around the world. Some estimates put the aggregate increase in transaction costs at one to two percentage points. If these costs become permanent, some way will have to be found to offset the increase -- for example by negotiating in the WTO or the Free Trade Area of the Americas an across-the-board reduction in industrial tariffs of an equivalent or greater amount.

Mexico's response, after a period of uncertainty and delay, was to negotiate with the United States a Border Partnership Action Plan recently announced by the two countries.²⁸ This accord is similar to the one signed in December 2001 by the United States and Canada on Smart Borders.

The Action Plan aimed to achieve three objectives: to secure infrastructure, to secure the flows of people and to secure the flows of goods. The securing of infrastructure will aim to:

...conduct a joint survey of ...[the]... border to identify bottlenecks that impedes the movement of goods and people...to develop integrated infrastructure investment plans...and to conduct security assessments of critical infrastructure and take steps to protect them from terrorist attacks.²⁹

The securing of the flows of people, in its turn, will aim to:

...develop and implement technology systems at ports of entry to speed the flow of bona-fide travelers; to cooperate to identify individuals who pose threats to...[both] societies before they arrive in North America and to coordinate efforts to deter smuggling of third-country nationals and establish a joint U.S. Mexico Advanced Passenger Information Exchange System.³⁰

Finally, the securing of the flow of goods aims to:

...implement technology-sharing programs to place non-intrusive inspection systems on cross-border rail lines and high-volume ports of entry; develop and implement technology systems to increase security at

²⁸ U.S. Department of State- Office of the Secretary, "Smart Border: 22 Point Agreement-U.S. Mexico Border Partnership Action Plan," *Fact Sheet* (2002) ([http:// www.state.gov/p/wha/rls/fs/8909.htm](http://www.state.gov/p/wha/rls/fs/8909.htm)).

²⁹ U.S. Department of State-Office of the Secretary, "Specific Measures that Compromise Joint Action Plan with Mexico", *Fact Sheet* (2002), ([http:// www.state.gov/p/wha/rls/fs/8910.htm](http://www.state.gov/p/wha/rls/fs/8910.htm)).

³⁰ *Ibid.*

all points of the supply chain that links producers and consumers and to expand partnerships with the private sector to increase security of commercial shipments.³¹

In other words, all these measures aim to “move the border away from the border” through fast tracking pre-cleared travelers at border points; integrated border enforcement teams staffed by the two countries with common objectives and integrated actions; Internet-based measures to simplify border transactions for small and medium sized enterprises; and infrastructure investment to improve access to border crossings through, for example, new highway bypasses that avoid congested downtown streets, along with a smart handling of goods and people at crossings. These are all sensible measures to secure an open border for goods and services.

But there are a number of sensitive measures that relate to the movement of people that still are undefined. Many measures will speed the cross-border movement of business travelers. Even permanent resident cards are contemplated, including a biometric identifier. These measures, also, will undoubtedly increase confidence that people from third countries coming to North America do not have malign intentions. But what is not clear from the border plan is the treatment to be given to Mexican migrant workers. Within this category there are, as we know, two groups: those who already reside in the United States, a group whose number reached between 3 and 4.5 million in the last decade,³² and those who will, in the future, come to the United States to work. All that was mentioned when the Action Plan was announced by presidents Fox and Bush in Monterrey, Mexico, was that the Cabinet level migration group should continue negotiating this issue the way it was charged with in previous meetings between both presidents in Guanajuato and Washington.³³ In these meetings both presidents committed to a “Grand Bargain” in immigration flows from Mexico, that is a search for alternatives to legalize or regularize the migrants who already reside in the United States and adopt a more liberal approach for those who will, in the future, come to the United States to work.

The question, however, is whether the “Grand Bargain” approach is still a viable initiative after the September 11th events. For Mexico, no doubt, immigration is an issue that has to form part of the Border Partnership Action Plan. The Mexican government considers the legalization of immigrant workers a matter of human rights and social justice -- and a necessary step in the economic integration of North America. In terms of economic benefits, legalization will help ensure that the Mexican economy receives a growing flow of worker remittances, which now run about \$13 billion a year (U.S.-Mexico Migration Panel 2001). The legalization of millions of Mexicans working in the

³¹ *Ibid.*

³² Robert Pastor, *op. cit.*; Steven A. Camarota, *Immigration from Mexico: Assessing the Impact on the United States* (Washington DC: Center for Immigration Studies, 2001).

³³ *Presidents Bush and Fox Announcement of Border Partnership Program*. 2002. (<http://www.whitehouse.gov/infocus/usmxborder>).

United States will moreover improve their economic prospects and enable many to return to Mexico as successful entrepreneurs.

On the U.S. side, feelings are equally strong. Some Americans flat out oppose any increase in immigration. More immediately, the attack on September 11th and the subsequent deterioration of the U.S. economy damped discussions of a “Grand Bargain” that started in the Administration and Congress in the fall of 2001. The fact that many of the terrorists overstayed their visas cast a huge shadow over any legalization initiative.³⁴ The recession and rising unemployment gave fresh impetus to groups that oppose the opening of the border to migrant workers. According to polls, taken after September 11th the American people grew more apprehensive about what they perceive as weak border control and voiced stronger support for enforcing immigration laws.³⁵

What does this imply for a Grand Bargain on undocumented immigration and the concept of a Border Partnership Action Plan? In my opinion, the shifting political landscape in the United States has superimposed security concerns on top of the already difficult economic issues wrapped up in immigration policy. Any deal on immigration will need to enhance the security climate by comparison with the current regime.

What kind of assurances could an immigration agreement provide that both satisfies security concerns and facilitates the creation of a secure border? The place to start is with the ongoing flow of migrant workers arriving in the United States. When the current recession gives way to a stronger economy, the United States should take up Fox’s challenge, put forward shortly before the September 11th attacks, to substantially enlarge the annual quota of Mexicans legally authorized to enter the United States on temporary (but renewable) work permits. In recent years, legal immigration from Mexico to the United States has numbered about 130,000 to 170,000 persons annually (U.S. Department of Justice 2002). Illegal immigration numbers are of course speculative, but the INS places the annual average at about 150,000 between 1988 and 1996 (U.S. Immigration and Naturalization Service 2001).³⁶

In my opinion, the way to tackle the flow problem is to start with an expanded number of legal visas, say 300,000 persons from Mexico annually. Additional visas should be issued on a work skill basis (including unskilled workers), not on a family reunification basis (the dominant test for current visas). However -- and this is where security is underlined -- to obtain a temporary work permit, the Mexican applicant will

³⁴ According to some analysts, September 11 shifted the immigration discussion from legalizing illegal migrants towards cracking down on them. Ronald Brownstein, *The American Prospect* (November, 21 2001): 31.

³⁵ In a national poll conducted after September 11 by John Zogby for the Center for Immigration Studies in Washington, D.C., some three-fourths of Americans said that the government wasn’t doing enough to control the border, and nearly as many said that it should greatly increase the resources devoted to enforcing immigration laws. See Brownstein.

³⁶ Camarota estimates that total legal and illegal immigration from Mexico averaged about 400,000 annually between 1998 and 2000. By implication, his figures suggest that illegal immigration was running over 200,000 annually in recent years (2001).

have to undergo a background check designed to avert security threats. Once inside the United States, temporary permit holders would need periodically to inform the INS electronically of their address and place of employment. Permit holders could renew their permits as long as they were employed a certain number of months (say eight months) in each rolling twelve-month period, had no felony convictions, and reported regularly to the INS. They could apply for U.S. citizenship after a certain number of years (say a cumulative five years as temporary permit holders). In the meantime, they should accumulate public Social Security and Medicare rights, as well as any private health or pension benefits.

Coupled with this substantial, but closely regulated, increase in temporary work permits, the United States and Mexico should embark on a joint border patrol program to reduce the flow of illegal crossings. The program should include features such as enhanced use of electronic surveillance, ineligibility for a temporary work permit for three years after an illegal crossing, and short-term misdemeanor detention (say 30 days) in Mexico following an illegal crossing. No border patrol program will eliminate illegal crossings, but a joint program, coupled with a substantial temporary work permit initiative, could reduce the flow.

That leaves the very difficult question of perhaps 4 million undocumented Mexicans living and working in the United States. There is no magic solution. The foundation for my tentative suggestions is the proposition that nearly all these people have made permanent homes in the United States and they are not going to pick up their lives and return to Mexico. Under a set of appropriate circumstances, therefore, they should be granted residence permits with eligibility for citizenship. The appropriate circumstances I envisage have two components -- a threshold relating to illegal crossings and standards for individual applicants.

- The resident permit program would be launched when the Presidents of the United States and Mexico could jointly certify that the annual rate of illegal crossings does not exceed 50,000 persons. This would entail a reduction of more than two-thirds in illegal crossings estimated in recent years. The resident permit program would be suspended in years when the Presidents could not make this certification.
- Individual eligibility would require evidence that the person resided in the United States prior to the announcement of the program. Otherwise, eligibility standards would parallel those for temporary work permits discussed earlier.
- An applicant for a residence permit who could provide satisfactory evidence of residence in the United States prior to the announcement of the program would not be subject to deportation (whether or not he met other eligibility requirements) so long as he periodically reported a place of residence to the INS and committed no felony after the issuance of the residence permit.

- Holders of residence permits would be immediately eligible for public Social Security and Medicare benefits, as well as private health and pension benefits. They could apply for citizenship say after seven years.