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**MEXICO'S ECONOMIC CRISIS:
CHALLENGES AND OPPORTUNITIES**

**Edited by
Donald L. Wyman**

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**Center for U.S.-Mexican Studies
University of California, San Diego Q-060
La Jolla, California 92093**

PROSPECTS FOR MEXICO-U.S. TRADE RELATIONS IN AN ERA OF ECONOMIC CRISIS AND RESTRUCTURING

by David R. Mares*
University of California, San Diego

Mexico is in the midst of an unprecedented economic crisis that is imposing extreme costs on the Mexican people. The very severity of the crisis is reason for analysts to examine closely Mexico's efforts at recovery. The administration of Miguel de la Madrid is trying to lay the foundation for a sustained recovery by restructuring the domestic economy, an approach that has profound implications for Mexican trade and development policies, and therefore for U.S.-Mexican trade relations.

Mexico's development efforts since the early 1970s tell us a great deal about its current circumstances and options. The introduction to this paper, therefore, presents a brief analysis of the attempts by the administrations of Luis Echeverría (1970-1976) and José López Portillo (1976-1982) to pursue a development strategy based on import substitution industrialization (ISI). The final two parts of the paper consist of a preliminary analysis of the trade strategy supported by the de la Madrid administration and a look at the prospects for trade conflict and economic integration in the U.S.-Mexico relationship.

The Inheritance

During the depression of the 1930s and the Second World War, Mexico and other Latin American countries produced goods domestically that they previously had imported from the industrial economies. For three decades after the war, Mexican leaders adopted import substitution as an explicit development strategy, believing that it would lead to industrialization. The early problems of import substitution industrialization, particularly inflation, were temporarily resolved with the introduction of a program of "stabilizing development" (*desarrollo estabilizador*),

*I would like to thank Donald Wyman for helpful comments. Naturally all responsibility for views presented herein is mine alone.

which included an emphasis upon long-term foreign debt and direct foreign investment to help avoid balance-of-payments difficulties.¹

In one respect the strategy was successful: in 1969 imports as a percentage of total supply represented only 5 percent of the consumer-goods sector, 22 percent of intermediate goods, and 50 percent of capital goods.² The strategy had costs, however, including a weak agricultural sector; in the 1970s agricultural imports increased. These imports and an expanding public sector (necessary to deal with the socio-economic implications of the strategy) led to a huge growth in government expenditures. Echeverría tried, unsuccessfully, to restructure productive capital and sustain ISI, and import substitution actually regressed in the first half of the 1970s.³ But the end result of Echeverría's turbulent administration was a political and economic crisis so serious as to stimulate rumors of a coup and the first devaluation of the peso in over twenty years.

By the middle of the Echeverría administration a consensus had developed among part of the political, economic and intellectual elites that Mexico had to reorient its development strategy from import substitution to the export of manufactured goods. López Portillo attempted to build upon this idea during the first two years of his administration, 1977-1978.⁴ Recognizing the connections between monetary policy and development strategy, he sought to keep the national currency competitive internationally and, five months after taking office, devalued the peso 10 percent. In addition, the government stimulated exports by tightening performance requirements in the automotive indus-

1. Raúl Ortiz Mena, "El desarrollo estabilizador," cited in René Villarreal, *El desequilibrio externo en la industrialización de México, 1929-1975* (México, D.F., 1976), p. 81.

2. Villarreal, *El desequilibrio externo*, p. 72.

3. E. V. K. Fitzgerald, "Stabilization Policy in Mexico: The Fiscal and Macroeconomic Equilibrium 1960-1977," in Lawrence Whitehead and Rosemary Thorp, eds., *Inflation and Stabilization in Latin America* (New York, 1979), pp. 23-64; Rogelio Ramírez de la O, "Industrialización y sustitución de importaciones en México," *Comercio Exterior* 30:1 (Jan. 1980), pp. 31-37; see also Albert O. Hirschman, "The Political Economy of Import Substitution in Latin America," *Quarterly Journal of Economics* 82:1 (Feb. 1968), pp. 1-32 for a discussion of the role of policy choices in surmounting the obstacles of import substitution industrialization.

4. The following summary of trade and development policy from 1976 to 1982 is taken from my "Trade Policy in Transitional Periods of Development Strategy: Mexico," unpublished, Aug. 1983.

try, and it subsidized general exports through a variety of mechanisms.

In this period the López Portillo administration began to rationalize import policy in order to stimulate competition in the domestic industrial sector. Trade officials anticipated that increased efficiency would heighten Mexico's ability to compete in the international market. In a very controversial but fundamental move, López Portillo began to convert Mexico into a fuller participant in the Western liberal trading system, of which reciprocity and trade liberalization were prominent features. Mexico appeared to be following the trend of most other third world nations who initially had rejected the idea that a developing country should subject its trade policy to rules created by the industrialized countries, but who now perceived that access to industrial markets required becoming a part of that liberal trading order. In support of this idea Mexico negotiated its first bilateral trade agreement with the U.S. in thirty years and initiated discussion of its accession to the General Agreement on Tariffs and Trade (GATT).

At first Mexican officials believed that Mexico's integration into the liberal trading system was necessary if Mexico were successfully to pursue a development strategy based on the export of manufactured goods. Within a short period, however, they revised their understanding of how the new strategy should be pursued. First, the insensitivity of certain U.S. policymakers in the natural gas controversy destroyed any possibility that Mexico would sign the bilateral trade agreement.⁵ Next, the second petroleum boom of 1979 convinced Mexican officials that they did not have to run the risks of increased participation in the liberal trading system in order to have access to the markets of developed countries.⁶ Rather, they anticipated that the

5. Richard R. Fagen and Henry R. Nau, "Mexican Gas: the Northern Connection," in Richard R. Fagen, ed., *Capitalism and the State in U.S.-Latin American Relations* (Stanford, Calif., 1979), pp. 382-427.

6. In this interpretation I differ significantly from those who use a pluralist and bureaucratic argument to explain Mexico's rejection of GATT membership. See, for example, Dale Story, "Trade Politics in the Third World: A Case Study of the Mexican GATT Decision," *International Organization* 36:4 (autumn 1982), pp. 767-794. These models of Mexican policymaking are weak because they do not explain why social forces that are able to influence decisions on some matters of importance to them are not able to influence all. One could ask therefore why the Mexican manufacturers were unable to prevent the substantial trade rationalization which did take place from 1977 to 1980 and why the Cabinet was unable to dissuade López Portillo from nationalizing the banks. The Mexican president can unilaterally give direction to policy formulation; pluralist and bureaucratic politics enter only into policy implementation. Thus, profit sharing was introduced, but private enterprise significantly modified its impact; the banks were nationalized, but compensation and the manner in which they will operate are influenced by politics.

political power associated with being a major oil exporter would guarantee markets for non-petroleum merchandise. Thus on March 18, 1980, the anniversary of the expropriation of the foreign oil companies, Mexico once again rejected the liberal order. López Portillo announced that Mexico would not join GATT, that it would not allow the market to determine the volume and direction of petroleum exports, and that it would not permit comparative advantage to regulate production and imports of agricultural products.

The trade and development policies adopted in 1980 constituted the manifestation of a "national project" in opposition to conformity to a multilateral order dominated by the developed market economies (DMEs). Unfortunately, the success of the national project depended entirely upon the performance of two international markets over which the country had extremely limited influence: the petroleum and financial markets. When those markets experienced dramatic changes in 1981, chiefly as a response to self-induced depression in the United States, Mexico suddenly found itself in the most severe economic crisis since at least the 1930s.⁷

Within this Mexican attempt to reorient development strategies, how were trade relations between Mexico and the U.S. affected? This question really requires two answers, one at the level of the "silent integration" of the two economies,⁸ the other with respect to the political attempts to influence that integrative process. The *de facto* economic integration that is occurring is the regional manifestation of fundamental changes in the international division of labor. In the 1970s the Mexican and U.S. economies became much more open to the international economy, with a resultant increase in their respective, but very unequal, vulnerabilities. Table 1 illustrates this clearly.

These figures do not do justice to the weight of the trade sector in the evolution of the Mexican economy between 1977-1981. The import elasticities for the manufacturing sector set records in 1978 (2.4), 1979 (2.7), and 1980 (3.1)⁹ and contributed significantly to the country's trade deficit: from 1977 to 1980 Mexico earned U.S.\$16 billion from petroleum exports but had a trade deficit of U.S.\$27 billion. Foreign borrowing was

7. From 1978 to 1981 GDP grew at an approximate 8.4-percent annual average, but in 1982 it declined 0.2 percent, and projections are for a decline in 1983 of between 3 and 5 percent.

8. Clark Reynolds, "Notes on U.S.-Mexican Trade Trends: Some Policy Alternatives," in Richard D. Erb and Stanley R. Ross, eds., *United States Relations with Mexico* (Washington, D.C., 1981), pp. 155-178.

9. *Economía Mexicana* 3 (1981), p. 11.

TABLE 1
OPENESS TO THE WORLD ECONOMY

	Ratio of Imports to GDP	Ratio of Exports to GDP
United States		
1970	4.3	4.4
1974	7.8	7.0
1980	9.9	8.5
Mexico		
1970	6.9	3.9
1974	8.4	4.2
1980	10.5	8.4
1970*	12.5	9.2
1974*	14.0	9.5
1980*	17.1	13.4

Sources: International Monetary Fund, *International Financial Statistics. Supplement on Trade Statistics*, Supplement Series No. 4, 1982, pp. 52-55; *Secretaría de Programación y Presupuesto (SPP), *10 años de indicadores económicos y sociales de México*, p. 183.

utilized increasingly to help cover the gap, with the result that the total public foreign debt in 1981 (U.S.\$53 billion) represented a 100-percent increase over that outstanding in 1978.¹⁰

Trade with Mexico became increasingly important within the overall trade picture of the United States, in which Mexico became the third most important trading partner. Nevertheless, U.S. trade with Mexico was still relatively minor, accounting for only 4 percent of total U.S. trade in 1978.¹¹ The composition of U.S. exports to Mexico remained stable throughout the decade, with manufactured goods providing some 65 percent of the total and chemicals contributing another 10 percent, although in selected years agricultural exports increased dramatically. From

10. Rosario Green, "México: crisis financiera y deuda externa," *Comercio Exterior* 33:2 (Feb. 1983), p. 105.

11. Reynolds, "Notes on U.S.-Mexican Trade," p. 163.

the end of the Second World War to 1981, the U.S. enjoyed a trade surplus with Mexico. In the latter part of the 1970s the value of this surplus grew tremendously: from \$0.5 billion in 1978 to \$4 billion in 1981. The collapse of the Mexican economy in 1982 brought the first U.S. trade deficit with Mexico in the postwar era.

Meanwhile, Mexican dependence upon trade with the U.S. remained extremely high, approximately 60 percent. The distribution of that dependence between imports and exports underwent important changes, chiefly as a result of the increased weight of petroleum in total Mexican exports (see table 2). The composition of Mexican exports also underwent a dramatic change: in 1974 manufactures (Standard International Trade Classifications 6, 7, 8) contributed 60.8 percent of the value of total Mexican exports to the U.S., while that of mineral fuels, lubricants, etc., represented only 0.9 percent; by 1981 manufactures had fallen to 31.6 percent, while mineral fuels, lubricants, etc., had risen to 50 percent.¹²

There was little success in terms of managing the economic interaction so that adjustment in the respective economies could allow both countries to benefit with minimal socio-economic, and therefore political, stress. López Portillo, in the midst of an economic crisis and searching for a new trade and development strategy, sought to bring the two economies closer through a bilateral trade agreement and natural gas exports. But for domestic reasons (President Carter's energy program), the U.S. rejected the natural gas agreement reached between the Mexican government and private U.S. companies, and thus doomed the bilateral trade agreement. Instead, Mexico sought to use petroleum exports to stimulate diversification of trade partners. But in the face of economic collapse, Mexico has once again tightened its trade ties with the U.S. For the U.S., managing the bilateral relationship implied getting Mexico to abide by the rules of the liberal trading system, either by joining GATT or by signing the Subsidy Code negotiated at the Tokyo Round. In addition, the U.S. government attempted to dissuade its Mexican counterpart from using performance requirements as an export promotion tool. On both counts failure greeted the U.S. government, but it has not given up the fight.

Present Mexican Trade Policy

Discussion of trade and development policies under the de la Madrid administration and of their repercussions on U.S.-

12. Emilio España Krauss, *El comercio de los E.U.A. con México de 1950 a julio de 1982* (México, D.F., 1982), pp. 54-56.

TABLE 2
MEXICAN TRADE WITH U.S.
AS PERCENT OF TOTAL MEXICAN TRADE

	Imports	Exports
1975	62.4	60.5
1976	62.4	62.2
1977	63.0	66.8
1978	60.4	71.9
1979	60.3	70.3
1980	61.5	61.8
1981	67.6	55.2

Source: SPP, *10 años de indicadores económicos*, p. 184.

Mexico trade relations must be preliminary. It is clear, however, that the intent of the new administration is to utilize the present economic crisis to reorient the productive structure so that future growth will not depend as much upon imports. The National Development Plan 1983-1988 recognizes that past policy generally underplayed the importance of the link between the Mexican and international economies.¹³ This realization, combined with the pressure of the present economic contraction, has pushed the new administration toward a return to the more rational opening of the economy that the strategy of 1977-1979 represented.

This renewed attempt at managing Mexico's increased participation in the international economy implies both increasing the process of ISI in the intermediate- and capital-goods sectors and stimulating non-petroleum exports. To date, the government has issued a variety of policy measures and general guidelines to lead the economy and society in this direction. The National Plan presents a general strategy for the industrial and trade sectors, but the government will not have an integrated policy that defines the measures to be undertaken and shows how they relate to one another until it completes the Program for Industrial Development and Foreign Trade (scheduled for late summer

13. Poder Ejecutivo Federal, *Plan Nacional de Desarrollo, 1983-1988* (México, D.F., 1983), p. 191.

1983). Nevertheless, based upon past experience and the National Plan, the following five policies stand out. In addition, some other measures, such as export subsidies, will attract a significant amount of public attention, although their overall contribution to the process actually will be slight.

Undervalued exchange rate

One of the problems that non-energy exports faced after 1979 was the progressive overvaluation of the Mexican peso. In today's international economy, de la Madrid does not have the option of utilizing outside resources to maintain an artificially high exchange rate. The profundity of the present economic crisis suggests that the domestic political costs of maintaining a downward floating exchange rate are less than those that López Portillo faced in 1980. Nevertheless, de la Madrid's political will to avoid the peso problems encountered by his two predecessors will be crucial because the significant differences between Mexican and U.S. inflation rates (and their projected continuance) will demand periodic and major devaluations.

For the short run, indications are that the benefits of this policy manifest themselves only on the import side. Imports declined dramatically in the first trimester of 1983 (71 percent), due not only to their high peso cost but also to the serious contraction of the Mexican economy (GDP is estimated to decline between 3-5 percent this year). But the devaluations have had little effect on Mexican exports: the value of total merchandise exports increased 11.1 percent in Jan.-March over 1982, but non-petroleum exports fell by 9.3 percent.¹⁴ In the medium run, the success of Mexico's new trade policy will be heavily influenced by the exchange rate policy that the government actually implements. The stimulus can be expected to manifest itself as demand in the industrial economies, particularly in the U.S., picks up after the recession and once exporters are not penalized by the exchange controls that require them to exchange their foreign earnings at the lower official controlled rate.¹⁵

Among the many advantages of an undervalued exchange rate is its relationship to international rules on export subsidies. It is not itself recognized as a countervailable bounty, and its effects contribute to national policymakers' decisions to retire direct export subsidies which are exposed to such duties. That

14. Petroleum is valued in dollars and therefore is relatively unaffected by a peso devaluation.

15. *Examen de la Situación Económica de México* 59:690 (May 1983), p. 235.

certainly was the case with Mexico's Cedi program, a tax rebate for exporters.

Control of internal demand

The National Plan places the same emphasis upon controlling and reorienting domestic demand as it does upon watching the exchange rate. Managing internal demand is believed to have several advantages. For one, it implies controlling the federal budget. For another, it should free up productive capacity for the new emphasis on export production. The importance of this diversion of resources is illustrated by the declining performance of non-petroleum exports after 1979, in part due to the tremendous demands of an economy growing at a real annual rate of 8-9 percent. In addition, emphasis on this goal will reinforce the above-mentioned exchange rate policy.

This process of reorienting the productive structure increases hardship for the lower classes, and in his inaugural address de la Madrid made clear his intent to reduce those problems to the extent possible. In this regard, the government continues to fund employment programs and to control prices for items that constitute the basic consumption basket. Nevertheless, wage increases have lagged considerably behind inflation and because of the depth of the present crisis, unlike the 1977-1979 period, this decline has not been offset for members of the major unions by increases in benefits. Prices of controlled items also have increased significantly, although their cost continues to be below what might have been the case otherwise. The strategy of limiting internal demand brings to mind the bureaucratic-authoritarian experiments in the Southern Cone of Latin America, but the pragmatism of the Mexican elite and the incorporating elements of the country's authoritarian political system suggest that Mexico may avoid the sociopolitical disorder associated elsewhere with this type of development strategy.

Rationalization of protection

The opening of the Mexican economy currently taking place is reminiscent of 1977-1978, and it includes a renewed attempt to rationalize, not liberalize, import policy. As earlier, import permits generally will be phased out in favor of tariffs. The intermediate- and capital-goods sectors will be the chief beneficiaries of the revamped protectionist structure, but even here the desire is to decrease the level of protection as the industries mature, thereby avoiding permanent inefficiency. Rationalization also requires more explicit criteria and a simpler solicitation procedure for import permits.

With these measures, Mexican trade policy becomes more like the policy of countries who ascribe to the liberal international trading regime. Such resemblance, however, is superficial. These changes in trade policy are all being undertaken

unilaterally, which is to say that the de la Madrid administration is making no commitments which could limit its ability to shift policy 180 degrees if conditions warrant. It should be remembered that López Portillo was able to respond quickly to changing international and domestic circumstances in the trade arena partly because he was not bound by any international agreements to continue with his original trade policies.

Export promotion

As mentioned earlier, maintenance of an undervalued exchange rate decreases Mexico's need for direct export subsidies. But in a world of competitive devaluations, further measures may be required. The National Plan (p. 196) notes four in particular: tax rebates, preferential credit, market promotion and information, and preferential treatment for export production in transportation, storage, and port facilities. The latter two generally are recognized as legitimate export promotion policies and thus the limits to these policies will be internal.

For tax and credit measures, however, the situation is quite different. The U.S.-sponsored GATT regime frowns on the concept of export bounties and subjects them to possible countervailing duties. With respect to tax rebates, the amount by which the rebate exceeds the verifiable import and indirect taxes paid by the exporting firm is held to constitute a bounty. In the case of credit, the bounty is the difference between the interest rate prevalent in the internal economy (it does not have to be a positive real interest rate) and the rate applied to finance for export. These two issues in recent years have dominated the public debate on U.S.-Mexico trade, embodied particularly in countervailing duty (CVD) cases involving the Cedi and preferential loan programs financed by the Central Bank. As a non-signatory to GATT or its Subsidy Code, Mexico is particularly vulnerable in these cases because petitioners do not have to prove that the subsidized exports actually contributed to their injury (i.e., the injury test).

The U.S. countervailing duty legislation is not straightforward and some room exists for administrative maneuvering on the part of the executive branch. In general, this branch has been unwilling to let interests of particular groups in the U.S. dictate the direction of Mexico-U.S. relations. But Congress recognized that the executive branch was predisposed to look out for what it perceived as foreign policy interests and acted to restrict executive discretion in this area. The Trade Act of 1974, for the first time, gave petitioners the right of appeal to the Courts against adverse CVD determinations. This effort to tighten the legislation was temporarily counterbalanced by legislation designed to strengthen the U.S. government's bargaining position at the Multilateral Trade Negotiations: the Secretary of the Treasury was given a non-appealable power to waive duties for a

four-year period, coinciding with the Tokyo Round. The Trade Agreements Act of 1979, however, further limited administrative discretion and tightened up definitions of what is countervailable. Thus there is presently a broader basis for the determination of subsidized imports from Mexico.¹⁶

Mexican policymakers under both López Portillo and de la Madrid understand the seriousness of the dispute over CVDs, and in the last two years they have attempted to reach a bilateral accord on the matter which would give Mexico the injury test. On each side of the negotiating table, however, there is a major issue which to date has prevented agreement. For Mexico it has been the insistence by the U.S. government, pressured by the Congress, that Mexico sign the GATT code on subsidies and reconsider (favorably) its decision to reject GATT membership. On the other hand, U.S. negotiators have found it very difficult to accept Mexico's insistence on complete freedom to have the bilateral treaty remain intact while it reimposes currently suspended subsidy programs if circumstances change in the future.

Performance requirements

Since the 1962 auto decree, Mexico has attempted to channel foreign investment into areas supportive of national development by stipulating that foreign enterprises must produce a specified amount of their inputs locally or that they should compensate imports with exports. In 1977 the auto decree was strengthened and the principle soon was extended to the pharmaceutical and computer industries. Indications are that use of this mechanism will be further stimulated in the years ahead,¹⁷ and this augurs for increased bilateral trade conflict.

Although the Multilateral Trade Negotiations did not clearly address the issue of performance requirements, there is general consensus in the U.S. that such measures constitute unfair trade practices. The State Department sent the Mexican government a diplomatic note in 1978, expressing its displeasure over the

16. As of June 1983, a variety of Mexican products had been involved in countervailing duty cases in the United States. Positive final determination had been reached in cases against the following products: carbon black, ceramic tile, construction castings, certain iron and metal castings, lead stabilizers, leather wearing apparel, litharge pectin, polypropylene film, red lead, and toy balloons. Negative final determinations had been reached in cases against: anhydrous ammonium. Investigations were active in cases against pork rind pellets and portland hydraulic cement and cement clinker (internal files, International Trade Administration, U.S. Department of Commerce).

17. Poder Ejecutivo Federal, *Plan Nacional*, pp. 197-198.

adoption of the 1977 Auto Decree. President Reagan has asked the GATT for a study on performance requirements. In addition, action has been initiated in Congress to retaliate against those countries that utilize performance requirements. Mexico is not the only nation to use them, and the United Auto Workers' Union is attempting to push similar legislation in Congress. Senators John Heinz and Daniel P. Moynihan introduced a bill (S.1150) designed to remove U.S. trade preferences for those countries that have performance requirements as a condition of foreign investment. Finally, the Overseas Private Investment Corporation (OPIC) Amendment Act of 1981 stipulates that OPIC will "refuse to insure, reinsure or finance any investment subject to performance requirements which would reduce substantially the positive trade benefits likely to accrue to the United States from the investment."

U.S. Trade Policy and Bilateral Conflicts

It would be misleading to assume that the sources for tension in the trade relationship arise only from Mexican policy. The Reagan administration, as mentioned, is trying to convince the GATT signatories to study the issue of performance requirements, in the belief that such a study would find that they violate the principles of liberal trade. But the greatest potential for disharmony in the bilateral trade relationship comes from U.S. graduation policy.

Graduation is one of the key issues in trade relations between the DMEs and the newly industrializing countries (NICs). The concept refers to the phasing out and ultimate elimination, for the more economically advanced developing countries, of the differential treatment in trade that they now receive. In addition there is pressure for the progressive alignment of the NICS' own policies with the rules of the international trading system created by the U.S. and its European allies. In the context of Mexican-U.S. relations these two concerns over graduation manifest themselves in the discussion over the Generalized System of Preferences (GSP) and the GATT, which was discussed above.

The GSP was established in 1974 for a ten-year period, with renewal to be negotiated between the executive and legislative branches. This program allows the president to grant duty-free treatment to specific merchandise from designated developing nations. There are a number of economic and political limits upon participation in the program. One is the economic criteria used to determine eligibility for GSP treatment. The value of imports of the particular item from one country must not equal or exceed 50 percent of the appraised value of total U.S. imports of that item, or have an appraised value whose ratio to U.S.\$25

million exceeds the ratio of the U.S. gross national product (GNP) of that year to the GNP of 1974 (in 1979 this value was U.S.\$37.3 million). The Trade Agreements Act of 1979 waived the former criterion "in cases where the value of the exports divided by \$1 million was not greater than the ratio of the GNP in the year the exports took place to the GNP of 1979." These limits mean that the contribution of GSP to sustained development must be channeled through production of relatively small amounts of numerous articles.

But political considerations limit GSP's contribution even more. For example, in 1979 Congress required suspension of access to GSP for a country which interrupted or ended the delivery of supplies of petroleum and petroleum products to the U.S. More importantly for Mexico, a number of items deemed to be "import sensitive" because of the opposition of domestic producers are excluded from GSP treatment. In addition, the U.S. government unilaterally decides if a country has reached a sufficiently high level of development and is sufficiently competitive in world markets in particular products so as not to require GSP treatment for them or for the country as a whole (the first four countries in table 3 are singled out on this latter point).

Table 3 illustrates the ambiguity in graduation discussions. Six countries plus Hong Kong are responsible for three-quarters of the use of U.S. GSP and thus are prime candidates for graduation. Nevertheless, both in terms of level of development (as measured by income per capita) and use of GSP there is little homogeneity among the group, and Brazil and Mexico do not really seem to belong. On the one hand, Taiwan and South Korea have similar levels of development to the Latin American countries, but their use of GSP is much greater: Taiwan by a factor of 4, and South Korea by 2. On the other hand, Hong Kong, Singapore, and Israel, whose use of GSP parallels that of Brazil and Mexico closely, have per capita incomes twice that of the Latin Americans. Such heterogeneity among the group raises serious questions about the inclusion of Brazil and Mexico in any such discussion.

While there is no question that Mexico benefits from the GSP program (between 1976 and 1982, its duty-free imports increased from U.S.\$253 million to U.S.\$599 million), the uncertainty in the program makes it a ripe area for continued controversy.

Conclusion

The de la Madrid administration proposes to follow a trade and development strategy that emphasizes efficient intensification of import substitution in the intermediate- and capital-goods industries as well as stimulation of non-petroleum

TABLE 3
U.S. GSP
MAJOR BENEFICIARIES (1982)

Country	Percent of GSP Use	Income Per Capita (U.S. dollars)
Taiwan	28	1,900
South Korea	13	1,500
Hong Kong	9.4	4,000+
Mexico	7	2,000
Brazil	6.7	2,050
Singapore	5.1	4,000+
Israel	4.8	4,000+

Source: Internal document, U.S. Dept. of State.

exports, particularly manufactured goods. As the preceding discussion makes clear, this would be a change from the development strategy of the previous administration. A number of major policy tools (such as use of the exchange rate, depression of domestic demand, and rationalization of protection) are consistent with the U.S.-sponsored liberal trade regime. Use of the exchange rate in particular should contribute to the easing of one of the major sources of recent tension in U.S.-Mexico trade relations, countervailing duty cases. To the extent that these mechanisms contribute to a restructuring of the Mexican economy, U.S.-Mexican trade relations should improve.

But any such benefit to the bilateral relationship is threatened by continuing disagreements in two general areas. One is the Reagan administration's offensive against performance requirements, one of the policies most likely to play a fundamental role in the Mexican strategy. More important, *all* of Mexico's individual policy decisions will take place within the context of the United States' likely graduation of Mexico. The graduation is an effort by the U.S. government to force Mexico to accept those norms that Mexico has rejected for some four decades as not appropriate or legitimate for a developing country.

Increased confrontation between the Mexican and U.S. governments over trade can be reduced only if one of them dramatically alters its trade and development policies. Mexican

leaders could abandon the historic role of the state as overseer of the domestic economy and thus eliminate one of the fundamental differences that stimulated bilateral trade friction. But this step implies a radical realignment in the political-economic coalition that has been responsible for fifty years of relative peace in Mexico. Stability in Mexico should be of special concern to the U.S., particularly at this time of economic restructuring. Massive migration northward to flee political or economic chaos in Mexico could be socially destabilizing in at least the southwestern U.S. In addition, a default on the Mexican external debt could trigger an international financial crisis. Finally, the Reagan administration itself points out that a troubled Mexico could bring the instability in Central America to the U.S. borders.

If tampering with the Mexican political economy is not in the interest of the United States, the only alternative is a change in the United States government's manner of dealing with bilateral trade tensions. The small weight of Mexican exports in the U.S. economy suggests that a concerned U.S. administration could accommodate an increase in imports from Mexico, but that step requires more than simply allowing more Mexican imports into the U.S. It also implies a U.S. acceptance of Mexico's need to abide by a different concept of the proper relationship between the state and the economy. Precedent already exists for the U.S. to open its markets to countries whose trading policies differ from its own: because national interests were perceived to be at stake, the U.S. accepted the European Common Agricultural Program and Japan's general protectionism.

The Mexican and U.S. governments ought to place a high priority on learning to manage their relations with each other, because no matter what policymakers in Washington and Mexico City do, the two economies will become increasingly integrated. In the process, the willingness of the U.S. to accommodate the concerns of its industrial allies over their perceived national interests ought to be extended to include other nations. It may be utopian to hope that attitude would guide relations between all countries, but it is certainly not foolhardy to argue that the special interests of the U.S. in Mexico call for an extension of special consideration to at least that country.

