The Impact of the North American Free Trade Agreement (NAFTA) On Industrial Wages in Mexico

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Abstract. NAFTA was expected to raise industrial wages in Mexico; however, ten years later, the opposite has occurred. Aggregate data for the first decade show a significant downturn in manufacturing wages, a slight upturn in wages in the *maquiladoras* and, for the first time in history, synchronization between wages paid in both industries. Data, disaggregated into nine industrial branches, show that manufacturing wages converged with those of the *maquiladoras* in a third of the cases, fell below the *maquiladora* level in another third, and remained independent in the rest. These results are explained in the light of the type of industrial restructuring resulting from trade liberalization.

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1. Introduction

One way of evaluating NAFTA's impact on Mexico is by analyzing the changes in wage levels paid in those industrial sectors that are most integrated into regional commerce. The expectations created around NAFTA were not only that it would help level the price of goods in the region but also that it would tend to level the cost of capital and labor. Instead of examining the tendency of any wage convergence between Mexico and the United States, this article will examine the degree to which the expectation of betterment in the price of labor has been fulfilled within Mexico, the low wage partner that was supposed to benefit most from this equalizing tendency.[2] Hence, the comparison is established within the Mexican transformation sector, between the manufacturing and *maquiladora* industries and between matching industrial branches within these two industries, where the former has traditionally paid double the salary level of the latter.

The analysis will measure changes in wages before and after NAFTA. Not everything that has happened since 1994 is attributable to this trade agreement; therefore, care will be taken to distinguish between NAFTA's effects and those attributable to Mexico's economic crisis. Also, other commercial measures taken to open the Mexican economy, both at the national level and within the particular industrial branches, are considered. Critical points of time are identified in the liberalization process and their effects on wages are observed.

The relation between trade liberalization and wages is not a direct one but rather is mediated by the different kinds of restructuring that has taken place in the industrial branches as a response to the increase in foreign competition. Therefore, before proceeding to the wage comparisons, it is necessary to sketch out the principal characteristics of this restructuring process in both parts of the transformation industry, manufacturing and *maquiladoras*. This will be done briefly in the following section, analyzing how one model for industrial restructuring lost out to another alternative model during the liberalization process. In the third section, the impact this has had on industrial wages will be analyzed.

2. Restructuring of the Manufacturing Industry according to the *Maquiladora* Model

The expectation of increasing wages under NAFTA was contingent on industrial restructuring taking place. Modernization of the transformation industry was required in order for it to adapt to the new competitive environment, expanding production and employment. The first restructuring model that the government promoted (since the first economic crisis in 1983) proposed orienting part of the transformation industry towards the business of supplying intermediate goods to the country's export industries, mainly *maquiladoras*. NAFTA's Article 303 reinforced this goal by providing a negative tariff stimulus that would encourage the substitution of temporary imports. In other words, NAFTA was supposed to strengthen the conversion of manufacturing and *maquiladora* industries into providers of intermediate goods for export industries. More specifically, Article 303 was designed to substitute temporary imports from third-party countries with regional intermediate goods. In order to do so, Article 303 taxes duty-free temporary intermediate imports from non-member countries after a seven-year transition period. After January 1, 2001, Mexico collected tariffs (that are much higher than those of the United States) on temporary imports of raw material, component parts and machinery coming from third parties, instead of allowing them to be temporarily imported with no tariffs charged (Gambrill, 2002, 200-204).

This change in the temporary import regime created an incentive to substitute third-party goods for goods of North American origin—from Mexico, United States or Canada. Supposedly, Mexico would have an advantage in this production, by converting pre-existing companies into suppliers of these intermediate goods or attracting foreign suppliers to Mexico. Thus, NAFTA opened a window of opportunity for restructuring part of the transformation industry into suppliers of raw materials and intermediate goods for the country's own export industries. This could have promoted a new industrialization model, similar to that carried out several decades earlier in Southeast Asia.