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HAVE LIBERALISATION AND NAFTA HAD A POSITIVE IMPACT ON MEXICO'S OUTPUT GROWTH?

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This paper analyses the role of real exports, and foreign direct investment in explaining real growth in an era of economic liberalisation. The econometric approach is based on time series analysis using VARs, Granger causality, impulse response functions and variance decomposition. The empirical results reveal that exports Granger cause output growth in Mexico, which is a possible confirmation of the Export-led growth paradigm. However, no effect from FDI on GDP is found. The inclusion of NAFTA's potential impact confirms the positive effect of exports and reveals that GDP and exports Granger cause FDI. The evidence suggests that export promotion and liberalisation in Mexico had the potential to attract greater flows of foreign capital and induce economic growth.

JEL classification codes: C32, F13, F21, O1
Key words: foreign direct investment, exports, output, NAFTA, Mexico

I. Introduction

The role of exports and foreign direct investment (FDI) in explaining economic growth in developing nations is an issue that continues to be of considerable theoretical and empirical interest. Since the early 1980s, and particularly since the signing of the North American Free Trade Agreement (NAFTA) in 1994, Mexico

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experienced large inflows of FDI and export production. From 1985, the Mexican government has pursued active policies that continue to remove barriers to investment from multinational corporations with the hope that FDI will promote economic growth.

The purpose of this paper is to investigate if exports and FDI have been decisive in explaining economic growth in Mexico (from 1980 to 2002). We also investigate if NAFTA has made a difference in the way exports, FDI and GDP interact. A dynamic analysis through impulse-response functions is presented to analyse how the variables respond to shocks in the innovations. This could be helpful to determine if policy changes are likely to create a positive response in the long-run. The questions we seek to answer are: is there a meaningful causal relationship among exports, FDI and GDP? What is the nature of such relationship? Are there any co-integrating vectors that suggest a long-run relationship? Has NAFTA improved the effect of exports and FDI on growth? And what is the response of GDP, FDI and exports to shocks?

Following the introduction, Section II contains a brief review of the Mexican economy. Section III discusses the literature review while Section IV contains the empirical methodology. Section V presents the results and the last section concludes.

II. The Mexican economy

Like other countries in Latin America, for many years Mexico's policy of industrialisation relied on protectionism as a way to build a domestic industry that could generate higher growth rates. During the 1940 to 1982 period, the average growth rate of GDP was around 5.9%. The strategy known as Import Substitution Industrialisation (ISI) also required large public spending to finance domestic production at least in the first stages of development. In the early 1980s, President Lopez Portillo (1976-1982) continued with former President Echeverria's expansionist economic policy. Many public enterprises were created to produce and supply a wide range of products. Public activities were diverse, ranging from selling basic products such as milk and sugar, to investing in the media and paper industry. In these years, average GDP growth was more or less the same as in the 1960s (6.4% per year). During the ISI, expansionary policy through public spending was one of the main instruments used to stimulate growth and this led to excessive public spending without equivalent tax revenues.

With oil prices falling in 1982, Mexico experienced a period of economic recession. For the first time, output growth fell below population growth. Mexico