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THE NORTH AMERICAN ECONOMY:
CAN IT COMPETE?

Luis de la Calle

Let me begin by saying that I'm going to take a little different strategy in trying to think about these issues. I'm thinking more the larger view of where we are and how the '08-'09 financial crisis will have significant impacts on trading flows across the Pacific, but also worldwide. And for Mexico, NAFTA should be in that context.

The crisis in Mexico one year ago in '09 was very sharp. Our GDP went down 6.5 percent, and the reason why GDP went down is only partially related to the declining exports to the U.S. I mean, our exports went down significantly, more than 30 percent for several months in annual rates, but so did our imports. So if we had consumption and investment constant in '09, GDP in Mexico would have come down only one, one-and-a-half percent. So the Mexican economy would have behaved very much in the way Brazil did.

The problem we had in '09 was that consumption and investment in Mexico collapsed, and they collapsed for several reasons, one of which was that Mexico was going through a business cycle before the Lehman Brothers crisis in October '08. The crisis in New York pushed Mexico to the abyss and off we went. And we had a pronounced business cycle with consumption and investment falling significantly. Exports have recovered more than 100 percent. Now we export more than in '08, and yet the economy is not fully recovered precisely because consumption and investment are not at the levels that we had in '09.

One of the distinguishing factors in the last year and a half has been that U.S. dollar has devalued. If you compare October '08 to October 2010 against many of the currencies of the main trading partners of the U.S., particularly Japan, the European Union, Canada a little bit, China is flat because they have a fixed exchange rate, and Mexico we have actually devalued against the U.S. dollar. So Mexico has become in the last few months tremendously competitive because the dollar has devalued against other currencies, and Mexico has devalued vis à vis the U.S. dollar.

The devaluation in Mexico began in October '08 and it went up 30-35 percent. This was the first real devaluation of the Mexican peso in many years, because we had previous devaluation periods in the past where inflation caught up very fast and the nominal devaluation did not translate into a real devaluation. So Mexico became relatively competitive in the world markets, particularly against China, but also others as a consequence of the crisis.

This factor combined with structural changes in North America has meant that Mexico’s participation in NAFTA in the U.S. market has increased significantly in the last two years. Our market share in the U.S. has grown almost two percentage points if you compare October ‘08 to the last number we have in August 2010. So you can put that in perspective. Two percentage points of U.S. imports, which is Mexico’s growth in the last 18 months, is equivalent to the entire Brazilian exports to the U.S., which is 1.9 percent. So Mexico has gained market share in the U.S.

One explanation is the devaluation of the peso in real terms. But the other explanation is that there is a reconfiguration of industrial activity across the Pacific. If you look 15 years ago, Japan used to have 20
percent of the U.S. market; now it has six. China used to have three percent; now it has 17 percent. Mexico used to have five percent and now has 12.2 percent. And Canada, they used to have, and Wendy mentioned some of this, close to 20 percent, is now at 15. So, what Japan has lost in terms of industrial base China has gained. And what the Midwest, including Ontario, has lost, Mexico has gained.

The restructuring of the industry across the Pacific is that China has been replacing Japan and Mexico has been replacing, not entirely, but partially, the Midwest. That’s why when Obama goes to Michigan and Ohio for the primaries, people react so strongly because they see a significant flow of production capacity into Mexico. And the change has been so strong and accentuated by the crisis that in the last numbers we have, which is August of 2010, Mexico is now a larger supplier to the U.S. than Canada if you exclude oil. Canada is becoming more a raw materials exporter, and Mexico is becoming increasingly more an industrial exporter to the U.S.

The reasons for this happening are, of course, that Mexico exports to the U.S. are growing faster than our competitors’. Our exports in 2010 are growing at 38 percent compared to a total market for the U.S. of 24 percent or so. So we’re getting market share even against China.

Now if you look at how this relates to the re-balancing of the world economy, pre-crisis we had countries with massive current account surpluses — China, Japan, Germany, and oil-producing countries. And then you had the countries with large deficits, which are easy to identify — the U.S., Italy, Greece, the U.K., Spain, Ireland, and all the countries that are undergoing or have to undergo adjustments.

The U.S current account deficit will have to come down; in the end there is no choice. If the U.S. was a normal country, the adjustment would have happened long ago. The U.S. is not normal. China on the other side of the Pacific is actually by co-producing with Canada and Mexico, but mostly Mexico.

There are only two ways in which you can reduce a current account deficit: either through increased exports or decreased imports. It’s in Mexico’s and Canada’s interest that the U.S. adjusts its current account deficit by increasing its exports rather than decreasing its imports. The only way that the U.S. can really increase its exports and penetrate markets across the Pacific is actually by co-producing with Canada and Mexico, but mostly Mexico.

So if we want to picture where should we go from here, I think that we need to start envisioning the possibility of transforming North America as a block into a net exporter. The U.S. does not have to reduce its current account deficit to zero because the dollar isn’t a reserve currency, but the U.S. would have to reduce its current account deficit significantly in due time. And the best way for the U.S. to do it and the best way for that to happen is through increased exports rather than decreasing imports significantly.

I think Mexico is probably the main beneficiary of the three main drivers of changing trading partners across the Pacific, which are a relatively depreciated dollar; the dollar will remain depreciated and that benefits Mexico because the peso is even more depreciated than the dollar.

There is a perception that there is an increased China risk. I mean, Mexico is probably the best country to diversify China risk. And we wanted to have a competitiveness policy in Mexico. Our competitiveness policy should be driven not only to reduce cost, as Gary was saying, or increase the value of what we produce, but actually to improve our risk profile. There is no better investment Mexico can make than improving its risk profile, and improving our risk profile implies improving our security situation of course, the rule of law, and having macroeconomic stability. No matter how many people ask Mexico to do otherwise, I think it would be foolish for Mexico to undertake a different path. If we improve our risk profile, Mexico will become very attractive to investment because we’ll participate in the process of the reindustrialization of North America.
And the final point is that the U.S. used to derive almost a third of its value-added from the financial sector. Well, people on Wall Street and in Washington would like that to continue for a long time. I don’t think it will. I think that the U.S. will have to reshuffle its internal economic dynamics and derive more value from the real side of the economy, in agriculture, industry, technology and specialized services outside finance. The country that will benefit the most from that reshuffling of U.S. priorities will be, of course, Mexico. If GE used to produce 50 percent of its profits from GE Capital is one thing, but if GE produces 70 percent of its profits now from industry, they will do the engines and the research in Mexico.

I think what we have to do is to envision international trade policy playing a role in re-balancing the global economy, and particularly the global imbalances across the Pacific. And I think that we should picture Mexico playing a very important role in that re-balancing process through the NAFTA and North America.

Luis de La Calle is managing partner of De La Calle, Madrazo, Manceras, Mexico City.