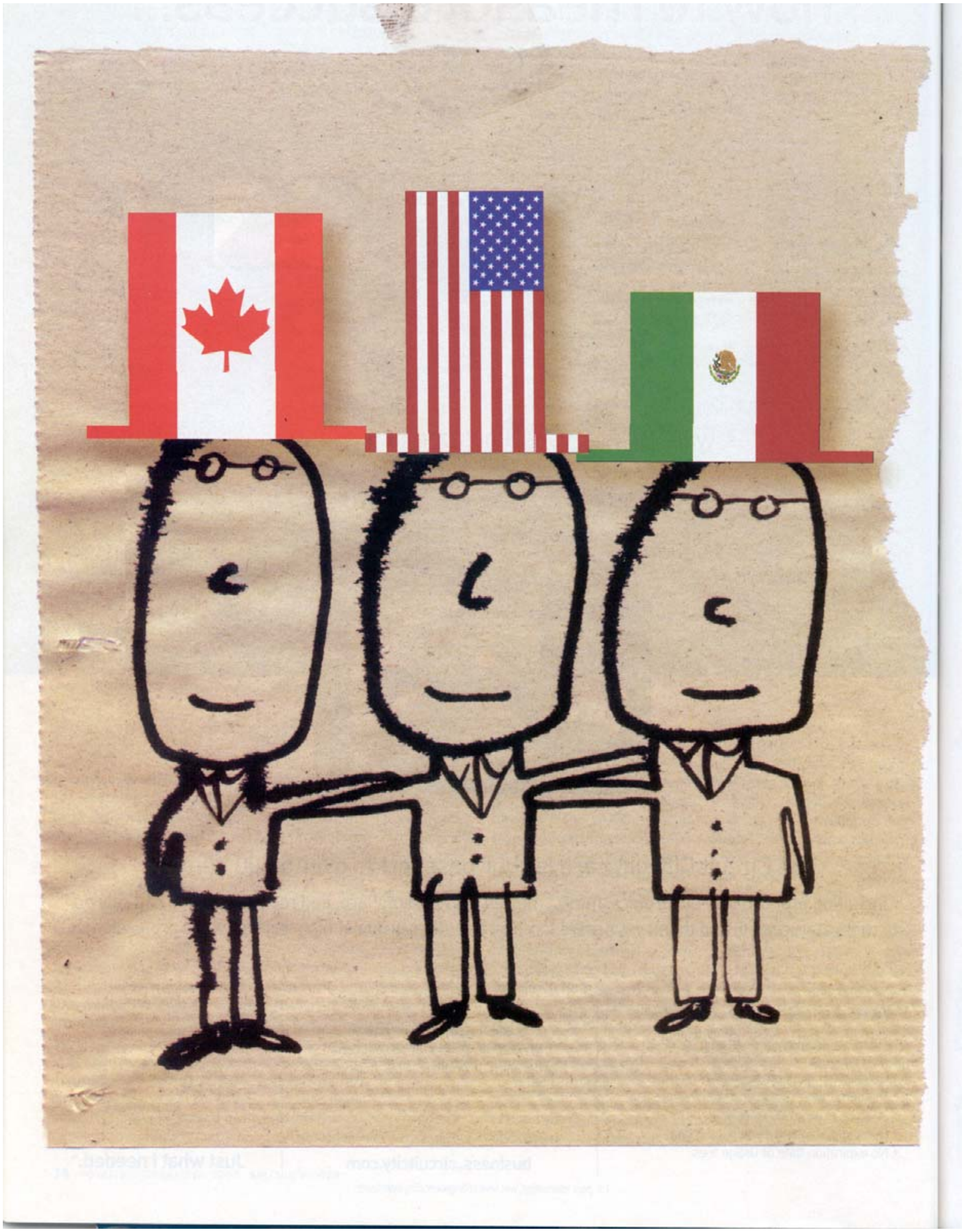

Mighty Neighborly

How NAFTA created a single profitable market for many American companies

By Robert McGarvey

Illustrations by Serge Bloch

If you are one of the executives who chuckles when NAFTA is mentioned, don't laugh. NAFTA is and will continue to restructure how you do business. And, you ain't seen nothing yet, because as many NAFTA experts assure us, the North American Free Trade Agreement, which turns 12 this year, is still maturing, still expanding its reach and becoming an ever-more-dynamic sales booster.

Even so, for many businesses, NAFTA never has seemed to live up to its advance hype. In the debate that preceded the treaty's enactment in 1994, many opponents direly warned of a "huge sucking sound" of jobs vanishing from the United States to points south, while starry-eyed proponents predicted that bringing Mexico into the fold would supersize everybody's sales and profits. Neither extreme – good or bad – ever happened. That doesn't mean NAFTA has added up to a big zero. Quite the contrary: "NAFTA has led to a considerable expansion of trade," says Dr. Joseph McKinney, a NAFTA expert at Baylor University in Waco, TX. Maybe the NAFTA reality never equaled the advance hype, but this, nonetheless, is an important treaty that has spawned considerable economic activity, says McKinney.

McKinney ominously adds that "winners and losers always emerge when trade liberalization takes place." The question is, where does your company figure in that balance sheet of trade winners and those who've come up empty?

Before you answer, there's a reality to ponder. "Everybody wants to talk about China. That's where all eyes are when it comes to trade," says George Haley, an international trade expert at the University of New Haven. As the Chinese economy has gained strength, considerable business attention has shifted away from NAFTA – particularly away from Mexico. This monocular focus, suggests Haley, is a mistake. "There are more profits in Mexico. US companies are earning 300 times more profits in Mexico today than they are in China." China just doesn't buy much that is Made in America – in 2004, Mexico bought $110 billion of US goods and services and China bought only $35 billion – and that's why US company profits so far have lagged.

Granted, the potential of China dwarfs that of Mexico (compare a nation of 1.3 billion people crammed into a land mass slightly smaller than the United States to a nation of 106 million in a country that's about three times bigger than Texas). That is tomorrow's potential. Today's reality, says Haley, is that already there is abundant two-way trade with Mexico that is richly rewarding the organizations that have figured out how to do business south of the border.

"What's the fastest growing food chain in Mexico?" asks Sean McDonald, a professor and NAFTA expert at Bentley College in Waltham, MA. "Taco Bell," he answers. According to McDonald, "In Mexico you don't find that persistent damn-Yankee sentiment you see in other countries. They are happy to do business with Americans." Of course, there are pockets of anti-American grumblers in Mexico. Compared with Pakistan, however, where multiple Kentucky Fried Chicken outlets have been burned to the ground to protest any American presence in the country (even though the burned stores are owned by Pakistani nationals), Mexico looks much more amiable. In one recent Pakistani case, six KFC employees were denied exit from their torched store. Four burned to death, and two others froze to death in a walk-in freezer where they had attempted to hide. That's an extreme example, but anti-Americanism is nonetheless on an upswing in much of the world, and this has chilled the international appetite for US brands. Mexico, by contrast, is a pro-American nation that still associates high prestige with US brands. From Coke to KFC and Marlboro, US brands thrive in Mexico.

Check out the size of these numbers as proof: in 2004, US firms exported more than $300 billion to NAFTA partners ($190 billion to Canada, $110 billion to Mexico). In the period from 1993 to 2003, total two-way trade between the United States and its NAFTA partners grew 111 percent – compared with a growth of 79 percent in trade with the rest of the world. In dollars, trade grew from $306 billion in 1993 to almost $621 billion in 2003. Note, too, that the big gains mainly are in Mexico, because in 1989, a US-Canada Free Trade Agreement (FTA) took effect and erased most barriers on the United States' northern border. NAFTA, in most respects, changed nothing in regard to US-Canada trade, but with Mexico, it ushered in a new world of investments and opportunities, as tariffs were phased down to zero in NAFTA's early years. When NAFTA was implemented, tariffs were often higher than 20 percent on US goods entering into Mexico; earlier in the twentieth century Mexican tariffs had been as high as 100 percent!

"NAFTA is working great," adds Jeff Meyer, executive director of the Van Andel Global Trade Center at Grand Valley State University in Grand Rapids, MI. "We are seeing much more creative uses of Mexico and Canada in the supply chain, and this is having large impacts on trade." By that, Meyer is referencing an increasingly pinpoint use of suppliers to maximize pricing efficiencies. For example, parts of an automotive brake might be manufactured in Mexico, shipped to Canada for final assembly, then shipped to the United States and installed in a car. "We will be seeing more fine-tuning of the cross-border supply chains," predicts Meyer.

Already, "many Volkswagen engines are made in Mexico," says Geraldo Vasconcellos, a business professor at Lehigh University in Bethlehem, PA. "Many US car components are made in Mexico. It's time to put to rest the idea that Made in Mexico means a product is shoddy."

One factor in this perceived improvement in Mexican quality is simply the fact that so many foreign companies – based in the United States, Germany, Japan and beyond – are setting up manufacturing operations to capitalize on comparatively low Mexican wage rates (still a fraction of US pay scales). Of course, this also represents selling opportunities for U.S. companies, since they can fairly readily extend their selling to include US-owned enterprises in Mexico (even in Canada).

That's just the start of what economists and government officials say are the enormous opportunities birthed by NAFTA. Exactly which sectors are prospering under NAFTA? US government experts pinpoint seven sectors that have recorded significant growth as a direct result of NAFTA.

Agricultural Equipment

Mexico is deep into a massive transformation to a modern agribusiness economy. This is a huge opportunity. Exports of agricultural equipment to Mexico from 1992 to 2002 grew 93 percent, compared with a rate of 47 percent for exports to the rest of the world. Many experts see sustained growth of US exports to Mexico in this category, as the Mexican economy scrambles to keep pace with agricultural improvements in other parts of the world (in the United States, Chile and Brazil). An interesting twist is, much Mexican agriculture is grown for export back to the United States. For instance, Roberts Irrigation, a San Marcos, CA, company, records significant sales of irrigation equipment to large Mexican farms where most of the crop is shipped to the United States. The US Commerce Department says many more US companies are winners in helping Mexican farms feed American consumers.

Pharmaceuticals

One category where the US exerts global leadership is drugs, and both Canada and Mexico are hungry consumers of US-made pharmaceuticals (despite the headlines about American seniors buying drugs in those countries). US pharmaceutical exports to Mexico and Canada grew 144 percent in the period from 1992 to 2002. The US Department of Commerce points to Procter and Gamble as a big NAFTA winner, because it has streamlined operations (three national units have been collapsed into one) while doubling sales in Mexico and increasing sales in Canada by 50 percent.

Chemicals

Another powerhouse sector for US business is chemicals. Chemicals record huge sales with NAFTA partners. In 2003, Mex-

Size Matters

Big losers in NAFTA have been small and medium-size enterprises, both in the United States and Mexico, say the experts. "Small and medium-size companies usually suffer in trade liberalization, because large companies come in and know how to compete," says George Haley, a marketing professor at the University of New Haven, who has extensively researched Mexican business. "In NAFTA, Mexico's large companies made out very well, as did large US companies that pursued opportunities in Mexico."

Large companies that haven't benefited from NAFTA are in a sector that didn't benefit yet, or they just didn't understand how to maximize benefits from the treaty. As for midsize and smaller enterprises, some did prosper as a result of NAFTA, and most of these winners aggressively sought and received trade assistance and counsel from federal, state and local government agencies. Experts readily acknowledge that on the home turf it's easy to do without government pep talks. But when companies try to penetrate a foreign market that operates under different rules, input from government experts can help level the playing field and let all companies – regardless of size – find profits in foreign places.

The most important stop for tapping into US government information pertaining to NAFTA is Export.gov, see www.export.gov, or call 1-800-USA-TRADE. More specific information, including tips sector by sector, are at www.ita.doc.gov, just click on the Trade Information Center, then Industry Information.

The bottom line is, there is plentiful information to help companies make profits under NAFTA, and savvy international traders mine these resources to help pinpoint opportunities and better refine operations to suit selling into NAFTA partner-nation companies.

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ico was the number-one importer of US chemicals, and Canada was number three. Big money is involved. In 2002, US firms exported $35 billion in chemicals to Canada and Mexico. Many experts see continued growth in this sector, as Mexico's modernizing economy needs more chemical feedstocks, and its agribusiness needs more fertilizers, pesticides and herbicides. The US government points to Eastern Color and Chemical in Providence, RI, as a NAFTA winner, because the maker of dyes and chemicals for the leather and textiles industry has enjoyed sizable increases in sales to Mexican companies (most of which, in turn, export their goods to US retailers).

IT and Communications

Mexico is plunging into first-world status, and that means there's widespread need for computers, phones, faxes, cell phones, modems and more. This is a bonanza for US-based companies. In 2002, US companies exported $21.4 billion in ICT products (information and communications technologies) to Mexico and another $18.5 billion to Canada. More important, US-made ICT gear goes into Mexico duty-free, while competitive equipment made in South Korea or Taiwan is slapped with a 23 percent tariff. Understandably, in 2002, US companies captured 51 percent of Mexico's ICT market. The US Commerce Department points to Kodak as a NAFTA winner. That company has seen its exports to Mexico grow $400 million under NAFTA (a rate four times faster than the growth of its global exports). Many, many more US ICT companies likewise are prospering under NAFTA, and experts predict Mexico's appetite for computers, phones and more will stay strong.

Motor Vehicles and Parts

This is another core US business. In 2002, US companies exported $77.9 billion in motor vehicles and parts, of which $43.9 billion went to Canada and $15.3 billion to Mexico. NAFTA partners account for three-quarters of the US-export market for cars, trucks and parts. Increasingly, automakers and suppliers see Canada, the United States and Mexico as a single market and a single source of manufacturing. For a case in point, Ford F-series truck engines are manufactured in Canada, the transmissions in the United States and the trucks themselves are assembled in Mexico and the United States. Don't think this is just a one-way highway, however. The US Department of Commerce reports that DaimlerChrysler has seen its exports to Mexico rise from 5,300 cars and trucks in 1993 to 260,012 in 2000.

Paper and Pulp

Sophisticated economies go through a lot of paper, and as Mexico progresses, its appetite for paper grows. In 2002, it bought $2.4 billion of US-made paper, and that is a number likely to keep growing. Many US companies are benefiting from NAFTA-engendered paper trade. For example, paper and cardboard maker Westvaco of Covington, VA, has seen its revenues jump 1,000 percent since NAFTA's enactment, reports the US Department of Commerce, which explains why the company's first and third leading export markets now are Canada and Mexico.

Services

By most accounts, services will continue to represent a growing segment of US economic activity. Already services are a mammoth slice of US exports – $279.5 billion in 2002. Canada consumed $24.3 billion of US services in 2002, while Mexico used $15.9 billion. Financial services – such as banking and insurance – have shown particular appeal to Mexican businesses and consumers. The sector will exhibit strong growth as the Mexican economy prospers, say the experts. US-based winners already are emerging. Blue Shield of California, for instance, reports it is enjoying great success marketing cross-border HMO services to companies that operate both in the United States and Mexico.

Good as that report card may look, most experts insist NAFTA is far from fulfilling its potential. Holding back the full flowering of the Mexican economy under NAFTA is a thick web of issues, from corruption to border congestion. Matters are so bad regarding border congestion that shipping giant UPS commissioned American University professor Frank DuBois to study why. Perhaps surprisingly, DuBois discovered that current border delays, which effectively make it impossible for international shippers to guarantee next-day delivery to Mexico, aren't due to corruption or to other, expected maladies but rather to a Mexican zeal to stamp out corruption. "Mexican Customs is overzealous," says DuBois. In many cases, all packages are diligently inspected (as opposed to the sampling that usually operates at US ports of entry). He adds that Mexico still needs significant investment in its logistics infrastructure, so that goods can freely move around the country.

The good news is, "these issues are being resolved," adds Meyer at Grand Valley State University. Mexico recognizes that, in a just-in-time world, it needs to pick up the pace – and, say many experts, progress is showing up along the border.

Those quibbles are overshadowed by the big plusses of NAFTA, stress the experts. Probably the biggest plus is political, says Bentley's McDonald. NAFTA has brought enhanced political and economic stability to Mexico, which translates into more security for the United States and, in the bargain, the United States is helping to nurture what will almost certainly be a long-term, substantial trading partner. "Mexico provides us with cheaper manufactured goods" – often components – "and it continues to buy many goods from US companies," says McDonald. "This trade will only increase." The biggest winner of all as a result of NAFTA is Mexico, and as the Mexican economy strengthens, it will continue to expand its appetite for US products. "Trade between the two countries will increase," says McDonald – and that is good news for US businesses that continue to pursue opportunities south of the border. •

Hit and Run

Patience is indeed a virtue in foreign trade. US companies, in particular, need to develop a longer view, urges Frank Wu, managing partner, operations for VizQuest Ventures, a sales performance consulting firm based in Concord, MA. Wu has helped many US companies develop profitable lines of business in Mexico, but he cautions, many Mexicans approach US companies with deep skepticism because so many have pulled out of Mexico after brief forays. "The reputation of US companies is that they need to see a quick ROI. They aren't seen as wanting to put in infrastructure or take the time to build relationships. They are seen as lacking a long-term commitment. That's why their performance isn't hitting expectations." NAFTA has exacerbated this, according to Wu, because right after the treaty was enacted, many US companies set up Mexican operations – only to shut them down within a few years, because they weren't fast successes. Mexicans, says Wu, will be studying potential US partners for signs that prove their commitment to Mexico is long-term. Organizations that persuade Mexicans of their sincerity are the ones that win big, says Wu.