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Border Controls, Public Policy, Immigration, and Trade with Mexico

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Introduction

The tragic events of 11 September 2001 directly illustrate the importance of international boundary and immigration controls. Formal guest worker registration programs provide one means for partially attaining these objectives in an efficient manner.[2,3] Stricter enforcement of visa provisions for lengths of stay provides another. Many of the steps likely to be taken, however, imply at least short-term disruptions to international trade. Border regions of Texas have already observed the impacts of heightened security measures on merchandise and commuter flows subsequent to 11 September.[4]

This article reviews some of the potential impacts of tighter border controls on economic ties between Mexico and the United States. Given the importance of Mexico as a trading partner to both Texas and the nation as a whole, the financial costs of these impacts are difficult to quantify, but will be substantial. It is important, therefore, to carefully consider the different manners in which trade and investment patterns will likely be affected. Section two of the paper provides a brief overview of economic research regarding economic linkages between these two countries. Section three examines recent bilateral economic trends, plus future prospects for merchandise trade and immigration. A summary is provided in the concluding section of the paper.

Related Studies

An important side effect of the geographic proximity between Mexico and the United States is a relatively high level of northward immigration during the past century.[5] As shown in Figure 1, international immigration flows tend to be highly variable. Not surprisingly, economic factors play both push and pull roles in the migratory decisions of the Mexicans that consider relocating. Push factors include periods of labor market weakness in Mexico that encourage greater volumes of worker outflows.[6] Historical episodes during which migration increased include the decade-long Mexican Revolution from 1910 through 1919, the “lost decade” of the 1980s debt crisis, and the mid-1990s devaluation.[7] Worker relocations are not solely related to the social shock absorber role that the United States has often played for Mexico. Frequently, periods of economic stability in Mexico are also associated with mass migration into Texas and the United States. The latter are triggered by pull factors such as labor scarcity and the natural allure of sizeable cross-border income differentials.[8]

Border regions of Texas have closely observed many of the factors associated with trade and migration changes in Mexico. One circumstance that plays an important role in the northward flow of migrants out of Mexico is the national labor code. Originally adopted during the 1934-1940 “sexenio” of President Lazaro Cárdenas, the labor code is nominally designed to protect workers. An unfortunate side effect is that many of its provisions cause private sector companies to, despite operating in a country with abundant labor resources, shy away from expanding payrolls when possible. In recent years, it has been estimated that labor code rigidities contribute to an ongoing circumstance wherein annual aggregate jobs creation lags behind labor force growth by approximately one-quarter million positions.[9] "Formal sector" jobs in Mexico are defined as those that enjoy benefits coverage under the Mexican Institute of Social Security. A large percentage of those members of the civilian labor force that are left without formal sector employment opportunities automatically head north, generally without proper documentation.[10]

An obvious answer to this persistent case of southern-style "Eurosclerosis" is labor market deregulation. Political pressures make the prospects for significant progress on this issue difficult at best.[11] This is not to say, however, that private sector jobs creation may not accelerate. Some limited headway at the federal level in Mexico has been achieved in recent years as a consequence of business start-up deregulation.[12] Those paperwork reduction efforts will eventually increase the rate of formal sector business creation and, by extension, help increase the demand for labor.[13] Companies are still likely, however, to be cautious about hiring efforts as long as labor code reforms in the areas of layoffs and contract terminations are not enacted. As long as that situation persists, labor surpluses will probably exist in Mexico and illegal migration will remain a problem.

There have been numerous studies regarding the impacts of ongoing migration from developing economies to more advanced economies.[14] Many of these efforts emphasize that a large number of migrants from Mexico to the United States are skilled workers.[15] While that observation is undoubtedly correct, a substantial percentage of illegal migrants have not graduated from high school. For border regions of Texas, that circumstance represents an obstacle to improved income performance. In 1990, the last year for which comprehensive data are currently available, it is estimated that below-average educational attainment rates caused the 14 border counties in Texas to collectively experience nearly $3.6 billion in personal income losses.[16] For the year in question, that represented a $2,620 per capita income shortfall relative to the rest of the state. As long as migration from Mexico includes large volumes of unskilled workers, it will be difficult for border counties to close the graduation gap with respect to Texas and the nation as a whole.

International trade between the United States and Mexico reacts to a number of different stimuli. Among the more prominent ones are national incomes, relative prices, exchange rate variations, and institutional factors.[17] Among the favorable institutional factors that encourage commercial exchanges of goods and services are negotiated efforts to lower trade barriers such as the North American Free Trade Agreement. Heightened security measures such as those enacted during the fall of 2001 serve as unintentional obstacles to business linkages between the two economies. Given the impacts of the recessions that affected the United States and Mexico in 2001 illustrated in Figure 2, it is still too early to be able to assess whether the evolving security measures will reduce the rate of growth observed for north-south trade volumes in this region.[18]

Greater delays at the border, plus the specter of potential port of entry closures, also raise the multinational cost of doing business in Mexico. Geographic proximity to the United States has permitted international manufacturing operations in Mexico to utilize "just-in-time" inventory logistics practices. Movements away from efficient materials deliveries raise operating costs at a bad point in time for manufacturers already facing declines in sales volumes. In addition, currency appreciation has already caused dollar-equivalent wage rates for Mexican labor to increase substantially in recent years.[19] The latter development has further eroded operating margins for companies with cross-border production facilities.

Current Trends and Future Prospects

Mexico and the United States entered into business cycle contractions well in advance of 11 September 2001. Prior to that date, the recession in the United States was largely confined to business segments of the economy, especially those tied to industrial electronics and telecommunications manufacturing. Those sectors expanded very rapidly between 1995 and 2000 due to the internet revolution and Y2K-related software and hardware upgrades. Business fixed investment in both structures and equipment grew at double-digit rates during this period. An almost inevitable consequence of such investment patterns is an eventual sharp drop-off such as that which took hold during the first half of 2001.[20]

Although business investment cutbacks caused overall growth to falter by mid-2001, personal consumption expenditures initially remained strong in the United States. Subsequent to the terrorist attacks, retail sales dropped sharply. In response, companies slashed prices and offered low-cost financing to improve sales. These efforts allowed volumes to remain healthy, but only at the expense of profit margins.[21] While the promotional strategies successfully prevented inventory build-ups from materializing, layoffs spread to the rest of the economy. Many regions in Texas experienced much higher unemployment rates during the second half of 2001 and payrolls were cut in consumer goods segments of the maquiladora industry in Mexico.[22]

While prospects for business investment remain weak, the outlook for industrial activity has strengthened in recent months. Contributing factors include low inventory-to-sales ratios, consumer confidence resiliency, increased factory orders, and accelerating defense-related purchases by federal agencies.[23] These developments bode well for cross-border commerce between Texas and Mexico. Historically, variations in United States industrial activity generate south-of-the-border maquiladora echo effects. During the 1980s and 1990s, maquiladora employment levels in Ciudad Juárez reacted to changes in north-of-the-border output levels within 60-day periods.[24]

For cross border trade flows, an important issue languishing in the shadows of tighter international boundary controls is whether modern supply chain and inventory management practices can continue to be utilized. The recently implemented security steps serve to intensify the severity of previously existing problems.[25] Border crossing delays have choked off large volumes of commercial activity in Texas in recent months.

Manufacturers may be forced to adopt "just-in-case" inventory management techniques involving partial load cargo shipments and greater supply stocks (via additional warehouse space). Such steps raise the cost of doing business in Mexico and risk encouraging new international investment flows to Louisiana trading partners in Central America and California trading partners in Southeastern Asia. Periodic press reports indicate that programs are continually being implemented to reduce border crossing wait times, but the bottlenecks remain firmly in place, wasting both time and money while reducing the cost effectiveness of Texas-Mexico trade links.[26]

Cost effectiveness is the key factor behind most direct foreign investment decisions. In terms of the collective comparative advantages provided by the geographic adjacency of Mexico and Texas, it is particularly important. That is because a large percentage of the merchandise trade between Mexico and the United States is intra-industry in nature.[27] As such, it directly involves cross-border movement of raw materials, intermediate inputs, and component parts rather than final products. This process represents a type of global business integration brought about by opportunities to increase vertical production efficiencies. Any policy changes, even when warranted by the risk of terrorist attacks, that affect transportation and warehousing costs reduce the viability of trade and manufacturing within this economic corridor.[28]

It is well known that many aspects of Texas-Mexico commerce and trade are influenced by currency market developments.[29] Historically, large-scale devaluations of the peso have been preceded by severe balance of payments problems.[30] A variety of different measures indicate that the peso has slowly become overvalued relative to the dollar in recent years.[31] Between the second quarter of 1995 and the first quarter of 2002, for instance, the inflationary gap between Mexico and the United States exceeded the cumulative rate of currency depreciation by approximately 25 percentage points.[32] When the peso appreciates against the dollar, illustrated by downward movements in Figure 3, a variety of impacts occur.

Because the international purchasing power of Mexican consumers increases, United States exports of finished goods rise above the levels they would otherwise attain. Included among the latter are border retail sales in cities such as El Paso, Presidio, Eagle Pass, Del Rio, Laredo, McAllen, and Brownsville.[33] Substantial uncertainty currently exists with respect to customer flows from Mexico due to the very long, and largely unpredictable, wait times across the international bridges that connect Texas and Mexico. While the aggregate commercial impact of a strong peso is probably muted in 2002, southbound merchandise sales are still higher than they otherwise would be.

On the Mexico side of the border, the impacts of a strong currency are reversed. Because exports become more expensive in dollar denominated terms (and imports less expensive), production and profit margins fall below what would otherwise be observed. Similarly, maquiladora dollar wage equivalents are much higher than they were prior to the appreciation of the peso. That factor is undoubtedly playing a role in the payroll reductions observed by in-bond assembly plants subsequent to December 2000. Given the current strength of the peso, a near-term return to the double-digit maquiladora growth rates of the mid-1990s is not likely, even if the United States economy stages a strong business cycle recovery.[34]

A 25-percentage point differential between cumulative inflation and exchange rate depreciation since 1995 raises the specter of previous large-scale devaluations (1949, 1954, 1976, 1982, 1986, 1994). A rapid loss in the international currency value of the peso would obviously affect regional trade and employment patterns. While exchange rates are notoriously difficult to model and predict, a maxi-devaluation does not appear imminent in Mexico.[35] That is because effective international reserve levels are higher than was the case in any of the post-war periods when severe currency instability resulted. For example, at the end of 2001, the import coverage ratio in Mexico was 2.7 months.[36] At the end of 1994, the reserves in months-of-imports estimate was only 0.9 months. While an import coverage ratio of 2.7 months still falls below the 2001 Latin American average of 5.3 months, Mexico in 2002 is in better economic and financial shape than it was in 1994.[37] Along these lines, real interest rates are positive and direct foreign investment inflows remain strong.

As noted above, a renewed central focus of United States border policy efforts in the aftermath of 11 September is immigration control. Given that, a natural question is what do current business conditions imply for migration out of Mexico? Short-run prospects are less dire than what might initially be expected. Typically, migratory flows out of Mexico slow whenever the United States economy suffers a recession.[38] Beyond that, a business cycle recovery in 2002 is also expected to increase in-country job opportunities for potential migrants.[39] Additionally, it is fairly common knowledge throughout Mexico that border controls have been more strictly enforced in recent months, making entry to the United States more difficult without proper documentation. In combination, these factors imply that the volume of migrants out of Mexico should subside relative to what was observed during the 1990s.

Demographic conditions and labor market dynamics in both economies, however, will also insure that relatively large numbers of persons will still seek gainful employment on the north side of the Rio Grande for many years to come. The persistent shortage in jobs in Mexico is paralleled by an ongoing surplus of employment opportunities in the United States. During the 1990s, north-of-the-border jobs creation exceeded growth in the domestic civilian labor force by more than one-half million positions per year. That trend is likely to resume once the national business cycle recovers and payrolls begin to expand again.[40]

Conclusion

The policy atmosphere between the United States and Mexico undergoes frequent changes under normal circumstances. The terrorist attacks of 11 September 2001 imposed a new set of multi-lateral considerations on top of a many-layered relationship between good neighbors. While relations between the two countries remain close, every aspect of these relations has been placed under a magnifying glass with the aim of minimizing international risks to the United States.

Because the demand for labor in the United States remains basically strong, there will continue to be numerous north-of-the-border employment opportunities for Mexican citizens. Due to labor market and business regulatory rigidities in Mexico, there will also likely be excess labor supplies in that economy for several years to come. Given those factors, a formal guest worker program may be a sensible step to take. Such an effort will not, however, eradicate the illegal migration problem unless domestic jobs creation accelerates in Mexico.[41] In the absence of such a development, a large portion of the international guest temporary work force will still become permanent residents, with or without legal documentation.

Greater border controls and heightened security measures have raised the cost of international commerce between the United States and Mexico. They have also raised the cost of doing business in Mexico, negating some of the natural advantages afforded by geographic proximity. Although numerous officials in both governments have announced proposals designed to streamline border crossings and trade, wait-times at the Texas bridges are very long and prospects for a "seamless border" seem remote. Additional manpower, technology, and infrastructure are required to overcome these problems, but it remains to be seen whether such resources are forthcoming.

Endnotes

1. Partial financial support for this research was provided by El Paso Electric Company. Econometric research assistance was provided by Arturo Elías.

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