

Does Mexico still need NAFTA?

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Why has Mexico underperformed?



English ▾



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The Mexican Paradox

Aug 10, 2017 | SANTIAGO LEVY, DANI RODRIK

After a series of macroeconomic crises in the mid-1990s, Mexico undertook bold reforms, from liberalizing its economic policies to investing in education. But, while these efforts brought some benefits, they failed to spur significant productivity and economic growth.

FEATUR

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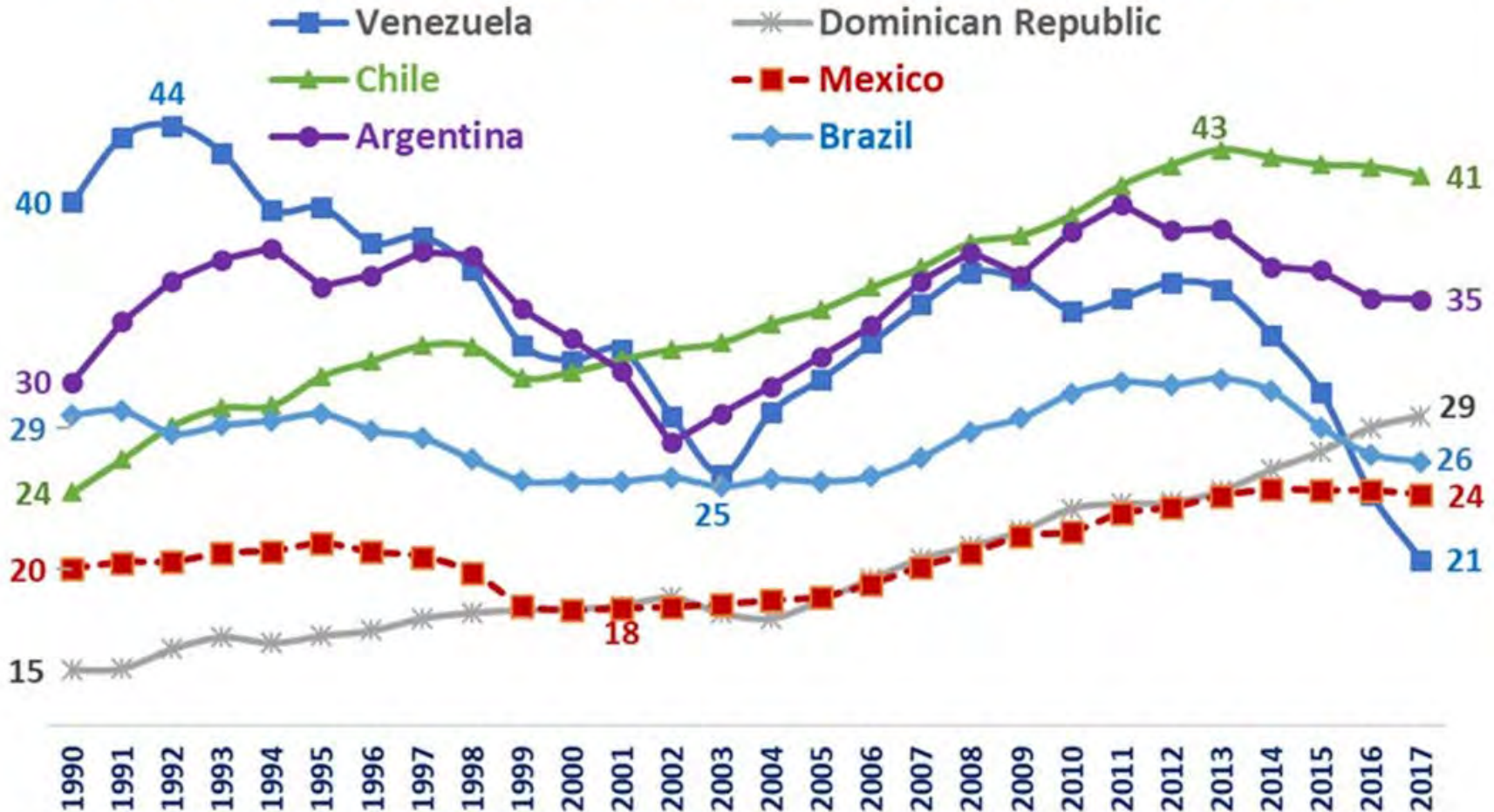
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Why has Mexico not exceled?

Figure W-2 1990 peers per capita income as % of U.S. \$PPP 2011



Source: IMF, WEO Oct 2017, <https://www.imf.org/external/pubs/ft/weo/2017/02/weodata/index.aspx>


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Mexico is nothing if not resourceful: the “day of the dead” celebration that Spectre was fictional but...

X-Ray ^ | View All

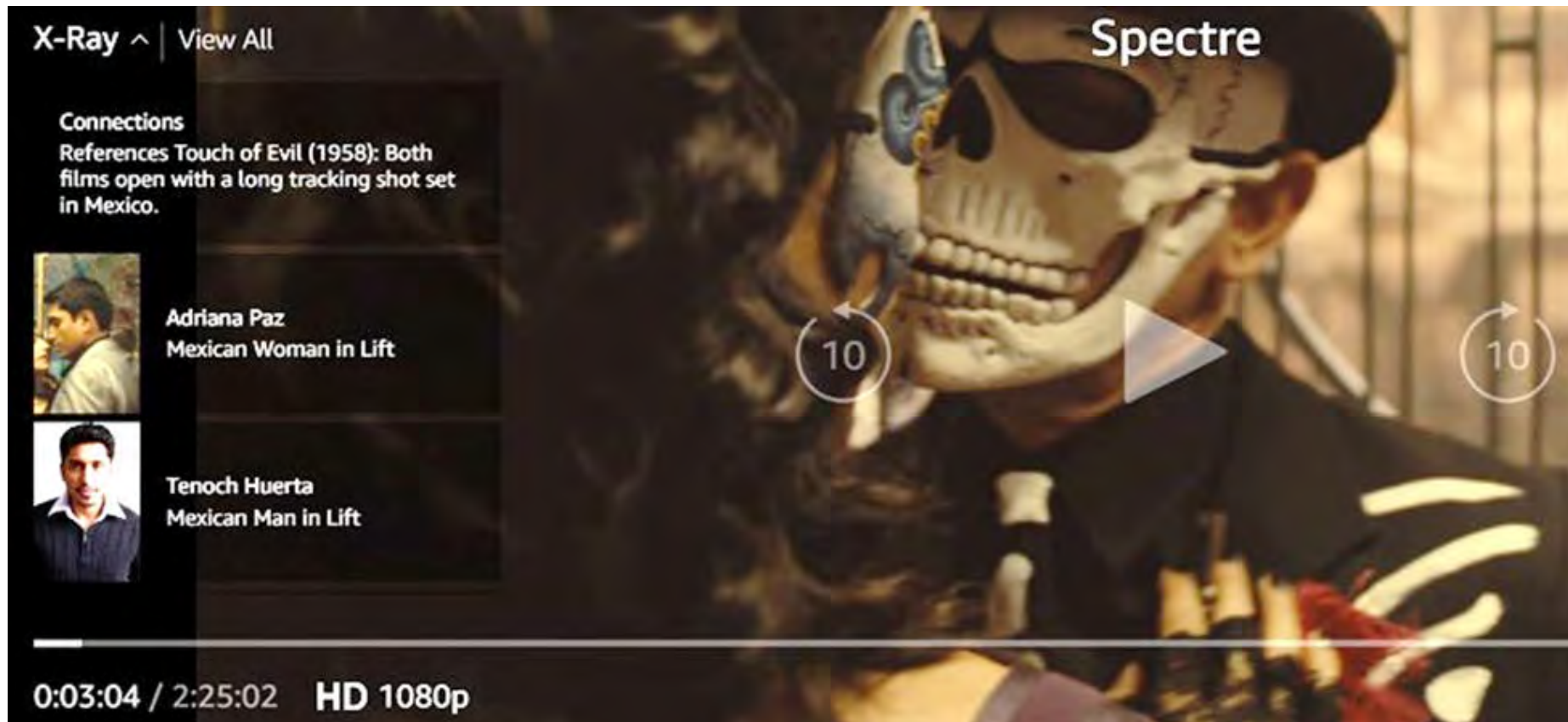
Spectre

Connections
References Touch of Evil (1958): Both films open with a long tracking shot set in Mexico.

 **Adriana Paz**
Mexican Woman in Lift

 **Tenoch Huerta**
Mexican Man in Lift

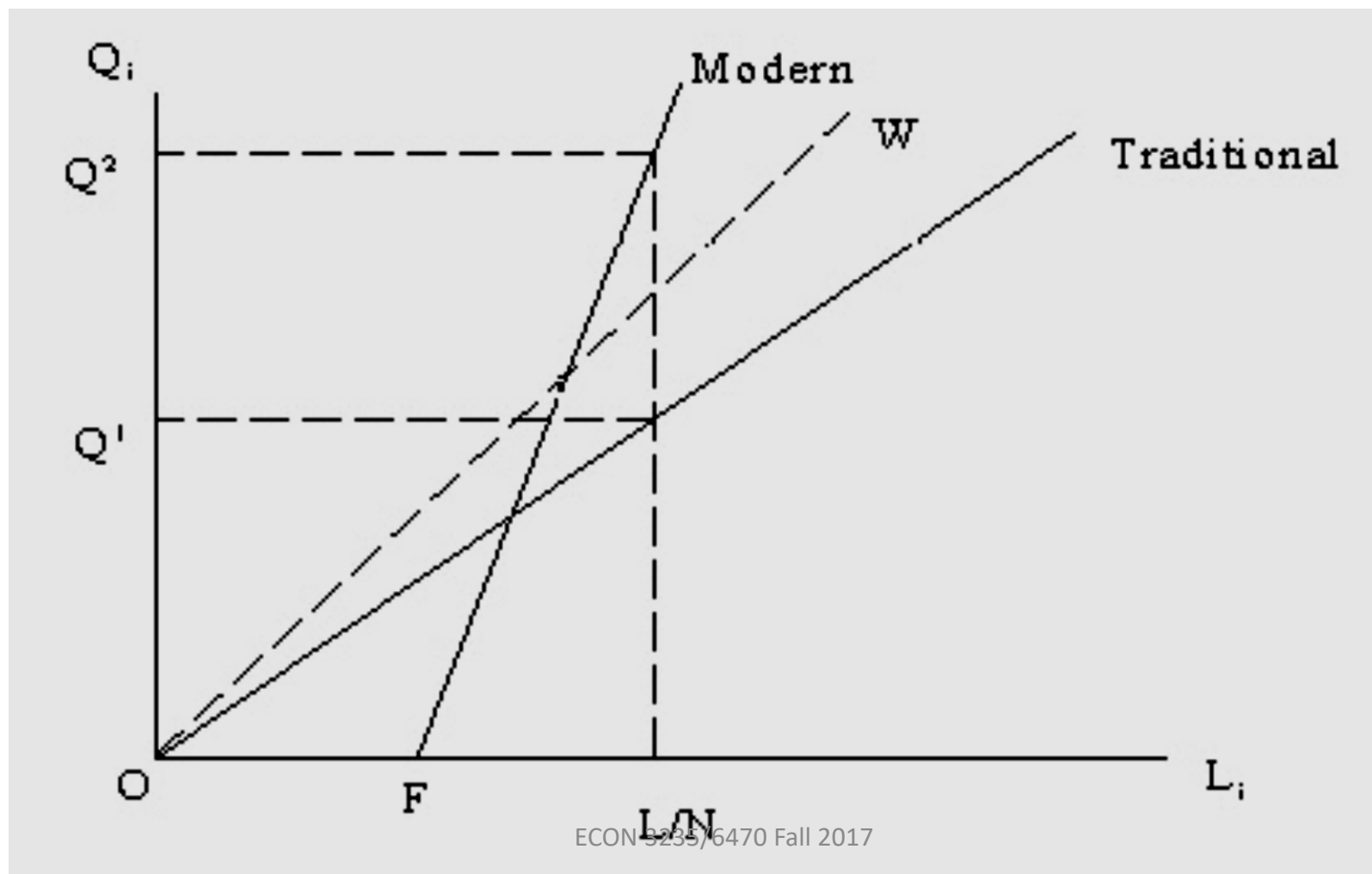
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Tenoch Huerta in Sin Nombre & Spectre

At Q_2 the modern sector is profitable, at Q_1 it is not,
... See discussion of Figure 1 in Krugman, [Rise and Fall of Development Economics](#) [see last page](#)



Garment factories have higher fixed costs leading to increasing returns

- Home production (H is formal education):

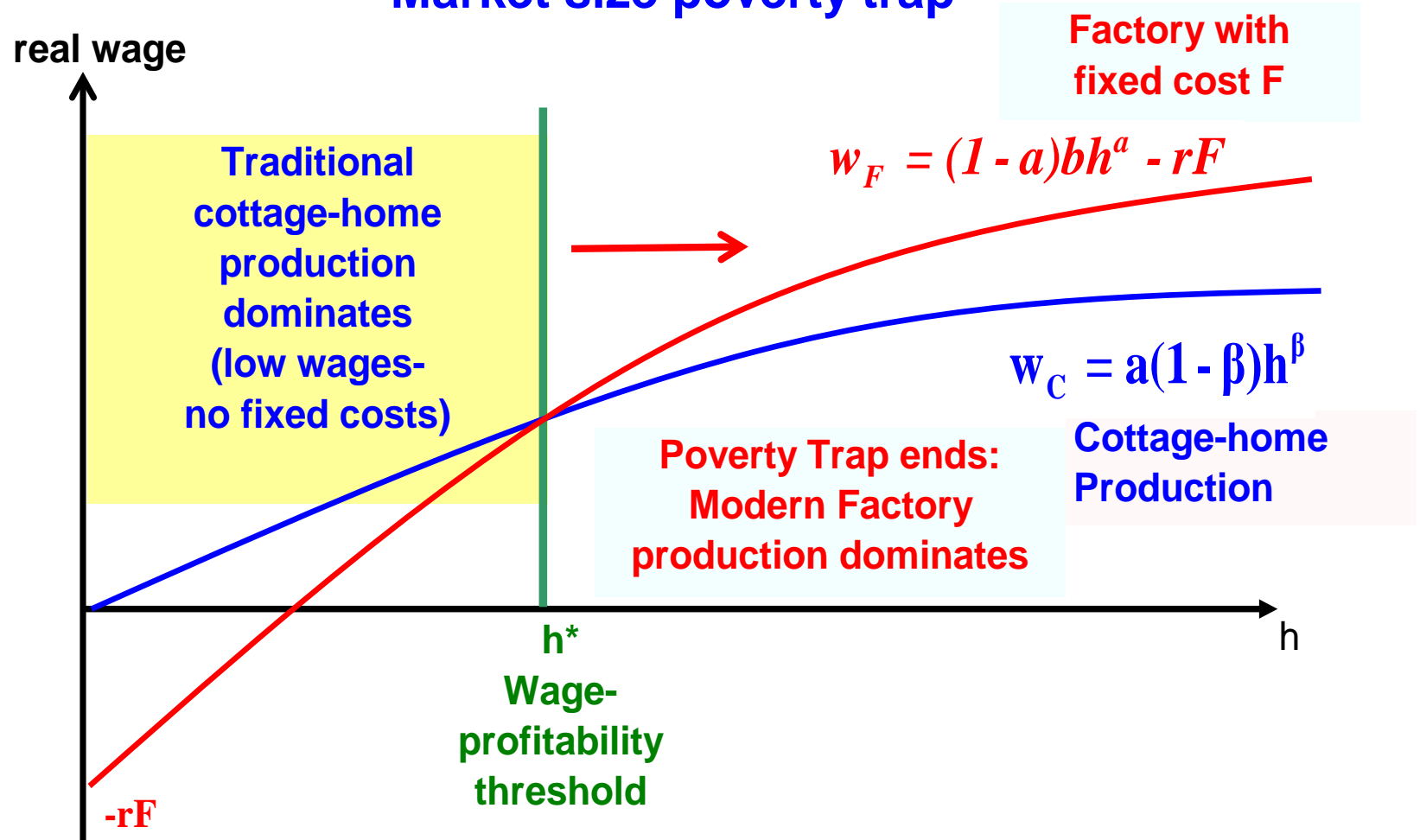
$$Q_T = aH^\alpha L^{1-\alpha}$$

- Factory production: (F is fixed cost)

$$Q_T^F = F + bH^\alpha L^{1-\alpha}$$

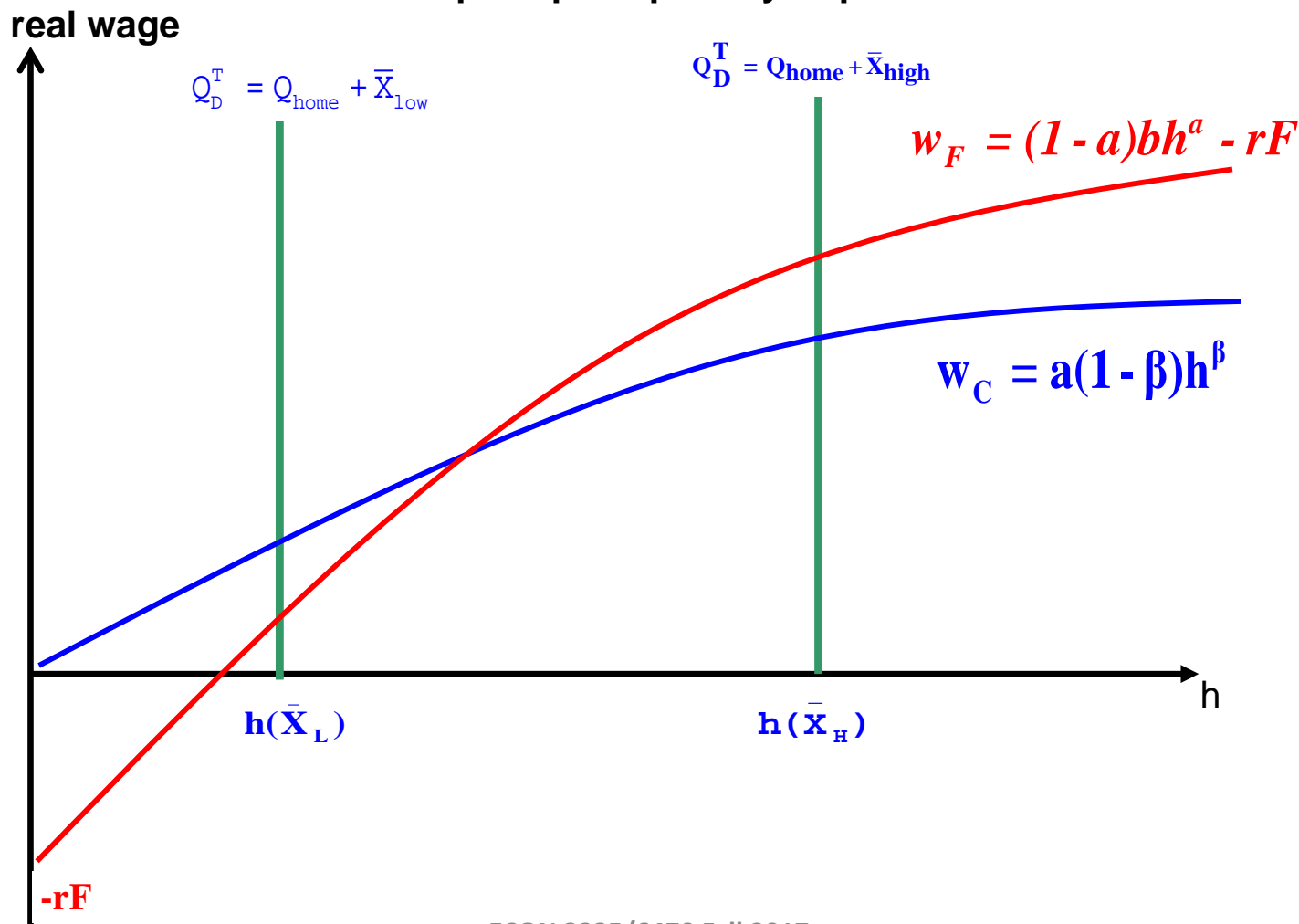
- Key assumption: b much larger than a so real wages higher .

Figure 8
Market size poverty trap



Additional MFA quotas ends poverty trap, allows factories to pay higher wages than traditional firms

Figure 7
An export quota poverty trap



S-shaped Poverty Trap with increasing then decreasing returns creates two steady states, k^* low and k^* high (not growth rate the same at both, a typo?) [BSIM Ch 1p, 76](#)

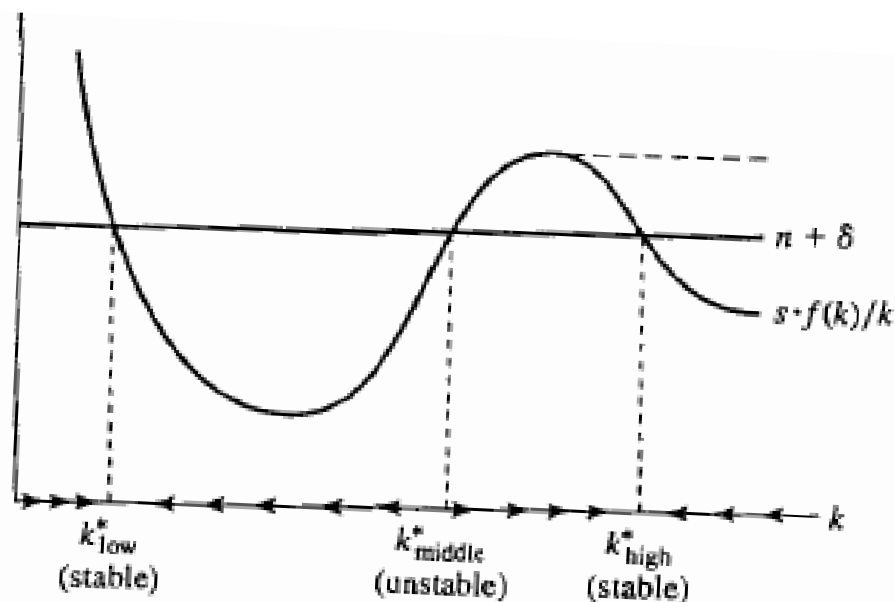
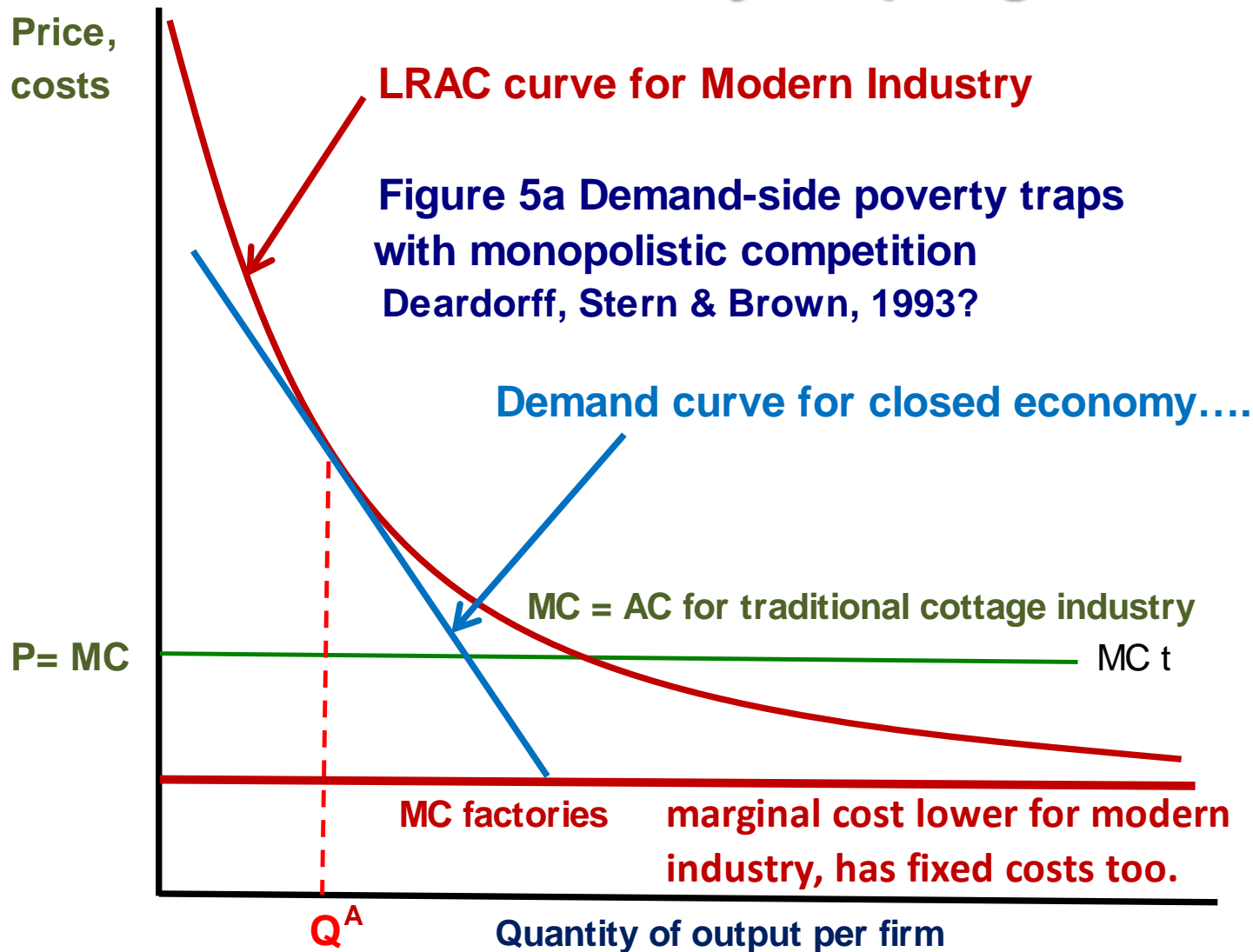


Figure 1.19

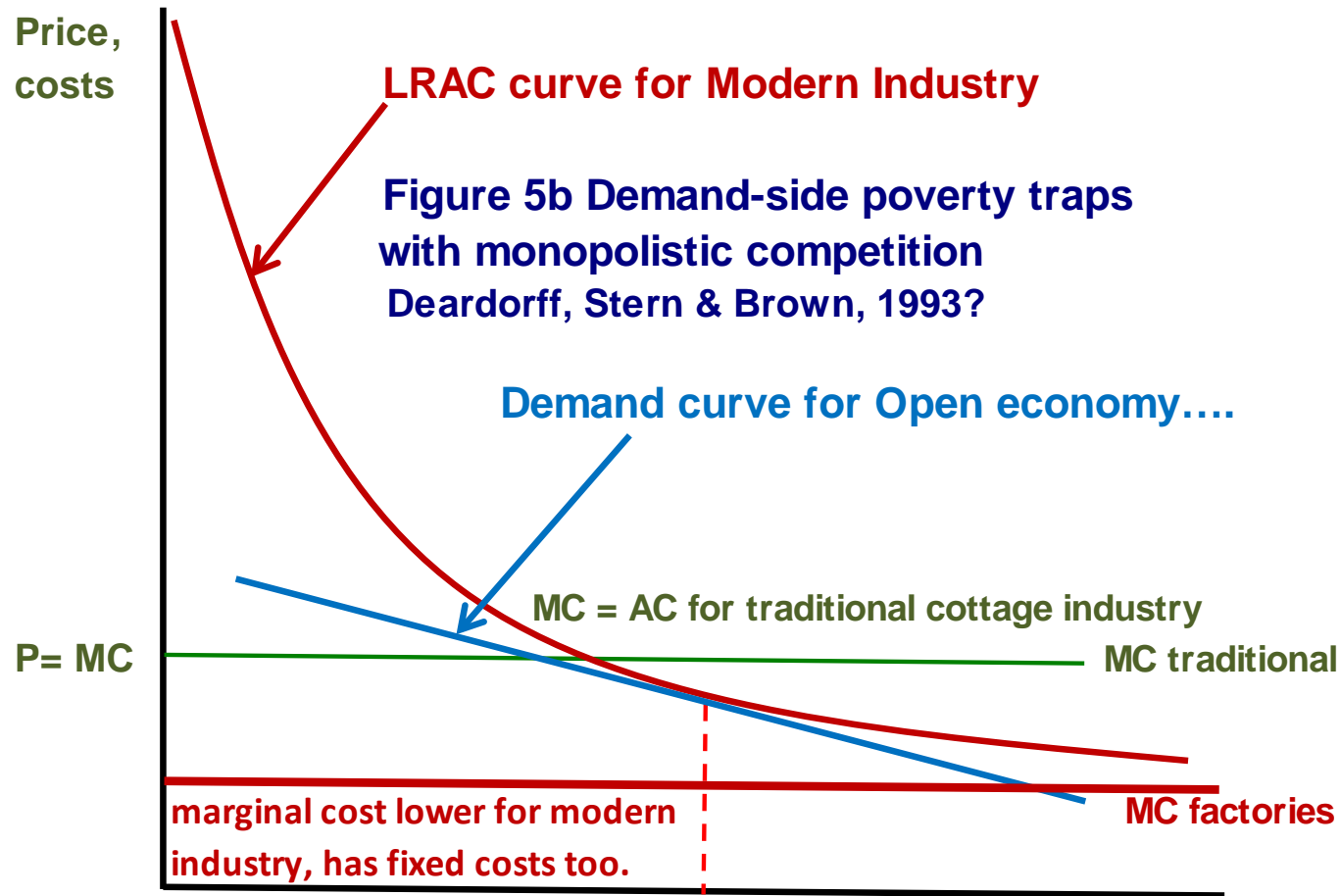
A poverty trap. The production function is assumed to exhibit diminishing returns to k when k is low, increasing returns for a middle range of k , and either constant or diminishing returns when k is high. The curve $s \cdot f(k)/k$ is therefore downward sloping for low values of k , upward sloping for an intermediate range of k , and downward sloping or horizontal for high values of k . The steady-state value k_{low}^* is stable and therefore constitutes a poverty trap for countries that begin with k between 0 and k_{middle}^* . If a country begins with $k > k_{middle}^*$, it converges to k_{high}^* if diminishing returns to k ultimately set in. If the returns to capital are constant at high values of k , as depicted by the dashed portion of the curve, the country converges to a positive long-run growth rate of k .

Demand side Poverty Trap Figure 5a



With inelastic demand, modern firms cannot compete (unless they outlaw competition-- perhaps with import tariffs or quotas + barriers to entry, expensive & hard to get business licenses or import permits)

Demand side Poverty Trap Figure 5b



Quantity of output per firm Q^{FT} Quantity of output per firm

With more elastic demand in open economy, modern firms can compete, but average firm size increases and productivity grows reducing employment (perhaps) and making traditional firms uncompetitive, but costs fall and productivity of those still employed, average firm size after free trade is larger, economies of scale cover fixed and lower LRAC as traditional no fixed cost firms exit.

**Closed
economy
demand side
poverty Traps:
evidence from**

Hsieh, Chang-Tai,
and Peter J.
Klenow. 2010.

"[Development
Accounting.](#)"

[American](#)

Economic Journal:
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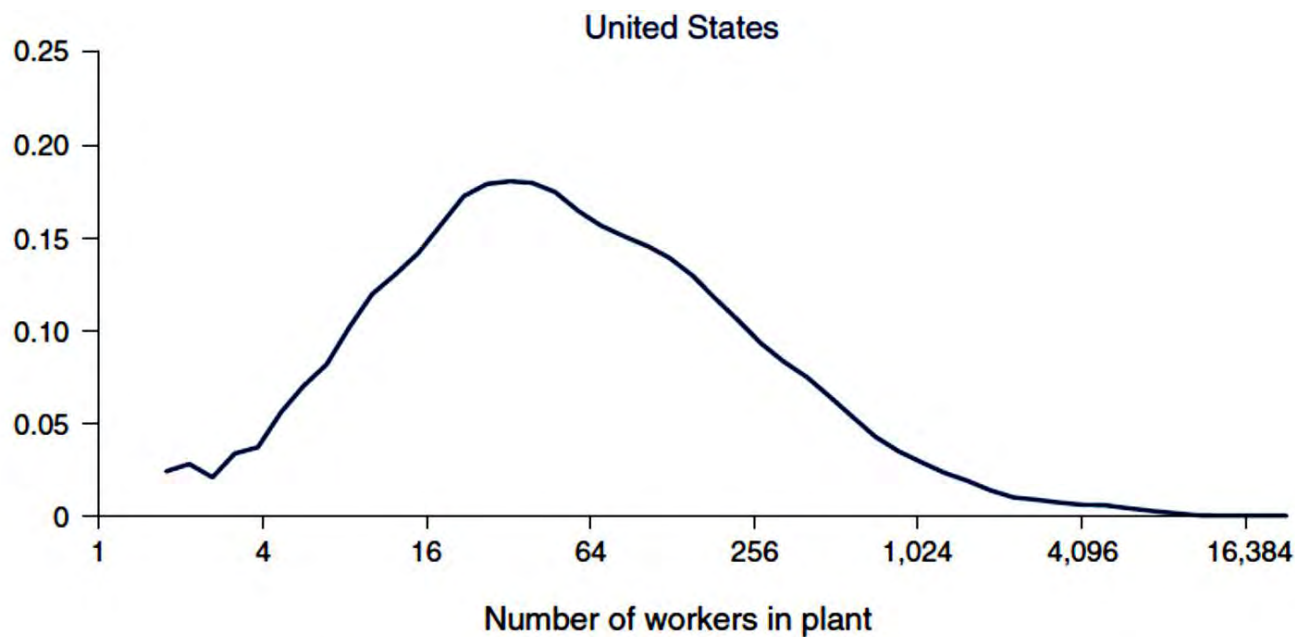
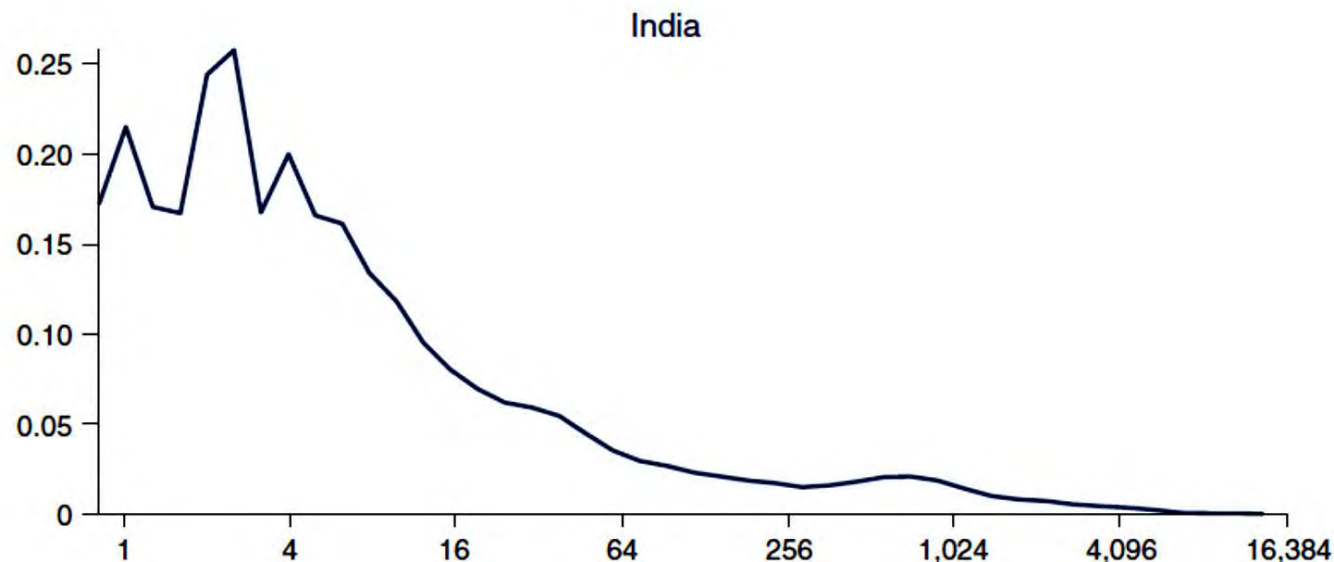


FIGURE 9. DISTRIBUTION OF PLANT SIZE, INDIA VERSUS THE UNITED STATES

References

Amirapu, A., & Subramanian, A. (2015). Manufacturing or services? An Indian illustration of a development dilemma. [Center for Global Development Working Paper](#), (408).

Krugman, P. (1994). The fall and rise of development economics. *Rethinking the development experience*, 39-59.

[Murphy, Kevin M, Andrei Shleifer, and Robert W Vishny](#). 1989. "Industrialization and the Big Push." *Journal of Political Economy* 97 (5): 1003-1026. (cited by 2195)