The Doubtful Future of the FTAA

The recent Americas Business Forum held in Toronto, Canada was intended to bring together the lobbying interests of business and government during the negotiation process of the FTAA. The event was noteworthy by the absence of any heavyweight political or business leaders. As the President of the US chamber of Business pointed out, the year 2005, the moment at which the Americas economies are to unite under one trade block, is too far into the future to be taken seriously in the present.

Since the original Miami summit in 1994 put the FTAA dream in motion, dozens of committees, comprised of the hemispheres bureaucrats, have been hard at work laying out the ground rules, or more likely different rules scenarios. Unfortunately, no country has yet to take any political leadership on the FTAA.

The concept has met with some obstacles. Mexico's devaluation fiasco soured the US interest in expanding its trade bloc further south. The Brazilian Real devaluation has seriously handicapped the relationship between Brazil and Argentina and converted the Argentines from dedicated free traders to skeptical at best. The condescending overtones of the US congress drug certification process makes enemies of several countries to any US led initiatives.

There is a commonly held belief in most of the hemisphere's 34 nations that freer trade is a positive step. Today, consumers pay far too much for imported goods. Industries trying to modernize need technology and training from abroad but pay up to 100% more than the same products and services cost in the USA or Europe. Even local governments who are trying to clean their water systems or computerize their health system face restrictions on imported technology.

The few forward thinking politicians and advocates who embrace free trade and voice their opinions have a lot of empirical evidence to support their reasoning for a trade bloc. The NAFTA ambitiously united the world's largest economy with a mid-size developed economy and a large developing and traditionally protectionist economy. Pockets of all three economies have suffered but as a whole, the members have grown thanks to the trade opportunities delivered by the NAFTA. Mexican goods now account for 12.3 percent of all US imports, up from 6.8 percent before NAFTA. In contrast, US goods account for 79 percent of all imports Mexicans buy, up from 69 percent. Mexico would not have received the massive credit support in early 1995 without the NAFTA to justify it. Mexico would not have embraced the Canadian standard for all its environmental regulations (recently announced) without the ties built through the NAFTA.

Yet in spite of all the proven benefits that support free trade, the FTAA dream remains beyond grasp for a number of primarily political reasons. The FTAA needs US leadership. The US makes up 75% of the hemisphere's economy. Almost every country in the region lists the US as its top trading partner. In Washington, advocates of the FTAA are now resigned to wait until after 2000 elections because there is no incentive to push the subject at present. President Clinton lost valuable political capital when he confronted his own personal demons in public. Fortunately, the four leading candidates, two from each party, are all free traders.

In this Issue:

Your Suggestions
Email our Monthly Report Writer, Jose Luis Gomez
jlgomez@infoamericas.com

For More Information
please consult our Website where you will find free industry whitepapers
www.infoamericas.com

Contact Us:

Corporate Office
corporate@infoamercias.com
Tel: +1(416) 927-7448

Mexico City Office
mexico@infoamericas.com
Tel: +52-5-545-4325

Sao Paulo Office
brazil@infoamericas.com
Tel +55-11-3044-1371

George Bush Jr., perhaps the leading contender, is an unequivocal supporter of the NAFTA and a friend of many Mexican politicians. None-the-less, the rest of the hemisphere will have to wait until mid-2001 before the FTAA reaches the to-do list of the next US executive office.

The other vital piece of the puzzle is Brazil. As the largest economy in Latin America and the anchor of Mercosur, Brazil knows that it weighs heavily in any free trade talks. Brazil's strategy has always been to build a stronger Mercosur and negotiate from a position of strength against the Americans.

Up until early 1999, Cardoso was the most popular President in South America and Brazil's disparate internal political interests were ready to make the necessary sacrifices to expand Mercosur and even embrace the FTAA. How times have changed. The devaluation of the Real stripped Cardoso of credibility. His opinion poll support sits at less than 30%. The left wing opposition in congress and at state levels is pressing for more fiscal spending, driving the Presidency inward to deal with domestic issues. The Argentines, Brazil's close cousin through a decade of the Mercosur is bitter and skeptical after Brazil floated the Peso without warning and threw the Argentine economy, stuck with an overvalued currency, into an un-competitive position.

A third daunting challenge facing the FTAA is the disparity of economic size amongst its proposed members. How on earth can Trinidad & Tobago compete in a free trade bloc that includes the USA or even its neighbor Venezuela? It seems a reasonable question when you consider that the economic premise for free trade is based upon the fruits of economies of scale that emerge from specialization and free trade. The most specialized agricultural economies of the Caribbean that dedicate close to all their fertile land to banana production still cannot come close to competing with central and south American banana exporters. At least one third of the 34 countries in the hemisphere are generously defined as tiny economies. These countries' governments have long relied on import duties to support a government structure. Can they afford to vote for free trade?

Another risk to integration is the re-emergence of populist politics in the region. The democratically elected President Chavez of Venezuela is being closely watched by all. Ten years of neo-liberal policies may have increased trade and investment but they have devastated the pocket books of the region's middle class. Only Uruguay, a country that has moved much slower than others towards an open economy, can claim that its middle class has grown as a proportion of society. In all other Latin American countries, even stars like Chile, the middle class has shrunk. In every country, unemployment has risen, while the social welfare system has been slashed. Armed with a transparent vote, the disgruntled middle class may choose to vote for a return to populist traditions.

With all of these obstacles ahead of any ratification process of the FTAA, what will become of this ambitious yet worthy initiative? It is too early and too difficult to make bold predictions. One possible scenario is the continuation of sub-regional blocks being formed and strengthened. Central America will probably form its own trade bloc and the Mercosur will likely move forward and may embrace more associate members such as Colombia, Venezuela and Peru. Mexico will continue to push for bilateral agreements within the region and importantly across the globe, now Europe, Japan next?

If US leadership can come forward again in 2001 and give the FTAA the support that it deserves, then perhaps some ratification may begin. It is likely that the US will turn to middle economies like Colombia, Peru, Chile, Bolivia, Ecuador and a Central American bloc and invite them to join the FTAA along with Canada and Mexico in its first round. Second and subsequent waves of membership would embrace Mercosur and the tiny Caribbean nations, upon guaranteeing lengthy phase-in periods and certain protections. Such a vision reflects what happened with the EEC whereby the most committed members joined first and more hesitant countries joined on only after evaluating its merits in practice. Such a scenario is not perfect, but it seems much more realistic than the idealistic 34 nation unified bloc on the books today.

MEXICAN AUTO INDUSTRY FORECAST

Mexico's automotive industry is only a few steps away from joining a seamless North American industry. The NAFTA has yielded profound effects on Mexico's auto sector. By exposing itself, through the NAFTA, to the most competitive autoparts region of the world (Canada and the USA), Mexico's pace of reform over the next 9 years will be startling, some of it to the detriment of Mexico's existing suppliers.

Beyond the NAFTA, the world's auto industry is globalizing and consolidating at all levels from auto assembly to 2nd and 3rd tier autoparts makers. Terminal assemblers are increasingly seeking globalized 1st tier suppliers to ensure greater economies of scale and simplified supply logistics. Assemblers have embraced the concept of one plant for the global market. Volkswagen's new "Beetle" production in Mexico, as an example, ships product worldwide.

Auto Assembly

For Mexico, consolidation of vehicle assembly is a positive move because Mexican based assembly plants can source parts from all over North America duty free. Mexico is a proven competitor in sub-compact, compact and light truck assembly.

VEHICLE PRODUCTION BY TYPE

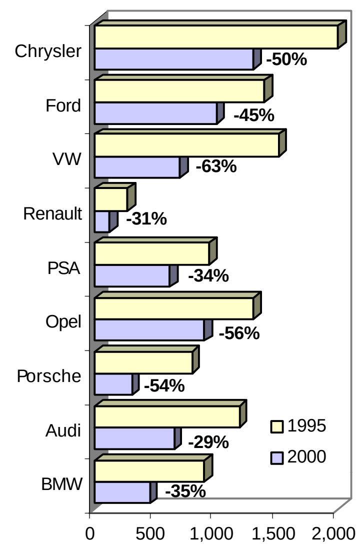
	Units Produced	
Segment	**1995**	**1998**
Compact	532,328	618,470
Light Trucks	230,684	464,911
Sub-Compact	160,215	260,708
Sport & Luxury	6,769	73,731

Source: SECOFI

The Big Three US auto assemblers have led production growth in Mexico since 1995. These companies had the flexibility to re-tool for exports when demand shifted from the domestic market to the export market. Before the collapse of the domestic market in 1995, the production leaders were Volkswagen and Nissan, in that order.

CONSOLIDATION OF SUPPLIERS

number of first tier suppliers



overall decrease 51%

In 1995, Mexican car consumption dropped 70% from the year before. Mexico's integration in the North American auto industry coupled by dazzling flexibility on behalf of the big three ensured that Mexico's auto assembly dropped only 17%. In 1999, domestic consumption is just now returning to 1994 levels. Auto production, on the other hand, recovered quickly from the down turn and by 1996, Mexico was recording historic levels. Each year since has marked a new record.

Mexico's blazing export growth leveled off in 1998 as a world supply glut relieved market demand in the US. As the US market slows over the next two years, auto imports from Mexico will stop growing or even shrink slightly. What will drive Mexican production until 2004 will be domestic demand. Mexican car consumption has long suffered from handicaps that have led to the development of an aging vehicular park and sub-optimal car ownership levels. The most important factor is a lack of financing options. Lending rates in Mexico today stand at 25%, onerous to anyone and not even offered at those rates to most middle class or working class Mexicans. When carmakers last forayed into subsidized lending as a way to boost sales in 1994, consumption shot up to record levels. Another factor has been protectionist policies surrounding the autoparts industry that produced a costly industry and raised prices for consumers.

As the NAFTA takes hold, automobiles assembled for sale in Mexico will come down in price. Retail prices will drop significantly in 2004 when US and Canadian assembled vehicles enter Mexico duty free in unlimited numbers. In 2009, 10 year old used cars can enter Mexico duty free. By 2018, one year old used cars will cross the border. Used car trade in Mexico will boom. Working class Mexicans will be able to buy a car or truck for the first time and the illegal import of US vehicles will screech to a halt.

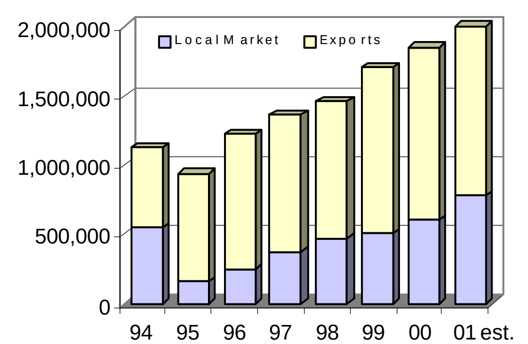
In the five years leading up to 2004, close to 6 million vehicles will become more than 15 years old or otherwise grow obsolete. This translates into a replacement demand of 1.2 million vehicles per year, in addition to market growth. These levels are more than double the existing domestic market volume and imply substantial future growth. Given Mexico's moribund banking system, real interest rates will remain high and credit will remain tight for another 4-5 years. Therefore, demand will not reach its 1.2 million vehicle potential until around 2006, helped by a flood of imports that will take a 1/3 market share in Mexico.

Projected Vehicle Consumption
Mexico 1995 - 2006

Year	Produced in Mexico	Imported	Total
1995	160,990	27,814	188,804
1996	251,437	88,987	340,424
1997	364,971	138,471	503,442
1998	469,435	197,396	666,831
1999	560,000	190,000	750,000
2000	600,000	250,000	850,000
2001	680,000	170,000	850,000
2002	700,000	200,000	900,000
2003	725,000	225,000	950,000
2004	750,000	250,000	1,000,000
2005	775,000	325,000	1,100,000
2006	815,000	385,000	1,200,000

Source: SECOFI, InfoAmericas

TOTAL VEHICLE PRODUCTION



Source: SECOFI

Mexican Minimum local content % of components

1994	36%	2001	31%
1998	34%	2002	30%
1999	33%	2003	29%
2000	32%	**2004**	**ZERO**

Autoparts

Mexico's autoparts industry will not fair so well over the next ten years. Industry consolidation is pushing continental assemblers in North America towards fewer, larger, well financed first tier autoparts suppliers. Probably only 1/5 of Mexico's autoparts companies, representing 55% of the nation's production, are qualified to survive in the brave new world of post-NAFTA autoparts trade. D-day for Mexico's autoparts industry is January 1st, 2004 when Mexico's minimum local content decree expires. The Mexican government, pressured by local industry, fought for a rather incongruous phase out period that drops suddenly from 29% minimum content in 2003 to zero in 2004.

Mexico's autoparts industry will be forced to specialize. New investment in the sector already reflects this. Large investments by foreign and Mexican autoparts production has focused on export ready products that can compete in a North American market. By 2006, today's list of 500+ 1st tier autoparts makers will shrink to less than 300 companies, confined to a small list of products that are competitively made in Mexico. The total value of Mexican autoparts production may shrink in 2004-5 but will begin to grow as investment in the strongest product segments pays off.

Mexico's MOST competitive autoparts (positive trade balance)	Mexico's LEAST competitive autoparts (negative trade balance)
1. Electrical systems	1. Carpeting and seats
2. Instrument panels	2. Stamped parts
3. Windshield glass and wipers	3. Motor parts
4. Transmissions	4. Tires
5. Assembled motors	5. Paints and chemicals

Published by InfoAmericas, Inc. www.infoamericas.com email – corporate@infoamericas.com
Latin America's leading market intelligence and strategic consulting firm
Offices in Mexico City, Sao Paulo, Toronto
Affiliates in Argentina, Chile, Venezuela, Colombia, Peru, Uruguay, Ecuador, Panama, Costa Rica, El Salvador, Honduras, Guatemala, Puerto Rico

Mexican Autoparts Maker	Challenges	Strategy for success & Outlook
Foreign owned Global Player (e.g. Delphi, Bosch)	• **Rely heavily on trade and are vulnerable to border bottlenecks** • **Face higher import tariffs on non-NAFTA component imports than competitor plants in the US and Canada.** • **Service US market but are exposed to Mexico country risk and potential US protectionism.**	• **Work with local terminal assemblers to make sure that assemblers do not drop production after 2004 when unlimited imports can enter** • **Diversify customer base in Mexico beyond big three to European assemblers who may arrive through their own free trade agreement with Mexico** • **Lobby Mexican government to lower tariffs on Asian 2nd tier components.** • **Positive outlook thanks to economy of scale and healthy financing. Will gain market share**
Large Mexican Producers (e.g. Alfa, Vitro)	• **Erosion of PITEX advantages and emerging disadvantage vis-à-vis the tax breaks of foreign dominated maquiladoras.** • **Reliance on costly and poor Mexican transportation infrastructure.** • **Face higher import tariffs on non-NAFTA component imports than competitor plants in the US and Canada.** • **More burdensome fiscal environment than US and Canadian competitors.**	• **Form alliances with global players to ensure access to foreign markets, improve product development and obtain more attractive financing** • **Focus investment on most exportable product groups and divest from less competitive areas** • **Lobby Mexican government for more competitive fiscal and trade regulations.** • **Mixed outlook. Race to globalize will determine the survivors.**
Foreign owned Mid-size Producers	• **Heavy reliance on Mexican 2nd tier suppliers and exposed to Mexican infrastructure inadequacies.** • **Came to Mexico upon invitation of their assembler clients** • **Undiversified client base in Mexico and low export volume**	• **Must diversify customer base in Mexico, especially towards Japanese and European assemblers who will continue to respect minimum content laws** • **Improve efficiency to exportable levels** • **Divest from Mexico production that is less competitive than US/Canadian based production** • **Negative outlook. Their cozy protected environment will be shattered in 2004.**
Mid-Size Mexican Producers	• **Heavy reliance on Mexican component and raw material suppliers** • **Limited access to assembler buyers** • **Compete against Asians in spare parts market on price** • **Under financed**	• **Must move to become 2nd tier "niche" suppliers because they cannot handle the fiscal burdens of a 1st tier supplier.** • **They need to establish alliances with foreign partners who can inject capital and technology into their operations** • **Lobby government to crack down on illegal imports of cheap Asian spare parts.** • **Weak outlook. Less than 50% will survive.**

Mexico's industrial competitiveness will be rigorously tested over the next five to ten years. The recent signing of a free trade agreement between Mexico and the EU will place further pressures on Mexico's automotive industry. Mexico is a proven competitor in labor intensive auto assembly, thanks to its abundant and inexpensive low-skill labor pool that is adept to training and unlikely to organize in a threatening fashion. However, the Mexican autoparts industry, beyond its very labor-intensive segments (electrical panel assembly, etc) is not a proven competitor. Mexico's 1st tier autoparts producers require cheaper financing, better trained employees, and a more attractive business environment to survive the onset of open competition through the NAFTA and soon afterwards, European free trade. US, Canadian, and European competitors will be preparing to capture the long awaited fruits of free trade.

INFOAMERICAS Current Projects

Sector	Markets Studied	Description
Automotive Repair Service	Mexico	A national level evaluation of the productivity of one of Mexico's leading auto dealership/after sale service networks.
Banking Services	Mexico	Competitive Analysis of Mexico's top five retail banks in select services.
Computer	Mexico	Competitive intelligence and price tracking of computer hardware for various US and Asian computer hardware producers.
Construction & Housing	Mexico	Industry analysis written on behalf of the Canadian Department of Foreign Affairs.
Credit Cards	Brazil	Market size and trend analysis of consumer and business to business credit cards.
Electrical Appliance Parts	Mexico	A market and competitive analysis of Mexican production of electrical appliances on behalf of a leading parts supplier.
Electrical Appliances	Mexico	Market size and growth and competitive analysis conducted for a leading US manufacturer of consumer appliance products.
Energy, construction, environment	Mexico	Development of a market intelligence Website for Alberta exporters interested in the Mexican market. Includes weekly updated project intelligence, Mexican distributors and agents database, Industry news, Pemex tender translations, and useful Website links in Mexico.
National Competitive Analysis	Mexico, Brazil, Argentina, Chile	The Mexico Investment Board has contracted InfoAmericas to analyze the competitiveness of Mexican industry vis-à-vis key competitors in Latin America and Asia.
Office Products	Mexico	A market size analysis of leading office products in Mexico via desk research.
Packaged Food	Mexico	J/V Partner search on behalf of a leading US beverage ingredient producer.
Retail Distribution	Brazil	A secondary research assignment that measures and segments the retail sector in Brazil.
Wireless ISP	Argentina, Brazil, Chile, Colombia, Ecuador, Central America, Mexico, Paraguay, Peru, Uruguay, Venezuela	An analysis of potential market "pockets" across the region based upon demographics, spending power, telecom penetration, telecom liberalization, and computer ownership.
Waste Management	Brazil, Argentina	Strategic market research of waste management policies and regulations, waste collection market, competition, market entry options on behalf of a leading US waste collection equipment supplier.
Wireless telecom	Mexico	Marketing strategy consulting for a leading Mexican paging company.

ECONOMIC FORECAST – MEXICO FOCUS

Mexico has proven to be a haven of stable growth in a volatile year for Latin America. Neither the devaluation of the Real nor the debt default in Ecuador seemed to trigger an external shock on Mexico's economy, whose prospects are increasingly tied to North America.

US consumer growth kept Mexico's manufacturing exports expanding, even while raised oil prices strengthened the Peso. The Mexican Central Bank will meet its 1999 inflation targets, thanks to an appreciated currency and continued tight monetary policy. Rebounding oil prices, that still constitute over 30% of the nation's fiscal revenue, will enable the government to achieve a low budget deficit.

2000 marks the final year of the sexeño (Presidential 6-year term) when traditionally the PRI expands fiscal deficits to boost job creating sectors like construction. Previous administrations, who managed the Peso, often spent precious foreign reserves to prop up the currency, whose value vis-à-vis the dollar can become barometer of nationalism during the election season.

Most analysts believe that this time, things will be different. Mexico's move to a floating Peso in 1995, albeit a dirty one at best, marks an important disarmament of the President's economic influence. A floating Peso prevents Mexico's trade and currency measures from growing unbalanced. It also keeps real wage growth slow. There has been no boom in this sexeño, following the bust of '95, but rather a slow and painful climb from the 30% loss in consumer purchasing power that resulted from 52% inflation & 20% wage gains in 1995. The risks of a post-election devaluation are largely factored into the present Peso value.

Today, Mexico's debt position and current account deficit are in far healthier terms than they were in 1994. The federal governments taste for dollarized debt went sour with a floating Peso, replaced by albeit expensive but less risky Peso denominated debt. Mexico's stock exchange attracted increased foreign monies in 1999 but foreign direct investment exceeds portfolio investment, a reverse of the situation in 1994. Almost two-thirds of next year's current account deficit will be covered by FDI.

Statistical Snapshot

Indicator	1998	1999f	2000f
GDP (USD Bn)	$412	$458	$466
Real GDP Growth	4.5%	3.3%	2.9%
Inflation	18.2%	13%	12.5%
Lending Rates	36%	20%	20%
Fiscal Balance (% of GDP)	-1.2%	-1.0%	-1.7%
Exports (USD Bn)	$117.5	$130	$135
Imports (USD Bn)	$125.2	$135	$143
Trade Balance (USD Bn)	-$7.7	-$5.0	-$8.0
Current Acct (USD Bn)	-$15.8	-$11.0	-$14
Current Acct (% of GDP)	-3.8%	-2.4%	-3.0%
Foreign Direct Inv. (USD Bn)	$10.2	$10.1	$9.0
FDI/Current Acct Deficit (%)	64.5%	91.0%	64.2%
Foreign Reserves (USD Bn)	$31.8	$32	$30
Foreign Debt (USD Bn)	$165	$161	$166
Foreign Debt (% of GDP)	39.8%	35.1%	35.6%
Peso/USD (annual Avg.)	9.15	9.6	10.7
Peso/USD (end year)	9.88	10.0	11.1

Sources include but are not limited to: *Latinvestor, El Universal de México, El Financiero, SECOFI, Bancomext, EIU, Business Monitor.*

The Mexican government finds itself in the envious position of being able to purchase a "corte" of $160 mm USD per day, even while the Peso continues to strengthen. These funds are destined for the Bank of Mexico's election year war chest, known as the "blindaje" that will be used to defend the Peso if investors get cold feet.

The only unknown factor that remains is the possibility of political instability. It is worth remembering that the previous three Presidential election seasons were marked by violence and/or fraud. Historically, political violence has been driven by both personal vendettas and political motive, and therefore cannot be completely discounted in 2000.

However, even seasoned cynics agree that the Mexico of 2000 is a very different brand of democracy than witnessed in any previous federal election. The PRI successfully completed a leadership primary with 9 million voters; a combined opposition (when they do see eye-to-eye) controls the Congress after clean mid-term elections in 1997; newspapers openly criticize the government; the federal election watchdog (IFE) has both resources and teeth; and opposition controlled state governments regularly confront the federal government over taxes, transfer payments and land control. Clearly, there is an unprecedented level of transparency and debate in Mexico's young democracy.

Mexico is better prepared today than it has been for thirty years to shake the curse of post-election instability that has defined its past. The Zedillo administration has prudently prepared the country for an historic transition.

Published by InfoAmericas, Inc. www.infoamericas.com email – corporate@infoamericas.com
Latin America's leading market intelligence and strategic consulting firm
Offices in Mexico City, Sao Paulo, Toronto
Affiliates in Argentina, Chile, Venezuela, Colombia, Peru, Uruguay, Ecuador, Panama, Costa Rica, El Salvador, Honduras, Guatemala, Puerto Rico