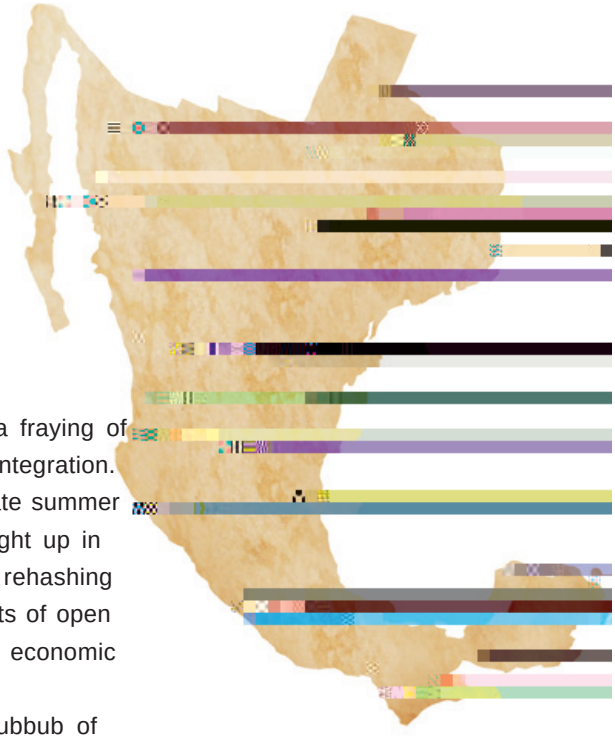
The Texas-Mexico Econom and its Uncertain Future



The past decade has seen a fraying of the consensus favoring greater integration. As we write this essay in the late summer of 2018, Texico's future is caught up in the greater drama of a world rehashing the old battle between adherents of open economies on one side and economic nationalism on the other.

Voters fed up with all the hubbub of economic change are casting ballots for new leaders who campaign on turning back the clock and restoring old ideas that favor protection over production, isolation over integration. With the ground shifting, Texas and Mexico nd their economic partnership at risk.

The challenge to the integration orthodoxy comes at a critical time. The past quarter century gave companies in Texas and Mexico more freedom to do business. They've responded with gusto, making myriad connections, most good for their companies and good for their customers. What's been gained so far, however, pales in comparison to what Texico could become if kept on track. Untapped opportunities abound.

Just over two decades in, Texico remains very much a work in progress—its future brighter than its past. Both sides of the Rio Grande would suffer if the revival of economic nationalism smothered the full realization of the economic partnership between Texas and Mexico.

The Right Time—at Last

Economic integration is an organic process, driven by the private sector. It

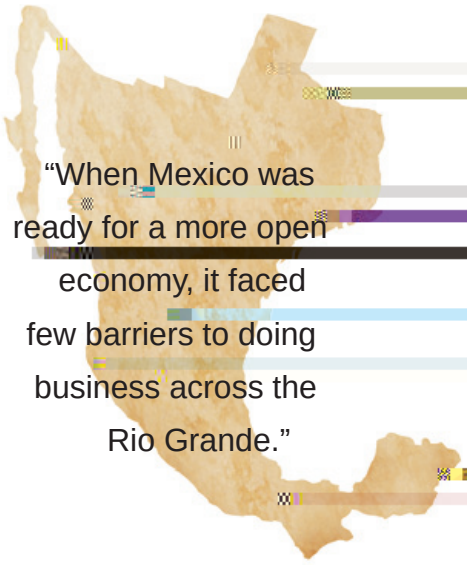
business opportunities.

It took a long time for Texas and Mexico to get it right. When Texas was part of Mexico's northernmost state in the early 1800s, economic collaboration between Texico's north and south was minimal because 900 miles of rough terrain and bad roads separated San Antonio and other Texas settlements from the heavily populated and relatively rich region of central Mexico.

Integration only became less likely after Texas declared its independence in 1836 and joined the United States in 1845. The acrimony of war lingered south of the border, and Texas' drive to integrate focused in other directions, shipping cotton, beef and eventually oil to the rapidly industrializing U.S. and European economies.

Throughout the 1800s and well into the 1930s, tariff walls protected the U.S. market—although Texas and the rest of the South, as exporters of farm products and importers of manufactured goods, generally opposed them. U.S. protectionism hardly mattered to Mexico, a largely agricultural economy with undeveloped ports or railroads that couldn't supply much beyond metals to the emerging American juggernaut.

In the closing decades of the 1800s, Mexico sought to industrialize under President Jose Por rio Diaz, a polarizing gure who served seven terms in the decades after 1876. He welcomed foreign investment, with some success in mining, railroads and



“When Mexico was ready for a more open economy, it faced few barriers to doing business across the Rio Grande.”

EXHIBIT 1

Slow to Gain Traction

Bilateral trade—the sum of merchandise exports and imports—was below 0.5 percent of U.S. gross domesti
1974 and below 1 percent until 1991. It exceeded 3 percent from 2013–15. Even with a surge after Mexico’s
revolution and the influx of farm workers, migration to Texas remained below 200,000 in every decade un
In an era of tighter immigration enforcement, it surged in the 1990s and tightened

0.0%
1869 1881 1893 1905 1917 1941 1953 1965 1977 1989 2001

the country's barriers to foreign trade and investment and joined the General Agreement on Tariffs and Trade (GATT), the multinational pact that certi es the rules for cross-border commerce. (Since then, GATT morphed into the World Trade Organization.)

Mexico jettisoned xed exchange rates. To thwart politically driven monetary policy, it enshrined the independence of Banco de Mexico, its central bank, in the constitution. State-owned enterprises were sold to the private sector. Carlos Salinas de Gortari, the next president, negotiated the North American Free Trade Agreement (NAFTA) with the United States and Canada to cement the open-market reforms. With Texas' economy already open, conditions were right for Texico—at last.

Texas and Mexico lived as neighbors for decades—so why did it take so long for cross-border business to start booming? Throughout the 1800s and most of the 1900s, neither economics nor policy were right, owing mostly to U.S. protectionism and Texas' commodity-based economy. In the second half of the 20th Century, U.S. policy improved, but Texas didn't rapidly diversify until after the 1980s oil bust. The same disruption sent Mexico's policy veering in a radically new direction. It's not too much to say that the genesis of Texico was the wreckage of the 1980s.

A quick look at trade and immigration will con rm the timing of Texico's origin. Data on state-level trade go back only a

Box 1 Texas and Mexico, By the Numbers

Bordering on a Great Divide

Texas was once part of Mexico's northernmost province, relatively poor and isolated, separated by an arduous journey from the population centers and wealth far to the south. After going their separate ways in 1836, the economies of the state and its former country took different paths.

Texas eventually cast its lot with the United States,

EXHIBIT 2

Trade Among Neighbors

shaping economic freedom, the integrity of institutions and investment in human capital.

Forging a stable, dynamic economy that could close the development gap motivated Mexico's opening in the mid-1980s. The country saw its salvation in foreign trade, investment and know-how. Since then, these ows arrived from many places—with big contributions coming from Texas.

Exhibit 1 showed that merchandise trade between the United States and Mexico grew 4.5 times faster after Mexico joined GATT. Domestic and foreign trade differ, but mixing U.S. states with countries shows how Texico's trade skews on a north-south axis. Mexico trades more with Texas than any country, including China. Texas trades more with Mexico than with any other state, including neighbors Louisiana and Oklahoma (see Exhibit 2, top tables, Page 6).

Since 1990, Texas has sprinted far ahead of other states in trade with Mexico. Exports moving south and imports moving north totaled $188 billion last year, or more than 11 percent of gross state product, putting Texas out by itself in doing business with Mexico(see Exhibit 2, bottom chart).

Trade with China, a low-wage competitor of Mexico's, consists mainly of nished goods ready for sale. Within Texico, intermediate goods make up the biggest chunk of what's shipped across the border. The difference stems from geography—deliveries from Mexico usually take days not weeks.

Cross-border supply chains illustrate why the Texas and Mexico economies are more formidable combined rather than separated. In Texico's relatively compact geographical area, companies linked by roads, railways and air service combine low-cost labor, skilled professionals and cutting-edge technology in a highly ef cient production network. The companies emerge more competitive in the global marketplace, able

EXHIBIT 3

Open for Business

With NAFTA's Implementation in January 1994, direct investment broke of the staid pattern of the previous 40 years, reaching new heights for b the United States and Mexico (a) t. The surge in investment coincides with a strong rise in Mexican sales among U.S. multinationals (

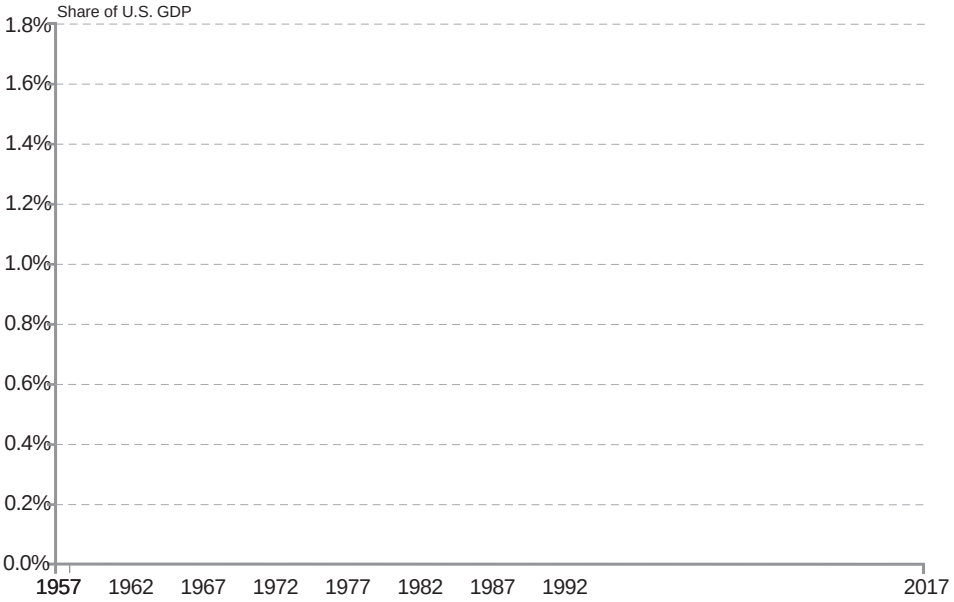


EXHIBIT 4

Working for Texas

Most Mexican-born U.S. workers are concentrated in Texas and a few other states (top chart). Mexicans make up more than half of all immigrants working in Texas, with their biggest contribution—by far—in construction, followed by manufacturing and agriculture (bottom table).

Foreign-Born Share of All Texas Employees (16 Years and Over)

INDUSTRY	Foreign Born	Born in Mexico	Born in Other Latin American Countries	Born Elsewhere
Agriculture	20.8%	12.2%	2.3%	6.4%
Construction	41.8	33.6	6.6	1.7
Manufacturing	27.4	14.7	3.7	9.1
Wholesale Trade	20.3	10.7	3.5	6.2
Retail Trade	17.7	8.8	2.7	6.2
Transportation	20.2			

northward and expanding their businesses, with tortilla-maker Mission Foods and Cinépolis, a movie theater chain, both settling in the Dallas area.

Setting up business in other countries entails foreign direct investment (FDI)—money spent to gain a physical presence on the ground. For most of its history, Mexico has been labor rich and capital poor; attracting more FDI was a key goal of the country's market opening. Data aren't available for Texas' FDI in Mexico, but state firms no doubt played a big role as the U.S. total soared to unprecedented levels since NAFTA went into force (see Exhibit 3, top chart, Page 7). Most U.S. companies invest in Mexico to establish supply chains that lower production costs.

A relative trickle before NAFTA, Mexican FDI bound for the United States picked up sharply in the past two decades. For Mexican investors, of course, the motive for FDI is almost always tapping into the rich U.S. consumer market. Many companies start U.S. operations selling to Hispanics, then broaden to a larger and more diverse market once they've established themselves.

Not all U.S. companies invest in Mexico to produce. Some enter the market to sell to consumers who display an affinity for U.S. brands. FDI catering to consumers has paid off: U.S. multinationals' sales jumped from 0.5 percent of U.S. GDP in 1989 to around 1.6 percent of a much higher GDP in the most recent data (see Exhibit 3, bottom chart).

Integration doesn't just entail goods and capital finding their markets. For millennia, migrants have been moving across borders to find work. Mexicans who want to work legally in Texas—or anyplace else in the United States, for that matter—face strict immigration limits intent on keeping foreigners from

Falling Behind

In recent decades, Mexico hasn't kept pace with the United States or the top

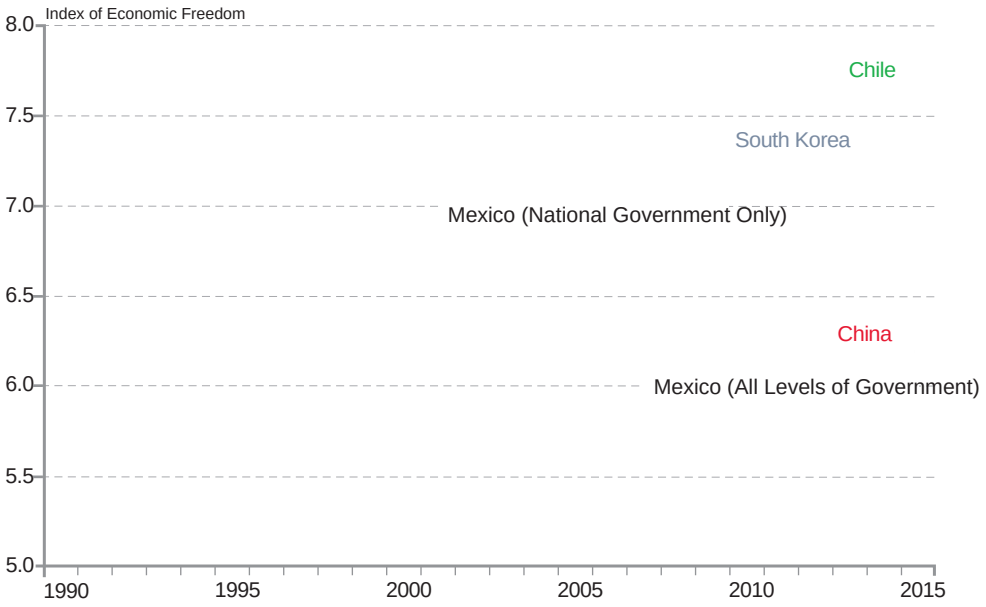
From the Periphery to the Center

for some products. The gap in automobile ownership only began to shrink in the past ve years or so. Mexican households were late in buying many popular technology products (bottom chart). The catch-up didn't begin until the early 2000s for computers, mobile phones and Internet

EXHIBIT 7

Faltering Economic Freedom

With policy reforms, Mexico's economic freedom score (blue line) rose after 1990—other emerging countries had larger gains. When state and local governments are included, Mexico's all-government economic freedom declined in the past decade (black line).



The authors would like to thank José Torra, Roberto Salinas León
and the Mission Foods Texas-Mexico Center at SMU Roberto Salinas León

Box 1: Mexico and Texas, By the Numbers

2017-18: Year in Review

The O'Neil Center's headline event for the 2017-18 academic year was a packed house for a speech by renowned economist Walter Williams, who warned that government growing bigger and more powerful posed a danger to individual liberty (see box right).

Before and after that October evening, our scholars published almost 50 articles for academic and general interest publications, and delivered nearly 70 speeches, presentations and lectures. They produced new data on economic freedom.

In addition to Williams' speech, the center's public events included lectures by five distinguished scholars, and the Texas Economic Forum discussed DFW's innovation economy in the fall and the impacts of President Trump's policies on the state economy in the spring.

The center's Annual Report essay explored the long-run interaction of technology and economic progress, with the goal of helping readers better understand today's upheavals and angst. Teaching Free Enterprise in Texas, a program providing instruction and curriculum materials to improve economic education in high schools, had its biggest year ever with more than 1,000 teachers attending workshops, plus six new curriculum units.

O'Neil Center professors taught over 700 students in SMU classes, with 72 more attending the center's six reading groups. The Workshop Series for academics featured seven presentations of research in progress. In the spring semester, the center began commemorating the 10th anniversary of its founding (see inside back cover). Recognition of the 10-year milestone will continue in the fall semester.

Williams' speech took the place of the O'Neil Center's annual conference, which for eight years had brought together well-known economists, authors and business leaders to discuss current issues within a framework of economic freedom. In the upcoming academic year, the conference will return. Before the end of May, the center had already received commitments from speakers, including Nobel laureate Vernon Smith, for a September program on the "Ethical Conundrums of Capitalism."

The O'Neil Center studies why some economies are rich and growing rapidly while others are poor and growing slowly. To this end, it fosters an understanding of economic freedom among students, policymakers and the general public. We're the only research institute with expertise in measuring economic freedom at all three levels of economic analysis—national, state and metropolitan areas.

A Free-Market Icon at SMU

Walter Williams began with a few data points on the growth of public spending and taxing over the past century. The George Mason University professor said these numbers showed that government had expanded far beyond its legitimate functions, such as national defense, policing, adjudicating disputes and providing true public goods.

Williams told an audience of nearly 500 people at SMU's Hughes-Trigg theater exactly what he saw in this bigger government—a threat to individual liberty. "The ultimate end of this process, ladies and gentlemen, is totalitarianism and tyranny."

"I am not saying we are a totalitarian nation yet," he continued. "But if you ask the question, 'Which way are we headed tiny steps at a time? Are we headed toward more personal liberty or are we headed toward more government control over our lives?' It would almost unambiguously be the latter. And remember, if you take tiny steps toward any goal, you're sooner or later going to reach it."

Williams conceded that government grows out of people's desire to do good—to help, for example, the poor or elderly. Yet, government has no resources of its own, and political leaders in Washington and state capitals don't reach into their own pockets when trying to do good. "The only way the government can give one American $1 is through coercion, threats and intimidation to confiscate that dollar from some other American."

Global Economic Freedom

Global Economic Freedom addresses the O'Neil Center's founding mission with research on why economies succeed and fail. Its centerpiece is The Economic Freedom of the World (EFW) report, an empirical measure that gives researchers a powerful tool to test ideas about free enterprise and its consequences. Studies find that high EFW scores correlate with higher incomes, faster economic growth, lower poverty rates, higher life expectancy and many other positive outcomes.

Lawson has been a key researcher on the EFW index for over two decades. At the O'Neil Center, he and Murphy compile the EFW data and calculate economic freedom ratings for 159 countries.

Released in September 2017, the latest EFW report by Lawson and co-authors James Gwartney and Joshua Hall showed that the most economically free places in the world were Hong Kong, Singapore, New Zealand, Switzerland and Ireland.

Regarding the United States, the report found a slight uptick in its economic freedom score, pushing the country from 13th place in 2014 to 11th place in 2015. The United States ranked highly in sound money and labor market regulation. Its lowest ranking was in size of government

Lawson gave public lectures on the EFW index and its implications at Ball State University, University of North Carolina Wilmington, Mackenzie University in Brazil, Oklahoma State

Lawson and Ben Powell, director of the Free Market Center at Texas Tech

State and Metro Economic Freedom

Since 2013, Stansel has been the primary author of the

Stansel and Tuszynski compiled a comprehensive review of empirical research articles on state-level economic freedom, which will be published as “Sub-national Economic Freedom: A Review and Analysis of the Literature” in the *Journal of Regional Analysis and Policy*.

The two O’Neil Center authors examined the extent to which economic development incentives might lead to an uptick of failing companies in “Targeted Business Incentives and Firm Deaths,” which has been submitted to the *Review of Regional Studies*.

Economic freedom and other state-level issues were central to five of Murphy’s articles:

- “Economic Freedom of North America at State Borders” in the *Journal of Institutional Economics* used data for counties on either side of state borders to gauge the impact of economic freedom;
- Both “Beggaring Thy Neighbor at the State and Local Level” in the *Journal of Financial Economic Policy* and “Vang (a (en-U1 0.177 Tw 9 0 0 l77iT13VbBan <</Lang (en-US)/MCID 2551 >>BI

Texas Economic Freedom

The O’Neil Center developed a research interest in the Texas economy early on, focusing its rst two Annual Report essays on the Lone Star State. The Texas Economic Freedom initiative, launched in 2015, expanded our efforts to

• "Dallas' Place in the Texas Triangle" put a spotlight on a dynamic region roughly bordered by DFW, Houston and San Antonio, which is a tenth of the state's land area but accounts for about three-quarters of the state economy.

O'Neil Center research on state and local economies has been featured in The Texas Economy, the center's online newsletter. The quarterly published the following articles in academic year 2017-18:

• In "Listening for the Texas Twang in the Innovation Economy," Alm summarized the proceedings of the fall Texas Economic Forum on innovation and entrepreneurship in the DFW area.

• Alm continued his study of the development of Texas' economy in "Entrepreneurs on Horseback," which chronicled the rise of the cattle industry after the end of the Civil War.

• In "Foreign-Born Workers in the Texas Economy," Cox and Alm presented data showing that Texas ranked sixth among states in employing immigrants. Foreign-born workers are particularly important in construction, an industry vital to a state with an expanding population.

• In "Trump and the Texas Economy," Alm summarized the Texas Economic Forum presentations on how the president's policies on trade, taxes, immigration and energy are likely to impact the state.

Stansel partnered with Vance Ginn on two op-ed articles discussing economic freedom in the state—on September 6, "Six Missed Opportunities in Special Session That Could Have Aided Economic Prosperity" in the Fort Worth Star-Telegram, on January 5, "Texas Ranks Near the Top (Again) for Economic Freedom" in the Dallas Morning News.

After Hurricane Harvey hit the Texas Gulf Coast, Davis wrote "Want to Help Storm Victims? Cash is King," a Dallas Morning News op-ed contending that money would allow the battered region to decide its recovery priorities for itself.

Student Enrichment and Public Outreach

Engaging with SMU students provides an opportunity to shape the next generation of American leaders, workers and voters. O'Neil Center professors teach classes and offer programs that introduce the ideas of liberty and economic freedom. Our commitment to education extends to the general public. The center sponsors speakers at SMU, makes presentations to non-academic audiences and responds to media requests.

Teaching Free Enterprise

The donor-supported program began in 2015 and offers workshops and curricular materials for high school teachers, with the goal of helping them meet Texas' mandate to provide economics instruction with an emphasis on the free-enterprise system and its benefits.

Under Serralde's direction, Teaching Free Enterprise moved forward during 2017-18 with 18 workshops and a total attendance of 1,072 teachers. These teachers returned to their jobs and taught classes with an estimated 162,000 students, suggesting a large impact for the program.

O'Neil Center staff members continued to play a big rolt9W 0 00.06 TTuw40 4 dDa1 Laws Tm [(helping them meet T)60 (exas' mandate t

discrimination in labor markets? What are the consequences of mass incarceration? Why do women typically earn less than men? What explains persistent poverty among Native Americans?

The summit with Tech, Baylor and Central Arkansas students was scheduled to give students the opportunity to attend the Walter Williams lecture and participate in workshops with the economist the next day.

In the spring, Stansel led his two reading groups on “Freedom and Human

Teaching SMU Cox Students

In April, Tuszynski led a group of 16 undergraduate students and faculty from five local universities in a daylong discussion of the works of Frederic Bastiat and F.A. Hayek. The sessions were moderated by Bradley Hobbs (Clemson University) and Stephen Gohmann (University of Louisville).

Luke Yeom was Murphy's research assistant the fall semester. The two co-authored "The Long-Run Impact of Agricultural Diversity on Economic Freedom," which appeared in the Journal of Regional Analysis & Policy

Eric Li was Murphy's research assistant in the spring semester. They will continue their collaboration this summer on a working paper begun in the spring semester.

During the spring, Murphy worked with O'Neil Center research assistant Nick Whitaker on an independent study project focused on rationality and economic enn <s

Speaking and Writing

Cox delivered the optimistic message of capitalism as a driver of American progress in 14 speeches. A sampling of his titles: “Good News: Why America Is Better Off Than You Think;” “Economic Outlook for the U.S.: A Tale of Two Economies;” “Age Shift: An Optimistic Perspective on America Today and Tomorrow;” and “The Imagination Age: Fourth Wave of American Economic Progress.”

Most of Cox’s speeches were to business

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