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The Texas-Mexico Trade Corridor

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The U.S.-Mexico relationship has been rocky for some time, and there is little doubt that the current recession has made matters worse. The relationship between the two countries has been strained by competition for jobs, infrastructure issues, security concerns, and a general misunderstanding of the value of the relationship. The potential losses are significant for both countries if the current tension continues, but border states, especially Texas, stand to lose the most.

The Texas-Mexico Trade Corridor primarily consists of South Texas and the northern Mexican states of Tamaulipas and Nuevo Leon, south to Mexico City and Guadalajara. The corridor has grown beyond an important logistics crossroad into a major regional manufacturing zone since the introduction of the North American Free Trade Agreement (NAFTA) in 1994. In addition to NAFTA's effect on reduced trade restrictions and lower tariffs, regional growth has been bolstered by a number of powerful factors.

In the early growth phase, many manufacturers moved to Mexico to take advantage of lower labor costs. While Mexican labor rates remained far below those in the U.S., in the late 1990's, manufacturers began to shift to China to seek even lower wages. The decision to locate in China was not always the right one, however, and the rise in oil prices and currency fluctuations of 2008 caused many firms to reconsider. Mexico now attracts many businesses for a variety of reasons:

- The cost of labor is still relatively low.
- Transportation costs and delivery times are lower due to proximity to the U.S. Large markets like Houston, San Antonio, and the Dallas - Fort Worth Metroplex (three of the ten largest cities in the U.S.) can be reached within a day from the border.
- Education levels and middle management skills are higher in Mexico than in most other outsource markets.
- Culture, language, legal, and customs issues are less troublesome due to NAFTA and a rich shared history between the U.S. and Mexico.
- Mexico often has access to raw materials that are not available or are more expensive north of the border.

Texas also attracts business for a variety of reasons that are related to its relationship with Mexico. These connections are critical to many business sectors but are often not well understood. Texas receives goods from Mexico for next-stage manufacturing. Texas manufactures goods that are imported into Mexico and then re-imported to Texas for further manufacturing. Perhaps most significant, Texas provides many services that are not counted in trade numbers. These services range from training and education to legal and technical. What factors have enhanced the state's ability to leverage its relationship with Mexico?

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- Texas firms have greater access to technology than Mexican companies, because products with a high sensitivity to intellectual property protection are more likely to remain on the U.S. side of the border.

- While Mexicans highly value education, Texas universities have vast resources, and Texans often have greater access to higher education.

- Texas firms often have better access to regional suppliers.

- Texas is a large market. In addition to large cities, even mid-sized cities like Austin (one of the top twenty in the U.S.) are numerous and represent a major opportunity.

- Texas is an important corporate hub.

These factors and others continue to support manufacturing growth in the region. Notice that Mexico's strengths nicely complement Texas' needs, and vice versa. Problems remain, however, and if the Texas - Mexico Trade Corridor is to continue its success, improvements are necessary. The key to success in any business endeavor is to achieve best practices and establish relationships that facilitate the "ease of doing business" with partners. The more difficult a region makes it to operate or generate a profit, the more likely it will not be the region of choice for any firm seeking a home.

Problems Ahead

While Texas and Mexico have many shared and complementary strengths, weaknesses remain and could become debilitating.

Congestion at border crossings

The most common complaint from industry, border delays are a ubiquitous problem in the post-September 11 era. Even as massive improvements have been and continue to be made, the general impression is that the border between Texas and Mexico is a bottleneck. Perceptions of slow crossing times are often inflated, however, and they indicate a need to make firms aware of "true" transit times. While things are improving, the Texas - Mexico Trade Corridor lags far behind the U.S. - Canadian and European Union borders in terms of best practices that could facilitate trade. There remains a need to improve processes and educate the business community on what has been done.

Infrastructure issues

Texas has the highest-rated highway system in the U.S., but Mexico's roadways are less robust. Mexico's diverse and vast landscape, coupled with rapid urban growth, presents transportation challenges. The distance between Dallas and Laredo is 450 miles and takes about 12 hours by truck. The distance between Nuevo Laredo and Mexico City is 570 miles and takes between

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24 and 28 hours. Mexican highways run through major cities and are slowed by poor road conditions and traffic congestion. Recent controversy around Texas toll road construction, however, has demonstrated that Texans may not be as willing to invest in highway development as in the past. Initiatives to increase North - South highway capacity have stalled or died. Rail has made some progress, but urban congestion on both sides of the border remains an issue.

Industry cluster development

The key to regional growth is the development of industry clusters that include manufacturers supported by an appropriate employee and supplier base. Many regional manufacturers who move to the Texas - Mexico Trade Corridor find it difficult to locate needed suppliers. Automotive manufacturers, for example, want their suppliers to be within a single day's delivery distance and their customers even closer. Figure 1 demonstrates that for the auto industry, there is a shortage of suppliers (compared to the north central and southeast) and a general mismatch between manufacturing capacity and customer markets. Attracting the right suppliers, in general, and increasing capacity to be consistent with the market is a major opportunity for the corridor.

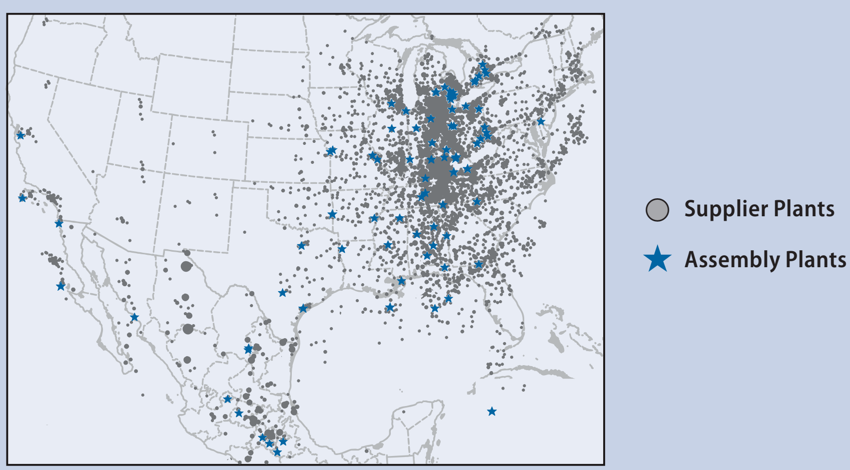
Workforce agility

A well-trained and flexible workforce affects regional manufacturers and communities equally. Examples abound where a business is drawn to a region only to discover that local educational institutions do not offer the right programs or training for an effective workforce. These institutions often make changes at a pace slower than industry requires, lack the necessary resources to introduce new programs as industry needs evolve, and often undervalue training programs compared to traditional education. The result is an increased training burden on firms. When key businesses find a better match in a different state, communities often suffer, leaving workers displaced and educational institutions left to introduce new retraining programs to attract replacement industries.

Customs and legal constraints

Customs compliance is a costly business issue. While NAFTA has improved many customs processes, customs documentation remain a major business

FIGURE 1
An Imbalance Between Customers and Suppliers



Source: *Federal Reserve Bank of Chicago,* Auto parts supplier plants and assembly plants in North America, *http://www.chicagofed.org/publications/fedletter/cfloctober2008_255a.pdf*

… most analysts agree that drug cartel violence is generally confined to the border, and media coverage that implies that safety conditions have deteriorated all over Mexico exaggerates the threat to U.S. firms and their employees.

expense for many firms. The cost of completing required documentation and the legal and other expenses necessary to meet complex customs processes are significant. Customs compliance delays are commonplace and result in additional inventory in the trade corridor supply chain and are a drag on efficiency.

Security issues

While often exaggerated by the media and others, security issues are significant nonetheless. Truck hijackings are not new to either country, but occurrence rates are higher in Mexico than in the U.S. The problem can be exacerbated by the differences in the two national legal systems. Loss recovery is more complicated in Mexico than in the U.S. and results in U.S. firms paying higher insurance premiums for more extensive loss coverage or higher costs for increased security on trucks and warehouses. A more worrisome concern in recent years has been that of personal security. As drug cartel violence has exploded along the Mexican side of the border, many U.S.-based businesses fear for their employees' safety when doing business in Mexico. Yet most analysts agree that drug cartel violence is generally confined to the border, and media coverage that implies that safety conditions have deteriorated all over Mexico exaggerates the threat to U.S. firms and their employees. Nevertheless, safety risk is a growing factor for U.S. firms doing business in Mexico.

Competition among cities, states, and communities on both sides of the border

The struggle for state or federal highway funds and bridge construction projects often pits communities against each other. Highway system projects in Texas have stalled because cities off the proposed route lobby against the expenditure. The reasons can be as varied as wanting support for their own infrastructure projects or fear that improvements in one area will draw business away from another. New bridge projects on the border have been delayed for years while communities argue in which part of town the bridge should be constructed. On the Mexican side, states compete for highways that would increase throughput (good for business) by diverting traffic around a high-congestion zone (bad for the highly congested business district). Competition affects ports as well, with inland ports fighting over highway improvements or customs procedures, and seaports fighting over business development and attempting to slow or divert the attempts to upgrade facilities by competative ports.

Perceptions of U.S. job losses

While U.S. manufacturing output has increased over the years, manufacturing employment has dropped considerably. Experts cite two principal causes. One is automation, a necessary efficiency that keeps U.S. manufacturers at home but reduces the number of jobs and changes the nature of factory work. Automation of manufacturing processes is responsible for most job losses in the sector, but it is not the most emotionally charged. Outsourcing to lower-cost labor markets like China and Mexico is often derided as a net job loss for the U.S. workforce, and in the case of China, perhaps, this is accurate, because exports to China are overwhelmed by imports. For Mexico, however, the argument is weaker because Mexico is the second largest consumer of U.S. goods. If oil is removed from the equation, Mexico's trade relationship begins to approach parity with the U.S. (see Figure 2). The displacement of U.S. jobs from outsourcing to Mexico has more to do with exporting industries growing more rapidly and displacing less competitive industries. And "less competitive" does not solely refer to the wage issue, as many firms that move to Mexico do so more for proximity to Texas and Mexico metropolises than for wage advantages. The need to manufacture in proximity to one's customers is ever more critical for firms today, as transportation costs increase and inventory holding costs explode under the pressure of rising customer demand for "just in time" delivery.

Perceptions of Mexico as a neighbor

In spite of a tremendous trading relationship; an average of one million Americans living, visiting, or doing business in Mexico on a daily basis; and a shared cultural history, Mexico often finds itself subjected to extreme and unfair criticism from the U.S. Illegal immigration complaints are often directed at Mexican workers rather than at U.S. employers who hire them, or at an immigration policy that makes legal worker status difficult for many Mexicans. Instead of being viewed as victims who risk their lives for a chance at a better life, Mexicans working in the U.S. are often described as criminals. When drug cartels became a menace in some Mexican border cities, many in the U.S. blamed lax Mexican policing rather than U.S. final demand for illegal drugs. This criticism also fails to recognize that the well-armed cartels overwhelming the Mexican police buy their weapons from U.S. suppliers.

Texans simply do not recognize the value of NAFTA. When decisions regarding NAFTA are made at the federal level, Texas must speak loudly in its defense.

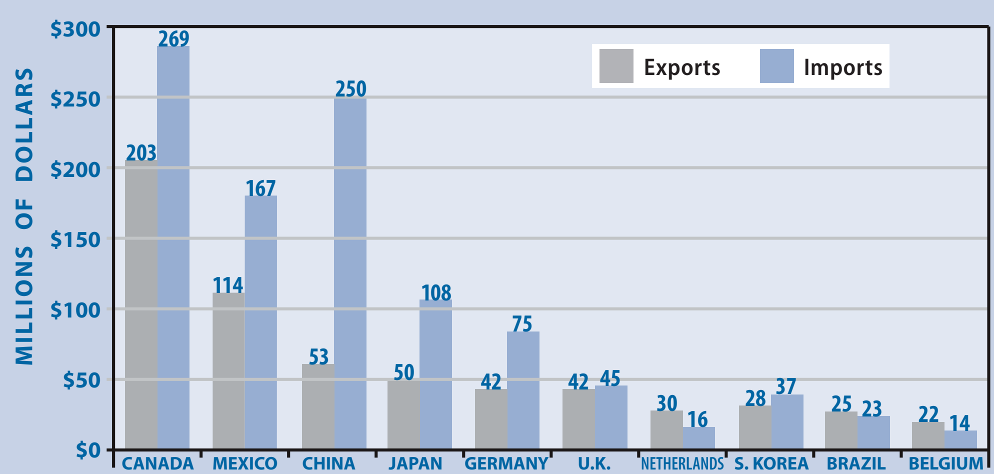
Understanding the value of NAFTA

For many of the foregoing reasons, NAFTA is often viewed negatively in the U.S. Most disturbing, it is viewed in a negative light by many Texans. No one can blame people in the Rust Belt for questioning the value of NAFTA, but for Texans who reap an economic benefit in excess of $100 billion in new trade and an unrecorded bonanza of services, to misunderstand NAFTA is troubling. Texans simply do not recognize the value of NAFTA. When decisions regarding NAFTA are made at the federal level, Texas must speak loudly in its defense. If Texas does not defend NAFTA, no one in the U.S. will.

Research supporting the Corridor

Texas A&M University has founded a consortium to study the "Ease of Doing Business" in the corridor. The consortium is composed of corporations; economic development groups;

FIGURE 2
Top U.S. Trade Partners, Ranked by 2008 Total Export Value for Goods



Source: U.S. Department of Commerce, Census Bureau, Trade Division.

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and federal, state, and local governments. It is supported by a grant from the U.S. Economic Development Administration (EDA). The consortium involves faculty and researchers from both sides of the border and multiple universities.

The research is conducted at two levels. First, each consortium member presents an issue they would like studied. Projects have included optimizing transportation across the border, demonstrating the value of services to Mexican manufacturers, determining market opportunities for a distributor interested in the Mexican market, and finding suppliers for a high technology manufacturer, to name only a few.

These projects provide "deep dive" information for the second level of consortium research. Because the EDA grant is intended to increase business opportunities for South Texas, the findings from the consortium's research will be combined with economic development studies to produce a study (to be released in the summer 2010) on how to make the region more competitive. One of the most significant projects is the development of a "location equation" that captures all costs, rather than the limited set of costs included in most studies. In 2010, that equation will be connected to "return-on-investment" estimates, linked to a regional balance sheet and income statement, and enhanced by market forecasts. For more information on the consortium and its Trade Competitiveness Conferences: http://trade.tamu.edu

The Value of the Corridor

The Texas-Mexico Trade Corridor offers great benefits to the U. S. and Mexico. Coming out of the current recession, the challenges to regional manufacturing are many, however, and include infrastructure issues, border management, competition for jobs, and, most importantly, negative perceptions on both sides of the border about the value of the relationship. Studies that demonstrate where improvements are needed and where value lies are critical to improving the Corridor and the public perception of this important manufacturing region. ◆