# Martin’s textile case – nafta

NAFTA is a trilateral free trade agreement among the United States, Mexico and Canada; which came into force in January 1994. In 1992, and on the eve of the deal, John Martin, CEO of a USA-based textile company, has to come to a really tough decision: move production to Mexico or wait for an imminent bankruptcy. Martin, as the vast majority of the US population did not understand how this agreement could beneficiate the country at all.

Opponents of NAFTA would argue that the treaty should not be adopted because of the negative impact it would have on employment in the United States, particularly in industries such as textiles, a labor intensive industry in which the price of labor is crucial. Free trade with Mexico, a much cheaper labor country, would mean that US production could no longer be competitive and many plants would have to close. They were already facing heavy competition with Asia, but now without any tariffs to Mexico, the situation could become worse.

The problem with these statements is that they misrepresent the real effects of trade on the U. S. economy: trade both creates and destroys jobs. Although there have been job losses in the US textile industry, defenders of NAFTA argue that there have been net benefits to the US economy in the form of lower clothing prices and an increase in exports from fabric and yarn producer. Trade has been created as a result of NAFTA. This is at the heart of the competitive advantage theory and Ricardo’s thoughts.

The gains from trade are being captured by US consumers and by producers in certain sectors. As always, the establishment of a free trade area creates winners and losers, but advocates argue that the gains easily outweigh the losses. Apart from this, NAFTA has also protected the American economy versus Asian markets. Mexico has overtaken China as the number one apparel supplier. Today, most U. S apparel is made in Mexico but with yarn and fabric from the U. S (unlike Asian clothing imports). In addition, U. S. rade with Mexico was growing before NAFTA’s implementation, and would likely have continued to grow. Why? Mexico is a solution for U. S. companies searching for cost reduction alternatives in a nearshore location, it’s a way to remain competitive in North America. In the case of Martin Textile’s they can save an estimation of more than 170 millions dollars per year (10$ savings in salaries x approximately 1000 manufacturing workers * 80 hours per weak per 52 weeks plus cheapest land rent). So, in my opinion, it is clear that moving to Mexico, if not the only option, it’s the best option.

And, if NAFTA had not taken place, Martin’s textile still would have had to move to Mexico or Asia anyway. However, we have to bear in mind the political, cultural, social and economic consequences that this decision may imply. The heaviest disadvantage of moving to Mexico would be letting go his employees. We are talking about a family business that see relationships with its employees as something more that contractual bonds. Most of the labor force had been with the company for many years and are old enough not to be able to get another job.

This would mean that around 1, 000 employees (let’s say that 65 % of the workforce is for manufacturing) would be expected to join a large group of unemployed people from other companies doing the same. In a period of recession for the United States, this would create a lot of conflict and social problems. It will increase the government spending in unemployed benefits and may even increase the ratio of illegal activities. But I believe this is a social cost that is unavoidable and, for that, must not be taken into account.

If the company keeps doing things the way they are doing it, they will soon go out of business due to high competition from Mexico and Asia. A solution for Mr. Martin would be to make the process of firing a transition and try to allocate people, as many as possible, into other departments like design or marketing. Invest in training if necessary. These employees are probably highly loyal and motivated to learn. We also must take into account the consequences of layoffs in the company’s culture and employee’s morale. Martin will need to find the right way of communicating the situation and making them understand his decision.

Your customer base will also be concerned with your decision of shutting down an American plant and moving to Mexico, so the public relations department has to handle it with sensitivity and grace. When moving to Mexico Mr. Martin will face two alternatives: outsourcing or creating their own plants there. I will only suggest the first option in the case of serious economic hardship as it would imply a loss of management control. Your outsourcing company will not be driven by the same standards and mission that drives your company.

They will be driven to make a profit from the services that they are providing to you and other businesses like yours. If you rent your own plants even though you will need to handle settling costs and personally deal with selection and recruitment, you will have more tools for quality control and branding. If the company is in serious danger of bankruptcy then he could also bear in mind the possibility of moving to China. But this option would bring more problems as transportations costs, tariffs, dealing with a total different continent, etc.

Moreover, Mexico is seen as having more credibility as a labor market and is viewed as not having the violations of human rights and below-par labor practices. The difference in wages between Mexico and Asia seems low to make such a costly operation. The additional intangible costs of moving to Mexico are political, currency risks and language barriers. Real costs are increased inventories, delays in time-to-market and transportation costs. Savings from moving to Mexico are supposed to offset these costs. On the other hand, it seems clear that if Mr Martin does not take any actions his company will go out of business.

If he decides to stay in the USA, his only option would be to invest heavily on marketing to pursue a differentiation strategy and become a premium brand so he can set a higher price to cover the high manufacturing costs. This, however, could be very difficult to achieve and may never be successful. This will increase nobody’s welfare. In short, after weighing all the options Mr Martin has, the decision of moving to Mexico and shut down US plants does not seem like a greed-driven one as other companies may have done, it’s the best decision to get a family business to survive.