

NAFTA's Bad Rap

It's sound bites and bumper stickers versus real facts and statistics.

BY GARY CLYDE HUFBAUER
AND JEFFREY J. SCHOTT

In January 2009, the North American Free Trade Agreement will reach its fifteenth birthday. No cause for celebration, say NAFTA critics, who argue that the trade pact must be fixed or ditched. Most economists disagree and regard NAFTA as a tremendous success, contributing to better jobs and higher income in the three partner countries—though in Mexico's case well below levels promised by politicians during the ratification debate.

Trade among the North American partners is up more than threefold since the pact entered into force in 1994, and now totals about \$900 billion annually. Canada and Mexico account for almost 30 percent of U.S. two-way merchandise trade. A rough calculation suggests that NAFTA has added about \$60 billion annually to U.S. national income, about \$200 per American. Yet level-headed NAFTA proponents recognize that economic integration spawns both losers and winners. Not every worker or community benefits, and adjustment programs for hard-hit workers remain inadequate to this day in the United States and Mexico. On balance, however, the rewards from economic integration far exceed the costs—by a ratio of ten to one or better.

So why does NAFTA have such a bad “rep”? The short answer is that many politicians and pundits dismiss the economists and blame NAFTA for all manner of problems. Naysayers rely on anecdotes to make their case, and when they use statistics, they are very selective.

In the battle of sound bites and bumper stickers, NAFTA has become the short cut for venting anger about the alleged misdeeds of globalization:

Gary Clyde Hufbauer is Reginald Jones Senior Fellow and Jeffrey J. Schott is Senior Fellow at the Peterson Institute for International Economics.

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888 16th Street, N.W.
Suite 740

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Phone: 202-861-0791

Fax: 202-861-0790

www.international-economy.com



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*Present at birth: the NAFTA initialing ceremony, October 1992. From left to right (standing): Mexican President **Carlos Salinas de Gortari**, U.S. President **George H. W. Bush**, and Canadian Prime Minister **Brian Mulroney**. Seated are Mexican Commerce Secretary **Jaime Serra Puche**, U.S. Trade Representative **Carla Hills**, and Canadian Minister of Industry and Trade **Michael Wilson**.*

grinding down workers, desecrating the environment, and fattening Wall Street. Such critiques are standard fare in Democratic stump speeches. Not surprisingly, anti-NAFTA rhetoric has escalated as the U.S. economy has weakened. Senators Barack Obama (D-IL) and Hillary Clinton (D-NY), in their race for the Democratic presidential nomination, even threatened to withdraw from the pact. Bombast not only makes headlines in U.S. primaries; it also excites Canadians and Mexicans. Words can be costly, even when they are no more than political slogans conveying idle threats. No U.S. president could pursue the disruptive course of action previewed by the Democratic candidates. American jobs would be lost, American exports would drop, and America's closest neighbors would become testy antagonists.

The bill of particulars recited by NAFTA opponents focuses on four main themes: NAFTA destroys U.S. manufacturing jobs; NAFTA suppresses U.S. wages; NAFTA has worsened the U.S. trade deficit; and NAFTA abets immigration from Mexico. In a moment, we will address those themes, but aside from carping about imaginary ills, NAFTA opponents are glued to the rear view mirror. They completely miss the challenges on the road ahead for North America, a subject we take up at the end of this essay.

JOBS LOST?

The “jobs lost” claim runs smack into a hard fact: employment has risen smartly in all three economies over the past fifteen years, and U.S. and Canadian unemployment rates are lower now than they were in 1994. Yet Senator Obama and others claim that “one million jobs have been lost because of NAFTA.”

There's no agreed way to track the impact of trade liberalization on the creation and destruction of jobs in the vast U.S. economy. The Obama critique draws on an extreme estimate published by union-funded economists of gross job losses of about 100,000 per year cumulated over ten years. This estimate uses antiquated arithmetic and ignores the dominant role that U.S. energy imports play in the U.S. merchandise trade deficit with Canada and Mexico (almost 70 percent of the deficit in 2007).

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contribute in a small way to “churn” in the job market. On average, about 16.5 million people quit or lose their jobs each year out of a total U.S. civilian labor market of about 140 million, while more than 18 million Americans take new jobs each year. Even if Senator Obama was right that 100,000 gross job losses can be attributed annually to NAFTA, the figure is only six-tenths of one percent of the annual “churn” in the U.S. job market. Moreover, the political soundbite ignores the fact that many American jobs are supported by U.S. merchandise exports to NAFTA partners. Finally, the soundbite totally ignores the fact that an integrated and efficient North American economy preserves U.S. production that would otherwise be outsourced to overseas suppliers, in Asia and elsewhere.

WAGES DEPRESSED?

Wait a minute, NAFTA critics argue. Even if workers find new jobs, the positions pay less and have fewer benefits. Adding insult to injury, they argue that U.S. companies use the threat of moving operations abroad to coerce wage concessions from their workforce. NAFTA critics again cite anecdotal evidence, including video footage ideal for YouTube downloads. True enough: real blue collar compensation has increased only 30 percent over the past 25 years (most of the increase has taken the form of untaxed fringe benefits, not cash wages). While globalization pressures have contributed in a minor way to sluggish blue collar compensation since the early 1980s, technology is the far stronger factor. The sharpest shortfall in blue collar compensation relative to white collar compensation occurred before 1994, when NAFTA entered into force. Blame for blue collar blues should not be laid on Mexico’s doorstep.

Compare, for example, manufacturing wages in U.S. states that trade extensively with Mexico to U.S. states that do not. Average weekly earnings (not adjusted for inflation) for all U.S. manufacturing workers rose by 26 percent over the period 1997–2006, when NAFTA was almost fully implemented. Four of the top five U.S. states, in terms of trade with Mexico, recorded wage growth higher than the national average (led by Texas, California, and Arizona with 49, 48, and 45 percent respectively).

BIGGER TRADE DEFICIT?

Politicians often evoke the mercantilist logic that exports are good and imports are bad. By extension, if a country runs a trade deficit, it’s a loser—regardless whether imports boost productivity of U.S.-based companies, increase consumer choice, and dampen inflationary pressures.

Applied to NAFTA, critics point to the growing U.S. trade deficit as evidence of failure: the U.S. trade deficit with its NAFTA partners grew from \$7 billion in 1993 to \$138 billion in 2007. What happened? Most importantly,



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—G. Hufbauer and J. Schott

net U.S. energy imports from Canada and Mexico increased by \$81 billion, and now account for more than two-thirds of the U.S. deficit with its NAFTA partners. To be sure, \$81 billion is a lot of money for oil, gas, and electricity, but isn't it better to buy energy from our friends than from OPEC? Excluding energy trade, the 2007 U.S. merchandise trade deficit with Mexico was \$47 billion, and the United States ran a \$4 billion surplus with Canada.

IMMIGRATION WOES?

NAFTA itself contains almost nothing about immigration, apart from NAFTA visas for skilled professionals. Nonetheless, politicians promised that NAFTA would narrow U.S.-Mexican wage disparities and dampen the desire of poor Mexicans to sneak into the United States. While NAFTA has definitely improved life in Mexico—particularly in the northern states and the metropolitan Mexico City area—it has not abated immigration pressures. By contrast with the politicians, serious demographers, such as Phil Martin, correctly forecast increased flows of Mexican migration into the United States in the 1990s and 2000s, followed by declining flows after two or three decades. These forecasts were based on Mexico's demographic structure: rapid growth in working age Mexicans between 1995 and 2015, and slower growth in later years.

Economic and political shocks reinforced the demographic forces in swelling the immigration tide during the first decade after NAFTA. To name three shocks: the peso crisis of the mid-1990s, sharp competition from China, and escalating drug wars. These shocks constrained Mexican economic growth, and hence Mexican job prospects. Not surprisingly, migration from Mexico, both legal and illegal, steadily increased. The flow of illegal immigrants from Mexico rose from an annual average of 270,000 in the 1990s to around 315,000 this decade. The estimated stock grew from 2.5 million persons in 1995 to 6.6 million persons in 2006.

Politicians blame NAFTA by association, ignoring the obvious demographic and economic explanations. But immigration pressures are largely a function of geography—we share a border of almost two thousand miles—and persistent huge earnings differentials between Mexico and the United States. At the level of opportunities for individual workers, U.S. wages continue to be far higher: in 2006, hourly compensation for manufacturing workers was \$29.60 in the United States and \$3.70 in Mexico. At the level of the overall economy, Mexican economic growth has simply not been fast enough to narrow the economic gap with the United States. Between 1995 and 2007, U.S. real GDP grew 3.1 percent per year compared to 3.7 percent annually in Mexico.

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In short, the Mexican economy has under-achieved, but not because of NAFTA. The Mexican political system did not deliver tax and energy reforms needed to generate new resources to fund investments in infrastructure and education, nor has it succeeded in eradicating corruption and narco-traffickers.

THE ROAD AHEAD

Despite all the nasty comments about NAFTA—indeed, because the primaries have pilloried the pact—the next U.S. president will likely take up new initiatives. And, truth be told, NAFTA does need some upgrading. Yes, the politicians are partly right on the prescription, even if they are off base on the diagnosis.

NAFTA was “state of the art” when it was crafted in the early 1990s, but after fifteen years it could stand some renovation to reflect lessons learned in subsequent trade deals, and more importantly changes in the world economy. In a few concluding paragraphs, we suggest how U.S. politicians might pursue constructive initiatives with Mexico and Canada that would put paid to their campaign obligations.

Labor and Environment. The easiest thing to achieve is what the Democratic candidates have railed about the most: strengthening provisions on labor and the environment. Recent free trade agreements have improved on the NAFTA model, incorporating more extensive obligations in the core treaty text and supplementing the trade provisions with commitments to tackle labor and environmental problems. The NAFTA provisions dealing with such issues need to be

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streamlined and strengthened. To this end, the NAFTA partners should draw on best practices from other accords. Among the U.S. pacts, the free trade agreements with Peru and Colombia contain the strongest provisions, including obligations mandated by the Democratic Congressional leadership in its May 2007 deal with the Bush administration. Canada and Mexico should not have substantive problems with adding similar provisions to NAFTA.

Climate Change. Climate change is an enormous challenge for everyone, including the NAFTA partners. U.S. efforts to promote alternative fuels and to reduce greenhouse gas emissions have already distorted regional trade and raised food prices. Ethanol from corn is the big culprit, but sugar trade is involved in its own food fight. Numerous bills on the congressional docket endorse additional subsidies and border taxes against carbon-intensive imports, presaging new barriers to North American trade. Similar legislation is being vetted in Canada.

Given this context, NAFTA partners should quickly reach agreement on common industrial standards and competitiveness provisions that will apply to regional trade. The three countries could design a meaningful supervisory institution, and build an efficient trading market for North American emission permits. Regional cooperation can serve as a model for global solutions both in multilateral trade talks and in the 2009 Copenhagen negotiations to design a new global climate change regime.

Turning the question the other way around, regional cooperation can help the three North American countries fulfill their climate obligations. Currently Canada emits 30 percent above its Kyoto target, and to meet that target, Canada will likely need to invest more in the Clean Development Mechanism. Under the post-Kyoto regime, the United States will face a similar problem. Regional cooperation can ease these burdens in effective ways, such as investing in emission reduction projects, and developing clean technology.

Border Security. Cargo security is another area where North America needs cooperative efforts. According to a recent estimate by Patrick Grady, post 9/11 “thickening” of the U.S.-Canada border has cut Canadian exports by around 10 percent. But that’s just a start. U.S. legislation will require all containers entering the United States to be scanned within the next five years. Superimposed on pre-existing congestion, this requirement spells longer and more variable crossing times, higher costs of moving cargo, and missed business opportunities.

Fortunately, in 2005, the United States and Canada signed a Container Security Initiative Partnership Agreement with the goal of pre-screening goods destined for North America. Owing to this Initiative, sealed cargo arriving in Canadian ports for onward shipment to the United States should not have to be scanned a second time at the U.S.-Canada border. But until some sort of joint inspection force is agreed between Canada and the United States, all other containers arriving at the U.S. border from Canada, loaded with Canadian merchandise, will still have to be scanned, with predictable and destructive consequences.

The ultimate goal should be inspection of all North American containers at their points of origin, either overseas or within North America, followed by sophisticated tracking of trucks, railcars, cargo planes, and ships as they haul merchandise across land, air, and sea borders. Let’s paint a vision: within the next decade, nearly all merchandise travelling across the Mexican and Canadian borders should face no greater obstacles than a shipment from Ohio to Pennsylvania.

These are just a few of the potential areas for constructive engagement. Mexican and Canadian officials surely have their own NAFTA “punch lists.” While the NAFTA partners have made great achievements in fifteen years, they still face a lot of shared work to advance their common economic and security objectives. This task is doable, if campaign rhetoric evolves into thoughtful dialogue. ◆