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NAFTA: A GOOD DEAL WITH A BUM RAP

The House of Representatives is about to vote on the North American Free Trade Agreement (NAFTA). If it passes, NAFTA would benefit all three parties — the U.S., Canada, and Mexico. Failure to adopt it would set back global progress on trade, weaken employment and wage growth throughout North America, and jeopardize the economic reforms of the Mexican government. The geopolitical consequences would be highly adverse.

NAFTA is not perfect. Because of the North American content rules, the trade expansion among the agreement participants will result in some trade curtailment with European and Asian trading partners. Numerous cushions for favored industries (including many in the United States) will delay tariff reductions and the free flow of investment across borders for 10 to 15 years. Some non-tariff barriers are removed unevenly. For example, Mexico's trucking firms will be able to operate in all 50 U.S. states after three years, but U.S. trucking firms will need to wait six years for full access to Mexico.

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Nonetheless, NAFTA is a useful and important first step toward reducing government intrusion into international commerce. Failure to adopt the treaty in its present form would not preclude another effort at a better treaty at a later date, but it would certainly make such an effort extremely difficult and a better outcome highly unlikely. Rejection would also set back efforts to develop a free trade zone throughout the Western hemisphere. Furthermore, it would cause the United States to lose the moral high ground at the Uruguay Round negotiations and to sink to a level, very muddy playing field with the Japanese and the French.

Economic effects

The effect of NAFTA on U.S. employment has become the key issue. Opponents assert that NAFTA would result in huge U.S. job losses. In fact, NAFTA is certain to increase U.S. jobs. Job gains have already begun.

NAFTA proponents calculate an immediate advantage of the pact for U.S. employment on the order of tens of thousands to as many as 200,000 jobs. Currently, 18% of U.S. sales to Mexico are tariff free versus 50% of Mexican sales to the United States. Furthermore, Mexico's tariffs on U.S. products (averaging 10%) are higher than U.S. tariffs on Mexican products (averaging under 2% — 4% on about half of Mexican products and 0% on the half covered by the GSP — Generalized System of Preferences for goods of developing nations). Mutual tariff elimination, therefore, must benefit the net U.S. trade balance with Mexico and provide net gains in U.S. employment in the traded goods sectors.

But this calculation is both too simplistic and too modest. The real wage and employment gains for the U.S. from the trade pact are in fact larger than the modest employment gains expected merely from differential tariff reductions.

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The real gains from NAFTA will come from greater production efficiencies and economic growth in all three nations. In addition, NAFTA will enhance Mexico's economic and political stability and ensure the continuation of Mexico's economic liberalization program and its integration into the world economy. This will reassure investors in Mexico of the safety of their investments. By reducing investment risk, NAFTA will further encourage capital formation and growth in Mexico.

Expanding production and rising incomes south of the border would encourage higher spending by Mexicans on U.S. machinery, computers, and consumer products. In addition, more efficient production in Mexico would reduce the cost of many U.S. imports, benefitting U.S. consumers and businesses. Under NAFTA, the economies of the U.S., Canada, and Mexico will all be larger and stronger than otherwise.

Immediate gains for all parties

Some opponents of the treaty admit that NAFTA will bring net gains, but claim that the pain they believe will result from NAFTA will be immediate, while the gains will be long in coming. In fact, the gains have already begun.

The very great job benefits of freer trade should not be held hostage to the desire of a small number of people to obtain or maintain a vested interest in a particular job.

Even before NAFTA was proposed, Mexican economic reforms and the opening of the Mexican economy to world trade boosted the Mexican economy and improved the investment climate. The prospect of NAFTA has further reduced the risk of investing in Mexico, contributing to higher rates of saving within Mexico, and a strong capital inflow. The capital inflow has contributed to a stronger peso, and given Mexico the foreign exchange it needs to import capital goods to modernize its economy. The result has been a sharp rise in Mexico's imports. Since 1986, U.S. manufactured exports to Mexico have risen from $12.6 billion to $40.6 billion. Sales of U.S. services to Mexico have reached $9 billion. Per capita, Mexicans buy more U.S. goods and services than the Japanese or Europeans. In aggregate purchases, Mexico is poised to pull ahead of Japan as our second largest customer (after Canada). A significant portion of these gains must be attributed to the prospect of the free trade agreement.

The bilateral U.S. trade balance with Mexico has shifted from a deficit of over $5 billion in 1986 to a surplus of over $5 billion in 1992; in manufactured products, the U.S. surplus was over $7 billion, partly offset by oil and agriculture deficits. The prospect of NAFTA, through its effect on capital flows and the peso, has already contributed to this soaring U.S. trade surplus with Mexico, with billions of dollars of additional sales of U.S. goods and services to Mexico supporting tens of thousands of U.S. jobs.

U.S. exports to Mexico range from consumer goods to chemicals, paper and wood products, specialty textiles, computers and software, and industrial machinery and other capital goods to education, telecommunication, financial and engineering services. The idea that NAFTA would cost manufacturing jobs, when the prospect of the agreement has already increased Mexico's purchases of manufactured goods from the U.S. substantially, is clearly wrong.

Efficiency => productivity => jobs & wage gains

Very fundamentally, expanded trade means greater efficiency in production, greater total output, and greater productivity of labor, hence more employment and higher wages for all participants in the trade.

Freer trade is always job creating. In simple terms, what is good for consumers is good for producers. Consumers' incomes stretch the furthest when they are free to buy the best products at the lowest prices, wherever the products come from. U.S. workers are U.S. consumers. The more that a dollar of U.S. wages can buy, the greater will be the incentive to work, the lower will be U.S. labor costs, and the greater will be the incentive to produce goods and services in the United States. Furthermore, the freer producers are to produce in the most efficient manner in the most efficient locations, the more they can provide consumers for any given amount of resources.

Because freer trade raises total output and employment, those claiming that NAFTA will result in job losses cannot be referring to the level of total employment in the economy. They are apparently referring to specific jobs lost by specific people in specific industries.

Indeed, reduced trade barriers and more efficient division of labor will mean some changes in the mix of jobs and output in each country. Some U.S. industries will gain, some lose, within the over-all expansion. Gainers will substantially outweigh losers.

Automobiles and appliances (U.S. tariffs 2.5% vs. 20% in Mexico), auto parts (U.S. tariffs 0%-4%, Mexican, 10%-20%), and high tech products will be among the big U.S. manufacturing winners as tariff barriers fall. U.S. auto exports to Mexico are virtually banned by quotas and Mexican content rules that would evaporate under NAFTA. U.S. automobile production costs are well below those in Mexico, in spite of wage differentials, and U.S. auto exports would soar under the agreement. In U.S. agriculture, major sectors such as milk, grain, cereal and cattle producers will gain.

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The losers will be those currently receiving protection, hence benefitting at the expense of the rest of the population. These include some low tech or assembly-type U.S. industries, such as cornbrooms, athletic shoes, and glassware, now enjoying tariffs between 30% and 50%. In agriculture, potential losers include sugar, tobacco, peanuts, citrus, tomatoes, and vegetables, where tariffs range from 26% on frozen orange juice to 765% on ground or pulverized tobacco stems used in inexpensive cigars. In the past week, President Clinton has extracted additional concessions from Mexico for many of these agricultural products to cushion the effect of the treaty.

There will be costs for those losing protection who have to seek alternative employment, and who face retraining and possibly relocation. However, no economy can perform at peak efficiency if people are allowed to lay claim to specific jobs for all time and defy economic forces for change. Most people hold several jobs during the course of their working years, sometimes because old jobs are lost and sometimes because of the employees' own efforts to get better jobs. The very great job benefits of freer trade should not be held hostage to the desire of a small number of people to obtain or maintain a vested interest in a particular job.

Fears of jobs being shifted in droves to Mexico because of low Mexican wages are groundless. NAFTA opponents assert that because of these lower Mexican wage rates, Mexican producers will be able to under-price U.S. producers of competing products. But the competitive position of a Mexican business vis a vis a U.S. company depends on unit labor costs, not wage rates. (If wage rates were all that mattered, the world's industrial output would be concentrated in Ethiopia, Bangladesh, and Laos.) Mexican labor is paid less because it is less productive than U.S. labor. This productivity differential is the reason why lower-wage Mexican labor is generally not a threat to U.S. workers. But what if Mexican productivity increases? Then so will Mexican wages, and Mexican labor will still not be a threat to U.S. workers.

Opponents have cried for assurances that Mexican wages will rise with productivity, and President Salinas has pledged to make that happen, if necessary through increases in Mexico's minimum wage and other legislation. These concerns are unwarranted. As Mexican labor productivity rises, it would take wage controls and a hoard of bureaucrats to prevent the market from bidding Mexican wages higher.

Labor, environmental, and sovereignty issues

Side agreements to the treaty establish Commissions to ensure the safety of the border environment and to protect workers' rights. The side agreements were negotiated to placate environmentalists and labor advocates who objected that U.S. firms would flee to Mexico to avoid the cost of complying with U.S. environmental regulations, or to exploit oppressed Mexican labor. (In fact, Mexico has been vigorously enforcing stiff environmental standards, and its labor laws are as tough as those of the United States and Canada.) These side agreements have in turn provoked opposition to the treaty from others who claim that the United States is surrendering sovereignty and that U.S. businesses will be slapped with more environmental restrictions as a result.

The agreements do not add to the body of environmental and labor law in any of the three countries. They merely require that all parties regulate domestic and foreign firms and products equally, enforcing their national laws in a non-discriminatory manner. For example, the U.S. may not impose stricter pesticide controls on imports than it does on domestic fruits and vegetables. Neither does it have to accept less stringent standards than it imposes on U.S. produce. The side agreements contain procedures for resolving disputes between the governments in these areas and rather vague expressions of hope that quality standards and inspection procedures among the trading partners can be harmonized.

No penalties can be imposed under the side agreements without the consent of both parties to a dispute, and there is no authority given to the Commissions to over-ride national, state, or provincial standards on the environment, food safety, or any other issue. The lack of additional regulations or automatic enforcement has lead environmentalist and labor opponents of the treaties to complain that the agreements lack teeth.

The language of the agreements contains clear protection of national control over environmental, health, and labor issues. The fears of a loss of U.S. sovereignty are groundless. Nothing — no recommendation, no tariff sanction, no fine, no ruling — under the side agreements is binding on any one of the parties without that party's consent. There will be no environmental regulations imposed on U.S. businesses that the EPA, the President, and the Congress have not determined to impose under U.S. law; no changes in U.S. labor relations that are not part of the federal government's rules and regulations. Foreign officials cannot harm U.S. individuals or businesses under the agreements; at most, they can only file complaints with the Commissions against the U.S. government regarding inaction by the U.S. government in enforcing its own laws. As for environmentalists outside the government, they have no standing under the treaty to bring actions against U.S. businesses.

Conclusion: Seize the opportunity with confidence and pride.

The opposition to NAFTA is not based on facts or sound analysis. The United States remains the most capital intensive and productive nation on earth. Although we could be saving more and growing faster, the United States is still progressing as fast or faster than other developed nations. For the United States to fear to compete with a country with one third its population and one twentieth its GDP is absurd. It is profoundly to be hoped that the Congress will look past the nation's current economic uncertainties and beyond narrow regional interests and enact a treaty that will contribute to the future well-being of the entire country, the continent, and the world.

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