THE CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES

NAFTA at Three

A PROGRESS REPORT

SIDNEY WEINTRAUB

Foreword by Julius Katz

CSIS

NAFTA at Three
A Progress Report

Sidney Weintraub

Foreword by *Julius Katz*

THE CENTER FOR STRATEGIC & INTERNATIONAL STUDIES
Washington, D.C.

Significant Issues Series

SIGNIFICANT ISSUES SERIES papers are written for and published by the Center for Strategic and International Studies.

Director of Studies: Erik R. Peterson

Director of Publications: James R. Dunton

Managing Editor: Roberta L. Howard

The Center for Strategic and International Studies (CSIS), established in 1962, is a private, tax-exempt institution focusing on international public policy issues. Its research is nonpartisan and nonproprietary.

CSIS is dedicated to policy analysis and impact. It seeks to inform and shape selected policy decisions in government and the private sector to meet the increasingly complex and difficult global challenges that leaders will confront in the next century. It achieves this mission in three ways: by generating strategic analysis that is anticipatory and interdisciplinary; by convening policymakers and other influential parties to assess key issues; and by building structures for policy action.

CSIS does not take specific public policy positions. Accordingly, all views, positions, and conclusions expressed in this publication should be understood to be solely those of the authors.

❖ ❖ ❖

The Center for Strategic and International Studies
1800 K Street, N.W.
Washington, D.C. 20006
Telephone: (202) 887-0200
Fax: (202) 775-3199
E-mail: info@csis.org
Web site: http://www.csis.org/

Significant Issues Series, Volume XIX, Number 1

Washington, D.C. 20006

Printed on recycled paper in the United States of America

99 5 4

ISSN 0736-7136
ISBN 0-89206-298-3

Library of Congress Cataloging-in-Publication Data

Weintraub, Sidney, 1922–
NAFTA at three : a progress report / by Sidney Weintraub ; foreword by Julius L. Katz.
p. cm. — (Significant issues series, ISSN 0736-7136 ; v. 19, no. 1)
ISBN 0-89206-298-3
1. Canada. Treaties, etc. 1992 Oct. 7. 2. Free trade—North America. 3. Free trade—Mexico. 4. North America—Foreign economic relations. 5. Mexico—Economic conditions—1994–
I. Katz, Julius L. II. Title. III. Series
HF176.W438 1997
382'.917--dc21 97-1941
CIP

NAFTA at Three

Foreword

The conclusion of NAFTA was one of the more significant achievements of U.S. trade policy in the past 50 years. It was at the same time a highly controversial trade policy development. An assessment of its results after only three years, as the author notes, must necessarily be preliminary. Yet a review is now timely for several reasons. Although NAFTA did not figure importantly in the 1996 election campaign, the direct attacks by Ross Perot, and his running mate, and the doubts raised by Senator Dole went mostly unanswered by President Clinton. With the campaign out of the way, a more balanced evaluation may now be possible.

A review is also timely because the Congress is likely to consider new "fast-track" legislation to permit negotiations to admit Chile and possibly others to the NAFTA. It will almost certainly want to examine how NAFTA is faring.

Finally, under the NAFTA legislation the president is required to provide a comprehensive study to the Congress by July 1, 1997 on the operation and effects of the agreement. The terms of reference for this report specified in the law reflect what Sidney Weintraub refers to as the "unadulterated mercantilism" employed by the Clinton administration to gain congressional support for the agreement. The effects of the agreement on the U.S. gross national product, employment, balance of trade, specific industries (including wages and productivity), and investment flows are among the factors to be assessed in the president's report.

As Weintraub points out, these are not the most appropriate criteria by which to evaluate the effects of the agreement. He notes that NAFTA is a framework for bilateral economic relations and not a dominant factor in the internal economies of the countries. Because of the huge disparity in size of the U.S. and Mexican economies—Mexico's is one-twentieth (and Canada's one-tenth) that of the United States—the influence of NAFTA on the U.S. economy is minimal at best. That is not to say that there is no impact on individual firms and communities, but even this effect must be viewed in the larger context of the world marketplace.

It is unfortunate that the worth of NAFTA came to be viewed largely in terms of the trade balance and jobs. The author has labeled these arguments as "95 percent rubbish." These were not the primary considerations that led the Bush administration to decide in 1990 to undertake the NAFTA negotiations.

While the public rhetoric of the Bush administration in support of free trade negotiations with Mexico, like that of the Clinton administration, spoke of exports and jobs, this was in reaction to the charge by the AFL-CIO that an agreement with Mexico would result in massive job losses for the United States. In internal deliberations, however, the Bush administration saw an agreement with Mexico as an element of a broader trade strategy that sought to promote free trade throughout the Western Hemisphere and provide a stimulus for multilateral trade negotiations.

An agreement with Mexico also was seen as a means of giving support for the economic reforms of the Salinas administration, which the U.S. administration believed would promote economic growth and greater cooperation between the two governments on matters of mutual interest such as drugs and immigration.

The major contribution of this progress report is to provide a more multifaceted balance sheet with which to assess NAFTA, more appropriate than the narrow focus on exports and jobs. Rejecting the automatic relationship between exports and jobs, the author points out that an analysis of the jobs issue requires a more complex inquiry than merely measuring net exports. Just as exports do not automatically equate with job growth, imports do not automatically equate with job losses. Imports of oil and other needed goods, for example, do not mean a loss of jobs. Similarly, imports of components may be tied to exports of finished goods and contribute to overall export competitiveness.

After examining the "wrong" criteria for assessing NAFTA, Weintraub discusses what he regards as the more salient criteria that should be used with respect to the U.S. relationship with Mexico. Among these are growth in total trade, not merely exports; the promotion of intra-industry trade and specialization; and the effects on productivity and wages, on the competitive position of industries, on the environment, and, finally, on institution building. I agree that this is an appropriate array of interests that should be examined in any assessment of NAFTA. Of these issues, only the environmental issue was not among the objectives initially contemplated by the Bush administration when the idea of a free trade negotiation with Mexico was first discussed in 1990.

Weintraub observes that Mexico and the United States were drawn kicking and screaming into linking trade and the environment by the insistence of environmental groups. When the link between trade and the environment and labor became issues in the fast-track debate in 1991, President Bush and his negotiators explicitly committed to the congressional leadership that the negotiations would include both issues. During the course of the negotiations, the environmental ministers met on numerous occasions, both with and without the trade ministers, and agreed on a range of environmental and labor commitments. A Memorandum of Understanding signed in May 1992 provided for closer cooperation and joint action on a range of labor issues over a five-year period, including projects in the areas of occupational health and safety, child labor, labor statistics, labor law, and worker rights.

On environmental policy, the United States and Mexico agreed in February 1992 on an integrated border plan intended, among other things, to strengthen enforcement of environmental laws, to reduce pollution through a number of joint initiatives, and to spend more than $1 billion on border air, water, and sewage projects.

In addition to the parallel arrangements, NAFTA itself contains several provisions dealing directly with the issue of the environment. NAFTA chapters on standards and on sanitary and phytosanitary measures were drawn to preserve the ability of the parties to the agreement to maintain strong health, safety, and environmental standards. The parties also agreed to give priority to several international environmental and conservation agreements in the event of any inconsistency between NAFTA and these international agreements. They also agreed that they would not relax environmental standards as a means to attract investment. The dispute-settlement chapter is intended to support environmental policy by placing the burden of proof on those challenging the consistency of an environmental measure with the agreement. Further, there is provision for convening an independent scientific review board on issues of fact concerning the environment, health, or safety. The treatment of environmental issues in NAFTA persuaded a number of major environmental groups to endorse the agreement.

Under the prodding of more radical environmental groups, as well as the AFL-CIO, President Clinton took the position that the NAFTA provisions on the environment and the parallel arrangements on labor and the environment were inadequate. He insisted on new side agreements, which contain the possibility of sanctions in the event a participating government fails to enforce its domestic laws and regulations in the areas covered by the agreements.

I would note finally that the Clinton administration has paid a price for having forced the Mexicans and Canadians to accept its side agreements. That price has been the unwillingness of the

Congress to renew fast-track negotiating authority in a form that would permit future agreements to use trade sanctions to enforce labor and environmental standards. Thus, the expectation that NAFTA would be expanded to include Chile and perhaps other countries has been frustrated so far. This was an unfortunate and unintended effect of the Clinton side agreements.

JULIUS L. KATZ
President, Hills & Company
Former Deputy U.S. Trade Representative

Acknowledgments

Because I live in Washington, D.C., I have ready access to many officials intimately engaged in making U.S. trade policy and am in regular contact with the many experts in this city who analyze and comment on what the policymakers do. These analysts are from the private and public sectors, from business, universities, and think tanks. My position at the Center for Strategic and International Studies enables me to discuss NAFTA and other trade issues with interested members of the U.S. Congress. My most important acknowledgments go to all these interlocutors. They are too numerous to list here.

Officials of the Mexican embassy in Washington also have provided their government's viewpoint on NAFTA issues, as have the responsible officials in Mexico City during my frequent visits. I stay in regular contact with nongovernmental analysts in Mexico. I owe much of my sense of how Mexicans see the effects of NAFTA to these conversations.

I am particularly grateful to Professor Chandler Stolp of the Lyndon B. Johnson School of Public Affairs of the University of Texas at Austin and to Jules Katz, both of whom read the final draft manuscript and made valuable suggestions. Most of these have been incorporated in the final publication. Jules, based on his long experience in trade policy as a government official—and a key negotiator of NAFTA during the administration of George Bush—and as a private observer, was also kind enough to contribute the foreword to this publication.

I am grateful to the five persons whose names appear on the back cover who graciously wrote words of encouragement to prospective readers. I value their recommendations because each of them played a major role in the negotiation of NAFTA, the public and congressional debate leading to its adoption, or both. They are Carla Hills, the U.S. Trade Representative during the most active phase of the negotiations; Robert Mosbacher, who, as secretary of commerce, traveled extensively in Mexico and the United States explaining the benefits of the agreement as he saw them; Ann Richards, the former governor of Texas, the state with the greatest commercial relationship with Mexico; William Richardson of New Mexico, now the U.S. ambassador to the United Nations, who played a major role in the House of Representatives in the NAFTA debate; and Peter Hakim, president of the Inter-American Dialogue, an institution that lives up to its name of encouraging dialogue on hemispheric issues.

I wish to thank John Melle, director of the Mexico program in the Office of the U.S. Trade Representative, for specific help on the operations of NAFTA. Two analysts from the U.S. Department of Commerce, Douglas Karmin and Helene Stevens, provided much information on trade disputes that have arisen between Mexico and the United States since NAFTA came into effect. I wish to emphasize the help I received from the economic analysis staff of the U.S. International Trade Commission. This was done at a number of meetings organized by Robert A. Rogowsky, director of operations, and through written material of the ITC staff. My judgment is that the most unbiased and comprehensive official material published on NAFTA is done by the research staff of the ITC because its independent position in the U.S. governmental structure encourages professional analysis rather than pre-cooked positions.

The Mexico program of CSIS, represented by Delal Baer and Armand Peschard-Sverdrup, provided the encouragement and financing for this publication. James O'Brien, then an intern at CSIS, gathered many of the documents that provided the raw material for the discussion in the publication. Carolyn Blackwell, my assistant, is responsible for getting the manuscript in shape and preparing the graphs in chapter 3. This is a much improved product over the original manuscript because of the dedicated editorial help from Roberta Howard of the CSIS publications office.

The material and opinions in this monograph are mine and not those of CSIS as an institution, and not necessarily those of any of the people who provided help and commentary.

SIDNEY WEINTRAUB
Washington, D.C.
February 1997

Contents

1

Introduction

Many U.S. government agencies periodically assess the progress of the North American Free Trade Agreement. They do this because of their mandates, coupled with pressure from the U.S. Congress. The Department of Commerce does this for overall NAFTA trade and for interchange in specific sectors. The Department of Agriculture's NAFTA economic monitoring task force makes periodic reports and was up to NAFTA-6 at the end of 1996. Regular reports come from the International Trade Commission, the Office of the U.S. Trade Representative, the State Department, the Labor Department, the Environmental Protection Agency—to name just some of the reporting agencies. There is now an elaborate network of intragovernmental committees. The Congressional Research Service of the Library of Congress issues a steady stream of analyses for the Congress, and the General Accounting Office has provided a number of oversight assessments. Most of the output is in hard copy and generally available electronically.

The facts presented in the executive agency reports tend to be impeccably correct, but they have a pro-NAFTA bias. The administration of Bill Clinton, after all, supports NAFTA—although this was hard to tell during the 1996 electoral season. So, too, did the administration of George Bush, but this also was hard to fathom from the Republican Party electoral rhetoric in 1996.

There is also a constant drumbeat of anti-NAFTA discourse emanating from established anti-NAFTA groups. These include the AFL-CIO, organizations established under the aegis of Ralph Nader, unreconciled environmental organizations, left-leaning think tanks complemented in this task by the ultranationalist right wing of the Republican Party, and, of course, Ross Perot and his supporters. Most of this material is not just anti-NAFTA, but against free (or, if one prefers another word, open) trade.

Most of the material with which the public is bombarded is therefore one-sided advocacy. Just about all of it is partial. The automobile producers love NAFTA, the unions in this industry despise it, and their respective press releases and publications reflect these positions. Groups that have always opposed NAFTA tell us that the Mexican side of the border is just as polluted, maybe even more so, as when NAFTA went into effect on January 1, 1994;[1] at the same time, those who have always supported NAFTA inform us about all the institutions that did not exist before that are now working on border environmental problems.

Newspapers and television talk shows, in their zeal to demonstrate impartiality, carry op-ed columns and talking heads from the extremes—rabidly anti-NAFTA (and anti-imports from just about anywhere) partisans arguing with those who see no fault in the way NAFTA is functioning. The "silent majority," those who see merit in the NAFTA concept but who are also critical of some features of the agreement, is less well represented.

It is not surprising, therefore, that the public that truly wishes information about the agreement is pretty well fed up with discussions of NAFTA. Non-experts and those not directly involved in the economic interchange with Mexico—those not competing with imports from Mexico and not profiting from exports to Mexico—have not been well informed about how the agreement is working. Instead, they are subjected to sound bites and isolated anecdotes generalized as inevitable verities. The purpose of this progress report is to fill in some of the gaps in the information regularly distributed to the public.

Fair-minded analysts—those who support the idea of greater economic integration between the United States and its two land neighbors, as I do, and those who oppose it—must admit that it is too early to make any definitive judgment about NAFTA's effects.[2] Why then am I writing now? I do this with diffidence because it will take time, ten years or more, before we know how the countries have adapted and restructured their economies to their growing economic integration. Mexico suffered the most severe economic decline in any year of its modern history in 1995 and this has overwhelmed all other short-term effects, including those of NAFTA.

My purpose is to put NAFTA into its proper context. The views of financially interested parties are largely caricatures. So are many of the one-sided government studies written by persons who are not free agents. NAFTA cannot be assessed by looking at one year's trade data, as both supporters and opponents do. NAFTA, in this view, was good for the United States in 1994 because the country had a bilateral trade surplus with Mexico, but bad in 1995 when the surplus turned into a deficit. Crass mercantilism of this nature should have gone out of fashion with Adam Smith some 220 years ago.

Even more sharply, assessing the effects of the agreement by looking at annual and even monthly trade balances—which side is ahead because its bilateral exports of the moment exceed its imports—borders on deception. Temporary trade balance measurements between two countries in a global trading system tell us very little. Honest commercial interchange is not between winners and losers. Who gets the better of the deal, the realtors who have money inflow when they sell homes, or the home buyers who must lay out money? Who's ahead, the grocer or the shopper? Whose welfare should we measure when Mexican tomatoes capture a larger share of the U.S. market—the Florida growers or the U.S. consumers?

While NAFTA is an agreement among three countries, what follows will focus on the U.S.-Mexico situation. The Canada-U.S. trade relationship has its specific conflicts, sometimes quite bitter, but the overall situation is not basically contentious.[3] The Canada-U.S. Free Trade Agreement, which went into effect in 1989, sailed through the congressional approval process with little discussion and even less controversy. By contrast, what was probably the most contentious national and congressional trade debate since the Smoot-Hawley tariff measures of 1930 erupted over free trade with Mexico. Trade integration with Mexico represented something new because of Mexico's status as a developing country and one right on the U.S. border. The agreement with Canada was also groundbreaking for U.S. trade policy, but was traditional at its core because Canada is a highly developed economy.

What follows will try to be reasonably comprehensive—without being prolix or too technical about the agreement's provisions or too theoretical in the economic analysis—in assessing the operation of NAFTA thus far. It would have been preferable to wait a number of years before reaching conclusions about NAFTA, but the political contention over the agreement precludes endless patience.

This progress report begins by setting forth the criteria by which an economic integration agreement of this nature should be assessed. The economic-political-social situation in Mexico will be described because this is necessary to understanding the functioning of the agreement. The bulk of the discussion will deal with developments in specific fields—trade, investment, finance, and the development of internal and cooperative institutions spawned by the combination of the internal situation in Mexico and the requirements of NAFTA.