ACTIVITY 3
THE NAFTA EFFECT*

So far, North America's free-trade deal has helped Mexico's economy without hurting the United States. But its chief effect reaches beyond economics.

To some, it was the road to hell: "Free trade equals slave trade," declared one banner in Texas in 1993. According to its enemies, the North American Free-Trade Agreement would suck jobs and investment out of the United States and Canada into their poor southern partner, Mexico. Not that this would do Mexicans any good: it would put them at the mercy of rapacious capitalists pouring filth into Mexico's air and rivers.

To others, especially the governments of the three countries, NAFTA was a distributor of milk and honey. America and Canada, already linked by their own trade deal since 1989, would be enriched by the opening of Mexico's economy; Mexico would rise on a flood of trade with and investment from its wealthy new friends.

Three and a half years later, the quarrels still rage, even if nobody now talks seriously of dropping NAFTA. Politicians in America and Mexico, the countries in which it has been most controversial, continue to debate it fiercely. Next week the Clinton administration is expected to deliver a doubtless glowing report to Congress on NAFTA's economic effects, and will receive an equally predictable raspberry from trade unions and environmentalists. In Mexico, left-wing candidates in the elections due on July 6th would like the treaty revised to allow freer migration of Mexican workers northwards a suggestion that brings raspberries from the northerners. So which side was right: the Jeremiahs or the Panglosses? Neither, by a long chalk. In an economy as large as America's, the effect of freer trade with Mexico was never likely to be great; and so it has proved, Mr. Clinton's report notwithstanding. In far smaller Mexico, whose economy is less than a twentieth the size of America's at market exchange rates, the economic impact has been greater, but is still less than the rosy-eyed would like to claim.

But NAFTA has had wider effects, and these matter a lot more. Up to a point, these wider consequences were intended, and are welcome. The trade agreement has helped to make sure that Mexico sticks to its programme of reform, and has thereby done much to improve the prickly relations between America and Mexico. Not at all intended, however, and far less welcome, has been NAFTA'S effect on American trade policy in general. The treaty's enemies have managed to blame it, usually unfairly, for all manner of ills; and, largely as a result, America's trade policy has stalled.

The modest economic plus

Start with the economics. Could the cause of such prolonged and savage argument really matter so little? Yes, it could, at least in the United States.

One reason is that, compared with the elephantine American economy, Mexico's is a mouse. Only 117,000 Americans have signed up for the benefits offered to workers displaced by NAFTA. Compare that with the 1.5m who lose their jobs each year from factory closures, slack demand and corporate restructuring, and the 2.8m new jobs created each year in the United States. Economists at the Institute for International Economics, a Washington think-tank, point out that American direct investment in Mexico has averaged less than $3 billion a year since 1994, NAFTA'S first year. That is under 0.5% of American firms' total spending on plant and equipment.

Second, other things have had a bigger effect on trade flows between the United States and

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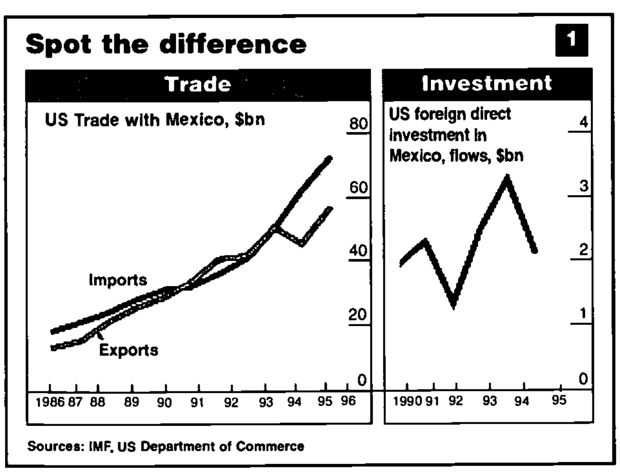
Mexico. Mexican exports to America have surged in the past two years, and trade in the opposite direction has slowed, chiefly because the peso's collapse in late 1994 and early 1995 made Mexican goods much cheaper in dollars, and American ones pricier in pesos. The currency crisis was the result of Mexican economic mismanagement. NAFTA, by promising a strong flow of investment, may have lulled the Mexicans into a false sense of security about the sustainability of the overvalued peso; but do not blame the pact itself.

Anyway, NAFTA was not the huge leap towards free trade that it's champions said it would be. The United States already had low tariffs on most of its goods. It therefore did not need to liberalise its markets much; and, even when it did, some favoured sectors, such as agriculture, remained protected. Furthermore, Mexican trade liberalization had begun in the mid-1980s. In 1985, the country's business and political leaders, fed up after yet another economic crisis, abandoned decades of protectionism, joining GATT the following year. By 1990, Mexico's exports were 14% of its GDP, twice as much as ten years before. Although NAFTA took things further, cutting tariffs on American (and Canadian) goods from 10% to 3%, trade between Mexico and the United States was booming long before (see chart 1).



Ah, say NAFTA'S defenders, but what about Mexico's response to the peso crisis? In 1995 Mexico did not put up the shutters against foreign goods, as it had after the debt crisis of 1982. NAFTA kept it closer to the straight and narrow. This is true but NAFTA cannot take all the credit. As economists at the University of California at Los Angeles say in a recent study,[1] Mexico's economy had already become closely integrated with that of the United States as a result of the 1980s reforms. Mexican exporters had to import materials and components in order to make their wares. Curbing imports would merely have intensified Mexico's economic pain.

Does all this mean that NAFTA'S economic effects have been negligible? Not at all. It is a deal among only three countries, and by discriminating against others may have damagingly diverted some trade and investment. Some of Asia's textile and car trade with the United States seems to have been lost to Mexico, and the Caribbean and Central American countries are badgering America for "parity" with the Mexicans.

But there have been solid benefits, too; and the place to look for them is in Mexico more than in the United States. The change is not to be found in the maquiladoras, the duty-free assembly plants that sit along the American border, although their exports have risen by more than 18% a year since 1994. Within Mexico, both local and foreign manufacturers have been sprucing up their production, distribution and sales systems to equip themselves to supply an integrated North American market.

In the car industry, for instance, the twin forces of NAFTA and the peso crisis have made Mexico an attractive manufacturing centre for the whole region: exports of cars and trucks

[1] Raul Hinojose Ojeda et al., *North American integration three years after NAFTA*. North American Integration and Development Centre. UCLA: December 1996.

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have doubled since 1994, to 1m units. Mexican firms whose suppliers provide second-rate material are spending a lot of money on training and financing local supplier networks. The textile-and-clothing business, says Gary Gereffi of Duke University, provides another example. In America, under pressure from Asian competitors, it had been in decline since the 1970s. The Mexican business was also in bad shape. Its protected manufacturers produced shoddy goods for local markets. Its *maquiladoras* worked for export, and used few local inputs.

Since the arrival of NAFTA, big firms in the southern United States and the north and centre of Mexico have been linking up. Manufacturers have been setting up joint ventures in Mexico which, unlike the *maquiladoras*, use local inputs: an example is the "textile city" project to be built near Mexico city by America's Guilford Mills and Dupont and Mexico's Grupo Alfa. And as big American retailers, such as Wal-Mart and Sears, have expanded their presence in Mexico, they are beginning to buy their branded clothes from Mexican plants, turning them from export-only *maquiladoras* into contract suppliers for the Mexican market. These big-name retailers are even starting to promote Mexican-made goods through their North American networks. The result of all these Mexican-American links, says MR. Gereffi, could be a North American textile-and clothing industry capable of taking on Asian rivals.

The biggest winners from this wave of investment and regional consolidation are likely to be ordinary Mexicans. They have long had to put up with tatty and/or expensive products manufactured by uncompetitive local firms. Tijuana is the world capital in television production; but television-buyers in Mexico City have until recently paid 10% more than Americans do. No longer. Mexicans can now buy a wider variety of things at lower prices, often with such once-unknown customer services as 24-hour free telephone numbers. Some pesticide makers deliver their products to customers in northern Mexico directly from warehouses in Texas; firms in other industries do the reverse from warehouses in Mexico. Goods arrive faster and firms can cut back on inventories: a gain both for customers and for the companies themselves.

The bigger gain—and loss

Fine: but the consequences go deeper. It is in politics, not economics, that NAFTA has had its biggest impact. The trade agreement has come close, and perhaps irreversible, embrace between Mexico and the United States. Given the history of hostility between the two countries, this embrace is remarkable. Its cause was the realization by American officials that their chance of stemming the flow of illegal drugs and immigrants from Mexico would be far greater were their southern neighbours rich rather than poor. Freer trade and internal economic liberalization in Mexico were therefore to be encouraged.

American presidents are now prepared to defend Mexico against an often hostile Congress. In return, Mexican leaders have ditched their old gringo-bashing rhetoric. Richard Feinberg, formerly an adviser of Mr. Clinton's, says contentedly: "We bought ourselves an ally with NAFTA."

Two incidents have made clear the importance of the alliance both to Mr. Clinton and to the Mexicans. One came after the peso crisis broke in December 1994, sending Mexico's economy tumbling into the worst recession in Mexican memory. Mr. Clinton rushed in, putting together a $50 billion international rescue package against the objections of Congress. According to John Sweeney, an American Treasury official, the rescue would have been almost impossible without NAFTA.

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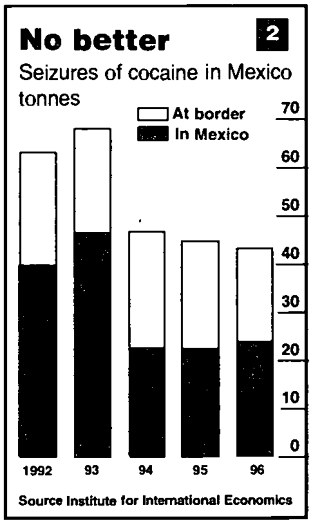

The second illustration of the political by-products of NAFTA came this spring, when Mr. Clinton renewed Mexico's "certification" as a good comrade in the war against drugs. He did this despite the stream of drugs that still crosses America's southern border, and despite the arrest in February of Mexico's top anti-drug policeman on suspicion of being in the pay of drug barons.

Alas, NAFTA's effect on the United States has not been entirely benign. Mr. Clinton has admittedly been more or less free, despite grumblings in Congress, to continue his political love affair with Mexico: witness a pally visit to Mexico in May, which yielded deals on farm trade, drugs and immigration. But the continuing squabbles over the effect of NAFTA have blighted his efforts to push on with other trade-liberalisation deals. "The aftermath of the politics of NAFTA," says Fritz Mayer, ex-Congress staffman and another academic at Duke University, "has frozen American trade initiatives."

When NAFTA came into operation, this was almost unthinkable. In a televised debate in November 1993, Vice-President Al Gore wiped the floor with Ross Perot, billionaire businessman and protectionist presidential candidate, who had famously forecast a "giant sucking sound" as American Jobs vanished southwards. The same month, NAFTA squeaked through Congress. This helped to break down resistance to a far more important global trade agreement the Uruguay round of GATT talks in December. All seemed set fair for further trade initiatives. Bringing Chile into NAFTA, the planned first stage of extending the agreement to cover all the Americas except Cuba, looked a doddle.

Yet, despite NAFTA's modest economic effects in the United States and the health of that country's economy it grew by 4.1% in the year to the first quarter of 1997, unemployment is down to 4.8%, the lowest level since 1973, and inflation is 2.2% and falling the squabbling over NAFTA is as bitter as ever. As a result, in the second term of his presidency, Bill Clinton finds himself trying, without success, to win "fast-track" negotiating authority on trade from Congress, so that he can ask Congress to vote a straight yes or no to trade deals without fiddling amendments. Unless the president gets his way on this, other countries will remain chary of making deals with America that could later be modified by Congress. As a result, Chile is still waiting to start serious talks with America on its entry to NAFTA, although it has signed trade agreements with both Canada and Mexico.

Other things are having to wait, too. Mr. Clinton has been unable to promise much trade liberalisation in the Asia-Pacific Economic Cooperation forum. This is a retreat: in 1993, after a successful meeting of the forum's leaders in Seattle, he seemed to be the leader of a campaign to open up the Pacific. And in the past few months Mr. Clinton's hopes of swift agreement on China's entry into the World Trade Organisation have turned to dust, despite a House of Representatives vote in favour of continuing to treat China on equal terms with America's other trading partners.

Granted, there are plenty of other forces at

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work besides rows over NAFTA. Mr. Clinton's China policy has been tarnished by charges that the Democrats' coffers for last year's election campaign were swollen by Chinese cash. After swallowing both NAFTA and the Uruguay round in quick succession, America's lawmakers were inevitably suffering some trade indigestion. And it is no surprise that a Congress in Republican hands, as it has been since 1994, does not want to help a Democratic president.

But NAFTA's opponents have been doing their damnedest to give both the pact itself, and the whole notion of free trade a bad name. Freer trade they fear, means that Americans have to compete with workers in poorer countries who are willing, or are made, to work for far less pay and to put up with unsafe and unhealthy surroundings. Given the gap in pay and conditions, they say, American workers stand no chance. And free trade does not make only Americans miserable; it exploits the downtrodden foreigners, too.

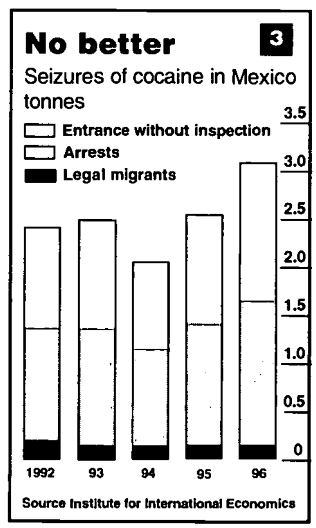
NAFTA is an obvious target, because the competing paupers are on America's doorstep. Moreover, NAFTA's "side accords" intended to monitor labour conditions and safeguard the environment have proved toothless: Canada and Mexico accepted them only grudgingly, after much American lobbying, and insisted on making them hard to enforce. So Mexico City remains probably the world's filthiest big city, and border towns are sprawls of maquiladoras and sewage-filled rivers. Mexican trade unions have been kept in check for years by the ruling party, though this may change if the left does well in this Sunday's elections.

The peso crisis gave NAFTA's critics a double opportunity. America's rising trade deficit with Mexico made the administration's promises that NAFTA would boost American exports (and so, it claimed, employment) look hollow. And Mr. Clinton's rescue package for the peso, although it turned out to be a remarkable success made it easy for NAFTA's opponents to claim that the United States had hitched itself to a deadbeat neighbor.

Another problem for NAFTA, says Mr. Mayer, has been "guilt by contagion: passing NAFTA made us closer to Mexico in some physical sense." Americans now look more sharply at Mexico than they did before NAFTA, and they do not like everything they see. Some see an open door to trade as little different from an open door to illegal drugs and illegal immigration, even though there is no reason why NAFTA should increase either. To add fuel to the argument, the recession south of the border has led Mexicans to try slipping into the United States in even greater numbers.

Just say yes

Worst of all for Mr. Clinton, perhaps, Americans' misgivings about trade are being



articulated not just by isolated hotheads in Congress and the labour movement but also by Richard Gephardt, the Democrats' leader in the House. Mr. Gephardt wants to succeed Mr. Clinton as president. The president would rather the job went to Mr. Gore.

And therein lies the rub. Mr. Gore, both as Mr. Clinton's number two and as Mr. Perot's demolisher, is linked with the passage of

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NAFTA. Mr. Gephardt, who in 1993 voted against NAFTA, insists there should be no new fast-track authority without negotiations on labor and environmental standards. The Republicans want no such conditions. If Mr. Clinton, who has said he will ask for negotiating authority again in September, wants a fast-track mandate, he will probably have to lean towards the Republicans. That would pit him, and Mr. Gore, directly against Mr. Gephardt.

As an old friend of the labour movement, Mr. Gephardt is doing these things out of conviction as well as opportunism. But the effect on Mr. Clinton's trade policy is the same, whatever Mr. Gephardt's motives. The president must forgo progress on trade, or risk scuppering Mr. Gore's chances of the White House.

For the United States, the best thing would be to snub the trade-union and green lobbies and press on with trade liberalisation. The brief history of NAFTA indicates that America has nothing to fear from trade with poorer countries; indeed, it has lots to gain from freer trade on a much wider scale. And freer trade would also be best for the developing countries. They would not only get richer, and be able to buy more American goods; in time, their working conditions and the state of their environment would improve, too, as their growing middle class insisted on the right to a cleaner and more comfortable life.

Thanks in part to NAFTA, this is the prospect in Mexico. And, as Mr. Clinton realises, a prosperous Mexico is more likely to keep its sons and daughters at home, and see fewer of them become illegal immigrants or drug smugglers. That would please people on both sides of the border.

ACTIVITY 4
TAKING SIDES: ASSESSMENT

Tell whether each of the following groups would be for or against NAFTA; explain your answers. If you think that group's opinion could go either way, explain that as well.

A. U.S. Trade unions

B. Mexican consumers

C. Environmentalists

D. Asian textile manufacturers

E. The American and Mexican textile and clothing business

F. The country of Chile