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FALSE PROPHETS
The Selling of NAFTA

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INTRODUCTION

Last month the United States opened formal negotiations with Chile over its proposed accession to the North American Free Trade Agreement (NAFTA). Chile's bid to join the free-trade area is another step toward hemispheric economic integration — a Free Trade Area of the Americas, which President Clinton hopes will be in place by 2005.

Before these negotiations proceed any further, policy makers should step back and assess the impact that NAFTA and related policies have had on Mexico and the United States. NAFTA supporters were wrong in virtually every prediction they made about the Agreement's short-term impact: The U.S. jobs they promised have not materialized, and freer trade has fostered neither stability nor prosperity in Mexico. There is no reason to believe that their judgment regarding Chile is any better. The same ideological commitment to "free trade" that blinded NAFTA's advocates to Mexico's economic instability, political corruption, and deep social divisions will similarly prevent a realistic assessment of the prospects for trade with Chile. The same false urgency and imbalance of political power that yielded a lopsided NAFTA, with strong protections for the property rights of transnational corporations and weak and unenforceable protection for labor and environmental standards, is likely to produce a similarly unbalanced agreement with Chile-and with future Latin American partners. The people leading the campaign for free trade and investment are so committed to the concepts of export-led growth, capital mobility, and market-based reform that they cannot envision alternatives to the free-trade juggernaut, nor can they digest facts contrary to their preconceptions.

One year after the implementation of NAFTA, Mexico is in serious and deepening social, political, and economic crisis. The Mexican peso has lost almost 50% of its value since December, bringing the government to the brink of insolvency; an armed uprising in the southern Mexican state

of Chiapas has highlighted the country's economic, geographic, and racial polarization; and political assassinations and allegations of corruption have undermined faith in the political system at its highest levels.

As a consequence of these related developments, U.S. exports to Mexico-and the jobs associated with them-will fall drastically in 1995, while imports will rise. In the first four months of 1995, the much-touted U.S. trade surplus with Mexico has already turned into a deficit averaging over $1 billion per month, which is likely to lead to a $10 to $15 billion deficit for the year.' Using the same formula NAFTA supporters used to calculate potential job gains from U.S.-Mexico trade, this deficit would entail the loss of around 300,000 U.S. jobs.[2] Meanwhile, the gap between Mexican and U.S. wages has risen sharply, rewarding companies that move or have moved production to Mexico and encouraging immigration, both legal and illegal.

The crisis in Mexico has dramatically, if painfully, clarified the hidden costs of NAFTA and of the accompanying economic policies for both Mexicans and Americans, while revealing the inconsistencies in many of the arguments made in favor of NAFTA two years ago. The image of Mexico as a rich consumer market for American products (and thus a spur to U.S. employment) has been replaced by one of a country sliding back into the Third World.

Mexico appears to be pinning its hopes for economic recovery on attracting more foreign direct investment, keeping wages from rising too rapidly, and exporting more and importing less. To the extent that Mexico succeeds on these terms, the U.S. trade balance with Mexico will continue to worsen. Some investment that would otherwise have gone to building or expanding U.S. factories will go instead to Mexico, and the wages of U.S. workers will come under increasing pressure from competition with much lower Mexican wages. Workers on both sides of the border will suffer, as predicted by NAFTA critics. NAFTA advocates who promised economic prosperity and trade-related job creation for the three North American partners have quietly changed the subject; they now talk vaguely about the long term, while still praising Mexico's "fundamentals."

Peso devaluation. Widespread loss of investor confidence. Recession. Loss of U.S. export jobs. Anti-American sentiment. Social unrest on the United States' southern border. Increased immigration pressures. This scenario may sound familiar, because these negative consequences were promised, not once, but twice-first, if Congress defeated NAFTA, and second, if the United States failed to put up tens of billions of dollars to support the peso in the wake of the devaluation.

But Congress passed NAFTA; President Clinton put together a $50 billion package of loans and guarantees;[3] and for the last decade, Mexico scrupulously followed the prescriptions of the international policy community. If NAFTA and the associated free-market policies had worked as predicted, this economic catastrophe ought to have been averted.

NAFTA's critics warned repeatedly that the Mexican economy was unstable, bolstered temporarily by speculative capital and an overvalued currency. They also argued that free trade alone was unlikely to solve these problems.' The high value of the peso exaggerated the consumer power of the Mexican economy and understated the wage gap. The economic policies implemented by President Salinas and his predecessor did not deliver sustained high growth or improvements in the standard of

living for most Mexicans: poverty and inequality were growing, job creation was slow, and in 1993 real wages still languished 30% below their 1980 level (Rendon and Salas 1994; Heredia and Purcell 1994; U.S. Department of Labor 1994). The key assumptions underlying the arguments in favor of NAFTA were thus wrong: Removing the relatively small tariffs did not guarantee the United States exclusive access to a large and growing market, and "locking in" Salinas's economic reforms did not foster a stable and prosperous Mexican economy.

But the prevailing theology of free trade and investment drowned out these objections and prevented the press and policy makers from examining the available evidence objectively. That same theology is now contributing to an "economic rescue" package for Mexico that involves larger doses of the same medicine that brought about this crisis in the first place-more austerity, wage repression, and reliance on the promise of foreign capital.

This paper will review the connections between NAFTA, the economic reforms associated with it, and the crisis in Mexico. It will also revisit the NAFTA debate and the predictions made by both sides. The author argues that the key problem is not economic integration with Mexico and Canada per se, but rather the specific set of rules embodied in NAFTA as well as the policies "locked in" in Mexico. A different process of economic integration-slower, more sensitive to the income disparities among and within the three NAFTA countries, and incorporating enforceable labor and environmental standards-would have mitigated the economic crisis. The integration process must be accompanied by a radically different and more humane set of domestic policies, including a less contractionary macroeconomic policy, a more carefully regulated financial sector, and a better-functioning democracy in all three countries. This would improve the chances of avoiding similar meltdowns in the future. The U.S. government should seize the present opportunity to negotiate with Chile to improve and strengthen the content and procedures of the labor and environmental provisions of NAFTA. The government should also use this opportunity to reexamine the conditions it attempts to impose on our trading partners in exchange for improved access to the U.S. market.

ASSIGNING BLAME

NAFTA on its own did not cause the present economic crisis in Mexico, in the sense that by the time it was implemented, the peso devaluation-and many of the negative outcomes associated with it-was already inevitable. As its proponents pointed out repeatedly, however, NAFTA was not an isolated policy, but simply an acceleration and a locking-in of policies President Salinas was already implementing unilaterally. In a Brookings Institution conference volume, Nora Lustig, Barry Bosworth, and Robert Lawrence (1992, 1) write that "NAFTA is only a formal recognition of changes that have already taken place." It is important, they argue, "because it institutionalizes the policy changes and confers a degree of permanence on them that is critical in attracting the foreign capital and technology needed for future growth." Thus, it is perfectly reasonable to assess NAFTA in the context of this policy package, rather than in isolation.[5] Together, these policies-of which NAFTA was an essential element-have caused the recent crisis.

The "Neoliberal" Economic Model

The policy changes, begun in the mid-1980s by President de la Madrid and continued by Salinas, included dramatic reduction of trade barriers, privatization of hundreds of state-owned firms, cuts in subsidies, market-oriented land reform, and dismantling of regulations on foreign investment and the financial sector.

The cuts in subsidies and tariffs on agricultural products, together with policies allowing private sale of communal land, worsened the plight of Mexico's subsistence farmers. This contributed to the uprising in Chiapas. (In their initial statement, the rebels demanded the elimination or renegotiation of NAFTA.)

The overall reduction in trade barriers led to a widening and unsustainable trade deficit for Mexico, as well as the failure of hundreds of small- and medium-sized businesses there. Without an industrial policy or a transitional adjustment plan in place, removing trade barriers simply accelerated imports of luxury consumer goods and destroyed existing businesses. While in the long run, this process of opening the economy to less regulated trade might result in more efficient production, it is both irresponsible and self-defeating to ignore the process of getting from here to there-a process that may take a generation or more.

Mexico's thirst for foreign capital led it to remove many restrictions on both the entry and exit of capital. High interest rates attracted large amounts of speculative capital, which ultimately had a destabilizing impact on the economy. Ronald McKinnon (1995) of Stanford University writes, "A flood of foreign capital can destroy a developing economy by creating a crippling current-account deficit." McKinnon recommends that Mexico limit the future use of foreign capital, either by limiting the amount foreign banks can invest or by taxing all large foreign investments.

Unqualified Praise for NAFTA

Economists, journalists, and government officials lavishly praised Mexico's economic reforms during the NAFTA debate. It was often argued that a major reason for passing NAFTA was to reward these policies. *The New Republic* wrote (1991,7-S) that "the best reasons for Congress to approve 'fast track' are political. President Salinas deserves the statement of support that a yes-vote would convey." Henry Kissinger (1993) gushed, "I know of no government anywhere that is more competent [than Salinas's]. ... NAFTA's defeat ... would humiliate President Salinas in his bet on trust and cooperation with the United States." Philip Trezise, a Brookings senior fellow in foreign policy studies, summed up the case: "If NAFTA is anything, it is the endorsement by Mexico of the free market economics that the United States has been so industriously peddling in Latin America, Eastern Europe and elsewhere around the globe."

All of these writers-and many more-were willing to give Salinas and his policies credit for whatever modest economic successes Mexico had achieved by the early 1990s. Now that the Mexican economy is crashing, these same analysts are reluctant to assign any blame to the economic policies that have been in place for the last decade.

NAFTA's boosters argued that if anything happened to reverse or even slow the implementation of Salinas's policies, such as a no-vote on NAFTA by the U.S. Congress, horrible consequences would ensue. The week before the NAFTA vote, a *Business Week* (1993, 32) cover story warned grimly that "the consequences for the world [of a NAFTA defeat] could be dire." *Business Week* envisioned the morning after: "anti-Yanqui protests have broken out in Mexico. Wire stories chronicle the peso's plunge and warn of a global drift toward protectionism" (p. 32). If Congress voted NAFTA down, it predicted, "Salinas' well-received economic initiatives ... could be thrown into reverse. The overheated Bolsa [the Mexican stock exchange], inflated by free-trade expectations, could plunge. And to prevent capital flight, interest rates would have to jump dramatically" (p. 34).

A *Washington Post* (1993a) editorial fretted that a delay of NAFTA (by a judge's decision that it should be accompanied by an environmental impact statement) would have severe consequences. "A courageous and vigorous government there is transforming the country with a sweeping series of reforms. The Mexican economy is gaining strength, supported by a heavy flow of investment from abroad." The Post went on to warn that if the United States did not keep its word in implementing NAFTA on schedule, then "investors may begin to hold back their money-resulting in great distress among Mexicans who are counting on that growth to generate jobs and rising incomes."

Phil Gramm (1993) cautioned that "without NAFTA to stimulate further growth in trade, U.S. exports to Mexico could decline just as sharply as they did in the early 1980s. ... With the approval of NAFTA, the mutual economic growth and prosperity that would follow may at last wash 'Yankee Go Home' from the walls of all our neighbors in the Americas."

Predictions Backfire

Almost every element of the nightmare scenario promised in the event of a NAFTA defeat is now occurring. Mexico will lose 800,000 jobs this year, according to the Mexican Embassy, and interest rates on credit cards are over 100% (Silver 1995). In addition, the economy is expected to contract by around 5%, while inflation may hit 50%.

NAFTA's impact in the United States is less dramatic, but still noticeable. Although the U.S. economy grew at a robust 4% in 1994 and productivity increased by about 2%, workers did not share in these gains. The real median wage fell by over 2%, continuing a 20-year downward trend.[6] Since NAFTA took effect in January 1994, 6 1,000 workers have been laid off in plants that have filed to receive NAFTA-related adjustment assistance. Of these, the Labor Department has certified almost 35,000 workers to receive assistance (i.e., it certified they had lost their jobs because of increased imports from Mexico or Canada, or because of the relocation of existing plants to Mexico or Canada[7]). While this is a small figure relative to the U.S. labor force, the rate at which workers have filed for assistance has risen substantially since the December peso devaluation. In addition, this figure almost certainly under-counts the workers adversely affected by NAFTA, since it omits: 1) workers who file for assistance under the broader Trade Adjustment Assistance program, which provides higher benefits; 2) workers who are unaware of the NAFTA-TAA program; and 3) job opportunities

lost in the United States because of corporate decisions to locate new plants or expand operations in Mexico (or Canada) rather than in the United States (AFL-CIO 1995; Anderson et al. 1994). (In this case, no workers would actually be laid off, but fewer new jobs would be created in the United States than would have been the case in the absence of the agreement.) There is also a multiplier effect not captured by the NAFTA-TAA filings. Some additional supplier jobs will be lost if production migrates to Mexico, and the reduced incomes of displaced workers will have a dampening effect on their local economies.

The Federal Reserve told Congress in February 1995 that the Mexican crisis would cost the United States between $13 and $28 billion in lost output this year, slowing growth by 0.2% to 0.4%. The peso devaluation could lead to U.S. job losses of 380,000 in the next four years, according to Regional Financial Associates, an economic consulting firm in West Chester, Pa. (Rose 1995). DRI/ McGraw Hill forecasts similar losses in jobs and output (Clements and Montague 1995), while WEFA is more pessimistic, predicting the loss of half a million jobs (Myerson 1995).

Fear that the peso crisis will increase illegal immigration pressures caused the Clinton Administration to announce in January that it would hire more than 1,200 new Border Patrol agents (Suro 1995). The new Republican leadership is expected to introduce a proposal this year to double the size of the Border Patrol to 10,000. Early evidence suggests that immigration flows did not abate in 1994 and may have accelerated in recent months.

Environmental projects along the border have been put on hold indefinitely, as government budget cuts take effect. "As Mexico's economy sinks," writes the Washington *Times,* "the environment, especially on the heavily polluted border with the United States, is coming up a big loser" (Nusser 1995).

Finally, the combination of the crisis and the proposed U.S. bailout has stirred anti-American sentiments just as ferocious as those forecast if NAFTA were voted down. "What Clinton wants is to make Mexico a colony," a Mexican street vendor told the New York *Times* (Golden 1995b). The *Times* article noted drily that there had been "no marches to the U.S. Embassy here by Mexicans wishing to show their gratitude" for the bailout.

Guilty as Charged

Despite all of these negative outcomes, Clinton administration officials and other NAFTA proponents continue to insist that NAFTA is "not guilty" and that without NAFTA, the crisis might have been even worse. The 1995 *Economic Report of the President* contends that "NAFTA neither contributed to the peso devaluation nor in any way affected the U.S. Government's response." It maintains that the measures Mexico adopted under NAFTA "have, if anything, shored up investor confidence and mitigated the peso depreciation" (U.S. Council of Economic Advisers 1995,224).

This argument is based on blind optimism, not facts. In a broad sense, NAFTA and related economic policies laid the groundwork for the pesos crisis, as discussed earlier. In a narrow sense, the anticipation of NAFTA, the hype surrounding it, and the political maneuvering to get it passed in all

three countries, may have actually accelerated and exacerbated the crisis. In particular, the false confidence engendered by NAFTA spurred unsustainable and fickle flows of speculative capital in the early 1990s.[8] These capital flows bid up the price of Mexican assets and inflated the value of the peso, worsening the crisis when it did come.

Furthermore, NAFTA-related political considerations in both Mexico and the United States may have prevented policy makers from taking steps to address the crisis earlier. Floyd Norris (1995) writes in the *New* York Times that American government officials were aware of the risks in Mexico as early as late summer, but "they decided not to sound a warning here because they believed that it was important to support the Mexican Government and economy, particularly in the wake of the bruising ratification battle over the North American Free Trade Agreement."

In an analysis of the crisis and how it took so many "experts" by surprise, the *Washington Post* reported that insiders attributed the problem to "clientitis:" "the administration had embraced the reformist regime of outgoing Mexican President Carlos Salinas de Gortari so enthusiastically, it was reluctant to pressure him to deal with the overvalued peso" (Smith and Chandler 1995). Washington was also concerned that "such a step might cause political instability as the [Mexican] presidential election neared," according to some U.S. officials (Smith and Chandler 1995). Professor Jagdish Bhagwati, a prominent free-trade advocate, blames NAFTA for the "complacency" that slowed Mexican officials' reaction to the crisis (Davis 1995b).

Official eagerness to get NAFTA approved by the U.S. Congress permeated every aspect of U.S.-Mexico relations. Even narcotics policy, which would seem unrelated to tariff levels and "free trade," was constrained by the politics of passing NAFTA. The New York Times reports that while NAFTA's approval was uncertain, "officials on both sides of the border emphasized Mexico's cooperation in fighting drugs," even though they were aware that the flow of cocaine through Mexico was continuing to rise (Golden 1995b).

The silence of Administration officials was even more striking with regard to economic policies. Jim Hoagland writes in a recent *Washington Post* column that Treasury Undersecretary Lawrence Summers, among others, was "aware that information the Mexican government was either suppressing or falsifying about the peso and reserves gave a misleading impression to the rest of the world" (Hoagland 1995). Yet Summers, Federal Reserve Chairman Alan Greenspan, and others remained silent, because, as Hoagland puts it, "Mexico was too important—especially as the NAFTA treaty was debated-for the truth to be told then, or even now."

Wall Street was also susceptible to wilful blindness regarding Mexico. *Fortune* magazine writes that as fund managers were "shipp[ing] money willy-nilly to emerging markets around the world ... Wall Street's eyes grew cloudy" (Smith 1995). Brokerage house researchers who came across disturbing economic indicators in foreign markets found there was "commercial pressure on analysts to always be positive about key emerging-market countries," according to David Hale, chief economist for Kemper Securities (Smith 1995). An article in *Global Finance* magazine in December of 1993 proclaimed that Mexico had joined "the big leagues of global business," noting that "The most imme-

diate indicator of Mexico's arrival is the virtual elimination of 'country risk' as a factor in considering credit or investment deals in Mexico" (McCrary 1993).

One of the factors contributing to the Mexican government's unwise decision to maintain the peso at an overvalued exchange rate even after its reserves became depleted may have been the desire to make NAFTA more palatable to the U.S. Congress. Keeping the peso high bolstered U.S. exports to Mexico and narrowed the apparent gap between U.S. and Mexican wages. The Financial *Post* of Canada reported that "Robert Brusca, chief economist at Nikko Securities in New York, said Mexico artificially supported the peso to make Mexican labor look 'less cheap' and less of a threat to the other NAFTA partners" (McParland 1995). Of course, the overvalued peso had domestic political advantages for the Mexican government as well: it boosted the spending power of the middle and upper classes for imported goods and foreign travel. This helped assure a wide margin of electoral victory for the ruling party in the August 1994 elections.

There were numerous warning signals that the Mexican economy was in trouble in 1994 and earlier: interest rates were high; the current account deficit was growing, financed in large part by short-term capital; and government reserves were dwindling. Nonetheless, those people with most at stake in the outcome-businesspeople with capital invested and U.S. treasury officials-defended Mexico's economic policies up to the last possible minute. Treasury Undersecretary Lawrence Summers was still emphasizing the "underlying soundness of Mexican economic policies" in late December 1994 (*Wall Street Journal* 1994).

Economists, investors, and politicians who had begun to believe their own rhetoric about the growth potential of "free trade" were caught by surprise when no magic growth spurt materialized. As Jagdish Bhagwati put it: "Everyone good-mouthed Mexico to the point where everyone lost touch with reality" (Davis 1995b). After praising Mexico's economic policies and holding it up as a model for the rest of Latin America and the developing world to emulate, the experts turned on Salinas personally, castigating him for bad timing, poor judgment, and mismanagement. They also criticized new President Ernesto Zedillo for his failure to inspire confidence and his hesitations regarding the devaluation.

Many of the same publications that sang Salinas's praises a few years earlier, became tough critics. After the devaluation, *The Economist (1995, 14)* wrote disdainfully that "Mexico's financial mess is a text-book tale of bungled economic management. A recent Heritage Foundation report (Sweeney 1995, 1) blamed Salinas's economic policies in the last two years of his Administration for causing the peso crisis. In particular, it cited Salinas's "use of the exchange rate to keep inflation down long after it had become clear that the peso had become overvalued." (In a 1993 report, in contrast, Heritage lauded Salinas's economic policies [Wilson 1993a, 4].)

A Flawed Economic Model

One has to be a pretty devout believer in the power of micro-managing the economy to think that Mexico's economic policies were right on track for the last 10 years, but that Salinas's decision to

delay devaluation by a few too many months or Zedillo's personal lack of charisma (failure to inspire confidence) could precipitate a crisis of this magnitude. Rather, it makes more sense to reject the underlying economic model-both as a basis for rebuilding Mexico's economy and as a model for other developing countries.

American University Professor Robert Blecker (1995, 4) argues persuasively that Mexico's policies over the last decade were "internally inconsistent and inherently flawed." Domestic policies were narrowly focused on repressing inflation, but they failed to provide any engine of growth for the economy. The Mexican government looked to NAFTA to provide export-led growth financed largely by foreign investment. "But what Mexico got," Blecker writes (p. 5) "was an excess of purely financial, speculative capital inflows that created the bubbles in Mexico's emerging asset markets and raised the peso to a value that was inconsistent with the desire for export-led growth."

Given the current context, even drastic devaluation will not resolve these contradictions. While a cheaper peso makes Mexico's exports more competitive (and chokes off growth in imports), it will also rekindle inflationary pressures. In order to reassure foreign investors and keep enough capital flowing in to meet its debt service obligations, the Mexican government is planning to keep interest rates high and implement extremely stringent austerity measures. As the New York Times reported recently, many economists believe that "at best ... the plan announced by Mexican officials would cause a recession in Mexico that should give the country a good-sized trade surplus" (Sanger 1995b).

Thus, Mexico still has not solved its central problems: growth and equity. The "neoliberal" policy package, which was formalized and accelerated by NAFTA, then further entrenched by the conditions attached to the bailout package, has failed to generate adequate growth during the last decade. As Mexican sociologist John Saxe Femandez points out in a forthcoming book, Mexican real per capita GNP grew more than three-and-a-half times faster in the 40 years preceding Mexico's adoption of the "neoliberal model" than during Salinas's presidency (Saxe Fernandez, 1995). Furthermore, it has sharpened the inequality of income distribution, which has contributed to social instability. This in turn undermines Mexico's potential for attracting direct investment, leaving it vulnerable to the volatility of speculative capital flows.

As Blecker points out, Mexico's current economic model essentially allows the economy to veer between two extremes: hyper-inflation on the one hand and an overvalued currency and current account deficits on the other. The engine of growth in either case is assumed to be external: foreign investment will provide the capital to produce exports to sell in someone else's market. But this reliance on foreign capital-in conjunction with NAFTA's lifting of regulations on foreign investment-leaves Mexico in a trap: "macropolicy is perpetually disciplined by the actual or threatened withdrawal of foreign funds, giving investors veto power over domestic policy, and forcing industrial and labor interests to be subordinated to the dictates of financial capital" (Blecker 1995, 17). The fact that foreign capital also responds-sometimes precipitously and not always rationally-to events not controlled by the government (such as the assassinations of political officials or the Chiapas uprising) greatly increases the volatility of an economy dependent on these capital flows.

U.S. policy makers also urge increased reliance on exports as a source of growth. The *Wall Street Journal* (1991a), for example, proclaimed in an editorial, that "The North American free-trade agreement is Mr. Bush's only pro-growth economic proposal." Similarly, President Clinton argued in favor of both NAFTA and the Mexican loan guarantees on the basis that U.S. jobs were at stake. Rather than allowing wages to rise (as productivity rises) in order to develop the internal market, both governments emphasize the downside of high wages-their contribution to inflation and their deterrent effect on attracting foreign investment.

The crisis in Mexico should cause a rethinking of the basic model of economic development that has been implemented in Mexico, the United States, and Canada. It should also cause a reevaluation of the way "free trade" is packaged and sold in this country.

UNFULFILLED PROMISES

While one year is much too short a period to judge the full impact of NAFTA (especially since many of its provisions are phased in over 10 or even 15 years), we can nonetheless examine some of the predictions that were made for its first year. NAFTA's proponents told us that it would benefit workers on both sides of the border, raising Mexican and U.S. wages and creating hundreds of thousands of net new jobs in both countries. Perhaps the most widely cited study predicted that NAFTA and associated economic reforms would generate 600,000 net new jobs in Mexico and 170,000 in the United States by 1995, while raising Mexican wages by 9% and leaving U.S. wages unchanged (Hufbauer and Schott 1992, 5 1; Hufbauer and Schott 1993, 14).

NAFTA was predicted to boost growth in all of the NAFTA countries, but especially in Mexico. Jeffrey Garten (1994, 18), undersecretary of Commerce for International Trade, was particularly optimistic: "Our range of estimates for Mexican GDP growth is between a supercharged six percent a year, worthy of Asia's tigers, and a startling 12 percent a year, comparable to China's recent growth."

The growth generated by freer trade would, in turn, solve all of Mexico's other problems, from environmental degradation to child labor to political democracy. The *Wall Street Journal* (1991 b), for example, admitted in an editorial that Mexico's child labor laws are poorly enforced, but argued that "economic growth spurred by free trade would make it less likely that children would be compelled to work." A *USA Today* editorial (1993) postulated: "The agreement also will lift Mexico's per capita income, with an accompanying lift of that country's environmental awareness." Michael Wilson (1993, 11) of the Heritage Foundation asserted that "NAFTA will also help sustain progress in other vital areas of cooperation, including anti-narcotics efforts, environmental protection, immigration, and human rights. ... [NAFTA] will consolidate democracy and greater respect for human rights in Mexico." When this "supercharged" growth failed to materialize in Mexico, so did these other potential benefits of NAFTA.

The United States was also to reap big gains. Don Newquist, chair of the International Trade Commission, claimed that NAFTA would create "more jobs, increased exports and higher wages" (Newquist 1993). Rudiger Dornbusch (1991) wrote: "If you are concerned about good jobs at good

wages, freer trade with Mexico will deliver just that: more good jobs for Americans as Mexico prospers and becomes a major market for American goods in the way Spain did for the European Community."

The most widely cited prediction that NAFTA would generate net new jobs was based on a calculation that linked an increase in the U.S. trade surplus with Mexico to new U.S. jobs (see endnote 2). Gary Hufbauer and Jeffrey Schott of the Washington-based Institute for International Economics predicted a U.S. merchandise trade surplus with Mexico of $7 to $9 billion by 1995, possibly rising to $12 billion annually by the following decade. "This surplus," they wrote, "would ensure the net creation of about 170,000 jobs in the US economy" (1993, 15).

This figure of 170,000 jobs was quickly rounded up to 200,000 by the U.S. Trade Representative's office.' In Washington's version of a nightmare game of "Telephone," 200,000 became first the "consensus" prediction of economists (despite the fact that most other standard economic models predicted no change in employment) and eventually, the minimum number of jobs NAFTA would create.[10] USTR Mickey Kantor used the 200,000 figure in speeches and interviews, and it appeared in USTR brochures."

The U.S. trade surplus with Mexico reached a peak of $5.4 billion in 1992—conveniently the last full year for which trade data were available when the NAFTA vote took place (in November 1993). It fell to $1.7 billion in 1993 and fell again to $1.3 billion in 1994. In 1995, the United States will run a sizeable deficit with Mexico, as the devalued peso dramatically reduces the price of Mexico's exports and raises the cost of U.S. goods in Mexico. By this yardstick, then, the United States has already lost a few thousand jobs through trade with Mexico (6,000 using the Hufbauer-Schott multiplier) and stands to lose several hundred thousand more in the coming year. Robert Scott (1995, 1) of the University of Maryland points out in a new report that using a more precise measure of the relevant trade between the U.S. and Mexico yields a loss of almost 17,000 jobs in 1994.[12] Scott also calculates that if the net export deficit of the first two months of 1995 is sustained for the rest of the year, 2 19,000 jobs will be eliminated.

Gary Hufbauer now says, "The best figure for the jobs effect of Nafta is approximately zero. The lesson for me is to stay away from job forecasting" (Davis 1995b). Julius Katz, former deputy U.S. trade representative under President Bush and one of NAFTA's chief negotiators, also admits that the Bush Administration used "totally phony [job] numbers," only because NAFTA's opponents were claiming that NAFTA would be a job loser (Davis 1995a).

While the Hufbauer-Schott methodology may be problematic (as a 1992 Economic Policy Institute Briefing Paper pointed out[13]), it is worth emphasizing that few mainstream economists or journalists took note of any of its drawbacks until the U.S.-Mexico trade data began to look less favorable. After NAFTA was safely passed, and the 1994 trade figures showed growing exports to Mexico but a shrinking surplus, there were many converts to the position that trade surpluses are the wrong measure of employment creation. "The balance of trade is not as important as the content of trade and the increase in exports. That's what raises our standard of living," Mickey Kantor told the

New York Times (Myerson 1994). After the initial devaluation of the peso in December, a New York Times editorial (1994) scolded NAFTA critics for focusing on the trade balance: "The purpose of trade is not to raise employment-which the Federal Reserve now controls-or rack up surpluses. Its purpose is to steer workers into high-productivity jobs, . . . The United States comes out ahead under NAFTA no matter what happens to the bilateral trade balance." Given this fickle use of numbers, it is not surprising that ordinary Americans are confused by trade debates.

Two other, more general, arguments were made about NAFTA's potential benefits. First, it was argued that because Mexico's tariffs on U.S. goods were higher than U.S. tariffs on Mexican goods, the United States would inevitably benefit most from tariff reduction. Senator Bill Bradley (1993) wrote: "Mexico's tariff on U.S. products is currently 2 1/2 times as high as ours is on Mexican products. The inescapable consequence of reducing both tariffs to zero is a 2 1/2 times greater comparative advantage for our products." Yet this argument ignored the possibility of a dramatic change in exchange rates. Even a 10% devaluation of the peso would have wiped out the U.S. advantage; the 50% devaluation that did occur completely swamped any differential in initial tariff rates. Thus, this argument, which was repeated ad nauseam by Carla Hills, Mickey Kantor, Bill Clinton, the *Wall Street Journal,* and many others, was empty.

The second argument often made (and now repeated vis-a-vis Chile) was that if the United States did not clinch the deal with Mexico, Japan and Europe would step in and gain a competitive advantage. Dombusch (1993, 20) argued that, "If NAFTA fails, Mexican President Carlos Salinas de Gortari will have to turn his back on the United States, Japan will get into the Mexican market, and U.S. companies will keep waiting for better access." *Business Week* (1993, *32-33)* claimed that rule-of-origin provisions in NAFTA "will make it unprofitable for Japan and European multinationals to assemble finished products in Mexico from foreign-made parts."

Even with NAFTA in place, Mexico increased its imports from countries other than the United States in 1994 *faster* than it increased its U.S. imports (relative to the amount of total trade). Mexico's total trade deficit rose from $13.5 billion in 1993 to about $18.3 billion in 1994. During that same year, the U.S. trade surplus with Mexico *shrank* from $1.7 billion to $1.3 billion. Even the most basic of pro-NAFTA predictions, that the United States would enjoy more exclusive access to Mexico's market, turned out not to be true. While it is true that Mexico buys about 70% of its imports from the United States, it is also relevant-although often not mentioned-that Mexico sends over 80% of its exports to the United States. This imbalance has grown during the past few years, indicating that Mexico has an increasingly limited export destination but a broadening base of import suppliers. Mexico appears to be turning into an export platform for European and Asian companies interested in selling in the U.S. market.

Contradictory Claims

Looking back on the NAFTA debate, it is clear that NAFTA proponents made contradictory claims on its behalf. On the one hand, NAFTA would enlarge Mexico's consumer market and open it

further to U.S. producers. Jeffrey Garten, undersecretary of Commerce for International Trade, said in a 1994 speech: "One of the messages of NAFTA is that we see the future of North America being enhanced by the addition of a rapidly growing market of 80 million people and we see the growth of that market accelerated by its close association with two of the world's most important industrial economies, America and Canada."

On the other hand, it was argued that shifting some production to Mexico would allow U.S. companies to compete more efficiently in global markets, as Japan has done successfully in Thailand and elsewhere. The Heritage Foundation wrote that "The U.S. economy ... will benefit from the NAFTA by integrating high technology with Mexico's low-cost labor" (Wilson 1993b, 4). This second argument was made less often than the first, probably because it overlapped uncomfortably with the argument NAFTA's opponents used: that under NAFTA Mexico would be transformed even more rapidly into an export platform for goods sold in the United States, undermining U.S. wages and costing jobs.

Those stressing the first argument claimed that Mexican wages and incomes would rise rapidly after entry into NAFTA, while proponents of the second argument focused on the benefits to U.S. companies of Mexico's low wages. As it turns out, the first line of argument has completely vanished, while the second is beginning to come true with alarming suddenness. According to Business *Week* (1995a, 33), Ford CEO Alexander J. Trotman now calls Ford's earlier plans to double vehicle shipments to Mexico to 50,000 this year "a pipe dream," nevertheless, "Ford says it's sticking with plans to shift some operations south of the border." Similarly, *Business Week* (1995b, 36) reports that "Samsung Electronics is going ahead with a $500 million investment in a Tijuana plant. But electronics producers who also had been targeting the Mexican market have put growth plans on hold." Textile executive and NAFTA booster Chuck Hayes, CEO of Guilford Mills, has also eased up on plans to sell more to Mexican consumers, while beginning to investigate moving production to Mexico and "accelerating efforts to persuade Guilford's garment-making customers to open plants in Mexico" (Geppert 1995). The Chicago *Tribune* reports that, "an increasing number of American manufacturers are transferring work to Mexico or planning such moves, hurried along by the peso's plummet" (Franklin 1995). These companies include Motorola, Halo Lighting, Rockwell Automotive, and Thyssen.

The Mexican newspaper *La Jornada* reported that new maquiladoras (export-oriented assembly plants) had been authorized at the rate of two or three a day in the first three months of 1995. If the maquiladora sector continues to grow at this rate, the number of maquiladoras could double by the end of 1996. This dramatic acceleration in the establishment of maquiladoras reflects the Mexican government's intention to create a dynamic and growing export sector (Muñoz 1995, 23).

Thus, of the predictions made by the opposing camps before the NAFTA vote-U.S. net exports would rise, and production would move-only the second appears to be materializing. Even in 1994, before the peso's devaluation, foreign direct investment in Mexico was up 64% over the previous year (Hall 1995). It is too early to say whether this shift of production will significantly reduce U.S.

companies' costs and improve their long-term "competitiveness," but it is fairly certain to have a negative impact on U.S. workers in terms of wages, lost jobs, and deteriorating working conditions.

Unsatisfactory Labor and Environmental Agreements

The weak labor and environmental side agreements that President Clinton negotiated after taking office have done little to mitigate NAFTA's harmful effects on workers and the environment. While three cases have been brought in the United States under the labor side accord, in only one—the case against Sony—did the National Administrative Office find that the Mexican government had persistently failed to enforce its own labor laws. Even in that case, the "penalty" was only that the Mexican secretary of Labor was required to take part in a consultation with U.S. Secretary of Labor Robert Reich. This consultation resulted in a disappointingly weak recommendation: the workers illegally fired by Sony for attempting to form an independent union were to be "informed of their rights" under Mexican law. In addition, a panel was to be formed "to conduct a study of labor law dealing with union registration and its implementation." Jerome Levinson, the lawyer who acted on behalf of the fired workers, called these remedies "cynical in the extreme." The beneficial effects of "sunshine" or publicity that were supposed to elicit better behavior from businesses operating in Mexico have not been evident, partly because the news media have devoted little or no attention to labor rights abuses (see Herman 1994 for a critical analysis of the New York *Times'* coverage). These companies have continued to harass or fire workers who attempt to organize independent unions, with minimal interference from the government. And the minimum wage continues to erode in value, especially as inflation accelerates.

The environmental side agreement has also failed to slow the environmental degradation along the border. The North American Development Bank (NADBank), set up to fund environmental clean-up and other development on a matching basis, has not funded a single project, largely because the Mexican communities trying to fund projects have been unable to come up with their share of the money (Nusser 1995).

Funding to help many of NAFTA's casualties appears to be drying up across the board. The Republican-dominated House of Representatives has submitted a budget that zeroes out funds for the NAFTA-related assistance for displaced workers, as well as for the NADBank. This was precisely the danger NAFTA opponents had warned of in implementing a trade agreement at a high level of binding obligations and weaker side elements. When budget-cutting is a high priority, the trade agreement itself remains in force, but those hurt by it will have to fend for themselves. Similarly, when the NAFTA-induced prosperity for Mexico failed to materialize, NAFTA's benefits for businesses (intellectual property rights protection and deregulation of foreign investment, for example) remained in effect, while protection and enforcement of labor and environmental standards were left to the mercy of good will and sunshine.

WHAT HAVE WE LEARNED?

As formal negotiations over Chile's accession to NAFTA continue, and working groups form to lay the groundwork for the Free Trade Area of the Americas, it is becoming clear that policy makers have learned little from the NAFTA debacle. While Chilean labor unions, environmental groups, and some sectors of the government have expressed support for incorporating enforceable labor and environmental standards into a new trade agreement, neither the Republican majority in Congress, nor the Clinton Administration negotiators appear to see this as a priority. Business groups continue to oppose vehemently any move to include protections for labor rights and environmental standards in the new agreements. Influential Republican members of Congress, including Senator Bob Packwood and Representative Dick Armey, have stated that they will oppose extending NAFTA's weak side agreements to Chile or other Latin American nations. The Clinton Administration's team of negotiators has agreed to set up 11 working groups to define issues and set priorities for FTAA negotiations: none of these will address labor or environmental issues. Without a commitment to rethinking the international rules governing trade and investment, trade liberalization will continue to polarize the distribution of income and destabilize fragile developing economies.

One of the main arguments against slowing down the negotiations over North American economic integration or attempting to forge a more democratic, egalitarian agreement was that free trade was an urgent and pressing need, especially for Mexico. If nothing else, the present crisis in Mexico should demonstrate that freer trade and investment, in and of themselves, cannot save an economy that is headed for trouble and may even accelerate its downfall. Given that, the United States should not rush to incorporate Chile and other Latin American nations into a flawed and incomplete agreement. The ultimate goal should be a higher standard of living, not simply a greater volume of trade. Similarly, attracting capital is not an end in itself; attention must be paid to where the capital is going and what it is funding. The distribution of the costs and benefits of trade matters, and the design of the trade agreement can have a great impact on this distribution. We don't need to stop trading, but we do need to open up the debate over trade.

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ENDNOTES

1. Meanwhile, the U.S. deficit with Canada is 63% above the level it was last year at this time. If this trend continues for the rest of the year, the U.S. deficit with its North American trade partners could increase by three- or fourfold this year.

2. Hufbauer and Schott (1993, 16) use a multiplier of about 19,000 jobs per billion dollars of change in net exports. If the U.S. runs a trade deficit of $15 billion with Mexico in 1995, down from a 1994 surplus of $1.3 billion, the Hufbauer-Schott formula would yield a loss of over 300,000 jobs. A more accurate estimate would adjust the multiplier down somewhat to account for increases in inflation and productivity (see Scott 1995).

3. Because some parties to the original loan package have subsequently backed out (notably the Bank of International Settlements and some of the private banks), the package is now worth only about $37 billion-$20 billion from the United States and $17 billion from the International Monetary Fund.

4. See, for example, Faux and Lee (1992), Faux (1993), Levinson (1994), Heredia (1993), and Whalen (1992).

5. Hufbauer and Schott (1993, 14), for example, based their job projections on the effect of NAFTA "in conjunction with Mexican domestic economic reforms."

6. Wage data based on EPI analysis of current population survey data for all wage and salary workers.

7. These figures were provided by the Labor Department's Office of Adjustment Assistance. They cover the period up through July 3, 1995.

8. In 1994, investor newsletters were full of optimistic pronouncements about the potential for NAFTA-led growth. For example, a Merrill Lynch newsletter stated, "The company [Quadrum, a finance company] should benefit from the expected NAFTA-driven surge in the Mexican economy."

9. According to David Walter, chief economist at USTR.

10. Deputy U.S.T.R. Rufus Yerxa on *MacNeil-Lehrer **News Hour*** (September 3, 1993): "The Administration has estimated that at a minimum we will see 200,000 new jobs, i.e., net new jobs over the next two years as NAFTA's implemented." Rep. Robert Matsui (D.-Calif.) on *NBC Meet **the Press*** [clip from ***McNeil-Lehrer*** September 3, 1993]: "[NAFTA] will create American jobs. ... And almost every study shows that it'll create a minimum of 200,000 jobs over the next 24 months if NAFTA passes."

11. ***USA Today*** interview with Kantor, "NAFTA Anxieties Are 'Overstated,'" May 27, 1993, 15A; USTR brochure: "Highlights of the North American Free Trade Agreement."

12. Scott uses Commerce Department figures corrected to exclude U.S. exports to Mexico that are simply being "transshipped," (i.e. imported from another country and then sent to Mexico). He also excludes U.S. imports that are to be reexported to another country, rather than consumed in the United States. These corrected figures more accurately represent the job-creating potential of trade.

13. In particular, we questioned their assertion that the peso would continue to rise against the dollar. We noted that the peso was overvalued and being maintained by speculative capital flows. "Should the speculative air leak out of the Mexican stock and bond markets, the peso will plummet and the currency advantage which is essential to the projections of U.S. job gains will vanish" (Faux and Lee 1992, 10).

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