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MEMORANDUM

DATE: November 16, 1992
RE: Rodiger Dornbusch and NAFTA

1. In testimony before the Senate Finance Committee on February 20, 1991, Dornbusch argued that environmental protection and workers' rights should be apart from the free trade agreement (see attached documents, page 65 of verbal testimony and especially pages 125-126 of formal testimony).

2. In response to Dornbusch's argument that environmental protection should be separate from a trade agreement, Senator Baucus asked why, since environmental matters do have economic consequences. Dornbusch's reply was to compare environmental protection with the rights to go to church (see attached documents, pages 76-77).

3. Dornbusch's reasons for separation of environmental protection and workers' rights from NAFTA (page 126) are very similar to the Bush administration line: (a) trade induced economic growth will 'automatically' result in more democracy, more resources for enforcement, etc. This argument could also apply to investor rights, intellectual property rights in Mexico, etc. (b) Even in the EC, environmental standards are on the 'political agenda', rather than part of EC 92. This is flat wrong. The goals for EC92 as set out in the 1987 Single European Act are intimately tied to environmental protection. One of the central goals of the EC is to integrate environmental policy into other EC policies (particularly economic policies).

<u>Note:</u> Although the Clinton/Gore position on NAFTA and environment calls for a 'separate' supplemental agreement, the intent is clearly to link the issues of trade and environmental protection and workers' rights. The purpose of the supplemental agreements and accompanying enforcement procedures is to stop dysfunctional North American economic competition based on lowering of environmental protection or worker safety standards. Dornbusch's testimony indicates that he opposes this linking of trade and environmental protection (and workers' rights).

George

S. Hrg. 102-75

UNITED STATES-MEXICO FREE TRADE AGREEMENT

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

FEBRUARY 6 AND 20, 1991

Dornbusch testimony

Printed for the use of the Committee on Finance

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Agreement between the United States, Mexico, and Canada which will benefit all of our countries.

Thank you, Mr. Chairman.

The CHAIRMAN. Congressman, thank you very much for a very forthright statement and obviously a very deep feeling concerning this issue.

I have no questions.

Are there members that would like to ask questions? Yes, Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, I would like to thank Representative Kolbe for a very thoughtful and responsive statement. I think that characterization of President Salinas is a very subtle and very important one. I certainly hope it proceeds as clearly it would be his wish.

I made the point about the previous 50 years and I do accept the point about the past 5. I thank you, sir.

Congressman KOLBE. Thank you, Senator.

The CHAIRMAN. Thank you very much for your testimony. It has been very helpful.

Congressman KOLBE. Thank you.

[The prepared statement of Congressman Kolbe appears in the appendix.]

The CHAIRMAN. Next we will have a panel consisting of Mr. Dornbusch, who is Ford International Professor of Economics and Mr. Jeff Faux, who is president of the Economic Policy Institute, Washington, DC.

If I have mispronounced that, please correct me.

Mr. FAUX. That is just right. Thank you.

The CHAIRMAN. Thank you.

Mr. Dornbusch, if you would proceed.

STATEMENT OF RUDIGER DORNBUSCH, FORD INTERNATIONAL PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CAMBRIDGE, MA

Professor DORNBUSCH. Thank you, Mr. Chairman, for the opportunity to present to this committee my views on the United States-Mexico Free Trade Agreement. I would urge the Congress to sustain the fast track authority without which an agreement cannot be meaningful and negotiated, and to support the ultimate outcome.

I believe a Free Trade Agreement will create in the United States more jobs and better jobs, that it will rapidly advance democratization and economic progress in Mexico, that it will be an important means to stabilize Central America, and lastly, that by now it is too late to turn back without major damage. I want to briefly comment on each of these points.

The United States is already a wide open economy. Mexico has special access under the general system of preferences and as a result of the Maquiladora program. Competitive effects of a free trade agreement with Mexico would be extremely limited on the import side to very few areas very strongly protected. The ITC has identified inexpensive household glassware and goes down very, very narrowly when one looks for damage.

On the other wide, of course, are areas like automobiles, chemicals, where Mexican quotas stop U.S. exports today and that list is very significant. We will get better jobs as a result of an opening with Mexico. An opening has to be a two-way street, of course, because in some form Mexico will have to pay for the increased imports from us.

I also believe—and that is perhaps the far more significant part of a trade agreement—that it will reinforce confidence in Mexico's reforms; and as a result speed up the return of flight capital. I estimate some $100 billion of Mexican capital abroad, that capital will allow Mexico to invest, to grow, to import and in the normal course of the 1990's run trade deficits of 2 to 3 percent of GNP.

That would mean an extra 150,000 jobs in the United States. We focus too much on the jobs lost in glassware and we do not focus on the jobs created as Mexico stabilizes and grows. I also want to emphasize in the context of jobs that we paid too much attention to the Mexican wage.

Numbers are quoted of 51 cents per hour that have absolutely no basis in any source you will find, United States or Mexican. The U.S. Labor Department reports hourly compensation of $2.32. Mexican statistics support that at very disaggregated levels and even at the firm level.

We also do not pay attention to the experience we have had already in textiles, where when Mexico opened up U.S. textile exports to Mexico boomed because the quality was so far superior to what is available in Mexico. Quality is an important dimension, because we are to Mexico what Japan is to the United States. That means we have a very privileged trade position.

On the side of democracy, worker's rights, safety standards and the environment, an enormous amount of work has to be done. But we have to ask what is the better way of making headway, to send Mexico back where it was 10 years ago or to have Mexico sustain the reforms and move ahead. All the experience we have is that open economies are democratic economies. And the more open they are, the faster we have democracy.

We do not apply in trade policy a rule that our tariffs are proportional to their democracy. Because Japan surely would deserve a 100-percent tariff and China a 1,000-percent tariff. We really want to ask: What is the best way of promoting democracy, sustaining the modernization underway, will it raise Mexican wages back to where they were in 1980 and it will decentralize the economy as is already obvious; and that is the basis for democratization.

I do believe the environment is an important issue. It calls for borderline commissions where there are specific local issues and it needs a North Atlantic Environment Treaty parallel, but apart from the free trade agreement. We cannot overemphasize the need for it, but surely we will not want to put it in a free trade agreement.

I want to make two more points. Central America, after the disappearance of Communism, has disappeared from U.S. interest and is in terrible trouble. Mexico has started stabilizing Nicaragua directly with money and with expertise. If we have a prosperous Mexico, Central America will be looked after by Mexico. Migration tant here is that category of workers. They could have called them semi-skilled. They could have called them anything. But it is a category of workers that represent 73 percent of the American labor force.

The issue is not whether those people are skilled or unskilled at anybody's judgment.

Senator Baucus. What about Mr. Dornbusch, the statement that the issue is not category but where they lose income.

Professor Dornbusch. We can say that anyone except the top 80 percent are in the group where jobs will be lost. And I do not know where we can cut off the axe.

But if you look at my handout you have the hourly compensation of the people.

Senator Baucus. Let me ask this question: In your view, if it is not 73 percent of the workers, will more Americans experience real wage income increase or will more Americans experience real wage income decrease as a consequence of this?

Professor Dornbusch. Of a 10-year period, which is the phase-in period for any reasonable trade agreement, we will have a very significant gain in real wages as a result of the agreement. There is absolutely no question about that.

Senator Baucus. Okay. Another question quickly. Which sectors of the American economy win, which ones lose under this agreement?

Professor Dornbusch. If you will have a look in Table 2 of my statement.

Senator Baucus. Very briefly.

Professor Dornbusch. I have pluses and minus. Automobiles, big gains; textiles, big gains; chemicals, big gains.

The problem areas: fruits, vegetables, people consume them even at the low wage end; inexpensive glass; garments. The garments because we will export the textiles but make it possible to do the garments there.

Senator Baucus. Okay. Mr. Faux, your winners and losers?

Mr. Faux. Certainly, garments, fruits and vegetables are losers. I believe that automobiles will be losers; I believe that textiles will be losers. I think that 10 years from now you are going to see a large part of the production of the big three shifted to Mexico. I think that is the clear implication of the ITC report.

I think it is just completely unrealistic to assume that this huge wage gap between ourselves and the Mexicans will not induce investment down there by U.S. manufacturers.

Senator Baucus. Mr. Dornbusch, why not include environmental matters in the free trade agreement? After all, they do have economic consequences and there is no national environmental frame work and we cannot wait 10 years for one to come into existence. Why not include environmental matters in the free trade agreement?

Professor Dornbusch. Environmental matters should be settled in a North Atlantic Environmental Treaty that deals with it on a much broader issue, including municipalities, not only corporations, all the set of issues, first the technical conference, then an agreement, separate free trade, which just means all barriers come down. Which is a totally separate issue.

Senator Baucus. You have not addressed my question. My question is: Because environmental matters do have economic consequences, why not address them in the free trade agreement?

Professor Dornbusch. But democracy also has economic consequences. We do not include rights to go to church that have economic consequences. It really is an effort to make Mexican——

Senator Baucus. What do economic consequences have to do with the right to go to church?

Professor Dornbusch. If you look at how it is handled in Europe, where we have a political union, even there environment and worker standards are handled parallel, but separately from Europe 1992. So I would draw attention to that experience. It probably allows you to make more rapid progress on the environment.

Senator Baucus. My time is up, but it is my view that these issues are converging much more quickly than a lot of us would like to have them converge. That is, we may not have the luxury to wait as long as you and others may want to wait.

Professor Dornbusch. I want it faster. That is why I want it initiated separately. It is easier, politically, in the United States to do the environment, than to do the free trade.

Senator Baucus. I do not know what leverage we have in other countries if not in terms of trade.

Professor Dornbusch. If you do it first, you will have a lot of leverage.

The Chairman. Senator Grassley?

Senator Grassley. Thank you, Mr. Chairman.

Do either of you have any views on the free trade agreement with Mexico as it interacts with the present GATT negotiations? For instance, should GATT be completed before we start on the free trade agreement with Mexico; or do you think it will make any difference. I would like to hear your point of view.

Professor Dornbusch. I believe that the GATT agreement is too difficult to bring about in the near future and does not address primarily the manufacturing issues that are very, very important in the context of Mexico; and that in services it may be much, much less sweeping than what we want from Mexico.

So with Mexico the agreement must be much more far reaching and therefore should be set ahead rather than become a GATT style agreement of a few items left over. I would like to see Mexico go ahead as we pursue GATT with whatever success we may have there.

Mr. Faux. I think they are basically separate questions. The issue with Mexico is as much a development issue for the North American Continent as it is a trade issue. The considerations that need to be included in such an agreement are much broader than anything we could have in a GATT treaty.

Senator Grassley. Okay. I thank you for your answers, but I would note for the record that The Business Roundtable, in a June 1990 report they published, very definitely felt that GATT/Uruguay Round ought to be completed before the Mexico free trade negotiations, other than the framework, be started.

I would also like to ask both of you how you feel the Mexico-United States agreements would interact with the present general-

- **IUE Local 849, Evansville, Indiana:** When Zenith shut down its two Evansville plants in the late 1980's and moved the work to Mexico, 1,000 hourly and salaried Evansville workers lost their jobs.

- **IUE Local 717, Warren, Ohio:** In 1973, IUE represented about 13,000 production workers at this GM, Packard Electric Division. Today, only 8,200 jobs remain in Warren. In Mexico, GM now has 24 manufacturing plants employing 23,700 workers.

- **IUE Local 463, Brooklyn, New York:** In the early 1980's, IUE represented some 600 workers at a Parker Hannifan (Ideal Clamp Division) shop. The company then opened a plant in Matamoros, Mexico. The Brooklyn shop is now closed.

- **IUE Local 255, Pittsfield, Massachusetts:** Fifteen years ago, GE employed some 15,000 workers in Pittsfield. By 1987, employment was down to 5,000. Today, only 1,000 hourly jobs remain. Last year, another 60 jobs were lost to Mexico.

- **IUE Local 731, Memphis, Tennessee:** In 1989, 400 workers assembled automobile lights at this plant. Last year, 44 workers were laid off because their jobs went to a GE plant in Acuna, Mexico. Shortly thereafter, the company announced that additional jobs would be going to Mexico.

- **IUE Local 118, Warwick, Rhode Island:** In 1979, 550 wiring assembly jobs at this GE plant were lost to Mexico. Today, no wiring work is done at this plant. Only 28 workers, who now manufacture lighting controls, remain.

- **IUE Local 761, Louisville, Kentucky:** Three years ago, when GE purchased the Roper Company, members of Local 761 were told they could expect 600 new jobs. None of those jobs materialized, however, because the Roper range is being built in Mexico.

- **IUE Local 806, Kirkland, Indiana:** In October, 1990, twenty-eight people, making wiring harnesses for auto suppliers, were employed at AES Interconnects. The next month, when a customer shifted a $45,000 order to another company with a manufacturing facility in Delanosa, Mexico, the Indiana workforce was reduced to fourteen.

- **IUE Local 840, Troy Illinois:** Since 1982, membership at Basler Electric has declined as the work, including the entire magnetics assembly operation, has been relocated to Reynosa and Matamoros, Mexico.

- **IUE Local 1010 FW, Los Angeles, California:** In April 1990, IUE negotiated its first contract for 45 production workers with Chair Factory, Inc. Six months into the contract, the company, citing "economic hardship," transferred 30 jobs to a subcontractor in Tijuana, Mexico.

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Prepared Statement of Rudiger Dornbusch

A free trade agreement with Mexico would represent a significant step in focusing trade policy on creating *more* and *better* jobs. Most of the work in improving the standard of living must come from education, skill building and research, but trade policy can contribute by opening and strengthening markets for our export industries. Except in the case of Japan or some Asian countries, increased market access will inevitably require that we also must give in on remaining protection at home. More and better jobs therefore come at the price of more competition for protected industries and they are sure to cause *some* losses of employment and wage pressure in uncompetitive sectors. That is bad news at a time where real wages are depressed and employment at best stagnant. (See Figure)

We must be concerned with these difficulties, but they must not mesmerize us into maintaining the status quo for poor jobs. We accept and indeed applaud competition as the key driving force responsible for raising the standard of living in the home economy and we recognize in looking at Eastern Europe that lack of competition is responsible for the desperate state of their economies. We should not let go of competition but displaced workers should get adjustment programs, skill building and education to help them get into good jobs. It is bad trade policy, however, to keep workers and their children in poor jobs and even pervert protection to the point where we attract immigrants into to perform this work. This state of affairs is responsible for the controversy surrounding the proposed FTA with Mexico, but the controversy is misplaced. Free trade with Mexico cannot be a panacea for all US problems, nor will it create "an economic and social disaster for US workers and their communities" as argued by the AFL–CIO.[1]

The other reason labor opposes the FTA is that their experience with trade opening focuses on Japan and developing economies which have participated in successive GATT trade liberalization rounds without much visible effect on their openness, thus creating a sharply biased competition. Labor is right on that score and should urge remedies in our trade relations with Japan. But that has no bearing on the proposed free trade agreement with Mexico. The dramatic effect of opening measures in Mexico is already amply demonstrated by the experience of the past three years.

TRADE AND EMPLOYMENT EFFECTS OF A FTA

Concerns about the effect of free trade on US jobs focus on the low level of Mexican labor cost. Numbers such as 61 cents an hour are routinely cited. Of course, Mexican labor costs, as shown in Table 1, are far higher than that even if they are low by comparison with the US. Moreover, even with these low labor costs, a move to free trade stands no chance of having major effects on the US economy at large or on manufacturing. Puerto Rico with an average wage of 5.70 in manufacturing has not destroyed manufacturing in the continental United States, nor has the free trade agreement with Israel where hourly compensation is half that in the United States.

Three factors support the assertion that an FTA with Mexico cannot plausibly bring major harm and is very likely to be beneficial. First, Mexico is very small relative to the US. Any significant increase in Mexican exports (measured on the US scale) would increase labor requirements and wages in Mexico dramatically and thereby squash competitiveness.

Table 1.—THE UNITED STATES AND MEXICO COMPARED: 1989

	United States	Mexico
GNP (Billions of U.S. dollars)	5,461	226
Manufacturing	948	50
Population (Millions)	251	81
Labor Force	124	30
Compensation (U.S. dollars/hour) [1]	14.21	2.32

[1] 1989 Hourly compensation for production workers in manufacturing reported by the US Bureau of Labor Statistics, Report 794.

[1] This view was advanced by Thomas R. Donahue, Secretary-Treasurer, AFL–CIO, before the Senate Finance Committee on February 6th, 1991: "The enactment of a free trade agreement with Mexico, as proposed by President Bush, would be an economic and social disaster for U.S. workers and their communities, and do little to help the vast majority of Mexican workers."

Second, although Mexican labor costs are low relative to those in the US, these labor costs also reflect a low level of productivity and in some areas such as textiles the very low quality of output. The quality factor especially is a major obstacle to a dramatic development of Mexican exports.

Third, the United States is a very open economy. Competition from abroad is not a threat but a complete reality. Protection continues only in a few sectors, not across the board in all lines of activity. Moreover, Mexico enjoys already a privileged position both as a result of the GSP and more importantly as a consequence of the maquila program which exempts reimports from US duties except for the Mexican value added component. The combination of factors reduces the *extra* impact of US trade liberalization to a few sectors and to a total effect that have simply no chance of amounting to much in terms of aggregate employment or output.

Employment Effects: A FTA will create more and better jobs, but in the process of doing so, some jobs are almost certain to be lost. The accompanying Table, drawing on the USITC study, reports the key sectors where employment impacts can be expected.

Table 2.—SECTORS WITH SIGNIFICANT REMAINING TRADE BARRIERS

	U.S. employment (1,000s)	Hourly compensation	High trade barriers [1]		FTA [2] Effect
			United States	Mexico	
Agriculture	NA	NA	7%*	11%*	++/− −
Automotive Products	992	21.51	*	*	++/−
Cement	20	NA	—	10%	+
Chemicals	835	18.19	—	15%*	......
Energy Products	275	21.26	—	*	+
Electronic Equipment	2,000	14.51	2%	16%*	++
Glass Products	143	14.52	22%	20%	−
Machinery and Equipment	110	15.33	3%	10–20%	+
Steel Mill Products	277	23.49	0.5–11%	10–15%	++
Textiles and Apparel	1,818	8.75	6%*	12–20%*	++/−

[1] Figures report average tariff rates where these are high and an asterix stands for some form of nontariff barrier.
[2] A plus denotes a moderate export gain, a minus a moderate import increase, double signs denote trade significant changes.
Source Adapted from USITC Publication 2353 and US Bureau of Labor Statistics data

The table shows that Mexico still has significant protection in key areas where the United States can as a result expect to score export growth. This includes specifically electronic equipment, automotive products, steel and textiles. Textiles in fact are a key example of an industry that has already demonstrated its ability to compete very effectively in Mexico. In 1989, and more so in 1990, the United States ran a bilateral trade surplus with Mexico in textiles and apparel. The key to understanding this is to look at *quality,* not only at wages. In the quality perspective, the US is to Mexico, what Japan is to the US.

Since the United States does continue to protect certain sectors with high duties and nontariff barriers, a FTA would open these areas to Mexican competition. Interestingly, the USITC identifies only horticulture and inexpensive household glass products as the areas where significant import increases must be expected. The explanation, once more, is that the United States is already substantially open to competition from low cost countries and even more so to Mexico. In automobiles, for example, the maquila program offers Mexico the opportunity to compete in the US.

To the extent that import increases can be expected in an area such as apparel, part of the extra imports will mostly displace sales by low cost producers in Asia. In part it will also reflect the result of US textile exports to Mexico which raises the quality of Mexican apparel to the levels required for the US market.

Table 3.—UNITED STATES-MEXICAN TRADE

[Billion of U.S. dollars]

	1986	1987	1988	1989
Exports	12.4	14.6	20.6	25.0
Imports	17.3	20.3	23.3	27.2
Oil	3.7	3.8	3.3	4.3

Table 3.—UNITED STATES-MEXICAN TRADE—Con

[Billion of U.S. dollars]

	1986	1987	1988	1989
Non-oil Balance	−1.2	−1.9	0.6	2.1
Maquila Value Added	1.3	1.6	2.3	3.0

The upshot of this discussion is that trade liberalization will give rise to increased imports, but that there is no plausible alarm scenario. Moreover, going beyond the particular loss of sensitive industries, trade creation induced by the FTA will produce new good jobs. It will cost primarily bad jobs or jobs that, in any event, are under threat from world competition. The maquila program has been cited as a major source of US job losses in the 1980s and a FTA is interpreted as a vast maquila program. But the fact is that the maquila program is quantitatively small—less than one third of a percent of US manufacturing GNP. More important, recently trade with Mexico has been a source of net job creation in the US. Since 1986/87 our non-oil trade with Mexico has swung by $3.6 billion toward a surplus and that means more jobs were created than destroyed. In fact, using the rule of thumb of 30 workers per $1 million exports, the swing in the non-oil trade balance has created more than 100,000 jobs in the United States.[2]

The focus on the non-oil trade balance is appropriate because the trend in the bilateral balance is the chief determinant of net job creation. To the extent that a FTA reinforces confidence in Mexico's modernization, as it already has started doing, flight capital will return to Mexico and foreign direct investment will grow. The availability of external capital until now has been a severe constraint on growth and on investment in Mexico.

With modernization reinforced by a FTA, capital availability will largely disappear as a serious problem and Mexico will resume trade deficits as appropriate for developing countries. Because the United States is Mexico's chief supplier, Mexican growth and deficits become a source of increases in US employment. Assuming that Mexico runs a trade deficit of 2 percent of GNP, US job creation over the next 5 years could be as high as 150,000. Even larger numbers are quite possible because a FTA gives us privileged access.

Foreign Investment in Mexico: Investment in Mexico by Asian or European firms should not be considered an unqualified disadvantage of a FTA. Clearly, such investment will be motivated to a large extent by the desire to build up an export base to the US market and as such seems threatening. But for the most part the goods come anyway, whether it be from Thailand or from Korea and Japan.

The penetration of our market by imports from Asia is already a fact, the only question is whether, at the margin, shifting the production from Asia to Mexico is in our interest. And here the answer is clearly yes. Mexican workers spend a far larger share of their income on our goods and hence we have an interest in their having good jobs at good wages. It is understood, of course, that import content provisions would apply. Location of Asian plants in Mexico cannot simply be a means of circumventing US trade restrictions by performing negligible assembly tasks in Mexico. The experience in Europe with certificates of origin demonstrates that while administratively cumbersome, it is by no means overwhelming.

The argument used for Asian producers goes in the same way for US firms. Co-production with Mexican labor is far better, from the point of view of US labor, than losing and entire operation to Asia or other locations. In many industries it is today totally implausible to produce goods fully with labor priced at the US level; foreign production is far too cost competitive. Co-production with Mexico represents by a wide margin the lesser of the two evils. In fact, the cost reducing effects may well be important enough to allow higher US wages and, at the same time, increased US competitiveness at home and abroad.

PROGRESS IN MEXICO

Democracy, workers' rights, safety and environmental standards are obvious issues on the political agenda of modern, open economies. A Free Trade Agreement

[2] See F. Duchin and G.M. Lange "Trading Away Jobs: The Effect of the US Merchandise Trade Deficit on Employment." Working Paper No. 102, Economic Policy Institute, Washington DC, October 1988.

supports modernization in Mexico and thus nurtures these objectives. It will also help raise wage levels in Mexico, back to their 1980 level and beyond. By contrast, trade restriction here must mean even more poverty there; poverty in turn fosters political radicalism, which is not in the American interest.

If we are seriously concerned about the standard of living in Mexico, and about democratization, we cannot escape the recognition that a thriving, open market economy will raise wages, create individual freedom, decentralize political power and allow people to organize around local issues. If Mexico prospers, it will in a better position to take up costly but urgent measures on safety standards at the work place and the environment.

Work standards and environment standards can obviously not become part of a free trade agreement; even in Europe where political integration is the object, standards are a political agenda, not an object of the 1992 regulations. But it is altogether plausible to foster crossborder union dialogue on the issue of safety standards. There is also an urgent need in reinforcing regional and North American environmental policies. This should be handled separately from the FTA discussion, but at the same time. Agreements might be expected to phase in stricter Mexican standards by requiring new plants to abide by US environment standards, while existing plants might have 12 years to adjust.

In discussing standards abroad we must not be tempted to make foreign producers uncompetitive. The object is to spread prosperity at an affordable pace. It will take a long time before Mexico will look like the United States, but we can start making some headway.

REGIONAL CONCERNS

If Mexico prospers, Central America will benefit. Mexican authorities already have started taking an active hand in the economic stabilization of Central America and much more can be expected. The United States shares in this stabilization: enhanced political stability and security in the region and reduced pressure of immigration are clearly in the national interest.

The example of Europe deserves far more attention in our design of trade policy. The core countries of the Common Market have systematically reached out to the periphery to spread prosperity and stability. Bringing Greece or Portugal into the Common Market is no different from a FTA with Mexico. And the discussion now with Eastern Europe serves much the same purpose. Unless the periphery has trade access there will be no investment. Without investment, jobs will be poor and the pressure for migration enormous.

Mexico is recognizing these realities on her own border in the South, responding to the dramatic decline in living standards in Central America, notably in Nicaragua. Mexico has now started filling the leadership vacuum, helping stabilize the region. A rising tide raises all ships; a prosperous Mexico will be a powerful shock absorber for us and a great help in nurturing economic stability and prosperity in a region that is too close to neglect but, except for communist threats, too small to draw much of our attention.

NO GOING BACK NOW

At this stage it has become very expensive to turn back on a free trade agreement. In Mexico, the idea of trade opening has become a corner stone of the economic modernization strategy. The United States has every interest in Mexico's demonstration that with sensible policies all of Latin America can return to prosperity.

Turning our back on trade opening means inviting a resurgence of protectionism not only in Mexico but throughout Latin America and beyond. Going back on the FTA with Mexico would send signals to the world economy far worse than the recent failure of the Uruguay Round.

In the postwar period the United States has invariably favored an open world economy. Successive GATT rounds have opened markets, at least across the Atlantic. In Europe, on a parallel track to GATT, the Common Market has pursued an aggressive project of regional integration with unquestioned benefits. The United States has so far done little to exploit the parallel track. Free trade with Mexico offers an important market opening for the 1990s and beyond. The focus must shift from seeing trade as a threat to viewing it as an opportunity for jobs and profits.

This is an unusual opportunity to implement an outward looking trade policy with Mexico. Looking for modernization as the way out of a difficult economic situation, Mexico today is open to far reaching trade reform. If we miss this opportunity,

we are bound to fail building an important Western Hemisphere trade and inment block in the 1990s.

ADDENDUM TO THE TESTIMONY OF RUDIGER DORNBUSCH

During the hearings questions were raised about wages in Mexico and about the likely impact on working Americans. I would like to expand on my remarks with a few facts.

1. What are the available facts on Mexican labor compensation?

The following tables show data from three different sources regarding Mexican labor compensation. The coverage in each case is different, but the data point to the fact that there is no merit whatsoever to the claim that Mexican wages are anywhere in the neighborhood of 50 or 60 cents an hour. Of course, Mexican wages are extremely low relative to US wages. In part that reflects the depressed conditions of the 1980s, but in a significant measure it is also a reflection of a low level of productivity.

Table 1.—UNITED STATES AND MEXICAN HOURLY COMPENSATION IN MANUFACTURING

[U.S. dollars per hour and index United States = 100]

	United States	Mexico	Ratio
1979–82	10.33	2.91	0.28
1983–86	12.70	1.88	0.15
1987	13.39	1.57	0.12
1988	13.85	1.99	0.14
1989	14.31	2.32	0.16

Source: U.S. Bureau of Labor Statistics.

Table 2.—MEXICAN COMPENSATION IN MANUFACTURING SURVEY DATA: 1990

[U.S. dollars per hour]

	Skilled		Unskilled	
	Maquila	National	Maquila	National
Base Salary	1.34	1.57	0.91	1.09
Supplemental Guaranteed	0.56	0.65	0.37	0.43
Supplemental Nonguaranteed [1]	0.48	0.55	0.32	0.37
Total	2.40	2.70	1.60	1.85

[1] Including profit sharing and labor related taxes.

Source: Intergamma de Mexico.

Table 3.—MEXICO: COMPENSATION PER HOUR IN INDUSTRY

[Dollars per hour]

	Compensation per employee	Wage earners	Salary earners	Social overhead
1988	2.19	1.16	2.52	0.63
1989	2.64	1.32	3.12	0.80

Source: INEGI, Mexico.

2. How do US-Mexico compensation differentials compare to those inside Europe. Specifically, is the proposed FTA with Mexico in any way comparable to Greece, Portugal, and Spain joining the Common Market?

Table 4 shows that for the Germany:Portugal comparison the wage relation is broadly the same as for the US-Mexico case. Spain's wages, however are almost half the German wage.