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Studies of the Economic Impact of NAFTA

Council of Economic Advisers
Executive Office of the President

October 20, 1993

Summary

The NAFTA may be the most thoroughly studied trade agreement in history. A review of the major studies of NAFTA's economic impact indicate a broad consensus on key points in the NAFTA debate: (1) All three NAFTA countries gain from the agreement. (2) In the U.S., labor will gain through increased employment, increased wages, or both. (3) Increased investment in Mexico will not be at the expense of investment in the U.S. The few studies reaching contrary conclusions have been strongly criticized by academic and other professional economists.

In his speech signing the side agreements to NAFTA, the President stated that nineteen out of twenty serious studies showed that NAFTA was good for the U.S. economy in general and labor in particular. A list of the major studies of the economic impact of NAFTA is attached. Of the twenty comprehensive studies listed, nineteen find that NAFTA is good for U.S. labor, leading to either increased employment, increased wages, or both.

Both past experience with trade liberalization and economic theory indicate that increased international trade benefits all participants. Given the lessons from history, it is hardly surprising that virtually all the studies that analyze the potential gains from trade liberalization find that NAFTA would benefit all three countries.

In a recent letter to the President, 286 academic economists, including 13 Nobel prize winners, expressed their support for NAFTA, stating: "While we may not agree on the precise employment impact of NAFTA, we do concur that the agreement will be a net positive for the United States, both in terms of employment creation and overall economic growth." The support for NAFTA among academic economists and serious researchers is simply overwhelming.

With the exception of a few studies, discussed below, the overwhelming conclusion from the large body of work assessing the economic effects of NAFTA is that NAFTA is good for all three countries.

All in all, an impressive array of academic, government, and business analyses of the economic impact of NAFTA have been done. NAFTA is probably the most thoroughly studied trade agreement in history. These studies have been extensively surveyed by impartial researchers at, for example, the International Trade Commission (ITC), the Congressional Budget Office (CBO), the General Accounting Office (GAO), and the Brookings Institution.

The ITC concludes: "Despite the different approaches taken in these studies, there is a surprising degree of unanimity in their results regarding the aggregate effects of a NAFTA. All three countries are expected to gain from a NAFTA. The greatest impact will on the Mexican economy, with less impact on the Canadian and U.S. economies."

The CBO report concludes: "A thorough review of the myriad changes brought about by NAFTA, and of their interactions, leads to the single resounding conclusion that the net effect on the U.S. economy would be positive and very small. . . . Contrary to some commonly expressed concerns, the reallocation of resources would not be massive. Americans should not fear that NAFTA would cause a wholesale relocation of U.S. manufacturing plants and jobs to Mexico to take advantage of the lower average wage."

The Brookings Institution survey concludes: "A consensus emerged . . . that the direct economic effects of NAFTA will be small for both Mexico and the United States. . . . [M]any of the changes in commercial relations that are often associated with NAFTA in public discussions have already occurred, and others will be spread over future years. . . . The general consensus of the studies . . . is that NAFTA will raise the average wage of U.S. workers and that the effect on low-wage workers will be negligible."

The GAO review concludes: "With the exception of a few U.S. policy analysis groups, the economic researchers in general agree that NAFTA would bring a small overall economic benefit to the U.S. and Canadian economies, and a larger benefit to the Mexican economy."

The one comprehensive study that found negative results is a paper by the Economic Policy Institute (EPI), written by Jeff Faux and William Spriggs (item 17 on the attached list), which drew on a model developed by Raul Hinojosa and Robert McCleery. This study found that 550,000 jobs were "lost" due to NAFTA, a number which has been widely cited by EPI in various press releases. However, the number largely consists of jobs "lost" due to return migration of workers from the U.S. to Mexico. In the scenarios generating this result, growth in Mexico raises Mexican wages, yielding return migration and higher wages in the U.S. These are not jobs "lost" by American workers, but rather U.S. jobs foregone by Mexican workers for whom NAFTA will provide increased income at home.

Hinojosa and McCleery wrote a letter to Faux, the President of EPI, complaining about what they considered to be a gross misuse of their model. The ensuing debate is described in a recent article by Robert Wright in The New Republic (November 1, 1993, p. 42). Wright is very critical of the EPI work, using terms like "anti-NAFTA misinformation."

The studies listed under the heading "Studies with selective consideration of certain issues" are the ones often cited as indicating that NAFTA is bad for the U.S. There are two by the Economic Strategy Institute (ESI), whose President, Clyde Prestowitz, initially argued that NAFTA would be bad for the U.S. Since then, Prestowitz has changed his mind. In an article titled "Time for NAFTA" (Economic

Strategy Institute, News and Notes, Vol. 1, No. 4, summer/fall 1993), he concludes: "Even with its imperfections, NAFTA will leave America better off than before." He notes: "The barriers that are being removed are mostly on the Mexican side. Ironically their removal may actually reduce incentives for U.S. firms to move south."

Critics of NAFTA, including EPI, often cite a study by Edward Leamer, a Professor at UCLA, as indicating that NAFTA will lower wages for non-professional workers in the U.S. by up to $1,000 a year. Those who have reviewed the Leamer paper note that it does not refer to NAFTA, but extrapolates from trends in the 1970s and 1980s. Robert Wright (The New Republic, Oct. 11, 1993, pp. 23-25) interviewed Leamer, who said that the use of his study by EPI was "extremely misleading." Leamer, in fact, supports NAFTA.

The study of NAFTA by Koechlin, Epstein, Bowles, and Larudee argues that NAFTA will lead to the loss of 290 to 490 thousand jobs in the U.S. The chain of argument in this article, however, is deeply flawed. They assume that: (1) NAFTA will generate increased foreign investment in Mexico; (2) much of this increased investment will come from the U.S.; and (3) increased U.S. investment in Mexico will reduce aggregate investment in the U.S., dollar for dollar, and lead to job losses as capital moves to Mexico. While the first two steps in this chain are reasonable, the final step is nonsense.

The Congressional Budget Office (CB0), in chapter 2 of their study of NAFTA (A Budgetary and Economic Analysis of the North American Free Trade Agreement), examined the question of investment diversion carefully, using a multi-country macro model. In a section entitled "Increased Investment in Mexico Is Not At the Expense of Investment in the United States" they conclude (p.26):

"A popular view holds that individual plant migrations would combine in a 'great sucking sound' as large amounts of net investment and jobs flow out of the United States into Mexico. This view rests on a misconception. Particular events in which capital appears to move to Mexico would be offset by others in which new capital, some from outside North America, flows to new investment projects in the United States."

In a review of the Koechlin *et al.* model in a book edited by N. Lustig, B. Bosworth, and R.Z. Lawrence (North American Free Trade: Assessing the Impact), Hinojosa and Robinson (pp. 85-86) conclude:

"There is no theoretical or empirical reason to think that these investment changes will have any effect at all on aggregate investment [in the United States]. In fact, EC experience after Spanish and Irish accession suggests that NAFTA should increase direct foreign investment (DFI) into the United States."

NAFTA Impact Studies that Provide Results for the U.S. Economy

COMPREHENSIVE STUDIES

Macroeconomic Models

1. INFORUM-CIMAT (Clopper Almon, Univ of Maryland)
2. DRI/McGraw-Hill

Static Computable General Equilibrium (CGE) Models

3. Boyd, Krutilla, and McKinnery (Ohio Univ & Baylor)
4. U.S. International Trade Commission (USITC)--February 1991
5. U.S. International Trade Commission (USITC)--January 1993
6. KPMG Peat Marwick (Bachrach & Mizrahi)
7. Hinojosa and Robinson (UC Berkeley)
8. Robinson, Burfisher, Hinojosa, and Therfelder (UC Berkeley and USDA)
9. Burfisher, Robinson, and Thierfelder (USDA, UC Berkeley, US Naval Academy)
10. Hinojosa, Robinson, and Wolff (UCLA and UC Berkeley)
11. Trela and Whalley (Univ of Western Ontario)
12. Brown, Deardorff, and Stern (Univ of Mich)--June 1991
13. Brown, Deardorff, and Stern (Univ of Mich & Tufts)--Oct 1992
14. Roland-Holst, Reinert, and Shiells (Mills College & USITC)
15. Hunter, Markusen, and Rutherford (San Diego St, Colorado, Western Ontario)

Dynamic Computable General Equilibrium (CGE) Models

16. Hinojosa and McCleery (UC Berkeley and East-West Center)
17. Economic Policy Institute (EPI)[1]
18. McCleery (Ease-West Center)

Analogy to Other Liberalizations

19. Institute for International Economics--IIE (Hufbauer & Schott)--February 1992
20. Institute for International Economics--IIE (Hufbauer & Schott)--February 1993

STUDIES WITH SELECTIVE CONSIDERATION OF CERTAIN ISSUES

1. Economic Strategy Institute--ESI (Prestowiz *et al.*)(1991)
2. Economic Strategy Institute--ESI (Chimerine & Cohen)(1992)
3. Koechlin, Epstein, Bowles, and Larudee (Skidmore & Univ Mass)
4. Leamer (UCLA and NBER)
5. Choate (Ross Perot)

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[1]This is the only comprehensive study finding a net job loss from NAFTA.

NAFTA Impact Studies that Provide Results only for Mexico

1. Adams, del Rio, and Adams (Univ of Pennsylvania)
2. Kehoe (Univ. of Minnesota)
3. Levy and van Wijnbergen (Boston Univ and World Bank)
4. Sobarzo (Colegio de Mexico)
5. Young and Romeo (Univ. of Texas and Colegio de Mexico)

NAFTA Impact Studies that Provide Results Only for Canada

1. Cox and Harris (Univ of Waterloo and Simon Fraser Univ)

Reviews of NAFTA Impact Studies

1. Brookings Institution--Lustig, Bosworth, and Lawrence
2. Congressional Research Service (CRS)--Bolle

3/4. Congressional Budget Office (CBO)--Arnold and staff study

5. U.S. Department of Labor--Schoepfle & Perez-Lopez
6. U.S. General Accounting Office--staff study
7. U.S. International Trade Commission (USITC)--staff study

NAFTA IMPACT STUDIES

NAFTA Impact Studies that Provide Results for the U.S. Economy

COMPREHENSIVE STUDIES

Marcoeconometric Forecasting Models

1. INFORUM-CIMAT (Clopper Almon, University of Maryland)
Interindustry Economic Research Fund, Inc., "Industrial Effects of a Free Trade Agreement Between Mexico and the USA." Prepared under contract to the U.S. Department of Labor, Clopper Almon, University of Maryland, principal investigator, September 1990.

2. DRI/McGraw-Hill
DRI/McGraw-Hill, "The Impact of the North American Free Trade Agreement on U.S. Regional and Sectoral Labor Markets," Lexington, MA, August 1992, Appendix B in National Commission for Employment Policy, The Employment Effects of the North American Free Trade Agreement Recommendations and Background Studies, Special report No. 33 (Washington, DC: National Commission for Employment Policy, October 1992)

Static Computable General Equilibrium (CGE) Models

3. Boyd, Drutilla, and McKinnery (Ohio University and Baylor University)
Boyd, Roy G., Kerry Drutilla, and Joseph A. McKinney, "The Impact of Tariff Liberalization between the United States and Mexico: An Empirical Analysis," Applied Economics 25 (1993), 81-89.

4. U.S. International Trade Commission (USITC)--February 1991
U.S. International Trade Commission, The Likely Effects on the United States of a Free Trade Agreement with Mexico, USITC Publication 2353 (Washington, DC February 1991)

5. U.S. International Trade Commission (USITC)--January 1993
U.S. International Trade Commission, Potential Impact on the U.S. Economy and Selected Industries of the North American Free-Trade Agreement, USITC Publication 2596 (Washington, DC, January 1993).

6. KPMG Peat Marwick (Bachrach and Mizrahi)
KPMG Peat Marwick, Policy Economics Group, "The Effects of a Free Trade Agreement between the United States and Mexico," prepared under contract to the U.S. Council of the Mexico-U.S. Business Committee (Washington, DC, May 1, 1991); see also, Bachrach, Carlos, and Loris Mizrahi, "The Economic Impact of a Free Trade Agreement Between the United States and Mexico: A CGE Analysis," Pp. 39-79 in U.S. International trade Commission, Economy-Wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2508 (Washington, DC: U.S. International Commission, May 1992).

7. Hinojosa and Robinson (University of California at Berkeley)
Hinojosa-Ojeda, Raul, and Sherman Robinson, "Alternative Scenarios of U.S.-Mexico Integration: A Computable General Equilibrium Approach." Working paper No. 609, Department of Agriculture and Resource Economics, University of California at Berkeley, April 1991.

8. Robinson, Burfisher, Hinojosa, and Thierfelder (Univ of Calif at Berkeley and U.S. Dept of Agriculture)
Robinson, Sherman, Mary E. Burfisher, Raul Hinojosa-Ojeda, and Karen E. Thierfelder, "Agricultural Policies and Migration in a U.S.-Mexico Free Trade Area: A Computable General Equilibrium Analysis."

Working paper No. 617, Department of Agricultural and Resource Economics, University of California at Berkeley, December 1991; also reprinted Pp. 457-507 in U.S. International Trade Commission, Economy-Wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2508 (Washington, DC: U.S. International Trade Commission, May 1992).

9. Burfisher, Robinson, and Thierfelder (US Dept. of Agric, UC Berkeley, US Naval Academy)
Burfisher, Mary, Sherman Robinson, and Karen Thierfelder, "Agricultural and Food Policies in a U.S.-Mexico Free Trade Area," The North American Journal of Economics and Finance 3:2 (Fall 1992), 117-139.

10. Hinojosa, Robinson, and Wolff (University of California at Los Angeles and UC Berkeley)
Hinojosa-Ojeda, Raul, Sherman Robinson, and Goetz Wolff, "The Impact of a North American Free Trade Agreement on California: A Summary of Key Research Findings." Working Paper No. 3, Lewis Center for Regional Policy Studies, Graduate School of Architecture and Urban Planning, University of California at Los Angeles, September 1992.

11. Trela and Whalley (University of Western Ontario)
Trela, Irene, and John Whalley, "Bilateral Trade Liberalization in Quota Restricted Items: U.S. and Mexico in Textiles and Steel," paper presented at a conference titled "North American Free Trade: Economic and Political Implications," Center for Strategic and International Studies, Washington, DC, June 1991; see also, Trela, Irene, and John Whalley, "Trade Liberalization in Quota Restricted Items: U.S. and mexico in Textiles and Steel," World Economy 15:1 (January 1992), 45-63.

12. Brown, Deardorff, and Stern (University of Michigan and Tufts University)--June 1991
Brown, Drusilla K. Alan V. deardorff, and Robert M. Stern, "A North American Free Trade Agreement: Analytical Issues and a Computational assessment," Institute of Public Policy Studies, mimeo, University of Michigan, June 24, 1991; and revised version, October 18, 1991; subsequently published in World Economy 15:1 (January 1992), 11-29.

13. Brown, Deardorff, and Stern (University of Michigan and Tufts University)--October 1992
Stern, Robert M. Alan V. Deardorff and Drusilla K. Brown, "A U.S. Mexico-Canada Free Trade Agreement: Sectoral Employment Effects and Regional/Occupational Employment Realignments in the United States," University of Michigan, Institute of Public Policy Studies, September 2, 1992, Appendix A in National Commission for Employment Policy, October 1992).

14. Roland-Holst, Reinert, and Shiells (Mills College and USITC)
Roland-Holt, David, Kenneth A. Reinert, and Clinton R. Shiells, "North American Trade Liberalization and the Role of Nontariff Barriers." Pp.523-580 in U.S. International Trade Commission, Economy-Wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2508 (Washington, DC: U.S. International Trade Commission, May 1992)

15. Hunter, Markusen, and Rutherford (San Diego State, Colorado, and Western Ontario)
Hunter, Linda, James R. Markusen and Thomas F. Rutherford, "U.S.-Mexico Free Trade and the North American Auto Industry: Effects on the Spatial organization of Production of Finished Autos." Paper presented at a conference titled "North American Free Trade: Economic and Political Implications." Center for Strategic and International Studies, Washington, DC, June 1991; subsequently published in World Economy 15:1 (January 1992), 65-81; see also, Hunter, Linda, James R. Markusen, and Thomas F. Rutherford, "Trade Liberalization in a Multinational-Dominated Industry: A Theoretical and Applied General Equilibrium Analysis." Pp. 39-42 in Federal Reserve Bank of Dallas, North American Free Trade: Proceedings of a Conference (Dallas, TX, June 1991); revised december 1991, Pp. 187-223 in U.S.

International Trade Commission, Economy-Wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2508 (washington, DC: U.S. International Trade Commission, May 1992).

Dynamic Computable General Equilibrium (CGE) Models

16. Hinojosa and MCCleery (UC Berkeley and East-West Center)
Hinojosa-Ojeda, Raul, and Robert K. McCleery, "U.S.-Mexico interdependence, Social Pacts and Policy Alternatives: A computable General Equilibrium Approach." Working Paper No. 596, Department of Agricultural and Resource Economics, University of California at Berkeley, March 22, 1991; reprinted, Pp. 113-154 in J.A.Bustamante, C.W. Reynolds, and R.A. Hinojosa Ojeda (eds.), U.S.-Mexico Relations: Labor Market Interdependence (Stanford, CA: Stanford University Press, 1992)

17. EPI -- Economic Policy Institute (Faux and Spriggs)
Faus, Jeff, and William Spriggs, U.S. Jobs and the Mexico Trade Proposal, Briefing Paper (Washington, DC: Economic Policy Institute, May 1991); see also, Spriggs, William E. Economic Policy Institute, "Potential Effects of Direct Foreign Investment Shifts Due to the Proposed U.S.-Mexico Free Trade Agreement," testimony before the Subcommittee on Commerce, Consumer Protection and Competitiveness of the U.S. House of Representatives Committee on Energy and Commerce, May 15, 1991.

18. McCleery (Ease-West Center)
McCleery, Robert K.,"An Intertemporal, Linked, Macroeconomic CGE Model of the United States and Mexico Focussing on Demographic Change and Factor Flows." Pp. 371-441 in U.S. International trade Commission, Economy-Wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2508 (Washington, DC: U.S. International Trade Commission, May 1992).

Analogy to Other Liberalizations

19. Institute for International Economics--IIE (Hufbauer and Schott)--February 1992
Hufbauer, Gary Clyde, and Jeffrey J. Schott, North American Free Trade: Issues and Recommendations (Washington, DC: Institute for International Economics, February 1992).

20. Institute for International Economics--IIE (Hufbauer and Schott)--February 1993
Hufbauer, Gary Clyde, and Jeffrey J. Schott, NAFTA: An Assessment (Washington, DC: Institute for International Economics, February 1993).

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1. Economic Strategy Institute --ESI (Prestowitz et al.) -- 1991
Economic Strategy Institute, "The Good News or the Bad News, Free Trade with Mexico: The Potential Economic Impact" (Washington, DC: Economic Strategy Institute, May 2, 1991);see also, Clyde V. Prestowitz, Jr. and Robert B. Cohen (with Peter A. Morici and Allen Tonelson), "The New North American Order, a Win-Win Strategy for U.S.-Mexican Trade" (Washington, DC: Economic Strategy Institute; Lanham, MD: University Press of America, 1991).

2. Economic Strategy Institute -- ESI -- 1992
Chimerine, Lawrence, and Robert Cohen, "NAFTA: Making It Better" (Washington, DC: Economic Strategy Institute, 1992).

3. Koechlin, Epstein, Bowles, and Larudee (Skidmore and Univ of Mass at Amhers)
Koechlin, Timothy, Gerald Epstein, Samuel Bowles, and Mehrene Larudee, "Estimates of the Impact of the Free Trade Agreement on Direct U.S. Investment in Mexico." Summary of Testimony to the U.S. Trade Representative Public Hearings on NAFTA, Boston, MA, September 11, 1991; see also, Koechlin, Timothy, Mehrene Larudee, Samuel Bowles, and Gerald epstein, "Effect of the North American Free Trade Agreement on Investment, Employment and Wages in Mexico and the U.S." Mimeo, Skidmore College and University of Massachusetts at Amherst, February 1992; Koechlin, Timothy, and Mahrene Larudee, "The High Cost of NAFTA," Challenge (September-October 1992), pp. 19-26.

4. Leamer (Univ Calif at Los Angeles and National Bureau of Economic Research)
Leamer, Edward, "Wage Effects of a U.S.-Mexican Free Trade Agreement." NBER Working Paper No. 3991 (Cambridge, MA: National Bureau of Economic Research, February 1992).

5. Choate
Choate, Pat, "Jobs at Risk: Vulnerable U.S. Industries and Jobs under NAFTA" (Washington, DC: The Manufacturing Policy Project, April 1993).

NAFTA Impact Studies that Provide Results Only for Mexico

1. Adams, Alanis, and del Rio (Univ of Pennsylvania)
Adams, F. Gerard, Mario Alanis, Abel Beltran del Rio, "The Mexico-United States Free Trade and Investment Area Proposal: A Macroeconometric Evaluation of Impacts on Mexico." Journal of Policy Modeling 14:1 (1992), 99-119.

2. Kehoe (Univ of Minnesota)
Kehoe, Timothy J., "Modelling the Dynamic Impact of North American Free Trade." In U.S. international Trade Commission, Economy-Wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2508 (Washington, DC: U.S. International trade Commission, May 1992).

3. Levy and van Wijnbergen (Boston Univ and World Bank)
Levy, Santiago, and Sweder van Wijnbergen,"Transition Problems in Economic Reform: Agriculture in Mexico-U.S. Free Trade Agreement." In U.S. International trade Commission, Economy-Wide Modeling of the Economic implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2508 (Washington, DC: U.S. International Trade Commission, May 1992).

4. Sobarzo (colegio de Mexico)
Sobarzo, Horacio E., "A General Equilibrium Analysis of the Gains from Trade for the Mexican Economy of a North American Free Trade Agreement." In U.S. International Trade Commission, Economy-Wide Modeling of the Economic implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2508 (Washington, DC: U.S. International Trade Commission, May 1992).

5. Young and Romeo (Univ of Texas and Colegio de Mexico)
Young, Leslie, and Jose Romeo, "Steady Growth and Transition in a Dynamic Dual Model of the North American Free Trade Agreement." In U.S. international Trade Commission and Mexico, USITC Publication 2508 (Washington, DC: U.S. International Trade Commission, May 1992).

NAFTA Impact Studies that Provide Results Only for Canada

1. Cox and Harris (Univ of Waterloo and Simon Fraser Univ)
   Cox, David, and Richard G. Harris, "North American Free Trade and its Implications for Canada: Results from a CGE Model of North American Trade," in U.S. International Trade Commission, Economy-Wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2508 (Washington, DC: U.S. International Trade Commission, May 1992).

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Bolle, Mary Jane, "NAFTA: U.S. Employment and Wage Effects." CRS Report for Congress 93-447E (Washington DC:Congressional Research Service, Library of Congress, April 27, 1993).

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U.S. General Accounting Office, North American Free Trade Agreement: Assessment of Major issues, Volumes 1 and 2, GAO/GGD-93-137 (Washington, DC: U.S. General Accounting Office, September 1993).

U.S. International trade Commission, Economy-wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico, USITC Publication 2516 (Washington, DC: USITC, Mary 1992).

THE WHITE HOUSE

WASHINGTON

November 18, 1993

The Honorable Laura Tyson
Council of Economic Advisors
The White House - OEOB
Washington, DC 20503

Dear Chairwoman ~~Tyson~~ Laura:

Now that the fight is over, I wanted to take the time to thank you for your support for and participation in the Nafta campaign. Your efforts made the difference, especially in the critical first months.

You dedicated your precious time and department resources to Nafta. If it were not for your personal commitment to the Nafta effort, and that of your staff, we would not have achieved this important victory.

Again, thank you for your cooperation and assistance. Please express my gratitude to your staff as well.

Sincerely,

Rahm

Rahm Emanuel
Assistant to the President and
Deputy Director of Communications

You + Tom have been the best.

WHITE HOUSE SITUATION ROOM

PRT: TYSON

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INFO RUEATRS/TREASURY WASHDC
RUCPDC/USDOC WASHDC
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RUEHGA/AMCONSUL CALGARY 0010
RUEHHA/AMCONSUL HALIFAX 0034
RUEHMT/AMCONSUL MONTREAL 0572
RUEHQU/AMCONSUL QUEBEC 0034
RUEHON/AMCONSUL TORONTO 0021
RUEHVC/AMCONSUL VANCOUVER 0134
RUEHXC/ALL USCONS MEXICO
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TREASURY FOR ROBIN RITTERHOFF
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USDOC FOR 4321/ITA/IEP/WH/OMKCHOPRA
LABOR FOR INTERNATIONAL AFFAIRS - OTERO
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STATE PLEASE PASS EPA/OIA
CEA FOR TYSON
E.O. 12356: N/A
TAGS: ELAB, EINV, ETRD, ECIN, EAIR, EAGR, MX, CA, US
SUBJECT: NAFTA NOTES: JANUARY 21, 1994
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-- PROCESS YOUR OWN: ONE SOLUTION TO MEXICO'S AG TRADE DEFICIT
-- IN TRANSITION UNDER NAFTA, MAQUILAS GROW, MOVE INLAND
-- BURLINGTON AIR EXPRESS PLANS EXPANSION IN MEXICO
-- A SAMPLING OF U.S.- MEXICAN "STRATEGIC ALLIANCES" FORMED IN 1993
-- DEPENDS ON HOW YOU COUNT THEM: ACCOUNTING SYSTEMS ADJUST TO NAFTA
-- U.S. LABORERS' UNION AND CTM TO COOPERATE ON ENVIRONMENT

1. MEXICAN CUSTOMS, SECOFI SLOWLY WORKING OUT TRADE GLITCHES

AT A JANUARY 13 MEETING USTR KANTOR RAISED WITH SECOFI SECRETARY SERRA PUCHE THE ISSUE OF NAFTA-RELATED CUSTOMS IMPLEMENTATION PROBLEMS AT MEXICAN PORTS OF ENTRY. SERRA PUCHE

WHITE HOUSE SITUATION ROOM

ASSURED KANTOR THAT HIS MINISTRY WOULD WORK ON THE PROBLEM WITH MEXICAN CUSTOMS AND THE TRADING COMMUNITY. TRUE TO HIS WORD, MEXICAN CUSTOMS AND TRADE MINISTRY OFFICIALS HELD A VARIETY OF SEMINARS AND MEETINGS WITH THE MEXICAN TRADE COMMUNITY DURING THE WEEK OF JANUARY 18-21 TO ADDRESS PROBLEMS IN CROSSING GOODS AT MEXICAN PORTS OF ENTRY. GOM OFFICIALS CONFIRMED, BOTH AT THOSE MEETINGS AND AT A JANUARY 20 PUBLIC SEMINAR SPONSORED BY THE AMERICAN CHAMBER OF COMMERCE IN MEXICO, THAT CERTIFICATES OF ORIGIN NEED NOT/NOT BE PRESENTED WITH THE CUSTOMS DECLARATION UPON IMPORTATION OF GOODS. AN OFFICIAL INSTRUCTION TO THAT EFFECT WAS SUPPOSED TO HAVE BEEN SENT BY MEXICAN CUSTOMS HEADQUARTERS TO PORTS OF ENTRY AND CUSTOMS BROKERS SOMETIME LAST WEEK. A HIGH CUSTOMS OFFICIAL PROMISED TO PROVIDE EMBASSY WITH A COPY SHORTLY. TO ITS CREDIT, THE GOM HAS ALREADY PUBLISHED TWO EXCELLENT PUBLIC DOCUMENTS ON THE "HOW-TO" OF NAFTA: ONE PUBLISHED BY SECOFI HAS AN EXTENSIVE Q AND A SECTION ON CERTIFICATES OF ORIGIN WHILE THE OTHER, PUBLISHED BY THE FINANCE MINISTRY, EXPLAINS IN DETAIL RULES OF ORIGIN AND CUSTOMS/ENTRY PROCEDURES. IF ONLY THEIR OWN OFFICIALS WOULD READ THESE...

2. QUERETARO; RHYMES WITH "READY TO GO" FOR NAFTA

UNCLAS SECTION 02 OF 06 MEXICO 01726
TREASURY FOR ROBIN RITTERHOFF
USDOC FOR 4300/IEP/WH/DAS/HUGHES
USDOC FOR 4321/ITA/IEP/WH/OMKCHOPRA
LABOR FOR INTERNATIONAL AFFAIRS - OTERO
STATE PLEASE PASS USTR/STROJE
STATE PLEASE PASS EPA/OIA
CEA FOR TYSON
E.O. 12356: N/A
TAGS: ELAB, EINV, ETRD, ECIN, EAIR, EAGR, MX, CA, US
SUBJECT: NAFTA NOTES: JANUARY 21, 1994

QUERETARO IS 160 MILES NORTH OF MEXICO CITY, ON THE MAIN ROAD TO LAREDO. THE CITY HAS LONG BEEN A CUSTOMS ENTRY PORT FOR PRODUCTS SHIPPED FROM THE U.S. TO THE INTERIOR OF MEXICO. MEXICAN CUSTOMS ANTICIPATES AN EVEN GREATER FLOOD OF IMPORTS AS A RESULT OF THE NAFTA. IN PREPARATION FOR THIS INUNDATION, CUSTOMA IS EXPANDING THE "INLAND PORT" FACILITIES OUTSIDE QUERETARO IN AN EFFORT TO RELIEVE INCREASING PRESSURE ON FACILITIES IN NUEVO LAREDO. IN ADDITION TO BUILDING FOUR NEW RAIL SIDINGS AND RAIL YARDS WITHIN THE CUSTOMS SECURITY ZONE, THEY ARE ALSO BUILDING TWO WAREHOUSES FOR ANTICIPATED MAQUILADORA (IN-BOND) OPERATIONS. THREE COMPANIES HAVE ALREADY MADE INQUIRIES ABOUT ESTABLISHING MAQUILA OPERATIONS WITHIN THE CUSTOMS AREA. ALSO UNDER CONSTRUCTION NEXT TO THE CUSTOMS COMPLEX IS A "WORLD TRADE CENTER" WITH HELIPAD, SO BUSINESSMEN

IN MEXICO CITY CAN QUICKLY TRAVEL BETWEEN THE TWO LOCATIONS. MEXICAN CUSTOMS OFFICIALS EXPECT THAT THESE FACILITIES WILL BE UP AND RUNNING BY MID-94.

3. SECOFI LISTS MEXICO'S "WINNING SECTORS" IN NAFTA

A REPORT DETAILING THE IMPACT OF THE NAFTA ON MEXICAN SMALL AND MEDIUM-SIZED INDUSTRIES PRODUCED BY SECOFI (SECRETARIAT OF TRADE AND INDUSTRIAL DEVELOPMENT) LISTS FIVE SECTORS EXPECTED TO BENEFIT SHORT AND LONG-TERM FROM THE NAFTA. SECOFI'S ANALYSIS IS THAT SMALL AND MEDIUM-SIZED MEXICAN COMPANIES IN TEXTILES AND APPAREL, AUTOPARTS, PLASTICS, FURNITURE AND AGROINDUSTRIES WILL BENEFIT SIGNIFICANTLY FROM THE NAFTA. WHAT IS INTERESTING ARE THE NAFTA MECHANISMS THAT WILL GENERATE THESE ADVANTAGES.

O TEXTILES ARE EXPECTED TO BENEFIT FROM INCREASED ACCESS TO U.S. MARKETS, THIS DESPITE THE FACT THAT MEXICO'S TEXTILE INDUSTRY SUFFERS FROM A GENERATION OF PROTECTION AND IS IN FACT ALREADY FACING TOUGH COMPETITION FROM U.S. TEXTILE PRODUCERS. APPAREL MANUFACTURERS ARE A MORE LOGICAL BENEFICIARY OF THE NAFTA, THOUGH FABRICS USED BY THE INDUSTRY WILL BE IMPORTED FROM THE U.S., AT LEAST UNTIL THE MEXICAN TEXTILE INDUSTRY MODERNIZES.

O MEXICO'S AUTOPARTS SECTOR (WHICH HAS 500 PRODUCERS, BUT ONLY 40-50 LARGE, WORLD CLASS COMPANIES) IS EXPECTED TO GROW AS THE NORTH AMERICAN AUTO INDUSTRY BECOMES MORE INTEGRATED. MORE STRINGENT LOCAL CONTENT RULES WILL ENCOURAGE GREATER USE OF NORTH AMERICAN INPUTS. THIS WILL, IN PART, FURTHER ENCOURAGE "STRATEGIC ALLIANCES" OF U.S. AND CANADIAN PRODUCERS WITH MEXICAN COMPANIES.

O THE ELIMINATION OF TARIFFS ON RESIN IMPORTS INTO MEXICO FROM THE U.S. AND ON PLASTIC PRODUCTS (ESPECIALLY INDUSTRIAL AND AUTO-RELATED ITEMS) IMPORTED INTO THE U.S. FROM MEXICO SHOULD PROVIDE A DOUBLE BOOST TO MEXICO'S PLASTICS INDUSTRY.

O THE FURNITURE INDUSTRY IS EXPECTED TO BENEFIT FROM THE ELIMINATION OF U.S. TARIFFS ON MEXICAN-MADE FURNITURE. MEXICAN COMPANIES' FINISHED PRODUCTS WILL REMAIN PROTECTED BY EXISTING TARIFFS YET THEY WILL BE ABLE TO BUY INPUTS AND COMPONENTS FROM THE U.S. AND CANADA TARIFF-FREE.

O MEXICAN AGROINDUSTRIES WILL BENEFIT FROM THE ELIMINATION OF

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U.S. TARIFFS ON FLOWERS (EXCEPT ROSES), ORNAMENTAL PLANTS, HONEY AND A WIDE ASSORTMENT OF FRUITS AND VEGETABLES. BY 1999, ROSES, FRUIT JUICES AND MOST REMAINING FRUITS AND VEGETABLES WILL MOVE ACROSS NORTH AMERICA WITHOUT TARIFFS. EXPANDED MARKETING OPPORTUNITIES FOR THESE PRODUCTS WILL ENCOURAGE ADDITIONAL FOREIGN INVESTMENT IN MEXICO'S SPECIALTY AGRICULTURE SECTOR AS WELL AS IN THE PROCESSED FOOD INDUSTRY. (SEE RELATED ITEM 4 NOTE BELOW.)

COMMENT: THE GOM HAS BEGUN A MAJOR PROGRAM TO UPGRADE, IN TERMS OF QUALITY, PRODUCTIVITY AND MARKETING SKILLS, THE SMALL AND MEDIUM-SIZED INDUSTRIAL AND MANUFACTURING SECTORS IN MEXICO. THERE WILL BE SOME SUCCESS STORIES IN THESE AREAS, BUT BY AND LARGE SMALLER COMPANIES WILL CONTINUE TO BE HAMMERED BY COMPETITION FROM THE REST OF THE NAFTA REGION, WHERE MODERN FACILITIES, MANAGEMENT TECHNIQUES AND MARKETING, AS WELL AS LONGER PRODUCTION RUNS GIVE U.S. AND CANADIAN PRODUCERS A DISTINCT ADVANTAGE, ESPECIALLY IN THE AREAS OF PROCESSED FOODS, FURNITURE, TEXTILES AND AUTOPARTS. IN REALITY, THE MEXICAN'S "BEST OPTION" IN THESE AREAS WILL BE TO AGGRESSIVELY SEEK OUT "STRATEGIC ALLIES" WHO CAN PROVIDED NEEDED CAPITAL AND MANAGEMENT EXPERTISE. END COMMENT.

4. PROCESS YOUR OWN: ONE SOLUTION TO MEXICO'S AG TRADE DEFICIT

UNTIL THE EARLY 1980'S, MEXICO WAS A LARGE IMPORTER OF BASIC GRAINS, PARTICULARLY BEANS AND CORN. AN EXPENSIVE SUBSIDY PROGRAM RAISED PRODUCTION TO SELF-SUFFICIENCY BY THE MID-80'S. SINCE THE OPENING OF THE MEXICAN MARKET TO IMPORTED PROCESSED FOODS, POST-GATT (1987), A NEW AGRICULTURAL TRADE DEFICIT EMERGED. NOW, IMPORTED FOOD PRODUCTS -- CANNED, FROZEN OR OTHER WISE PROCESSED -- ARE 78 PERCENT OF MEXICO'S AGRICULTURAL SECTOR TRADE DEFICIT (UP FROM 29 PERCENT IN 1981). SINCE ENTERING GATT, EXPORTS OF MEXICAN PROCESSED FOODS HAVE DECLINED FROM 47 PERCENT OF THEIR AGRICULTURAL EXPORTS TO 25 PERCENT IN 1993. STARTING IN 1994, THE GOM IS ENDING ITS TRADITIONAL SUBSIDY PROGRAM (WHICH PAID 2.5 TIMES THE WORLD PRICE TO CORN FARMERS WHO SOLD THEIR CROP TO THE MEXICAN GOVERNMENT BUYING AGENCY). IT IS BEING REPLACED BY A MORE TARGETED, MORE EXPENSIVE SUBSIDY PROGRAM (PROCAMPO) DESIGNED, IN PART, TO AID SUBSISTENCE FARMERS.

THE CONTINUED AND ACCELERATING INTEGRATION OF THE NORTH AMERICAN MARKET UNDER NAFTA, COMBINED WITH THE INCREASING INCOMES OF MOST MEXICANS, GUARANTEES THAN THE PROCESSED FOOD SECTOR WILL REMAIN A GROWTH AREA FOR U.S. EXPORTERS. SEVERAL

MEXICAN TRADE GROUPS AND "THINK TANKS" ARE BEGINNING TO ADDRESS THE DECLINE OF LOCAL PRODUCERS AND THE IMPORTANCE OF BUILDING CROSS-BORDER ALLIANCES, BOTH IN MARKETING AND PRODUCTION, TO TAKE ADVANTAGE OF THESE TRENDS.

5. IN TRANSITION UNDER NAFTA, MAQUILAS GROW, MOVE INLAND

MEXICO'S MAQUILADORA (IN-BOND) INDUSTRY CONTINUED TO GROW THROUGH THE FIRST THREE QUARTERS OF 1993. THE NUMBER OF MAQUILAS IN OPERATION IN MEXICO GREW 4.8 PERCENT THROUGH SEPTEMBER, 1993 TO A TOTAL OF 2,182 AND EMPLOYMENT IN THIS SECTOR INCREASED BY 7.4 PERCENT TO 552,078. MOST OF THESE NEW MAQUILAS ARE LOCATED AWAY FROM THE U.S.-MEXICAN BORDER, IN STATES SUCH AS JALISCO, QUINTANA ROO AND YUCATAN, ALTHOUGH 85 PERCENT OF THE EMPLOYMENT IS STILL CONCENTRATED IN THE FIVE

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BORDER STATES OF CHIHUAHUA, BAJA CALIFORNIS, TAMAULIPAS, COAHUILA AND SONORA. EMPLOYMENT IN THE SECTOR IS EXPECTED TO GROW BY OVER 10 PERCENT IN 1994 AS A RESULT OF THE EXPECTED EXPANSION IN PRODUCTION TO BE GENERATED BY NAFTA. MAQUILA WORKERS CONSTITUTE MORE THAN 20 PERCENT OF MEXICO'S MANUFACTURING WORK FORCE. THE AVERAGE MAQUILA SALARY ROSE 0.3 PERCENT IN 1993, TO USD 3.14 PER HOUR. THE MAQUILA INDUSTRY WILL NOT BE AFFECTED BY NAFTA UNTIL THE YEAR 2001 WHEN THE PROGRAM SIMPLY WILL BECOME ANOTHER PART OF MEXICO'S DOMESTIC MANUFACTURING SECTOR AND BE ABLE TO SELL ITS OUTPUT WITHIN MEXICO.

6. BURLINGTON AIR EXPRESS PLANS EXPANSION IN MEXICO

BURLINGTON AIR EXPRESS, WHICH RANKS AMONG THE TOP FIVE AIR FREIGHT CARRIERS IN MEXICO, PLANS TO EXPAND ITS SERVICE IN 1994. BURLINGTON CURRENTLY FLIES FOUR TIMES A WEEK TO MONTERREY AND CHIHUAHUA AND PLANS TO EXTEND ITS MONTERREY FLIGHT TO GUADALAJARA IN ORDER TO PROVIDE BETTER SERVICE TO ITS MULTINATIONAL CUSTOMER BASE, WHICH INCLUDES THE GUADALAJARA OPERATIONS OF EASTMAN KODAK, ALPHA MEDICAL, IBM AND HEWLETT PACKARD. LATER IN THE YEAR, BURLINGTON PLANS TO OFFER DIRECT SERVICE BETWEEN ITS HUB IN TOLEDO, OHIO AND MEXICO CITY. CARGO

ARRIVING IN MEXICO CITY COULD, THEORETICALLY, RECEIVE OVERNIGHT SERVICE TO 13 OTHER MEXICAN CITIES VIA THE NETWORK OF AEROFLASH, A MEXICAN COURIER SERVICE IN WHICH BURLINGTON HAS A 20 PERCENT EQUITY STAKE. THE PROBLEM IS THE CUSTOMS CLEARANCE IN MEXICO CITY CAN TAKE ANYWHERE FRON A FEW HOURS TO SEVERAL DAYS, WHICH SEVERLY DIMINISHES THE QUALITY OF SERVICE BURLINGTON AND ITS PARTNER AEROFLASH CAN OFFER CARGO CUSTOMERS.

7. A SAMPLING OF U.S.- MEXICAN "STRATEGIC ALLIANCES" FORMED IN 1993

IN ANTICIPATION OF THE ENTRY INTO FORCE OF THE NAFTA, U.S. AND MEXICAN COMPANIES BEGAN TO FORGE "STRATEGIC ALLIANCES" TO TAKE ADVANTAGE OF MARKET-OPENING OPPORTUNITIES AND SYNERGIES EXPECTED TO FLOW FROM NAFTA. ALTHOUGH BY NO MEANS EXHAUSTIVE, THE FOLLOWING LIST OF U.S. FIRMS INVESTING IN MEXICAN COMPANIES GIVES A FLAVOR OF THE ACTIVITIES TAKING PLACE IN THE CORPORATE WORLD:

U.S. INVESTMENTS IN MEXICAN FIRMS

ANHEUSER-BUSCH BOUGHT 18 PERCENT OF THE STOCK OF MEXICAN BEER GIANT GRUPO MODELO FOR USD 477 MILLION.
COCA-COLA PURCHASED 30 PERCENT OF THE SHARES OF SOFTDRINK DIVISION OF FEMSA FOR USD 195 MILLION.
MOTOROLA INVESTED USD 80 MILLION FOR A MINORITY PARTICIPATION IN THE CELLULAR TELEPHONE COMPANY CEDETEL.
AETNA INSURANCE ACQUIRED A 49 PERCENT STAKE IN VALORES INDUSTRIALES DE MONTERREY FOR USD 76 MILLION.
MCKESSON BOUGHT 23 PERCENT OF THE SHARES OF THE PHARMACEUTICAL COMPANY NACIONAL DE DROGAS FOR USD 58 MILLION.

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MILLER BREWING TOOK AN 8 PERCENT STAKE IN THE BEER DIVISION OF FEMSA.
DANA CORPORATION ACQUIRED 49 PERCENT OF THE SHARES OF AUTOPARTS MANUFACTURER UNIK.
BAUSCH AND LOMB PURCHASED OPTICAL FIRM OPTIMA INDUSTRIAL.
ALLIED SIGNAL ACQUIRED A MINORITY POSITION IN THE FILTRAM

AUTOPARTS DIVISION OF GRUPO PROEZA.
JOHNSON AND HIGGINS PURCHASED AN INTEREST IN THE BROCKMAN AND SCHUH INSURANCE FIRM.
STANDARD AND POOR INVESTED IN THE FINANCIAL RATING FIRM CALIFICADORA DE VALORES.
NEW YORK LIFE BOUGHT 30 PERCENT OF THE SHARES OF INSURANCE FIRM COMPANIA GEO.
SARA LEE PURCHASED TEXTILE MANUFACTURER RINBROS/MALLORCA.

8. DEPENDS ON HOW YOU COUNT THEM: ACCOUNTING SYSTEMS ADJUST TO NAFTA

ACCORDING TO THE MEXICAN FINANCIAL DAILY EL ECONOMISTA, DIFFERING ACCOUNTING PRACTICES BETWEEN THE U.S. AND MEXICO PRESENT AN OBSTACLE TO THE IMMEDIATE IMPLEMENTATION OF THE FINANCIAL SERVICES CHAPTER OF THE NAFTA. FINANCE MINISTRY ASPE REPORTEDLY ADMITTED THAT, AFTER 24 MONTHS ON THE PROJECT, MEXICO IS STILL WORKING OUT HOW IT WILL RECONCILE ACCOUNTING PRACTICES USED BY THE NAFTA COUNTRIES SO THAT THE PERFORMANCE OF FINANCIAL COMPANIES CAN BE COMPARED. THE MEXICAN INSTITUTE OF PUBLIC ACCOUNTANTS, WHICH CONDUCTED A STUDY OF ACCOUNTING SYSTEMS USED IN THE NAFTA COUNTRIES, PREDICTS THAT THE ACCOUNTING BODIES OF MEXICO, CANADA AND THE UNITED STATES WILL RELEASE A JOINT PUBLICATION NO LATER THAN JUNE, 1994 TO ADDRESS THE ISSUE.
WHILE SOME DIFFERENCES IN ACCOUNTING ARE ROOTED IN BUSINESS PRACTICES AND ECONOMIC CONDITIONS SPECIFIC TO A COUNTRY, FURTHER HOMOGENIZATION OF ACCOUNTING PRACTICES IS ANTICIPATED AS A NATURAL DEVELOPMENT OF ECONOMIC INTEGRATION. MEXICAN COMPANIES SOLICITING U.S. INVESTMENT, FOR INSTANCE, ALREADY PREPARE FINANCIAL STATEMENTS ACCEPTABLE TO U.S. INVESTORS.

9. U.S. LABORERS' UNION AND CTM TO COOPERATE ON ENVIRONMENT

BOTH THE LABORERS' INTERNATIONAL UNION OF NORTH AMERICA (LIUNA) AND THE CONFEDERATION OF MEXICAN WORKERS (CTM) WERE PLEASED AT THE RESULTS OF LIUNA PRESIDENT CORA'S EXPLORATORY VISIT TO MEXICO. LIUNA IS MOVING AHEAD WITH PREPARATIONS TO WORK WITH CTM AND OTHER MEXICAN CONSTRUCTION UNIONS TO IMPROVE TRAINING OF MEXICAN CONSTRUCTION WORKERS TO PARTICIPATE SAFELY AND WITH HIGH SKILL IN THE CLEAN UP OF MEXICO'S ENVIRONMENT, ESPECIALLY ALONG THE BORDER, AS WELL AS IN HIGHWAY CONSTRUCTION, MINING, ETC. CTM PRESIDENT FIDEL VELASQUEZ WELCOMED THIS COOPERATION AND DESIGNATED DEPUTY INTERNATIONAL RELATIONS SECRETARY HECTOR SAN RAMOS, A MEDICAL DOCTOR WITH OSHA EXPERIENCE, TO FACILITATE AND COORDINATE THE COOPERATION.
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THE WHITE HOUSE

WASHINGTON

**FAX FROM THE OFFICE OF
THE DEPUTY DIRECTOR OF COMMUNICATIONS**

TO: Laura Tyson

FAX: 6958

FR: **Rahm Emanuel**

Carola McGiffert

PH: **202-456-2531**

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MESSAGE:

These questions may be brought up tomorrow.

Thanks.

NAFTA

NATIONAL GOVERNORS' ASSOCIATION

Carroll A. Campbell Jr.
Governor of South Carolina
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Howard Dean
Governor of Vermont
Vice Chairman

Raymond C. Scheppach
Executive Director

Hall of the States
444 North Capitol Street
Washington, D.C. 20001-1512
Telephone (202) 624-5300

December 6, 1993

Ambassador Mickey Kantor
U.S. Trade Representative
600 17th Street, N.W.
Washington, D.C. 20507

Dear Mickey:

Congratulations on the recent NAFTA win. As you know, Governors strongly supported that agreement and worked with you and the President to get it passed. We also were pleased to successfully address several state concerns regarding implementation of the NAFTA package. Many of those same concerns, as well as others, apply to the current Uruguay Round GATT negotiations in Geneva.

On behalf of the nation's Governors, I commend the efforts of the administration to conclude a comprehensive and substantive multilateral trade agreement that lowers worldwide trade barriers and establishes new rules for services and agriculture trade. We have advised the U.S. negotiators for several years about the state perspective, and wanted to take the opportunity to remind you of several items as you prepare to conclude the Round this month.

1. **As with NAFTA, we seek clarification that states are not precluded from setting higher environmental, health, and safety standards than federal and international minimums.** We understand and agree that a scientific basis must be used for developing new standards. We know that USTR has been working with environmental groups to modify certain provisions to clarify that U.S. standards will not be reduced by GATT. We hope and expect that this stipulation will apply to all levels of government, so that states can continue to set standards that effectively protect their citizen. Certainly, at least the NAFTA language in this area should be used, and a stronger statement would be preferred.

2. **The states should have a clear and direct role in GATT dispute settlements involving state laws.** Because of the automaticity features being put in place regarding GATT panel decisions, and because of the likelihood that state laws will be challenged under GATT in the future, we are concerned that states have adequate access and participation in the dispute settlement process. States have the sole or predominant responsibility within our federal system for such activities as: regulation of services, provision of economic development and other subsidy programs, development of environmental and safety standards, and attraction of foreign investment. It is essential that states, particularly in these areas where they have the expertise and the responsibility, have a direct role in developing and defending the U.S. position when a state law is challenged by a GATT party.

7. We continue to applaud the approach taken by USTR to achieve voluntary state commitments to the GATT Government Procurement Code. The process of obtaining individual state commitments has been an opportunity for improving mutual understanding between the federal government's trade policy officials and the Governors. We believe that lessons learned in this exercise can serve to further the emerging federal-state relationship regarding trade policy matters. We hope you will consider a mechanism for allowing additional states to join the code voluntarily at a later date, so that the United States can continue to expand access to procurement markets abroad.

8. The mechanism for federal-state coordination set out in NAFTA should stay in place and even be enhanced under GATT. Both GATT and NAFTA represent the beginning of a new era for federal-state relations. We applaud the designation of a NAFTA coordinator for state matters and pledge to work with your office to ensure that this new trade policy partnership between the federal government and the states is strong and effective. Of course, GATT, with its additional provisions and requirements, will demand even closer coordination and communication.

In conclusion, we wish you well in your efforts to finalize the Uruguay Round. We stand ready to advise you and the other negotiators on the above matters as you approach the final days of talks. Please do not hesitate to contact me if you have questions or comments. Your staff may also reach Ms. Jody Thomas of the NGA staff at (202) 624-7824.

Sincerely,

Tommy G. Thompson

Governor Tommy G. Thompson of Wisconsin
Lead Governor on International Trade

THE PRESIDENT HAS SEEN 11/30 Matthew

■ COMMENTARY

GS/Laura/Bob R – can't let this happen

NAFTA: An empty victory?

Bill Clinton won the contentious battle with Congress last week, but the president could end up losing the global war for free trade

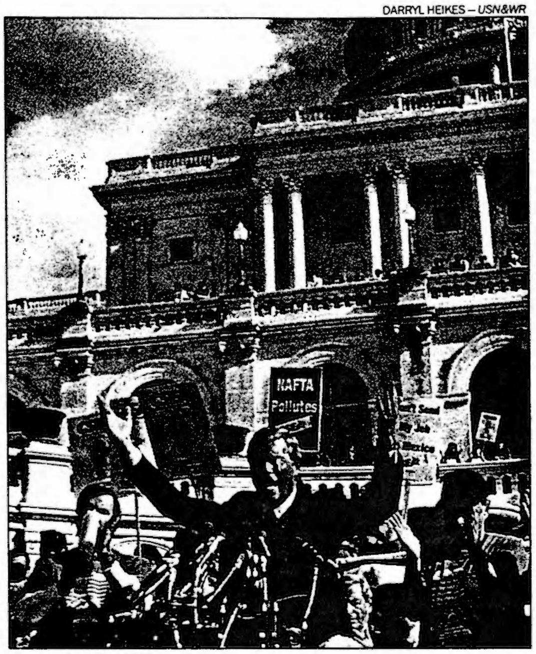
In ancient times there was a king named Pyrrhus who fought a long war against the Romans. Pyrrhus won all of the battles, but he lost so many men in the process that in the end it was the Romans who won the war. Ever since, a pyrrhic victory has meant a victory won at such cost that it is hardly better than a defeat.

Last week's NAFTA vote was a great victory for Bill Clinton and for free trade against protectionism. But was it a victory that left the free traders weaker than they were before? In particular, did the administration sell the agreement in a way that mortgages the future of U.S. trade policy?

One concern, of course, is the extent to which uncertain votes were swayed by special deals. By making concessions to lobbies for sugar, citrus fruit, winter vegetables and cut flowers, the White House bargained away some of the economic benefits of NAFTA. But the biggest worry for many free traders is their feeling that the trade agreement with Mexico will aggravate future trade tensions with other countries because of how it was marketed.

Those who fret about the aftershocks of the NAFTA debate are disturbed not so much by the arguments of its opponents—there have always been people like Ross Perot, and their arguments haven't changed much over the past 200 years—as by the arguments of its supporters. Unfortunately, the administration made a basically dishonest case for NAFTA and that dishonesty could come back to haunt the United States.

DARRYL HEIKES – USN&WR



NAFTA foe. *Rep. Richard Gephardt rallies troops.*

Boosting productivity. The real economic case for NAFTA is that it will increase the efficiency of the North American economy. With free trade the United States and Mexico will be able to restructure their economies in order to concentrate on the things they do relatively well. America will focus on those industries in which it has a huge productivity advantage over Mexico, like computers; Mexico will concentrate on those industries in which the productivity gap is smaller, like clothing. This industrial restructuring will raise the average productivity of workers in both countries. The number of jobs won't change much, but higher productivity will mean that on average workers will earn more on both sides of the Rio Grande.

Alongside this economic argument is a powerful foreign-policy concern: A rejection of NAFTA would have had devastating effects on the pro-market, pro-American reformers who now run Mexico, and it would have signaled the world that America was no longer willing to stand for open markets.

These economic and political arguments make a compelling case for NAFTA. But this wasn't the case that the White House made. How, then, did the administration sell NAFTA? By making two arguments that embarrassed many of the agreement's supporters and angered many of our allies.

First, the White House sold NAFTA as a jobs bill. It claimed that the agreement would create hundreds of thousands of jobs, because Mexico would buy more from the United States than it would sell in return. This is a mercantilist point of view: Exports are good, imports are bad. That sounds fine when applied to Mexico, which has run a trade deficit with the United States in recent years. But is international trade really a struggle over jobs, which you win only if you run a surplus? If those are the rules of the game, then brace yourself for trade wars with Japan, which runs persistent surpluses with the United States, and with the European Community, which runs persistent deficits in its trade with America and has plenty of protectionists of its own.

Second, in the last desperate weeks of the NAFTA campaign, the administration began claiming that the trade agreement was a competitive weapon against America's rivals. Lee Iacocca appeared in TV commercials, urging people to support NAFTA because the Japanese and Europeans supposedly don't like it. The president himself raised the specter of a rejected Mexican president receiving an emissary from Japan who would cut an alternative deal. Maybe members of the administration believed this fantasy, maybe they just thought it was smart politics. But the Japanese were furious at once again being portrayed as economic bogymen. Both Japan and Europe now fear that NAFTA will mean more—not less—U.S. protectionism against the rest of the world.

What happens next is up to President Clinton. He can start re-educating the American public by using international forums—like the Pacific Rim summit in Seattle—to explain that international trade is good for everyone, not just the countries that run trade surpluses. And he can repair the damaged relations with our trade allies by pressing hard for a successful completion of the General Agreement on Tariffs and Trade negotiations before the deadline on December 15. If Clinton doesn't change the dialogue on trade—if the debate over NAFTA is the way that trade policy will be handled from now on—then this victory for free trade will turn out to be the beginning of its defeat. ■

BY PAUL R. KRUGMAN

EXECUTIVE OFFICE OF THE PRESIDENT

COUNCIL OF ECONOMIC ADVISERS

WASHINGTON, D.C. 20500

THE CHAIRMAN

October 8, 1993

MEMORANDUM FOR STEPHEN SILVERMAN

FROM: LAURA D. TYSON

SUBJECT: NAFTA

On Tuesday, October 5, I delivered an address (via satellite) to The University of Maine's Governor's 20th Anniversary Economic Development Conference. In my comments on the Administration's overall economic strategy, I spent considerable time on NAFTA both in general and as it benefits Maine.

GEORGE J. MITCHELL
MAINE

I spoke about NAFTA at the event.

United States Senate
WASHINGTON, D.C. 20510

October 1, 1993

The Honorable Laura D'Andrea Tyson
Chair, Council of Economic Advisors
OEOB Room 314
Washington DC, 20500

Dear ~~Dr. Tyson:~~ Laura

I wanted to express my sincere thanks for your participation in the University of Maine's Governors' 20th Anniversary/Economic Development Conference.

The University of Maine serves all of Maine by making opportunities like this possible. Your willingness to be a part of this program enables more individuals to become educated on the economic issues of today.

Again, your participation is greatly appreciated.

With best wishes,

Sincerely,

George

George J. Mitchell

Thanks!

NAFTA and Southern California

Office of the Assistant Secretary for Economic Policy, U.S. Treasury
Council of Economic Advisers, Executive Office of the President

November 11, 1993

Summary

California's exports to Mexico amount to more than 15 percent of U.S. total exports to Mexico. The bulk of these exports come from southern California, which has extremely close economic ties with Mexico. Southern California will see more than its proportional share of the benefits from expanded trade with Mexico as a result of NAFTA. Perhaps the most significant effect of NAFTA on the economy will be realized through reduced migration into California. Expanded employment opportunities in Mexico as a result of NAFTA are the best way to reduce illegal immigration from Mexico. Such a reduction in potential labor competition could significantly raise the wages and improve the opportunities of low-wage southern Californians.

Southern California's Exports to Mexico

California firms and workers exported $6.6 billion worth of products to Mexico in 1992. $6.4 billion of these exports were manufactured goods. These exports represent a threefold increase compared to five years ago, when Mexico began its successful program of economic reform and trade liberalization.

California provides more than 15 percent of Mexico's purchases of U.S. goods. Southern California is a region very well-positioned to benefit from an expansion of trade with Mexico.

The Los Angeles area is the major manufacturing center of California and the nation: no county in the United States has more manufacturing jobs than Los Angeles county, which accounts for nearly half of California's manufacturing jobs.

Table 1: California's Top 10 Industries Exporting to Mexico in 1992

Industry	1992 Value (Millions)
Electric and Elect. Equipment	$1,497
Indus. Mach. and Computers	1,036
Transportation Equipment	390
Fabricated Metal Products	345
Primary Metal Industries	340
Food Products	315
Rubber and Plastic Products	296
Lumber and Wood Products	288
Scientific and Measuring Instruments	279
Refined Petroleum Products	276
Industries Not Shown	1,494
TOTAL	$6,557

The Administration has estimated that California's exports to Mexico support roughly 90,000 jobs. More than three quarters of the jobs supported by California exports to Mexico are in southern California, and more than half of these jobs are in Los Angeles county.

The jobs supported by exports to Mexico are for the most part in high-wage, high-skill, capital-intensive industries. According to the 1990 census, the seven of these industries that provided the largest net exports to Mexico employed more than 400,000 workers in the Los Angeles area:

- 106,111 in fabricated metals.
- 98,717 workers in industrial machinery.
- 63,700 workers in rubber.
- 62,764 workers in food processing.
- 35,704 workers in chemicals.
- 26,396 workers in steel and metals.
- 23,939 workers in paper.

In 1992 the net exports to Mexico of these industries amounted to $11 billion nationwide.

The expansion of trade with Mexico over the past five years has favorably shifted the demand for southern California's workers, increasing employment opportunities for workers in California.

Future Changes in Trade with Mexico

A failure to implement NAFTA could lead to a sharp drop in trade with Mexico, reducing exports and export-related employment.

In the absence of NAFTA, even if the Mexican government remains wholeheartedly committed to its policy of reform, Mexico will be unable to maintain its current pace of purchases from the United States. Without NAFTA, Mexicans will be unable to borrow at favorable terms on the world capital market. Their balance of trade will have to adjust. Their purchases of U.S. exports will fall.

The Wharton forecasting group has projected that failure to implement NAFTA will reduce U.S. annual exports to Mexico by $35 billion by 2003. According to their forecast, failure to implement NAFTA will raise the U.S. unemployment rate in 2003 by 0.3 percentage points.

Were trade with Mexico to shrink back to 1987 levels, 70,000 California workers—approximately three-quarters of them in southern California—would lose their jobs. Given the current high level of structural unemployment in southern California, many of these workers would have great difficulty finding other employment.

Those that did would be highly unlikely to find jobs that paid as well as those in the relatively high-wage manufacturing industries that make up the backbone of California's trade with Mexico. The rise in California's unemployment rate might well be significantly higher, and would certainly not be lower, than the 0.3 percentage point rise in the national unemployment rate projected by Wharton.

If NAFTA and President Salinas' other reforms succeed in boosting Mexican growth, and if under NAFTA the United States—and California—hold onto their share of the Mexican market, then by 2010 California producers would export approximately $20 billion a year to Mexico, of which over $15 billion would come from Los Angeles.

Such a flow of exports to Mexico would support approximately 200,000 jobs in southern California. It would amount to 2.3 percent of California's gross state product. And once again, such export-supported jobs would pay higher wages than alternative employment.

Los Angeles Apparel and NAFTA

Many critics of NAFTA fear that it will cause substantial job dislocation. Even though NAFTA will produce more and higher-wage jobs in the United States, critics fear that those who benefit will be a different group from those who see their employment opportunities restricted as a result of Mexican competition.

This Administration is concerned with job dislocation and is investing substantial resources in labor-dislocation adjustment and through the creation of the North American Development Bank to ensure that economic change benefits all.

But more importantly, a number of considerations suggest that fears of large-scale job dislocation in southern California as a result of increased imports from Mexico are overblown.

Consider the apparel industry, a relatively low-wage industry and the largest non-durable manufacturing industry in southern California. Economists Raul Hinojosa (from UCLA), Sherman Robinson (from U.C. Berkeley), and Goetz Wolff (an economic consultant) have examined the likely impact of NAFTA on the apparel industry in Los Angeles in a study partially supported by the Southwest Voter Research Institute.[1] They find that the Southern California apparel industry—a relatively low-wage and labor-intensive industry—is unlikely to be a locus of U.S. job dislocation under NAFTA.

They find that the Los Angeles and Mexican segments of the apparel industry are complementary—as shipments of Mexican apparel to California have increased, so have shipments from California to Mexico: the industries appear to increase demand for each other's products rather than competing with each other.

The study showed that the quality of Los Angeles-area apparel was significantly better in Los Angeles than in Mexico. And the nature of the apparel industry in Los Angeles places a strong premium on its remaining in the United States: Los Angeles is the style and marketing center for the nation in the fast-changing women's sportswear and casual wear market segment.

Thus the Los Angeles apparel industry requires those close linkages between design, production, and marketing, which encourage the clustering of the industry in Los Angeles.

Note that the Los Angeles apparel industry now accounts for nearly ten percent of all apparel employment in the United States, and for 22 percent of employment in women's wear. Apparel is one of the largest industries in Los Angeles, accounting for almost 100,000 on-the-books employees and for nearly one-third of total non-durable manufacturing employment in Los Angeles.

California Electronics and NAFTA

The UCLA study also examined the southern California electronics industry, and concluded that there will be no significant change in the location of electronics production as a result of the NAFTA. There have been major structural shifts in electronics in the 1980s. The electronics industry employment segments that remain in the United States today are the high-wage, high-skill, high-value segments in which Mexico is relatively uncompetitive.

NAFTA will make locating in Mexico somewhat more attractive relative to trans-Pacific economies. Electronics jobs that migrate back across the Pacific to Mexico will boost high-wage electronics employment in the U.S. Electronic components assembled in Asia are likely to have been produced in

[1] In an October, 1992 study for UCLA's Lewis Center for Regional Policy Studies.

Japan, while components assembled in Mexico are much more likely to have been produced in the United States.

Migration and NAFTA

Southern California is the recipient of an extremely large flow of undocumented migrants from Mexico. Half of all Mexican migration to the United States is migration to California. The Tijuana-San Diego area is the source of the largest legal flow of cross-border traffic, and is the source of an estimated one-quarter of undocumented migration as well.

This continued inflow of migrants to California inescapably puts downward pressure on the wages of low-income Americans in southern California. With NAFTA, increased Mexican economic growth would diminish migration from Mexico and increase the employment rate and wages of a significant number of Californians with low incomes.

All studies indicate that NAFTA, by increasing growth in Mexico, will retard undocumented migration from Mexico to the United States in the long run.

In recent testimony, Raul Hinojosa reviewed the evidence and concluded that even in the short run "NAFTA-Plus" [with the side agreements attached] will reduce pressure for Mexicans to migrate illegally to the U.S. He testified that the defeat of NAFTA would be "the worst option in terms of increasing...pressure for undocumented migration to the United States."

The Wharton study cited earlier estimates that, if NAFTA is not implemented, gross undocumented migration will be higher by 594,000 in an average year over the next decade.

The fundamental reason that so many Mexicans have migrated to the United States over the past several decades is the lack of employment opportunities in Mexico.

The greatest impact of NAFTA will be to increase wages and economic growth in Mexico: the Wharton study estimates that Mexican real GDP and Mexican wage levels will be fifteen percent higher in a decade if NAFTA is implemented than if NAFTA is rejected.

A richer Mexico will reduce pressure on Mexicans to migrate. More attractive employment opportunities in Mexico will pull some migrants back across the border, and will make others decide not to move to the United States in the first place.

This will, in turn, increase the incomes of low-wage workers in the U.S. by reducing competition for jobs from undocumented immigrants. The effects of diminished migration are likely to be felt most strongly and immediately in southern California, and the increases in the incomes of low-wage Americans produced by a reduction of migration pressure will be greatest in southern California as well.

Note that NAFTA does nothing to relax or weaken U.S. immigration law or border immigration control policies. But we must recognize that it has been, and will continue to be, very difficult to stop undocumented migration across the 2,000 mile border.

The best way to reduce this undocumented immigration—and eliminate pressure on the wages of low-income Californians—is to increase the productivity of the Mexican economy through NAFTA.

FACSIMILE TRANSMISSION

Date: November 10, 1993

To: Council of Economic Advisors
Attn: Dr. Laura Tyson, Chair

From: ABN AMRO BANK N.V.
San Francisco International Branch

Fax Number: 202 395-6947 (Alice Williams)
Telephone: 202 395-5042

Reference Number: 026100

Re: NAFTA

Laura,

FYI, attached are letters which we were asked to sign by our senior management. We hope it helps!

Best personal regards,

Carol

Carol Levine
Vice President
(415)984-3721

Telex: 278137 (ABNSF UR)
Telefax: (415) 362-3524

Authorized by: Cal

NUMBER OF PAGES TO FOLLOW: 3

IF YOU HAVE NOT RECEIVED THIS MESSAGE IN GOOD ORDER, PLEASE CONTACT SENDER IMMEDIATELY.

ABN·AMRO Bank N.V.

San Francisco International Branch
555 California Street, Suite 2750
San Francisco, California 94104-1603
Fax: (415) 362-3524
(415) 984-3700

November 5, 1993

The Honorable Dianne Feinstein
United States Senate
Washington, DC 20510

Dear Ms. Feinstein:

On behalf of ABN AMRO Bank N.V. with 50 employees in California, I am writing to you to urge your active support for the North American Free Trade Agreement (NAFTA). I strongly believe that enactment of NAFTA will create new jobs and spur economic growth in both California and the United States.

A ratified NAFTA will:

Create more US jobs. NAFTA will boost demand for US products in Mexico, creating an estimated 200,000 new export-related job opportunities over the next two years.

Preserve the more than 700,000 US jobs that already depend on exports to Mexico. Without NAFTA, Mexico may retreat from its new open-market policy and many of these jobs would be lost.

Increase America's ability to compete in world markets. Under NAFTA, the US will have a significant edge over European and Asian products in the rapidly-growing Mexican market. This advantage will grow as the free trade area is expanded to include Central and South American nations. Moreover, with a new strategic alliance with Mexico and Canada, the US will be poised to compete more effectively in the global marketplace.

Strengthen my company and the opportunities available to the American work force.

I firmly believe that NAFTA will be a boon for the United States and for California. I hope that you will support NAFTA implementation legislation.

Sincerely,

Carol A. Levine

Carol A. Levine
Vice President

ABN·AMRO Bank N.V.

San Francisco International Branch
555 California Street, Suite 2750
San Francisco, California 94104-1603
Fax: (415) 362-3524
(415) 984-3700

November 5, 1993

The Honorable Barbara Boxer
United States Senate
Washington, DC 20510

Dear Ms. Boxer:

On behalf of ABN AMRO Bank N.V. with 50 employees in California, I am writing to you to urge your active support for the North American Free Trade Agreement (NAFTA). I strongly believe that enactment of NAFTA will create new jobs and spur economic growth in both California and the United States.

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Carol A. Levine

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Vice President

ABN·AMRO Bank N.V.

San Francisco International Branch
555 California Street, Suite 2750
San Francisco, California 94104-1603
Fax: (415) 362-3524
(415) 984-3700

November 5, 1993

The Honorable Nancy Pelosi
State Capital
Sacramento, CA 95814

Dear Ms. Pelosi:

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Sincerely,

Carol A. Levine

Carol A. Levine
Vice President

ILLINOIS NAFTA RALLY

North American Free Trade Agreement

203 N. LaSalle • Suite 1630 • Chicago • Illinois • 60601 • 312/853-3131

VIA FACSIMILE

TO: C.E.A. Chairman Laura Tyson
c/o Alice Williams. (202)395-6958

FR: LISA COCHRAN LEINENWEBER
DEIRDRE MANNA
AGENDA COMMUNICATIONS
PH: 312/853-3131
FX: 312/853-0955

RE: NOVEMBER 12, 1993 CHICAGO NAFTA RALLY

For your information, attached is an update on the rally to be held in Chicago, next Friday, November 12 at noon.

The site has been finalized. The lobby of the Chicago World Trade Center, (formerly the Merchandise Mart Plaza), was selected.

We have heard from several people their concerns about opposition and the ability to draw crowds. We are confident the indoor site which was chosen will address these concerns.

Over the past few weeks, Agenda Communications has been working with the Illinois NAFTA corporations about employee participation. Currently, we have commitments from several corporations to bus employees to the site. Students and small businesses have been contacted and we have commitments from hundreds of people.

In terms of security, passes have been printed and distributed to all the corporation sponsors. Security will be placed around Center to ensure our 2,000 corporate NAFTA supporters are placed in the lobby where the rally will be held. The North Lobby, where video screens will be projecting the rally, will handle any overflow. Over 32,000 workers and visitors walk through the Chicago World Trade Center on a daily basis.

If you have any questions, please do not hesitate to contact Agenda Communications.

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Illinois NAFTA presents...

THE SAY "YES" TO NAFTA RALLY

NORTH AMERICAN FREE TRADE AGREEMENT

Held just 5 days before Congress votes on NAFTA, this rally will be our final push to show public support for the North American Free Trade Agreement!

Date: Friday, November 12, 1993

Time: Noon to 1:00 p.m. (arrive at 11:30 a.m.)

Place: Chicago World Trade Center (Lobby, Merchandise Mart) Our indoor location will enable us to oversee who enters the rally.

Crowd: Large corporations, small businesses, and schools in Illinois are busing hundreds of pro-NAFTA workers and students in for the rally. Rally passes have been prepared to identify our guests and participants.

Security: The Illinois NAFTA Rally Security Team will work with the Illinois State Police and Chicago Police to ensure a safe and secure environment to root for NAFTA .

Media: Extensive national media coverage is expected.

Support: We are circulating pro-NAFTA petitions and sending letters to members of the Illinois Congressional Delegation to demonstrate public support for NAFTA.

If you have any questions, please contact Agenda Communications (Illinois NAFTA Rally) at 312/853-3131.

POTENTIAL COSTS OF THE NORTH AMERICAN FREE TRADE AGREEMENT

STAFF STUDY

PREPARED BY THE STAFF OF THE JOINT ECONOMIC COMMITTEE

DAVID R. OBEY
CHAIRMAN

NOVEMBER 1993

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POTENTIAL COSTS OF THE NORTH AMERICAN FREE TRADE AGREEMENT

SUMMARY

As the debate over on the North American Free Trade Agreement (NAFTA) intensifies prior to the upcoming Congressional vote on the agreement, there is much controversy over how much NAFTA might cost American taxpayers, and how to pay for those costs.

There are two aspects to the debate on NAFTA-related costs: direct implementation costs over five years, and longer-run costs over the next decade. Implementation costs involve the budget offsets that must be found for lost tariff revenue and other costs associated with the NAFTA implementing legislation. The Administration has estimated these direct costs at approximately $2.7 billion over five years, largely for lost tariff revenues.

The second set of costs are the total NAFTA-related costs over the next decade. Although these costs are not dealt with directly in the implementing legislation, they should be considered when the NAFTA decision is made. These costs include further tariff losses, training and income support for worker dislocation, and environmental and infrastructure costs.

This report presents the results of a Joint Economic Committee (JEC) staff review of both sets of costs. The review finds that direct implementation costs over the next five years may be $868 million more than the Administration estimates. And total NAFTA-related costs that might have to be paid from the federal budget in three areas—lost tariff revenues, programs for dislocated workers, and environmental and infrastructure costs on the U.S. border—could require the Federal Government to come up with $20.1 billion over the next decade.

Implementation Over the Next Five Years Could Cost 30 Percent More Than Administration Estimates

There are two reasons that the five-year implementation costs could be higher than the Administration estimates: an additional loss of tariff revenues of up to $700 million and a lack of resources for all of the proposed U.S. contributions to the new North American Development Bank (NADBank).

Tariff losses are estimated by the Administration at approximately $2.5 billion over four years. But the basis for this calculation may understate potential lost revenues, by understating the current trend in Mexican imports to the U.S.

The $2.5 billion figure is consistent with about a 7 percent growth rate in Mexican imports; as tariffs fall, the revenues from those imports would be lost. But the actual growth in nonoil imports from Mexico is much higher, and the growth over the next five years could easily be 14 percent.[1] If this historical trend in Mexican imports continues over the next five years, then lost tariff revenues could reach $3.2 billion, 30 percent higher than current estimates.

Another implementation cost is the proposed NADBank, which would cost the U.S. $224 million in direct contributions over the next five years. But the United States is currently $819 million in arrears to international financial institutions, making it difficult to see where the new funds will come from. The implementing legislation does allow for the first year's contribution of $56 million, but the subsequent three years are not funded,

[1] This is the recent historical trend, without NAFTA.

meaning that $168 million for the NADBank is not paid for in the Administration's proposal.

Finally, the approximately $140 million, around $28 million annually, allocated for dislocated workers seems extremely low. But this underestimate is not included in the five-year calculations, because the additional costs of the dislocation programs were not required as part of the implementing legislation. A full critique and alternative cost projections are presented below, in the discussion of potential ten-year costs, but it should be noted that the Bush Administration was calling for $335 million annually for NAFTA-related dislocations, twelve times what the current implementation proposal calls for.[2]

Costs Over The Next Decade Could Reach $20.1 Billion

Beyond these problems with the five-year implementation costs, the potential unmet costs related to NAFTA in three areas—lost tariff revenues, and new spending needed to pay for worker dislocation and environmental and infrastructure costs could reach $20.1 billion in the next decade.

The JEC estimates are summarized in Table 1—full details for each area of concern are provided in the body of the report.

TABLE 1. POSSIBLE COSTS ASSOCIATED WITH NAFTA OVER THE NEXT DECADE

	10 Years[a]
Lost tariff revenues	$8.8 billion
Dislocated workers	$3.9 billion
Environmental and infrastructure gap	$7.4 billion
Total possible costs	$20.1 billion

a. These are gross estimated potential federal budget costs over a ten-year period; they do not take into account any proposed revenue offsets.

There are three reasons that NAFTA costs could reach this higher level.

*1. **Tariff losses***. The Congressional Budget Office (CBO) has estimated lost tariff revenue at $2.5 billion over five years, as tariffs are phased out on Mexican products entering the U.S. But, as discussed above, CBO may have underestimated this figure, by underestimating the growth in Mexican imports to the U.S. If imports from Mexico continue to grow in line with recent trends, then more tariff revenues will be lost. This loss could amount to $8.8 billion over the next decade.[3]

*2. **Dislocated workers.*** The Administration has proposed a "bridge" program for workers who lose their jobs due to NAFTA, budgeted at a projected total cost of approximately $140 million, or $28 million annually. This would provide services to only 5,175 workers displaced by NAFTA annually, or about 51,750 over ten years.

The program would be phased out if and when a new, future "comprehensive" program is implemented.[4] As noted above, this annual figure is far less than the Bush

[2] *Report of the Administration on the NAFTA and Actions Taken in Fulfillment of the May 1, 1991 Commitments*, September 18, 1992.

[3] Total tariff losses would rise in the second five years, as the cumulative effect of phasing out tariffs takes hold and the U.S. and Mexican economies grow.

[4] Of course, new revenues will still have to be found to pay for additional NAFTA dislocations that would be covered by this program.

Administration's proposal to reserve $335 million annually for NAFTA-related dislocations, twelve times the Administration's annual proposed budget.[5]

The JEC staff estimates that costs for an adequate program for NAFTA dislocations over the next decade could reach $3.9 billion. Three factors could drive up the costs of NAFTA dislocations to this level—greater job losses, higher *per capita* program costs, and providing funds to serve a higher percentage of dislocated workers.[6]

- *Total job losses:* The Administration is using a conservative figure to estimate possible job losses from NAFTA. A recent JEC staff review found that as many as 500,000 workers could lose their jobs due to NAFTA over the next decade. If more dislocated workers need services than the Administration is predicting, it will increase the costs significantly.[7]

- *Costs for each worker.* The Administration is using a modest per capita figure in estimating costs of dislocation. They estimate an average federal cost of $7,260 per participant for the "bridge" program, covering both training and income support. But earlier Department of Labor estimates for training and income support in the future "comprehensive" program are higher. Using those figures, an adequate full-year program could cost $12,940 per worker.

- *Serving a higher percentage of dislocated workers.* The implementation plan's figures suggest that a relatively low percentage of eligible workers will actually get training and income suport—around 26 percent of direct NAFTA dislocations.[8] But the average percentage of participants getting training in the current Trade Adjustment Assistance (TAA) program, on which the bridge program is modeled, is around 60 percent. Using that percentage will increase total costs. In addition, current proposals do not provide adequate funds for workers who lose their jobs due to indirect NAFTA impacts on the surrounding community and local economy.

3. Environmental and Infrastructure Costs. The Administration has estimated that approximately $8 billion over the next decade will be needed for specific environmental costs on the U.S.-Mexico border. The JEC staff has estimated that the direct environmental and highway costs could easily reach $11.3 billion, and that there is a potential $7.4 billion "financing gap" in meeting these costs over the next decade.[9]

This gap results from several factors.

- *Costs of Environmental Cleanup and Regulation.* The Administration figures do not account for the necessary cleanup of existing toxic and solid waste hazards, or for the future costs of environmental regulation. These costs could add an additional $800 million over ten years.

- *Costs of New Highways.* New highway construction and border crossing improvements will be needed to handle increased traffic for goods and people. These costs could easily reach $2.5 billion over ten years in the U.S.

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[5] See footnote 2.

[6] These are only direct program costs for NAFTA-dislocated workers. They do not include any compensation for the downward wage pressure that NAFTA may cause for employed workers, which could be over one percent of full-time manufacturing compensation.

[7] Joint Economic Committee staff report, "Potential Economic Impacts of NAFTA: An Assessment of the Debate," October 1993.

[8] Experience in some states, and the Administration's own earlier assumptions about the "bridge" program, suggest that an even higher rate could be used—around 90 percent.

[9] In some estimates, these financing gaps will be covered by an unspecified mix of private, state, and local spending. But if these sources are not forthcoming, then the federal budget may have to bear these costs, or the problems will not be resolved.

- *Financing Gaps.* The Administration hopes to have $2 billion available in financing from the NADBank, leveraged by a $224 million contribution from the United States. The Administration's plan does provide NADBank financing for the first year, but not for subsequent years. As noted earlier, the U.S. is $819 million in arrears to international financial institutions. If the full NADBank contributions are not provided, then the projected $2 billion in leveraged capital will fall short by $1.5 billion, adding to the financing gap. Even if the Administration persuades Congress to support the new bank, it will be hard to get further funds in later years, especially when the United States is behind in its obligations to existing international financial institutions.

The Total Costs of NAFTA

Although the debate over the costs of NAFTA has concentrated on an implementation cost of around $2.7 billion over five years, those five-year costs could be close to $900 million higher than projected. And the total costs that could fall on the federal budget over the next decade could reach $20.1 billion. These higher potential costs come mainly from higher estimated tariff losses, allowing for more comprehensive services to a higher number of dislocated workers, and a financing gap for environmental and infrastructure needs.

The estimates provided here are only for <u>direct</u> possible revenue losses or expenditures by the federal government. They do not include the total possible economic costs of NAFTA, especially the ripple effects on communities and workers indirectly affected by NAFTA job losses, or the potential wage and income losses due to increased downward pressure on U.S. wages, both of which are plausible outcomes from NAFTA. Adding estimates for these factors would add substantially to the total potential costs of NAFTA.[10]

Economists often defend free trade by saying that there are more winners than losers, and that some of the gains that might be won under free trade should go to helping the losers. But under current proposals, it does not appear that enough resources are being set aside to make up for lost tariff revenue, much less to adequately help the losers from NAFTA or correct the problems that it might cause. A failure to provide these resources breaks the implicit political bargain that underpins free trade—some percentage of the projected gains will be used to help the losers and address problems created by the agreement.

The remainder of this report provides detailed descriptions of the JEC staff calculations for tariff revenues, dislocated workers, and environmental and infrastructure needs.

[10] See the recent JEC staff report, "Potential Economic Impacts of NAFTA: An Assessment of the Debate", October 1993.

ESTIMATED TARIFF REVENUE LOSSES

Enactment of NAFTA will result in a loss of revenues to the U.S. Treasury because of the lower tariff rates on Mexican imports to the United States. CBO has estimated the net loss of revenue due to NAFTA at $2.5 billion for the 1994-98 period,[11] but JEC staff calculations show that the expected revenue losses could reach $3.2 billion, or $700 million higher over five years.

Further, JEC staff calculations find that tariff losses could accelerate in later years, leading to as much as $8.8 billion in lost tariff revenues over the next decade. The lower estimates of tariff losses understate the problem by understating the current likely trend in Mexican imports to the United States. Extrapolation from the actual trend produces the higher estimated tariff losses.

The Budget Act sets several important scorekeeping rules that come into play in estimating tariff losses from NAFTA. First, the estimate must take into account any changes in law already scheduled for the next five years, regardless of NAFTA, to establish a baseline.[12]

Second, according to the budget scorekeeping rules, early each year CBO must make projections for the next five fiscal years on several key measures of the overall condition of the U.S. economy. In making cost estimates for proposed legislation for the rest of that year, CBO takes its projections of GDP growth, unemployment, inflation and interest rates as fixed and not alterable by any subsequent proposed legislation. The scorekeeping rules do not require, however, that CBO ignore clear historical trends in microeconomic data that directly apply to the legislation under consideration.[13]

Despite the requirement of fixed macroeconomic assumptions, the microeconomic assumptions of the baseline revenue estimate—what would happen under current law—are important. The larger the amount of goods and services assumed to be imported from Mexico under current law and tariff structure, the larger the resulting loss of revenues as the effective tariff rate on these imports is cut under NAFTA.[14]

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[11] Congressional Budget Office, "CBO Estimates of Changes in Revenue and Direct Spending Associated with NAFTA, 1994-1998," November 4, 1993.

[12] Roughly one-sixth of imports from Mexico now enter duty free under the Generalized System of Preferences (GSP) program designed to assist developing countries such as Mexico. Since the GSP program is authorized only through the end of calendar 1994, an estimate of revenue losses under NAFTA must consider the potential additional baseline revenue that would come to the United States following an expiration of GSP.

[13] For example, in projecting GDP, CBO needs to consider the prospects for total imports, but not necessarily imports from specific countries. When it becomes necessary to focus on Mexico, the trend for Mexico need not match the total so long as the relationship is plausible. Indeed, it would be reasonable to assume that U.S. imports from Mexico might be raised by NAFTA, but it also would then be necessary to take account of the possibility that imports from other countries might be lower. These assumptions could still comply with the budget scorekeeping rule that the budget estimate for the legislation be consistent with the original GDP forecast—and that it not assume a net change in production or employment in the U.S. economy even though gross changes in imports or employment would be likely to occur.

[14] Of course, in the transition period when tariffs are falling but are above zero, the amount of customs duties collected is affected by offsetting factors: a decline in the tariff rate, but an increase in the volume of goods on which some tariff is paid. In principle, the duties collected could be unchanged or even rise. Note, however, that NAFTA is estimated to eliminate tariffs on 60 percent of dutiable goods in 1994 and on another 9 percent by 1998, with the tariff reductions accounting by then for about 85 percent of the value of tariffs under current law. Given the already low level as well as the steep decline in tariff rates, the possibility of substantial offsets to loss of customs duties resulting from an increase in the volume of imports is unlikely. First, the adjustment would have to be implausibly large and rapid. Estimates of the effect of NAFTA on trade are quite uncertain and responses large enough to have a noticeable effect on tariff revenues, at very low tariff rates, are dubious. Second, this offset would occur only if the increased imports of goods still subject to some (though a declining) amount of tariff were substitutes for domestically produced goods. Of course, some such substitution is likely. However, it is also likely that some increased imports from Mexico will be substitutes for imports from other countries that face higher U.S. tariffs. Increased imports from this source would actually result in a greater loss of customs duties than if the volume of imports were unchanged.

Taking the revenue losses as projected by CBO, one can impute the growth rate that CBO anticipated for imports from Mexico in the absence of NAFTA. They appear to have used a growth rate of about 7 percent. This rate is within a consensus range for U.S. imports from the world over the next five years, assuming CBO's baseline GDP forecast.

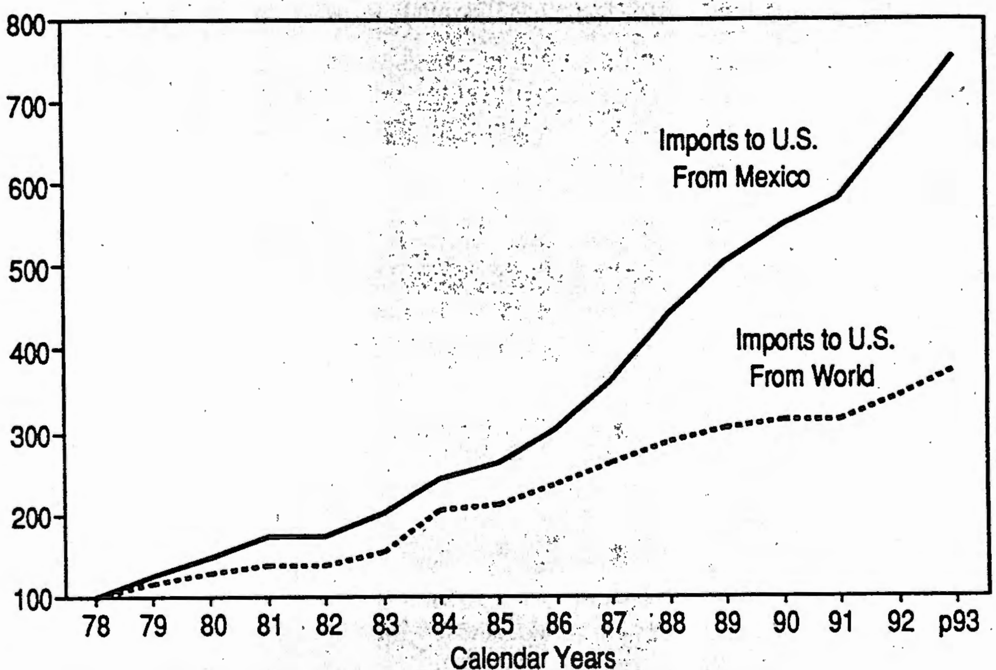
An assumption that U.S. imports from Mexico would grow at the same rate as imports from the world would be appropriate if past experience showed that they were growing at roughly the same rate. However, that is not the case. For the last fifteen years, U.S. imports from Mexico have grown much faster than imports from the world at large.

As Figure 1 shows, in the period from 1978 to date, U.S. nonoil imports from Mexico have dramatically outstripped imports from the world.[15] Although the growth rate of imports from Mexico varied from year to year, the increase exceeded total import growth from the entire world in 14 of the last 15 years.

FIGURE 1

Mexican Imports Have Grown Faster Than World Imports

Index, 1978=100



Source: Census Bureau data on merchandise trade (customs valuation).

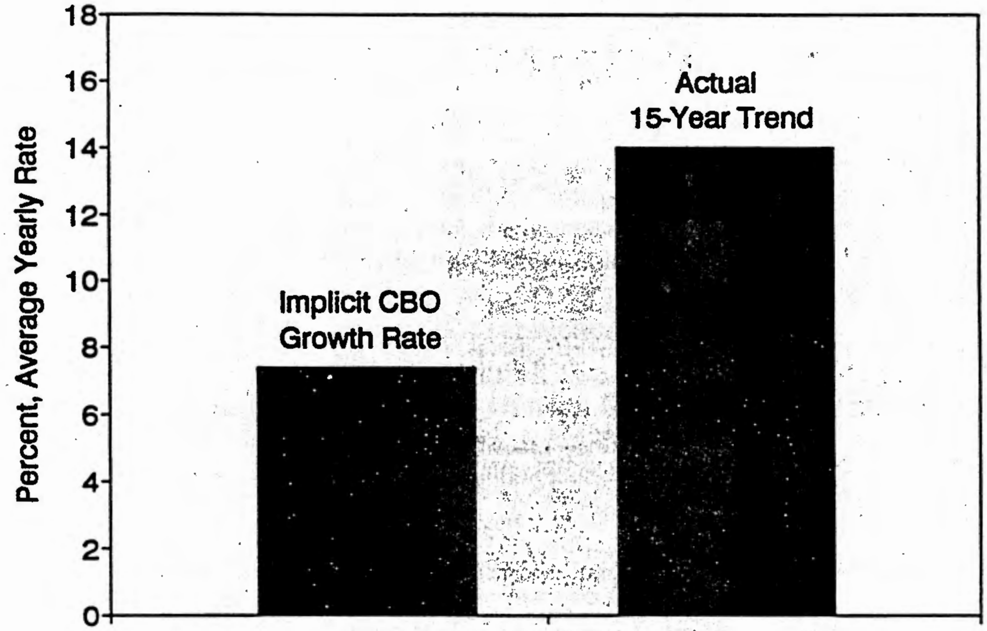
To assume that imports from Mexico will grow only at the rate of all imports, as CBO seems to do, ignores this historical evidence and results in a lower estimate of lost tariff revenues. As Figure 2 shows, using the actual historical growth rate for Mexican imports to the United States gives a much higher estimate—almost double the impact of using the total world growth rate.

[15] Source data for these calculations are the merchandise trade statistics from the Bureau of the Census, Foreign Trade Division. Because of accounting changes, data prior to 1978 are not directly comparable.

FIGURE 2

Projected U.S. Imports From Mexico

1992-1998



Source: JEC calculations; non-oil imports.

Total imports from Mexico would reach $70 billion by fiscal 1998 if they continue to increase at their 15-year trend rate, but only $51 billion if, as assumed by CBO, they slow down to roughly half that pace.

To understand the significance of the import growth rate on the revenue estimate, it is useful to consider FY1998. CBO has reported that NAFTA will reduce duties on imports from Mexico by about 85 percent by 1998.[16] Thus, NAFTA will lower the effective tariff rate on 1998 imports from Mexico by 1.8 percentage points.[17] Taking that difference in tariff rate times the almost $20 billion difference in CBO and JEC staff projections of 1998 dutiable non-oil imports from Mexico gives $350 million difference between projections of customs duty loss for that year alone.[18]

Using the same type of calculations for all five years of the budget projection period implies a total revenue loss from NAFTA of up to $3.2 billion—$700 million greater than the CBO estimate of $2.5 billion, as shown in Figure 3.

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[16] Congressional Budget Office, *A Budgetary and Economic Analysis of the North American Free Trade Agreement* (July 1993), p. 9.

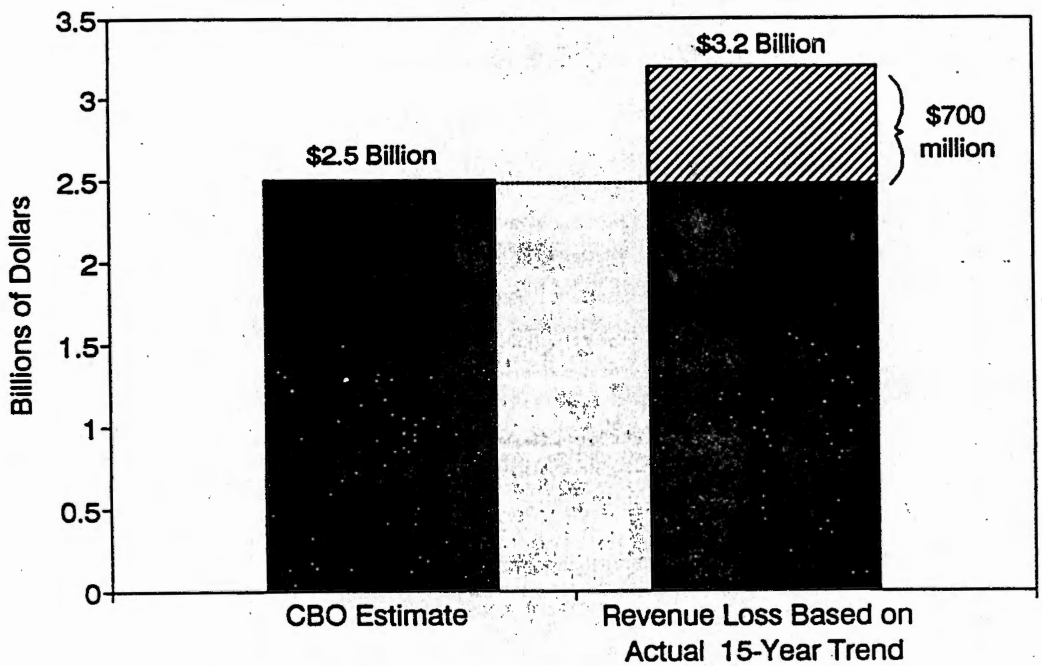
[17] The estimated effective tariff rate in FY93 is about 2.1 percent, calculated from estimated customs duties collected on imports from Mexico divided by estimated customs valuation of imports, adjusted for GSP goods.

[18] The effect on total revenues is only about three-quarters of that amount, about $260 billion, because some of the revenues are regained in higher taxes from other sources. Thus, instead of the $672 million in tariff revenue losses estimated by CBO for FY1998 based on a slow non-NAFTA growth rate, there could be losses of up to $930 million, with a projection of imports from Mexico at the fifteen year trend rate.

FIGURE 3

Historical Growth Rate Means Higher Revenue Loss

Fiscal Years 1994-98



Source: JEC calculations.

Extending the revenue loss for a 10-year period requires allowing for further growth in the annual loss from its amount in the fifth year, as the U.S. and Mexican economies grow, and allowing for the remaining phaseout of tariffs. By this estimate, the 10-year loss of tariff revenues to the United States plausibly could be as much as $8.8 billion.[19]

[19] No comparison is provided with CBO for the 10-year figure, as CBO does not provide such estimates.

NAFTA-RELATED JOB DISLOCATION AND PROGRAM COSTS

The Administration estimates that its "bridge" program for workers displaced during the first five years of NAFTA would cost about $140 million. This may underestimate the potential extent of displacement and the potential costs of programs aiding displaced workers. There are three factors that could increase spending: the numbers of workers displaced due to NAFTA; the length and cost of appropriate training; and the length and cost of income support.

1. Participants. The Administration estimate of workers displaced by NAFTA is taken from the CBO estimate of 200,000 displaced workers over ten years. However, this estimate is well below other plausible estimates cited in the JEC's recent study of NAFTA models, which concluded that 500,000 workers displaced due to NAFTA is "a realistic possibility."

As Table 2 shows, CBO reduces that pool from 200,000 to a projected 51,750 who will actually get training and income support. This is only 5,200 workers per year, or 26 percent of all workers who CBO estimates will be displaced due to NAFTA. Under these assumptions, 3 out of 4 NAFTA-displaced workers would not be covered.

TABLE 2. ESTIMATES OF TEN-YEAR COSTS FOR NAFTA-DISLOCATED WORKERS

	Estimate			
	Based on CBO		By JEC	
1. NAFTA-Related Dislocations	200,000		500,000	
2. Total Receiving Services[a]	51,570		300,000	
3. Annual Average Cost per Participant: Total	$7,263[b]		$12,940	
a. Training	$1,579		$ 5,200[c]	
b. Income support	$5,684		$ 7,740[d]	
4. Total Ten-Year Cost (line 2 x line 3)	$375	(million)	$3.9	(billion)

a. CBO assumes 50 percent of those displaced will be eligible for existing TAA. Of that 50 percent, 45 percent actually receive services; some will get income support and training, others will get only a shorter period of income support. Of the remaining 50 percent ineligible for existing TAA, CBO estimates that less than 7 percent will get services under the new provision relating to plant relocations to Canada or Mexico. JEC assumes that 60 percent of those dislocated will get full training and income support, which approximates the current experience under TAA, as cited by CBO.

b. Average of two groups, those receiving both training and income support, and those receiving only a shorter period of income support.

c. JEC assumes 52 weeks of training, based on the DOL draft "comprehensive program."

d. At current average level of $180 weekly average unemployment benefits, JEC assumes a federal share of income support of 43 weeks, with the balance paid by the regular state unemployment insurance program.

But around 60 percent of current TAA participants are in training. JEC uses this 60 percent figure to calculate possible numbers of program participants. Assuming a 60 percent enrollment rate for 500,000 dislocated workers, yields 300,000 trainees over ten years.

2. Length of training. The Administration "bridge" proposal calls for 39 weeks of training at a cost of $4000 for those actually getting training. But present Administration plans for the "comprehensive workforce investment strategy" to go into effect in mid-1995 anticipate an average length of training of 52 weeks. This corresponds closely to the median length of training in the current TAA program, which is 50 weeks. If this quality and quantity of training were to be used for the initial cohort of displaced workers under the bridge program, training costs per participant cost would be about $5,200.

3. Length of federal income support. The Administration bridge proposal assumes that around 30 of the 39 weeks spent in training would be covered under the bridge program financing. The first nine weeks would be supported by regular State UI, due to the requirement that workers enroll by the 16th week of their unemployment spell. If training is increased to 52 weeks, as outlined for the comprehensive program, then income support would be needed for 43 weeks, with a resulting increase in federal expenditures.

4. Potential costs for dislocated workers. As Table 2 shows, a higher total spending figure for NAFTA-dislocated workers than projected by the Administration results from considering these three factors: higher numbers and serving a greater percentage of dislocated workers, higher *per capita* program costs in training based on the Administration's own draft "comprehensive" program, and a higher amount of income support in order to allow for the full training period of 52 weeks.

Table 2 shows the range of possible costs. The weekly costs for training are taken from the Administration's figures, and applied to the 52 week training period anticipated for the new comprehensive program for all dislocated workers. If the program has to train 300,000 NAFTA-displaced workers over ten years, it could require total spending of $3.9 billion.

ENVIRONMENTAL AND INFRASTRUCTURE COSTS ON THE BORDER

1. Environmental Costs. The Treasury Department (Shafer, 1993) estimates that $8 billion is needed over 10 years for water supply, wastewater treatment, and municipal solid waste infrastructure on both sides of the border.[20] This is somewhat of a midpoint in estimates; other sources estimate between $6.5 billion and $14 billion over ten years.[21] It includes capital and operation and maintenance (O&M) costs necessary to control new flows of pollution.

However, it excludes cleanup costs due to wastes that have been improperly disposed of in the past. Cleanup costs in the border region, particularly on the Mexican side, are likely to be substantial due to inadequate pollution control over the last decade (AMA, 1990, Sanchez, 1990, GAO, 1991a, 1992). The Sierra Club (1993) has estimated the cleanup cost of municipal solid waste in the border region to be $114 million,[22] and the cost of hazardous waste cleanup to be $417 million,[23] giving the total estimated cleanup costs shown in Table 3 of $0.53 billion.[24]

The $8 billion figure does not include additional public sector costs for environmental regulation (monitoring, permitting, inspections, enforcement activities). The state of Texas has estimated these costs on its side of the border over the next 10 years. These costs include regulation for water supply, wastewater, solid waste, air quality, and hazardous waste.[25] Applying this estimate of regulatory costs to the U.S. population on the Texas border yields a per capita regulatory cost, which is then multiplied by the total border population for a regulatory cost of $219 million for the United States.[26] Another regulatory cost, the U.S. share of expenses for the Border Environment Cooperation Commission, estimated at $50 million over 10 years (Shafer, 1993), raises the total U.S. regulatory costs to $269 million.

As Table 3 shows, a conservative estimate of total 10-year environmental costs for the border region is $8.8 billion.[26]

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[20] It is often said that these costs are not directly attributable to NAFTA. However, they are a direct result of increased U.S.-Mexico trade and investment integration in the 1980s without concurrent increases in public infrastructure and environmental regulation.

[21] The U.S. Section of the US-Mexico Business Council (1993) and the Sierra Club (1993). The Council report estimates the capital costs of watersupply, wastewater, municipal solid waste, and hazardous waste infrastructure to be $6.5 billion over 10 years. The Sierra Club (1993) estimates that $14.0 billion is needed for watersupply, wastewater, municipal solid waste, hazardous waste, air quality, habitat conservation, and environmental management over 10 years.

[22] The Sierra Club (1993, p. 18) assumes that 20 percent of the municipal solid waste dumped informally in the last 10 years is recoverable and poses a threat to human health. The collection and disposal costs are $48 million. The Sierra Club assumes that 50 percent of municipal solid waste put in open air dumps is a threat to human health. The costs of removal and sanitary landfill is estimated to be $66 million. The total cost of cleanup of informal dumps and open air dumps is $114 million.

[23] The Sierra Club estimates the hazardous waste generation in the Mexican border region based on maquiladora exports to the US. An estimate of waste dumped illegally in 1991 is derived by using a state of Texas estimate of annual hazardous waste generation by maquiladoras of 40,000 tons less the 2,600 tons returned to the US. To determine hazardous waste dumped illegally since 1970, a constant ratio of maquiladora exports to hazardous waste dumping is assumed. This yields 200,832 tons of hazardous waste. Assuming that 1 ton of hazardous waste contaminates 16 tons of soil and that the cleanup cost of contaminated soil is $130 ton yields the total cost estimate.

[24] These costs exclude any cleanup costs of groundwater contamination and of sediments in surface waters. Since it is extremely likely that such contamination is present in the border region (Perry and others, 1990, National Toxic Campaign Fund, 1991), this estimate of cleanup costs is conservative.

[24] These costs are from the Spring 1993 draft of the Texas report, and only the Executive Summary of the Summer 1993 report is available. However, the Texas estimates of all environmental infrastructure costs are very close in the two reports.

[25] The U.S. regulatory cost estimated by the state of Texas is $59.349 million, and the U.S. population on the Texas border is 1,550,250 persons (EPA 1992, p. II-7). This yields a per capita cost for the U.S. of $38.28. This per capita estimate, multiplied by the total U.S. border population of 5,722,694 persons, yields the total regulatory cost.

[26] Some environmental costs are not included in the JEC estimate. For example, the estimated costs do not include

TABLE 3. ESTIMATED BORDER INFRASTRUCTURE COSTS (in billions of U.S. Dollars 10 years)

	Total Cost
Control of pollution flows:	8.0
Water supply	
Wastewater	
Municipal Solid Waste	
Cleanup of existing pollution:	0.53
Solid Waste	
Hazardous Waste	
U.S. Environmental Regulation[a]	0.27
Total Environmental Cost	8.8
U.S. Highways	2.5
Total Environmental and Highway Cost	11.3

Source: GAO (1991b), Shafer (1993), Texas (1993b), Sierra Club (1993), JEC calculations.

a. Includes new regulatory costs and U.S. expenses for Border Environmental Cooperation Commission.

*2. **Highway Costs.*** Highways are another type of border infrastructure that is directly related to increased trade and investment between Mexico and the United States. The vast majority of the value of U.S.-Mexico trade is transported via highways (Texas, 1993b), and the state of Texas estimates that $2.0 billion is needed over the next 10 years for existing and projected highway costs on the U.S. side of its border only. According to a GAO (1991) survey, the costs of accommodating current traffic levels and a doubling of border traffic in New Mexico, Arizona, and California would be $500 million; adding this to the Texas figure gives the total highway cost estimate of $2.5 billion shown in Table 3.

*3. **Estimate of Financing Gap.*** The total cost of $11.3 billion is shown in the first row of Table 4. According to the Treasury Department (Shafer, 1993), the U.S. and Mexican Governments have committed to $1.4 billion in grants for the border region ($700 million from each country). Mexico is also expected to receive $2 billion in new funding from the World Bank and the Inter-American Development Bank (IDB).

TABLE 4. FINANCING GAP FOR BORDER INFRASTRUCTURE (in billions of U.S. Dollars over 10 years)

1. Total Cost	11.3
2. Available Financing	3.9 to 5.4
3. Financing Gap	5.9 to 7.4

Source: Shafter (1993), JEC calculations.

In addition, the proposed North American Development Bank (NADBank) is expected to provide $2 billion in financing.[27] This will require a total of $450 million in paid-in capital ($225 million from each country).

the capital costs of air pollution control infrastructure and new construction of hazardous waste disposal facilities because they are paid for by the private sector. However, the internalization of these costs depends on effective public sector regulation.

[27] Up to 10 percent of NADBANK capital is for community adjustment and investment outside the border region.

But the source of the U.S. funding for capitalization of NADBank is highly uncertain, given that the U.S. is currently $819 million in arrears on commitments to international financial institutions. The Administration's proposal does allow for the first year's contribution to NADBank of $56 million, which is expected to leverage $500 million. But no financing is provided in the outyears.

If the Administration's financing assumption is accepted, and revenues to start NADBank are found in the outyears, then the maximum available financing is $5.4 billion (U.S. and Mexican government grants plus World Bank/IDB plus NADBank), as shown in the second row of Table 4. If NADBank is not funded beyond the first year, then only 25 percent of the additional $2 billion—$500 million—will be leveraged, leaving a $1.5 billion gap. The available financing will then only be $3.9 billion.

It may be difficult to find additional funds at a time when total discretionary spending may have to be cut substantially just to meet the budget caps already enacted. In addition, the United States is already behind on existing commitments to other international financial institutions.

The third row of Table 4 shows the financing gap for border infrastructure, a $5.9 billion gap if total NADBank financing is available and a $7.4 billion gap if further NADBank financing is unavailable. This gap would have to be met by a combination of private, Mexican, state and local, or U.S. federal funding.

It is likely that much, if not all, of this gap could have to come from the federal government. Little private financing may be available, because much of the activity to be financed will not generate revenues that would provide adequate returns to private investors. The Mexican government may not have additional funds, and economically disadvantaged U.S. communities like those on the border have had difficulty in the past in being able to afford loans for infrastructure such as state revolving loan funds.[28]

[28] Copeland, Claudia, 1993. *Clean Water Act Reauthorization,* Congressional Research Service Issue Brief 93013, p. 3.

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Joint Economic Committee Study Warns of $20 Billion "NAFTA Deficit"

New Analysis Finds that Long-Term Budget Costs of Free Trade Agreement Will Likely be Much Greater than Predicted

WASHINGTON, D.C. -- Congressman Dave Obey (D-WI), Chairman of the Joint Economic Committee, released a new JEC staff study today that calculates the potential budget costs of the North American Free Trade Agreement (NAFTA). The study finds that the total amount of NAFTA-related costs that would have to be paid from the federal budget over the next decade could reach as high as $20.1 billion. Additionally, the direct costs of implementing NAFTA over the next five years could be 30 percent higher than the current estimates being used by the Administration.

The new JEC study examines two separate considerations of future NAFTA-related costs. The first is a calculation of the budget offsets that must be found in order to replace lost tariff revenues and other costs connected directly to the NAFTA implementing legislation. The second is a prediction of the total NAFTA-related costs over the next decade -- including expenses that are not directly part of the implementing legislation such as further tariff losses, training and income support for dislocated workers, and environmental and infrastructure costs.

Five-Year Cost Differences

The Clinton Administration has estimated that the direct NAFTA implementation costs will be approximately $2.7 billion over a period of five years. But the JEC study finds that this figure is based on low tariff loss estimates and does not include the budget shortfall for the proposed U.S. contribution to the new North American Development Bank (NADBank). The Administration figure understates potential lost tariff revenues by as much as $700 million because it is not based on historical growth rates of Mexican imports to the U.S. The proposed NADBank would require U.S. contributions of $224 million over the next five years, but the current implementing legislation only includes $56 million of this total. Because the U.S. is already $819 million in arrears to international financial institutions, and that figure has more than doubled over the past fiscal year, it is difficult to see how this gap can be closed.

By combining the additional lost tariff revenues and the potential deficits in NADBank contributions, the JEC study finds that the total five-year costs connected directly to the NAFTA implementing legislation will be approximately 30 percent higher than the Administration estimate.

The JEC study also argues that the Administration allocation of $138 million, (28 million annually) for dislocated worker programs is extremely low, but this underestimate is not included in the JEC five-year calculations, because the additional costs of worker dislocation programs were not immediately required as part of the implementing

[more]

legislation. By contrast, the Bush Administration originally proposed $335 million a year for NAFTA-related dislocated worker programs, more than twelve times what is now being suggested.

Ten-Year Cost Estimates

The ten-year cost estimates of the JEC study are based on three significant factors -- further lost tariff revenues, additional dislocated worker program costs, and NAFTA related environmental and infrastructure expenses:

TOTAL BUDGET COSTS OF NAFTA OVER THE NEXT DECADE

Lost Tariff Revenues	$8.8 billion
Dislocated Worker Assistance	$3.9 billion
Environmental and Infrastructure Gap	$7.4 billion
TOTAL COSTS OVER TEN YEARS:	**$20.1 billion**

The $8.8 billion tariff loss estimate from the JEC study is based on the rate of growth of Mexican imports over the past fifteen years projected over the next decade. Three factors drive the cost for an adequate dislocated worker program to $3.9 billion -- the probability of greater job losses than expected, higher *per capita* program costs, and the cost of providing assistance to a higher percentage of affected workers than under current programs. The $7.4 billion in environmental and infrastructure costs represents a "financing gap" between available grants and loan funds and the likely costs for pollution control, border cleanup, and new roads and border crossings.

The JEC study cost predictions are conservative -- estimates are made only for direct possible revenue losses or expenditures by the federal government. The total social and economic costs of NAFTA could be even higher if other factors are considered, especially the ripple effects on workers and communities indirectly affected by NAFTA and the potential downward pressure on U.S. wages.

"My purpose in releasing this analysis is not to persuade anyone on how they should vote on NAFTA. My purpose is to make sure that members of Congress have a full understanding of what we will have to pay out of the federal treasury should NAFTA be passed," Obey remarked. "No one should vote for NAFTA unless they are prepared to cough up the money necessary to make all the promises a reality," he added.

"Many economists who have endorsed NAFTA have done so with the expectation that Congress will take sufficient action to mitigate the short and long term impact of the agreement, but it's my judgement that many of the same members of Congress who will vote for NAFTA on the 17th are simply not prepared to vote to appropriate the funds that are necessary to meet NAFTA's true costs," Obey said.

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