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POTENTIAL ECONOMIC IMPACTS OF NAFTA: AN ASSESSMENT OF THE DEBATE

STAFF STUDY

PREPARED BY THE STAFF OF THE
JOINT ECONOMIC COMMITTEE

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EXECUTIVE SUMMARY

As the nearly 3-year debate over the merits and possible consequences of NAFTA comes to a close, both proponents and opponents of the agreement have cited numerous economic studies to support their arguments. Too often, proponents and opponents on both sides of the debate have been overreaching when they use these studies.

For example, last week the Office of the Special Counselor to the President for NAFTA issued a statement claiming that "nineteen of twenty comprehensive studies" indicated that NAFTA would produce positive results for the United States. But the math in that conclusion is seriously flawed, including double counting some studies, and excluding others. This biases their results towards a one-sided view of these studies. (A full explanation of the difficulties follows the section entitled "List of Models in JEC Report," which comes after the Summary.)

Need response — what is the justification for our list.

In order to clarify the use of these studies for public debate, the staff of the Joint Economic Committee (JEC) has analyzed sixteen major NAFTA economic impact studies. In determining which studies to include, the JEC staff analyzed the largest predicted aggregate impact on the U.S. economy reported in each of the sixteen studies. Ten claim generally favorable or neutral outcomes from NAFTA, while six reach mostly negative conclusions about the potential impact of NAFTA on the U.S. economy and labor force.

Although some NAFTA proponents have used the preponderance of supposedly positive studies to create the perception that the economic evidence all overwhelmingly supports NAFTA, this analysis concludes that, in fact, the predictions of the studies are widely contradictory and the utility of the studies in reaching policy conclusions on NAFTA is extremely limited.

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NAFTA, TRADE, AND INVESTMENT

Most public debate on NAFTA is focused on the fact that NAFTA eliminates tariffs and other trade barriers over a 15-year transition period. Although Mexico during the 1980s unilaterally reduced its top tariff rate from 100 percent to 20 percent, there are still average Mexican tariffs of 10 percent on U.S. goods. U.S. tariffs on Mexican goods average 3.5 percent. Much of the NAFTA debate has concentrated on these tariff barriers.

But it is important to understand that, despite its name, NAFTA is far more than a trade agreement. Another central purpose of the agreement is increasing foreign investment in Mexico. As noted by the Congressional Budget Office, NAFTA is meant to "to attract and productively absorb foreign capital," and to make Mexico "more attractive for U.S. investors" (1993, p.iii).

Unlike the environmental and labor side agreements, which were recently added to NAFTA, the investment provisions are central to NAFTA's design and goals. NAFTA imposes a comprehensive set of obligations for each nation regarding treatment of foreign investors. It assures the rights of investors, including bringing back profits at favorable exchange rates, special dispute resolution procedures enforced by trade sanctions, and equivalent regulatory and legal treatment for U.S. firms operating in Mexico.

The central nature of investment in NAFTA can be highlighted by a comparison with labor law standards. For investor rights, U.S. negotiators identified a series of specific issues in Mexican law and regulation that they wanted to change. For labor law standards, no specific changes in Mexican law or practice were demanded or negotiated.

The importance of investment means that studies evaluating NAFTA's effect on the U.S. economy should focus not only on trade impacts, but on possible investment impacts as well. Otherwise, they fail to incorporate one of the two central thrusts of NAFTA.

THE KEY ISSUES

Six important issues must be addressed in any thorough consideration of NAFTA:

- *Investment* — Will NAFTA encourage significantly higher levels of new investment in Mexico, particularly investment diverted from the United States?
- *Trade* — Will NAFTA have a significant impact on import and export patterns between Mexico and the United States, and on the overall balance of trade between the two nations?
- *Immigration* — Will NAFTA affect the level of immigration from Mexico to the United States?
- *Net Job Changes* — Will NAFTA have a positive or negative net job impact on employment levels in the U.S.?
- *Gross Job Losses* — Will NAFTA cause significant gross job losses in the U.S.?
- *Impact on Wages* — Will NAFTA have any effect on wages in the U.S.?

Although all of these questions are important, there is no single NAFTA study that represents a thorough and comprehensive approach to this full range of economic questions. Each of the economic impact studies addresses one or more of these points, but none of them analyze all the questions simultaneously. Therefore, both policy makers and the public should recognize that the claims and predictions of the various NAFTA studies are, at best, only partially useful, for three reasons.

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correct – we should agree with the – limitations

1. The Assumptions of Economic Models Determine Outcomes

[illegible]

The predictive utility of the NAFTA impact studies is inherently limited, because they each begin with assumptions that limit the possible conclusions that can be reached.

All economic models must make simplifying assumptions in order to solve their equations and produce statistical findings. But the particular assumptions underlying any economic model heavily influence the projections that flow from that model.

Many of these studies assume away major economic issues. Sometimes these limiting assumptions are unrealistic. In other cases, the original assumptions mean that studies cannot address basic questions about NAFTA.

It should be no surprise that many of the models that assume favorable economic conditions reach favorable conclusions about NAFTA. For example: agree that

- Ten of the models begin by assuming that no investment will be diverted from the U.S. to Mexico, and are therefore unable, by design, to conclude that the U.S. could suffer job losses because of shifted investment. to this is reasonable assumption
- Seven of the models begin by assuming that the U.S. will experience no net change in its employment levels in the future. These models are therefore by design unable to conclude that the U.S. could lose jobs under NAFTA. full employ w. deteriorates model
- The four studies that predict net job gains for the U.S. begin by assuming no diversion of investment from the U.S. to Mexico.
- Four of the five studies that forecast rising U.S. wages begin by assuming no net employment change in the U.S., and thus cannot predict any loss of U.S. jobs, removing from consideration one factor that might put downward pressure on wages. agreed but
- Thirteen of the models contain no prediction about possible changes in Mexican immigration to the United States, and therefore are unable to address this issue and its possible economic consequences. other models

Same

2. Most Models Do Not Test Alternative Assumptions

In order to assess the impact of these limiting assumptions, it is good practice to vary the major assumptions, such as full employment and investment diversion, and see if major changes result in the conclusions. But many of the studies do not conduct these alternative tests that alter the major assumptions. Studies that do alter major assumptions underscore the danger of relying on studies that do not because when major assumptions are changed, the results are strikingly different. but they do different ones and arrive at same conclusion

One study does allow most major assumptions to vary in different combinations, permitting side-by-side comparisons of virtually the full range of issues that concern most people in the NAFTA debate, including full employment and investment diversion. The results range from close agreement with NAFTA proponents when their set of assumptions are used to a "maximum displacement" scenario that produces sharply negative results when testing the effects of investment diversion, possible job loss in the U.S., and improved productivity in Mexico. This study even includes a "social NAFTA" model, testing the impact of higher labor standards in Mexico and domestic investment in the U.S. and

Canada, which produces gains for all three nations. Other studies would be more credible and useful if they had conducted comparable tests.

3. Many Models Stretch Economic Reality

In addition to the limitations imposed by assumptions and the wide variation in empirical findings, many of the studies are implausible in light of economic realities. For example:

- One study has predicted that almost 6 million U.S. manufacturing jobs are "at risk" of moving to Mexico. This is highly implausible. The six million manufacturing jobs represent about 50 percent of all U.S. production worker jobs. Accommodating such a massive shift would require infrastructure development, new construction, capital investment, and worker training on a scale that is well beyond the capability of the Mexican economy.

- On the other hand, another study forecasts an <u>increase</u> in the U.S. of over 2.8 million jobs because of NAFTA. But the U.S. Department of Commerce estimates that it takes $1 billion in U.S. exports to support 19,600 U.S. jobs. Therefore, an additional 2.8 million new U.S. jobs attributable to increased U.S. exports to Mexico would require NAFTA to cause roughly $140 billion in new U.S. economic output. That would require a ripple effect that would be equal to 350 percent of 1992's exports to Mexico of $40.5 billion. Clearly, this is not a reasonable conclusion.

- Several pro-NAFTA studies also predict U.S. job growth as a result of increasing net exports to Mexico, arguing that Mexico can continue to import U.S. goods at a high rate. But Mexico's ability to import U.S. goods may already be slowing down. In the first eight months of 1993, there has been a 52.6 percent reduction in the U.S. trade surplus with Mexico, as U.S. export growth has slowed from 22 percent in 1992 to a projected two percent growth in 1993. This slowdown should be viewed in light of Mexico's balance of payments, which has swung away from a three percent surplus of GDP in 1987 to a seven percent of GDP deficit. This deterioration probably cannot continue without some adjustment mechanism. If Mexico was forced to devalue the peso to improve its trade balance, as it did in the 1980s, this could raise the relative cost of U.S. goods and depress Mexican wages and living standards, reducing U.S. exports to Mexico.

WHAT CAN BE LEARNED FROM THE MODELS

Confronted with this range of assumptions, techniques, and contradictory outcomes, it may seem tempting to ignore the economic impact studies and regard all of them as equally invalid. But discounting their utility entirely does not mean that they are without value. Models can be helpful when they address the critical economic issues and create a general range of possibilities for most of the important questions associated with the impact of NAFTA.

Although most of these studies claim positive results from NAFTA, there are in fact several plausible economic analyses that clearly imply negative effects, particularly in the areas of gross job dislocation and wage declines for U.S. workers.

Net job change as an outcome of NAFTA is likely to be much smaller than many proponents or opponents claim — perhaps up to 200,000 net jobs gained or lost over five years or more. But even if the U.S. turned out to be a marginal winner in net jobs, that does not mean that NAFTA could not have substantial negative impacts for a large number of Americans. In fact, NAFTA could result in gross job dislocations of 500,000 or more, and downward pressure on U.S. wages, especially for non-professional workers.

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where?

Higher levels of dislocation will mean much more disruption and "churning" in the labor market, at a time of slow job and wage growth. Some estimates of NAFTA's downward wage impact predict a loss of $348 in average full-time compensation for a manufacturing worker. As real average compensation has only grown by 7.5 percent since 1973, this downward pressure could wipe out over fourteen percent of those gains.

Because the economic studies reviewed in this report are severely limited in their usefulness, the basic decision about NAFTA should be based on other considerations. For instance, NAFTA should be evaluated on whether the agreement deals adequately with the possible economic consequences of widely different labor conditions and standards in Mexico and the U.S., and whether the U.S. has a sufficiently effective plan in place to respond to the needs of workers who will be negatively affected by NAFTA. As the debate over NAFTA intensifies, policy makers and the public should not allow the predictions of economic models to divert our attention from those basic questions.

LIST OF MODELS IN JEC REPORT

The main criterion for including NAFTA models in this report is whether they provide estimates of aggregate impacts on the US economy. Models that provide only Mexican or Canadian impacts as well as models of individual U.S. economic sectors are excluded, but all major studies that forecast U.S. aggregate impacts, and that have been the focal point of the debate, are included here.

In general, the scenario with the largest US impacts, whether positive or negative, is chosen. These define the boundaries for possible impacts from NAFTA; consideration of intermediate scenarios would not change the analysis or conclusions of this report.

The table below provides a brief description of the models included in the JEC paper.

NAFTA MODELS INCLUDED IN THE JEC PAPER

Model	Description
1. Boyd, Krutilla, McKinney	Static computable general equilibrium (CGE) model. Assumes tariff removal only, no foreign direct investment (FDI), no international migration.
2. U.S. International Trade Commission	Static CGE model. Assumes trade liberalization only, no FDI, predicts changes in US-Mexico migration.
3. Bachrach, Mizrahi (KPMG Peat Marwick) (199)	Static CGE model. We include the scenario whic- assumes removal of tariff and nontariff barriers, additional FDI in Mexico, no international migration.
4. Brown, Deardorff, Stern	Static CGE model; includes Canada. We include the scenario which assumes trade liberalization, more FDI in Mexico, no international migration.
5. Robinson, Burfisher, Hinojosa-Ojeda, Thierfelder	Static CGE model. We include the secnario which assumes free trade, no FDI, and elimination of all farm support programs in Mexico, and predicts migration.
6. Roland-Holst, Reinert, Shiells	Static CGE model; includes Canada. We include the scenario with removal of all tariff and nontariff barriers, no FDI in Mexico, and no international migration.

[continued]

Model	Description
7. Stanford	Static CGE model; includes Canada. We include the scenario that assumes that assumes free trade, additional FDI in Mexico which displaces US (and Canadian) domestic investment, improved Mexican technology, displaced agricultural labor in Mexico, US and Mexican goods are close substitutes, no international migration.
8. Economic Policy Institute	Dynamic CGE model. We include the scenario which assumes trade liberalization, FDI in Mexico, and predict changes in US-Mexico migration. All FDI is assumed to displace US domestic investment.
9. McCleery	Dynamic CGE model. We include the scenario which assumes free trade, additional FDI in Mexico, one half of FDI displaces US domestic investment, on increase in the growth rate of US and Mexican productivity, no international migration.
10. Almon	Macroeconomic model. We include the scenario with tariff and nontariff barrier liberalization, no FDI in Mexico, no international migration.
11. DRI/McGraw-Hill	Macroeconomic model. We include the scenario with gradual removal of tariff and nontariff barriers, no FDI in Mexico, no international migration.
12. Hufbauer, Schott	Estimates changes in US and Mexican exports and imports based on experience of other countries which have undergone trade liberalization. Assumes additional FDI in Mexico, no international migration.
13. Koechlin, Larudee	Estimates increase in US FDI in Mexico using experience of Ireland and Spain's accession to the European Community. Assumes all US FDI in Mexico displaces US domestic investment. No international migration.
14. Economic Strategy Institute	Estimate change in US-Mexico imports and exports for 10 major manufacturing sectors. Assumes Mexico receives additional FDI in export industries. No international migration.

[continued]

Model	Description
15. U.S. International Trade Commission 1993)	Estimates changes in US-Mexico trade for major US economic sectors. It consists of a quantitative model which only considers removal of tariff and nontariff barriers, and a qualitative analysis of additional US FDI in Mexico and its effect on US-Mexico trade and US jobs. No international migration.
16. Choate	classifies US jobs at risk of relocation to Mexico based on whether labor costs are 20 percent or more of total costs. Based on prospectus of a small fund formed to buy US companies and relocate them to Mexico. No international migration.

THE SPECIAL COUNSELOR'S REVIEW OF ECONOMIC STUDIES

In a recent report, the Office of the Special Counselor to the President on NAFTA claimed that "nineteen of twenty comprehensive NAFTA studies" showed positive effects from NAFTA for the U.S. economy. But this list of twenty double counts some studies, includes others that are not estimates of aggregate impact on the U.S. economy, and excludes still others.

The JEC report includes twelve of the studies in the Special Counselor's report, and adds four others for consideration, for a total of sixteen. The JEC's selection criteria, established before seeing the Special Counselor's list, was to consider studies that estimate aggregate impacts on the U.S. economy, and to analyze the largest reported impact, positive or negative.

The differences are based on the following:

Weeding the List of Twenty

1. *Double Counting of Studies.* Eight of the studies cited in the Special Counselor's report should really only be counted as four in total; the other four are preliminary versions that were superseded in later publications by the authors.[1]

2. *Including Studies of Narrow Sectors.* Three of the studies cited are of specific sectors — agriculture, textiles and steel, and automobiles. These do not meet the criterion of a "comprehensive" study.

3. *Including Studies of Specific States.* One study is confined to a single state, California. Again, this does not meet the criterion of a "comprehensive" study.

After excluding four double-counted studies, three sectoral studies, and one state-specific study, the Special Counselor's "comprehensive" list can be pared from twenty to twelve.

[1]In each of these cases of double counting, the JEC report only includes the most recent version of each study — Brown et al., 1992; Robinson et al., 1992; McCleery, 1992; and Hufbauer and Schott, 1993.

Adding Studies for Consideration

The JEC report also considers four studies that estimate aggregate impacts for the U.S. economy that are excluded from the Special Counselor's list: Stanford, 1993; Economic Strategy Institute, 1992; Koechlin and Larudee, 1992; and Choate, 1993. All of these studies reach some negative conclusions about NAFTA.

The exclusions from the Special Counselor's list are puzzling. Three of the studies are relegated to a subsidiary list of studies charged with "selective consideration of certain issues." But this criteria does not seem to hold up.

First, the Economic Strategy Institute study, excluded from the list, covers ten broad manufacturing sectors. This is more comprehensive than four of the studies included on the "comprehensive" list.

Second, the studies by Koechlin and Larudee and by Choate do concentrate on certain major issues, such as foreign direct investment and investment dislocation, and the impact on U.S. industries with high labor costs. But the same is true about studies like that of Hufbauer and Schott, which considers the effects of a large capital inflow into Mexico, and is included on the "comprehensive" list. Further, both of these excluded studies, especially Choate's, have been widely referenced in the debate over NAFTA. It seems that any full treatment of NAFTA studies ought to include all major efforts, pro and con, even if the analysts differ with the conclusions.

Finally, the Special Counselor's report does not even mention the study by Stanford (1992) done at the Brookings Institution, which provides the richest range of testing alternative assumptions in a CGE model.

Reconciling the Two Lists

Eight of the studies on the Special Counselor's list do not seem to fit, either because of double counting, or because they are too narrow to fit a definition of "comprehensive." This leaves twelve studies. The JEC report also considers four other studies that examine aggregate impacts on the U.S. economy, but which are excluded from the Special Counselor's list of twenty. Adding these four to the twelve where there is overlap gives the list of sixteen studies with aggregate maximum impacts on the U.S. economy, positive or negative, that the JEC analyzes.

Further Exclusions

Finally, the bibliography in the Special Counselor's report fails to mention at least one critical review of NAFTA impact studies conducted for the Department of Labor by Robert A. Blecker and Beverly J. Burr at American University.[2]

[2] *Literature Survey on the Effects of North American Trade and Investment Liberalization on U.S. Manufacturing Employment and Compensation*, September 1993.

Chapter I

INTRODUCTION: KEY ECONOMIC ISSUES AND NAFTA

As the debate over the proposed North American Free Trade Agreement (NAFTA) intensifies, the issues of its economic impacts remain of central importance. A variety of claims and counterclaims about NAFTA's possible or likely economic impacts have been made, often buttressed by reference to complex economic and statistical studies.

This report reviews and critiques sixteen major analyses that address key economic issues relating to NAFTA, and assesses the issues in light of those studies. It concentrates on economic questions that have been the object of econometric analysis; thus, although environmental, labor rights, and other issues also are central parts of the debate over NAFTA, those issues are not analyzed here. Those issues should be major considerations in reaching conclusions about NAFTA, but this report is confined to an analysis of economic studies.

Although proponents and opponents of NAFTA cite a number of studies that use economic models in support of their positions, it is important to understand the limitations of the models that underlie those studies. For a variety of technical reasons, all economic models must make simplifying and theoretical assumptions in order for the models to produce statistical results. The role of these assumptions often is overlooked, yet such assumptions are critical for understanding what the models predict.

All economic models are in fact scenarios that must exclude consideration of some questions and simplify others. Models are constrained by the available data, by the demands of particular statistical techniques, and by theoretical assumptions about key issues.

In short, economic models cannot substitute for the reasoned judgment of policy makers. They can provide important information, providing that people using the models understand what assumptions they rest on. Because all results from economic models rest in large part on these assumptions, the credibility of the assumptions must be a central consideration when evaluating the results from the models. When those assumptions are not credible, the conclusions should not be a major factor in deciding public policy.

KEY ECONOMIC ISSUES IN ASSESSING NAFTA

The debate over NAFTA involves several key economic issues. These questions can be divided into NAFTA's direct effects and the resulting impact of those effects.

For example, the question of the net gain or loss of jobs in the United States--the impact that has dominated much of the debate thus far — is tied to assertions about several direct effects of NAFTA, including the likelihood of displacement of investment from the United States to Mexico, and questions about NAFTA's effect U.S. exports to Mexico.

The economic debate over NAFTA revolves around six major sets of issues:

- *Investment* - Will NAFTA encourage significantly higher levels of new investment in Mexico, particularly investment diverted from the United States?

- *Trade* - Will NAFTA have a significant impact on import and export patterns between Mexico and the United States, and on the overall balance of trade between the two nations?

- *Immigration* - Will NAFTA affect immigration from Mexico to the United States?

- *Net Job Changes* - Will NAFTA have a positive or negative net job impact on employment levels in the U.S.?

- *Gross Job Losses* - Will NAFTA cause significant gross job losses in the U.S.?

- *Impact on Wages* - Will NAFTA have any effect on wages in the U.S.?

These are the key questions that members of Congress and the public are struggling with. Some of the issues overlap, and all of them should be kept in mind in evaluating NAFTA's potential impacts.

Before reviewing the models and their assumptions, this report outlines key provisions of NAFTA in section II. Section III reviews the models in detail, and section IV assesses the key economic questions in light of the models. Section V summarizes the findings.

Chapter II

KEY PROVISIONS OF NAFTA

The North American Free Trade Agreement contains important provisions on trade and investment, liberalizing trade between the U.S., Canada, and Mexico and providing guarantees to protect foreign investments.

TRADE PROVISIONS

NAFTA eliminates tariffs on goods meeting the rules of origin[1] over a 15 year transition period. Table 1 shows the tariff reduction schedule on U.S. imports from Mexico. The gradual phase-in of tariff reduction is meant to ease the transition for those in import-sensitive industries.

TABLE 1. NAFTA TARIFF ELIMINATION SCHEDULE FOR U.S. IMPORTS FROM MEXICO

Year (January 1st)	Percentage of Duitable Imports on which Tariffs are eliminated
1994	60
1998	9
1999	11
2003	12
2008	8

Source: Congressional Budget Office, *A Budgetary and Economic Analysis of the North American Free Trade Agreement*, 1993, p. 10.

NAFTA has additional provisions relating to workers in import-sensitive industries. During the transition period, if NAFTA causes an import surge which threatens or causes serious injury to a domestic industry, the importing country may 'snapback' tariffs to the pre-NAFTA levels for up to 4 years, although this action can only be taken once. In addition, a country taking a safeguard action must provide the exporting country with trade concessions equivalent to the value of the additional duties imposed by the action. The Supplemental Agreement on Import Surges calls for an "Early Warning System" to anticipate employment trends in import-sensitive industries, and a country that sees such trends may call consultations with the exporting party to determine if NAFTA safeguard measures are necessary.

[1] The rules of origin determine what goods will receive preferential tariff treatment. A good is considered as originating in North America if it is completely North American (e.g., minerals, agricultural commodities) or if it had non-regional materials that were transformed in North America so that the tariff classification changed. If a good is in the same tariff class, it may still meet the rules of origin if it has a specified percentage of value in North America. There are specific rules of origin for automobiles, textiles and apparel.

INVESTMENT PROVISIONS

Despite its name, NAFTA is far more than a free trade agreement; its provisions on investment are equally important. NAFTA creates a comprehensive set of obligations regarding treatment of foreign investors. The principles of national treatment and most-favored-nation treatment will apply to investors from any NAFTA country.[2] NAFTA phases out performance requirements on investments, including specified export levels, minimum domestic content, preferences for domestic sourcing, trade balancing, and technology transfer.[3] It also includes protections for intellectual property rights and copyrights.

NAFTA also assures the right of investors to convert local currency for earnings, proceeds of a sale, loan repayments or other transactions associated with an investment. NAFTA virtually prohibits expropriation of investments, and requires compensation to the owner for any expropriated investments.

In addition, NAFTA provides a special dispute settlement procedure, allowing foreign investors to go directly to binding arbitration. If an investor does not get a successful settlement, then their national government may resort to general NAFTA dispute settlement procedures, which include consultation, a meeting of the NAFTA Trade Commission, requests for arbitration panels, and possible suspension of other trade benefits.

These investment provisions have received less attention than trade barriers and tariff reductions, but they are essential for understanding the controversy over NAFTA. One of Mexico's primary goals in pursuing NAFTA is attracting more investment from the U.S. and elsewhere. As Blecker summarizes the investment provisions, "... they are mainly intended to force Mexico to revise its laws to provide more favorable treatment for foreign investors...While it is possible to define all of these investment provisions as fitting some broader definition of 'trade liberalization,' it is clear that their main purpose is to increase capital inflows into Mexico (1993, p. 4)."

The centrality of the investment guarantees is highlighted by a comparison with labor issues. The U.S. reached a side agreement with Mexico on labor rights issues, but the contrast with the treatment of investor rights is striking, not just in technical, but in practical political terms. In technical terms, the most significant labor issues in the Mexican context (the right to organize, to right to bargain collectively, and the right to strike) are subject to a very limited review process and enforcement under the agreement is not permitted.

Perhaps more important, the practical political treatment of labor rights differs fundamentally from the treatment of investor rights. In the case of investor rights, U.S. negotiators identified a series of current Mexican laws and practices for which they wanted change.

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[2]NAFTA does not change Mexico's constitutional prohibition against foreign investment in the oil, gas, basic petrochemicals, nuclear, and electricity sectors.

[3]Mexico has taken reservations which allow a gradual phaseout of performance requirements in some areas. These include a 10 year phaseout of auto industry requirements and a 7 year phaseout of the requirement that maquiladoras' domestic sales not exceed specified percentages of export sales.

The Mexican government in turn acknowledged that its current law and practice departed from the U.S. demand and it publicly agreed to change either its law or the enforcement of its law. With respect to labor rights issues, however, the U.S. government did not identify current Mexican laws or practices and demand that they be changed.

Chapter III

ECONOMIC MODELS OF NAFTA IMPACTS

This section reviews models of NAFTA that estimate aggregate impacts on the U.S. economy. Key assumptions and predictions of U.S. impacts of the models reviewed here are shown in Table 2.

TYPES OF ECONOMIC MODELS

Seven of the models in Table 2 are static computable general equilibrium (CGE) models. These models have a detailed structure based on microeconomic estimates. The model is fitted to data from a selected "base year" that serves as a reference point for determining the effects of trade liberalization.

To simulate NAFTA, the model is run with no change from the base year except the reduction in trade barriers. Economic impacts then are calculated by comparing the change in variables before and after the trade liberalization impacts. These models are referred to as "static" models because they calculate the impacts of a change in trade barriers while holding all other factors constant.

Unlike static models, dynamic computable general equilibrium models compare changes over time for economies with and without a policy change such as NAFTA. They allow predictions of NAFTA's effect on the growth rates of economic variables such as GDP, in contrast to static models that only estimate one-time absolute changes in levels. Over the long run, gains from small changes in the growth rates of economic variables such as GDP and labor productivity can dwarf one-time changes in absolute levels. The Economic Policy Institute (Spriggs, 1991) and McCleery (1992) models both simulate the U.S. and Mexican economies over the 1991 to 2000 period with and without NAFTA.[4]

A third group of models, macroeconomic models, use econometric techniques to trace the correlations between key economic variables over time. They do not rely on the microeconomic underpinnings typical of CGE models, but instead extrapolate into the future the historical relationships of different variables. The Almon study (1992) and the DRI/Mc-Graw Hill (Shiells and Shelburne, 1992) model simulate the U.S. and Mexican economies with and without NAFTA in this manner.

A fourth type of model predicts NAFTA impacts by using the historical experience of other countries that have undergone trade liberalization. The Hufbauer and Schott (1992, 1993) model is derived from a World Bank study of 31 cases of economic liberalization, and assumes that NAFTA is accompanied by a comprehensive Mexican liberalization program that includes greater oil production, monetary and fiscal restraint, and greater privatization. Projections then are made for Mexico's trade from 1989 to 1995 with and without NAFTA. The Koechlin and Larudee (1992) model estimates U.S. investment in Mexico due to NAFTA and its effect on U.S. jobs through a statistical study of U.S. FDI

[4] The EPI model is a variant of a model by Hinojosa-Ojeda and McCleery (1992).

in 23 countries, and a more specific study of the additional U.S. FDI that Ireland and Spain received upon joining the European Community.

A fifth type of model utilizes case studies of major industries to predict NAFTA impacts. The Economic Strategy Institute (ESI) 1992 model projects the changes in investment in Mexico, U.S.-Mexico trade, and U.S. jobs in 10 industries from 1994-2002. The ITC (1993) study assesses potential NAFTA impacts on major U.S. industrial, agricultural, energy, and service sectors. Both of these models were done after the NAFTA text was finished in the fall of 1992. Hence they consider actual provisions of NAFTA (such as tariff reduction schedules and rules of origin) that earlier studies could not.[5]

The sixth type of NAFTA study provides only a single simple criterion for classification of U.S. jobs "at risk" rather than a formal model. Choate (1993) defines U.S. jobs at risk as those in manufacturing industries with labor costs that are at least 20 percent of total costs. It is based on the investment criteria of a fund that was established to buy U.S. manufacturing companies and move all or a portion of them to Mexico.

[5]Hufbauer and Schott provided a qualitative assessment of the actual NAFTA text in 1993. However, the only change in their quantitative model of NAFTA impacts was not drawn from the substance of NAFTA, but on a revision in the Commerce Department estimate of the number of U.S. jobs per billion dollars of U.S. exports.

TABLE 2. KEY ASSUMPTIONS AND PREDICTIONS OF U.S. IMPACTS OF NAFTA MODELS

Model	Assumptions						Predictions			
	Time Frame (years)	Net U.S. Job Change Allowed	U.S. Consumer Preference for U.S. Goods	FDI in Mexico Allowed	U.S. Invest. Division Allowed	Growth in Mexican Prod. Allowed	Gross U.S. Job Loss (persons)	Net U.S. Job Change (persons)	Net U.S. Wage Change	Immigration to U.S. (persons)
1. Boyd, Krutilla, Mckinney	5 to 7	No	Prefer U.S. goods	No	No	No	NR	0 by assump.	+0.01%	No migration
2. ITC (1991)	NR	No	Prefer U.S. goods	No	No	No	NR	0 by assump.	+0.018% skilled +0.005% unskilled	Decreases
3. Bachrach, Mizrahi	NR	No	Prefer U.S. goods	Yes: $25 bil. rise in Mexican capital stock	No	No	33,900	0 by assump.	+0.03%	No migration
4. Brown, Deardorff, Stern	10	No	Preference based on firm	Yes: 10% rise in Mexican capital stock	No	No	76,623	0 by assump.	+0.2%	No migration
5. Robinson, Burfisher, Hinojosa-Ojeda, Thierfelder	NR	N0	Prefer U.S. goods	No	No	No	NR	0 by assump.	-3.4% rural -4.2% unskilled +0.3% skilled +0.3% professional	+610,000
6. Roland-Holst, Reinert, Shiells	NR	Yes	Prefer U.S. goods	No	No	No	NR	2,839,710	0 by assump.	No migration
7. Stanford	NR	Yes	Prefer U.S. goods	Yes: $30 bil. rise in Mexican capital stock	$26 bil.	Yes	NR	-91,974	-1.08%	No migration

[continued]

Table 2. (continued)

Model	Assumptions: Time Frame (years)	Net U.S. Job Change Allowed	US. Consumer Preference for U.S.Goods	FDI in Mexico Allowed	U.S. Invest. Division Allowed	Growth in Mexican Prod. Allowed	Predictions: Gross U.S. Job Loss (persons)	Net U.S. Change (persons)	Net U.S. Wage Change	Immigration to U.S. (persons)
8. Economic Policy Institute	10	No	Preference not based on country	Yes: $44 bil. rise in Mexican capital stock	$44 bil.	No	550,000	0 by assump.	-0.16% skilled +4.8% unskilled	—1,581,000
9. McCleery	8	No	Preference not based on country	Yes: $92 bil. rise in Mexican capital stock	$46 bil.	Yes	NR	0 by assump.	-0.8% mfg +0.3% skilled +2.4% unskilled	No migration
10. Almon	5	Yes	NA	No	No	No	18,800	44,500	NR	No migration
11. DRI McGraw-Hill	8	Yes	NA	No	No	NR	NR	221,000	+1.0% mfg. +1.0% service	No migration
12. Hufbauer, Schott	5 to 6	Yes	NA	Yes: $60 bil.	No	NR	145,000	171,000	NR	No migration
13. Koechlin, Larudee	8	Yes	NA	Yes: $31 bil. to $53 bil.	$31 bil. to $53 bil.	NR	290,000 to 490,000	No estimate of job gains	-1.2% to -2.0%	No migration
14. Economic Strategy Institute	9	Yes	NA	Yes: $63 bil.	No	Yes	837,500 to 912,500	-32,000 to -220,00	NR	No migration
15. ITC (1993)	15	NA	NA	Yes: 6% to over 16% by sector	Yes: some sectors such as home appliances	NR	+/-0 to over 5% by sector	NR	NR	No migration
16. Choate	NR	Yes	NA	Yes	Yes	NR	5,900,000 jobs "at risk"	No estimate of job gains	NR	No migration

Abbreviations: NR = not reported; mfg = manufacturing; NA = not applicable; FDI = foreign direct investment; Prod. = total factor productivity

Notes to Table 2:

I. U.S. Consumer Preference for U.S. Goods:

The ITC (1993) qualitative study does not make explicit assumptions concerning U.S. consumer preferences. The ITC (1993) study has a quantitative model of each industrial sector which assumes that U.S. consumers prefer U.S. made goods.

II. FDI in Mexico:

All of the estimates in this column represent the amount of FDI over the entire time period of the model; they are not annual changes. The FDI in the Stanford model and the EPI model represents the amount induced by a 10 percent reduction in the risk premium on investment in Mexico. The FDI in the McCleery model represents the amount induced by a reduction in the risk premium on investment in Mexico by a full percentage point in the manufacturing sector and 700 basis points in the non-manufacturing sector. The Hufbauer and Schott estimate includes capital inflows other than FDI. The additional FDI in the ESI model is calculated by using the model's prediction of a 100 percent increase in annual FDI and its estimate of current levels of FDI ($7 billion).

III. Predictions of U.S. Impacts:

The models by Brown and other, Roland-Holst and others, and Stanford include U.S.-Canadian trade in their predictions of U.S. impacts.

IV. Gross U.S. Job Loss:

All gross job losses are over the time period specified by the model; they are not annual job losses. The ESI gross job losses are calculated by applying this study's U.S. job multiplier to its projections of additional Mexican exports to the U.S. by the year 2002.

V. Net U.S. Job Change:

All net job changes are over the time period specified by the model; they are not annual changes. The net job change in the Roland-Holst model is calculated by multiplying the percentage of U.S. employment (2.47%) by total U.S. civilian employment in 1988, the base year of the model. The net job change in the Stanford model is calculated by multiplying the percentage of U.S. employment (-0.08%) by total U.S. civilian employment in 1988, the base year of the model.

VI. Net U.S. Wage Change:

The ITC (1991) net wage changes are the midpoint of 7 estimates, which vary depending on the degree of preference of U.S. consumers for U.S. made goods over goods made in Mexico and the rest of the world. The net wage changes in the EPI, DRI/McGraw-Hill, and McCleery models are for the year 2000.

VII.Sources: The date in the table are derived from the models and the calculations described above. All of the model citations are in the References section.

KEY ASSUMPTIONS OF NAFTA MODELS

Like all economic models, the results of the NAFTA studies depend on key assumptions. Among the most important of these assumptions are full employment in the U.S., the amount of foreign direct investment Mexico receives due to NAFTA, the extent of investment diversion from the U.S. to Mexico, whether NAFTA will increase productivity in Mexico, and whether consumers in the three nations can or will express strong preferences for goods made in their home countries. (These assumptions are shown in Table 2.) Understanding these assumptions is essential for assessing the findings reported by the various models, because many models often cannot address key economic questions due to limiting assumptions.

Full Employment

Seven models assume full employment,[6] defined as no net change in total U.S. employment. Thus, by definition, these models cannot predict that NAFTA would result in a net reduction in U.S. jobs. This assumes that the U.S. economy can be expected to operate at or near full employment most of the time. At full employment, changes in policy may affect the composition, but not the absolute, number of jobs. However, the U.S. economy has been operating in recent years with an unemployment rate over 6.5 percent, a level well above most estimates of full employment. Models that assume full employment ignore the last decade of experience in the U.S. economy, and they cannot, by design, find that NAFTA would result in net job losses for the United States.

Foreign Direct Investment (FDI) in Mexico

Six models assume no increase in FDI in Mexico, although FDI is an important reason for the increase in U.S.-Mexico trade in the 1980s and a central goal of Mexico in pursuing NAFTA. Models that do not permit analysis of FDI thus fail to consider a potentially important effect of NAFTA.

It is very difficult to predict the actual levels of change in foreign direct investment in Mexico due to NAFTA. Thus some models, such as those by Brown and others, and Robinson and others, simply assume some increase in investment in Mexico.

The case studies by ESI and ITC (1993) are based in part on interviews with industry experts and current trends in FDI in Mexico. But their predictions range very widely. The ESI model predicts that FDI in Mexico will double due to NAFTA. The ITC (1993) study predicts that U.S. investment in the Mexican bearings and pharmaceutical industries will increase by 6 to 15 percent in the long run (e.g., the full 15 year phase-in of NAFTA). It also predicts that U.S. investment in Mexican auto production and auto parts, computers and electronics, major household appliances, and apparel will increase by 16 percent or more in the long run.

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[6]Bachrach and Mizrahi run a version of their model assuming unemployment exists in the US. This version predicts a net increase of 61,000 US jobs.

The Choate model does not provide a quantitative investment forecast, but it assumes that U.S. jobs employing 52 percent of U.S. production workers in manufacturing are "ar risk" of relocation to Mexico or to competition from low-cost imports from Mexico. It does not take into account other important factors determining job location and movements, such as educational levels by industry in determining vulnerability, sunk costs in plant and equipment, relations to suppliers, etc.

Overall, the models' assumptions concerning FDI in Mexico vary widely, indicating the uncertainty involved in taking account of this key factor. If FDI in Mexico is larger than predicted by a given NAFTA model, then Mexican exports to and imports from the United States, and the potential gross job losses and gains, may be larger.

Investment Diversion

Investment diverted specifically from the United States to Mexico will have different impacts on U.S. workers than general increases in FDI in Mexico. Alternatively, additional FDI in Mexico could be moving from somewhere else overseas, or simply represent an addition to global investment activity. But investment diversion is investment in Mexico that would otherwise have been invested in the United States. It will affect U.S. workers through the direct loss of capital investment in addition to indirect trade effects.

Ten models assume no investment diversion. Models that exclude investment diversion by assumption cannot provide findings that U.S. workers will be harmed by location of factories in Mexico instead of the United States. If there is diversion of investment, these models will underestimate gross U.S. job losses due to NAFTA.[7]

The Stanford model predicts an additional $30 billion invested in Mexico of which $26 billion is diverted from the U.S. and the remainder from Canada. The EPI model assumes that all $44 billion of their projected increase in FDI in Mexico from 1991 to 2000 is diverted from U.S. domestic investment. The Koechlin and Larudee model assumes that all of the estimated U.S. FDI in Mexico of $31 billion to $53 billion over 8 years is diverted from the U.S. It is not likely that all FDI Mexico receives due to NAFTA will represent investment diverted from the United States. If some of the capital flowing to Mexico would have gone to other industrialized countries in the absence of NAFTA, then these models will overestimate the amount of investment diversion due to NAFTA.

The McCleery model predicts that NAFTA will increase FDI in Mexico by $92 billion from 1991 to 2000.[8] The ITC (1993) model predicts that some investment diversion will occur in industries such as major home appliances (p. 16-2). However, it does not divide the predicted increases in U.S. FDI in Mexico in each industrial sector into the amount diverted from the U.S. and from other countries.

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[7]Investment diversion will imply some gross job gains due to balance of payments effects. The outflow of US FDI to Mexico should increase U.S. exports to Mexico, other things constant. Thus the net job effects of investment diversion are uncertain.

[8]The additional capital in Mexico is relative to the baseline of the McCleery model, not the free trade only scenario.

Growth in Mexican Productivity Due to NAFTA

Eight of the models in Table 2 assume that NAFTA does not increase productivity in Mexico. As the Congressional Budget Office (1993c, p. 8) has noted, this assumption will affect the studies' predictions of gross job losses. Models with this assumption will predict smaller increases in Mexican exports to the U.S. than models that assume increases in Mexican productivity.

The assumption that Mexican productivity will not increase is highly questionable, especially for models that include additional FDI in Mexico. Much of the recent foreign direct investment in Mexico has been world class capital embodying modern technologies, which should increase productivity. Assuming no increase in productivity is equivalent to assuming that new capital investment in Mexico will be no more productive than the average Mexican capital stock, which includes much inefficient equipment from the import substitution era.

For those models with increases in Mexican productivity, Stanford assumes that total factor productivity in foreign owned manufacturing plants in Mexico is 55 percent higher than domestic-owned plants.[9] The McCleery model assumes that the rate of total factor productivity growth depends on the level of output of capital goods in both Mexico and the U.S. The ESI model incorporates productivity increases by assuming that new FDI in Mexico will have the same capital/output ratios as their counterpart industries in the United States.[10]

Consumers' National Preferences

Six models assume that consumers in the U.S. can and will exercise a strong preference for goods made in the U.S. over similar goods made in Mexico.[11] In other words, U.S. consumers can both distinguish products in terms of the country of production, and exhibit a preference for those goods. Models with this assumption will reduce the Mexican-made goods that U.S. producers buy after NAFTA, other things constant, and result in less displacement of U.S. workers than models assuming that goods are not differentiated according to where they are produced.

This assumption is a standard assumption for many models that assume that the economy is in "equilibrium" despite similar production occurring in both countries. But for products made by major multinational enterprises operating similar facilities in the U.S. and Mexico, and especially for Mexican produced components of U.S. assembled products (e.g., car parts), such an assumption is hard to accept.

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[9]The 55 percent figure is based on a study by Blomstrom and Wolf (1989) which compares total factor productivity in multinational affiliates in Mexico and domestically owned firms in Mexico.

[10]This assumption is not stated in the 1992 ESI study (*NAFTA: Making it Better*) described in the text. However, it is made in their earlier study *The New North American Order: A Win-Win Strategy for U.S.-Mexican Trade* (1991). See page 46. We assume that this same assumption is used in the 1992 study.

[11]The national product differentiation assumption is referred to as the Armington assumption. See Armington (1969).

PREDICTIONS OF U.S. IMPACTS

Fourteen of the models in Table 2 provide some measures of impacts on U.S. trade with Mexico. The predictions cannot be compared exactly because they cover different periods of time and present the results in different forms, but an approximate comparison can be made. Estimated increases in U.S. exports to Mexico range from 5 percent to 74 percent,[12] while estimated increases in U.S. imports from Mexico range from 6 percent to 98 percent.[13]

Unlike the predictions concerning NAFTA's positive effects on the volume of U.S. trade, there is no consensus concerning the direction of NAFTA's effects on the total U.S. trade balance. Many models begin by assuming that NAFTA does not change the U.S. trade balance, and those models that predict changes in the trade balance cover different time periods and yield conflicting results. Estimated narrowing of the the U.S. trade deificit range from well under 1 percent to 11 percent.[14] The largest predicted widening in the U.S. trade deficit is 5 percent,[15] so the absolute range of variation in models is sixteen percent.

Thirteen of the models in Table 2 do not consider potential changes in labor migration from Mexico to the U.S. due to NAFTA. Hence most of the models provide no insight on whether NAFTA will affect U.S. jobs and wages through changes in labor migration.

The ITC model predicts a reduction in migration from Mexico to the U.S. due to a narrowing of U.S.-Mexico wage differentials. The model by Robinson and others assumes no increase in the Mexican capital stock and elimination of protection for Mexican farmers, resulting in extensive rural job displacement. This adds 610,000 persons to the existing flow of labor migration to the U.S., which is a major reason why the wages of U.S. rural and urban unskilled workers fall by over 3 percent.[16]

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[12]The 5 percent increase is from the Bachrach and Mizrahi model, and the 74 percent increase is from the ESI model. The ESI model provides estimates of a range of additional US exports to Mexico of $28.7 billion to $31.2 billion by 2002. The midpoint estimate of $30 billion is compared to 1992 US exports to Mexico of $40.5 billion to determine the percentage increase.

[13]The 6 percent increase is from the Almon model and the model by Robinson and others. The 98 percent increase is from the ESI model. The ESI model provides estimates of a range of additional US imports from Mexico of $33.5 billion to $36.5 billion by 2002, after accounting for trade diversion. The midpoint estimate of $35 billion is compared to 1992 US imports from Mexico of $35.6 billion to determine the percentage increase.

[14]The Bachrach and Mizrahi model predicts an improvement in the total US trade balance of 0.07 percent. The Almon model predicts an improvement of 11.3 percent.

[15]The ESI model predicts a decrease in the US trade balance of from $1.3 billion to $8.8 billion. Using a midpoint estimate of $5 billion, this would be 5 percent of the 1992 US trade deficit of $96 billion.

[16]The model by Robinson and others has another scenario which assumes a ten percent increase in the Mexican capital stock (without investment diversion) and a greater degree of trade protection for Mexican farmers. This results in net outflow of migration from the United States to Mexico of 2000 people. It predicts 0.0% to 0.2% wage gains for the four types of U.S. workers.

Seven of the models in Table 2 assume full employment, so they cannot find a net job loss in the U.S. The largest net gain is the Roland-Holst model's prediction of 2,839,710 jobs over a period of several years.[17] The DRI/McGraw Hill model predicts a net employment increase of 221,000. Stanford predicts a net job loss of 91,974 people.[18] The ESI model predicts a net job loss of from 32,000 to 220,000 jobs by 2002.[19]

Nine of the models in Table 2 provide measures of gross job displacement. These range from 18,800 jobs over 5 years in the Almon model to a potential loss of 5.9 million jobs over an undetermined amount of time in the Choate model. This estimate of "jobs at risk" is more than six times higher than any other estimate of gross job loss. The largest estimate other than the Choate model is the ESI prediction of 837,500 to 912,000 jobs displaced by 2002, an annual average of up to 114,000.[20]

SUMMARY

These models' results can be roughly classified according to their assumptions. Five of the six models, which assume no increase in FDI in Mexico due to NAFTA, predict positive U.S. labor impacts. This is not surprising because, without additional FDI, Mexico would not receive modern capital equipment and technology which would boost its exports to the U.S. and the wage pressure on some U.S. manufacturing workers. Models that assume no additional FDI in Mexico are likely to predict minimal adverse U.S. labor impacts, based in large part on the assumption.

Models that include investment diversion generally predict larger U.S. gross or net job losses and wage reductions than models that do not consider investment diversion. In particular, investment diversion is primarily responsible for the substantial gross job losses predicted by the EPI and Koechlin and Larudee models. Stanford conducted multiple scenarios in part to do a sensitivity analysis of investment diversion. The inclusion of investment diversion in his displacement model contributes to its predicted 1.08 percent reduction in U.S. wages.

Models that project total factor productivity growth in Mexico also predict larger adverse U.S. impacts than many other models, including downward impacts of U.S. wages. The assumption in the ESI model that new FDI in Mexico has total factor productivity

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[17]The absolute job number is derived by multiplying the percentage of US employment gain from the model (+2.47%) by the total US civilian employment of 114,968,000 people in 1988 (BLS, 1993), the base year of the model.

[18]The absolute job number is derived by multiplying the percentage of US employment loss from the model (-0.08%) by the total US civilian employment of 114,968,000 people in 1988 (BLS, 1993), the base year of the model.

[19]The ESI model predicts net US job gains in 1994 and 1998 due to a US trade surplus with Mexico. The net job losses in 2002 are due to a projected US trade deficit with Mexico of from $1.3 billion to $8.8 billion.

[20]The ESI model predicts that Mexican manufacturing exports to the US will increase by a range of $39.5 billion to $43.5 billion by 2002. However, $6 billion to $7 billion of this increase will be trade diversion (replacement of imports from other countries rather than additional US imports). Hence the net additional U.S. imports would be $33.5 billion to $36.5 billion by 2002. Using the ESI job multiplier of 25,000 jobs per $1 billion of US trade, we calculate the gross job losses to be 837,500 to 912,500 by 2002.

equal to U.S. productivity is a major reason why it predicts such large increases in Mexican exports to the U.S. and resulting U.S. gross job losses.

NAFTA-induced changes in labor migration are responsible for much of the adverse U.S. labor impacts predicted reported by the model by Robinson and others. The assumption that U.S. consumers distinguish and prefer U.S. made products tends to reduce U.S. adverse job impacts due to NAFTA.[21]

In sum, models are more likely to predict substantial U.S. gross job losses or wage reductions if they include FDI in Mexico, investment diversion from the United States, increases in productivity in Mexico, and assume that U.S. consumers do not distinguish between similar goods made in the United States and Mexico. The inclusion of migration in NAFTA models may raise or lower adverse U.S. labor impacts depending on the treatment of capital flows, the Mexican agricultural sector, and the impact of NAFTA on the ease of economic interaction between the U.S. and Mexico. These key assumptions are inherently uncertain, again illustrating that the models cannot substitute for judgment concerning the pros and cons of NAFTA.[22]

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[21]An example is provided by the Stanford model. One scenario, which assumes national product differentiation, predicts positive U.S. labor impacts. A second scenario, which assumes a smaller degree of preference by U.S. consumers for U.S. made goods, predicts U.S. net job and wage losses.

[22]The fact that judgment has to be used in considering these models is shown by Clyde Prestowitz's (president of ESI) switch from opposition to support of NAFTA. Although he did not disallow the ESI model, he now believes that there may be significant displacement of Asian production by Mexican production, which will reduce adverse impacts on US workers. See "NAFTA: Why We Hafta," *The Washington Post*, September 19, 1993.

Chapter IV

WHAT DO THE MODELS SAY ABOUT THE KEY ECONOMIC ISSUES?

The previous section discussed the findings and limits of economic models relating to NAFTA. This section uses those findings to assess the six key economic questions identified in section I.

TRADE IMPACTS

A central issue in NAFTA is changes in trade — U.S. exports to Mexico, U.S. imports from Mexico, and the resulting overall balance of trade. Higher U.S. exports to Mexico would support U.S. jobs, while increased imports from Mexico could displace U.S. companies and workers. As noted earlier, most analyses predict increases both in U.S. exports to Mexico and in U.S. imports from Mexico, resulting from reduced tariff and other trade barriers.

Assessing the Prospects for Trade

In evaluating these varying claims, it helps to consider recent historical data and trends. For example, proponents cite the small size of existing U.S. and Mexican trade barriers as evidence that NAFTA will have inconsequential impacts on U.S. workers; the U.S. and Mexico currently have trade-weighted average tariffs of 3.4 and 10 percent respectively (ITC, 1991a).

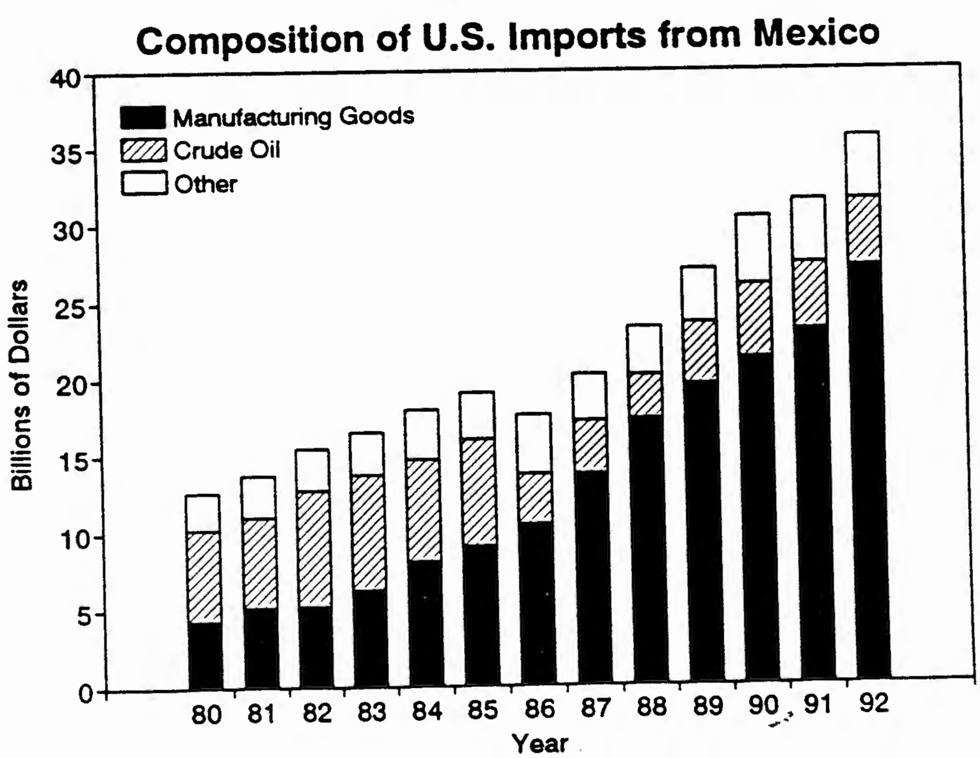
At the same time, supporters point to the large increase in U.S. exports to Mexico since 1987. The last decade has seen significant growth in U.S.-Mexico trade, as shown in Figure 1. Bilateral trade (exports plus imports) increased from $28 billion in 1980 to $79 billion in 1992. Mexico's share of all U.S. trade increased from 6 percent in 1980 to 8 percent in 1992 (BEA, 1993, p. 76). Trade in manufactured goods has expanded even more rapidly than trade overall, as shown in Figure 2.[23] Advocates of NAFTA claim that the agreement will maintain or accelerate this trend in U.S. exports to Mexico, creating still more jobs for U.S. workers.

[23]Dependent on oil for almost half of its exports just a decade age, Mexico now relies on manufacturing for three quarters of its exports to the U.S. In dollar terms, Mexico's manufactured exports have risen from $4 billion in 1980 to $27 billion last year.

Figure 1

Source: Department of Commerce.

Figure 2

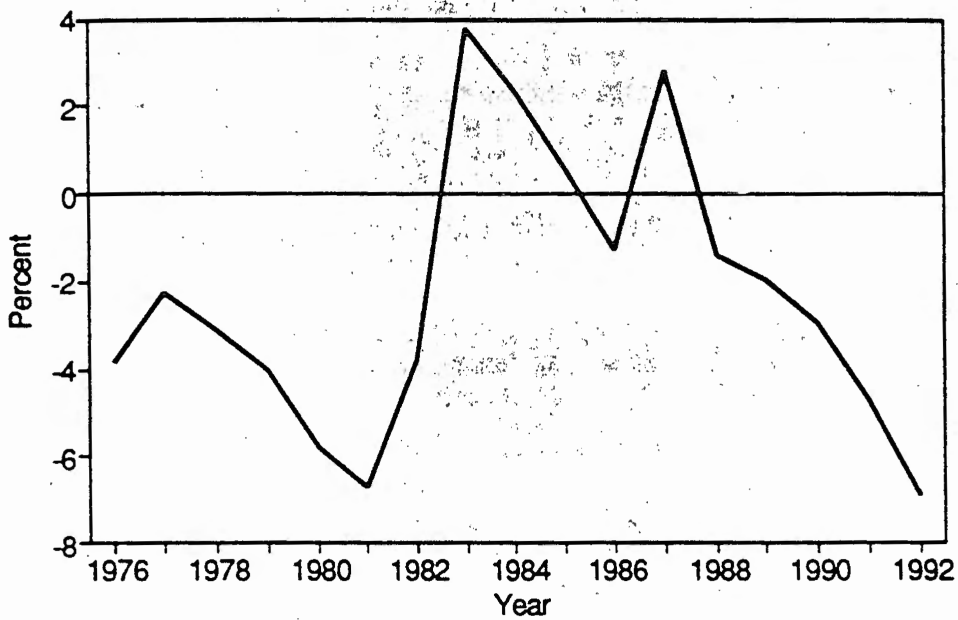


Source: Department of Commerce.

The issue of whether the recent growth in U.S. exports to Mexico can be sustained must be considered in light of the deterioration in Mexico's current account.[24] Mexico has swung from trade surplus to trade deficit, not just with the U.S. but with the rest of the world. In 1987, Mexico had a surplus on its current account (which includes payments for services as well as merchandise) equivalent to 3 percent of its GDP. By 1992, that surplus had dropped to a deficit equal to 7 percent of its GDP, as shown in Figure 3.

Figure 3

Mexican Current Account Balance As a Percent of GDP



Sources: Department of Commerce; Banco de Mexico; Joint Economic Committee.

While the U.S. trade balance with Mexico strengthened between 1987 and 1992, the change was very modest in comparison to the total change in Mexico's current account. Mexico's merchandise trade balance with the U.S. declined by $11 billion, but its total balance including services and trade with the rest of the world fell by $27 billion, as shown in Figure 4.

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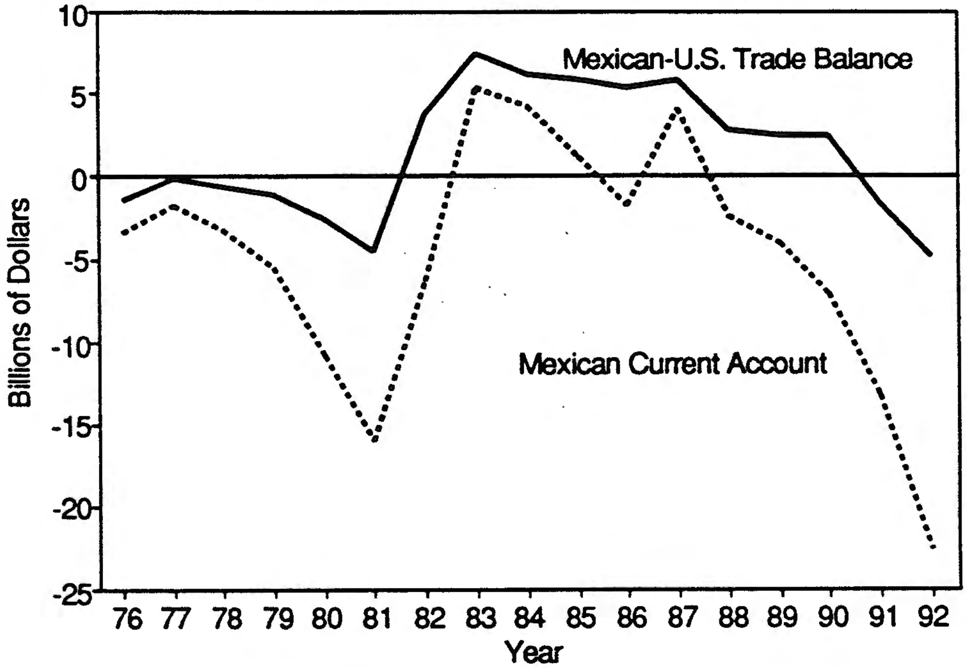
[24] The current account includes merchandise exports and imports, exports and imports of services (net investment income, net receipts from foreign travel, other services); and net transfers (gifts).

Figure 4

Mexican Current Account Balance



Sources: Department of Commerce, International Financial Statistics; Banco de Mexico; Joint Economic Committee.

It is unlikely that Mexico can continue to run widening current account deficits, and the mechanism for adjustment may require a real depreciation of the peso. There has been a real appreciation of the peso relative to the dollar since 1987.[25] This increase has greatly benefitted the price competitiveness of U.S. exporters to Mexico, helping to fuel the recent U.S. export boom. A correction of Mexico's current account deficit would reduce the growth rate of U.S. exports to Mexico and increase U.S. imports from Mexico, by changing the relative price of U.S. goods and depressing living standards in Mexico.

Thus, extrapolating the 1987 to 1992 trend in U.S. exports into the future, as some have done, is questionable in light of Mexico's current account imbalance today. At some time, Mexico will have to begin repaying the borrowed capital that is now financing the U.S. trade surplus, slowing the growth in the number of U.S. jobs that are supported by exports to Mexico.

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[25]The annual change in the real peso exchange rate was calculated by adjusting the nominal depreciation in the peso relative to the dollar for the annual difference in U.S. and Mexican inflation rates. The inflation rate was measured using each country's consumer price index.

INVESTMENT IN MEXICO AND THE UNITED STATES

Some of the most difficult issues to quantify regarding NAFTA relate to investment. Will NAFTA encourage new foreign investment in Mexico? How much of that investment will be diverted from investment and job creation in the United States?

On the one hand, NAFTA reduces Mexican barriers to imports which have provided an incentive for U.S. producers to locate in Mexico. On the other hand, as discussed in section II, much of NAFTA is specifically designed to further reduce barriers to U.S. investment in Mexico. Indeed, as the Congressional Budget Office notes, a central goal for Mexico under NAFTA is "to attract and productively absorb foreign capital," and to make Mexico "more attractive for U.S. investors" (CBO 1993a, p.iii). Thus, NAFTA may result in sizeable new investment flows to Mexico, some at the expense of investment and jobs in the U.S.

Given the importance of the investment issue, especially its potential impact on U.S. jobs, it is somewhat surprising that ten of the models received in this report do not consider the question of whether U.S. investment would be diverted to Mexico as a result of NAFTA.

What is the justification for excluding possible investment diversion? There are two arguments. First, some analysts claim that no investment diversion will occur because Mexico will only receive foreign investment that otherwise would have gone to other countries. The investment would not have occurred in the United States in any case, with or without NAFTA, so there is no reason to include it as a direct impact of NAFTA. In this view, any increase in U.S. FDI in Mexico due to NAFTA will all be at the expense of U.S. FDI in other countries, rather than direct investment in the United States.

The second argument against including investment diversion is that any investment shifts from the U.S. to Mexico would be too small to affect aggregate domestic U.S. investment. For example, if $2.5 billion of direct investment in manufacturing were diverted from the U.S. to Mexico in 1992, it would be only about 1.5 percent of the $174 billion in U.S. manufacturing investment in the U.S. (BEA, 1993). Thus, any investment diversion that does occur will be far too small to significantly affect the U.S. economy.

The claim that no FDI in Mexico would have been made in the United States is undercut by Mexico's impressive performance in attracting U.S. investment, and in producing goods requiring world class capital, technology, and labor skills such as engines and cars for export to the U.S.[26] Factories producing such goods could well have been located in the U.S. Given Mexico's growing capacity for high-quality production, it would be surprising if no investment was diverted from the U.S. to Mexico under NAFTA.

The fastest growing component of U.S. investment in Mexico is manufacturing. According to the latest U.S. Commerce Department survey, U.S. companies planned to spend $2.3 billion on plant and equipment in manufacturing businesses in Mexico in which

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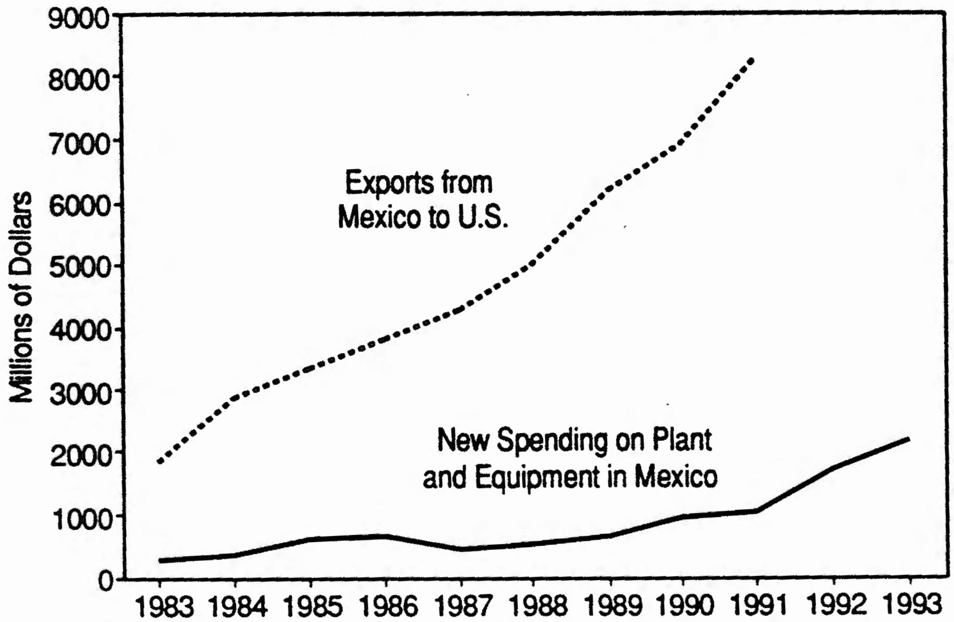
[26]U.S. imports of motor vehicles from Mexico increased from $1.17 billion in 1989 to $2.59 billion in 1992 (U.S. Deparatment of Commerce, 1993).

they had control, at least three times the amount of five years ago. As indicated by Figure 5, there already has been a rapid escalation in such spending in recent years.[27] U.S. imports from those U.S. companies operating in Mexico are rising at a comparable rate to that of investment. It seems unrealistic to assume that there will be no investment diverted from the U.S. to Mexico, nor that additional imports from Mexico to the U.S. will automatically be offset by U.S. capital goods exports to establish those plants.

Figure 5

U.S. Manufacturing Companies' Activity in Mexico



Source: Department of Commerce.

The second argument against including investment diversion dismisses the problem, because potential investment shifts would be small relative to total U.S. investment. However, the relatively small size of potential investment shifts provides no reason to ignore their impacts on the U.S. economy. The 700,000 U.S. jobs that NAFTA supporters claim were tied to exports to Mexico in 1992 is only 0.6 percent of total U.S. civilian employment. If such job claims are included by proponents in evaluating of NAFTA's impacts, the potential losses due to investment diversion should also be considered. Again, this takes on special importance when trying to assess NAFTA's impact on U.S. jobs, where investment diversion could be a major contributor to U.S. losses.

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[27] It should be noted that these data exclude spending in joint ventures and other ventures in which U.S. companies lack majority control.

IMMIGRATION FROM MEXICO TO THE UNITED STATES

A third key issue in assessing NAFTA's economic impact is immigration from Mexico to the United States. In recent decades, Mexico has almost certainly had a greater effect on the U.S. economy through migration of its people than through trade in goods. NAFTA's impact on migration flows should be considered in any comprehensive analysis of its economic effects.

Of the sixteen studies reviewed here, only three consider the potential effects of NAFTA on labor migration from Mexico to the United States. These effects range from an increase of 610,000 Mexican immigrants to the United States to a decrease of 1,587,000 Mexican immigrants to the United States.

Modelling immigration movements with any degree of precision is difficult, especially when trying to predict the changes as a function of economic impacts which are themselves subject to large variations. Offsetting factors difficult to predict come into play. Immigration into the U.S. would be reduced if wages and job opportunities improve in Mexico. On the other hand, greater imports of farm products into Mexico would displace labor from Mexico's rural areas more rapidly, which would stimulate migration to urban areas in Mexico and the U.S. In a recent study of possible immigration effects, Martin (1993) predicts that NAFTA will initially increase the number of Mexicans moving permanently to the United States by between 20,000 and 30,000 per year for the rest of the decade, followed by decreases after 2000. The increases in the 1990s are due to increased demand for farm workers in the US, job displacement in Mexico due to elimination of protection for Mexican farmers, and an acceleration of existing migration patterns in Mexico that will bring more displaced Mexican workers to border areas that are accessible to the United States.

NET JOB GAINS OR LOSSES IN THE UNITED STATES

Most of the debate over NAFTA's economic impact has centered on this question. Job gains or losses are variously ascribed to increased net exports from the U.S., diverted investment to Mexico, changes in migration patterns, or other factors.

It may surprise non-economists to find that ten of the models offer no estimates of net job changes. In seven of the ten cases, the exclusion is due to a theoretical assumption of full employment — no net job change in the U.S. Thus, by definition, these models cannot result in a finding of net job losses in the United States.

Economic theory and statistical modeling do not lend themselves to reliable estimations of net changes in the total number of jobs due to expansion of trade and foreign investment. In these approaches, trade expansion has effects much like technological innovation: some workers gain, some lose, and work requirements for the same level of national consumption often are reduced. The net quantity of jobs cannot be estimated with confidence since it will depend on the pace and sequence of many offsetting market decisions.

Six of the models predict net job effects, again with wide variation. The estimates range from net U.S. losses of 220,000 jobs to gains of 2.8 million jobs.

Estimates of job impacts ranging into the millions, positive or negative, strain credibility. A positive gain of 2.8 million jobs in U.S. economic output to increase by roughly $140 billion. That would be 350 percent of U.S. exports to Mexico in 1992 of $40.5 billion.[28]

Other models make estimates of net job effects within plausible ranges, but make assumptions that limit their productive utility. For example, as discussed above, a critical issue is whether investment in Mexico will take place at the expense of investment in the United States. But the four models that predict net U.S. job gains as a result of NAFTA also assume that some diversion of investment will not occur. For those who believe that diversion is a significant possibility, these models should be given less weight.

Some analyses argue that the Mexican economy is too small to have a significant impact on U.S. jobs. But different statistics can paint very different pictures of the Mexico's potential to affect the U.S. labor market. As Table 3 shows, Mexico has total economic output valued at around 5 percent of U.S. output.[29] On the other hand, Mexico has a large working age population, around thirty percent of the U.S., as shown in Figure 6. This implies that Mexico has more potential to affect the U.S. labor market than a simple GDP comparison might suggest.

TABLE 3. STRUCTURAL DIFFERENCES BETWEEN THE U.S. AND MEXICO

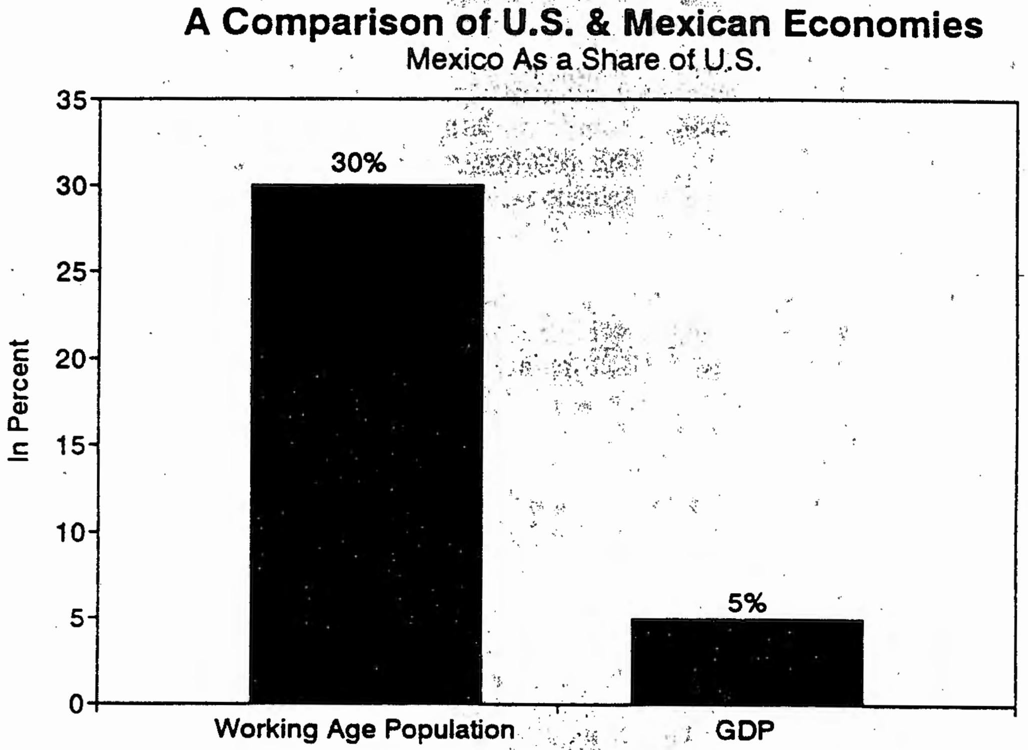
	U.S.	Mexico	Mexico as a Percentage of U.S.	U.S. to Mexico Ratio
Gross Domestic Product in billions of 1991 U.S. dollars	5611	283	.05	20 to 1
GNP Per Capita in 1991 U.S. dollars	22240	3030	.14	7 to 1
Working-Age Population 15-64 Years, 1992 (in millions)	166	50	.30	3.3 to 1
Projected Working-Age Population 15-64 years, 2025 (in millions)	197	93	.47	2 to 1
Hourly Compensation in Manufacturing in dollars, 1991 (index, U.S.=100)	100	14	.14	7 to 1

Source: Blecker, 1993.

[28]According to the U.S. Department of Commerce, there are 19,600 U.S. jobs for each $1 billion of U.S. merchandise exports to Mexico (Davis, 1992).

[29]It is often said that NAFTA would create the "world's largest free trade area." While technically true, this does not indicate that the market for U.S. goods has enlarged very much. Since the U.S. economy itself is larger than the combined EC economies, a free trade area of the U.S. and Grenada would set a world record. As a practical matter, the five percent growth of the U.S. economy in 1988 added as much to the market for U.S. producers as would NAFTA.

Figure 6



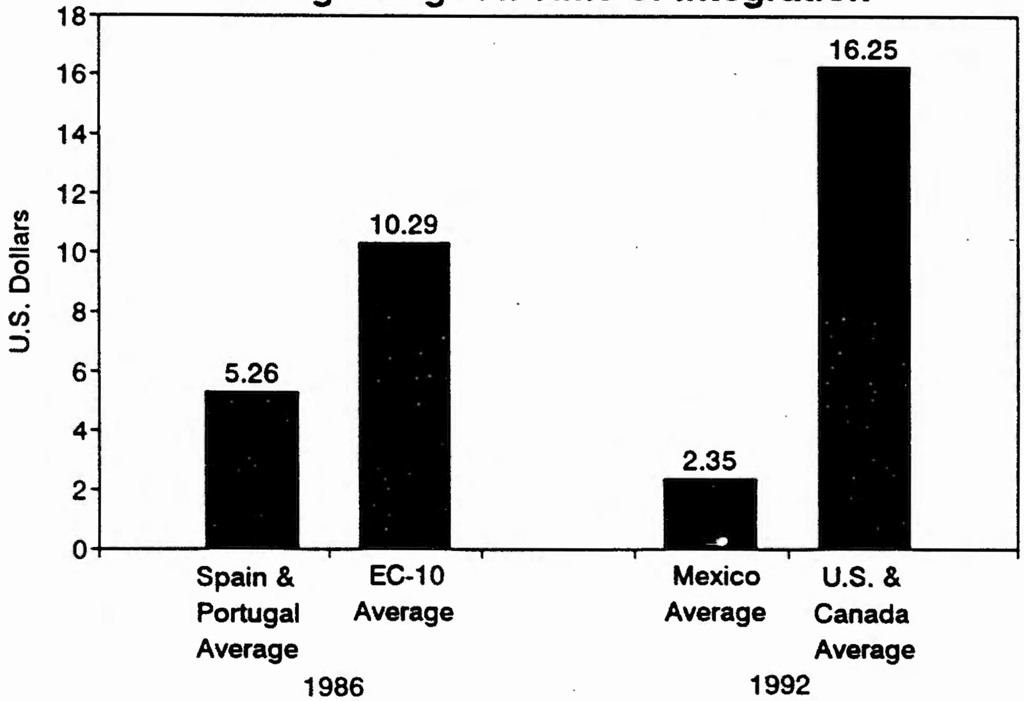
Sources: Department of Commerce; Banco de Mexico; IBRD.

A large working age population is a necessary, but not sufficient, condition for Mexico to have substantial effects on the U.S. job market. The key additional factor is modern capital equipment with its associated skills training, technology, and managerial methods. With increased foreign direct investment a major goal of Mexico in pursuing NAFTA and the treatment of U.S. investors a major concern of U.S. negotiators, the agreement includes many provisions sought by U.S. companies considering new or expanded operations in Mexico.

Some NAFTA supporters argue that wages in Mexico will increase with these productive inputs, closing the gap with the U.S. and limiting downward pressure on U.S. jobs or wages. They also sometimes cite the accession of Spain and Portugal to the European Community in 1986 to argue that low- and high-wage labor forces can be integrated with minimal disruption. However, the hourly compensation differential between U.S.-Canada and Mexico is 7 to 1, as shown in Figure 7.[30] This is much larger than the 2 to 1 hourly compensation differential between the EC-10 and Spain and Portugal in 1986.

[30]Hourly compensation is defined as (1) all payments made directly to workers, before payroll deductions of any kind, and (2) employer social insurance expenditures (expenditures for legally required insurance programs and contractual and private benefit plans). See BLS (1993).

Figure 7
Average Wage At Time of Integration



Sources: Department of Labor, Bureau of Labor Statistics; OECD; Joint Economic Committee.

In addition, the combined work force of Spain and Portugal was one seventh of the work force of the EC-10, while Mexico has a labor force roughly a quarter the size of the U.S. and Canada.

GROSS JOB DISLOCATIONS IN THE UNITED STATES

An analytically related but distinct question is the possible gross job dislocation in the United States. Even with a modest net gain in U.S. jobs from NAFTA, large gross job dislocation would present a substantial adjustment problem for many U.S. workers, and put pressure on public training and income maintenance programs. Nine studies that report estimates of gross job dislocation range from 18,800 to 912,500. One analysis (Choate) estimates U.S. "jobs at risk" under NAFTA to be almost 6 million — 5,900,000. This estimate is not based on any attempt to model the agreement or its possible impacts on investment, trade, or other factors. Further, Choate's estimate is for manufacturing industries alone, and represents about one-third of all jobs in U.S. manufacturing industries, and fifty percent of production workers.

By some estimates, NAFTA would have to provide Mexico with an additional $300 billion of exports to the United States to attract six million additional jobs. In 1992, total Mexican exports to the U.S. were valued at $35.6 billion, and the total size of the Mexican economy was $329 billion. If all the jobs "at risk" in Choate's scenario were to move, this would require Mexico's exports to the U.S. to rise by an amount equal to 91 percent of total Mexican GDP.

However, there are plausible estimates of gross dislocation of over 300,000 U.S. jobs, up to around 600,000. This question of gross dislocation has not received as much attention as the question of net jobs effects, but these levels would require significant program efforts for worker adjustment, beyond what is currently contemplated.

IMPACT ON WAGES IN THE UNITED STATES

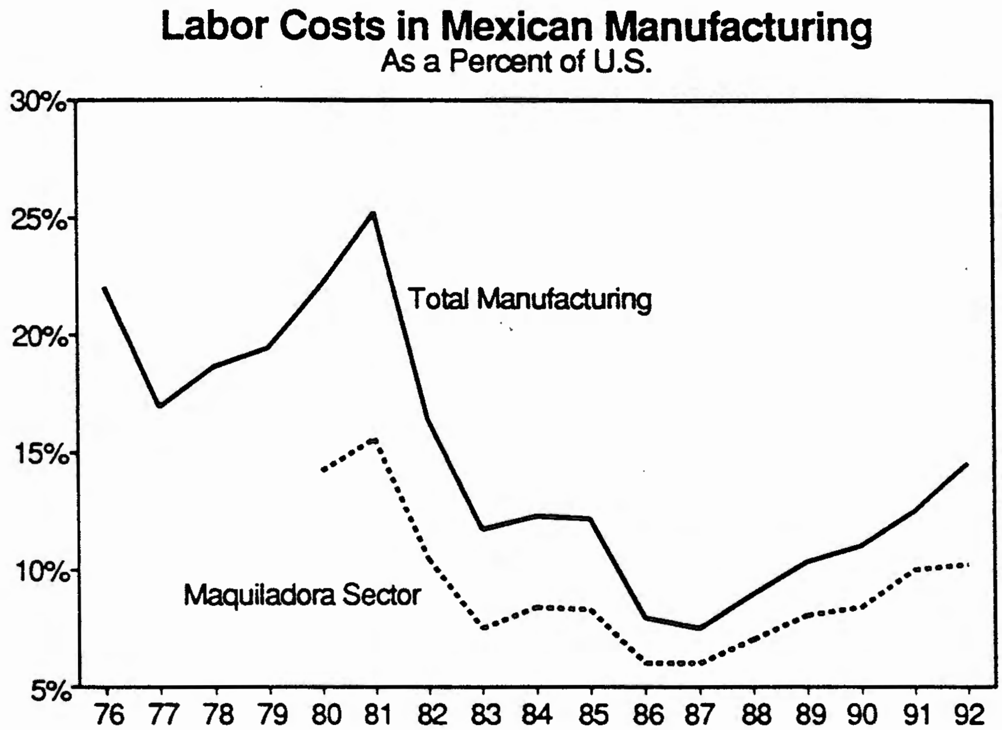
This question also has received relatively little attention in the debate over NAFTA. Yet it may be the issue with the most far-reaching impact on the United States. Many analysts believe that NAFTA will put downward pressure on U.S. wages, independently of any net or gross job impacts.

Six of the models do not provide prediction of NAFTA's impact on U.S. wage levels. Of the models that provide estimates, five present aggregate wage levels without examining subgroups based on skills or industrial sector.

U.S. workers engaged in manufacturing are directly exposed to competition, but workers in nontraded sectors also may be adversely affected. Wages of service workers may be depressed by NAFTA, especially in regions which depend heavily on industries which suffer production losses due to increased imports from Mexico.

In contrast, many NAFTA proponents argue that the agreement will not reduce U.S. wages. They claim that Mexican wages (measured in U.S. dollars) have risen relative to U.S. wages in recent years. But this argument overlooks the huge decline in Mexican wages relative to U.S. wages that occurred earlier in the 1980s. Even after accounting for the increases in Mexican wages since 1987, average Mexican hourly compensation in all manufacturing is now only 15 percent of U.S. levels, far below the 22 percent of 1980. As Figure 8 shows, this drop is true for the maquiladora sector, as well as total Mexican manufacturing.

Figure 8

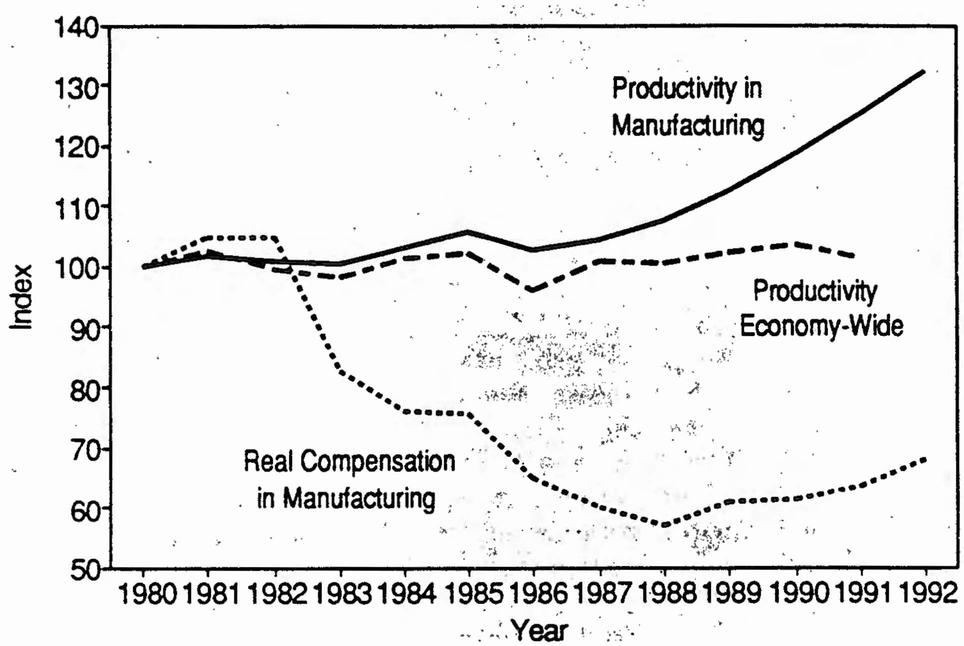


Source: Department of Labor, Bureau of Labor Statistics.

Of course, for Mexican wages to converge with the U.S., and thus lessen downward wage pressure on some U.S. workers, two things must occur: Mexican worker productivity must grow more rapidly than in the U.S., and those productivity gains must translate into higher Mexican wages. However, over the 1980-1992 period, there has been a dramatic divergence of Mexican labor productivity and real compensation. As Figure 9 shows, Mexican labor productivity — not just in manufacturing but in the overall economy — was higher last year than in 1980 while real compensation of labor in Mexico's manufacturing sector stood roughly one-third lower.

Figure 9

Labor Productivity and Compensation in Mexico



Sources: Banco de Mexico; INEGI; Joint Economic Committee.

NAFTA supporters claim that U.S. labor productivity is sufficiently higher than Mexico's to justify the 7 to 1 U.S.-Mexico hourly labor compensation. However, the proper comparison is not average productivity for each entire economy, but sectors where Mexican workers are equipped with advanced technology and adequate capital resources. There is evidence from case studies that Mexican labor productivity reaches levels approaching U.S. levels when Mexican workers are supplied with similar capital, technology, and management as U.S. workers.

Indeed, case studies of the operations of plants making similar products in the U.S. and Mexico find much narrower differences in the productivity levels in the two countries than in their wage levels. Shaiken (1992, 1993) has done case studies of engine plants in the U.S. and Mexico. In engine production, a rough labor productivity measure is the engines produced per person in an eight hour work day.[31] A Mexican plant produced three quarters as many engines per person as a more automated U.S. plant in 1991.

This productivity difference is far less than the seven to one difference in hourly compensation. While not typical of the Mexican economy overall, a modern engine plant is becoming increasingly typical of operations in Mexico producing exports for the U.S. market.

[31]This measure includes both direct and indirect labor and managerial overhead on the shop floor.

SUMMARY

The argument that Mexican wages are rising rapidly relative to U.S. wages uses a base year of 1987, when Mexican wages were seven percent of U.S. wages. It omits the fact that Mexican wages are much lower relative to U.S. wages in 1992 than in 1980. The contention that Mexican real compensation is now rising in tandem with real productivity increases is not supported by evidence from the last decade. The arguments against investment diversion ignore the fact that Mexico is already producing goods requiring highly skilled labor for export to the U.S.

The contention that Mexico is too small to affect U.S. labor markets ignores the size of Mexico's working age population. Although the Mexican economy is only one-twentieth of the U.S., Mexico's working age population is about one-third of America's. The reasoning that U.S. labor impacts will be minimal due to already low trade barriers overlooks NAFTA's reduction in barriers to investment in Mexico and the size of Mexico's labor force. The argument that NAFTA will result in no diversion ignores the fact that Mexico is already producing goods requiring highly skilled labor for exports to the United States.

The U.S. export boom to Mexico has coincided with a real appreciation of the peso relative to the dollar and a huge increase in Mexico's current account deficit to almost 7 percent of GDP in 1992. It is implausible to base future U.S. export trends and job gains on a continuation of this scenario.

Chapter V

SUMMARY AND CONCLUSION

This report has concentrated on three issues related to economic studies of NAFTA. First, it has shown that many of the assumptions used in the models rule out consideration of key questions. Second, in cases where models make predictions of the economic results of NAFTA, a wide variation in predictions is produced, and it is hard to reconcile the disparities. Finally, assumptions and predictions must be assessed in light of historic and economic trends, to assess their plausibility.

Although economic models can be useful in isolating key questions and trying to make empirical estimations of NAFTA's impact, the models cannot provide definitive answers to key questions about NAFTA. In addition, there are critical questions about the adequacy of the agreement itself that the models cannot answer, and those issues deserve more attention as the debate over NAFTA comes to a head.

This final section summarizes the role and limits of economic models, assesses the empirical findings on U.S. jobs and wages, and discusses key questions about NAFTA that cannot be addressed by models or empirical analysis.

USING ECONOMIC MODELS TO ASSESS NAFTA

The economic models reviewed in this report employ a wide variety of assumptions, techniques and data, and differ substantially in their empirical conclusions about NAFTA's results. In some cases, the models do not address the key questions. For example, models that assume full employment in the United States cannot conclude that the U.S. will have a net loss of jobs due to NAFTA. It is therefore difficult to compare their conclusions to models that do not make this assumption.

This wide range of differing assumptions spans key issues, including full employment, whether or not U.S. investment might be diverted to Mexico, the preferences of U.S. and Mexican consumers for goods produced in their own nation, the impact of increased investment on Mexican labor productivity, and whether immigration to the United States will be affected by NAFTA.

Because all of these issues are important in the NAFTA debate, it would be preferable for models to allow these assumptions to vary in relation to each other. This would permit modeling the interaction among these different factors (e.g., the impact of changing exports or diverted investment on U.S. jobs and wages). It is also desirable for analysts to vary the assumptions. For example, if a reader is especially concerned about the possible impact of diverting U.S. investment to Mexico, then having models that compare results with and without investment diversion can show what might be at stake for jobs and wages.

Regrettably, many of the analyses in the NAFTA debate fail to fully address either problem. Most of the models tightly constrain key variables with assumptions. And, although many of them present a variety of slightly modified scenarios, few of them conduct sensitivity analyses that fully test the effect of relaxing critical assumptions.

As a result, many of the empirical conclusions from these models are in large part reflecting the impact of the assumptions. As the CBO review of NAFTA models states, "Most, though not all, of what can reliably be concluded from the models merely confirms what economists already knew or believed to be very likely (CBO 1993c, p.4)." Blecker, who reviewed NAFTA models for the Department of Labor, testified to the Senate Committee on Labor and Human Resources that the "vast majority of existing studies are so strongly influenced by their authors' theoretical views and prior beliefs that they do little more than quantify those preconceptions" (1993, p. 11).

A notable exception is found in the analysis conducted at the Brookings Institution by Stanford (1993). Stanford constructs a general equilibrium model that does not assume full employment and allows wages to vary depending on workers' ability to bargain. Stanford then varies different sets of the critical assumptions, producing strikingly diverse results. In doing so, he illustrates the sensitivity of models to assumptions, and also allows direct comparison of different economic scenarios.

In fact, Stanford models virtually the full range of issues that concern most people in the NAFTA debate. In one model, which he calls the "neoclassical" approach, Stanford uses assumptions similar to those used by many other economists cited by NAFTA proponents, and gets similar results as theirs.

He then varies the assumptions, including the "Maximum Displacement" scenario reported in Table 2 [32] that tests the effects of investment diversion to Mexico, improved productivity in Mexico, and increased displacement of Mexican agricultural workers, and produces substantially worse results for the U.S. and Canada than economic models with more optimistic assumptions. Stanford even models a "Social NAFTA" that projects the impact of reducing Mexico's external debt, an increase in Mexican labor standards, and domestic investment stimulus by the U.S. and Canadian governments. This scenario produces gains for all three nations.

Stanford's work is the clearest illustration of the critical importance of assumptions in affecting empirical results from these models. By varying key assumptions that are of direct policy concern, he shows that assumptions do matter. His results also underscore that NAFTA could have very different economic consequences depending on how it is finally implemented.

In addition to the general failure to use substantially different assumptions in their models, many of the empirical studies fail to ground their assumptions in real-world trends. For example, in models that allow for changes in foreign direct investment in Mexico, and diversion of U.S. investment to Mexico, several models estimate possible changes in investment flows based on the experiences of other developing countries when trade relations were changed. These estimates are then plugged into the U.S.-Mexico models.

In contrast, the Economic Strategy Institute model conducted direct research into current patterns of trade and investment between the U.S. and Mexico to estimate invest-

[32]The models in Table 2 were selected for their maximum impact, positive or negative, on the U.S. economy.

ment changes. The ESI researchers supplemented these data by interviewing corporate executives and industry analysts about possible investment plans, and they also incorporated an analysis of the actual provisions of NAFTA. Using these specific estimates, the ESI study predicts much larger gross job displacement than studies that use investment estimates extrapolated from indirect sources.

While such attention to specific detail does not guarantee final accuracy, it does indicate that the analysts have tried to make their model as realistic as possible. When empirical assumptions are made about different issues, they should be grounded to the extent possible in real world trends. Unfortunately, many of the NAFTA models make a priori assumptions about key issues, often without trying to evaluate those assumptions in light of other empirical trends.

WHAT CAN BE CONCLUDED FROM THE MODELS?

Confronted by this range of assumptions, techniques, and contradictory outcomes that influence the models' empirical conclusions, it may seem tempting to ignore the economic impact studies, and regard them all of them are equally invalid. But that would be overreacting. The models can be helpful when they address the critical economic issues, and create a general range of possibilities for most of the important questions associated with the impact of NAFTA.

The models reviewed here range from implausible and overly simplistic analyses to models that carefully consider the limits of data and technique in producing their results. This section assesses the models on three areas of concern for NAFTA's impact on the U.S. economy — net impact on total number of jobs, gross job dislocation and the possible impact on U.S. wages.

Net Job Change

This issue unfortunately has dominated much of the debate over NAFTA, to the exclusion of other issues. The partial consensus on this issue has to some extent masked the other issues of gross losses and pressure on U.S. wages, which also are critical to evaluating NAFTA.

This represents a rare agreement in the NAFTA debate. Compare Jeffrey Schott, a leading supporter of NAFTA, with Blecker, one of the principal critics of the economic studies. Schott: "the 'jobs debate' has been marked by hyperbole on both sides (Schott, 1993, p. 2)." Blecker: "There are no credible estimates of large net (aggregate) job losses from NAFTA, but then there are no credible estimates of large net gains either" (1993, p. 11). "The aggregate employment implications of NAFTA have, quite simply, been overblown on both sides" (1993, p. 13.) But this fragile consensus on relatively small net job impacts breaks apart on two other vital questions: gross job dislocation due to NAFTA, and the impact on U.S. wages.

Gross Job Dislocation

The questions of gross dislocation due to NAFTA should be considered separately from the question of overall net job impact. If NAFTA does not produce much job dislocation, then relatively little will have to be done to adjust to those impacts. But a high level of dislocation will mean much more disruption and "churning" in the job market, at a time of slow job growth.

Unlike the estimates of net job impact, the range of plausible gross dislocation is much broader. Hufbauer and Schott estimate a gross dislocation of about 145,000 workers over five to six years, while the Economic Strategy Institute estimates that up to 912,500 workers could lose their jobs over nine years because of NAFTA.

Because they consider only jobs in traded-goods industries, the estimates of dislocation probably are underestimates. Severe economic dislocation, especially if concentrated in specific industries and regions, can have a larger "negative multiplier" effect, as jobs and incomes in local service industries are affected by the direct loss of jobs due to NAFTA. And it will put additional burdens on federal programs for dislocated workers and economically distressed communities, at a time of severe budget pressure.

Blecker's summary seems fair: "gross job dislocation on the order of about a half a million workers over a decade is a realistic possibility, and this figure is probably conservative (1993, p. 15)." If indirect, "negative multiplier" efects were to be estimated, dislocation would be even higher.

Impact on U.S. Wages

If the issue of job dislocation has been somewhat underplayed, there has been even less attention to a third critical issue: the possible impact of NAFTA on U.S. wages, especially for workers in the lower part of the income distribution.

Again the models vary in their conclusions. Some models estimate a slight gains in average U.S. wages, although in many cases their assumptions of full employment and little or no investment diversion push them in this direction. Without job or investment losses, there are few other factors in these models that could drive wages down.

In addition, several models that predict wage gains do not differentiate among different groups in the labor market. Thus their findings of positive wage gains represents an overall average, potentially masking simultaneous wage growth for some and decline for others.

Much economic theory and experience suggests that closer economic ties between the U.S. and Mexico will lead to downward pressure on U.S. wages, especially for non-professional workers and those without a college education. It is important to emphasize that this downward pressure on wages does not depend on finding significant net or gross job losses due to NAFTA, but is an independent potential result.

For example, Stanford (1993) estimates a possible reduction in U.S. labor income of up to 1.1 percent, in the absence of corrective social policies or greater efforts to stimulate U.S. economic growth. At current rates, this would represent a loss of up to $348 from the average full-time compensation for a manufacturing production worker.[33] This may seem like a relatively small amount, but it should be viewed in relation to the wage and income stagnation of the past twenty years. Real compensation in the nonfarm business sector has risen just 7.5 percent since 1973. If NAFTA reduced this by Stanford's estimate, it could wipe out 15 percent of those gains on average.[34]

OTHER QUESTIONS IN JUDGING NAFTA

This report has reviewed sixteen models of various estimated economic impacts if NAFTA goes into effect. In contrast to a widely-held perception that the vast weight of the economic evidence supports NAFTA, this review finds that there are several plausible economic analyses that predict negative economic impacts from NAFTA. Policy makers and the public should not assume that the economic studies of NAFTA predict unambiguously positive effects for the United States.

However, the models and economic analyses also do not automatically prove the opposite conclusion — that NAFTA is unambiguously bad for the American economy. For this report also has emphasized the limits to economic models. People on both sides of the NAFTA debate often are overreaching when they use these economic models. As discussed, some of the models are simply too crude to shed much light on the issues at hand. In other cases, models rule out, by assumption, consideration of key questions.

But even when done with as much rigor as available data and technique permit, the models are only tools for reaching judgments about NAFTA. Several critical questions about NAFTA's impact are not addressed in these models, and answering those questions should be part of reaching a decision about the agreement.

1. *Are economic provisions and the side agreements adequate?* Most of the models were run before NAFTA was finalized. Thus they do not attempt to model its specific provisions, either the trade and investment provisions at the heart of the agreement, or the side agreements on labor. Because passage of NAFTA may well set the terms for future trade agreements between the United States and additional newly industrializing countries in Latin America and East Asia, assessment of the side agreements is a critical issue. NAFTA may become a template for future U.S. trade agreements.[35] If this happens, and

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[33]U.S. production workers in manufacturing would be expected to suffer a cut in compensation at least as large as the average cut for all workers in the economy, which Stanford estimates at 1.1 pecent. According to the most recent BLS figures, U.S. production workers in manufacturing in 1991 were paid for an average 41 hours a week for 52 weeks a year and worked for 93.4 percent of the paid hours, for a total of 1991 hours of work per year. With average compensation per hour worked of $16.17 last year and if hours paid were unchanged, then annual compensation totaled $32,194 and a loss of 1.08 percent would equal $348.

[34]Compensation data from *Economic Indicators*, September 1993, and the *Economic Report of the President, 1993*, Table B-44.

[35]The *New York Times*, in a recent message to Latin American leaders, "President Clinton promised that American approval of NAFTA would be 'the first step' in achieving a goal of freer trade throughout the region." *New York Times*, October 19, 1993, p. A10.

economic problems do result from NAFTA-type agreements, then the U.S. economy will experience more job dislocation and downward wage pressure.

2. *Are economic and adjustment policies adequate?* Most analysts expect some gross job dislocation in the U.S., and some forecast significant increases in dislocation, with additional likely negative effects on communities and industries. The higher the level of possible dislocation, the more important it is to assess the adequacy of U.S. labor market and community adjustment policy.

In addition, NAFTA may well put further downward pressure on wages of non-professional workers in the U.S. In light of this pressure, which has not received much attention in the NAFTA debate, it is important to consider the adequacy of U.S. policies to generate higher economic growth and higher wages and incomes to help combat these low-wage pressures.

3. *Foreign policy considerations.* The impact of approving or rejecting NAFTA on U.S. relations with Mexico, Latin America, and the rest of the world is an important issue, but the economic models are of little help here.

4. *Environmental Issues.* The economic models reviewed here do not address environmental concerns, which also are significant in the overall debate over NAFTA.

This report does not pretend to solve the complex economic or other issues relating to NAFTA. It has a more modest goal — to conduct a thorough review of economic models of NAFTA, emphasize the limitations on those models as a guide to public policy, and point out that there is a plausible range of positive and negative economic outcomes from NAFTA. Economic analysis and models can be useful tools when used properly, but they cannot substitute for the overall process of evaluation and judgment that must be made on a complex issue like NAFTA.

It is this report's conclusion after carefully reviewing the evidence that likely outcomes from NAFTA include relatively small net impacts on American jobs, potentially significant gross job dislocations, and downward pressure on wages for non-professional and technical U.S. workers. But this conclusion is not, and cannot, be written in stone.

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MEMORANDUM

COUNCIL OF ECONOMIC ADVISERS

August 9, 1993

TO: LAURA TYSON
ALAN BLINDER
JOE STIGLITZ

FROM: SHERMAN ROBINSON SR

SUBJECT: The Politics of NAFTA

From recent newspaper coverage and conversations on the hill, I think we are starting to get a pretty good idea of where the battle lines are forming in Congress regarding NAFTA. All agree that passage of NAFTA requires a bipartisan coalition that includes a significant majority of the 100 or so undecided freshmen members, mostly Democrats. The current solid core of supporters includes more Republicans than Democrats. There is a potential coalition of liberal Democrats forming around Rep. Torres, who has been a steady critic of NAFTA (he voted against fasttrack) but who has stated he could support NAFTA under some conditions (good side agreements, especially regarding labor, and the creation of a North American Development Bank —NADBank). Gephardt is also clearly concerned about adjustment issues, and wrote a letter supporting Torres' proposal for NADBank (as did, interestingly enough, Orin Hatch of Utah).

In assessing the political problems the Administration faces in getting NAFTA approved this fall, I make a few assumptions:

(1) The economic situation will not look very encouraging in the fall. That is, the recovery will still look weak, with a high unemployment rate and a steady stream of news stories about companies firing workers at all levels.

(2) The side agreements will look good, but will not satisfy the more extreme critics who want strong sanctions in both the labor and environmental areas.

(3) Perot will probably look a bit weaker, but he will still be a steady critic of NAFTA, with more speeches about "sucking sounds."

In this environment, I think that the major problem concerning NAFTA will be that voters are uncertain and fearful about the state of the economy and the security of their employment. Perot and the labor unions have succeeded to a large degree in making NAFTA a metaphor for this uncertainty. Any trade agreement, almost by definition, involves adjustments and changes in the structure of production and employment. Such adjustments are much easier in a rapidly growing economy. With economic uncertainty, voters are fearful and want to protect themselves. Promises of long-run benefits will not be enough, unless they get guarantees that the Government, which is introducing these changes, will manage the adjustment process. In the words of Carl Rowen in a recent Washington Post column (8/8/93), the President "must assure that there will be adequate compensation to those workers and companies that may lose out."

In the past few Deputies meetings, we have focused on environmental issues, especially regarding financing environmental projects along the border. Some, especially Tim Wirth, have argued that environmental issues are crucial, and that there is potential support for NAFTA by environmental NGOs, who will be crucial in forming the winning coalition. While I think that environmental concerns are important, I think this argument is exaggerated. It is far more important to meet the concerns of the liberal Democrats, for whom environmental issues are significant but adjustment problems are crucial. For Torres and Gephardt, environmental issues are certainly not as important as adjustment problems.

I think a few conclusions follow:

(1) The institutional response to establishing NAFTA should be seen as ambitious rather than minimal. NAFTA-PLUS is more than just a re-packaging of the Bush Administration approach, but represents a different view of NAFTA. The Clinton Administration must be seen as responding to the fears of workers and to be effectively managing the adjustment process.

(2) To meet the concerns of environmental groups, it is necessary to provide an institutional mechanism for implementing environmental investment projects and to provide a stable source of funding for such projects. We have focused on this concern the most.

(3) It is necessary to provide support for displaced workers to meet the concerns of those who are worried about labor displacement due to changes in the structure and volume of trade. The current proposals from the Labor Dept. to provide general support for labor adjustment should go a long way toward meeting this concern.

(4) It is necessary to provide mechanisms to provide or encourage investment, both along the border and elsewhere, to provide social overhead and physical infrastructure to ameliorate the adjustment costs inherent in achieving closer economic integration under NAFTA. This is a problem area.

The most recent proposal concerning the side agreements, currently under discussion with the Mexicans, would establish two institutions in addition to the labor and environment commissions. There would be a Border Environment Administration (BEA), and a Border Environment Finance Facility (BEFF), which would be "associated" with the IDB. These two institutions would be narrowly focused on border environmental problems.

I think that the side agreements plus the BEA and BEFF should meet the concerns of many environmentalists, even if the environment commission does not have strong enforcement powers. The effect should be to split the major environmental groups, which would suffice.

My concern is that the current NAFTA package does not adequately address concerns (1) and (4). Simply managing environmental needs will not be seen as an adequate institutional response to those worrying about economic insecurity. In the past week, Torres' response to the various press reports indicates that he feels strongly that a narrow focus on funding only environmental projects will not suffice, and I think that Gephardt feels the same way. Indeed, Torres is reported as saying that he would vote against NAFTA if the Administration does not move toward his NADBank proposal.

Torres is pushing his NADBank idea because he sees it as a broader institutional response to the adjustment problems inherent in NAFTA. While it is hard to judge the cohesion of the coalition he has put together supporting the NADBank idea, I see no reason at this point to make it difficult to compromise. I have stated a number of times that we should keep the funding institution flexible, so that we could move some distance toward creating the sort of NADBank that Torres proposes, if that seemed politically desirable. I would not have called it a "Border Environment Finance Facility" because that appears to lock in a very narrow focus. I favored calling it a "NAFTA Development Bank" (NDB), just to keep open the possibility of compromise later. Why paint yourself into a corner for no reason!

At this point, I recommend that we should:

(1) rename the BEFF, say that we plan to be flexible in designing the institution within the IDB, and also say that we could move toward Torres' proposal, if the Mexicans are also willing; and

(2) make sure that both the BEA and the NDB are tied to NAFTA. The environmentalists would be delighted to have the BEA without NAFTA, and Torres would also be content to have the development bank without NAFTA.

MEMORANDUM

COUNCIL OF ECONOMIC ADVISERS

August 9, 1993

TO: LAURA TYSON
ALAN BLINDER
JOE STIGLITZ

FROM: SHERMAN ROBINSON

SUBJECT: Newspaper coverage of NAFTA

There is continuing newspaper coverage of the NAFTA, mostly focusing on mechanisms to pay for environmental projects along the border. I discussed some of the articles that appeared last week in a previous memo. I attach some of the recent stuff that I think is especially interesting.

There is a good article by Bob Davis in the WSJ (8/6/93), a pretty good article in the Financial Times, and what looks like more hurried coverage by the NY Times, all based on detailed knowledge of the draft discussed at the Deputies meeting on Monday (8/2/93). There is also an excellent column by Hobart Rowen in the Sunday Washington Post (8/8/93) discussing the problems of passing NAFTA in Congress.

U.S. Would Provide Most Funds for Bank Proposed to Clean Up Mexican Border

By Bob Davis
Staff Reporter of The Wall Street Journal

WASHINGTON – The U.S. would provide most of the capital for a proposed U.S.-Mexico development bank to pay for environmental cleanup along the two countries' border, even though most of the projects would be in Mexico.

Under a plan Clinton administration officials are discussing with Mexico, Washington would provide 85% of a proposed $525 million in start-up money for the bank, and guarantee most of the remaining $4.5 billion it would raise over five years. As a result of its contribution, the U.S. would have effective control over the $5 billion bank.

The bank would lend to specific projects, which also would raise their own money through user fees and their own bonds. Because virtually all of the cleanup projects would be on the Mexican side of the border, though, Mexico would guarantee repayment of the bulk of the projects' bonds. U.S. officials say that the U.S. would benefit from the projects because much of the pollution on the U.S. side of the border originates in Mexico.

The bank would be one of two institutions that the U.S. recommends creating to deal with environmental problems along the two countries' border. The other, a binational Border Authority, would approve and oversee the environmental projects in the border region. The authority's territory would be defined as the border area's "watershed ecosystems, regardless of political boundary."

The proposals come as trade officials from the U.S., Mexico and Canada continue discussions on labor and environmental side-agreements to the North American Free Trade Agreement. Border cleanup funding is a central part of those talks, although Canada has said it doesn't want a formal role in the effort.

The talks are at an impasse over U.S. demands that it be able to impose trade sanctions if an arbitration panel finds that Mexico or Canada aren't enforcing their environmental or labor laws. The U.S. has discussed a compromise plan calling for fines on governments for nonenforcement; only if Nafta governments didn't pay the fines could sanctions be imposed.

But House Majority Leader Richard Gephardt (D., Mo.) and Sen. Max Baucus (D., Mont.), who is chairman of the Senate Finance Committee's international trade panel, wrote U.S. Trade Representative Mickey Kantor on Tuesday that such a compromise would be unacceptable to them. "Unfortunately, the proposals appear to be aimed at accommodating the interests of those in the business community and our trading partners, who believe there is nothing wrong with the status quo," they wrote Mr. Kantor. The support of both Democrats is crucial for Nafta to pass Congress.

With regard to the separate environmental funding plan, a Nafta working group of the White House's National Economic Council on Monday endorsed the proposals that are being negotiated with Mexico. U.S. officials caution that the share of funds contributed by each country could change during negotiations, as could other specifics. But the plan, prepared by the Treasury Department, gives the most detailed look at how the U.S. proposes to proceed with border cleanup.

The border development bank, which would be housed in the Inter-American Development Bank in Washington, would provide loans and credit-guarantees to projects approved by the Border Authority. Of the $525 million in seed money, raised over five years, the U.S. would contribute $445 million. The 85% U.S. share would "practically assure" that the bank could obtain a triple-A rating for the bonds it would issue, according to a copy of the plan obtained by The Wall Street Journal. The remainder of the funds would come in the form of so-called callable capital, which would be guaranteed mainly by the U.S. government.

U.S. officials said that Mexico may want to contribute more capital in order to get a greater stake in the development bank. In turn, Mexico may ask the U.S. to pick up more of the tab for specific environmental projects.

The draft of the plan says its objective is "to help get congressional support for Nafta passage by creating mechanisms to ensure that environmental problems along the U.S.-Mexico border are addressed." But it may not go far enough to satisfy Nafta critics. Rep. Gephardt has said he wants to guarantee Nafta environmental funding by imposing a tax on border trade. The administration says that federal spending of $150 million annually would come from general appropriated funds.

Meanwhile, Rep. Esteban Torres (D., Calif.), a Nafta opponent, said he would support the pact if the administration backs his idea for a North American Development Bank that would cover spending for roads, bridges and other infrastructure – not only environmental projects. He also would allow the bank to finance projects further from the border; the administration plan wouldn't fund projects in Mr. Torres's district, which is 120 miles north of Mexico.

"I'm really disappointed in their present position," said Rep. Torres. "It doesn't create jobs away from the border."

"This is arguably half a loaf," added Charles Kamasaki, a vice president at the National Council of La Raza, a big Hispanic group that backs the Torres plan. "But half a loaf gets you no votes. A full loaf gets you a lot of liberal and centrist Democrats."

Airlines Set Earlier Date For Fall Fare Discounts

A Wall Street Journal *News Roundup*

The airline industry's fall fare war will take effect earlier than expected.

The industry, led by Delta Air Lines, cut advance-purchase fares Wednesday as much as 35% for travel between Sept. 15 and Dec. 15. Yesterday, Wings Holdings Inc.'s Northwest Airlines, seeking to stir up end-of-summer vacation business, applied the discount for trips that begin after Aug. 23. Discounts apply on tickets bought 14 days in advance. AMR Corp.'s American Airlines, Continental Airlines, UAL Corp.'s United Airlines, USAir Group Inc.'s USAir unit, America West Airlines and Trans World Airlines said they would match the Northwest move, and all major carriers are expected to follow suit.

Delta appears to have broken any hesitation in the industry to impose across-the-board discounts. Some analysts believe airlines have been holding off on fare sales until the outcome of a federal antitrust lawsuit in Galveston, Texas. In that suit, Northwest and Continental have accused American of trying to drive them out of business by steeply discounting fares.

But Northwest's quick move to extend the Delta-led fare sale supports the notion that the airlines, facing sluggish demand among price-sensitive leisure travelers, are eager to discount.

Southern National Corp.

First Savings to Be Bought In $181 Million Stock Swap

Southern National Corp., Lumberton, N.C., said it will buy First Savings Bank FSB, in Greenville, S.C., in a stock swap valued at $181 million.

Southern National, which has $5.2 billion in assets, said it will issue 0.855 common share for each First Savings share outstanding. The acquisition would make Southern National the third largest bank in South Carolina and give Southern National entry into 21 new South Carolina markets.

First Savings, with assets of about $2 billion, is the largest remaining independent bank in a state where many banks have been bought by out-of-state concerns. In June, First Savings' stock rose $2 on the announcement that it entered into preliminary talks about being acquired. In over-the-counter trading, First Savings rose 50 cents to $16. Southern National fell 12.5 cents to $21.75 on the New York Stock Exchange.

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Financial Times 8/6/93

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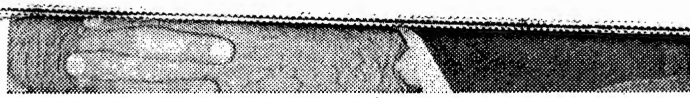

ing and get money to the ... gotten people," he says.
Mr Palmiro Soria Sauzedo,

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Clinton administration seeks special facility to raise $20bn for border projects

Mexico-US environment fund proposed

By Nancy Dunne

THE CLINTON administration has suggested to Mexico that the countries set up a finance facility, only loosely linked with the InterAmerican Development Bank, to raise up to $20bn (£13.4bn) for environmental projects at the border.

The proposal is part of negotiations on the North American Free Trade Agreement now under way in Washington. The trade ministers of the US, Canada and Mexico met again yesterday to take up where their subordinates left off in talks throughout the week.

The official word was that progress was being made but reports filtering out of the negotiations indicated otherwise – only partly due to the US desire to hold the Nafta grand finale after Congress has approved a new budget. The US is still insisting on the use of trade sanctions to enforce environment and labour aspects of the agreement; Canada and Mexico are, to different degrees, still resisting.

Although the administration is proposing a stand-alone financing facility for the environment for the first time, the idea is stirring little excitement in Congress, where several Democrats are still hoping for the creation of a North American Development Bank.

The Clinton plan is for a border institution, established through presidential agreement between the US and Mexico. It would co-ordinate a regional plan on the environment, review project designs for dealing with waste water and industrial pollution, assess the technical and financial feasibility of proposed projects, and oversee construction and operation.

It would also mobilise private sector finance, direct government supports (loans, guarantees, equity finance) and provide money through the finance facility.

The latter would be separately chartered and capitalised by the US, which would provide 85 per cent of the $525m in paid-in capital, and Mexico, which would provide the rest. It would be capitalised initially at $5.025bn, a sum expected to yield up to $20bn for lending. The IADB would be associated with it in some form of advisory capacity.

The scheme has been criticised as inadequate by Mr Albert Jacquez, chief of staff to Congressman Esteban Torres, who has introduced legislation to create a North American Development Bank.

UK exports 'lose out' in Argentina

BRITISH exporters to Argentina complain that the prohibitive cost of recently extended government export insurance is losing them busi-

Menem finds that free trade is something of a mixed blessing

John Barham reports on second thoughts in Argentina

A STEADILY deteriorating trade balance and approaching elections are forcing Argentina to backtrack

Inflation in Argentina has fallen to its lowest level in 24 years, reaching a

year to $4.93bn and Brazil is now Argentina's biggest export market as well as its biggest supplier.

NY Times
8/6/93

U.S. and Canada Make Deal On Beer Amid Trade Talks

By KEITH BRADSHER

Special to The New York Times

WASHINGTON, Aug. 5 — The United States and Canada settled a five-year-old trade dispute today that had threatened to result in sharply higher prices for imported Canadian beer.

Mickey Kantor, the United States trade representative, and Trade Minister Thomas Hockin of Canada struck the deal during a recess from their continuing negotiations on labor and environmental issues linked to the North American Free Trade Agreement.

The talks, which also include Trade Minister Jaime Serra Puche of Mexico, are scheduled to continue on Friday.

In a separate development today, new details emerged of the Clinton Administration's plan to create a joint agency with the Mexican Government to clean up the United States-Mexico border region. An internal Administration document calls for Congress to authorize $750 million in spending over five years, much of which would be used as the security for issuing $5 billion worth of bonds for the agency, while $61 million a year would be used for grants.

By eliminating punitive American taxes on beer from Ontario, today's agreement "ends the beer war between Canada and the United States," Mr. Hockin told reporters in the lobby of the Madison Hotel here, where the negotiations are being held.

Just over a year ago, the United States imposed a tax of $2.60 to $3 on each 24-bottle case of beer from the Province of Ontario, which has long restricted foreign beer sales and which had just imposed a tax on aluminum beer cans. The move came after four years of unsuccessful talks between the two countries about the problems faced by American breweries seeking to enter the Canadian market.

To preserve their share of the

Continued on Page D2

At Trade Pact Talks, U.S. and Canada Settle Beer Dispute

Continued From First Business Page

American market, Canadian breweries and their American bottlers have avoided raising prices and paid at least $3 million a month in taxes out of their profits, said Daniel Gagnier, the president of the Brewers Association of Canada.

If negotiators had not reached a deal, Canadian breweries could have eventually been forced to pass along the tax to American beer drinkers, Mr. Gagnier said.

In today's compromise, Ontario agreed to reduce various barriers to the distribution of imported beer like handling fees charged on imported beer by the Ontario Liquor Control Board. But Ontario retained its tax on aluminum beer cans, which falls mainly on American breweries because most Canadian beer is sold in bottles.

The United States, in return, eliminated its special tax on beer from Ontario. The main brands imported from Ontario are Molson and Labatt's.

Focus on Border Cleanup

This week, the labor and environment talks related to the North American Free Trade Agreement have focused on how to pay for the cleanup of the Mexican border area.

Several members of Congress said the White House was unenthusiastic about striking an overall deal in labor and environmental talks before the end of the month to avoid giving opponents more time to criticize the agreement before representatives and senators in their home districts.

As described last week by a senior Administration official, the United States wants to create a United States-Mexico border agency that would use money from bond issues to build water treatment and sewage centers.

The internal Administration document was obtained through lobbyists keeping track of the trade talks. According to the lengthy document, a new border authority would develop a regional environmental plan and then oversee the construction and financing of water treatment and sewage centers to carry it out.

Creating a Bond Agency

A separate Border Environmental Finance Bank would be set up within the Inter-American Development Bank, an institution similar to the World Bank, and would issue the bonds, which would be guaranteed by the Federal Government. The United States would own 85 percent of this new institution, while the Mexican Government would own the rest, according to the document.

Also today, the White House and senior legislators headed off a potentially damaging vote on the free trade pact by freshman House Democrats.

Led by Representative Sherrod Brown, Democrat of Ohio, half the freshmen class had called for a vote condemning the pact, contending that it would lead to the loss of American jobs to low-wage Mexican workers and to Mexican factories, which are not subject to the same environmental regulations as American companies.

A vote against the pact would have been a setback for the Administration, which has tried to persuade lawmakers to avoid taking positions until side agreements are struck on labor and environmental issues. The White House and its Congressional supporters plan an aggressive lobbying campaign this autumn.

But Representative Lucille Roybal-Allard, Democrat of California, gathered 22 other freshmen in opposing any immediate vote.

Representative Bill Richardson, the New Mexico Democrat who is the chief deputy majority whip, led House supporters of the free-trade pact in an successful effort to persuade the freshmen to postpone the vote. "This would be divisive at a time that reconciliation is taking place, and we ought to postpone it until after the side agreements are in place," he said in an interview before the meeting.

HOBART ROWEN

NAFTA's Fate Is in Hands Of Clinton

In the down-to-the-wire fight for his budget package, President Clinton was able to count on the strong support of House Majority Leader Richard A. Gephardt (D-Mo.), House Majority Whip David E. Bonior (D-Mich.) and the powerful House Ways and Means Committee chairman, Dan Rostenkowski (D-Ill.).

But it will be a different ballgame when it comes to the North American Free Trade Agreement, which is due to be presented some time in the fall.

Bonior is dead set against NAFTA—believing it will cost thousands of jobs in the auto industry and related industries. He's made clear to Clinton that despite his party leadership role, he will actively fight to defeat NAFTA.

Gephardt is lukewarm. He has said

See ROWEN, H12, Col. 1

Washington Post 8/8/93

HOBART ROWEN

Clinton Needs to Show Strong Support for NAFTA

ROWEN, From H1

that if the "side agreements" Clinton seeks to harden Mexico's commitment to reform of workplace rules and to strengthen environmental safeguards aren't good enough, he will vote against NAFTA.

Rostenkowski is strongly pro-NAFTA. But given the possibility that charges of misuse of government funds may force him to step down, the considerable clout he might have had will be absent. "There is no substitute for Rosty's influence," said a pro-NAFTA Democrat.

Thus, the administration faces an uphill fight of considerable proportions. Until now, the pro-NAFTA forces—largely based on industry support—have not gotten their act together, and they have lacked the strong, personal, unequivocal backing of Clinton.

Many congressmen, especially freshmen, have been unsure of where Clinton really stands. Yet, having endorsed NAFTA during the campaign—if the side agreements can be reached—he can hardly back away from it. That would be a huge blow to his credibility. An actual defeat of NAFTA would be devastating.

"If NAFTA goes down," said a strong supporter, "it will affect his whole trade agenda." Some believe Clinton might then lose the extension of the General Agreement on Tariffs and Trade, or GATT, and be weakened in his effort to get greater access for U.S. companies to the Japanese market.

Those same freshmen members of Congress looking for guidance from Clinton have no doubt where Ross Perot stands. Many first-timers come from districts where there is a large Perot swing-vote potential. Looking ahead to 1994, they don't want to offend Perot supporters.

Office of Management and Budget Director Leon E. Panetta told reporters last week that "Perot has lost a lot of credibility" in recent weeks, by failing to answer specific questions on his own deficit-reduction proposals.

On NBC News's "Meet the Press" last Sunday, Perot was battered by good, tough questioning on his proposal for saving $141 billion in Medicare and Medicaid—a much bigger bite than is in the Clinton package.

As usual, Perot ducked: "I cannot quote it [the details] out of my head," he whined to my colleague, David Broder. He also couldn't say whether his business-colleague son was for or against NAFTA, although Ross Perot Jr. is on the record supporting NAFTA.

Yet, it would be a mistake to discount the Perot influence. His scare talk about "the great sucking sound" of American jobs being swished to Mexico neatly tallies with organized labor's well-focused campaign of opposition.

The fight over NAFTA will not be strictly partisan like the battle over the budget: There will be Democrats and Republicans for and against the treaty. A private head count by pro-NAFTA forces of the division in the House, where the battle is likely to be won or lost, assuming the Senate will vote for the pact, reveals the extent of the challenge ahead for Clinton.

This tally shows that those who are for NAFTA, or leaning that way, are at the moment about balanced with those against NAFTA—around 160 votes for each side. But the "pro" side has a significant majority of Republicans, while the "anti" side has an equally significant majority of Democrats.

If the critical group of more than 100 still-undecided congressmen—mostly Democrats—splits the same way, NAFTA is almost a sure loser.

"The Democratic party is clearly divided on NAFTA," House Speaker Thomas S. Foley (D-Wash.) told reporters Friday. "The very nature of the NAFTA proposal is that it will excite strong opposition within the Democratic Party and I don't even know whether the majority of Democrats are for NAFTA. . . . NAFTA is going to be a bipartisan, tough, tough fight."

So, if NAFTA is to have a chance—and it should because the treaty, weighing benefits against drawbacks, is positive for all three countries involved—the pro-NAFTA forces must be better organized, especially at the White House. They must convey to the public the essential facts, such as the following, to counter Perot and the labor leaders:

- Manufacturers don't need NAFTA to move to Mexico: They have been doing that in droves.
- NAFTA will reduce the incentive of some manufacturers to move to Mexico because tariffs eventually will be cut to zero.
- Union-made U.S. products, even now, are flooding into Mexico, and providing U.S. jobs—contradicting anti-NAFTA union propaganda. That process should accelerate under NAFTA.
- Equally important, NAFTA will stabilize the Mexican economy and reduce the ever-present incentive for illegal immigration into the United States.

The president must take on this challenge directly, in person. He must assure that there will be adequate compensation to those workers and companies that may lose out. He must show that the benefits exceed such costs. That's where presidential leadership can make a difference.

"Without him," said a pro-NAFTA congressional leader, "we're dead."

TO: Laura Tyson
Alicia Munnell
FR: Kim Hopper, Laura Schwartz
Office of Media Affairs
RE: NAFTA Conference Call 5:00pm - 5:30pm
DT: Friday, November 12

Thank you both for spending time with Southern California newspapers today to talk about NAFTA. You will be talking with four reporters from Southern California, representing mid to large sized newspapers.

5:30pm EDT - 6:00 pm EDT	Conference Call
LA Times	Patrick Lee
LA Daily News	Chris Gessel
Riverside Press Enterprise	Sherilyn Bankole
AP, Los Angeles	Jim Anderson

NAFTA STORIES

2:30 P.M.

October 25, 1993

Rep. David Obey Press Conference, The Reuter Transcript Report, 10/25/93.

"Pena Outlines D.C. - Detroit Partnership", PRNewswire, 10/25/93.

"Mexico Isn't Yet Democratic, but NAFTA Will Help", Roll Call, 10/25/93.

Prepared by Felton Newell
Office of Communications Research
x7845

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THE REUTER TRANSCRIPT REPORT
NEWS CONF/OBEY PAGE 4 10/25/93
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Q Are you saying that you're going to block funding of these NAFTA-related institutions because of --

REP. OBEY: No, no, no, no, no, no. Look, what I'm saying is that what the administration appears to be suggesting is that we add more money to the international financial institutions when we haven't been able to meet our international obligations to fund what we've already agreed to for these institutions. So I'm simply raising that to assess the realism of the administration's newest suggestion.

Q Mr. Obey, people in Europe and in Asia and here are talking about globalization. I wonder what you understand what is globalization following your kind of thinking, and (does ?) anybody ever (to ?) stop that kind of process?

REP. OBEY: Well of course you're not.

Q So can you please explain your logic here being against NAFTA.

REP. OBEY: I think I just did.

Q Do you know --

REP. OBEY: Well, with all due respect, I'm not here to debate you, but I'll answer any questions you have.

Q Okay, I have another one. You know the recent reports; the tide is in favor of opportunity, that means NAFTA.

REP. OBEY: I don't make --

Q My question would be, aren't you afraid because the landscape is shaping up, you know, of the next campaign, aren't you afraid of being (hunted ?) out of your office because you prevented opportunity?

REP. OBEY: I'm not afraid of anything, first of all. And secondly, I don't make my decisions on the basis of polls or fear. I make my decisions on the basis of what I think is best for this country and the people I represent.

Q Mr. Obey, what about the contrary studies, those of Ross Perot and Pat Buchanan, et cetera, how realistic are those?

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REP. OBEY: Well, as I indicated in my statement, I thought that the Choate -- we believe the administration made a mistake in not including the Choate study on their list. But having said that, we also indicate that we find their conclusions lacking credibility.

Q Mr. Obey, your study is at odds with the GAO report released this summer, commissioned by Mr. Gephardt, which took a look at all of the studies on the impact of NAFTA. It said that each study is based on a different formula and some of them include assumptions which have to be made in order to carry out
a -- (inaudible) -- study, and said that the results are kind of fuzzy, but generally it's safe to say that the results are going to be positive for the U.S.

REP. OBEY: Well, I just -- I simply don't agree that we're at variance with what Mr. Gephardt has been saying. I'll simply let my statement stand for itself. The fact is that when a study, by definition, starts with the assumption that we cannot suffer job loss in this country, when it starts with that assumption and then says, ``Oh, by the way, boys and girls, we don't have any job loss as part of our conclusion,'' I don't think we should be surprised by that conclusion, but I also don't think we ought to give it much credibility in evaluating whether there will be job loss in this country.

Q Mr. Obey, sir, while it's true that the pro-NAFTA forces have argued very strongly through these studies that this will help create jobs, it seems to me that the anti-NAFTA rhetoric has to an even greater extent relied on the idea that this was going to cost jobs, and that's certainly the reason the AFL-CIO is so strongly against it. Aren't you afraid by questioning the legitimacy of those studies as well that you're undercutting one of the main arguments against NAFTA?

REP. OBEY: To the contrary, this strengthens my view that NAFTA ought not be approved, because I think that none of these studies define clearly what will happen under NAFTA.

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**** filed by:RB--(--) on 10/25/93 at 11:57EST ****
**** printed by:WHPR(JOPP) on 10/25/93 at 14:18EST ****

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Certainly there is no overwhelming body of opinion as the administration has tried to create with their assertion that 19 out of 20 studies demonstrate positive results. Certainly I think that this study demonstrated that that's not correct. I noticed that Citibank in The New York Times yesterday indicated that 18 out 19 studies predicted NAFTA would increase overall employment. I don't know which one they left out, but I think it's the same baloney.

The fact is that, because there are so many faulty assumptions built into these studies to begin with, you can't totally discount them, but you have to greatly discount them and ask other questions, two of which I laid out, in order to determine what the right course is for a policymaker.

Q Mr. Chairman?

Q Mr. Obey?

Q Can you tell me what -- elaborate some of the faults of the IIE study and tell me if this is a --

REP. OBEY: I'm not going to single out any study for criticism. The report lays out what the problems are, and you can reach your own conclusions on that.

Q Can you tell me if this is a joint Democratic-Republican JEC report, or is it just --

REP. OBEY: This is -- I'm the chairman of the Joint Economic Committee. This is a report put out by the chairman of the Joint Economic Committee, based on the staff review of that study. The Republican staffers on JEC don't work for me.

Q Mr. Obey --

REP. OBEY: They wouldn't want to.

Q -- on your point on investment diversion, isn't it true that most of these studies that you criticize for not (fixing ?) any diversion of investment assume that foreign investment will increase in the United States to a much a greater extent than U.S. investment going down to Mexico; that, in effect, opening up this market for the United States will mean that the investment flows will be -- (inaudible) --

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REP. OBEY: Well, they may or may not, depending on which studies you look at. The fact is that I question the utility of any study which begins with the assumption there will not be any net transfer of investment to

Mexico.

Q . But they're not saying that. What they're saying is let everything be equal, a very important -- (inaudible) -- because we think that investment will be greater in the United States under NAFTA than would be diverted down to Mexico. We're not even going to take that into consideration. I mean, that is, in fact, what they did in the IIE study.

REP. OBEY: Well, so -- but they start with an assumption -- my point is a very narrow one. You can believe any blessed thing you want. And I've learned a long time ago that nobody on this issue is going to be influenced by somebody's facts on the other side if they've already made up their mind. And when studies start with the conclusion that there will be no transfer, that means there can't be any transfer. So my point is simply, if the administration wants to launch arguments or if anybody else wants to launch arguments on NAFTA, use some other tool to make your case. These studies don't make the case.

Q . But how do you explain the fact that all these Nobel Prize-winning economists have endorsed -- (inaudible) --

REP. OBEY: Very simply. I think you have to distinguish between economists' evaluation NAFTA as economic experts and their pronouncements on NAFTA as value judgments.

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