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NAFTA'S THREE-YEAR REPORT CARD: AN "A" FOR NORTH AMERICA'S ECONOMY

INTRODUCTION

President Bill Clinton is legally required to provide Congress with a detailed "report card" by July 1, 1997, covering the first three years of implementation of the North American Free Trade Agreement (NAFTA), which includes the United States, Mexico, and Canada. This report will come under intense congressional scrutiny because many Members of Congress have indicated that their willingness to renew the President's fast-track negotiating authority will depend on their perception of how well NAFTA has performed during its first three years. If the Clinton Administration's report is objective and accurate, it will show NAFTA to be a remarkable success.

Despite the doomsday warnings about what would happen under NAFTA, hundreds of thousands of U.S. jobs have *not* been destroyed, the U.S. manufacturing base has *not* been weakened, and U.S. sovereignty has *not* been undermined. Instead, total NAFTA trade has increased, U.S. exports and employment levels have risen significantly, and the average living standards of American workers have improved.

Indeed, if NAFTA were to be graded on its effects after only three years, it would receive an "A+" for enhancing the level of trade between the United States and its North American neighbors; an "A+" for increasing the number of U.S. jobs that support this increased trade; an "A+" for its positive impact on manufacturing and on the personal income of American workers; and a "B" both for encouraging U.S. compliance with implementation of NAFTA's deadlines and for improving U.S. relations with Mexico in general. Finally, although much more can be done, NAFTA has been instrumental in the strides Mexico has made in liberalizing its economy, and is one reason Mexico is taking steps to reform its political system. With this kind of report card, Congress should have no doubts about the success that NAFTA has achieved.

THE NAFTA REPORT CARD

The Clinton Administration's three-year evaluation should rate the effects of the North American Free Trade Agreement as follows:

- **Growth in Trade: A+**

  Total North American trade increased from $293 billion in 1993 to $420 billion in 1996, a gain of $127 billion or 43 percent during NAFTA's first three years.[1] If that gain had been with a single country, it would have made that country the fourth-largest trading partner of the United States. In 1996, U.S. exports to Canada and Mexico, at $190 billion, exceeded U.S. exports to any other area of the world, including the entire Pacific Rim or all of Europe. Mexico and Canada purchased $3 of every $10 in U.S. exports and supplied $3 of every $10 in U.S. imports in 1996. Overall, total U.S. exports of goods and services grew from $602.5 billion in 1993—the last year before NAFTA was implemented—to $825.9 billion in 1996, a gain of $223.4 billion.[2]

- **Growth in U.S. Exports: A+**

  Thanks to NAFTA, Mexican tariffs—which had averaged 10 percent before the trade agreement was implemented—now average less than 6 percent, while average U.S. tariffs have fallen from 4 percent to about 2.5 percent. As a result, U.S. exports to Mexico grew by 37 percent from 1993 to 1996, reaching a record $57 billion.[3] During this period, U.S. exports to Canada also increased by 33 percent, to $134 billion. Total two-way trade between the United States and Canada was $290 billion in 1996, while total two-way trade between the United States and Mexico was nearly $130 billion. According to the U.S. Department of Commerce, U.S. exports to Mexico in the fourth quarter of 1996 were growing at an annualized rate of $64 billion. Moreover, U.S. market share in Mexico increased from 69 percent of total Mexican imports in 1993 to 76 percent in 1996.[4] During NAFTA's first three years, 39 of the 50 states increased their exports to Mexico; moreover, 44 states reported a growth in exports to Mexico during 1996 as the pace of U.S. exports to that country accelerated.[5]

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1 In 1996, U.S. global trade (exports plus imports) totaled $1.765 trillion—over 23 percent of U.S. GDP, compared with 10 percent in 1970. The Office of the U.S. Trade Representative (USTR) has estimated that by 2010, trade will represent about 36 percent of U.S. GDP. Since 1988, almost 70 percent of U.S. economic growth has been derived solely from exports (roughly 25 percent since 1992). More than 11 million U.S. jobs depend on exports, 1.5 million more than in 1992; 20 percent of American jobs are supported by trade and pay between 13 percent and 16 percent more, on average, than non-export jobs.

2 The U.S. Department of Commerce estimates that every $1 billion increment in U.S. exports creates 22,800 new jobs in the United States. This would mean that U.S. export growth from 1993 to 1996 was responsible for creating over 5 million U.S. jobs, or 57.7 percent of the 8.8 million net new payroll jobs created by the U.S. economy during this three-year period.

3 Exports of U.S. components to Mexico's duty-free component assembly industry made up approximately 28 percent of total U.S. exports to Mexico in 1996, according to a report for the USTR by the U.S. International Trade Commission (ITC). The ITC found that the use of U.S. components in Mexican assembly plants had grown at an average yearly rate of 15.8 percent since NAFTA was implemented in 1994.

4 Testimony of Regina Vargo, Deputy Assistant Secretary for the Western Hemisphere, U.S. Department of Commerce, before the Subcommittee on International Economic Policy and Trade of the House Committee on International Relations, March 5, 1997.

- **Growth in U.S. Employment: A+**

  NAFTA has shattered the myth that U.S. trade deficits destroy U.S. jobs. The combined U.S. trade deficit with Canada and Mexico increased during the first three years of NAFTA's implementation—from $9 billion in 1992 to $39.9 billion in 1996—because Canada and Mexico suffered economic recessions. Since 1992, however, the U.S. economy has created 12 million net new jobs. Moreover, manufacturing employment grew from 16.9 million jobs in 1992 to 18.3 million in 1993, an increase of 1.4 million net new jobs.[6] The general unemployment rate declined from 7.5 percent in 1992 to 5.3 percent in 1996. U.S. exports to NAFTA countries currently support 2.3 million U.S. jobs.[7]

- **Output Gains for U.S. Manufacturing: A+**

  The largest post-NAFTA gains in U.S. exports to Mexico have been in such high-technology manufacturing sectors as transportation and electronic equipment, industrial machinery, plastics and rubber, fabricated metal products, and chemicals.[8] NAFTA also has been a boon for major U.S. agricultural states like Montana, Nebraska, and North Dakota, and traditional southern textile states like North Carolina and Alabama. NAFTA has encouraged U.S. and foreign investors with apparel and footwear factories in Asia to relocate their production operations to Mexico. This diversion of investment from Asia to Mexico "saved the heavier end of clothing manufacture in the U.S.: the textile mills," as Rich Nadler, a journalist who has covered NAFTA's progress since 1992, recently observed.[9]

- **Improved Standards of Living for American Workers: A+**

  According to Nadler, who has reviewed pre- and post-NAFTA growth rates in U.S. standards of living, the rate of increase in personal wealth has more than tripled since NAFTA was implemented.[10] His review measured the improvement in three ways: (1) inflation-adjusted gross domestic product (GDP) per capita grew by 1.79 percent annually in 1994 and 1995, compared with only 0.23 percent from 1990 to 1993; (2) disposable personal income growth, adjusted for inflation, averaged 1.89 percent annually in 1994 and 1995, compared with 0.25 percent annually from 1990 to 1993; and (3) personal consumption expenditures grew by an inflation-adjusted 1.76 percent annually during 1994 and 1995, compared with 0.56 percent a year from 1990 to 1993.

5 Data from Massachusetts Institute of Social and Economic Research.

6 As of February 24, 1997, 110,408 U.S. workers had been certified as eligible for training assistance under NAFTA's Trade Adjustment Assistance Program, administered by the U.S. Department of Labor. The U.S. economy, however, currently creates this many net new jobs in about two weeks. The general U.S. unemployment rate declined from 7.5 percent in 1992 to 5.3 percent in 1996.

7 Office of the USTR, "NAFTA and Jobs," 1996.

8 Since 1992, U.S. industrial production has increased 18 percent. During this four-year period, U.S. manufactured exports increased 42 percent, high-technology exports rose 45 percent, services exports were up 26 percent, and agricultural exports expanded 40 percent. The Western Hemisphere and the Asian Pacific Rim now account for over 70 percent of total U.S. exports, up from 65 percent in 1992.

9 Rich Nadler, "NAFTA: Jobs, Jobs, Jobs," *K. C. Jones*, Overland Park, Kansas, April 1997.

10 *Ibid.*

- **U.S. Compliance with NAFTA: B**

  In December 1995, the Clinton Administration postponed indefinitely the implementation of a NAFTA deadline to allow Mexican trucks to circulate in the southwest United States. The Administration based its decision on concerns relating to transport safety and the fight against drug traffickers. The President, however, was acting in response to pressures from union and environmentalist groups that joined forces with bipartisan anti-drug hawks to block implementation of that provision of NAFTA. The decision established a negative precedent but did nothing to improve Mexican truck safety or diminish the flow of illegal drugs across the porous and unguarded U.S.–Mexico border.

- **U.S.–Mexico Trade Relations: B**

  President Clinton's first official trip to Mexico this month came at a time in which relations between the two countries were at their lowest point in years.[11] The trade and investment growth achieved during NAFTA's first three years has been eclipsed by the peso crisis and political turmoil in Mexico and by growing bilateral tensions over drug control policy, immigration, and the Helms–Burton Act's tightening of economic sanctions against Cuba. These tensions in U.S.–Mexico relations have surfaced because the Clinton Administration did not assign a sufficiently high priority to Mexico during its first term in office. Protectionists have laid the blame for all of these problems at NAFTA's door. NAFTA, however, was never intended to be anything other than a free trade agreement—a three-way pact by the United States, Mexico, and Canada to eliminate all tariff and non-tariff barriers to trade over a period of 10 to 15 years. NAFTA was designed to encourage faster growth in North American trade and investment, which it has been doing successfully since January 1, 1994. It was not meant to solve other problems in U.S.–Mexico relations.

- **Reform Process in Mexico: A**

  Although Mexico has made great strides during the past decade in liberalizing its economy and reforming its closed political system, it still is undergoing a difficult transition from a closed economy and political system to an open capitalist democracy. Moreover, this transition will continue for at least another decade or two. One of NAFTA's important achievements has been to "lock in" the process of economic and political reform under way in Mexico for the past decade. Mexico's membership in NAFTA, the World Trade Organization, the Asia-Pacific Economic Cooperation forum, and the Organization for Economic Cooperation and Development has created international commitments and linkages that it cannot ignore. Even though The Heritage Foundation's *1997 Index of Economic Freedom* still accords Mexico a ranking of 3.35, or "Mostly Not Free,"[12] Mexico has become a more democratic country since NAFTA was implemented. Under President Ernesto Zedillo, Mexico's constitution was amended in 1996 to make the electoral process more free, more transparent, and more independent of the government. These reforms, in effect for Mexico's

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11 Julia Preston, "U.S. Trying to Smooth Mexico Path for Clinton," *The New York Times*, April 20, 1997, p. 4.

12 Kim R. Holmes, Bryan T. Johnson, and Melanie Kirkpatrick, eds., *1997 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Co., Inc., 1997), pp. 306–308.

July 6, 1997, elections to Congress, will accelerate both the demise of the one-party system that has dominated Mexican politics for nearly 70 years and its eventual replacement by a competitive multi-party democracy.

NAFTA: A SUCCESS BY ANY OBJECTIVE STANDARD

The data on trade, production, and employment growth for NAFTA's first three years quantify objectively that NAFTA is good for the United States. Moreover, a recent economic analysis published by the U.S. Federal Reserve Bank of Chicago concludes that NAFTA will lead to output gains for all three participant countries. [13] These gains are roughly twice as large as those predicted by previous forecasts of NAFTA's potential for accelerated growth in North American trade, output, and employment growth.

The Federal Reserve study, based on a dynamic economic model, also predicts that the adjustment to NAFTA should be virtually completed by 2004 (although NAFTA will not be fully phased in until 2009) and that NAFTA will greatly expand the flow of all goods, both from Canada and the United States to Mexico and from Mexico to the United States and Canada. In general, bilateral Mexican–North American trade should increase about 20 percent as a result of NAFTA.[14] This projected growth also means more U.S. jobs and a higher standard of living for American workers.

CONCLUSION

In his State of the Union speech on February 4, 1997, President Clinton called on Congress to approve new fast-track negotiating authority in order to pursue new trade initiatives in Asia and Latin America during 1997 and 1998. "Now we must act to expand our exports," the President said, "especially to Asia and Latin America—two of the fastest growing regions on earth—or be left behind as these emerging economies forge new ties with other nations."[15]

The President is right to emphasize the importance of U.S. trade with Latin America. The Western Hemisphere accounted for 39 percent of U.S. goods exports in 1996 and was the only region in which the United States recorded a trade surplus in both 1995 and 1996. As a market for U.S. goods, the Western Hemisphere already is nearly twice as large as the European Union and nearly 50 percent larger than Asia. Moreover, while U.S. goods exports to the world generally increased 57 percent from 1990 to 1996, U.S. exports to Latin America and the Caribbean (excluding Mexico) increased by 110 percent during the same period.[16] If current trends continue, Latin America alone will exceed Japan and Western Europe combined as an export market for U.S. goods by the year 2010.

Congress should have no doubts about the success of NAFTA. Although only three years old, this international trade agreement is growing with amazing speed. Even though three years may seem like too little time to reach any final judgments about NAFTA, it already is clear that critics of this agreement have been wrong on all counts.[17] Congress

13 See Michael A. Kouparitsas, "A dynamic macroeconomic analysis of NAFTA," *Economic Perspectives*, Federal Reserve Bank of Chicago, January 1997. The study concluded that, under NAFTA, Mexico's GDP is predicted to rise 3.26 percent, U.S. GDP will rise 0.24 percent, and Canada's GDP will increase by 0.11 percent.

14 *Ibid.*

15 "Clinton calls for fast-track authority in State of the Union speech," *Inside NAFTA*, Vol. 4, No. 3 (February 6, 1997), p. 1.

16 Office of the USTR.

will be acting in the U.S. national interest when it approves a new fast-track negotiating authority so that the Clinton Administration can put U.S. trade policy back on track around the world.

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17 See Sydney Weintraub, "NAFTA at Three: A Progress Report," *Significant Issues Series*, Vol. XIX, No. 1, Center for Strategic and International Studies, Washington, D.C., 1997.