Chapter 8:
NAFTA: Retrospect and Prospect

Anne O. Krueger

Anne O. Krueger, Senior Research Professor of Economics of the School of Advanced International Studies at Johns Hopkins University, began her plenary presentation by outlining three topics she would be examining: (1) The debates over NAFTA at the time of its formation: how accurate were they in retrospect?; (2) The current state of NAFTA affairs; and (3) Key issues for NAFTA's next 20 years. She noted that her discussion would be mainly from the U.S. point of view, not only because that's what she knows best, but also because the United States' economy is so much larger than the other two. The main conclusion that she drew from her examination was that, while NAFTA's effects are very hard to isolate and measure, initial estimates of these effects seem to have been pessimistic as a whole overstating NAFTA's negative consequences while understating its benefits.

Krueger highlighted some lessons we can learn from the NAFTA experiment moving forward, including: (1) PTAs (preferential trade agreements) are susceptible to lobbying and other third-party pressures; (2) To succeed, future PTAs must operate under the multilateral trade system or the World Trade Organization (WTO), given the growth in importance of global value chains; and (3) NAFTA needs to be strengthened by enabling faster transit of goods, facilitating great labor mobility, increasing regulatory uniformity, and adopting policies for energy and agriculture. Energy and agriculture are areas with huge potential gains.

Krueger began by pointing out that, at the time NAFTA was being negotiated, most of the world had embraced the open, multilateral trading system that existed under the General Agreement on Tariffs and Trade (GATT). PTAs were few, and even fewer were successful. The success of the multilateral system was highlighted by the changes in average tariff rates on manufactured goods globally. These had fallen from 45-48 percent in 1956 to about 5 percent in the early 1990s, the time at which NAFTA was being negotiated. The main preferential agreement at that time—the customs union between EU members—improved even more on this global system (i.e., the customs union dropped tariff rates from 45 percent to 0 percent instead of to 5 percent).

The first stage of NAFTA, the Canada–U.S. Free Trade Agreement (CUSTFA) between the United States and Canada, went relatively unnoticed by the U.S. populace. Canada was a relatively large and industrial economy that was already one of the United States' largest trading partners. However, Mexico was still a closed economy (relatively speaking) when a PTA between it and the United States was first proposed and political debate sprung up about the merit of a PTA between the two countries from a U.S. standpoint. There was less debate over the prospect of a Mexico-Canada PTA since trade between Mexico and Canada was quite small at the time of NAFTA's negotiations and, in relative terms, is still fairly small today (albeit much bigger than 20 years ago). Krueger also mentioned that the nature of Canada-U.S. trade was quite similar to that of Mexico-U.S. trade; the United States received mainly primary commodities and intermediate goods from both partners and shipped out mainly processed goods to them.

Although it was not the focus of her presentation, Krueger briefly mentioned her objection to the early-1990s argument that NAFTA would spur Mexican immigration into the United States, costing many U.S. workers their jobs. She simply pointed to the implausibility of seeing more immigrants entering at a time when U.S. domestic employment was falling. While Mexican immigration did rise after NAFTA entered into force, it was because Mexican growth rates of employment and real wages were slower than hoped due to the Tequila Crisis (the Mexican Peso Crisis) around the same period, which caused inflation rates of over 100 percent.

Complexity of Examining the Effects of NAFTA

Krueger argued that there are many factors complicating the examination of the effects of NAFTA. The first is that NAFTA occurred at a time in history when many other facets of the world economy were changing simultaneously. Tariff reductions were going into effect across the industrial world, and the Uruguay Round (eventually leading to the founding of the WTO) was ongoing. Within Mexico, besides the Tequila Crisis, there was the Mexican current-account deficit, the stagnation of Mexican economic growth in the 1990s, and the impact of China's emergence as a major trading competitor with Mexico (which became even more noticeable following China's accession to the WTO).

What Effects Did We Expect from NAFTA—and What Effects Can We Observe?

So what did we expect to happen? Krueger pointed out that many analysts believed NAFTA would lead to job losses in the United States as Mexico shifted to a current-account surplus. These people argued that NAFTA would help the Mexican manufacturing sector so much that capital inflows into Mexico would surge while U.S. firms would be wiped out, causing U.S. business to relocate to Mexico. In reality, U.S. FDI had already been directed towards Mexico in the years before NAFTA in the form of intermediate parts and goods that would eventually be shipped to the United States. Krueger then discussed how the concerns over U.S. job losses also proved unfounded, since unemployment reached a low of 4 percent in 2000 and rose only during and after the dot-com recession of 2001–2002. Krueger cited Congressional

Budget Office (CBO) numbers to predict a gain of 150,000 net jobs over five years. Another noticeable effect of NAFTA lay in wages. Contrary to some of the pre-NAFTA fears that U.S. wages would fall, Krueger added, the only real noticeable effect of NAFTA on wages was the one highlighted in a previous presentation by Caliendo and Parro (2014).[16] Caliendo and Parro found that real wages actually rose in all three countries, albeit the increase was relatively small—especially in Canada and the United States, due to the relative sizes of the respective economies.

On the other hand, the tariff reductions (and other trade liberalizations) affected under NAFTA were much larger for Mexico than the other two countries. Krueger pointed out that Mexico still imposed various import restrictions as late as 1994, and did not join GATT until 1986. She went on to state that the average production-weighted tariff in Mexico fell from about 25 percent pre-NAFTA to about 12 percent post-NAFTA—and to 0 percent in trade with its NAFTA partners. Mexico also had a system of import licensing during this time, and the last piece of it was not disbanded until 2000.

Krueger noted that other researchers have found that export growth has been the largest contributor to Mexican growth since 1993, with non-oil exports from Mexico to the U.S. increasing by almost 600 percent between 1993 and 2012. Over the same time period, FDI has increased 10-fold, which is reflected partly in the current-account deficits Mexico displayed. As others have already noted, the largest gains in trade were in parts and components that were eventually shipped elsewhere for final production. Krueger then pointed out how Mexico's decision to fit itself into global value chains may have indirectly aided the United States in maintaining a competitive advantage relative to Asia. This was due to Mexico providing the United States with unskilled labor-intensive parts and components.

Lessons Learned from NAFTA, and Future Opportunities

In concluding, Krueger highlighted some lessons she feels we can draw from the first 20 years of NAFTA:

1. A FTA is more susceptible to lobbying pressures (and other third-party forces) than are multilateral trade negotiations.
2. The lower the preexisting external trade barriers are, the smaller the trade diversion and welfare losses from PTAs will be.
3. The agreement needs to be strengthened by enabling faster transit of goods, facilitating great labor mobility, increasing regulatory uniformity, and adopting policies for energy and agriculture.

[16] See the presentation by Fernando Parro in this volume for details.

Moving forward, Krueger noted that it's important to understand and acknowledge that no geographic region can function in isolation. Worldwide, countries are entering into deeper agreements with their trading partners, while we are generally not seeing any erecting of new trade barriers (or adding to existing ones) towards nonmembers of agreements. Successful future PTAs will be those that operate under the aegis of the open, multilateral trade system we know as the World Trade Organization (WTO). The growth in importance of global value chains makes this multilateral system all the more important, and the WTO controls rules of origin among other facets of this system.

Speaking to the latter point, Krueger noted that the multilateral system (i.e., the WTO) needs to become the focus for policymakers again. She pointed out that PTAs (and their success) have distracted policymakers away from the global system, and the WTO, coming out of the Bali ministerial, should be given renewed attention. Moreover, a global economy full of smaller regional PTAs and a weak WTO would not be a healthy international economy. That said, steps can certainly also be taken to strengthen NAFTA in a regional sense. Krueger noted that trade facilitation to enable faster transit of goods is one example of this. Another would be policies that facilitate more labor mobility and a more desirable immigration outcome (both permanent and temporary) for workers in particular sectors of the economy. Regulatory uniformity, as well as improved energy and agricultural policies, are other major needs; energy and agriculture are areas with huge potential gains still to be realized. Lastly, working toward a better understanding of NAFTA's place in a global economy—one that soon may have other trade agreements of its size or larger (TPP and/or TTIP)—is also worth exploring.

References

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