The Benefits of NAFTA for Jobs, Wages and the Future of America

The North American Free Trade Agreement has recently taken center stage in a widespread debate. The following roundtable discussion among Dallas Fed economists addresses key topics in the debate.

What's in the North American Free Trade Agreement for the average American?
Vargas: Under NAFTA, more goods will be able to enter the United States freely, meaning lower prices and more choices for the American consumer. The average American will benefit by having a greater variety of goods, such as leather products, shrimp and tuna, available at lower prices. In Pennsylvania, for example, cantaloupes cost $2.99 each—if you can find any. Limes there cost a dollar for two—in Texas, they're a dollar for a dozen, simply because of increased availability. Under NAFTA, that same type of increased availability of goods will mean an increase in the purchasing power of the average American.

Won't NAFTA mean fewer jobs for Americans? Won't NAFTA mean lower paying jobs for Americans?
Gruben: No, on both counts. NAFTA means more and better paying jobs for Americans. That's the whole point. NAFTA in an economy with high unemployment would mean more jobs for Americans. NAFTA in an economy with full employment would mean higher wages. NAFTA in an economy somewhere in between would mean more jobs *and* higher wages. Since Mexico began to open its economy in 1986, the number of American workers producing exports to Mexico has increased substantially. Under NAFTA, an additional increase in export-related jobs is expected by 1995. Moreover, wages of U.S. workers in export-related jobs are already higher than the national average (*Charts 1 and 2*).

NAFTA's provisions would make it more attractive for investors to put their money into new and existing businesses in Mexico. This increased investment means Mexican businesses would need more workers. Because of the limits of Mexico's labor pool, the businesses there would have to pay more to hire the workers they want. Higher wages for those workers mean more money for them to spend on U.S. goods and services. As a result, American businesses would have to hire more workers, increase wages, or do both to meet the increased demand from Mexico.

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—Lucinda Vargas
Economist

Does Mexico really have enough buying power to serve as a viable market for U.S. companies?
Vargas: Mexico is already one of the United States' three largest trading partners, with a per capita purchase of American goods exceeding that for the United Kingdom, Japan, Canada and Germany. About 70 cents of every dollar that Mexico spends on foreign products is spent on U.S. goods (*Charts 3 and 4*).

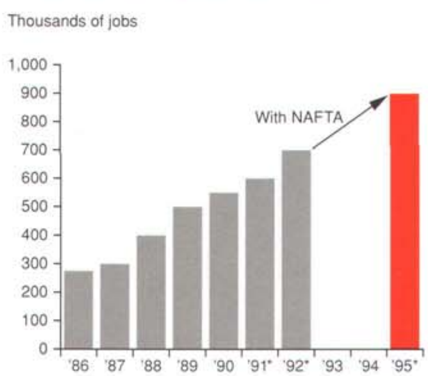
"Low wages are not the only concern of companies. If you add other costs of doing business—along with political instability and the risk of inflation—the lure of low wages becomes much less attractive."

—John H. Welch
Senior Economist

After nearly a 10-year lapse, Mexico is now investing heavily in its economy by purchasing U.S. computers, machine tools and other capital goods. Consequently, over the next 10 years, there will be more job and income growth in Mexico, leading to an increase in the purchase of U.S. consumer goods, which Mexican consumers crave. In many areas, Mexican consumers favor U.S. goods more than U.S. consumers do—automobiles, apparel and appliances, for example.

Mexico is very much a cash society—much more so than the United States—and the typical Mexican consumer carries very little debt. Although the average Mexican consumer may not be as wealthy as the average American consumer, keep in mind that Sam Walton made a fortune selling goods to the lower end of the market.

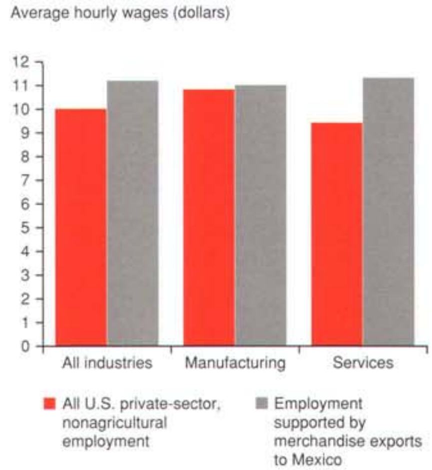
Chart 1
U.S. Employment Supported by Merchandise Exports to Mexico



* Estimated.

SOURCE: Office of the U.S. Trade Representative.

Chart 2
Export Jobs Pay More



Wages for all jobs compared with wages for jobs supported by exports to Mexico.

SOURCE: Office of the U.S. Trade Representative.

Won't some people lose their jobs because of NAFTA?

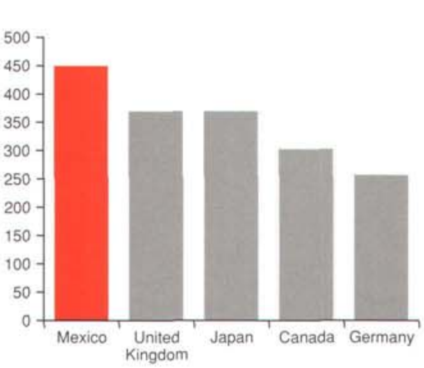
Gruben: More jobs will be created by NAFTA than lost; however, in the long run, free trade simply reallocates jobs among different industries within a country. When the U.S. trade barriers that artificially protect certain industries are phased out over the next 15 years under NAFTA, some people will lose their jobs as those industries are not able to compete. However, jobs will be created in industries whose exports will grow as a result of NAFTA. Whether jobs are lost or gained, the total number affected by NAFTA will be small compared with the normal job turnover in our country.

It's important to note that most of the jobs that would be lost under NAFTA are part of inefficient industries, and the cost of saving those jobs is already extremely burdensome. The 28-percent tariff on frozen orange juice costs consumers $240,000 per year for each job saved. The 38-percent tariff on low-cost glassware costs consumers $200,000 per year for each job saved. While some may argue that saving such jobs is worth the cost, using trade barriers to save jobs is like fishing with dynamite. You lose a lot more than you gain. Protecting the steel industry from foreign competition meant 17,000 steelworkers were able to stay on the job. But the sacrifice was 52,000 fewer jobs for workers in steel-using industries. They couldn't compete because the high cost of saving the steel industry jobs pushed the steel-using industries out of the market.

What will happen to the few jobs that are lost after NAFTA?

Gruben: NAFTA will replace low-paying, low-skilled jobs with higher paying, higher skilled jobs. Compared with Mexico, the United States has a large share of high-skilled workers supported by large amounts of high-tech equipment. This means that when trade barriers are lowered, the United States will be in a prime position to export goods and services to Mexico that require high-skilled labor and high-tech equipment. There will be an increased need for workers in these industries, meaning not only more jobs but better ones. Retraining displaced workers would help fill this need. It typically costs much less to retrain someone who loses a job than it does to protect that job from being lost.

Chart 3
Mexicans Outspend Other U.S. Trading Partners



Per capita purchase of U.S. goods, 1992.
SOURCE: U.S. International Trade Commission.

O'Driscoll: Keep in mind, also, that we need to avoid locking our children and our grandchildren into the jobs we're doing today. The challenge is to find solutions for the people who would lose their jobs *without* hindering the development of better jobs for future generations.

Can the United States really compete with a low-wage country like Mexico?

Welch: U.S. industries already successfully compete with Mexico and other developing countries. Not only has our trade with Mexico grown in recent years, but exports have grown faster than imports. In 1992, we enjoyed an annual trade surplus of $5.4 billion with Mexico (*Chart 5*). On the other side, Mexico often argues that it cannot compete with the United States because of American workers' high levels of productivity.

How do U.S. producers compete with low-cost Mexican labor?

Welch: U.S. producers have many advantages that offset the difference in labor costs, which are only a portion of overall costs. Interest, insurance, transportation, communication, managerial, engineering and inspection costs are all significantly higher in Mexico. All these costs and the lower average skill levels of Mexican workers make them less productive than U.S. workers. In fact, the average U.S. manufacturing worker is almost five times as productive as the average Mexican manufacturing worker. The fact that wages in Mexican manufacturing are one-fourth as much as in U.S. manufacturing should not scare anyone; if you adjust for productivity, Mexican workers are paid no less than U.S. workers.

"While some may argue that saving jobs is worth the cost, using trade barriers to save jobs is like fishing with dynamite. You lose a lot more than you gain."

— William C. Gruben
Senior Economist
and Policy Advisor

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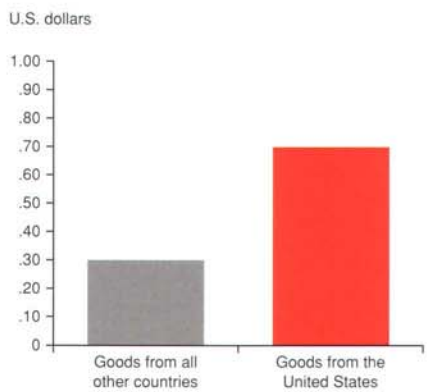
— Gerald P. O'Driscoll, Jr.
Vice President and
Economic Advisor

Have Mexico's low wages attracted investment that would otherwise have gone to the United States?
O'Driscoll: Low wages probably have attracted some investment to Mexico. However, it's unlikely that such an investment would have been made in the United States—it would have gone to another low-wage country if not Mexico. By and large, investment geared toward low-wage jobs is not going to stay in the United States.

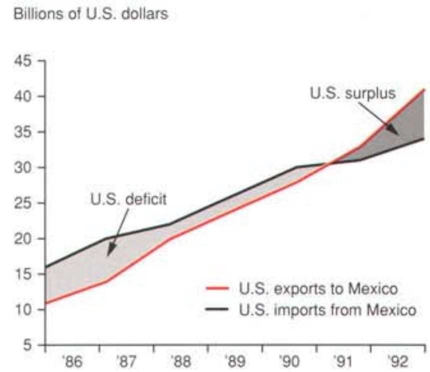
What's to stop U.S. companies from moving their operations to Mexico to take advantage of low Mexican wages?
Welch: If companies are only concerned with low wages, they could have—and would have—already moved to Mexico. However, low wages are not the only concern of companies. If you add other costs of doing business—along with

Chart 4
Mexicans Buy American



Mexican spending on foreign goods, 1992.
SOURCE: Office of the U.S. Trade Representative.

Chart 5
Mexican Liberalization Boosts U.S. Exports



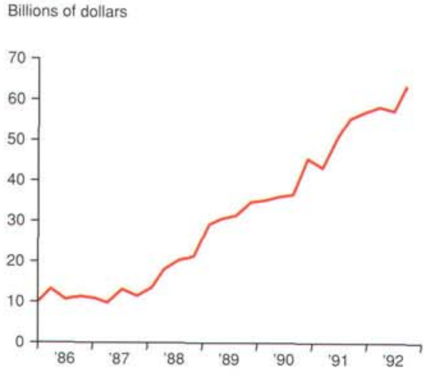
SOURCE: Office of the U.S. Trade Representative.

political instability and the risk of inflation—the lure of low wages becomes much less attractive. For the past several years, as the number of higher paying, higher skilled jobs in the United States has increased, the number of low-wage, low-skilled jobs has decreased—*without NAFTA*. Low-wage, low-skilled jobs have gone to Hong Kong, Singapore and Southeast Asia, as well as to Mexico. When it is no longer economically feasible for those jobs to remain in America, they will leave. The question is, Where do we want them to go? By steering them to Mexico, the United States will benefit as Mexico's economy grows and its producers need more U.S. goods and services. The large trade surplus that we now enjoy with Mexico will become even larger. In the big picture, loss of jobs due to NAFTA will be very small relative to losses that have occurred for other reasons. With or without NAFTA, low-skilled jobs will continue to disappear in our growing technology-based economy. What NAFTA will do is help ensure the creation of better jobs to replace them.

If NAFTA contributes to the loss of even a few jobs in America, why is the agreement a good deal for the United States?
Cox: Economic wealth advances on two legs—technology and trade. In many ways, NAFTA is the same as

any major innovation that has improved U.S. living standards over the past 100 years. Farm machinery, electricity, the airplane, the telephone, the automobile and the computer all contributed to society's wealth, but they also contributed to the loss of American jobs. Think about the computer, for example. To save the jobs of many clerks, bookkeepers, typists, slide rule manufacturers and adding machine assemblers, we could have outlawed computers. (Stalin did.) But with the benefit of hindsight, we can also see the absurdity of such a protectionist act. Today's Dallas-area *Yellow Pages* lists 46 pages of computer businesses—nearly 2,800 companies. The 1960 *Yellow Pages*, on the other hand, devoted less than one page—no more than 10 listings—to computer businesses. More than 1.3 million workers in the United States earn their livings as computer programmers and operators today, compared with fewer than 5,000 in 1960. The better jobs created as a result of the computer would never have come about had we protected the jobs of slide rule manufacturers, adding machine assemblers and the like. Protectionism keeps us in the past. It keeps us tied to low-paying jobs. NAFTA is a new opportunity to prosper.

Chart 6
U.S. Trade Surplus in Services



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

How can you say with confidence that with NAFTA in place, the U.S. economy will continue to create jobs? Won't there just be more service jobs, making the United States a nation of "hamburger flippers?"

Cox: This economy can and does create jobs—better jobs—and will continue to do so with NAFTA. Look at the progress we've made in this century. In 1900, the most common jobs in America included launderers, cotton mill workers, blacksmiths, sawyers, housekeepers and miners. Today's list includes engineers, nurses, accountants, health technologists and computer scientists. NAFTA will give us the opportunity to continue to make the transition to better jobs by allowing us to specialize in what we do best.

Last year, our trade surplus in services reached more than $60 billion (*Chart 6*). Our top service exports are in the areas of banking, insurance, engineering, telecommunications and computers—each an area in which we lead the world. These are the service jobs that will flourish under NAFTA, because these things that we do best are what other countries want.

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—W. Michael Cox
Vice President and
Economic Advisor