Marriott Student Review

Volume 1
Issue 1 *The Power of Words*

Article 10

April 2017

Insights from Professors

Hannah Salzl
Brigham Young University - Provo, hsalzl03@gmail.com

Krista Johnson
Brigham Young University - Provo, k.johnson0293@gmail.com

Rex L. Facer II

NAFTA is a three-way trade agreement between Canada, Mexico, and the United States. NAFTA was initially negotiated by the George H.W. Bush administration, but was finalized by the Clinton Admin-istration. It went into effect in 1994. Tariffs were cut to zero for virtually all manufactured products traded between the three countries. According to a report from the Wharton School at the University of Pennsylvania trade between the U.S., Canada, and Mexico has grown from $337 billion in 1993 to more than $1.338 trillion in 2014 an increase of 297 percent over the last two and a half decades. Since the inception of NAFTA, we are exporting more to those countries than we ever have. I want to briefly explore two of the issues that I believe highlight the complexity of understanding NAFTA's impact: pollution and jobs.

A common critique of NAFTA and other trade agreements, especially when the agreement is with countries that have mismatched levels of environmental regulation, is that firms will move to the country with the least stringent environmental regulation. The underlying assumption is that if the cost to move is less than the cost to comply with the regulation, all else equal, then a firm will move to a new location. We might expect, in the case of NAFTA, to see polluting firms moving from the U.S. and Canada to Mexico, since the level of environmental regulation has historically been less stringent.

According to a recent article published in the Journal of International Economics there has been a decrease in environmental pollution in the U.S. associated with NAFTA. Unfortunately, we do not have any solid research on the pollution impact on Mexico. Let us assume for a minute that what has happened is that highly polluting U.S. firms have moved to Mexico. In this case, there is a clear benefit to the U.S. in reduced pollution. However, there may also be an increase in pollution in Mexico which should be troubling if we care about the health and well-being of our trading partners. Nonetheless, this appears to be a case where the U.S. is better off than we were before, we have lower levels of pollution. Importantly, it is likely that we didn't simply trade highly polluting U.S. facilities for highly polluting Mexican facilities. It may well be the case that as the plants move to Mexico the result is lower levels of pollution since the cost for pollution control may be a lower for new manufacturing facilities. This could then result in lower levels of pollution in Mexico than we initially had in the U.S.. Accordingly, it is very possible that overall pollution levels for the same level of production are lower than they would have been had firms not relocated.

"Even if the U.S. were to back out of NAFTA, there are still basic provisions that the U.S. must comply with as an obligation of our membership in the WTO that would limit how we could impose tariffs on imports."

In the public policy world we often talk about unintended consequences of policy choices. I want to highlight one of the unintended consequences that could come about as a result of renegotiating NAFTA – a shifting of the location of jobs. Historically, conser-vatives have been advocates of free trade policies since they create an oppor-tunity to expand trade. In expanding trade, two basic things happen. First, there is access to new markets. Second, there is increased competition for suppliers. With access to new markets, there may be the opportunity to expand pro-duction, thereby creating more jobs. However, with increased competition not all firms will be able to compete in the expanded market. A supplier now competes with other firms and if wages or other production costs are lower for other firms, the original firm may be at a disadvantage and will either need to find ways to cut their costs (reduce wages, reduce employees, or change production processes to name a few options) or they will go out of business.

While most economists believe that there will be a net expansion as a result of the opening of new markets through trade deals, not all firms will benefit. One of the challenges associated with NAFTA is that it is difficult to untangle some of the employment issues. First, it is clear that there has been a decline in manufacturing jobs over the NAFTA period. Some of that decline is due to firms not being able to compete with companies located in Canada or Mexico. According to Hufbauer and Cimino-Isaacs after "NAFTA's enactment, fewer than 5 percent of U.S. workers who have lost jobs from sizable layoffs (such as when large plants close down) can be attributed to rising imports from Mexico." Further, they then argue that "almost the same number of new jobs has been created annually by rising U.S. exports to Mexico." Importantly, part of the problem is that the new jobs are not created in the same place where the old jobs were. The U.S. Chamber of Commerce notes that "most of these jobs have been lost to ... 'productivity.' Technological change, robotics, automation, and widespread use of information technologies have enabled firms to boost output even as some have cut payrolls. Research suggests that technological advances are making sophisticated capital goods substitutes for low-skilled workers". Unfortunately, to workers being laid off there is no difference in the layoff due to technology and the layoff due to NAFTA. It appears on the jobs front that part of the unintended consequence is that there is a mismatch between where new jobs have been created and where the old jobs were lost.

While it is clear that there are some complicated issues in understanding the complete impact of NAFTA, perhaps the most complicated issue would be to renegotiate the treaty. Remember, the president does not act alone. "The President... shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur". Any modification to NAFTA would necessarily require the "Advice and Consent of the Senate." Accordingly, the simple claim that we can easily negotiate a better deal is a simplistic view. Even if the U.S. were to back out of NAFTA, there are still basic provisions that the U.S. must comply with as an obligation of our membership in the World Trade Organization that would limit how we could impose tariffs on imports. Additionally, other countries, in the case of NAFTA, Mexico and Canada could then likely impose tariffs on our exports to their countries. Thereby increasing costs for both consumers and firms.

James R. Kearl

Protectionist rhetoric is standard fare with each election. Heretofore, it's ebbed after the polls close. As a consequence, since WWII the US has moved steadily, albeit in fits and starts, away from the colossal economic disaster triggered by the 1930 Smoot-Hawley Tariff and toward more open trade. NAFTA was a notable step in this direction since it was the first agreement between fully developed and developing economies. Mr. Trump's hostility to NAFTA exhibits a profound ignorance of the effects of trade on the US economy. A change in US policy that reduces the openness of the US economy to trade with Mexico will, in the end, reduce economic wellbeing in the US. Put simply: there are no advantages to the US economy of Mr. Trump's actions, just disadvantages, although there will be sectors of the US economy that benefit from trade restrictions because more open trade creates both winners and losers. The gains to the winners, however, are larger than the losses incurred by the losers. A renegotiation of NAFTA that reduces the openness of the US economy to trade with Mexico, as it's surely intended to do, will allow Mr. Trump to claim (and show) that some in the economy benefit. In doing so, however, Mr. Trump will be ignoring the more-than-offsetting costs that his foolish policy imposes, including higher prices and lower quality for consumer goods in the US and a reduced ability of US producers to sell their products abroad.

> "A change in US policy that reduces the openness of the US economy to trade with Mexico will, in the end, reduce economic wellbeing in the US."

The facts are clear: trade with Mexico increased five-fold between 1992-2015; US foreign direct investment in Mexico increased from $15 billion to $108 billion over the same period; Mexican imports from the US soared (Mexico imports more than do Brazil, Russia, India, and China combined); supply chain inte-gration grew from trivial to substantial – $.40 of each dollar of US imports from Mexico originates in the US.

What is unclear is whether any of this is due to NAFTA.

The best research to date finds that the aggregate effects of NAFTA for the US have been modest. This was to be expected: US tariffs were near zero before NAFTA, so an important gain (which will be lost) was greater US access to the Mexican market. Disappointingly, the effects for Mexico have also been modest (for reasons that are unclear given the dramatic benefits of moves to more open trade in Hong Kong, Singapore, South Korea, Taiwan, China, and elsewhere in the world where import-substitution policies have been aban-doned over the past two or three decades), although this modest overall effect hides a compositional effect: northern Mexico has seen substantial benefits, with higher wages, more jobs, and booming industries while southern Mexico has seen little, if any, benefit. However, Mexican consumers have seen lower prices and higher quality products across the board because of NAFTA. With regard to jobs in the US, there has been a small net loss (about 15,000 per year), but the export-related jobs gained (around 185,000 per year) pay an average salary 15 to 20 percent more than those lost. Hence, there has been a net aggregate gain to the US economy from NAFTA. And there are other, less easily quantifiable, effects. One of particular importance is the increased ability of the US to compete outside of NAFTA because of the supply-chain efficiencies within NAFTA.

That is, integrating with Canada and Mexico makes US producers more competitive vis-à-vis the rest of the world. Another is that while the economic effects for Mexico have been disap-pointingly modest, it is in our interest to foster a vibrant, growing economy along our southern border, not a depressed, struggling economy with few opportunities for its citizens. Challenges with immigration and a host of other issues would be substantially less if we had an economy on our southern border that was closer to the economy we have along our northern border. To the degree that Mr. Trump's protectionist policies vis-à-vis Mexico increase, rather than reduce, the economic differences between the US and Mexico (as they will), the US will be worse off. The US will not be better by making Mexico worse off. Rather, the US will be better off as Mexico becomes better off, and NAFTA contributes to this outcome.

Notes on pg. 47