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NAFTA at 10: An Economic and Foreign Policy Success

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Ten years ago this month, leaders of the United States, Canada, and Mexico signed the historic North American Free Trade Agreement. Although NAFTA remains a lightning rod for critics of free trade, by any measure it has been a public policy success.

As a trade agreement, it delivered its principal objective of more trade. Since 1993, the value of two-way U.S. trade with Mexico has almost tripled, from \$81 billion to \$232 billion, growing twice as fast as U.S. trade with the rest of the world.¹ Canada and Mexico are now America's number one and two trading partners, respectively, with Japan a distant third.

Exaggerated Impact

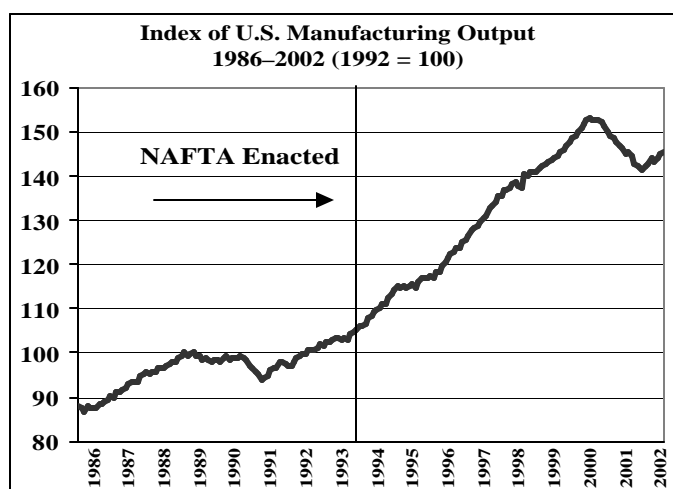
One reason NAFTA remains controversial today is that advocates and opponents alike were guilty a decade ago of exaggerating its impact. Advocates claimed it would create hundreds of thousands of jobs in the U.S. economy due to a dramatic rise in exports; opponents claimed far more jobs would be destroyed by a flood of imports entering the United States and a stampede of U.S. companies moving to Mexico to take advantage of cheap labor. During a presidential debate in 1992, H. Ross Perot famously predicted, "You're going to hear a giant sucking sound of jobs being pulled out of this country."²

In reality, NAFTA was never going to have much of an impact on the U.S. economy. America's GDP at the time was almost 20 times larger than Mexico's, and U.S. tariffs against Mexican goods already averaged a low 2 percent.

A Foreign-Policy Triumph

For the United States, NAFTA was more about foreign policy than about the domestic economy. Its biggest payoff for the United States has been to institutionalize our southern neighbor's turn away from centralized protectionism and toward decentralized, democratic capitalism.

By that measure, NAFTA has been a spectacular success. In the decade since signing NAFTA, Mexico has continued along the road of economic and political reform. It has successfully decoupled its economy from the old boom-and-bust, high-inflation, debt-ridden model that characterized it and



Source: U.S. Federal Reserve Board.

much of Latin America up until the debt crisis of the 1980s. In 2000, Mexico avoided an election-cycle economic crisis for the first time since the 1970s. Today Mexico and Chile are the two most stable and dynamic economies in Latin America—and the two that have reformed most aggressively.

Just as important, the economic competition and decentralization embodied in NAFTA encouraged more political competition in Mexico. It broke the economic grip in which the dominant Institutional Revolutionary Party (PRI) held the country for most of the last century. It is no coincidence that, within seven years of NAFTA's implementation, Vicente Fox became the first opposition-party candidate elected president after 71 years of the PRI's one-party rule.

"Giant Sucking Sound," Where Art Thou?

With a decade of hindsight, it is difficult to find any evidence of a "giant sucking sound" of jobs, investment, and manufacturing capacity heading south.

American Jobs. Trade is not about more jobs or fewer jobs but about better jobs, and NAFTA is no exception. Of

course, competition from Mexico closed some U.S. factories, but those closures have allowed resources to shift to sectors where American producers enjoy a greater advantage in efficiency. That's the whole idea of trade: we increase production in sectors and industries where we can produce more efficiently and reduce production in sectors where we are less efficient. The result is a shift to better paying jobs.

Meanwhile, the overall level of employment is determined by such macroeconomic factors such as monetary policy, labor-market regulations, and the business cycle.

For the record, the U.S. economy created millions of new jobs after passage of NAFTA. Civilian employment in the U.S. economy grew from 120.3 million in 1993 to 135.1 million in 2001, an increase of almost 2 million jobs per year. The unemployment rate fell steadily after the enactment of NAFTA, from an average of 6.9 percent in 1993 to under 4 percent in 2000.³ The unemployment rate jumped to 6 percent in 2002, but that was because of the recent and relatively mild recession of 2001—a recession brought on not by NAFTA but by rising interest rates and energy prices and a falling stock market.

Foreign Investment. Despite predictions, NAFTA did not cause anything like an exodus of manufacturing investment to Mexico. U.S. investment in Mexico did increase after NAFTA, along with trade, but those flows are a trickle compared to what we invest domestically. In the eight years after the implementation of NAFTA, from 1994 through 2001, U.S. manufacturing companies invested an average of \$2.2 billion a year in factories in Mexico.⁴ That is a mere 1 percent of the \$200 billion invested in manufacturing each year in the domestic U.S. economy.⁵

The small outflow of direct manufacturing investment to Mexico has been overwhelmed by the net inflow of such investment from the rest of the world—an average of \$16 billion a year since 1994, most of it from Europe and Japan.⁶ At the end of 2001, the stock of U.S. direct manufacturing investment in Mexico was \$19.7 billion, less than one-tenth the stock of U.S. investment in high-wage, high-standard Europe.⁷

U.S. Manufacturing. Nowhere were the predictions about NAFTA more apocalyptic than in regard to manufacturing. H. Ross Perot accused NAFTA of “deindustrializing our country,” and Rep. David Bonior, the soon to be ex-congressman and Democratic Whip from Michigan, predicted flatly that NAFTA “will destroy the auto industry.”

In the eight years since the implementation of NAFTA, those predictions have become laughable. Between 1993 and 2001, manufacturing output in the United States, as measured by the U.S. Federal Reserve Board, rose by one-third. Output of motor vehicles and parts rose by 30 percent.⁸ In fact, in the first eight years of NAFTA, manufacturing output in the United States rose at an annual average rate of 3.7 percent, 50 percent faster than during the eight years before enactment of NAFTA. (See figure.) Of course, this is not an argument that NAFTA was the primary cause of the acceleration in manufacturing output, but it does knock the wind out of the myth that NAFTA has somehow caused the “deindustrialization” of America.

Manufacturing employment has fallen in the past few years, but that cannot in any plausible way be blamed on NAFTA. In fact, the number of Americans employed in manufacturing grew by 706,000 in the first four years of NAFTA, from January 1994 to January 1998.⁹ The decline in manufacturing jobs since 1998 has not occurred because those jobs have gone to Mexico; it has occurred because of (1) collapsing demand for our exports due to the East Asian financial meltdown in 1997–98, (2) our own domestic slowdown in demand due to the 2001 recession, and (3) the ongoing dramatic improvement in manufacturing productivity—fueled by information technology and increased global competition—that has allowed American factories to produce more and better widgets with fewer workers.

Conclusion

By every reasonable measure, NAFTA has been a public policy success in the decade since it was signed. It has deepened and institutionalized Mexico's drive to modernize and liberalize its economy and political system. It has spurred trade, investment, and integration between the United States and Mexico. And in a more modest way it has enhanced American productivity and prosperity—refuting the critics who were wrong 10 years ago and are just as wrong today.

1. See Bureau of the Census, “FT900—U.S. International Trade in Goods and Services: 1993,” [www.census.gov/foreign-trade/ Press-Release/93_press_releases/Final_Revisions_1993](http://www.census.gov/foreign-trade/Press-Release/93_press_releases/Final_Revisions_1993); and “U.S. International Trade in Goods and Services—Annual Revision for 2001,” [www.census.gov/foreign-trade/ Press-Release/2001pr/ Final_Revisions_2001](http://www.census.gov/foreign-trade/Press-Release/2001pr/Final_Revisions_2001).

2. Public Broadcasting System, “Debating Our Destiny: The Third Presidential Debate,” *NewsHour*, October 19, 1992, www.pbs.org/newshour/debatingourdestiny/92debates/3prez2.html.

3. Joint Economic Committee of Congress (JEC), *Economic Indicators* (Washington: Government Printing Office), October 2002, p. 11.

4. U.S. Department of Commerce, Bureau of Economic Analysis (BEA) “U.S. Direct Investment Abroad,” www.bea.doc.gov/bea/di/di1usdbal.htm.

5. JEC, p. 11.

6. BEA, “Foreign Direct Investment in the U.S.,” www.bea.doc.gov/bea/di/di1fdibal.htm.

7. Maria Borga and Daniel R. Yorgason, “Direct Investment Position for 2001: Country and Industry Detail,” *Survey of Current Business* (Bureau of Economic Analysis, July 2002), Table 2.2, p. 33.

8. U.S. Federal Reserve Board, “Industrial Production and Capacity Utilization: Data from January 1986 to Present (Tables 1, 2, and 10), Industrial Production, Seasonally Adjusted,” Series B00004, www.federalreserve.gov/releases/g17/table1_2.htm.

9. In January 1994, 18,155,000 Americans were employed in manufacturing, compared to 18,861,000 in January 1998. See U.S. Bureau of Labor Statistics, “Employment, Hours, and Earnings from the Current Employment Statistics Survey (National), Manufacturing Employment, Seasonally Adjusted,” Series EES30000001, data.bls.gov/cgi-bin/surveymost?ee.