



The Operation and Effects of NAFTA

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I am pleased to be able to give this testimony on the effects of NAFTA a little more than three and one-half years into its existence because it provides an opportunity to set the record straight on perhaps the most important issue that concerns the U.S. public. This is the effect of NAFTA on overall U.S. employment.

Before I get into the main and really only theme of this statement, I wish to comment on a few important misconceptions that have become accepted wisdom about NAFTA's effects.

1. Public opinion polls indicate that there is a pervasive feeling among the majority of the U.S. public that there is little benefit for the United States in cementing close trade relations with developing countries. In point of fact, the fastest growing U.S. markets are in developing countries. My purpose here is not to discuss the proposed Free Trade Area of the Americas, but the most rapid growth of U.S. exports is in the Western Hemisphere.

2. With respect to Mexico in particular, the contention of opponents of NAFTA is that the country is too poor and its income too unequal for it ever to become an important market for U.S. exports. Mexico, in fact, has this year become the second most important market for U.S. exports after Canada.
3. We are told by opponents of free trade with developing countries that this will result inevitably in U.S. trade deficits with those countries because their wages are so much lower than in the United States. Our largest bilateral trade deficits are with Japan and Canada, each a high-wage, industrialized country; and with China and Mexico, both much lower-wage, underdeveloped countries. It is evident to anybody prepared to scan the world for U.S. trade performance that there is no clear picture of U.S. exports to and imports from individual countries based solely on wage levels. Trade levels, both imports and exports, depend on so many things that singling out wages as the explanatory factor is simply wrong-headed.

Why do these unfounded perceptions persist? There are two solid reasons. The first is that there has been a steady, anti-trade drumbeat by opponents of open markets. The second has been the unwillingness of many of our political leaders, from both parties, to speak out against protectionism. I hope this will change, stimulated by the work of this subcommittee.

Now to my main theme.

Perhaps the most salient single economic fact of the current situation in the United States is the remarkably low level of unemployment. This has resulted from steady economic growth coupled with an astounding level of job creation. This is being accomplished with low inflation. I am not one who believes that we have discovered the utopia of ending economic ups and downs, or that we will grow indefinitely without inflation. But even the most dire pessimists must admit that the United States is now at full employment.

Please consider what full employment means. This means that we cannot create any significant number of new jobs without stimulating higher inflation. It means that we are not losing jobs as a result of trade because the country is creating as many jobs as there are takers without stimulating inflation. This gives the lie to those who assert that NAFTA has resulted in hundreds of thousands of job losses. NAFTA could not have done this because the country is at full employment. I want to repeat this simple truth over and over again so that each

time some critic of open trade talks about job losses, a direct challenge to his or her credibility is forthcoming.

NAFTA obviously does not deserve the credit for the two and one-million or so jobs that have been created each year since it came into effect. This was accomplished by the job-creating power of the prosperous U.S. economy.

I have no doubt that if the protectionists have their way, if higher barriers are put on imports from Mexico and other countries, this would compromise the ability to create all these new jobs without stimulating inflation. A tariff is a tax on consumption and this surely would have its adverse effect on the price level. If this happened, the Federal Reserve would have to take action to restrict growth, presumably by raising interest rates. One of the surest ways to kill the goose that lays the golden egg of job creation is to tax the job-creating conditions out of existence by higher tariffs and import barriers.

I hope that those who listen to or read this testimony including the media do not misinterpret what I am saying. My point is that the country as a whole cannot have lost jobs as a result of NAFTA. The existence of full employment is conclusive evidence of this. Individuals may have lost jobs because of a host of causes, such as increased imports, the shift in production from one part of the country to another or out of the country, changes in technology that disadvantage persons who do not have the needed skills. But many more jobs are being created than are being lost and employment cannot increase significantly for the nation as a whole without stimulating inflation. I think we owe those who are hurt in this process, those who do lose whether from imports or changes taking place within the domestic economy, some form of meaningful assistance. This kind of job loss that should be dealt with by special adjustment assistance is quite different from arguing that protectionism is the way to sustain jobs or create new ones for the country as a whole..

My view is that NAFTA has worked remarkably well since its inception. Mexico faced a horrible period in 1995 for reasons unrelated to NAFTA, but its recovery has been both rapid and robust. NAFTA made it necessary for Mexico to deal

with its problems by means other than import restrictions and this is one reason for the rapid recovery. The ability to export to the U.S. market when its domestic market dried up permitted the economic turnaround to take place. Mexico last year grew by more than 5 percent. Its gross domestic product is growing even faster this year. So, too, are U.S. exports to Mexico growing as a consequence of its rapid recovery.

Our neighborhood is important to us. Our northern neighbor, Canada, is far and away the largest market for U.S. exports. Mexico, which has long been our third largest market after Canada and Japan is overtaking Japan this year because its high economic growth is sucking in U.S. imports. We export more merchandise to our two NAFTA partners than we do to all of Europe. This situation can continue as long as our two neighbors prosper, and NAFTA contributes to this prosperity