The Takeaway
Policy Briefs from the Mosbacher Institute for Trade, Economics, and Public Policy

The NAFTA Intellect Disconnect

Actual Costs and Benefits versus Popular Perceptions

RAYMOND ROBERTSON
The Bush School of Government and Public Service

The North American Free Trade Agreement (NAFTA), which was initiated during the Republican administration of George H.W. Bush and completed during the Democrat administration of Bill Clinton, has been studied intensively since it went into effect in 1994. Although an objective review of the literature suggests that NAFTA's overall effects have been small but positive for both Mexico and the United States, Donald Trump has called it the "worst trade agreement ever." Others have claimed that NAFTA benefits Mexico at the expense of the United States. This brief revisits the evidence surrounding NAFTA, in particular, and free trade agreements, in general.

There are many ways to evaluate trade agreements. Perhaps the best place to start is by evaluating how well an agreement achieved its stated goals. The Preamble to the NAFTA lists fifteen goals.[1] Most focus on increasing the

WHAT'S THE TAKEAWAY?

Overall, NAFTA's effects have been small but positive for both Mexico and the United States.

Free trade agreements lead to increased exports and imports.

US exports are often linked to US jobs.

US consumers benefit significantly from imports.

The overall benefits of trade outweigh the costs.

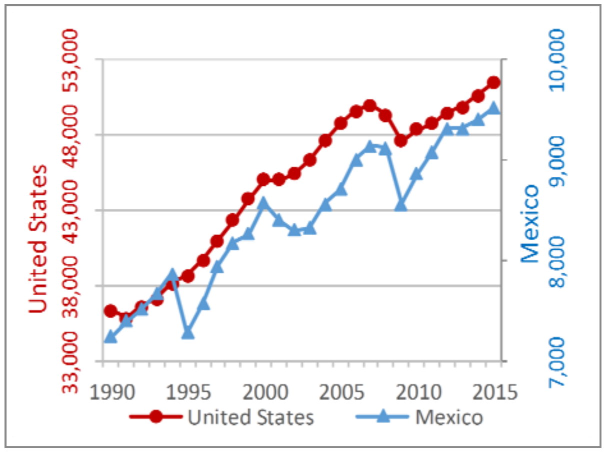
volume of trade by reducing barriers to trade and investment. It is clear that since NAFTA, trade and investment have significantly increased between the three NAFTA countries. In particular, goods traded between Mexico and the United States increased by more than a factor of five between 1994 and 2015.[2] US exports to Mexico increased from $50.84 to $235.7 billion, while US imports from Mexico increased from $49.5 billion to $296.4 billion. Goods traded between Canada and the United States more than doubled over the same period. In other words, NAFTA appears to have accomplished its primary objectives.

Since US imports from Mexico increased more than our exports to Mexico, some have suggested that NAFTA and trade agreements like NAFTA benefit our trading partners much more than they benefit the United States. In the case of Mexico, however, the facts do not support the claim that Mexico has benefitted more from NAFTA than the United States. In fact, recent evidence suggests that earnings in the two countries have grown at about the same rate since NAFTA.[3] Adjusted for inflation, US GDP per capita increased steadily (with the exception of the 2001 and 2008 recessions) from $36,566 to $51,486 between 1992 and 2015 (in constant 2010 US dollars). Mexico's GDP growth has experienced larger fluctuations (including the December 1994 peso crisis), but over the same time period Mexican GDP per capita increased from $7,509 to $9,517 (in constant 2010 US dollars).[4] See figure 1.

If Mexico gained more than the United States, the gap between Mexican and US incomes would have closed. On the contrary, the ratio of Mexican to US GDP per capita fell from 20.5% of US GDP per capita in 1992 to 18.5% in 2015. This means that, at least in terms of rising incomes, there seems to be no evidence that Mexico has benefitted more than the United States from NAFTA. See figure 2.

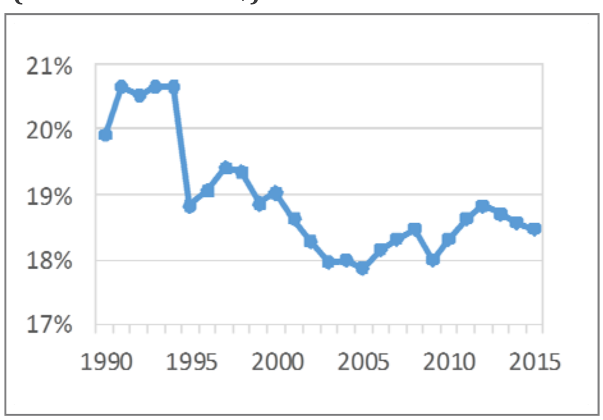
Furthermore, even though imports have grown rapidly, much of the value of the US imports from Mexico includes parts produced in the United States that are exported to Mexico for assembly and then re-exported to the United States. This arrangement, known as outsourcing, increases the demand for US workers doing higher-productivity work.

Figure 1: GDP per Capita (constant 2010 US$)



Source: The World Bank

Figure 2: Ratio Mexican to US GDP per capita (constant 2010 US$)



Source: The World Bank and author's calculations

Not all products imported from Mexico were assembled from US parts. Mexico has also increased its exports of many other goods, including agricultural products (like avocados and tomatoes) that show up on the dinner tables of US consumers. In fact, trade theory and empirical evidence both suggest that US consumers benefit significantly from imports from Mexico, in particular, and from imports in general. Countries import goods that cost less than products produced at home. The availability of these cheaper products has helped lower-income families stretch their dollars and make ends meet.

EMPLOYMENT EFFECTS OF TRADE

But doesn't trade explain why families are poor in the first place? Doesn't importing lower-cost products cost jobs at home and lower incomes? There are definitely some examples of these adverse effects. Several mainstream academics[5] have produced empirical evidence suggesting that imports are associated with job losses. However, these effects are extremely localized and tend to affect less-educated workers in especially hard-hit areas (e.g. Detroit) and industries (e.g. apparel). Even under the assumption that these effects are entirely due to trade, the number of workers who have been adversely affected is in the thousands while the number of people who benefit from trade runs in the millions. The overall benefits of trade outweigh the costs.

Furthermore, exports are unambiguously associated with job gains. Overall in 2015, 11.5 million US jobs were dependent on export trade. Of those jobs, Texas, California, Washington, Illinois, and New York benefitted the most with 2.8 million jobs, or 41% of jobs related to goods exports (not including service exports).[6]

MEXICO AS PARTNER

Mexico is one of the United States' most important trading partners. In 2015, total exports to Mexico accounted for 11.8% of overall US exports and total imports from Mexico accounted for 11.5% of overall US imports.[7] The total value of trade between Mexico and the United States exceeded half a trillion dollars, and Mexico was the second largest market for US good exports. (Our other neighbor and NAFTA trading partner—Canada—was first.)

> *The most accurate way to think of the NAFTA economic area is as one combined market.*

Trade with Mexico is especially important for Texas. The automobile sector in particular in Texas is very closely integrated with production in Mexico. Parts made in the United States are shipped to Mexico for assembly (often into more aggregated parts) and returned to the United States for additional processing by working Texans. As a result, the most accurate way to think of the NAFTA economic area is as one integrated economy rather than three separate ones. That is, rather than thinking of Mexico as a competitor, we should think of Mexico as a partner in our national production process.

My own research supports this idea. Comparing the changes in employment in Mexico and the United States over time and across different manufacturing industries, the data show that when employment expands in the United States, it also expands in Mexico, and when it contracts in the United States, it also contracts in Mexico.[8] In other words, Mexican and US workers are complements and not substitutes in production. The anecdotal evidence we observe in particular industries, such as the automotive industry, indicates that the strong connections between US and Mexican employment are because they are part of the same production process.

IMPLICATIONS

The potential for future gains from globalization for US consumers, producers, and workers, is very large. With the United States constituting only 5% of the world economy, 95% of the world's consumers (with roughly three fourths of the world's purchasing power) lay outside the United States. Research by the Peterson Institute estimates that eliminating the remaining global trade barriers would increase the benefit America already enjoys from trade by another 50%.[9] Free trade agreements are a proven way to improve economic conditions for both the United States and our trading partners.

Raymond Robertson is a professor and holder of the Helen and Roy Ryu Chair in Economics and Government at the Bush School of Government and Public Service. He serves as faculty coordinator of the Mosbacher Institute's Program in Integration of Global Markets and is widely published in the field of labor economics and international economics.

Notes:

[1] The preamble to NAFTA is available at http://tech.mit.edu/Bulletins/Nafta/00.preamble.
[2] US Census Bureau, 2016. https://www.census.gov/foreign-trade/balance/c2010.html
[3] Gandolfi, Halliday, and Robertson (2016).
[4] World Bank Development Indicators. http://data.worldbank.org/data-catalog/world-development-indicators
[5] Kletzer, Lori (2001). Job loss from imports: Measuring the costs. Peterson Institute for International Economics, Washington D.C.; White, Roger (2015). Making sense of anti-trade sentiment international trade and the American worker. Palgrave MacMillan: New York, NY; and David H. Autor, David Dorn & Gordon H. Hanson (2016). The China shock: Learning from labor market adjustment to large changes in trade. *Annual Review of Economics*, 8(1), pp. 205-240.
[6] http://www.trade.gov/mas/ian/employment/ and http://www.trade.gov/mas/ian/build/groups/public/@tg_ian/documents/webcontent/tg_ian_005503.pdf
[7] Office of the United States Trade Representative, 2016.
[8] Robertson, Raymond (2016). Are Mexican and U.S. workers complements or substitutes? Unpublished Working Paper: The Mosbacher Institute for Trade, Economics and Public Policy, The Bush School of Government, Texas A&M University.
[9] https://ustr.gov/issue-areas/economy-trade

ABOUT THE MOSBACHER INSTITUTE

The Mosbacher Institute was founded in 2009 to honor Robert A. Mosbacher, Secretary of Commerce from 1989-1992 and key architect of the North American Free Trade Agreement. Through our three core programs–Integration of Global Markets, Energy in a Global Economy, and Governance and Public Services–our objective is to advance the design of policies for tomorrow's challenges.

Contact:
Cynthia Gause, Program Coordinator
Mosbacher Institute for Trade, Economics, and Public Policy
Bush School of Government and Public Service
4220 TAMU, Texas A&M University
College Station, Texas 77843-4220

Email: bushschoolmosbacher@tamu.edu
Website: http://bush.tamu.edu/mosbacher

To share your thoughts on *The Takeaway*, please visit http://bit.ly/1ABajdH