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NAFTA: Economic Effects on the United States After Eight Years

Arlene Wilson, Consultant, Foreign Affairs, Defense, and Trade Division

Updated August 20, 2002

Abstract. This report examines available data to determine NAFTA's economic effect on the Unite States.

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NAFTA: Economic Effects on the United States After Eight Years

Summary

The North American Free Trade Agreement (NAFTA) among the United States, Canada and Mexico went into effect on January 1, 1994. It is the first trade agreement the United States has entered into with a geographically-close developing country and has raised concerns about its economic effect, particularly on U.S. communities and workers.

Since the mid-1980s, when Mexico began reducing trade restrictions, the U.S. and Mexican economies have become more highly integrated. This is evidenced by the rapid growth in U.S. merchandise trade with Mexico, which is now 12% of all U.S. trade (up from 8% in 1993 and 6% in 1988) and especially by the growth of intra-industry and intra-firm trade. This growing integration has, by reducing costs, made the U.S. economy (and particularly the Mexican economy) more productive and globally competitive. Greater integration of the U.S. and Mexican economies probably would have occurred without the NAFTA, but the NAFTA, by improving business confidence in Mexico, may have accelerated the process.

The U.S. foreign direct investment position in Mexico grew more rapidly before 1994 than after, probably in anticipation of NAFTA. Although growing significantly, U.S. foreign direct investment in Mexico is still relatively small, accounting for 2.8% of all U.S. foreign direct investment abroad in 2000. U.S. flows of direct investment to Mexico of $3.5 billion in 2000 are also very small compared with U.S. domestic investment in U.S. plant and equipment of $1,362 billion.

It is estimated that NAFTA caused job dislocation for about 415,000 workers between January 1, 1994 and December 31, 2001, about 34% of whom were in the textile and apparel industry and 5% in the automotive industry. The number of U.S. workers dislocated by NAFTA over eight years is less than 1% of the 134.3 million U.S. workers employed in 2001.

Nevertheless, a study published in August 2001 by the U.S. General Accounting Office of six communities who were hard-hit by job dislocation from NAFTA illustrates the need for improving the skills and job opportunities of dislocated workers. Generally, dislocated workers had less education than the U.S. workforce as a whole and many had limited English language skills. These case studies suggest that, in the past, trade adjustment assistance programs did not meet the needs of the workers in these communities. The Trade Act of 2002 includes provisions that may improve the effectiveness of trade adjustment assistance.

Overall, the NAFTA has had a relatively small effect on the U.S. economy. Future free trade agreements between the United States and other countries, which are not major U.S. trading partners and are geographically further away, will likely have an even smaller effect on the U.S. economy.

This report will not be updated.

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NAFTA: Economic Effects on the United States After Eight Years

Introduction

The North American Free Trade Agreement (NAFTA) among the United States, Canada and Mexico went into effect on January 1, 1994 after a well-publicized debate by the public and the Congress. The primary fear of NAFTA's opponents was that the United States would lose jobs as corporations shifted production to Mexico where wage rates are substantially less and labor standards are not always enforced. Ross Perot coined the term "the giant sucking sound" of U.S. jobs going to Mexico, a phrase that resonated with the American public. At the same time, the Clinton Administration focused on the large number of jobs that might be created by NAFTA which, it was claimed, would expand U.S. exports to Mexico.

There are two basic reasons for analyzing the economic effects of NAFTA at this time. First, many people are still apprehensive and concerned about NAFTA. Two recent polls tell the story. One question in a 1999 poll was "Do you think the NAFTA has been good or bad for the United States?"[1] The responses were: 44% good, 30% bad, 7% neither, and 19% don't know. In a poll taken in 2001, one question was "Do you think America should continue the NAFTA agreement, pull out of NAFTA, or should the NAFTA be continued with changes?"[2] The responses were: 28% continue NAFTA, 14% pull out of NAFTA, 37% change NAFTA, and 21% undecided.

Second, since proposals to expand and deepen NAFTA are being discussed, the lessons learned from NAFTA may be helpful. Negotiations are underway towards a Free Trade Area of the Americas (FTAA) and a U.S. trade agreement with Chile. The Bush Administration announced its intention to explore a U.S.-Central American Free Trade Agreement among the United States and Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua in January 2002. Reportedly, the United States and the five Central American countries may begin negotiations by the end of 2002.[3]

Mexico's President Vincente Fox has proposed a "deepening" of NAFTA to become a common market, which could include a regional fund to stimulate

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[1]Gallop/CNN/USA Today Poll conducted in November 1999. Website: pollingreport.com/trade.htm

[2]Poll conducted for the Association of Women in International Trade in October 2001. Website: [nationaljournal.com/member/polltrack/2001/todays/10/1026epicmra.htm]

[3]United States, Central American Nations May Launch Trade Talks by End of 2002. *International Trade Reporter*. June 20, 2002, p. 1099.

Mexican economic growth.[4] Others have suggested measures such as a common external tariff, coordination of regulatory systems, and freer movement of citizens among the three NAFTA partners. One Canadian analyst suggested that deeper integration is necessary to prevent border closings for security reasons (such as that in the immediate aftermath of September 11, 2001) which imposed an economic hardship on Canada.[5]

The purpose of this report is to examine the available data to determine NAFTA's economic effect on the United States. The two questions addressed are: How has NAFTA affected the U.S. economy? What is the magnitude of the effect? The data studied include trade (both merchandise and services) flows, foreign direct investment, and the number of U.S. workers certified as having lost (or been threatened with the loss of) their jobs as a result of NAFTA (a proxy for job dislocation). Selected case studies of U.S. communities adversely affected by plant relocations to Mexico are summarized.

This report focuses more on the U.S. trade and investment relationship with Mexico than with Canada. The NAFTA is the first major trade agreement the United States has had with a geographically-close developing country where per capita income is much lower than in the United States. In 2000, Mexico's per capita GDP was about $6,000, compared to $35,000 in the United States. Issues of concern in U.S. trade with Mexico, such as lower Mexican wages, are not relevant to U.S. trade with Canada, where the two economies are quite similar.

The main findings of this report are:

- Since the late 1980s, when Mexico began reducing trade restrictions, the U.S. and Mexican economies have become much more highly integrated. This is evidenced by the rapid growth in U.S. trade with Mexico and especially by the growth of intra-industry and intra-firm trade. This growing integration has, by reducing costs, made the U.S. economy (and particularly the Mexican economy) more productive and globally competitive. Greater integration of the U.S. and Mexican economies in fact was happening before the NAFTA, but the NAFTA, by improving business confidence in Mexico, may have accelerated the process.

- Between January 1, 1994 and December 31, 2001, about 415,000 U.S. workers have suffered job dislocation as a result of U.S.-Mexican economic integration. Although this number is very small relative to the size of the U.S. workforce, it may have imposed a significant economic hardship on those workers and their families who have lost jobs.

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[4]Pastor, Robert A. *Toward a North American Community: Lessons from the Old World for the New.* Institute for International Economics, 2001, p. 190.

[5]Dobson, Wendy. *Shaping the Future of the North American Space: A Framework for Action.* C.D. Howe Institute Commentary, No. 162, April 2002, p. 1.

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- Both the benefits of the NAFTA (increased trade and investment and enhanced global competitiveness) and the costs (job dislocations) are very small relative to the size of the U.S. economy.

Background

An implicit goal of the NAFTA was to increase economic integration among the three partner countries (by increasing trilateral trade and investment) which, in turn, was expected to raise each country's productivity and global competitiveness. In analyzing the NAFTA's effect, however, it is important to recognize that economic integration between the United States and its NAFTA partners had been underway for some time before the NAFTA was negotiated. Cross-border integration of production resulted from market forces in which businesses, to be competitive, had to devise cost-saving strategies (such as shifting part of their production abroad), and by government policies and bilateral agreements that reduced trade restrictions.

Economic Benefits and Costs of Free Trade

Generally, when trade restrictions such as tariffs and quotas are reduced in a free trade agreement, the economies of all participating countries benefit over time. Freer trade allows each country to specialize in producing those goods in which it has a comparative advantage. Each economy may also benefit from lower production costs per unit as it produces for a larger market or by trade's stimulation of technological developments. Consumers can choose from a wider variety of products, and greater competition leads to higher quality goods at lower prices.

The costs of liberalizing trade generally fall to the workers and industries whose products are no longer competitive. They are forced to adjust, sometimes very painfully, as domestic plants close or relocate to other countries.

The benefits of free trade generally exceed the costs. The benefits, however, are widely distributed over the entire population, and, as a result, each person's gain is quite small. In contrast, the costs are borne by relatively few people, but may be huge for those workers and their families who have lost jobs.

The economies of the United States and Canada, in particular, have been highly integrated for a long time. The Automotive Agreement of 1965 between Canada and the United States eliminated tariffs on shipments of autos and auto parts between the two countries, which allowed cost-savings from cross-border production of automobiles. The U.S.-Canada Free Trade Agreement (FTA), which went into effect on January 1, 1989, phased out bilateral tariffs over a 10-year period. Consequently, when the NAFTA superceded the FTA in 1994, most U.S.-Canadian tariffs were already eliminated or very low.

In the mid-1980s, Mexico dramatically reversed its trade policies by unilaterally liberalizing many tariff and nontariff barriers. The extent of the liberalization was actually greater than the reductions in trade barriers in the NAFTA.[6] At that time,

[6]Hinojosa-Ojeda et. al. *The U.S. Employment Impacts of North American Integration After NAFTA: A Partial Equilibrium Approach.* School of Public Policy and Social Research. (continued...)

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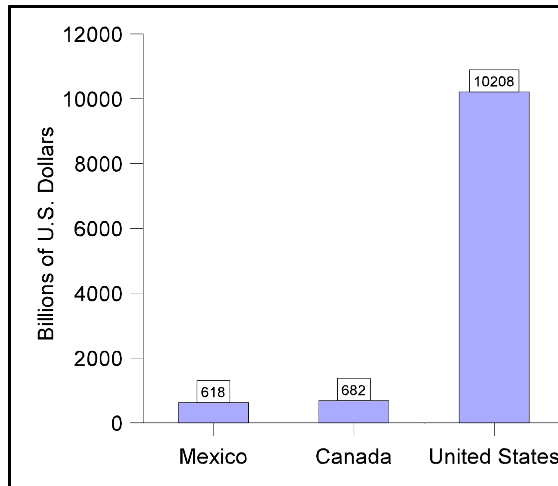
Mexico also liberalized investment restrictions. Mexico's accession to the General Agreement on Tariffs and Trade (GATT, the forerunner of the World Trade Organization, or WTO) in 1986 locked in the reductions in trade and investment barriers. Cross-border production took place through Mexico's maquiladora program (established in the 1960s), in which foreign-owned businesses could import intermediate goods tariff-free as long as the final product was exported. (The original maquiladora program ceased to exist in 2001 when NAFTA rules applied to all imports.)

The NAFTA is a wide-ranging agreement that "locked in" the trade reforms of the previous decade in Mexico.[7] By making it less likely that the Mexican government can reverse its previous trade and investment liberalizations, many argue that business confidence in Mexico improved.

Figure 1. Gross Domestic Product 2001



There are several reasons why NAFTA's effect on the U.S. economy would be expected to be small. First, from an economic perspective, the relationship among the three countries is very asymmetric. As shown in figure 1, Mexico's GDP in 2001 of $618 billion was only 6% that of the United States of $10,208 billion. Even Canada's 2001 GDP of $682 billion was only 7% of U.S. GDP.

[6](...continued)
UCLA. January 2000. p. 38.

[7]The NAFTA includes chapters on investment, services, intellectual property protection, government procurement, agriculture, energy, and dispute settlement. In addition, side agreements on the environment and labor standards facilitate cooperation on these issues by the United States, Canada and Mexico.

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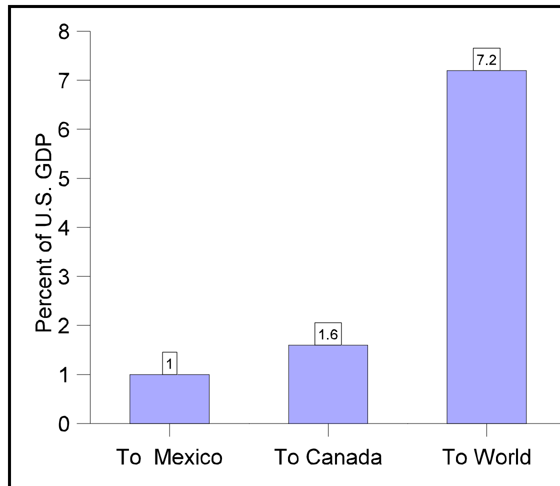
U.S. trade with Mexico and Canada provides another perspective. Even though Mexico is the second largest U.S. export market, U.S. exports to Mexico were only about 1% of U.S. GDP in 2001 (see figure 2). U.S. exports to Canada (the largest U.S. trading partner) were 1.6% of U.S. GDP. U.S. exports to Mexico and Canada have increased substantially since 1994 (see p. 6), but they are still relatively small in relation to U.S. GDP.

Figure 2. U.S. Merchandise Exports as a Percent of U.S. GDP, 2001



Second, tariffs were already low or nonexistent between the three countries when the NAFTA went into effect and have continued to decline. Under the Canada-U.S. Free Trade Agreement, which was superceded by the NAFTA, some tariffs were eliminated on January 1, 1989, and the rest phased out over 5 or 10 years. By January 1, 1999, virtually all U.S.-Canadian tariffs had been eliminated.

When the NAFTA went into force in 1994, half of U.S. exports to Mexico became duty-free, while the remaining half were to be phased out over 5, 10, or 15 years. By January 1, 2001, the average Mexican tariff on U.S. products had declined from 10% to 1.27%, while the average U.S. tariff on Mexican products had declined from 4% to .35%.[8]

[8]Office of the United States Trade Representative. *2001 Trade Policy Agenda and 2000 Annual Report of the President of the United States on the Trade Agreements Program.* Washington, 2001, p. 115.

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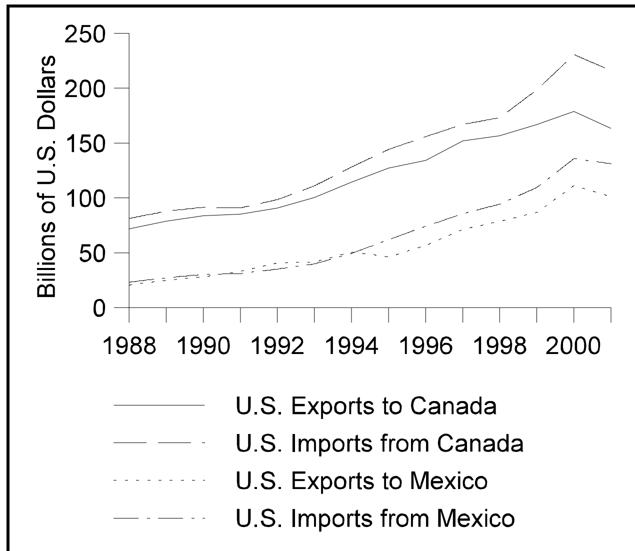
Analysis of Merchandise Trade Trends

Figure 3 shows the trends in U.S. exports to and imports from Mexico and Canada since 1988. Generally, U.S. trade with Mexico has been increasing faster than U.S. trade with Canada since 1988, but the rate of increase accelerated from 1994, the year NAFTA went into effect, to 2001. More specifically, from 1988 to 1993, U.S. trade increased by 86% with Mexico, 38% with Canada and 37% with the world. Even in the pre-NAFTA period, then, U.S. trade with Mexico was increasing faster than with Canada or with the world. From 1993 to 2001, U.S. trade increased 185% with Mexico, 79% with Canada and 79% with the world. Again, the increase in trade with Mexico far exceeded that with Canada and with the world.

Figure 3. U.S. Merchandise Trade with Canada and Mexico



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As a result, U.S. trade with Mexico accounted for 12% of all U.S. trade in 2001, up from 8% in 1993 and 6% in 1988. By contrast, U.S. trade with Canada remained at about 20% of all U.S. trade since 1988.

It should be emphasized that the rapid growth in U.S. merchandise trade with Mexico occurred *since NAFTA, not necessarily because of NAFTA*. Other factors, especially the high economic growth period of the 1990s followed by the global economic downturn in 1991, the peso-dollar exchange rate, and the growing amount of trade in intermediate goods (discussed more fully later), contributed to changing trade flows. Although difficult to quantify, several recent studies have used econometric methods in an attempt to isolate the effects of NAFTA on U.S.-Mexican trade. Most studies found that NAFTA had a small, but positive effect on trade growth.[9] Generally, in such studies, changes in GDP had a much greater effect on U.S. exports to and imports from Mexico than did NAFTA.

The 1995 peso crisis in Mexico had a large effect on trade in that year. The peso depreciated 47% against the U.S. dollar in 1995, the year after NAFTA went into effect, making U.S. imports from Mexico much cheaper and U.S. exports to Mexico

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[9]Ferrantino, Michael J., Evidence of Trade, Income, and Employment Effects of NAFTA. International Trade Commission. *Industry Trade and Technology Review*. December 2001, p. 3.

more expensive (to Mexicans). At the same time, the peso crisis caused Mexico's real (inflation-adjusted) GDP to decline by 6% in 1995, further reducing Mexican imports from the United States. Mexico's economy rebounded quickly, growing 5% in 1996 and almost 7% in 1997. Strong economic activity in all three countries contributed to the substantial growth of trade in the late 1990s.

Trade Creation, Trade Diversion and The Dynamic Effects of Trade

The growing share of Mexico in U.S. trade raises the question of whether NAFTA has led to trade creation or trade diversion. Trade creation occurs when the removal of trade restrictions in a regional trade agreement increases the flow of trade between the trading partners because it becomes more efficient to trade some products than produce them domestically. Economists believe that trade creation improves economic welfare of both the trading partners and the world. Trade diversion, on the other hand, occurs when a country imports from the trade agreement partner because the tariff removal has made the product cheaper, even though a firm in a non-trade-agreement country can produce the product more efficiently. In other words, by reducing tariffs among a few trading partners and not others, trade could be diverted from the non-participating country, which may be the more efficient producer, to the trade agreement partner. Economists argue that trade diversion worsens economic welfare.

It is not possible to measure the magnitude of trade creation or trade diversion with any degree of precision. Several studies, however, indicate that trade creation exceeds trade diversion among the NAFTA partners.[10] The majority of U.S industries whose exports to Mexico have grown most rapidly are those in which the United States has a comparative advantage, such as capital goods. Similarly, U.S. import growth has been fastest in Mexican labor intensive industries where Mexico has a comparative advantage.

Preliminary data from one study suggests that trade diversion is occurring with respect to U.S. imports from Mexico versus the rest of the world.[11] A significant amount of trade diversion is most likely occurring in the textiles and apparel sector, partly because the rules of origin established in the NAFTA for this sector tend to favor trade within the NAFTA countries.[12]

Fears of trade diversion may have encouraged some non-NAFTA countries to negotiate trade agreements with Mexico. For example, the European Union

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[10]Mutti, John. NAFTA: the Economic Consequences for Mexico and the United States. Economic Strategy Institute, February 2001, Website: [econstrat.org/naftacons.htm], p. 2.

[11]Hinojosa-Ojeda, *Op.Cit*., p. 68.

[12]Rules of origin in a free trade agreement specify the proportion of the content of the product that must originate within the partner countries in order to qualify for the benefits of the agreement.

negotiated a free trade agreement with Mexico after its share of Mexican imports fell from 15% in 1990 to 12% in 1993 and 9% in 1999. [13]

In addition to the short-term static effects of trade creation and trade diversion, the NAFTA may also generate positive long-term dynamic effects. It is likely that the long-term dynamic benefits are greater in magnitude than the trade-creating or trade-diverting effects of NAFTA. Achieving long-term dynamic effects was probably the most important economic consideration when the United States, Canada and Mexico agreed to negotiate the NAFTA.

There are three main long-term dynamic effects. First, as producers face increased competition, they are likely to become more efficient. In fact, Mexico's goal of making its economy more efficient was one of the incentives for negotiating a NAFTA. Second, being able to sell to a larger market enables firms in NAFTA countries to take advantage of economies of scale, in which the per unit cost of production falls as output increases. Economies of scale might arise from one country's being able to concentrate on a particular size or model of a product, and were important considerations in Canada's negotiating its free trade agreement with the United States in 1988. Finally, the NAFTA (and anticipation of the NAFTA) attracted foreign investment from non-NAFTA countries whose firms wanted to produce within the NAFTA area to take advantage of the area's lower trade barriers. Foreign direct investment from non-NAFTA countries to Mexico increased during the years immediately preceding NAFTA.

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Integration of the U.S. and Mexican Economies

Even before NAFTA was negotiated, U.S. companies were in the process of internationalizing production to become more competitive globally. In many cases, this meant locating part of their production processes in Mexico to take advantage of lower wages, which were only partly offset by lower productivity. As discussed earlier, such shifts were facilitated by Mexico's unilateral reduction in trade barriers and the NAFTA, which made it less likely that Mexico could revert to higher tariffs and nontariff barriers.

One way of estimating the extent to which production has become more integrated is to examine changes in intra-industry trade between the United States and Mexico. As cross-border production increased, it would be expected that exports and imports of similar products (intra-industry trade) would also increase. According to an OECD study, intra-industry manufacturing trade in 1996-2000 accounted for 73% of manufacturing trade in Mexico, up from 62% in 1988-1991.[14] The OECD study credits the NAFTA, which strengthened Mexico's trading links with the United States, as a contributor to Mexico's growing intra-industry trade.

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[13]Mutti, *Op. Cit*., p. 2.

[14]Organization for Economic Cooperation and Development. Intra-Industry and Intra-Firm Trade and the Internationalisation of Production. *OECD Economic Outlook 71*. June 2002, p. 161.

Another finding of the OECD study was that U.S. intra-firm trade with Mexico accounted for 66% of all U.S. goods traded with Mexico in 1999, up 3% since 1992.[15] U.S. intra-firm trade is particularly concentrated in transportation equipment, computer and electronic products, and machinery and chemicals. U.S. Department of Commerce data show that, from 1989 to 1999, U.S. majority-owned affiliates' exports to Mexico (including exports to affiliates and non-affiliates) nearly doubled to 9% of all U.S. exports by majority-owned affiliates to the world.[16] In contrast, Canada's share, at 21% of all U.S. exports, remained about the same. Mexico's increased share, according to the Department of Commerce, reflected the growing presence of foreign affiliates of U.S. parent firms in Mexico, as well as the higher Mexican tariffs prior to NAFTA.

Since a high proportion of U.S-Mexican trade is intra-industry or intra-firm trade, total U.S. exports to Mexico can be expected to grow at about the same rate as U.S. imports from Mexico. Looking again at figure 3, it can be seen that U.S. exports to and imports from Mexico are fairly well correlated, as are U.S. exports to and imports from Canada, where the economies have been integrated for quite a while. One of the implications, then, of increased integration of production is that when the U.S. economy slows, not only will U.S. imports from Mexico and Canada decline, but U.S. exports of components to Mexico and Canada will also decrease. This may account for some of the decline in both U.S. exports to and imports from Mexico and Canada in 2001 shown in figure 3. The decline in growth of U.S. GDP to 1.1% and the negative growth of 0.6% for Mexican GDP in 2001 also contributed to the decline in U.S. exports and imports.

The five U.S. industry sectors with the greatest volume of trade with Mexico and Canada are automotive, chemicals and allied products, computer equipment, textiles and apparel, and microelectronics.[17] Not surprisingly, these sectors are also heavily involved in intra-industry trade. For Mexico alone, between 1993 and 2001, U.S. trade (exports plus imports) in all five sectors grew faster than U.S. trade with the world.[18] Bilateral automotive trade, by far the largest of the five sectors in absolute terms, grew 254%, compared with 72% for the world. In computer equipment, the growth was especially large; U.S-Mexico trade grew 553% while U.S. trade with the world grew 80%. In contrast, U.S. trade with Canada grew slower than U.S. trade with the world in all of the sectors except textiles and apparel.

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[15] *Ibid.*, p. 165.

[16] U.S. Department of Commerce. Operations of U.S. Multinational Companies. *Survey of Current Business*. March 2002, p. 37.

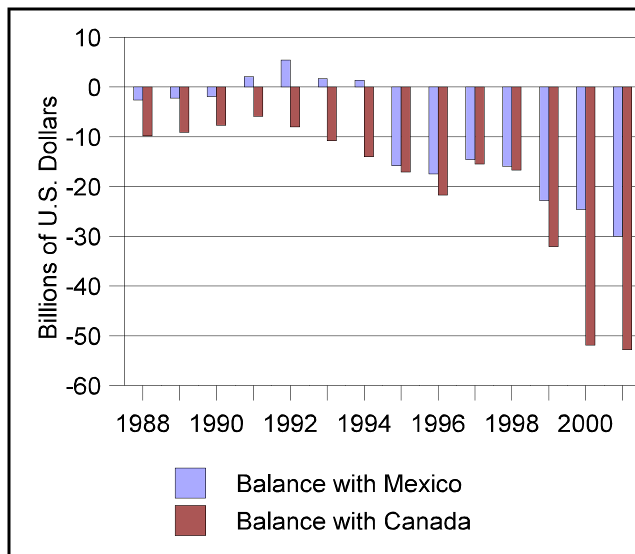
[17] For a more detailed analysis, see CRS Report RL31386, *Industry Trade Effects Related to NAFTA*, by M. Angeles Villarreal.

[18] Computed by CRS based on data in *Ibid.*, p. 7 and 9.

U.S. Merchandise Trade Balances with Canada and Mexico

As figure 4 indicates, the United States had a merchandise trade deficit with both Mexico and Canada in almost every year since 1988. The trade deficit grew substantially in 1995, probably in response to the Mexican peso crisis. Since 1999, the trade deficit has been especially large, and, surprisingly, the deficit with Canada has been larger than that with Mexico. In 2001, the U.S. trade deficit was $53 billion with Canada and $30 billion with Mexico. The 14% appreciation of the U.S. dollar against the Canadian dollar since 1996 likely contributed to the worsening U.S. trade deficit with Canada. As the dollar appreciates, U.S. imports increase because the price in dollar declines, and U.S. exports increase as the price in foreign currencies increases.

Figure 4. U.S. Merchandise Trade Balances with Canada and Mexico



For perspective, it is interesting to compare the U.S. trade deficit with Canada and Mexico with the total U.S trade deficit. In 2001, the U.S. trade deficit with Canada and Mexico was $83 billion, about 20% of the U.S. trade deficit of $411 billion with the world. Moreover, the U.S. trade deficit with the world is growing faster than the U.S. trade deficit with Canada and Mexico. Since 1996, the U.S. trade deficit with Canada and Mexico has increased 112 %, while the U.S. trade deficit with the world has increased 142%. This suggests that factors other than NAFTA, especially a strong U.S. economy, have been the driving forces behind the growing U.S. trade deficit with Canada and Mexico.

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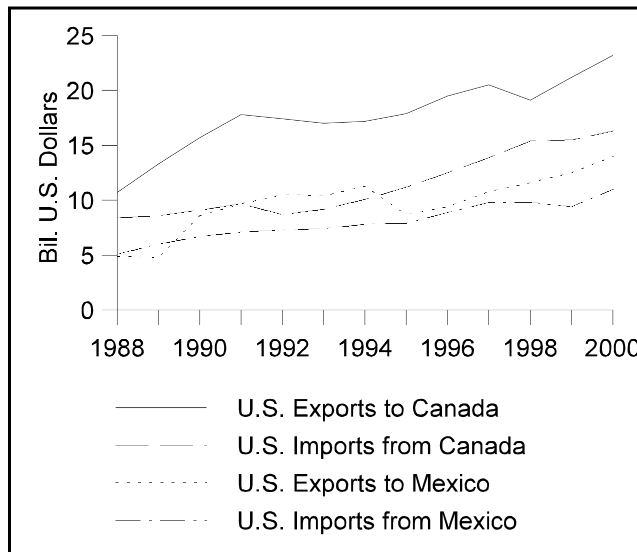
Trade in Services

U.S. private services trade with Mexico and Canada is small by comparison with merchandise trade.[19] For example, in 2000 (the latest year for which services data are available), U.S private services exports to Mexico were $14 billion, compared with U.S. merchandise exports to Mexico of $101 billion.[20] U.S. private services imports from Mexico were $11 billion, while U.S. merchandise imports from Mexico were $136 billion.

Figure 5. U.S. Private Services Trade with Canada and Mexico



Private services trade fluctuated quite a bit over the 1988-2000 period. There was a noticeable drop in U.S. services exports to Mexico in 1995, probably reflecting the peso crises of that year. For example, the depreciation of the peso and the decline in Mexican GDP in 1995 likely reduced the number of Mexicans traveling to the border to purchase U.S. goods.

Generally, U.S. services trade (exports plus imports) with Mexico increased more in the pre-NAFTA period (from 1988 to 1993) than since 1993. U.S. services trade with Mexico increased 79% from 1988 to 1993, and 40% from 1993-2000. The pattern for U.S. services trade with Canada and the world was just the opposite – the growth rate was greater for 1993 to 2000 than for 1988 to 1993.

Unlike merchandise trade, the United States had a surplus in services trade with Mexico and Canada in almost all years. In 2000, the U.S. services trade surplus was $3 billion with Mexico and $7 billion with Canada. The $10 billion surplus is small, however, compared with the $77 billion merchandise trade deficit with Canada and Mexico in 2000.

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[19]Private services trade include exports and imports of travel (purchases of goods and services by U.S. persons traveling abroad and foreigners traveling in the United States), passenger fares, other transportation (related to transport of goods), royalties and fees and other (education; financial services; insurance; telecommunications; business, professional, and technical services; and other).

[20]The services data in this section were taken from (or calculated by CRS based on data in) U.S. Department of Commerce. U.S. International Services: Cross-Border Trade in 2000 and Sales Through Affiliates in 1999). *Survey of Current Business*. November 2001.

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Not surprisingly, given their geographic proximity and the significant amount of cross-border tourism and business travel, the largest category of services trade with the NAFTA partners is travel, passenger fares and other transportation. In 2000, this category represented close to 50% of U.S. services exports to Mexico and Canada. For U.S. services imports, the amounts are much higher – 66% for Canada and 81% for Mexico. The next highest category was "other services." U.S. exports of other services exceeded U.S. imports of other services by a considerable amount to both Mexico and Canada in 2000.

U.S. services are also provided in Mexico through affiliates of U.S. multinational firms. Although the amounts are relatively small, such sales have been growing rapidly. For example, in 1999 (the latest data available), sales to U.S. affiliates in Mexico were $4.8 billion, up from $1.3 billion in 1993, a growth of 269%. This growth rate was much greater than for U.S. services sales through affiliates in Canada (84%) and in the world (137%).

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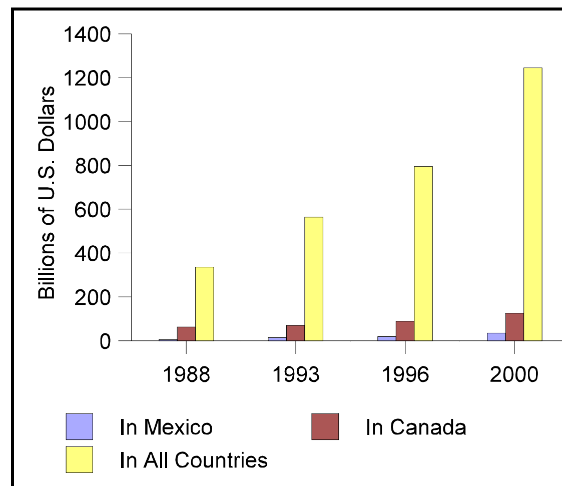
Foreign Direct Investment

The U.S. foreign direct investment (FDI) position (the cumulative amount, or the stock) in Mexico grew rapidly in the pre-NAFTA period.[21] From 1988 to 1993, the U.S. FDI position in Mexico grew 166%, compared with 12% in Canada and 68% in the world.[22] Growth continued at a somewhat lower, but still high, rate after NAFTA went into effect. From 1993 to 2000 (the latest data available), the U.S. FDI position in Mexico grew 133%. In contrast, from 1993 to 2000, U.S. direct investment in Canada and the world grew 81% and 121% respectively, greater than during the period preceding NAFTA.

Figure 6. U.S. Direct Investment Abroad



Despite fairly rapid growth rates, especially in the pre-NAFTA period, the amount of U.S. direct investment in Mexico is currently small relative to total U.S. direct investment abroad. In 2000, the U.S. direct investment position in Mexico was $35.4 billion, only 2.8% of U.S. FDI in all countries of $1,244.7 billion, up from

[21]Direct investment is defined as the ownership or control, directly or indirectly, by one person (individual, partnership, etc.) of 10% or more of the voting securities of an incorporated business enterprise or an equivalent interest in an unincorporated business enterprise. Data in this section are for FDI at historical cost.

[22]Computed by CRS from data in U.S. Department of Commerce. *Survey of Current Business*. Various Issues.

1.7% in 1988 and 2.7% in 1993. Even the U.S. direct investment position in Canada in 2000 was only 10.2% of the total U.S. FDI, down from 18.7% in 1988.

About 58% of all U.S. FDI in Mexico was in the manufacturing sector in 2000. Food products, transportation equipment, and chemicals account for almost 70% of U.S. manufacturing investment in Mexico.

Examining U.S. direct investment *flows* to Mexico shows that they are very small relative to U.S. domestic investment. The amount of new U.S. FDI in Mexico was $4.6 billion in 1998, $5.1 billion in 1999, and $3.5 billion in 2000. By comparison, U.S. domestic investment in U.S. plant and equipment was $1,362.2 billion in 2000.[23]

Employment

The argument that NAFTA destroys U.S. jobs resonates strongly with the public. It is indeed true that NAFTA has resulted in the elimination of some U.S. jobs, especially in the textile and apparel and food products sectors. At the same time, NAFTA has created new jobs as exports to Mexico in the capital goods and "new economy" industries increased. *On balance, it is likely that NAFTA's net effect on U.S. employment is close to zero. However, NAFTA has probably affected the composition of jobs in the U.S. economy, as the demand for unskilled workers declined while the demand for skilled workers increased.*

Unfortunately, there are no available data bases to measure or estimate the number (and types) of jobs created by NAFTA. As will be discussed below, it is possible to roughly estimate the number of workers dislocated as a result of NAFTA.

This section examines the job dislocation caused by NAFTA from two perspectives. First, the available data show that the estimated number of jobs lost is relatively small compared to total U.S. employment. Second, several case studies of the effect of NAFTA-induced job loss on several communities are described. It is clear that while job dislocation may be small relative to aggregate employment, the hardships faced by those workers and communities that lose jobs is a serious concern. This section concludes with a brief discussion of NAFTA's effect on job security in the United States.

Job Dislocation Relative to Total U.S. Employment

The implementing legislation for the NAFTA (P.L. 103-182) included a Transitional Adjustment Assistance (TAA) program, which provides employment services, training, income support, and job search and relocation allowances to eligible workers. To receive benefits, workers must be certified by the U.S. Secretary of the Labor as having lost their jobs (or threatened with job loss) by increased import competition from Mexico or Canada or by production shifts to Mexico or Canada.

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[23]U.S. Department of Commerce. *Survey of Current Business*. July 2001, p. D-3.

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One by-product of the NAFTA-TAA program is that it provides data on the number of workers certified as eligible to receive NAFTA-TAA benefits. Since these data may include workers who were never laid off from their jobs, or who quickly found new jobs, it may overstate the number of dislocated workers. On the other hand, since some firms and workers may not know of the TAA program or that their displacement results from NAFTA, the data may understate the number of dislocated workers. Consequently, these data should not be considered a definitive measure of job dislocation, but rather an indication of the magnitude of NAFTA-related job losses. Although clearly imperfect, they are the best available data on job dislocation.

In the eight years ending December 31, 2001, 414,761 workers were covered by certification, of which 34% were in the textiles and apparel industry, and 5% in the automotive industry.[24] By comparison, total U.S. employment in the fourth quarter of 2001 was 134.3 million workers.[25] Thus the 414,761 workers certified over eight years is relatively small – about three tenths of a % of total U.S. employment of 134.3 million. The number of dislocated NAFTA workers is also very small relative to the total number of unemployed workers in the United States. The 414,761 workers covered by certification over eight years is about 6% of the 6.7 million unemployed in 2001. This suggests that the effects of NAFTA are swamped by macroeconomic trends in the U.S. economy.

In a recent study, it is estimated that NAFTA has eliminated 766,030 job opportunities in the United States between 1994 and 2000 because of the growing trade deficit with Mexico and Canada.[26] Most economists disagree with the methodology used in making this estimate.[27] Nevertheless, assuming the estimate is realistic, the number of job opportunities lost is still relatively small – about six tenths of a percent of total U.S. employment.

Job Dislocation in Selected U.S. Communities

According to the NAFTA-TAA program, from January 1, 1994 to December 31, 2001, 3,331 U.S. plants were closed as a result of import competition from NAFTA or production shifts to Mexico. Of these, 1,549 plants (involving 210,621 workers) were certified as eligible because of production shifts to Mexico. This section summarizes the experience of a few of the communities in which plants closed or production was shifted to Mexico as a result of NAFTA. It provides a perspective on

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[24]U.S. Department of Labor. Office of Trade Adjustment Assistance. Data based sorted by CRS.

[25]Website: bls.gov

[26]Scott, Robert E. NAFTA's Hidden Costs: Trade Agreement Results in Job Losses, Growing Inequality, and Wage Suppression for the United States. In *NAFTA At Seven: Its Impact on Workers in All Three Nations*. Economic Policy Institute Briefing Paper. 2001, p. 3.

[27]The methodology is based on the U.S. trade deficit with its NAFTA partners. As discussed earlier, the trade deficit primarily results from changes in macroeconomic factors such as changes in exchange rates and economic activity in the three NAFTA countries.

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the problems facing dislocated workers and the problems inherent in existing attempts to aid such workers.

A recent case study by the U.S. General Accounting Office (GAO) included six U.S. communities that were especially hard-hit by trade-related layoffs since the mid-1990s.[28] The six communities were Watsonville, California; Coushatta, Louisiana; Owosso, Michigan; Washington and Chocowinity, North Carolina; El Paso, Texas; and Martinsville and Henry County, Virginia. The purpose of the study was to examine the impact of trade-related layoffs on the communities and their experience with trade adjustment assistance. Most of the layoffs were in the apparel, electronics, furniture and food processing industries. Layoffs attributed to NAFTA were not separately identified, but it can be assumed (since data from the NAFTA-TAA program were used) that many of the layoffs were due to import competition or plant relocation to Mexico.

Of the six communities, El Paso, Texas had 17,069 workers certified as eligible by NAFTA-TAA since 1994. Of 6,000 workers laid off in Martinsville and Henry County, Virginia since 1993, 3,500 were certified by NAFTA-TAA. Washington and Chocowinity, North Carolina lost 1,500 jobs in the 1997-99 period. All the other communities lost fewer than 1,000 jobs since 1994.

Workers affected by the layoffs in these six communities had less education than the U.S. workforce as a whole. Eighty percent of the trade adjustment assistance participants in the six communities had a high school education or less, compared to 42% in the U.S. workforce. Many of the workers had limited English language skills. The majority of workers were in their 40s, and women accounted for two-thirds of the unemployed. Generally, the workforces were not suited to the "new economy" jobs, and therefore local government officials could not easily attract such industries to the area.

The layoffs caused a dramatic rise in the unemployment rate in the six communities. Local government tax revenues declined, affecting the services that could be provided. Retail sales dropped as workers had less money to spend. Business suppliers or contractors to the plants that closed were also adversely affected. Many of the workers found new jobs in the area, but often at a lower wage.

An important lesson from the GAO study is that current trade adjustment assistance is not meeting the needs of the workers in these communities. The requirement that separate TAA (the trade adjustment assistance program that is not directly related to NAFTA) and NAFTA-TAA accounts be maintained is administratively inefficient and confusing.[29] Since dislocated workers receive income support for l8 months and training benefits for 24 months, they often drop out of training after 18 months.

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[28]U.S. General Accounting Office. *Trade Adjustment Assistance: Experiences of Six Trade-Impacted Communities*. GAO-01-838. August 2001.

[29]The NAFTA-TAA and TAA were consolidated into a single program with one set of procedures and eligibility criteria in Title I of the Trade Act of 2002 (P.L. 107-210, 116 Stat. 933) which was signed into law by President Bush on August 6, 2002.

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News accounts tell similar stories of plant closings in different communities. For example, Chilhowie, Virginia became a thriving manufacturing town in the 1970s, producing clothing, and furniture as well as other products.[30] Since NAFTA went into effect in 1994, four apparel factories Buster Brown (300 jobs), Tultex (200 jobs), Natalie Knitting Mills (350 jobs), and Spring Ford (450 jobs) have shut their doors. Recently, American of Martinsville, a furniture manufacturer (450 jobs) announced it would close its plant, citing competition from imports from China and the effect of September 11 on the lodging industry.

Another example is the closing of three apparel plants in rural Louisiana.[31] About 240 jobs will be eliminated in Olla, Many and Ville Platte, Louisiana as the plants relocate to Mexico, the Middle East and other foreign countries. Steve Graf, the company's Louisiana director of manufacturing, was quoted as saying "It was strictly a business decision. These people are hard-working, and they helped build Holloway (the Ohio-based manufacturer), but unfortunately, due to NAFTA, we can't compete."

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Effect on Job Security

While the number of plant relocations to Mexico appears to be relatively small, some argue that many employers use the *threat* of moving production to Mexico at the bargaining table, in organizing union drives and in wage negotiations with individual workers. In this respect, then, NAFTA may be increasing the economic insecurity among U.S. workers. Kate Bronfenbrenner, Director of Labor Education Research at Cornell University's School of Industrial and Labor Relations, researched this issue. She found that in National Labor Relations Board (NLRB) certification elections, more than 50% of employers made threats to close all or part of the plant during the organizing drive.[32] By comparison, in the late 1980s, only 29% of employers made plant closing threats during NLRB campaigns. Also, it is possible that threats to close plants prevented union organizing drives from getting underway.

Conclusions

U.S. merchandise trade with Mexico, especially intra-industry and intra-firm trade, increased more rapidly since 1994 than in the pre-NAFTA period and now accounts for 12% of U.S. merchandise trade. This suggests that the process of economic integration of the two economies, which began prior to 1994, strengthened after 1994. The NAFTA, by improving business expectations, probably played a significant role in the growth of trade and investment since 1988. Given Mexico's trade liberalization in the 1980s, however, economic integration probably would have occurred without NAFTA, although more slowly.

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[30]A Town Out of Work; Globalization Takes Toll on Industries. *Seattle Times*. May 11, 2002, p. A3.

[31]More Job Loss from NAFTA. *Advocate* (Baton Rouge, La.), May 11, 2002, p. 8-B.

[32]Kate Bronfenbrenner. Testimony, U.S. Trade Deficit Review Commission. Hearings, Oct. 29, 1999. Website: [ustdrc.gov]

U.S. trade and investment with Mexico will probably continue to grow, but in the near future its effect on the large U.S economy will remain relatively small. At some point, the process of U.S. economic integration with Mexico will likely slow down, as it did with Canada. U.S. merchandise trade with Canada has remained at 20% of total U.S. trade for some time. The experience of the NAFTA suggests that future free trade agreements between the United States and other countries will have a small effect on the U.S. economy. If integration with close geographical partners like Mexico and Canada has a small effect on the United States, it is likely that trade agreements with more distant countries will have an even smaller effect on the U.S economy.

Growing economic integration between the United States and Mexico has increased productivity and efficiency for the U.S. economy. These benefits are small, however, especially when distributed over the entire population. The costs of economic integration are disproportionately borne by the workers who lose jobs and the communities in which they live. The low level of education and skills of the dislocated workers makes it difficult for them to be retrained in a short period of time.

From a policy perspective, a central issue is that, in the past, trade adjustment assistance programs have not been very effective in helping workers gain new skills or find new employment. Congress has attempted to remedy this deficiency in Title 1 of the Trade Act of 2002 which includes changes to the trade adjustment assistance program.

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