Supporting Question 4	
Featured Source	**Source A:** Congressional Budget Office, summary report on the effects of NAFTA, *The Effects of NAFTA on U.S.–Mexican Trade & GDP*, 2003

Summary

The North American Free Trade Agreement (NAFTA), which took effect on January 1, 1994, called for the phasing out of virtually all restrictions on trade and investment flows among the United States, Canada, and Mexico over 10 years (with a few of the most sensitive restrictions eliminated over 15 years). The United States and Canada were already well into the elimination of the barriers between themselves in accordance with the Canada-United States Free Trade Agreement, so the main new feature of NAFTA was the removal of the barriers between Mexico and those two countries.

Now, more than eight years later, most artificial impediments to trade and investment between the United States and Mexico have been dismantled. In 2001, 87 percent of imports from Mexico entered the United States duty free. The average duty on the remainder was only 1.4 percent, for an overall average tariff rate of 0.2 percent, down from 2.1 percent in 1993. The overall average Mexican tariff rate in 2001 was only 1.3 percent, down from 12 percent in 1993. Enough time has passed and enough of NAFTA's trade and investment liberalization has been phased in that any substantial effects of the agreement should be evident by now.

This paper assesses the effects of NAFTA on overall levels of trade in goods between the United States and Mexico and on U.S. gross domestic product (GDP).[1] Such an assessment is important not only for its own sake but also because of its relevance to other proposed U.S. free-trade areas with developing countries. Since NAFTA went into effect, proposals have been made and, in some cases, negotiations have begun (or even been completed) for a Free Trade Area of the Americas and for free-trade areas with Chile, Central America, Southern Africa, Morocco, Singapore, and various other countries of the Association of Southeast Asian Nations.

The challenge in assessing NAFTA is to separate its effects from the effects of other factors that have influenced trade between the United States and Mexico. Those factors include the considerable economic and political turmoil that occurred in Mexico in the early post-NAFTA years—turmoil that, for the most part, was unrelated to the agreement—and the long U.S. economic expansion that lasted throughout most of the 1990s. The Congressional Budget Office (CBO) used a statistical model of U.S.-Mexican trade to separate out the effects of those factors and reached the following conclusions:

- U.S. trade with Mexico was growing for many years before NAFTA went into effect, and it would have continued to do so with or without the agreement. That growth dwarfs the effects of NAFTA.

- NAFTA has increased both U.S. exports to and imports from Mexico by a growing amount each year. Those increases are small, and consequently, their effects on employment are also small.

- The expanded trade resulting from NAFTA has raised the United States' gross domestic product very slightly. (The effect on Mexican GDP has also been positive and probably similar in magnitude. Because the Mexican economy is much smaller than the U.S. economy, however, that effect represents a much larger percentage increase for the Mexican economy.)

1. Lack of data and other considerations make analyzing trade in services problematic, and as noted earlier, almost all barriers to U.S.-Canadian trade had already been removed (or were scheduled for removal within a few years) before NAFTA went into effect.

Some observers look at NAFTA's effects on the U.S. balance of trade with Mexico (the difference between the values of exports and imports) as an indication of the economic benefit or harm of the agreement. The balance of trade dropped substantially after NAFTA took effect and has declined further in more recent years, leading some people to conclude that NAFTA has been bad for the U.S. economy.

However, changes in the balance of trade with a partner country are a poor indicator of the economic benefit or harm of a trade agreement. A better indicator is changes in the levels of trade. Increases in trade—both exports and imports—lead to greater economic output because they allow each nation to concentrate its labor, capital, and other resources on the economic pursuits at which it is most productive relative to other countries. Benefits from the greater output are shared among the countries whose trade increases, regardless of the effects on the trade balance with any particular country. Such effects do not translate into corresponding effects on the balance of trade with the world as a whole; for a country as big as the United States, that balance is largely unaffected by restrictions on trade with individual countries the size of Mexico. Moreover, even declines in a country's trade balance with the world have little net effect on that country's output and employment because the immediate effects of those declines are offset by the effects of increased net capital inflows from abroad that must accompany those declines.[2]

Furthermore, CBO's analysis indicates that the decline in the U.S. trade balance with Mexico was caused by economic factors other than NAFTA: the crash of the peso at the end of 1994, the associated recession in Mexico, the rapid growth of the U.S. economy throughout most of the 1990s, and another Mexican recession in late 2000 and 2001. NAFTA, by contrast, has had an extremely small effect on the trade balance with Mexico, and that effect has been positive in most years.

Besides increasing trade, NAFTA has had a substantial effect on international investment. It has done so for at least two reasons. First, it eliminated a number of Mexican restrictions on foreign investment and ownership of capital. Second, by abolishing tariffs and quotas, NAFTA made Mexico a more profitable place to invest, particularly in plants for final assembly of products destined for the United States. However, it is difficult—if not impossible—to separate the increases in foreign investment in Mexico that resulted from NAFTA from the increases caused by prior liberalization of Mexico's trade and other economic policies. Modeling such investment flows and their effects on the U.S. economy is similarly difficult. Consequently, this paper does not examine NAFTA's effects on investment in any detail but instead concentrates on the agreement's effects on trade.

How Has U.S.-Mexican Trade Changed Over Time?

For Mexico, the North American Free Trade Agreement was only part of a much larger program of economic liberalization extending back to the mid-1980s. That program included joining the General Agreement on Tariffs and Trade in 1986; lowering the average tariff rate from 27 percent in 1982 to 12 percent (or 10 percent as calculated by some sources) in 1993—a larger drop than remained to be accomplished by NAFTA's elimination of tariffs; reducing import licensing requirements and restrictions on foreign investment; privatizing and deregulating various state enterprises, including banks; and implementing an inflation-reduction program, which brought inflation down from a peak of 187.8 percent in 1987 to 6.4 percent at about the time that NAFTA went into effect.

Since Mexico began its program of economic reform and trade liberalization, its trade with the United States—both exports and imports—has grown substantially. That growth started long before NAFTA and has continued since then. A year after NAFTA went into effect, the U.S. trade balance with Mexico dropped suddenly from near zero to a substantial deficit. It recovered partially over the

2. By an accounting identity derivable directly from the definitions of the economic terms, net capital inflows must increase by the same amount that the trade balance declines. More precisely, changes in the net inflow of foreign investment must be equal in magnitude and opposite in sign to changes in the current-account balance, which is a broad measure of the trade balance that includes trade in services and income flows on foreign investments in addition to trade in goods. See Congressional Budget Office, *Causes and Consequences of the Trade Deficit: An Overview* (March 2000).

next few years but then began declining again to record deficits. That decline has continued ever since.

Changes in Exports and Imports

Over the past two decades, U.S. trade with Mexico has increased dramatically. In dollar terms, exports of goods to Mexico rose by almost a factor of six between late 1982 and late 1993 (just before NAFTA), and they nearly tripled again by the third quarter of 2000 before declining during the recent recession in the United States and Mexico. That growth was not smooth: a year after NAFTA took effect, exports dropped by 21.4 percent in just over two quarters before they resumed their climb. U.S. imports of goods from Mexico almost tripled between late 1982 and late 1993 and then more than tripled again by the third quarter of 2000, at which point they too fell back during the recession. Even with exports and imports expressed as percentages of GDP, growth was substantial (*see Summary Figure 1*).

The growth was sufficiently large and rapid that Mexico's share of U.S. trade with the world rose considerably. At the end of 1982, exports destined for Mexico represented

Summary Figure 1.

U.S. Trade in Goods with Mexico

(As a percentage of U.S. GDP)

Source: Congressional Budget Office using data on trade from the Bureau of the Census and data on gross domestic product from the Bureau of Economic Analysis.

Note: The dashed vertical line marks the beginning of the North American Free Trade Agreement on January 1, 1994.

3.7 percent of all U.S. exports of goods. In the last quarter before NAFTA went into effect, that figure stood at 8.8 percent, and it reached 14.2 percent by the end of 2001. Similarly, imports from Mexico rose from 4.6 percent of all U.S. imports of goods at the end of 1986 (the end of a decline resulting from a crash in crude oil prices) to 7.1 percent just prior to NAFTA and then to 11.8 percent by the end of 2001. Before NAFTA, Mexico was the third-largest market for U.S. exports and the third-largest supplier of U.S. imports. By 2001, it was second in both categories.

Changes in the Trade Balance

The balance of trade in goods with Mexico has declined substantially since NAFTA went into effect. Its descent actually started almost two years before NAFTA, but the balance did not decline much until a year after the agreement went into force. It recovered slightly from 1995 through 1998 before resuming its descent.

The United States also experienced a growing deficit in trade in goods with the world as a whole during that period and for many years beforehand; Mexico's share of that deficit has been smaller than might be expected from the country's size as a U.S. trading partner. Indeed, for almost all of the past 17 years, Mexico's share of the U.S. trade deficit with the world has been smaller than its shares of U.S. exports and imports (the only exception being the seven quarters from the beginning of 1995 through the third quarter of 1996). Correspondingly, Mexico's ranking on the list of trading partners with which the United States has the largest deficits has been lower than its rankings on the lists of top U.S. export markets and import suppliers. Nevertheless, the large decline in the trade balance since NAFTA took effect has led critics to suspect that the agreement significantly worsened, if not caused, the trade deficit with Mexico.

Other Factors Besides NAFTA That Have Affected U.S. Trade with Mexico

Numerous factors other than NAFTA have substantially influenced U.S.-Mexican trade. Four events that occurred after the agreement went into effect are particularly important:

- A sudden major decline in the value of the peso at the end of 1994 (which reduced U.S. exports to Mexico and increased U.S. imports from Mexico),

- An associated harsh Mexican recession in 1995 (which lowered Mexico's demand for all countries' exports, including those of the United States),

- The long U.S. economic expansion that lasted through most of the 1990s (which increased U.S. demand for imports from all countries), and

- Recessions in the United States and Mexico in late 2000 and 2001 (which reduced Mexican demand for U.S. and other countries' exports and U.S. demand for imports from all countries).

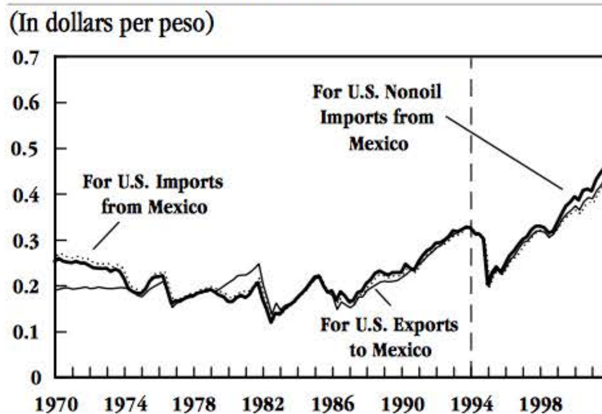
The prolonged U.S. expansion and the U.S. and Mexican recessions in late 2000 and 2001 are clearly unrelated to NAFTA, and their effects must be removed from the observed fluctuations in U.S.-Mexican trade to isolate the effects of NAFTA. The peso crash and ensuing Mexican recession, however, merit further discussion. Both were severe. From the last quarter of 1994 to the first quarter of 1995, the real value of the peso (the value adjusted for inflation in the United States and Mexico) dropped by one-third (*see Summary Figure 2*). In the recession, seasonally adjusted real Mexican GDP declined by 9.7 percent (*see Summary Figure 3*). Because of their magnitudes, both of those events could be expected to have had a substantial influence on trade. Their occurrence just a year after NAFTA went into effect might lead some people to suspect that the agreement played a role in causing them or making them worse. However, that is not the case.

A number of factors converged to cause the financial crisis that led to the peso crash and Mexican recession of the mid-1990s. They include the market's nervousness about the historically high real value of the peso; considerable political turmoil in 1994 (an armed rebellion in the state of Chiapas, a presidential election and change of administration, two major political assassinations, and the resignation of the Deputy Attorney General claiming a coverup in the investigation of one of the assassinations); rising interest rates in the United States; well-intended Mexican

Summary Figure 2.

Real Exchange Rates for U.S. Trade in Goods with Mexico

(In dollars per peso)



Source: Congressional Budget Office using data on nominal exchange rates and Mexican prices from International Monetary Fund, *International Financial Statistics*, and data on prices and quantities of U.S. traded goods from the Bureau of the Census, Bureau of Labor Statistics, Bureau of Economic Analysis, and Energy Information Administration.

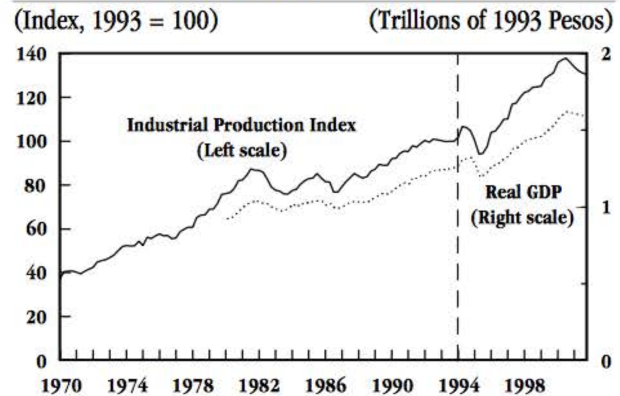
Notes: The effects of Mexican inflation over time were removed using the Mexican wholesale price index. The effects of U.S. inflation over time were removed using price indices for U.S. exports to and imports from Mexico that CBO constructed from the data sources cited above.

The dashed vertical line marks the beginning of the North American Free Trade Agreement on January 1, 1994.

Summary Figure 3.

Mexican Industrial Production and Real Gross Domestic Product

(Index, 1993 = 100) (Trillions of 1993 Pesos)



Source: International Monetary Fund, *International Financial Statistics*.

Note: The dashed vertical line marks the beginning of the North American Free Trade Agreement on January 1, 1994.

government policies that ended up exacerbating the crisis; and the market's memories of past Mexican government actions in somewhat similar situations that had hurt investors.

In response to those factors, net foreign investment in Mexico plummeted in 1994, causing interest rates to rise and putting severe downward pressure on the value of the peso. The Mexican central bank ran out of the foreign exchange reserves required to keep the peso from falling and was forced first to devalue it and then to let it float. Interest rates skyrocketed, the government and private sector were unable to borrow from abroad, and the country went into a severe recession.

NAFTA had little to do with that course of events. Consequently, the effects of the peso crash and Mexican recession must be removed from the observed fluctuations in U.S.-Mexican trade along with the effects of the other factors listed earlier in order to isolate the effects of NAFTA.

The Effects of NAFTA on U.S. Trade with Mexico

To disentangle the effects of NAFTA from those of other influential factors, CBO constructed a statistical model of U.S. trade with Mexico. Simulations from the model indicate that NAFTA has slightly increased U.S. exports to and imports from Mexico of goods and that the vast bulk of the growth and fluctuation of exports and imports has occurred for reasons other than the agreement. On the basis of those simulations, CBO estimates that roughly 85 percent of the increase in U.S. exports of goods to Mexico between 1993 and 2001, and 91 percent of the increase in U.S. imports of goods from Mexico over the same period, would have taken place even if NAFTA had not been implemented. In addition, the major fluctuations in exports and imports would have been similar to what actually occurred.

By CBO's estimates, NAFTA increased U.S. exports to Mexico by 2.2 percent ($1.1 billion) in 1994—an effect that rose gradually, reaching 11.3 percent ($10.3 billion) in 2001. Similarly, the agreement boosted imports from Mexico by amounts that rose from 1.9 percent ($0.9 billion) in 1994 to 7.7 percent ($9.4 billion) in 2001.

Relative to the size of the economy, the increases in exports never exceeded 0.12 percent of U.S. GDP, and the increases in imports never exceeded 0.11 percent of U.S. GDP. The effects were more significant for the much smaller Mexican economy, however. The increase in U.S. exports to Mexico represented 1.9 percent of Mexican GDP in 2001, and the increase in U.S. imports from Mexico equaled 1.7 percent of Mexican GDP.

Although NAFTA's effects on the balance of trade with Mexico are unimportant economically, they are of considerable interest politically. The perception that the agreement is responsible for the decline in that balance since 1993 has contributed to negative attitudes toward NAFTA and toward other proposals for trade liberalization. However, simulations from CBO's model indicate that NAFTA has had an extremely small effect on the balance of trade in goods with Mexico in all of the years since the agreement went into force—and a positive effect in most of those years. The largest effects indicated by the simulations are increases of $0.9 billion, $1.3 billion, and $0.9 billion in 1999, 2000, and 2001, respectively—the most recent three years in the simulation. The effects for all years are less than 0.02 percent of GDP in magnitude.

The reason for the substantial fall in the trade balance with Mexico since NAFTA took effect lies primarily in fluctuations of the U.S. and Mexican business cycles. The balance went abruptly into substantial deficit at the end of 1994 and the beginning of 1995 because of the severe Mexican recession and, to a much lesser extent, the peso crash. The recession significantly reduced Mexican demand for U.S. exports, and the peso crash further reduced that demand slightly and increased U.S. imports from Mexico slightly.

Those factors affected Mexico's trade with other countries more than its trade with the United States. Mexican imports from the rest of the world fell by 17.4 percent between 1994 and 1995, whereas its imports from the United States declined by 6.3 percent. Likewise, its exports to the rest of the world rose by 46.2 percent over the same period, whereas its exports to the United States increased by 28.0 percent.

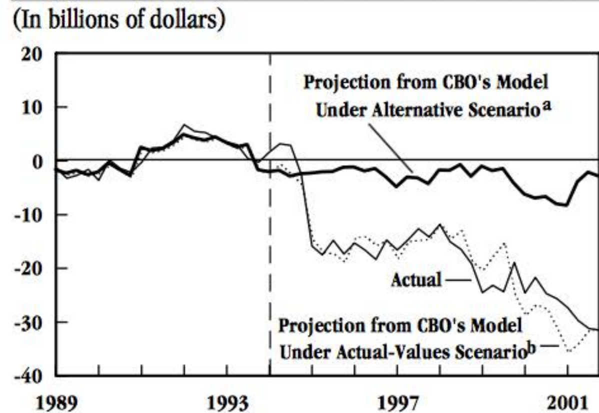
In 1996, Mexican demand for U.S. exports began to recover along with the peso and the Mexican economy. However, U.S. imports from Mexico (as well as from other countries) began to rise in response to the economic expansion in the United States. Consequently, the U.S. trade balance with Mexico did not recover much, and in fact, it began to decline further in 1998. In 2001, the U.S. recession caused imports from Mexico to fall, but a coinciding Mexican recession caused U.S. exports to Mexico to fall even more, so the trade balance continued to decline.

Projections from CBO's model indicate that if the peso crash, the associated Mexican recession, the prolonged U.S. economic boom, and the U.S. and Mexican recessions in late 2000 and 2001 had not occurred, U.S. trade with Mexico would have remained near balance throughout the entire post-NAFTA period (*see Summary Figure 4*).

Summary Figure 4.

U.S. Balance of Trade in Goods with Mexico Under Alternative Scenarios

(In billions of dollars)



Source: Congressional Budget Office using data from the Bureau of the Census for the actual trade balance and projections from CBO's model for other trade balances.

Note: The dashed vertical line marks the beginning of the North American Free Trade Agreement on January 1, 1994.

a. This alternative scenario assumes no peso crash and associated Mexican recession in 1994 and 1995, no prolonged U.S. economic expansion in the 1990s, and no U.S. or Mexican recession in late 2000 and 2001.

b. The actual-values scenario assumes the values of U.S. gross domestic product, the Mexican industrial production index, and real exchange rates that actually occurred.

The Effects of NAFTA on U.S. GDP

Precisely estimating the effects of NAFTA on U.S. GDP involves assessing how much of the increase in imports from Mexico that was caused by NAFTA merely displaces imports from other countries rather than adding to them. Such an assessment is beyond the scope of this paper. Other studies have tackled that issue, however, and by combining their results with CBO's estimates of the effects of NAFTA on U.S. trade, it is possible to conclude that NAFTA has increased annual U.S. GDP, but by a very small amount—probably no more than a few billion dollars, or a few hundredths of a percent.

The effect on Mexican GDP has also been positive and probably similar to the effect on U.S. GDP in dollar terms (at least to the same order of magnitude). However, because the Mexican economy is much smaller than the U.S. economy (Mexican GDP ranged from one-16th to one-21st the size of U.S. GDP between 1996 and 2001), that increase represents much larger percentage growth for the Mexican economy than for the U.S. economy.

Public domain. Available at http://www.cbo.gov/sites/default/files/report_0.pdf.

Supporting Question 4	
Featured Source	**Source B:** National Public Radio, collection of audio reports reviewing the effects of NAFTA, *20 years of NAFTA*, December 2013

NOTE: The screen shot below depicts the top of the introductory page to this set of audio reports. The reports themselves can be accessed at the website listed below the image.

Available online at: http://www.npr.org/series/249998251/20-years-of-nafta

Supporting Question 4

Featured Source	**Source C:** Pew Research Center, summary of public opinion on NAFTA, "Americans Are of Two Minds on Trade" (excerpts), November 9, 2010

Americans Are of Two Minds on Trade:

More Trade, Mostly Good; Free Trade Pacts, Not So

Overview

Support for Increased Trade...

Increased trade with ___ would be ...	Good for U.S. %	Bad for U.S. %	DK %
Canada	76	14	9=100
Japan	60	30	10=100
EU countries	58	28	14=100
India	55	32	12=100
Brazil	53	31	17=100
Mexico	52	37	11=100
South Korea	45	41	14=100
China	45	46	9=100

Skepticism about Impact of Free Trade Agreements

Free trade agreements like NAFTA, policies of WTO...	Good for U.S. %	Bad for U.S. %	DK %
October 2010	35	44	21=100
November 2009	43	32	25=100
April 2009	44	35	21=100
April 2008	35	48	17=100
November 2007	40	40	20=100
December 2006	44	35	21=100

PEW RESEARCH CENTER Nov. 4-7, 2010 Omnibus survey; Nov. 4-7, 2010 Post-Election survey.

The public is of two minds when it comes to trade with other countries. Most Americans say that increased trade with Canada, Japan and European Union countries — as well as India, Brazil and Mexico — would be good for the United States. But reactions are mixed to increased trade with South Korea and China.

More generally, there is increased skepticism about the impact of trade agreements such as NAFTA and the policies of the World Trade Organization. Roughly a third (35%) say that free trade agreements have been good for the United States, while 44% say they have been bad for the U.S.

Support for free trade agreements is now at one of its lowest points in 13 years of Pew Research Center surveys. In 2008, an identical percentage (35%) said free trade agreements were good for the U.S. Support for free trade agreements had increased last year, to 44% in April and 43% in November, despite the struggling economy.

As in past surveys on trade, many more Americans say free trade agreements have a negative rather than a positive impact on jobs in the U.S., wages for U.S. workers, and economic growth in this country. And more say their personal finances have been hurt (46%) rather than helped (26%) by free trade agreements….

Impact of Free Trade Agreements

Most Say Trade Agreements Lead to Job Losses

Impact of free trade agreements on…	Total %	Rep %	Dem %	Ind %
Jobs in U.S.				
Create jobs	8	5	12	6
Lead to job losses	55	58	47	63
No difference	24	24	27	22
Wages in U.S.				
Make wages higher	8	5	11	8
Make wages lower	45	45	42	49
No difference	34	37	33	35
Nation's economy				
Lead to growth	19	17	22	18
Slow economy	43	48	34	49
No difference	24	22	26	26
Prices in U.S.				
Make prices higher	31	31	28	33
Make prices lower	31	30	31	32
No difference	25	26	23	26
People of developing counties				
Good	54	55	51	57
Bad	9	7	10	11
No difference	23	23	24	21

PEW RESEARCH CENTER Nov 4-7, 2010. Q63a-e.

The public continues to be skeptical about the benefits of free trade agreements to the United States, especially when it comes to jobs, wages and economic growth. Opinions about the impact of free trade agreements have changed little since last year, although they are somewhat less negative than in April 2008.

More than half (55%) say that free trade agreements lead to job losses in the United States, compared with just 8% who say these agreements create jobs; 24% say they make no difference. And while 45% say free trade agreements make wages lower, far fewer (8%) say they make wages higher. Similarly, the public does not see much benefit from free trade agreements for the overall economy — 43% say they slow the economy down while fewer than half as many (19%) say they make the economy grow.

Opinions are less negative about the impact of trade agreements on prices in the U.S.; as many say they make prices lower as higher (31% each). People in developing countries are widely perceived as benefitting from trade agreements: 54% say they are good for people in developing countries while just 9% say they are bad.

Roughly six-in-ten independents (63%) and Republicans (58%) say that free trade agreements lead to job losses in the United States; fewer Democrats (47%) agree. Independents (49%) and Republicans (48%) are more likely than Democrats (34%) to say that trade agreements slow the U.S. economy. There are only slight partisan differences in views of the other effects of free trade agreements, including their impact on wages in the United States.

Gaps Within GOP over Impact of Free Trade Agreements

Impact of free trade agreements on...	**Among Reps, Rep-leaners** **Agree w/ Tea Party**	**Disagree/ No opinion**
Nation's economy	%	%
Lead to growth	13	22
Slow economy	62	40
No difference	14	28
Wages in U.S.		
Make wages higher	8	6
Make wages lower	54	39
No difference	26	47
Jobs in the U.S.		
Create jobs	5	8
Lead to job losses	67	55
No difference	17	26

PEW RESEARCH CENTER Nov 4-7, 2010. Q63b-d.

There also are differences among Republicans over the impact of free trade agreements on economic growth, and wages and jobs in the U.S. Fully 61% of Republicans and Republican-leaning independents say free trade agreements lead to slower growth in the U.S. That compares with 40% of Republicans and Republican leaners who either have no opinion of the Tea Party or disagree with the Tea Party.

More than half (54%) of Republicans who agree with the Tea Party say free trade agreements make wages lower, compared with 38% who have no opinion of the Tea Party or disagree with the movement. The differences among Republicans and Republican leaners are nearly as large about whether free trade agreements lead to job losses in the U.S. (67% of Tea Party vs. 55% of non-Tea Party).

Reprinted from Pew Research Center. The full article can be found at http://www.pewresearch.org/2010/11/09/americans-are-of-two-minds-on-trade/#impact-of-free-trade-agreements.