12th Grade Free Trade Inquiry

Is Free Trade Worth the Price?

Presidents Ford, Carter, Bush, and Clinton during the NAFTA discussions, September 14, 1993.
Getty Images/Credit: Cynthia Johnson / Contributor.

Supporting Questions

1. What are the arguments for free trade?
2. What are the arguments against free trade?
3. Why did the United States sign on to the North American Free Trade Agreement?
4. Has NAFTA achieved its goals?

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Is Free Trade Worth the Price?

New York State Social Studies Framework Key Idea & Practices	**12. E4 THE TOOLS OF ECONOMIC POLICY IN A GLOBAL ECONOMY**: Globalization and increased economic interdependence affect the United States economy significantly. The tools that policy makers have available to address these issues are fiscal policy, monetary policy, and trade policy. ✔ Gathering, Using, and Interpreting Evidence ✔ Economics and Economic Systems
Staging the Question	Participate in a trading simulation in order to understand why people trade and why trade is important.

Supporting Question 1	Supporting Question 2	Supporting Question 3	Supporting Question 4
What are the arguments for free trade?	What are the arguments against free trade?	Why did the United States sign on to the North American Free Trade Agreement (NAFTA)?	Has NAFTA achieved its goals?
Formative Performance Task	**Formative Performance Task**	**Formative Performance Task**	**Formative Performance Task**
List the arguments for free trade on one side of a T-chart.	List the arguments against free trade on the second side of the T-chart.	Write a paragraph detailing three reasons why the United States signed on to NAFTA.	Develop a claim with evidence about the extent to which NAFTA achieved its goals.
Featured Sources	**Featured Sources**	**Featured Sources**	**Featured Sources**
Source A: Excerpt from *Protection or Free Trade* **Source B:** Excerpt from *The Fruits of Free Trade* **Source C:** Video lecture on *Free Trade Versus Protectionism*	**Source A:** "Our Misplaced Faith in Free Trade" **Source B:** Excerpt from "Is Free Trade Passé?" **Source C:** Video interview and transcript of *Free Trade?*	**Source A:** Press conference on the North American Free Trade Agreement signing **Source B:** Selected remarks by Presidents Clinton, Bush, Carter, and Ford and Vice President Gore on signing of the NAFTA agreements	**Source A:** Excerpt from *The Effects of NAFTA on U.S.–Mexican Trade & GDP* **Source B:** NPR audio reports: *20 years of NAFTA* **Source C:** *Americans Are of Two Minds on Trade*

Summative Performance Task	**ARGUMENT** Is free trade worth the price*?* Construct an argument (e.g., detailed outline, poster, essay) that addresses the compelling question using specific claims and relevant evidence with information from contemporary sources.
	EXTENSION Students could adapt the argument by holding a "fishbowl" debate in which students discuss the question "Should the United States continue the NAFTA?"
Taking Informed Action	**UNDERSTAND** Research the fair-trade movement and the principles underlying this recent economic initiative. **ASSESS** Identify businesses or organizations in the community that engage in or promote fair trade and evaluate their foothold in the community. **ACT** Organize a classroom forum that invites business and/or community leaders to discuss whether the country should engage in free trade, fair trade, or both.

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Overview

Inquiry Description

Nobel Prize–winning economist Milton Friedman once said, "There is a standard cliché which I am sure you have all heard, that if you have two economists in one room, you are bound to have at least three opinions." Drawing on disciplinary experts who disagree on a fundamental free-market economic tenet, this inquiry asks students to investigate the dispute over free trade. By considering the arguments of professional economists who may use the same data but come to very different conclusions, students examine the "price" of free trade as it relates to the North American Free Trade Agreement (NAFTA). In understanding the arguments for and against free-trade policy in general and applying such concepts to existing policy more specifically, students can gain clarity about this age-old debate and become participants in a contemporary discussion involving international trade.

In addition to the Key Idea listed earlier, this inquiry highlights the following Conceptual Understanding:

- (12.E4d) Trade policies and agreements (tariffs, quotas, embargoes) set the rules for trade between the United States and other nations. Agreeing on such rules is very difficult because each nation has different interests, and each nation has special interests trying to influence the negotiations.

NOTE: This inquiry is expected to take five to seven 40-minute class periods. The inquiry time frame could expand if teachers think their students need additional instructional experiences (i.e., supporting questions, formative performance tasks, and featured sources). Teachers are encouraged to adapt the inquiries in order to meet the needs and interests of their particular students. Resources can also be modified as necessary to meet individualized education programs (IEPs) or Section 504 Plans for students with disabilities.

Structure of the Inquiry

In addressing the compelling question "Is free trade worth the price?" students will work through a series of supporting questions, performance tasks, and sources in order to construct an argument with evidence and counterevidence from a variety of sources.

Staging the Compelling Question

In order to stage the compelling question "Is free trade worth the price?" students will need to understand why countries trade in the first place. Teachers may want to use the International Monetary Fund's lesson *Why People Trade* (Lesson #3: http://www.imf.org/external/np/exr/center/students/hs/think/lesson3.pdf). In the lesson, students participate in a trading simulation and use this experience to discover the benefits of free trade.

Supporting Question 1

The first supporting question—"What are the arguments for free trade?"—asks students to consider the economic consequences of protectionist trade policies including tariffs, quotas, standards, and subsidies. The formative performance task calls on students to list the arguments for free trade by filling in the first half of a T-chart labeled "Arguments for Free Trade." The featured sources for this task highlight three leading economists—19th century political economist Henry George, Federal Reserve economists Michael Cox and Richard Alm, and Nobel Prize–winning university economist Milton Friedman—each of whom argue for the elimination of trade barriers. Teachers using Featured Source A may want to select among the data tables to focus students' investigation of the supporting question.

Supporting Question 2

For the second supporting question—"What are the arguments against free trade?"—students consider why a government might limit free trade with the imposition of trade barriers. In formative performance task, students use the second half of the T-chart to list the arguments against free trade, which should enable them to understand the logic behind protectionist policies. The featured sources for this task come from Nobel prize–winning economists Joseph Stiglitz and Paul Krugman and economic-policy analyst Jeff Madrick, who argue that free trade is untenable or, in Krugman's words, "an idea that has irretrievably lost its innocence." As students begin to conceptualize the arguments presented before them in the sources from the first two formative performance tasks, they will have developed a framework for considering one of the most hotly debated free-trade policies, the North American Free Trade Agreement (NAFTA).

Supporting Question 3

By answering the third supporting question—"Why did the United States sign on to the North American Free Trade Agreement?"—students establish a foundational understanding of NAFTA and what the agreement set out to accomplish. The featured sources in this supporting question are a C-Span video of the press conference that followed the historic, bipartisan signing of the agreement as well as selected remarks by the four United States presidents who attended and supported the law's passage.

Supporting Question 4

The final supporting question—"Has NAFTA achieved its goals?"—invites students to build on their understandings of free trade by evaluating the impact of NAFTA. The formative performance task asks students to

construct a claim supported with evidence about the extent to which NAFTA achieved its stated goals. The featured sources for this task are excerpts from a report by the Congressional Budget Office and a collection of short articles broadcast on National Public Radio on the 20-year anniversary of the agreement. Additionally, students should use a recent study by the Pew Research Center, *Americans Are of Two Minds on Trade,* to help them consider public opinion on free trade.

Summative Performance Task

At this point in the inquiry, students have examined the economic arguments for both free trade and protectionist policies in light of the 20-year NAFTA experience. Students should be expected to demonstrate the breadth of their understandings and their abilities to use evidence from multiple sources to support their distinct claims. In this task, students construct an evidence-based argument responding to the compelling question "Is free trade worth the price?" It is important to note that students' arguments could take a variety of forms, including a detailed outline, poster, or essay.

Students' arguments likely will vary, but could include any of the following:

- Whether a nation imposes trade restrictions or not, there are opportunity costs of either decision, and it is important to consider those costs.
- Most economists support unregulated trade because, in the end, most people will be better off, and that ought to be the goal of every society.
- Free trade is an unrealistic theory in a global world, so the government should look to regulate it with enlightened protectionist policies.
- When it comes to international trade, nations must look out for themselves, their industries, and their workforce, so if erecting barriers to trade will protect these interests, then a nation should strongly consider it.

Students could extend the argument by holding a "fishbowl" debate in which students discuss the question "Should the United States continue NAFTA?"

Students have the opportunity to Take Informed Action by working as a class to research and *understand* the fair-trade movement and then *assess* the extent to which fair trade is present within the "glocal" community. Students can *act* by organizing a classroom forum that invites business and/or community leaders to discuss whether the country should engage in free trade, fair trade, or both.

Supporting Question 1

Featured Source	**Source A:** Henry George, argument against trade barriers, *Protection or Free Trade, An Examination of the Tariff Question, with Especial Regard to the Interests of Free Trade* (excerpt), 1905

Trade is not invasion. It does not involve aggression on one side and resistance on the other, but mutual consent and gratification. There cannot be a trade unless the parties to it agree, any more than there can be a quarrel unless the parties to it differ. England, we say, forced trade with the outside world upon China, and the United States upon Japan. But, in both cases, what was done was not to force the people to trade, but to force their governments to let them. If the people had not wanted to trade, the opening of the ports would have been useless.

Civilized nations, however, do not use their armies and fleets to open one another's ports to trade. What they use their armies and fleets for, is, when they quarrel, to close one another's ports. And their effort then is to prevent the carrying in of things even more than the bringing out of things—importing rather than exporting. For a people can be more quickly injured by preventing them from getting things than by preventing them from sending things away. Trade does not require force. Free trade consists simply in letting people buy and sell as they want to buy and sell. It is protection that requires force, for it consists in preventing people from doing what they want to do. Protective tariffs are as much applications of force as are blockading squadrons, and their object is the same—to prevent trade. The difference between the two is that blockading squadrons are a means whereby nations seek to prevent their enemies from trading; protective tariffs are a means whereby nations attempt to prevent their own people from trading. What protection teaches us, is to do to ourselves in time of peace what enemies seek to do to us in time of war.

Can there be any greater misuse of language than to apply to commerce terms suggesting strife, and to talk of one nation invading, deluging, overwhelming or inundating another with goods? Goods! What are they but good things—things we are all glad to get? Is it not preposterous to talk of one nation forcing its good things upon another nation? Who individually would wish to be preserved from such invasion? Who would object to being inundated with all the dress goods his wife and daughters could want; deluged with a horse and buggy; overwhelmed with clothing, with groceries, with good cigars, fine pictures, or anything else that has value? And who would take it kindly if any one should assume to protect him by driving off those who wanted to bring him such things?

Public domain. Henry George, *Protection or Free Trade, An Examination of the Tariff Question, with Especial Regard to the Interests of Free Trade*. New York: Doubleday, Page, and Co., 1905.

Supporting Question 1	
Featured Source	**Source B:** Federal Reserve Bank of Dallas (W. Michael Cox and Richard Alm), annual report advocating free trade, *The Fruits of Free Trade* (excerpts), 2002

NOTE: The text below includes the introduction of the report, which is then followed by key tables from within the report.

The Fruits of Free Trade

Attacks on free trade don't make economic sense. In fact, the critics often get it backwards.

We hear that trade makes us poorer. It's just not so. Trade is the great generator of economic well-being. It enriches nations because it allows companies and workers to specialize in doing what they do best. Competition forces them to become more productive. In the end, consumers reap the bounty of cheaper and better goods and services.

We hear that trade costs jobs and depresses wages. Again, it's just not so. By spurring economic activity and reducing costs, trade helps create jobs. By enhancing productivity, it keeps U.S. companies vibrant, leading to fatter pay-checks and added benefits. Workers protected by trade barriers might keep their jobs a while longer, but the costs in inefficiency and higher prices make it economic folly. Whenever we erect barriers to trade, we negate the gains from free exchange and competition. Trade protection degenerates into a negative-sum game in which special interests jostle for advantage at the expense of the common good.

We hear that exports are good because they support U.S. industry but imports are bad because they steal business from domestic producers. Actually, imports are the real fruits of trade because the end goal of economic activity is consumption. Exports represent resources we don't consume at home. They are how we pay for what we buy abroad, and we're better off when we pay as little as possible. Mercantilism, with its mania for exporting, lost favor for good reason.

We hear that free trade isn't fair trade. Cheap imports can hurt higher-cost U.S. suppliers, but consumers certainly will gain. Why penalize them with tit-for-tat retaliation that only raises prices in the United States? Other countries' trade transgressions don't warrant missteps of our own. A nation will consume more whenever it opens its markets, even if other nations don't reciprocate.

We hear that trade makes us dependent on foreign suppliers, but America doesn't have the climate and resources to make everything it needs. Other nations can produce many goods and services at lower cost. The price of independence is too steep.

Americans can't afford to buy into these trade fallacies. As a society, we often have to choose between protecting domestic industries and opening markets. In a weakened economy, steelmakers, catfish farmers and other producers are lining up to declare war on imports, creating a potential hit on Americans' wallets. At the same time, U.S. negotiators are seeking to expand the world trading system with new free trade agreements.

We need to understand what's at stake. Being wrongheaded on trade increases the risk of making bad choices that will sap our economy and sour our relations with other nations. Getting it right will promote prosperity and peace.

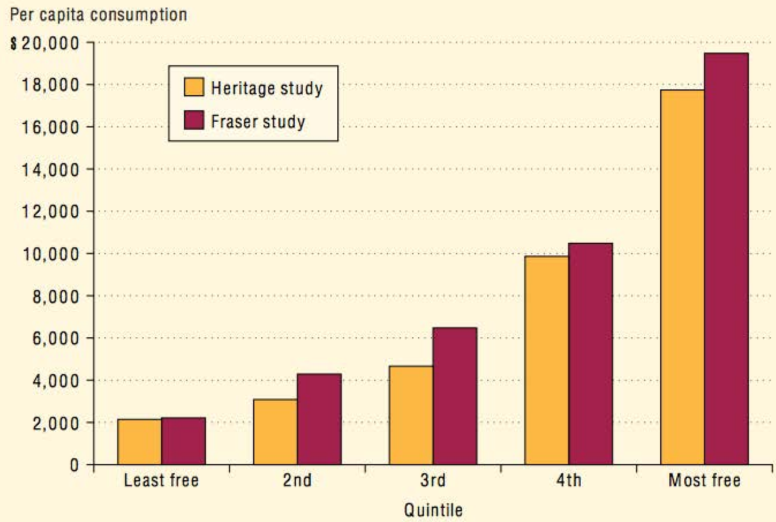
EXHIBIT 2. **The Alchemy of Exchange**

Five hundred Chinese workers can each produce four pairs of shoes or eight bushels of soybeans. One hundred U.S. workers can each produce five pairs or 100 bushels—more productive in both jobs but comparatively more so in farming. Under an autarkic regime—isolated from foreign trade—Chinese workers can afford one pair of shoes each and six bushels of soybeans; Americans, three and 40. Trading freely, China will specialize in shoes and America in soybeans, raising world production of shoes from 800 to 2,000 pairs and soybeans from 7,000 to 10,000 bushels. Chinese workers can then afford three pairs of shoes and 10 bushels of soybeans; American workers, five and 50.

	Autarky		Free Trade	
	China	U.S.	China	U.S.
Labor Force	500	100	500	100
Output per worker				
Shoes	4	5	4	5
Soybeans	8	100	8	100
Employment				
Shoes	125	60	500	0
Soybeans	375	40	0	100
Production				
Shoes	500	300	2,000	0
Soybeans	3,000	4,000	0	10,000
Consumption				
Shoes	500	300	1,500	500
Soybeans	3,000	4,000	5,000	5,000
Consumption per person				
Shoes	1	3	3	5
Soybeans	6	40	10	50

EXHIBIT 7. **Free to Consume**

People who live in free countries enjoy substantially higher living standards than those living in repressive countries. The World Bank collects data on per capita consumption by country. Two independent research groups—the Heritage Foundation in Washington, D.C., and the Fraser Institute in Canada—measure economic freedom across the world using a broad variety of criteria based on key components of free enterprise, including trade policies and openness to foreign investment. Relating the consumption and freedom data sets, one finds that per capita consumption in the economically freest fifth of countries is eight to nine times that of the least free fifth.



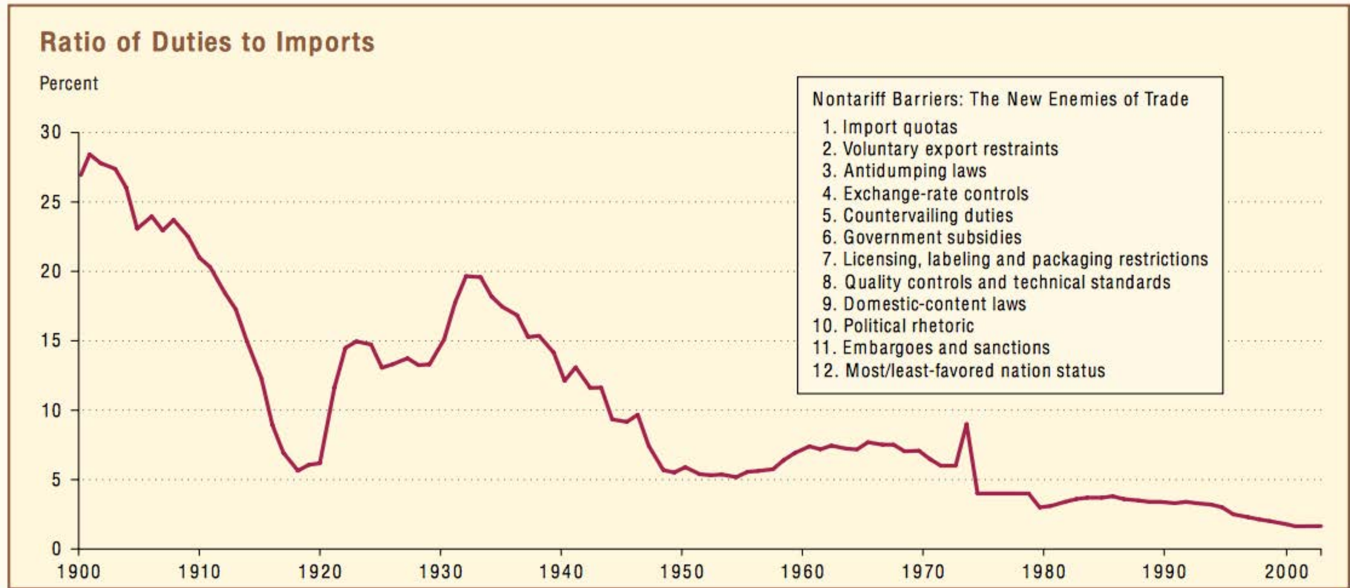
A Tale of Two Countries

In North Korea, which ranks lowest in economic freedom, consumers must wrangle for the most basic items, even food. Per capita income averages just $950 annually.

South Koreans enjoy the bounty of a capitalist-oriented, economically free society. Per capita income is $11,428—12 times that of North Korea.

EXHIBIT 8. **The Tax on Trade**

Reduced tariff rates lowered trade barriers and helped stimulate economic growth in recent decades. A growing number of nontariff barriers, however, threaten to undo the good. Voluntary export restraints; antidumping laws; government subsidies; licensing, labeling and packaging restrictions; domestic-content laws and others have emerged as the new enemies of free trade.



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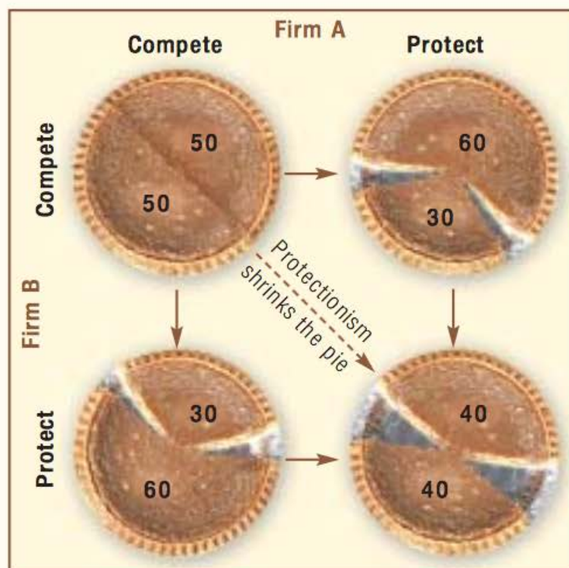


EXHIBIT 9. **The Politics of Protectionism: A Negative-Sum Game**

By offering trade protection, lawmakers create a dilemma for producers: Compete or seek protection. The economic pie is never greater than when firms compete because then they focus every resource on production. But suppose firm A can increase its piece of the pie (say, from 50 to 60 out of 100) by promising votes or campaign contributions in return for political favors. Then its incentive is to do so even though the total pie will shrink (say, to 90) as resources shift from production to protection. Its competitor, firm B, will do likewise, with similar results. The politics of protectionism lead ultimately to the worst possible outcome: a negative-sum game in which less is produced than under free trade. The only way out of this mess: *Nobody* gets protection.

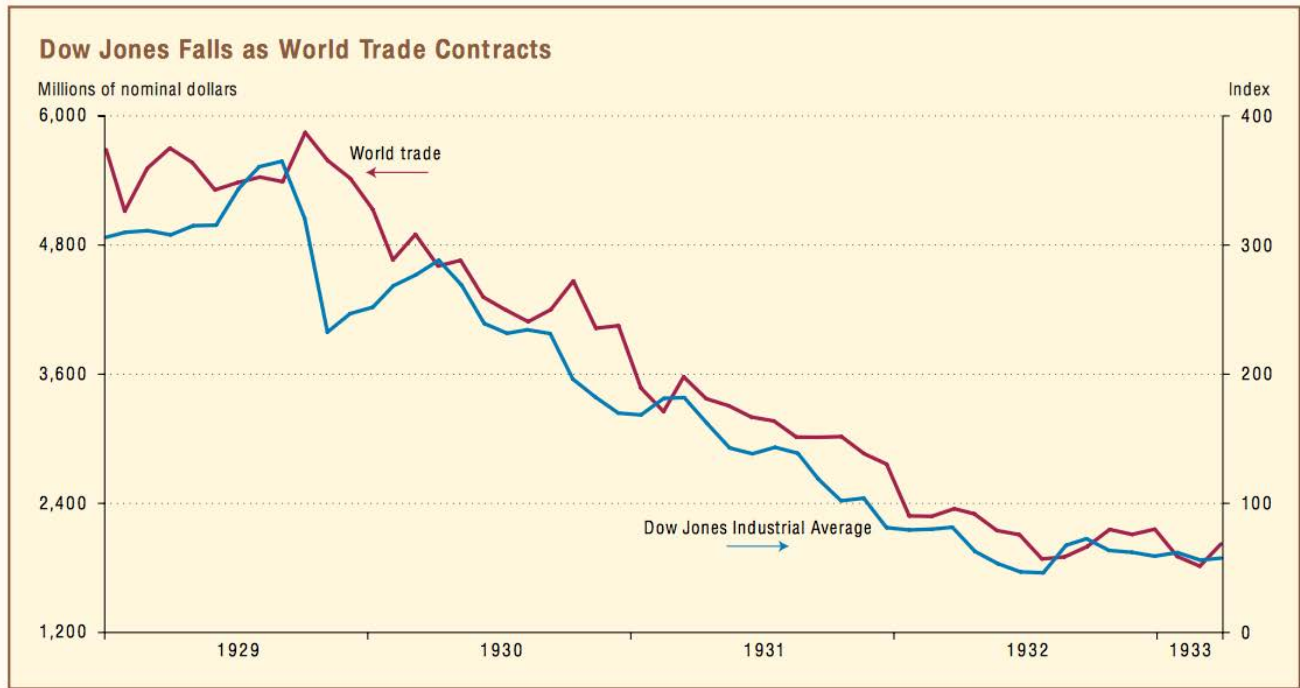
EXHIBIT 13. **Protect and Destroy: The Lesson of Smoot–Hawley**

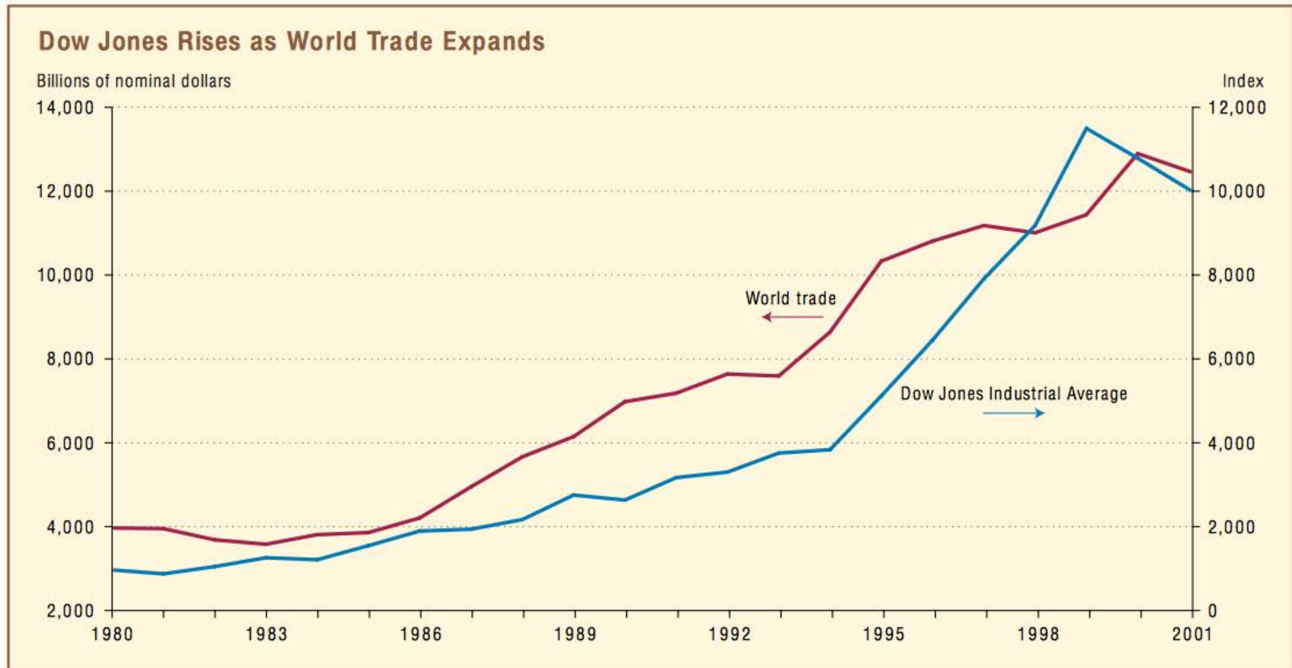
The stock market hates protectionism. That lesson—perhaps the clearest history has ever taught—comes from the Smoot–Hawley Tariff Act of 1930. In the late 1920s farmers, whose economic fortunes had not kept pace with industrialists', lobbied Congress for tariffs on agricultural products. The proposed act had few political sponsors at first (two of the three major political parties opposed it), and the stock market ignored it.

But as word of the bill spread, more and more U.S. producers joined the bandwagon, arguing for tariffs to assist domestic industry or protect them from foreign competition. Smoot–Hawley eventually expanded to cover more than 20,000 items across the gamut of U.S. production, with rates practically prohibitive to trade. With so many political constituents now on board, the Progressive and Democratic parties jumped the fence and on October 28, 1929, joined the Old Guard Republicans in supporting the legislation. That day the stock market crashed, falling 12 percent.

In the months that followed, foreign governments filed 34 formal protests, and 1,028 economists petitioned President Hoover not to sign the bill. But he did, on June 17, 1930, and the Great Depression engulfed the nation. The Dow Jones Industrial Average fell from a daily high of 381 in September 1929 to a low of 41 in 1932 as world trade contracted from $5.7 billion to just $1.9 billion three and a half years later.

It was the most expensive lesson markets have ever taught: Protect and destroy.





The entire report can be found online at http://www.dallasfed.org/assets/documents/fed/annual/2002/ar02.pdf.

Federal Reserve Bank of Dallas, *The Fruits of Free Trade*. 2002 Annual Report. Used with permission.

Supporting Question 1

Featured Source	**Source C:** Milton Friedman, videotaped Kansas State University lecture advocating free trade (transcribed excerpt), *Free Trade Versus Protectionism,* 1978

Transcribed Excerpt from the Lecture:

In the international trade area, the language is almost always about how we must export, and what's really good is an industry that produces exports. And if we buy from abroad and import, that's bad. But surely that's upside-down. What we send abroad we can't eat, we can't wear, we can't use for our houses. The goods and services we send abroad are goods and services not available to us. On the other hand, the goods and services we import, they provide us with TV sets we can watch, automobiles we can drive, with all sorts of nice things for us to use. The gain from foreign trade is what we import. What we export is the cost of getting those imports. And the proper objective for a nation as Adam Smith put it, is to arrange things so we get as large a volume of imports as possible, for as small a volume of exports as possible.

This carries over to the terminology we use. When people talk about a favorable balance of trade, what is that term taken to mean? It's taken to mean that we export more than we import. But from the point of view of our well-being, that's an unfavorable balance. That means we're sending out more goods and getting fewer in. Each of you in your private household would know better than that. You don't regard it as a favorable balance when you have to send out more goods to get less coming in. It's favorable when you can get more by sending out less.

The entire lecture can be found online at https://www.youtube.com/watch?v=urSe86zpLI4.

Supporting Question 2

Featured Sources	**Source A:** Jeff Madrick, editorial opposing free trade, "Our Misplaced Trust in Free Trade," *New York Times,* October 3, 2014

Trade is one of the few areas on which mainstream economists firmly agree: More is better. But as the Obama administration pursues two huge new trade deals — one with countries in the Asia-Pacific region, the other with the European Union — Americans are skeptical. Only 17 percent believe that more trade leads to higher wages, according to a Pew Research Center survey released last month. Just 20 percent think trade creates jobs; 50 percent say it destroys them.

The skeptics are on to something. Free trade creates winners and losers — and American workers have been among the losers. Free trade has been a major (but not the only) factor behind the erosion in wages and job security among American workers. It has created tremendous prosperity — but mostly for those at the top.

Little wonder, then, that Americans, in another Pew survey, last winter, ranked protecting jobs as the second-most-important goal for foreign policy, barely below protecting us from terrorism.

Many economists dismiss these attitudes as the griping of people on the losing end of globalization, but they would do better to look inward, at the flaws in their models and theories. Since the 1970s, economic orthodoxy has argued for low tariffs, free capital flows, elimination of industrial subsidies, deregulation of labor markets, balanced budgets and low inflation. This philosophy — later known as the Washington Consensus — was the basis of advice the International Monetary Fund and the World Bank gave to developing countries in return for financial help.

The irony is that during the Industrial Revolution, today's rich countries — Britain, France and the United States — pursued the very opposite policies: high tariffs, government investment in industry, financial regulations and fixed values for currencies. Trade expanded, and capital flowed anyway.

World War II changed everything. Tariffs were seen as having exacerbated the Depression, and inadequate globalization as one cause of the two world wars. So, through the late 1970s, the United States and Europe cut tariffs, though currencies were fixed and capital was still highly controlled. Astonishing American prosperity in the three decades after 1945 led economists to overestimate the impact of free trade. In reality, high growth in those years resulted from many factors: pent-up demand from the war; the Marshall Plan; Cold War military spending; investments in universities, highways and scientific research; and falling oil prices.

Starting in the 1970s, however, under the influence of free-market enthusiasts like Milton Friedman, economists urged further removal of barriers to trade and capital flows, hoping to turn the world into one highly efficient market, unobstructed by government.

The results were often disastrous. The lowering of protective tariffs did not lead to rapid growth in Latin America, which stagnated in the 1980s.

Mr. Friedman's acolytes also urged the reduction or elimination of capital controls — starting in the 1970s in the United States, and in the 1980s in Europe — along with lower tariffs. This, too, was ruinous. An exodus of short-term investments contributed to financial crises in East Asia, Russia, Argentina and Turkey in the mid-1990s, and to the collapse of the Long-Term Capital Management hedge fund in 1998 (a prelude to the 2008 crisis).

Though these mistakes were recognized, the World Trade Organization continued to push one-size-fits-all rules, premised more on ideology than experience, that hurt developing countries.

In 1995, it demanded that members substantially reduce subsidies for export industries. Imagine what would have happened if South Korea, Japan and Taiwan had had to follow this guidance; they became economic powerhouses in the 1960s and 1970s by nurturing their export sectors. (To join the W.T.O., in 2001, China was forced to slash industrial subsidies, but it resorted to currency manipulation to boost its export sector.)

Also that year, the W.T.O. adopted a rule obliging members to abide by rich nations' patent laws. (Never mind that Americans stole technologies from Europe throughout the 1800s.) These laws typically enabled investors in rich countries to reap substantial rewards, while poor nations like India were forced to pay the same price for patented drugs as the rich West, because they were not allowed to make generic substitutes.

But the consensus was flawed. Even free-trade advocates now admit that American wages have been reduced as a result of outsourcing, the erosion of manufacturing and an ever-increasing reliance on imports. Middle-income countries, meanwhile, have been blocked from adopting policies that might make them world-class competitors. Nations that have ignored the nostrums of the Washington Consensus — China, India and Brazil — have grown rapidly and raised their standards of living. Improvements in poverty and inequality occurred in Latin America only in the 2000s, after the I.M.F. and the World Bank reduced their grip on those nations.

Expanding global markets is a worthy goal, but history offers lessons that can lead to more constructive trade, capital and currency policies.

The first is that gradual reform is more effective than a sudden turn to free markets, deregulation and privatization. Shock therapy in Russia was a failure, and nations from Argentina to Thailand paid a dear price for liberalizing capital markets too quickly. The historical models of sustained growth are clear: gradual development of core industries; economic diversification; improvements in literacy and education, especially for women; slow, deliberate opening of capital markets; and the protection of labor from abusive pay and working conditions.

A second lesson is that nations should be left space for experimentation. Some spend too much on social programs, others too little; some need transportation infrastructure, others improved banking; some require literacy programs, others advanced education; some need to subsidize emerging industries, others to privatize bloated state industries; some need worker protections like unemployment insurance, others need labor mobility. Most have too few regulations to protect the environment, finance and consumers.

A third lesson is that models of growth that depend indefinitely on exports are not sustainable. The large imbalances in trade between China and the United States distort economies. The same is true of Germany's huge trade surpluses, which are based on a fixed euro and restrained domestic wages.

Finally — and this is especially true for rich nations — every free-trade agreement should come with a plan to strengthen the social safety net, through job training, help for displaced workers, and longer-term and higher unemployment benefits. Free-trade deals must also be accompanied by policies to stimulate growth through infrastructure investments, subsidies for clean energy and, perhaps, other industries, as well as loans to small businesses, and even wage subsidies.

Free trade has been a priority for the Obama administration, but Congress, wisely, has not given it "fast track" authority, as it gave Presidents Bill Clinton and George W. Bush, to negotiate new trade deals without its approval.

Any trans-Pacific agreement, its terms still a secret, should be discussed in the open with ample protection of worker rights and healthy debate over regulatory changes requested by developing countries or big business. A

trade agreement with the European Union makes more sense, but the danger is that environmental, financial and product-safety regulations will be watered down to meet the demands of corporate interests.

Economists are correct that free trade need not be a zero-sum game. But the genuine gains in prosperity from free trade can be maximized, and broadly shared, only if the policy errors of the past 40 years are properly understood.

Jeff Medrick, "Our Misplaced Faith in Free Trade," *New York Times Sunday Review*, October 3, 2014. http://www.nytimes.com/2014/10/04/opinion/sunday/our-misplaced-faith-in-free-trade.html.

Supporting Question 2

Featured Source	**Source B:** Paul Krugman, editorial opposing free trade, "Is Free Trade Passé?" (excerpts), *Economics Perspectives*, Fall 1987

If there were an Economist's Creed, it would surely contain the affirmations "I understand the Principle of Comparative Advantage" and "I advocate Free Trade." For one hundred seventy years, the appreciation that international trade benefits a country whether it is "fair" or not has been one of the touchstones of professionalism in economics. Comparative advantage is not just an idea both simple and profound; it is an idea that conflicts directly with both stubborn popular prejudices and powerful interests. This combination makes the defense of free trade as close to a sacred tenet as any idea in economics.

Yet the case for free trade is currently more in doubt than at any time since the 1817 publication of Ricardo's *Principles of Political Economy.* This is not because of the political pressures for protection, which have triumphed in the past without shaking the intellectual foundations of comparative advantage theory. Rather, it is because of the changes that have recently taken place in the theory of international trade itself. While new developments in international trade theory may not yet be familiar to the profession at large, they have been substantial and radical. In the last ten years the traditional constant returns, perfect competition models of international trade have been supplemented and to some extent supplanted by a new breed of models that emphasizes increasing returns and imperfect competition. These new models call into doubt the extent to which actual trade can be explained by comparative advantage; they also open the possibility that government intervention in trade via import restrictions, export subsidies, and so on may under some circumstances be in the national interest after all.

To preview this paper's conclusion: free trade is not passé, but it is an idea that has irretrievably lost its innocence. Its status has shifted from optimum to reasonable rule of thumb. There is still a case for free trade as a good policy, and as a useful target in the practical world of politics, but it can never again be asserted as the policy that economic theory tells us is always right....

However, showing that free trade is better than no trade is not the same thing as showing that free trade is better than sophisticated government intervention. The view that free trade is the best of all possible policies is part of the general case for laissez-faire in a market economy, and rests on the proposition that markets are efficient. If increasing returns and imperfect competition are necessary parts of the explanation of international trade, however, we are living in a second-best world where government intervention can in principle improve on market outcomes. Thus as soon as the respectability of non–comparative-advantage models in international trade was established, international trade theorists began to ask whether the new view of the *causes* of trade implied new views about appropriate trade *policy.* Does acknowledging economies of scale and imperfect competition create new arguments against free trade?

Paul Krugman, "Is Free Trade Passé?" *Journal of Economic Perspectives* 1, no. 2 (1987): 131–144. Copyright © 1987 American Economic Association. http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.1.2.131.

Supporting Question 2

Featured Source	**Source C:** Joseph Stiglitz, videotaped interview by Jere Van Dyk about barriers to free trade, *Free Trade?* (excerpt from transcript), April 3, 2006

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With
Joseph Stiglitz
Economist and Professor
Columbia University
April 3, 2006

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Joseph Stiglitz: Free Trade?
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JOSEPH STIGLITZ: We don't really have a free trade regime. Free trade would mean that you took away all barriers to trade, all impediments to a level playing field.

For instance, the United States and the European Union subsidize agriculture. That means that almost half of the income of produced in these countries comes from government subsidies; they don't just rely on the market. Free trade would be to rely on the market alone. Some might argue that they spend more money farming Washington than they do farming the land.

The problem is that developing countries, too poor to give subsidies, have to compete with this highly subsidized Western agriculture. So even if they were twice as efficient, they would have a hard time competing. But they have all kinds of other problems that would make it more difficult for them to take advantage of a free-trade regime, even if such existed. For example, you have to take your product to the port, put it on a ship to the United States where it can be sold. But if your roads don't exist, if your ports aren't very good, it's hard to export. Developing countries have a very weak infrastructure. So we say that they have internal barriers to trade as well as the artificial barriers to trade of tariffs and other artificial government-imposed trade impediments.

Trade negotiations lower the artificial barriers, but in the past they have done nothing about the internal barriers. Europe opened up its markets unilaterally to the least-developed countries about three or four years ago. They recognized that in the past, trade agreements had been totally unfair to developing countries and they said: "We care about those who are less fortunate than us. We give aid. Well, rather than just giving a handout, let's help them grow and let's open up our markets." So they took away their tariffs on most goods.

But very little trade resulted. Part of the problem was the technical provisions, but it also had to do with supply-side constraints—that they had neither the goods to produce, nor the infrastructure to deliver any goods to market. The result was very little increase in real trade.

The video of the entire interview can be found online at https://www.youtube.com/watch?v=4rgj9EG5PS8.

Reprinted with permission from Carnegie Council for Ethics in International Trade Full transcript available from the Carnegie Council website at http://www.carnegiecouncil.org/studio/multimedia/20060403/index.html.

Supporting Question 3	
Featured Source	**Source A:** Presidents Bill Clinton, George H. W. Bush, Jimmy Carter, and Gerald Ford, press conference on the signing of the North Atlantic Free Trade Agreement, C-SPAN, September 14, 1993

NOTE: The screen shot below is the initial image from the video. Teachers may want to select key points in the video found at: http://www.c-span.org/video/?50372-1/north-american-ree-trade-agreement-signing. *After an approximately eight-minute introduction by Vice President Gore, President Clinton speaks about the projected benefits of NAFTA for about 20 minutes. At about the 30-minute mark, Clinton signs the NAFTA side agreements. Former presidents Bush, Carter, and Ford then make some comments about NAFTA.*

Public domain. Image from video of Presidents Ford, Carter, Bush, and Clinton after NAFTA was signed, September 14, 1993. Reproduced from C-SPAN.

Supporting Question 3	
Featured Source	**Source B:** Presidents Bill Clinton, George H. W. Bush, Jimmy Carter, and Gerald Ford and Vice President Albert Gore, transcript of remarks from the press conference on the signing of the North Atlantic Free Trade Agreement (excerpts), September 14, 1993

For Immediate Release September 14, 1993

REMARKS BY PRESIDENT CLINTON,

PRESIDENT BUSH, PRESIDENT CARTER, PRESIDENT FORD,

AND VICE PRESIDENT GORE

IN SIGNING OF NAFTA SIDE AGREEMENTS

The East Room

10:39 A.M. EDT

VICE PRESIDENT GORE: Ladies and gentlemen, please be seated. We'd like to welcome all of you. President and Mrs. Ford, President and Mrs. Carter, President Bush, Mr. President, to the First Lady, to the Ambassador of Mexico, Mr. Montano, Ambassador Keegan of Canada, Ambassador Kantor....

There are some issues that transcend ideology. That is, the view is so uniform that it unites people in both parties. This means our country can pursue a bipartisan policy with continuity over the decades. That's how we won the Cold War. That's how we have promoted peace and reconciliation in the Middle East. And that's how the United States of America has promoted freer trade and bigger markets for our products and those of other nations throughout the world. NAFTA is such an issue....

We will, indeed, have much room for free debate during this controversy. That it is in our nation's best interest to ratify and pass this treaty cannot be left to doubt. The person who is leading the fight and who has marshaled support in both parties is the person it is my pleasure to introduce now. The President of the United States, Bill Clinton. (Applause.)

THE PRESIDENT: ...It's an honor for me today to be joined by my predecessor, President Bush, who took the major steps in negotiating this North American Free Trade Agreement; President Jimmy Carter, whose vision of hemispherical development gives great energy to our efforts and has been a consistent theme of his for many, many years now; and President Ford who has argued as fiercely for expanded trade and for this agreement as any American citizen and whose counsel I continue to value....

Today we turn to face the challenge of our own hemisphere, our own country, our own economic fortunes. In a few moments, I will sign three agreements that will complete our negotiations with Mexico and Canada to create a North American Free Trade Agreement. In the coming months I will submit this pack to Congress for approval. It will be a hard fight, and I expect to be there with all of you every step of the way. (Applause.)

We will make our case as hard and as well as we can. And, though the fight will be difficult, I deeply believe we will win. And I'd like to tell you why. First of all, because NAFTA means jobs. American jobs, and good-paying American jobs. If I didn't believe that, I wouldn't support this agreement....

For two decades, the winds of global competition have made these things clear to any American with eyes to see. The only way we can recover the fortunes of the middle class in this country so that people who work harder and smarter can at least prosper more, the only way we can pass on the American Dream of the last 40 years to our children and their children for the next 40 is to adapt to the changes which are occurring.

In a fundamental sense, this debate about NAFTA is a debate about whether we will embrace these changes and create the jobs of tomorrow, or try to resist these changes, hoping we can preserve the economic structures of yesterday….

I believe that NAFTA will create 200,000 American jobs in the first two years of its effect. I believe if you look at the trends—and President Bush and I were talking about it this morning—starting about the time he was elected president, over one-third of our economic growth, and in some years over one-half of our net new jobs came directly from exports. And on average, those export-related jobs paid much higher than jobs that had no connection to exports.

I believe that NAFTA will create a million jobs in the first five years of its impact. And I believe that that is many more jobs than will be lost, as inevitably some will be as always happens when you open up the mix to a new range of competition.

NAFTA will generate these jobs by fostering an export boom to Mexico; by tearing down tariff walls which have been lowered quite a bit by the present administration of President Salinas, but are still higher than Americans.

Already Mexican consumers buy more per capita from the United States than other consumers in other nations. Most Americans don't know this, but the average Mexican citizen—even though wages are much lower in Mexico, the average Mexican citizen is now spending $450 per year per person to buy American goods. That is more than the average Japanese, the average German, or the average Canadian buys; more than the average German, Swiss and Italian citizens put together.

So when people say that this trade agreement is just about how to move jobs to Mexico so nobody can make a living, how do they explain the fact that Mexicans keep buying more products made in America every year? Go out and tell the American people that. Mexican citizens with lower incomes spend more money—real dollars, not percentage of their income—more money on American products than Germans, Japanese, Canadians. That is a fact. And there will be more if they have more money to spend. That is what expanding trade is all about.

In 1987, Mexico exported $5.7 billion more of products to the United States than they purchased from us. We had a trade deficit. Because of the free market, tariff-lowering policies of the Salinas government in Mexico, and because our people are becoming more export-oriented, that $5.7-billion trade deficit has been turned into a $5.4-billion trade surplus for the United States. It has created hundreds of thousands of jobs.

Even when you subtract the jobs that have moved into the Maquiladora areas, America is a net job winner in what has happened in trade in the last six years. When Mexico boosts its consumption of petroleum products in Louisiana, where we're going tomorrow to talk about NAFTA, as it did by about 200 percent in that period, Louisiana refinery workers gained job security. When Mexico purchased industrial machinery and computer equipment made in Illinois, that means more jobs. And guess what? In this same period, Mexico increased those purchases out of Illinois by 300 percent.

Forty-eight out of the 50 states have boosted exports to Mexico since 1987. That's one reason why 41 of our nation's 50 governors, some of them who are here today—and I thank them for their presence—support this trade pact. I can tell you, if you're a governor, people won't leave you in office unless they think you get up every day trying to create more jobs. They think that's what your jobs is if you're a governor. And the people who have the

job of creating jobs for their state and working with their business community, working with their labor community, 41 out of the 50 have already embraced the NAFTA pact.

Many Americans are still worried that this agreement will move jobs south of the border because they've seen jobs move south of the border and because they know that there are still great differences in the wage rates. There have been 19 serious economic studies of NAFTA by liberals and conservatives alike; 18 of them have concluded that there will be no job loss.

Businesses do not choose to locate based solely on wages. If they did, Haiti and Bangladesh would have the largest number of manufacturing jobs in the world. Businesses do choose to locate based on the skills and productivity of the work force, the attitude of the government, the roads and railroads to deliver products, the availability of a market close enough to make the transportation costs meaningful, the communications networks necessary to support the enterprise. That is our strength, and it will continue to be our strength. As it becomes Mexico's strength and they generate more jobs, they will have higher incomes and they will buy more American products.

We can win this. This is not a time for defeatism. It is a time to look at an opportunity that is enormous.

Moreover, there are specific provisions in this agreement that remove some of the current incentives for people to move their jobs just across our border. For example, today Mexican law requires United States automakers who want to sell cars to Mexicans to build them in Mexico. This year we will export only 1,000 cars to Mexico.

Under NAFTA, the Big Three automakers expect to ship 60,000 cars to Mexico in the first year alone, and that is one reason why one of the automakers recently announced moving 1,000 jobs from Mexico back to Michigan.

In a few moments, I will sign side agreements to NAFTA that will make it harder than it is today for businesses to relocate solely because of very low wages or lax environmental rules. These side agreements will make a difference. The environmental agreement will, for the first time ever, apply trade sanctions against any of the countries that fails to enforce its own environmental laws. I might say to those who say that's giving up of our sovereignty, for people who have been asking us to ask that of Mexico, how do we have the right to ask that of Mexico if we don't demand it of ourselves? It's nothing but fair.

This is the first time that there have ever been trade sanctions in the environmental law area. This ground-breaking agreement is one of the reasons why major environmental groups, ranging from the Audubon Society to the Natural Resources Defense Council, are supporting NAFTA.

The second agreement ensures the Mexico enforces its laws in areas that include worker health and safety, child labor and the minimum wage. And I might say, this is the first time in the history of world trade agreements when any nation has ever been willing to tie its minimum wage to the growth in its own economy.

What does that mean? It means that there will be an even more rapid closing of the gap between our two wage rates. And as the benefits of economic growth are spread in Mexico to working people, what will happen? They'll have more disposable income to buy more American products and there will be less illegal immigration because more Mexicans will be able to support their children by staying home. This is a very important thing. (Applause.)

The third agreement answers one of the primary attacks on NAFTA that I heard for a year, which is, well, you can say all this, but something might happen that you can't foresee. Well, that's a good thing; otherwise we never would have had yesterday. (Laughter and applause.) I mean, I plead guilty to that. Something might happen that Carla Hills didn't foresee, or George Bush didn't foresee, or Mickey Kantor, or Bill Clinton didn't foresee. That's true.

Now, the third agreement protects our industries against unforeseen surges in exports from either one of our trading partners. And the flip side is also true. Economic change, as I said before, has often been cruel to the middle class, but we have to make change their friend. NAFTA will help to do that.…

This agreement will create jobs, thanks to trade with our neighbors. That's reason enough to support it. But I must close with a couple of other points. NAFTA is essential to our long-term ability to compete with Asia and Europe. Across the globe our competitors are consolidating, creating huge trading blocks. This pact will create a free trade zone stretching from the Arctic to the tropics, the largest in the world—a $6.5 billion market, with 370 million people. It will help our businesses to be both more efficient and to better compete with our rivals in other parts of the world.

This is also essential to our leadership in this hemisphere and the world. Having won the Cold War, we face the more subtle challenge of consolidating the victory of democracy and opportunity and freedom.…

(NAFTA side agreements are signed.) (Applause.)

I'd like to ask now each of the presidents in their turn to come forward and make a statement, beginning with President Bush and going to President Carter and President Ford. And I will play musical chairs with their seats. (Laughter and applause.)

PRESIDENT BUSH: Thank you very much. I thought that was a very eloquent statement by President Clinton, and now I understand why he's inside looking out and I'm outside looking in. (Laughter and applause.)….

You heard an eloquent statement by the President about jobs, and let me just say a word on another facet of this, which he also touched on.

Under Carlos Salinas, a truly courageous young leader, Mexico has changed. And they have moved on environmental matters and on labor matters. And they're working closely with us in the narcotics fight. They're good neighbors and they're good friends, and they're good partners. And on a wide array of fronts, Mexico's courageous young President has tangled with his own bureaucracy, taken on his own special interests. Moving to privatization, he's dramatically improved Mexico. And now the whole world—and President Clinton touched on this—particularly those countries south of the Rio Grande are watching and they're wondering if we're going to go through with this excellent agreement.

Other countries in South America want in, as the President said. And in my view, we should encourage similar deals with other countries because that just simply means more jobs for Americans.

Skeptics abound. Many are taking the cheap and easy way out on this one, appealing to demagoguery and to interests that are very, very special. There's been some longstanding feeling down below our border—oh, well, the United States will make a free trade agreement with Canada, but when it comes to Latin America, when it comes to Hispanics, see if they'll do the same thing for Latin countries. And if we fail, the losers will be those in South America, not just in Mexico who want better relations with us, and the biggest loser, of course, in my view, will be the good old USA.

Democracy is one the rise in this hemisphere, anti- Americanism is waning, and I honestly believe democracy will be given a setback in those countries if we fail to pass this outstanding agreement. We must say to Mexico that we want you as equal trading partners, and that's good for both of us.

So let's not listen to those who are trying to scare the American people, those demagogues who appeal to the worst

instincts that our special interest groups possess, let's do what is right and let's have enough confidence in ourselves, as the President just said, to pass this good agreement.

Thank you very much. (Applause.)

PRESIDENT CARTER: …Since I left the White House, which is a long time ago, we've spent a lot of time in Latin America. The Carter Center has special programs, one of which is to promote democracy. With my good friend, Gerald Ford, we went to Panama to try to bring both peace and democracy to that country. It finally came with the help of George Bush. We went into Nicaragua to try to hold an honest election and to replace a communist regime. We went to Haiti and to the Dominican Republic and, later on, to Guyana, and just recently to Paraguay. And just this month they've inaugurated a democratically-elected civilian to be the President of Paraguay.

The point is that there is a wave of democracy brought about by the strong U.S. human rights policy that is indeed inspirational to us and is very beneficial to those of us who live in the United States.

We haven't made any progress on Cuba. And Mexico has a long way to go to have a truly honest democratic election. But I think the single most important factor that will democracy and honest elections to our next-door neighbor is to have NAFTA approved and implemented. If this is done, then I believe that we will have rich dividends for our own country.

I'm not going to go into detail about how this will be done. I think you can see it clearly. And I'll get to that in just a few minutes. The two most rapidly growing trade areas in the world are Asia and Latin America. Asia is rapidly growing because their exports to us are increasing. Latin America is rapidly growing because our exports to them are increasing. It's obvious to everyone who looks at this rationally that it's much better to have democracy, freedom and eager markets for American products among our next-door neighbors, who have always looked to the United States with intense interest, far exceeding what I even realized when I was President—sometimes with trepidation, sometimes with admiration, and sometimes with confidence.…

President Bush obviously started the NAFTA agreement, a very superb achievement for him. There were some honest problems with it. I called Bill Clinton only three times during his administration—during his campaign. I was for him from the beginning. It's the first time I ever said this publicly, but I'm proud of it. (Laughter.) Because I've tried to stay neutral, you know, within the Democratic Party, but Rosalynn and I were for Bill. I called him three times. One of those times was when I feared that he might make a public statement denouncing the North American Free Trade Agreement. And he said, okay, I will be for it, but with provisos. We've got to do something about labor, to protect the working people of our country, and we've got to do something about the environment. That has now been done. The side agreements have alleviated the serious questions that did arise about NAFTA. That's been done.

Finally, let me say that in a time like this with an earth-shaking change in international relations confronting us, there are those who doubt the ability, or even the integrity of government. That exists, I guess, in all countries and in ours as well. And there are those who are uncertain about the future and doubtful about their own jobs. …

PRESIDENT FORD: It's a very, very high honor and a very great privilege for me to have the opportunity to follow each of the former Presidents and President Clinton to indicate my very strong affirmative endorsement of the NAFTA Agreement. I will not repeat what each one of them have said—they've done it eloquently and convincingly—but I'm old enough and have been around this town long enough to remember some things that

ought to be put on the table.

Right after World War II, there was a tremendous effort by Democratic presidents, Republican presidents, Democratic congresses and Republican congresses to pass what we then called reciprocal trade legislation. And the aim and objective, as Lloyd Bentsen well knows, was to undo the stupidity of what had been done in 1930 and '31 by the then-Congress of the United States to pass what they called the Smoot- Hawley Tariff Act, which raised tariffs all around the United States to prevent any imports. And the net result was, we, the United States, could not sell abroad.

And in order to undo that very unwise decision back in '30 and '31, Republicans and Democrats, the White House and the Congress strongly supported the kind of legislation that has led to tremendous expansion of trade on a global basis.

I don't recall the statistical data, but the truth is that world trade has been the real engine that has given the free Western industrial nations the capacity to have prosperity and growth.

In my judgment, NAFTA is a follow-on to what was done in the post-World War II period to undertake a new global effort. And the consequence of NAFTA, as has been pointed out by my predecessors, is vitally important not only for the United States, this hemisphere, and the globe, but it's important primarily for jobs that are going to be built here in the United States. Our exports will expand tremendously, as the President has pointed out.

And then let's look at what has happened in our neighbor to the south. A few of us can remember five, six years ago when we were deeply concerned with Mexico's $100-billion foreign debt, how was that going to be resolved. We were worried about runaway inflation in Mexico, over 100 percent. We were concerned about the instability of government in our good neighbor to the south.

In my judgment, President Salinas has done a fantastic job. You no longer hear about their foreign debt. They've privatized banks, airlines, et cetera. They've reduced inflation from 100 percent to less than 10 percent. Mexico is a growing, thriving neighbor, and we should be happy.

I fear very strongly that if NAFTA is defeated it could have serious political and economic ramifications in Mexico. Under Salinas, jobs are growing, wages are going up. Mexicans want to stay in Mexico and work in Mexico.

I read the other day a prominent Mexican political leader said, pass NAFTA and we will have jobs for Mexicans in Mexico. Defeat NAFTA and there will be a tremendous flow of Mexicans to the United States wanting jobs in the United States. We don't want that. We want Mexicans to stay in Mexico so they can work in their home country. We don't want a huge flow of illegal immigrants into the United States from Mexico.

And I say with all respect to my former members of the House and the Congress, don't gamble. If you defeat NAFTA, if you defeat NAFTA, you have to share the responsibility for increased immigration to the United States, where they want jobs that are presently being held by Americans. It's that cold-blooded and practical. And members of the House and Senate ought to understand that.

I think it's a matter of tremendous importance for NAFTA to be approved so we can solidify 370 million people in all of Western society. So we can have growth, prosperity, jobs from the Arctic to the Antarctic. And I applaud those—President Bush, Carla Hills and her associate, President Clinton, Mickey Kantor and his—for bringing before this country an opportunity for future prosperity and good living for people in this entire hemisphere.

We can't afford to make the stupid, serious mistake that was made in the 1930s and 1931 with the passage of legislation that tried to put a protective ring around the United States with high tariffs and high tariff barriers. So I hope and trust that the Congress, the House and Senate, will respond affirmatively. It's good for the United States.

It's good for our people in the Western Hemisphere.

And I'm pleased to be here this morning to join President Clinton and his associates on this occasion. Thank you very much. (Applause.)

END 11:33 A.M. EDT

Public domain. Available from the Clinton Presidential Materials Project, National Archives, http://clinton6.nara.gov/1993/09/1993-09-14-remarks-by-clinton-and-former-presidents-on-nafta.html.

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 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.

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.

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:

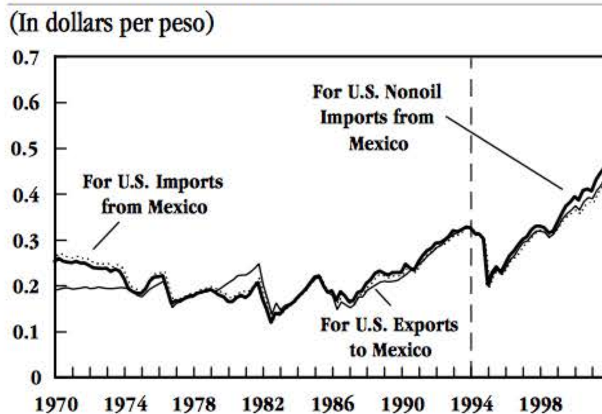
- A sudden major decline in the value of the peso at the end of 1994 (which reduced U.S. exports to Mexico and increased U.S. imports from Mexico),
- An associated harsh Mexican recession in 1995 (which lowered Mexico's demand for all countries' exports, including those of the United States),
- The long 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

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.

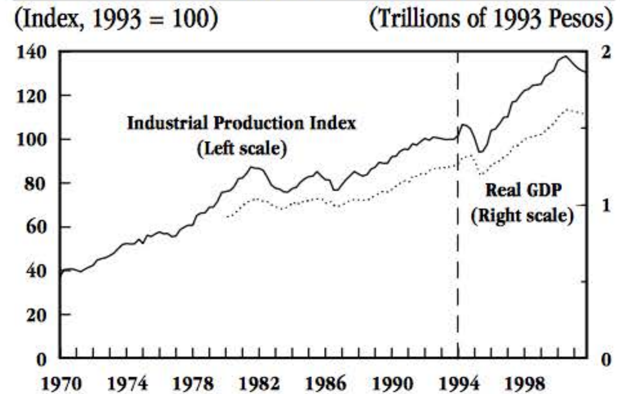
Notes: The effects of Mexican inflation over time were removed using the Mexican wholesale price index. The effects of U.S. inflation over time were removed using price indices for U.S. exports to and imports from Mexico that CBO constructed from the data sources cited above.

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.

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

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.

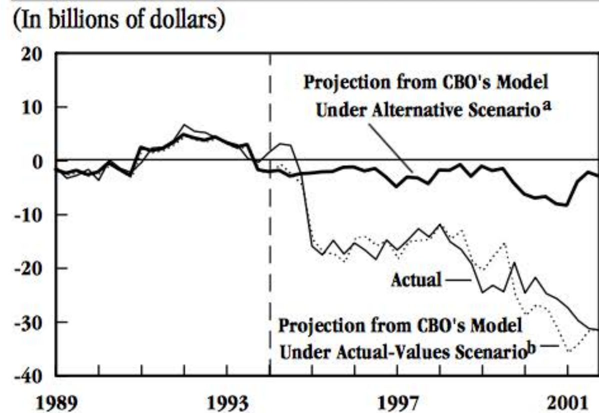
In 1996, Mexican demand for U.S. exports began to recover along with the peso and the Mexican economy. However, U.S. imports from Mexico (as well as from other countries) began to rise in response to the economic expansion in the United States. Consequently, the U.S. trade balance with Mexico did not 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

	Among Reps, Rep-leaners	
Impact of free trade agreements on...	**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.