Love in the Time of Free Trade: NAFTA's Economic Effects Ten Years Later

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> *This is life or death for a lot of workers.*
>
> —Rep. (D) David Bonior[1]

> *It's good for the American economy.*
>
> —President Clinton[2]

> *The free trade system is destructive. It breaks up old nationalities and pushes the antagonism of the proletariat and the bourgeoisie to the extreme point. It is in this revolutionary sense alone, that I vote in favor of free trade.*
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> —Karl Marx (1848)[3]

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1. Jackie Calmes, *Nafta Is Wedge Issue for Democratic Leadership, But It's Not Republicans Wielding the Hammer*, WALL ST. J., Nov. 2, 1993, at A24.

2. Jeffrey Birnbaum, *Clinton Concedes He Lacks Nafta Votes, Lashes Out at Organized Labor, Perot*, WALL ST. J., Nov. 8, 1993, at A3.

> *The first rule of trade agreements is that the benefits are widely dispersed, the costs are very concentrated, and the losers are very vocal.*
>
> —Bernard Wysocki, Jr., *Wall Street Journal*[4]

I. RENEW THE VOWS?

Traditionally, when couples celebrate their tenth wedding anniversary, one bestows a gift made of tin. The United States and Mexico, via the North American Free Trade Agreement (NAFTA), recently reached this milestone.[5] Shall we then call upon the tinsmith to fashion a gift? Is free trade the panacea its proponents claimed?[6] Or is it the economic equivalent of the bogeyman, wreaking havoc on the American and Mexican economies, as the agreement's vocal critics warned it would?[7] Not surprisingly, the truth lies somewhere in between the facile answers offered by the interest groups and the concomitant political rhetoric. The short answer to the above inquiries is that the critics (trade unions, Ralph Nader/Public Citizen, Ross Perot, etc.) were clearly wrong on nearly all their major predictions, while those in favor of free trade were overenthusiastic about the positive economic effects in store, especially those predictions concerning Mexico. So while the tinsmith is at work, we should prepare to dispense some avuncular wisdom with our anniversary gift: chastise lightly for the amateur mistakes that should have been avoided and provide constructive criticism for the future of free trade in North America and beyond.

II. THE GENESIS OF THE ROMANCE

A. *Courting NAFTA*

In 1988, the United States and Canada signed a free trade agreement (CFTA) to little fanfare.[8] Not long after this there were rumblings of a free trade agreement that would encompass the whole

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3. KARL MARX (1848), *quoted in* Bob Davis, *The New Demon: In Debate over Nafta, Many See Global Trade as Symbol of Hardship*, WALL ST. J., Oct. 20, 1993, at A1.

4. Bernard Wysocki, Jr., *The WTO: The Villain in a Drama It Wrote*, WALL ST. J., Dec. 6, 1999, at A1.

5. NAFTA went into effect in the United States on January 1, 1994. *See* Approval and Entry into Force of the North American Free Trade Agreement, 19 U.S.C. § 3311 (2000).

6. *See* Martin Fletcher, *Comeback Kid Reaps Rewards of Nafta Victory*, TIMES (London), Nov. 19, 1993, at 16 (describing the economic and political benefits of NAFTA).

7. *See* Irwin Stelzer, *Nafta Victory Swells Protectionist Army*, SUNDAY TIMES (London), Nov. 21, 1993, at 9 (listing the concerns of the primary opponents of NAFTA).

8. *NAFTA's Progress: Northern Rumblings*, THE ECONOMIST, Jan. 14-20, 1995, at 26.

continent.[9] Canada and Mexico were in talks to establish their own free trade agreement, and the United States had just established one with its northern neighbor.[10] Mexico, still recovering from the "infamous Mexican weekend," began in the late 1980s to show signs of economic maturity.[11] The United States took note and, in November 1990, President George Bush and Mexican President Carlos Salinas de Gortari met at a summit to discuss, among other things, a free trade agreement.[12] Even then, the factions that would vehemently oppose NAFTA—unions, environmentalists, right-wing protectionists, and populists—began to coalesce.[13]

Congress had granted "fast track authority"—allowing the president to negotiate a trade agreement which would then be put to a majority vote in both Houses—in May 1991.[14] After his election in 1992, President Clinton made passing NAFTA one of his administration's top priorities.[15] The President couched the agreement in terms of a "defining moment" for the United States.[16] Clinton's opponents, nonplussed, gave him the pejorative nickname "Nafta Claus" because of the numerous side deals he made with various members of Congress in his zeal to pass NAFTA.[17] He also characterized the agreement as an arrow in the country's economic quiver against the European Union and Japan.[18]

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9. *American Survey: Mexico Beckons, Protectionists Quaver*, THE ECONOMIST, Apr. 20-26, 1991, at 23 [hereinafter *Mexico Beckons*].

10. *Id.*

11. 1982 was the height of a much more far reaching crisis. By the early 1990s, however, Mexico began to turn its economy around. Jane Hughes, *Latin America*, *in* THE GLOBAL DEBT CRISIS: FORECASTING FOR THE FUTURE 26-28 (Scott B. MacDonald et al. eds., 1990); *see also Mexico: The New Model Debtor*, THE ECONOMIST, Oct. 6-12, 1990, at 85.

12. M. Delal Baer, Editorial, *Mexican Elections: Shadow over the Summit*, WASH. POST, Nov. 30, 1990, at A29.

13. *Id.*; *see also* Wysocki, *supra* note 4; Fletcher, *supra* note 6.

14. *See Mexico Beckons*, *supra* note 9, at 23; *see also The Fast Track West*, THE ECONOMIST, June 1-7, 1991, at 20.

15. *See* Michael K. Frisby & James M. Perry, *Clinton's Nafta Dealing Shows Gambler's Instincts*, WALL ST. J., Nov. 18, 1993, at A14.

16. Martin Fletcher & David Adams, *White House Makes Final Push to Save Shaky Nafta*, TIMES (London), Nov. 11, 1993, at 15.

17. Martin Fletcher, *Nafta Waverers Hit the Jackpot in White House Bazaar*, TIMES (London), Nov. 16, 1993, at 15. Some examples: Congressmen simply asked for a "presidential photo opportunity or a visit by Hillary Clinton." *Id.* Clinton played golf with those still undecided, held White House dinners, and even secured one congressman's vote after a promise to build the new National Institute of Standards and Technology. *Id.* (quoting David Levy, a New York Republican). One congressman even joked, "Someone told me I could get a bridge built in my district, but I have no water here." *Id.* Another tactic was to pressure those politically vulnerable Democrats into voting for NAFTA by implying that they would face Democratic challengers in the next election cycle unless they voted in favor. *Id.*

18. Ann Devroy & Peter Behr, *Clinton Warns of Competing Mexican Deals: Chamber of Commerce Hears NAFTA Pitch*, WASH. POST, Nov. 2, 1993, at A7.

The business community of course supported the agreement.[19] A group of executives from America's largest corporations, the Business Roundtable, formed "USA-NAFTA" to lobby Congress.[20] *The Wall Street Journal* estimated that this coalition spent about $17 million—including twenty large corporations initially donating $100,000 each—$3.5 million of which went towards advertising.[21]

There were international concerns that the General Agreement on Tariffs and Trade (GATT) talks, due to end a month after Congress voted on NAFTA, would break down if Clinton could not get NAFTA through Congress.[22] The London newspaper *The Times* compared NAFTA to the Maastrich Treaty (the European Community's plan for economic and monetary union) and proclaimed, "Nafta Must Win."[23]

B. Speak Now or Forever Hold Your Peace

It is easy to forget the intense animosity of the rhetoric and harsh (sometimes over the top) political haymakers thrown in the weeks leading up to the House's vote on NAFTA. It is also easy to forget that the NAFTA vote took place when Ross Perot still had political capital.[24]

Ross Perot, who famously said that NAFTA will create a "giant sucking sound"[25] during his 1992 presidential campaign, co-wrote a book with Pat Choate called *Save Your Job, Save Our Country: Why NAFTA Must Be Stopped—Now!*, in which they claimed that "millions of Americans [would] lose their jobs" as a result of NAFTA.[26] The Sacramento chapter of Perot's organization, "United We Stand America" hung its congressman in effigy upon hearing he was undecided on NAFTA.[27] Perot even "reported that a Cuban hit-squad" hired by a pro-

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19. *See* Jill Abramson & Bob Davis, *Expense Battle over Nafta Has Each Side Claiming It's Being Outgunned and Overspent*, WALL ST. J., Nov. 15, 1993, at A14.
20. *Id.*
21. *Id.*
22. Editorial, *Nafta Must Win: Today's Vote Is a Critical Test of Clinton's Authority*, TIMES (London), Nov. 17, 1993, at 17 [hereinafter *Nafta Must Win*]. *But see* Wolfgang Münchau, *Apocalypse Now for Nafta Could Spell the End for GATT*, TIMES (London), Nov. 17, 1993, at 27 (explaining that even though there are concerns that if NAFTA fails GATT will follow, but if GATT in fact fails, it cannot be blamed on any failure of NAFTA).
23. *Nafta Must Win*, *supra* note 22.
24. It is noteworthy that the list of some of the most vocal critics of NAFTA—Pat Buchanan, Ross Perot, and Jesse Jackson—no longer have large reserves of political capital.
25. Perot referred to his belief that the sucking sound would be made by American jobs and investments moving to Mexico. John J. Audley, *Introduction* to NAFTA'S PROMISE AND REALITY 4 (2003).
26. ROSS PEROT & PAT CHOATE, SAVE YOUR JOB, SAVE OUR COUNTRY: WHY NAFTA MUST BE STOPPED NOW!, at i (1993).
27. Davis, *supra* note 3, at 1.

NAFTA faction "planned to kill him because of his opposition to Nafta."[28] Whatever the validity, economic or otherwise, of these statements and actions, the Clinton Administration took the Perot threat seriously enough to send then Vice President Al Gore to debate Perot live on CNN.[29]

The St. Louis archdiocese's Commission on Human Rights cast its concerns with NAFTA pietistically, stating that the agreement did not reflect the "Gospel teachings of the primacy of love, the call to justice [and] human unity."[30] The United Methodist Church also came down on the anti-NAFTA side; because it "believe[d] [that] Nafta would throw people out of work and wreck the environment."[31] A Sacramento Bishop claimed that allowing unrestricted free trade "can harm the poor."[32]

Environmental groups formed another wing of the anti-NAFTA coalition.[33] In addition to their concerns that free trade generally could pose a threat to the world's environmental health,[34] the Sierra Club, among others, filed suit asking the court to order the government to file a report on NAFTA's effects on the environment.[35] Large companies, went the argument, would move factories to Mexico where the lackadaisical enforcement of environmental laws would allow them to pollute at will.[36] "Fair Trade Not Toxic Trade," became a favorite rallying cry.[37]

Undoubtedly, the trade unions, along with Ralph Nader's organization Public Citizen, were the most vociferous in their attacks on

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28. Irwin Stelzer, *Nafta Marks the Turning Point in America's Future World Role*, SUNDAY TIMES (London), Nov. 14, 1993, at 7.

29. *See* Bob Davis & Michael K. Frisby, *Gore Puts Perot on the Defensive in NAFTA Debate*, WALL ST. J., Nov. 10, 1993, at A3.

30. Davis, *supra* note 3, at A9.

31. Bob Davis, *Fighting NAFTA: Free-Trade Pacts Spurs a Diverse Coalition of Grass-Roots Foes*, WALL ST. J., Dec. 23, 1992, at A1.

32. Davis, *supra* note 3, at A1.

33. *See* Michael McCloskey, Editorial, *Rescue Nafta-Safeguard the Environment*, WALL ST. J., July 8, 1993, at A13.

34. *See* JAGDISH BHAGWATI, FREE TRADE TODAY 61 (2002). Environmental groups, many of which are nongovernmental organizations (NGOs) such as Greenpeace, have branched off into two groups. The first are the moderate groups, (for example, the Sierra Club) who want environmental protections included in free trade agreements and also want to be an integral part of the bargaining process over the agreement. The second groups, which are much more radical, such as the Earth Liberation Front and many of the Seattle protesters at the World Trade Organization (WTO) talks, believe that free trade in any form is perfidious. They believe that free trade is the product of multinational corporations (MNCs) flexing their economic muscle solely in concern of their bottom lines. *See* ROBERT GILPIN, GLOBAL POLITICAL ECONOMY: UNDERSTANDING THE INTERNATIONAL ECONOMIC ORDER 226 (2001).

35. *See* Pub. Citizen v. U.S. Trade Representative, 5 F.3d 549 (D.C. Cir. 1993).

36. *After NAFTA*, THE ECONOMIST, Mar. 20-26, 1993, at 71.

37. Asra Q. Nomani & Michael K. Frisby, *Clinton Opens Free-Trade Drive, But Side Accords Could Fall Short*, WALL ST. J., Sept. 15, 1993, at A18.

NAFTA. The unions made veiled threats to freshman Democrats in the House saying that those who voted for NAFTA were making "a bad miscalculation" and promising to withhold union campaign contributions.[38] Lane Kirkland, then head of the AFL-CIO, accused Clinton of "abdicat[ing] his role as leader of the Democratic Party" and referred to NAFTA as "this lousy agreement."[39] Labor also succeeding in mobilizing their members in Congress, heard overwhelmingly from those with an anti-NAFTA stance.[40]

After the House of Representatives voted on the agreement, the president of Public Citizen, Joan Claybrook, warned, "'This is the beginning—not the end,'" and added, "'There's such anger.'"[41] Ralph Nader said "There's indignation. [The taxpayers] feel outraged."[42] Kirkland warned that "no one should underestimate the strength and depth of those feelings on this issue."[43]

Despite the strength of these feelings, it was all for naught. On Wednesday evening, November 17, 1993, the House of Representatives passed NAFTA by vote of 234-200.[44] One hundred and thirty-two Republicans and 102 Democrats voted yes, while 156 Democrats, 43 Republicans, and 1 independent voted no.[45]

III. A (DIS)PASSIONATE LOOK AT FREE TRADE

At the time of the NAFTA debate, the United States had a $100 billion trade deficit (in goods). Noting this, one of Perot's "United We Stand America" local chapter bosses said, "If we just stopped trading with the rest of the world, we'd be $100 billion ahead."[46] Most economists would find it hard to imagine a more economically implausible statement. But this man is not alone. In March of 1993, when the battle over NAFTA began to emerge, a Gallup Poll found that

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38. John Harwood & Jackie Calmes, *Freshman House Democrats Feel Special Bind as Labor Applies Pressure for Anti-NAFTA Votes*, WALL ST. J., Oct. 25, 1993, at A22.

39. *Lane Kirkland, Internationalist*, THE ECONOMIST, Nov. 20-26, 1993, at 34.

40. Bob Davis, *Clinton Urges Corporations to Support Retraining of Those Losing Jobs to Nafta*, WALL ST. J., Oct. 29, 1993, at A16 (quoting Joan Claybrook, President, Public Citizen).

41. Asra Q. Nomani, *In Vote's Wake, an Odd Coalition of Opponents Sharpens Swords but May Clash on Priorities*, WALL ST. J., Nov. 19, 1993, at A16.

42. *Id.*

43. *Id.*

44. The Senate's confirmation had never been called into doubt. *See* Jackie Calmes, *Series of White House Deals on Nafta Don't Seem to Draw New Congress Votes*, WALL ST. J., Nov. 5, 1993, at A10; *How the House Voted on the North American Free Trade Agreement*, WALL ST. J., Nov. 18, 1993, at A14 [hereinafter *How the House Voted*].

45. *How the House Voted*, *supra* note 44, at A14. It should be noted that there was a vacancy in the House at that time.

46. Davis, *supra* note 3, at A1.

only thirty-one percent of Americans supported the agreement.[47] *The Economist* conducted a poll comprised of citizens from Russia, Australia, the United States, France, Italy, and the United Kingdom to gauge their opinion on free trade.[48] In each country, more people supported protectionism than free trade.[49]

One of the world's leading economists, MIT Professor Jagdish Bhagwati, shares this revealing anecdote in his book, *Free Trade Today*:

> But let me say also that the case for free trade in the public domain has suffered from neglect because few of us have been prepared to enter the fray in its defense. Faced with the critics of free trade, economists have generally reacted with contempt and indifference, refusing to get into the public arena to engage the critics in battle. I was in a public debate with Ralph Nader on the campus of Cornell University a couple of years ago. The debate was in the evening, and in the afternoon I gave a technical talk on free trade to the graduate students of economics. I asked, at its end, how many were going to the debate, and not one hand went up. Why, I asked. The typical reaction was: why waste one's time? As a consequence, of the nearly thousand students who jammed the theater where the debate was held, the vast majority were anti-free traders, all rooting for Mr. Nader. I managed pretty well, but I must confess that the episode brought home to me that unless we confront these misguided critics, the public-policy stage will be occupied solely by the critics of free trade, and then politicians cannot be blamed for having to listen and attend to the chorus of free trade's critics.[50]

Even the students at one of the top universities in the country seem confused. To understand NAFTA for what it is—a regional free trade agreement—an understanding of free trade itself is necessary. So while an exhaustive discussion of the literature on free trade is beyond the scope of this Comment, a short exegesis of free trade is in order.

A. Unabashed Love—Free Trade and Neoclassical Economics[51]

A major reason why economists have not deigned to take on the antifree traders is that the economic benefits of free trade were "proven" by David Hume in the eighteenth century.[52] To economists, this is

47. Michael Duval, *The Weak Case Against Nafta*, WALL ST. J., Nov. 5, 1993, at A8.

48. TOMAS LARSSON, THE RACE TO THE TOP: THE REAL STORY OF GLOBALIZATION 56 (2001).

49. *Id.*

50. BHAGWATI, *supra* note 34, at 8-9.

51. Neoclassical economics is "the body of methods and theories accepted and utilized by most members of the economics profession." GILPIN, *supra* note 34, at 46.

52. PAUL A. SAMUELSON, ECONOMICS 608-09 (McGraw-Hill Book Co., 11th ed. 1980) (1948).

analogous to asking a mathematician to defend simple addition; the veracity of it is seemingly self-evident. Nonetheless, the key to understanding why free trade between two countries is beneficial is *comparative advantage*.[53] Free trade allows the maximization of comparative advantage by enabling countries "to specialize and to export those goods and services" where their advantage is present, and to import "those goods and services in which they lack comparative advantage."[54]

To illustrate, comparative advantage can work as following: there is a man in your hometown who is both the best doctor and baker. Likely, he will choose to concentrate his efforts on medicine as his skills are more likely to be needed in the medical field because of the time, effort, and intellectual know-how involved in becoming a doctor; therefore, his *comparative* advantage is quite high. Many people can bake bread (though not as well as him), but his comparative advantage will be less significant in the baking sector. This is simply because the gap between his and the neighbor's pumpernickel loaf will be *less* than the gap between his and his neighbor's medical advice. While others in town are at a comparative *disadvantage* (even in baking), they will be able to produce bread and other culinary delights because the doctor will not likely squander his labor baking pastries when he could be out saving lives and slowing the spread of disease (not to mention the marked difference in salary).[55]

Further benefits economists connect to free trade include undermining anticompetitive practices, lowering prices, increasing consumer choice, and increasing national efficiency.[56] Free trade also provides for the dissemination of technology and "know-how" from developed to less developed countries (LDCs), therefore allowing those countries that lag behind to "catch up in income and productivity with more advanced economies."[57]

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53. Samuelson defines the principle of comparative advantage:

> Whether or not one of two regions is absolutely more efficient in the production of every good than the other, if each specializes in the products in which it has a *comparative advantage* (greatest *relative* efficiency), trade will be *mutually profitable* to both regions. Real incomes of productive factors rise in *both* places.

Id. at 630.

54. GILPIN, *supra* note 34, at 198.

55. This illustration draws from Samuelson's example. *See* SAMUELSON, *supra* note 52, at 628-29.

56. *See* GILPIN, *supra* note 34, at 198.

57. *Id.*

Trade barriers such as tariffs or quotas have been continually shown by economists' models to be counterproductive.[58] One of the most important economists of the twentieth century said that when the rule of comparative advantage is "*properly* stated, [it] is unassailable [and illuminates] . . . gross fallacies in the political propaganda for protective tariffs aimed at limiting imports."[59]

Given all this, one may ask: why do protectionists and antifree traders succeed or very nearly succeed in the political process? The quote from *The Wall Street Journal* at the beginning of this paper is instructive. There will be "winners" and "losers" in the game of free trade. The "losers" will be those industries threatened by the foreign competition. The "winners" will be consumers as a whole. Because of the narrow costs (in a single industry, for instance) and the widely disseminated benefits (throughout the entire population), the motivation to be the loudest will be on those who are directly affected.

As an example, assume that the copyright on Walt Disney's creations (Mickey Mouse, Goofy, etc.) is nearing its expiration. Disney alone will have to bear the costs of losing such copyrights as opposed to the cost consumers will bear when they have to pay an increased admission price to Disney World on their next family vacation. Thus, it makes economic sense for Disney to lobby for extension of their copyright protection, whereas it may seem odd of our next door neighbor to spend his free time lobbying to save a few dollars on his next family vacation (assuming he is even aware of Disney's machinations).

Recall the statement by the local chapter boss from "United We Stand America" at the beginning of this section.[60] Apparently, he believed that free trade constituted a zero-sum game.[61] In reality it is quite the opposite; international trade does not operate in such fashion.[62] An "unfavorable" trade deficit—like the $100 billion trade deficit the chapter boss referred to—is part of what economists call the *balance of international payments*.[63] Terms like "unfavorable" or "deficit" are misleading. This is because importing more than is exported, that is, a

58. *See* GARY CLYDE HUFBAUER & KIMBERLY ANN ELLIOTT, INST. FOR INT'L ECON., MEASURING THE COSTS OF PROTECTION IN THE UNITED STATES (1994).

59. SAMUELSON, *supra* note 52, at 626.

60. Davis, *supra* note 3, at A1.

61. *See* THOMAS SOWELL, BASIC ECONOMICS: A CITIZEN'S GUIDE TO THE ECONOMY 307 (2004). A *zero-sum game* is one in which there is one winner and one loser, such as chess, or tennis. A *non-zero sum game* (i.e., free trade) is one in which Player *A*'s gain doesn't necessarily come at the expense of Player *B*. Indeed there can be cases in which their interests overlap.

62. *Id.*

63. SAMUELSON, *supra* note 52, at 614.

trade deficit, does not spell economic doom and may even be economically positive.[64]

The term "deficit" arises from simple accounting language. Countries place goods and services that they export in the "credits" column, while they figure imports as "debits."[65] An example from history shows why the chapter boss's economic reasoning is wrong: during the Great Depression in the 1930s, the United States enjoyed a trade surplus, that is, a favorable balance of payments.[66] Clearly, then, a trade surplus does not automatically signal a healthy economy. An important reason why the United States ran a trade deficit in the 1990s is because the balance of international payments does not factor in foreign payments for services rendered.[67] Therefore, as the United States has shifted towards services and away from manufacturing, one might expect a trade deficit in goods.[68]

Ralph Nader and Ross Perot had their own expectations and predicted disastrous consequences for American workers and widespread unemployment if Congress passed NAFTA.[69] Economists have shown this not to be the case. Robert Gilpin, a Princeton political economist, writes: "In a well-functioning economy, trade does not decrease or increase unemployment."[70] In fact, as Gilpin points out, a nation's unemployment rate is largely the result of macroeconomic decisions made by the government.[71] However, trade may redistribute jobs from one economic sector of the country to another.[72]

Trade unions also feared that free trade with low-wage countries would depress the wages of unskilled union members.[73] Economists disagree with this assessment.[74] While it is true that the wages of low-skilled American workers have declined,[75] the decline is attributable to "[t]echnological advances such as the computer and the information economy, [which have] significantly decreased the demand for low-skilled workers and greatly increased the demand for skilled, especially

64. *See id.*
65. *Id.* at 620.
66. *See* SOWELL, *supra* note 61, at 309.
67. *See id.* at 330.
68. Another less sanguine reason for the imbalance is the United States' low national rate of saving vis-à-vis domestic investment. GILPIN, *supra* note 34, at 203.
69. Davis & Frisby, *supra* note 29.
70. GILPIN, *supra* note 34, at 206.
71. *Id.* at 205.
72. *See id.* at 206.
73. Davis, *supra* note 31, at A1.
74. *See* BHAGWATI, *supra* note 34, at 82-89.
75. GILPIN, *supra* note 34, at 204.

college-educated, workers."[76] The apt analogy here is the urbanization that took place in late 1800s that was due to new machines leaving many farm workers unemployed.[77]

B. Still Like What You See?

To have a greater understanding of free trade one needs to review some of the recent developments in trade theory.

The rise in prominence and power of the multinational corporation (MNC) and the resulting foreign direct investment by these MNC's has led some economists to heavily scrutinize their trading habits.[78] For example, "[a] substantial proportion of world trade now takes place as *intrafirm* transfers at prices set by the firms and as part of global corporate strategies."[79] By the 1990s, "over 50 percent of American and Japanese trade was intrafirm trade."[80] The debate over MNCs and their levels of foreign direct investment, however, is mostly between noneconomists and economists.[81] The noneconomists believe that the MNCs' foreign direct investment comes at the expense of the rest of the world, while economists adhere to the view that the MNCs are rational actors and their trade is beneficial to everyone.[82]

The other development to concern oneself with is "strategic trade theory" (STT).[83] STT is important for two main reasons: first, it "challenges the theoretical foundations of the economics profession's unequivocal commitment to free trade,"[84] and second, it "has had an important impact on government policy and has undoubtedly been a factor in the slowdown in the growth of world trade."[85] The theory takes into account factors that are not included in the usual trade models: "imperfect competition, economies of scale, economies of scope, learning by doing, the importance of R & D, and the role of technological spillovers."[86] The main thrust behind this is that economists' models assume perfect competition, conditions where no single firm can alter

76. *Id.*
77. *Id.* at 204-05.
78. *Id.* at 210.
79. *Id.* A pertinent example would be when the American corporate parent buys a certain product manufactured by its subsidiary in China.
80. *Id.*
81. *Id.*
82. *Id.*
83. *See id.* at 214.
84. *Id.*
85. *Id.* at 217.
86. *Id.* at 214.

market conditions by its own actions;[87] whereas STT allows one to conceptualize and predict what might happen to trading conditions under an oligopoly and imperfect competition.[88] Two strategies used by oligopolies to capture an enlarged market share are "*dumping* (selling below cost to drive out competitors in the product area) and *preemption* (through huge investment in productive capacity to deter other entrants into the market)."[89]

Dumping is a form of predatory pricing. The strategy behind predatory pricing is that once the smaller firms have been driven out of the market, because they could not compete with the larger firms' price cuts, the remaining firm or firms raise the price of the goods and enjoy *supercompetive* profits.[90] Many economists and antitrust scholars point to the implausibility of such a strategy and question if dumping or predatory pricing could truly happen.[91]

STT also posits that certain industries are more important than others and suggests that a government can take specific actions to help its own oligopolistic firms as opposed to foreign firms.[92] While economists do not quarrel with this idea, and indeed call it an *optimum tariff*,[93] the debate largely surrounds the theory's further suggestion that the important industries receive direct subsidies or import protection to avoid market failure.[94] Economists dismiss this as veiled protectionism and sophistic reasoning.[95]

IV. THE PRENUPTIAL AGREEMENT

NAFTA is an agreement facilitating free trade, but includes caveats and exceptions that limit the amount of free trade.[96] It is instructive to look at the text of the agreement to see if any country either put itself in a better position to profit or set itself up for economic heartache.

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87. *See* SAMUELSON, *supra* note 52, at 61-62.
88. *See* GILPIN, *supra* note 34, at 214-15. An oligopoly is characterized by a highly concentrated market, usually only with a few large firms. *See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE § 1.5(c) (1st ed. 1994).
89. GILPIN, *supra* note 34, at 215.
90. *See* HOVENKAMP, *supra* note 88, at 307-14.
91. *See* SOWELL, *supra* note 61, at 377-78. *See generally* ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (1978) (discussing predatory tactics within the scope of antitrust economics).
92. GILPIN, *supra* note 34, at 214-16.
93. An optimum tariff can be accomplished by restricting imports and decreasing the demand for a product, thereby allowing a nation with sufficient market power and a large economy to be able to cause the price of the imported good to fall. *Id.*
94. *Id.* at 216-17.
95. *See id.* at 217.
96. North American Free Trade Agreement, Dec. 8-17, 1992, 32 I.L.M. 289.

A. What Did We Agree To? The Terms

NAFTA is a two thousand page document, but the important aspects are easy to recognize. Most importantly, the agreement put the "free" in free trade by incrementally reducing and eliminating tariffs and quotas over a period of up to fifteen years.[97] Another major aspect is the so-called *Rule of Origin*.[98] This rule asserts that only the goods made in North America will qualify for the reduced or eliminated tariffs; however, the rule also applies if the goods or materials are substantially transformed in the hemisphere.[99]

Textiles and apparel attempted to leave their industry better protected than most: the goods have to be made from North American spun-yarn or from fabric woven from North American fibers.[100] Importantly, if there are prospects of serious damage to the industry, quotas could be reimposed temporarily.[101]

To no one's surprise, agricultural concerns also are taken into account and NAFTA protects more heavily politically sensitive crops in both countries.[102] The countries agree not to lift the tariffs on corn, sugar, citrus fruit (United States), peanuts, and orange juice (Mexico) for fifteen years.[103]

Foreign direct investment was encouraged by more favorable treatment of foreign investors, subject to restrictions on the American airline industry, American radio industry, the Mexican energy sector, Mexican railroads, and the Canadian cultural industry.[104] Furthermore, foreign investment, that was previously restricted in Mexican banks, and insurance and brokerage firms, would be lifted over the next seven to fifteen years.[105] Mexico also allowed American businesses to invest in most petrochemical and electric-generation sectors, subject to certain restrictions on oil and gas exploration.[106]

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97. *The Agreement's Key Provisions*, WALL ST. J., NOV. 18, 1993, at A14 [hereinafter *Key Provisions*]. *But cf.* James Sheehan, Editorial, *Nafta-Free Trade in Name Only*, WALL ST. J., Sept. 9, 1993, at A21 (arguing the *Rule of Origin* is too strict as the side agreements create environmental and labor bureaucracies and regulations and impede on national sovereignty).
98. *See Key Provisions*, *supra* note 97, at A14.
99. *See* Sheehan, *supra* note 97, at A21 (arguing that the rules of origin are too strict).
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.*; *see also* Calmes, *supra* note 44, at A10.
104. *See Key Provisions*, *supra* note 97.
105. *Id.*
106. *Id.*

B. What Did We Agree To? The Conditions

In concessions to the environmental and labor lobbies, President Clinton agreed to side agreements and established an oversight agency for each area.[107] The environmental agency, headquartered in Canada, has the authority to investigate claims of "environmental abuse" and punish violators with fines or trade sanctions.[108] The labor board, headquartered in Washington D.C., is charged with investigating labor abuses in areas such as minimum wages, child-labor, and worker safety rules, and may also punish violators in a similar manner.[109]

There were efforts to reduce any possible negative effects of the agreement. For those workers who would lose their jobs as a result of NAFTA within the first year and a half of its implementation, the agreement budgeted $90 million for job retraining and financial aid.[110] Border areas along the Rio Grande (Rio Bravo in Mexico) were an area of concern to environmentalists.[111] The environmental lobby secured a provision setting up the United States-Mexico Border Environmental Commission, slated to receive $8 billion from the North American Development Bank (NADB) in order to cleanup polluted areas.[112] The NADB would also "borrow $3 billion and lend the money to aid communities hurt by the agreement and to help clean up border areas."[113]

V. A SHORT HONEYMOON

Less than a year into NAFTA, its supporters, economists, and laymen claimed victory.[114] One NAFTA expert, who predicted great things if NAFTA passed, did try to temper the enthusiasm by writing, "[d]efinitive answers based on experience can't yet be given."[115] And they could not be, but there were already signs of the positive and negative effects that accompanied free trade.

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107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.*
111. Cindad Juarez, *See More Muck Than Money*, THE ECONOMIST, Oct. 16-22, 1993, at 50.
112. *See Key Provisions*, *supra* note 97, at A14.
113. *Id.*
114. Gary Hufbauer, Essay, *NAFTA Has Delivered—Just as Its Supporters Said It Would: I Was Right*, WALL ST. J., Oct. 28, 1994, at R13.
115. *Id.*

U.S. companies quickly expanded into the Mexican market, some growing at a fantastic rate.[116] After the tariffs took effect on January 1, 1994, trade between the United States and Mexico increased by $3.5 billion during the first two quarters of that year.[117] Foreign direct investment by U.S. companies also increased, causing Mexican companies to become more competitive.[118] American consumers, economists estimated, would save $600 million in 1994 because of NAFTA.[119] Gross job losses, not taking into account those jobs gained from increased imports, numbered only 10,000, only 1% of Perot's calamitous prediction.[120]

The portents were not all hopeful. Many small and medium sized Mexican businesses began to face stiff financial pressures with a significant number of businesses eventually succumbing to the increased American presence.[121] Companies in sectors traditionally protected by the Mexican government, e.g., the air travel industry, were sent into a "financial tailspin."[122] In the United States, generally low-skilled workers with few other opportunities faced unemployment.[123]

These were all to be minor setbacks relative to the Mexican Peso Crisis of 1994-95. Even though the economic meltdown could not be attributed to NAFTA,[124] this did not stop NAFTA's critics from attempting to portray it this way.[125] Without lapsing into economists' jargon, poor economic policy on the part of the Mexican government precipitated the crisis.[126] Professor Robert Gilpin writes:

116. *See* Bob Davis, *Going South: With More Opportunities and Greater Confidence, U.S. Businesses Are Expanding into Mexico*, WALL ST. J., Oct. 28, 1994, at R4; *see also* Robert Keatley, *Reaping the Benefits: A Look at Some U.S. Companies Poised to Take Advantage of Nafta*, WALL ST. J., Oct. 28. 1994, at R4.

117. *See* Keatley, *supra* note 116.

118. *See id.*

119. *See* Hufbauer *supra* note 114.

120. *See id.*

121. Dianne Solis, *The Small Shall Suffer: With Big U.S. Companies Turning up the Competitive Heat, Mexico's Family-Run Stores Are Being Squeezed*, WALL ST. J., Oct. 28, 1994, at R10.

122. *Id.*

123. Raju Narisetti, *Not Everybody Wins: Nafta May Be a Success So Far: But Don't Tell That to These Workers*, WALL ST. J., Oct. 28, 1994, at R10.

124. Sandra Polaski, *Jobs, Wages and Household Income*, *in* NAFTA'S PROMISE AND REALITY, *supra* note 25, at 24.

125. *See* BHAGWATI, *supra* note 34, at 11.

126. The Federal Reserve raised interest rates which reduced the capital inflow to Mexico in 1994. Polaski, *supra* note 124, at 19. In addition, there was a political revolt in the Chiapas region and a Mexican presidential candidate was assassinated. *Id.* The Mexican government decided, the lowlight in a series of poor fiscal decisions, to transfer nearly all public debt to three-month bonds. *Id.* Investors, suspecting (rightly so as it turned out) problems, made a run on the

> The 1994-1995 Mexican crisis was made worse by the poor information about Mexican financial conditions supplied by the Mexican Government to the IMF and investors. For example, the size of both Mexico's financial reserves and its external debt were kept secret.[127]

The Clinton Administration orchestrated a $40 billion bailout,[128] without which the crisis would have surely spread to other Latin American markets and further beyond.[129]

VI. WOULD WE DO IT ALL OVER AGAIN?

The enormous size of the American economy, especially in relation to Mexico, seems to have been lost in the polemics during the NAFTA debate. This is important because basic economic principles would show that trade with Mexico would have little to no real impact on America's macroeconomic situation. A 1993 study accurately predicted that the United States economy would be 0.6% larger in 2003 than it otherwise would be without NAFTA.[130]

The Carnegie Endowment for International Peace (Carnegie) conducted a study to determine NAFTA's effects after ten years and concluded that there were negligible positive effects on the American economic machine.[131] The study indicated that in the United States, the best models to date suggest that NAFTA has caused either no net change in employment or a very small net gain of jobs.[132] Furthermore, the widening gap between the wages of skilled and unskilled workers is due, at least in part, to trade with Mexico.[133]

The Carnegie report posits that even though there has been job growth, the net gain in employment has been weakened by loss of jobs in the agricultural industry.[134] The study reported:

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peso. *Id.* By the end of 1994, the peso had depreciated over fifty-five percent once the government announced a floating exchange rate. *See id.*; GILPIN, *supra* note 34, at 274.

127. GILPIN, *supra* note 34, at 274.

128. *Brinksmanship*, THE ECONOMIST, Jan. 28-Feb. 3, 1995, at 68 (stating that the $40 billion was in the form of loan guarantees).

129. *See* GILPIN, *supra* note 34, at 263.

130. Bob Davis, *Some Questions and Answers on Nafta*, WALL ST. J., Nov. 17, 1993, at A14.

131. *See* Polaski, *supra* note 124, at 12.

132. *Id.*

133. *Id.* It should be noted that the study further concluded that NAFTA has almost no effect on worker productivity in the United States because of low American tariffs and the negligible amount of trade conducted with Mexico as opposed to the rest of the world. *Id.*

134. *Id.* Although there was job growth in the manufacturing sector, this was largely offset by the many farm workers whom NAFTA displaced. *Id.* at 14-15, 17, 20.

> Mexican agriculture has been a net loser in trade with the United States, and employment in the sector has declined sharply. U.S. exports of subsidized crops, such as corn, have depressed agricultural prices in Mexico. The rural poor have borne the brunt of adjustment to NAFTA and have been forced to adapt without adequate government support.[135]

Even worse, real wages in Mexico are *less* than they were pre-NAFTA; however, this is due to the Mexican Peso Crisis, not NAFTA.[136] Economic trade theory tells us that wages in the lower wage country (Mexico) should converge with wages of that in higher wage country (United States).[137] However, there has been an internal divergence of wages in Mexico, although the study attributes this mostly to the 1982 and 1994-1995 Mexican financial crises.[138] The report continues stating that other possible causes include competition from China and other low-wage countries along with Mexican governmental programs that intentionally keep wages down.[139]

The Carnegie report attributes most of the job growth in the manufacturing sector to the *maquiladoras* (export assembly plants).[140] This sector added 800,000 jobs between 1994 and 2001, and then 250,000 jobs were lost within two years.[141] Therefore, while there has been an increase of 550,000 jobs in this sector, the recent loss of nearly a third of those jobs is probably due to increased membership in the World Trade Organization (WTO).[142] Moreover, in 2003, "China displaced Mexico as the second-largest exporter to the United States (after Japan)."[143]

In the non-*maquiladora* manufacturing sector, overall employment declined between 1994 and 2003.[144] Nearly ten years after NAFTA's inception, there were 100,000 fewer jobs in this sector than before, after a growth peak of 91,000 jobs in 2000.[145] The report attributes the recent

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135. *Id.* at 12.
136. *Id.*
137. *See* GILPIN, *supra* note 34, at 184.
138. *See* Polaski, *supra* note 124, at 24. However, Mexican wages had been converging internally from 1940 to 1980, began to diverge following the debt crisis in 1982, converged again for a short time, and then began to diverge again. *Id.* at 26.
139. *Id.* at 25.
140. *Id.* at 15-16.
141. *Id.* at 15. It is noteworthy that the *maquiladora* program dates back to 1965 and was created to "allow tariff-free and tax-free imports of materials and components into Mexico for assembly and re-export to the United States." *Id.*
142. *Id.* at 15-17.
143. *Id.* at 17. Probably feeling much like a jilted lover, Mexico was the last country to agree to allow China membership in the WTO.
144. *Id.*
145. *Id.*

job depletion to the recession in the United States, as the two economies have become increasingly integrated following NAFTA.[146]

The report further analyzes NAFTA's effects on Mexico's environment. Although those environmental groups who predicted economic disaster were misguided, it appears that NAFTA has had some pernicious environmental effects.[147] Because the Mexican government either did not foresee or refused to foresee that NAFTA's provisions opening up the agricultural markets would likely displace rural, subsistence farmers (*ejidos*) and has not properly dealt with the problem,[148] many of these farmers have begun farming "more marginal land, a practice that has resulted in an average deforestation rate of more than 630,000 hectares per year since 1993."[149] Unfortunately, this land is some of the most biologically diverse land in the world.[150]

The report also indicates that NAFTA seems to be the cause of increased nitrogen runoff pollution.[151] This source of pollution "is also the leading cause of eutrophication and algae blooms affecting Mexico's rivers and lakes, the Sea of Cortez, and the Gulf of Mexico."[152]

VII. AVUNCULAR ADVICE

A. Seeing the Trees

After reading through the literature, it is astounding that the main problems that have resulted from NAFTA were not noticed before the agreement took effect. The two major problems spawned by the agreement are the plight of the rural subsistence farmers and the concomitant environmental issues.[153] The two are integrally related: because neither the Mexican Government, nor NAFTA itself, provided any alternatives, aid, or job and skills retraining, the subsistence farmers took the requisite survival steps; unfortunately, this includes slash-and-burn farming on some of the most ecologically diverse land left in the world.[154]

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146. *Id.*

147. *See* Audley, *supra* note 25, at 6.

148. *See* Polaski, *supra* note 124, at 17, 20.

149. *See* Audley, *supra* note 25, at 6.

150. *See* Scott Vaughan, *The Greenest Free Trade Agreement Ever?*, *in* NAFTA'S PROMISE AND REALITY, *supra* note 25, at 64.

151. *See id.* at 62. It is noteworthy that the largest source of pollution in North America is nitrogen runoff. *Id.*

152. *Id.*

153. *See supra* notes 125-152 and accompanying text.

154. *See* Polaski, *supra* note 124, at 52; *see also Vaughan*, *supra* note 150, at 62.

As this Comment has shown, free trade creates winners and losers. It should not have been difficult to predict that opening up the Mexican agricultural market to the heavily subsidized American agricultural market would produce a shock to the Mexican market.[155] Unfortunately, the situation looks as though it will get worse before it gets better. Mexican President Vicente Fox, instead of making the tough, but wise policy decision to allow the markets to work, chose to ratchet up the agricultural subsidies to assuage the agriculture lobby.[156] When the tariffs on corn, which is a staple crop in Mexico, are fully eliminated in 2008, it is probable there will be even more displaced or marginalized farmers.[157] With three million corn farmers, each averaging five dependents, it is imperative that Mexico address the problem.[158] But, as *The Economist* bluntly put it, "Don't hold your breath."[159]

The proposal here, lest it be misconstrued, would not merely be to let the markets work. Although this certainly needs to happen (as does cutting back on wasteful agricultural subsidies) it is the right and humane thing to protect those workers displaced by NAFTA with a social welfare safety net. The Mexican Government could take the money earmarked for the agricultural subsidies and use it to implement a job skills retraining program for the rural subsistence farmers to allow them to function in an increasingly global economy. There should also be aid provided to the farmers and their dependents while they go through the painful transition phase.[160]

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155. *See generally Farm Subsidies: Ploughshares into Carving Knives*, THE ECONOMIST, Oct. 7-13, 1995, at 28 (discussing current crop subsidies and their futures).

156. *See Floundering in a Tariff-Free Landscape*, THE ECONOMIST, Nov. 30-Dec. 6, 2002, at 31. It is also noteworthy how beholden the government is to the agricultural lobby in the United States. For example, Americans pay $1.9 billion a year in inflated prices for products containing sugar, while the sugar lobby makes large campaign contributions to both Democrats and Republicans. The United States government also pays $1.4 million per month to store the excess sugar produced. *See* David Barboza, *Sugar Rules Defy Free Trade Logic*, N.Y. TIMES, May 6, 2001, at 1. Congress passed a farm subsidy bill in 2002 estimated to cost "the average American family more than $4,000 over the next decade in taxes and inflated food prices." SOWELL, *supra* note 61, at 36. Until America rids itself of the romantic, but inaccurate, notion of the contemporary farmer as a Jeffersonian yeoman, and yields to an accurate conception, that of a large corporation such as Archer Daniels Midland, these subsidies will likely continue.

157. *Floundering in a Tariff-Free Landscape*, *supra* note 156, at 32.

158. *Id.*

159. *Id.*

160. *But cf.* Vaughan, *supra* note 150, at 81. Mr. Vaughan assumes that because of the "strong pull that southern farmers, indigenous peoples, and communities in the region feel toward their land, providing grants for employment training and relocation—even if financing were available—would not break the circle of poverty and environmental degradation." *Id.* The author of this Comment respectfully disagrees. The author cannot see how the "pull" of the land is any greater for the Mexican farmers than it was for those agricultural workers displaced generation by generation as the Industrial Revolution spread throughout the United States and Western Europe.

Likewise, by allowing those rural farmers who were displaced by the influx of American agriculture to make their living in ways other than slash and burn farming, this would help eliminate deforestation of the biologically diverse and ecologically important land in southern Mexico.[161]

The nitrogen runoff pollution does not seem to have been a problem in Mexico until the large farming interests, pressured to keep pace with the Canadian and American agricultural sectors, began to "overappl[y] . . . nitrogen, phosphorous, and other agrochemical inputs."[162] While NAFTA may be strictly to blame, this problem seems to have equally resulted from modern farming practices.[163] It is under publicized that nitrogen runoff pollution is the *largest* source of pollution in North America.[164] Simply condemning free trade as an environmental scourge would miss the point. A more productive course of action is to use the media to highlight the problem and bring it to lawmakers' attention. This may result in more money for research and may stimulate efforts to slow this source of pollution.

B. Seeing the Trees and the Forest

The Seattle protests at the 1999 WTO meetings, and their part in ending the meetings early and without any new trade agreements, represents an unfortunate misunderstanding of free trade and globalization, just as those who vociferously decried NAFTA displayed their ignorance.[165] For example, it is obvious that the major concerns of the environmental groups, air and water pollution, hazardous waste, global warming, and carbon dioxide emissions, are of pressing importance. However, it is not readily obvious how these concerns implicate free trade, save for global warming and the pollution of

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As referenced earlier, in the United States the overly romantic conception of the farmer as Jeffersonian yeoman retains a persistent presence in American mythology when in reality the vast majority are large corporate interests. *See supra* note 156 and accompanying text. Was this "strong pull" of the land, that still exists today, any less for those American and Western Europeans farmers than those farming in southern Mexico? Moreover, the financing *could* be available if the Mexican agricultural subsidies, which range in the billions of dollars, were scaled back. *See Floundering in a Tariff-Free Landscape*, *supra* note 156.

161. *See* Vaughan, *supra* note 150, at 62-64.

162. *Id.* at 62.

163. *Id.*

164. *Id.*

165. When the protesters first arrived in Seattle leaders briefed them on the "evils" of globalization and their attendant perfidy in a "plush symphony hall whose benefactors had made their money from exports." *The New Trade War*, THE ECONOMIST, Dec. 4-10, 1999, at 25.

international waters.[166] As Professor Gilpin notes, "almost every environmental issue can be most effectively dealt with on a domestic or regional basis."[167] Moreover, the WTO has no authority to "fix" these environmental problems.[168]

And it is also true, as anyone with an antiglobalization bent would emphasize, that MNCs are of global importance.[169] But again those in the antiglobalization camp exaggerate: MNCs are not "integrating societies into an amorphous mass in which individuals and groups lose control over their own lives and are subjugated to the firms' exploitative activities."[170] Nor have MNCs grown to become more powerful than governments and nation-states, as many in the movement believe.[171] Nation-states still regulate companies with their laws and the vast majority of foreign direct investment by MNCs is still highly concentrated in Europe and the United States, with only a small amount going to the least developed countries.[172]

The point here is that in allowing those with a simplistic and ill-informed world view to dominate the free trade debate, the people who will end up worse off in the end are the people the antiglobalization contingent ostensibly tries to protect.[173] If countries like Mexico are to join the ranks of the advanced developed countries, the protectionism of closed markets, as economists have demonstrated, is not the answer.[174] While free trade is neither a panacea nor a virus for developing countries, it remains a worthwhile goal.

166. *See* GILPIN, *supra* note 34, at 227.

167. *Id.*

168. *Id.*

169. *See id.* at 289-92.

170. *Id.* at 291.

171. *Id.*; *see also Face Value: Why Naomi Klein Needs to Grow Up*, THE ECONOMIST, Nov. 9-15, 2002, at 70 (arguing that Klein's criticisms are illogical and naive).

172. *See* GILPIN, *supra* note 34, at 289, 291.

173. Moreover, it is hard to suspend cynicism and believe that the trade unions truly care about workers' conditions in a given LDC as opposed to merely protecting themselves from foreign competition.

174. It is important, however, to note the limitations of economics. The world does not exist in an economic vacuum, and economists' models do not take into account the decisions of governments or actors who may not always act rationally. Nevertheless, there is no doubt that the economies of LDCs are better off with free trade than without it. For a thorough explanation of the limitations of economics, see GILPIN, *supra* note 34, at 60-69.