The North American Free Trade Agreement Expanded Trade but Did Not Deliver Job Growth or Shared Prosperity

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As the U.S. Congress debates whether to expedite another round of major international trade agreements, what do we know about how similar pacts worked out in the past? Twenty one years after its start in 1994, the North American Free Trade Agreement offers the best evidence we have. This pact among the United States, Canada, and Mexico created the world's largest free trade area and has been unquestionably successful in expanding cross-border commerce. Over two decades from 1993 to 2013, total merchandise trades between the United States and Mexico increased almost six-fold – from $80 billion to $459 billion.

But expanded trade was not an end in itself. Trade growth was supposed to generate new jobs, lift incomes, and stimulate economic development. Unfortunately, research shows that twenty years of expanded trade between the United States and Mexico has produced disappointing results for the larger goals that count. The North American Free Trade Agreement stands as a cautionary tale about what could unfold after similar pacts to further unleash global trade.

Successful Trade Expansion without Projected Benefits

As part of his effort to persuade Congress to pass the North American Free Trade agreement in 1993, President Bill Clinton predicted that exports from the United States to Mexico would boom, generating a million U.S. jobs in five years. Backing up Clinton's claim about American job growth, supportive economists predicted a trade surplus for the United States in its dealings with Mexico – that is, they estimated that U.S. exports were projected to exceed its imports from Mexico.

Unfortunately, these optimistic predictions were not borne out – U.S. trade with Mexico went from a slight surplus in 1994 to an almost $100 billion deficit in 2013. As a result of this trade imbalance, the Economic Policy Institute estimates that instead of the million new jobs that President Clinton promised, 700,000 U.S. workers ended up being displaced.

- For Mexico, the results seem at first glance to be more positive. The expansion of exports to the United States has stimulated the growth of more advanced manufacturing technologies and led to the creation of new jobs in export manufacturing. However, a closer look at the effects of the North American pact on the Mexican economy reveals a less positive story, because as Mexico's trade surplus with the U.S. has grown, its trade deficit with China has exploded. These two trends have unfolded together because almost three-fourths of Mexico's manufactured exports to the United States are products assembled from imported parts and components. Only three percent of the exports from Mexican border plants are assembled from sources within Mexico.

For Mexico and the United States alike, in short, trade expansion has been only weakly connected to domestic economic growth, a disturbing fact given all the rosy promises at the time the North American Free Trade Agreement was instituted.

Rising Productivity and Declining Wages

As the United States and Mexico share expanded trade across their border, both countries have also experienced a waning connection between trends in economic productivity and wages. Productivity has gone up as trade has expanded, but wages have stagnated or even declined.

By 2011, productivity in the United States had risen to about 170% of what it was when the North American Free Trade Agreement was instituted. But the average U.S. worker has not reaped much benefit from this improvement in the productivity of the economy. Real hourly compensation for American workers rose by only about 16% in the same period.

In Mexico, the relationship has been even more disappointing. By the time the North American trade agreement was implemented in 1994, Mexican manufacturing wages had been declining for more than a decade – they were 30% below what they had been in 1980. To counter domestic opposition to the agreement, Mexican politicians relied heavily on claims that more trade with the United States would reverse the prior wage deterioration.

We now know that, like President Clinton's promises about job creation, the arguments from Mexican trade supporters were based on the false assumption that trade expansion would automatically lead to rising wages. Expanded trade certainly helped stimulate new investment, and the adoption of more advanced manufacturing technologies in Mexico helped, in turn, to generate increases in productivity. Labor productivity in Mexican manufacturing rose by 76% between 1994 and 2011. However, when adjusted for inflation, typical hourly compensation for Mexican manufacturing workers did not improve. As a matter of fact, in 2011 wage compensation was 20% below what it was at the start of the North American Free Trade Agreement – not at all what had been projected by boosters of the pact.

Cautionary Lessons from the Past

What can we learn from this historical experience? The most important lesson is straightforward: trade expansion should not become an end in itself. In all countries that are party to possible pacts, the real stakes for citizens lie in more and better jobs, in economic growth that benefits most workers and families. Experience with the North American Free Trade Agreement shows that trade may very well grow without spurring more jobs or ensuring shared prosperity. Proponents of unleashing ever more trade across borders invariably claim that new pacts will "lift all boats," helping workers on both sides of the border. But the record shows that such rosy thinking was misplaced for the North American Free Trade Agreement. Now, the same misplaced optimism may be in play again. Rather than rush into new rounds of disappointing decisions to vastly expand global trade, Americans need to be sure their elected legislators support only the kinds of international agreements that truly encourage prosperity for all.

Read more in Harley Shaiken, "The NAFTA Paradox." *Berkeley Review of Latin American Studies* (Spring 2014).