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FAST TRACK, FAST SHUFFLE

THE ECONOMIC CONSEQUENCES OF THE ADMINISTRATION'S PROPOSED TRADE AGREEMENT WITH MEXICO

By Jeff Faux and Richard Rothstein

Introduction

The Bush Administration has notified the Congress of its intention to negotiate a Free Trade Agreement (FTA) with Mexico and its desire to have the ratification of such an agreement put on a special legislative "fast track." The legislation authorizing a fast-track for trade treaties -- originally intended for GATT agreements -- expires this Spring. Congress must act by June 1 to decide on a renewal of fast-track authority and whether to allow its use for the Mexican FTA.'

The immediate question before the Congress is ostensibly procedural, but in practical terms, a *decision on fast track is also a judgment on the specific version of a U.S.- Mexico agreement that the Administration intends to negotiate.* Once the Congress has agreed to fast track, its options and powers will be severely limited. Amendment is impossible, and rejection is improbable, inasmuch as it will be seen as an affront to Mexico and Canada and an undermining of U.S. international credibility.

* The Mulroney Administration in Canada, with whom the U.S. now has a free trade agreement, has recently agreed to join the talks. But the critical question for the Congress is the U.S.-Mexican economic relationship, to which this report is addressed.

Thus, the decision on fast-track implies an answer to two questions:

1. Is the Administration's notion of an FTA obviously so good that the risks of rushing into a major policy blunder are negligible?

2. Are the consequences of rejecting the fast track so dire as to justify the risks of a rush to approval?

An examination of the evidence clearly leads to a negative answer to both questions.

As the following analysis shows, the potential economic costs vastly outweigh the potential benefits, and major damage both to U.S. competitiveness and to balanced economic development in Mexico is the logical outcome. The FTA as presently conceived will mean a net loss of income and employment to substantial numbers of U.S. working families, a significant shift of U.S. production to Mexico and a weakening of U.S. environmental, health and safety standards. Over the long run, it will encourage U.S. producers to meet international competition not by improving their products and productivity, but by reducing the wages -- thus, the living standards -- of the U.S. workforce. By making, in effect, low wages in Mexico the centerpiece of U.S.-Mexico integration, an FTA could cause living standards for working people in both nations to decline.

The eventual integration of the economies of North America is potentially a worthy goal. But it is a complex and risky task and must be carefully designed to support prosperity in both nations, rather than undermine it. Thus, the FTA negotiations should only take place in the context of broader economic development strategies for both nations. To permit careful consideration of these complex issues, fast *track should be* ***denied.***

The FTA and Abstract Theory

Much of the argument in favor of the U.S.-Mexico Free Trade Agreement is simply a restatement of the theory that free trade always brings benefits to both parties. As most economists understand, economic theory guarantees such an outcome only when certain ideal conditions are satisfied (full

employment, absence of economies of scale, static comparative advantages, and frictionless entry to and exit from markets).' Inasmuch as these conditions are rarely met in the real world, whether freer trade will result in net costs or net benefits depends on the specific case.

FTA proponents often point to the experiences of South Korea or Taiwan as examples of the potential of the Mexican economy for rapid growth based on free trade with an export orientation. But actual experience suggests the opposite conclusion. Nations like Korea and Taiwan grew by keeping their domestic markets protected from outside competition, by keeping wages artificially low, by tight controls over capital investment, and with heavy government subsidies, including aid from the United States. If East Asia is the theoretical inspiration for Mexican development, then the free trade model does not apply.

Ironically, the inadequacy of free-trade theory as a guide to the costs and benefits of the Bush Administration's FTA is reflected in the most comprehensive case for the FTA -- the report of the U.S. International Trade Commission (ITC), to the House Ways and Means and Senate Finance Committees in February, 1991.[2] On the basis of a general belief in free trade, the report asserts that an FTA will benefit the U.S. economy overall by "expanding trade opportunities, lowering prices, increasing competition, and improving the ability of U.S. firms to exploit economies of scale," and that these benefits "are likely" to outweigh the costs. But the actual analysis made by the ITC of the specifics of U.S.- Mexico economic integration leads to the opposite conclusion, i.e., that the costs will far outweigh the benefits.

The Illusion of Gains from Exports

Despite its assertions, the ITC study quantifies neither benefits nor costs. It gives us no numbers on job or income gains or losses. This is clearly because the researchers understand that no such numbers are credible. Other proponents have not been so careful: Professor Rudiger Dombusch, for example, told the Senate Finance Committee that "Assuming that Mexico runs

a trade deficit of 2 percent of GNP, U.S. job creation over the next five years could be as high as 150,000."[3]

But no U.S. export "boomlet" is likely to occur. The ITC's own analysis tells us why. First, despite a population of almost 90 million, the overwhelming bulk of the Mexican people, suffering from high unemployment and low wages, simply do not have the purchasing power to consume many American-made products. Mexico's money economy is tiny: As a share of U.S. Gross Domestic Product, Mexico's GDP in 1989 was 3.6 percent.

Secondly, U.S. export gains from an FTA will be small because most trade between the two nations is already free as a result of trade liberalization begun in 1986. Today, Mexico's average tariff is only 6 percent. Non-tariff barriers have also been dismantled. Only 19 percent of Mexican import value now requires import licenses, down from 100 percent just ten years ago.[4] The trade liberalization of the last five years released the pent-up demand for U.S. consumer goods by the small Mexican middle class, whose purchases of U.S. goods had previously been restricted by import barriers. As a result, between 1986 and 1989, U.S. exports rose and our trade deficit with Mexico narrowed from 4.9 to 2.2 billion dollars. As the ITC concludes, this argues against further dramatic expansion in the future because these gains have already been made.

The very small potential of the Mexican market is illustrated by an ITC scenario, which assumes that the Mexican economy would grow by an extraordinary 2 percent per year because of an FTA. This works out to a net increase in U.S. exports over 20 years of a minuscule 0.16 percent of U.S. Gross Domestic Product.' This figure is less than the measurement error that exists in the estimate of the U.S. GDP. Claims that such a tiny market will create "new economies of scale" for American export firms are simply not credible.

The Reality of Losses from Imports

The negative impact of an FTA on U.S. jobs and income has been grossly understated by Administration supporters. Proponents' assertions that short term losses for U.S. workers will be made up by long term gains are contradicted by the evidence, which indicates that the losses be widespread and hurt some people substantially -- particularly those working families who already suffered real wage decline in the 1980s. As U.S. companies shift more of their production to Mexico, these losses will grow more severe with time.

A. <u>Low-Wage Production</u>

Proponents claim that losses will be limited to a few, primarily low wage sectors of the U.S. economy (e.g., apparel, glass, fruits, vegetables, and trucking). But according to the IX! report, "unskilled workers in the United States would suffer a slight decline in real income." The ITC does not quantify the words "slight decline" nor does it tell us exactly how many people it thinks will be affected, but no one should be misled by the term "unskilled." According to the definitions used by the ITC study, *this* refers to 73 percent of all U.S. workers!'

The report goes on to say that U.S. "skilled workers and owners of capital services would benefit more from lower prices and thus enjoy increased real income." Thus, the trade-off is between loss of jobs and incomes for three-fourths of the U.S. workforce on the one hand and lower consumer prices for the highest income Americans on the other (ITC Report, pp. 2-6).

Among the workers who would be hurt most are the poorest and least mobile. The U.S. apparel industry, for example, while declining under pressure of import competition, still employs over 1 million workers who are disproportionately disadvantaged minorities, immigrants, and rural Americans for whom there are few alternatives. Also hurt would be the large number of U.S. workers who have suffered major real income losses over the past decade, particularly the three-quarters of the U.S. workforce without a college degree. Between 1979 and 1987 (the last year for which data are available), the real

income of families headed by high school graduates aged 25-34 dropped 7 percent. Among white male high school graduates with one to five years' work experience, the drop in real weekly wages was 18 percent. Given the steady decline in real wages for American workers since 1987, we know that the economic squeeze among young working families is now even worse.

Proponents claim that the jobs lost to Mexico from an FTA are being lost anyway -- to Asia. Since Mexicans are likely to use their earnings to buy more U.S. goods than are people in Korea, Taiwan, Hong Kong or Singapore, the U.S. economy is better off if the jobs are lost to Mexico, according to this argument.

There is no evidence to support the assertion that a Mexican FTA would divert sufficient U.S. imports from Asia to Mexico to a greater extent than it would divert production from the U.S. to Mexico. Wages in the principal developing countries of Asia are already higher than in Mexico. In 1988, average hourly earnings (including fringe benefits) in the *maquiladora* zone were $0.98.' In Singapore they were $3.09; in South Korea they were $3.57: and in Taiwan, $3.53.[8] And there are obvious substantial transportation, communication, and response time advantages to producing in Mexico now.

B. Higher Wage Production

The lure of low wages is not limited to low-wage U.S. industries. When the *maquiladora* zone was established 25 years ago, the major activity was sewing garments. Today, less than 10 percent of *maquiladora* workers are in the apparel trades. Almost 40 percent work in electronics. Another 20 percent make transportation equipment (mostly autos).[9] Mexico now possesses automobile manufacturing plants as technologically advanced as any in the world. Their use of Mexican parts, including engines and transmissions, increases steadily. IBM, Hewlett-Packard, Wang, and Westinghouse are also among the major employers.

Maquiladora enterprises typically began with labor-intensive assembly operations. As management and labor skills improved, capital became

available and Mexican industry is now moving up along the route that producers in Singapore, Taiwan, Korea, and now China have followed: establishing secure, low-wage, labor-intensive apparel and electronic assembly industries as the customer base for the development of increasingly sophisticated higher technology industries up the supplier chain.

Intellectual property protection in Mexico will further encourage the relocation of high-tech production there. It will also make US. manufacturers feel more secure about transferring technology to their Mexican operations. U.S. pharmaceutical firms (whose domestic employment will grow, according to proponents], for example, see potential for the expansion of their manufacture of pharmaceuticals in Mexico, once intellectual property reform is enacted."

C. bosses from Shifting Investment

The ITC calculation of a negative impact on almost three-quarters of the U.S. workforce is even more dramatic when we consider that the Commission -- like virtually all of the proponents -- ignored the impact of the most important factor impacting U.S. living standards: the shift of U.S. investment to Mexico.

Despite its name, the primary purpose of a Free Trade Agreement for governments in both Washington and Mexico City is not to ease restrictions on the flow of trade: it is to increase the ability of U.S. multinational corporations to shift production to Mexico while keeping free access to the U.S. market.

Trade is already largely free. As Mexico has liberalized trade barriers, so has the U.S.. Tariffs on Mexican goods average about 3 1/2 percent, while half of all Mexican exports already enter the United States almost duty free (see ITC Report, February 1991, pp. l-5).

Mexican restrictions on foreign investment -- with the major exception of petroleum and extractive industries -- have also been liberalized. Some restrictions remain. But more importantly, multinational corporations are reluctant to make the massive long-term investment in plant and equipment needed to take full advantage of cheaper costs in Mexico because of concern

over the political climate. Specifically, they fear a return of popular hostility to foreign investment and the threat of nationalization. Their solution is to put the rights of foreign investors into an international treaty that any future Mexican government would **find difficult** or impossible to change. As the ITC report notes: "by codifying liberal trade and investment policies in an international agreement **...** a U.S.- Mexico **FTA** would increase the confidence of investors in Mexico's economy.""

Despite this admission and despite the fact that it credits out-sourcing to Mexico with reducing U.S. companies* labor costs, the **ITC** report ignores any impact that the elimination of these political barriers to U.S. investment would have on U.S. jobs and living standards. At one point, the Commission tells us that such investment will be limited because of the small size of the Mexican money economy. But as we have seen, it is not Mexico's tiny domestic market that is of interest to U.S. multinational manufacturers, it is the labor force of almost 30 million -- roughly 25 percent of the U.S. labor force -- willing to work for subsistence wages. In order for U.S. producers to enjoy that resource, Mexico must be made safe for long term foreign capital investment. Therefore, the need for a treaty.

Of course, if US investment in Mexico grows, we can expect some **shortrun** increases in exports of US capital goods needed to 'equip the new industrial plants (although certainly not all of the new machinery will be bought from the U.S.) But this will not lead to a sustained net trade surplus for the U.S. nor a net increase in income and jobs for U.S. workers. Because the purpose of investment in Mexico is primarily to serve the U.S. market, any gain in U.S. export jobs will be more than offset by losses to imports and from reduced capital goods sales to U.S. caused by the diversion of investment to Mexico. Over time, as the production facilities in Mexico expand, the losses to US workers will grow. Indeed, scattered throughout the **ITC's** report are warnings that if U.S. investment in Mexico ***does*** increase substantially, job and income losses will be much higher than the Commission has guessed and will extend to those U.S. industries that the ITC now assumes will be gainers from

the FTA, such as automobiles and machinery. For example, because the Big Three automakers* actual intentions are today "unknown" to the ITC, the report does not consider the potential impact of a future investment shift on U.S. employment. Likewise, the U.S. machinery and equipment industry is presumed to gain from the treaty. Yet the study admits: "In the long run, and assuming that an FTA does not result in the equalization of wages and health, safety, and environmental standards, U.S. firms may accelerate the process of producing more finished machinery and equipment in Mexico" (ITC Report, p. xv). As the next section shows, the ITC does not really expect anything like an equalization of wages from an increase of wages in Mexico and is mute on the subject of environmental standards.

By elevating the rights of U.S. investors to treaty status, an FTA would also encourage investment from other sources: non-U.S. multinational manufacturers interested in building plants in Mexico for the cheap labor and access to U.S. consumers. There are today some 24 Japanese production sites in the *maquiladora* sector, with 50 more in the planning stage.[12] Any security given to American investors by an FTA would undoubtedly extend to other foreign investors as well, giving Asian and Western European firms access to the U.S. market without them having to produce here. It also would open up the opportunity for transshipping products or components made elsewhere through Mexico to the United States. There is serious doubt that either indifferent Mexican trade regulators or an understaffed U.S. Customs Service would have the capacity to identify the Mexican value-added component of the increased amount of goods that will be coming across the border.

Will The Wage Gap Shrink?

The wage differential between U.S. and Mexican workers is very large -- at *least* seven to one.[13] Proponent claim that this will decline dramatically. Among others, Deputy U.S. Trade Representative Julius Katz testified before

Congress that “wages in Mexico would rise very rapidly in the face of free trade.”[14]

There is little evidence to support this optimism. Recent history suggests that wage levels in Mexico will not automatically increase with productivity and will depend far more on fiscal, monetary, and exchange rate policies than on a free trade agreement with the United States. Between 1982 and 1988 -- the period of Mexico’s debt crisis -- Mexican wages fell about 50 percent in real terms. Its per capita gross domestic product declined by about 12 percent, largely as a result of austerity required by the nation’s international creditors.[15] Mexican manufactured exports to the U.S. climbed at an average rate of 24 percent per year -- from $5 billion in 1982 to $18 billion in 1988.[16]

Despite this reality, proponents assert that as Mexican plants and workers reach U.S. levels of efficiency, the wage gap between the countries will automatically close. In his testimony before Congress, Professor Dombusch said: “Although Mexican labor costs are low in relation to those in the U.S., these labor costs also reflect a low level of productivity.“” But the overwhelming evidence is that wage differences between the U.S. and Third World nations far exceed productivity differences. One case study of automobile engine production, for example, showed Mexican plants operating at 80 percent of U.S. productivity while wages were 6 percent of U.S. rates.” Professor Dombusch himself previously noted a weakness in the theory: “[one] argument that used to be advanced is that low wages in the NICs reflect low levels of productivity. That, too, is now understood to be wrong in many cases. Productivity levels in many industries are at the U.S. levels, but wages are only one-tenth of our level.”[19]

Again, in its effort to make the best possible case, the ITC study is instructive. The only evidence for any narrowing of the wage gap at all is an old estimate that elimination of trade barriers that existed between the two nations in the 1960s would have reduced the U.S.- Mexican wage gap by 18 percent (ITC Report, pp. 2-5, 2-6). But even an 18 percent reduction would

still leave a huge wage gap. This estimate was made before the liberalization of the mid-eighties had eliminated most of the trade restrictions. In today's climate, even according to the ITC, the ratio of real U.S. to Mexican wages of skilled and unskilled workers combined would fall by "much less" than 18 percent.

Mexico's vast surplus labor pool will continue to restrain workers' wages. One million new jobs must be created each year just to keep up with increases in Mexico's labor force. This rate of job creation would require steady real economic growth of 6.5 percent a year. Additional job growth would be necessary to absorb Mexico's 8.5 - 10 million currently unemployed and underemployed workers. Such a growth rate is unrealistically high, even under the most optimistic assumptions about free trade. In 1988 real GDP grew by 1.1 percent, and in 1989, by 2.9 percent.[20]

Another factor limiting Mexican wage increases will be the probable displacement of large numbers of subsistence farmers who will not be able to compete with highly mechanized U.S. grain farmers in a free trade regime. Some Mexican farmers may fmd work in fruits and vegetables (which are not so mechanized) for export, but the net result will undoubtedly be the displacement of millions of peasants. Rural workers, flooding industrial labor markets, will put further downward pressure on wages which could more than offset any labor market tightening effects of increased investment.

Moreover, Mexico continues to be subject to adjustment programs dictated by the World Bank, the International Monetary Fund, and the Brady Plan. These programs are aimed at producing wage restraint in order to maximize export growth and to assure that resultant earnings will go toward debt repayment rather than higher wages and increased consumption. The Bush Administration has announced its intention to extend this austerity southward by negotiating trade agreements with every Latin American nation, provided they agree to such programs. Just as the threat (and reality) of plant relocation to Mexico has reduced manufacturing wages in the United States in

the last decade, so will the threat (and reality) of moves to the Caribbean Basin, Guatemala, or Venezuela restrain wage growth in Mexico.[21]

Finally, although in discussions with members of the U.S. Congress, Mexican and U.S. officials forecast dramatically rising Mexican wages, they tell potential investors the opposite. Last fall, for example, U.S. Commerce Secretary Mosbacher and Mexico Commerce Secretary Jaime Serra Puche conducted a series of day-long seminars to convince U.S. business executives to invest in Mexico. Distributed to the executives were materials which explained that "for every $10 per hour (fully burdened) job transferred to Mexico, the company will earn an additional $15,000 per year:

> . . .[B]ecause demand has hardly made a dent in supply, the direct [Mexican *maquila*] wage in 1994 should be only about $1.75 compared to $1.40 today. .. And the gap between the U.S. minimum wage and the Mexican direct wage will in fact increase during this period as labor shortages in the U.S. increase demand."[22]

The Lack of a U.S. Adjustment Ladder

Some proponents assert that the FTA will provide net benefits to U.S. workers by allowing them to move up a ladder of opportunity. The theory is that as Mexican workers increase their share of the less skilled and lower wage jobs in the new integrated economy, Americans will be "freed up" to take higher paying, higher skilled jobs. But this notion of an upward ladder is clearly contradicted by our experience. Americans who have lost their jobs because of imports typically have ended up with less skilled jobs at lower pay. Surveys of dislocated manufacturing workers fmd that only two-thirds find new jobs, and that more than half were jobless for at least six months. In the apparel sector, almost half did not find new jobs. And inasmuch as the U.S. economy as a whole has been shifting towards lower wage jobs, it is hard to see how "freed up" workers will shift to better jobs.[23]

The often-used analogy between the FTA and the entrance of Spain and Portugal into the European Community is also misleading. Mexico's population is much larger relative to that of the U.S., and the income gap is

much wider.[24] Western Europe has a strong social safety net for the unemployed and a world-class retraining and relocation system. Moreover, part of the deal that brought Spain and Portugal into the EC involved a dramatic increase in subsidies to these poorer areas in order to help them catch up to the rest of the EC.

In stark contrast to the European Community, the U.S. lacks effective systems of retraining, job search help, and economic redevelopment assistance for industries and communities hit with low-wage competition. Over the last decade, unemployment compensation and other safety nets for people unemployed through no fault of their own have been frayed further. Given tight public budgets at all levels of government for the foreseeable future, we can only expect things to get worse. The indifference of this Administration to the fate of affected workers is reflected in this year's Federal budget, in which the allocation for trade adjustment assistance is zero!

Environmental Standards

The *maquiladora* sector is a growing environmental tragedy, involving among other things, toxic wastes poured into open sewers, major air pollution, and lack of basic sanitary facilities for its population.

Mexican labor and environmental standards are so much lower than our own that liberalized trade has led, and will continue to lead to, a flood of firms leaving the U.S. solely to escape environmental regulation. Until recently, for example, Southern California was the second largest (after North Carolina) furniture manufacturing center in the U.S. with 63,000 employees. In 1988, however, smog pollution control authorities required Southern California plants to install spray chambers to prevent escape of hydrocarbon fumes from paint solvents. The result: since the new rule was announced, more than 40 furniture manufacturers have moved (or are in the process of moving) from Southern California to the border region of Mexico, where they are not required to install spray chambers and their smog production is relatively unimpeded.[25]

California's Salton Sea is already polluted by over 100 industrial chemicals discharged by Mexican factories into rivers which then flow to California.[26] The responsible factories are outside the reach of the U.S. Environmental Protection Agency.

Fruits and vegetables imported from Mexico have DDT and other pesticide residues which have been banned in the United States. Mexican agricultural workers are exposed to pesticide contamination from which the U.S. Occupational Safety and Health Administration would protect them if they worked in the United States. If a free trade agreement further liberalizes agricultural commerce, years of environmental reform could be effectively undone.

In response to concerns about some of these issues, the Administration and the Mexican Government contend that progress has been made, and they have suggested separate discussions on environmental issues. But without the leverage of a trade agreement, we must rely on the good intentions of the Mexican government. Unfortunately, the prospects are not reassuring. Mexico's environmental rules, on the books, are already similar to those in the United States. Indeed, one Mexican regulation requires any manufacturer located within 100 kilometers of the U.S. border to abide by U.S. EPA standards as well as any additional standards adopted by the contiguous U.S. state.[27] The problem is lack of enforcement on the part of SEDUE, Mexico's environmental agency. Of over 600 *maquiladora* plants in Tijuana, only seven have had their SEDUE applications approved: operation is not contingent on receiving approval.[28]

The Impact of a Free Trade Agreement on Immigration

Both the Bush and Salinas Administrations claim that free-trade-induced economic growth in Mexico will reduce the flow of undocumented immigrants to the United States. However, the evidence suggests that continued economic integration between the United States and Mexico is likely to *accelerate* undocumented immigration to the U.S., rather than slow it.

One reason is that immigration is stimulated by economic and social disruption, a concomitant of industrialization. Once displaced from peasant agriculture to urban areas in Mexico, migrants find it easier to take the second step of seeking work in the United States. Exacerbating this phenomenon is the fact that job growth which results from economic integration is likely to continue to be disproportionately located in Mexico's northern states, to take advantage of proximity to U.S. markets. From there, Mexican workers are much more likely to immigrate to the U.S. to obtain higher wages. At least part of the high rate of labor turnover (averaging as much as 10 percent per month) in the *maquiladora* plants is attributable to employees moving on to the United States.

Studies of characteristics of undocumented Mexican immigration to the United States confirm these speculations. Recent immigrants tend to have more work experience, be more educated, and are more likely to come from urban areas.[29] In short, increased immigration from Mexico is less the product of unemployment and lack of skills, and more the product of heightened aspirations which stem from the expansion of low-wage industrial employment in Mexico.

Effect of FTA on Investment Decisions of U.S. Firms

It is a mistake to see the problem of the adjustment of U.S. workers and businesses to a free trade agreement as a "one-time only" problem. An unregulated trade agreement along the lines of the Administration proposal would subject an increasing number of American workers to continuous pressure to lower their wages, benefits, and living standards in order to compete with low-wage Mexican labor using high-tech machinery and equipment. The effect will not be limited to those firms out-sourcing or threatening to out-source to Mexico. It will spill over to most companies employing workers with average skills, in the same way that U.S. trade deficits resulted in a lowering of wages for all noncollege-educated workers in the 1980s.

Thus, the greatest danger to the U.S. economy of an Administration-style *FTA* is *that it will encourage American firms to find a low-wage solution to the problem of global competitiveness. As the* recent report of the high-level task force on the U.S. economy chaired by former Secretaries of Labor Bill Brock and Bay Marshall concluded, we are facing an historic strategic choice in how we respond to the global marketplace.[30] One strategy -- the "high-skills, high-wage" path -- competes by producing innovative high-quality goods efficiently so that they can be sold at high enough margins in the global marketplace to pay high wages and maintain U.S. living standards. This path requires the maintenance of correspondingly high levels of private and public investment to continually upgrade the quality of our capital and labor.

The alternative "low-wage" path means competing on the basis of cutting labor costs. This is the strategy of the Administration's proposal. With a large labor pool of Mexican workers willing to work for a small fraction of U.S. wages in an environment free of meaningful regulation over working conditions, health and safety, and pollution, why would rational managers invest in labor-saving equipment? Why would they opt for the riskier path of improving the quality of the product when cutting labor costs with cheap wages is an easier path? As major expansion or relocation decisions come up, why would not more and more firms choose to produce in Mexico rather than in Texas or Louisiana or New Jersey?

What Makes Sense?

The fatal weaknesses in the Administration's case do not mean that we should abandon the goal of North American economic integration. As the leading economic power in the Western Hemisphere we have a responsibility to assist our neighbors in their efforts to raise their living standards. It is also in our own interest to do so, especially if the rest of the developed world forms into large economic "blocs" in Europe and Asia. If Mexican development was not linked to a low wage strategy, Mexican purchasing power could rise with increased productivity and industrialization: this kind of regional strategy

would create the economies of scale which proponents mistakenly seek in a low wage FTA.

What is needed, however, is not a "quick-fur" trade agreement, but a genuine development strategy aimed at raising living standards on both sides of the Rio Grande. As part of a broader strategy, a free trade agreement would make sense.

Debt Relief

The fundamental cause of Mexico's stagnation is its debt burden caused by its own failure to invest effectively the proceeds of international loans: by loan-pushing of international bankers in the 1970s; and by the high interest rate *regime* produced by U.S. monetary policies. Underlying the FTA proposal is the question of who -- besides the Mexican worker whose living standards have been slashed during the debt crisis -- will pay Mexico's debt? In effect, the Bush Administration is proposing that American workers also be required to pay Mexico's debts by lowering their incomes and losing jobs.

Debt relief, on the other hand, would allow the Mexican economy to expand without undercutting the wages of its own and U.S. workers. Real Mexican wage levels could then rise to the pre-debt crisis level. New funds would be available for Mexico's domestic investment, making Mexico less totally reliant on runaway shops from the United States. And debt relief would expand Mexico's appetite for U.S. imports, helping to create the transnational prosperity of which free trade hopes to take advantage. The Brady Plan for debt relief is inadequate since Mexico's creditors have not been willing to forgive enough debt to free Mexico to borrow for growth. Substantially more concessions should be made by the international lenders who facilitated the borrowing binge.

This will, of course, require some sacrifice on the part of bank shareholders. But much of the debt is already listed as non-performing, and major banks have written off a substantial part of it. In any case, if the Bush Administration can organize international creditors to forgive 50 percent of

Poland's external debt, it ought to be able to do something similar for a nation so much closer to our vital interests.

Harmonization of Labor and Environmental Standards

The United States maintains a federal minimum wage, in part to prevent employers from engaging in competitive impoverishment strategies. We do not consider it a legitimate free market activity for the state of Mississippi to promise wage rates of less than $4.25 per hour in order to lure a Toledo manufacturer to relocate. Why should we create conditions under which the state of Chihuahua can induce U.S. manufacturers to relocate to take advantage of $1 hourly wage rates?

Similar questions apply to environmental regulation. No state can recruit employment by promising exemption from EPA standards. Yet our current and proposed economic arrangements with Mexico permit states south of the border to engage in just such recruitment.

The gradual "harmonization" of labor and environmental regulation -- bringing Mexican standards and enforcement up to the U.S. level -- should be a principal element in a U.S.- Mexico trade pact. At the very least, the U.S. should require certification that products exported to the U.S. market were manufactured with labor, health and safety, and environmental standards equivalent to those applicable in the United States. If Mexico chose to exempt its own domestic production from such requirements, it could do so.

Mexican authorities insist that, in a period when Mexico's public sector is being rapidly reduced, they do not have the public funds available to expand enforcement of environmental laws. This is the kind of practical problem with which a negotiated political package, off the fast track, could deal. One solution is for the U.S. to participate in the financing of Mexico's environmental enforcement agencies* expansion. Inasmuch as the Bush Administration's "Brady Plan" and its associated adjustment programs require Mexico to reduce its public sector, it is appropriate for the President to ask the

Congress to shoulder some of the expense of addressing the resultant environmental costs.

Certainly wage harmonization would have to be gradual and would take some account of lower levels of overall development. In these discussions, Mexico has a right to be assured that its adoption of higher labor standards will not result in a shift of investment away from Mexico towards even lower wage nations in the Caribbean, Latin America, and the Pacific. The assurance can only be accomplished by an Administration decision to enforce provisions of current U.S. trade law which already require imports to this nation to be manufactured in accordance with internationally recognized labor standards.

A Program of Adiustment Assistance for U.S. Workers

A serious adjustment assistance program for U.S. workers, industries, and communities affected is essential on the grounds of both fairness and efficiency. Only if there is a shift of U.S. labor up the value-added ladder does any trade agreement make sense.

The present trade adjustment assistance programs are inadequately managed, seriously flawed, and made ineffective by an Administration that is hostile to the basic concept. To create new opportunities for those dislocated on this side of the border means a serious rethinking of adult training and retraining programs. This is long overdue in any case. Compared with our major competitors, U.S. vocational training is primitive. Aid to affected industries to upgrade their technology and redirect production to higher value products should also be part of the package, as should redevelopment assistance to localities that are particularly vulnerable.[31]

Political Liberalization in Mexico

Political liberalization in Mexico will have direct bearing on how an FTA affects U.S. living standards. Protections against environmental exploitation and labor abuse in America are not achieved simply by the laws enacted by government, but by the strength of independent institutions, such as

environmental organizations, civil rights groups, and labor unions. Their ability to monitor, to expose, to sue in court and to defeat candidates who are indifferent to their concerns is the rock upon which such protections are founded.

Mexico's one-party system, with its interconnections between business, labor, and political institutions, does not yet provide the culture to nurture the necessary independent advocacy, membership, and pressure groups. The judiciary, which is key to the implementation of protection of people and the environment, is still dependent on the government and the ruling party.

It is foolhardy for us to rush to integrate our economy with that of a nation with such different institutions. The more sensible path is the one the European Community took with the integration of nations who emerged from years of undemocratic government, such as Greece, Portugal, and Spain. In those cases, the EC carried on lengthy negotiations and insisted on demonstrations of solid progress in developing democratic institutions, before these nations were admitted. The U.S.- Mexico ETA is not a political merger, and therefore the U.S. will have little influence over internal Mexican political structures once an FTA is in place. This makes it all the more important to move cautiously.

No Fast Track

The Administration is indifferent to the many risks involved in the FTA. Moreover, the history of trade negotiations over the last decade have seen the Reagan and Bush Administrations consistently ignore U.S. economic interests in favor of ideological and political considerations. Given this record, promises by the Administration that Congress' concerns will be seriously considered in the negotiations are not worth very much. If Congress allows itself to be stampeded along a fast-track, it will lose whatever leverage it has. It will be a signal to all concerned -- the Administration, the private interests involved, and the governments of Mexico and Canada -- that the Administration has the power to override Congress* concerns.

Proponents claim that the absence of fast-track will doom any proposal. They assert that narrow "special interests" will block passage. The idea that only those opposed to the bill have special interest is, of course, absurd. There are special interests on both sides as there are in practically every piece of economic legislation that goes before the Congress. Tax spending and other important bills are not on fast tracks, and the FI'A should not be on one either. Sorting out special interests and the national interest is the work of representative democracy.

Fast Track was created to deal with the problem of having to renegotiate a treaty with a huge number of nations -- 100 -- involved in GATT. But with just two countries who are neighbors, the problems of possible amendment to a proposed FTA are certainly not insurmountable.

The so-called "threat" that Mexico would not enter into negotiations if they were not on a fast-track is hardly credible, given the apparent political benefits that this treaty gives the Salinas Administration.

Finally, it is important to remember that there is no economic urgency. The U.S. economy has a number of problems, but there is nothing broken here that will be fixed by a Free Trade Agreement with Mexico. On the other hand, the consequences of recent radical policymaking based upon dubious economic theories -- the fiscal deficit and the Savings and Loan disasters are two examples -- suggests the dangers in store if we put such a risky proposition on a fast-track.

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ENDNOTES

1. These conditions are spelled out in international trade theory textbooks, such as Paul R. Krugman and Maurice Obstfeld, International Economics: Theory and Policy, Glenview, IL: Scott, Foresman, and Company: 1988; and Jagdish N. Bhagwati and T.N. Srinivasan, *Lectures on International Trade*, Cambridge, MA: MIT Press, 1983.

2. 'The Likely Impact on the United States for a Free Trade Agreement with Mexico." U.S. International Trade Commission (USITC). Washington, DC February 1991.
Since the issuance and subsequent criticism of this report, the Administration has attempted to disown its analysis and is making a desperate and transparent effort to come up with "new" estimates.

3. Rudiger Dombusch, "US-Mexico Free Trade." Testimony before the Finance Committee of the United States Senate, February 20, 1991, page 7.

4. United States International Trade Commission, Review *of Trade and Investment Liberalization Measures by Mexico and Prospects for Future United States-Mexican Relations; Phase 1; Recent Trade and Investment Reforms Undertaken by Mexico and Implications for the United States,* USITC Publication 2275, April 1990, Table 4-4, p. 4-5.

5. Calculation by William Spriggs of the Economic Policy Institute assuming 2.5 percent annual real growth in U.S. GNP for next 20 years. See USITC p. 2-2, footnote 20.

6. The ITC has consistently refused to show the factual and statistical evidence for its assertions. This estimate is based on telephone conversations between William Spriggs, Economic Policy Institute: and Kyle Johnson, ITC, February 14 and 19, 1991. The ITC model, based on the 1980 Census, classified 26 million Americans as skilled and 70 million as unskilled. Neither the ITC nor the U.S. Trade Representative has contradicted the EPI 73 percent figure. On March 8, John Suomela, the U.S. ITC director of the Office of Economics, sent a memorandum to the Commission indicating that he now thinks that it is likely that no workers will lose income because of the FTA. No new numbers, however, were made public. Indeed, the unwillingness of the ITC to reveal the statistical basis for its conclusions to the Congress or the public shows the dangers of putting the treaty on a track too fast to verify confusing claims and counterclaims.

7. U.S. Department of Labor, Bureau of Labor Statistics, Office of Productivity and Technology, "Hourly Compensation Costs for Production Workers in Manufacturing Industries - Mexico, 1975-1988." April 1990

8. U.S. Department of Labor Bureau of Labor Statistics. "International Comparisons of Hourly Compensation Costs for Production Workers in Manufacturing, 1975-89," October 1990, Report 794.

9. ITC Publication 2275, April 1990, p. 5-14.

10. ITC Publication 2275, April 1990, p. 6-2 to 6-5.

11. ITC Report, February 1991, p. viii.

12. Richard N. Sinkin. "Manufacturing in Mexico: Prospects for the 1990s." In Interamerican Holdings Co., et. al., *A Partnership for Growth: Investing & Manufacturing in Mexico,* briefing book distributed by U.S. Department of Commerce for briefing session for U.S. business executives in Los Angeles, CA, October 26, 1990, p. 3.

13. Report 794. U.S. Department of Labor, Bureau of labor Statistics, October 1990. "Supplementary Tables for BLS Report 771," U.S. Department of Labor, Bureau of Labor Statistics, Office of Productivity and Technology, August 1989. International Monetary Fund, *International* Financial Statistics, Yearbook 1990, Washington, DC: IMF, 1990.

For the purpose of this discussion, the above are conservative estimates. As shown in testimony before Congress, wages in the export-oriented *maquiladora* plants are considerably lower than they are in the rest of Mexico.

14. Statement of Ambassador Julius L. Katz, Deputy United States Trade Representative, Hearing on American Economic Policies Toward Mexico and Latin America, Monday, September 17, 1990, United States Congress, Joint Economic Committee, p. 36.

15. 'Prepared Testimony of Nora Lustig on the Agreement Signed by Mexico and Its Commercial Banks before the Subcommittee on International Development, Finance, Trade and Monetary Policy of the House Committee on Banking, Finance, and Urban Affairs." February 7, 1990, p. 4.

16. Mexican-manufactured export figures based on data prepared by the Commerce Department for the United Nations Economic Commission for Latin America and the Caribbean (UN-ECLAC). Unpublished data.

17. Rudiger Dombusch, "US-Mexico Free Trade." Testimony before the Finance Committee of the United States Senate, February 20, 1991, page 3.

18. Walter R. Mead. The Low-Wage *Challenge to Global Growth: The Labor Cost Productivity Imbalance in Newly Industrialized Countries.* Washington, DC: Economic Policy Institute, 1990, pp. 17-18.

19. From "Commentary," by Rudiger W. Dombusch, in Albert E. Burger, ed., U.S. *Trade Deficit:* Causes, **Consequences, and Cures.** Proceedings of the Twelfth Annual Economic Policy Conference of the Federal Reserve Bank of St. Louis. Boston, Kluwer Academic Publishers, 1989, p. 111.

20. Commerce Department, International Trade Administration. "Mexico Fact Sheet." Fax transmittal January 3, 1991.

21. Early this year, President Salinas met with the presidents of Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica and agreed to establish a regional free trade zone. Venezuela and Colombia sent observers to the meeting and can be expected to join this new trade zone as well.

22. Richard N. Sinkin, "Manufacturing in Mexico" in *A Partnership for* **Growth:** *Investing &* Manufacturing in Mexico, **p.** 2.

23. Richard Rothstein. Keeping *Jobs in* Fashion: Alternatives *to the Euthanasia for the* U.S. Apparel *Industry.* Washington, DC: Economic Policy Institute, 1989, p. 18.

24. Department of Labor, Report 794. International Monetary Fund, *Financial Statistics Yearbook, 1991.* International Monetary Fund, *Direction of Trade Statistics Yearbook, 1990.*

25. Chris Kraul. "A Warmer Climate for Furniture Makers," *Los* Angeles *Times,* May 14, 1990.

26. Jane Kay. 'The Toxic Dump that Flows into California," *The San Francisco Examiner,* June 22, 1986.

27. "A New Hope for the Hemisphere?", interview with Carlos Salinas de Gortari, New Perspectives *Quarterly,* Winter 1991, p. 6.

28. Richard N. Sinkin, "Manufacturing in Mexico" in A Partnership *for Growth: Investing &* Manufacturing in Mexico, p. 4.

29. Alejandro Portes and Ruben Rumbaut. Immigrant *America, A* Portrait. Berkeley, CA, University of California Press, 1990, page 11. Portes and Rumbaut give as their sources for these data: Bean, Browning, and Frisbie, 'What the 1980 Census Tells Us About the Characteristics of Illegal and Legal Mexican Immigrants," Population Research Center, University of Texas at Austin, mimeographed, 1985; North and Houstoun, 'The Characteristics and Role of Illegal Aliens in the U.S. Labor Market," Washington, DC: Linton, 1976, mimeographed; Massey, "Do Undocumented Immigrants Earn Lower Wages Than Legal Immigrants? New Evidence from Mexico," International Migration Review 21 (Summer 1987) p. 236-274; and Portes, "Illegal Immigration and the

International System: Lessons from Recent Legal Mexican Immigrants to the United States," Social Problems 26 (April 1979), p. 425-438.

30. Brock and Marshall Report, *America's Choice: High Skills or Low Wages. The* Report of the Commission on the Skills of the American Workforce, June 1990. New York: National Center on Education and the Economy, 1990.

31. David Osborne, *Economic Competitiveness: The States Take the Lead.* Washington, DC: Economic Policy Institute, 1987.

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