

Oral Testimony of Sandra Polaski

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**United States Senate
Subcommittee on International Trade
of the Committee on Finance**

**“NAFTA at Year Twelve”
Craig Thomas, Chairman
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Thank you, Chairman Thomas and Senator Bingaman and thanks to Senator Grassley and Ranking Member Baucus for this opportunity to comment on the performance of NAFTA at 12.

My name is Sandra Polaski, and I am a senior associate at the Carnegie Endowment for International Peace, where I direct policy work on trade and development. Previously, I had the privilege of serving Secretaries Colin Powell and Madeleine Albright as the Secretary of State’s Special Representative for International Labor Affairs. Among other responsibilities, I negotiated the labor issues in trade agreements. Prior to that, I was the director of research for the NAFTA labor secretariat, an intergovernmental organization of the U.S., Mexico and Canada.

As that brief biography suggests, my analysis of trade agreements includes particular emphasis on the employment, labor market, income and related effects of trade agreements.

In the case of NAFTA, it is very instructive to look at the agreement’s employment consequences, because that is one of the most important channels through which NAFTA has affected the United States. I am speaking not about the employment and income effects within the United States itself, because these effects were very small, given the enormous difference in the size and comparative advantages of the U.S. and Mexico. Rather, it is the employment and income effects of NAFTA *in Mexico* that are key to understanding several related policy challenges that now confront the U.S., and the Congress in particular. In Mexico, NAFTA was a key contributing factor to a series of changes that have had deep and important consequences for migration, economic growth and political stability.

My written testimony provides a thorough review of the evolution of overall employment, trade-related employment and agricultural household incomes in Mexico during the twelve years of NAFTA. Today, I will mention the highlights.

- NAFTA has produced disappointing results for job growth in Mexico. Data and the difficulty of isolating NAFTA effects from other causes preclude an exact tally, but it is clear that overall, the jobs created in manufacturing have not kept pace with jobs lost in the agricultural sector.
- There has also been a decline in non-maquiladora manufacturing since NAFTA took effect in 1994. Employment in the non-maquiladora manufacturing sector stood at about 1.4 million in January 1994, declined sharply during the peso crisis, and then began a brief recovery before declining again over the past six years. In June 2006 there were about 130,000 fewer jobs than when NAFTA took effect.
- The pattern in the maquiladora sector has been more positive. Maquiladora assembly plants added about 800,000 jobs between NAFTA's enactment in January 1994 and the sector's peak employment in early 2001. The plants then shed about 125,000 jobs through January 2006. Currently, maquiladoras employ about 700,000 more workers than they did before NAFTA.
- Adding the results for the two manufacturing sectors in Mexico shows a net gain of about 570,000 manufacturing jobs between January 1994 and June 2006.
- By contrast, Mexican agriculture has been a net loser in trade with the United States, and employment in the sector has declined sharply. U.S. corn exports in particular have depressed corn prices and agricultural employment in Mexico. The rural poor have borne the brunt of adjustment to NAFTA.
- Agricultural employment in Mexico stood at about 8.1 million in the early 1990s, just before NAFTA came into force. It actually increased slightly in the aftermath of the peso crisis, when widespread unemployment led some workers back to the farm. Employment in the sector then began a downward trend, with about 6 million employed in the first quarter of 2006, a loss of over 2 million jobs compared to the pre-NAFTA levels. While not all of that reduction can be attributed to NAFTA, other forces that affected trade, such as the sharp devaluation of the peso during 1994-1995, pushed in the opposite direction, toward greater growth of Mexican exports over imports. In fact, the height of the peso crisis in 1995 was the single post-NAFTA year in which Mexico had a surplus in its agricultural trade with the United States, and agricultural employment did improve modestly for a few seasons thereafter. However, once the peso stabilized, the agricultural trade balance again turned against Mexico and agricultural employment resumed its decline.

- The one bright spot for Mexico, an increase in exports of fruits and vegetables, has not kept pace with Mexican imports of U.S. grains and oilseeds. This may be due in part to greater efficiency among U.S. producers, but it is also partly due to U.S. subsidies. By one estimate, U.S. corn was sold in Mexico from 1999 through 2001 at prices 30 percent or more below the cost of production.
- The experience of Mexico confirms the prediction of trade theory, that there will be winners and losers from trade. The losers may be as numerous as, or even more numerous than, the winners, especially in the short-to-medium term. In Mexico, more farmers lost than gained from NAFTA-induced changes.
- Looking at another important measure, real wages for many Mexicans today are lower than when NAFTA took effect. The stunning setback in wages is mainly attributable to the peso crisis of 1994-1995. However, during the NAFTA period, productivity growth has not translated into wage growth, as it did in earlier periods in Mexico. Mexican wages are diverging from, rather than converging toward, U.S. wages.
- The overall performance of labor markets, employment and wages in Mexico is one of the key factors explaining the surge in migration out of Mexico, both during the period of strong U.S. employment growth in the late 1990s and during the recession and slow employment recovery in the U.S. in the last five years. Migration is always a function of both *push* and *pull* factors—*push* out of the sending country, which cannot satisfy the employment and income needs of its population, and *pull* into the receiving country, which may have more job opportunities than its own work force can satisfy. But the fact that Mexican migration to the U.S. continued to surge during and after the U.S. recession of 2001—while U.S. unemployment rose—indicates that the *push* factor is more important in the migration pattern we have seen from Mexico over the past decade.
- The policy consequences of this surge in migration are well known to this committee. I hope that my analysis has helped trace the sources of the migration push, which in part point to NAFTA.
- This leads to another important policy issue which will confront the committee next year. As you are well aware, tariffs and other restrictions on the most sensitive products in U.S.-Mexican trade are scheduled to be eliminated in January 2008. This includes white corn and beans, in the case of Mexico. There is no doubt that this further liberalization of agricultural trade between the countries will add new and high impact stresses on the countryside in Mexico. These stresses have implications for migration to the U.S. and for political stability in Mexico. They should be addressed with great seriousness. There will be a need for much more trade adjustment assistance to small-scale farmers by the Mexican

government and there may be a need for flexibility by the U.S. in the timetable for implementation of tariffs on white corn and beans.

- The U.S. government should also consider development assistance targeted at the Mexican countryside, particularly those regions that have felt negative impacts from NAFTA in the agricultural sector but few positive effects in other sectors. This would be an investment in good-neighborliness, but also one of the more effective investments to address tensions arising from migration. It would also contribute to the political stability of one of our closest neighbors and allies.
- In addition to the other policy considerations that I have mentioned, let me make one final point. As more free-trade agreements are negotiated and World Trade Organization (WTO) membership grows, all of the advantages Mexico gained as the first developing country to have a free trade agreement with the United States are progressively eroded. The accession of China to the WTO has meant mounting competition for Mexico's manufactured exports, particularly in labor-intensive sectors such as apparel and electronics. In 2003, China displaced Mexico as the second-largest exporter to the United States. The U.S. free trade agreement with Central America will add a sizable pool of low-wage labor to the available regional labor supply, further undermining Mexico's remaining advantages.
- It is not in the United States' strategic interest to demonstrate that free trade agreements between the U.S. and developing countries do not produce clear advantages for the poorer trading partner. This is one more reason why the U.S., and this committee, should take a leadership role in assuaging NAFTA's negative impacts on Mexico.
- Thank you for your attention, and again, thank you for the invitation to share my research with the committee.