President's Message

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Despite Flaws, CAFTA Is Step in Right Direction

CAFTA, the trade agreement that President Bush signed in August, has faced some of the same criticism as its predecessor, NAFTA. But like the earlier agreement, CAFTA will benefit each of the participating countries.

The Central American Free Trade Agreement breaks down most trade barriers between the United States and five nations of Central America (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua) plus the Caribbean country of the Dominican Republic. Most products from this region already were entering the United States duty-free, but CAFTA will make sure more U.S. products and services get the same treatment down south.

To be sure, CAFTA is not perfect. It is really a "freer trade" rather than a "free trade" agreement. Certain special interests were successful in creating important protectionist exceptions to the principle of free trade.

But it's important to remember that similar problems, fears and shortcomings surrounded NAFTA when it was passed more than 10 years ago. Yet today, most U.S. economists agree NAFTA has succeeded not only in Mexico and Canada, but also in the United States. Without question, the economies of the NAFTA countries have become more and more integrated. Some evidence:

- Total two-way trade between the United States and our NAFTA partners grew a remarkable 111 percent between 1993 and 2003, while total two-way trade between the United States and the rest of the world grew by 79 percent.
- Because NAFTA reduced or eliminated most barriers that limit access to goods, U.S. exporters have greater market access and a price advantage over competitors such as Japan, South Korea and China.
- NAFTA provisions in the auto sector allow U.S. automakers to treat the participating countries as a single market, maximize efficiencies and become competitive on a global scale.
- Mexico's investment in the United States increased 280 percent from 1994 to 2002, while investment in the United States by non-NAFTA countries grew by 185 percent.

Critics blame NAFTA, CAFTA and other trade agreements for large-scale job losses. But most of the U.S. jobs that are lost are low-wage, low-skill jobs. These losses force workers to train for higher-skill, higher-paying jobs—the kinds we want. What trade expansion does in the U.S. labor market, essentially, is to expand employment in higher-paying industries and occupations and depress it in lower-paying jobs. In fact, the net impact on the number of U.S. jobs is negligible. However, the individuals who are helped are not the same as those who are hurt. That fact provides the rationale for government trade-adjustment assistance. Meanwhile, companies can help to cushion the blow of unemployment by providing ample notification of plant closings and assistance to departing employees.

The real issue with regional trade pacts is that they can prevent U.S. consumers from enjoying the benefits of even cheaper goods that might be available from countries not included in the regional agreements. However, it is probably true that in the absence of greater progress on truly multilateral trade agreements to expand trade for all countries, progress on freer trade through regional agreements is constructive, if only because it keeps the public debates and the momentum for freer trade alive.

In the end, we must remember that trade restrictions can be very costly. A study by economists Gary Clyde Hufbauer and Kimberly Ann Elliott showed that consumers were paying an average of $139,000 for each job protected in 1990 in the apparel industry, an industry in which the typical production worker made less than $15,000. In the sugar industry, the consumer loss for each job that was saved totaled $600,000!

Finally, CAFTA is about more than trade. U.S. sales to that region totaled a mere $15 billion a year before the pact—about 2 percent of total exports—and certainly won't skyrocket anytime soon. But trade agreements also promote democratic and economic reform. A greater sense of economic opportunity and progress creates more stable political environments. These benefits were emphasized in the debate over NAFTA, and Mexican experience over the past decade seems to bear out the optimists.

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