WALL STREET JOURNAL
15-6-15

On Trade Deal, Nafta Is the Wrong Cautionary Tale

Chinaøs accession to the WTO points to what can go wrong with free trade

By Greg Ip

Critics of the 12-nation Pacific trade deal pushed by President Barack Obama have repeatedly criticized it as õNafta on steroidsö in pointing out what can go wrong with free trade.

But in comparing the Trans-Pacific Partnership to the 1994 pact with Mexico, critics may have picked the wrong target. It isnøt the North American Free Trade Agreement but Chinaøs accession to the World Trade Organization in 2001 that offers the cautionary tale to legislators who will likely vote again this week on whether to give Mr. Obama authority to complete the TPP.

With both Mexico and China, the U.S. hoped not just to benefit from more exports but to encourage reforms in those countries and to strengthen geopolitical ties. Of the two, Nafta came closer to filling that promise.

Critics note that the U.S. went from a small trade surplus with Mexico in 1994 to a deficit of $30 billion, or 0.3% of total economic output, in 2000. But that had little to do with Nafta. The year after it went into effect, Mexico suffered a severe financial crisis, and the peso crashed. The depreciation and ensuing recession caused Mexican imports to plunge. Once the peso stabilized and Mexico emerged from recession, the surplus persisted, but against the backdrop of large, and growing, two-way trade. Cross-border investment and supply chains grew significantly.

Nafta, which also included Canada, did cost some American workers jobs or pay. But on net, both Mexico and the U.S. were better off as a result, though it is difficult to prove given the diversity of influences on both countriesø growth, the small size of Mexican trade relative to U.S. and the many obstacles to development Mexicoøs poorer households still face.

While the economic payoff of Nafta was likely modest, the political benefit wasnøt. The Mexican government saw Nafta õas a means to institutionalize the new liberalized policies and signal that they will be long-lasting,ö recalls Aaron Tornell, a Mexican government official in the early 1990s who now teaches at the University of California, Los Angeles. It has largely retained that policy framework, though successive governments were slow to broaden and extend the reforms.

The experience with China was initially similar, with President Bill Clinton declaring in 2000 that its entry in the WTO would spur economic openness and õstrengthen the rule of law.ö

China used the WTO as a spur to overhaul inefficient state-owned enterprises and introduce market-based changes, which helped propel a remarkable rise in Chinese living standards. With the threat of higher tariffs significantly reduced, Western firms set up shop in China to export products back to the U.S., and imports from China boomed. American workers suffered on a far

greater scale than they did from trade with Mexico. One study concludes increased trade with China cost more than two million American jobs.

U.S. exports to China grew quickly but are far from enjoying the success they have had in Mexico. The U.S. trade deficit with China ballooned from $83 billion in 2001 to $268 billion in 2008, a whopping 1.8% of U.S. economic output. Last year, U.S. exports to China were just 27% of imports; the comparable figure for Mexico is 82%.

Several factors limited the success of U.S. producers in China. As with Mexico, one was a cheap currency. But unlike Mexico, China kept its currency down as a deliberate policy to bolster exports and suppress imports, enforced through capital controls.

And unlike Mexico, trade liberalization with China didnøt produce a broadly more liberal economic and political regime. The liberalizing impulse that surrounded WTO accession started to fade around 2006. China largely adhered to its WTO obligations, but it found multiple avenues to subsidize domestic enterprises and discriminate against foreign firms. China became more politically repressive at home and confrontational with its neighbors.

Given how low U.S. tariffs already are with most TPP countries, its impact would likely be far smaller than with either Nafta or Chinaøs WTO accession. Nonetheless, there are lessons. One is that the impact of a trade agreement can be swamped by other factors, such as currency policies. Defining currency manipulation without compromising legitimate monetary policy is probably still too difficult to insert into TPP. But itøs a good reason to be wary of admitting China for the foreseeable future.

The second lesson is to take promises of noneconomic trade liberalization benefits with a grain of salt. To be sure, those countries who want to use TPP to liberalize their economies should be cheered on. But whether they ultimately succeed will depend less on the treaty and more on each countryøs political priorities.