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ON THE FUTURE EROSION OF THE NORTH AMERICAN FREE TRADE AGREEMENT

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A large number of economists have already inflicted their attentions upon the attempts of Mexico and the United States to enter into a free trade agreement, but some of its short-run and long-run implications have received less consideration than they deserve.[1] ~~Even when their research fully considers the dynamic~~ implications of the change from no free trade agreement to free trade agreement, economists tend to assume the effects of the agreement will remain in place once it has been installed.

Over time, much pressure may arise to erode the effects of the agreement. While most analysts treat the free trade agreement as a cooperative game, the game may become noncooperative in later iterations. Moreover, most of the pressure to ultimately erode the effects of the agreement will probably come from the United States.

To appreciate the motivations for erosion, it is useful to consider what inspired Mexico to initiate discussions and to recall differences between what the United States and Mexico get out of such an agreement.

I. The Death of Mexican Import Substitution

Mexico is the United States' third most important trading partner, after Canada and Japan. But historically, the government of Mexico has been protectionist. And traditionally, Mexico has sold more to the United States than the United States has to Mexico.

Mexico's traditional protectionism was part of a growth strategy that has characterized most Latin American countries since World War II. Mexico based its trade policy on the arguments of Raul Prebisch (1950,

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[1] Although the expected North American free trade agreement will likely involve Canada, this discussion focuses almost entirely on the effects of a pact between the United States and Mexico.

1959). Prebisch argued that the terms of trade were turning against nations whose chief exports were raw materials and were turning in favor of exports of manufactured products. But, instead of focusing on manufacturing for export, Prebisch's thesis involved import substitution. In accordance with the Prebisch paradigm, Mexico protected manufacturers with high tariffs and other trade barriers, but maintained an exchange rate policy designed to keep the price of imported capital goods low.

For a while, this strategy turned out to be consistent with persistent economic growth. Aided by its protected manufacturing sector, Mexico grew rapidly during much of the post-World War II period. Expansion was strong well before the oil boom of the 1970s. Between 1940 and 1970, Mexico's real GDP grew at an average annual rate of 6.4 percent, while per capita GDP rose at 3.3 percent.

During the 1970s, when rising oil revenues stimulated growth, the Mexican government spent its increased income by raising subsidies and other supports to domestic industries and by taking over insolvent private firms. These steps also involved deficit spending, which Mexico covered in part with foreign loans. When oil prices fell in the 1980s, and Mexico's money-losing, state-owned enterprises were absorbing increasing amounts of government revenue, raw materials exports could no longer earn enough foreign exchange to make foreign loan repayments on schedule. To regain its inflows of foreign exchange, Mexico prepared to alter its foreign economic policy.

II. The Abridgement of U.S. Multilateralism

While these events were taking place in Mexico, other trade-related changes occurred in the United States, and it is important to explain their background. From the end of World War II until the early 1980s, the United States attempted to expand trade by means of the most favored nation clause of the General Agreement on Tariffs and Trade. According to this clause, any reciprocal tariff reduction negotiated between the United States and any of its trading partners would apply to all U.S. trading partners.

The United States began to back away from this multilateral trade policy by the beginning of the last decade. The United States was frustrated over what it saw as widespread cheating and foot-dragging among GATT participants, and unfair trade practices by non-GATT members. In retaliation against what it viewed as the contamination of multilateralism, the United States commenced a reign of trade terror with countervailing actions, such as raising the barriers it had lowered and increasing its filings of dumping charges. These actions accelerated over time.

More generally, the United States' frustration with multilateralism allowed the equilibrium level of protectionism - at which the political pressures from protectionist lobbies just offset those from free trade lobbies -- to rise. Trade barriers in textiles and apparel, and in steel, began to move up.

One major victim of both countervailing actions and other increases in U.S. protectionism in the 1980s was Mexico. In retaliation for alleged dumping by Mexican producers, the U.S. imposed a 58 percent duty on imports of Mexican cement. U.S. producers also successfully demanded countervailing duties against iron and steel imports from

Mexico. Moreover, Mexican iron and steel exports to the United States are subject to high U.S. non-tariff barriers, as are exports of textiles, apparel, and agricultural products.

III. Mexico's Trade Liberalization

Needing foreign exchange and a jump-start for its stalled economy, the Mexican government moved to subvert U.S. protectionism by opening its own economy. If the Mexican economy became more open, how could the United States -- with its declared commitment to free trade -- remain closed to Mexico?

Mexico not only joined the General Agreement on Tariffs and Trade, but opened its economy at a far more rapid rate than it had agreed to. In 1985, import tariffs ranged from 0 percent to 100 percent but, by the end of 1987, the range was from 0 to 20 percent (Sobarzo, 1990; 15). The trade-weighted average tariff declined from 24 percent in 1985 to only 13 percent in 1989.

In addition, while all imports formerly required import licenses, Mexico dropped licensing for all but 11 percent of items appearing in Mexican tariff law, or about 35 percent of the value of imports from the United States at the time. (See Schatan, 1991) Mexico began to permit controlling ownership by U.S. and other foreign capital in a number of formerly restricted industries. Moreover, in 1987, Mexico established a special negotiation framework for liberalizing its trade with the United States and followed up with a more comprehensive negotiation framework in 1989.

These agreements were particularly compelling for Mexico in the late 1980s. To earn the foreign exchange it needed to pay foreign debts and to revitalize its economy, Mexico had to rely increasingly on manufactured exports. Under the old import substitution strategy, manufacturers could focus on domestic markets and leave exports alone. Under Mexico's new circumstances, that strategy would not work. During the late 1980s, Mexico successfully tried to increase its exports of manufactures to the United States. To further open U.S. markets to Mexican exports, Mexico proposed a free trade agreement. In June 1990, the presidents of Mexico and the United States endorsed the concept of a comprehensive bilateral free trade agreement.

IV. The United States' Motivations for a Free Trade Agreement

If Mexico has already liberalized, what motivates the United States to sign a free trade agreement with Mexico? While Mexico has liberalized, tariff rates not only remain higher in Mexico than in the United States, but other types of protection impede U.S. exports and restrict U.S. investment there. Despite liberalization, imports of computers, autos and parts, pharmaceuticals, and some types of farm products and of machinery remain protected. Mexico's old import substitution policies have not entirely disappeared.

At least as important, from the point of view of the United States, is the continued restrictiveness of Mexican laws on foreign investment. While Mexico has significantly liberalized these laws, they still ensure that Mexican investors control banking, insurance, radio and television broadcasting, exploitation of forestry resources and a number of other types of extractive activities. Moreover, the Mexican government reserves for itself the extraction of petroleum and natural gas.

V. Mexico's Motivations for Free Trade

Compared with the United States, Mexico's motivations focus less upon investing in its trade agreement partner(s) and more on opening export markets.[2] An important additional motivation is to convince Mexico's domestic producers that the government's turn from import substitution is permanent, and that Mexico will continue to concentrate on the needs of its exporters.

It has long been common for Mexicans to complain that foreign protectionism impedes their country's economic growth. Since Mexico has long focused on its own import-substitution-related protective policies, these complaints have not carried much weight (Weintraub, 1990). Since Mexico has for now turned at least partially away from import substitution and toward export promotion, these concerns have taken on more substance.

A number of U.S. trade restrictions impede Mexico's ability to sell what it wishes to U.S. buyers. Not only does the United States protect its steel and apparel and textile industries through "voluntary" quota arrangements, but the U.S. imposes high duties on shipments from Mexico's important horticultural and fishing sectors and on household glass products, and restricts the U.S. activities of Mexican trucking and other transport-related firms.

By and large, Mexico's foreign market is the United States. The United States absorbs about two-thirds of all Mexican exports and more than four-fifths of its manufactured exports. Without substantial changes in Mexico's export patterns, which are increasingly unlikely in

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[2] The United States is already largely open to Mexican investors.

the face of European economic unification and Asia's lack of interest in Mexican products, raising exports means raising exports to the United States.

While no one knows the ultimate configuration of the North American Free Trade Agreement, most estimates of its long-run impacts suggest greater percentage growth rates for the Mexican economy than for the United States. There are exceptions. Both scenarios in a study by Klopper Almon et al. (1990) suggest positive effects for the United States and negative for Mexico. But virtually all other studies (Hinojosa Ojeda and McCleery, 1991; Hinojosa Ojeda and Robinson, 1991; Peat Marwick, 1991; U.S. International Trade Commission, 1991) not only suggest higher growth rates in Mexico, but rates of expansion that are several times as high as in the United States.[3]

These conclusions should surprise no one.[4] Even though the U.S.

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[3] Hinojosa Ojeda and McCleery (1991) show real GDP in Mexico in the year 2000 at a little more than ten percent higher with a free trade agreement than under post World War II policy regimes or regimes of the late 1980s. In their model, the FTA actually lowers U.S. growth. In a more disaggregated model, Hinojosa Ojeda and Robinson (1991) offer alternative scenarios for trade liberalization between the United States and Mexico. The great majority show positive GDP growth for both Mexico and the United States. Peat Marwick (1991) shows positive real income growth for both the U.S. and Mexico. Depending on the scenario, Mexico grows about ten to fifteen times as large as the United States. The USITC (1991) offers only qualitative remarks, but the authors clearly expect percentage Mexican growth from the FTA to be stronger than that of the U.S.. Sobarzo's (1991) computable general equilibrium model addresses only the effects of alternative trade liberalization schemes upon Mexico. The overall effects are always positive. According to Young and Romero's (1991) dynamic dual model of the impact upon Mexico, the long run effect is a 6.5 percent increase in Mexican net domestic product under real interest rates of 15 percent and a 9.0 percent increase under real interest rates of 10 percent. In sum, the results of the Almon et al. (1990) study, in which the United States gains while Mexico loses, are highly anomalous.

[4] An important difference between these studies is how they account for the effects of Mexico's liberalization of foreign investment rules. In a discussion of the Peat Marwick, USITC, and Almon et al. studies, Meade (1991)

economy is already more open to Mexican exports than the Mexican economy is to U.S. exports, the U.S. economy represents such a larger market than the Mexican economy that the impact on Mexican growth will be greater. While Mexico's population is about one-third that of the United States, Mexico's gross domestic product is less than 4 percent as large as the United States'. Even though Mexico's population is more than three times Canada's, Canada's GDP and income are nearly three times as large as Mexico's.

VI. Free Trade as a Policy Credibility Signal in Mexico

The free trade agreement would also help Mexico to make credible its past changes in foreign economic policy. Credibility turns out to be important. When Latin American governments change their economic policies, these nations' business communities often suspect the changes will not last. This problem was particularly acute in Chile and Argentina in the late 1970s, and in Mexico in 1988 (Rodrik, 1989) and 1982 (Riding, 1985).

The academic literature on "policy credibility" is a scholarly consequence of these observations upon Latin American policies. The question this literature poses is, how does a government make its entrepreneurs believe it isn't lying?

This question is important because lack of credibility, as Calvo (1986) notes, is functionally equivalent to a distortion in the structure of intertemporal relative prices. When a policy is

argues that they do not fully address these effects. Faux (1991) argues that Hinojosa and McCleery (1991) addresses them correctly. There are other differences. Employment is endogenous in the Almon study, but exogenous in the Peat Marwick study. See Meade (1991) for particulars on the differences between the three studies she considers.

incredible, the entrepreneur still forms and acts upon price expectations. But these expected prices differ from what the entrepreneur knows would settle out if the reform persisted. This difference creates a second-best environment. Even though the reform may be welfare-enhancing under certainty, overall welfare can be reduced when the reform is not credible.

Suppose the new policy represents a move away from import substitution and toward export promotion, as in Mexico since the late 1980s. How does a government convince entrepreneurs that the policy change is permanent, so that they will invest in export capacity sooner and not later? According to one strand of the literature, if the credibility of a regime is questionable, effective signaling may require irreversible acts such as export sector-specific public investments (Aizenman, 1991).

If the stream of services from such investments would be eroded - and known to be eroded - by a return to import substitution, these public investments may send a credible signal. In the case of Mexico, a public investment shift towards projects that aid potential exporters - and away from what benefits industries viable only under protectionism - sends the right signal. As an example, Aizenman (1991: 21) notes investments in "highways, telecommunications, and infrastructure in Tijuana and along the Mexican border with California...."

From the point of view of political economy, a government can send a similar signal by destroying its political capital through measures that permanently damage a constituency that benefits from import substitution. Indeed, Mexico's massive reduction of its import barriers in the late 1980s may play this role.[5] The additionally profound aperture of the Mexican economy to U.S. and Canadian exporters through a free trade agreement, in the wake of Mexico's earlier unilateral liberalization, would reconfirm this policy commitment.

A free trade agreement has the related credibility-linked benefit of establishing a long-term opening to Mexico's largest foreign market. With a free trade agreement, the opening is more likely to persist than under an analogous aggregation of sector-by-sector agreements. An FTA increases the security of expectations. For Mexican entrepreneurs who may be otherwise discouraged from investing in plants and equipment that will pay off only if the U.S. market remains open for a long time, the FTA may not only signify a long term reduction in administrative and other restrictions that are unpredictable and capricious, but implies a commitment that new restrictions will not intrude. (See Harberger, 1991; 45-46)

A related phenomenon not only contributes to credibility, but lowers transactions costs associated with international trade. An important reason both for Mexico's entry into the GATT and for its initiation of a free trade agreement with the United States, has been to formalize countervailing appeal processes, so that the United States could not easily impose countervailing actions without extensive due

[5] In a somewhat related argument, Rodrik (1989) concludes that establishing the credibility of such a policy shift may necessitate overshooting free trade by actually subsidizing imports. Aizenman's (1991) model explicitly motivates the taxation of private investment in the importable sector to establish the credibility to the export sector of the policy reversal. Mexico's unilateral opening of its economy may be seen as tantamount to such a tax.

process. As Schatan (1991) notes, a good deal of concern has existed in Mexico over the United States' aggressive use of trade remedy legislation. Mexican exporters are injured not only when these laws result in the imposition of a countervailing duty, but when U.S. import-competing firms simply use them as avenues for harassing foreign competitors. Import-competing U.S. firms can initiate such actions with relative ease and defending oneself against frivolous suits can be expensive. If Mexico's free trade agreement with the United States resembles Canada's, the increased formalization of due process through bilateral-trade-agreement-linked dispute settlement mechanisms will reduce cost uncertainties beyond what Mexico's entry into the GATT has contributed.

VII. The Potential For Erosion

In the first two paragraphs of this paper, I noted that many economists assume the North American Free Trade Agreement will remain in place once it has been installed, but that we actually may expect ongoing attempts to erode its effects. In addressing this issue, it is useful to begin by offering arguments on behalf of the original contention - that the prospective agreement will remain in place and that its effects will not erode. This contention is at least implicit in the construction of virtually every empirical model dealing with the agreement.

An analyst who believes expectations are rational might reasonably conclude that U.S. agents would have fully anticipated any negative effects of the agreement. Accordingly, the United States' entrance into a free trade agreement with Mexico ought to signify a long-lived defeat of U.S. protectionist forces. Since potentially injured agents knew what free trade would do to them, they must have fought it with everything they had, and lost.

A related argument in favor of a long and undiseased life for the free trade agreement involves the difference between a free trade agreement and sectoral - or industry-by-industry - agreements. Consider an argument against sectoral agreements. The benefits of freer trade are often highly diffuse, while the injuries are concentrated among small groups. Suppose the injured groups are not much compensated, as is almost always the case despite ex ante promises to the contrary. Then free rider problems mean that benefitted parties will not work as hard to keep or advance free trade as injured parties will to stop or impair it. Accordingly, sectoral agreements against protectionism are hard to reach because those who benefit from them are a more diffuse and harder-to-unite group than those who benefit from the protectionism.

Why, according to this logic, would a free trade agreement be more effective? In the construction of a free trade agreement, ways may be found to pit exporters who benefit greatly from one aspect of the agreement against producers who compete against imports and are injured by some other part of it. One component of the agreement may prop up another because, if the exporters do not work against the import-competitors, the whole agreement may fall.

Even if the benefits of a particular U.S. trade aperture are highly diffuse, exporters who do not much benefit from that aperture will fight against closing it. Closing it might cause Mexico to drop the whole agreement, so that a Mexican aperture that benefits the exporters would also close. In sum, because one portion of a free trade agreement may prop up another, a free trade agreement offers a good deal of certainty. A free trade agreement provides a political **equilibrium** heavily weighted towards free trade, where a political equilibrium involves a balance of political pressures that has no tendency to change. (See Gould, 1991)

Before offering arguments that at least weaken the above conclusions, it is useful to frame them by discussing a common sense notion called the **compensation effect** (Brock, Magee and Young, 1989; Young, 1982). This effect may represent a response to a political **disequilibrium**. The idea of the compensation effect is that, if a factor's economic fortunes decline, it turns to politics for relief.

As an example of the process that generates the compensation effect, suppose that a free trade agreement lowers import prices in the United States for some goods or services that U.S. establishments also produce. This phenomenon is likely to occur in some cases because of increased competition from Mexican firms, and in other cases because U.S. firms set up new operations in Mexico.[6] Some classes of wages

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[6] This last phenomenon could result from Mexico's liberalization of foreign investment laws and seems to be of greater concern to labor organizations than competition from Mexican-owned operations in Mexico. (Faux, 1991; Cypher 1991; Anderson, 1991). The concern is not simply over lost jobs in some industries. Labor organizations are also concerned about the downward pressure on wages that these job losses impose on U.S. workers who remain employed. By itself, the credible threat implied by increased opportunities for and returns to U.S. physical capital investments in Mexico may hold down wages. Studies that show net U.S. job growth from the agreement still find employment declines in some industries (Almon et al., 1991), such as apparel and footwear manufacture. Anderson (1991) argues that newly legalized investment opportunities and low wages are not the only attractions for U.S. plant location in Mexico, but that lax environmental protection there will additionally attract U.S. capital.

fall.[7] This reduces the opportunity cost of lobbying for the labor lobby, for example, so it expands its political efforts on behalf of protectionist candidates or a protectionist party. In response, the protectionist party increases its equilibrium level of protectionism. The increased protectionism raises the domestic price of importables and permits an increase in union wages that partially offsets the initial decline caused by the rise in terms of trade implied by the drop in import costs.[8] In sum, when a factor's income falls, arbitrage between economic and political activity causes the factor's lobby to get more for itself out of the political system.

These allegations not only represent common sense but, in some circles, common knowledge. At the U.S. congressional hearings on the Mexico -U.S. free trade agreement, one Mexican businessman noted his concern that "there has been a past pattern of the United States increasing trade barriers whenever Mexico becomes competitive in a particular industry." (USITC, 1990; 1-3)

In the context of the compensation effect, I shall now argue

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[7] It is common to suppose that Mexico has an advantage in processes that use low-skilled labor, since Mexico has a relatively large number of such workers and their wage rates are lower than those of U.S. workers. In most studies, U.S. industries that intensely employ such workers (apparel, for example) have the largest job losses from the free trade agreement, because these industries will not be able to compete easily with imports from Mexico. The implication is that the most likely U.S. wages to fall will be those of low-skilled workers. Conversely, because of the abundance of high skilled labor and physical capital in the United States, the standard argument is that U.S. industries that use such factors most intensely will benefit from the agreement. As a result, the agreement will push up the wages of and demand for some types of high skilled U.S. laborers. Cypher (1991), however, argues that many high-skill jobs will also go to Mexico, and cites the increasing skill requirements of jobs in some types of maquiladoras.

[8] The political compensation effect cannot, in the Brock, Magee and Young casting, more than offset the wages effects of the original shock.

against the likelihood of an ever-youthful free trade agreement and in favor of progressive middle-aged spread. I first consider the rational expectations argument, that U.S. producers who are negatively affected by the agreement ought already to have anticipated its effects, fought against it with everything they had, and lost. A significant body of rational expectations literature starting with Muth (1961) suggests that agents may not only draw erroneous conclusions about the future, but that erroneous conclusions may persist in being drawn for a long time. Blume and Easley (1982), construct examples in which both the true model of the world and the wrong model are locally stable - so that agents need not necessarily ultimately converge to rational expectations.

The implications of these claims may be seen as particularly compelling in the case of the imputed effects of a free trade agreement. These effects involve dynamics that imply a long-term increase in productivity (Weintraub, 1990). Scale effects of the free trade agreement motivate increases in productivity in Mexican Industry A, which allow it not only to increase its exports, but to lower its product prices when it sells inputs to Mexican Industry B. This decline in prices motivates a redistribution of input composition in Industry B, so that B's exports now become viable.

In the above case, the impacts of an FTA upon U.S. import-competing sectors progress over time. Where erroneous conclusions about this future have been drawn by U.S. industries or special interest groups, they will ultimately increase their efforts at protectionism. That is, the compensation effect will set in. But it may take a lot of time. The onset of a free trade agreement can then be seen not as the protectionists' loss of their last battle, but the loss of a significant battle in a war that continues.

While the preceding argument may not seem compelling in and of itself, it takes on additional significance when we consider the importance of subterfuge and of the innovation of subterfuge in protectionism. Here I appeal to the voter information paradox (Brock, Magee, and Young, 1991), a dynamic political process which might appear in the United States in response to the dynamic economic process - described two paragraphs back - in Mexico. To motivate the voter information paradox it is useful to note that redistributive behavior, of which protectionism is an elephantine example, turns out to be most successful when undetected (Brock and Magee, 1984). The voter information paradox is that, as voters become increasingly sophisticated in their opposition to protectionism, political parties respond with higher equilibrium levels of more opaque distortions.

The history of trade liberalization is a history of this paradox. When tariff walls are knocked down, quotas appear. When the use of quotas is constrained, "voluntary" export restraints are introduced. The development of these protectionist innovations may be expected to resemble other types of innovations in economic life. That is, innovations will be increasingly applied as rates of return to them rise. Rising imports from Mexico increase the returns to protective innovation in the United States.

So far, I have argued that the intentions of a Mexico-United States free trade pact may be abridged over time because some agents will become more sensitive to their own costs from it, as its effects set in, and because some agents will devise protectionist innovations over time. I have claimed that the free trade agreement may, in later stages of its life, be seen as a noncooperative game.[9] That is, as the free trade agreement reaches middle age, soft spots may be found.[10] However, an additional detail not only motivates erosion more fully, but motivates an even more profound erosion.

I have claimed that the erosion of the effects of the free trade agreement is more likely to occur because of U.S. actions than because of Mexican actions. This detail is directly linked to the likelihood that erosion will take place at all. Erosion is most likely where there is little chance of retaliation. It is when the threat of retaliation is palpable that a free trade agreement is most effective, because of the agreement's propping structure. One component of the agreement may prop up another because, if the exporters do not work against the import-competitors, the whole agreement may go down.

In the case of a free trade agreement involving Mexico and the United States, the threat of bringing the whole agreement down is not evenly balanced between the two countries. Not only does Mexico benefit

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[9] Brian R. Copeland (1990) offers a formalized characterization of this general phenomenon, but without asymmetric threat credibility.

[10] A somewhat different but related argument (Stahl and Turunen-Red, 1989) characterizes governments as subject to random political variations, so that the life span of a particular political administration is likely to be short. The model identifies potential government types which do not base their actions on the maximization of a nation's total welfare, but focus on consumer and producer surpluses, respectively. Individual administrations support either consumers or producers, but not both. In the absence of side payments between the consumer and producer groups, but with short-lived political administrations chosen by a random process, an infinitely repeated tariff-setting game may ultimately generate the erosion of a free trade agreement.

more fully than the United States in the most obvious sense - as expressed by percentage growth rates in gross product - but part of the benefit for Mexico involves the result of the credibility signals discussed previously. This latter point is more compelling for Mexican policy-makers than for their U.S. counterparts, because the United States does not have an overwhelming twentieth century tradition of import substitution to overcome. Since Mexico gains more from the agreement, Mexico has more to lose from its destruction. Since the United States gains much less from the agreement, the United States' threat to withdraw from it is more credible than Mexico's.

If Mexico's freedom to retaliate is more constrained than the United States', then the United States' freedom to abridge the agreement - or at least its effects - is less constrained than Mexico's.[11] That is, the United States can get away with eroding the effects of the agreement to a greater extent before Mexico's threat is credible than vice versa. More specifically, while the credibility of a Mexican threat to abrogate may become palpable once U.S. predatory behavior passes some threshold point, that point may be far higher than the one at which the credibility of a U.S. threat becomes palpable in the face of Mexican predation. If the threats were equally credible, the overall - or collective - potential for erosion of the agreement may be smaller. This notion may most clearly be elucidated by considering the behavior of bullies. If bullies prefer to pick on persons who are smaller than they are, less bullying would take place if everyone were the same size.

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[11] For example, exporters are less likely to lobby against import competitor predation if they do not believe it will lead to the abrogation of the entire free trade pact.

IX. Conclusions

One obvious reason why the United States and Mexico have begun negotiations for a free trade agreement is because both countries imagine they will benefit economically. Mexico gains broader access to a large market, while the United States gains access to a platform for investments in plant and equipment involving the application of low-cost Mexican labor. Moreover, the agreement is likely to provide for additional judicial safeguards that lower the opportunities to reintroduce protectionism through harassment.

While the benefits to the nations involved are palpable, it is important to note that the agreement does not find favor within every group in either country. Some groups will be injured in each country and, if the past is any guide, their injuries will not be fully redressed. As a result, these groups will be motivated to seek additional protectionism through loopholes in the agreement.

The reimposition of protectionism may be particularly strongly motivated on the side of the United States because of the difference between the two nations' abilities to issue credible threats to abrogate the treaty. Because Mexico would lose more from an abrogation than the United States would, U.S. protectionist forces may be able to push their schemes farther before the Mexican threat is likely to become credible.

In sum, the North American Free Trade Agreement cannot be considered as a statue - which is carved, placed on a pedestal, and then exhibited - but ought to be considered as an organism that can age and weaken. The most fundamental policy implication of such a claim is that an ongoing free trade agreement requires ongoing care and, above all, some means to assure that attempts to reintroduce protectionism are as transparent as possible. The motivations to return to protectionism will continue to exist.

It should be noted, however, that even in the face of ongoing efforts toward protectionism, a free trade agreement between Mexico and the United States is welfare improving. What is important to consider is that a free trade agreement will not, in whatever form it takes, represent a once-and-for-all abrogation of protectionism. It simply represents a framework that will permit less efficient forms of protectionism than what may occur without it.

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