low-wage workers in the U.S. may fall substantially. Leamer concludes that the latter is most likely to occur and argues that one plausible set of calculations suggests that NAFTA will increase the earnings of every $1000 worth of capital by $13. At the same time it will increase the annual earnings of professional and technical workers in the U.S. by $6000 and lower the annual earnings of other workers by $1900.

The issue of how NAFTA will alter regional and local production and employment is considered in papers by J. Vernon Henderson and by Paul Krugman and Gordon Hanson. Henderson’s paper focuses on the impact of NAFTA on urban employment in several industries that are likely to undergo expansion as a result of the agreement. These include textiles, plastics, and electrical machinery. Locational considerations and transport costs imply that the most significant expansions in U.S. employment will occur in the west and southwestern regions of the country. While Henderson explores the impact of NAFTA on the location of U.S. production, Krugman and Hanson look at its implications for the location of production within Mexico. Their approach follows that taken by Krugman in a recent series of papers that is aimed at integrating the “new” trade theory, with its emphasis on economies of scale and market structure, and location theory, which stresses increasing returns and market access. They argue that NAFTA will result in an expansion of manufacturing output in Mexico, although the Mexicans will continue to be net importers of such goods, and will cause a reallocation of Mexican economic activity away from Mexico City outward toward the periphery.

The three remaining papers focus on how NAFTA will affect certain industries whose lobbying efforts had a large impact on the NAFTA debate: California agriculture, the automotive industry, and the financial service sector. Robert Feenstra and Andrew Rose consider the increased competition NAFTA will generate for California’s agricultural sector and the important related issue of its effects on water usage. They argue that although freer trade in agricultural goods with Mexico will lead to a more efficient allocation of agricultural resources, these gains may be more than swamped by increased inefficiencies in the allocation of water under the current system for determining water rights. This can be avoided by reforming the system of water rights allocation in conjunction with the implementation of NAFTA.

During the debate over NAFTA one issue that surfaced time and again was the possibility that it might result in a reallocation of automobile production to Mexico as U.S. firms seek out lower wage workers. A related but neglected issue concerns the potential for a vast expansion of U.S. auto exports to Mexico as the Mexican market is opened to U.S. auto firms. Steven Barry, Vittorio Grilli, and Florencio Lopez de Silanes argue that the largest effects of NAFTA on the U.S. auto industry should come from this channel, not from the reallocation channel.

The volume’s final paper by Peter Garber and Steven Weisbrod examines how NAFTA will affect the market for financial services. Conventional wisdom in the U.S. argues that the U.S. has a comparative advantage in the provision of banking and other financial services. The implication is that under NAFTA the U.S. financial sector will play a major role in the provision of financial services within Mexico. Garber and Weisbrod argue against this viewpoint and conclude that under NAFTA the role of U.S. banks in Mexico will continue to be marginal.

Taken as a whole the papers in the volume provide a heavy dose of empirical insight into the effects NAFTA is likely to have on certain selective but important aspects of the Mexican and U.S. economies. These insights are well reasoned and carefully thought out and are a most welcome addition to the discussion surrounding NAFTA.

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The great debate over the proposed North American Free Trade Agreement was pre-eminently a battle of the think tanks. Aca-
Academic economists were overwhelmingly in favor of NAFTA, on general principles. Washington, however, has little respect for general principles and less for academics. Congress and the Administration wanted specific numbers about NAFTA's impact, and they wanted them packaged for political consumption; and so they turned to institutes that specialize in this kind of short-order economics.

Such research institutes vary widely in both quality and honesty. Among the best on both counts is the Institute for International Economics, a small shop that specializes in international trade and financial issues. Hufbauer and Schott's *Nafta: An Assessment* was IIE's entry in the NAFTA sweepstakes; like many previous IIE studies, it succeeded in playing a pivotal role in the debate.

After the introductory chapter, Hufbauer and Schott's book consists of three main elements. A single but crucial chapter discusses the likely impacts of NAFTA on employment. This is then followed by three chapters that provide a mercifully concise description of the actual content of the agreement. Finally, a long appendix compares the actual provisions of NAFTA with a set of recommendations made by the authors in an earlier book, *North American Free Trade: Issues and Recommendations* (Washington, DC: Institute for International Economics, 1992).

The descriptive material in the book is excellent. During the debate over NAFTA, critics of the agreement used to complain that supporters had never even read the treaty; what they didn't point out is that trade agreements are written in a legal jargon that is absolutely impenetrable even to economists. Anyone wanting to know what NAFTA actually involves will want this book just for Chapters 3 and 4. The former describes, clearly and lucidly, how NAFTA will affect barriers to imports in many sectors; the latter describes how it will affect less conventional issues such as direct investment and intellectual property rights.

The appendix, which contrasts the actual agreement with the authors' earlier recommendations, is also surprisingly helpful. It turns out that comparing NAFTA with a sort of idealized North American pact—in effect, comparing what real negotiators achieved with what sensible economists would have done—is a good way to throw both the successes and failings of the negotiating process into relief.

The description of the agreement's provisions, and the comparison with an idealized treaty, occupy the great bulk of Hufbauer and Schott's book. In the debate over NAFTA, however, these were not the parts that mattered: the press and the politicians focused almost completely on the assessment of likely job impacts in Chapter 2. Unfortunately, this is also the weakest part of the book.

The essential conclusion on Chapter 2 is that NAFTA will lead to higher employment in the United States than would have been the case in its absence. Why? Because NAFTA will encourage capital flows to Mexico, which will therefore be able to run trade deficits with the United States. Hufbauer and Schott made more or less off-the-top-of-the-head guesses at the size of Mexico's trade balance with and without NAFTA, divided the difference by standard estimates of value added per trade related worker, and arrived at an estimated net job creation of 170,000—a number that recurred over and over again in the political debate.

It is hard to see why the authors (or anyone else) thought that this was a reasonable procedure. In the first place, it opens the authors to an immediate logical question, which they were lucky their opponents didn't make too much of: if NAFTA is good for the U.S. because we will run a trade surplus, isn't it bad for Mexico—and in that case why do the Mexicans want it?

It also is or should be obvious, even to a politician, that the line of reasoning from NAFTA, through presumed effects on investor confidence, to capital flows and thence via the trade balance to jobs is a pretty shaky construct. How much faith can one have in any such estimate? (In fact, political unrest in Mexico has already led to a slowdown in economic activity, and a sharp reduction in the U.S. bilateral surplus.)

More fundamentally, the Hufbauer-Schott jobs calculation seems to involve a kind of naive Keynesianism, which views output in the United States as purely demand-driven. Even if you think that any natural tendencies
for the economy to return to a normal level of employment are too weak to matter much over a period of several years, surely it is obvious that an inflation-conscious Federal Reserve is not passive—that it would be likely to lean against any effect of NAFTA on demand, positive or negative, and that any effects on overall employment via demand effects would therefore be very small.

Why, then, did Hufbauer and Schott base their most crucial chapter on such a dubious foundation? The answer, surely, is that they were responding to the political exigencies of the moment. Treasury Undersecretary Lawrence Summers caught the mood perfectly when he said of NAFTA that "it's not just good economics; it's good mercantilism, too": because NAFTA probably does tend to improve the U.S. trade balance (even if nobody really knows by how much), it was very tempting to make this easy point rather than try to explain the real arguments in the agreement's favor.

The problem is that intellectual cheap shots, even in a good cause, debase the quality of discussion—and that may be expensive in the long run. What if it turns out that Mexico runs a bilateral surplus one of these years, and American protectionists cry foul? Or what if a future Administration needs to justify trade liberalization in a case where there are no obvious short-run benefits to the trade balance? In other words, what will happen when we need to justify good economics that doesn't also happen to be good mercantilism?

The answer is that Hufbauer and Schott will have made that already difficult task a little bit harder.

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In December 1990, Economists Against the Arms Race sponsored a conference on some of the economic issues associated with disarmament. Papers from that conference were published in a book edited by Jurgen Brauer and Manas Chatterji. The essays are, on the whole, of high quality, although some are dated as a result of the rapid pace of world events. Twenty-five essays address issues associated with disarmament from different methodological and ideological viewpoints. There is, however, no single paper that provides a theoretical model of the problem of disarmament. Because I cannot do justice to so many contributions in a brief review, I will attempt to supply a simple model. I will then use this model to comment on some of the issues raised in the volume.

Imagine an overlapping generations economy with a stationary population. There are two countries (the Reds and the Blacks) that consume two goods, food and defense, which are consumed in fixed equal proportions. The production of defense requires weapons as an input. Food and weapons are produced by sector specific skilled labor and labor that is initially unskilled but becomes skilled after one period. Individuals are born without any skills and in the first period of their lives acquire skill as producers of food or weapons. Food can be produced by one of two processes. In the first, the input of one unit of skilled labor and one unit of unskilled labor produces two units of the food and one unit of skilled food producing labor. In the second, the input of one unit of skilled labor and two units of unskilled labor produces one unit of food and two units of skilled food producing labor. Thus, there is a trade-off between producing food and training people to produce food. Production of the weapons is similar. Further assume that weapons last for one period so there is no accumulation of weapons.

Defense, the good that is actually consumed, is a function of the weapons produced and deployed by both countries. Weapons that are not deployed have no use. If we make some careful assumptions we can construct a defense technology such that if each country devotes half of its resources to the production of weapons, one unit of defense is produced and if both countries produce no weapon then 100 (any very large number)