

COMMISSIONER HILLS: Thank you, Dr. Vargas.
Dr. Thurow?

COMMISSIONER THUROW: I want to be a little
unfair to Mr. Weinstein about Texans loving trade.

If my memory is right, a few years ago there
was a goat issue and we were doing some agriculture
negotiation about goats. And Senator Gramm vetoed the
entire negotiations because it threatened the Texas
goat industry. And I think Texas is like everybody
else; where you think you're going to win, you're in
favor of international trade, and when you think
you're going to lose, even if it's trivial, goats, you
fight like hell for protection, and in that sense I
don't think Texas is different than anybody else.

But economists are strange beasts. They
carry with them things on airplanes to read that
nobody else does, and I want to come to Mr. Leamer's
defense on the average Joe in Texas because I just
happen to have the data because I was reading this
state-by-state analysis of what's happened to income
and wages in the last ten years in the United States.

And one of the things that comes out of the
Census Bureau, if you take the ten states where the

income inequality between the top and bottom growth was the greatest between 1996 and 1998, Texas is on the list. And if you take the ten states where the growth and income equality between the top ten and the middle ten was the greatest, Texas is on the list.

If you go and look at median family incomes and you say the middle 20 percent, what share do they have, where do you think Texas stands? It's the second worse state in America. The only state in America where the middle 20 percent has a smaller share of total income is New Mexico. It's the 49th out of 50.

And then if you go off and you say what's happened to the bottom 20 percent and the top 20 percent, technically you're right. The bottom 20 percent of the wageworkers in Texas have gotten a small increase. Over the last ten years the earnings of that bottom 20 percent of families has gone up by \$339, approximately zero. At the same time the income of the top 20 percent in Texas has gone up by \$18,547.

Now, I guess my question is given that poor performance, why does Texas love trade?

COMMISSIONER HILLS: Are you directing your question to --

COMMISSIONER THUROW: Mr. Weinstein.

COMMISSIONER HILLS: Thank you.

COMMISSIONER THUROW: I'm being unfair and I recognize it.

MR. WEINSTEIN: I've seen that study as well and they use some census data, but this was not a report from the Bureau of the Census.

But you'll notice, if you compare the ten states that have achieved more equality versus those in which the gap appears to be widening, for the most part those that are, quote more equal are small states. They don't have heterogeneous populations. They still have a fairly strong agricultural sector. If you look at the states where these disparities are allegedly widening, they tend to be larger, more industrial states and states that have had a tremendous amount of immigration over the last ten years.

COMMISSIONER THUROW: Yes. But the fact of the matter is if you look at inequality, Texas is the second most unequal state in America. Only New Mexico

is worse. If you use the measure, how much income does the middle 20 percent of the population get, and that's a reasonable measure.

MR. WEINSTEIN: And again, I would explain that in terms of the changing demographic makeup --

COMMISSIONER THUROW: California's had more migration. That isn't true of the other top ten states. If you looked at the bottom states in terms of inequality, Texas would be the only big state in the group.

MR. WEINSTEIN: Texas has a number of economies. The data I was referring to were for the Dallas-Ft. Worth and Houston areas --

COMMISSIONER THUROW: But if I only look at the rich, I only look at the rich. That isn't --

MR. WEINSTEIN: Well, we're talking about two metropolitan areas that account for 50 percent of the state's population.

COMMISSIONER THUROW: Yes. But all the point I want to make is Texas economic performance is poor if you look at income inequality. That's the facts.

COMMISSIONER HILLS: The causal connection there may not be to trade but we have other Commissioners who will follow-up undoubtedly on that issue.

Dr. Weidenbaum?

COMMISSIONER WEIDENBAUM: Thank you. I have a question for Professor Leamer relating to the adjustment to trade deficits.

Like my good friend from Cambridge, I too, read statements on the plane, even footnotes, and so I'd like to call your attention to your interesting analysis beginning on page 2 of your written testimony, number 5, talking about the role of the Fed in all this sort of thing. I found you sketched out a very interesting scenario and then, like a good academic, you covered yourself.

After convincing this reader that you were on to something, you said, "but this is not my prediction. This is a possible scenario."

Well, let me try to tease out of you if not a prediction, you have a more -- what is your most likely scenario? I'm serious in terms of what kind of guidance you can provide.

DR. LEAMER: So you're asking me how I hold my assets, I guess. Do you want to know investment advice? Is that what it amounts to?

I think there are three --

COMMISSIONER WEIDENBAUM: That might be valuable. I don't know your investment record, so I assume it's better than mine.

DR. LEAMER: Three scenarios: One is it's the old economy and that growth comes from putting people to work. The unemployment level so low that the growth prospects for the United States are very slight and another kind of standard recession is around the corner. That's for scenario one.

COMMISSIONER WEIDENBAUM: Excuse me. Could you say that again. I couldn't hear what you were saying.

DR. LEAMER: The traditional old economy got growth by putting people to work. You had high growth when you had a high unemployment and falling unemployment, and that because the unemployment rate is so low -- we're basically at full employment -- there's no prospect for growth through additions to the labor force. That's the old economy.

The new economy says we don't produce it with people anymore, so that the limitations with regard to the labor force are not material for thinking about growth; computer technology and outsourcing -- all these kinds of technological changes are going to make next year and the year after just like this year, with extraordinarily high rates of GDP growth and tremendous appreciation of U.S. assets.

It's a new economy and all the data in the past is totally irrelevant, except for this last year.

And the third scenario is the one that I laid out in my written testimony which is the U.S. is doing so well over the last few years basically because of the high risk in the emerging markets, starting with Mexico and Brazil and Indonesia, et cetera, so that the global investors are seeking a safe haven and they've plowed a lot of money into the United States. And when those emerging markets asset markets start to settle down, the global investors start to look in that direction and then you get a very serious problem for the Federal Reserve Board, as I've said.

I think that last scenario has a pretty high probability. I'm not a new economy kind of guy. I look at the data and I have to hold on to the historical data. I'm just not a big believer in the dot.coms and the new economy, so I say it's either the old economy in which there's sort of a standard recession fairly soon in the future or a more serious problem.

It's not going to be Mexico in 1995. It's not going to be as severe as that, because the United States' dependence on external markets isn't similar to Mexico. But the idea that there will be a global flight from U.S. assets that will cause very severe problems for the United States, that seems like a high probability.

COMMISSIONER WEIDENBAUM: Thank you. That's all.

COMMISSIONER HILLS: As a follow-up, let me step out of my role as Chair and just ask: when you see us as the equivalent of Mexico or refer to the problems in Asia, do you really think that there would be a massive capital flight from the U.S. because this

year or next those markets offered lower risk, higher rewards thus causing a sharp crash here?

DR. LEAMER: Yes. I'm using my own rhetoric here and overstating the case. We're not going to have a dramatic change in the U.S. economy like in Mexico and Indonesia. I don't foresee that. But I can foresee a sort of slow moving out of U.S. equities, a decline in the value of the dollar, an attempt by the Federal Reserve Board to maintain the value of the dollar by higher interest rates, and thus a more severe recession than in 1990-91.

COMMISSIONER HILLS: And isn't that the natural mechanism for the correction?

DR. LEAMER: Well, the problem is hot money here. These emerging markets are suffering from the hot money problem, where global investors are buying liquid assets and then getting out. They're causing big problems for these emerging countries -- huge amounts of unemployment and slow rates of growth for these emerging markets. And the U.S. too is susceptible to hot money fluctuation.

COMMISSIONER HILLS: I don't want to abuse my position here, and we have Commissioner Zoellick, who would like to ask a question.

COMMISSIONER ZOELICK: Thank you. I'd like to thank the panel. I had a chance to look at their papers. I know they had to speak quickly, but I appreciate the effort they put into it. I have two questions.

I believe the Federal Reserve Bank of Dallas has done work on mobility within income distribution, and if so, if you would relay that to Commissioner Thurow, because I think it might be useful to focus on the fact that we have a dynamic economy as opposed to a static one, and I found the results, as I recall, looking at the University of Michigan data, to be quite startling about the mobility of people within those income quintiles.

The two questions I have -- one relates to anti-dumping rules, and this is for whoever feels most competent on this.

It seems reasonable to me to try to deal with unfair practices like dumping. The problem I have is how do you define dumping? And I've been

particularly struck that as I've looked at pricing models that some of the Internet companies are now using, they would seem to violate the anti-dumping rules because they are basically selling at a loss to try to acquire large customer bases, which they see as an asset.

So I would appreciate, since I think these rules are going to become increasingly important, if any of you could give me a sense of how I should evaluate the rules that we're using for anti-dumping.

The second question also plays off information technology. Clearly we see a huge transformation in terms of information technology and communications technology, now with the Internet, new business models for companies in the United States and all over the world.

Do we need to change our approach to trade negotiations because of these changes in business models? Should we have different goals than we've been having for a long time in our trading system because of this change in the Internet economy?

COMMISSIONER HILLS: Don't all rush to the microphone.

(Laughter.)

COMMISSIONER HILLS: Dr. McKinney?

MR. MCKINNEY: I'll start. I think there have been problems all along with the application of anti-dumping rules, and they are complicated some by the changes -- technological changes -- that we see currently. How things will develop here is not easy to predict.

An economist at the International Trade Commission said to me a year or so ago that he thought changes in the anti-dumping rules were inevitable because they were being emulated by other countries, and as U.S. corporations got a dose of their own medicine, so to speak, he thought there would be significant political pressure brought on Congress for that change. I don't know that that has begun to happen yet, but that was his assessment of the anti-dumping situation.

With regard to whether we need to change the rules with regard to trade because of changes in technology, I doubt that we do. I think the striving for --

COMMISSIONER ZOELLICK: Excuse me. The question wasn't rules. It was goals.

MR. MCKINNEY: Goals.

COMMISSIONER ZOELLICK: In other words in the trade liberalization agenda, should we be focusing on different goals?

MR. MCKINNEY: Goals. No. I think our major goal has been an open economy based on certain rules, and I don't see -- personally, I don't see why we would need to change our goals because of the changing technology. I'll defer to some other members of the panel --

COMMISSIONER HILLS: Would any of our panelists like to comment on the questions? Professor Leamer?

DR. LEAMER: I think regulation of competition inside the United States should be the same as regulation across borders, and to push that a little farther, I think anti-dumping is a disgrace. It's a way of imposing trade barriers and appearing to be out for a free and open economy. We're teaching every other country in the globe how to close down its borders in this hidden discretionary way --

COMMISSIONER ZOELLICK: Could you just expand -- that's a conclusion but could you just expand on your logic a little bit, because I think most people here are anti-dumping and it sounds like you should be against dumping. So why do you say that you think it's a bad --

DR. LEAMER: I thought your question invited its own answer, which is you said these Internet firms were charging low prices. That sounds good to me, not bad. And when foreign firms charge low prices, that sounds good to me, too. If it's predatory pricing then the same regulatory legal structure that applies to competition inside the country ought to apply across borders.

Why do we treat cross border commerce with this separate regulatory legal apparatus? It's only a device for rendering -- for transferring wealth to U.S. corporations. They use it as part of their strategy. Wouldn't it be great for Texas if Texas could get anti-dumping actions against every other state in the country? And every corporation in Texas would do that if that were an option, but it's not

allowed inside the borders of the United States,
wisely.

MR. WEINSTEIN: Just a quick comment,
Commissioner Zoellick. You talked about the pricing
models as you looked at -- I'm sure you appreciate how
difficult it is to determine what dumping is.

And I would hearken back to some comments
earlier today, the kind of unilateral disarmament
argument. Dumping or predatory pricing, whatever you
want to call it, can't go on forever. At some point,
the company's going to go belly up or the industry's
going to go belly up.

And so I would like to see some rethinking,
but I'm also concerned, as the other panelists are,
about the tremendous abuse of the anti-dumping laws
that's occurred.

COMMISSIONER HILLS: Commissioner Rumsfeld?

COMMISSIONER RUMSFELD: Thank you, Chairman.

I appreciate the presentations of the panel and the
responses to the questions.

I'd like to give Mr. Weinstein an
opportunity to expand a bit on the earlier question
about income inequality. I don't read footnotes on

airplanes, and I'm not particularly knowledgeable about the innards of the income inequality data. But I'm uncomfortable with it, instinctively because of the fact that in my experience, the world isn't static; that there's a good deal of mobility and people moving in and out of those various quintiles and quartiles, and it strikes me that that's not a trivial point.

MR. WEINSTEIN: No, it's not. There is a lot of dynamics within the bell curve -- within the income distribution.

I'll give you one example of a dynamic here in Texas, which is a state I know best. In 1982, per capita income in Texas was about 2 percent above the U.S. average, and that's the wealthiest we've ever been. If you want to use the per capita income model, the wealthiest we were ever -- we've ever achieved in Texas was 2 percent above the U.S.

After the energy and real estate busts and all of the other vicissitudes from the mid-1980s, per capita income in Texas slipped to 12 percent below the U.S.

COMMISSIONER LEWIS: What year was that?

MR. WEINSTEIN: Well, I'd say between 1982 and 1987. In five years in Texas -- and we had maybe 13 million people then. We've got 20 million people today -- we went from 2 percent above the U.S. to 12 percent below. And since the recovery began in the late '80s, we have crept back up to about 95-96 percent of the U.S. average.

So we have felt the winds of trade and changes in the global economy, but as I said earlier -- and we can debate this until the goats come home -- but --

(Laughter.)

MR. WEINSTEIN: -- our open economy and in our trade our focus -- our global business focus -- and it's really help improve the economy of this state. And we're still a poor state. I admit it. We are a poor state by the per capita income measure. We have an income distribution that is highly skewed, but if it weren't for trade and international investment, I think the situation would be much worse.

COMMISSIONER HILLS: Commissioner Angell?

COMMISSIONER ANGELL: I want to thank the panelists for their statements advocating free and

open trade. I particularly appreciated, Professor Weinstein, your giving us advice and hoping that we will become advocates for free trade and a vocal critic of protectionism.

Now, it seems to me that we have one agreement already as to what we should do from these four panelists, which is, I presume, you're advocating we should repeal all our anti-dumping laws. But beyond that, what you have to say about the factors that derailed the talks in Seattle that the linkup between worker standards and environment and free trade, if we all agree that it's a good goal to have better working conditions in the United States and around the world and it's better to have a good environment, is there any gain that can be made as you see it by linking these issues?

COMMISSIONER HILLS: Are you directing your question --

COMMISSIONER ANGELL: Well, yes. I'm directing it to Professor Weinstein, since he is advising us, and I presume that the greatest obstacle is the linkup between labor and environmental issues,

but I would be open to replies from any other members of the panel.

MR. WEINSTEIN: This whole trade issue became so convoluted during the Seattle follies, and unfortunately, the media hype and all the other stuff was -- that was going on and some of the aftermath has really diverted attention from some of these basic issues. World Trade Organization meetings probably shouldn't be public and media events, but that's another story.

This question though about should we be tying labor standards and environmental issues to trade explicitly? I guess I'd say no, only because I believe that expanded global commerce by itself helps to improve working conditions in other countries, and I haven't been all over the globe, but I've spent a fair amount of time in Mexico and at the maquiladoras, and I would argue that working conditions in the maquiladoras are a lot better than they are in many other work places in Mexico.

So that's kind of my feeling. I'd like to hear what the other panelists have to say.

COMMISSIONER HILLS: Dr. Vargas?

DR. VARGAS: I think that one of the merits of NAFTA is that it has to be recognized that it's the only agreement of its kind that already has side agreements on labor and the environment, so irrespective of the fact of whether trade should be tied to these two issues, it's at least good that there are side agreements that are attentive to whatever issues do surface that have to do with labor rights and the environment for the benefit of all the parties concerned.

So at least it's positive that we have these arrangements to deal with externalities or side effects that NAFTA or trade might have on these two topics.

However, I agree with Dr. Weinstein that trade is proven to grow economies, and the more the economy grows, the more attentive that economy is to raise its environmental standards, therefore, lower pollution. And the more the economy grows, of course, the more jobs you get, and therefore, the more attentive the economy generally is to the labor conditions associated with those jobs.

So in general -- in general terms, I don't think there should be a tie-in because by itself it will be corrected if you just let trade grow. But in terms of side effects on labor and the environment -- NAFTA does bring those two side agreements to the table to at least address matters that concern all parties involved if there's unfairness on those two issues.

MR. MCKINNEY: With regard to labor and environmental issues, whether we like it or not I don't think these issues are going away. I think they will have to be addressed within the multilateral trade framework. We may well have to develop institutions such as those that are part of the NAFTA side agreements at least to increase the public's comfort level with regard to these issues.

With regard to the effects of trade on the environment, there were two interesting recent studies. A study by the World Bank found that rather than a race to the bottom, in fact environmental conditions in less developed countries are improving during a time of trade liberalization and rapid growth in international trade.

Also the North American Commission on Environmental Cooperation studied environmental issues within North America, and they also found that, as best they could determine the impact of trade on the environment in Mexico had been positive in that the industry mix is changing in a way that is favorable to the Mexican environment. Some of the heavier industries in Mexico that were heavily polluting were industries in which Mexico did not have a comparative advantage, and in fact the increase in trade with Mexico is working in a favorable direction with regard to the environment there.

DR. LEAMER: I agree with the other panelists, but I would also add one comment. If you want to look at the countries that have had improvements in economic well-being over the last couple of decades, look at the Asian countries: Japan, Korea, and Taiwan, et cetera. These countries had their improvements not because they had labor standards imposed on them by the United States but because they had open access to the best high wage marketplace in the world, the U.S. marketplace.

And we want to encourage growth in Mexico, surely NAFTA is going to do that.

COMMISSIONER HILLS: Commissioner Wessel?

COMMISSIONER WESSEL: Thank you. I would like to ask a number of questions of Ms. Vargas relating to maquiladoras.

During negotiations on NAFTA, President Salinas and a number of others involved in the politics of the negotiations indicated that the maquiladoras would cease to be part of the developmental model of Mexico. Number one, they would cease to, in terms of number, have the dramatic growth rate, and number two, that they would move inland; that there would be an effort to try and expand growth in other areas of the economy.

And I think we've seen probably just the opposite. There certainly has been some growth in other areas but we've seen, I believe, a doubling of employment on the border. I believe there are close to 3,000 maquiladoras now, if not more. We've also seen, I think, attendant with that, a dramatic increase on the pressures on the infrastructure along the border. Somebody talked about the NAFTA highway

and the long lines at the border, which I've sat in for well over an hour, and that's not dissimilar to what the trucks sit in.

With the pollution that comes from that, cases of anencephaly in Nogales, on our side of the border, et cetera -- and so the health, environmental and on the other infrastructure concerns. Where do you see the maquiladoras in terms of the developmental model, not only in terms of how Mexico views it but also in terms of how our own companies view it?

Business Week several weeks ago ran an article on how General Electric is viewing that -- Mexico as a major component of their strategy for industrial production in the coming years.

So how do you see their developmental model proceeding in the next couple of years and what costs on our own economy did we not anticipate as part of the NAFTA negotiations?

DR. VARGAS: I think the maquiladora industry will continue to be a very important component of the Mexican economy and of U.S. corporate strategy to try and be competitive worldwide. I think it's not sufficiently recognized that NAFTA came with

a mandate for the North American Development Bank to address infrastructure problems that were being created at the border specifically through the sheer growth of the maquiladoras or just trade outside of the maquiladoras.

So the Border Environment Cooperation Commission, which responds to NADBank on these issues and is funded by NADBank, is taking care of some of the bottlenecks that may have resulted in the dynamic growth that occurred prior to NAFTA and the growth that is continuing to occur in the maquiladora industry. So if anything, NAFTA has put the spotlight on the border to try and raise funds at the state and federal levels, even in addition to what BECC and NADBank are doing, to try and correct these bottlenecks, to the benefit of both sides of the border.

Regarding the critical component that maquiladoras can be for a U.S. company or are for a U.S. company such as General Electric, I think one of the reasons GE may be saying that it is viewing Mexico as a major component of its industrial production strategy is that you may know that Mexico has been

very aggressive in signing free trade agreements throughout the hemisphere. It's got free trade agreements with a lot of South American countries, Central American countries, and has just signed a trade agreement with the European Union.

So a lot of maquiladoras are positioning themselves not just to sell within the NAFTA territory up north, but also to sell unimpededly into the southern part of the hemisphere. Now, also, they'll be able to sell west to the European Union. Mexico's also part of the APEC group of Asian countries so they can sell east, as well.

So I think the maquiladora strategy virtually is telling U.S. companies and European companies and Asian companies -- because all of those companies are represented in the maquiladora structure -- that if they locate in Mexico they don't only achieve production cost benefits but can also sell north, into Mexico and anywhere in the world.

COMMISSIONER WESSEL: In terms of the cost of the maquiladora -- the increase in the maquiladora employment and production, have you done estimates on what the infrastructure costs are, what the health

impact is? We heard earlier that NAFTA has been win-win, but in fact there are increasing costs along the border and pressures that we're going to have to meet through these existing organizations and additional resources.

Do you have an estimate on what those resources might be?

DR. VARGAS: I -- we've not done studies at the Federal Reserve as to what costs the maquiladoras bring to the border in terms of negative externalities or any kind of infrastructure associated costs. But I've posed the same question to the Border Environment Cooperation Commission, which happens to be based in Ciudad Juarez on the Mexican side of the border, and they apparently are collecting the data to try and come up with assessments -- definitive assessments to see what costs are associated and what action plans can be pursued to try and correct some of these sort of infrastructure bottlenecks.

I will comment, however, that although it may not be known what kinds of costs in terms of social infrastructure may be occurring because of the dynamic growth the maquiladoras have presented to

border economies on the Mexican side, maquiladoras are being part now of the solution to correct some of those bottlenecks.

For instance, Delphi Automotive in 1997 structured a program to try and make affordable housing available to their workers because they, of course, were recognizing that a lot of workers were coming from the interior and cities like Ciudad Juarez weren't able to accommodate some of these workers in housing, and Delphi Automotive, which used to be part of General Motors, took matters into their own hands and decided to do a joint venture type of an agreement with the Mexican government to try and produce this type of housing and assist workers with financing.

Since then, other big maquiladora companies have followed the same example as Delphi Automotive. So I guess what I'm trying to say here, that it's going to be a combination of the private sector, meaning maquiladora companies themselves, to try and look at where they can intervene to try and correct some of these bottlenecks, but in association also with the Mexican government and even with the sort of compromise-type of structures like NADBank and other

NAFTA related organisms have produced to solve some of these infrastructure problems.

COMMISSIONER WESSEL: My recollection -- the issue of the housing though, there is a legal requirement that they make contributions, and there is some question of whether those contributions were being made to the housing fund. So in fact that's a legal requirement and not necessarily out of the goodness of the heart of all these corporations in terms of addressing the housing problems in the colonias, et cetera.

Let me turn to one other issue. You raised the question of for the first time NAFTA linking labor environmental issues, albeit in side agreements, but creating that as a model, and I'd like to hear from the other panelists. The model there was not to impose higher standards, U.S., Canadian, or other standards on Mexico, but rather to address the enforcement -- the lack of enforcement because of resources and potentially in some areas as part of the developmental model.

If the issue is trying to ensure that as we look at signing new trade agreements with other

countries that the rule of law will be equally applied, whether it's on intellectual property, whether it's in labor, environment, or other issues. How do you view that; rather than the imposition of higher standards simply saying as we look at a model - a country's model of their economy, we view labor and environment as part of the competitive equation? And I open that up to all of the panelists.

MR. MCKINNEY: I'll respond first. I think certainly we do have to take account of differences in countries. These provide the basis for comparative advantage. The model that was developed in NAFTA perhaps does provide a blueprint for something that can be done on the multilateral level.

As you indicated, in NAFTA the agreements were that each country would enforce its own environmental and labor standards, and that citizens from any of the countries involved could "blow the whistle," so to speak, if countries were not abiding by their own environmental and labor standards. You might wonder what good would that do if each country is able to set its own environmental and labor standards, but I think countries do have an

international reputation that they are sensitive to. Because of that, they sign on, for example, to the ILO labor standards of conduct and to environmental treaties and so on and sometimes do not follow through with the enforcement of what they have agreed to do.

So I think that something like we have in the NAFTA agreement could have a salutary effect on environmental and labor standards around the world.

COMMISSIONER HILLS: Does anyone else wish to comment? I would like to point out that we have two more Commissioners that are on my list, and we have 15 minutes remaining.

MR. WEINSTEIN: Real quickly, don't misconstrue the comments I made earlier. I'm not opposed to environmental and labor standards and protocols. I just think they should be separate from the trade negotiations and investment and the like.

And one other comment -- you had asked Ms. Vargas about the maquiladoras and some of the social and economic impacts. They've had a very positive impact on the U.S. side of the border, even though they're located in Mexico. Four of the ten poorest

counties in the U.S. are located in south Texas in the Lower Rio Grande Valley.

For the first time in 30 years, they've got single-digit unemployment rates, with the exception of McAllen. These are the cities -- the metropolitan areas. Without question, the maquiladoras and all that border activity is having a positive economic impact on not only the poorest region in Texas but one of the poorest regions of the United States, creating tens of thousands of new jobs.

And what I hope is that five years from now, when we see these per capita income figures, that those four counties are no longer on the list of the ten poorest.

COMMISSIONER WESSEL: The point of my question though is to also address the externalities, because as you indicate, yes, there may have been employment gains, but having been with Congressman Sylvester Reyes in his town recently, he pointed out the dramatic infrastructure problems, and in fact there is a rampant pollution on the Juarez side and that has had an impact on health.

So there are externalities that we need to take account of as we look at what the benefits have been. I believe that the border institutions create the foundation to help address that, but I have a problem that the resources as well as the political infrastructure has not adequately addressed that yet.

MR. WEINSTEIN: And I agree with you on that.

COMMISSIONER HILLS: Commissioner Lewis?

COMMISSIONER LEWIS: Thank you very much for your presentations. I think that Dr. McKinney and Weinstein both said that you assume they're running a surplus with Mexico or that the trade deficit with Mexico will get less. I think you've each said something similar to that.

We had heard a long time about the twin deficits of U.S. economy and the trade deficit, and that if we somehow got the budget deficit in balance, the trade deficit would get less, and we found that wasn't so because U.S. savings rate has deteriorated more.

If, in fact, the trade deficit with Mexico worsens over the next few years, would that cause you

to rethink your present conclusions about what's happening.

MR. MCKINNEY: It would depend on what caused the worsening of the trade deficit. If, for example, events in Mexico unfold in such a way to make the investment climate there much less favorable even than it is today, then certainly I would have to revise my expectation with regard to what would happen to our trade balance with Mexico.

COMMISSIONER LEWIS: What is your time frame on your two predictions as to what's going to happen with trade with Mexico? What time frame were you thinking of?

MR. MCKINNEY: I would think, as I said, if the presidential election in Mexico goes smoothly and if the new Administration sends strong signals that it's going to not only not reverse the economic reforms in Mexico but perhaps proceed further with those, that will be viewed very favorably by investors not only in this country but in other countries. In that case there will be a substantial increase in investment in Mexico in fairly short order, I would think, that will provide foreign exchange beyond what

Mexico needs to service its very large foreign debt and that will enable them to upgrade their capital stock.

And I think --

COMMISSIONER LEWIS: Do you expect that within three years?

MR. MCKINNEY: I would say three to four years. Yes. That would be my best guess.

COMMISSIONER LEWIS: Thank you.

MR. WEINSTEIN: I didn't predict that our deficit with Mexico to go back into surplus, but it is true, we were running a surplus I think through the first year of NAFTA, and the Mexican economy goes in the tank, and since then we've been running deficits. But without question, that deficit with Mexico has helped the Mexican economy recover, so I would certainly expect that trade deficit to narrow in the years ahead.

But there's another -- there are two related issues, and maybe you all have come across this in your other hearings. Number one, there is so much production sharing within NAFTA and stuff going back and forth that I'm not sure what we're counting

anymore. Second, if NAFTA is one of these days going to become a true free trade area or even a common market, then this type of accounting is meaningless.

It will be --

COMMISSIONER LEWIS: Let me just understand one thing you just said.

MR. WEINSTEIN: Yes.

COMMISSIONER LEWIS: The deficit with Mexico has helped Mexico recover?

MR. WEINSTEIN: What I'm saying is --

COMMISSIONER LEWIS: Mexico's surplus with us has helped Mexico --

MR. WEINSTEIN: Has helped our -- their surplus has helped the Mexican economy --

COMMISSIONER LEWIS: So if a Mexican surplus helped them recover --

MR. WEINSTEIN: Yes.

COMMISSIONER LEWIS: -- then how does our deficit help us?

MR. WEINSTEIN: Our deficit with Mexico?

COMMISSIONER LEWIS: No. With the world. Mexico had a surplus with us which helps them.

MR. WEINSTEIN: Yes.

COMMISSIONER LEWIS: But we have a deficit with the world which also helps us. So on one case a surplus helps them but a deficit helps us.

MR. WEINSTEIN: There's the real economy out there then there are the ways that we count. What I said earlier was that, yes, we have a deficit and I think the deficit is more their problem than our problem. What I mean by that is if and when we see some significant economic growth in Europe, Latin America, Asia, which -- they're doing better today than they were a year or two ago -- I would expect that deficit to narrow, because they'll be buying more of our exports.

And as I said earlier, our export performance has really been quite good. November was a record month for U.S. exports. Unfortunately, the global economy doesn't march in locked step. Some of us economists believe as the global economy becomes more economically integrated we won't see these disparities to the same degree, in which case the surpluses and deficits might not be as large in a particular time frame and maybe we won't be focused on them as much.

COMMISSIONER LEWIS: Thank you. I have one question for Dr. Vargas and one for Dr. Leamer.

Dr. Vargas, isn't it true that, as Dr. Weinstein said, the counties along the U.S. Mexican border are among the poorest in the country. Isn't it true that in the last five years the unemployment in those counties has actually increased?

DR. VARGAS: No. That's --

COMMISSIONER LEWIS: It is not true?

DR. VARGAS: No. It is not true. If you look at a trend, say, pre-NAFTA --

COMMISSIONER LEWIS: Yes.

DR. VARGAS: -- 1993 up through 1999, the trend would be downward in all -- at least in the four major border Texas metropolitan areas.

COMMISSIONER LEWIS: I see.

DR. VARGAS: So they're lower than even pre-NAFTA, all unemployment rates; in some cities more than others.

COMMISSIONER LEWIS: And then, Dr. Leamer, I would like to ask you a question.

As somebody who found it difficult to find a barber on Nassau Street, I'd like to ask you about

your barber's job contested by Chinese workers. I don't quite understand that. But I also want to ask you the serious question -- the European Union is running a trade surplus with Mexico, both before and after NAFTA, and ours has deteriorated. Even with the peso devaluation the European Union is running a surplus with Mexico.

Why the difference between these two trading blocks?

DR. LEAMER: First with regard to my barber

--

COMMISSIONER LEWIS: Yes.

DR. LEAMER: -- Los Angeles has an active apparel district.

COMMISSIONER LEWIS: Right.

DR. LEAMER: Princeton doesn't.

COMMISSIONER LEWIS: Right.

DR. LEAMER: Your barber in Princeton is not -- his or her job is not contested with the Chinese, but in Los Angeles we have a very active apparel district. Those jobs are contested by Chinese production. So if a Chinese worker takes that job away from the U.S. worker in the apparel industry,

that man or woman starts to look to the barber shop,
and that's the major connection.

So the main point is that import levels by
themselves do not indicate the breadth of
contestability in the U.S. economy. And nobody knows
the answer to how broad it is, but it's a lot broader
than suggested by import levels.

Secondly --

COMMISSIONER LEWIS: So Russian barbers,
therefore, are contesting the Dallas barbers?

DR. LEAMER: But there's not really a
material link between the Russian product and the
product being made in --

COMMISSIONER LEWIS: In Dallas.

DR. LEAMER: -- in Dallas. Dallas is not
much connected with China either. It's the apparel
sector that you want to see --

COMMISSIONER LEWIS: I see. Thank you.

DR. LEAMER: Then I want to go back to labor
standards. I think a word that you need to put in
your discussions and thinking is transparency. When
the government takes actions, I'd like to get a bill.
I'd like to know how much that action is costing.

I'd like to have it transparent. And the value of a tariff is that it's very transparent. I can see how much extra I have to pay in order to have that product.

The problem with this vast array of non-tariff barriers, including anti-dumping, is I'm paying -- I'm making some kind of tax payment for all that stuff but I never get a bill. I never know how much I'm really paying. And when it is a successful anti-dumping action, maybe some economist could figure out how much, but the mere threat of anti-dumping actions is making me pay more for those products, and I don't know how much.

That's not good because it means that the government is taking actions that I as a voter or citizen don't know how much it's really costing. I don't know if the benefits are worth the cost. That's true with labor standards as well. They're very non-transparent.

Maybe we have this charitable attitude toward the Mexicans and Chinese, et cetera. Maybe it's well intentioned that we're going to somehow improve the well being of those people in those low-

wage countries. Well, let's find a way of making it transparent. Let's make our donations directly out of our wallets rather than indirectly through this labor standards mechanism, because I don't know how much I'm contributing.

COMMISSIONER LEWIS: Have wages in Mexico increased since NAFTA, on the average?

DR. LEAMER: In the northern states they definitely have, so this goes back to this issue of distance. The southern states of Mexico might as well be on the moon as far as the United States is concerned. Chiapas and even Mexico City is too far away. There is what's known as the gravity model in international economics. It describes trade between different points in space.

That gravity model says that product doesn't flow -- most product doesn't flow more than 1,000 miles. So the northern states of Mexico are genuinely being integrated with the southern states of the United States for sure, and there have been wage improvements, and there's been a movement of business a little farther south in Mexico where you see somewhat lower wages.

Correct me if I'm wrong, because I may be shooting my mouth off, but I'm --

COMMISSIONER LEWIS: Could you tell me your view about the European Union trade with Mexico?

DR. LEAMER: I don't know.

COMMISSIONER LEWIS: You don't know?

DR. LEAMER: This whole discussion that we had -- that you had just a minute ago was talking about current account, goods and services, and I think fundamentally we ought to think about these deficits and surpluses as being driven by the capital account.

Mexico is running a huge deficit of 4 or 5 or 6 or 7 percent of GDP in 1993, not because they couldn't sell exports but because Wall Street thought that was one heck of a good place to locate -- to purchase assets.

And then we've got Wall Street's disenchantment in Mexico. The deficit turns around virtually overnight, within a few days. And that's not because of anything having to do with products. It has to do with assets only. In my scenario only about these emerging markets are getting quieter and less risky. That's a scenario in which Mexico starts

to run, again, a very substantial deficit, as they should.

There ought to be an investment flow into Mexico out of the United States. It shouldn't be going in the direction it is now. The reason it's going now in my mind is because we have this crazy equities market which is creating over valuations of stocks and making everybody want to buy U.S. equities, when you ought to be making real investments in these emerging markets.

When people start coming to their senses with regard to the proper valuation of U.S. equities, then you'll see Mexico running a big deficit and the U.S. running a surplus.

COMMISSIONER LEWIS: So you really have no opinion about the European Union trade with Mexico?

DR. LEAMER: No. I like to give opinions about things that I've thought carefully about, and that's not one of them.

COMMISSIONER LEWIS: Okay. Fair enough. Thank you very much.

COMMISSIONER WESSEL: Could Ms. Vargas though please respond --

COMMISSIONER HILLS: Wait --

COMMISSIONER WESSEL: I'm just asking her to respond to the question on real wages.

DR. VARGAS: Wages in Mexico?

COMMISSIONER WESSEL: Yes.

DR. VARGAS: Wages in Mexico suffered in 1995 because of the economic recession that Mexico witnessed as a result of the peso devaluation in late 1994. So your question of whether wages have improved since NAFTA was signed has to be put in light of other developments that happened in the Mexican economy which include that very deep recession of 1995.

However, Mexico was able to relatively quickly recover from that recession to where now in 1999 wages are higher than in the pre-devaluation period. Just slightly though in the overall manufacturing sector, but if you just take the maquiladora portion of that sector, definitely the progress has been up and much more quickly than in the non-maquiladora sector of the Mexican economy.

Why? Because this maquiladora sector is very much linked to the prosperity and growth of the

U.S. economy, so that sector didn't shrink with the recession; it boomed as these companies expanded.

Now, the other thing with wages is that if you viewed them in dollar terms, yes, you're going to see a decline. But in peso rates, real terms, right now they're slightly positive.

COMMISSIONER LEWIS: Slightly positive to the pre-NAFTA days?

DR. VARGAS: Correct.

COMMISSIONER HILLS: We have two Commissioners who desire to ask a question -- Wayne Angell has a very quick question -- we have five minutes -- and our esteemed Vice-Chairman has the last word. So that's going to be the lay of the land in the last five minutes.

COMMISSIONER ANGELL: I thought that Commissioner Lewis had a very important direct question that I detected some hesitancy to answer, and that is if Mexico's surplus is helping Mexico, has the U.S. deficit helped the United States? And I would presume -- dissent if you like -- I would presume that given our technology economy that has driven productivity in future income flows and wealth up

above \$40 trillion, that that then gives cause to American households buying more than we are -- it seems able to produce at this point in time and thereby our deficit is a direct benefit to the United States.

Alan Greenspan, I think, is so overly concerned about running out of labor that I think Alan Greenspan would have -- and the others on the FOMC probably would have risked increased interest rates much more rapidly if we had not had this inflow of goods to satisfy consumers. Disagree if you like.

MR. WEINSTEIN: In a non-inflationary way.

COMMISSIONER ANGELL: In a non-inflationary way.

COMMISSIONER HILLS: Can we have a very quick response to that?

MR. WEINSTEIN: My response would be the deficit hasn't hurt.

COMMISSIONER HILLS: Yes. Did you want to respond, Professor Leamer?

DR. LEAMER: Yes. Think about whether you want to invest in Mexico. The problem with Mexico is it became a very unattractive place to invest, and

what they need to do is to sell exports to the United States and look for high growth in exports. They need to grow the economy. When both of those things start looking good, that's when you'll see Mexico grow into a deficit again.

COMMISSIONER HILLS: Dimitri, please.

DR. PAPADIMITRIOU: Thank you very much.

Thank you very much for your commentaries.

I think they'll be very helpful in our deliberations.

I have more of a general question, and perhaps a follow-up question.

In the 1980s most of us had been concerned, at least in the economics profession, about the problem of the twin deficits. Somehow or other, we always thought that there would be a day of reckoning. Having managed to solve one of the deficits, now we seem to not worry about the other. You say that, well, it's really the result of the growing economy and if the markets ultimately decide that the trade deficit is not good, then that will be self-corrected.

I'm particularly interested in Professor Leamer's answer because you have said, if I heard you right, that you don't believe in the new economy; that

in fact this is still the old -- you don't believe in the dot.com economy; therefore, shouldn't we worry about the trade deficit as we did in the 1980s -- I would be interested in your answer as well as to hear from the other panelists.

My follow-up question is that if we're to look at the net foreign investment, the statistics in the net foreign investment do not indicate the transfer of stock, that is, transfer of ownership, so when Daimler-Benz buys Chrysler, there really has not been any foreign investment, but in fact a change of paper. And yet in those statistics the transaction is reflected as a net foreign investment.

Thank you.

DR. LEAMER: I'll speak to the deficits. My view is that the twin deficits problem is caused by an accounting error. The liabilities that are needed to pay back the Federal Government's borrowing, the future tax liability are not put on our personal balance sheets, because I think you're going to pay the taxes and you think somebody else is going to pay the taxes. Consequently, what the federal deficit did

is it made us all feel wealthier than we really were, and that encourages borrowing from foreign sources.

I think we have another sense -- there's another sense of overvaluation in the U.S. today. The reason we're all feeling so wealthy today is not because of the accumulation of Federal Government debt, which we're not putting on our personal balance sheets, but rather this huge appreciation of equities, which I think is ephemeral and going to disappear.

And it's making us all feel a lot wealthier than we really are and we spend like crazy. Our savings rate is really going down. And that I think is a big problem for the economy. I forget the other question.

COMMISSIONER PAPADIMITRIOU: Yes. That question has to do with the statistics of the net foreign investment that do not distinguish the change of equity.

DR. LEAMER: Yes. So we need to -- I think we need to distinguish between sales of existing assets and borrowing to finance the accumulation of additional assets. And we're doing way too much, as is implicit in your statement. We're doing way too

much selling of our current assets, apparently because foreigners think that those assets are more valuable than we do, and that seems like a more problematic situation -- it's like pulling down a bank account.

The trade deficit is like pulling down a bank account rather than borrowing -- spending the money on consumption rather than investing in new plant equipment. And that seems problematic to me, because we've got to pay it back in the future.

COMMISSIONER HILLS: We're grateful to all four panelists. You've really done a splendid job, and we very much appreciate your time and thought and your submitted remarks. We've gained from it. We have come to the end of our time, and a little more, and we must go into our 11:30 panel.

Thank you so much.

(Pause.)

COMMISSIONER HILLS: We've now reached our panel on the interaction of trade and investment. We are very delighted that you're both here.

Dr. Mohatarem from General Motors, we'll ask you to lead off, and it's good to see you.