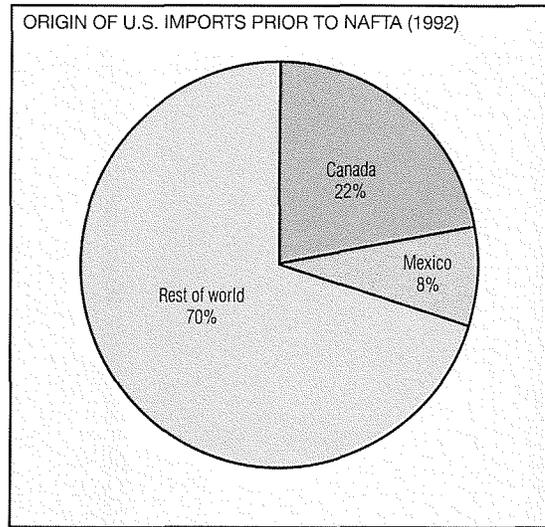
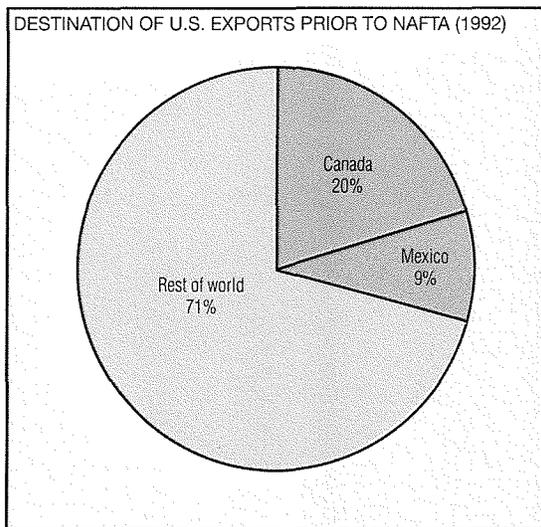


The Benefits of NAFTA

Long-run Effects of NAFTA (Percent deviation from pre-NAFTA steady state)				
	Canada	Mexico	U.S.	Rest of world
Welfare	0.01	0.96	0.12	0.01
Real GDP	0.11	3.26	0.24	0.01
Real consumption	0.08	2.52	0.25	0.01
Labor hours	0.07	1.99	0.14	0.00
Real wages	0.09	2.12	0.25	0.01
Capital investment	0.16	5.05	0.37	0.01
Imports	0.29	12.47	1.40	0.14
Exports	0.37	13.87	1.46	0.02

NAFTA: A Prisoners' Dilemma Game ^a		
	Mexico	
	Status quo	Liberalize trade
Status quo	0, 0	0.4, -2.7
U.S. Liberalize trade	-0.2, 3.5	0.1, 1.0



a. Columns and rows list strategies. Payoffs (net welfare gains) are for U.S. on the right and Mexico on the left.
 SOURCE: Michael A. Kouparitsas, "A Dynamic Macroeconomic Analysis of NAFTA," Federal Reserve Bank of Chicago, *Economic Perspectives*, January/February 1997, pp. 14-35.

The North American Free Trade Agreement (NAFTA), which took effect on January 1, 1994, will curtail most barriers to trade and investment between Canada, Mexico, and the U.S. by the time it is fully implemented in 2004. Although economists generally expect that the increased specialization and trade associated with the agreement will confer significant benefits on all participating countries, most studies have shown these gains to be relatively small. However, this research

does not incorporate the impact of the trade agreement on the pace of capital accumulation.

An important new study of NAFTA (by Michael Kouparitsas of the Federal Reserve Bank of Chicago) adjusts for this deficiency and reports output and consumption gains that are approximately twice as large as most previous estimates. However, it also finds that the overall welfare gains (the utility associated with consumption and leisure) are comparatively small because NAFTA raises work effort.

Perhaps further extensions that accommodate population growth and trade-induced productivity advances will uncover larger welfare gains.

While demonstrating that free trade will make Mexico, the U.S., and Canada better off, Kouparitsas shows that no country benefits from unilateral trade liberalization. Formal agreements like NAFTA are necessary to resolve the prisoners' dilemma game inherent in trade liberalizations and to secure the benefits of free trade.