"Infectious Greed" or the Working of Capitalism?

by Martin Eisenberg

During the year 2002, corporate business and accounting practices came under close public, media and governmental scrutiny in the United States as scandals were exposed at a number of corporations. The companies included Enron, a major energy trader, Arthur Anderson, one of the big five accounting firms in the nation, WorldCom, a hundred billion dollar communications giant that declared bankruptcy, and Halliburton, a military contractor formerly headed by Vice President Dick Cheney. The serial scandals contributed to a crisis of confidence that shook the stock markets and contributed to the volatility and continuing plummet of stock prices. Alan Greenspan, chairman of the Federal Reserve, who had expressed concern that the "bull market" of the late 1990s was characterized by "irrational exuberance," blamed these developments on "infectious greed." In this article, Martin Eisenberg examines the role of corporate Chief Executive Officers (CEO), their remuneration and the issue of "infectious greed." He makes a case that the economic crisis was not caused by individual corruption, but reflects a deeper problem within the capitalist economic system. Eisenberg's essay is followed by responses by New Jersey and New York teachers.

An important question for economics and other social studies teachers is how to help students get past the muckraking orientation of the newspapers so they can start to examine the greed, fraudulence and self-inflation of various top CEOs and the submissiveness of their boards of Directors as part of a systemic analysis of capitalism. Doubts are becoming more widespread about whether the pay that top CEOs receive is actually related to the jobs they do. The median total pay that the executives at large companies received in 2001 increased 9% even as profits fell 35%, according to a study of 200 companies. Research shows that executive pay in big companies does not correlate with either the size of the corporation (as measured by assets and number of employees), with the size of profits, or often even with stock prices. It is clear that CEOs do not "earn" those astronomical salaries. So, what does determine CEO pay?

Pay is determined by what the CEO wants, how much power he has over the Board of Directors, and how cooperative Board members are with the CEO. How submissive the Board will be is related to the money, information, prestige, perquisites and support for their own goals that Board members get in exchange. *The New York Times* (Leonhardt, 2002) examined Dennis Kowalski of Tyco as representative of many of the controversies surrounding executive pay. Over the previous three years, Tyco's Board paid Kowalski $19 million in cash and perks, almost $80 million in stock, and $13.4 million in stock options. In addition, he received a $75,000 fee for sitting on his own Board of Directors (as chairman). Meanwhile, since 1999, Kowalski quietly sold $300 million dollars of stock back to the company that he had bought with money borrowed from Tyco. While this is an extreme example, it seems clear that the top officers of the top corporations are unaccountable to anyone else for the decisions they make about their salaries, stock options or payment fees.

INDIVIDUAL GREED?

Because of its fixation on individual behavior rather than on the way corporations function in a capitalist economic system, the *Times* article did not ask who makes up the Tyco Board of Directors, why a Board that is supposed to set executive salaries went along with Kowalski, and what they received in exchange. Perhaps, besides the $75,000 fee each received for being a member of the Board, they also got loans to buy more stock, like President George W. Bush did when he served on the Board of Harken Corporation in the 1980s. Maybe they were tipped off to sell Tyco stock before the price began to sink from almost $60 per share in December, 2001 to $16 in June, 2002. Maybe board members are CEOs or top corporate managers who rely on reciprocal support from colleagues when they request salary increases from their companies.

The key question is whether we are looking at cases of greedy individuals or a system where greed is not only a moral good, but is the main and almost exclusive incentive to action? Are these cases of crooked individuals or are these CEOs and Board members exemplars of a capitalist economic system where organizations generate wealth and profit through social efforts (including the efforts of workers), but where they are able to privately appropriate huge shares of this wealth because they are accountable only to themselves?

Most board members in big corporations are top executive officers from other top corporations. Many members serve as interlocks with other boards; often the CEO of one company will sit on the Boards of Directors of several others. The sharing of leadership through interlocks contributes to the dispersal of information among insiders about corporate plans and operations, reduces competition among corporations, represents outside influences over the corporations, and strengthens inter-corporate unity in the economy and in efforts to sway the government and the public on significant political issues (Kerbo, 2000: 197-198). There is also a strong tendency for the people on these Boards to laud their mutual indispensability loudly, publicly and often, and to scratch one another's backs at the expense of workers, the vast majority of shareholders who are not in the know, and, of course, consumers.

This gargantuan concentration of economic power among a few thousand individuals translates into enormous power over the economy, over the government, and over the public consciousness. Among the serious economic consequences of allocating of tens of millions in salaries to people at the top of the corporate structure are significantly less money for research and development, less money for wages for tens of millions of workers, increased political influence for a select few, greater concentrations of personal wealth and greater income and wealth inequality in the United States. Such concentrated economic power, accountable to no public, is a major obstacle to economic growth and a major obstacle to democracy.

VALUED ADDED?

The astronomical size of executive pay is typically justified by the idea that they earn their salaries by creating value and increasing corporate profits. However, none of them "earn" the enormous salaries they get. If their companies' profits increased and their stock prices climbed in the 1990s, it was because the world and national economies were expanding and the productivity of workers was increasing, not because of the genius of CEOs. In an interdependent and global economy, no individual or set of individuals can take credit alone for enormous increases in profits. Nevertheless, CEOs do not hesitate to claim sole credit and ignore the contribution of workers to expanding profitability. Between 1973 and 1999, real hourly wages of workers remained stagnant at the same time that corporate profits and CEO pay were skyrocketing.

In a June, 2002 op-ed piece in *The New York Times,* Jeffrey Sonnenfeld (2002), an associate dean of the Yale School of Management, wrote that the deliberately opaque and misleading accounting practices and flaws in board governance were only part of the problem with Kowalski at Tyco, Lay and Schilling at Enron, Ebbers at WorldCom, Winnick at Global Crossings and Rigas at Adelphia. All of these chief executives were, what Sonnenfeld calls, "serial acquirers." Kowalski, Sonnenfeld wrote, had no understanding of the social and economic implications of "merger/buy-out/conglomerate capitalism." He once offered a "CEO academy" to help new chief executives follow in his path and believes that everyone should do what he does.

Sonnenfeld says these CEOs saw their jobs first and foremost as expanding the holdings of their own companies to increase the amount of their company's profits, rather than managing their companies to produce better products and services. They did not build business around core competencies, but were scavengers for good deals. For example, in three years, Tyco acquired 700 companies including valve makers, health care products, security system services, diaper makers, and telecommunications manufactures. At the same time, Tyco moved its headquarters to Bermuda as a tax dodge while operating out of New Hampshire. Many people cheered Tyco's tricks, including, unceasingly, Dennis Kowalski, because they produced a 20% annual growth rate until the first half of 2002 when its stock fell by 80%.

These "serial acquirers" aim, like all capitalist business enterprise, to increase their profits. The ultimate theoretical basis for conducting business enterprise within capitalism in this thoroughly anti-social way is that if every business enterprise pursues its own self-interest, the inevitable over-all social and economic consequence, as guided by an the market's invisible hand will be the creation of greater economic wealth and, presumably, social progress. The presumption is that the market will discipline the inefficient, the unwise, the spendthrift, and the unproductive and drive them out of business.

ORPORATE SCAVENGERS?

These corporate leaders seem different from many other CEOs. They are certainly different from the capitalist CEOs of the late 19th and early 20th centuries, such as Andrew Carnegie. Unlike Carnegie who cared about the steel he made -- although not his steelworkers -- these "serial acquirers" neither care much about workers nor whether their companies create new products or provide better services. They are scavengers off the profitable firms created by others and off the larger economy. They are parasites that dodge the taxes that fund the government that supports the social and economic infrastructure that makes doing business possible. They dodge the taxes that support the social welfare for workers who produce their goods, and their families who purchase their goods. These corporate leaders seem to care about very little beyond aggrandizing themselves and their cronies, not unlike the "crony capitalism" that was said to be the cause of the Asian economic crisis.

If all major corporation executives acted in this Kowalski-like way, there would be little wealth created to scavenge from. They are so focused on the central aim of capitalist business enterprise - making a profit - that they have dumped the always presumed, but mainly unstated goals and values that leavened the greed of earlier entrepreneurs. Those earlier goals and values (e.g., the Protestant ethic or the spirit of capitalism), accompanied by an emphasis upon the values of honesty and scrupulosity, connected the effort to make a profit with something larger (e.g., building a business, *creating* wealth and *creating* jobs for the greater glory of God). However The too many contemporary leaders are not interested in *creating* wealth or jobs; just shifting them around in order to boost stock prices, accumulate profit and acquire money.

SOCIAL CONTRACT?

My brother is a senior vice president in charge of financial printing for a transnational business services firm that does $7 billion/year in business. He participates in strategic meetings of the top managers with the CEO present. When he went to work there 15 years ago, their mission statement read that the company was committed first to its employees, then to its customers, and finally to its stockholders. Whether the order of this commitment was accurate, they thought of themselves as having a commitment to two groups besides their stockholders. He says that the social contract between the corporations and their employees was broken in the eighties. A few years later, a new leadership emerged and the mission statement was changed to read that the company was first and foremost committed to its stockholders. Workers and customers were omitted.

Using General Motors as an example, economist Paul Krugman (2002a/b) says that 25-30 years ago, CEO salaries were tiny compared to today's lavish packages. Furthermore, companies recognized a responsibility to multiple constituencies, including their employees. But, as economic growth faltered in the 1970s, corporate raiders arrived on the scene. They claimed (often correctly) that they could increase profits and stock prices by becoming lean and mean, replacing much of a company's capital with debt, and forcing management to shape up or go under. At the same time, companies gave executives a larger personal stake in the company's ownership, inducing the CEOs to do whatever was necessary to raise the stock price.

Krugman does not ask where G.M's commitment to its employees came from. Certainly a capitalist commitment to the livelihood of workers was not part of the rules of capitalism in the U.S. between 1865-1935. In any case, as global competition intensified in 1965-1985 period, the most highly unionized companies and industries, mainly in manufacturing, automated/robotized/computerized their production processes. Companies reduced their need for workers, went out of business, shifted production to anti-union parts of the country, hired sophisticated union busters, relied upon a conservative NLRB appointed by conservative presidents, and moved to cheap labor parts of the world. Union membership declined, as did the proportion of the labor force that was union members; and, the political and economic strength of organized labor diminished. As unions decreased in strength, so also did employer commitment to workers. Whatever "social contract" had existed as a consequence of the combination of labor struggles in the 1930s and 1940s and U.S. global military and economic pre-eminence after WW II, grew threadbare and snapped.

Krugman says that the fatal flaw in the system that offers princely rewards to CEOs, as their stock prices rise, is that such rewards tempt executives who control the information unavailable to outsiders, to fabricate the appearance of success. They engage in aggressive accounting, fictitious transactions that inflate sales, and I would add, serial acquisitions; whatever it takes to jack up stock prices. Sociologists call this *paper entrepreneurialism*, not *productive entrepreneurialism*.

Making something better or providing a better service is abandoned, at least while the atmosphere of "trust", established by prior generations, and necessary to entice investors, remains. However, as the pursuit of money and higher stock prices in fraudulent or misleading ways is revealed, trust diminishes. Capitalism requires trust but it generates actors who betray trust. Investment capital becomes less available. Foreign capital disappears. Stock prices go into a tailspin, and an economic crisis, not just slump, looms.

Is the problem simply CEO greed, seductive temptation, and a structured lack of accountability among top officials that can be controlled by legal remedies? I think the problem is much deeper and more extensive. We need to recognize, first, that the enormous concentration of privately held economic power in the U.S. is an inherent consequence of an advanced capitalist economy; and, second, that such power exists without any countervailing labor movement or any challenge to this system. We need to recognize that fraudulent dealing without accountability is an inherent aspect of how this system works, because it is possible, and because there is no reason not to be misleading except for the possibility of getting caught. We need to recognize that we live in an economic system whose top leadership may be characterized as structurally anti-social (advancing self-interest is a moral good), mendacious (because truth-telling may subvert stock prices), and greedy (because all that matters is profits and personal income). And, we need to see how a system that encourages the worst forms of behavior in corporate leadership, also blocks economic growth and the growth of democracy.

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Responses to "'Infectious Greed' or the Working of Capitalism?"

Nicholas Ventimiglia, economics teacher, John F. Kennedy High School, Plainview, NY:

After first reading the piece, "Infectious Greed" by Martin Eisenberg, I was all set to lock, load and fire back. I did not. I waited a bit and read it again. I repeated these steps a few more times and, after starting to appreciate some of the things he has espoused, I have changed the direction of both my target and content.

I teach economics at the high school level, but I have not always done so. My first career included serving in senior executive positions at some of the more formidable financial institutions on the planet. I believe that I bring a different perspective into the classroom based on knowledge accumulated while working at Arthur Andersen and Co. and Citicorp (now Citigroup). I used to be unwaveringly proud to have been associated with both of these giants. There was a time when they were highly respected and admired for their rock-solid accomplishments and results. However, I am now forced to weigh the gravity of my pride and business experience against the claims and pronouncements of Martin Eisenberg.

Initially, I wanted to scream, "Oh, what do you know?" In a number of spots, I found the piece somewhat "savvy-thin." For example, having high-priced executives sitting on each others' boards is not about being in a good-old-boy club and sharing $75,000 fees. It's more about the power of attraction. There really are credible names and personalities who possess the ability to attract major financial capital. They help to rationalize large investments, just by having their names printed in an annual report. Corporate lenders, fund managers and even individual investors find security in seeing some of the value-added expertise at the board table of a company where they are committing dollars. In many cases, this alone is well worth the nominal fee (and to this crowd, $75K is nominal).

But Eisenberg's words are valid when he poses the issue of CEOs and their leverage of power on their own board of directors. Some of the recent "perks" make me wince at the grossness of the greed. The amounts of severance to be paid to these people, regardless of the quality of the work performed, is staggering. All of this spells *C-O-N-T-R-O-L*.

In a free market economy, it is basically accepted that one gets all she or he can based on their market value. It is this principle that has allowed us to swallow very hard and accept $25 million dollar a year shortstops and film stars. When Michael Jackson signed his $100 million dollar contract with Sony Music, many in the business world wondered if he was really worth it; but they were willing to accept that Sony thought he was. However, considering where Jackson and Sony are today, the arrangement has not helped the company's revenue power.

These are examples of what the free and very public market is willing to pay based on financial projections of the star power of these people. What the very private, closed-door sessions of boards of directors decide is a whole different ballgame. I know of no market compensation studies on executive remuneration that justify $6,500 wastebaskets and $15,000 shower curtains (both having been recently noted as perks to Kowalski of Tyco) or golden parachutes guaranteeing Midas-like riches for toppled CEOs and their descendents.

Some of the recent "perks" make me wince at the grossness of the greed.

Eisenberg points out something that I, too, have personally felt: the disconnect between corporate goals and their employees. I was in the position to feel it first hand. As a senior executive on the management team in Human Resources of a company of over 100,000 employees, I was responsible for a sizeable population of my company's "human capital." In the late 1980's and into the mid-1990's, enormous budget squeezes were quarterly events, all in the name of hitting celestial corporate earnings targets. While on the surface this sounds rather natural in a market economy, by the end of this period, the fat had been trimmed so much that financial officers were beginning to slice into the bone.

The two largest budget items dominating most of company's balance sheets were people and premises. With programs already in place to sell major properties (including a New York City landmark skyscraper which bore its name) and lease wherever possible, the "people line" was the last bastion. The cuts from this line were painfully deep and fast. This was not just "right-sizing;" it was the elimination of basic benefit compensation, insurance and nearly all training and development (the one time, life-blood of our company).

The intent of these cuts was widely known inside the company. Push the earnings number hard so the top 23 executives would collect their seven-figure bonuses. They told us it was good for the stock price and those of us with stock options would also greatly benefit. It is at this point that Eisenberg gained my nod. Greed amongst mega-CEOs is nothing new. The original captains of industry taught us that. The fact that, through board sitting, many share a near-incestuous professional relationship is hardly alarming. However, in the face of number-changing, rule-bending, and confidence-shaking corporate behavior, greed, as described by Martin Eisenberg, is unforgivable.

Riza Laudin, economics teacher, Herricks High School, New Hyde Park, NY:

Martin Eisenberg's article certainly provides food for thought. I believe that teachers have a responsibility to not just provide students with information, but to aid them in their development as intelligent and questioning adults. "Infectious Greed" should be required reading for anyone who does not believe that economics should be part of the Social Studies curriculum.

In my classes I teach comparative economic systems. Students are required to understand the theory behind each system and the errors in each system. In addition, we study the systems in practice. The laissez-faire capitalism of Adam Smith is very different than the increased government intervention we have today. Like Teddy Roosevelt, who called for anti-trust legislation, and Franklin D. Roosevelt, who instituted Keynesian economics, I believe we need a strong government that can pass stringent legislation requiring more transparency and greater penalties for violators.

I disagree with Mr. Eisenberg's argument that the capitalist system is fatally flawed.

On the other hand, I disagree with Mr. Eisenberg's argument that the capitalist system is fatally flawed. Yes, there are, as Mr. Eisenberg says, "top economic leaders who are anti-social and greedy," but there are also numerous other CEOs that are positive forces in society. George Soros, Ben and Jerry of "Ben & Jerry's Ice Cream," Michael Bloomberg and Bill Gates are examples.

There are a myriad of reasons to include economics as part of the curriculum. Foremost would be to educate the populace about our capitalist system, how it works, its benefits, its problems and how it impacts their lives. I require students to bring in weekly economics articles from the newspaper. They summarize articles, discuss the economic principles and how the issue described in the article impacts their lives. They are encouraged to think in economic terms and most importantly, to question what impact the actions a company, the government, and other influences have on their lives.

Our representative democracy works because the schools strive to develop an educated electorate. Throughout our history, corruption in the system has become evident and over time remedied by the political process. Why can't we create an active questioning economics citizenry? As a teacher of economics, I understand how limited the economic knowledge of students is. How can they possibly call for reform of the system if they don't understand how the system works ?

Arthur Green, Consultant for Social Studies, Brooklyn and Staten Island High Schools, New York, NY:

This article examines a number of aspects of the corporate scandals the United States is currently experiencing. It details some of the more outrageous examples of greed and arrogance by corporate CEOs. It correctly points out that their pay and benefits are negotiated with overly compliant Boards of Directors. The welfare of the company or concern for employees does not seem to fit within the equation. Certainly, these issues require examination in the classroom. A major difference, between the recent scandals and the "robber barons" of the past is this lack of concern for the welfare of the company. Rockefeller, Ford and Carnegie did not care for their employees. However they did care about the welfare of their companies and their products.

Where I take issue with Martin Eisenberg is his claim that corporate greed "reflects a deeper problem within the capitalist economic system." I believe that the problem of corporate greed can better be attributed to the lack of integrity of the individuals who committed these actions. A lack of "checks and balances" in corporate leadership and the easing of government oversight contributed to the situation. However, the basic issue is the absence of personal integrity, responsibility and honesty on the part of those in power, not an inherent flaw in the capitalist system. History documents that other systems have also produced spectacular examples of corruption and mismanagement.

We must reemphasize our mission to prepare citizens to exercise control over the destiny of their communities in a free society.

As Social Studies educators, we must reemphasize our mission to prepare citizens to exercise control over the destiny of their communities in a free society. This requires citizens with a high degree of intelligence and skills, a well developed sense of morality, and a commitment to the welfare of all. The best constitution and system of oversight are no better than those who govern. That is why the founders of this nation placed such a great stress on the value of education.

In economics classes, the scandal should be analyzed so student understand not only its impact on the individual companies, but also on the welfare of employees, stockholders, communities, suppliers, and markets, the overall national economy, and the common good. Greed should be presented as a problem of some individuals who have risen to positions of power and of a society, which has to some degree, lost its moral compass. Are the corporate scandals totally unrelated to the outrageous actions committed by others in the fields of law, medicine and sports? Is a CEOs compensation less deserved than those of major league athletes, movie stars and pop musicians? Is their behavior more dangerous than price gouging by a doctor or hospital or the denial of service to patients without health insurance?

Business schools are now wrestling with the ethical implications of the acts committed by their graduates. But ethical training needs to begin in the public schools where we prepare the next generation of citizens.

John McNamara, Social Studies Supervisor, West Windsor-Plainsboro R.S.D., NJ:

The past year corporate greed and fraudulent accounting practices, overseen by a number of top business executives, have created a crisis of confidence in the public marketplace that has severely shaken the integrity of the American economy, increased employee lay-offs, caused stock prices to plummet, and evaporated the financial value of many employees' retirement savings and college-tuition accounts. Since the majority of Americans own stock, either directly or through mutual funds, these corporate scandals have not merely been "balance sheet blunders" and "paper losses" that have marginally affected impersonal investment institutions. Rather, these financial irregularities and improprieties are serious capital crimes that have adversely affected the lives of "real" working people across the nation. The blatant manipulation of company records to embellish profits, cover up losses and inflate stock prices, devious insider trading, illegally shredding corporate documents, and siphoning funds from company coffers for top executives' personal use have betrayed the trust of average Americans and small investors who have lost confidence in our capitalist economic system, abandoned stock market investments, and often incurred significant losses of their lifetime savings.

The essential question for this unit would be: "Is greed the seed of the American creed?"

In his article, Martin Eisenberg contends that the cause of these corporate scandals is a flawed capitalist economic system which has blocked opportunities for significant economic growth and democratic development in the marketplace. His article definitely provides food for thought and suggests several open-ended questions for critical analysis by high school students. My list of "top ten" evaluative questions for class discussion based on the article would include: (1) "Should corporate profits be the top priority for business leaders?"; (2) "Is the work ethic and spirit of capitalism merely a myth?"; (3) "Should a social contract exist between a corporation and its consumers and employees?"; (4) "Are corrupt business leaders or a flawed economic system more to blame for the recent wave of corporate crime?"; (5) "Are business consolidations and combinations in the best interest of consumers and our economy?"; (6) "To what extent are CEOs today similar or different from their entrepreneurial counterparts of the 19th century?"; (7) "Can private corporations and government effectively collaborate to promote national prosperity and economic democracy?"; (8) "Is government obligated to protect the public against unfair business practices?"; (9) "Does government need to regulate big business more thoroughly today?"; and (10) "Have the recent business scandals changed your attitudes about 'white-collar crime'?" Overall, the essential question for this unit would be: "Is greed the seed of the American creed?"

The business scandals of this past year at such companies as Enron, Tyco, and WorldCom. have shocked many investors and severely shaken a turbulent American economy. The media has highlighted the arrests of several high-profile corporate executives, contentious committee hearings on Capital Hill, and the secret shredding of corporate memos and documents. It is crucial that students be aware that the majority of corporate leaders uphold the law, and most publicly- traded companies report their financial status to their shareholders with honesty and integrity. Yet, our students should also be informed that these recent business scandals have adversely affected the lives of many Americans across the nation. This episode in our history in not merely about impersonal investment institutions, balance sheets, and financial profits and losses. It is about "real people," both individuals who betrayed the public's trust for their personal gain and those who are innocent victims of their unscrupulous behavior and criminal activity. Indeed, there are many lessons to be taught and learned from the tragedy of this travesty of our free enterprise system.

Kyle Sabo, social studies teacher, Division Avenue High School, Levittown, NY:

After discussing this article with colleagues in my social studies department and thinking about its message, I believe that there is a major problem with Martin Eisenberg's position. He claims that the problem with corporate America, uncovered this year with the failure of Enron, Tyco and Worldcom, lies not with the greed of the specific CEOs, but in the very system of capitalism itself. However, Eisenberg's essay only assigns blame to Republicans such as President Bush and conservative-leaning government agencies. If his argument is correct, then as unbiased social scientists, we should fairly and evenly assess blame across the political spectrum and target the political process that created loopholes in laws and permitted these events to occur.

My concern is the tens of millions of dollars that flow to both major parties.

Ideologically, the Republican Party favors less government regulation and lower taxes with the idea that an environment of laissez-faire capitalism fosters economic growth and opportunity for everyone. Public opinion polls show that Americans believe the Republicans are generally closer to big business than Democrats. However, as long as big business contributes vast sums of money to candidates on both sides of the aisle, national campaign committees and individual issue groups, we should hold all politicians accountable for the failure of corporate America to produce solvent, well-run companies. To do otherwise smacks of partisanship and does not support Eisenberg's thesis that this is a systemic problem, not an individual problem caused by a small, privileged elite. Democratic and Republican politicians should both be held responsible for the collapse of the public trust in the American economic system.

As a citizen and as a teacher, my concern is the tens of millions of dollars that flow to both major parties. This money buys access, denies the general public a voice in public policy, and creates an environment in which egregious abdications of business ethics occur. The problem is neither greedy CEOs nor the capitalist economic system. It is the financing of the political process that is the real threat to democracy and social justice. Reforming the relationship between big business and the political system will foster corporate responsibility, eliminate the abuses of the CEOs, and re-enfranchise the American public. Eisenberg makes a mistake by letting the Democrats off the hook when they controlled Congress for most of the last forty years as this system developed.

Has the North American Free Trade Agreement Been a Success?

Economics Class Project and Document Package prepared by Jessica Berni and Dennis Mooney

In Spring 2002, while teaching at Benjamin Cardozo High School in Queens, New York, Jessica Berni and Dennis Mooney organized an "economics dialogue" on the question, "Has the North American Free Trade Agreement Been a Success?" (See the article by Michael Pezone, Jennifer Palacio and Lauren Rosenberg in the "Teaching Ideas" section for dialogue guidelines). Jessica and Dennis developed a document package (reprinted below) as a starting point for research, but also encouraged students in examine other sources. Students in Dennis' classes spent two periods preparing the affirmative case. Students in Jessica's classes prepared the negative one. On the day of the "economics dialogue," half of each class went to the room of the other teacher for formal discussion. Another day was spent in evaluation and on the final day each student wrote a document-based essay answering the "economics dialogue" question.

Document 1. An Introduction to NAFTA

(Adapted from *The World & I*, October 1997, *www.worldandi.com*)

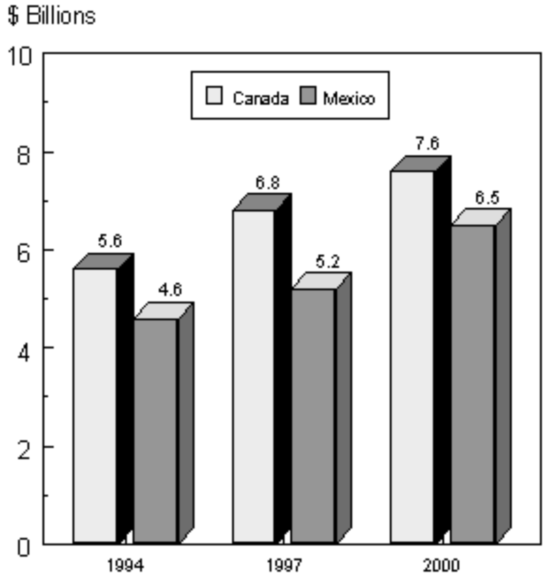
The North American Free Trade Agreement (NAFTA) was signed into law in the fall of 1993. In pressing the case for NAFTA, proponents in the United States raised two major points. The first point was economic: NAFTA would produce real economic benefits, including increased employment in the United Sates and increased productivity. The second point was political: NAFTA would support the political and economic reforms being made in Mexico and promote further progress in these two domains. These reforms had made Mexico a "better" neighbor; that is, Mexico had taken steps to become more like the United States, and NAFTA would support further change. Both of these two major points reinforced a third claim made on behalf of NAFTA: the improvements in economic and political conditions in Mexico might lead to a reduction in the flows of illegal immigrants and drugs into the United States.

In fighting NAFTA, opponents in the United States argued that freer trade between the United States and Mexico would mean a transfer of work and jobs from the United States to Mexico. Opponents argued that the notion of passing NAFTA as a reward to the Mexican government was premature; the government had not done enough to improve economic and political conditions in Mexico.

Joe Cobb, president of the Trade Policy Institute in Washington, D.C., asserts that NAFTA has been a success. The U.S. manufacturing base remains strong, and hundreds of thousands of jobs have not been lost. Instead, for the overall U.S. economy, exports are up, employment has increased, total trade has expanded, and the average standard of living of American workers has increased. Cobb reports that during NAFTA's first three years the following has resulted: total North American trade increased by 43 percent, with 39 of the 50 states increasing their exports to Mexico; U.S. market share in Mexico increased from 69 percent to 76 percent; and U.S. exports to Canada increased by 33 percent. He accepts the U.S. Department of Labor's calculation of 110,000 American workers who qualified for training assistance under NAFTA but offsets this negative effect by stating that at current rates the United States creates more than this number of jobs every two weeks. He also states that U.S. exports to NAFTA countries support 2.3 million U.S. jobs.

Researcher Alan Tonelson negatively assesses NAFTA based on his contentions that the real winners were large U.S. multinational corporations, that median wages in the United States and Mexico have declined, and that the flows of illegal immigrants and drugs into the United States from Mexico are high. Tonelson argues new Mexican production "is simply replacing production in the United States." Although he is willing to accept the argument that the loss of production to Mexico is better for the United States than the loss of production to the Far East, Tonelson believes that "simply accepting these conditions ultimately condemns American workers and their foreign counterparts to a global race to the bottom in terms of wages and working conditions."

Document 2. Trade with NAFTA Partners, 1994-2000 (*www.worldandi.com*)



Document 3. Wages in Mexico 1993-1999 (1990=100%)
Source: Public Citizen (*www.citizen.org*)

Year	Minimum wage	Contractual wage	Manufacturing wage
1993	67.5%	84.9%	111.4%
1994	65.8%	81.5%	105.2%
1995	81.1%	85.5%	88.7%
1996	66.5%	76.6%	81.2%
1997	58.9%	68.2%	82.9%
1998	56.9%	66.5%	85.7%
1999	55.4%	66.8%	88.4%

Document 4. Benefits of NAFTA
(Source: *FAS BACKGROUNDER,* July 6, 2001
www.fas.usda.gov/itp/policy/nafta/nafta_backgrounder.htm

The continued strength of North American Free Trade Agreement (NAFTA) markets has been one of the brightest spots for U.S. farmers, agricultural exporters, and the industries that support them. Together, our NAFTA partners, Canada and Mexico, purchase 27 percent of U.S. Agricultural exports. Farmers in the United States, Canada, and Mexico all benefit from NAFTA. Two-way agricultural trade between the United States and Mexico increased more than 55 percent since 1994, reaching more than $11.6 billion last year. Two-way agricultural trade between the United States and Canada increased more than 50 percent in the same time frame reaching $16.3 billion in 2000.

Although U.S. imports have grown under NAFTA, so have U.S. exports. Without NAFTA, the United States would have lost these expanded export opportunities. Since implementation of the U.S./Canada Free Trade Agreement, U.S. agricultural exports to Canada have doubled. Canada is the No. 2 market for U.S. agricultural exports, purchasing $7.6 billion worth last year. Since NAFTA was approved in 1993, U.S. agricultural exports to Mexico have nearly doubled. Mexico imported $6.5 billion of U.S. agricultural products in 2000, making it our third largest agricultural market.

Canada took record levels of many key U.S. commodities in 2000: fresh vegetables, fresh fruits, snack foods, poultry meat, live animals, pet foods, dairy foods, vegetable oils, planting seeds, breakfast cereals, tree nuts, nursery products, and red meats. Record U.S. exports to Mexico in 2000 included red meats, processed fruits and vegetables, poultry meat, snack foods, fresh fruits and vegetables, juices, tree nuts, pet foods, feeds and fodder, and rice. This broad cross section of commodities suggests the benefits of NAFTA are widely distributed across U.S. agriculture.

Document 5. Mexican Trucking Companies Sue U.S. government
(Source: www.landlinemag.com/Hot_Issues/NAFTA/Mexicans_sue_US.htm)

Eleven Mexican trucking companies filed a $4 billion class-action lawsuit on Tuesday, claiming the U.S. government illegally denied them access throughout the United States in accordance with the North American Free Trade Agreement. The $4 billion includes business and profits lost since 1995. The complaint, filed in U.S. District Court in Brownsville, alleges federal agencies - including the U.S. Department of Transportation - violated NAFTA by denying them permits to operate within the U.S. interior and violated the U.S. Constitution by allowing Canadian firms more access than Mexican companies. It also says U.S. officials discriminated against Mexican nationals by denying Mexican truckers the ability to invest in, own or control trucking companies based in the United States.

Document 6. Not Happy After NAFTA: The Accord Remains A Hot-Button Issue

by Ben Wildavsky (Source: U.S. News and World Report, January 11, 1999)

Exactly five years after taking effect, the North American Free Trade Agreement remains as controversial as ever. That could mean trouble for administration officials if they follow through on their plan to once again ask Congress for fast-track trade negotiating authority for the president. Most trade watchers don't expect fast track to go anywhere but down -- fast. Its opponents on Capitol Hill have rallied around the cry of "no more NAFTAs." Their stance reflects the view of many voters, who even in these booming economic times are skeptical of free trade. In a recent NBC/*Wall Street Journal* poll, 58 percent of those surveyed said foreign trade has been bad for America because cheap imports have hurt wages and cost jobs.

NAFTA naysayers still charge that a rise in imports from Mexico has taken a toll on American jobs. "Imports destroy jobs just like exports create them," says economist Robert Scott of the labor-backed Economic Policy Institute. But the doomsday warnings of massive job losses (recall Ross Perot's "giant sucking sound" of jobs being pulled out of this country) are belied by an economy that is running at full employment. The Labor Department says 210,000 workers have suffered NAFTA-related job losses over the past five years -- fewer than the 267,000 new jobs created in the U.S. last November alone.

U.S. Trade Representative Charlene Barshefsky says that the accord has dramatically increased trade among the three North American nations as it was designed to do. She says NAFTA has boosted export-related U.S. economic growth and that trade with Mexico has blunted the blow of economic downturns elsewhere in the world. NAFTA has "served as the most effective export-insurance policy we could have," she says.

Document 7. NAFTA Partners Speed up Elimination of Tariffs on $25 Billion in Trade (January 9, 2002)

(Source: 0-www.mac.doc.gov.library.csuhayward.edu/nafta/pr.jan09.htm)

WASHINGTON - The United States, Canada, and Mexico have agreed to accelerate the benefits that NAFTA brings to each country's consumers, workers, and businesses by eliminating tariffs on $25 billion in total trade. The provisions of the North American Free Trade Agreement (NAFTA) allow for this accelerated process and were agreed upon in December. The changes are effective January 1, 2002.

"Speeding up the elimination of tariffs brings NAFTA's benefits to American consumers, workers, and businesses that much faster," said U.S. Trade Representative Robert B. Zoellick. "Over the next few years, this will help our economies sharpen their competitiveness and efficiency. I'm pleased that the three NAFTA partners were able to agree to cut their tariffs even faster than NAFTA's provisions required."

Canada and Mexico are the United States' largest trading partners. With the 2002 reductions, Mexico's average tariff on U.S. goods will fall from the pre-NAFTA average of 10 percent to under one-half of one percent. Each day the NAFTA parties conduct nearly $1.8 billion in trilateral trade. Zoellick noted that NAFTA has greatly benefited the American economy:

- The longest period of economic growth in U.S. history came in the aftermath of NAFTA.
- Since NAFTA's implementation, U.S. exports to Mexico and Canada now support 2.9 million American jobs -- 900,000 more than in 1993. Such jobs pay wages that are 13 to 18 percent higher than the average American wage.
- When the Congress approved NAFTA in 1993, trade between the United States and Mexico totaled $81 billion. In 2000, U.S./Mexican trade reached $247 billion -- nearly half a million dollars per minute.
- U.S. exports to our NAFTA partners increased 104 percent between 1993 and 2000; U.S. trade with the rest of the world grew only half as fast. Today the United States exports more to Mexico than to Britain, France, Germany, and Italy combined.

Document 8. NAFTA and Workers Rights and Jobs

(Source: Public Citizen, August 29, 2001, www.citizen.org)

Public Citizen has monitored the promises President Clinton made to Congressional Representatives to push NAFTA passage to determine whether those promises were kept. Many of the commitments that the Clinton Administration made in 1993 in order to get NAFTA passed were never fulfilled. Many of the actions that the Clinton Administration did take proved worthless for the parties they were supposed to help. The outcomes of the deals granted to industries concerned about NAFTA should serve as a warning for those now seeking safeguards for sectors likely to be threatened by future trade agreements.

The central focus of pro-NAFTA campaigning was the issue of U.S. job creation, so it is fair to measure NAFTA's real-life results against its backers' expansive promises of hundreds of thousands of new, high-paying U.S. jobs. Even measured against the more lenient "do no harm" standard, NAFTA has been a failure. Using trade flow data to calculate job loss under NAFTA yields net job destruction numbers in the hundreds of thousands. It is clear that NAFTA has indisputably led to widespread job loss, with over 363,121 U.S. workers certified as NAFTA casualties under just one narrow government program. The fact that job growth totally unrelated to NAFTA has produced a net gain in U.S. employment during this period in no way changes the reality that NAFTA has cost large numbers of individual workers their jobs, most of whom are now unemployed or working at jobs that pay less than the ones they lost.

The U.S. economy created jobs at a fairly rapid rate in the 1990s, but without NAFTA, hundreds of thousands of full time, high wage, benefit-paying manufacturing jobs would not have been lost. It is also important to note that while the U.S. economy is generating substantial numbers of new jobs in absolute terms, the quality of jobs created is often poor. The U.S. Department of Labor projects that the professions with the greatest expected future growth in the U.S. are cashiers, waiters and waitresses, janitors and retail clerks. These and other lower-wage service jobs are the kind that will most likely be available to workers displaced by NAFTA.

Economic surveys of dislocated workers shows that the jobs lost to NAFTA, in many cases high-paying manufacturing jobs, are, in the majority of cases, replaced by lower-paid employment. NAFTA also has had a negative effect on the wages of many Americans whose jobs have not been relocated but whose wage bargaining power with their employers is substantially lessened; NAFTA puts them in direct competition with skilled, educated Mexican workers who work for a dollar or two an hour or less. NAFTA was supposed to ameliorate this problem by raising Mexican living standards and wages. Instead, both have plummeted, harming the economic prospects for workers on both sides of the border.

Document 9. Mexico to Lift Import Tariffs (April, 2002)

(Source: www.agroenlinea.com/agro/pestado/news/180402a.htm)

MEXICO CITY - Economy Minister Luis Ernesto Derbez said late Thursday that Mexico will lift anti-dumping import duties on high fructose corn syrup from the United States, but will limit tariff-free imports to 163,000 tons (148,000 metric tons) per year. Derbez told a news conference that the import quota matches the amount of Mexican sugar that the United States allows to be imported tariff-free. Any fructose imports over the new quota will pay an import tariff of 210 percent, he said. Derbez said that Mexico is seeking access to the U.S. market for all of its excess sugar production, as stipulated in the North American Free Trade Agreement. A NAFTA panel Monday ordered Mexico to lift the anti-dumping duties because they were incompatible with Mexico's international trade commitments.

Mexico imported about 385,000 tons (350,000 metric tons) of fructose from the United States last year. Derbez said the decision to limit fructose imports seeks to support debt-troubled domestic sugar farmers, without violating the spirit of NAFTA. President Vicente Fox and his government have clashed in recent months with a Congress that has historically supported tariffs to block the importation of U.S. fructose.

The government in February suspended for five months a 20 percent tax on beverages made with fructose instead of sugar, which the Congress passed as it made modifications to Fox's tax reform package late last year. Derbez said the tax hurt Mexico's soft drink industry and was "not the adequate strategy" to resolve the fructose controversy. Derbez said the government will continue to discuss the issue with legislators, and hopes to "show Congress that this is the right path to take."

Document 10. In Corn's Cradle, U.S. Imports Bury Family Farms

by Tim Weiner (Source: *The New York Times*, February 26, 2002)

For many generations, corn has been the sacred center of civilization in Mexico, the place where the grain was first cultivated some 5,000 years ago. Gods and goddesses of corn filled the dreams and visions of the great civilizations that rose and fell here before the Spaniards came five centuries ago. Today the corn tortilla is consumed at almost every meal. Among the poor, sometimes it is the entire meal. But the modern world is closing in on the little patch of maize that has sustained millions of Mexicans through the centuries. The powerful force of American agribusiness, unleashed in Mexico by the North American Free Trade Agreement, may doom the growing of corn as a way of life for family farmers here.

Lorenzo Rebello, a 53-year old dirt farmer, works two and a half acres of corn and beans in Mexico's central highlands. Mr. Rebello is one of about 3 million Mexicans who farm corn and support roughly 15 million family members. His grown sons have left for the United States to make a living. It is the same story all over Mexico: thousands of farmers pulling up stakes every year, heading for Mexico City or the United States.

Roughly a quarter of the corn in Mexico is now imported from the United States. Men like Mr. Rebello cannot compete against the mechanized, subsidized giants of American agriculture. Since NAFTA took effect eight years ago, imports of corn to Mexico from the United States have increased nearly eighteenfold, according to the United States Department of Agriculture. The imports will probably keep growing for the next six years as the final phases of NAFTA take effect.

In the United States, corn growers receive billions of dollars a year in subsidies from Congress, much of it going to huge agribusiness operations. That policy fuels huge surpluses and pushes corn prices down. In Mexico, NAFTA did away with many traditional subsidies and generous price supports. Some contend it is doing away with small farmers. Under a slowly lifting ceiling, the United States will be able to export all the corn it wants to Mexico, duty free, by 2008. NAFTA's drafters told Mexico's farmers that as the ceiling lifted, the price of corn in Mexico would slowly fall toward United States and international prices over the 15-year period. But instead, prices plunged quickly, converging with the free-market price by 1997. This was good news for big companies in Mexico importing corn for animal feed and processed food. But it was hard on the farmers, who have little political clout under the government of President Vicente Fox, an ardent free-trader.

Document 11. Bills Aim To Ease Impact (1997)

(Source: Public Citizen, www.citizen.org)

Two separate pieces of legislation in Congress aim to soften the impact of free trade on workers. One bill seeks to consolidate the worker retraining programs included in NAFTA and the Trade Adjustment Act to make them more helpful to workers, said a spokesman for U.S. Representative Robert Matsui, a Democrat from California and the chief sponsor of the bill. The bill, now before the House Ways and Means subcommittee on trade, would create a single program to provide training and economic assistance for workers who lose their jobs because of imports or manufacturing shifts in production to foreign countries.

A second measure, the NAFTA Accountability Act, calls for the government to reassess the trade pact and renegotiate any provision not found to be working. In the Republican-controlled House, the bill has languished in committee. But the bill's chief sponsor, Representative Marcy Kaptur, an Ohio Democrat, plans to reintroduce the legislation this year and push for its main provisions, such as improved worker and environmental benefits. "NAFTA really shifted the playing field for trade," Kaptur said. "We need a monitoring system. This (act) is a good recipe for what needs to be done in order to make a trade agreement successful."

While aggressively defending free trade policies, Commerce Secretary William Daley said the government and employers should do more to help workers hurt by global trade. "It's easy for us who have jobs to talk about (free trade) and not sound sensitive to someone who has just lost their job because the company's owner has just said he's moving to Mexico," said Daley. "People have to have skills, and companies have to keep workers trained for the jobs of today."

Document 12. NAFTA After 5 Years: "Free" Trade Is Often Costly

by Kathy McCabe (Source: The Boston Globe, May 9, 1999, *www.bostom.com/globe*)

Gleaming with fresh paint and revving up for 200 new workers by fall, Jostens Inc.'s Attleboro plant is set to reclaim its place as the crown jewel of high school ring makers. Two years ago, the company shifted most of the production at its flagship Attleboro (Minnesota) factory to Mexico after the North American Free Trade Agreement was enacted. But it recently moved back, citing high production costs and poor craftsmanship south of the border.

Five years after NAFTA created the world's largest free trade zone, the controversial pact hasn't always worked the way it was supposed to. Some employers who moved operations out of the United States have encountered problems with quality and production. Many displaced workers say they are not satisfied with NAFTA's job retraining benefits.

In the bigger picture, NAFTA has not lived up to its goal of narrowing the U.S. trade imbalance and expanding the American economy by spurring American exports, some economists and critics say. Last year, the U.S. trade deficit hit a record $230 billion, compared to $150 billion in 1994, the year NAFTA took effect. The trade gap has grown wider with Mexico and Canada, too. A $1.3 billion surplus with Mexico in 1994 turned into a $15.7 billion deficit last year. The deficit with Canada grew from $13.9 billion to $18.5 billion last year. Commerce Secretary William Daley attributes the surging deficit more to the global financial crisis and the strength of the U.S. economy than to trade pacts such as NAFTA.

NAFTA has not proven to be a magic bullet. And for employers and employees alike, the trade agreement has brought hidden costs and unexpected challenges. Jostens, the nation's largest maker of high school rings, aimed for big profits and lower labor costs when it packed up most of its Attleboro plant two years ago and shifted production to a subcontractor's factory in Mexico.

Jostens aimed to save $5 million to $10 million annually. But it didn't work out that way for the Minnesota-based company. It discovered that cheaper labor -- its Mexican work force earned about $4 per hour -- came at a high cost. The company was forced to spend more money to train low-skilled workers who struggled to master stone setting, enameling, toolmaking, and other skills. Also, most of its work force didn't return after a Christmas shutdown, a problem Jostens attributes to severe instability in the labor force.

In February, Jostens buttoned up its contract facility in Nuevo Laredo and hauled its equipment back to Attleboro, a nationally known jewelry making center, where Jostens has operated for 31 years. Since returning to Attleboro, Jostens has invested $500,000 to retool the plant and is now looking to hire up to 200 full-time and seasonal workers by October. Some of the 30 employees it has hired so far are the same workers it had previously laid off. The jobs pay from $7 to $10 per hour, with benefits.

Document 13. Impact of NAFTA on New Jersey (Source: Public Citizen, *www.citizen.org*)
By 1997, the United States Department of Labor had certified 4,138 New Jersey workers as having lost their jobs due to NAFTA. Companies which laid-off over 100 employees are listed on this chart.

Company	Product	Lay-0ffs	Cause	Town
Alcatel Data Networks	printed circuit boards	120	Moved to Mexico	Mt. Laurel
American Standard	ceramic plumbing	250	Moved to Mexico	Hamilton
Anchor Glass	glass bottles	300	NAFTA imports	Cliffwood
Anchor Hocking	metal closures	327	Moved to Canada	Glassboro
Central Products	carton sealing tape	120	Canadian Imports	Linden
Economy Color Card	books of wallpaper	180	Mexican Imports	Roselle
Gandalf	computer equipment	148	Moved to Canada	Cherry Hill
Gist Brocades Food	compressed yeast	100	Moved to Canada	East Brunswick
Haywood Pool	pool lights	450	NAFTA imports	Elizabeth
Kalina Sportswear	ladies' jackets	107	NAFTA imports	Hammonton
Melnor	lawn/garden equipment	180	Moved to Mexico	Moonachie
Thomas and Betts	electrical fittings	214	Moved to Canada	Elizabeth
U.S. JVC Corp.	television sets	198	Moved to Mexico	Elmwood Park
Val Mode Lingerie	ladies sleepwear	150	Moved to Mexico	Brigdeton
Wallace and Tiernan	hydraulic pumps	550	Moved to Mexico	Belleville

Document 14. Impact of NAFTA on New York (Source: Public Citizen, *www.citizen.org*)
By 1997, the United States Department of Labor had certified 10,785 New York workers as having lost their jobs due to NAFTA. Companies which laid-off over 100 employees are listed on this chart.

Company	Product	Lay-0ffs	Cause	Town
Al Tech Specialty Steel	stainless steel products	150	Moved to Canada	Dunkirk
Al Tech Specialty Steel	steel manufacturing	1100	Moved to Canada	Watervliet
Amphenol Corporation	electrical components	104	Moved to Mexico	Sidney
AMSCO Basil Mfg.	industrial washing	100	Moved to Canada	Wilson
Daniel Greene Co.	casual footwear	140	Canadian imports	Dolgeville
Fisher-Price	toys	520	Mexican imports	Medina
Fulton Brewery	beer	900	NAFTA imports	Fulton
Hospitak Inc.	disposable medical	180	Moved to Mexico	Lindenhurst
Imperial Wallcovering	wallcoverings	172	Moved to Canada	Plattsburgh
Leslie Fay Co.	apparel	100	NAFTA imports	New York City
Lockheed	circuit boards	384	Moved to Mexico	Utica
Mallinckrodt	airway products	400	Moved to Mexico	Argyle
Mallinckrodt	medical devices	450	Moved to Mexico	Argyle
Mobil Chemical	PXS film	165	Moved to Canada	Maccoon
Niagara Mohawk	electric (hydro) power	2600	Canadian imports	Syracuse
Occidental Chemical	molding compounds	175	Moved to Canada	North
Ogden Atlantic Design	printed circuit boards	120	NAFTA imports	Poughkeepsie
Shorewood Packaging	cartons, record jackets	104	Moved to Canada	Farmingdale
Smith Corona	typewriters/ wordprocessors	874	Moved to Canada	Cortland
Standard Products	auto body side molding	264	Canadian imports	Schenectady
Truck-Lite Company	vehicular lighting fixtures	100	NAFTA imports	Falconer
TRW	switches	420	Moved to Mexico	Union Springs