

In Brief

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NAFTA Revisited: Achievements and Challenges

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In this comprehensive analysis of the North American Free Trade Agreement's performance, the authors compare actual experience against both the objectives of the agreement's supporters and the charges of the critics. Hufbauer and Schott assess the overall economic gains to Canada, Mexico, and the United States; the results in key sectors such as autos, agriculture, and energy; and the operation of the dispute settlement, labor, and environmental provisions. They then lay out a blueprint for upgrading the trade pact in light of new trade and security challenges, including the post-9/11 threat of terrorism, competition from China, and globalization in general.

The authors conclude that, overall, NAFTA did what it was designed to do—promote trade and investment among the partner countries—but not everything that exuberant politicians promised. High-profile failures involving softwood lumber, trucking, and sugar mar an otherwise solid record on regional trade and investment.

The North American economy is more integrated and more efficient today than it would have been without NAFTA. When it entered into force in January 1994, NAFTA represented a \$6 trillion economy with a population of 360 million. Ten years later, the NAFTA area grew to a \$12.5 trillion economy with a population of 430 million. North American firms have restructured to take advantage of economies of scale in production and intraindustry specialization. US-Mexico trade has grown twice as fast as US trade outside of NAFTA, and foreign investment in Mexico has soared. The US and Canadian economies have performed well during the NAFTA era, growing by average annual rates of 3.3 and 3.6 percent, respectively; by contrast, Mexican growth—in part dragged down by the peso crisis of late 1994–95—averaged only 2.7 percent, well below potential. Moreover, gains from economic integration have been distributed unevenly and mask adjustment problems afflicting some workers and firms in each country.

While NAFTA has substantially advanced economic integration, its footprint has been limited in important respects. The trade pact was not designed to limit illegal immigration nor do more than scratch the surface of long-standing labor and environmental problems. Key economic and social issues were deliberately excluded from the pact. Obstacles to US-Canada agricultural trade and problems related to migration from Mexico were overlooked. Attempts to draft common NAFTA rules on subsidies, and on antidumping and countervailing duties, were abandoned. Side agreements on labor and the environment saved NAFTA from congressional defeat but were not backed by meaningful financial resources or authoritative judicial mechanisms. Energy policy was included in the pact, but Mexico was exempted from the most important investment provisions. Thus, Mexico missed an opportunity to attract much-needed investment and technology for expanding energy production. Important NAFTA institutions—the prime example being the North American Development Bank (NADBank)—lack adequate mandates and funding and consequently fell short of aspirations.

To address these problems, the authors propose that the three countries

- adopt a NAFTA **common external tariff** to expand their trade further and considerably reduce the distortions generated by NAFTA rules of origin. The three partners should also work toward better consultation and cooperation on domestic regulations, particularly in food safety.
- **negotiate solutions to current trade disputes** that have festered for a decade or more. These disputes include, first and foremost, softwood lumber (with Canada) and sugar (with Mexico) but also trucking, wheat, corn, and tomatoes.
- **agree to use the stronger World Trade Organization (WTO) dispute settlement mechanism** to address future conflicts over antidumping and countervailing duties.
- **strengthen energy security.** The United States should deepen cooperation with Canada in infrastructure planning and regulation. Mexico should pursue tax and energy policies that help stimulate new investment—especially in oil and gas production and electricity generation and distribution—and thereby provide a strong foundation for Mexico’s economic growth. In so doing, Mexico also would contribute to energy security and thus to the long-term health of the North American economy—on which Mexico is so dependent.
- update NAFTA **to incorporate new labor and environmental provisions** developed in recent US free trade agreements. The labor side agreement should be recast to focus attention on a short list of core labor standards. Also, NADBank funding should be substantially expanded to address environmental and other infrastructure needs.
- forge **common visa standards for non-NAFTA visitors and immigrants.** This goal is highly significant from a security standpoint, and North America needs a shared system for excluding non-NAFTA nationals who pose a security threat. The partners should also **create a more efficient system for handling legitimate travelers** among the three NAFTA countries. The Smart Border Accord between Canada and the United States contains useful elements: high-tech identity cards for permanent residents, biometric identifiers, and preclearance programs for frequent travelers. Finally, and most difficult, the **United States and Mexico need to devise new policies for improving the life chances of some 10 million illegal Mexican immigrants** in the United States.

The authors argue that it would make economic sense for many of their proposals to be implemented by the three countries on a unilateral basis. If the United States rationalizes its own immigration laws, it will be the primary beneficiary of a more secure border and a more accountable workforce. If Canada improves its border security, it will be protected against disruptions in US-Canada trade. If Mexico implements energy reforms, it will mitigate severe energy shortfalls that are hampering growth. And if all three resolve long-standing trade disputes, they will benefit from a vastly improved North American trading environment. While enlightened self-interest will go far in upgrading NAFTA, in the real world of give-and-take politics, reforms may be possible only in a fresh round of NAFTA negotiations.

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