

Canadian-American Business Council

The economic benefits of NAFTA

April 2008

The U.S. presidential election has prompted a debate on renegotiating the 1994 North American Free Trade Agreement.

The agreement came into force January 1, 1994, and as of January 1, 2008, it has been fully implemented. Virtually trade in all products manufactured in Canada, Mexico and the U.S. cross the borders tariff-free.

Presidential candidates on the Democratic side and the presumed Republican nominee have said they plan to push for changes in the 14-year-old agreement.

Both Senators Hillary Clinton and Barack Obama have said they want to “fix” NAFTA by including tougher labor and environmental standards, mirroring those found in other bilateral trade agreements the U.S. has signed with other countries subsequently.

Republican Senator John McCain has indicated that he wants to strengthen U.S. Trade Adjustment Assistance, which was designed to assist trade-affected U.S. workers who have lost jobs as a result of increased imports from Canada or Mexico or shifts in production out of the U.S.

Calls by the presidential candidates to renegotiate parts of NAFTA have sparked responses from Canadian and Mexican politicians. In Canada's case, the government of Prime Minister Stephen Harper has suggested it would make changes to the guarantees Canada has given on exports of oil, natural gas and electricity to the U.S. Canada is the largest exporter of energy to the U.S. Mexico is threatening to end the special treatment to U.S. agricultural products in the Mexican market.

There is little argument that NAFTA has generated substantial economic gains for all three countries. Gary Clyde Hufbauer and Jeffrey J. Schott, trade experts at the Peterson Institute for International Economics in Washington and authors of [NAFTA Revisited: Achievements and Challenges](#), say that on a basic level NAFTA's impact on North American companies is clear.

"NAFTA was designed to promote economic growth by spurring competition in domestic markets and promoting investment from both domestic and foreign sources. It has worked. North American firms are now more efficient and productive," the authors conclude. "They have restructured to take advantage of economies of scale in production and intra-industry specialization."

Statistics are telling as well.

Between 1993 and 2007, trade among the NAFTA partners has more than tripled, to US\$930 billion a year from US\$297 billion a year. When NAFTA came into force in 1994, the combined gross domestic product or economic output for the three countries was US\$6 trillion among a total population of 360 million. A decade later, the NAFTA continental

economy had grown to a US\$12.5 trillion with a population of 430 million. Last year, the three countries' total GDP was US\$15.8 trillion with a population of 445 million. It is the largest trading relationship in the world.

While the phenomenal economic growth cannot be solely attributed to NAFTA, the pact among Canada, Mexico and the U.S. has made a significant difference in trade patterns among the three countries since 1994.

Today, trade with NAFTA partners now accounts for more than 80% of Canada and Mexican trade and about a third of U.S. trade, according to the U.S. Trade Representative's Office.

The pact has also had an impact on individual sectors such as the automobile industry, the U.S. Department of Commerce says.

"NAFTA provisions in the auto sector allow U.S. automotive producers to treat the three countries as a single market, maximize efficiencies, and become internationally competitive."

Hufbauer notes, however, that it can be difficult to pinpoint which industrial sectors have stayed put because of NAFTA rather than migrate to lower wage countries because public announcements by companies are focused largely on moving to a new location.

"However, I believe that the yarn-forward rules of origin in textiles, coupled with NAFTA, have strengthened the textile complex," he says. "Certainly electronics and autos benefit from slicing up the value added chain and performing each part in the cheapest NAFTA location. Also, we do a lot more food processing within NAFTA than 15 years ago."

With NAFTA fully implemented -- with tariffs on virtually all products, except dairy, poultry and sugar, crossing the borders eliminated -- there is an expectation trade could grow even more, especially among agricultural products. "In 1994, our combined agricultural exports to Canada and Mexico totaled US\$10.1 billion," said acting US Agriculture Secretary Chuck Conner in a statement in January. "They are expected to reach US\$28 billion in 2008."

The Canadian perspective:

Between 1994 and 2003, Canada's economy had average annual growth rates of 3.6%, compared with 3.3% in the U. S. and 2.7% in Mexico. The Canadian government notes that employment since NAFTA has shown steady gains, with overall employment rising from 14.9 million to 15.7 million in the early 2000s. Last year, employment stood at 18.1 million.

Since the implementation of the original Canada-U.S. Free Trade Agreement in 1989, two-way trade has tripled. Under NAFTA, growth in bilateral trade between Canada and the U.S. has averaged 6% annually over the past decade. In 2007, the federal government said bilateral trade in goods and services was C\$597 billion, with more than C\$1.7 billion worth of goods and services crossing the border every day.

In a recent speech in Boston, Canada's Ambassador to the U.S., Michael Wilson, outlined the significant impact NAFTA and the earlier Canada-U.S. Free Trade Agreement have had on the Canadian economy.

“Since the Canada–U.S. Free Trade Agreement was signed in 1988, there’s no doubt that our bilateral trade has been the key to growth,” he said. “During those 20 years, Canada–U.S. trade has more than tripled, from C\$225 billion to C\$720 billion. Investment flows have also increased substantially.”

Not only, he said, is Canada the biggest export market for U.S. products — more than China, Japan, the U.K. and Germany combined — Canada ranked No. 1 in 36 states.

Canada's trade with the U.S. is equivalent to 53% of Canadian GDP. The U.S. receives about 80% of Canadian exports while the U.S. ships about 20% of its exports to Canada.

As Ambassador Wilson pointed out, Canada and the U.S. have also one of the world's largest investment relationships. The U.S. is the largest foreign investor in Canada and the most popular destination for Canadian investment. In 2006, U.S. direct investment in Canada was worth more than US\$241 billion while Canadian direct investment in the U.S. was close to C\$224 billion and C\$4.4 billion in Mexico. In 2006, the U.S. and Mexico direct investment in Canada reached 61% of the total C\$449 billion invested in Canada from foreign investors.

The Canadian government notes that most cross-border shipments move without problems. There are notable exceptions such as softwood, but Canada insists both the World Trade Organization and NAFTA dispute settlement processes can handle most issues.

Canada remains the U.S.’s largest trading partner, at least for the moment. The U.S. Census said that in January this year that Canada-U.S. trade for the month was US\$46.7 billion, followed by China with \$32 billion and Mexico with US\$28.9 billion.

The U.S. perspective:

From the current U.S. government's perspective, the U.S. economy has been a big winner under NAFTA. U.S. Trade Representative Susan Schwab says U.S. merchandise exports to Canadian and Mexico grew more rapidly – 157% – than U.S. exports to the rest of the world, which was 108%.

About US\$2.4 billion worth of goods crosses the northern and southern borders each day. As a result, Canada and Mexico are the U.S.'s first and second largest export markets, although China is soon expected to be the U.S.'s largest trading partner. Initial worries about NAFTA, from the U.S. perspective, had little to do with trade with Canada. Instead, former presidential candidate Ross Perot, characterized then widespread concerns about America job losses to Mexico as “that giant sucking sound.

That does not appear to have happened.

Instead, Schwab says that U.S. economic growth during the past 14 years of NAFTA has been strong: U.S. employment rose 22% to 137.2 million in December 2006 from 112.2 million in December 1993. The average unemployment rate was 5.1% between 1994 and 2006, compared with 7.1% between 1981 and 1993.

U.S. manufacturing output rose by 63% between 1993 and 2006, nearly double the 37% seen between 1980 and 1993. Wages in the same sector increased 1.6% between 1993 and 2006 compared with 0.9% between 1980 and 1993.

Excluding housing, U.S. business investment has risen by 107% since 1993, compared with 45% between 1980 and 1993

The U.S. Trade Representative also insists that NAFTA's investment provisions such as Chapter 11 do not prevent the U.S. – or any NAFTA country – from adopting or maintaining non-discriminatory laws or regulations that protect the environment, worker rights, health and safety or other public interest.

Schwab notes that to date the U.S. has not lost a challenge in cases decided under NAFTA, nor has it paid a penny in damages to resolve any investment dispute. Even if the U.S. were to lose a case, it could be directed to pay compensation but it could not be required to change the laws or regulations at issue.

The Mexican perspective:

In its latest analysis, the Mexican government says NAFTA has increased both imports and exports between Mexico and the U.S. Its most recent data indicates that between 1994 and 2003, 48 out of 50 U.S. states and the District of Columbia have seen a growth in exports to Mexico. Among these, 31 states have at least doubled their sales to Mexico.

On the export side, Mexico is among the top 10 exporters to 46 states with the biggest increases being to Maryland, Wyoming, Virginia, South Carolina, West Virginia, Colorado, Massachusetts and New York.

Not surprisingly, the southern border states of California and Texas have seen a huge boost in exports to Mexico. California's sales to Mexico have more than doubled to US\$14.8 billion in 2003, from US\$ 6.5 billion in 1993, ahead of California exports to Canada

and Japan. Texas exports to Mexico have doubled to US\$41.5 billion in 2003 from US\$ 20.3 billion in 1993.

In 2006, trade with Mexico's two northern partners accounted for almost 90% of its exports and 55% of its imports.

However, translating that growth in trade to economic growth in Mexico remains more difficult. The Council on Foreign Relations, in its March 2008 review of NAFTA benefits (http://www.cfr.org/publication/15790/naftas_economic_impact.html), reports that economists suggest growth in the country has been less than expected under NAFTA.

Since 1994, Mexico's GDP has increased at an average annual rate of 2.7%, lagging the average growth rates of 3.3% in the U.S. and 3.6% in Canada. That is despite the fact that Mexican exports to the U.S. have quadrupled since NAFTA, to US\$280 billion a year from US\$60 billion, the Washington-based council found.

However, Schott and Hufbauer of the Peterson Institute say while Mexican growth economic rates have been "a disappointment," the lackluster growth may be more linked to what the economists see as a slow opening up to foreign investment of sectors such as energy not covered by NAFTA.

"Sectors that were shielded from NAFTA—particularly energy in Mexico—have also been shielded from its positive effects."

The road ahead:

In an election climate, it is always difficult to judge how serious a winning presidential candidate would ultimately go in attempting to renegotiate international trade agreements.

Both Senators Clinton and Obama have made it clear they want to amend NAFTA to include what they describe as core labor and environmental standard. Clinton also wants to create a trade prosecutor, eliminate the rights of foreign companies to sue to overturn U.S. laws that protect the environment as well as health and safety of workers.

Senator McCain, who supports NAFTA, has limited his criticism of the pact to the U.S. Trade Adjustment Assistance program, which he wants to strengthen and which was designed to help U.S. workers affected by U.S. industries moving to other NAFTA countries or by competition from imports.

Largely in response, Canadian politicians have made it clear they may use the opportunity to change the energy provisions of NAFTA, which assures that Canada will continue to ship oil, natural gas and electricity to U.S. markets. Canada is the largest exporter of energy to the U.S. Said Prime Minister Stephen Harper: "Of course, if any American government ever chose to make the mistake of opening (NAFTA), we would have some things we would want to talk about as well." Mexico, a major importer of U.S. agricultural products, has raised similar concerns.

Paul Moen, former senior policy advisor to Canada's Minister of International Trade, points out that both Republican and Democratic presidents have been under pressure to be more protectionist in tough economic times.

But as he pointed out in a recent letter to the Financial Times: “When all is said and done, Americans have always carried the torch of free trade in the world since 1945, and without their leadership the evolution of a rules-based system would be in serious jeopardy.

Trade experts and governments are concerned that an attempt by a new Democratic president – should one be elected this November -- to re-open an existing international trade agreement will be a tricky road to go down. Much like pulling at a loose yarn on a sweater, there is a very real risk NAFTA could completely unravel.

And that would have even broader foreign relation ramifications for the next U.S. president, notes Derek Burney, former Canadian Ambassador to the U.S. who was intimately involved in NAFTA negotiations.

“A decision to torpedo a highly successful international agreement would certainly backfire on a new Democratic President’s intentions to refurbish U.S. standing in the world,” says Burney, a CABC advisory member.