

# The Future of the North American Free Trade Agreement



**By Carla Anderson Hills**

This a joint policy paper by the Scowcroft and Mosbacher Institutes based on a presentation by Carla A. Hills delivered during a discussion on the North American Free Trade Agreement (NAFTA) at the Bush School of Government and Public Service at Texas A&M University in College Station, Texas.

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## Introduction

Good evening. I have been asked to share my thoughts on the future of the North American Free Trade Agreement (NAFTA), a topic that we have been hearing about, for better or worse, for many months.

These are turbulent times economically, politically, and technologically that are affecting our domestic, bilateral, and global relationships. Global institutions that helped to create unprecedented peace and prosperity during the 70-years following World War II are under siege as never before. Brexit, the surprisingly positive performance of nationalist parties across Europe, the 2016 presidential election in the United States are all signs of the backlash against globalization.

In America, economic nationalism is now the short-hand term used by some to describe our current trade policy. In his inaugural address, President Trump stated “[w]e must protect our borders from the ravages of other countries making our products, stealing our companies, and destroying our jobs.” Shortly after making those remarks, he withdrew the United States from the landmark Trans-Pacific Partnership and focused on his second central campaign pledge by announcing he would renegotiate or terminate the NAFTA, if he could not fix it. For months now, off and on, he has threatened to scrap the agreement and others like it which his supporters see as a threat to our national sovereignty and economic well-being.

The NAFTA renegotiation talks among Mexico, Canada, and the United States that began this past August had the ambitious goal of reaching a conclusion by the end of 2017. After the 4<sup>th</sup> round of negotiations, the parties agreed to extend the negotiations through March 2018. The process will not be easy. We are likely to be in for a bumpy ride.

## NAFTA’s Historical Accomplishments

Before discussing the renegotiation, it is important to remember what NAFTA accomplished for its benefits are of substantial significance economically and strategically to all three countries.

- It was the first comprehensive Free Trade Agreement to join a developing economy with developed ones.
- By linking the economies of Canada, Mexico, and the United States, it created a \$19 trillion market with 490 million consumers.
- It eliminated tariffs on all industrial products and almost all agricultural products but for a handful with Canada.
- It was the first trade agreement to open a broad range of services, including financial services and banking, and provide national treatment for cross-border service providers.
- It opened up the agriculture, automotive, textiles, and apparel markets between Mexico and the United States.
- It removed significant investment barriers, ensured basic protections for North

American investors and created an effective dispute settlement mechanism to ensure investors had access to neutral, third-party arbitration in cases of disagreements with host governments.

- It was also the first trade agreement to establish enforceable protection of copyrights, patents, trademarks, and trade secrets.

Its expanded coverage set a powerful example globally, giving much needed momentum to the Uruguay Round of Multilateral Trade Negotiations, the largest multilateral trade negotiation ever.

The Uruguay Round, launched in 1986, was an effort by the then 123 member nations of the General Agreement on Tariffs and Trade (the GATT) to upgrade that agreement. Those negotiation had reached a stalemate in 1990. Within four months of the NAFTA taking effect in January 1994, the Trade Ministers from all 123 participating nations returned to the negotiating table and completed the Uruguay Round. They incorporated many of the new provisions in the NAFTA (like protection of intellectual property), and created the World Trade Organization, our modern-day system governing international trade. NAFTA's disciplines not only incentivized our global system to create a broad range of enforceable trade disciplines, moving beyond past agreements governing tariffs on goods, it provided a template for our future regional and bilateral trade agreements.

## **NAFTA's Positive Impact Today**

After nearly a quarter century how has the NAFTA's impacted North America? Without question all three economies have benefited. US manufacturing output is up 40 percent since we signed the NAFTA, and last year hit a record \$2.4 trillion. Fourteen million US jobs depend on US trade with Mexico and Canada. In Mexico, it accelerated and "locked in" ongoing economic reforms that reduced its public debt, stabilized inflation and built up its foreign reserves. Today, 80 percent of world trade is conducted through global supply chains, and NAFTA has created one of the most vibrant. Specialization among the three NAFTA partners has boosted the region's productivity. Our collaboration has made North America the most competitive region in the world.

Intraregional trade is up five-fold since the agreement's implementation. Last year alone, more than \$1 trillion in goods were traded in North America. And, today, one third of the United States' global trade is with our NAFTA partners. You have undoubtedly noticed that a disproportionate share of the criticism about NAFTA in the United States is focused on Mexico. It is said that "NAFTA is Mexico's gain, and America's pain." Too few Americans know that Mexico is the United States' second largest export destination, behind only Canada. US exports to Mexico are up six-fold since NAFTA took effect in 1994. In fact, the United States sells more to Mexico than to all the rest of Latin America combined. Indeed, we sell more to Mexico than to Germany, France, the United Kingdom, and the Netherlands combined. In reality, we don't simply sell to each other, we

make things together. Forty percent of what the United States imports from Mexico consists of US content, 25 percent from Canada. By comparison the US content in goods imported from China is 4 percent and from Japan 2 percent.

In addition, Mexico is not only a vibrant trading partner, it is a terrific export agent for the United States. It has twice as many trade agreements as the US involving 45 nations including the European Union. Mexico's exports have high US-content which effectively give US producers of that content preferential access to markets where we have no trade agreements. And remarkably every dollar Mexico earns on its exports, it spends roughly 50 cents on US goods.

In the United States, it is sometimes said that Mexico has taken American jobs. But NAFTA has helped create jobs in both of our countries. In 1993, US jobs connected to trade with Mexico totaled 700,000. Today that figure is 5 million. Similarly, according to a study by the Mexican Institute for Industrial Development & Economic Growth, 2.7 million Mexican jobs are directly related to its NAFTA trade with the United States. Contrary to the public posturing on both sides, neither of us can afford to lose these very substantial economic benefits. Without NAFTA, the average tariff on US shipments to Mexico would be 7.4 percent, about twice what Mexican exports would face coming into the United States.

But in specific sectors like agriculture and auto parts, key exports for Texas, tariffs would be much higher. Today our economies are so economically interdependent,

that any significant decoupling would be catastrophic economically. But we would not only suffer commercially. Equally worrisome, decoupling would put at risk unprecedented trilateral collaboration in dealing with today's strategic challenges. Today our three governments work closely together to improve the security at our borders. We share intelligence to reduce the reach of organized crime and to expedite more efficient movement of legitimate travel and products across our borders. We work together to respond to pandemics and natural disasters and much more. NAFTA helped to catalyze these new habits of cooperation in order to take full advantage of the economic opportunities it created. We cannot assume that our strategic partnership would hold up if our economic relationships were adversely impacted.

### **How to Upgrade NAFTA (Without Damaging Our Economies)**

It is decidedly in our shared interests to build on the vibrant commercial and security ties that have developed over the past two decades. Much has changed since we launched the NAFTA negotiations over 25 years ago. We need to modernize NAFTA to take advantage of new 21<sup>st</sup> century opportunities.

It is clear that all three of our nations would benefit from agreeing to modern rules governing digital flows, e-commerce, financial services, telecommunications, and energy. Concerns with cross-border data flows and the export of digital products did not exist in the early 1990s. Today broader protection of intellectual property, covering digital

content, is essential to growing a 21<sup>st</sup> century economy.

These, plus a new chapter to facilitate trade by small-and-medium-sized enterprises which constitute a majority of our exporters, rules governing cross border activities of state-owned enterprises, and new text on energy to reflect Mexico's easing of investment restrictions are all topics that are being actively discussed by the negotiators.

Also, I support efforts to strengthen NAFTA's labor and environmental commitments, and fold what now are "side agreements" into the main text making those commitments subject to dispute settlement like other obligations in the agreement. This step would reflect a heightened awareness of their growing importance to sustainable trade and development.

The Trans-Pacific Partnership (TPP) trade agreement, to which all three governments were once signatories, offers a template for how to treat these and other issues important to businesses of all sizes, such as trade facilitation and present-day customs procedures. The business community in all three countries plead in favor of a "do no harm" approach in the ongoing negotiations.

Highly controversial is the US proposal to remove or make optional Chapter 11, the investor-state dispute settlement mechanism. Without the objective trilateral panels to resolve those differences investors would face uncertainty with respect to investments beyond our borders. Interestingly we have never lost a case under Chapter 11.

The US government has publicly announced that it is considering efforts to strengthen the rules of origin that are used to determine whether products are made in North America and thus eligible for NAFTA's tariff benefits. NAFTA's rules of origin already are the toughest in any major FTA. They add an estimated seven percent in compliance costs, which is especially burdensome for small-and-medium-sized businesses.

In the United States, SMEs constitute over 90 percent of our goods exporters. NAFTA's rules of origin can be simplified and updated to reflect changing production processes. But requiring that a greater share of product be made in North America or in a single specified country could throw sand in the gears of complex North American supply chains and hamper our regional competitiveness.

Governments understandably want to maximize their ability to use national trade remedy laws to address what they see as unfair trade practices. But there is scant evidence of bias in the existing NAFTA panel reviews of national measures taken under Chapter 19 of the Agreement to rectify unfair trade. Chapter 19 was a key issue for Canada during the US-Canada FTA negotiations, and so any attempt to eliminate it will almost certainly be met with firm resistance. A "sunset provision" that terminated the agreement in 5 years or permitted a party to opt out, would create unacceptable uncertainty for our investors.

Finally, proposals that view NAFTA as a vehicle "to fix" the US trade deficit with Mexico with respect to goods, which last year to-

taled \$63.2 billion, will create formidable obstacles to a successful negotiation with no positive outcome. Mainstream economic analysis shows that trade deals do not appreciably impact deficits.

### **The Status of the Negotiations: Time Is of the Essence**

Today negotiators are meeting for a fifth round of talks in Mexico. There has been progress since the talks began in August, with texts being drafted, shared, and discussed in what has been an intense negotiating schedule.

All three governments have indicated a desire to complete negotiations rapidly because the political clock is ticking with Mexico's Presidential election in July and our mid-year elections in November. To meet the aggressive timetable, negotiators need to resolve some very difficult and potentially divisive issues in the weeks ahead.

The US side must bring home an agreement that wins private sector support and obtains approval both from the President and the Congress. Under our legislation, the President cannot sign the agreement until he has given the US Congress a report on trade remedies and has published the text on the Trade Representative's website. It is unlikely that even if our negotiators reach agreement in March that our Congress could vote on the agreement until sometime in the summer of 2018.

By then, the United States will be tangled up in politics involving the November 2018 mid-term, legislative elections. Our history tells us that trade issues, even those that are

overwhelmingly in America's best interest, are a tough sell during a political cycle. My hope is that we can focus on moving ahead expeditiously, making progress with the issues that will make a positive difference for our businesses, large and small, and make our workers more secure, while sidestepping unnecessary controversy.

However, my concern is that trade in general and the NAFTA in particular, has become such a polarizing political issue for a significant but influential minority of Americans that an updated agreement that leaves us all better off may be beyond our reach at this moment in history. It would not be surprising to me if the talks break down at some point. In that case those of us who care about keeping our markets open would need to focus on finding ways to encourage all three governments to make their way back to the negotiating table in the near future. The fact is that the United States has not approved a significant trade agreement for six years.

During the last US election, both major political parties were highly critical of our trade agreements. To some extent mainstream media, and social media amplified the shrill anti-trade voices of candidates, and drowned out those with an opposing view. According to the Pew Research Center, while a narrow majority of Americans view free trade agreements favorably, a substantial minority – 40 percent – believes that our trade agreements are harmful both to our country and to their financial wellbeing.

Our nation seems to be gravitating to what *Washington Post* columnist Robert Samuelson called "a new mercantilism," which he

defined as “policy intended to advance [one country’s] economic and political interests at other countries’ expense.” That is a big problem. Treating trade negotiations as a zero-sum game – especially with your neighbors – is not the path to success. What can we do to change that?

### **The Role of Social Safety Nets, Trade Education, and the Private Sector**

First, we have to ask why do so many Americans hold an adverse view of trade agreements despite their demonstrable economic and security benefits? I believe there are two basic reasons: The first is workers’ anxiety with respect to stagnant wages, loss of jobs, and growing social and economic inequality and immobility. The second is the lack of information or misinformation about why trade matters. With respect to the first, our governments and private sectors need to work together to address the legitimate anxiety that exists in many of our communities. Technology and globalization have caused an upward shift in higher paying jobs and sizeable increases in national GDPs, but those facts are cold comfort to the worker who has lost his or her job and does not have the training to secure a new one.

It is true that American manufacturing jobs have decreased over the past 20 years, but that decline began in the 1980s – well before NAFTA. Today, US factories produce twice what they did in 1984 but with half the workers, owing primarily to technological advances. However, there are 6 million higher-skilled, higher-paying jobs that are currently vacant in the United States. Many of these jobs do not require a college degree but often

just 10 to 15 weeks of training. The answer is not to undercut national competitiveness by turning inward but to put in place effective social programs structured for the economy of the 21<sup>st</sup> Century. Here, we have fallen woefully short.

In my view, there are a number of creative ways to tackle the problem. For example, we could:

- Make better use of the Internet to match job-seekers with vacant jobs nation-wide;
- Provide stipends for necessary relocation and support during a re-training period;
- Implement an effective earned income tax credit program; and
- Establish public-private partnerships to create training centers with the businesses that are in real need of trained workers.

With respect to the lack of information about trade, most Americans are unaware of the benefits that flow from our cross border commercial activities. For example, they do not know that the opening of global markets after World War II enabled international trade and investment to expand which caused America’s GDP to increase by more than \$2 trillion. That translates into a per capita gain of over \$7,000. Nor do they know that US jobs connected to trade on average pay 13 to 18 percent more than jobs in our overall economy. They are unaware of our collaboration that fights against human and drug trafficking. Our sharing of intelligence enabled us to capture drug kingpins like El Chapo. If we are to continue to reap the economic and security benefits we have gained over the years

from NAFTA and agreements like it, we desperately need to get these facts out to our citizens and their elected leaders.

I urge business leaders to talk to mayors, local and state officials, rotary clubs, and most importantly their employees about how keeping markets open expands their commercial opportunities and generates their revenues. US companies could put in the envelopes holding the employees' monthly paycheck a note stating, for example, that

37% of the company's revenues come from our NAFTA trade and 37% of this check is dependent upon our continued NAFTA trade. I believe it could make a difference. In addition to business leaders, universities and think tanks need to engage with a sense of urgency in a dialogue about why trade deals like NAFTA matter and – just as importantly – how to help those left behind by globalization. It will take leadership, the kind of leadership that people in this room exemplify.

***The views expressed herein are those of the author(s) and do not necessarily reflect the positions of any of the institutions to which they are affiliated (e.g., the Scowcroft Institute of International Affairs; the Mosbacher Institute for Trade, Economics, and Public Policy; the Bush School of Government and Public Services; or Texas A&M University).***



## **The Bush School of Government and Public Service**

***Mark Welsh, Dean and Holder of the Edward & Howard Kruse Endowed Chair***

Founded in 1997, the Bush School of Government and Public Service has become one of the leading public and international affairs graduate schools in the nation. One of ten schools and colleges at Texas A&M University, a tier-one research university, the School offers master's level education for students aspiring to careers in public service.

The School is ranked in the top 12 percent of graduate public affairs schools in the nation, according to rankings published in U.S. News & World Report. The School now ranks thirty-third among both public and private public affairs graduate programs and twenty-first among public universities.

The School's philosophy is based on the belief of its founder, George H.W. Bush, that public service is a noble calling—a belief that continues to shape all aspects of the curriculum, research, and student experience. In addition to the Master of Public Service and Administration degree and the Master of International Affairs degree, the School has an expanding online and extended education program that includes Certificates in Advanced International Affairs, Homeland Security, and Nonprofit Management.

Located in College Station, Texas, the School's programs are housed in the Robert H. and Judy Ley Allen Building, which is part of the George Bush Presidential Library Center on the West Campus of Texas A&M. This location affords students access to the archival holdings of the George Bush Presidential Library and Museum, invitation to numerous events hosted by the George Bush Foundation at the Annenberg Presidential Conference Center, and inclusion in the many activities of the Texas A&M community.

## **The Scowcroft Institute of International Affairs**

*Andrew S. Natsios, Director and E. Richard Schendel Distinguished Professor of the Practice*

The Scowcroft Institute of International Affairs (SIIA) is a research institute housed in the Bush School of Government and Public Service at Texas A&M University. The Institute is named in honor of Lt. Gen. Brent Scowcroft, USAF (Ret.), who had a long and distinguished career in public service serving both as National Security Advisor for Presidents Gerald Ford and George H.W. Bush. The Institute's core mission is to foster and disseminate policy-oriented research on international affairs by supporting faculty and student research, hosting international speakers and major scholarly conferences, and providing grants to outside researchers to use the holdings of the Bush Library.

*“We live in an era of tremendous global change. Policy makers will confront unfamiliar challenges, new opportunities, and difficult choices in the years ahead I look forward to the Scowcroft Institute supporting policy-relevant research that will contribute to our understanding of these changes, illuminating their implications for our national interest, and fostering lively exchanges about how the United States can help shape a world that best serves our interests and reflects our values.”*

— Lt. Gen. Brent Scowcroft, USAF (Ret.)

## **The Mosbacher Institute for Trade, Economics, and Public Policy**

*Lori L. Taylor, Director and holder of the Verlin and Howard Kruse '52 Founders Professorship*

The Mosbacher Institute for Trade, Economics, and Public Policy was founded in October 2009 upon the request of President George H.W. Bush to honor Robert A. Mosbacher, Sr., who served as Secretary of Commerce from 1989 to 1992. Secretary Mosbacher's significant accomplishments while at the helm of the Commerce Department include helping to lay the foundation for the North American Free Trade Agreement and significantly closing America's trade deficit with key trading partners, such as Japan and South Korea. The mission of the Mosbacher Institute is to produce innovative policy research and top-quality education and training to help the decision makers of today and tomorrow meet the challenges posed by a new world of global markets and increasingly diffuse political and economic power. The Institute aspires to engage all of its stakeholders in the design of policy solutions to the complex and difficult challenges confronting the United States and world economies.

*“We live in a new world of global markets and increasingly diffuse political and economic power. We must rethink the domestic implications of these changes and chart the way forward.”*

— Robert A. Mosbacher, Sr.