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COMMENT

BUILD ON NAFTA TO FURTHER INTEGRATE THE NORTH AMERICAN MARKET

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Request for Comments on Negotiating Objectives Regarding Modernization of North American Free Trade Agreement with Canada and Mexico
Agencies: Office of the United States Trade Representative
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The Office of the United States Trade Representative has requested public comments on matters relevant to the modernization of the North American Free Trade Agreement (NAFTA) in order to inform development of US negotiating positions.

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The North American Free Trade Agreement has benefited the people of the United States for more than two decades by strengthening America's economy and its ties with the two

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market democracies next door, Canada and Mexico. While there are opportunities to improve NAFTA, it would be a blunder of historic proportions for the United States to withdraw from the agreement.

ANALYSIS

By every reasonable measure, NAFTA has been a success. The trade agreement delivered on its central promise of deeper North American economic integration. Since NAFTA's passage, America's two-way trade with Canada and Mexico has more than tripled, with trilateral trade flows within NAFTA topping $1 trillion in 2011. Canada and Mexico are now the largest and second-largest foreign markets, respectively, for US goods and services, collectively buying more than one-third of total US exports.[1]

Leveling the Playing Field

NAFTA has already delivered the level playing field that political leaders often demand. Before NAFTA, Mexico imposed tariffs that were generally higher on US agricultural and manufactured goods than were US tariffs on Mexican goods. For example, Mexico's trade-weighted tariffs on US agricultural exports before NAFTA averaged 11 percent, with one-quarter of US farm exports to Mexico subject to restrictive import licensing. Prior to NAFTA, Mexico imposed a 20 percent duty on US automobile exports compared to the 2.5 percent duty imposed on Mexican automobiles imported to the United States.[2] Upon full implementation, NAFTA reduced all duties in all directions to zero.

As a result, North American production and capital markets are highly integrated, making companies in all three partner countries more competitive in global markets. In fact, NAFTA is a major reason why, despite other challenges, the three major North American economies have generally outperformed those of the European Union and Japan in the past two decades. The auto sector is especially intertwined, going back to the US-Canada auto pact of 1965. Today, US automakers are thriving in the zero-tariff North American market created by NAFTA. Consider:

- In 2016, more than 12 million cars and light trucks were assembled in the United States. That exceeds the average annual assembly of 10.7 million vehicles during the past 30 years.
- Real automotive manufacturing output, including parts and final assembly, reached record levels in 2016. Output has more than doubled since NAFTA went into effect in 1994.

1. M. Angeles Villarreal and Ian F. Fergusson, "The North American Free Trade Agreement (NAFTA)," Congressional Research Service, April 16, 2015, 10.
2. Ibid., 5–6.

- US auto factories are operating at 85 percent of capacity, according to the Federal Reserve. That is well above the 80 percent that is considered normal and a full 10 percent above the industry average since 1986.[3]
- Motor vehicle and light truck exports from the United States have set records in recent years, exceeding 2 million since 2013.[4]

The decrease in total employment in US auto factories, compared to decades past, is due not to declining production but to impressive advances in productivity fueled by automation. This rising productivity means US automakers can pay their workers more and still remain competitive in global markets.

Most studies show a modest positive effect from NAFTA on the US economy.[5] The agreement was never going to have a huge impact on the United States. When NAFTA took effect, the US economy was more than 17 times larger than Mexico's, US trade barriers to Mexican imports were already low, and America's two-way trade with Mexico was a mere 1.4 percent the US gross domestic product.

Manufacturing investment to Mexico did increase after NAFTA, but it remains a fraction of annual manufacturing investment in the US domestic economy. In the five years after the passage of NAFTA, the US economy added a net 700,000 manufacturing jobs. Real, inflation-adjusted manufacturing output is up 40 percent since NAFTA came into effect. The loss of manufacturing jobs in the past two decades is driven by gains in productivity fueled by automation, not by any modest effect that NAFTA might have had.

Positive Effects on Immigration

Along with economic gains for the United States, NAFTA has locked in Mexico's economic reforms and stabilized its economy. Mexico today is a multiparty democracy with a growing middle class. America's relations with this southern neighbor and its 100 million citizens have generally improved under NAFTA compared to the recurring tensions of past decades.

The improving situation in Mexico lowers the incentive for its citizens to migrate to the United States. This is a major reason why net immigration to the United States from Mexico has turned negative in recent years, with more Mexicans returning to their homeland each year than entering the United States. If Mexican workers are barred from selling their goods in the United States, they will be more tempted to export their labor.

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3. For automotive assemblies, real output, and capacity utilization, see Federal Reserve Board, "Industrial Production and Capacity Utilization—G.17," May 16, 2017, tables 1, 2, 3, and 10.
4. For motor vehicle exports, see Department of Commerce, International Trade Administration, Office of Transportation and Machinery, "Motor Vehicle Trade Data: New Passenger Vehicles and Light Trucks Exports," accessed June 9, 2017.
5. See US International Trade Commission, "Economic Impact of Trade Agreements Implemented Under Trade Authorities Procedures, 2016 Report," June 2016; and Gary Clyde Hufbauer, Cathleen Cimino-Isaacs, and Tyler Moran, "NAFTA at 20: Misleading Charges and Positive Achievements" (Policy Brief 14-13, Peterson Institute for International Economics, Washington, DC, May 2014).

Improving the Agreement

NAFTA's record of success does not mean there are no opportunities to improve the agreement. Potential areas of improvement include protecting data transfers, barring the forced localization of servers, adding additional disciplines against the abuse of antidumping duties, and further liberalizing the services trade, including US maritime shipping and Mexican oil and gas drilling. Ironically, many of these improvements were contained in the Trans-Pacific Partnership agreement that included all three NAFTA nations as signatories.

CONCLUSION

The United States should build upon and improve the North American Free Trade Agreement, not withdraw from it. Overturning a successful commercial agreement with America's two biggest business partners would disrupt supply chains and put millions of current US jobs at risk. It would make US companies less competitive in global markets, reducing US imports, exports, output, and employment. That would be a bad deal by any measure.