RICE UNIVERSITY'S
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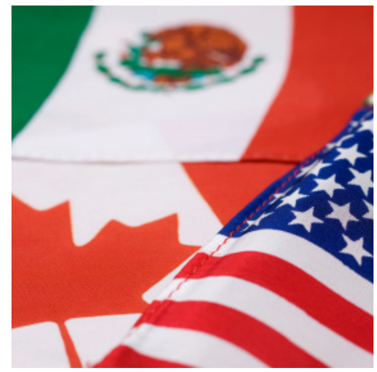
POLICY BRIEF

RECOMMENDATIONS FOR THE NEW ADMINISTRATION

Whither NAFTA?



The North American Free Trade Agreement (NAFTA) has become progressively more controversial in the United States. President-elect Trump has, accordingly, called for a critical evaluation of multilateral trade agreements, including NAFTA. Still, the United States economy has benefited from its free trade relationship with Canada and Mexico. Over the course of 23 years, NAFTA states have created one of the world's largest and most dynamic economic blocs, with nearly 500 million people and a GDP of $22 trillion.

The Trump administration's reevaluation of NAFTA, aimed at expanding American job creation, should focus on modernizing the agreement to add new chapters that level the playing field—ensuring equitable conditions among member nations in order to benefit American workers, while at the same time advancing our country's and the continent's economic potential.

NAFTA AND THE UNITED STATES

Since 1994, trade between NAFTA states has expanded substantially. In 2016, Canada was America's foremost trading partner with a 16.4% share of all U.S. trade. Mexico was third, with a share of 14.5%. In the same year, the NAFTA region had combined trade of more than $1.2 trillion—nearly equivalent to Asia's entire intraregional trade.[1] At the same time, Canada and Mexico's trade surpluses vis-à-vis the U.S. are less than those of China, Japan, and Germany. America's trade deficit with Mexico was responsible for only 8.9% of the total U.S. trade deficit in 2014, as opposed to 56% with China, 17% with Europe, and 10.6% with Japan.[2]

Overall, NAFTA's effects on the U.S. have been mixed and the subject of debate.[3] U.S. investment in Mexico ($92.8 billion) has been much higher than Mexico's investment in the U.S. ($16.6 billion).[4] Nonetheless, Mexican FDI in the U.S. may be responsible for over 100,000 U.S. jobs.[5] Since NAFTA was signed, exports of American goods and services to Mexico grew from $41.5 billion in 1993 to $211.8 billion today—more than twice current U.S. exports to China.[6] Exports to Canada grew from $100 billion in 1993 to $250 billion. Mexico's exports to the U.S. are composed of 40% U.S. components, surpassing both Canada (25%) and China (4%), indicating that American supply chains are well positioned within the North American manufacturing platform. In addition, U.S. agricultural exports to Mexico have grown substantially. Mexico is today the third largest agricultural export market for the U.S., topping $20 billion in 2016.[7]

NAFTA's impact on jobs and wages has also been mixed. An estimated six million jobs in the U.S. are currently affected by trade with Mexico.[8] Some U.S. sectors have lost jobs to Mexico, while others have gained jobs dependent on exports to Mexico. According to one study, an estimated 200,000 American job losses per year can be linked to NAFTA, but the agreement also annually creates about 160,000 jobs dependent on NAFTA exports, leaving an annual total of 40,000 job losses directly attributable to the agreement.[9] It is, however, important to recognize that automation is increasingly responsible for many of the manufacturing jobs lost in the U.S,[10] a trend that is likely to continue. On wages, it has been publicly noted that NAFTA has hurt some workers and jobs, as in the case of auto manufacturing.[11] However, there is also evidence that companies in the U.S. and Mexico that are globally engaged pay better wages than those focused exclusively on the domestic market.[12]

U.S. firms and workers are best served by an examination of the agreement to improve and modernize the relationship and make it more equitable to all partners. A reworked agreement can benefit the American economy, as well as that of Canada and Mexico.

This policy brief is part of a series of recommendations from the Baker Institute for the incoming president's administration.

MODERNIZING & ENHANCING NAFTA

A strong case can be made to modernize and enhance NAFTA. These efforts should be guided by the fact that Canada, the United States, and Mexico are complementary economically. A complete renegotiation of NAFTA would present serious difficulties because every industry sector would come to the table with demands that would be extraordinarily difficult to meet. Dissolution of the bloc in favor of higher trade barriers between the three states would jeopardize the economic growth that has resulted from the agreement. U.S. firms and workers are best served by an examination of the agreement to improve and modernize the relationship and make it more equitable to all partners. A reworked agreement can benefit the American economy, as well as that of Canada and Mexico. Side agreements and new chapters to NAFTA—addressing labor, environmental, energy, intellectual property, currency, financial, and anti-corruption issues, among others—can accomplish this goal.

In this process, Mexico's economic practices should be examined so American workers do not have to compete against locations made unfairly cheap by inadequate labor conditions and regulatory standards. Efforts to modernize and enhance NAFTA should aim for a convergence of standards to benefit companies and workers in the U.S., Mexico, and Canada.

In the long run, it will be most beneficial to the U.S. to reaffirm America's partnership with its neighbors and leverage its strength to consolidate a North American platform that enables it to compete far more effectively with other regions. Withdrawing from NAFTA altogether will hurt the American economy, American leadership, and American competitiveness.

ENDNOTES

1. WTO *International Trade Statistics 2015*, https://www.wto.org/english/res_e/statis_e/its2015_e/its2015_e.pdf.
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3. Peterson Institute for International Economics, https://piie.com/sites/default/files/publications/pb/pb14-13.pdf.
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8. Trade Partnership Worldwide LLC and U.S. Chamber of Commerce, https://www.uschamber.com/sites/default/files/legacy/reports/1204EnhancingtheUS-MexicoEconomicPartnership.pdf.
7. Peterson Institute for International Economics, https://piie.com/sites/default/files/publications/pb/pb14-13.pdf. There is, however, some disagreement on the number of jobs created, with the Public Citizen's Global Trade Watch arguing that NAFTA has failed to create jobs in the United States. See "NAFTA's Broken Promises: Failure to Create U.S. Jobs," Public Citizen's Global Trade Watch, January 1997, http://www.citizen.org/publications/publicationredirect.cfm?ID=7106. At the same time, workers employed by firms that are globally engaged, such as those that participate in NAFTA, are paid between 7% and 12% more than those employed by firms that are not. See David J. Richardson, "Uneven Gains and Unbalanced Burdens? Three Decades of American Globalization," in *The United States and the World Economy: Foreign Policy for the Next Decade*, ed. C. Fred Bergsten (Washington: Institute for International Economics, 2005).
8. David H. Autor, David Dorn, and Gordon H. Hanson, "China Syndrome: Local Labor Market Effects of Import Competition in the United States," *American Economic Review* 103, no. 6 (2013): 2121.
9. Peterson Institute for International Economics, https://piie.com/sites/default/files/publications/pb/pb14-13.pdf.
10. Richardson, "Uneven Gains," 2005.

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