RENEGOTIATING NAFTA - WHAT MAJOR CHANGES SHOULD BE CONSIDERED TO BENEFIT AMERICAN BUSINESSES AND CONSUMERS?

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Introduction

The objectives of this essay are to develop a fundamental understanding of the North American Free Trade Agreement (NAFTA) and to address the major changes that should be made to this agreement to benefit American consumers and businesses. First, we will review NAFTA's origins and initial purpose, as well as define important key concepts for a holistic view of the effects of the agreement. Second, we will examine the leading criticism of NAFTA today, as well as smaller, yet still pressing issues facing the agreement. Last, we will explore and expound upon solutions to remedy outstanding problems and to provide a more sustainable framework for NAFTA's future use.

NAFTA: Origins and Purpose

NAFTA was created in 1994 by Mexico, Canada, and the United States, inspired by the success of the European Economic Community. The initial purpose was to:

- eliminate trade barriers between the participating countries;
- promote conditions of fair competition;
- increase investment opportunities;
- provide protection of intellectual property rights;
- create effective procedures for implementation and application of this agreement;
- establish a framework for further expansion and enhancement of this agreement (cbp.gov, 2014).

The provisions called for gradual reduction of tariffs, customs duties, and other trade barriers during a transition period of fifteen years. The belief was that free trade would bring about increased trade and production to the participating countries. This belief was certainly true in that there were significant increases in trade for each of the participating countries after NAFTA was implemented (See *Figure 1*).

Trade volumes (million USD)				
Channel	**2015**	**1993**	**Nominal increase**	**Real increase***
U.S.-Canada	$518,217	$199,184	160.2%	63.5%
U.S.-Mexico	$481,543	$85,224	465.0%	255.0%
Mexico-Canada	$34,344	$4,052	747.6%	432.5%
Trilateral	$1,034,104	$288,460	258.5%	125.2%
**Adjusted for inflation using BLS core CPI; source: Mexican Embassy in Canada*				

Figure 1. Trade volumes chart. Adapted from "NAFTA's Winners And Losers" by David Floyd, 2017, *Investopedia.* Retrieved January 27, 2018 from https://www.investopedia.com/articles/economics/08/north-american-free-trade-agreement.asp

Key Concepts

Free trade agreement (FTA)

A free trade agreement is the buying and selling, importing and exporting of goods and services, not capital or labor, between two or more countries that have no limits or quotas or barriers or unbalanced tariffs (Black's Law Dictionary, 2014).

Trade barrier

A trade barrier is a government-imposed restraint on the flow of international goods or services. The most common barrier to trade is a tariff- a tax on imports. Tariffs raise the price of imported goods relative to domestic goods (Barriers to Trade, 2010).

Comparative advantage

Comparative advantage is an economic law referring to the ability of any given economic actor to produce goods and services at a lower opportunity cost than other economic actors (Staff, I., 2017). Related to comparative advantage is the Heckscher-Ohlin theory, which states that a country specializes in the production of goods that it is particularly suited to produce (Nobel Media AB, 2014). This means, for example, that if China excels at producing car parts, China will likely try to become the best at producing car parts in comparison to other countries. This specialization would then typically give way to a comparative advantage. If a country puts effort, time, and money into trying to be the best, then they will more than likely be ahead of the competition, and thus gain the comparative advantage.

NAFTA's Criticisms

In recent years, the U.S. has received a large influx of criticisms regarding NAFTA and its provisions. Here we will investigate these criticisms to have a deeper understanding of NAFTA's flaws so we can be better equipped to yield more sustainable solutions.

The growing trade deficit

One of NAFTA's most talked about and dangerous problems is the growing trade deficit that the United States is experiencing. A trade deficit, also known as a negative balance of trade, is an economic measure of international trade in which a country's imports exceeds its exports (Momoh, 2017). The U.S. currently has a trade deficit with Mexico of $65.6 million (see *Figure 2*) and a trade deficit with Canada of $15.3 million (see *Figure 3*).

- 2017 : U.S. trade in goods with Mexico

NOTE: All figures are in millions of U.S. dollars on a nominal basis, not seasonally adjusted unless otherwise specified. Details may not equal totals due to rounding. Table reflects only those months for which there was trade.

Month	Exports	Imports	Balance
January 2017	19,533.8	23,481.6	-3,947.8
February 2017	18,146.9	23,909.7	-5,762.8
March 2017	21,021.8	28,054.3	-7,032.6
April 2017	18,863.5	25,157.7	-6,294.2
May 2017	19,876.9	27,167.8	-7,290.9
June 2017	21,350.5	27,309.0	-5,958.4
July 2017	19,737.8	24,661.2	-4,923.4
August 2017	20,868.7	27,047.0	-6,178.4
September 2017	20,087.4	25,791.2	-5,703.8
October 2017	22,111.9	28,723.2	-6,611.3
November 2017	21,671.1	27,650.9	-5,979.8
TOTAL 2017	**223,270.4**	**288,953.8**	**-65,683.3**

Figure 2. Trade deficit chart. Adapted from "2017: U.S. trade in goods with Mexico," 2017, *the U.S. Census*. Retrieved January 27, 2018, from https://www.census.gov/foreign-trade/balance/c2010.html

- 2017 : U.S. trade in goods with Canada

NOTE: All figures are in millions of U.S. dollars on a nominal basis, not seasonally adjusted unless otherwise specified. Details may not equal totals due to rounding. Table reflects only those months for which there was trade.

Month	Exports	Imports	Balance
January 2017	20,868.6	24,282.3	-3,413.7
February 2017	21,138.3	23,265.3	-2,127.0
March 2017	24,952.9	26,292.5	-1,339.6
April 2017	22,701.0	24,333.5	-1,632.5
May 2017	24,962.6	26,331.3	-1,368.8
June 2017	25,402.7	25,864.1	-461.4
July 2017	21,829.0	22,891.7	-1,062.7
August 2017	24,172.9	24,966.6	-793.7
September 2017	24,123.3	24,374.1	-250.8
October 2017	23,882.2	25,786.2	-1,904.0
November 2017	25,155.9	26,134.7	-978.8
TOTAL 2017	**259,189.5**	**274,522.4**	**-15,332.9**

Figure 3. Trade deficit chart. Adapted from "2017: U.S. trade in goods with Canada," 2017, *the U.S. Census*. Retrieved January 27, 2018, from https://www.census.gov/foreign-trade/balance/c1220.html

Canada is the United States' largest goods export market, with the main exports being vehicles, machinery, and electrical machinery (ustr.gov, U.S.-Canada, 2016). This means that the country with which the U.S. exports the most to is Canada, indicating the biggest chunk of trade profits is coming from trade with Canada, and yet the U.S. imports more from Canada than it exports, so a deficit continues. In fact, the top three countries that the U.S. exports to are Canada, China, and Mexico, and the U.S. has trade deficits with all three. Despite having a trade surplus in services with Canada and Mexico, the U.S. cannot seem to climb out from underneath the ever-growing trade deficit in goods with its two partner countries.

This problem gives way to another alarming issue: growing trade deficits always result in growing trade-related job displacement (Scott, 2011). This is because imports are substituted for more expensive goods that are produced domestically. The more that domestic goods are replaced by foreign substitutes, the less they are produced in the domestic country, meaning a decline in the jobs involved in the production of that good. On average, about 40,000 jobs per year in the United States have been displaced since the implementation of NAFTA, and most of these jobs were in manufacturing industries (Scott, 2011).

An additional source for the increase in the trade deficit is foreign direct investment (FDI). U.S. FDI in Mexico (stock) was $92.8 billion in 2015, while Mexico's FDI in U.S. (stock) was $16.6 billion in 2015 (ustr.gov, U.S.-Mexico, 2016). Nearly half of total FDI investment in Mexico is in its booming manufacturing sector (America, 2016). This means that the U.S. is further supporting the Mexican manufacturing industry, not only by importing their manufacturing goods, but also by directly investing in their manufacturing sector. This money could go toward investments in the United States manufacturing sector, which would create more jobs in the U.S. and possibly reduce the deficit. However, investors are looking at the markets with the most potential for the cheapest cost, and as Mexico has lower labor costs than the U.S., investors will continue to pour money into that market.

Another important point to bring up is the effects trade deficits have on a country's gross domestic product (GDP). GDP is the value of the goods and services produced by the nation's economy less the value of the goods and services used up in production (US Department of Commerce, 2017). The formula for GDP can be written as:

GDP= private consumption expenditures + investments + government expenditures + (exports-imports)

The focus here is that if the United States and its consumers spend more on goods produced in foreign countries (imports) than what is sold to foreign countries (exports), a trade deficit will exist, and GDP will decrease.

Minor Issues with NAFTA

Other, more minor criticisms of NAFTA claim that it is outdated and inflexible and that environmental and labor protection provisions need to be further examined.

NAFTA's Inflexibility in Today's World

NAFTA was created just before the digital age really took off. It counted on customs work being done by hand, a slow process, as that was the only way to do business at the time, with the original drafters unable to know that a faster, more efficient option was to become available. Now that the Internet is at most peoples' fingertips, there has been an increase in digital trade. The Internet has made it easier for small traders to sell across borders (The Economist, 2017). However, unclear rules for electronic documentation combined with the burden of customs paperwork deters many small traders from ever conducting business. Thus, the U.S. is excluding a niche market of potential exporters.

Examination of Labor and Environmental Protection Provisions within NAFTA

Labor and environmental protection is an intensifying concern in the world today. However, NAFTA is, for all intents and purposes, a trade agreement. It is meant to address aspects of trade with Canada and Mexico. The current protection provisions included in NAFTA lack enforcement and are viewed more as suggestions than as rules to follow. The importance of these protections should not be discounted, however, they would be more beneficial if they were dealt with separately from NAFTA and given full attention to, rather than being an afterthought included in a trade agreement.

What Can Be Changed?

NAFTA is a hot-button issue in the United States at the moment, as President Trump has vowed to renegotiate NAFTA for the better, or else tear it up. So the question remains: can NAFTA be changed so that American businesses and consumers are benefitted, or would it be more advantageous for the U.S. to pull out of NAFTA altogether?

Winners and Losers

First, we shall address what would happen if the United States were to completely withdraw from NAFTA. To do this, we will concentrate on the theory of winners and losers in today's marketplace. The idea is that, in a competitive arena, there will always be one that prevails in some way and one that loses in some way. In the case of trade, the winner will be the country that is able to export more than others, while also importing less than others. This is optimal as it increases GDP and results in a trade surplus.

The United States has, unfortunately, been losing in this area, as it is unable to stop the increase of its trade deficit. However, to pull out of NAFTA could have drastic consequences. This would result in no longer having free trade with current partners, meaning a reimplementation of trade barriers. This could give rise to unfavorable trade relationships with Mexico and Canada, as they would no longer benefit from free trade. In response, Mexico and Canada could employ retaliatory trade policies, raising their tariffs on imports from the United States. They could also pull their FDIs from the United States and invest elsewhere.

The outcomes of withdrawing from the agreement could be detrimental to the U.S. Not only would it potentially lose its biggest trading partners, but it would also lose investments in American businesses. The United States would no longer have the advantage of free trade with Canada and Mexico, and thus would be like every other country competing for Canada and Mexico's business, which would be a much larger loss than the current issues facing NAFTA.

Addressing the Issue of Job Displacement

One last small point to confront before exploring recommendations is the topic of job displacement. Many critics of NAFTA blame the agreement for the growing job displacement. Though the movement of jobs to the other participating NAFTA countries, namely Mexico, has increased since the introduction of NAFTA, it is unfair to say that the agreement is solely responsible for the job loss. NAFTA's creation coincided with the start of the digital era. Technology and automation in many industries have made the need for human labor obsolete, and this will only continue as technology becomes more and more advanced. For that reason, job displacement needs to be thoroughly researched and considered before attributing it exclusively to the United States' involvement in NAFTA.

Main Recommendations

Modernization of NAFTA

NAFTA needs to be able to compete in the 21st century, meaning getting on board with digitization. With digitization comes greater accessibility, transparency, and efficiency. It is easier now more than ever before to participate in the global marketplace. Consumers are no longer just consumers, but are now also producers. By making customs paperwork easier for the average American to understand, and standardizing the process for online business, the United States could gain a substantial amount of new business, which would positively affect GDP and help to counterbalance the growing trade deficit.

Providing Incentives and Boosting Enforcement

In the past, some provisions of NAFTA have been treated by participating countries more as suggestions than as enacted laws. This is mainly is due to the fact that enforcement is not especially strict, so if an advantageous approach to doing trade business presents itself, that approach will most likely be followed, regardless of it being in opposition to the trade agreement. A suitable way to reduce this cherry-picking would be to incorporate incentives into the agreement, while also including enforcement provisions.

Periodic Review

The modern world is constantly changing due to advancements in technology and education. Therefore, it is pertinent that laws are updated to remain relevant. A review process to assess NAFTA provisions every five years would benefit each participant. This could eliminate confusion, increase efficiency, and keep things running smoothly.

Conclusion

NAFTA is an integral component of the United States' involvement in the global trade market. NAFTA's initial purpose, to increase trade between its participants, was experienced by the United States with a total real increase in trade of 318.5%. However, unforeseen side effects were encountered in the form of a trade deficit, job displacement, and unexpectedly rigid provisions. The original framework for NAFTA no longer benefits all of its participants, which is the basic principle behind a free trade agreement.

Sustainability, not withdrawal, is the key to a more successful NAFTA. Updates, reviews and enforcement measures should help to keep NAFTA on a more beneficial path for the United States. We do not know what the future holds, so we cannot provide a master list that covers any possible issue that arises. However, we can put in place broad measures that can also be applied to specific situations to help guide the United States through the unpredictable and that can provide benefits to American businesses and consumers in the process.

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