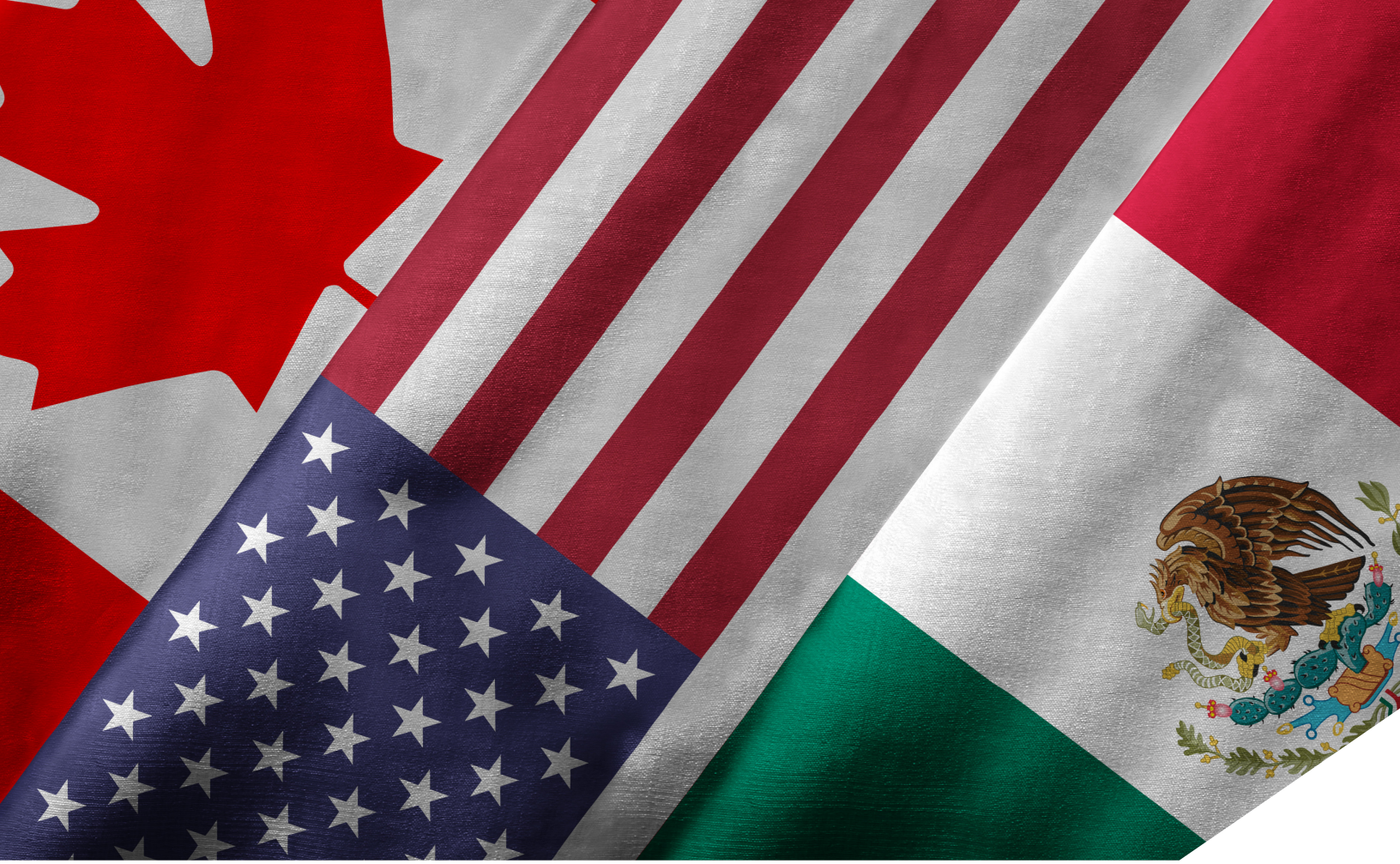

North American Free Trade Agreement

An Overview

June 2017

BIPARTISAN POLICY CENTER

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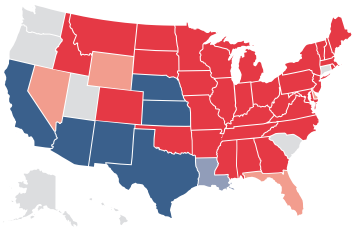
TOP NAFTA FACTS

In **43** out of **50** States



Canada or Mexico is the **1st or 2nd largest export market**

- Canada #1 Trading Partner
- Mexico #1 Trading Partner
- Canada #2 Trading Partner
- Mexico #2 Trading Partner

(Note that "#2 trading partner" only applies when Canada or Mexico is not the #1 partner)

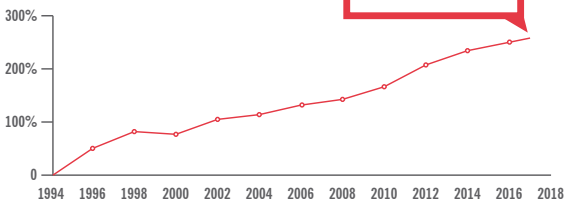
Canada and Mexico account for over a **third of all** *U.S. exports* and over a **quarter of all** *U.S. imports*

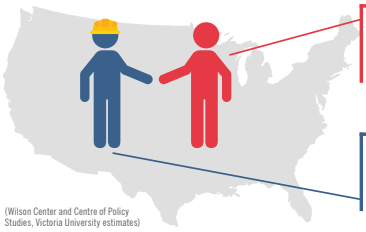
CANADA is the U.S.'s **LARGEST EXPORT MARKET**

MEXICO is the U.S.'s **2ND LARGEST EXPORT MARKET**

Since NAFTA, U.S. manufacturing ***exports to Canada and Mexico***

INCREASED 258%





9 million U.S. jobs depend on trade and investment with Canada

5 million U.S. jobs depend on trade and investment with Mexico

(Wilson Center and Centre of Policy Studies, Victoria University estimates)

IN 2014, ***THE TOP FIVE***
U.S. EXPORT ITEMS TO NAFTA PARTNERS WERE:

- Motor Vehicle Parts
- Refined Petroleum Producs
- Motor Vehicles
- Crude Petroleum Oil
- Machinery Parts

Increased trade increases GDP.
Based on the trade growth since NAFTA's adoption, it's estimated that the U.S. is
$127 BILLION RICHER
annually

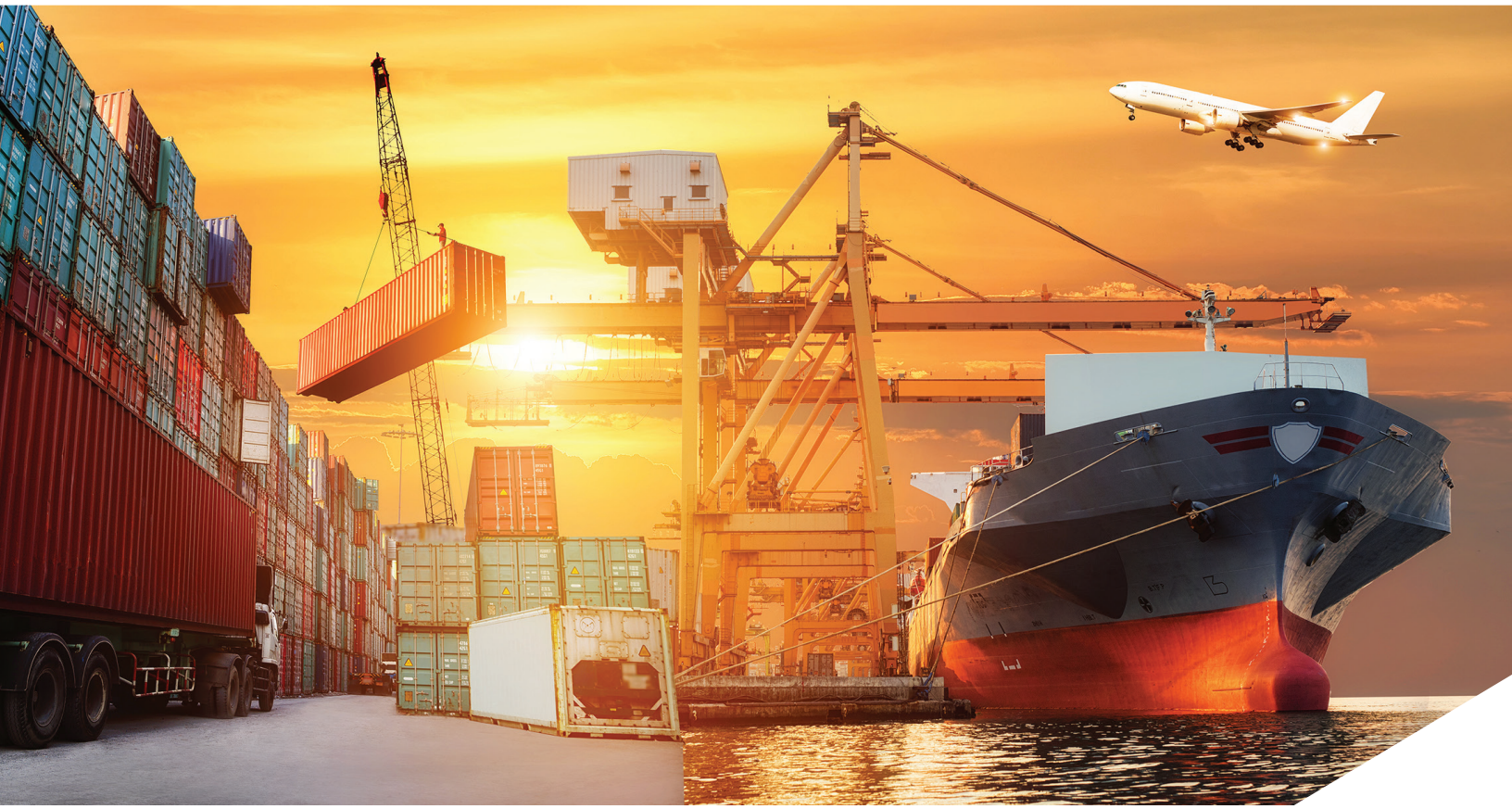
Despite an overall trade deficit, the U.S. has trade ***surpluses*** *in certain sectors, including the* ***services*** *trade (e.g. education, financial services, and telecommunications)*

The U.S. services trade surplus with Canada was
$43.2 billion in 2013

The U.S. services trade surplus with Mexico was
$39.5 billion in 2013

Estimates suggest that **40% of the content of U.S. imports from Mexico** *and* **25% of the content of U.S. imports from Canada** *Originated in the U.S.*

Executive Summary



From its very beginning, the North American Free Trade Agreement (NAFTA) has been a source of controversy and the subject of expansive claims about its benefits and negative impacts on the American economy and workers alike. Assessing the truth of those claims is difficult and complex, largely because the changes directly attributable to NAFTA coincided with numerous other unrelated shifts taking place in the global economy.

For some sectors of the U.S. economy the costs and benefits of the agreement are easier to unpack. For example, for most of the agriculture sector NAFTA has been a major success as U.S. exports have grown significantly. Similarly, for the U.S. service industry, NAFTA opened two large markets—U.S. services exports have grown significantly and the United States runs a large trade surplus in services with both Canada and Mexico.

For other parts of the U.S. economy the impact is less clear. U.S. companies have expanded manufacturing operations in Mexico and now export more products to the U.S. market from those factories, usually at lower cost to U.S. consumers. While the shift of manufacturing operations to Mexico likely had some impact on U.S. employment, it is difficult to conclude that any of those lost jobs would have remained in the United States absent NAFTA. Other economic developments could have moved those jobs to other countries, jobs could have been lost to increased automation, or without trade with Canada and Mexico those jobs might never have existed.

On balance, the wealth of economic analysis on the impact of NAFTA on the United States generally finds the following:

- NAFTA resulted in significant increases in trade in goods, services (such as financial services, legal services, education, and tourism), and investment between the three countries.
- NAFTA has created a trade surplus in services for the United States with Canada and Mexico.
- The economies of the three countries became more closely intertwined as complex supply chains, integrated manufacturing processes, and services and investments developed to take advantage of the trade liberalization the agreement brought about.
- Overall, NAFTA has had a small but positive impact on the U.S. economy, resulting in higher economic growth and employment than there otherwise would have been.
- While the overall impact may be positive, some sectors of the economy saw a net negative impact. For example, while some manufacturing production has moved to Mexico, the United States has created new jobs in higher-technology manufacturing and intermediate goods.
- In spite of this, there has been detailed and pointed criticism of the agreement based on the perception of significant negative effects. Often, NAFTA is judged based on trade deficits with Canada and Mexico. However, NAFTA is not the sole cause of U.S. trade deficits and trade deficits not the sole cause of job losses in the United States.

Overall, NAFTA has had a small but positive impact on the U.S. economy, resulting in higher economic growth and employment than there otherwise would have been.

Introduction

The North American Free Trade Agreement (NAFTA) was a major milestone in U.S. trade policy. It was the first trade agreement between the United States and multiple other countries, and the first to attempt to comprehensively address trade in goods and services. It was also the first pact to consider trade issues related to investment and intellectual property rights. The implementing legislation was signed into law on December 8, 1993, and many aspects went into effect soon afterward.[1]

NAFTA accelerated trade liberalization already in process and implemented new provisions for greater trade expansion among the three partners—the United States, Canada, and Mexico. Trade among NAFTA countries has grown significantly because of the agreement. U.S. trade with Canada and Mexico has more than tripled since the implementation of the agreement and has grown more quickly than U.S. trade with the rest of the world.[2] While NAFTA has indisputably increased trade flows, discussion continues over its impact on the overall economy, particularly in the United States and Mexico. While the impact of NAFTA varies based on individual sectors or industries, most economic analysis has found that NAFTA has had a small but positive net impact on the overall U.S. economy, and that economic growth and employment in the United States is higher than it would have been without the agreement.

U.S. trade with Canada and Mexico has more than tripled since the implementation of the agreement and has grown more quickly than U.S. trade with the rest of the world.

NAFTA Goals

The NAFTA negotiations began in 1992 under the administrations of President George H.W. Bush of the United States, Prime Minister Brian Mulroney of Canada, and President Carlos Salinas of Mexico. Notably, in the cases of both the United States and Canada, the political party in power at the beginning of the negotiations lost subsequent elections and NAFTA was signed into law by the administrations of President Bill Clinton in the United States and Prime Minister Jean Chretien in Canada. The three countries pursued the NAFTA negotiations for a number of reasons including to expand upon trade liberalization begun under the U.S.-Canada Free Trade Agreement of 1989. For Mexico, it was viewed as a way to lock in domestic economic reforms the Salinas government had enacted, to open new and growing markets to exports, and to help shape other international trade and economic negotiations including the Uruguay Round negotiations under the General Agreement on Tariffs and Trade.[3]

The major goals of NAFTA were to reduce barriers to trade, promote fair competition, increase investment opportunities, and protect intellectual property rights among all three countries. NAFTA also established procedures for the resolution of trade disputes between parties. A core principle found throughout all aspects of the agreement is that the three countries must treat individuals and companies doing business across national borders in a manner similar to how they treat their own citizens and companies. This principal of reciprocal treatment is laid out explicitly in NAFTA's obligations on trade in goods, services, and investment. The following are summaries of some of the key aspects of the agreement.

Elimination of Barriers to Trade and Promoting Fair Competition

NAFTA locked in existing tariff treatment for trade in goods between the three countries as of the date of enactment, and for most products began a process of eliminating those tariffs over the next decade. By 2005, tariffs on goods traded among the three countries averaged essentially zero. The agreement also generally prevents the implementation of any new prohibitions on imports of goods from the other partners that did not exist before the agreement. NAFTA extensively lays out rules for specific goods to be eligible for tariff-free status under NAFTA, as well as rules tailored to each member country (so-called "rules of origin"). These rules and tariff reductions help to promote increased trade among the parties and ensure that no single country has an unfair advantage over the other two. The principle is that goods from any of the three countries should be treated the same as domestic goods for market access in each country.

Cross-Border Service Trade

The agreement also generally requires that services traded between the three countries should be treated in the same manner as domestic services. Trade in services can include provision of legal, financial, insurance, or other services in another country, among others. Tourism and telecommunications are also considered trade in services, as is the provision of education to foreign students. Under the agreement, cross-border service providers do not have to maintain a representative office in other NAFTA countries to conduct business there. NAFTA prohibits countries from adopting overly burdensome licensing and certifications for foreign service providers and ensures such measures are not merely disguised trade barriers. The agreement also mandates similar standards among the countries for recognition of education, experience, licensing, and certification obtained in the other countries. NAFTA asks that temporary licensing systems be adopted for engineers that are professionally recognized in another partner country.

Importantly, NAFTA marked the first time a U.S. trade agreement used a "negative list" approach to determining what services the obligations in the agreement cover.[4] Under a negative list approach all services are covered unless expressly exempted. In contrast, the "positive list" approach, used under previous agreements, requires countries to provide trade agreement benefits only to those services explicitly covered.

As a result of the services provisions in NAFTA, U.S. service providers—especially financial service providers—have benefited.[5] The United States has consistently run a trade surplus in services with Canada and Mexico. In 2015, the United States held a surplus of $271.8 billion in services trade with Canada and Mexico.[6] In addition to financial services, transportation services (air, sea, and ground), travel related services (business, tourism, and educational), and payments for the use of intellectual property rights all contribute significantly to the U.S. surplus in services trade.

Rules of Origin

Rules of origin determine when a product qualifies for duty-free treatment under NAFTA. The rules in NAFTA set out the extent to which a good must be produced (originate) in one of the NAFTA countries to qualify for preferential tariff treatment under the agreement. At the first level, goods produced entirely in—and from inputs also made entirely in—any of the three NAFTA countries can qualify for duty-free import into another NAFTA country. However, the rules also allow goods that are not entirely

made from inputs from Canada, Mexico, or the United States to still qualify as a "NAFTA product" under certain circumstances. These rules of origin are created specifically for each product and are based on whether the final product has 1) a change in Harmonized Tariff Schedule classification from its inputs, also known as a "tariff shift," 2) a minimum specified value content originating from within the NAFTA countries, or 3) both. These types of rules are explained below.

Tariff shift rules allow products produced in one of the three NAFTA countries to receive the lower NAFTA tariffs, even if the inputs for the products come from outside North America, as long as the final product is sufficiently transformed from its inputs that the tariff classification of the product changes.[a] Tariff shift rules may require that the finished good is classified in a different chapter, heading, or subheading of the Harmonized Tariff Schedule from its components, depending on how stringent the rule is. In general, a shift to a different chapter requires a greater transformation of the final product from its inputs than a shift among headings or subheadings. Therefore, if the rule specifies a chapter change, more production has to take place in the NAFTA country, while allowing changes between subheadings allows the use of more non-NAFTA components with less local processing.

Rules of Origin in Practice

For example, the NAFTA tariff shift rule for pork sausage (tariff heading 1601) is "a change to headings 1601 through 1605 from any other chapter." So, if a food company in Mexico produces pork sausage (classified in tariff heading 1601) using pork meat imported from Argentina (classified in tariff heading 0203) and spices from Jamaica (classified in tariff heading 0907) the pork sausage still meets the tariff shift requirement and is eligible for duty-free treatment under NAFTA when exported to the United States.

In contrast, a value content rule measures the added financial value of any manufacturing or processing that takes place within any of the three NAFTA countries to determine whether a product is sufficiently transformed from its inputs to receive NAFTA treatment. For example, the regional value content requirement for autos is 62.5 percent, meaning that 62.5 percent of the value of the auto must be comprised of NAFTA country-produced products. So for an auto valued at $20,000, the value of non-NAFTA components cannot exceed $7,500.

Changes to these rules of origin have been discussed as one area for renegotiation, specifically to require more NAFTA content to qualify for duty-free import. Because these rules are product-specific and the calculation of the origin is complicated, any changes to these rules could be extremely complex and challenging.

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[a] The Harmonized Tariff Schedule is used to classify products into discrete categories. Each category has an associated tariff assigned to it. Thus, where a product is classified determines its duty treatment. All WTO member countries utilize the same classification system to ensure consistent classification and treatment of products, however the duty treatment associated with each category various from country to country. For example, imports of screens for computers or televisions imported into the U.S. from Canada or Mexico are tariff free under NAFTA but imports from other WTO member countries are subject to a duty of 4.5 percent.

Investment

NAFTA established rules that investors from any partner country must be treated equally as a domestic investor would be under the law. Countries cannot impose on investors from the other two countries domestic ownership requirements that require a minimum level of equity in an enterprise of another party be held by its own nationals,[b] and no country can force an investor from one of the other countries to sell any investment made within its territory. The agreement allows countries to impose regulations and requirements for the application of health, safety, and environmental standards.

Resolution of Disputes

NAFTA established a Free Trade Commission to supervise the implementation of the agreement and to help resolve disputes.[c] Disputes that fall under the jurisdiction of both NAFTA and the General Agreement on Tariffs and Trade (GATT, a global agreement generally governing the rules of trade among nations dating from the post-World War II era, currently managed by the World Trade Organization) may be settled in either forum. If a resolution cannot be worked out between the parties, the commission may assist the parties in resolving a dispute. If a dispute has still not been resolved at this stage, the commission may establish an arbitration panel to settle the dispute. NAFTA established an extensive list of committees and working groups to help facilitate effective trade relationships and prevent or resolve disputes.

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Intellectual Property Protection

Under NAFTA, all countries must afford adequate and effective intellectual property protections to nationals of other parties. Intellectual property protections include copyright, sound recordings, trademarks, patents, trade secrets, and others. These protections shall, at a minimum, be guaranteed by various international conventions on intellectual property rights. NAFTA countries must treat partners the same under the law as their own nationals in enforcing their intellectual property rights. The legal process must be accessible to nationals of all parties to resolve any intellectual property disputes. Criminal procedures must be available as a mechanism of enforcement of intellectual property law.

Labor Provisions

The North American Agreement on Labor Cooperation (NAALC) was a side agreement added to NAFTA prior to its implementation. The major goals of this side agreement were to improve working standards and living conditions, promote

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[b] Under trade agreements, the term "nationals" refers both to individuals who are citizens of the treaty country, and to companies or other legal entities that have the "nationality" of the treaty country.

[c] The NAFTA Free Trade Commission is comprised of a minister or cabinet member responsible for international trade from each member country. In addition to overseeing implementation and resolving disputes, the group oversees the work of NAFTA committees and other subsidiary bodies, including the NAFTA Secretariat. *See also:* http://www.naftanow.org/about/default_en.asp.

certain labor principles, encourage innovation and productivity growth, and to promote compliance and enforcement with labor law in all three countries.

There was significant concern among labor advocates that NAFTA might result in a "race to the bottom" by employers for cheap labor, and the side agreement was designed to address these concerns. NAALC laid out guiding principles to be followed by the parties, such as protections for children, equal pay for men and women, and the right to strike and bargain collectively. NAALC established the Commission for Labor Cooperation to help further the ability of the parties to NAFTA to meet the goals laid out by the side agreement. However, since the side agreement was not formally part of NAFTA, is not covered by the dispute settlement procedures and provisions. Thus, while the dispute settlement procedures in the agreement can be used to settle commercial disputes between the countries, they cannot be used to settle disagreements about whether a country is meeting its labor obligations under the agreement.

Environmental Provisions

The North American Agreement on Environmental Cooperation was another side agreement added to NAFTA prior to its implementation. The major goals of this side agreement were to foster the protection and improvement of the environment, promote sustainable development, increase cooperation and compliance with the law between parties, avoid the introduction of new environmental-related trade barriers, promote economically efficient and effective environmental measurers, and promote pollution prevention policies. This agreement established the Commission for Environmental Cooperation, with functions and duties similar to the commissions established by NAFTA and NAALC.

NAFTA Trade Relationships

Prior to NAFTA, the United States and Canada had already begun to liberalize trade through the 1989 U.S.-Canada Free Trade Agreement, while Mexico was at that time a more closed and developing economy. As a result, the three countries faced very different starting circumstances. Table A, below, offers summary statistics for each country for 1993, the year before implementation of NAFTA, and 2015, the last full year for which data is available, on three relevant metrics: per capita gross domestic product (GDP), exports as a share of GDP, and the overall current account (trade) balance.[7]

A country's current account balance is a measure of its trade balance in goods and services plus its balance in investment and other financial transfers, although trade in goods and services is often the largest part of the calculation. Thus, the current account captures goods, services, and investments—all of which were affected by the NAFTA-imposed obligations.

It is worth noting that all three countries ran a current account deficit both before and after NAFTA was implemented, which shows that NAFTA alone is not responsible for trade deficits in the three countries and that at least some portion of the deficits are driven by trade with non-NAFTA partners and other economic factors. Therefore, any analysis of the overall current account and trade deficits of the three countries must explicitly examine the role of trade with non-NAFTA countries in shifting exports and imports.

Table A. Summary Trade Positions for Canada, Mexico, and the United States before and after NAFTA

Per Capita GDP		
Country	1993	2015
Canada	$21,365	$44,201
Mexico	$7,484	$17,894
United States	$26,428	$56,066
Exports as Share of GDP		
Country	1993	2015
Canada	29.1	31.6
Mexico	13.6	35.2
United States	9.5	12.6
Current Account Balance as Share of GDP		
Country	1993	2015
Canada	-3.9	-3.4
Mexico	-4.7	-2.8
United States	-1.2	-2.6

Per capita GDP, a broadly-used measure of standard of living, has more than doubled in all three countries since the implementation of NAFTA, with Mexico experiencing the largest increase—although per capita GDP in Mexico remains significantly less than in Canada or the United States.

Taken together, these statistics show that NAFTA cannot be the sole cause of trade deficits among the three countries and corroborate the economic analysis discussed below that NAFTA had a positive overall impact on the U.S. economy.

Per capita GDP has more than doubled in all three countries since the implementation of NAFTA.

U.S. Trade after NAFTA

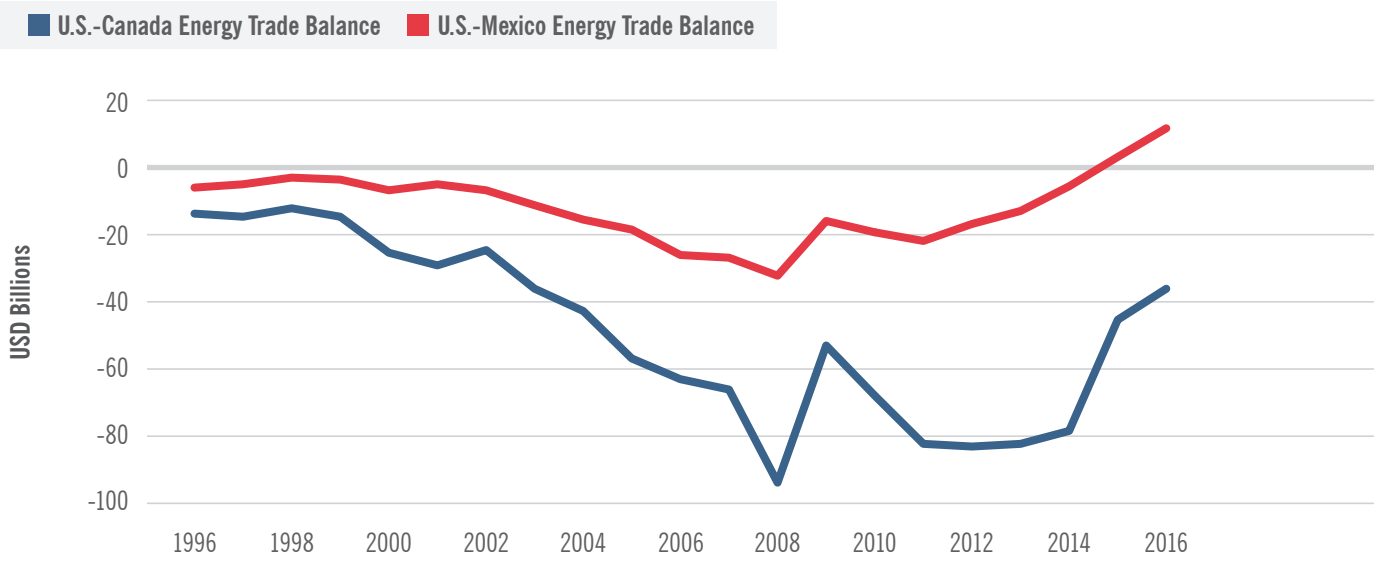
The overall volume of U.S. trade with the other NAFTA countries has increased as a result of NAFTA. However, so has the U.S. trade deficit in goods with both NAFTA countries since the implementation of the agreement (Figure 1). While this has been the cause of a great deal of concern, it is overly simplistic to say that the increase in the trade deficit is either 1) the direct result of NAFTA and no other factors, or 2) an overall negative for the United States. As noted above, the United States had a trade deficit with both countries before NAFTA, so there are many other factors that could contribute to the increase in the trade deficit over the more than 20 years since NAFTA went into effect—most particularly, the increase in technology and trade with other countries outside of the North America. Further, as described below, even with trade deficits, overall employment in the United States has also gone up and unemployment has gone down (despite the Great Recession), since NAFTA went into effect.

While this correlation does not necessarily indicate causation, it does show that tying deficits too directly to employment is likely an oversimplification.

It is also necessary to look deeper than just the overall trade deficit data. In the case of both Canada and Mexico, trade in energy-related products such as crude oil and refined products was a major driver of the increased U.S. trade deficit after NAFTA, primarily as the United States imported increased amounts of crude oil from both Canada and Mexico (Figure 2).

Figure 1. U.S. Trade Balance with NAFTA Countries

Figure 2. U.S. Energy Trade Balance with NAFTA Countries



However, in the last few years the United States has increased its domestic production of oil and natural gas, and exports of natural gas and refined petroleum products caused the U.S. trade deficit in energy products with NAFTA countries to decrease in 2015 and 2016. Additionally, trade in auto parts and automobiles has been a significant driver of past trade deficits that seems to be turning around in recent years. If these trends continue, the trade balance picture could change in the future.

In addition, the United States runs a significant trade *surplus* in services with both countries and U.S. investment in Canada and Mexico has been significantly larger than Canadian or Mexican investment into the United States. Both factors affect the overall trade account balance with Canada and Mexico and are a growing part of the overall trade among the countries.

The charts below (Figures 3 and 4) show the top five sectors in which the United States ran a trade surplus or deficit with Canada and Mexico for both 1993 and 2016. Figure 5 shows which sectors comprised the largest share of the trade deficit with both Mexico and Canada in 2016.

Figure 3. Top 5 Surplus and Deficit Sectors with Canada and Mexico 1993

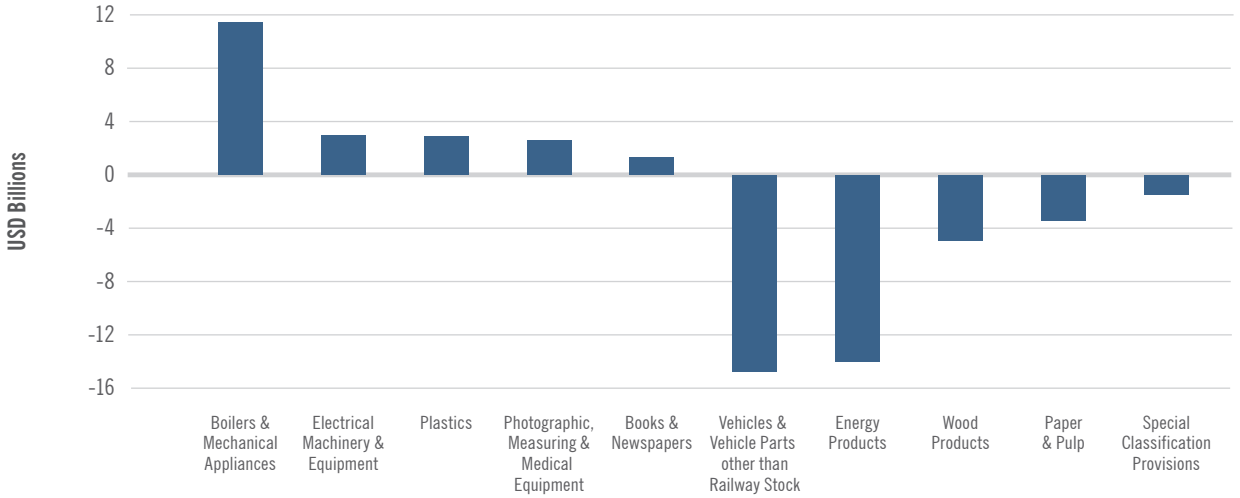


Figure 4. Top 5 Surplus and Deficit Sectors with Canada and Mexico 2016

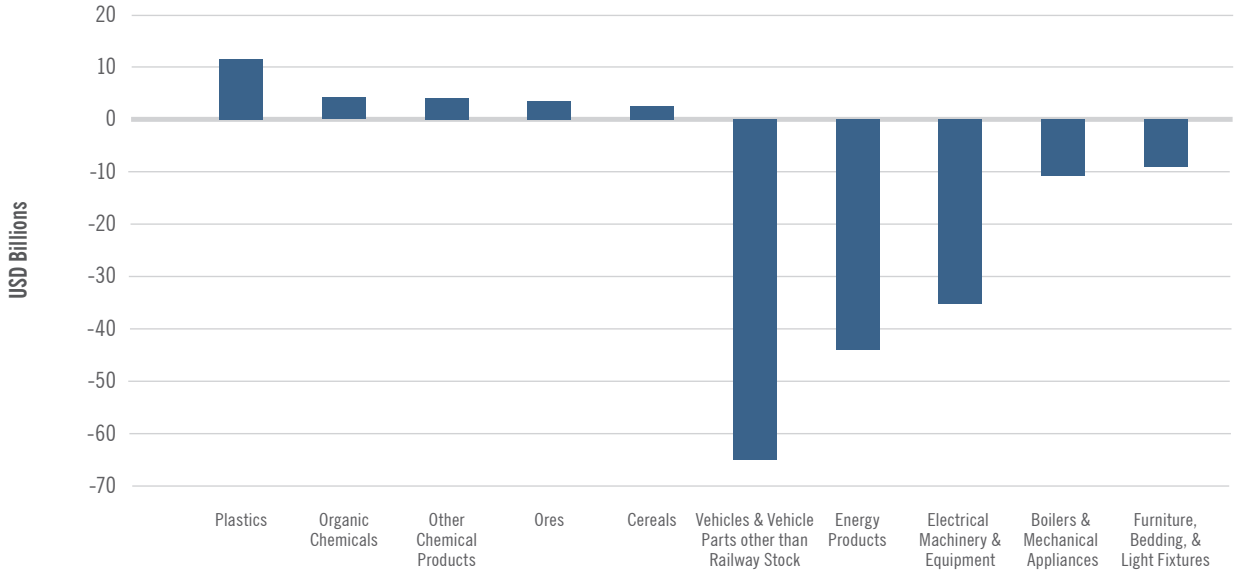
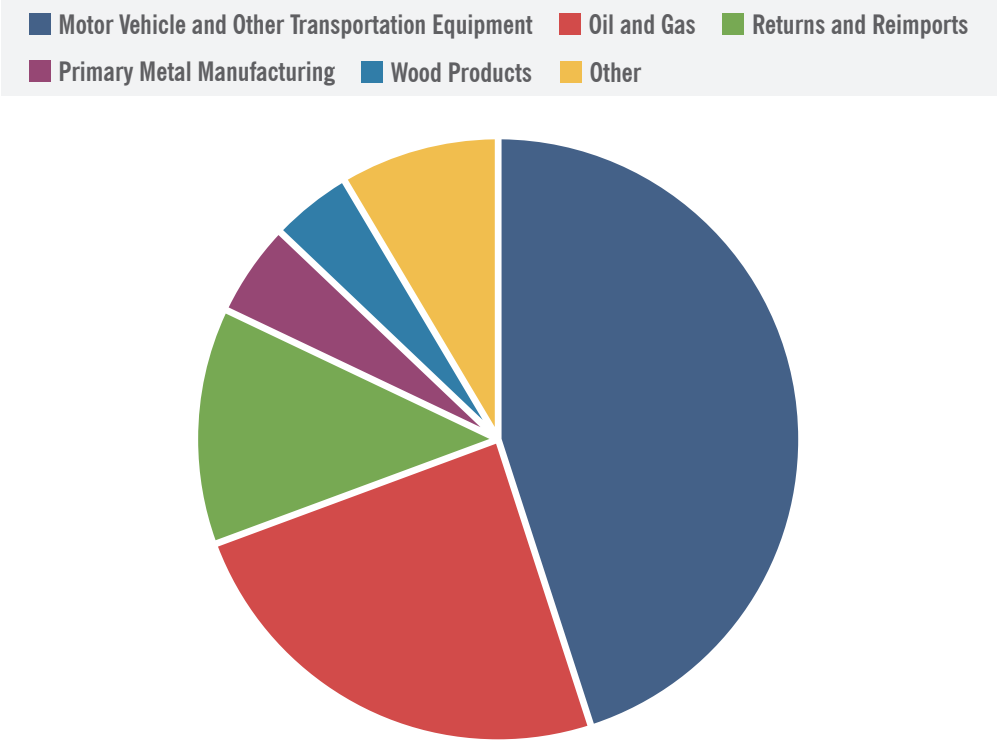


Figure 5. U.S. Trade Deficit with NAFTA Countries by Sector



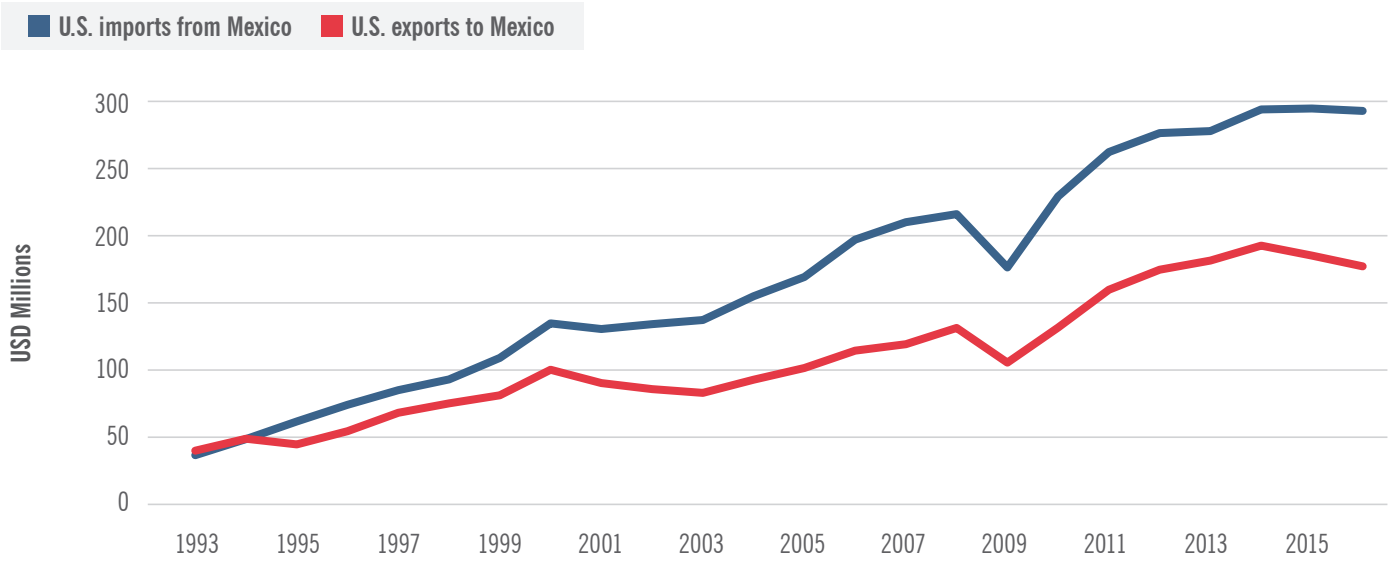
Trade with Mexico

In contrast to Canada and the United States, which had already begun to liberalize trade between them prior to NAFTA, Mexico still kept significant restrictions on trade and investment with the United States and Canada in 1993. For example, according to one analysis, in 1993 the average tariff on imports into Mexico was 12.5 percent and the average tariff on imports into Canada was 4.2 percent, while the average tariff was only 2.7 percent in the United States.[8] The same analysis found that, by 2005, average tariffs on most goods traded among all three countries were at or close to zero. Another study found that in 1996, immediately after the implementation of NAFTA, the average tariff on U.S. imports into Mexico had declined to 3 percent and the average U.S. tariff on imports from Mexico declined to approximately 1 percent.[9] Thus, the reduction in tariffs on U.S. exports to Mexico was significantly greater than the reduction in tariffs on imports from Mexico, which makes sense since Mexico had higher tariffs to begin with. The increase in both exports to and imports from Mexico show that the overall tariff reductions did grow the trade relationship (Figure 6).

However, the overall U.S. trade balance with Mexico has significantly declined since the implementation of NAFTA (see Figure 1, supra). In 1993, the United States held a modest surplus in goods trade, but that scenario significantly changed in the ensuing decades and by 2016, the United States ran a trade deficit of $115 billion in goods.[10]

But as stated above, the overall trade deficit does not tell the whole story. Historically, imports of energy products have constituted a significant share of the U.S. trade deficit with both Canada and Mexico. Between 1996 and 2013, the U.S. trade

Figure 6. U.S. Trade with Mexico



deficit in energy products with Mexico accounted for between 13 and 38 percent of the total trade deficit.[11] Yet in the last few years, the U.S. deficit in energy products with Mexico has decreased and actually reversed to a trade surplus in 2015 and 2016. U.S. exports of energy products to Mexico began to grow in a significant and sustained way beginning in 2011. Although U.S. exports declined somewhat in 2015 and 2016, likely due to the drop in overall energy prices, U.S. imports from Mexico declined even more dramatically.

The other major contributor to the U.S. trade deficit with Mexico since the implementation of NAFTA has been trade in automobiles and automotive components. Prior to the implementation of NAFTA, the United States ran a trade deficit in autos and auto parts. That deficit slowly but steadily increased from 1989 through 1995. In 1996, the deficit in autos and auto components accounted for 49 percent of the total deficit and has ranged between 24 and 50 percent of the total deficit each year since. Combined, the U.S. trade deficit in energy, autos, and auto components accounted for between 50 and 80 percent of the total U.S. trade deficit with Mexico until 2016, when the surplus in energy products and a sharp reduction in the auto deficit reduced this share to 20 percent.[12] While the United States still has an overall trade deficit with Mexico, again, the shifts in these large components of the trade deficit can have significant impacts on the overall trade deficit or surplus, and respond to external factors mostly beyond those in the initial NAFTA agreement.

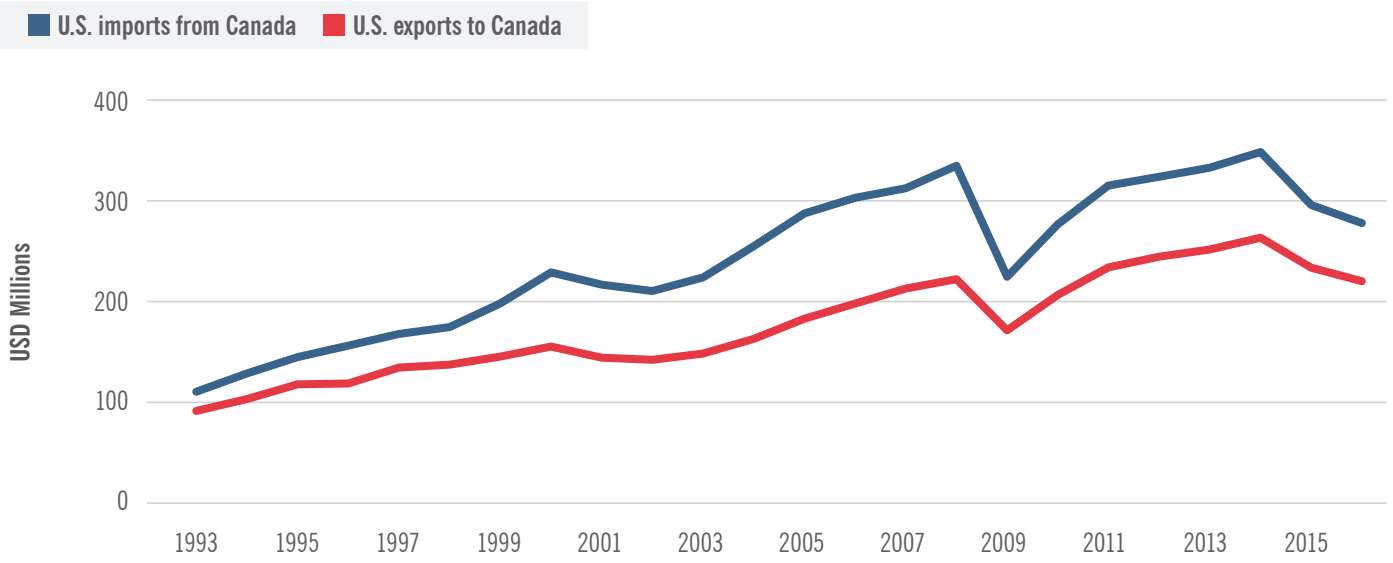
In contrast to the deficit in goods trade, the United States runs a trade surplus with Mexico in services trade. Data from the Bureau of Economic Analysis shows that in 2015, the latest year for which data are available, the United States ran a surplus of $9.6 billion in services trade with Mexico.[13] This surplus has more than doubled since 1999. Major drivers of the U.S. surplus in services with Mexico includes maintenance and repair services, transportation services, and licenses and other charges for the use of intangible property such as patents, copyrights, and trademarks.

In addition to significantly increasing trade between the United States and Mexico, NAFTA also increased foreign direct investment (FDI) between the two countries, the third major part of the overall current account balance. U.S. direct investment in Mexico increased from $15.2 billion in 1993 to $92.8 billion in 2015.[14] While smaller, Mexican investment in the United States has also grown, from $1.2 billion in 1993 to $16.6 billion in 2015.[15] Immediately after the implementation of NAFTA, U.S. investment in Mexico was dominated by investment into the transportation sector. However, over time U.S. investment in Mexico has become more diverse with investment in a wide array of sectors, including manufacturing, non-bank holding companies, and mining.[16]

Trade with Canada

As with Mexico, NAFTA led to a significant increase in both exports to and imports from Canada (Figure 7). Although there was a significant drop in overall trade during the great Recession from 2007 to 2009, trade increased through 2014 when both imports from and exports to Canada declined. Declines in the value of the Canadian loonie against the U.S. dollar reduced U.S. exports and reduced the value of imports from Canada to the United States, particularly energy imports.[17]

Figure 7. U.S. Trade with Canada



Prior to the implementation of NAFTA (during the implementation phases of the bilateral U.S.-Canada Free Trade Agreement) the United States ran a trade deficit with Canada that was slowly growing. The U.S. trade deficit with Canada grew further after NAFTA, from 1995 to 2007, before beginning to decline in 2008. The trade deficit declined significantly in 2010 and—although it has since increased—it remains below its peak in 2007.

As is the case with Mexico, the overall trade deficits do not tell the entire story. Prior to and early in the implementation of NAFTA, the United States ran a trade deficit in auto parts and autos and motor vehicles with Canada. By 2016, however, the United States ran a significant trade surplus in auto parts with Canada, while the trade deficit in finished autos and

other transportation vehicles remains. In 2016, in fact, this was one of the largest contributors to the overall U.S. trade deficit with Canada.

Though the auto industry receives the lion's share of media attention when discussing trade with Canada, energy products have dominated U.S. imports from Canada and have regularly constituted the largest single contributor to the overall trade deficit with Canada. Imports of energy products from Canada into the United States have exceeded the size of energy imports from Mexico into the United States every year since the implementation of NAFTA. In the last few years this difference has widened even further. By 2016, U.S. imports of energy products from Canada were nearly eight times as large as U.S. imports of energy products from Mexico.

On the services side, in 2015 the U.S. trade surplus in services with Canada totaled $27.4 billion. While this was down somewhat from the peak surplus in 2013 of $32.1 billion, it was still significantly above the overall average over the period of 1999 to 2015 for which data are available.[18] Major drivers of the U.S. surplus in services with Canada include travel and tourism services and financial services.

U.S. FDI into Canada was growing prior to the implementation of NAFTA, with the increase in U.S. FDI coinciding with the implementation of the U.S.-Canada Free Trade Agreement. However, the rate of growth accelerated after the implementation of NAFTA. Canadian FDI into the United States has always been smaller than U.S. FDI into Canada, however, it grew rapidly immediately after implementation of NAFTA. Canadian FDI into the United States has been concentrated in the same sectors that dominate U.S.-Canada goods trade, specifically the energy sector, transportation sector, and electrical machinery sector.[19] Prior to NAFTA, U.S. investment into Canada was dominated by investment in the chemical sector. Since the implementation of NAFTA investment in the chemical sector has remained a top destination for U.S. investment and U.S. investment in the transportation sector has increased significantly.[20]

NAFTA Impact on the Economies of United States, Canada, and Mexico

Many studies have tried to quantify the impact of NAFTA on the U.S. economy and on the economies of Mexico and Canada. There is no dispute that trade and investment spurred by NAFTA has encouraged significant capital investment and currently supports many American jobs. However, there is still significant public debate on whether NAFTA *as a whole* has been a net positive or negative for the United States.

NAFTA has encouraged significant capital investment and currently supports many American jobs.

There have been many studies done on this point offering differing conclusions, in part depending on what is measured and how. The discussion below summarizes a select number of these studies. Generally, the studies agree that NAFTA significantly increased trade and investment flows among the three countries. Most studies find that NAFTA has had a small positive net impact on the overall economies of each of the three countries. However, different sectors of the economy have fared differently, and the impact on jobs is even more in dispute.

A joint study from Yale University and the Federal Reserve in 2014 found that NAFTA significantly increased trade among the three countries, had a small but positive impact on the U.S. economy overall and contributed to higher wages in the United States.[21]

Specifically, the study found that:

- Trade with the other two NAFTA partner countries increased by 118 percent for Mexico, 11 percent for Canada, and 41 percent for the United States.
- Overall economic welfare increased by 1.31 percent for Mexico, 0.08 percent for the United States, and declined by 0.06 percent for Canada as a result of the increased trade from NAFTA.
- For the United States and Mexico, the three sectors that contributed the most to increased trade were electrical machinery, communication equipment, and motor vehicles. These three sectors accounted for 76 percent of the increased trade for Mexico and 51 percent of the trade for the United States.
- For Canada, motor vehicles were also one of the three largest sectors contributing to increased trade along with other transportation equipment and base metals. Combined, these three sectors accounted for 53 percent of the increased trade for Canada.

This study relied upon an extensive multi-country, multi-sector macroeconomic model. This analysis reached similar findings for the effect of NAFTA on Mexico, although the positive impact of NAFTA was deemed stronger for Mexico than the United States. The study found that Canada may have experienced a net negative impact due to a decline in export prices for Canadian manufacturers which offset increased trade in intermediate products and other gains.

The Yale and Federal Reserve study found that because NAFTA had such a profound impact on trade in intermediate goods, two sectors in particular—auto parts and electrical machinery—accounted for much of the increase in trade and the impact of the agreement on the three countries. This intermediate goods trade—trade of products that are inputs for other finished products—is what is referred to as the "integrated supply chains" in North America. NAFTA removes tariffs on components of finished products manufactured in any NAFTA country, allowing duty-free shipment across borders. As a result, in many manufacturing areas, especially autos, companies that supply various parts for North American manufactured goods are spread out across Canada, Mexico, and the United States.

Another study by the Economic Policy Institute (EPI) also found that NAFTA had particularly significant impacts on these two sectors, but that it led to a significant decline in overall U.S. employment.[22] The EPI study did not directly survey jobs to come to this conclusion, rather, it estimated the number of jobs associated with a particular dollar volume of production (including all inputs and outputs) in order to estimate the number of jobs that theoretically would be "lost" or "gained" from imports from and exports to Mexico. The study presumed that all imports from Mexico resulted in "displaced" U.S. jobs that would otherwise have made that product in the United States, and assumed no other external factors affected the jobs. Because the United States runs a net trade deficit with Mexico, the study model showed that after netting exports and imports, trade with Mexico had "displaced" 682,900 U.S. jobs. The EPI study found no material impact on jobs in the United States from trade with Canada because U.S.-Canada trade flows were largely balanced.[d]

[d] Official US trade statistics show that the US has run a trade deficit with Canada every year since 1990.

Critics of this study point out that the methodology utilized in the EPI report assumes that had NAFTA not been implemented, every product currently imported from NAFTA would instead have been produced or manufactured in the United States, which, given the expansion of U.S. trade with other nations—particularly China—during this period, may not be accurate. In addition, the study does not consider the effect of technology on the declining number of manufacturing jobs in the United States, nor that absent NAFTA some of this trade likely would not exist at all and therefore would not be produced anywhere, including in the United States. Finally, this type of analysis posits that all trade that permits imports necessarily "displaces" domestic jobs. Such a broad interpretation is not supported in most economic literature.

However, the EPI study makes a potentially important qualitative observation about the impact investment rules in NAFTA may have on the U.S. manufacturing sector. Specifically, the EPI study asserts that the investment and other provisions in NAFTA made Mexico a much more stable and attractive market for U.S. and other foreign investment. The paper states that without these provisions it is unlikely that U.S. manufacturers would have been willing to invest significantly in manufacturing operations in Mexico and these investments are a significant driver in the shift in manufacturing in some sectors from the United States to Mexico.

While this may be true, there are other benefits to the United States that result from investment in Mexico. For example, the ability of the United States and Mexico to assemble products cross-border—instead of just shipping finished products to each other—has made North American trade more competitive and able to compete on a global stage.[23] The Brookings Institution released a report a few months ago on the rapidly declining rate of undocumented immigration across the southern border, and specifically noted how a strengthened Mexican economy reduces the incentive for illegal entry into the United States.[24]

The U.S. International Trade Commission (ITC), an independent, non-partisan federal agency, conducted a broad analysis of the impact of various trade agreements on the U.S. economy and on selected sectors in 2016.[25] The ITC analysis found that the United States has generally benefited from trade agreements. In its more detailed analysis of the impact of NAFTA on the auto sector, the ITC found that NAFTA significantly increased the supply chain between the three countries. Like the EPI study, the ITC report noted that since NAFTA, U.S. production of auto parts and employment in that sector have declined. However, the report noted that employment in the U.S. auto parts sector initially increased until 2000, when employment began to decline significantly. (The most often cited cause of the decline is the robust entry of China in the auto parts market around this time.)[26] The report further notes that over the first five years of NAFTA, the amount of NAFTA content (a measure of the share of the components that are produced in one of the three countries) increased significantly—from 50 percent to 62.5 percent. So, the rise in U.S. employment broadly occurred over the same period in which the increase in content requirements were implemented.

A study by the Peterson Institute for International Economics that analyzed the impact of NAFTA on the U.S. economy found that NAFTA increased trade among the three countries, which in turn increased GDP in all three countries.[27] The analysis noted that immediately after the implementation of NAFTA, Mexico experienced a credit crisis that caused a significant devaluation of the peso, making imports into Mexico very expensive and exports from Mexico more competitive. That led to a significant drop in

imports into Mexico, including from the United States. The study calculated that the average U.S. tariff on imports from Mexico pre-NAFTA was 4.3 percent while the average Mexican tariff on imports from the United States was 12.4 percent.

The Peterson Institute study found that approximately 2.6 million U.S. jobs depend on exports to Canada and 1.9 million U.S. jobs depend on U.S. exports to Mexico. The paper also notes that a significant percentage of imports into the United States from NAFTA countries contain large percentages of U.S.-sourced components. The study cites other research showing approximately 40 percent of the value of U.S. imports from Mexico comes from U.S.-produced components used in the imported products. The study cites a figure of 25 percent U.S.-produced content in goods imported from Canada.

In contrast to the EPI study, the Peterson Institute study found that job loss associated with increased imports from Mexico is rather modest. The Peterson Institute study estimates job losses from imports from Mexico at about 203,000. The study notes that this is equivalent to about 5 percent of total U.S. job loss and that most job losses in the United States are the result of other factors like technological change and competition within the U.S. economy. The study also found an inverse correlation between trade deficits and the U.S. unemployment rate. That is, the U.S. unemployment rate was generally lower when trade deficits where larger. This is because the unemployment rate and the trade deficit are both predominantly functions of the overall health of the U.S. economy—when the U.S. economy is growing quickly and at full potential, the labor market is tight and U.S. consumers spend more, including on imports.

A study undertaken on behalf of the U.S. Chamber of Commerce at NAFTA's 20-year anniversary found that NAFTA resulted in a net increase in GDP growth and an increase in jobs in the United States. Specifically, the increase in trade generated by NAFTA increased U.S. employment by 5 million jobs.[28]

Another study in 2016 by the Wilson Center found that nearly 5 million net U.S. jobs depend on trade with Mexico.[29] This is equivalent to one out of every five U.S. jobs. This analysis used a specific macroeconomic model (a computable general equilibrium or CGE model) that uses the same the input-output matrix as the EPI study discussed above, and then builds on those tables to calculate indirect impacts on other sectors of the U.S. economy. Importantly, the Wilson Center analysis finds that the impacts on employment from exports to and imports from Mexico tend to cancel each other out with no net change in jobs. The increase in employment therefore stems mostly from the indirect effect of lower costs in the United States for consumers and U.S. businesses. These indirect benefits are predominantly felt in sectors not directly related to trade with Mexico as they benefit from consumers and businesses having more income to spend on non-tradable goods and services.

Most economic studies find that NAFTA has unquestionably increased trade and investment between the three countries and that overall the agreement has likely benefited the economies of the three countries. The studies also note that NAFTA affected different sectors of the U.S. economy in different ways, including some manufacturing sectors shifting production and employment out of the United States to Mexico. However, the net effect of these shifts on overall employment or jobs in the United States may not be as large as some have presumed.

Conclusion

There is no doubt that NAFTA delivered on its goals of opening the markets of the three countries and increasing trade. Overall the agreement has had positive economic outcomes, but the effect on jobs—particularly in the United States—is more controversial. However, the deal absolutely resulted in increased integration of the three economies, a goal that was established in part to allow North America to better compete with what was at the time a growing European Union and later, increasing competition from Asia, and China in particular. The integrated markets have made North America as a block more competitive in exports to other countries around the world, made the economies more self-sufficient in energy, and made NAFTA countries more resilient to economic and trade shocks. During the current effort to renegotiate and improve NAFTA, these goals and outcomes should remain at the forefront for all three countries.

Most economic studies find that overall NAFTA has likely benefited the economies of the three countries.

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