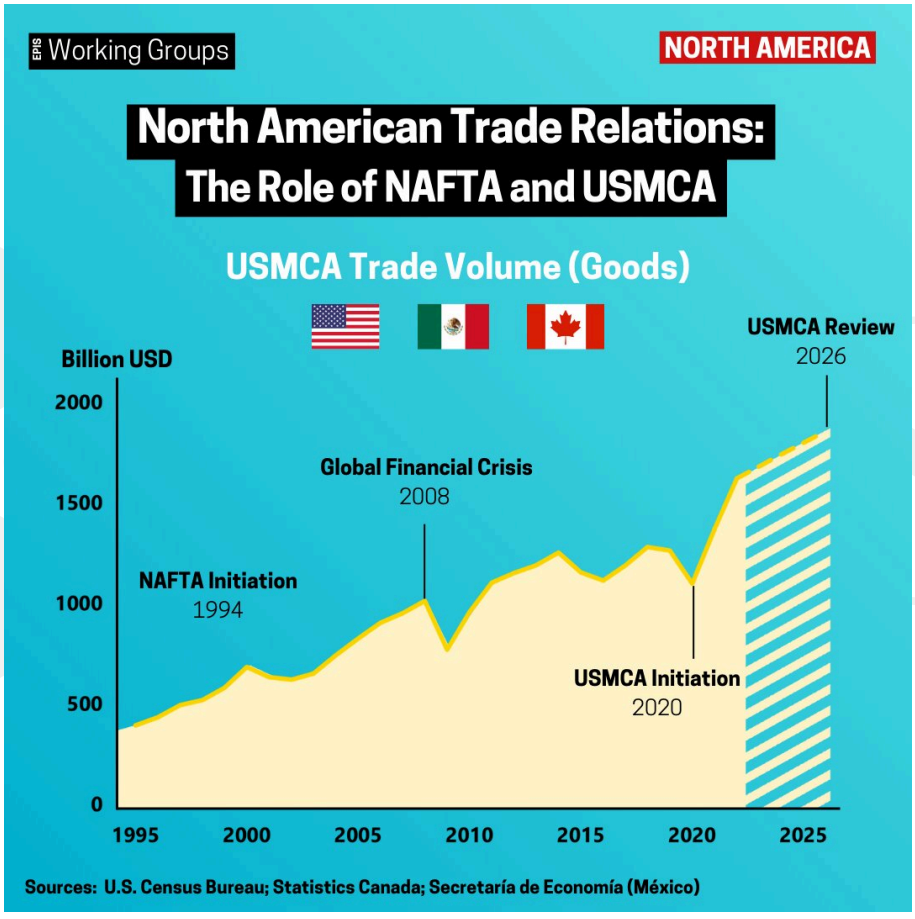
North American Trade Relations

8 JUNE 2024

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In his 2016 presidential campaign, one of Donald Trump's pillars was trade policy. Repeatedly calling the North American Free Trade Agreement (NAFTA) "the worst trade deal" became infamous and played a pivotal role in his surprising sweep of Rust Belt states such as Pennsylvania or Wisconsin. As President, Trump acted on his promise and renegotiated. On 1 July 2020, the United States-Mexico-Canada Agreement (USMCA) – termed "NAFTA 2.0" by some – came into effect. This raises questions: Was NAFTA really "the worst trade deal"? What motivated Trump's vocal opposition against it? And what is USMCA? In this brief, we shortly review North American trade relations.

First, let us revisit the origins. During the 1980s, U.S. president Reagan promoted the idea of a North American free trade zone. His rationale followed neoclassical economic theory. Reducing barriers to trade and investment would allow the United States, Canada, and Mexico to each specialise in goods for which they enjoy a comparative advantage. Trading with these goods would then enable each to capture welfare gains in the form of economic growth and job creation. After years of negotiations among the three countries, NAFTA was ratified in 1993 (with bipartisan support in the U.S.) and came into force in January 1994. The groundbreaking free trade agreement (FTA) created the world's largest trading bloc at the time and was the first FTA between two developed countries and a developing country. Over the following 15 years, the vast majority of tariffs between the participating countries were eliminated.

Ever since its enactment, NAFTA and its effects have been controversial and the subject of economic and political debate. Most economists concur that the agreement has benefitted North America's economies. Intraregional trade grew from roughly $430 billion in 1996 to more than $1.11 trillion in 2016. During the same period, foreign direct investment between the USA and NAFTA countries rose from almost $170 billion to over $850 billion. Furthermore, consumers profited from lower prices in goods such as food and petrol. However, NAFTA likely brought about distributional consequences: Although trade created many winners, some people lost from it. Prominently, the U.S. has seen nearly 5 million manufacturing jobs vanish between 1996 and 2016. This led to discontent in affected regions, especially the Rust Belt. Notably, due to multiple influencing variables, it is very difficult to quantify the economic effects of NAFTA. Moreover, a 2017 review by the Congressional Research Service finds positive and negative effects to be moderate. Hence, the impact of NAFTA remains disputed to date.

Back to our questions: With a small to positive influence on aggregate welfare, was NAFTA "the worst trade deal"? Most likely not. And yet, the reality is: Millions of American workers who have lost their jobs due to structural change have a strong resentment towards FTAs. Donald Trump capitalised on (and contributed to) this globalisation backlash with his "America First" rhetoric, which earned him decisive votes in states like Pennsylvania. This is an apparent explanation for at least part of his opposition to NAFTA. Shortly after taking office, Trump initiated steps to renegotiate NAFTA. Canada and Mexico followed suit. USMCA was born and came into effect on 1 July 2020.

Now, what is USMCA? Compared to its predecessor, the FTA strengthens incentives for U.S. automotive production, updates labour and environmental standards, modernises provisions regarding intellectual property and digital trade, reduces controversial dispute settlement mechanisms, and introduces a sunset clause. The latter means that USMCA must be extended by all countries every six years, for if not, the agreement expires

after ten years. Interestingly, the extent of modifications itself is debated. Whereas politicians from both parties praised the improvements, according to the Congressional Research Service, "many economists (...) believe that USMCA is not expected to have a measurable effect on U.S. trade and investment (...), jobs, wages, or overall economic growth."

Therefore, both NAFTA and its successor, USMCA, have played important roles in shaping North American trade relations. Attributable to the agreements or not, North American economies grew substantially, while intraregional trade and investment soared. Nonetheless, both agreements remain surrounded by uncertain evidence and doubts about their influence. Hence, strong statements about NAFTA or USMCA more often than not reflect political rhetoric instead of economic reality.

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