

# Trade Relations between US and Mexico (NAFTA)

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**Professor Ian Sheldon**

**sheldon.1@osu.edu**

**<http://aede.osu.edu/programs/Anderson/trade/>**

**Mexico Study Abroad Preparation Course**



# Lecture Plan

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- ◆ **Ways to freeing trade**
- ◆ **What is NAFTA?**
- ◆ **Overall impact of NAFTA**
- ◆ **NAFTA and agriculture**
- ◆ **Future of NAFTA**

# Ways to freeing trade



*David Ricardo*

## ◆ Unilateral reduction of tariffs:

- cheaper imports raises domestic productivity and consumer purchasing power
- an article of faith among economists since Ricardo
- does not pass the political “laugh test”



**“...try telling that to a member of Congress, who imagines defending a trade deal in the home district, saying, ‘We gave x, y and z, and they didn’t give up a thing’...” (Ford Runge, University of Minnesota, 2006)**

# Ways to freeing trade

WORLD TRADE  
ORGANIZATION



## ◆ Multilateral trade liberalization:

- within GATT/WTO, each member country makes tariff concessions on a *quid pro quo* basis (reciprocity)
- any concession made to one member is automatically extended to all other members (non-discrimination)
- it works politically:

**“...multilateral trade liberalization is a sort of jujitsu that uses exporters’ determination to get into foreign markets to overwhelm domestic lobbies that would sooner keep home markets closed...”** (*The Economist*, July 27, 2006)

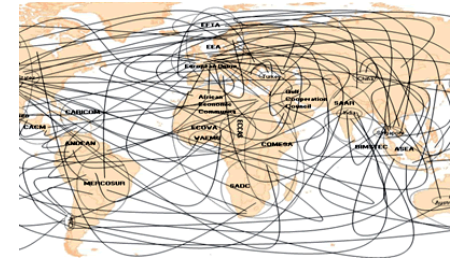
# Ways to freeing trade



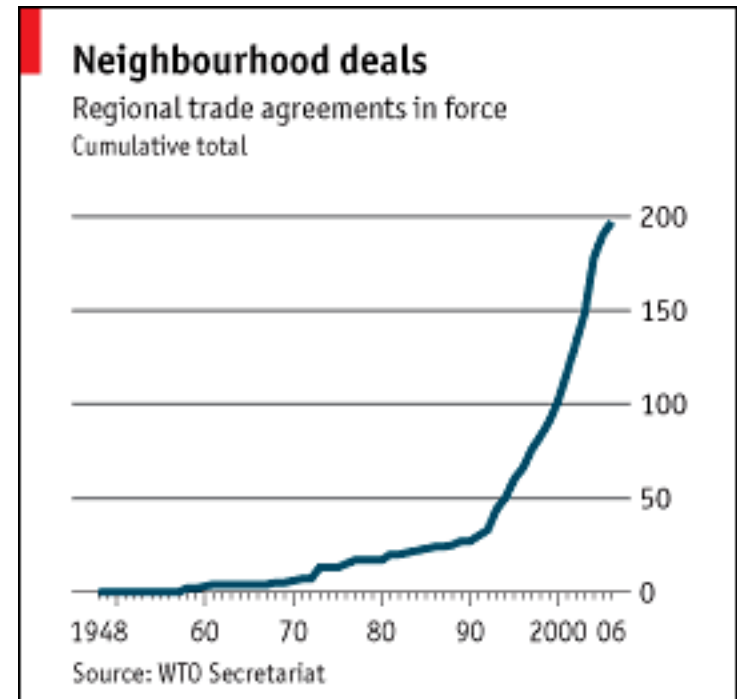
## ◆ Regional/bilateral trade agreements:

- trade liberalization on a discriminatory basis, i.e., concessions only made between parties to agreement
- free trade areas (NAFTA) or customs unions (EU)
- in conflict with principle of non-discrimination in GATT/WTO Article 1, but allowed under Article 24 if tariffs are reduced for “substantially all trade” between parties

# Regionalism is growing



- ◆ **Regional and bilateral trade deals have mushroomed since 1990**
- ◆ **Bush Administration has signed 14, negotiating another 11**
- ◆ **East Asia will have 70 by end of 2006**
- ◆ **EU will negotiate more if Doha Round of WTO fails**
- ◆ **GATT/WTO probably never envisioned this many – a “spaghetti-bowl” effect**



# What is NAFTA?



- ◆ **North American Free Trade Agreement (NAFTA) is a regional trade agreement - Canada, Mexico, and US**
- ◆ **Much of NAFTA is structured as three separate bilateral agreements: (i) Canada and US; (ii) Mexico and US; (iii) Canada and Mexico**
- ◆ **(i) Canada-US free trade agreement (CUSTA), took effect January 1, 1989 - subsequently subsumed into NAFTA**
- ◆ **Presidents Bush and Salinas agreed in 1990 to pursue negotiation of a free trade agreement between US and Mexico, Canada joining negotiations in 1991**
- ◆ **(ii) and (iii) found in NAFTA itself, took effect January 1, 1994 during first Clinton administration**

# What is NAFTA?

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## ◆ NAFTA has several distinct features:

- Unlike EU, three countries unwilling to cede any sort of national sovereignty or provide fiscal transfers between themselves
- NAFTA unlikely to provide for free labor mobility between the three countries, unlike earlier CUSTA
- NAFTA will not deal with monetary and exchange rate issues as compared to the EU, where there is already a single currency, i.e., the Euro



# Overall impact of NAFTA

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- ❖ **NAFTA called for phasing out of nearly all restrictions on trade and investment flows between Canada, US and Mexico over 10 years (15 years for some sensitive products)**
- ❖ **Canada and US had already eliminated most restrictions between themselves under CUSTA**
- ❖ **By 2001, 87% of US imports from Mexico entered US tariff-free, average tariff on rest was 1.4%**
- ❖ **Average Mexican tariff down to 1.3% by 2001**

# Overall impact of NAFTA

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- ❖ **Hard to separate effect of NAFTA from other factors that have influenced US-Mexican trade**
- ❖ **For Mexico, NAFTA part of larger program of economic liberalization that began in mid-1980s when it joined GATT**
- ❖ **Prior to NAFTA, trade with US – imports and exports – grew substantially in dollar terms:**
  - **1982-93, US exports to Mexico rose six-fold**
  - **1982-93, US imports from Mexico tripled**

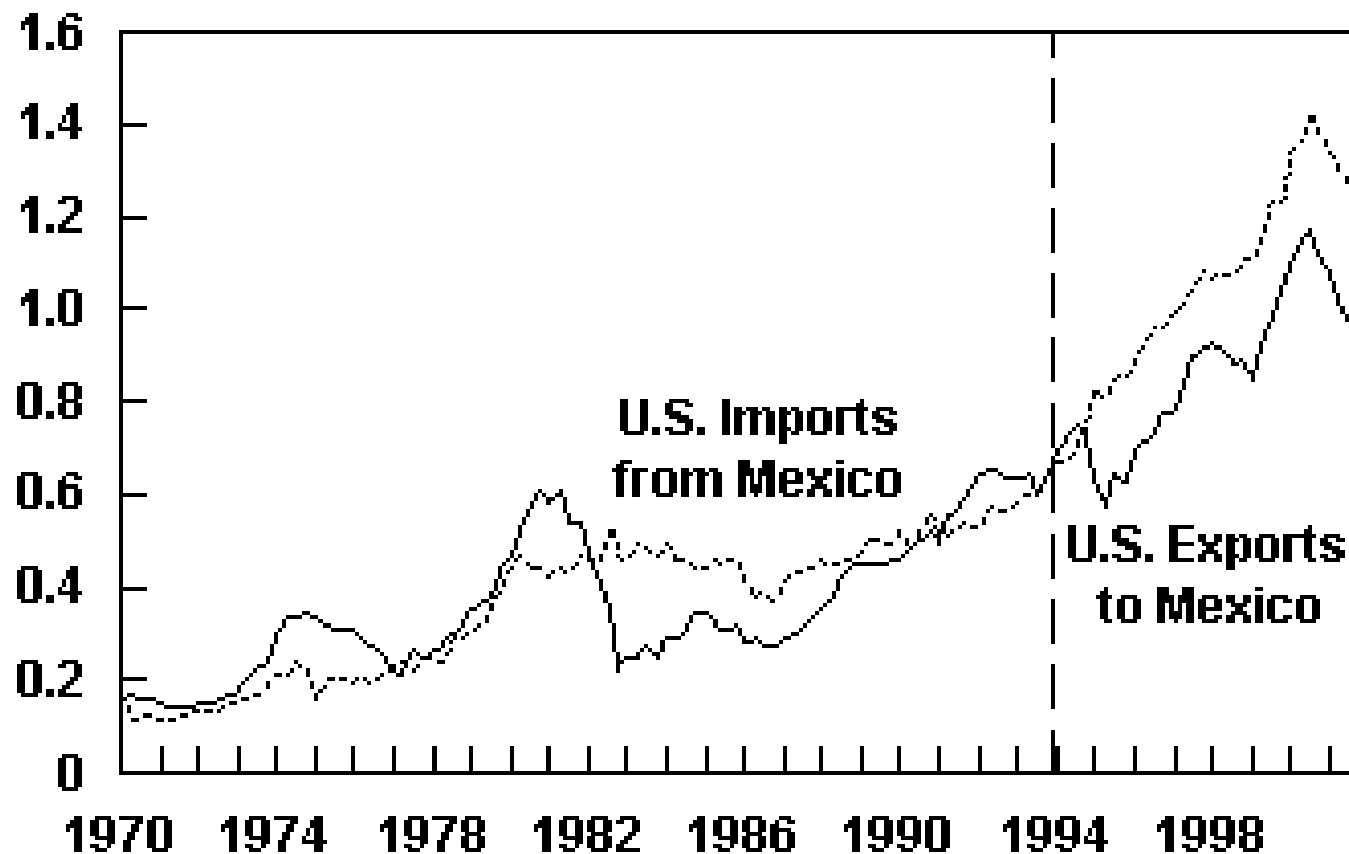
# Overall impact of NAFTA

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- ◆ **Prior to NAFTA, Mexico third-largest market for US exports, third-largest supplier of US imports – second in both categories by 2001**
- ◆ **Four events significantly affected US-Mexican trade after NAFTA was signed:**
  - **depreciation of peso at end of 1994**
  - **Mexican recession in 1995**
  - **extended US expansion in 1990s**
  - **US and Mexican recessions in 2000/2001**

# Overall impact of NAFTA



Source: Congressional Budget Office

# Overall impact of NAFTA

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- ◆ **Several factors caused peso-crisis:**
  - **overvalued peso**
  - **political turmoil in 1994**
  - **rising US interest rates**
  - **history of Mexican macroeconomic policy**
- ◆ **Net foreign investment fell → put downward pressure on peso → Mexican central bank ran out of foreign exchange reserves → forced to allow peso to float → had to borrow from abroad → recession in 1995**

# Overall impact of NAFTA

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- ◆ **Impact of NAFTA on US employment has really been much exaggerated**
- ◆ **Most economists argue trade has a modest effect on unemployment as compared to technological change, the business cycle and macroeconomic policies**
- ◆ **Also hard to separate impact of NAFTA from overall impact of increased global trade**
- ◆ **US Dept. of Labor data suggest 525,000 US workers adversely affected 1994-02**
- ◆ **Very small % of total displacement of US labor force over same period**

# NAFTA and agriculture

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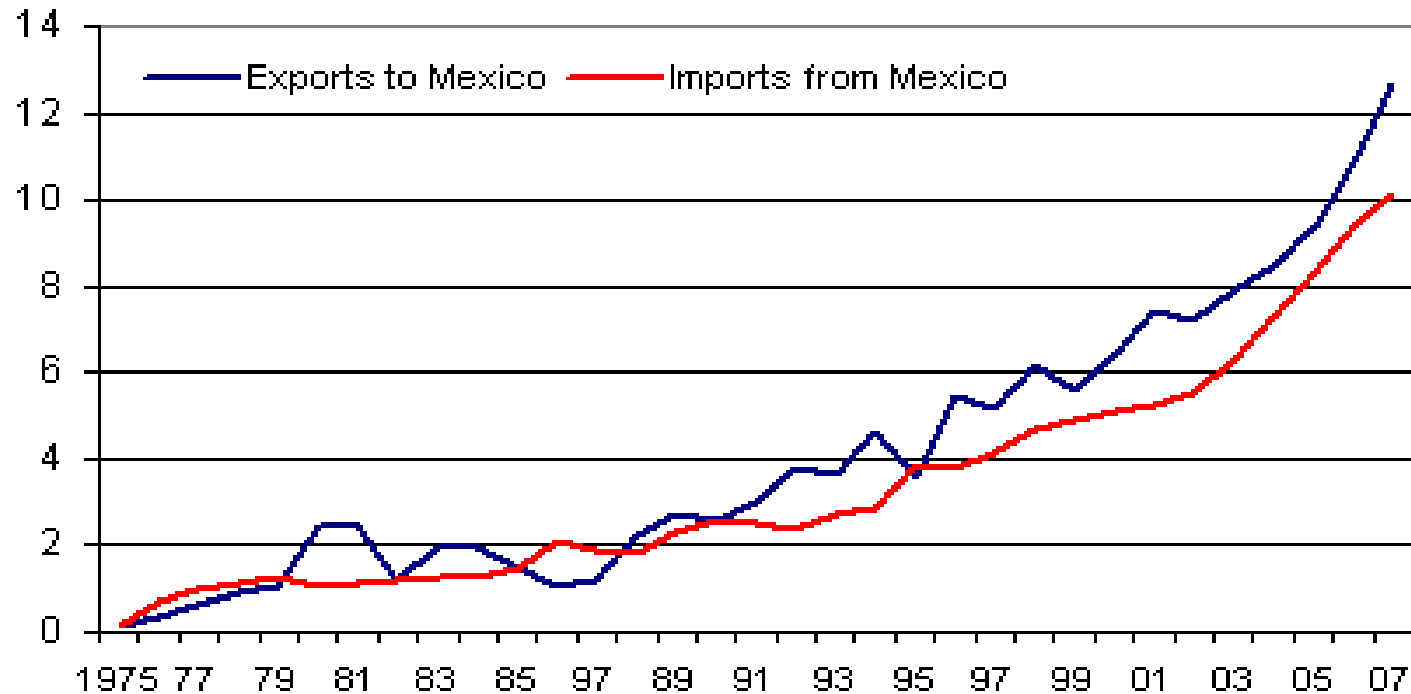
- ❖ **While much media focus has been on negative aspects, agricultural trade has clearly prospered under NAFTA**
- ❖ **Mexico has become third-largest agricultural trading partner of US, following Canada and EU**
- ❖ **In 2007, Mexico accounted for about 15% of both US agricultural exports and imports**
- ❖ **1993-2007, US agricultural exports to Mexico expanded at annual rate of 9.4%, while agricultural imports from Mexico grew at annual rate of 9.9%**

# NAFTA and agriculture



**U.S. - Mexico agricultural trade has experienced strong growth since the late 1980s**

U.S. dollars (billion)



Sources: USDA, Foreign Agricultural Service, *U.S. Trade Internet System* (1989-2007), and USDA, Foreign Agricultural Trade of the United States database (1975-88).



# NAFTA and agriculture

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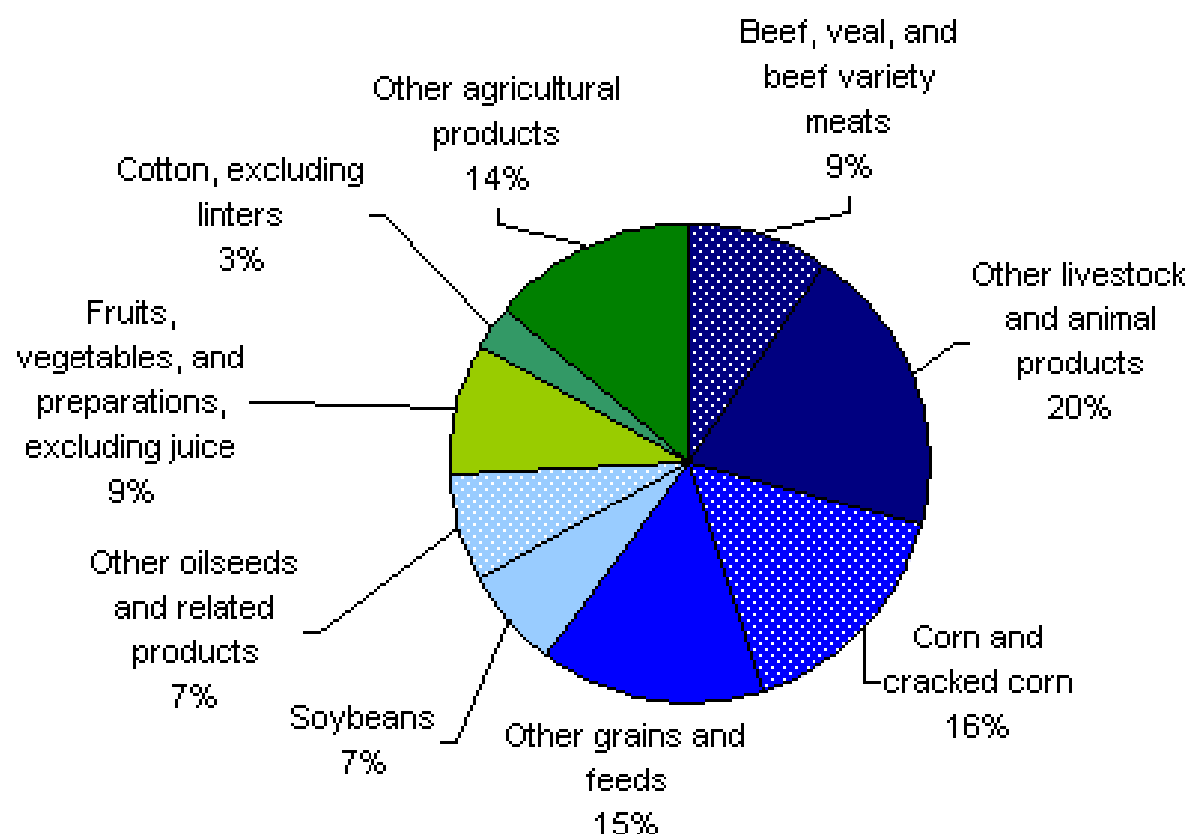


- ❖ **US-Mexican agricultural trade is largely complementary, based on comparative advantage**
- ❖ **Grains, oilseeds and meat account for 75% of US agricultural exports to Mexico**
- ❖ **70% of US agricultural imports from Mexico consist of beer, vegetables and fruit**
- ❖ **In contrast, Canadian-US agricultural trade is characterized by two-way trade in similar products, especially processed foods**

# NAFTA and agriculture



Grains, oilseeds, meat, and related products made up about three-fourths of U.S. agricultural exports to Mexico in 2007 <sup>1/</sup>



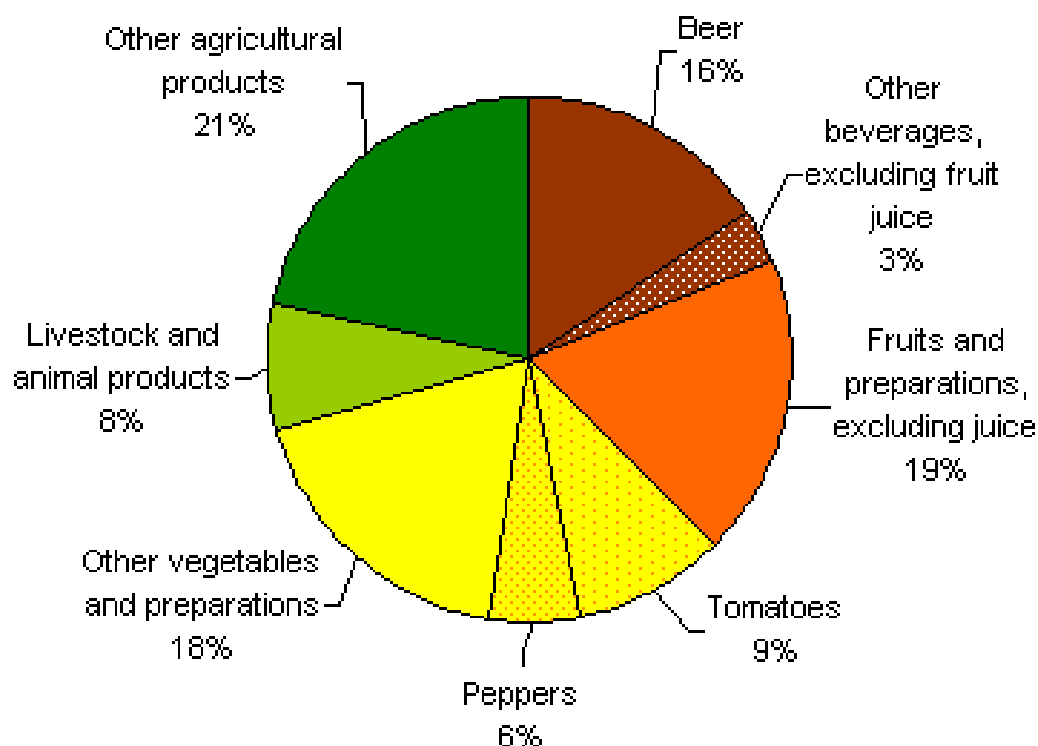
<sup>1/</sup> Data are for calendar year 2007, when U.S. agricultural exports to Mexico equaled \$12.7 billion.

Source: USDA, Foreign Agricultural Service, *U.S. Trade Internet System*.

# NAFTA and agriculture



Over 70 percent of U.S. agricultural imports from Mexico in 2007 consisted of beer, fruits, or vegetables <sup>1/</sup>



<sup>1/</sup> Data are for calendar year 2007, when U.S. agricultural imports from Mexico equaled \$10.2 billion.

Source: USDA, Foreign Agricultural Service, *U.S. Trade Internet System*.

# NAFTA and agriculture

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- ◆ **Virtually all agricultural trade restrictions will have been removed by end of 2008**
- ◆ **Corn imports by Mexico covered by transitional tariff-rate quotas, ending in 2008 – Mexico has lowered tariffs much faster though**
- ◆ **2006, US and Mexico negotiated bilateral agreement on trade in sugar and sweeteners to start in 2008:**
  - **US promised tariff-free access for fixed amount of raw sugar**
  - **Reciprocal, tariff-free access for HFCS into Mexico**

# Future of NAFTA

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- ❖ **Protectionist sentiments growing in US as voters somehow see a connection between trade and recession**
- ❖ **Despite political rhetoric during primaries, very unrealistic to think that NAFTA could/would be renegotiated – economic and political costs high**
- ❖ **Likely external diplomatic pressure will be put on new administration to assert US leadership in stalled Doha Round of WTO**
- ❖ **Actual ability to provide leadership will depend on Congress providing President with trade negotiating authority**