NAFTA: WHAT'S NEXT?

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The renegotiation of the North American Free Trade Agreement (NAFTA) is at the forefront of the U.S. trade policy agenda. As the negotiations develop, it is difficult to forecast their outcome. Most of the issues under discussion are related to manufactures; however, agriculture has been a clear beneficiary of NAFTA and just as trade agreements entail loses and winners, so does their reversal. This policy brief summarizes the main findings in the recent literature looking at the potential effects of a NAFTA reversal. Although our emphasis is on agriculture, the benefits and costs of withdrawing NAFTA for other sectors are also discussed.

The North American Free Trade Agreement (NAFTA), signed on January 1st, 1994, sought to promote free trade across the United States, Canada, and Mexico through the systematic elimination of most tariff and non-tariff barriers to exchange goods, services, and investments. NAFTA has become the second world largest Regional Trade Agreement (RTA) with exports of $2,493 billion that represented 14% of the world trade in 2014 (WTO, 2015). Furthermore, NAFTA created the world's largest free trade area of 486.95 million people with total GDP of $21.20 trillion as of 2016 (World Bank, 2016). After 23 years, some questions have started to emerge regarding the economic advantages and disadvantages that these countries face under this agreement. Many of these questions relate to the perceived failure

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of NAFTA to deliver on many of the benefits used to justify its signature (Cavanagh et al. 2002; McLaren & Hakobyan, 2010; Caliendo & Parro, 2015).

One of the most likely effects of reversing NAFTA would be a reinstatement of the "Most Favored Nation"[2] import tariff rates (Walmsley and Minor, 2017). Walmsley and Minor (2017) examine the economics of a NAFTA reversal using a general equilibrium model of the world economy. Their model is based on the database and model spearheaded by the GTAP project (Hertel, 1997), both workhorses in the analysis of trade issues; Walmsley and Minor enhance this model with detailed treatment of supply chains, which make the analysis especially appealing from assessing the costs of reverting NAFTA. In the aggregate, they find that an increase in the tariffs that the US imposes on Canadian and Mexican goods, as well as in the tariffs that these countries impose on US goods, would lead to a modest decline in real GDP in the U.S. (of 0.09%), with the largest declines occurring in the livestock and food industries (where output would contract by 1.16% and 1.69%, respectively).

Explicit treatment of supply chains in the analysis of NAFAT is important because one of the most fundamental changes brought about from NAFTA is the formation of various cross border supply chains that have become critical for easy access to inputs for producers and access to a wider variety of products by consumers (Hendrix, 2017). For instance, in 2014, the US imported around 4.9 million Canadian piglets, out of which 3.9 million were feeders ranging from 8 to 12-week old, weighing 10–60 pounds (USDA 2015). These piglets were brought to Iowa, Minnesota, Illinois, and Indiana, to be fed on price

[2] The term Most Favored Nation (MFN) is a status that stablishes that all nations are under the same set of benefits or disadvantages. If some changes are made, it will impact in the same way to all the WTO members, without any preference, or discrimination (WTO, 2017). In practice, MFN tariff rates are substantially higher than the tariffs applied under preferential trade agreements such as NAFTA.

competitive US corn and soybean meal, and then slaughtered and processed in US facilities. The pork cutlets are either consumed in the US market or exported back to Canadian and Mexican markets. Disrupting this supply chain would lead to a reduction in the access to cheaper US pork, with consequences for its upstream feed industries as well as for grain and oilseed producers. The pork industry is representative of the supply chain trend evident in the grain, oilseed, processed foods and livestock industry within the North American market. Other prominent supply chains stimulated by the NAFTA agreement are motor vehicles and textile manufacturing. In 2015 the foreign direct investments from Canada and Mexico in the US was about $286 billion (U.S Bureau of Economic Analysis, 2016). According to Dziczek et al., (2017), less costly automotive parts produced in the wider NAFTA area lowered supply chain risks and ensured the stay of the auto industry in North America. Likewise, the wearing and apparel sector experienced market integration between Mexico and United States (Walmsley & Minor, 2017).

The complex relationships along supply chains spread across the vast geography of North America and extends all the way to final consumption in the three countries and beyond, explaining why reverting NAFTA is costly. A useful measure of such costs are the changes in employment estimated by Walmsley and Minor (2017) (see table 1). These authors estimate job losses under two scenarios: unilateral withdrawal of the U.S from NAFTA whereby the U.S. imposes MFN tariffs on Mexico and Canada, but these countries still grant preferential access to US produced goods into their markets (*U.S raises tariffs* in table 1); and an scenario in which Mexico and Canada also increase their tariffs to MFN levels (*Reciprocation* in table 1).As shown, Walmsley and Minor, find that with or without reciprocation there would be a relocation of skilled workers from sectors across industries, without changes in net employment. For unskilled workers, however, an uncontested U.S. withdrawal from NAFTA would results on a net loss of 67,726 unskilled jobs, many of those in manufacturing industries upstream of manufacturing supply chains. However, in the more realistic scenario in which Mexico and Canada also go back to their MFN tariffs, an additional 187,950 jobs are lost, for a net change in employment of 256,000 unskilled jobs, with thousands more workers having to relocate to other sectors to find employment. Notice that many of the estimated job losses from a complete NAFTA reversal are concentrated in the primary crop and forestry and livestock and fishing sectors. Moreover, across the board, all the food processing sectors would experience significant reductions in employment.

Table 1. Employment changes in the US as result of NAFTA withdrawal.

	U.S raises tariffs		Reciprocation		
	Skilled	Unskilled	Skilled	Unskilled	Total
Crops and forestry	1,348	886	-1,446	-1,703	-914
Livestock and fishing	-140	-155	-5,072	-4,142	-9,510
Sugar	498	1,164	-104	-281	1,276
Extraction	-471	-1,575	1,493	3,198	2,646
Meat	76	-64	-2,334	-6,254	-8,576
Food	603	747	-7,774	-20,418	-26,842
Textiles	297	411	-1,272	-3,882	-4,446
Wearing apparel	259	414	511	605	1,789
Chemicals	-274	-2,137	3,256	3,173	4,018
Metals	-510	-2,589	4,434	6,273	7,609
Electronic equipment	-428	-1,329	2,559	5,079	5,880
Machinery	-1,929	-7,160	13,253	23,404	27,568
Motor vehicles	707	1,002	-4,929	-13,667	-16,887
Other manufactures	-1,484	-6,027	7,001	8,883	8,373
Other services	1,447	-51,312	-9,576	-188,218	-247,658
Total unemployment	0	-67,726	0	-187,950	-255,676

Source: Walmsley and Minor (2017)

The results reported by Walmsley and Minor support the notion that a tariff reversal within NAFTA will adversely affect the Midwestern states as these are the leading exporters of livestock (33.3%

of US production is exported to Mexico and Canada) and grains (28% of US production exported to Mexico) (Hendrix, 2017). Withdrawing from NAFTA will also negatively impact agricultural-producing states along the northern and southern borders such as Delaware, Wyoming, Maine, Vermont, Michigan, New Mexico, South Dakota, and Texas that rely heavily on cross border trade (Johnson, R. 2017). In addition, some analysts have indicated that the erosion of the U.S. leadership in the NAFTA markets could weaken the US leverage ability in future negotiating for terms of trade and trade-related policies and regulations, as well as cross-border environmental and labor practices and standards (Johnson, R. 2017).

To be sure, the ongoing NAFTA negotiations are complex and dynamic. As the time of this writing, the trade negotiators of the three NAFTA countries have made some advances in revising the NAFTA agreement but significant issues remain ahead. This occurs in complicated political calendars with congressional elections in the US (November) and presidential elections in Mexico (early in July). Sensitive issues include U.S proposals for more stringent “rules of origin,” which set a minimum content that should be sourced within the NAFTA region; the inclusion of a “sunset clause,” under which the agreement expires after five years unless all the countries in the agreement decide to continue; and the softening of the existing mechanisms to solve trade disputes. Most analysts and business groups agree that stable and predictable rules for trade and investment are key to engage in long-term beneficial trade; a sunset clause would introduce considerable uncertainty reducing the incentives to establish cross-border commercial relationships. Meanwhile, mechanisms for settling disputes are a way to ensure that trade agreement obligations are enforced. The way in which these issues are resolved will determine the viability of a future NAFTA.

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