

EXECUTIVE SUMMARY

This report delves into the North American Free Trade Agreement (NAFTA), offering a comprehensive analysis of its background, trade history, statistics and policies within the region, while also critically evaluating the barriers and challenges faced during its implementation. Furthermore, this report provides insightful recommendations and concludes by summarizing the significance of NAFTA in the context of North American trade relations. It is concluded that the agreement's focus on methods to facilitate trade and gradually reduce tariffs was crucial in expanding cross-border trade, which benefited a variety of sectors, consumers, and small companies. However, the loss of jobs prompted questions about the effect on regional economies and the workforce, and the damaging impacts on Mexico's environment and agricultural sector underscored the need for a sustainable and balanced approach to trade cooperation.

Looking forward, trade agreements must be supported going ahead by proactive measures. These include thorough job retraining, strict environmental restrictions, strong labor standards, and frequent evaluations to assure adaptability and alignment with changing social and economic dynamics. By embracing these recommendations, trade agreements can achieve their intended goals of fostering growth, while also mitigating the negative consequences for workers, industries, and the environment.

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1. INTRODUCTION

An economic trade zone is a designated area within a country with distinct economic regulations (Barone 2023). Nowadays, economic trade zones are crucial in the modern world as they facilitate foreign investments and drive economic growth through favorable regulations and incentives (Shkvarya and Wang 2019). This report delves into the North American Free Trade Agreement (NAFTA), offering a comprehensive analysis of its background, trade history, statistics and policies within the region, while also critically evaluating the barriers and challenges faced during its implementation. Furthermore, this report provides insightful recommendations and concludes by summarizing the significance of NAFTA in the context of North American trade relations.

2. BACKGROUND

2.1 Brief trade history

NAFTA emerged from discussions initiated in the 1980s, building on U.S President Reagan's proposal for a North American common market and drawing inspiration from Europe's European Economic Community. It came into force on January 1, 1994, facilitating cross-border trade and reshaping regional economic dynamics (U.S Trade Representative 2023). NAFTA was succeeded by the United States-Mexico-Canada Agreement (USMCA), which came into effect on July 1, 2020. USMCA modernized and updated trade relations among the three North American countries, incorporating provisions addressing digital trade, labor rights, environmental protection, and intellectual property (Ludwikowski and Lopez 2022).



Figure 1. NAFTA's countries (Kenton 2023)

2.2 Trade statistics

NAFTA's internal trade encompassed exchanges between member countries. During the last five reported years the exports of NAFTA have changed by \$485B from \$2.1T in 2016 to \$2.59T in 2021 (OEC 2023). In 2021, key internal exports were Crude Petroleum, Cars, and Motor vehicle parts. In terms of external trade, NAFTA's top exports went to China, Japan, and South Korea, with notable external exports including Crude Petroleum and Cars. In total, NAFTA exported \$2.59 trillion in 2021, with the primary destinations being the United States, Canada, Mexico, China, and Japan (OEC 2023).

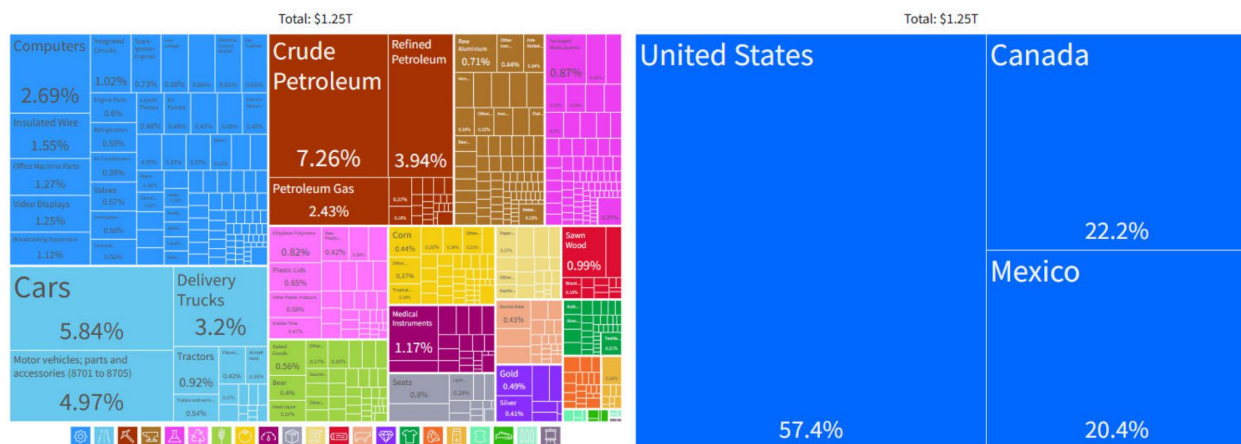


Figure 2. NAFTA's internal exports (left) and internal destinations (right) in 2021 (OEC 2023)

3. TRADE INSTRUMENT

3.1 Description of trade policies and procedure

NAFTA's trade policies and procedures aimed at fostering economic integration among its members through the gradual reduction of tariffs and trade barriers. These measures spanned from immediate removal to periods of up to 15 years, eventually resulting in duty-free access for various goods (U.S. Customs and Border Protection 2023). The agreement granted "National goods" status to imports from NAFTA countries, prohibiting taxes or tariffs imposed by state, local, or provincial governments.

With the implementation of NAFTA, smaller enterprises were among the major beneficiaries, as reduced costs enabled them to engage in foreign markets without a physical presence. The framework established by NAFTA not only facilitated trade but also prioritized critical aspects such as intellectual property rights (Levy and Weiser 1993), dispute resolution mechanisms (Bialos and Siegel 1993), and environmental safeguards (Mumme 1993). This framework engendered an environment conducive to growth, ensuring businesses operated on a level playing field. Consumers felt the positive effects of NAFTA as well, due to reduced tariffs translated to decreased import costs, thereby mitigating inflation risks and maintaining lower interest rates. For example, prior to NAFTA, automobiles and auto parts faced significant tariffs when traded between the United States, Canada, and Mexico. However, with the implementation of NAFTA, these tariffs were gradually phased out or significantly reduced, leading to a decrease in import costs for automotive products (Montout et al. 2002).

3.2 Barriers and challenges of the implementation

The implementation of the NAFTA brought forth transformative economic cooperation, yet it was marred by significant barriers and challenges. Three primary obstacles stand out, each casting a shadow on the initial vision of seamless trade and growth. Firstly, it was reported that the agreement led to a substantial loss of jobs in the United States. The relocation of manufacturing industries to Mexico, driven by lower labor costs, resulted in a trade deficit of \$97.2 billion and the exodus of 682,900 U.S. jobs by 2010 (Scott 2011), underscored the detrimental consequences for the American workforce. This labor-driven challenge not only disrupted livelihoods but also strained the social fabric of affected communities.

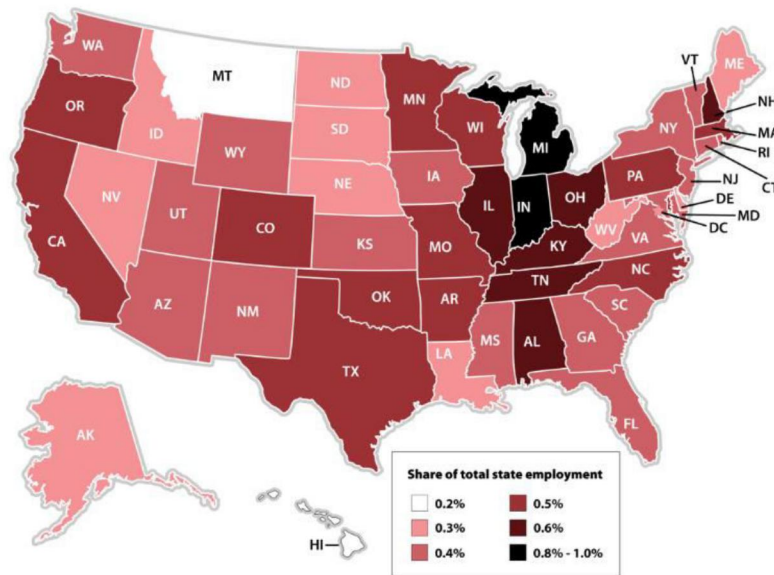


Figure 2. U.S. net jobs displaced due to trade with Mexico in 2010 (Scott 2011)

Secondly, it was reported that NAFTA proved detrimental to Mexico's agricultural sector. The influx of heavily subsidized U.S. agribusiness products led to the displacement of Mexican farmers, with nearly 1.3 million jobs lost between 1994 and 2004 (Ratner and Scott 2005). Meanwhile, Mexico's withdrawal of subsidies compounded the plight of small farmers, enabling large American agribusinesses to dominate the market (Ramirez 2003). This erosion of Mexico's farming landscape perpetuated rural poverty and highlighted the disparities exacerbated by the trade agreement.

Thirdly, it was reported that due to NAFTA's competitive pressures, Mexico's environment deteriorated significantly. The increased demands of Mexican agribusiness led to a heightened usage of fertilizers and chemicals, resulting in an annual pollution cost of \$36 billion. Concurrently, rural farmers expanded onto marginal lands, contributing to deforestation at an alarming rate of 630,000 hectares per year Liang (2021). As a result of the mentioned weaknesses of NAFTA, the implementation of the USMCA as a replacement for NAFTA aimed at rectifying the issues that had arisen, ultimately fostering a more balanced and sustainable approach to economic cooperation among the member countries.

3.3 Recommendations

For successful international trade and economic cooperation, addressing the challenges that arise from NAFTA is crucial to ensuring equitable growth and sustainable development. In this report, four key recommendations stand out as effective strategies to tackle the weaknesses and challenges posed by such agreements.

Firstly, to counter the adverse effects of job displacement caused by the relocation of manufacturing industries, a proactive approach is essential. Establishing comprehensive job retraining and transition programs for affected workers can facilitate their integration into emerging sectors (Henry et al. 2020). For instance, if a factory closes down due to trade-related shifts, providing training in fields like renewable energy, digital technology, or healthcare equips workers with relevant skills for new opportunities. This not only safeguards livelihoods but also fosters a dynamic and adaptable workforce.

Secondly, equally vital is the enforcement of robust labor standards across member countries. By ensuring fair wages, safe working conditions, and the protection of workers' rights, companies would be discouraged from relocating solely to exploit lower labor costs. A coherent example is the International Labour Organization's conventions, which set universal standards for labor rights (ILO 2023). If countries adhere to and enforce these standards, the temptation to compromise human dignity for cost-cutting measures diminishes.

Thirdly, environmental preservation is another imperative concern. Strengthening environmental regulations and monitoring mechanisms can mitigate pollution and deforestation resulting from competitive pressures (Zhao et al. 2022). As a result, collaborative efforts among member countries can create a shared commitment to sustainable practices. For instance, the European Union's emissions trading system encourages industries to reduce greenhouse gas emissions collectively, promoting environmental responsibility in trade-driven economies (European Parliament 2023).

Finally, establishing regular reviews and adaptation mechanisms for trade agreements is essential. This approach ensures that the impacts of agreements like NAFTA or USMCA are

continually evaluated across sectors, enabling timely adjustments to counter negative consequences.

4. CONCLUSION

In conclusion, NAFTA stands as a significant milestone in the realm of international trade, shaping the economic landscape of North America for decades. The agreement's emphasis on gradual tariff reduction and trade facilitation mechanisms played a pivotal role in boosting cross-border commerce, benefiting industries, consumers, and small businesses alike. However, job displacement raised concerns about the impact on local economies and the workforce, while the adverse effects on Mexico's agricultural sector and environment highlighted the need for a balanced and sustainable approach to trade cooperation. In moving forward, international trade agreements must be underpinned by proactive strategies. These include comprehensive job retraining, robust labor standards, stringent environmental regulations, and regular reviews to ensure adaptation and alignment with evolving economic and social dynamics.

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