

THE REFLECTIONS ON NAFTA AND WHAT CAN BE LEARNED FROM IT

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THE REFLECTIONS ON NAFTA AND WHAT CAN BE LEARNED FROM IT

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## **ABSTRACT**

### **THE REFLECTIONS ON NAFTA AND WHAT CAN BE LEARNED FROM IT**

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**SUPERVISING PROFESSOR: EDWARD MIHALKANIN**

The number of international trade agreements is growing, but their efficiency still raises doubts. In this thesis, I decided to assess NAFTA, because it is the first free trade agreement among asymmetrically developed countries. Today, almost eighteen years after NAFTA was founded, the results of it can serve as a reference to other developing countries in making their decision whether to join asymmetrical trade agreements or not.

## **1. Introduction**

International affairs is an intriguing, broad and complex subject that makes both direct and indirect impact on all of us. As a student of International Studies I have decided to take a closer look at international trade as probably the most important aspect of international affairs and the biggest motive behind contemporary international actions. In particular, I am interested in the increasing number of international trade agreements, why and how they come into existence and who benefits from them.

Since the beginning of the 20<sup>th</sup> century, the international trade has been continuously intensified as a result of major breakthroughs in transportation and communication. The actors in the ever growing international trade soon realized that some general framework, rules and directions needed to be laid out. In 1943 at the conference in Bretton Woods, New Hampshire 44 leading nations of that time met together to regulate the international monetary and financial order. On that occasion the institutions of IMF and IBRD were set up to be a reference point for all future international trade, followed by the creation of GATT four years later. They also became the foundation for all regional trade and economic agreements.

The tendency of countries to form regional agreements in most cases comes from two sources. First, countries that are physically close to each other have historically



always been the greatest trading partners. It helps that within a region markets are usually very similar in their preferences as well as problems. Second, with international integration the competition became frightening, so the countries started looking to each other to build ever larger, more competitive markets. A regional market has been expected to increase the total resources and decrease the production costs, thus aggregating power of the member states vis-à-vis the rest of the world.

For the purposes of this thesis I will focus on NAFTA, because it is the first reciprocal trade agreement ever negotiated between asymmetrically developed countries (Echeverri-Carroll: 5; McGaughey: 2). In asymmetrical trade agreements the less developed country will be more dependent and find more costly to enter and leave the agreement (Keohane and Nye: 11). That means that countries with similar levels of development stand greater chances to enter a trade agreement and such agreement has a higher probability of surviving. All three member-countries of the North American Trade Agreement, the United States of America, Canada and Mexico, are in the top fifteen world economies in terms of their GDP, so the term “asymmetrically” needs to be taken conditionally. Even though Mexico has the fourteenth largest GDP in the world (<https://www.cia.gov/library/publications/the-world-factbook/fields/2195.html>), the United States economy is the largest economy in the world and compared to it almost all economies seem dwarfed. Additionally, if we look at the GDP PPP (Purchasing Power Parity) the “asymmetry” in the development level becomes obvious, with the United States at eleventh, Canada twenty-second, and Mexico at only eighty-fifth position (<https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html>).

NAFTA was officially founded in 1994 after several years of negotiation. Created on the foundations of CUFTA, the 1988 free trade agreement between the United States - Canada, Mexico joined and NAFTA came into existence. NAFTA was a precedent as the first trade agreement between asymmetrically developed economies, raising a lot of criticism, questions, and controversies. Today, NAFTA is undoubtedly the largest and most impressive free trade area in the world. The controversies around it persist and the final word on it is yet to be heard.

The goal of this thesis is to see how member states did under NAFTA in terms of their initial goals and the extent to which these goals were later met. Why did these three particular countries enter the agreement? Why did Mexico, lagging economically so much behind the United States and Canada, decide to join NAFTA? What conditions did Mexico have to meet to enter NAFTA and was it pushed around by the stronger partners? What could the United States possibly gain from its considerably weaker partners, especially from the politically unstable Mexico? In the end, to what extent were the objectives from each of the member-countries met by NAFTA?

In the first part of the thesis, I am going to discuss what reasons the United States, Canada, and Mexico had to join NAFTA. I will look into historical data and try to explain how it contributed to the creation of NAFTA at this particular point in history. I will also examine the creation of NAFTA in the context of what was going on in the world at that time.

In the second part I will discuss NAFTA results. First of all, what were the results? I will look for the results in the relevant academic literature on the subject. I will consult multiple sources and compare their way of reasoning in order to assess the validity. Then I will compare the motives each of the parties had to join NAFTA to the actual results in order to assess the effectiveness of NAFTA. I will analyze what factors have to be accounted so that we can fully understand the outcome of the NAFTA. In the end, I will discuss if the motives to enter the trade agreement can be justified by the results.

Lastly, in the third part I will try to explain why the negotiation results turned out the way they did. In preparing for this thesis I came across different interpretations of NAFTA's results, so I want to discuss the results through the prism of different techniques of statecraft. My hope is that this kind of comparison would clear out some of the ambiguities that appear in the literature in regard to NAFTA results. First of all, I will bring the attention to the limitations that all of the eco-political researches inherently have. Authors all too often present their results in the absolute terms, failing to recognize the huge number of interchanging causes and results which leave us heavily dependent on the probability. Secondly, by comparing different statecraft techniques shoulder to shoulder, I will try to prove that NAFTA, or more generally free trade, were indeed the best political choice for the particular set of circumstances. The results should always be assessed in regard to the motives and the alternatives, thus creating outcomes that are

relatively positive or negative. So my intention is to clear out what got me interested in NAFTA in the first place – its controversy.

## **2. The goals of NAFTA members at its creation**

Why did the United States, Canada, and Mexico decide to join NAFTA? There are some general ideas why countries enter trade agreements, to achieve economies of scale for example. There are also more country specific motives to enter a trade agreement. In this chapter, I want to discuss what are generally assumed to be benefits of the free trade agreement and list the particular motives that the United States, Canada, and Mexico had to create NAFTA. Taken from NAFTA's Article 102 the official objectives of the agreement were:

- Promote regional trade and investment
- Increase employment, improve working conditions and living standards in each of the countries
- Provide a framework for the conduct of trilateral trade relations and for the management of disputes
- Strengthen and enforce environmental laws and basic workers' rights
- Work together to promote "further trilateral, regional, and multilateral cooperation to expand and enhance the benefits of this agreement"

The potential benefits of free trade were first observed by Adam Smith. He said that only a fool would produce something that would cost him more to produce than to buy (Smith: 175). It was a revolutionary thought in strong opposition to the mercantilist's

philosophy of that time which praised exports and disdained imports. Smith said that countries could gain if each produces exclusively the good(s) in which they are most suited to and then trading between each other to meet consumption needs.

The idea of Adam Smith, which is based on absolute advantage, was further developed by David Ricardo. According to Ricardo, even if one of the partners has absolute advantage in every possible aspect of production, the partners could still benefit from trade based on their comparative advantage. The comparative advantage is based on the idea that if a country specializes in a production of one good, it can reach the economies of scale, lower the production costs, and sell a product at a lower price. In doing so, even the country which has absolute advantage would still be better off economically from trade than they would pretend to be self-sufficient (Ricardo: 7.18).

Adam Smith and David Ricardo with their theories gave the first motive for the creation of free trade agreements. However, free trade agreements are a policy of lowering trade protection, most of all tariffs and subsidies. Government interventions can increase or decrease the price of goods and services, but under a free trade agreement those prices are becoming a true reflection of supply and demand. A free trade agreement creates a clear picture of market needs, allows access to foreign markets thus creating a bigger pool of consumers, and it makes easier for a country to reach the economies of scale (Francois: 65). The economies of scale bring two major benefits: a) they lower the prices for the local consumers and b) they increase the competitiveness of free trade agreement members on the international market.

So the first motive for the United States, Canada, and Mexico to join NAFTA is of the economic nature. All three countries wanted to have access to a greater market for their goods and services. And while the United States and Canada were expected to become partners considering their *au pair* economic strength and political stability, the question is why would the United States abandon its protectionist policy (Orme:71) toward the economy such as Mexico's? It may be that the United States consciously agreed to potential economic loss, but that loss was offset by political and social considerations. However, if there was a political and social stability motive, it was most likely in service of market expansion; Mexico, along with the risks, offered much more opportunities than, for example, a mature Canadian market. Further analysis may reveal other valid reasons why the access to the markets was opened.

As a general rule, free trade agreements are most like to occur among the countries that are in geographic proximity. If we look at the list of free trade agreements in today's world, it is easy to notice that they are all regional; Greater Arab Free Trade Area (GAFTA), South Asia Free Trade Agreement (SAFTA), Southern African Development Community (SADC), Southern Common Market (MERCOSUR), Economic Community of West African States (ECOWAS), Central European Free Trade Agreement (CEFTA), and many more. Countries that are physically close to each other have historically always been the biggest trading partners. Prior to NAFTA, Mexico's largest trading partner was the United States accounting for more than 31 percent of exports and seven percent of its imports (Robert: 23). Similarly, Canadian exports to the

United States counted for the unbelievable 69 percent while imports from the United States reaching 21 percent (Clement et al.: 15). The reason for such great trade flux within a region is that those markets are usually very similar in their preferences as well as their problems. Let us look now at the more country specific motives for joining NAFTA.

<b>North American trade 1989 (% of total imports/exports)</b>			
	US imports % of total	Canadian imports % of total	Mexican imports % of total
US exports % of total		21.13%	6.74%
Canadian exports % of total	69.31%		0.43%
Mexican exports % of total	31.68%	0.53%	
Note: Different accounting methods may lead to inconsistency			
Table 1. pg. 15, N.C. Clement, North American Trade Integration			

### *2.1. USA's motives*

Why would the United States – the largest and strongest economy in the world – want to sign FTA's with considerably smaller economies such as Mexico, Chile, Singapore or Morocco? The most important general reason is capital's risk aversion. Since the investors are not interested in the opportunities with politically unstable countries which inherently impose a threat on their capital, FTA's are seen as a way to support the growth of political pluralism in a given country. So the first two reasons why



the United States would enter into a trade agreement are to use its influence to a) support stability in a given country, and b) protect its capital (Clement et al.: 255-6).

The influence of the United States comes from the remarkable size of its economy as well as political stability. At the time NAFTA was created the United States economy (in terms of GDP) was almost double the size of the second-positioned Japan, and ten and twenty-three times larger than that of Canada and Mexico respectively (Francois: 62; <http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?page=3>). Parallel to that, since World War II, the United States has not experienced any severe political turmoil. With such credentials, the support of the United States is welcomed by most of the countries in the world and seen as path to progress. Countries are motivated to make changes so that they could do business with the largest economy in the world, expecting that they will become richer faster. On the other hand, the United States is getting a foothold into a newly stabilized, unexplored market making it better for US exports. Furthermore, politically speaking, those countries are very likely to be loyal to the United States in its international policy.

By creating a stable and secure political environment, the United States will protect its capital. It is, of course, United States capital that is protected. For the United States, trade agreements are most of all an opportunity to invest in a new, unexplored market. Considering the balance of power that the United States has within NAFTA, it was highly probable the United States' capital will be warmly welcomed by the NAFTA partners.

Some authors also argue that it is because smaller groups are easier to manage that the United States favors smaller trade agreements over the WTO (Yeung, Perdakis, and Kerr: 4; Clement et al.: 256). I believe this is the case of NAFTA and a third valid motive for why the United States decided to create NAFTA. For the United States the important goal of the FTAs was to establish trading rules that have not or cannot be brought in by WTO. The Uruguay Round (1986 – 1993) of WTO negotiations did not look very promising. What the Americans felt that needed to be urgently addressed in the Uruguay round were, for example, Intellectual Property Rules (IPR). Yet, the difficulties that Round had in making decisions are broader than IPR and longstanding, resulting in frequent collapse in negotiations such as the 1982 Geneva meeting stall on agriculture and 1988 Montreal deadlock. ([http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact5\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact5_e.htm)).

What the United States wanted so urgently to impose on the rest of the world were stricter intellectual property rights and this goal is the fourth reason why the United States wanted to create NAFTA. The problem was that quite often local entrepreneurs in many third world countries would not pay the original developer for the intellectual rights, i.e. the problem was piracy (Clement et al.: 269). The protection of intellectual property in the United States' opinion was not strict enough under the WTO causing American companies to lose money. Examples can be found in biochemical and pharmaceutical industry, as well in the sphere of culture. A country that signs an FTA with the United States can no longer use the exemptions and under the TRIPS (Trade-

related Aspects of Intellectual Property) of WTO (Managing Intellectual Property, June 2004). This way, the US companies that are heavily invested in research and development have their investment protected from the knock-offs produced in the developing countries.

The fifth motive that made the United States to consider seriously a common market with its southern neighbor came from the 1970s oil crisis in the United States and major discoveries of oil in Mexico (Robert: 23; McGaughey: 20). The United States wanted to ease and secure the access to the Mexican oil reserves as an important source of energy. Of course, for that reason the United States could have also turned to the Middle East and reach trade agreements with some of them, but here is where the earlier mentioned geographic proximity plays an important role. When a secret meeting between the representatives of Mexico and the United States took place in 1990 it came as a surprise to many. The reason, apart from the already mentioned economic differences, was the traditional animosity of Mexico for its northern neighbors. Still, the geographical proximity and highly developed economy indeed made the United States a desirable partner.

When it made a decision on joining NAFTA the United States representatives assumed that the large population of Mexico would be a great potential market right in their “back yard” and that is the United States’ sixth reason. All that was needed to be done was to ease access to the Mexican market and make the political environment stable. NAFTA, through the economies of scale and spurred foreign investment, had the

potential of creating economic growth in Mexico, and to allow for US products to penetrate to numerous customers in Mexico (Waverman: 25).

In terms of market expansion, Canada was not the United States' concern. The two countries traditionally had very close relations, mutual understanding, excellent transportation infrastructure, and a soft border. Probably the crown of that relation was the creation of CUFTA which liberated the trade between the countries before NAFTA came into place. Besides, in terms of population the Canadian population of 30 million in 1990 is small compared to the Mexico's 83 million of that same year (Waverman: 23).

The seventh reason why the United States wanted NAFTA was that blocs similar to NAFTA have been created in Europe and Asia. These blocs had the potential of aggregating power and eventually imposing a threat to the United States international position. The creation of NAFTA was the United States reaction to the increasing number of multinational trade agreements and a foot in the doors of new markets.

By creating NAFTA, US negotiators wanted to press Canada to repeal compulsory licensing and to end various subsidies left untouched by CUFTA (Robert: 208). So as the eighth reason it can be stated that the United States wanted "to establish permanent investment and service codes favorable to the transnational investment" (McGaughey: 21). By including Mexico, the United States would have a partner against Canadian trade barriers and show it is not just their whimsy.

Environmental issues were also one of the United States. These concerns which have not been implemented by the WTO at the acceptable pace and can be placed as the ninth and final reason the United States may have had for NAFTA. Since developing countries such as Mexico usually have low environmental standards only to attract jobs, the provisions on environment, like the ones in the United States and Chile agreement, would be beneficial to the quality of life of local citizens and promote the United States as environmentally conscious nation.

Probably not a motive in itself, but definitely a reason why NAFTA came into existence at this particular point in history was the change in the political climate in all three of the countries. The United States, Ronald Reagan who found his ideological equivalents in Brian Mulroney and Carlos Salinas in Canada and Mexico respectively. These leaders advocated regional trade liberalization as a means of economic growth (Mayer: 16, 37; Robert: 23, 25, 27).

## *2.2. Canada's motives*

Canada trade was, just like in the case of Mexico, heavily dependent on the United States. The initiative of Canada's president Trudeau and its government to diversify trade with other countries was unsuccessful. Instead, in 1985 Canada started to seek freer trade with the United States which resulted in creation of CUFTA. Political analysts agree that a trade agreement with Mexico was never a part Canada's ambitions, but once the negotiations between the United States and Mexico took place, Canada decided to join in (Mayer: 48; Robert: 32).

In spite of its traditional good relations with the United States, soft border, and heavy dependency on the US market, Canada's preoccupation always was to maintain its distinct identity from the United States. Such an attitude was the main obstacle in crafting economic integration with its neighbor. When Investment Canada was created 1985, fears about a loss of autonomy to the United States begun to disappear and the Canada-US FTA (CUFTA) entered into force in 1989 (Hofbauer and Scott: 99).

Canada obviously entered trade agreement with the United States for different reasons than it did with Mexico. The first motive for Canadian officials to join NAFTA was strictly defensive - they did not want to be left behind. There are two parts to this motive. First, Canada wanted to avoid allowing the United States, which was heading for two bilateral trade agreements, to become the center of North American trade (McGaughey: 21). Canada did not want to take part in the United States – Mexico free trade negotiations, but the idea of being left out was equally troubling (Mayer: 48). As the second part to this motive, the U.S. market historically absorbed almost one third of Canada's total exports (Clement: 15), and Canada could not afford to lose its share in the United States market to Mexico (McGaughey: 29). Because of the size and wealth of the United States market, as soon as Carlos Salinas of Mexico proposed a free trade agreement with the United States, Canada was prompted to join the talks as well (Hofbauer and Scott: 100).

Canada's decision to enter a trade agreement with Mexico came incrementally and indirectly through Canada's interest in the United States. Still, as its second motive, Canada wanted to play a role in building Mexico in spite of the potential costs, such as losing share in the US market to Mexico. Assuming that Mexico, supported by NAFTA, would experience economic growth and increase in purchasing power, a large new market with an enormous appetite for imports, capital, technology and know-how would be created (Waverman: 25).

The third reason why Canada decided to join NAFTA was the shortcomings of CUFTA. CUFTA had several important achievements, such as lowering tariffs and dispute settlement, but several points remained unresolved. Most notably subsidies, government procurement, energy sector investment, transportation, and intellectual property rights still needed to be addressed, or addressed in a more efficient way (Hofbauer and Scot: 99). Canada wanted to revise many of these topics under NAFTA.

Although geographical proximity was already mentioned as a general rule in the creation of free trade agreements, I want to stress how important this argument is in the case of Canada. To understand it, we need to know that nearly 90 percent of Canadian population lives within 200 kilometers from the United States border. A high level of social and economic development in both of the countries, same language, and ease of transportation created great trust and a soft border between the two. As such, the United States and Canada are arguably the two most open neighboring nations in the world.

For many “the Canadian interest in NAFTA is ambiguous” (McGaughey: 20). First of all, Canada started the negotiation process from a defensive point motivated by protection of its presence on the United States market and prevention of the United States from becoming a trading center. Second, Canada did not have clear and firm motives such as the United States’ objectives of stricter IPR’s, access to oil resources, and repeal of compulsory licensing. Canadian motives of access to a potentially dynamic Mexican market and helping build a more stable democratic society were lacking a sense of urgency or critical need.

### *2.3. Mexico’s motives*

Some of the reasons for Mexico to join NAFTA have been indicated already. What is most important is to realize that there was not one, but several, often highly contextual, cause that each of the member countries had for joining NAFTA.

Since World War II, Mexico used all possible tariff and non-tariff means to shelter its domestic market. A direct result of its protectionist policy was the 1980s debt crisis, in spite of recently discovered oil resources on Mexican soil. Throughout that same period (1980s) any idea of Mexico entering free trade with the United States had been firmly rejected (Mayer: 2). The country was on its knees and it became obvious that some structural changes had to be made. Presidents Miguel de la Madrid and Carlos Salinas undertook a series of reforms to liberalize trade, make foreign investment easier, better control public enterprises and liberalize and privatize financial system (Robert: 26; Mayer: 35).



In 1986, Mexico joined GATT and made adjustments to its trading system making it more liberal. Mexico desperately needed economic growth, and its leaders rightly recognized that it could only be achieved through liberating trade, increase exports, and foreign investment. In that sense, joining GATT represented the first step toward the North American Trade Agreement. It was a sign of good will and made Mexico a much more attractive trading partner to its northern neighbors. A further step in that direction was the controversy around the 1988 presidential elections which indicated that greater reforms were about to come and further encouraged international interest in Mexico's goods and services.

Changes in Mexico's trade policy were not the motive for joining NAFTA, but they were a reason why the negotiations started. The first motive that Mexico had to join NAFTA was to overcome domestic political obstacles to economic reform (Mayer: 62). Mexico expected that an external influence from the United States and Canada would support, justify, and reinforce undergoing domestic changes (Orme: 5, 56). This could best be understood if we think that Mexico's strongly exaggerated corruption problem (Nevaer: 232) could be best fought by an external, independent body. And even though Mexican politicians saw the need for closer relations with its northern neighbors, deeply rooted distrust towards Americans and the perception of Americans as exploiters made every domestic talk about the trade liberalization a very challenging task for the Mexican government (Mayer: 43).

Mexico could have joined an economic agreement of Latin American countries, MERCOSUR. However, Mexico wanted to leave the South and underdevelopment behind (Orme: 1). Those countries were facing the same economic problems and political instability like Mexico. Greater benefits in terms of financial, political, and social influence were to be expected from the developed nations such as the United States and Canada.

The second important motive Mexico had to join NAFTA was to attract foreign investment (Mayer: 62). It was not only foreign investment from the United States and Canada that Mexico was after, but from the whole world (Mayer: 44). Mexico had two valid reasons to believe that foreign capital would be interested in coming. First, it was a once-in-a-lifetime opportunity to buy valuable state-owned enterprises, such as telephone companies. Second, foreign investors would be attracted to Mexico to produce for the neighboring United States market (McGaughey: 24). An inflow of foreign capital had a potential of boosting economic growth and create new jobs. Of course, foreign capital would come only if the environment for it was safe.

By creating closer relations with the United States and Canada, Mexico would appear to be a trustworthy business partner. NAFTA would be sending a message of Mexico's reliability in two forms: a) if the United States and Canada were willing to trust in Mexico, it would give Mexico credentials and deepen international trust in Mexico, and b) if the United States and Canada created closer relations with Mexico it would be in their interest to do as much as they could to make sure Mexico performed well (Clement

et al.: 281-282). We need to have in mind that all capital, including that from Europe or Asia, is risk averse and it looks for a stable environment to be deployed.

The third important motive Mexico had to push for the trade negotiations with its neighbors was the world trend of creating free trade agreements. This is most of all true in regards to Europe which was the second largest investor in Mexico (Robert; 23). After the fall of communist bloc and Europe's integration there was a fear that potential European investment will be diverted from Mexico to the newly opened opportunities in Eastern Europe (Orme: 58). The Mexican government reacted by initiating its own trade union - NAFTA. By integrating its market with the United States and Canada, Mexico would appear to have more muscle vis-à-vis EU, giving the impression of stability and become more attractive for the foreign investments.

The fourth motive why Mexico wanted NAFTA was to counterbalance CUFTA, because CUFTA produced significant economic gains for the involved sectors (Clement et al.: 257). It was as if the big boys, the United States and Canada, were playing and Mexico felt left behind. CUFTA imposed a threat to the Mexican share in the United States market. To a certain extent it was an unreasonable fear that once Canada removed its trade barriers with the United States it will take low paid jobs and industries from Mexico. Still, the example of Honda, a Japanese car manufacturer, justified some of the Mexico's concerns. By placing its factories in Canada, Honda used the 1965 Auto Pact as a platform to enter the United States market (Robert: 153). A similar scenario may repeat

again once the trade barriers between the United States and Canada were removed, which Mexico did not intend to allow.

One last motive for Mexico to enter a free trade agreement can be recognized. Since World War II, Mexicans emigrated to the United States in search of better paid jobs. In the first years after the war they were welcomed by the United States officials, but since 1967, United States' immigration rules keep getting stricter. Still, stricter rules did not prevent drainage of labor force. The only way Mexico could prevent labor emigration was to create more of the better paid jobs (Hofbauer and Scott: 100) and NAFTA had a potential of doing that.

In conclusion, some motives for joining NAFTA can be recognized throughout all three of the countries. The first and foremost reason for these three particular countries to form a FTA is their geographic proximity. Their rich trading history is based on that proximity. Also, all three countries wanted to create bigger market for themselves. A bigger market would make economies of scale easier to reach. The international tendency of creating multilateral trade agreements, such as EU, MERCOSUR, and ASEAN, was a motive to create NAFTA too.

Apart from these common ones, there were also county-specific motives. Specific for the United States were concerns about stricter enforcement of Intellectual Property Rights, an aspect in which WTO displayed inefficiency, creating a better natural resource base (oil), promote environmental rules, and support stability in the region. Canada was

the only country which entered trilateral trade agreement primarily for defensive motives. It soon realized the marketing opportunity which comes from helping Mexico to become more stable and prosperous country. Unlike the other two, Mexico was looking for an external support for its ongoing political and economic changes, as well as to attract foreign investment not only from the United States and Canada, but from all over the world.

Looking at the list of motives that NAFTA was created from it is obvious that all three nations had high expectations. And while the United States and Canada were fishing for opportunities in foreign markets, Mexico was more introverted when it came to NAFTA. It had essential needs for a more politically stable society, retention of its labor force, and international investments. Of course, great ambitions can easily lead to great disappointments.

### **3. The results of NAFTA**

Mexico, Canada and the United States had high hopes that the North American Trade Agreement it would enhance production efficiency, increase investment, create jobs, and generally improve standard of living for their citizens. Those hopes, dominantly held by economic and political elites, were very reasonably based on positive experiences from CUFTA, changes in Mexico already well under way, and the global economic context. Today it has been almost eighteen years since the creation of NAFTA, which is more than enough to see how much of these hopes actually came true and to assess the efficiency of the agreement.

What needs to be stated at the very beginning is that any attempt to assess NAFTA cannot be made with absolute certainty. There are so many variable factors which are influencing the economic situation in each of the countries that it is virtually impossible to determine how much impact each factor has on the final outcome (Clement et al: 285). Therefore the final outcome is often a subject of interpretation. Hans Morgenthau recognized and listed the shortcomings to this kind of research as:

- a) In political science experiments cannot be conducted to the same extent as in natural science. There are no laboratory (controlled) conditions and no possibility to repeat certain effect at will (Morgenthau: 128). Therefore the results of

- b) NAFTA are product of social interaction and depend on the culture of the society, objectives, and methods of the inquiry.
- c) One cause can have multiple effects (Morgenthau: 127). The United States had every reason to believe that the creation of NAFTA will bring political stability to Mexico and subsequently the region, create environment suitable for investment, enforce strict IPR's, ease access to the oil reserves, and remove compulsory licensing.
- d) One effect can have multiple causes (Morgenthau: 127). Greater output of American car manufacturer can be caused by NAFTA by lowering the price of production through the economies of scale, new technology, and lower price of the final product due to newly discovered abundance of raw material. There is no way of telling to which extent each of these causes contributed to the effect.
- e) Causes can be effects and vice versa (Morgenthau: 131). Foreign investment in Mexico is, among others, caused by the political stability, and foreign investment as an effect has higher employment rate.

It becomes obvious that the NAFTA's results that I am about to present need to be taken only as a degree of probability.

### *Trade*

The common motive for all three countries to join NAFTA was to increase trade. Under NAFTA, regional trade did increase, although different authors give different attributes next to that increase. "Sharp expansion" is how Hofbauer and Scoot describe trade under NAFTA. According to that source, in the first ten years of NAFTA United

States merchandise exports and imports with Mexico increased 166 and 290 percent respectively, which makes total of 227 percent trade increase. For comparison, at that same period United States trade with non-NAFTA countries increase 124 percent. The United States exports and imports from Canada increased 140 and 190 percent respectively, an increase which is not as impressive as in Mexico's case but it is higher than the non-NAFTA average (Hufbauer and Scott: 18).

Looking at the intra-NAFTA trade Duina (p. 22) describes NAFTA as being a moderate success. His evaluation is based on the 1994-2001 average overall trade increase of 2.5 percentage points. Mexico and Canada had indeed become the United States' leading trade partners, as it was expected, but the increase was unevenly distributed. Among the member states Canada experienced 7, the United States 4, and Mexico negative 3.5 percentage points, so that NAFTA cannot be characterized as a complete success.

John Murphy, the vice president of international affairs at the United States Chamber of Commerce, presents NAFTA as a success for the United States. According to Murphy's interpretation, NAFTA facilitated increases in trade, most obvious in the tripling of United States trade with Canada and Mexico, from \$293 billion in 1993 to just under \$1 trillion in 2008. More importantly, Canada and Mexico have tripled their purchase of United States goods, making for more than a third of total United States' export in 2008. Bottom line, even if NAFTA has not contributed to the economic growth, it certainly did not hurt it. (Haugen and Mach: 32).



The criticism of NAFTA in regard to manufacturing Murphy says are unfounded. Manufacturing rose by 57% between 1993 and 2007. But at the same time the service sector grew – typical for the developed countries - taking some of the importance from the manufacturing sector and reducing its share in GDP from 15.6% to 12%. Not only that, manufacturing output increased thanks to the technological improvements, automation, and use of information technology. In the face of the 2008 recession, US manufactures are facing difficulties, but that only makes United States exports to Canada and Mexico that much more critical.

Weinstein makes a good point when he notes that well before NAFTA's implementation trade among the three countries had grown substantially. In the nine-year period between 1984 and 1993, U S exports to Mexico neatly quadrupled (Weinstein: 340). What can be inferred is that perhaps NAFTA was not the only contributor to the intra-regional trade growth, although Weinstein does not state that explicitly. Still, he admits that United States exports to Mexico accelerated dramatically after the commencement of NAFTA, with the exports to Canada also being very impressive. Imports from Mexico increased from \$75 billion to \$135 billion while imports from Canada jumped from \$155 billion to \$230 billion.

Rugman (6) agrees that NAFTA caused an increase in trade among the member states. Intra-regional trade increased from 49.2 percent of total trade with the world in 1996 to 55.7 percent in 2003. As the main reason Rugman see increasing dependence of

both Canada and Mexico on the United States market. In 2000 87 percent of Canada's exports and 88.7 percent of Mexican exports were to the United States.

The reason why Duina, Murphy, Hufbauer, Scott, Rugman, and Weinstein all offer different interpretations of trade results lies in the fact that this increase in overall trade is not in itself the evidence of NAFTA performance. Depending on the selected model (computable general equilibrium, gravity models, etc.) the results of, for example, trade gains in a given year differ from a modest 5 all the way up to 50 percent. The only thing we can be certain is that NAFTA made a positive impact on trade, but there are no known estimating models that could reliably quantify that impact.

I would like to add a few more specific patterns of trade among members, to show how impact of NAFTA on trade varies through sectors, thus adding to the complexity of assessment. The largest single sector increase of trade under NAFTA was experienced by the auto industry accounting for 20 percent of total intra-NAFTA trade. Mexico was the member state which gained the most out of it. In 2003 Mexico auto trade was five times greater than in 1993 (Hufbauer and Scott: 20). In Canada and the United States the effect of NAFTA was not so impressive, simply because these two countries had experienced the process of trade liberalization during the CUFTA period. Trade liberalization of the auto sector had such a huge success, because just-in-time processes in auto industry make it very sensitive to border disputes.

Stephan Collins, the president of the Automotive Trade Policy Council, called the auto industry a “win-win-win”. The United States’ worst fear, that of automakers abandoning the United States assembly plants did not happen under NAFTA. Instead, NAFTA turned to be a winning combination for the United States car manufacturers increasing their output by 30 percent (Peloso: 55). Mexico won as well by opening its market under NAFTA. With NAFTA, Mexicans were able to cross the border, buy a car, and drive back home without additional fees, giving its consumers greater choices and increase local manufacturing efficiency. Auto sales in Mexico (and by Mexicans) increased 66% since 1994, creating handsome revenue for the United States’ auto companies in Mexico. Canada had similar experience from the 1965 United States – Canada Auto Pact. NAFTA only extended those benefits. (Detroit Free Press, December 24, 2003)

Out of the other trading sectors it is worth mentioning that the trade in energy among the NAFTA member states contributed about 7 percent to the trade increase. Agriculture accounted for another 5 percent increase in NAFTA trade, but that result was shadowed by the political sensitivity of the sectors and several disputes over softwood lumber, sugar and high-fructose syrup (Hufbauer and Scott: 22). The trade in services also increased significantly under NAFTA, jumping from \$44 billion in 1993 to \$74 billion in 2004, or by 70 percent (Hufbauer and Scott: 25).

Agriculture, a vital sector for every country, had also been experiencing a steady record of trade increases with small positive influences on agricultural employment.

However, the NAFTA impact is hard to isolate from, for example, technological changes. For most of the commodities the increase in trade has been minor, but several cases recorded increases of 15 percent or more. Great examples are United States -Canada beef and hog trade, United States pork meat exports to Canada and Mexico, Mexican raw peanuts exports to the United States and Canada, Canada and Mexico almost doubled the cotton exports, United States -Mexico sugar trade jumped from 7,258 mt in 1994 to 116,000 mt in 2008, etc. (Peloso: 42-50).

John Murphy states that for the United States' agriculture NAFTA was nothing but beneficial. Canada and Mexico account for 37% of the total increase in United States agricultural exports. Especially important was the role of NAFTA in opening highly protected Mexican market (Haugen and Mach: 45).

As a by-product of NAFTA and further stimulus for the trade increase came the liberalization of cross-border trucking. (Peloso; 50) Up until NAFTA, Mexican trucks were not allowed to operate in the United States. It is hard to determine the net profit trucking liberalization brings, but if we take in consideration that 80 percent of bilateral trade between the United States and Mexico is done by trucks, the importance of this development becomes obvious.

Some of the NAFTA provisions turned out to be harmful to the overall success of trade. The rule of origin on textile and apparel industry was imposed to make United States firms preferred suppliers for the Mexico apparel manufacturers (Hufbauer and

Scott: 23). Not only was the rule of origin a protectionist measure frowned upon by WTO, but it also increased administrative barriers and complicated production and trade. Fortunately, NAFTA ministers recognized the failure and in 2004 agreed to liberalize rule of origin.

### *Investment*

Foreign direct investment was also very important to all three countries, although for different reasons and to a different extent. The situation with the FDI's under NAFTA did not turned out as positive as trade. Overall investment among NAFTA members decreased relative to FDI with non-NAFTA members from 30.3 percent in 1986 to 18.2 percent in 1999. The main reason is a decrease in the percentage of the United States FDI to Canada (Rugman: 7).

While the investment in Canada was falling, investment from Canada into the foreign markets has increased (Safarian and Hejazi: 24), but not significantly. According to Rugman, the reason why investment in Canada was decreasing is better access of the United States business to the Canadian market. Barriers to trade were down and the United States as the biggest investor in Canada were not compelled to invest as much (Rugman: 8). In addition, the United States increased its investment in EU and Asia.

Hufbauer and Scott (35) claim that the increase of two-way investment between the United States and Canada grew 187 percent. However, if we compare that to the increase in the two-way investment to the non-NAFTA countries which rose 333 percent,

the results might be a bit disappointing. Still, we need to keep in mind that the United States and Canada have well matured two-way investment and trade relationship, and it was unreasonable to expect some major breakthroughs.

Other sources claim that NAFTA accelerated two-way investment among the three partners (Weinstein: 341). Canadian investment literally exploded rising from \$5 billion in 1994 to more than \$25 billion in 2000. Mexican direct investment in the U.S. also grew significantly from \$1.5 billion in 1994 to more than \$5 billion in 2000. The United States' investment to Canada did not increase, while in Mexico it quadrupled to \$15 billion in 2001.

Mexico, the country which had FDI high on its list of objectives, benefited the most from this segment of NAFTA. Since 1994 foreign direct investment in Mexico increased encouraged by the very existence of NAFTA. NAFTA strengthened the rights of foreign investors, and enforced standards of security and quality. At the same time, Mexico begun to practice more stable and conservative monetary policy. Spread across almost all sectors of the economy FDI's in Mexico grew from \$33 billion in 1994 to \$166 billion in 2003 (Hufbauer and Scott: 30). Only United States FDI rose in that same period from \$17 to \$61.5 billion. Equally important is to notice that Mexico has attracted FDI's from different parts of the world (most of all EU, Japan, and Switzerland in) rising from 8.5 percent in 1993 to 29 percent in 2004 (Hufbauer and Scott: 31).

The United States direct investment in Mexico's food processing industry increased by about two-thirds and almost three times in Canada. On the other side Mexican firms also increased their investment in the United States food industry from \$306 million in 1997 to 1 billion in 1999, but Canadian investment dropped from \$6.7 billion to one billion (Peloso: 42)

Mexico would have benefited even more from FDI's under NAFTA had there not been strong competition from China. In the recent years FDI's are getting increasingly diverted from Mexico. What also gets into the frame is that Mexico, suffers widespread corruption, absence of a stable legal framework, poor highways, and electricity outages all of which discourage investment. Mexico had and still has major advantages in its geographical proximity to the world's largest market. However, the question for the years to come is will that be sufficient for the Mexican economy in face of the ever increasing competition and recent and ongoing United States economic struggle.

In discussion on the results of trade and investment there is a relationship between the two that needs to be mentioned, specifically in case of Mexico. It is a cyclical pattern in which in the times of crisis and peso devaluation, (Mexican) exports always increase and (Mexican) products become cheap for the customers abroad. At the same time, because foreign goods become more expensive for domestic (Mexican) consumers, there is an increase in foreign reserves (Clement: 295). To now, Mexico did not manage to reach the critical point of foreign reserves.

### *Employment*

Arguably the most difficult, if not even impossible, is to assess accurately the impact NAFTA had on employment. Along with Morgenthau's objections to categorical assessment, in the case of employment we are dealing with an extremely biased approach in all three countries due to a social sensitivity of the subject and direct impact this subject has on the citizens.

There are several early assessments that differ greatly. According to the United States official report in the first three years NAFTA has boosted jobs associated with exports to Mexico between roughly 90,000 and 160,000 (Clinton: iii). Completely opposite is a report from an independent survey, which notes that many in the United States had promised to create jobs, but have actually laid off workers because of NAFTA (Public Citizen, 1997a). According to their estimation, total job loss due to NAFTA is over 600,000 by the end of the 1996 only. More moderate assessments say that while NAFTA has been good to some North Americans, the cost of it was much heavier to many more (Economic Policy Institute, 1997a:1). They estimate total job loss in the first three years at approximately 420,000. The subsequent study showed that all three of these estimations depend on methodological approach of the researchers (Clement et al.: 292). It acknowledges that there has been job loss, but the overall effect of NAFTA on the employment was slightly positive.

In case of the United States, the threats of mass job and production loss to the south proved to be ridiculous (Orme: 105) – United States partners in NAFTA were just



too small economically to do real damage. Nonetheless, according to Bureau of Labor Statistics (BLS) in 2001 alone, more than 1 million United States jobs were dislocated. Jobs were lost over the mass layoffs, but the same number of jobs was created as well. Roughly 25 percent of “dislocated” employees suffered pay cuts of 30 percent or more (Hufbauer and Scott: 39), whereas most of the new, mainly export-oriented, firms paid 13-16 percent higher than the national average (Hufbauer and Scott: 41).

Based on NAFTA TAA (Transnational Adjustment System) program through 2002 approximately 525,000 United States jobs were dislocated. The problem in this particular case is that NAFTA TAA certification tells us that imports from Canada and Mexico adversely affected jobs in the United States, but it does not offer any evidence that liberalization under NAFTA is the actual cause to this. This is only one more example why assessing NAFTA tends to become perhaps too ambitious a venture.

There is a record of a decline in United States manufacturing jobs, as was predicted. But the cause was not NAFTA. The East Asian financial crisis in 1997-8 significantly decreased the demand for United States exports. The 2001 United States crisis further lowered regional demand from car manufacturers. In spite of increased productivity, United States auto industry was rapidly losing domestic market share failing to keep pace with foreign competitors, better fuel efficiency, and safety features. Finally, information technology allowed United States manufacturers produce more with fewer workers (Insight on the News, January 21, 2003).

There is no available data on jobs created in the United States in export industries, but some rough calculation can be made. It is estimated that 8,500 manufacturing jobs are supported by \$1 billion of United States exports. Based on that, with \$12.5 billion a year gained in exports, NAFTA created 100,000 United States jobs per year. (Hufbauer and Scott: 41)

John Murphy (Globalization, 2010) also argued that NAFTA did not cause United States job loss to Canadian and more importantly Mexican competitors. In fact, United States employment has risen under NAFTA from 110.7 million in January 1994 to 138.9 million in December 2007. At the same time the United States unemployment rate averaged at 5.1%, lower than 7.1% from the previous fifteen year period. NAFTA did not create 28 million jobs, but it did foster growth in export-oriented jobs which generally pay 15-20% higher wages than the jobs that are not tied to exports.

In Mexico NAFTA failed to create decently paid jobs to the army of those who needed it. The biggest proof is the number of migrants. The number of migrants is especially big in the countryside. Farmers would leave their fields to earn three times more in Canada or the United States than they would in Mexico doing the exact same type of job (The Economist, Jan. 3rd 2004).

For Mexico part of the problem were the overly optimistic objectives set by the local politicians in order to attract supporters (The Economist, Jan. 3, 2004). In case of the auto industry, the most promising of all industry branches, employment actually

declined in contrast to all predictions how it could suck the life out of United States auto-industry. But what NAFTA did for Mexico is less tangible than job creation and that is often overlooked. It forced structural adjustment across a number of industries.

NAFTA alone could not generate jobs in Mexico on a magnitude of scale. To get there Mexico has to reach for internal changes instead of relying solely on external factors. The expectations that NAFTA will somehow alleviate rural poverty on its own were completely irrational. In the *maquiladora* sector located along the border, employment under NAFTA increased from 540,000 (1993) to 1.34 million (2000) (Hufbauer and Scott: 43), but only minor migrations from the poor areas to the *maquiladora* region have been recorded. As mentioned before, the problem of the same jobs that are being paid three times better north of the border causing huge seasonal migrations only deepened the problem and left poor parts of Mexico poor. The truth is that real results in job increase can only be expected over a long period of stable growth, and NAFTA alone, without changes in political structure of Mexico, cannot suffice.

However, assessing Mexico's performance based only on numbers could be somewhat misleading. Unrelated to NAFTA, "sins of the past" caught up with Mexico and in 1994, before the first year of NAFTA ended, Mexico suffered a severe economic shock. The scope of that crisis was so big that only in 2004 did the Mexican economy come to the pre-crisis levels.

In Canada NAFTA did not cause some great turbulence in the employment levels, but its effect was positive with about one third of a million rise per year. However the growing worry of Canadians was their lagging productivity growth of 1.58 percent compared to the United States 1.85 percent (Hufbauer and Scott: 42). According to convergence theory under the FTA countries are supposed to experience increases in productivity, especially the smaller and less productive country, in this case Canada. That is why most of the experts are prone to attribute this unusual development to Canadian aversion to produce and adopt the new IT technologies as rapidly as their United States counterparts. In support of that is the fact that the biggest productivity gaps were recorded in IT sensitive industries such as finance, insurance and real estate.

The employment and wages under NAFTA experienced, most experts agree, generally positive effects. Employment and wages did not blossom as optimists predicted nor did it collapse as pundits said it would. During the first fourteen years of NAFTA the United States unemployment rate was falling steadily. The events of the 2008 economic crisis changed that, but that was out of NAFTA's influence. A claim that NAFTA decreased wages is absolutely false for the United States and Canada. Mexico's 1994/5 Tequila crisis emerged from years of mismanagement and had such devastating impact on the economy that NAFTA could not change that. However, NAFTA was a factor of stability and helped the recovery.

### *Other motives*

Political stability was Mexico's big motive for creating NAFTA. With its strong influence on foreign investment, emigrations problems etc., political stability is Mexico's core motive. American and Canadian interest in regional political stability was also present, but more indirectly through securing their investments and market expansion. If we are to believe "The Economist", NAFTA was a political failure due to the unpopularity of NAFTA shared by all three member countries. It says that this perception of NAFTA was, among other things, caused by high expectations set by NAFTA proponents. Instead, the more moderate expectations, such as reforming the labor market, would have made outcomes appear much greater (The Economist, Jan. 3<sup>rd</sup> 2004).

In support of that negative perception is the claim that the American political elite had invested so heavily in a NAFTA Mexico, that it cannot admit the deal produced none of the predicted benefits for the United States. If this assumption is true the future of the United States -Mexico relations and NAFTA will continue to deteriorate and create greater deficits for all parties involved (Peloso:55). Furthermore, the negative perception of NAFTA was coming from constant debates about job loss (The Economist, Jan. 3<sup>rd</sup> 2004). Even if there was a net job loss, it did not tell the whole story and it mislead to a negative perception of what NAFTA really is. Finally, the negative perception of NAFTA is set not only because of the high expectations, but also because of the tendency to blame NAFTA for every economic disappointment over the course of its existence, regardless of its international context. (The Economist, Dec. 30th 2003)

When it comes to NAFTA's negative perception among Canadians, it comes from results were overshadowed by the fear that the closer relations with the United States would force changes to their social-welfare state and threaten the culture (The Economist, Dec 30<sup>th</sup> 2003). In the late 1990s Canada indeed had to downsize its public expenditure, not because of NAFTA, but because of its growing external debt. Yet, it kept its integrity and social policy, proving that fears were unfounded.

Navear claims that NAFTA actually facilitated political stability in Mexico (Nevaer: 3). Popularity aside, Mexico remained stable through a delicate period of radical transformation. The 1994-5 peso crisis was largely unrelated to NAFTA (The Economist, Jan.3<sup>rd</sup> 2004). In fact, under NAFTA Mexico has dramatically reduced its public deficit (Hofbauer and Scott; 101), while its trade and FDI's grew, so the question is why Mexico would not stay politically stable. In the end, the final verdict on NAFTA in Mexico will rest heavily on whether the pact proves to be a success in the aspects of trade, investment, and labor (The Economist, Jan.3<sup>rd</sup> 2004).

Greater protection of Intellectual Property Rights was initiated by NAFTA in order to spur the innovation and development of indigenous industries, attract foreign investors, and protect consumers from low quality replicas. Although we intuitively understand the benefits of Intellectual Property Rights, unfortunately it is very difficult to measure the true impact of these (Managing Intellectual Property, September 2004).

More strict protection of the Intellectual Property Rights was one of the reasons the United States wanted a FTA with Mexico in the first place. Once Mexico agreed to follow United States standards on Intellectual Property Rights, it limited the country's ability to produce food crops. Paying for patent rights can elevate production cost significantly, to the point when production is no longer feasible. At the same time, without the applications of new discoveries a country loses its competitiveness. In pharmaceuticals, Mexico faced difficulties in ensuring a stable supply of essential medicines. Such negative FTA outcomes are attributed to lack of transparency in negotiations (Managing Intellectual Property, June 2004).

In repealing Canada's compulsory licensing the United States was successful. The goal was reached over the negotiation phase of NAFTA and implemented as Article 1709(10). Compulsory licenses can be issued in case of national emergency with its scope and duration limited to the purpose for which it was authorized (Robert: 211).

NAFTA forced the Mexican government to confront environmental problems and in that sense NAFTA turned out to be successful. The pressure from activists in both the United States and Mexico made Mexico sign international conservation accords, shut down polluting factories, as well as enact tougher air quality rules, toxic dumping rules, and inspection control (Orme: 153). As a byproduct ecological concerns had created business for the United States' firms, as they got to offer state-of-the-art technology for dismantling hazardous Mexican factories and power plants. Due to these businesses and

general success in trade, cynics named NAFTA the “greenest trade treaty ever drafted” (Orme: 154).

Other sources claim that the environmental benefits for Mexicans were not delivered by NAFTA (Peloso: 124). Examples can be seen in the industrialized maquiladora region where goods, mainly for United States market, are produced with significantly less regulation than north of the border. Under NAFTA local environmental laws should not discriminate against trade, which is, to say the least, controversial. Seen as the main cause of such environmental results are non-transparent negotiations, which allowed for such shameful provisions to slip through.

According to INEGI (Mexico’s National Institute for Statistics, Geography, and Information Systems) Mexico turned out to be the showcase of trade liberalization, but also of the environmental costs of trade-led growth. Between 1985 and 1999 rural soil erosion grew by 89 percent, municipal waste production by 29 percent, and urban air pollution by 97 percent. The costs of this environmental degradation were estimated 10 percent of GDP for that same period. With 2.5 percent of average GDP growth, it becomes obvious that the costs of environment deterioration are greater than the gains from NAFTA (NACLA Report on the Americas, July/August 2004).

Both of these contradictory assessments of NAFTA’s environmental efficiency have good arguments. Still, I am prone to assess NAFTA’s effects on the environment as positive. First of all, until NAFTA, Mexico deliberately overlooked waste disposal in



rush to create employment through 1980s (Orme: 166). Numerous widely reported and deeply disturbing stories of cancer cases and birth defects attributed to maquiladora discharges were ignored before NAFTA entered into force. Secondly, NAFTA spurred collaborative planning (and inspection) across the borders of member-countries. This is important for two reasons: a) environmental issues know not political borders, and b) with international inspections it is easier to avoid corruption. The results of NAFTA would have been even better had American society shown more of its environmental concerns by example instead of wasting far more energy and water than Mexico.

In addition to the motives for NAFTA that were listed in the second chapter, the trade agreement got one additional, very specific dimension after September 11, 2001. After the terrorist attacks the United States was forced to fortify its territory and Canada had to reconsider its role in NAFTA. Even though it was not the primary target, Canada was a highly developed country with great access to the United States. As such Canada's focus switched from avoiding close relations with the United States to holding tight to the United States in order to maintain access to United States' market. In the end, a new North American partnership with close political and cultural relationship seems to be inevitable. It may come by design or organic changes initiated by technology, security or market requests.

### *Conclusion*

First, I would like to briefly summarize the results of NAFTA. Trade was the most important motive and it had huge influence on employment, political stability, and

investment which turned out to be very positive. Unlike trade, foreign direct investment experienced an overall decrease. Still, FDI did increase in Mexico, the country where it mattered the most. The impact of NAFTA on employment was the hardest one to assess. It seems that the job loss is present, but the overall effect on employment is generally positive (wages and work conditions). Also, it is fair to say that Mexico did not seize the opportunity NAFTA brought. When it comes to the environmental provisions, NAFTA initiated critical positive changes, but there is a rightful concern that more should have been done. Finally, following the United States' goal Canada's compulsory licensing was repealed.

Virginia Postrel (The New York Times, January 27, 2005) made a good point by reminding us that benefits from free trade reveals itself gradually over a longer period of time. We intuitively understand that lowering tariffs will at first hammer highly protected industries. However, Canada is good example of the initial downslope, which ten years later transformed itself into the employment gains in the manufacturing sector and annual earnings growth. Most importantly, NAFTA did not cause loss of jobs. Additionally, productivity gains were huge because of NAFTA; in the case of Canada they jumped by more than 15 percent. (Interestingly, is the estimated that half of those gains came from closing inefficient plants.)

In spite of the positive tendency, NAFTA at the same time has a lot of room to improve. At the Cancun round of the World Trade Organization Mexico brought to international attention that the United States is still keeping its tariffs high, especially in agriculture, textiles and apparel industries (The Washington Post. September 16, 2003).

Those tariffs are causing overproduction, dumping on the global market, and damage to the farmers in developing countries. As a result of NAFTA, developing countries have expressed openly their resistance to exposing their industries to international competition any further.

NAFTA will soon celebrate its twentieth anniversary, and on that occasion we have every reason to expect a lot of new material on its performance. For now, based on the information we have and if we acknowledge the limitations which this kind of assessment inherently carries within itself, it is fair to say that NAFTA met most of the goals its creators initially had. “Despite the enormous challenges posed by Mexico’s economic difficulties, NAFTA is functioning.” (Clement et al.: 285; Weinstein: 347).

#### **4. How can NAFTA be explained?**

Each of the NAFTA-member countries had its goals to enter the free trade agreement, and the agreement to a certain extent met those goals. Still, that does not answer the question why the United States, Canada, and Mexico chose free trade as the preferred tool of statecraft. The results themselves are not persuasive enough to remove all doubts about this policy choice. In this chapter I will run the three NAFTA-member countries through several hypothetical “what-if” scenarios of different policy options. My expectation is to get a result which would show that free trade, even if it is not incredibly efficient tool of statecraft, it is still the best statecraft technique we know of at this point of our evolution.

A definition of statecraft states that it “embraces all the activities by which statesmen strive to protect cherished values and to attain desired objectives vis-à-vis other nations” (Sprout: 135). K.J. Holsti offers a similar definition, only he allows for non-state actors to take part in statecraft as well (Holsti: 239). Statecraft consists of conducting domestic and, for this discussion more important, foreign policy. Due to the limited resources and restless human nature, states, or any kind of human community for that matter, have always been looking outside of their borders for solutions to their problems and hence the need for foreign policy.

Harold Lasswell recognized four techniques of statecraft, or for our purposes foreign affairs: propaganda, diplomacy, economic statecraft and military statecraft (Lasswell: 1936). Later he rephrased the techniques as words, deals, goods, and weapons (Lasswell, 1945: 205). There are also other categorizations of statecraft techniques such as Morgenthau's oversimplified division of *war* and *diplomacy* (Morgenthau, 1964) or Hermann's eight different, often overlapping, techniques of statecraft (Hermann: 159-161), none of which I find adequate for the analysis. Nonetheless, the question is had the NAFTA-members used techniques other than economic statecraft in order to achieve their goals, would they achieved same or better results?

The United States, Canada, and Mexico wanted to achieve certain set of foreign policy goals through NAFTA, some of which were common to all three and some which were country specific. The common goals were to expand markets, the political and economic stability of Mexico, to correct inadequacies of CUFTA, and to counterbalance the EU and other trade and economic agreements around the world. For now, let's focus on these motives, since they are also the most important ones. At zero level of analysis let's assume that the Unites States, Canada and Mexico decided to refrain from any kind of international agreement, do nothing in terms of foreign policy, and follow the ancient Greece's ideal of state self-sufficiency. Economic self-sufficiency is an alternate economic statecraft strategy in opposition to free trade agreements. Which of the above listed goals could they expect to achieve? Increase in trade could not have been achieved, because the theory is too archaic to recognize the benefits that come from the economies of scale. Canada and Mexico would face severe economic downslope due to their heavy

dependency on trade with the United States. Mexico would struggle with its political stability and could easily slip into another seventy years of single-party regime dominance or even dictatorship. The agreement such as CUFTA would not make sense a more. Similarly, self-reliance would not be any relevant response in face of the increasing number of international trade agreements. If this policy was to be introduced unilaterally, the biggest chances of relative success would have the United States since it has the most diverse resource base out of all three countries. Binary, if we have only pass (1) or fail (0) to assess the overall success of a political method in face of the preset goals, self-sufficiency would be assessed like:

The United States 0

Canada 0

Mexico 0

The second proof by contradiction is propaganda. Propaganda is the softest of the statecraft techniques and its power is subtle. It is fairly cheap tool usually used as an integral part of other three statecraft techniques. By itself it was successfully used during the Russian communist revolution as a domestic policy tool to indoctrinate and inform. The power of propaganda can be traced to Lasswell's observation that how we identify ourselves changes through time (Lasswell: 282). Propaganda, which by definition means deliberate manipulation of verbal symbols, does precisely that - over time it changes the common perception of identity or an idea. In terms of discussion on NAFTA this means that, hypothetically, the three parties involved could have proclaimed one national body that the United States, Canada, and Mexico are creating from now on. It could be compared to the strategy of China's Cultural Revolution, which, whether we like it or not, is reaching its goal of changing China's traditional culture and promoting socialism.

Likewise, the mantra of one nation will incrementally become a part of people's subconscious and identity. However, in case of North America we are dealing with not one, but three democratic countries and such radical change of national perception is difficult to imagine. Propaganda could perhaps have some more success with the side motives of environmental concern or intellectual property. But even so, soft as it is, propaganda would take a lot of time deliver those results. Also, if the United States could not negotiate removal of Canadian compulsory licensing under CUFTA, it is hard to believe that propaganda would give better results. Therefore, efficiency assessment of propaganda as the only technique of statecraft in achieving goals set for NAFTA is:

The United States 0

Canada 0

Mexico 0

The third option is to assume that the conflict and warfare would be the best techniques of statecraft to deliver goals of market expansion, regional stability, and all other goods that supposedly come with increased power. It is the most radical and arguably the most expensive tool of statecraft. Prevalent in the realist school of political thought, war is also the ultimate technique of statecraft. It is perceived that war will increase the power, or the power of the winner at least, and power is the only thing statesmen should care about. That being said, as much as, for example, Machiavelli appreciated an energetic foreign policy, he would still advised Canada and Mexico to stay out of an armed conflict with much more powerful United States. The reason is in that they could not possibly win the war against the Unites States, only jeopardize the power they have and their core state-interest.

On the other hand, following the same logic the United States could have invaded Canada and Mexico. After all, international relations are a state of war as Thomas Hobbes teaches us. The United States had the power supremacy in every aspect of statecraft (military, financially, technologically) over both countries. Once the United States won, it would have absolute rule over the resources on the conquered territory. No energy or resources would have to be spent on diplomacy and exhausting negotiations, allowing the US statesmen to, like good realists, get a chance and focus on acquiring more power. However, by engaging in war with its neighbors the United States would also have to face certain losses, most of all economically. The war itself is an expensive affair, but that is not even the worst part. Direct costs can be easily compensated with the newly acquired territory, but what is more worrying is that the war would severely jeopardize the United States' trade in new technologies and services, types of trade that dominant in all highly sophisticated and well developed countries.

The United States, as any developed country, makes most of its profit through trade in new technologies and services, so if its two formally biggest trading partners get devastated in the war, the United States will face an economic downturn. Furthermore, in this scenario it is very likely that the rest of the world will turn its back to the United States. Since World War II we have not seen any major armed conflicts, because the weapons became more destructive and the human rights became valued more than ever before. The world would stand united against the United States imposing sanctions and other forms of trade barriers in order to exhaust the United States. Facing severe



economic costs it is very likely that the United States would in the long run get out of the war with less power than it had before.

Under the warfare statecraft the United States would reach a larger market and economies of scale, but would probably lose trading partners around the world. The issues with CUFTA would be removed and the aggregated power vis-à-vis the increasing number of international trade agreements. In the warfare statecraft the United States would reach most of its goals, while Canada and Mexico would not reach any. However, almost twenty years after the war, the same age NAFTA is in right now, the United States would be financially exhausted and without most of its initial power. Binary result would look like this:

The United States: 1	Canada: 0	Mexico: 0
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Even the prominent realists, such as Thomas Hobbes, have noticed that actors might enter some form of a covenant, commonwealth or social agreement. According to Hobbes, states would do that out of selfish reasons to protect their existence and enhance their power to fight other states, even if it means giving up some of their independence. That is a sound ground for treaty such as NAFTA and brings us to the fourth technique of statecraft diplomacy.

We need to understand here that division of statecraft techniques is not clear cut. The techniques of statecraft are often used simultaneously, and so the economic statecraft or warfare statecraft uses a lot of diplomacy and propaganda. However, it is useful to

think how Lasswell rephrased diplomacy as deals and economic statecraft as goods. In terms of the common foreign policy goals that the United States, Canada and Mexico state for themselves, it is fair to say that with diplomacy the stability in the region can be achieved. The question here is what would motivate those countries to make an effort towards stabilization. To this day there is no theory in international relations that explains why a state would act like a good Samaritan. The League of Nations was a diplomatic agreement conceived on good intentions, but failed for the lack of efficiency and realistic incentives.

When we talk about regional stability, we are talking about Mexico. Without any tangible incentive, such as market expansion, why would the United States bother to help Mexico? We can hope for a high level of social awareness in the participating states, but it is a hope. Luckily, market expansion is indeed one of the motives stated by all three states and the one closely related to political stability. The economic benefit that arises out is a great incentive for countries to get engaged in reaching regional stability. So the countries will enter diplomatic talks and most likely they would reach some sort of deals. They would also appear united and stronger in face of the world, thus meeting the third common motive of counterbalancing EU and other international agreements around the globe. Likewise, changes or annulation of CUFTA can be easily reached through diplomatic deals. Finally, with market growth and increased trade the living standard in Mexico would increase, thus reducing or perhaps even completely removing the problem of illegal immigrations.

The problem is, however, that countries will engage in diplomatic activity for the sake of market expansion, but how will that market expansion be carried out? What kind of conditioning could be there among the United States, Canada, and Mexico that would produce mutual benefits? Market expansion, or phrased differently trade, is no longer diplomacy, it is an issue in economic statecraft. Could perhaps security be a good motive for diplomatic agreement? It may sound like racketeering, but the United States can offer protection to Mexico and Canada in exchange for market access. Backed up by the powerful United States, Canada and especially Mexico would attract new trading partners and investors thus making their economies stronger, while the United States would increase its access to new markets, and therefore, all motives under NAFTA would be met. Still, the question is protection from what? And after the horrible events of 9/11 it is the United States who has looked for greater protection.

Diplomacy has a potential of being a low-cost tool of statecraft, but without a realistic incentive it lacks credibility. Its efficiency in reaching goals stated by the United States, Canada, and Mexico is highly questionable. And again, if the removal of the compulsory licensing couldn't be coerced during the CUFTA negotiations, what could make us think that the diplomacy would reached by itself? Therefore the efficiency of diplomatic statecraft in reaching the goals of the United States, Canada and Mexico is assessed as:

The United States 0

Canada 0

Mexico 0

Finally, there is economic statecraft as a foreign policy tool. The idea of economy as means of foreign policy is not new. In the ancient Greece and Rome we find that the difference in natural conditions makes nations trade among themselves (Viner: 100). In the fifteenth century Niccolo Machiavelli, whose take on statecraft was dominantly focused on brute force, noticed that governing is under the strong influence of the economy (Ch. 16). Earlier in this thesis, I mentioned Adam Smith and David Ricardo who offered sound economic reasoning for international trade and tariffs, but it was Richard Cobden who was the first to use economics to create a political theory. Cobden reasoning was that low tariffs will lower price, and low price will increase the demand. The demand would then increase international trade. This sequence will result in a higher standard of living for the citizens of all nations and considerably reduce the chances of warfare. Cobden was, of course, an idealist. Still, even though Cobden forgets that the resources are limited and actors can be somewhat scared and greedy, the idea of tariffs as a tool of positive foreign policy was revolutionary. In today's world economy is by far the most common technique of foreign policy and very efficient one as well.

Economic foreign policy can affect the behavior of actors in a number of ways. According to Baldwin, economic statecraft has a potential of weakening or strengthening the leadership of another state (US-Cuba in 1962), changing domestic or foreign policies of another state (UN-Libya in 1992), changing the political system (UN-Serbia in 1992), promoting particular ideology (US-Yugoslavia in 1956), acquiring and maintaining allies (US-Armenia in 2002), or weakening or strengthening alliances of another state (Arab countries-Japan 1955). It can also be used to prevent war or the use of violence in another

country, change the economic growth of another state, change the economic system in another country, deny another state access to goods and services, and acquire access to goods and services of another state (Baldwin, 1985: 40). This impressive list proves how powerful tool of statecraft economy really is. Baldwin also says that the problem of the economic statecraft is that it is hard to verify its efficiency (Baldwin, 1985: 58) - but then again, that is the problem of every statecraft technique, only perhaps to lesser extent in case of brute force of war.

To achieve their goals through economic statecraft the United States, Canada and Mexico had a number of options at their disposal: embargo, boycott, tariffs, blacklisting, quotas, license denying/approval, dumping, preclusive buying, direct purchase and others. In the first scenario which I will explore the three countries choose negative sanctions in order to achieve their goals, and not positive sanctions. Negative sanctions by definition cannot increase trade, at least not among the nations targeted by the sanctions. Perhaps the trade would be redirected to a country outside of North America and due to that the overall trade could potentially increase, but there is a reason why, for example, the United States specifically wanted an access to Mexican oil – because it is close which keeps transportation costs low. Employment, on the other hand, might have done better had the negative sanctions been placed instead of NAFTA. This is especially true in case of the United States, because it had good manufacturing base, and perhaps not so much in case of Mexico who was in that respect dependent on its northern neighbor and its investment.

For the same reason, Canadian heavy trade dependency on the United States is likely to reflect negatively in case of disruptions of exports and imports. With increased barriers political stability across the border would no longer be of any interest to any of the parties. With inward politics intellectual property rights would be harder to reach. Environmental problems would not directly be addressed; perhaps lower trade ratios would result in lower industrial activity in critical areas of Mexico, which would then result in lower pollution. Since the statesmen hardly ever impose sanctions solely to influence the behavior of foreigners (Baldwin, 1985: 48), the political stability in Mexico becomes totally irrelevant goal when there is no trade involved. Finally, sum total for the use of negative sanctions is:

The United States	1	Canada	0	Mexico	0
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Negative sanctions and other forms of coercion are usually closely linked to mercantilism which is based on the premise of economic policy in strictly nationalistic service. Mercantilism places great emphasis on exports and defines trade exclusively in terms of power. Yet mercantilism is not a type of economic statecraft, only a doctrine which uses economics as an instrument (Baldwin: 73). Due to its greedy and selfish nature and the idea that trade must be a positive sum game, mercantilist doctrine is often condemned as the prime source of war. In sharp contrast with mercantilism stands economic liberalism which is no seen to promote peace. It is also closely linked to use of positive sanctions and cooperation.

NAFTA in fact is an excellent example of positive economic sanctions or the economic statecraft of cooperation. It is a scenario whose results have been discussed in the previous chapter. Most of the goals set were reached in all three countries, in other words

The United States 1

Canada 1

Mexico 1

At this point all of the statecraft techniques have been examined. When evaluating the utility of any of the statecraft techniques it is critical to discuss them in terms of alternative policy options (Baldwin, 1985: 226). In Table 2 I have created the matrix of simple binary assessment results. Based on that, data cooperative economic statecraft is the most effective of all statecraft techniques for achieving goals that before NAFTA. Since the North American Trade Agreement is based on trilateral voluntary tariff reduction, it is a form of cooperative economic statecraft and as it was the right choice of the policy makers in the United States, Canada and Mexico.

Table 2, Statecraft Efficiency Matrix			
	The United States	Canada	Mexico
Self sufficiency	0	0	0
Propaganda	0	0	0
Warfare statecraft	1	0	0
Diplomacy	0	0	0
Economic statecraft of conflict	1	0	0
Economic statecraft of cooperation	1	1	1

Two things have to be stated here: a) some of the alternative statecraft techniques would be more beneficial to only one of the parties involved, especially in reaching side motives such as intellectual property rights, and b) NAFTA did not benefit all the

participating countries to the same extent. When it comes to alternative techniques that are beneficial to only one of the states, only the technique that satisfies all parties involved stands a good chance of surviving in the long run. Every other scenario creates imbalance and leads to conflict. The country that made the most out of NAFTA was Mexico which experienced increased trade, employment, and foreign investment increase, achieved greater political stability, better protection of intellectual property rights, and brought greater awareness and transparency to the environmental issues. Since 1994 Canada did not feel any great oscillations in employment, foreign investment in Canada slightly decreased, but its investment and presence in foreign markets increased, making the Canadian case somewhat neutral. Finally, the United States experienced slight trade increase, received better protection of intellectual property rights, and better quality of jobs, but the quantity of jobs has decreased and the external debt increased. To debt increase NAFTA was only one out of several causes, but the fact is that Mexico's market did not fully meet the expectations. So it can be stated that the United States lost with NAFTA, but we need to keep in mind that it is US trade and credit policy that makes it role of world's greatest buyer possible.

Of course, the discussion of NAFTA through the prism of alternative statecraft techniques was highly hypothetical. However, in the real life statesmen need to employ a reasonable amount of imagination in order to assess alternatives. As stated at the beginning of the third chapter, there are no laboratory conditions that could control or recreate the exact set of conditions for a certain action, but we need to use reasoning and



rely on the greatest probability. Nonetheless, it is important for a statesman is to consider alternative policy options.

Free trade is not absolutely the best statecraft tool. The choice of free trade as a preferred tool of statecraft depends on policy goals and even then it may hurt some actors in some aspects. The paradox of the free trade is that, if utilized to its full extent, it annihilates the very existence of economic statecraft. Without any trade barriers, international trade becomes similar to domestic trade and it loses any power to reach foreign policy goals. Still, for the actors that are using free trade it harmonizes their interests and the end result proves to be mutually advantageous.

With the constraints that political science has in that it cannot be conducted under laboratory conditions, that the observed results are influenced by great number of variables, and that the relations among variables changes, the controversy around NAFTA is not that surprising. Yet, that the evaluation of trade agreements is to great extent based upon estimation and probability has not been stated that often in the literature. In that sense, this kind of discussion that presents NAFTA in relative, not absolute, terms can be very helpful.

It also needs to be said that global capitalism with free trade as its main tool is facing problems. As mentioned before, what happens after all trade barriers get stripped? And secondly, capitalism should not be discussed only through developed countries, but also the countries like Congo. That country does not work, it is a hell on Earth and yet it

is a part of international capitalism. The same could be argued for some Latin American countries in second half of 20<sup>th</sup> century. As the established Slovenian philosopher Slavoj Zizek points out, what kind of a global capitalistic dynamic treats some countries like we treat Congo? (<http://www.nacional.hr/clanak/120869/zizek-sjedinjene-drzave-europe>).

This is not to say that Lenin was right by stating that imperialism was the final stage of capitalism, but in order for us to have a full scale benefit from free trade we would need to change the system under which it operates and avoid situations like the Congo.

NAFTA, in spite of its success, cannot be copied or replicated to other countries, because the system in which the free trade operates is in itself not necessarily replicable and it clearly faces its limits. A new, perhaps technocratic, form of governance is necessary. It would have to account for the values of compassion, welfare, justice and security and it would allow for the free trade to be used in all its capacity in order to create universal democracy.

## **5. Conclusion**

Since the academic work that was done on North American Free Trade Agreement offers ambiguous picture of its success, I tried to assess NAFTA by comparing it to the alternative forms of statecraft. What I found was that NAFTA, or better yet free trade, was indeed the best policy choice in the context of preset goals, point in history, and its alternatives. However, that does not mean that free trade absolutely the best policy method, but merely that is less evil than the rest of options.

In the first part I tried to understand what motivated statesmen of the United States, Canada, and Mexico to consider forming a free trade treaty. The most important to take from this part is to note that there was not one, but multiple motives that each of the states had to enter the agreement. Also very important is to note that even though states hardly ever engage in economic statecraft without self-interest, most motives these three countries had were common motives. This means that free trade helps countries harmonize their interests, which then stands in support of the free trade as peace promoter.

In the second part I examined what the literature says about NAFTA outcomes. As stated before, the outcomes were very ambiguous and there are some objective reasons for that. It is the nature of political science and even economics that do not allow

for examining one information, or one signal, irrespectively of whole bunch of variables, or very complex network. In that kind of environment the results have very interpretative character, making the scientist rely on probability. That being said, the main objection to all literature on NAFTA is that the lot of it presents the results as ultimate truth, forgetting to remind the reader that the assessment cannot be operated in laboratory conditions.

Generally speaking the results of NAFTA in terms of presented goals were positive. The impact of NAFTA was different on each of the member-states. Mexico as the least developed country to enter NAFTA had the most to gain and so it did. We may argue whether NAFTA was the only cause to its progress, but it definitely was the major one. Trade, employment, foreign investment, environmental standards all improved under NAFTA. Most importantly, after decades of struggle Mexico finally managed to become a stable economic and political factor on the international scene. Canada did not experience some great oscillations under NAFTA, most of all because it had trade agreement with the United States in place even before NAFTA. The greatest benefit that came from NAFTA was greater presence of Canada in foreign markets. Lastly, the United States could have gone without NAFTA, because direct benefit from it was modest. But when we look at the goals that the United States had for NAFTA, we will realize that those are not directly targeted at domestic market. The United States American once again took the role of world's creditor in order to create buyers. That being said, if the results of NAFTA were arguably positive, then at least they did not have negative impact.

Motivated by such arbitrary results I have decided to take a different approach in assessing NAFTA. In the third part I used the information on motives and compared them to the alternative statecraft tools at hand. It was the proof by conflict, where I actually argued why not to use any other statecraft technique other than economic. I used binary “true or false” method of assessment, because if the choices are limited, the result becomes obvious. For sure, multiple factors and enterprise conditions have to be discussed since NAFTA in different sectors had different success, but the sum total for particular technique has to be either “pass” or “fail”. The results have shown that some statecraft techniques may be beneficial to one state, but not the other. The only technique available that ensured realization of most motives in all of the member-countries was cooperative economic statecraft. By that measure, NAFTA is the best option or the least bad option.

That does not mean that NAFTA or free trade in general is the best technique of statecraft by absolute standards. The choice of technique depends, most of all, on goals. Secondly, context, both historical and geographical, plays an important role. But most of all, on a more broad discussion, I am concerned with the context of political system under which free trade is run. Although very powerful, free trade is reaching its limit under global capitalism and if we want this tool to reach its full potential, premises of political philosophy will have to find a way to tangibly account for causality that comes from compassion, welfare and justice. With the new technologies the world is increasingly becoming smaller, so it may be that the new big idea is, in fact, technocratic governing

with free trade as means for overcoming national interests. It might be that this binary discussion is a small step in that direction.

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