

The Political-Economy of Trade Policy: North American Free Trade Agreement (NAFTA)

By Sheldon Neil Birkett
3rd-Year Bachelor of Global and International
Studies Specialization in Global Politics

Relevance of NAFTA's Trilateral Trade Relationship

- NAFTA is responsible for USD \$1 trillion in total trilateral merchandise trade.
- North American trade represents 28 percent of the world's gross domestic product (GDP).
- NAFTA was the first free trade agreement (FTA) involving two developed countries and one developing country.
- The total effect of NAFTA, although hard to precisely measure, is estimated to be 0.1 to 0.5 percent increase in the United States' GDP.

Approach Taken in Research Essay

- Research Question:

“What are the domestic and international factors that have resulted in the United States' decision to renegotiate the North American Free Trade Agreement?”

- Analytically outlines the factors behind a state's decision to enter a bilateral free trade agreement (FTA) or regional free trade agreement (RFTA).
- Takes an analytical approach, by identifying the factors that persuade a state to enter a free trade agreement, in order to isolate the potential factors that would cause a state to exit (or renegotiate) a free trade agreement (FTA).

Global Governance of Trade Policy in the 21st Century

- Challenges to global trade policy since 1947 have built resilience within the international trade regime, which have developed more “comprehensive” free trade agreements within the existing World Trade Organization (GATT/WTO) framework.
- World Trade governance is characterized by the “reciprocal exchange of material access concessions,” balancing the demands between import-competing industries and export producing industries.
- Over the past 70 years of global trade governance there has been an “issue widening” of FTAs from mere tariff reduction policies to comprehensive economic partnerships that include monetary, labour, and social policy harmonization. As well, FTAs have been critical to garnering international cooperation and alliance formation.
- With the “issue widening” of FTAs, trade negotiators' main concern should not be “how do we maximize trade and market access?” but rather “how do we enable countries to develop by means of trade liberalization?”

Part I: NAFTA's “Second Image” – Domestic Constraints

The 2017 NAFTA renegotiations are the result of United States' domestic opposition rooted in “a modern populism” that defends America against globalization.

The probability of entering into a FTA is dependent on the range of policy options at the domestic level which constrains the range of policy options at the international level of trade negotiations (Putnam, 1988).

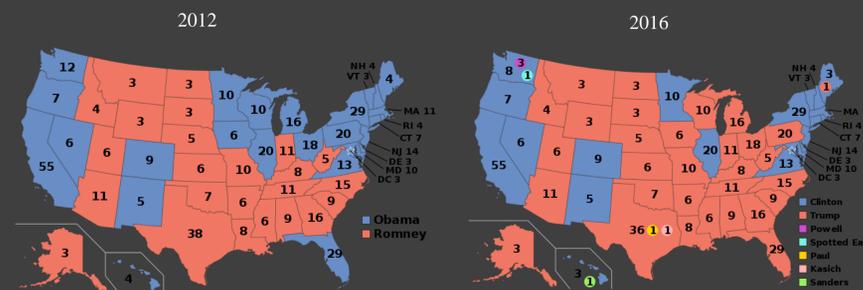
• Voter Perception

- Voters that have lower educational attainment levels are more likely to resist free trade agreements because they have experienced a lower wage growth rate.
- Negative public perception of NAFTA has not reflected the economic reality in the United States.
- Negative economic anxieties generated by voter perception of FTAs does not determine a population's political orientation.

• Income Distribution Effects and Populism

- In the literature Rodrik, Rogowski, and Samuelson have consistently found that international trade has direct effects on income distribution and formation of domestic political cleavages. As seen in the historic downward trend in labour's share of income relative to capital share of income, among G20 nations, which shows that labour is more likely to be adversely affected by FTAs.
 - In Canada and the United States industries abundant in labour have seen a modest decline in wages since the implementation of NAFTA.
 - In Mexico there has not been a substantial increase in wages for low-skilled workers since the implementation of NAFTA.
- NAFTA's acute negative economic implication on labourers' wages has been generalized to fuel anti-trade political rhetoric, which has negatively altered voters' perceptions of FTAs in the United States.

Figure 1 & 2: US Electoral College Map 2012 and 2016 Comparison



Images showing changes in the United States' domestic political affiliations between 2012 and 2016 presidential elections.

Source: Wikimedia Commons. (2016). File: Electoral College 2012 & 2016. Wikimedia Commons. Retrieved from <https://commons.wikimedia.org/wiki/>

Part II: NAFTA's “Second Image Reversed” – International Constraints

Increased trade through NAFTA has resulted in greater economic interdependence while at the same time constraining the freedom of government action in trade policy. For instance, total merchandise trade between Canada and the United States doubled between 1993 and 2015 while domestic deliberation on NAFTA was minimal.

• Institutional Structure

- Centralization of trade liberalization decision-making in the United States' executive branch has alienated domestic interests in FTA negotiations.

Article 1 Section 8 of the United States' Constitution:

“The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States”

Source: National Constitution Center. (2018). Constitution of the United States, *The National Constitution Center*. Retrieved from <https://www.constitutioncenter.org/interactive-constitution/articles/article-1>.

Trade legislation in the United States has historically elevated global concerns over domestic concerns through the “fast-track” process in negotiating FTAs since 1947. This was outlined in Article 1 Section 8 of the American legislative statute which allowed congress to transfer its regulatory powers of foreign commerce to the executive branch.

“It is important not only to look at the domestic factors but the international factors as well, because a state's 'domestic structure is derived from the 'exigencies' in the international system itself.'” (Gourevitch, 1978).

• Domestic Political Support & Changes in Political Affiliation

- The 2016 presidential election has brought dramatic changes to the United States domestic political affiliations (see figure 1 & 2).
 - Changes in domestic political affiliations is representative of a populist reaction against increasing globalization.
- Reductions in tariffs for a minority of workers, as a result of NAFTA, are associated with a reduction in wages for a locality's blue collar workers.
 - Two-factor Stolper-Samuelson trade model supports the finding that losses incurred by the adversely affected group are higher after a tariff barrier is removed, as measured in per dollar efficiency gain.
- Free trade has the potential to alter a country's domestic political landscape through income distribution effects.
 - FTAs reduce the well-being of individuals employed in the relatively scarce factors of production (i.e. labour, capital, land), which are using those factors less intensively in production, in exchange for greater economies of scale.
- FTAs can be characterized by “complex interdependence” when a state gives up domestic trade protection in exchange for diplomatic relations.

Strategic Trade Policy

NAFTA was created as a geopolitical economic bloc in response to growth in exports from Asia's newly industrializing countries (NICs) and the European Economic Community (EEC).

“NAFTA can be regarded as an attempt to deal with the external constraints that are undermining its [the United States] economic and political clout” (Deblock & Rioux, 1993).

- In response to the United States' historic decline in exports (see figure 3) NAFTA was created as a strategic economic bloc to gain economic power for a political end.
- NAFTA allowed the United States to use trade policy instruments to mitigate predatory trade policies from other regional economic blocs.
- NAFTA can be viewed as a reactionary foreign policy objective as an effort to derive global comparative advantage to substantiate the United States' strategic position in future trade negotiations.

Figure 3: United States' Declining Trade Balance 1962-2016



Red line are US Imports. Blue line are US Exports. Measured in 2016 USD Billions (B)/Trillions (T).

Source: Observatory of Economic Complexity. (2016). What is the trade balance of the United States? *The Observatory of Economic Complexity*. Retrieved from <https://atlas.mccba.mtl.edu/en/visualize/line-site/show-usa/all/1962-2016>.

Summary of Key Findings From Research Essay

- The United States' decision to renegotiate NAFTA was the result of a combination of domestic and international factors.
- The United States' decision to renegotiate NAFTA cannot be explained by a single mono-causal factor.
- International Factors:
 - Regime change.
 - Centralization of state power in international trade agreements.
 - A country's relative terms of trade as a measure of a state's competitive economic dominance.
- Domestic Factors:
 - A state's internal institutional structure.
 - Income distribution.
 - Political cleavages.
 - Voter perception.

Part III: Conclusion and Take-Away

- The United States' renegotiation of NAFTA is a challenge to the traditional “trade promoting” role the United States has played since 1945.
- Factors that led to the NAFTA negotiations present an interdependence of constraints on each actor involved.
- A multi-factor approach that identifies explicit and implicit challenges towards FTAs is only a starting point in identifying potential solutions to problems in global trade governance.