Forum: Economic and Social Council

Issue: Question of a United States-Mexico-Canada Free Trade Agreement

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Introduction

As economists witnessed the ramifications of extra-high tariffs on the US economy since the Great Depression, many saw free trade as the alternative for stimulating economic growth. In pursuit of trade liberalization, the United States of America implemented multiple free trade agreements over the past century. In the 1980s, as a response to protectionism and isolationism, President Ronald Reagan proposed the North American Free Trade Agreement (NAFTA) with Canada and Mexico. The NAFTA was an accord intended to eliminate tariffs and promote free trade between the US, Canada, and Mexico. By January 1994, the trilateral trade pact came into effect. Over the recent 20 years, NAFTA more than quadrupled trade, led to a price reduction in food products, and contributed to the economies of all three countries through increasing economic production and creating new jobs in the manufacturing sector.

While the agreement boosted economic activity and production in its respective countries, the net economic impact is merely considered to be modestly beneficial on the U.S. Gross Domestic Product (GDP). As a result of NAFTA, instability rose in the labor market. In search of low import prices and set wages, corporations from the U.S. diverted to Mexico for sourcing and manufacturing. In the circumstance where the U.S. and Mexico are both able to produce quality products of the same category, with examples including the shoe and automotive industry, the US, with comparatively expensive labor, became severely uncompetitive. During former President Barack Obama's campaign, he promised to amend the NAFTA to fix its shortcomings in areas such as corporate rights and agriculture. Recently, US politicians have harshly criticized the deal, now awaiting ratification for a renegotiated United States-Mexico-Canada Free Trade Agreement (USMCA). President Donald Trump intends to amend all areas of NAFTA through the USMCA, by supporting U.S. export growth, enforcing regulations protecting the U.S. workers, while continuously endorsing the USMCA trade bloc.

Definition of Key Terms

Free Trade

Free trade is a trade policy that minimizes barriers to imports and exports between countries. Free trade agreements introduced international trade without restrictions such as tariffs and quotas. Historically, free trade has

been primarily adopted by economically liberal governments, with advantages including increasing accessibility to foreign products and furthering international relations.

Tariffs

Tariffs are a form of taxation, specifically taxes on trade imports and exports collected at customs. This form of fiscal policy is a method for sovereign states to tax foreign commodities. Often used as a protectionist measure, tariffs protect the domestic industry from external competition. Protectionism, the practice of imposing tariffs to protect local industries, is an alternative to free trade. Throughout the history of international trade, many countries have imposed tariffs to support national income.

The North American Free Trade Agreement (NAFTA)

The NAFTA is a trilateral free trade agreement signed by the United States, Mexico, and Canada. Since its founding in 1994, the deal served to provide the basis for regulations and transactions between these three parties. The agreement had initially been negotiated to expand exports and create new jobs, acting as a driving force for globalization in trade. The deal promoted geopolitical relationships and commerce between the countries. Critics claim that the NAFTA is an ineffective agreement which led to evident trade deficits, job losses, and illegal immigration. The Trump Administration has renegotiated NAFTA to form the United States-Mexico-Canada Agreement, which has been planned for implementation in 2020.

The United States-Mexico-Canada Agreement (USMCA)

The USMCA is a renegotiation of the aforementioned NAFTA, initiated in 2017 and drafted in 2018. President Trump had promised to sign this agreement in his presidential campaign to revamp the NAFTA and address undesired economic effects the previous deal had on the US economy. Significant amendments the USMCA aims to enforce include country of origin rules, labor provisions, intellectual property extensions, and an added sunset clause. The agreement aims to foster reciprocity in trade and increase stability in labor markets. The deal has not been ratified by the US congress yet.

Intellectual Property Regulations

Intellectual property (IP) regulations are laws for intangible human creations. Examples of IP regulations include copyrights, patents, trademarks, and trade secrets. In the context of a United States-Mexico-Canada free trade agreement, NAFTA was the first trade treaty to establish standards for protecting intellectual property rights. NAFTA provides penalties for violation of IP rights in chapter 17. The new USMCA extends the terms of copyright and period for a pharmaceutical drug to be protected from the generic competition while enacting provisions with digital intellectual properties.

Comparative Advantage

Comparative advantage is a concept which suggests countries possess varying capabilities, efficiency, and resources in production, hence suggesting how both producers will benefit from a situation where both parties utilize

their advantage in exports and exchange. The concept advantage is the basis of free trade agreements, where countries achieve reciprocity without restrictions. However, in some industries, states may be equally capable, leading to unwanted competition within trade blocs.

Background

Throughout history, politicians and economists have disputed implementation regarding free trade and protectionist policies. Since the United States' first free trade deal, the Israel-United States Free Trade Agreement in 1985, the U.S. has initiated negotiations on multiple trade deals. Between 1994 and 2019, the NAFTA deal had various worrying economic drawbacks which critically disrupted the labor market. The treaty's benefit towards the USMCA trade zone was insufficient, resulting in major conflicts of interests, particularly in the United States. As countries of the NAFTA free trade zone become more opened to free trade policies, the primary issue would be to resolve these conflicts of interest that hinder the equitability and ethicality of trade promoted by the USMCA agreement.

Effects of the NAFTA

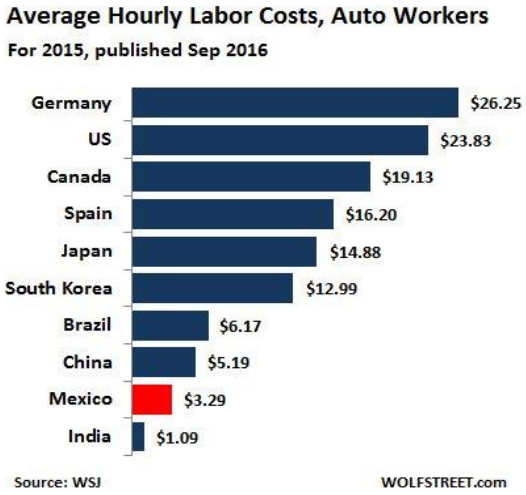
The automotive industry

The NAFTA transformed the North American automotive industry. The free trade policies successfully guaranteed inexpensive sourcing and selling of these car products. Through eliminating tariffs, domestic automotive industries could invest in either of the three countries within the trade zone for free trade. Consequently, due to the significant wage difference between Mexico and the other countries, investors focused on Mexico, which had a workforce that is willing to receive lower wages in comparison with the US.

Unemployment

Unemployment has been deemed the most precarious disadvantage of a United States-Mexico-Canada Agreement. As seen in figure 1, there is a massive gap between average hourly labor costs for the US and Mexico, with $26.25 for the US, and only $3.29 for Mexico. The wage gap is a notable cause of the NAFTA-induced unemployment in some US states. Statistics show that the US underwent A loss of up to 600,000 jobs as a result of NAFTA. Ultimately, it is the US manufacturing sector, which has been burdened by competition from NAFTA. The manufacturing industry, including the automotive industry, accounts for 60.8% of the total number. Manufacturing-heavy states such as Michigan and Kentucky have experienced

the most job loss. In the US auto industry alone, more than 30% of the auto manufacturing jobs disappeared



since 1994, whereas Mexico auto jobs thrived.

Figure 1, showing differences in average hourly labor costs for auto workers, a significant wage gap between the NAFTA nations.

Cost in the automotive industry

NAFTA effectively controlled the car prices, such that if at least 62.5% of a car's components were made from North America, it would qualify as a NAFTA product and hence be tariff-free. A 2.5% tariff would be imposed on vehicles that infringe upon the set percentage. The agreement allowed NAFTA countries to source automotive components with low cost, ensuring affordability and stability of automobile prices. While automotive products became more affordable, the NAFTA resulted in low wages to the workers and unhealthy foreign competition due to the absence of clear-cut policies protecting local businesses. Should the trade zone impose the new USMCA, and manufacturers will be liable for paying higher tariffs as a result of a more rigid set of qualification prerequisites for production. Factory managers will either be obliged to paying more wages to employees or alter their sourcing of supplies, as tariffs could be imposed on products that used some components from non-USMCA states.

The agricultural and manufacturing industry

A notable industry impacted by NAFTA is the agricultural sector. The NAFTA negotiation for the agricultural industry has been controversial as it is the only section of the agreement that did not undergo trilateral negotiation. Alternatively, three separate treaties were signed to satisfy the needs of all three parties. The Canada-U.S. agreement-imposed tariff quotas on products of the agricultural sector, including sugar and poultry. The U.S. is the world's greatest agricultural exporter, which thus was an obstacle for Mexico and Canada to compete. For example, the efficiency of the Mexico-U.S. agreement has been constantly debated, as Mexico had limited agricultural infrastructure to contend with US exports.

Another industry under NAFTA's influence is the manufacturing industry. The NAFTA aided the maquiladora program, by which U.S. companies at the South run Mexican factories employing Mexican

workers. The program provided limited workers' rights, which is an attribute of the USMCA the Democrats are arguing for.

Other effects of the NAFTA

There are several other effects the NAFTA had on the North American economy, including socioeconomic and environmental factors ranging from trade deficits, effects on labor, and environmental impact.

Socioeconomic

The reason behind the unemployment in the automotive industry is the trade deficits cumulated as a result of the NAFTA. While the free trade deal eliminates barriers for the US to receive diverse and cheap imports, the US exports are relatively expensive and exported less in consumer goods. The principal drivers of the deficit are automobiles and consumer products, of which the US imported $648 billion on consumer goods while only exporting $206 billion. Trade deficits in these areas boosted foreign industries from trading partners and hence led to debt, as well as a loss of competitiveness in a cross-border transaction. When industries lose competitiveness, factories hence shut down due to a shortage of trading opportunities.

Environmental

As the only past United States-Mexico-Canada free trade agreement, NAFTA did not concentrate on evaluating its environmental impact and sustainability. The trade deal has been accused of leading to the expansion of deforestation and pollution due to promoting export-oriented trading. Agribusinesses also began to use fertilizers and chemicals to compete with foreign businesses. Increased profit-oriented and unethical production then jeopardize and exploits the environment.

Current plans for the USMCA

In response to disadvantages of the NAFTA, the Trump Administration has proposed the USMCA, primarily to lower the trade deficit between the U.S. and Mexico, while further protecting the North American economy from foreign competition. President Trump is proposing the new deal to make the free trade zone more centered around North American trade and for the mutual benefit of the three parties.

Modifications to the NAFTA

The most substantial amendments made to the NAFTA in the USMCA include rules of origin, labor protections in the manufacturing sector, a sunset clause, and dairy products. The accord raises the regional percentage for auto production from 62.5% to 75%, increasing automotive production in the free trade zone itself. This percentage change would affect countries outside the USMCA trade zone and imposes stricter tariffs on these countries.

The Trump administration decides to improve workers' living conditions and equitability for the US wage level by specifying that factories must pay workers at least $16 hour in the auto industry. In contrast to the

unlimited timeframe of NAFTA, the USMCA provides a sunset clause that will promote constant discussions between the trade bloc on revisions for the deal.

In the NAFTA deal, Canada has protected its dairy product with its supply management framework, which the US considered to be excessive protection of the domestic product. It persuades Canada to open the dairy market partly.

Lack of bipartisan approval

Another significant barrier to the modification and re-branding of the NAFTA is the current political tension between the Democratic and the Republican party in the US congress. As the Senate of Mexico ratifies the USMCA in June 2019, the Canadian and American governments have not yet ratified the trade deal. While Canadian Prime Minister Trudeau begins the process to ratify the agreement, the Trump administration has to cope with further obstacles to achieve the ratification of the agreement. As Nancy Pelosi, speaker of the House of Representatives decided to impeach Trump, while realizing that the USMCA does not necessarily put forward momentous changes that would fulfill the Democrats' agenda, the ratification process requires more negotiation as to secure bipartisan approval for the new pact to be implemented.

Major Parties Involved

The United States of America

The US is considered to be the initiator of NAFTA, with former President Ronald Reagan first proposing the idea of a USMCA deal in his presidential campaign in 1979. The US is the most dominant economy in the world, having the seventh-highest GDP per capita and the highest GDP level. In the 1980s, the United States government was confident that a North American free trade agreement could lead to the expansion of US exports and create job opportunities. Later, as the NAFTA eventually prompted job losses in US regions, governmental officials from both the Democratic Party and the Republican Party called for a renegotiation of the NAFTA. Being the party that first instituted proceedings for the agreement and also the first organization to advocate for renegotiation, the U.S. .plays a crucial role in the future of the free trade deal. As a politician who often condemns globalism and prioritizes the national economy over the global one, Trump has been proposing new negotiations to elevate the treaty’s benefit on the U.S. Between 2017-2019, measures for ratifying the USMCA agreement have been conducted by the Trade Promotion Authority legislation, under the Office of United States Trade Representative (USTR). The United States' stance on the agreement had often fluctuated due to internal disagreements within the national congress. As an influential stakeholder in the North American economy, the U.S. is likely planning to enact USMCA to prioritize its national interests.

Mexico

Mexico is one of the three countries involved in the NAFTA and USMCA trade pacts. As the least developed economy within the three parties, Mexico has a unique role in affecting the economic implications of the free trade agreement. Under the provisions of the NAFTA, Mexico grew from a small export partner of the U.S. in the meat

and agricultural industry to its second largest export market of U.S. agricultural products in 2018. Mexico has a comparative advantage in producing particular goods such as avocadoes and wheat. More importantly, as a less developed country, within its primary and secondary sectors, Mexico has a larger and concentrated in comparison to the U.S and Canada, who are willing and able to work for fewer wages. This example of comparative advantage has attracted foreign investments, as corporations seeking to profit from low production wages. The comparative advantage Mexico possesses is a key reason why US consumers can access a greater variety of foreign goods. At the same time, US factories in competition with Mexico lose investment because of Mexico's low-priced labor. In December 2019, the Mexican Senate approved of the USMCA, ratifying the changes to the NAFTA deal.

Canada

Before the 1994 NAFTA, Canada had engaged in free trade with the US, an act to eliminate barriers and liberalize trade, hence a precursor of NAFTA's establishment, which superseded the 1988 Canada-United States Free Trade Agreement. Canada is also one of the three countries involved in both NAFTA and USMCA. Overall, NAFTA increased productivity in Canada by up to 15% in some industries, reducing unemployment and raising the nation's trade volumes significantly. However, as bilateral trade in agricultural products increased, Canada could potentially experience an increase in manufacturing unemployment due to an economic gap with the U.S. agricultural sector. As the primary trade partner of the U.S., the U.S. economy, particularly concerning natural gas and oil, are heavily dependent on Canada. Over recent decades, the Canadian dairy system has adopted the supply management framework to ensure the local population's access to these products, which set prohibitive tariffs of over 200% on many dairy products. This measure of tariff led to a dispute as Trump fiercely opposed the framework, pressuring Canada to open its dairy market to the U.S. consumers.

Timeline of Events

Date	Description of event
January 2, 1988	The Canada-United States Free Trade Agreement, also known as the Free Trade Agreement between Canada and the United States of America (CUFSTA) signed
January 1, 1994	North American Free Trade Agreement (NAFTA) founded
July 7, 2017	Office of United States Trade Representative (USTR) publishes objectives of the U.S. for NAFTA renegotiation
November 30, 2018	The signing of the United States-Mexico-Canada Agreement (USMCA) as a side of event of the G20 Summit
December, 2018	Trump announced that if the congress refuses to ratify the USMCA, the U.S. will return to pre-NAFTA trading conventions
June 20, 2019	Senate of Mexico ratifies the USMCA agreement
September 26, 2019	U.S. House Speaker and Congresswoman Nancy Pelosi states that the U.S. House of Representatives is proceeding with discussion on USMCA

Previous Attempts to Resolve the Issue

Over the last few decades, not many attempts to resolve the issue were made, as NAFTA had a mostly positive impact on the economic growth of the U.S., Canada, and Mexico. NAFTA is considered to be the first official trilateral trade pact between the said nations, hence a previous attempt to smoothen mutually beneficial trade. The attempt offered dispute settlement mechanisms in chapter 20, chapter 19, and chapter 11. The mechanisms were country-to-country resolution mechanism, anti-dumping and countervailing duties, and investor-state dispute settlement. The United Nations Permanent Forum on Indigenous Issues (UNPFIP), however, has argued that NAFTA's provisions continued subordination and marginalization of indigenous peoples, in reserving the right to adopt measure denying 'any rights or preferences provided to aboriginal peoples.' Further than its ethicality, these dispute settlement mechanisms have been contentious and thus require further amendments from the delegates.

Under Trump's presidency, various more substantial changes were made to NAFTA, as the agreement was often deemed to be unsuccessful in ensuring security in labor. The most eminent attempt to resolve the issue is the USMCA, which added stringent requirements to protect workers and to strengthen updating of the pact, through a stipulation demanding revision from the three countries every six years. A 16-year sunset clause has also been introduced. The USMCA also establishes the requirement for 40-45% of the manufactured cars to be assembled by workers earning at least $16 per hour, with 75% of components made in Mexico, US, or Canada to qualify as USMCA products. As such, the product would very likely end up being more expensive than regular NAFTA products of the same quality, leading to potential consumer dissatisfaction. The UN's involvement in this issue has been minimal, as the NAFTA itself is a trade-related entity for the North American region among the U.S., Canada, and Mexico. Despite this fact, the lack of constant renewal of the trade pact did result in an inefficient resolution towards undesired effects of the agreement. Specific UN discussions on the USMCA have not been conducted.

Possible Solutions

When tackling the economic issues of the USMCA, delegates should seek reciprocity and mutual economic benefits between the three countries. Delegates are encouraged to take into consideration whether further changes could be formulated before the trilateral ratification of the USMCA. The most critical barrier for the new USMCA deal is that the Democrats in the U.S. Congress believe that Trump's USMCA does not make convincing changes to the existing NAFTA, making ratification before 2020 unlikely. Delegates should thus aim to amend the USMCA pact, **advocating for settlement between both the Democrats and the Republicans**, hence finding a middle ground of bipartisan approval.

One of the significant issues with the previously negotiated attempt, the NAFTA, is the lack of criteria and supervision for evaluation of the treaty's efficacy, as well as the insufficiency of discussions to address conflicts of interests over the course of the free trade relationship. An example of battle could be seen in competition in the automotive industry, causing job loss in the U.S. To implement modifications to existing trade policies, delegates should consider **holding regular meetings between the U.S., Mexico, and Canada on the USMCA pact to**

consistently evaluate and amend the trade policy. Through actively modifying the free trade agreement to prevent outdated trade policies, the countries could thus oversee the execution of the USMCA and alleviate detriment to the economy. These discussions should also assist the three states in deciding and estimating which sectors of the free trade agreement would be the most successful, hence prioritizing areas such as the automotive industry, where unhealthy competition could hinder employment, then establishing measures to resolve issues in these areas immediately.

As the NAFTA has increased foreign competition and pressure on domestic businesses, a possible solution is to **develop mechanisms fostering local businesses through microcredit**, an alternative to protectionism. This solution is necessary if delegates wish to alleviate inequitable trade, as newer businesses in sectors that are dominated by foreign exports quickly lose competitiveness, hampering the creation of jobs. Concerning international relations and global trade, in the current USMCA, the U.S. disqualifies products manufactured with over 25% of the components from non-USMCA nations. Delegates should, therefore, evaluate whether such a policy would affect international diplomacy.

Overall, delegates should aim to find a balance between economic benefits and employment issues of the free trade agreement. A measure which delegates could use is advising the USMCA coalition to **protect domestic jobs from foreign competition** in economic sectors where countries are equally capable producers, through controlling the percentage of components in a product sourced from other countries. However, delegates should be aware that protectionists would, therefore, conflict with the motive of a free trade agreement. While shielding these jobs from the competition, delegates are advised to **protect workers' rights** and mitigate the trade zone's impact on labor markets, through establishing wage standards for legitimate production.

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Appendix or Appendices

The section below includes materials which will help you consolidate understanding on the background of the discussed trade agreement. Please use the following sites for extension and specific provisions of the trade deal if needed.

I. https://usmca.com (United States-Mexico-Canada Agreement full text)

The website consists of all details of the USMCA protocol, including preamble, initial provisions, general definitions, tariff schedule appendices, and all trade policies of the USMCA. The website is from the office of the United States Trade Representative (USTR). It is an official documentation of the USMCA for delegates who wish to gain holistic understanding of the agreement.

II. https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/fta-ale/index.aspx?lang=eng (North American Free Trade Agreement full text)

The website is an official site of the Canadian Government. The site includes details and policies provided by the NAFTA, the first United States-Mexico-Canada free trade agreement. The table of contents, along with the full text of this agreement offers delegates the opportunity to explore the relationship between the economic effects of the agreement and its original provisions.