PIIE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

NAFTA at 20 / TPP Lessons for TTIP

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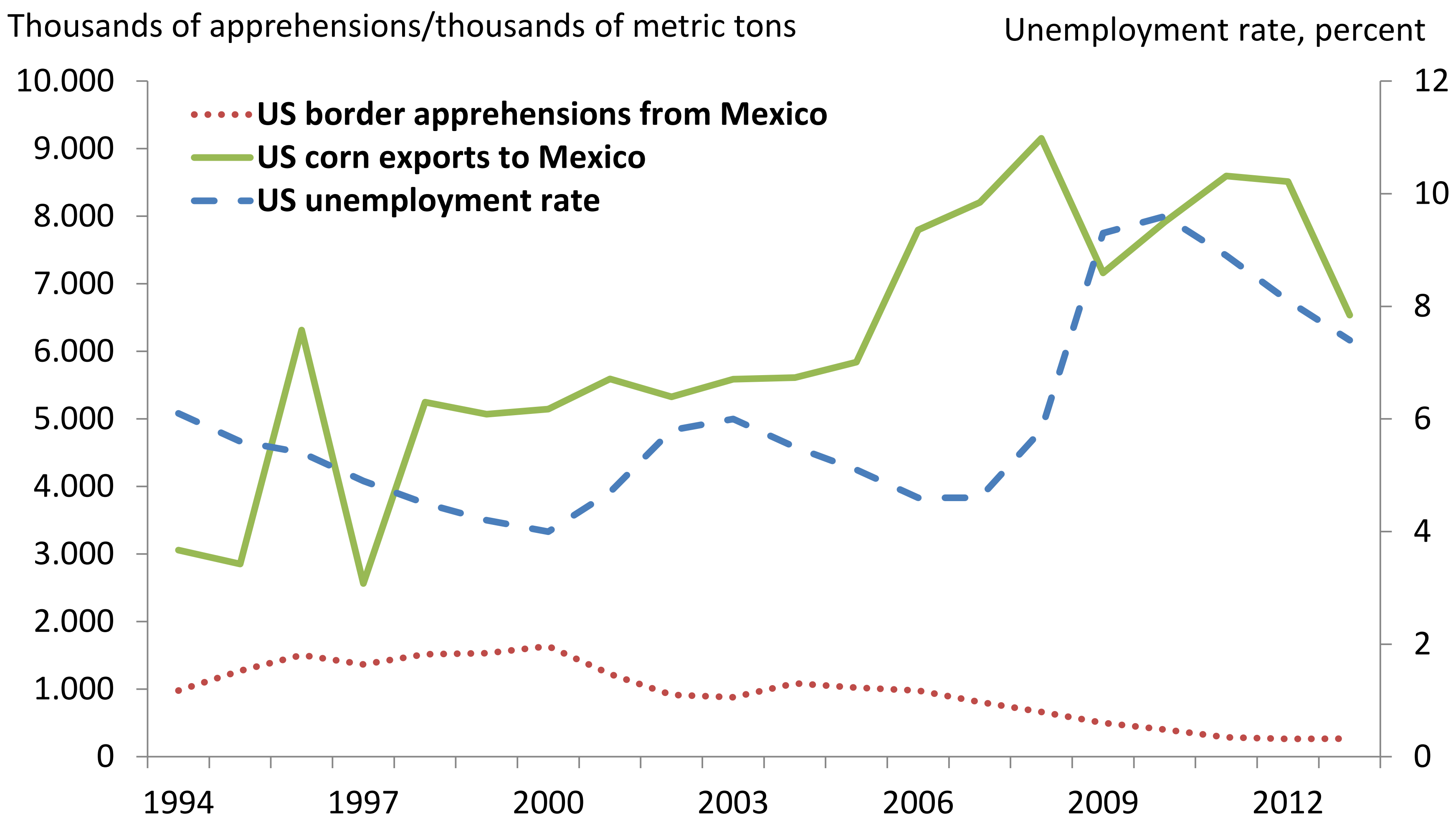
NAFTA at 20

Misleading Charges and Positive Achievements

NAFTA at 20: Misleading Charges

1. The boom in US agricultural exports turned rural Mexicans into illegal emigrants.
2. NAFTA fostered a growing US trade deficit.
3. Trade with Mexico increased US unemployment.
4. Job loss depressed US wages, especially in manufacturing.

US agricultural exports expanded after NAFTA, but did not cause increased migration

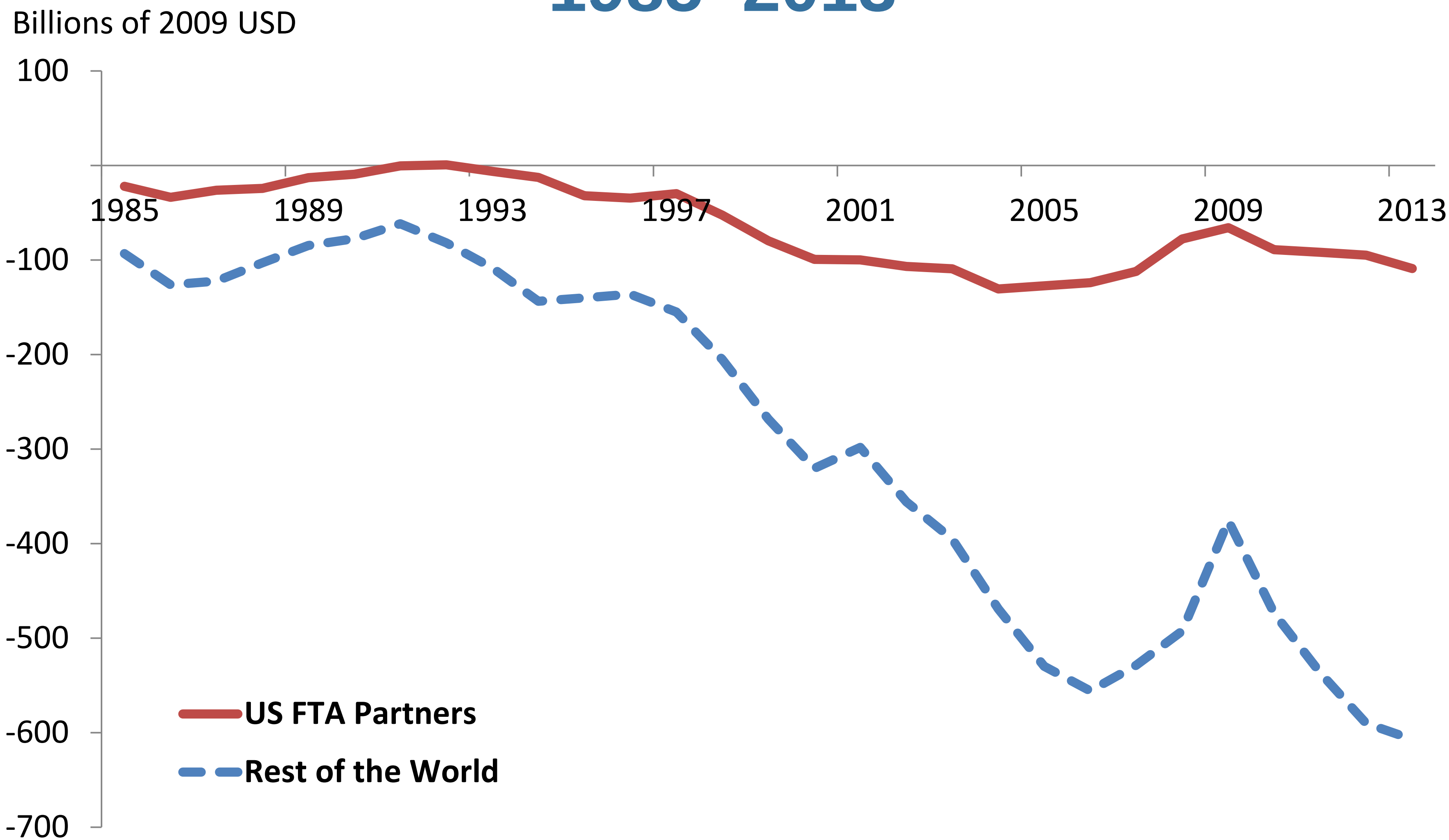


Sources: US BLS; US Border Patrol; USDA Foreign Agricultural Service.

NAFTA and other FTAs did not foster a growing US trade deficit

- US bilateral trade with Mexico went from a surplus of $5 billion in 1994 to a deficit of $45 billion in 2013.
- Internal Mexican events—the Peso Crisis and Mexican reforms—were important contributors.
- But the main reason was the growing imbalance between income and spending within the US.
- The global enlargement of trade deficit is not an outcome of NAFTA or other FTAs.
- If NAFTA had never been agreed, the US global trade deficit would not have been $45 billion lower in 2013.

US nonfuel merchandise trade balance, 1985–2013



Source: World Bank's WITS database.

NAFTA did not raise US unemployment

- Growing trade downsizes less efficient firms and upsizes more efficient firms. Job displacement is painful, but pays off for country as a whole.
- Imports from Mexico have increased by an average of $27 billion annually, displacing 200,000 jobs annually.
- But US exports to Mexico increased by an average of $25 billion annually, adding 188,000 new US jobs annually.
- Less than 5% “dislocated” US workers over past decades can be attributed to Mexican imports (200,000 out of 4 million).
- Demand for both domestic labor and foreign goods is dominated by local economic conditions, not trade policy.
- Payoff from trade is lower prices, higher productivity and better jobs, not more jobs.

NAFTA’s impact on manufacturing wages was limited

- Autor et al. (2013) found imports from Mexico and CAFTA did not depress US wages, while imports from China had a negative effect over 15 years.
- China’s impact was driven by its explosive productivity growth; Mexico and Central America did not have a comparable impact despite trade preferences.
- US workers command higher wages through high productivity, not trade protection.

But Mexico's growth has been slow

- Mexico has not grown as quickly as predicted following NAFTA: On average, real per capita GDP growth below 1.4% annually over the past 20 years.
- Mexico is underperforming compared to its peers, but why?
- McKinsey research shows "NAFTA sector" of Mexican economy (large firms 500+ employees) performed strongly; but productivity declined among smaller firms (≤10 employees accounting for 42% of workforce), falling 6.5% per year (Bolio et al. 2014).
- Widespread drug-related violence slowed growth.
- Poor infrastructure in cities dampened urbanization.
- Corruption and the monopolization of key sectors undermined competition and productivity growth.

What did NAFTA achieve?

- **Economic Payoff**
  - Benefits flow both from larger exports and larger imports of goods and services. US two-way trade is $635 billion larger on account of NAFTA.
  - A $1 billion increase in trade generates GDP gains of $200 million for countries like Canada and US; for Mexico it generates GDP gains of $500 million.
  - For US household of 3 persons, payoff is about $1,200.
  - For each net manufacturing job lost, national payoff is about $450,000 annually for an indefinite period.
- **Political Payoff**
  - A new foundation for US-Mexican relations.
  - Mexico's transition from one-party system of state capitalism to multiparty, market-oriented system.

NAFTA teaches several lessons

1. The US benefits from freer trade and investment with both rich and poor countries.
2. A good FTA can double two-way trade from its baseline, and spark direct investment.
3. Adjustment burdens are wildly exaggerated in the public debate.
4. The big payoff is ***better*** jobs, not more jobs.
5. Trade policy can compliment a growth strategy, but internal factors will dominate the result.

TPP Lessons for TTIP

TPP versus TTIP ambitions

- The Trans-Pacific Partnership (TPP), signed in February 2016 between the United States and 11 other countries, is the most ambitious trade and investment agreement yet concluded.
- TPP's success could be in inspiring "competitive liberalization"—EU already concluding or initiating new pacts with several TPP members.
- At its launch in 2013, the Transatlantic Trade and Investment Partnership (TTIP) was even more ambitious than TPP.
- TPP could be a benchmark for a future APEC-wide regional trade deal, but whether it sets a benchmark for TTIP depends on the issue at hand.

National treatment and market access

- TPP extends national treatment principles to sub-federal governments, limits performance requirements and export restrictions, and calls for transparency in licensing procedures.
- But the US excludes the merchant marine from national treatment, which EU has long insisted on covering in TTIP.
- Overall, TPP achieves high liberalization of 99% of tariffs, but with some slow phaseouts and use of tariff rate quotas.
- US tariff exceptions in TPP for autos, agriculture, apparel in particular may be central to TTIP talks:
  - 30 year phaseout for US 25% duty on light trucks/SUVs for Japan;
  - 10-12 year phaseouts for US textile and apparel duties, coupled with restrictive “yarn forward” rule of origin.

Investment and ISDS

- Investor-state dispute settlement (ISDS) enables investors to claim damages from a host state on account of denial of “fair and equitable” treatment or expropriation.

- ISDS has become major point of contention for TPP and TTIP critics, who contend ISDS gives undue power to multinationals to challenge domestic regulations, e.g., Vattenfall vs. Germany.

- TPP significantly improves transparency and preserves the right to legitimate environmental, health and safety regulations; but no mechanisms for appeals.

- But TPP will not satisfy the EU vision for a reformed ISDS.

- The EU proposal for an “international court” is not politically feasible in the US, but some kind of appeals mechanism should be viable.

Services and government procurement

- Services liberalization is a major priority of TTIP—transatlantic tariff equivalent barriers are still high, above 50 percent in construction and finance (CEPII 2011).
- TPP includes GATS-plus liberalization for several countries, but the US maintained several “sacred barriers,” all priority areas in TTIP to some extent:
  - Restrictions on maritime and airline transport;
  - State and municipal restrictions on services procurement;
  - Restrictive requirements for foreign professionals;
  - Ownership restrictions in telecom, broadcast, airlines;
  - Regulatory barriers on financial services.
- Moreover, the US did not liberalize sub-federal procurement in TPP—a red line for the EU.

SPS, TBT, regulatory coherence provisions of TPP not a TTIP template

- TPP sanitary and phytosanitary (SPS) chapter emphasizes scientific analysis and risk management for rules ensuring food safety, animal and plant health standards; no mention of EU precautionary principle.

- TPP technical barriers to trade (TBT) chapter primarily reaffirms WTO obligations, with little attention to mutual recognition of national standards.

- TPP regulatory coherence chapter urges transparency and consultations, but falls well short of TTIP ambitions.

- SPS disputes can be subject to TPP dispute settlement; TBT disputes related to WTO obligations can only be raised in WTO; and regulatory coherence obligations are not enforceable.

New rules in electronic commerce

- TPP establishes groundbreaking provisions in e-commerce: (1) prohibits duties on digital commerce; (2) ensures free flows of data; (3) public interest measures to fight cyber-crime and preserve individual privacy; (4) protects source code from forced technology transfer.

- For TTIP, cross border flow of data much more contentious due to heightened privacy concerns and widely divergent US-EU data protection systems.

- TTIP will not resolve these issues, but could include safeguards related to corporate handling of data that reflect revised Safe Harbor provisions.

Concluding thoughts

- Compared to TPP, the bargaining calculus is much different between two large economies like the European Union and United States.
- Like TPP, TTIP has high ambitions for goods liberalization but will likely follow suit with slow liberalization of key sectors like autos and agriculture.
- For services and government procurement, TTIP will require TPP-plus compromises.
- For investment, the main issue will be how ISDS takes shape.
- In rulemaking and standards, TPP rules on e-commerce and state-owned enterprise will likely inform TTIP talks; TPP outcomes in technical barriers to trade and regulatory coherence are far less useful.