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Three Recommendations for Renegotiating NAFTA

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One of President Trump's first actions was to announce plans to fulfill his campaign promise to renegotiate the North American Free Trade Agreement (NAFTA). Three recommendations to improve NAFTA include[1]:

1. **Modernizing** the agreement to take advantage of technological advances since NAFTA took effect in 1994;
2. **Expanding** the agreement to include areas that were excluded from the original agreement; and
3. **Eliminating** counterproductive areas of the agreement that are detrimental to U.S. interests.

Modernization of NAFTA

When NAFTA took effect in 1994, Google and Netflix did not exist and Steve Jobs was more than a decade away from creating the first iPhone. Ninety percent of Americans did not even own a cell phone.[2] Thousands of CompuServe users spent 60 to 90 minutes downloading Aerosmith's "Head First," the first new song made available on the internet.[3]

Much has changed since then. According to a McKinsey Global Institute (MGI) report: "Remarkably, digital flows—which were practically nonexistent just 15 years ago—now exert a larger impact on GDP [gross domestic product] growth than the centuries-old trade in goods."[4] The report added:

> Trade was once largely confined to advanced economies and their large multinational companies. Today, a more digital form of globalization has opened the door to developing countries, to small companies and start-ups, and to billions of individuals. Tens of millions of small and midsize enterprises worldwide have turned themselves into exporters by joining e-commerce marketplaces such as Alibaba, Amazon, eBay, Flipkart, and Rakuten. Approximately 12 percent of the global goods trade is conducted via international e-commerce. Even the smallest enterprises can be born global: 86 percent of tech-based start-ups surveyed by MGI report some type of cross-border activity. Today, even the smallest firms can compete with the largest multinationals.

In addition, according to a policy paper from eBay:

> Small businesses, for the first time in history, are utilizing the Internet and the services built on top of the Internet to go beyond their local consumer base and reach out to the world. These micro-multinationals are able to compete in the global market, while maintaining a local physical presence. The economic and social benefits that are being created as a result of this new trend are astounding.[5]

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These technological advances have had a dramatic impact on the U.S. economy. A 2014 U.S. International Trade Commission study calculated that digital trade increased real U.S. GDP by $517.1 billion to $710.7 billion and boosted U.S. employment by up to 2.4 million jobs.[6]

Many government barriers may interfere with digital transactions, including:

- Measures that block cross-border data flows;
- Data localization requirements, such as efforts to mandate the use of domestic servers or content;
- Traditional customs barriers;
- Measures that undermine the protection of privacy;
- Demands for software code;
- Differing standards for protection of intellectual property; and
- Censorship.

In 2015, in response to the growing role of e-commerce and related issues, Congress mandated the inclusion of digitally traded goods and services in U.S. trade negotiations.[7] Modernizing NAFTA to protect digital transactions would be beneficial in its own right, and would also provide a template for future trade agreements.

Expansion of NAFTA

According to the *Federal Register*: "The goal of NAFTA is to eliminate all tariff and non-tariff barriers of trade and investment between the United States, Canada and Mexico."[8] When NAFTA was negotiated, however, some sectors of the economy were exempted from this goal. NAFTA should be expanded to encompass these previously exempted sectors.

Perhaps the most prominent example is Mexico's energy sector. In 1938, Mexico's government nationalized the oil industry and expropriated foreign oil assets.[9] NAFTA allowed the government of Mexico to reserve to itself the following activities, including investment in such activities and the provision of services in such activities:

- Exploration and exploitation of crude oil and natural gas; refining or processing of crude oil and natural gas; and production of artificial gas, basic petrochemicals, and their feedstocks and pipelines;
- Foreign trade; transportation, storage, and distribution, up to and including the first-hand sales of crude oil, natural and artificial gas, goods obtained from the refining or processing of crude oil and natural gas, and basic petrochemicals;
- Supply of electricity as a public service in Mexico, including, except as provided in paragraph 5, the generation, transmission, transformation, distribution, and sale of electricity; and

1. The White House, "Trade Deals That Work for All Americans," *Issues*, https://www.whitehouse.gov/trade-deals-working-all-americans (accessed January 3, 2017).
2. "Cell Phone Subscribers in the U.S., 1985 to 2010," Infoplease.com, http://www.infoplease.com/ipa/A0933563.html (accessed January 3, 2017).
3. Deborah Wilker, "Aerosmith Rocks Cyberspace (This Is Only a Test)," *Sun Sentinel*, June 27, 1994, http://articles.sun-sentinel.com/1994-06-27/lifestyle/9406260159_1_compuserve-sound-card-geffen (accessed January 3, 2017).
4. James Manyika, Susan Lund, Jacques Bughin, Jonathan Woetzel, Kalin Stamenov, and Dhruv Dhingra, "Digital Globalization: The New Era of Global Flows," McKinsey Global Institute *Report*, March 2016, http://www.mckinsey.com/business-functions/digital-mckinsey/our-insights/digital-globalization-the-new-era-of-global-flows (accessed January 3, 2017).
5. eBay Public Policy Lab, "2015 US Small Business Global Growth Report," p. 6, http://www.ebaymainstreet.com/sites/default/files/2015-us-small-biz-global-growth-report.pdf (accessed January 3, 2017).
6. U.S. International Trade Commission, *Digital Trade in the U.S. and Global Economies*, Part 2, Publication No. 4485, August 2014, www.usitc.gov/publications/332/pub4485.pdf (accessed January 3, 2017).
7. Bipartisan Congressional Trade Priorities and Accountability Act of 2015, S. 995, 114th Cong., 1st Sess.
8. Federal Register, "North American Free Trade Agreement (NAFTA)," *The Daily Journal of the United States Government*, https://www.federalregister.gov/north-american-free-trade-agreement-nafta- (accessed January 3, 2017).
9. Gary Clyde Hufbauer and Jeffrey J. Schott, "Energy," in *NAFTA Revisited: Achievements and Challenges* (Washington, DC: Peterson Institute for International Economics, 2005), https://piie.com/publications/chapters_preview/332/07iie3349.pdf (accessed January 3, 2017).

- Exploration, exploitation, and processing of radioactive minerals; the nuclear fuel cycle; the generation of nuclear energy; the transportation and storage of nuclear waste; the use and reprocessing of nuclear fuel and the regulation of their applications for other purposes; and the production of heavy water.[10]

Since NAFTA was implemented, Mexico has made major strides to open its energy market. Constitutional reforms enacted by Mexico in 2013 liberalized the oil, natural gas, and energy sectors. These reforms should be locked in and expanded as NAFTA is modernized.

A report by the Americas Society/Council of the Americas concludes:

> Increased production will find new export destinations as Canada, the United States, and Mexico reap an energy bonanza. Increased production, lowered costs, and more refined market access will lead to greater competitiveness which can benefit all three nations. Mexico's energy reforms will benefit North America broadly, by providing an opportunity for North American leaders to develop a fully integrated North American energy sector.[11]

The U.S. should seek to remove exceptions for energy and other sectors originally excluded in NAFTA.

Elimination of Counterproductive Components of NAFTA

The biggest flaw in NAFTA was the inclusion of non-trade issues such as environmental and labor regulations in politically motivated "side agreements" that accompanied the trade deal. A study by the Peterson Institute for International Economics noted:

> The NAFTA labor and environmental side agreements were never designed to make substantial progress in addressing labor and environmental problems [but] to provide cover to Democratic members of the U.S. Congress to support NAFTA.[12]

In 1993, Representative Jim Kolbe (R–AZ) observed: "We should keep in mind that the NAFTA is first and foremost a trade agreement. It is not a labor or environmental pact."[13] In 1995, House Ways and Means Chairman Bill Archer (R–TX) stated that trade bills would not provide "authority to monkey around with labor standards and environmental standards around the world."[14]

Subsequent trade agreements slowly but surely increased environmental and labor mandates that added to the "managed trade" aspect of international commerce. For example, President Obama called the proposed Trans-Pacific Partnership (TPP) the "most progressive trade deal in history."[15]

U.S. trade agreements should be designed to increase economic freedom, not government control. Inclusion of environmental and labor mandates risks turning trade agreements into supranational regulatory arrangements that restrict trade flows instead of freeing them.

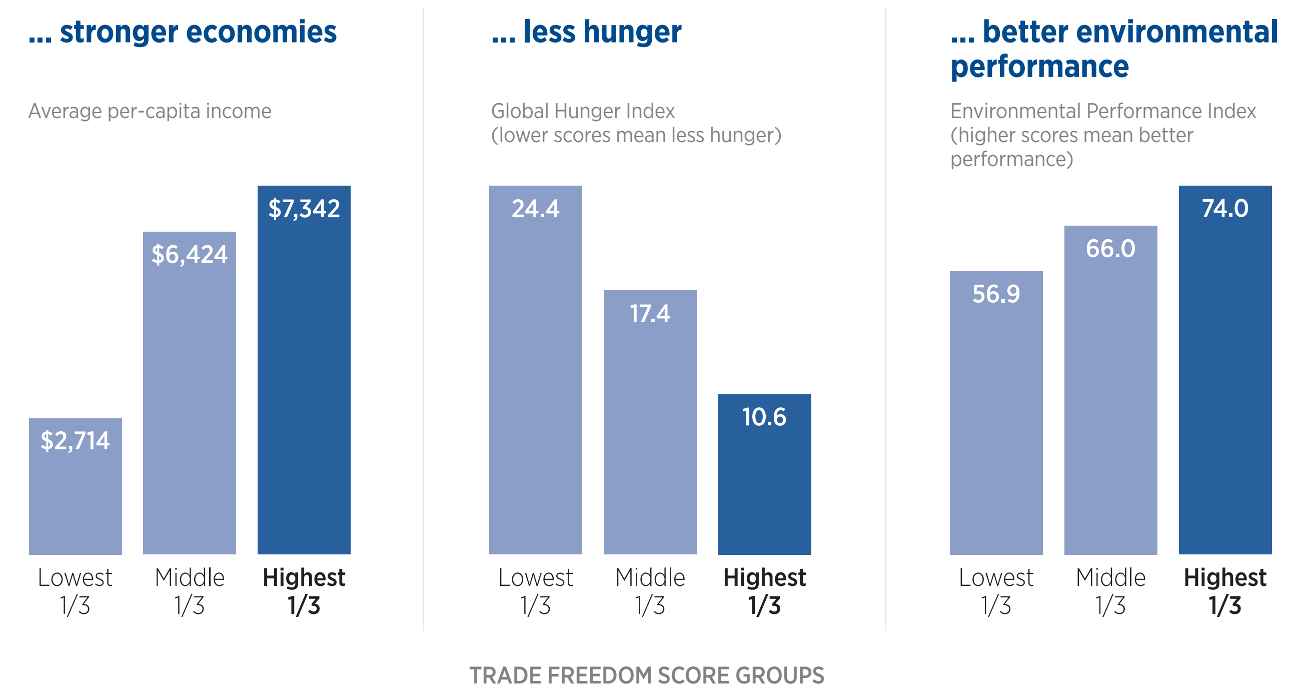
Such regulatory deals also obscure the fact that trade is good for workers and for the environment. According to data in The Heritage Foundation's annual *Index of Economic Freedom*, countries that are more open to trade have stronger economies and score higher on the global Environmental Performance Index.[16]

10. Organization of American States, "North American Free Trade Agreement," http://www.sice.oas.org/trade/nafta/chap-06.asp (accessed January 3, 2017).
11. Americas Society/Council of the Americas Energy Action Group, "Mexico: An Opening for Energy Reform," *Working Paper*, July 2014, p. 13, http://www.as-coa.org/sites/default/files/MexicoEnergyReport2014.pdf (accessed January 3, 2017).
12. Gary Clyde Hufbauer and Jeffrey J. Schott, "Recommendations for North American Economic Integration," in *NAFTA Revisited: Achievements and Challenges*.
13. Jim Kolbe, "NAFTA and the Side Agreements: Risks in Turning NAFTA Into a Labor/Environmental Pact," Heritage Foundation *Lecture* No. 449, May 13, 1993, http://www.heritage.org/trade/report/nafta-and-the-side-agreements-risks-turning-nafta-laborenvironmental-pact.
14. Steve Charnovitz, "Environment, Labor and Trade," *Journal of Commerce*, April 9, 1995, http://www.joc.com/environment-labor-and-trade_19950409.html (accessed January 3, 2017).
15. Vicki Needham, "Obama Puts TPP Trade Deal at Top of 2016 Agenda," *The Hill*, December 18, 2015, http://thehill.com/policy/finance/263754-obama-puts-tpp-at-top-of-2016-agenda (accessed January 3, 2017).
16. Bryan Riley and Ambassador Terry Miller, "2017 Index of Economic Trade and Freedom: Trade and Prosperity at Risk," Heritage Foundation *Backgrounder* No. 3168, November 23, 2016, http://www.heritage.org/international-economies/report/2017-index-economic-freedom-trade-and-prosperity-risk.

CHART 1

Major Benefits of the Freedom to Trade

The nations of the world are divided into three groups based on their trade freedom score in the *2017 Index of Economic Freedom*. The chart below shows that nations with more trade freedom also have ...



NOTE: Figures are based on 102 countries.
SOURCES: Heritage Foundation calculations from the *2017 Index of Economic Freedom* (forthcoming 2017) and:

- World Bank, "GNI per Capita, Atlas Method (Current US$)," http://data.worldbank.org/indicator/NY.GNP.PCAP.CD (accessed October 12, 2016).
- International Food Policy Research Institute, "2016 Global Hunger Index," http://ghi.ifpri.org/trends/ (accessed October 12, 2016).
- Yale University, "2016 Environmental Performance Index," http://www.epi.yale.edu (accessed October 12, 2016).

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America First Trade Policy

The U.S. Trade Representative is committed to an "America First Trade Policy" aimed at encouraging companies to stay in the U.S., create jobs in the U.S., and pay taxes in the U.S. That objective can be advanced by keeping the parts of NAFTA that work, modernizing NAFTA to take advantage of new technologies, expanding NAFTA to encompass sectors that were excluded from the original agreement, and eliminating counterproductive environmental and labor regulations.

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