SHOULD NAFTA EXPAND?: AN ANALYSIS OF EXPANSION

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ABSTRACT

The emerging global economy differs from the international economy in that resources are becoming more mobile and intra-industry trade is becoming more important. Evidence is presented that these developments require compatibility and harmonization of technical and policy standards. It is easier to harmonize standards on a regional level than globally; thus the rise of regional integration movements (Atkinson, 1998). This idea has led many to support the expansion of NAFTA to include other regions, such as South America. There are potential advantages and disadvantages to expanding free trade agreements. Therefore, several considerations must be taken into account before the U.S. enters such agreements. However, the U.S. must actively seek to expand its trade agreements with other countries or risk losing influence over decision-making processes in achieving globalization.

INTRODUCTION

The North American Free Trade Agreement (NAFTA) has raised several questions, since discussions began to establish the agreement. One heavily debated question was whether NAFTA would lead to the expansion of free trade agreements in other regions across the globe, and if this would be a viable prospect for the U.S. There are several reasons for establishing free trade agreements but several issues must be addressed before such agreements can be implemented.

The rationale for developing international trade is focused on economic developments and politics. The globalization of the world's economy establishes the need to form trade agreements with other countries. Today, economies are interdependent therefore; events in one country affect other countries in the world. For this reason, globalization is a desirable goal. NAFTA is a prime example of an integration technique used to achieve globalization. Proponents contend that regional trade agreements (RTAs) will enable a smoother transition into the globalization of trade policies. This argument has forced the U.S. to evaluate the expansion of its current trade agreements, such as NAFTA.

Developing free trade agreements involves numerous factors that must be taken into consideration. The understanding and identification of two specific factors is crucial for the success of expanding NAFTA and free trade agreements in general. First, the U.S. must gain an understanding of the economy and political environment of the country or region where expansion is proposed. Understanding these factors allows the U.S. to only enter into productive agreements. Identifying distinctive competencies is another element in target regions or countries and in the establishment of successful agreements. The distinctive competencies of a country's are the natural resources and/or processes that distinguish the country from others with the same resources or products available. Identifying these competencies helps the U.S determine how to best utilize strengths and implement successful strategies.

A major concern associated with expanding NAFTA arises from differences in economic, social, and political policies. These policies dictate the way countries conduct business operations, which alters the way partner countries conduct their business operations. NAFTA negotiations were prolonged because of these issues. During NAFTA negotiations, labor and environmental policy differences were addressed at great lengths. U.S. labor unions were concerned that labor policies in Mexico would eliminate jobs for Americans, and environmentalists were concerned that lower environmental standards and lack of enforcement of such policies would cause corporations to relocate. Another consideration the U.S. must take into account are existing trade agreements in a region. Stipulations in existing agreements can make it difficult for the U.S. to expand its trade agreements.

The objective of this study is to determine if the expansion of NAFTA would be a viable prospect for the United States. This study will also provide a detailed investigation of factors associated with the level of success attained by such agreements.

LITERATURE REVIEW

The United States is one of the strongest economies in the world. Therefore, other countries often try to emulate the decisions made by the U.S. By expanding regional trade agreements, the U.S. sets the standard for such agreements and is viewed as a leader in globalization. Globalization can be achieved more efficiently through expansion of regional trade agreements such as NAFTA (Pasquero, 2000).

Proponents of international trade contend that nations should specialize in production and trade to take advantage of their different resource bases. The existence of an emerging global economy differs from the international economy for two main reasons. First, resources are becoming more mobile. Second, intra-industry trade is becoming more important. Furthermore, evidence suggests that harmonization of technical and policy standards are crucial to successful globalization of economies (Atkinson, 1998). RTAs provide a basis for harmonization of these policies.

Numerous areas for expansion of NAFTA have been considered. However, several factors have caused the U.S. to refrain from expanding into any other regions. The U.S. loses valuable opportunities to influence developing countries by not expanding NAFTA into other regions (Balze, 2001). The lack of U.S. involvement in these agreements has caused several countries to seek other agreements (Beerman, 1996). This causes another potential problem for the U.S. because of lost trade opportunities that could have aided in the development of more efficient markets.

Free trade agreements if not carefully managed can cause numerous problems for the countries involved. NAFTA was strongly opposed by many environmentalists and labor unions before its inception. Many felt that

NAFTA would hurt workers and U.S. firms and would be detrimental to the environment. Proponents argued that the agreement would strengthen ties between the U.S. and Mexico and create jobs. After the inception of NAFTA several studies were conducted to determine the affects of the agreement.

Overall, estimates are that trade among the U.S., Mexico, and Canada has increased 75% since 1993, with total trade between the U.S. and Mexico at almost $175 billion and U.S. agricultural exports to NAFTA markets doubling between 1992 and 1998. An economist from Washington D.C., said, "NAFTA has more or less done what he and others expected." This group feels NAFTA has created more jobs than have been lost in the U.S.. However, as one study noted, "Five years after implementation the North American Free Trade Agreement remains a work in progress." (Summerour, 1999, p. 12).

WHY NAFTA WAS CREATED

NAFTA came into existence out of Mexico's desire to attract capital. Capital was needed to supplement the low level of national savings in the country. The trade agreement did this by changing international perceptions about Mexico's economy and by offering firms located in Mexico access to the U.S. market. NAFTA, also, helped cement the changes made by President Salinas to open the Mexican market. Canada, basically, did not want to be excluded from the free trade agreement because it granted greater access to the U.S. market (Gerber, 1999).

One unique characteristic of NAFTA is that it is an agreement between three countries, which are at very different levels of economic development, and since the inception of NAFTA there have been upward trends in trade between the U.S., Canada, and Mexico. Canada is the leading trading partner with the U.S. and Mexico is the second leading trading partner with the U.S. Furthermore, economic improvements have been great for both Mexico and Canada. When considering the effects of NAFTA it is important to bear in mind that Mexico's economy represents 4 to 5 percent of the U.S. The significance of this fact is that no matter what happens with NAFTA, the impact to the U.S. will be small. Another important factor is that trade between the U.S. and Mexico and U.S. and Canada is as much market driven as institutionally driven. Indicators of economic interaction between these countries show that trade and investment were growing significantly before NAFTA. Even without NAFTA, many of the same trade and investment flows probably would have occurred anyway (Gerber, 1999).

ADVANTAGES OF EXPANSION

Although free trade agreements are not global agreements, they are developed and accepted under the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO), as long as their general objective is to lower barriers to trade and competition. Therefore, trade agreements serve as an intermediary in the globalization of trade rules under GATT, the WTO, and domestic trade liberalization within member countries (Pasquero, 2000).

Market integration is the extension of free trade among neighboring countries, which is driven by powerful economic, ideological, and technological forces. Three advantages of market integration are achieved through free trade. First, free trade agreements lower and sometimes, eliminate trade barriers. This provides businesses easier access to new markets at no additional cost. The elimination of trade barriers can promote more efficient markets, which is a primary goal of any economy. Second, because the new rules are negotiated, widely published, and publicly enforced, they are made more transparent for both importing and exporting firms throughout the free trade area. This allows investors and businesses to make better decisions regarding market strategy. Finally, free trade agreements normally come with agreed-upon, and often jointly managed dispute resolution mechanisms, reducing the potential for unilateral action by one member country against another. Each of these three advantages aid in the harmonization of policies on a global level.

The expansion of trade agreements results in expanded markets. Greater access to foreign markets requires aggressive trade policy to lower tariffs and eliminate distorting subsidies. Failure to provide strong leadership in global trade liberalization will result in our producers and exporters being left behind. The potential impact the U.S. could have on various markets is significant, and the results of inaction could be harmful to the growth of the U.S. economy. Other nations are aggressively pursuing agreements, and the U.S. is falling behind in this area.

Regional and bilateral trade agreements create export opportunities, which can be important building blocks for trade liberalization. NAFTA has had promising results, especially in certain markets. Since the implementation of NAFTA, U.S. food and agricultural exports to Canada and Mexico have expanded by 59 percent, while corresponding exports to the rest of the world have grown by only 10% (Food & Agricultural Policy, 2000).

Unfortunately, the U.S. has fallen behind some of its competitors. Today, there are more than 130 preferential trade agreements throughout the world, and the U.S. is part of a small percentage of those agreements, with NAFTA being one. The European Union, alone, has 27 preferential agreements with other countries and is in the process of negotiating more (Food & Agricultural Policy, 2000), illustrating the importance of U.S. involvement in negotiations for free trade areas. Free trade agreements should supplement global trade liberalization. Expansion of free trade agreements, such as NAFTA, can accelerate the pace of liberalization and provide momentum for global reform, but they also have limitations. Trade distortions caused by export subsidies and domestic supports cannot be effectively addressed in free trade agreements (Food & Agricultural Policy, 2000).

The expansion of free trade agreements allows the U.S. to become a proactive leader in the globalization of the world's economy. The U.S. is referred to by many nations as a world leader, and it does not bode well with many nations that the U.S. has not expanded its trade agreements. This has forced many nations to engage in trade with other countries. Chile is a prime example of a target area for expansion abandoned because of political issues within the U.S., which forced Chile into other agreements. It is important for the U.S. to actively seek new areas of expansion for NAFTA, because it allows the U.S. to spread its views on national policy. Major factors in trade negotiations are the national policies in the target area. The U.S. has the ability to influence those policies when free trade is extended to an area. The lack of our presence in free trade agreements hurts us in the harmonization of such policies, and eliminates any chance for U.S. views in such policies.

CONCERNS OF EXPANSION

Industrial labor unions are often in opposition to expanding free trade agreements. Differences in labor policies are of primary concern for U.S. labor unions. One fear is that competition with low wage countries will drive down wages at home and cause jobs to migrate overseas. In other words, high wage U.S. labor will be forced to compete for jobs against impoverished workers from third world countries. One problem with this view is that productivity differences account for differences in labor wages. For example, Mexican workers typically earn less than U.S. workers for three reasons: lower education and skills, less sophisticated capital, and the distribution channels are less reliable. During NAFTA negotiations, labor issues were of great concern for many opponents to the agreement. However, a labor side agreement was established to help alleviate differences in labor policies.

Differences in environmental policies are also a major concern. Environmental concerns linked to global trade expansion of NAFTA draw from many areas, starting with issues related to emerging patterns between current international trade and environment law and ending with a general view of sustainable development that sometimes conflicts with economic principles promoted by industry, governments and international economic institutions.

Environmental activists fear that companies will relocate to countries in which the economic policy has lower standards. Concerns are also expressed regarding the enforcement of existing environmental policies. Regions in which environmental policies are not enforced result in unfair advantages to firms in that region.

One advantage of the expansion of NAFTA, however, is the ability to identify and correct such discrepancies in policies. This is a much easier task at the regional level compared to the global level. Establishing trade relations can make differences smaller and less pervasive (Gerber, 1999).

The concerns of environmentalists cannot be ignored. Differences between the U.S. and other countries' environmental policies can cause large problems if not addressed. Negotiations between the U.S. and other countries tend to be difficult because of such differences. In fact, at times target regions for expansion may be unwilling or incapable to make the changes necessary to insure that the U.S. benefits from expanding free trade in the target area.

Companies choosing to relocate to areas of weaker environmental policy can give an advantage over companies located in the U.S.. Furthermore, even countries with established environmental policies may not enforce those policies. This would also provide an incentive for firms to relocate into that area, because current policy is not enforced. Firms are attracted to areas where environmental restrictions are not as tough as the U.S. because it lowers their costs. This allows them to produce more efficiently in the short-run, but long-term it is detrimental to the environment.

Another potential disadvantage of free trade agreements is the terms of agreements can result in low cost external suppliers being replaced with higher cost regional suppliers (Sargent & Matthews, 2001). Some economists feel that trade agreements reap inefficient markets, because the agreements cause trade between countries that may not be the most effective route of production. This could actually increase the costs of transactions between the U.S. and partner countries. However, the successful identification of strengths and weaknesses during the planning phase of negotiations can reduce or eliminate problem areas.

The expansion of NAFTA is not a simple process. In order for all trade partners to reap benefits from the agreement, it must create value for U.S. firms. In most cases, developing or undeveloped countries will derive benefit from their association with the U.S.. However, the U.S. may not. The natural resources in a country or their processes that are more efficient than current processes are the main attraction for free trade. If expansion into a country or area diverts more trade than it creates the U.S. should not expand into that area.

The U.S. cannot simply expand NAFTA to follow the practice of other nations. Rather a real benefit must be derived from the association of the U.S. with a particular region. However, the U.S. is currently not actively seeking to establish such agreements, while the rest of the world is. The U.S. is, therefore, left out of an important element in the steps toward globalization of the world's economy. The U.S. must actively seek areas of potential expansion and act on the distinctive competencies of other regions.

FACTORS AFFECTING FREE TRADE

Before the expansion of free trade agreements in the U.S. can be effectively negotiated, it is important for the President to have fast tracking authority. Fast tracking authority allows the President to bypass approval of Congress of negotiations, which speeds the process tremendously. The expansion of free trade agreements slowed greatly when President Clinton failed to obtain renewal of fast track negotiating authority from Congress that hammering out new pacts requires (Balze, 2001). Without such authority the technical and bureaucratic issues prolong and ultimately destroy the likelihood of designing effective free trade agreements between the U.S. and other countries.

Economic, political, and social policies in a particular region are key in expanding NAFTA. Differences in policies can create problems, which would cause trade between the regions to be fruitless. However, this is one advantage of expanding trade, because during negotiations these differences are targeted and steps are made to harmonize the policies. The U.S. can have a significant influence over the policies in other countries due to our attractive capital markets. These policies are key decision factors in expansion, but also provide opportunities for improvement of existing policies. As mentioned previously, harmonization of policies is a key element in successful globalization, and the expansion of NAFTA can alternatively reduce differences in policies.

AREAS OF EXPANSION

Since the inception of NAFTA, the debate of expanding NAFTA began. One of the first areas for expansion mentioned was Latin America; because the region represents a U.S. export market larger than Canada and almost as large as China plus all of developing Asia. Furthermore, the International Monetary Fund (IMF) projected that Latin America would grow almost twice as fast as the major industrial countries in the near term, making trade opportunities huge. Latin America is currently involved in a complex set of overlapping regional trade agreements, like Mercosur. These regional pacts have led to trade, particularly in locally produced capital equipment, that does not reflect comparative advantage and is wasteful. Some feel that growth in Latin America will be faster if it is based on open trade policies that encourage efficient production. This is one of the goals of expansion of NAFTA, to effectively and efficiently combine markets. From a U.S. perspective our exporters suffer by being excluded from these growing markets (Little, 1997).

Chile also represents an area that various interest groups advocate is suitable for expansion following the implementation of NAFTA. Chile was one of the biggest success stories of the 1990s. The annual growth rate for Chile was over seven percent a year, which caught the attention of businesses around the world including the United States, European Union, Asia, Canada, and Mexico. Furthermore, Chile has been a principal trading partner with the U.S. for most of the twentieth century (Beerman, 1996). However, the U.S. has not locked into a trade agreement (such as NAFTA) with Chile. Several negotiations have been underway to establish trade agreements between Chile and various markets, but Chile did not commit to any of them because it considered the U.S. a primary target for an agreement. However, the protectionist leaning U.S. government struck down Chile's bid to enter the North American Free Trade Agreement and put off further debate until later. This action was not greeted warmly.

In the wake of these incidents, Chileans have become frustrated. They strongly wished to become apart of NAFTA; joining NAFTA would grant them access to North American services and high technology products, opening an already profitable market. Many businessmen in Chile expressed anger towards the U.S. for their refusal to grant access into the North American market. Lavreano Gili, director of P.M. Chile S.A., a textile importer in Santiago, refers to the NAFTA pledge, "as merely another example of the United States talking about free trade and then not acting on it" (Beerman, 1996). However, pressure against Chile's entry into the NAFTA has come from several sources. Church groups, Amnesty International, Greenpeace, and other organizations argue that Chile ought to be denied entry in NAFTA as punishment for Chile's questionable human rights and environmental records. These issues will be discussed later in the paper.

Some cited South America as the best area for expansion. The appeal for South American countries is easier access to capital (Clarke, 1995). Furthermore, expansion into the Southern Cone would offer great advantages to all its participants, helping to stabilize and enrich the Americas, and further the process of hemispheric integration (Balze, 2001). Clearly the region of expansion is uncertain, but the predominate element is the expansion of free trade to enable globalization which is inherent in all of these areas.

NAFTA EXPANSION

Table 1 (Appendix A) is a comparison of trade flows to U.S. domestic shipments by SIC codes. The table provides potential trade creation and trade diversion effects associated with the expansion of NAFTA into various markets. The most recent data available when the study was conducted is from 1991. Table 1 presents the results from four different scenarios, the accession to NAFTA of, Chile, the Andean Pact (Ecuador, Peru, Venezuela, Colombia, and Bolivia), Mercosur (Brazil, Argentina, Paraguay, and Uruguay), and a Western Hemisphere FTA including all countries in the first three groups. The largest six 2-digit SIC codes (in terms of trade creation) for each region are presented. These codes represent more than 75 percent of the total trade effect under each given scenario (Anderson & Smith, 1997).

Under the first scenario of a U.S. and Chile free trade agreement the trade creation is $34.52 million. The estimates for trade diversion associated with expansion of NAFTA to include Chile are $51.88 million. Considering these two factors, the overall impact of expansion into Chile is modest. Special attention should be paid to textiles and apparel imports because they represent 57 percent of all predicted trade effects (Anderson & Smith, 1997).

The trade creation that would result from expansion of NAFTA with the Andean Pact is $206 million, while trade diversion is $327 million. Total trade effect of the Andean Pact's accession to NAFTA is estimated at $312 million. As with Chile, the expansion of NAFTA into this region would create only modest benefits (Anderson & Smith, 1997).

Under the third scenario, expansion of NAFTA to include Mercosur would result in trade creation of $477 million. Trade diversion under this scenario totals to $838 million. The total trade effect of Mercosur's accession to NAFTA is estimate at $796 million, representing nine percent of the regions total merchandise trade with the U.S..

The presence of Brazil creates large predicted increases in exports for Mercosur, much larger than the combined effects of Chile and the Andean Pact. In this combination industrial products and industrial machinery are among the leaders in trade creation and trade diversion. However, from the U.S. perspective the increase of less than $800 million is relatively small compared to total imports of more than $500 billion.

The fourth scenario illustrates expansion into the Western Hemisphere. Total trade creation in this situation is estimated to be $720 million, while trade diversion estimates are $1.277 billion. The total effect of Latin America's accession into NAFTA is estimated at $1.15 billion. Apparel, textiles, and leather products account for 62 percent of the total trade effect. However, the effects on import competing U.S. industries will be small, as it is only trade creation not trade diversion which comes at the expense of the domestic industry (Anderson & Smith, 1997).

Under each scenario discussed, the trade creation was less than trade diversion. This makes it difficult to determine the best area for expansion. However, some would argue the U.S. should not expect a tremendous impact on trade because of expansion of trade agreements in any particular region. The rationale behind this argument is that, most of these areas represent a small percentage of the U.S., and therefore their impact should not be considered individually, but as a whole. NAFTA is an illustration of this very point. Regardless of the outcome of the agreement when it was originated, the impact to the U.S. economy would be negligible.

The information from Table 1 may cause the reader to believe that the U.S. will not benefit significantly from the expansion of NAFTA, however the opposite is true. It is important to bear in mind that each of these target areas for expansion represents varying levels of economic, social, and political development. The benefits associated with trade agreements in these areas may be difficult to see in the beginning, but will increase significantly as the country begins to develop new policies. The U.S. has the ability to influence the policies of these countries through trade agreements, which is beneficial for the globalization of the economy. Simply stated, the U.S. must expand existing free trade agreements in order to sustain its position as a world leader.

CONCLUSION

The expansion of NAFTA or regional free trade agreements with the U.S. and other countries is inevitable. In order to sustain economic and political growth, the U.S. must increase its free trade agreements. Free trade agreements are vital elements in the goal of globalization. The advances made in political, economic, and social policy through RTAs aid in harmonizing the global economy. However, this does not mean the U.S. should enter into free trade agreements merely to aid in the development of world trade. It does insist that the U.S. play an active role in the development of those ultimate goals to ensure the U.S. maintains its position as an economic powerhouse.

The U.S. benefits through improved relations and strengthening of political ties, as well as by improved efficiency of markets. Underdeveloped and developed countries are also able to improve current policies and better prepare themselves for a global market. These countries can also benchmark American processes and, as a result, improve trade efficiency within their country.

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Appendix A

Table I: Summary of Trade Creation and Trade Diversion by Region

(Top six SIC categories ranked by TC; figures in U.S.$ millions; estimating equation From Technical Appendix in parentheses)

					Total Trade Effect	
Region/SIC	TC (1)	TD (2)	TD (3)	TD (5)	(1) + (2)	% Share Of Imports
Chile						
23 Apparel	17.0	8.1	0.0	17.0	25.1	76.0
20 Food	4.1	0.3	0.1	4.1	4.4	1.7
22 Textiles	3.5	0.6	0.0	3.5	4.1	31.2
31 Leather	2.9	5.8	0.0	2.9	8.7	40.2
33 Prim. Met	1.8	0.6	0.1	1.8	2.4	0.6
01 Crops	1.7	0.4	0.1	1.7	2.1	0.5
Other	3.5	1.1	0.0	3.5	4.6	1.5
Total	34.5	16.9	0.4	34.5	51.4	3.5
Andean Pact						
23 Apparel	108.2	56.2	1.6	107.4	164.4	57.7
13 Oil & Gas	25.1	12.3	3.4	25.1	37.4	0.6
29 Pet/Coat	20.1	10.9	6.2	20.1	31.0	0.6
01 Crops	14.1	9.7	5.0	13.7	23.8	2.9
22 Textiles	12.6	2.8	0.2	12.6	15.4	15.9
31 Leather	8.7	14.1	0.1	8.7	22.8	25.4
Other	17.5	9.2	0.4	17.5	26.7	0.8
Total	206.3	105.3	16.9	205.1	311.6	2.2
Mercosur						
31 Leather	143.7	242.6	19.8	140.8	386.3	30.3
33 Prim Met	62.1	10.7	4.5	61.7	72.8	6.4
20 Food	59.5	4.3	5.5	58.8	63.8	4.8

Table I: Summary of Trade Creation and Trade Diversion by Region						
(Top six SIC categories ranked by TC; figures in U.S.$ millions; estimating equation From Technical Appendix in parentheses)						
					Total Trade Effect	
Region/SIC	TC (1)	TD (2)	TD (3)	TD (5)	(1) + (2)	% Share Of Imports
23 Apparel	45.8	25.6	0.7	45.7	71.4	36.0
35 Ind. Mach	44.4	5.4	5.6	43.5	49.8	6.7
37 Trans. Eq	21.3	7.7	0.1	21.3	29.0	4.3
Other	99.9	23.3	6.9	102.8	123.2	3.6
Total	476.7	319.6	43.1	474.6	796.3	9.1
Western Hemisphere						
23 Apparel	165.8	87.0	3.7	164.1	252.8	48.9
31 Leather	155.3	258.0	22.1	152.0	413.3	29.8
20 Food	71.8	4.3	17.9	70.6	76.1	3.0
33 Prim. Met	68.2	11.8	5.9	67.7	80.0	3.7
35 Ind. Mach	44.8	5.4	5.6	43.9	50.2	6.6
22 Textiles	37.3	6.8	2.5	36.5	44.1	14.0
Other	177.3	59.5	25.2	176.1	236.8	1.4
Total	720.5	432.8	82.9	710.9	1,153.3	4.7
Source: Anderson and Smith (1997)						