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North American Free Trade Agreement (NAFTA)

Overview

What Is It? NAFTA is a free trade agreement (FTA) among the United States, Canada, and Mexico that entered into force on January 1, 1994 (P.L. 103-182). All three partners are currently in negotiations for a Trans-Pacific Partnership (TPP), a proposed comprehensive and high standard FTA among 12 countries in the Asia-Pacific region, which could alter certain NAFTA provisions. NAFTA continues to be of interest to Congress because of the strong U.S. trade and investment ties with Canada and Mexico, and because of its significance for U.S. trade policy. At the time it was negotiated, NAFTA was unusual in global terms because it was the first time that a U.S. FTA linked two advanced economies with a developing country. For this reason, the agreement sparked debate among policy makers, industries, agriculture producers, labor unions, nongovernment organizations, and academics about its potential benefits and costs. NAFTA-implementing legislation included revisions to the U.S. trade adjustment assistance program to address production shifts and assist dislocated workers.

NAFTA Facts

Milestones. Negotiations began in February 1991. The agreement was signed by President George H. W. Bush on December 17, 1992. NAFTA side agreements were signed in August 1993. The NAFTA Implementation Act was approved by Congress on November 20, 1993, and signed into law by President William J. Clinton on December 8, 1993.

Prior Liberalization. NAFTA enhanced prior liberalization efforts. The U.S.-Canada FTA had been in effect since 1989, and Mexico was in the process of substantive unilateral trade and investment liberalization measures.

NAFTA Text. NAFTA includes eight parts consisting of 22 chapters. It contains provisions on tariff and non-tariff barrier elimination, customs procedures, energy and petrochemicals, agriculture, technical barriers to trade, government procurement, foreign investments, services trade, temporary entry for business persons, intellectual property rights protection, and dispute resolution procedures.

Labor and Environmental Side Agreements. NAFTA parties approved additional binding side agreements on labor and the environment, including the establishment of the North American Development Bank.

Why Is NAFTA Important? NAFTA initiated a new generation of trade agreements in the Western Hemisphere and other parts of the world, influencing negotiations in areas such as market access, rules of origin, intellectual property rights (IPR), foreign investment, dispute resolution, worker rights, and the environment. NAFTA addressed new trade policy issues and served as a catalyst for future FTAs and for concluding major multilateral trade negotiations. The United States now has 14 FTAs with 20 countries.

What Are Supporting Views? Past and present proponents of NAFTA view the agreement as an opportunity for generating economic growth, creating jobs, increasing productivity, reducing income disparity, strengthening trilateral relations, and enhancing North American cooperation.

What Are Opposing Views? Opponents argue that the agreement has caused job losses in the United States as companies moved production to Mexico to lower costs, put downward pressure on U.S. wages, increased income disparity, led to environmental degradation, and has been an infringement on U.S. sovereignty.

Key NAFTA Provisions

Market Opening. An important aspect of NAFTA relates to national treatment and market access for goods and services. The agreement eliminated tariffs over 10 years (15 years for sensitive products) and most non-tariff barriers on North American goods, as long as they meet specific rules of origin. Trade barriers on sensitive items, such as sugar and corn, received the longest phase-out periods.

IPR Protection. NAFTA was the first trade agreement to include a chapter on IPR. It set minimum standards of protection and enforcement for patents, copyrights, trademarks, and other forms of IPR. It also served as a template for the World Trade Organization's (WTO) Trade-Related Aspects of Intellectual Property Rights Agreement.

Foreign Investment. NAFTA removed significant investment barriers, especially in Mexico, ensured basic protections for NAFTA investors, and provided a mechanism for dispute settlement. It includes country-specific liberalization commitments and exemptions such as Mexico's energy sector and cultural industries in Canada.

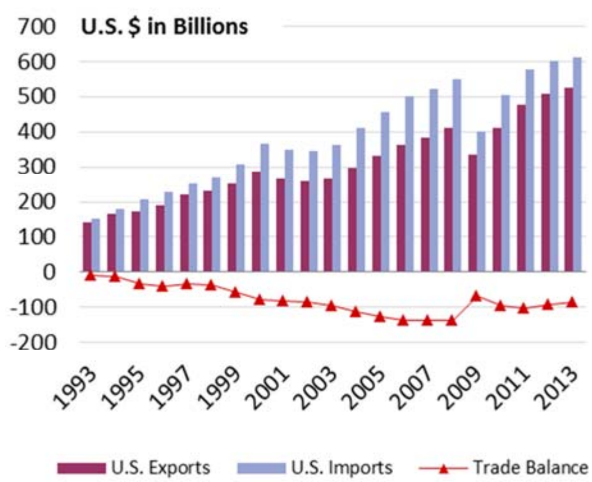
Labor and Environmental Provisions. The original text of the agreement did not include enforceable labor or environmental provisions. Due to congressional concerns at the time, the three countries negotiated and signed separate binding side agreements, but these do not go as far as more recent FTAs. A notable aspect of these provisions is the dispute settlement process, which, as a last resort, may impose monetary assessments and sanctions if a party fails to enforce its laws.

Economic Effects

The overall net effect of NAFTA on the U.S. economy appears to have been positive, though modest, primarily because trade with Canada and Mexico account for a small percentage of U.S. GDP. Most economists contend that the claims on both sides of the NAFTA debate were overblown. It did not cause the job losses feared by the critics or the employment gains predicted by the proponents. Not all changes in trade and investment patterns within North America can be attributed to NAFTA, especially since there were other liberalization efforts at the time. Trade also has been affected by factors such as currency fluctuations and economic conditions. Job gains and losses since NAFTA's entry into force may not be totally attributable to the agreement. Trade and employment levels tend to increase during cycles of economic growth and tend to decrease as growth declines.

Although the net economic effect was positive, there were worker and firm adjustment costs as many industries adapted to the more open and competitive trade environment. These losses tended to be more concentrated in specific industries, such as the apparel industry in the United States or the agricultural sector in Mexico. Industries tend to be concentrated in certain geographical regions, making some communities more vulnerable than others to adverse employment effects. In contrast, the gains from trade tend to be more widespread.

Figure 1. U.S. Merchandise Trade with NAFTA Partners



Source: Compiled by CRS using data from ITC.

Trade Trends Since NAFTA

U.S. trade with NAFTA partners has more than tripled since the agreement took effect. It has increased more rapidly than trade with the rest of the world. Between 1993 and 2013, according to the U.S. International Trade Commission (ITC), U.S. trade with Mexico increased by 522%. In comparison, trade with Canada went up by 200%, while trade with non-NAFTA countries increased by 279%. In 2013, Canada was the leading market for U.S. exports, while Mexico ranked second. The two countries accounted for 33% of total U.S. exports in 2013. In imports, Canada and Mexico ranked second and third, respectively, as suppliers of U.S. imports in 2013.

NAFTA has spurred greater economic integration among the three countries. Much of the trade between the United States and its NAFTA partners occurs in the context of production sharing, as manufacturers source components from all three countries. An estimated 40% of the content of U.S. imports from Mexico and 25% of the content of U.S. imports from Canada are of U.S. origin. This type of trade, however, requires a border infrastructure that facilitates commerce while maintaining security objectives.

Issues for Congress

The rising number of bilateral and regional trade agreements throughout the world could have implications for U.S. trade policy with its NAFTA partners. Some trade policy experts contend that a deepening of economic relations with Canada and Mexico will help promote a common trade agenda with shared values and that it would have positive implications for competitiveness, corporate governance, worker rights, the environment, and democratic governance. However, labor groups and some consumer-advocacy groups argue that the agreement needs to be reconsidered because it has resulted in U.S. job losses, outsourcing, lower wages, and job dislocation in Mexico, especially in agriculture.

Both proponents and critics of NAFTA agree that policy makers could consider ways in which to work with NAFTA partners to address issues related to trade facilitation, worker rights, environmental conditions, competitiveness, and trade relations. Policy makers could consider measures such as strengthening institutions to protect the environment and worker rights; considering the establishment of a border infrastructure plan, including more investment in infrastructure to make border crossings more efficient; increasing regulatory cooperation; promoting research and development; and/or creating more efforts to lessen income differentials.

Another key issue for Congress related to NAFTA is the proposed TPP. If a TPP is reached and approved by Congress, it could alter the rules governing North American trade since NAFTA entered into force, in areas such as investment, energy, IPR protection, state-owned enterprises, global value chains, discriminatory regulatory barriers, worker rights, and the environment.

For more information see CRS Report R42965, *NAFTA at 20: Overview and Trade Effects*, and CRS Report R42694, *The Trans-Pacific Partnership (TPP) Negotiations and Issues for Congress.*

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