NAFTA: Capitalizing on Natural Advantages

Analysis
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(Stratfor)

Summary

Editor's Note: *This is the final installment of a seven-part series examining how the world's regional economic blocs are faring as the largest of them — the European Union — continues to fragment.*

More than two decades after its signing, the North American Free Trade Agreement (NAFTA) is still a source of controversy. But the debates occurring in the bloc's member states — the United States, Mexico and Canada — are less about whether their experiment in integration was a good idea and more about how close they should get. The three were bound to merge in some respects, after all, considering that North America is one of the only major economic regions that can largely sustain itself without trading beyond its borders.

Even so, the contention that surrounds the prospect of deeper ties among NAFTA's economies will likely prevent the bloc from seriously considering steps beyond the free trade agreement it already has in place. Instead, the geopolitical forces pulling the organization's members together will manifest in less formal links, such as the construction of connective infrastructure, tightening of regional supply chains and growth in energy trade. Whether NAFTA will remain

the dominant framework for North American trade in the long run, or someday be superseded by a more robust deal like the Trans-Pacific Partnership (TPP), is unclear. It is clear, however, that at least for the next few decades, the three NAFTA members will maintain their close friendship, regardless of the form it takes.

Analysis

North America has been endowed with geographic advantages that few other regions in the world have. From central Canada's Great Plains to the United States' Mississippi River Basin and Mexico's Gulf Coast, the continent's vast river networks and arable land have laid the groundwork for its lasting prosperity. Though the United States' location, wealth, abundance of natural resources, and established military and economic might have enabled it to dominate the Atlantic and Pacific oceans today, the same could easily be true of another North American power in the future.

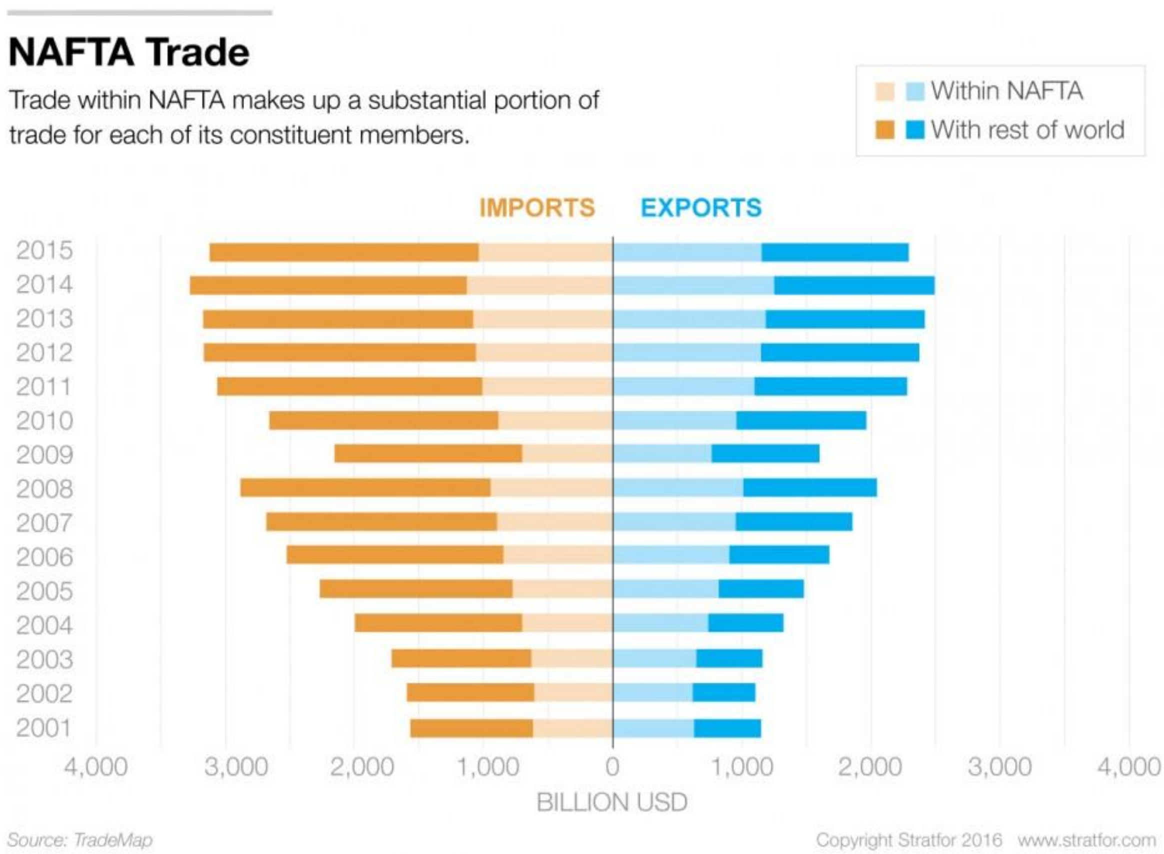
For now, though, the United States' massive consumer economy has made it, by default, the region's economic engine. Mexican and Canadian exports are relentlessly drawn toward the U.S. market, just as U.S. goods head first and foremost to its northern and southern neighbors. Some economic integration — and often security and political coordination — was therefore only natural, with or without a formal framework such as NAFTA in place.

But this inclination toward connectivity did not draw the three countries together as quickly as one might expect. Beyond a restricted and short-lived trade deal prior to Canada's independence, a full-blown free trade agreement between the United States and Canada did not materialize until 1989; a similar deal including Mexico was not struck until 1994. The slow pace of their integration was largely due to the political debates it stirred in NAFTA's member states. Canada had long fought to preserve its sovereignty and was torn over whether a trade deal would bring it one step closer to a political union with its giant southern neighbor. Mexico, meanwhile, was ruled for decades by an Institutional Revolutionary Party dynasty that had staked its political future on the protectionist and nationalist fervor that emerged when the state took over the Mexican oil industry in 1938. Breaking down the resistance to regional free trade in both countries took generations, just as whittling away at the current opposition to deeper integration will likely take generations more.

This year's North American Leaders' Summit, NAFTA's annual conference, showed just how persistent North America's aversion to closer ties is. The U.S. Republican Party's then-presumptive presidential nominee, [Donald Trump](), declared in a speech that if he were chosen to lead the country, he would renegotiate the NAFTA arrangement or invoke the article allowing for the United States' withdrawal. Trump's stance is hardly new to U.S. politics; both Democratic rival Hillary Clinton and current President Barack Obama made the same claims during their 2008 campaigns.

Cooperation, for Better or Worse

On the surface, NAFTA appears to have had a hefty impact on North American trade. In 1993, the year before Mexico joined the bloc, trade between the United States and its southern neighbor equaled less than $300 billion. By 2015, that figure had risen to $1.1 trillion. As a whole, 52 percent of NAFTA members' exports and 34 percent of their imports now go to or come from fellow bloc members, and their internal trade accounts for a whopping 14 percent of global trade. Of course, none of these gains can be attributed solely to the creation of NAFTA; they also came as trade rose worldwide and as changes in technology stretched and expanded global supply chains.



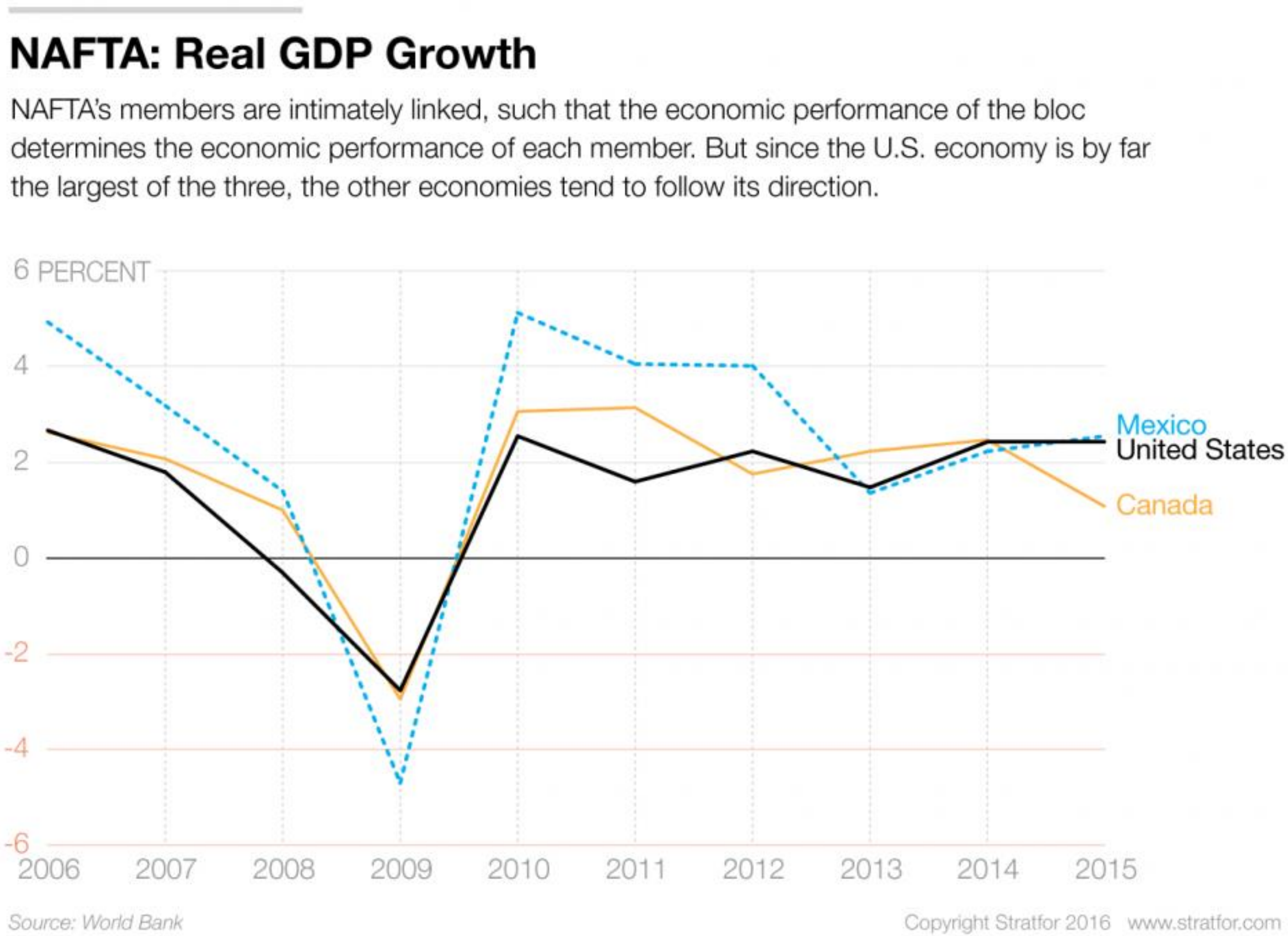
The potential downsides to NAFTA have been similarly difficult to tease out. One of NAFTA's biggest political goals, for example, was to spur industrialization in Mexico in the hope of reducing economic disparity among the bloc's members. And for the most part, Mexico has benefited as planned: Today, exports of Mexican vehicles and their parts to the United States and Canada have more than tripled, amounting to an impressive $80 billion (and 21 percent of Mexico's total exports) in 2015. The automobile sector, along with other industrialized sectors such as plastics, electronics and aerospace — many of which are specifically geared toward the U.S. and Canadian markets — have become indispensable to the Mexican economy. NAFTA critics have noted, however, that Mexico's industrialization has hardly been uniform and that its gains have largely been concentrated in key metropolitan or border areas such as Puebla, Monterrey and Mexico City.

In the United States, moreover, the bloc has taken the fall for the recent disappearance of manufacturing jobs. From 1965 to 2000, 17 million to 19 million U.S. workers were employed in the manufacturing sector. But since then, the sector has bottomed out, dipping to as low as 11.5 million jobs in 2010 — the fewest in the United States since it entered World War II. The loss of manufacturing jobs has been problematic to say the least for certain cities, particularly since the industries they service often support the communities they are built on. Gary, Indiana, for instance, grew into a city of nearly 180,000 after it was founded by the U.S. Steel Corp. in 1906. Today, its population is thought to be below 80,000.

Though U.S. manufacturing jobs have certainly declined, it is difficult to pinpoint how much of that slump is directly related to NAFTA rather than to broader changes in the U.S. economy, technological advances, rising U.S. labor costs or trade agreements with other countries such as China. In fact, there is an argument to be made that deeper economic integration with Mexico has protected some U.S. industries, though most studies have concluded that NAFTA's impact on the U.S. labor market and job creation has been minimal. Since the 1980s, global supply chains have undergone a dramatic transformation. Trade in components and parts — not just the final assembled products — has grown, especially in Asian electronics and automobile sectors. Mexico's protectionist policies (and the United States') in these sectors have allowed it to thrive, becoming the middle-tier, middle-wage manufacturing hub that U.S. workers simply are not interested in being a part of. Mexico's automobile sector has since woven itself into the United States' sector, where cheaper Mexico-made parts can support what otherwise may have been unprofitable U.S. endeavors. Volkswagen, for example, was nearly forced to pull out of North America in response to rising costs. Now it has opened a major auto plant in Chattanooga, Tennessee, where it sources 85 percent of its parts from other NAFTA states (the bulk of which come from Mexico).

Unity That Transcends Union

For now, NAFTA's fate will remain subject to the ebb and flow of domestic politics, making the establishment of a customs union or a common market highly unlikely in the coming years. Realistically, the development gap between the Mexican economy on one hand and the U.S. and Canadian economies on the other will be politically difficult to bridge in the pursuit of deeper ties. The creation of a smaller customs union between the United States and Canada, by comparison, is far more feasible if their attention moves beyond their current focus: renegotiating NAFTA to better protect their citizens' jobs.



Even though a substantial reworking of the NAFTA accord is possible, it would not be easy, nor would it stop the bloc's members from ramping up their cooperation in other ways. Companies, supply chains, laws, standards, tariff structures and countless other operations have adjusted to the circumstances put in place by NAFTA's creation. Rolling the agreement back would be incredibly disruptive to them all, and though British voters were willing to absorb such a shock because of their concerns about European immigration, no similar catalyst exists in North America to trigger the departure of one of NAFTA's members.

In the meantime, Mexico — which, because of its comparatively small economy, stands to gain the most from deeper integration — will continue to push for fewer trade restrictions and barriers among NAFTA states, particularly as it liberalizes and develops its manufacturing sector. New technologies such as advanced manufacturing techniques will probably shift some manufacturing away from other parts of the world and back toward North America as well. And Mexico, with its lower wages and rising semi-skilled workforce, will be well-positioned to receive it, cementing the country's role as the United States' primary manufacturing provider. The United States' preoccupation with job loss will no doubt continue to be a pressing issue for Washington, but its trade and labor disputes will likely center more on Asia and the TPP over the coming decade as the United States turns its gaze toward the Pacific.

Closer to home, the NAFTA debate will morph into a bilateral dispute between the United States and Mexico over immigration. The conflict is more likely to play out in favor of deeper integration than against it, with the Hispanic vote swaying U.S. politics toward cooperation with Mexico on several issues. The uptick in migration from Mexico to the United States is beginning to level off as the Mexican economy improves (thanks in part to NAFTA) and as more jobs become available south of the border. Rising U.S. nationalism is unlikely to create backlash against Mexico itself, but much as it has in the manufacturing jobs debate, U.S. political rhetoric on immigration has been slow to catch up with realities on the ground.

Either way, there is little to suggest that North American trade ties will dissolve any time soon. But the framework dictating them could. The TPP, which includes all of NAFTA's members as well as most of the Pacific Rim, might someday render the North American bloc moot, though it, too, faces political obstacles that it may never overcome. In many ways the TPP is a more robust trade agreement than NAFTA, and the United States considers it a crucial opportunity to counter the rise of China — whose economy, by some accounts, is already larger than the United States' — in the Asia-Pacific region. Mexico and Canada, by comparison, view the potential bloc as a threat to their competitiveness within the U.S. market. (Mexico, in particular, directly competes with many Asian exporters.) Even so, participating in the TPP, should it come to pass, will be necessary for NAFTA's smaller members to ensure their continued connection to the United States. And this is the dynamic that will define the future of North American integration: The United States will continue to set the pace and direction of its own global trade ties, leaving Canada and Mexico no choice but to follow its lead.