Introduction

Twenty years after its implementation, the North American Free Trade Agreement, or NAFTA, has helped boost intraregional trade between Canada, Mexico, and the United States, but has fallen short of generating the jobs and the deeper regional economic integration its advocates promised decades ago. Trade relations have broadened substantially, and U.S. manufacturers created supply chains across North America that have made companies more globally competitive. These factors may have stimulated economic growth; Canada has expanded at the fastest average rate and Mexico at the slowest. But economists still debate NAFTA's direct impact, given the many other economic forces at play and the possibility that trade liberalization might have happened even without the agreement. Both advocates and critics of the treaty have lobbied for changes to NAFTA, but momentum has stalled and is likely to be overtaken by larger trade agreements under negotiation such as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership.

What is NAFTA?

NAFTA is a trilateral free-trade deal that came into force in January 1994, signed by U.S. president Bill Clinton, Mexican president Carlos Salinas, and Canadian prime minister Jean Chrétien. The central thrust of the agreement is to eliminate most tariffs on products traded among the United States, Mexico, and Canada. The terms of the agreement called for these tariffs to be phased out gradually, and the final aspects of the deal weren't fully implemented until January 1, 2008. The deal swept away import tariffs in several industries: agriculture was a major focus, but tariffs were also reduced on items like textiles and automobiles. NAFTA also implemented intellectual-property protections, established dispute-resolution mechanisms, and set up regional labor and environmental safeguards, though some critics now lobby for stronger measures on this front.

How do economists assess NAFTA's economic impact?

It is difficult to determine causality between NAFTA's implementation and economic growth, and it is impossible to quantify the counterfactual—how trade policy might have liberalized without NAFTA. Intraregional trade flows have increased significantly over the treaty's first two decades, from roughly $290 billion in 1993 to more than $1.1 trillion in 2012. Cross-border investment and travel have also surged. The United States trades more in goods and services with Mexico and Canada than it does with Japan, South Korea, Brazil, Russia, India, and China combined. Much of this growth has been due to increased trade between the United States and Mexico, where the trade balance—the difference between exports and imports—swung from a $1.7 billion U.S. surplus in 1993 to a $61.4 billion deficit in 2012.

"NAFTA was designed to promote economic growth by spurring competition in domestic markets and promoting investment from both domestic and foreign sources. It has worked," write Gary Clyde Hufbauer and Jeffrey J. Schott, experts at the Peterson Institute for International Economics and the authors of NAFTA Revisited: Achievements and Challenges.

Originally, critics of NAFTA focused on labor-market dislocations, and warned that the United States would experience sharp job losses as companies moved production to Mexico to lower costs. But this effect has proven to be modest for the United States because total trade with Mexico and Canada account for a small percentage of the U.S. economy.

Many trade experts say that in the long term, free-trade deals such as NAFTA produce benefits despite some painful short-term costs such as the movement of some jobs and industries across borders. But according to at least one major study, the benefits are limited. The Congressional Budget Office attempted a full-scale examination of NAFTA's economic consequences in 2003, and concluded that:

U.S. trade with Mexico was growing before NAFTA's implementation, and would likely have continued to grow with or without the deal on a scale that "dwarfs the effects" of NAFTA itself; the direct effect of NAFTA on U.S.-Mexico trade is fairly small, and thus the direct impact on the U.S. labor market is also small; and overall, the NAFTA deal has only expanded U.S. gross domestic product (GDP) "very slightly," with a similarly small and positive effect on the Canadian and Mexican economies.

Source: Congressional Research Service

Some studies overlook the effect of the development of supply chains, which has been credited to NAFTA. Companies in the three countries, especially U.S. auto manufacturers but also North American makers of electronics, machinery, and appliances, have benefitted from spreading production lines across each country to reduce costs and become more globally competitive, a tactic that would be more difficult without the tariff reductions of NAFTA. Economists estimate that 40 percent of the content of U.S. imports from Mexico and 25 percent of the content of U.S. imports from Canada are of U.S. origin [PDF]. U.S. imports from China, by comparison, only contain 4 percent U.S. content. "Ignoring these input-output linkages could underestimate potential trade gains," noted a Congressional Research Service report.

How has NAFTA affected the U.S. labor market?

Wide disagreement persists on how and to what degree NAFTA accounts for changes in net employment from adjustments in the labor market. Supporters of NAFTA, and many economists, see a positive impact on U.S. employment and note that new export-related jobs in the United States pay 15 to 20 percent more on average than those focused on domestic production. But side effects of the treaty should not be ignored. Edward Alden, a senior fellow at the Council on Foreign Relations, notes that wages haven't kept pace with labor productivity and that income inequality in the United States has risen in recent years, in part due to pressures on the U.S. manufacturing base. To some extent, he says, trade deals have hastened the pace of these changes in that they have "reinforced the globalization of the American economy."

Opponents of NAFTA take a starker position. Thea M. Lee, the deputy chief of staff at the AFL-CIO, which opposes NAFTA and lobbies against other free-trade agreements unless they include provisions that raise labor and environmental standards, said that NAFTA forced "workers into more direct competition with each other, while assuring them fewer rights and protections." Public Citizen, the left-leaning Washington nonprofit consumer rights organization, said in a report that the "grand promises made by NAFTA's proponents remain unfulfilled" [PDF] twenty years after implementation and resulted in the loss of one million U.S. jobs by 2004.

But most economists say it is a stretch to blame these shifts on NAFTA. Manufacturing in the United States was under stress decades before the treaty, and job losses in that sector are viewed as part of a structural shift in the U.S. economy toward light manufacturing and high-end services. Alden says that broader economic trends affecting U.S. employment, such as China's economic rise, wouldn't be substantially altered by U.S. policy shifts toward NAFTA.

What impact has NAFTA had on Mexico?

One lofty, unrealized promise of NAFTA was that the treaty would narrow the gap between the per capita incomes of Mexico, the United States, and Canada. Per capita income in Mexico rose at an annual average of 1.2 percent over the past two decades, from $6,932 in 1994 to $8,397 in 2012, far slower than Latin American countries such as Brazil, Chile, and Peru. NAFTA was also expected to discourage Mexican emigration to the United States, yet despite the 2007–2009 recession and increased deportations, Mexican-born people living in the United States doubled since 1994 to 12 million in 2013, writes Jorge G. Castañeda, a professor at New York University and former foreign minister of Mexico. Industries excluded from NAFTA—such as telecommunications, television, and transportation—allowed Mexico's wealthiest to become even richer; the country now claims the world's richest man, Carlos Slim Helu.

Some critics single out Mexico's farm industry, saying NAFTA has crippled Mexican farming prospects by opening competition to the heavily subsidized U.S. farm industry. Economists dispute this assessment. The Economist notes that despite increased competition, Mexican farm exports to the United States have tripled since NAFTA's implementation, in part because of reduced tariffs on maize.

Experts say trade liberalization between Mexico and the United States has had positive consequences for Mexicans generally, not just Mexican business interests. For instance, the deal has led to a dramatic reduction in Mexican prices for clothes, televisions, and food, which helps offset slow income growth. GEA, a Mexico City-based economic consulting firm, estimates that the cost of basic household goods in Mexico has halved since NAFTA's implementation. Mexican workers in the car manufacturing and aeronautics sectors of northern Mexico have benefitted from the treaty and helped expand the country's manufacturing base.

And Mexico has enjoyed an intangible benefit of NAFTA: The country has adopted orthodox economic management practices and is no longer prone to crises. "The agreement ended up straitjacketing a government accustomed to overspending, overpromising, and underachieving," wrote Castañeda. The government abandoned many protectionist policies and allowed the prices of tradable goods to converge on both sides of the border, which reduced deficits and limited the potential for currency crises, he added.

What impact has it had on Canada?

If anything, Canada has seen the strongest gains among the three NAFTA countries, though, again, it is difficult to attribute direct causation, particularly given that Canada and the United States had a free-trade deal that predated NAFTA. Canada is the leading exporter of goods to the United States, U.S. and Mexican investments in Canada have tripled, and Canada has added 4.7 million new jobs since 1993. Canadian manufacturing employment held steady, though the "productivity gap" between the Canadian and U.S. economies wasn't narrowed: Canada's labor productivity stood at 72 percent of U.S. levels in 2012 despite Canada's highly educated work force [PDF].

"NAFTA was designed to promote economic growth by spurring competition in domestic markets and promoting investment from both domestic and foreign sources. It has worked." –Gary Clyde Hufbauer and Jeffrey J. Schott, Peterson Institute for International Economics

One of NAFTA's biggest economic effects on U.S.-Canada trade has been to increase bilateral agricultural flows. Canada is the leading importer of U.S. agricultural products, and U.S. agricultural exports to Canada roughly doubled between 1994 and 2003. The U.S. Department of Agriculture offers a sector-by-sector review of U.S.-Canada trade since NAFTA's implementation, which shows broad increases in trade in several sectors.

What’s next for NAFTA?

During the 2008 U.S. presidential election, many Democrats called for an amendment of NAFTA to include additional labor and environmental standards. Renegotiation of NAFTA was floated, but the idea was abandoned after the campaign and wasn't a factor in the 2012 election. With jobs as a perennial political issue, many economists who broadly support NAFTA say that reforms to the Trade Adjustment Assistance (TAA) program could help quell anger directed at trade liberalization. Experts including Alden note that positive long-term economic change often is accompanied by job-market turbulence, though the ability of TAA to address these challenges is limited. While some Democrats want the program expanded, many Republicans favor its elimination. One component of an expanded TAA could be wage insurance, which a 2007 Council Special Report argued would protect workers who face sustained long-term wage losses.

Robert Pastor, the late Latin America specialist and American University professor, noted in a 2013 Policy Innovation Memorandum that trade growth under NAFTA was much faster between 1993 and 2001 than in subsequent years. He attributed part of the decline to post-9/11 border restrictions and rising Chinese exports after Beijing joined the World Trade Organization, but placed most of the blame on the "failure of leaders in the three countries to build on NAFTA's foundation and create a seamless market." Pastor argued for deeper North American integration under NAFTA to invigorate the three economies and make them more competitive.

Both critics and proponents of NAFTA have proposed changes that would improve trade and economic relations in North America. A 2013 Congressional Research Service [PDF] report on NAFTA notes that some of these policies include strengthening protections for workers and the environment, enhancing regulatory cooperation, investing in border infrastructure, and promoting research and development to improve the competitiveness of North American industries.

Trade remains a divisive issue in the United States, and efforts to advance regional integration through NAFTA have largely stalled. But new potential trade agreements, such as the Trans-Pacific Partnership (TPP)—which comprises Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, Japan, the United States, and Vietnam—may bring in a set of rules that go beyond NAFTA and ultimately deliver the reforms that regional negotiations haven't reached. Proposed TPP provisions on labor and the environment, stronger intellectual property rights, and constraints on state-owned enterprises, if agreed upon, will effectively update trade relations without reopening the treaty.

Lee Hudson Teslik contributed to this report.