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FREE TRADE AGREEMENTS AND NORTH AMERİCAN FREE TRADE AGREEMENT

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Introduction

This essay is divided into four parts. In the first part we will attempt to define "free trade" in both theoretical and practical terms

The second part is a review of the history and evolution of major bilateral and multilateral free trade agreements, including: The US-Isreal Free Trade agreement, The U.S.-Canada Free Trade Agreement (CFTA), The Asian Pacific Economic Cooperation (APEC), The Europen Economic Community (EEC), The European Free Trade Association (EFTA), and The General Agreement on Tariffs and Trade (GATT).

Part III looks at the core of this essay, that is to say the analysis of the proposed North American Free Trade Agreement (NAFTA). In this part, we will look at the economic structure of Mexico, the U.S., and Canada and at their intertrade relationships.

In part four, some of the most important nontrade issues around the NAFTA debate are discussed as well as the impact of this agreement on the world trading system. The conclusion of this essay is presented in part five.

Historical Evaluation of Free Trade Agreements

To promote the trade liberalization, bilateral trade agreements have become both a complement and an alternative to the General Agreement on Tariffs and Trade (GATT). The GATT is a multilateral trade agreement which contains guidelines of conduct for international trade and is based on three basic principles: nondiscriminatory treatment of signatories in trade

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matters; eventual elimination of tariff and non-tariff barriers, accomplished largely through negotiations; and the resolution of conflicts or damages arising from the trade action of another signatory through consultation. Free Trade Zones (FTZ) and Export Processing Zones (EPS) are the pioners of free trade. More than 65 countries currently have at least one FTZ or EPZ. Asia's progress in international trade has been, in part, the result of FTZ and EPZ.

As the US trade deficit improves, there is less opposition from congressional leaders to free trade.

Bilateral Trade Agreements

The United States began entering into bilateral agreements with Isreal in 1975 and with Canada in January 1989. The US is currently engaged in the negotiations for a North American Free Trade Agreement with Mexico and Canada.

GATT, The Multilateral Trade Agreement

The General Agreement on Tariffs and Trade (GATT) has, since its creation in June 1947, fostered unrestricted multilateral trade among its close to 100 member nations.

GATT was created in an effort to harmonize the trade by eliminating the distorting barriers and practices in it.

Free Trade Organizations

Some scholars invisage a tri-polar trade system, including:

1– NAFTA, 2– The E.C., 3– APEC (The Asion Pacific Economic Cooperation), and 4 – EFTA (The European Free Trade Association).

It is expected that by 1992 the European Community will have removed all the barriers in the free flow of GOODS, SERVICES, CAPITAL and PEOPLE. The proposed North American Free Trade Agreement, in contrast to the EC, will only include GOODS and CAPITAL (no people) and maybe SERVICES. This is because of the differences in the social and economic structures between Mexico, Canada and the US.

Theoretically, free trade should drive the price of LABOR, LAND, CAPITAL and OTHER FACTORS of PRODUCTION to the same level in all countries.

As economic and political reforms take place in their trade relations in Eastern Europe, the East and the West are coming closer in terms of trade. We should envisage the elimination of trade barriers for Eastern European Countries in the near future.

North American Free Trade Agreement

The economic changes that have taken place in the world have made the US, Canada and Mexico realize the need for strengthening their economic relationships through the creation of a North American free trade area.

NAFTA should also be analized in the context of multilatarel trade.

This agreement will create the largest free trade area in the world with 360 million people and a yearly out-put of $ US 6 trillion.

In order to eliminate the barriers, the involute countries should agree to harmonize their measures and standands to make them compatible.

The creation of a common monetary system and the free flow of people will not be part of the NAFTA negotiations. The negotiations will be comprehensive. They will address the symmetrical phase out of the barriers in investment, intellectual property rights, financial services and in other areas.

Since Canada only accounts for approximately 8 % of ($ US 33 million) FDI in the US and the US accounts for close to 70 % of FDI in Canada, within the framework of NAFTA. There might be the possibility of investment diversion from Canada down to Mexico.

MEXICO

Since the mid 1980's Mexico has introduced important economic reforms (liberalization of the economy, reduction of the debt through agreements with commercial banks, etc.)

Mexico's economy has softened, from a high external debt, low capacity of export and a negative trade balance. This situation worsened as a result of political difficulties that is congruent to the transition from the La Madrid government to the Salinas administration.

The Salinas economy policy has included: a) the control of the wages by means of an agreement reached between workers, businessmen and the government. b) The renegotiation of the foreign debt that was inhibiting economic growth. c) The reduction of inflation that allowed for the opening of the economy to free trade. d) The introduction of new policies to attract foreign investment and the creation of a legal framework to protect the fiscal policy system.

In 1989 the foreign trade of Mexico was divided into the following proportious: US was 67 %, with the European Comminity 13 %, with the Pacific basin 7 %, with the Latin America 6 %, and 8 % with the rest of the world(1). Three fourths of its trade with the US.

This agreement hope is favoring the growth of Mexican economy as a result of NAFTA. The US will be able to increase its exports to Mexico,

(1) The Mexican Agenda; October 1990,Presidency of Mexico Office of the Press Secratary to the president.

and some border problems "such as drugs, immigiration and pollution" will be alleviated. Furthermore, Mexico exports, as a result of NAFTA to reduce its capital flight.

Mexico, in comparison to other investment sites, offers proximity and secutiry of access to the US market.

Mexico will benefit from the influx of FDI specially at a time of global capital shortage.

However many Mexicans are worried that free trade will make Mexico less self-sufficient.

Mexico: Statistical Profile

Government: Federal Republic
President: Carlos Salinas de Gortari
Term ends: December 1994

	1987	1988	1989	1990(E)
Economy (US $ billions unless noted)				
Population[5] (millions)	82.0	83.5	84.5	86.0
GDP (current $ at controlled exchange rate)[1,5]	143.1	175.0	201.4	228.0
GDP Real Growth[5]	1.4	1.1	2.9	3.0
GDP Per Capita[5]	1.537.0	2.096.0	2.375.0	2.651.0
Government Spending as Percentage of GDP[3]	43.0	43.4	40.0	N/A
Consumer Price Index[5]	159.2	51.7	19.7	28.0
Unemployment (Unofficial Rate)[5]	18.0	18.0	18.0	18.0
Average Exchange Rate	1.366.7	2.250.0	2.453.0	2.848.0
Foreign Debt[5]	107.4	105.0	95.0	93.6
Debt Service Ratio	42.0	46.0	40.0	N/A
Manional Minimum Wage (pesos/day)	4.254.0	7.998.0	10.080	11.900.0
Foreign Trade (US $ billions unless noted)				
Total Mexican Exports of Goods (FAS Value)[3]	20.6	20.6	22.7	24.6
Total Mexican Imports of Goods (CUs. Value)[3]	12.2	18.9	23.4	25.7
Total Mexican Imports of Services[3]	9.3	11.2	N/A	N/A
Total Mexican Exports of Services[3]	14.3	16.4	N/A	N/A
U.S. Exports to Mexico (FAS Value)[2]	14.6	20.6	24.9	28.5
U.S. Imports from Mexico (Customs Value)[2]	20.2	23.2	27.2	30.5
U.S. Exports of Services to Mexico[2]	3.5	4.1	5.2	N/A
U.S. Imports of Services from Mexico[2]	6.1	6.9	7.9	N/A
Principal U.S. Exports[2]				
Motor Vehicle Parts	1.4	1.8	2.0	2.8
ADP Equipment	.3	.5	.4	.4
Sorghum	.1	.1	.3	.4
Corn	.3	.3	.4	.5
Principal U.S. Imports[2]				
Crude Petroleum	3.6	2.9	4.0	4.0

Passenger Cars	1.2	1.3	1.2	1.4
Television Receivers	.3	.6	.9	.9
Coffee	.4	.3	.5	.5
Foreign Supplier Share of Imports				
United States	61.9%	66.7%	70.8%	N/A
West Germany	6.5%	6.3%	6.1%	N/A
Japan	6.2%	6.0%	4.8%	N/A
BOP Current Account Balance[3]	3.9	–2.4	–3.1	–5.0
Mexico'c Trade Balance with Leading Partners				
United States	5.8	.9	–.11	N/A
Japan	.5	.1	.24	N/A
West Germany	–.5	–.7	–1.00	N/A

Import Policy

Tariffs: Range from 0 to 20 percent

Additional Taxes: 0.8% Customs Handling Fee; 15% VAT

Licensing: 2.7 percent of tariff categories, 25 percent based on value of imports.

Best U.S. Export Prospects[5]

Oil and Gas Field Machinery and Equipment
Eelectric Power Production and Distribution Equipment
Computer Systems and Peripherals, Software and Services
Agricultural Equipment
Telecommunications Equipment
Pollution Control Equipment
Hotel and Restaurant Equipment
Medical Instruments, Equipment and Supplies

Foreign Direct Investment

Total U.S. Direct Investment:[4] $7.1 billion (1989 estimate)
U.S. Share, Foreign Direct Investment:[5] 62.1% (1989 estimate)
Top Three U.S. Investors:
Chrysler of Mexico
General Motors of Mexico
Ford Motor Company
Principal Third Country Foreign Direct Investment, as Prencentage of Total:[5]

West Germany	7.0%
Japan	6.4%
Switzerland	4.6%
United Kingdom	4.2%

Total Mexican Investment in the United States: $ 958 million (1989 estimate)

Sources:
1: International Monetary Fund
2: U.S. Department of Commerce
3: Bank of Mexico
4: Bureau of Economic Analysis
5: U.S. Embassy, Mexico City

Note: Mexican merchandise trade data does not include in-bond transactions.

Prepared by U.S. Department of Commerce, Office of Mexico, January 23, 1991.

CANADA

After looking at same statistical data on the economic and social structures of the US, Mexico and Canada, we can ask what will the position be in the future of each of these countries the frame of the proposet North American Free Trade Agreement.

February 1991
CANADA FACT SHEET

1. Profile

Population (1989): 26.094.000
Religion: Catholic (47.3%), Protestant (41.2%)
Government: Federal Republic, Parliamentary
Prime Minister: Brian Mulroney
Languages: English and French
Current Prime Minister's term ends: Must call an election by November 1993.

2. Economy

	1987	1988	1989
GDP ($ billions)	412.8	487.2	546.2
GDP (constant '81 $'s)	353.9	371.6	380.9
GDP Per Employee	35.951.0	36.571.0	36.771.0
GDP Per Capita ($)	13.878.0	14.403.0	14.594.0
Inflation	4.4%	4.1%	5.1%
Average Unemployment	8.8%	7.8%	7.6%
Official International Reserves ($ billions)	8.2	16.2	15.9
Exchange Rate (1 US$=C$)	1.33	1.23	1.19
Industrial Product Price Index (1981=100)	122.8	128.1	131.0
Canadian World Exports ($ billions)	94.6	111.2	116.7
Canadian World Imports ($ billions)	86.3	103.3	112.8

3. U.S. –Canada Trade ($ billions)

	1987	1988	1989	1990
MERCHANDISE:				
U.S. Exports	59.8	71.6	78.8	83.9
U.S. Imports	71.1	81.4	87.9	91.4
TOTAL	130.9	153.0	166.7	175.3

BALANCE	–11.3	–9.8	–9.1	–7.5
SERVİCES:				
U.S. Receipts	9.0	9.9	11.2	12.8e
U.S. Payments	5.8	7.7	7.7	6.2e
TOTAL	14.8	17.6	18.9	19.0e
BALANCE	3.2	2.2	3.5	6.6e
GOODS AND SERVICES:				
TOTAL	145.7	170.6	185.6	194.3e
BALANCE	–8.1	–7.6	–5.6	–.9e
PRİVATE RECEIPTS ON U.S. ASSETS IN CANADA				
U.S. Receipt	13.3	15.8	14.9	12.9e
U.S. Payments	3.0	3.7	3.6	4.8e
TOTAL	16.3	19.5	18.5	17.7e
BALANCE	10.3	12.1	11.3	8.1e
GOODS, SERVİCES AND PRİVATE RECEIPTS ON U.S. ASSETS IN CANADA				
U.S. Export/Receipts	82.1	97.3	104.9	113.0e
U.S. Imports/Payments	79.9	92.8	99.2	102.9e
TOTAL	162.0	190.1	204.1	215.9e
BALANCE (Current Account)	2.2	4.5	5.7	10.1e

4. Forign Direct Investment ($ billions)

U.S. Direct Investment in Canada	57.0	61.0	63.0	n/a
Canadian Direct Investment in the United States	22.0	27.0	30.0	n/a

SOURCES: **Survey of Current Business:** U.S. Department of Commerce, December 1990, Table 10.

U.S. Foreign Trade Update: U.S. Department of Commerce, February 1991, Table 3.

Canada is joining Mexico and the US to create a North American Free Trade zone for a variety of reasons, amog them: a) to profect its trade interest, b) to enter the Mexican market, and c) to enjoy the benefits of a more stable Mexico that has undergone economic and social reforms.

Despite of economic differences between Canada and Mexico, Canada expects to benefit from Mexico more than from the U.S.

In trasportation, free trade will encourage the traffic of capital and goods from East-West movements towards increased North-South movements.

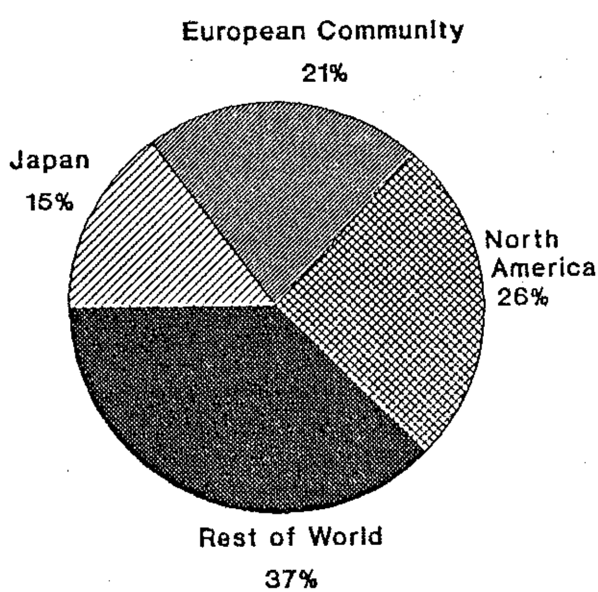
One of the major interests for Canada to join Mexico and the U.S. in a free trade agrement is to secure its ability to attract foreign investment.

The USA

As you know the US economy is one of the largest in the world and analyzing the total performance of the US economy is a task that goes beyond the faction, scope of this paper. So we will only highlight the US-Canada and the US-Mexico trade relationship in order to point out some of the potential economic effects of NAFTA on the US economy.

The following figure shows the position of the US in the world trade system, in 1990.

U.S. Total World Trade
1990



26 %, nearly one-third of the total of US trade, takes place in North America.

Canada is its largest partner and Mexico is its thirdlargest partner coming after Japan.

(Billion dollars)	Export	Import	Balance
JAPAN	44.6	93.6	–49.0
CANADA	78.6	88.2	– 9.6
MEXICO	25.0	27.2	– 2.2

Source: The Free Trade Agreement and trade relations between Mexicon and The US; Sectetary of commerce and industrial development worksheet, January 1991, pg: 10.

US exports to Mexico have increased at an annual rate of 20% during the last seven years. It has jumped from 12 billion dollars in 1985 to almost 25 billion dollars in 1989. Furthermore this increase in exports has generated 375.000 additional jobs in the U.S. between 1985 and 1989(2). The market size, population structure, faktor endowment and production processes of the countries involved, will be altered by the effects of the proposed NAFTA.

The market size of North America is expected to encompass 350 million people with a gross of domestic produts of $ US 5.032 billion dollars.

When we compare the factor allocations of the U.S. and Mexico, we can see that the U.S. has advantages in high technology, capital intensive production processes, since 83% of Mexicans are under the age of 40.

The U.S. imports approximately 25% of its fruit and vegatables from Mexico. Some states, such as California, Texas and Florida worry that NAFTA will have negative effects on their agricultural economies.

As a result of a US-Canada free trade agreement, institutions of Canada were expected to increase their ownership in the U.S.

The trade increasing is expected to reduce. The problem of enormous ammounts of paperwork and traffic at the locations of border crossing. Transportation specialists and brokerage houses should introduce electronic data of interchange systems (E.D.I.).

Basics On NAFTA

1. First bilateral agreement,
2. Plurilateral "(No multilateral/No bilateral)
3. A successful NAFTA will lead to the creation of a hemispheric free trade area, as intended by president Bush's "Enterprise for the Americans".
4. A symmetrical phase out of trade barries.
5. Traiff and non-tariff goods,
6. Currently no international rules governing services,
7. 360 million people,
8. $6 trillion annual output
9. Since 1986 accounted for more than 40 % of US Ec. growth,
10. $237 billion US-MEX-CAN trade in 1990.
11. Business should be familiar with:
    a) Harmonized system of tariff classification (HS)
    b) Rules of origin of agreement
    c) Exporter's certificate of origin

(2) Same Source, pg: 11.

12. US accouts for nearly 70% of FDI in Canada.
13. Canada is the 4th largest foreign investor in US with 8% of total FDI,
14. Negotiations are highly contentious,
15. Global capital shortage,
16. The US imports 25% of its fruits & vegetables from Mexico annualy,
17. More than 1/4 of US world trade takes place in North America,
18. Since 1980, US trade with CANADA & MEXICO more than doubled,
19. US exports to MEXICO have almost doubled since 1987,
20. Automobile parts are US leading export to MEXICO.

Conclusions

In a world increasing trade competition, nations have tended to form trading blocks. NAFTA will be the first major tri lateral trade agreement that will give place to major changes in the economic structures and trade relations partners of the USA, Canada and Mexico. A successful NAFTA is expected to facilitate the creation of an hemispheric free trade are, as intended in president Bush's "Enterprise for the Americans".

Currently NAFTA negotiatians are taking place and since they have decore highly contentious, it is difficult to foresee the content of what has become a promising agreement for the economies of North America.

References:

1. The Mexican Agenda; October 1990, Presidency of Mexico Office of the Press Secratary to the President.

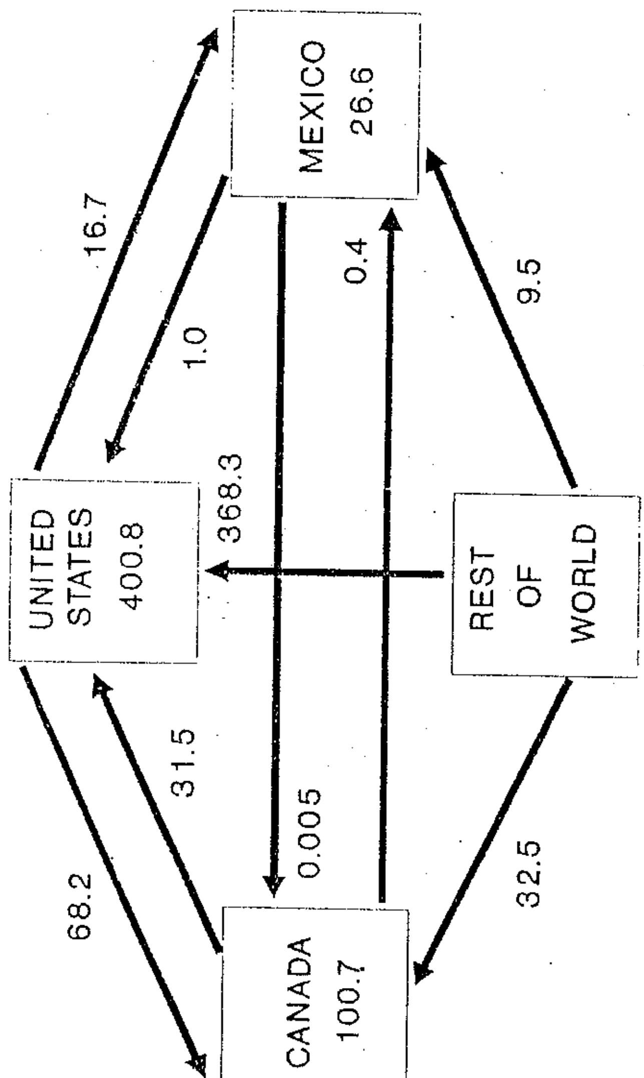
2. U.S. Department of Commerce, Office of Mexico, January 23, 1991.

3. The free trade Agreement and trade relations between Mexico and the US, Secretary of commerce and industrial development worksheet, January, 1991.

4. Investment Canada compilation using data from Statistics Canada, U.S. Department of Commerce, and the Mexican National Commission on Foreign Investment (N.C.F.I.)

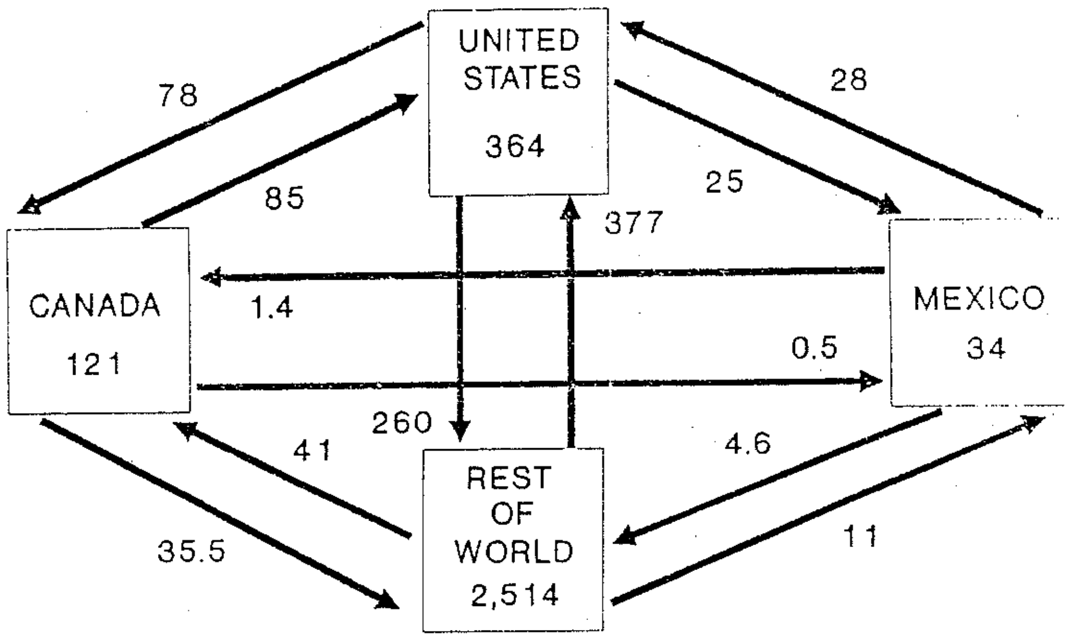
5. Investment Canada compilations from Direction Of Trade Statistics, I.M.F.

Foreign Direct Investment Stocks, 1989 (US$ Billions)
Canada - U.S.- Mexico - Rest of the World



Note: Stock of FDI for Country/Region shown in box.
Source: Investment Canada compilation using data from Statistics Canada, U.S. Department of Commerce, and the Mexican National Commission on Foreign Investment (NCFI)

1989 Exports (US$ Billions)
Canada - U.S.- Mexico - Rest of the World



Note: Total exports for country/region shown in box.
Source: Investment Canada compilations from
Direction of Trade Statistics, IMF.