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North American Free Trade Agreement (NAFTA)

Overview

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). At the time it was negotiated, NAFTA was unusual because it was the first time that a U.S. FTA linked two advanced economies with a lower income country. For this reason, the agreement sparked debate among policymakers, industries, labor unions, and other stakeholders 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.

On May 18, 2017, the Trump Administration sent a 90-day notification to Congress of its intent to renegotiate NAFTA, as required by the 2015 Trade Promotion Authority (TPA). Negotiations began on August 16, 2017, and eight formal rounds of negotiations had taken place as of April 2018. In May, the parties continued a "permanent round" of talks to resolve contentious issues related to U.S. proposals on automotive rules of origin, seasonal produce, dispute settlement, and a sunset clause to reevaluate the agreement every five years and to negotiate other issues such as labor and intellectual property rights (IPR). The 115th Congress may continue oversight of and its role in the negotiations, consider whether the Administration is following consultation requirements and negotiating objectives under TPA, and evaluate economic implications of a new agreement or possible NAFTA withdrawal.

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. NAFTA entered into force on January 1, 1994.

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 nontariff barrier elimination, customs procedures, energy, 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 side agreements on labor and the environment, which were included in the NAFTA Implementation Act.

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, 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 concluding multilateral 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, and strengthening trilateral relations. They ask that the Trump Administration "do no harm" in the NAFTA renegotiations.

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, and has been an infringement on U.S. sovereignty. Some labor groups ask that the NAFTA renegotiations include stronger protection of worker rights.

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 nontariff 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 side agreements. NAFTA was the first U.S. FTA with labor and environmental commitments and dispute settlement provisions, but these do not go as far as more recent FTAs.

Economic Effects

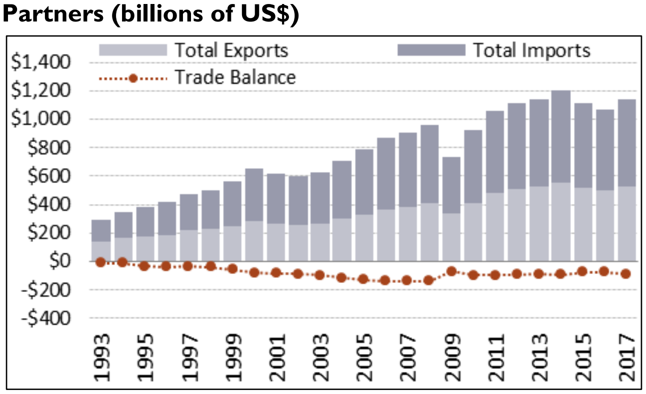
The overall net effect of NAFTA on the U.S. economy appears to have been positive, though modest, primarily because trade with Canada and Mexico account for a small percentage of U.S. GDP. Most economists contend that the claims on both sides of the NAFTA debate were exaggerated. NAFTA did not cause the job losses feared by the critics or the employment gains predicted by the proponents.

Many economists and other observers credit NAFTA with helping North American manufacturing industries become more globally competitive through greater economic integration, including through the development of supply chains. The deepening of manufacturing integration among NAFTA parties has significantly changed the nature of the trilateral economic relationship. The three countries do not simply sell finished products to one another, but increasingly produce them together. As a result of this unique trade relationship, supply chains have increasingly crossed national boundaries as manufacturing work is performed wherever it is most efficient.

While NAFTA may have accelerated North American trade since 1993, other factors, such as economic growth patterns and Mexico's unilateral liberalization measures, also affected trade. Trade also has been affected by factors such as currency fluctuations and economic growth. 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 (billions of US$)



Source: Compiled by CRS using data from ITC.

Trade Trends Since NAFTA

Since NAFTA's entry into force, U.S. merchandise trade with Canada and Mexico has more than tripled. In 2017, Canada was the leading market for U.S. goods exports, while Mexico ranked second. The two countries accounted for 34% of total U.S. exports and 35% of U.S. imports. Canada and Mexico ranked second and third (China was first), respectively, as suppliers of U.S. imports. Merchandise imports from NAFTA partners increased from $151 billion in 1993 to $614 billion in 2017 (307%), while exports increased from $142 billion to $525 billion (271%).

Issues for Congress

Congress may consider numerous policy issues related to the renegotiation of NAFTA and the future of U.S. trade policy such as the roles of Congress and the President regarding the negotiations or potential NAFTA withdrawal, as well as the economic effects. It may also consider political and strategic implications of U.S. relations with Canada and Mexico, as well as the economic effects of their trade initiatives such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Canada, Mexico, and the nine other remaining signatories of the Trans-Pacific Partnership (TPP) signed the CPTPP on March 8, 2018. The agreement has the potential to affect the economic well-being of certain U.S. stakeholders, as well as U.S. global economic leadership and long-standing U.S. promotion of an open, rules-based trading system.

The outcome of NAFTA renegotiations has implications for the future of U.S. trade policy and the broader North American economic and strategic relationship. Some economists estimate that if NAFTA were to terminate, real GDP, trade, investment, and employment would decline in all three NAFTA countries. A successful conclusion of the negotiations could modernize NAFTA with updated provisions in areas such as digital trade, labor, IPR protection, and anti-corruption. A new FTA would likely be considered by Congress under TPA. On the other hand, NAFTA implementing legislation states that the President may proclaim modifications to certain rules of origin and tariffs under certain circumstances and subject to Congressional consultation and lay-over provisions.

Some policy experts contend that maintaining an open trade relationship with NAFTA parties helps promote cooperation and has a positive impact on the economy and overall relations. Labor groups and some consumer-advocacy groups argue that NAFTA needs to be reconsidered because of possible job losses, negative effect on U.S. wages, poor working conditions in Mexico, and the perception that it weakens U.S. regulatory protections.

For more information see, CRS Report R44981, *NAFTA Renegotiation and Modernization*, by M. Angeles Villarreal and Ian F. Fergusson, CRS In Focus IF10038, *Trade Promotion Authority (TPA)*, by Ian F. Fergusson and CRS In Focus IF10000, *TPP: Overview and Current Status*, by Brock R. Williams and Ian F. Fergusson.

M. Angeles Villarreal, Specialist in International Trade and Finance

IF10047

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