Economic Reconciliation in North America

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Abstract

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North America is composed by Mexico, United States, and Canada. These three countries have had a history of cultural trouble and reconciliation throughout time but, is it possible for their economies to reconcile? This paper explains the ins and outs of the Mexican economy, the Canadian economy, and the economy of the United States. The purpose of this is to find the benefits and disadvantages of these countries' economies by finding their similarities and differences. This paper does this by providing an economic analysis of their monetary policies, fiscal policies, and exchange rates. This paper also explains what NAFTA was and what USMCA will be and how these type of agreements affect each country's economy. Finally, this paper explains under what circumstances the economic reconciliation in North America would be possible and beneficial and under what circumstances it would not.

Economic reconciliation in North America

It is widely known that Mexico, Canada, and the United States comprise the geographical region of North America. These countries might share a geographical area, but they do not have reconciled economies. Once upon a time, the economies of Mexico, Canada, and the United States were even further apart than they are today. Between 1960 and 2017, the economy of the United States grew by approximately 36 times, the Canadian economy increased by about 40 times, while Mexico experienced the greatest economic expansion of the three, rising by about 88 times (World Bank, 2018). The growth of these countries' economies reflects the catching up that Mexico and Canada are doing with regards to the United States, which is the biggest economy of them all.

Despite the catching up that the Mexican and Canadian economies are doing with regards to the United States' economy, the economy of the United States is still significantly larger. The economy of the United States was about 16.86 times larger than the Mexican economy and about 11.73 times larger than the Canadian economy as of 2017 (World Bank, 2018). This means that the gap between the economies of the United States, Mexico and Canada, is quite significant. The problem with economic growth of countries is that they do not always grow at a consistent rate. Rather, they fluctuate depending on many different situations and conditions.

Decades ago, the leaders of North America saw this issue and decided to do something about it. They signed the NAFTA (North American Free Trade Agreement) in 1994. This agreement called for opening of the economic borders in North America and reconciling these three economies by promoting free trade between the member nations. The current president of the United States, Donald J. Trump, said in a recent press conference on October 1st, 2018 that "NAFTA was the worst trade deal ever made". Although this statement has been proven to be false, this belief is why he decided to renegotiate the agreement with Mexico and Canada. He threatened to enact what is known as the "sunset clause", which means that the USA would exit

NAFTA if Mexico and Canada did not agree to renegotiate the deal. The three countries finally came to a resolution very recently, and created a new agreement. They named this the USMCA (United States, Mexico, Canada Agreement). The problem with this new treaty is that its purpose is not to reconcile the economies or to bring them together, but to benefit each individually from it, especially for the United States. Nevertheless, economic reconciliation in North America is possible. Mexico, Canada, and the United States can reconcile their economies through trade agreements that benefit all of the countries and through friendly negotiations, not threats. If all of the economies in North America reconcile with one another, the member nations can become one of the most powerful trading blocs in the world.

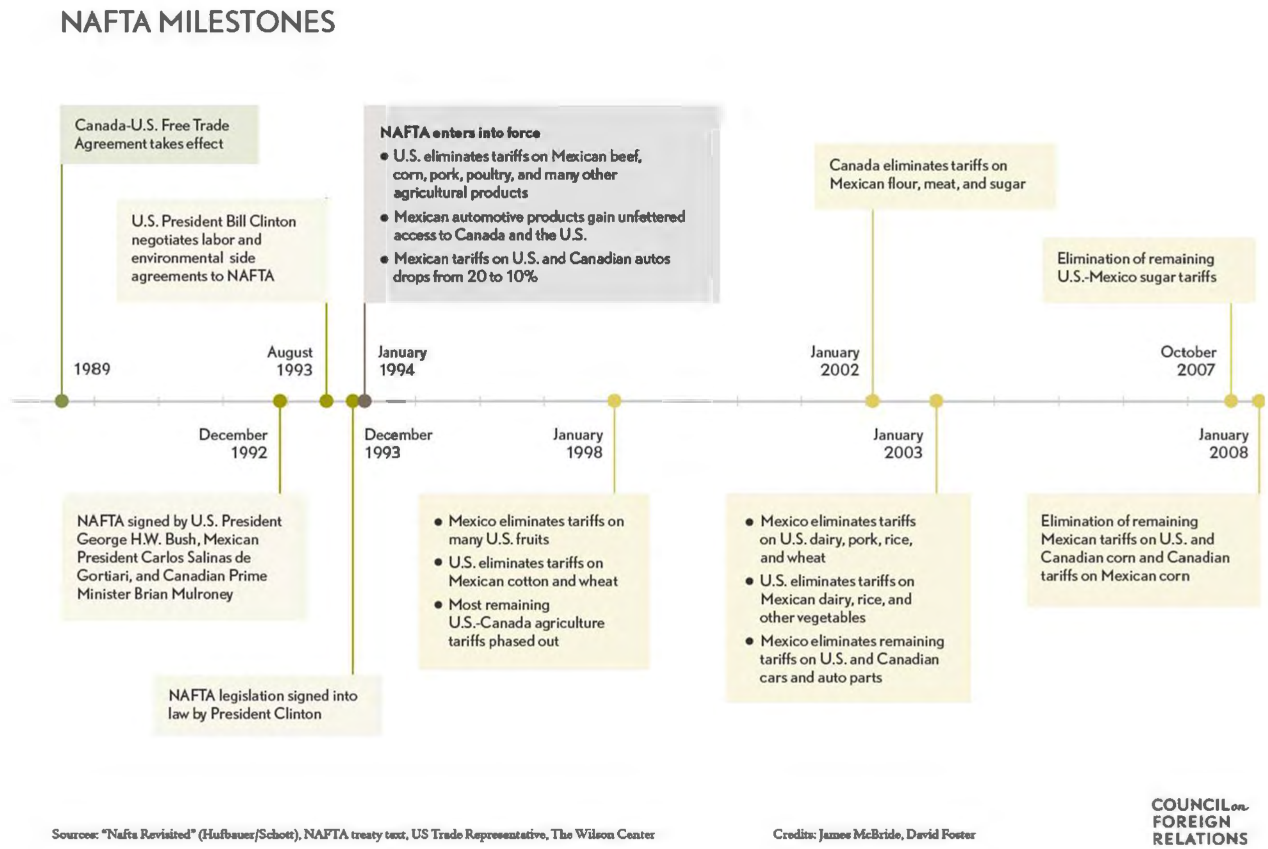
Historically, North America has been through phases of peace and war. As the 20th century was coming to an end, the North American economies started to grow more evenly than they had previously (World Bank, 2018). The United States and Canada commenced bilateral trade negotiations more than 30 years ago, resulting in the U.S.-Canada Free Trade Agreement, which entered into force on January 1, 1989. In 1991, bilateral talks started between Mexico and the United States. Canada eventually joined this conversations, and in January 1, 1994 NAFTA entered into force (USTR, n.d.).

The realities of situations in Mexico, Canada, and the United States were different at the time NAFTA was implemented. The Mexican economy was undergoing one of the worst economic crises that Mexico had ever faced. The Mexican GDP went from 527.8 billion USD in 1994 to 360.1 billion USD in 1995 (World Bank, 2018). This economic crisis was partially due to a rapid growth in the Mexican private sector, and a lack of adequate mechanisms of supervision and central banking regulations. The rapid growth was mostly attributed to a massive increase in foreign capital investment in Mexico, that first originated in 1988. This type of investment constituted 8% of the Mexican GDP from 1991 to 1993. The problem was that the foreign debt was financed by this short term rather than long term capital, increasing the country's leverage and increasing the Mexican economy's vulnerability. In addition to that, the Mexican Peso depreciated drastically against the US dollar. To get out of this crisis, the Mexican government, then led by Carlos Salinas de Gortari, had to take immediate action. First and foremost, the Mexican economy needed a boost. This boost was achieved by the use of restrictive fiscal and monetary policies, the adaptation of a flexible exchange rate, and through International funding to repay the debt (Ortiz, 2009). Secondly, Mexican president Carlos Salinas de Gortari concluded that Mexico would enter a free trade agreement with Canada and the United States, for which he had been in bilateral talks with the United States president, George H. W. Bush since 1991. Canadian prime minister Brian Mulroney joined the conversation later, and they finalized the North American Free Trade Agreement in 1994 (USTR, n.d.).

The situation of the United States and Canadian economies was different. The Canadian economy was stable, not undergoing any notable booms or busts, but it was experiencing very little growth in the early 1990's (World Bank, 2018). The economy of the United States started to grow at a more rapid rate than it had before 1991. Of the economies of North America, the one of the United States was the strongest one in the early 1990's. These disparities between the economies in North America called for immediate action so these economies could reconcile and grow more evenly. The leaders of North America responded to this need by signing a trade agreement: NAFTA.

NAFTA was created with the purpose of opening the economic borders of North America. It sought to do this through free trade. Since 1994, "tariffs were eliminated progressively and all duties and quantitative restrictions, with the exception of those on a limited number of agricultural products traded with Canada, were eliminated by 2008." (USTR, n.d.) "Liberalization of trade in agriculture, textiles, and automobile manufacturing was a major focus. The deal also sought to protect intellectual property, establish dispute resolution mechanisms, and, through side agreements, implement labor and environmental safeguards." (McBride and Aly Sergie, 2018)

Once NAFTA was established, it had an immediate but lasting impact in all of the economies of North America. "It fundamentally reshaped North American economic relations, driving unprecedented integration between Canada's and the United States' developed economies and Mexico's developing one" (McBride and Aly Sergie, 2018). In other words, NAFTA seemed like it was going to reconcile the economies of North America. The three economies started to grow as soon as NAFTA was implemented. Mexico exited the recession and the Mexican economy started to grow at a rapid rate. Canada's economy started to increase its growth rate, especially after the year 2000. The economy of the United States kept its steady growth that had since 1991. This would imply that the United States did not benefit from NAFTA, but the fact is that their benefit was not only economic but political as well. NAFTA's milestones are shown in the diagram below:



When NAFTA was created, “the goal for all three countries was the integration of Mexico with the highly developed, high-wage economies of the United States and Canada” (McBride and Aly Sergie, 2018). The hope was to make the Mexican economy stronger and steadier through free trade, increasing the demand for workers in Mexico and, this way, decrease illegal immigration in the United States. Basically Mexico would be the low cost manufacturer for the bigger companies in the United States and Canada, which would benefit from this and become more competitive globally. Acclaimed economists such as Lorenzo Caliendo, part of Yale University and the National Bureau of Economic Research, and Fernando Parro, part of the Federal Reserve Board, agree that NAFTA has provided benefits to the North American economies and helped them reconcile with each other. They conclude that, in consequence of the tariff reductions that came along with NAFTA, “Mexico’s welfare increases by 1.31%, U.S.’s welfare increases by 0.08%, and Canada's welfare declines by 0.06%.". They also found that "intra-bloc trade increases by 118% for Mexico, 11% for Canada and 41% for the U.S." (Caliendo & Parro, 2012). They measure welfare through economic models that focus on easiness of transactions, wages, productivity in the world place, etc. On the other hand, NAFTA drastically increased regional trade between the North American countries. This went from roughly $290 billion in 1993 to more than $1.1 trillion in 2016. During this same time period, United States' Foreign Direct Investment stock has gone from $15 billion to more than $100 billion (Villarreal & Ferguson, 2017).

To further analyze the economic reconciliation in North America, the effects of the treaty that brought these economies together need to be addressed. Since NAFTA, the trade of the United States with Mexico and Canada "has more than tripled, growing more rapidly than U.S. trade with the rest of the world". Mexico and Canada now account for more than a third of the total exports of the United States as well. (McBride and Aly Sergie, 2018). Most estimates conclude that NAFTA´s overall impact in the GDP of the United States has been small but positive. This has been less than .5%, or about $80 billion. Studies also show that roughly fourteen million jobs in the United States rely on trade with Mexico and Canada, while the estimated two hundred thousand export-related jobs correlated to NAFTA pay from 15% to 20% more than the jobs that were lost (Villarreal & Ferguson, 2017). This suggests economic growth. Gary Clyde Hufbauer and Cathleen Cimino-Isaacs, economists of the Peterson Institute for International Economics (PIIE), agree with this suggestion which implies that higher wages and increased trade produce gains for the overall economy of the United States. They say that although there is loss of jobs due to imports, new jobs are created as well. In addition to this, the overall benefit for consumers is greater since prices of imported goods are lower and their quality is normally higher too. Hufbauer and Cimino-Isaacs back this up with a study which suggests that “about 15,000 jobs are lost each year due to the pact, but for each of those jobs lost the economy gains $450,000 in the form of higher productivity and lower consumer prices” (Hufbauer and Cimino-Isaacs, 2014). Higher productivity and lower consumer prices are factors that economists use to measure an economy, so having and increase of $450,000 in these factors for each job lost is seen as a great gain for an economy.

The impact that NAFTA has had in Mexico cannot go unnoticed. Mexico has been the country most influenced by NAFTA’s effects. The place where NAFTA’s impact is reflected the most is on Mexico’s exports. Since NAFTA was implemented, Mexican farm exports to the United States have tripled. The auto manufacturing industry in Mexico grew as well, with an increase of hundreds of thousands of workers in the industry. Mexican productivity and consumer prices faced a positive impact too (Villarreal & Ferguson, 2017). As a consequence of NAFTA, and to aid Mexican exports, the Mexican Peso devalued in 1994, making Mexican imports cheaper for Canada and the United States. This stopped when China’s low cost manufacturing sector decreased prices substantially in the early 2000’s, making it more expensive to buy Mexican products than Chinese products (Morales, 2008). With Chinese products becoming so cheap, consumers in the United States, Canada, and even Mexico started to buy Chinese products instead of products manufactured in North America. This was a turning point in the positive effects of NAFTA.

At the time of the creation of NAFTA, Mexico had already reduced some tariffs. This was when Mexico joined the General Agreement on Tariffs and Trade (GATT), the precursor to the WTO, in 1986. Despite this reduction in tariffs, Mexico still had an average tariff level of 10% from the time it joined the GATT to the time it entered NAFTA (USITC, 1991).

Internally, Mexico also underwent some changes that helped the stabilization of the economy. Exports were increasing and the demand for workers and materials was increasing. Mexico's leaders reduced public debt, introduced a balanced budget rule, stabilized inflation, and built up the country's foreign reserves. These internal changes to the Mexican economy helped the recovery after the economic crisis originated in the United States in 2008. Although the Mexican economy became very dependent on the exports to the United States, which fell by 17%, the Mexican economy only fell by 6% in 2009. Luckily, Mexico's economy was more stable at this time, so it was able to bounce back and return to growth in 2010.

Mexico's GDP experienced 5% growth from 2010 to 2014, and then fell 2% between 2014 and 2015 (Villarreal & Ferguson, 2017). These changes in growth were partially due to internal changes in the Mexican government and economic policies, but also partially due to NAFTA's existence. After the financial crisis of 2008, the rate of immigration from the United States to Mexico became higher to that from Mexico to the United States. This shift is explained by different factors, like stricter border enforcement, changing demographics in Mexico, and the combination of less available jobs in the United States alongside more available jobs in Mexico (Gonzalez-Barrera, 2018). The decrease in jobs in the United States was caused by the financial crisis originated in this country, while the increase in jobs in Mexico was due to higher stability in its economy and the opportunity of increasing exports to the United States.

Some experts argue that although the Mexican economy has been benefited by the assistance from the United States and Canada, Mexico's main problem is that it possesses a two-speed economy. This means that on one side Mexico is fast-growing, "with globally competitive multinationals and cutting-edge manufacturing plants". On the other side, there are plenty of "traditional Mexican enterprises that do not contribute to growth". This causes the Mexican economy to move in two opposite directions. “The largest companies are raising productivity by an impressive 5.8 percent a year, while the productivity of small, slow-growing enterprises is falling by 6.5 percent a year” (Bolio, Remes, Lajous, Manyika, Ramirez, & Rossé, n.d.). Knowing these facts, one can conclude that, of the countries that constitute North America, Mexico is the one with the most fluctuating growth and the weakest economy. In order to reach a reconciliation between the economies of North America and help them come together, the Mexican economy will continue to need boosts like NAFTA was to aid its growth. These boosts do not need to be of an economic nature, but they can be related to infrastructure.

Finally, Canada has been the one that has benefitted the most from NAFTA. Since 1993, investments from Mexico and the United States in Canada have tripled. The investment from the United States in Canada accounts for more than half of its FDI stock, and it went from $70 billion in 1993 to $368 billion in 2013 (Villarreal & Ferguson, 2017). Before NAFTA, Canada and the United States had entered in the Canada-U.S. Free Trade Agreement (CUSFTA) in January 1, 1989. Since then, Canadian trade increased, but it was after NAFTA that Canadian trade had a major boost. Between 1994 and 2017, Canadian exports to the United States grew from $110 billion to $346 billion. The industry that witnessed the greatest boost post-NAFTA in Canada was the agriculture industry. “Canadian agricultural trade with the United States more than tripled since 1994, as did Canada’s total agriculture exports to NAFTA partners” (McBride and Aly Sergie, 2018).

When the current president of the United States, Donald J. Trump, took office, he criticized NAFTA and said that his intention was to either renegotiate it or exit it. The truth is that NAFTA has not been all sunshine and rainbows, but facts have pointed out that in order to achieve economic reconciliation, and become one of the most powerful economic blocs, Mexico needs the infrastructure already existent in the United States and Canada, and these two need the resources coming from Mexico. Formal negotiations to terminate or renegotiate NAFTA started in August 2017 between the three countries. To incentivize Mexico and Canada to agree to renegotiate the deal, "Trump used tariffs as bargaining leverage throughout the process, applying import tariffs on steel and aluminum in early 2018 and threatening to do the same with autos"(McBride, 2018). Among the things that Trump wanted to change about NAFTA, these were included: "higher demands for the auto industry, more access to Canada's highly protected dairy market, better labor protections, dispute resolution reform, and new rules for intellectual property and digital commerce" (McBride and Aly Sergie, 2018). On September 30, 2018, the leaders of the three countries signed the agreement USMCA (United States, Mexico, Canada Agreement), responding to Trump's threats to exit. The reasoning behind each of the countries to sign this agreement was different, and so are the benefits and consequences.

The USMCA is sometimes called NAFTA 2.0 because it was based on the original NAFTA, with some modifications. Out of all the modifications made in the 1,200 page document of the USMCA, there are a few key implications to focus on when it comes to identifying who will be winning, who will be losing, and how reconciliation could be obtained after the signing of this document, if approved by Congress in each of the three countries. The changes made to the USMCA that could become setbacks in the economic reconciliacion of North America are in the automotive, dairy, pharmaceutical, e-commerce, steel, and aluminum industries. The automotive industry will suffer a setback since now 75% of each automobile will need to come from pieces manufactured in North America, and the wages of 30% of the labor will need to be of at least $16 per hour, well above the current wages of car manufacturers. This will reduce the production of cars in North America, increasing the amount of imports from other parts of the world, like Asia. The dairy industry will be affected since the United States will now have access to 3.6% of the Canadian dairy production, instead of the 3.2% that it had in NAFTA. This is a significant increase, since it will modify Canada's supply management. Canada will also eliminate pricing schemes in Class 7 dairy products (protein, skim milk, etc.). This will lead to an even greater alteration on their supply management, hurting Canadian producers. The pharmaceutical industry will be affected in the way that patents will now last 10 years, instead of 8. This means that Mexico and Canada will not be able to sell generic drugs for a longer time. E-commerce is another one of the affected industries. This will be affected with an increase in duties exemptions. This will hurt local producers, since consumers will be able to buy duty-free items for amounts up to $150, instead of the amount allowed with NAFTA of $20. Import tariffs in the United States on steel and aluminum will remain unchanged. This means that what the president of the United States, Donald Trump, started as a threat to force Mexico and Canada to renegotiate NAFTA will not be changed.

After reviewing the key changes that the USMCA offers, and understanding how these changes will affect the economies of Mexico, Canada, and the United States, one can see that this new deal will mostly benefit the United States. Mexico and Canada celebrate the signing of the USMCA because this means that NAFTA will not be completely terminated, and some of NAFTA's clauses are included in the USMCA. The truth is that Canada's prime minister, Justin Trudeau agreed to the signing of the USMCA in response to the pressures and threats from Donald Trump, while the Mexican president, Enrique Peña Nieto, signed because he did not have much of a say and knew that exiting NAFTA would end up being worse than signing the USMCA.

The USMCA is currently being reviewed by the Congress of Mexico, the United States, and Canada. The Congress of each country will decide if they approve of the deal and if their country will enter. If the USMCA comes to reality, the gap between the economies of North America will become greater and greater, making the economic reconciliation of North America seem unfathomable.

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