NAFTA Then, NAFTA Now: Interconnected Regional Economies

Sherman Robinson
Peterson Institute for International Economics (PIIE)
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US Potential Trade Wars

  • US: Steel/aluminum tariffs, Autos/Parts threatened
• US pulled out of TPP, renegotiating NAFTA and KORUS
  • International response: TPP11/CPTPP
  • Mexico-Canada response: join CPTPP
  • Many new separate deals with EU
• Public statements that the WTO is “unfair” to the US
  • Threats to “leave” the WTO
• Potential withdrawal of the US from global trade system
US Trade Policy

• US willing to go outside of the WTO and use Sections 201, 232, and 301 to justify widespread import tariffs/quotas

• Stated US policy to “protect” domestic industries
  • 201: temporary import relief: tariffs or NTBs on imports that injure or threaten to injure domestic industries producing like goods. Used for imported solar panels.
  • 232: National security. Used for Steel/aluminum and autos/parts
  • 301: tariffs in response to unfair trade practices (actions that are “unjustified, unreasonable, or discriminatory, and that burden or restricts U.S. commerce”).
    • Anti-dumping is the most common. Commodity specific.
    • Trump trade war: response to China’s unfair trade practices related to the forced transfer of U.S. technology and intellectual property
Post WW II: Evolution of Interconnected Regional Economies (ICREs)

• In the post-war period, global foreign trade grew much faster than global GDP
• There was also rapid growth in productivity, associated with the growth of trade
• Early post war: world economy was dominated by the US: largest economy, hegemonic role in trade
• Europe recovered, grew rapidly, and became an interconnected regional economy (ICRE).
  • Deep economic and institutional integration
Interconnected Regional Economy (ICRE)

• ICRE can be defined as a collection of countries with a deep network of trade relations and higher trade shares within the ICRE than outside the region.

• North America also rapidly evolved as an ICRE, including the US, Canada, and Mexico.

• In East Asia, the “Asian miracle” of rapid growth started in the 1960s. With the addition of Australia, New Zealand, China, and the poorer countries, it evolved into an E&SE Asia ICRE.

• Three ICREs: Europe, North America, and E&SE Asia.
### Bilateral Trade by Region as Share of Global Trade, GTAP 9 Data

<table>
<thead>
<tr>
<th>Region</th>
<th>NAFTA</th>
<th>Europe</th>
<th>E&amp;SE Asia</th>
<th>RoW</th>
<th>Total exports</th>
<th>Share of global GDP</th>
<th>Share of global population</th>
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<td>NAFTA</td>
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Notes: exports from row to column. Table sums to 100.
Export Shares by Countries/Regions to ICREs

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<tr>
<th></th>
<th>NAFTA</th>
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<th>Asia</th>
<th>RoW</th>
<th>Total</th>
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<td>63.9</td>
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<tr>
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<td>26.7</td>
<td>28.0</td>
<td>100.0</td>
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The US and ICREs

• NAFTA accounts for only 14% of world trade
  • Europe first with 37% and E&SE Asia second with 28%
• US is no longer hegemonic in the world trading system
  • Europe is much less dependent on other regions
• China is an anchor country in E&SE Asia, with 30% of its trade within the region
  • Within-region trade of other members is over 50%
• China is a major destination for trade within E&SE Asia, but less so for exports from other regions/countries
  • Only about 8% of US exports go to China, 27% to all E&SE Asia
ICRE Expansion

- Non-ICRE countries (Latin America, South/Central Asia, Africa) have more diversified trade
  - No other group of counties has coalesced into an ICRE
  - Some integration: MERCOSUR, SAFTA, but not strongly enough to form an ICRE
- Recent trade share data indicate that India may be in the process of joining the E&SE Asia ICRE
- Europe ICRE is expanding in its region
  - Middle East and North Africa (MENA) countries
  - Former Soviet Union (FSU) countries
Policy Implications of ICRE Evolution

• The formation of ICREs pre-dated any explicit RTA
  • North America and Europe ICREs formed 20-30 years before NAFTA and EU agreements
  • E&SE Asia: Still no single unifying formation agreement but lots of overlapping RTA agreements

• Four kinds of RTAs:
  • ICRE formalization (e.g. EU, NAFTA agreements)
  • ICRE accession/expansion (e.g. EU expansion)
  • ICRE consolidation (e.g. EU complete the market, CPTPP)
  • Market access (e.g. many bilateral agreements and components of multilateral RTA agreements such as CPTPP)
NAFTA Renegotiation

• NAFTA is under negotiation: a three-party deal
  • US wants two bilateral negotiations
  • Congress is authorized to approve 1 3-way deal, not 2
• Separate discussions of
  • Autos/parts. Mexico: “Rules of origin,” “domestic content,” and Mexican wage requirements
  • Dairy. Canada: dairy support program. Designed to insulate Canadian support from trade policy.
    • Similar to US dairy and sugar support programs
    • Canada has opened up some under CPTPP agreement
NAFTA Renegotiation

• NAFTA renegotiation is not deepening integration, but instead undoing it

• New rules for autos/parts are designed to protect US auto/parts industry—return mfg to the US
  • Arbitrary rules instead of market mechanisms

• Weakening dispute resolution provisions and requiring review of NAFTA after 6 years makes integration uncertain, and investment unlikely
Autos/Parts: US Auto Industry

• US auto industry: inward looking post war
  • Very slow to respond to foreign competition
  • 1970s protectionist period: managed auto trade

• NAFTA was enormously beneficial to US
  • Integrated North American auto industry
  • Fine specialization across the three countries
  • Now a globally competitive industry

• NAFTA renegotiation and potential for further protection by US both hurt US auto industry
Autos and Parts Export Shares: NAFTA (Rows sum to 100)

<table>
<thead>
<tr>
<th></th>
<th>USA</th>
<th>Canada</th>
<th>Mexico</th>
<th>NAFTA</th>
<th>E&amp;SE</th>
<th>Asia</th>
<th>EU+</th>
<th>Other</th>
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## Interconnected Regional Economies (ICREs), Autos and Parts, Selected Shares

<table>
<thead>
<tr>
<th>Region</th>
<th>Import share of total supply</th>
<th>Exports share of production</th>
<th>Share of global production</th>
<th>Share of global final demand</th>
<th>Share of global GDP</th>
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<td>26.3</td>
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<tr>
<td>Europe</td>
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<td>57.0</td>
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<td>26.6</td>
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<td>Other regions</td>
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<td>11.0</td>
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<td>Total</td>
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## Autos and Parts: Shares of Global Trade

<table>
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<tr>
<th>Region</th>
<th>NAFTA</th>
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<th>Europe</th>
<th>Other</th>
<th>Total Exports</th>
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</table>
Autos/Parts: Proposed 232 Tariffs

• Study by Mary Lovely, PIIE
• Import content of cars produced in the US:
  • Compact cars, 51%. Compact SUVs, 56%, Luxury compact, 84%.
• Tariffs “should” protect, but will not in this case
  • Will increase cost of all cars in the US, imported and domestic
• Car prices higher: $2,000-3,000 for low end, $5,000-7,000 for high end
NAFTA: Conclusions

• US-Mexico-Canada are tightly linked economies
  • NAFTA is an Interconnected Regional Economy
  • Autos/parts industry especially closely linked
• US is a net importer of autos/parts, and will likely remain so, even if NAFTA is changed dramatically
• Policy of moving the industry back to the US is a very bad idea
  • Will raise the price of autos in the US
  • Make the US industry uncompetitive in world markets
Trade Wars: Conclusion

• US is no longer the dominant player in world trade
  • It is #3 ICRE, and a far third
  • And NAFTA is under threat
• NAFTA renegotiation is counterproductive
  • It will unwind integration and damage US trade
• US withdrawal from global trade system will damage the US
  • Rest of the world will adjust, divert trade around the US
  • Other ICReS will gain shares in global markets