NAFTA:

LEARNING TO LOVE THY NEIGHBOR

Trade between the United States and its two closest neighbors has accelerated under NAFTA. But there are still some rough patches to work out between the three countries.

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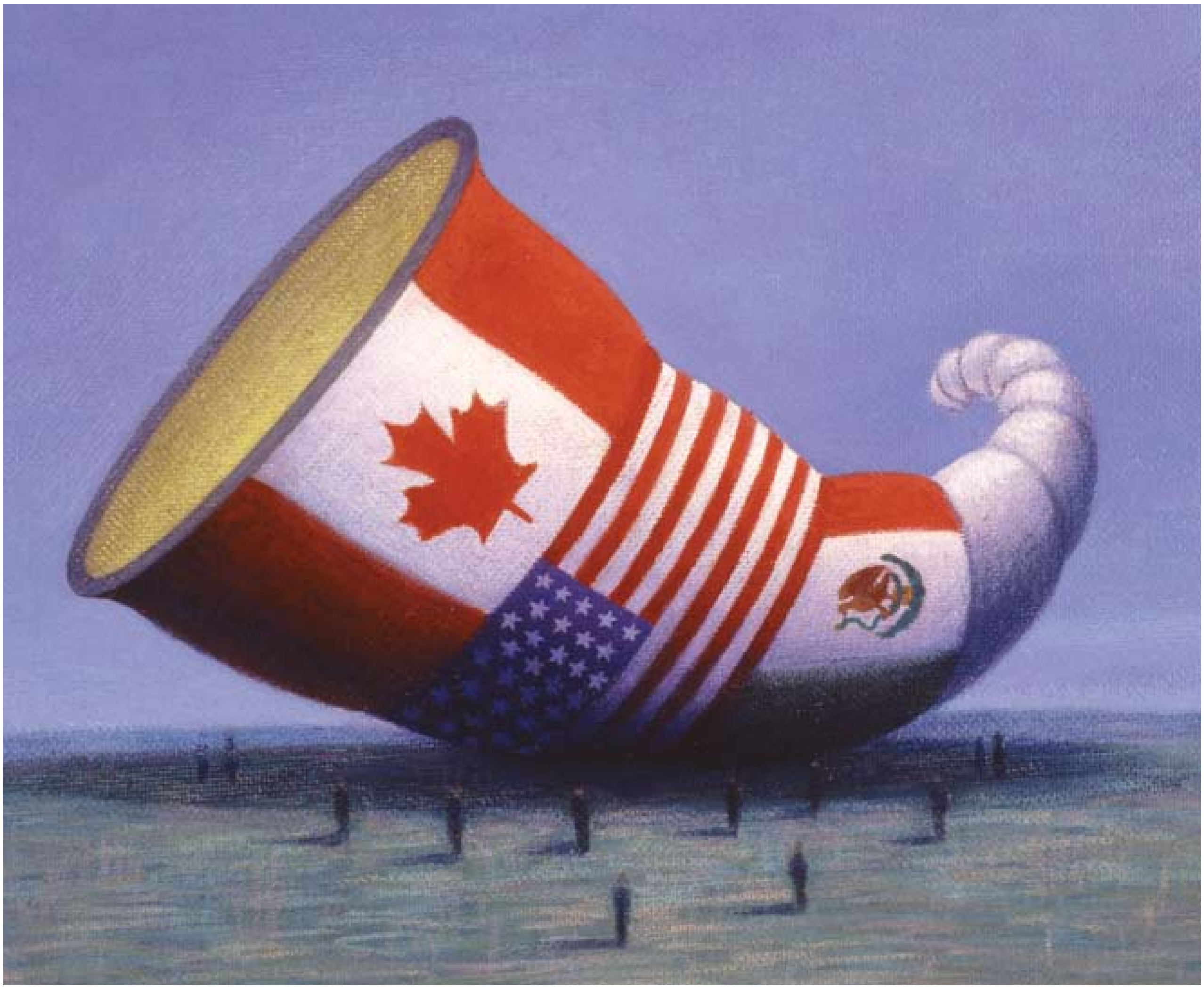

Given President Obama's well publicized ambivalence toward the North American Free Trade Agreement (NAFTA) during the presidential campaign, it's a good time to ask: Is NAFTA working? From a U.S. export market perspective, NAFTA has indeed delivered the goods. Specifically, U.S. goods exported to Canada and Mexico have more than doubled between 1993 and 2007—from $141.9 billion to nearly $385 billion. NAFTA accounts for fully a third (33%) of the U.S. trade total.

Merchandise trade between the United States and its NAFTA partners as a share of U.S. GDP has grown from 4.4% in 1993 to 6.6% in 2007. From a regional perspective total trilateral merchandise trade (both imports and exports) rose more than threefold since 1993, now exceeding $900 billion annually.

OK, that's fine for the economists, but what has NAFTA meant for U.S. manufacturers? Looking at the period from January to June 2008, U.S. manufactured exports to Canada amounted to $109.5 billion, while $56.4 billion worth of U.S. goods were exported to Mexico. That represents a $17.5 billion surplus with Canada and a $20 billion deficit with Mexico.

"The overall picture of U.S.-NAFTA trade in manufacturing is highly positive. The trade is roughly in balance with a positive trend which is helping to reduce the global deficit," explains Ernie Preeg, an economist and senior fellow in trade and productivity at the Manufacturers Alliance/MAPI.

What especially pleases Preeg is the nature of the products that the U.S. is exporting. Automotive, machinery and high-tech products top the list of exports to Canada and Mexico. "These export products are at the heart of high-skilled, higher-paying manufacturing jobs," explains Preeg. For example, with Canada the United States shows a trade surplus in the areas of both electric and nonelectric machinery and parts, as well as power generating machinery and equipment. Surpluses are also found in specialized machinery, iron and steel and scientific equipment. In Mexico, the United States enjoys trade surpluses in plastics, organic chemicals and miscellaneous manufactured products.

Much of NAFTA commerce is concentrated in automobiles, auto parts and energy. Together these three sectors account for a third of regional trade.

Top 10 Priorities for NAFTA Countries

Deloitte Research has identified the key priorities for North American governments to address to help improve their global competitiveness:

1. LABOR COST
2. TAX POLICY
3. AVAILABILITY OF SKILLED LABOR
4. GOVERNMENT BUREAUCRACY
5. LABOR UNIONS
6. EXCHANGE RATES
7. RAW MATERIALS PRICES
8. TRADE POLICY
9. ENERGY POLICY
10. LABOR POLICY

Source: Deloitte Research's "Made in North America" report

The National Association of Manufacturers (NAM) also views NAFTA in a positive light.

"Free trade is the solution to our trade deficit and not the problem," says Frank Vargo, NAM's vice president for international economic affairs. "U.S. free-trade agreement partners continue to be the shining part of the U.S. trade picture, with a rapidly growing surplus." Supporting that perspective is the fact that NAFTA is the largest export market for 42 states.

Thinking Globally

Manufacturing executives also share in their belief that NAFTA has been good for their business. In a recent report, "Made in America," produced by Deloitte Touche Tohmatsu, nearly half (49%) of manufacturing executives say NAFTA has had a positive impact on their business. Forty-one percent are neutral regarding NAFTA's impact while only 10% report a negative effect.

Deloitte surveyed 321 executives of leading North American manufacturing enterprises across product sectors to obtain their perspectives on their current and expected future competitiveness. Of those surveyed, 45% are from the United States, 36% from Canada and 17% from Mexico. Among the companies represented in this survey, 23% had revenues over $1 billion; 15% had revenues between 200 million to $1 billion; and 62%, below $200 million in revenues.

"NAFTA gave companies the opportunity to enter new markets and think globally," explains Craig Giffi, Deloitte's vice chairman and U.S. leader for consumer and industrial products. "Executives told us that trade agreements enable companies to improve top-line growth across new markets. The result is that companies that focus on global trade, and thus new customers, outperform their counterparts." More than two-thirds of the companies surveyed for the report showed revenue growth and bottom-line profit levels that were 5% higher over the last three years.

Mexico's Full Potential Yet to be Reached

As a trading partner Mexico has grown in importance, Giffi points out. "It wasn't top of mind for key drivers prior to 1992," he says. But improvements in Mexico through economies of scale and more efficient retail distribution and lower prices have created a strong market for manufacturers. The labor advantage continues to be a strong factor for growth in Mexico, "In addition to considerable wage rate differentials, the workforce is young, hungry and eager," says Giffi.

And this workforce is very educated, according to George Haley, director of the Center for International Industry Competitiveness at the University of New Haven. "Workers are generally both highly trained and trainable. The education system turns out highly effective managers who also graduate with extensive business networks."

NAFTA was the driving force behind the increase in transparency in Mexico. The country now has its own version of the Administrative Procedures Act, which allows the public to comment on proposed rules. Aside from helping U.S. and Canadian companies do business in Mexico, the Act has also helped Mexican entrepreneurs.

What is clearly not a competitive advantage for Mexico is the issue of security. "There is a problem doing business with Mexico and that is violence," explains Haley. This past year in particular has seen a large increase in violent crime.

In fact crime is one of the key factors inhibiting Mexico's potential. "Mexican growth has been a disappointment: 2.9%, well below its potential," says Gary Hufbauer, senior fellow at the Peterson Institute for International Economics. "Mexico should grow at 6% a year. However, the Mexican political system has not delivered the tax and energy reforms necessary to fund investments in physical infrastructure, social services and education. Mexico has neither rousted the drug lords nor eradicated the corruption mentality."

Growth is on its way, though, says Giffi. "Manufacturing is a global chess game. Companies are now rethinking their supply chains and are bringing factories back to North America. This should bring back jobs as well," explains Giffi.

Bringing back jobs is a sore spot whenever NAFTA is mentioned. "A realistic estimate is that around 60,000 jobs are lost a year because of increased trade with Canada and

Mexico, while U.S. exports to NAFTA partners support 70,000 new jobs a year," says Hufbauer. "Annually the dynamic U.S. economy displaces approximately 17.5 million jobs and creates about 18.3 million new jobs. NAFTA accounts for a small fraction (under 1%) of annual job churn," he claims.

Automating Trade Compliance

While Mexico is underperforming, the Canadian economy has performed well during the NAFTA era, growing by 3.1%, according to Hufbauer. Canada sends 80% of its exports to its NAFTA partners. Total merchandise trade between Canada and the United States more than doubled between 1993 and 2007. Trade between Canada and Mexico has almost quadrupled over the same period. In 2007, Canada's merchandise trade with its NAFTA partners reached $598.4 billion. Exports to the United States grew at an annual rate of 6.6% from 1993 to 2007. Canada's bilateral trade with Mexico reached $22 billion in 2007.

To bolster further the impact of NAFTA, manufacturing companies are automating trade compliance. "Trade between countries has specific requirements. Merchandise moving from the U.S. to Mexico has different aspects than moving from Mexico the U.S.," explains Nathan Pieri, senior vice president of marketing and product management with Management Dynamics, a provider of global trade management solutions. Pieri says his clients, which include Steelcase, General Electric, Honeywell and Procter & Gamble, are choosing to automate the NAFTA qualification process. For example, Haworth, a $1.4 billion office furniture and interiors manufacturer, was able to save $1.2 million in duties and taxes by automating the NAFTA qualification process as well as generating trade documentation to maintain export compliance.

Mexico is becoming an increasing popular location for Pieri's clients as supply chain management and quality issues continue to raise concerns about outsourcing production to China. Pieri sees some of his clients moving back to North America, especially Mexico. "Being able to control the flow of inventory from Mexico is a lot more cost effective than trying to do that overseas given the logistic difficulties."

Indeed, as noted in the "Made in North America" study (see sidebar, "Top 10 Priorities for NAFTA Countries," page 39), manufacturers would strongly prefer North America as a hub for their manufacturing operations "in an ever-expanding global economy if proper investments (both public and private) are made and if government policies focus more on reducing or eliminating competitive barriers." IW