by Mike W. Peng

WHAT HAPPENS IF NAFTA GOES AWAY?

Free Trade is Not Free

In effect since 1994, the North American Free Trade Agreement (NAFTA) has caused no shortage of controversies. Criticisms have ranged from Ross Perot's prediction that it would lead to a "giant sucking sound" destroying American jobs, to Donald Trump's indictment of the agreement as a "disaster" and "the worst trade deal." As Trump assumes power, his threats to repeal NAFTA altogether force us to entertain a previously unthinkable scenario: What happens if NAFTA goes away? The answer to this question boils down to what NAFTA has brought to the United States — and to Texas.

What Has NAFTA Brought To The Country?

In two decades, trilateral merchandise trade among the three member countries grew nearly fourfold, from $290 billion in 1993 to $1.1 trillion in 2016. Approximately $3 billion in goods and services cross the border every day now — that is an astonishing $2 million every minute. U.S. trade with Canada tripled and trade with Mexico increased by five times, while U.S. trade with the rest of the world grew 280 percent. Canada and Mexico are, respectively, the second and third largest exporters to the United States (behind China) and the first and second largest importers of U.S. goods. Mexico imports more U.S. goods than China, and absorbs more U.S. imports than Britain, France and Germany combined. Canada imports even more made-in-the-USA goods.

What about jobs? In brief, there's been no "giant sucking sound." Approximately 300,000 U.S. jobs — an average of 15,000 per year — were lost due to NAFTA in its first two decades, but about 100,000 jobs were added and the net loss was small, since the US economy generated at least 25 million new jobs during the same period. While the Congressional Research Service acknowledged some worker and firm adjustment costs brought by NAFTA, it reported conclusively that the agreement did not cause the exponential job losses critics feared. At present some eight million U.S. jobs depend on trade with Canada and another six million on trade with Mexico. Even for every job lost, the economy gains $450,000 in the form of higher productivity and lower consumer prices, which benefit all.

A hard count on jobs misses another subtle but important benefit: NAFTA has allowed U.S. firms to preserve more U.S. jobs, because 40 percent of the value of imports from Mexico and 25 percent from Canada is actually made in the U.S. — in comparison, only 10 percent of the value of U.S. imports from China is made here. In 1994, U.S. imports from Mexico only contained 5 percent of the value made in USA. Clearly NAFTA has facilitated seamless supply chain integration, with goods, components and parts crossing the border multiple times before assembly. Without NAFTA, entire industries may be lost — not just the labor-intensive portions.

What About Texas?

Blessed by its location, Texas lies near the geographic center of NAFTA. Dallas is about equidistant from Mexico City and Toronto (1,300 miles each way), and Texas features a 1,200-mile border with Mexico. Thanks to NAFTA traffic, Laredo is the country's third largest port in terms of total dollar value, behind Los Angeles and New York.

Growing by leaps and bounds, Texas has been the country's champion state in merchandise exports since 2001. In 2015, it contributed $251 billion (17 percent) of the $1.5 trillion merchandise exports from all the 50 states. In comparison, second-ranked California exported $165 billion, or 11 percent. Undoubtedly Texas' awesome export economy is powered by NAFTA, with Mexico and Canada being its top two export markets. Some 380,000 jobs in Texas depend on trade with Mexico and over two million jobs are trade-related In 2015, Mexico absorbed $93 billion in exports from Texas, and $27 billion from second-ranked California. The Federal Reserve Bank of Dallas estimated that NAFTA accounts for approximately a quarter of Texas' six-fold increase in exports to Mexico since 1994.

Greater diversification and stronger NAFTA integration has benefitted Texas in another crucial way: its economy is no longer so dependent on oil prices. Despite some political rhetoric, executives, officials and experts agree that the good has far outweighed the bad for the United States — and especially for Texas.

If NAFTA Goes Away

First, relax: these benefits won't all disappear. NAFTA merely represents some relatively new rules of the game that are artificial and man-made. Given their natural geographic proximity and historical links, the three North American neighbors had been trading for ages before 1994. Their tightly knit economies cannot and will not immediately stop trading, though the trade-related gains will decrease. An example closer to home is that we will still be able to enjoy plenty of avocados from Mexico, but we will have to cough up more money for our beloved guacamole.

Second, if the Trump administration unilaterally imposes high import tariffs, Canada and Mexico will certainly respond in kind. Given the reality of the NAFTA supply chain, a tariff is like a wall in the middle of a factory. As a state, Texas has benefitted the most from NAFTA and will suffer the most from its collapse. Hard-won export market share in Canada and Mexico will shrink and thousands of jobs in manufacturing, logistics and other services will disappear. We will need to encourage job creation and economic growth in non-trade-related sectors. Texas will probably continue to do better than the rest of the country, but with the low oil prices, the Lone Star state will not shine quite like before.

Third, since both Canada and Mexico have free trade agreements (FTAs) with the European Union (EU), the U.S. withdrawal from NAFTA will significantly help increase EU firms' market share there. In other words, EU firms, propelled by their own FTAs with Canada and Mexico, will be delighted to take over the market share vacated by U.S. firms. What's more, strong competitors from China, Japan and Korea will be elbowing their way into Canada and Mexico, even without help from FTAs. Reducing the preferential treatments NAFTA offers will clip U.S. firms' wings in the competition for export markets in Canada and Mexico. Ironically, gutting NAFTA will help enhance the competitiveness of America's global rivals.

Finally, shutting down NAFTA will not bring back lost manufacturing jobs. The recent crises facing U.S. manufacturing jobs, which fell from 17 million to 11 million between 2000 and 2010, have little to do with NAFTA. Instead, competition with China and technological changes have largely contributed to the decline. Blaming Mexico and dismantling a beneficial FTA will not solve the problems associated with manufacturing job losses.

Keep Calm And Remember: "Free Trade" Is Not Free

There is widespread belief that Trump's nasty NAFTA rhetoric is just talk. Procedurally, Trump is required to seek congressional approval if he wants to renegotiate NAFTA. Congress is unlikely to support an attempt to throw away so many benefits (and likely spark retaliatory trade sanctions in America's top two export markets) with so few gains.

As far as Texas is concerned, while NAFTA is not a panacea, and certainly has its problems, it would be politically suicidal for Trump to undermine a foundation of economic growth and job creation for the red state that delivered the largest number of electoral votes to send him to the White House.

Even if NAFTA is here to stay, executives, state officials and other stakeholders need to remember an important lesson: free trade is not free. It requires constant efforts and sacrifices to demonstrate, safeguard and advance the gains from such trade. ★

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Most of Texas' two million trade-related jobs are in manufacturing, especially in Texas' top five export sectors:

1. Computer and Electronic Products
2. Petroleum and Coal Products
3. Chemicals
4. Machinery
5. Transportation Equipment

Contributors

“Depending on the type of product you are exporting, freight costs may have the power to render you non-competitive in the international marketplace.”

Doug Kramer
President & CEO, Lapolla Industries

“Request to have a person available by phone, any time of day or night, who can address service interruptions or shipping delays and implement a Plan B.”

Keeli Jernigan
CEO & President, Trans-Expedite Inc

“NAFTA has allowed U.S. firms to preserve more U.S. jobs, because 40 percent of the value of imports from Mexico and 25 percent from Canada is actually made in the U.S. – in comparison, only 10 percent of the value of U.S. imports from China is made here.”

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