

# **North American Free Trade Agreement (NAFTA) Trade Disputes Attributed to Asymmetric Relationships Leading to the United States' Bad Neighbor Policies with Canada and Mexico**

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## **ABSTRACT**

*Sixteen years ago NAFTA embellished the value of free trade but over the years the dominant U.S. economy in the North American partnership has simply dictated terms of trade with its neighbors to the north and south. The United States has feuded with Canada over such trade disputes as softwood imports. The U.S. – Mexico dispute of most significance is the continuous refusal to allow Mexican trucks to operate freely on American roadways. Although a pilot program to ascertain the safety improvements in Mexican trucks was started by the Bush administration it was not funded in the stimulus bill last year, resulting in Mexico imposing retaliatory tariffs on U.S. exports. This paper argues that the Obama administration needs to make changes so America honors its trade agreements, avoids protectionist measures, and employs statesmanship as one of the ways to avoid trade disputes.*

## **INTRODUCTION**

This paper argues that a trade dispute is never good, especially in recessionary times, and that it is time for the North American partners (Canada, Mexico, and the United States) to work together in order to resolve trade disputes and avoid them altogether when possible. As Pastor (2008) notes, the dual-bilateral strategy (U.S. – Canada, U.S. – Mexico) is a failed institutional structure that needs remedying since it exacerbates the defining and debilitating characteristic of the United States' relations with its contiguous neighbors – asymmetry. Nowhere else are the asymmetries between interlinked neighbors so severe (O'Neil, 2009: 740). It leads Washington to ride roughshod over its border trade partners by either ignoring them and their interests or simply try to impose its will, all of which causes Ottawa and Mexico City to either retreat or be defensive. Given the imbalance in power and wealth, a truly equal relationship may be elusive, but it is in the long-term interests of all three trade partners to build institutions that will reduce this imbalance (Holbrooke, 2008; Pastor, 2008: 93).

This paper begins with a background discussion of the growth of regional trade agreements (RTAs). This is followed by discussion of NAFTA: the formation, its importance, how it has contributed to growth in trade and foreign direct investment (FDI). At the end of this recapitulation, the paper turns to the details of American trade policy actions under NAFTA and the World Trade Organization (WTO) in two sensitive areas: Canadian softwood lumber, and the trucking issue with Mexico. This is followed by how costly the Mexican retaliatory tariffs to the ban on Mexican trucks operating unfettered in the U.S. are to America. Finally, some possible breakthroughs by the Obama administration are discussed as potential opportunities for a continental North American partnership that may well lead to the formation of a customs union. Additionally, a summary and discussion of the key points presented in the paper are provided followed by conclusions and suggestions for future research.

## **REGIONAL TRADE AGREEMENTS**

Overall, there are more than 200 RTAs in operation worldwide and the share of world trade accounted for by members of these agreements increased from 37 percent in 1980 to 60 percent in 1990 and to more than 70 percent by 2005. Western Hemisphere countries have pursued economic integration through numerous RTAs. By early 2006, Mexico had entered into a total of 12 FTAs involving 42 countries. It has negotiated bilateral or multilateral trade agreements with most countries in the Western Hemisphere including the United States and Canada, Chile, Bolivia,

Costa Rica, Nicaragua, Uruguay, Colombia, Guatemala, El Salvador, and Honduras. Mexico has ventured out of the hemisphere in negotiating FTAs and, in July 2000, entered into agreements with Israel and the European Union (EU). Mexico has also completed an FTA with the European FTA (EFTA) of Iceland, Liechtenstein, Norway, and Switzerland. The Mexican government has continued to look for potential free trade partners, and expanded its outreach to Asia in 2000 by entering into negotiations with Singapore, Korea, and Japan. In 2004, Japan and Mexico signed an Economic Partnership Agreement; negotiations on FTAs with Singapore and Korea are stalled (Villarreal, 2009: 15). Large countries such as the U.S., have signed several regional and bilateral trade agreements with much smaller countries: NAFTA, the U.S.-Chile FTA, the U.S.-Jordan FTA and the EU's FTAs with several developing countries. An interesting characteristic of all of these deals is that at least one country always gains from an FTA (Sara, 2008).

Realism theory considers international institution-making as unnatural for states, which, according to realist premises, should grant supreme value to the maximization of their autonomy and independence. Even more so when the institutions' finality, as it is the case with FTAs, is to facilitate economic integration and interdependence. So, when nation-states nevertheless agree to participate in an economic alliance like NAFTA, because there are sufficient gains to be made, we should expect the members of that alliance to seek counterbalancing effects. However, such a reaction will depend for a large measure, on the relative power of member states. While dominant states in an alliance may possess enough power to compensate alone for the relative loss of autonomy induced by an institutional arrangement (internal balancing), less powerful states may need to look for others to build some counter-power and de-concentrate their entanglement (Belanger, 2004). Park (2000) studies a two-country model, where market size is an indicator of a country's ability to manipulate in terms of trade. He points out that market size asymmetry gives use to inefficiencies only on the large country's part due to its ability to affect its terms of trade. Certainly, in the NAFTA pact, the United States predominance among the other two trading partners appears to sway the U.S. to use "hardball tactics" to affect its terms of trade. Thus, realism, because it is a theory of power politics, introduces a variable that institutionalization theories tend to neglect, namely, the relative symmetry or asymmetry of capabilities among member states and, by doing so indicates that asymmetry may lead to diverging preferences among the members of an institutional alliance, be it a military or economic one. An amended realist theory of international cooperation argues that less powerful nation-states often fear that institutionalized co-operation, even if it proves to be advantageous for everyone, would increase their dependence on a dominant and potentially hegemonic neighbor. For this reason, they negotiate a form of institutionalization that gives them a certain level of effective voice or voice opportunities (Belanger, 2004).

Free trade areas comprising the United States, on the one hand, and on the other, countries with substantially less economic strength than that of the United States, must deal with the asymmetric power of the United States. By their nature, these free-trade areas run the risk of becoming extensions of hegemonic U.S. policies. When the United States, rather than accommodate the interests of another country in a FTA, forcefully defends the economic interests of a domestic U.S. industry, it may evince unfavorable or resentful reactions in the other country. The dynamics of such a free-trade area contrast with the diplomatic give and take in the WTO, a larger multilateral organization, where hegemonic power may be diluted or effectively contained.

## **NAFTA: THE NORTH AMERICAN FREE TRADE AGREEMENT**

Europe's success at economic integration caused other nations to consider the benefits of forming their own regional trading blocs. Accelerating integration in Europe caused new urgency in the task of creating a North American trading bloc. Preceding the creation of NAFTA, the United States and Canada had the world's largest bilateral trade agreement; each was the others' largest trading partner. To further support trade activity, the two countries established the U.S.-Canada FTA (USCFTA) in 1989 which was designed to eliminate all trade barriers between the two countries. This bilateral trading relationship is the world's largest, with \$700 billion in volume. About 80 percent of Canada's exports (approximately one-third of its GDP) go to its southern neighbor, making it the largest exporter to the United States. Canadian products command approximately 20 percent of the U.S. import market share. In comparison, China, the second largest exporter to the United States, only commands less than 10 percent. Canada is also the largest import

market of U.S. products, absorbing about one-fourth of U.S. exports. The United States runs a sizable trade deficit with Canada, at approximately \$82 billion in 2006.

### **The Inclusion of Mexico**

Policy makers in Ottawa and Washington considered extending their FTA to Mexico and creating NAFTA shortly after the joint successes gained under the USCFTA. The whole idea was subjected to extensive debate in all three countries. Including Mexico was not accomplished without great struggle and debate. For instance, when unemployment was 7 percent in the early 1990s, many Americans thought it did not seem to be the best time to open up borders. The proposed agreement was negotiated in the midst of a recession in the United States. The initial reaction from some sectors of the U.S. economy was very negative to the proposed agreement. Organized labor argued that NAFTA would result in hundreds of U.S. companies relocating to Mexico to take advantage of cheap labor, which would result in a loss of jobs in the U.S. At the same time, corporate America and its leaders supported the agreement because the potential lower production costs that would be derived through the agreement.

By the mid-1980s, many Latin American economists had abandoned their statist views of the 1950s and 1960s in favor of sound budgets, low inflation, deregulated markets, and free trade, the so-called Washington Consensus (Krugman, 2009: 34-35). In 1990 Mexico and the United States announced their intention to negotiate an FTA between their countries (Krugman, 2009). The next year Canada joined the process. Merchandise trade between the United States and the NAFTA partners as a share of U.S. gross domestic product (GDP) has grown from 4.4 percent in 1993 to 6.6 percent 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 (Selko, 2009: 38).

From the start, NAFTA was bitterly controversial in all three countries as the economic integration process was debated. Most recognized that NAFTA was an attempt to accelerate economic integration or even a reckless experiment in globalization. FTAs represent economic integration whereby countries seek to remove all barriers to trade between themselves, but each country determines its own barriers against nonmembers. An FTA is the lowest level of economic integration that is possible between two or more countries. Countries belonging to an FTA also typically establish a process by which trade disputes can be resolved. A customs union is one step beyond an FTA. In addition to all the arrangements of an FTA, a customs union imposes common external policies on non-participants to combat trade diversion.

Because of the very different levels of economic development, NAFTA was labeled one of the most radical free trade experiments in history. This huge FTA covering more than 8 million square miles and comprised of more than 430 million people supercharged trade among the three signatory countries. Since 1993 trade in goods between the three countries has almost tripled, from \$297 billion to \$883 billion in 2006. American merchandise exports to the other two NAFTA countries rose 157 percent; service exports rose 125 percent. Looking at American sales increases between 1993 and 2004, they rose in Canadian markets from \$100 billion to \$189 billion; and from \$42 billion to \$111 billion in the Mexican marketplace (Forbes & Ames, 2009).

Latin America generally refers to all countries south of the United States. This definition includes Mexico but excludes the island nations of the Caribbean (Bruton, Ahlstrom, & Puky, 2009). But politically, the Mexican government was interested in cementing market liberalization reforms by demonstrating its commitment to free trade. Economically, Mexico was interested in securing preferential treatment for 80 percent of its exports. Consequently, by the stroke of a pen, Mexico declared itself a North American country (Peng, Wang, & Liang, 2008).

Those voting con in the debate pointed out that the civil law legal system is based on a whole different philosophy of law; the language is different; and, in Mexico, much of the business activity is aimed at export to the United States. The institutional and financial infrastructure lacked the strength of the other two partners and the issue of taxes and accounting procedures became a concern as well. Mexico is a developing country with unique social problems related to poverty and income distribution (Husted & Allen, 2006). Critics further argued that it would simply make the poor worse off and start an environmental race to the bottom. Equally, advocates of the agreement made some bold claims about the good it would bring (e.g., create lots of new and better jobs, growth would accelerate, incomes would rise, and extra resources would be available to meet environmental concerns). For many observers and decision-makers, the entry

into force of the NAFTA in 1994 signaled the beginning of a new era for the negotiation of regional preferential trade agreements. By its scope, comprehensiveness, and precision, the treaty established a new standard: NAFTA, according to one observer, is among the most highly detailed international trade agreements ever negotiated between governments (Belanger, 2004).

It comprises twenty-two chapters setting forth specific obligations on trade in goods, services, intellectual property rights, dispute settlements and much more. It incorporates a panoply of annexes that elaborate the extent (and limits) of obligations. For comparison purposes, this treaty is as detailed and perhaps broader in scope than the World Trade Organization (WTO) agreement. And, NAFTA was drafted at a level of detail substantially higher than the European Commission treaty (Belanger, 2004). Nevertheless, the NAFTA design incorporates some sticky institutional features, namely its lack of governance structures and secondary rule-making provisions. This, in turn, pushes the less-powerful states, Canada and Mexico, to look for other RTA opportunities outside of this treaty. In other words, the weaker partners attach a relatively higher value to gaining voice opportunities and as a consequence, Canada and Mexico will diverge from U.S. trade strategies (Belanger, 2004). However, the signatories of NAFTA deliberately wanted to avoid establishing any bureaucratic or supranational institutions.

### **U.S. – Mexico Economic Relations**

The United States and Mexico have strong economic ties. Based on a gross domestic product (GDP) of \$1.0 trillion in 2008 (about 7 percent of U.S. GDP), Mexico has a free market economy with a strong export sector. As a partner in NAFTA and due to the proximity of Mexico to the United States, the close trade and investment interactions, and other social and political issues are highly important to the United States. Mexico has a population of about 110 million people making it the most populous Spanish-speaking country in the world and the third most populous country in the Western Hemisphere (Villarreal, 2009).

As NAFTA celebrates its 16<sup>th</sup> anniversary in 2010, not all is rosy. Opponents of globalization in both Canada and the United States no longer focus on the negative impact of competition from Mexico but rather on China and India. Despite its impressive gains, many Mexicans feel betrayed by NAFTA. Because of Chinese competition, Mexican real wages in manufacturing have stagnated. Many U.S., Canadian, European, and Japanese multinationals are shifting some of their factory work to China, which has now replaced Mexico as the second largest exporter to the United States (after Canada); and China may displace Canada in 2010.

About 1,000 maquiladora factories have closed down since 2000. One reason many Mexicans are disappointed is that the deal might have been oversold by its sponsors as a cure-all for Mexico, billed as the next South Korea. If NAFTA has disappointed, it may be in part because the Mexican government has not capitalized on the tremendous opportunities NAFTA has offered. There is only so much free trade can do; other reforms in infrastructure and education need to keep up with the changes in the globalized world.

### **U.S. – Mexico Bilateral FDI**

Exporting and importing are not the only strategies for companies to engage in international operations; FDI is another option. In 1993, more than \$30 billion in foreign capital was invested in Mexico (Krugman, 2009: 38). It forms another part of the economic relationship between the United States and Mexico. It consists of investments in real estate, manufacturing plants, and retail facilities, in which the foreign investor owns 10 percent or more of the entity. The United States is the largest source of FDI in Mexico. U.S. FDI on a historical cost basis in Mexico increased from \$17 billion in 1994 to \$91.7 billion in 2007. Mexican FDI in the United States is much lower than U.S. investment in Mexico, with levels of Mexican FDI fluctuating over the last decade. In 2005, Mexican FDI in the United States totaled \$8.7 billion, representing an increase of 440 percent since 1994. The sharp rise in U.S. FDI since NAFTA implementation is also a result of the liberalization of Mexico's restrictions on foreign investment in the late 1980s and the early 1990s. Prior to NAFTA, Mexico had a very protective policy that restricted foreign investment and controlled the exchange rate to encourage domestic growth. Mexico's policy reversals and economic reforms helped bring in a steady increase of FDI flows into Mexico (Villarreal, 2009). Nearly half of total investment in Mexico is in the manufacturing industry of which the maquiladora industry forms a major part. Mexico's export-oriented assembly

plants are closely linked to U.S. – Mexico trade in various labor intensive industries. These plants generate a large amount of trade with the U.S. and a majority of the plants have U.S. parent companies. These plants account for a substantial share of Mexico's imports and about half of its exports (Villarreal, 2009).

FDI is another phenomenon that grew significantly in the second half of the twentieth century. FDI represents capital investment – such as building a factory or purchasing a company – in another country. When foreign capital is invested in the domestic market it is labeled as inward FDI. When domestic residents invest capital abroad, it is defined as outward FDI. The motivations for FDI include (1) seeking new markets and cheaper resources, (2) avoiding trade barriers, and (3) strategically increasing efficiency of a firm's foreign operations. When a company establishes a plant overseas, it usually imports capital goods to the foreign country. It may or may not export goods out of the country. FDI also contributes to the transfer of technology, which can benefit both countries. From a political perspective, FDI can be a sensitive issue. Government policies can influence FDI by altering the relative attractiveness of the host country to foreign investors in a wide variety of ways (Elango & Pattnaik, 2007; Globerman & Shapiro, 1999).

The NAFTA liberalized the environment for FDI in several ways. It strengthens some of the protections embodied in the FTA including a provision forcing states and provinces to also grant national treatment to investors. National treatment in NAFTA is further strengthened by Most Favored Nation and minimum standard of treatment provisions whereby respectively signing parties must grant investors treatment no less favorable than that granted to investors and investments of non-signing countries and that provided for under international law (Globerman & Shapiro, 1999). Chapter 11 of NAFTA concerns protection of private investments in the member states. It is unique in granting private investors the right to sue sovereign foreign governments. Typically, international treaties permit one state (the home of the investor) to sue another state. Under NAFTA, foreign individuals and foreign firms have the unprecedented right to challenge the policies of sovereign states if the value of their investment diminishes due to any law, regulation, procedure, requirement or practice (Duina & Buxbaum, 2008).

Foreign investment in domestic markets may be viewed negatively – as loss of ownership – to domestic outsiders. Similarly, when domestic companies go overseas, critics will point to the loss in employment and income as negatives for the home country. FDI and international trade will grow as long as trade barriers continue to fall under the stewardship of the WTO. Although there are occasional calls for protectionism, the growth of FDI and international trade continues unabated as we head toward a truly global market. The only reason for FDI to take place is the existence of market imperfections. A majority of studies have focused on the macroeconomic imperfections in the marketplace to explain the motivations for FDI. Another branch of study has looked at FDI from a microeconomic perspective; the skills and know-how of a firm require that it be located overseas to exploit its full productivity. Among the various theories offered in the literature, Dunning's eclectic OLI paradigm provides an overview of both the imperfections in the market and the uniqueness of the firm to explain FDI. The O stands for ownership, L for location, and I for internalization (Dunning, 2009; Dunning, 2002). Dunning's OLI paradigm is able to integrate the multiple motivations for FDI into three broad and simple categories. It recognizes the impact of both macro and micro factors involved in the decision to go overseas and substitute FDI for trade. Other authors have classified the motives strictly from the perspective of the multinational as it operates in a global environment without national boundaries. Multinationals engage in FDI to seek resources and markets and to achieve global efficiency and strategic fit. Strategic fit may encompass several different criteria such as securing markets, cutting costs, and accommodating other factors, including import barriers, shortage of foreign exchange, and uniqueness of product (Buckley, Clegg, Cross, Liu., Voss, and Zheng, 2007).

The flow of international trade is affected significantly by the flow of foreign direct investment. FDI can either complement trade or act as a substitute for trade. Earlier studies had pointed to a negative correlation between FDI and trade, especially bilateral trade. Recent studies overwhelmingly show a positive relationship between FDI and trade. This interaction requires new policies and coordination by and between countries. If FDI results in increased trade for both countries, it makes sense to lower trade barriers to the fullest extent possible. However, the benefits of trade through FDI may not be immediate, and the short-term effects of FDI can be destabilizing for a country. The WTO has to balance the social and economic consequences of FDI and trade to achieve the right balance of free trade policies (Filatotchev, Strange, Piesse, and Lien, 2007; Luo, Chung, and Sobczak, 2009; Luo and Tung, 2007).

## **U.S. – Canadian Economic Relations and Trade Difficulties**

For a number of years, going back to 1982, American timber firms argued that Canadian rivals, which cut trees mostly from publicly owned Crown lands, paid artificially low cutting fees that were an unfair subsidy. By May 2002, for the fourth time, the U.S. Department of Commerce imposed a 27 percent countervailing duty on Canadian softwood lumber. The tariff effectively barring the importation of Canadian softwood lumber was contested by the government of Canada and several provinces and lumber companies. The issue went before NAFTA panels and the WTO several times with rulings generally in favor of Canada. In 2004, a bi-national NAFTA panel issued a “final” decision finding (1) that Canadian firms had not injured U.S. rivals and (2) that approximately \$4 billion in U.S. tariffs collected needed to be refunded (Howe, 2009). The United States ignored the “final” ruling and launched a post-final decision “extraordinary challenge” (allowed by the NAFTA rules), alleging that the first panel was unfair. In 2005, NAFTA’s extraordinary challenge committee upheld the original panel’s verdict. However, the United States ignored even that ruling. Washington’s initial response was that the ruling doesn’t settle anything – and that it will take more negotiation before this dispute is wrapped up. But by November 2005, the U.S. Commerce Department said it would comply with the NAFTA ruling, even though it disagreed with it. In the following months the Commerce Department said it had recalculated its countervailing and anti-dumping duties on softwood. This resulted in new duties to be set at a total of 10.8%, almost halving the old rate. The decision was expected to save Canadian lumber companies \$600 million a year (Howe, 2009).

Because a major selling point of NAFTA to Canadians was that it would set up an institutional framework to adjudicate trade disputes like this, Canadian newspapers questioned whether America’s signature meant anything at all. Secretary of State Rice, at that time, insisted that America’s record on honoring treaties was “as good as gold.” Canadian radicals called for cutting off oil and gas exports in retaliation. The Canadian government, not so radical, launched an information campaign to inform other countries seeking trade treaties with the United States about what lessons Canadians learned (Howe, 2009). Last year the “Buy American” proposal included in the Administration’s economic recover bill stirred up more resentment in Canada until the issue was finally resolved.

## **TRUCKING BAN ON MEXICAN TRUCKS**

When NAFTA was enacted a provision granting Mexican truckers full access to the United States was negotiated but never put into effect. The U.S. has avoided complying with provisions of the transportation chapter of NAFTA for over a decade, causing Mexico’s leadership to bring the issue before the WTO during that time (Barfield & Levy, 2009). Efforts to comply have been met with opposition on the grounds of safety, security, environmental pollution and job losses for U.S. truckers (Forbes & Ames, 2009). U.S. lawmakers and the International Brotherhood of Teamsters, among other groups, maintain concerns regarding the safety of Mexican trucks. A NAFTA panel evaluated the situation in 2001 in determined that the United States was in violation of NAFTA in their refusal to allow access to the Mexican trucks. The panel held that the United States could put safety requirements on the trucks and prevent certain companies from driving their trucks in the United States, but could not prevent access all together (Howe, 2009).

In response to this, the Bush administration created a pilot trucking program. The program began in 2007 and was designed to allow certain Mexican trucks to drive into the U.S. for one year. The program was intended to show that Mexican trucks driving in the U.S. would be able to comply with U.S. safety regulations. Various claims of success were made about the pilot program but it was short-lived because when President Obama signed the \$410 billion omnibus spending bill on March 10, 2009, that slashed funding for the program. According to two members of the House of Representatives, both Republicans, terminating this pilot program in fact violated the U.S. NAFTA obligations (Howe, 2009).

The decision made by Congress was stunning; daring Mexico to retaliate. It was also incomprehensible other than it may have acted as a repayment of debt owed to the Teamsters Union for its support of the Democrats in the recent elections. When Senators Biden and Obama had the chance both voted to cut off funding for the pilot program. Now, with Obama signing the funding bill that included earmarks, and not saying anything about the cutoff in funds for the pilot program, it sent a clear message to Mexican authorities that the U.S. had no intention of allowing their trucks to

operate in the United States (Weintraub, 2009). In response to the cancellation of the pilot program, Mexico increased duties on \$2.4 billion worth of U.S. exports; these retaliatory tariffs represented Mexico's voice against U.S. protectionism.

### **AN ESTIMATION OF LOSSES BECAUSE OF THE BAN ON TRUCKS**

Proponents of lifting the U.S. ban and freeing up Mexican trucks to directly deliver goods in their neighbor countries will cut logistics costs by millions of dollars, reduce pollution due to truck delays at the ports of entry, and ultimately benefit consumers in both nations. The delays at the border introduce uncertainty in the supply chain and this uncertainty triggers an assortment of "hidden costs," such as lost sales, rotten produce, and need for more inventory procedures (Carey, 2007). And the so-called three truck dance – having cargo pass from Mexico to the U.S. that has to be off-loaded, carted across the border, and then loaded onto another truck, is costing consumers up to \$400 million a year in the U.S. Costs created by the current complex process to move cargo across the border are not just in the uncertainty about crossing times and delays at the border. There exists environmental costs due to idling checks polluting the air and evidence suggests that the lost time in traffic is an important trade friction. Improving the operation of trucking between Mexico and the U.S. is an important step to maximize the benefits of NAFTA.

Mexican-imposed duties are hitting American farmers and manufacturers in 40 states. There's been over \$4 million worth of export losses (Ikowitz, 2009). The retaliatory tariffs has opened up and undercut a lot of the intended free trade provisions of NAFTA. The ramifications of an extended trade tiff will cause tremendous damage to both economies (Grillo, 2009, Ortega, 2009; Roberts, 2009a; Roberts, 2009b). The National Corn Growers Association (NCGA) and 140 other agricultural, manufacturing and service organizations and associations all signed a letter sent to the White House urging the President to work quickly to resolve the dispute. The NCGA claim \$900 million worth of agricultural products will be affected by these tariffs and 12,000 jobs will be at risk (President Obama urged, 2009). This April 7, 2009 letter to the President and copied to leaders of key Washington agencies urged the administration to work "expeditiously" to comply with NAFTA since the feud threatens not only 12,000 agricultural jobs but another 14,000 manufacturing jobs. The signatories included, among others, the National Pork Producing Council, U.S. Chamber of Commerce, American Farm Bureau, National Association of Manufacturers, Grocery Manufacturing Association, National Cattlemen's Beef Association, National Foreign Trade Council, Emerging Committee for American Trade, and the NCGA. Mexico is a major grain market. In 2008, Mexico was the top export destination for U.S. rice, the number two destination for U.S. soybeans, and the third largest buyer of U.S. wheat. Today, commerce between the two countries is worth an estimated \$350 billion and more than 70,000 trucks cross the border daily.

### **HOW MEXICAN RETALIATORY TARIFFS COST AMERICANS**

Mexico's new tariffs on American-made goods, roughly 90 products that account for approximately \$2.4 billion in exports to Mexico in 2007, mostly face import duties of 10 to 20 percent of their value. Many of the choices of products are aimed at specific members of Congress. The tariffs apply to 36 agricultural and 53 industrial products. Mexican officials appear to have targeted products from states represented by lawmakers who are influential in Congress or have some voice on trade issues. The tariffs took effect March 19, 2009 and Mexico's assistant Economy Secretary, Bearriz Leycegui, warned that the list of tariffs could grow unless there is progress toward resolving the trucking dispute. Mexican Economy Secretary Gerardo Ruiz Mateos called the U.S. trade policy wrong (protectionist) and a clear violation of NAFTA. Mexico is the U.S.'s third largest trading partner and the new tariffs will affect goods across 40 states. California's table grapes will face a 45 percent duty at the Mexican border; wine, almonds and juices among other agricultural products will pay 20 percent. With the cost of imported U.S. products now higher, Mexicans will substitute these U.S. brands with products from Europe, Canada, and Latin America. U.S. exporters will lose market share and the consequences of a trade war is the last thing the slumping U.S. economy needs with its neighbor.

## DISCUSSION

The paper illustrates clearly that the United States needs to resolve the current trade spat with Mexico and perhaps equally as important, acting to provide the world with needed reassurance that the U.S. will stand by its trade agreements in these difficult times. This paper provides unequivocal evidence that in order to be taken seriously in the global market-place the U.S. must avoid agreeing to one thing while actually doing something different. The non-compliance with a NAFTA provision hurts the U.S. credibility with trading partners in regard to our ability to enforce existing obligations under trade agreements and undermines the U.S. ability to call on other countries to meet their obligations under trade agreements. Increasing efficiency in trade between the United States and Mexico will benefit both sides and strengthen President Calderon's pro-market policies. But alas, the U.S. trade relationship with Mexico is now in peril, a victim of the politics of protectionism and populism. And with the U.S. executive branch of government ready to declare the recession over, tariffs from Mexico are obviously detrimental to this economic recovery plan.

Although Canada and Mexico have traditionally been the top U.S. trade partners, the rapidly 21 percentage annual growth in U.S. – China trade from 2001 through 2007 resulted in China supplanting Mexico as the U.S. number two trade partner in 2006. Despite dropping to third place as a U.S. trade partner, the value of Mexico's trade with the United States still rose throughout the period. Nevertheless, many of the low-cost manufacturers that moved to China could have had Mexico as the main destination if the supply chain management infrastructure had been in place allowing cross-border trucking. This lack of institutional laws and structures to support inter-modal transportation fully among NAFTA partners provided Mexico with an added cost while the U.S. benefited from the expansion of trade with China. While perhaps understandable for Mexico to finally slap duties on American goods as legally permitted, this will either increase the costs of American consumer products in Mexico or force consumers there to switch brands. Mexico has free trade agreements with 43 nations, and if retaliatory duties drive up the price of U.S. goods in Mexico, consumers there have plenty of options elsewhere. Meanwhile, U.S. exporters will lose market share in Mexico, costing more U.S. jobs and loss of income.

It should not be lost on any member of Congress that the Great Depression was deepened significantly by the Smoot-Hawley Tariff Act of 1930. While it may be politically popular to bash international trade during recessionary times, these types of actions will only serve to inflict more pain on the American people and will tarnish America's reputation for honoring legal commitments. The modern free-trade era began during the Great Depression, after the catastrophe of the 1930 tariff that ignited a "beggar-thy-neighbor" reaction around the world, and the flow of goods and services slowed tremendously. The 80-year history of free trade progress is now under pressure from the global recession. In the United States, labor union anti-trade views dominate the Democratic Congress and protectionism is increasingly becoming popular in this country and others. This collapse in trade raises questions about the future of international business in a world of globalization. The US President should press Congress to ratify the trade pacts negotiated already with both Columbia and Panama. In addition to the right message to Central and South America, the President should also press Congress to ratify the already negotiated FTA with South Korea. Thus far, Mr. Obama has coddled protectionist supporters (Nau, 2010).

Fortunately, the U.S. – Canadian feud over lumber has ended. But looking southward, certainly the Obama administration needs to move forward quickly on several fronts simultaneously in order to avoid the trap of managed trade and protectionism. One of these minor yet important initiatives is honoring the NAFTA pact and the arbitration panel ruling and open-up the U.S. border to Mexican trucking. A swift removal of the retaliatory Mexican tariffs is necessary as well. Despite these challenges, the dream of a seamless North American trade economy can be realized through sincere, fair, and trustworthy diplomacy and statesmanship going forward.

While the Mexican government has demonstrated patience over the years on the trucking impasse, perhaps some of its disquiet stems from the disequilibrium in trade: some 80 percent of Mexico's merchandise exports normally go to the U.S. whereas Mexico now receives about 12 percent of total U.S. exports of goods, making any trade tiff a higher stakes venture for Mexico. The Obama administration's second year has nearly ended and no new vision of moving forward to become a better trade partner with neighbors to the north and south has been articulated. The leaders of the two countries have been meeting in person but when they get together they tend to be occupied with more pressing

matters than trucks due to Mexico's efforts to subdue the drug cartels and the US concern of the spillover into Arizona and other border states. President Obama told President Calderon that his administration is dealing with the truck issue but his administration wants to see more trade move to rail and sea and off the road (Palmer, 2010; Trade with Mexico, 2010).

## CONCLUSION

The objective of this paper has been to emphasize the importance of America's commitment to trade agreements, in particular under the NAFTA umbrella. The U.S. has proved willing to disregard internationally agreed rules when they did not coincide with American interests, and rather rely on whatever weight or leverage it has in its relations with Canada and Mexico. The disputes represent a prominent and revealing case where power-politics has prevailed over international trade rules. Major U.S. economic and political interests have led to a disregard for CUSFTA/NAFTA provisions and left the two weaker trade partners to negotiate whatever settlement may prove acceptable to the Americans. The disputes raise key questions concerning the effective business of the Canadian-U.S. partnership and the Mexican-U.S. partnership.

The Canada-U.S. softwood lumber dispute has been one of the longest and most significant trade disputes between the two countries. The dispute was prolonged by virtue of the fact that Canada and the U.S. not only are partners to NAFTA, but also are members of the WTO. NAFTA contains provisions for the resolution of a trade dispute by an arbitration panel. A WTO agreement known as the Dispute Settlement Understanding (DSU) separately provides for the creation of panels to resolve trade disputes. Because these NAFTA provisions and the DSU are parallel dispute-settlement mechanisms, independent of each other, it is possible for a party to have separate recourse to each of these mechanisms.

Although the NAFTA proceedings were essentially favorable to Canada, the U.S. was unwilling to look at NAFTA, a regional trade agreement, as the appropriate basis for resolving this regional dispute. Instead, the U.S. sought to rely on its hegemonic economic power to coerce Canada to yield to the interests of U.S. producers.

The United States should have accepted the NAFTA decision. Admittedly, U.S. action along these lines might require a high degree of statesmanship and political creativity, and might result in U.S.-abandonment of scorched earth litigation tactics that serve as an on-going barrier to trade. Further, the United States must swiftly move to honor its signatory obligation within the North American Free Trade Agreement to allow unfettered Mexican trucking services on American roadways.

One of the key contributions of this paper is bringing the sixteen year feuds between contiguous countries to the forefront and highlighting the costs and related difficulties of conducting international trade in an environment that has now evolved into Mexico assigning significant retaliatory tariffs to U.S. exporters. A full-fledged fight between the neighboring countries of Mexico and the United States alone could threaten more than \$350 billion in annual commerce between the two parties and that is clearly in nobody's interest.

Future research suggestions include an investigation of why NAFTA and other regional trade agreements lack adequate enforcement powers and how diplomacy and statesmanship can be brought to the forefront in the conduct of international trade. The oversight and management of populism, protectionism, and tariffs and non-tariff barriers to trade should also be further researched in the context of one or more RTAs.

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