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NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) BETWEEN CANADA, MEXICO AND USA - ITS MAIN FEATURES AND IMPLICATIONS FOR CONTRACTING PARTIES, LATIN AMERICAN, CARICOM COUNTRIES AND BELIZE

The North American Free Trade Agreement (NAFTA) between Canada, Mexico and USA signed on 12th August, 1992, will usher in a new era of developments affecting not only the signatory countries but also many other developed and developing countries. The Agreement has been designed to promote economic growth in each country through expansion of trade and investment opportunities in free trade area, and by enhancing the competitiveness of Canadian, Mexican and US firms in global markets in a manner that protects the environment. The Agreement for achieving its objectives seeks to eliminate barriers to trade, promote conditions of fair competition, increase investment opportunities, provide adequate protection for intellectual property rights, establish effective procedures for the implementation and application of the Agreement and for the resolution of disputes and to further trilateral, regional and multilateral cooperation.

The Agreement will create world's largest trading bloc, encompassing population of 360 million people, Gross National Product (GNP) of about US$6 trillion and trade value of US$6000 million. The salient features of the Agreement which is yet to be ratified by the concerned governments are given below:

Market Access

The Agreement improves market access for the goods produced and traded within North America. It provides for the progressive elimination of all tariffs on goods qualifying as North American under its rules of origin. Out of 9000 tariff items, tariffs on 50 percent are proposed to be eliminated immediately, 15 percent in 5 years, and for the rest, there are gradations of between six and fifteen years.

The three contracting countries will eliminate prohibitions and quantitative restrictions applied at the border such as quotas and import licences. However, special rules will apply to trade in agriculture, autos, energy and textiles. The Agreement provides for the refund (draw back) or waiver of customs duties on material used in the production of goods in one NAFTA country and subsequently exported to another NAFTA country.

RULES OF ORIGIN

The Agreement has framed its own rule of origin to:

i. ensure that NAFTA benefits are accorded only to the goods produced in the North American region and not to goods made wholly or in large part in other countries;
ii. provide clear rules and predictable results; and
iii. minimize administrative burdens for exporters, importers and producers trading under NAFTA.

The rules of origin specify that goods originate in North America if they are wholly North American. Goods containing non-regional materials are also considered to be North American if the non-regional materials are sufficiently transformed in the NAFTA region so as to undergo a specified change in tariff classification. In some cases, goods must include a specified percentage of North American content, in addition to meeting the tariff classification requirement. The regional value content may be calculated using either the "transaction value" or the net cost method. The transaction-value method is based on the price paid or payable for a product. This method avoids the need for complex cost accounting system. The net-cost method is based on the total cost of the product less the cost of royalties, sales promotion, packing and shipping. Although producers have the option to use either method, the net-cost method must be used where transaction value is not acceptable under the GATT Customs Valuation Code, and must also be used for certain products such as automotive goods.

The rules of origin also provide to prevent goods from losing

eligibility for preference solely because these contain minimal amount of non-originating material. It is provided that goods which would otherwise fail to meet a specific rule of origin will none-the-less considered to be North American if the value of Non-NAFTA material comprises not more than seven percent of the price or total cost of such goods.

Textiles and Apparels

The Agreement provides special rules for trade in fibres, yarns, textiles and clothing in the North American Market. The NAFTA textiles and apparel provisions take precedence over those of the Multifibre. Arrangement and other agreements between NAFTA countries, applicable to textile products.

According to the Agreement, the three countries will eliminate immediately or phase out over a maximum period of 10 years their customs duties on textiles and apparel goods manufactured in North America that meet the NAFTA rules of origin. In addition, the USA will immediately remove import quotas on such goods as produced in Mexico, and will gradually phase out import quotas on Mexican textiles and apparel goods that do not meet such rules. No NAFTA country may impose any new quota, except in accordance with specified safeguards provisions. The safeguards clause provides that if textiles or apparel producers face serious damage as a result of increased imports from another NAFTA country, the importing country may, during the "transition period" either increase tariffs, or with the exception of Canada-US trade, impose quotas on the imports to provide temporary relief to that industry. In the case of goods that meet NAFTA'S rule of origin, the importing country may take safeguard actions only in the form of tariff raising.

The Agreement defines rule of origin for textiles and apparels, enabling them to qualify for preferential treatment. For most products, the rule of origin is "yarn forward" which means that textiles and apparel goods must be produced from yarn made in a

NAFTA country in order to benefit from such treatment. A "fibre forward" rule is provided for certain products such as cotton and man-made fibre yarns. Fibre forward means that goods must be produced from fibre made in a NAFTA country. In order cases, apparel cut and sewn from certain imported fabrics that the NAFTA countries agree are in short supply, such as silk, linen, and certain shirting fabrics, can qualify for preferential treatment. Additional provisions, responsive to the needs of North American industry, include Tariff Rate Quotas (TRQ'S), under which yarns, fabrics and apparels that are made in North America, but do not meet the rules of origin, can still qualify for preferential duty treatment up to specified import levels. The TRQ'S for Canada that were included in the Canada-US FTA have been increased and provided an annual growth rate for at least the first five years.
Further, it is provided that NAFTA countries will undertake a general review of the textile and apparel rules of origin prior to January, 1998. In the interim period, they will consult on request whether specific goods should be made subject to different rules of origin, taking into account availability of supply within the free trade area. In addition, the three countries have established a process to permit annual adjustments to TRQ'S levels.

Automotive Goods

The Agreement seeks to eliminate barriers to trade in North American automobiles, trucks, buses and parts (automotive goods) within the free trade area, and eliminate investment restrictions in this sector over a ten-year transit period. Most trade in automotive goods between Canada and the USA is conducted on a duty-free basis under the terms of either the Canada-USA FTA or the Canada-US Autopart. For trade in automotive goods between USA and Mexico, for its imports from Mexico, the US will:-

i. eliminate immediately its tariffs on passenger automobiles;
ii. reduce immediately to 10 percent its tariffs on light trucks and phase out the remaining tariffs over five years; and

iii. phase out its tariffs on other vehicles over 10 years.

For imports from Canada and USA, Mexico will:-

i. reduce immediately by 50 percent its tariffs on passenger automobiles and phase out the remain tariffs over 10 years;

ii. reduce immediately by 50 percent its tariffs on light trucks and phase out the remaining tariffs over 5 years; and

iii. phase out its tariffs on all other vehicles over 10 years.

Canada will eliminate its tariffs on vehicles imported from Mexico on the same schedules as Mexico and the USA.

Similarly, for auto parts, each country will eliminate its tariffs on certain automotive parts immediately and phase out tariffs on others over 5 years and a small portion over 10 years.

The NAFTA rules of origin provide that in order to qualify for preferential tariff treatment, automotive goods must contain a specified percentage of North American content (rising to 62.5 percent for passenger automobiles and light trucks as well as engines and transmissions for such vehicles, and to 60 percent for other vehicles and automotive parts) based on the net-cost formula. In calculating the content level of automotive goods, the value of imports of automotive parts from outside the NAFTA region will be traced through the production chain to improve the accuracy of the content calculation. Under the Agreement, Mexico will:-

i. eliminate immediately the limitation on imports of vehicles based on sales in the Mexican market;

ii. amend its trade balancing requirements immediately to permit assemblers to reduce gradually the level of exports of vehicles and parts required to import such goods, and eliminate, at the end of transition period, the requirement that only assemblers in Mexico may import vehicles;

iii. change its "national value-added" rules by reducing the percentage of parts required to be purchased from Mexican parts producers, by counting purchase from certain in-bond production facilities toward this percentage;

iv. ensure that Canadian, Mexican and US parts manufacturers may participate in the growing Mexican market on a competitive basis, while requiring assemblers in Mexico during the transition period to continue to purchase parts from Mexican parts producers; and

v. eliminate at the end of transition period the national value-added requirement.

Further, in accordance with the NAFTA'S investment provisions, Mexico will immediately permit "NAFTA investors to make investments of up to 100 percent in Mexico national suppliers of parts, and up to 49 percent in other automotive parts enterprises, increasing to 100 percent after five years. Mexico's thresholds for the screening of takeovers in the automotive sector will be governed by NAFTA'S investment provisions.

Agriculture

The Agreement includes separate bilateral undertakings on cross-border trade in agricultural products, one between Canada and Mexico, and the other between Mexico and the USA, while the rules of Canada-US FTA on tariff and non-tariff barriers will continue to apply to agricultural trade between Canada and the USA.

Relating to trade between Mexico and USA, both these countries will eliminate immediately all non-tariff barriers to their agricultural trade, generally through their conversion to either "tariff-rate quotas" (TRQ'S) or ordinary tariffs. The TRQ'S will facilitate the transition for producers of import-sensitive products in each country. No tariff will be imposed on imports within quotas amount. The quantity eligible to enter duty-free under the TRQ'S will be based on recent average trade levels and will grow generally at 3 percent per year. The over-quota duty - initially established at a level designed to equal the existing tariff value of each non-tariff barrier - will progressively decline to zero during either a 10 or 15-year transition period, depending on the product.

Further, under the Agreement, Mexico and USA will eliminate immediately tariffs on a broad range of agricultural products. It is estimated that with this elimination, roughly one-half of US-Mexico bilateral agricultural trade will be duty free immediately. All tariff barriers between Mexico and USA will be eliminated not later than 10 years, with the exception of duties on certain highly sensitive products - including corn and dry beans for Mexico, and orange juice and sugar for the USA. The tariff phase-outs on these few remaining products will be completed after 5 more years.

Mexico and USA will gradually liberalize bilateral trade in sugar. Both countries will apply TRQ'S of equivalent effect on third country sugar by the sixth year after the Agreement goes into effect. All restrictions on trade in sugar between the two countries will be eliminated by the end of the 15-year transition period, except that sugar exported under the US Sugar Re-Export Programmes will remain subject to most - favoured nation (MFN) tariff rates.

Similarly, Canada and Mexico will eliminate all tariff and non-tariff barriers on their agricultural trade, with the exception of those in the dairy, poultry, egg and sugar sectors. Canada will immediately exempt Mexico from import restrictions covering wheat, barley and their products, beef and veal and margarine. Canada and Mexico will eliminate immediately or phase out within 5 years tariffs on many fruit and vegetable products, while tariffs on remaining fruit and vegetable products will be phased out over 10 years. A small number of these products will be subject to special transition safeguards.

Investment and Environment

The Agreement:-

i. seeks to remove investment barriers;

ii. ensures basic protection for NAFTA investors; and

iii. provides a mechanism for settlement of disputes between such investment and a NAFTA country.

NAFTA investors include all enterprises with substantial business activities in a NAFTA country. Investment covers all forms of ownership and interests in a business enterprises, tangible and intangible property and contractual investment interests. Each country under the Agreement will treat NAFTA investors and their investments no less favourably than its own investors - national treatment - and investors of other countries - most-favoured nation treatment. In addition, each country must provide investment in accordance with international law, including fair and equitable treatment and full protection.
It is further provided that no country should lower its environmental standards to attract an investment and the countries will consult on the observance of this provision. The Agreement also specifies that a country may take action consistent with the NAFTA'S investment provisions to protect its environment.

Financial Services

The Agreement seeks to promote and regulate financial services in NAFTA countries, covering banking, insurance and securities sectors as well as other financial services.

Intellectual Property Rights

The Agreement establishes a high level of obligations respecting intellectual property. The Agreement states that each country will provide adequate and effective protection of intellectual property rights on the basis of national treatment and will provide effective enforcement of these rights against infringement, both internally and at the border. The Agreement sets out specific commitment regarding the protection of:-

i. copy rights including sound recording;
ii. patents;
iii. trade marks;
iv. plant breeders rights;
v. industrial designs;

vi. trade secrets;
vii. integrated circuits (Semi-conductor Chips); and
viii. geographical indications. The copy rights protection will:-
i. cover computer programmes as literary works and data bases as compilations;
ii. rental rights for computer programmes; and
iii. protection of at least 50 years for sound recordings.

Other Areas

The Agreement also covers several other areas of mutual interest of NAFTA countries such as sanitary and Phyto sanitary measures, technical standards, anti-dumping and countervailing duties, government procurement, cross-border trade in services, land transportation, telecommunications, competition policy, monopolies and state enterprises.

Institutional Arrangements

The Agreement, besides creating several special committees to deal with day-to-day functioning of Agreement such as labelling for textile products, federal automotive standards, agricultural trade, sanitary and phyto-sanitary measures etc., establishes a Trade Commission as its central institution, comprising Ministers or Cabinet level officers designated by each country. There will be a secretariat to serve the Commission as well as other subsidiary bodies and dispute settlement panels. The administrative and technical support by the secretariat will ensure effective and joint management of the free trade area.

Accession to Agreement

The Agreement provides that other countries or groups of countries may be admitted into the Agreement if the NAFTA countries agree to this.

Amendments and Withdrawal

The Agreement provides for its amendment by the member countries, subject to domestic approval procedures. Members can also withdraw from the Agreement by giving 6 months notice to this effect.
Although the Agreement has been signed, the legislatures in the three countries still have to ratify it. President Clinton supports the ratification, but says that the side agreements covering labour issues, the environment and safe-guards against surges must first be negotiated.

Steps Towards Further Integration

The Agreement is a step towards further integration. The economies of three NAFTA contracting parties are highly integrated. The USA and Canada are each others biggest trading partners, the USA accounting for 66 percent of canadian imports and 75 percent of its exports; and Canada making up 25 percent of the USA imports and 20 percent of its exports. Similarly, the USA accounts for 66 percent of Mexican imports and 70 percent of its exports. Already, each Canadian imports merchandise worth US$3,270 from the USA. Similarly, at present, on an average, each Mexican imports US$380 of US merchandise annually. The Mexican propensity to import from the USA is on the increase further. Thus, scope for the USA increasing its exports to Mexico is astounding.
Further, the US-Mexican trade indicates a growing trend of integration in various industrial sectors, particularly the automotive industry. It is obvious from the fact that during 1992, among the top valued US exports to Mexico, were the automobile parts and accessories, telecommunication equipment and equipment for distribution of electricity. These three items were also among the top US imports from Mexico.

Possible Geographical Expansion

While at present NAFTA covers three countries, but these countries acting together plan to take into their fold several other countries. Chile is the first choice due to its rapid strides towards an open economy. When this has been achieved, negotiations may start with other Latin American trading blocs namely the Caribbean Community, the Central American Common Market, the ANDEAN Group and the Mecosur (Southern Market). These regional organizations are promulgating open and dynamic trading systems. The countries like Argentina, Venezuela, Brazil and Colombia have undertaken several impressive reforms, while others have followed their example. It is also likely that some of the groups may merge with each other to acquire greater strength.

These blocs with their members are mentioned below:

Caribbean Community (CARICOM) - 12 members

Antigua, Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines and Trinidad and Tobago.

Central American Common Market (CACM) - 5 members

Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica.

Andean Group - 5 members

Venezuela, Colombia, Ecuador, Peru and Bolivia.

Mercosur (Southern Market) - 4 members

Brazil, Paraguay, Uruguay and Argentina.

The Group of Three (G-3) - 3 members

Mexico, Venezuela and Colombia.

It is a matter of debate whether the Latin American countries will gain from the Free trade Agreement (FTA) with the USA. The World Bank study on the subject contends that, except Brazil and Mexico, the most Latin American countries stand to gain less with US than the US stands to gain from FTA's with them. The existence of GSP and the current low import duties from the Tokyo Round of multilateral trade negotiations are the two critical factors that account for the low level of trade gains. The sizeable cuts in Most Favoured Nation (MFN) and other tariffs in the current Uruguay Round will lower even further the trade gains to be expected by Latin American from the FTA with the USA. Despite this if the Latin American countries negotiate FTA with USA, they need to go in for multilateral negotiations of FTA's with the USA as the bilateral agreements, extending preferences to the other Latin American countries, could negatively impact the level of intra-regional trade.

NAFTA and EEC

As the USA continues strengthening its trade and economic relations with Latin America, its dependence on the EEC may diminish. This will give US greater negotiating power with American countries compared to the EEC.

As the Agreement is primarily intended for the contracting parties, the benefits under it will also mainly accrue to them.

Benefits to USA

Benefits to USA from Mexico will include the following:

- The USA will have better access to large and growing Mexican market;
- the USA will secure guarantees for protection of its intellectual property rights;
- the USA will increase its competitiveness at home and abroad;
- the USA will protect its direct foreign investment in Mexico.

While the US economy as a whole is likely to benefit from the Agreement, some US sectors will face competition. These are: household glassware, ceramic tiles, certain fruits and vegetables. Canada will also benefit in the same way as the United States covering: better access to the Mexican market, protection of intellectual property rights, increased competitiveness, long-term guarantees for protection of direct foreign investment and achieving greater productivity through economies of scale.
The specific Canadian sectors to benefits are: mining, telecommunications, machinery, environmental equipment and services and transportation equipment.

Benefits to Mexico

Mexico will benefit in the following ways:

- It will have greater and secured access to the US and Canadian markets;
- it will achieve international creditability and therefore increased foreign investment in the country;
- it will achieve specialization and productivity through economies of scales in production.

Among the three, Mexico will benefit greatly from the Agreement in trade and investment. The Agreement will reinforce the extensive market-oriented policy reforms implemented in the country since 1985. The reforms have promoted economic growth of 3-4 percent annually and falling inflation during the last three years. Further, by codifying liberal trade and investment policies in an international agreement and by Mexico closely aligning its economic policies to the US, the Agreement will increase investors confidence in Mexico. An increase of investment in Mexico will raise wage incomes and employment, and will also facilitate the transfer of technology. Mexico has already begun to benefit from large capital inflows. During 1992, capital inflows to Mexico were estimated at US$18,000 million, of which about US$5,000 million was foreign direct investment. The sectors like autos, textiles and

apparels are being strengthened with these investments.

Impact on Labour Force

The Agreement is expected to have a positive effect on employment levels in three countries. In the USA, the real income for US workers is expected to increase slightly due to the trade creating effects of the Agreement. There is a unanimity among the various studies that the Agreement will result in increase in the gross domestic product, employment and wages.

It is expected that rising US exports to Mexico under the Agreement will generate new high-wage jobs in the country. The new jobs will be able to offset the losses mostly of low-wage jobs. It has been predicted that the Agreement will lead to a net gain of 175,000 new jobs (325,000 gross job gains less 150,000 workers dislocation). Thus the real problem that the Agreement poses for the USA is not a net loss of jobs, but the transition from old jobs to new jobs. It is perhaps in this context that the Agreement is being criticized and it was also on account of this that in August 1992, President Bush announced creation of a five-year US$10 billion workers adjustment programme. Similarly, in Mexico, with the growth of it a economy, the employment and wage rates will rise, providing for better living standards.

Mexican and Canadian Interests

Both Mexico and Canada share a strong interest in securing growing access to the US market. Canada became partly to the Agreement in order to avoid growing US protectionism. The Canadian industries heavy dependence on the US market could not endure increased trade barriers. In December 1990, the failure of GATT to remedy the agricultural subsidy crisis, made clear to Canada to devise a strategy of shielding itself against the US protectionism.

Similarly, Mexico also realized that EEC interest will be more in Eastern Europe than in Mexico despite Mexican trade liberalization. Therefore, it became apparent that Mexico will have to depend more

on US investment to increase its productivity, exports and wages. Both Canada and Mexico heavily depend on the USA. Canada is the US biggest trading partner, sourcing 66 percent of its total imports from the USA and directing 75 percent of its exports to the USA. Mexico ranks third as USA trading partner after Canada and Japan, directing 70 percent of its exports to the USA and sourcing 66 percent of its imports from that country.
With trade relations improving further under this Agreement, the demand for Canadian and Mexican products will increase in the USA.

Interse Competition Among Canada and Mexico

Although efforts have been made under the Agreement to foster trade between Canada and Mexico, but it will take some time to achieve that as both Canada and Mexico have often perceived each other as a threat. Mexico is becoming a major competition for Canada in the USA in respect of such items as vehicles, automotive parts, machinery, cement, patro-chemical products, steel, textiles, apparels, footwear, furniture, agriculture, mining, beer and paper products. Consequently, neither country would like to see the other entering a bilateral trade with United States in these areas.

Impact on Latin American Countries

the Agreement will put the Latin American countries at a disadvantage in relation Mexico in the US market. trade gains for Mexico under the Agreement in the US market will result in trade loss for the Latin American countries in view of their largely the same composition of exports as that of Mexico to the USA. It has been estimated that the FTA between Mexico and US will result in an increase of about US$1.6 billion trade annually and will displace about US$28 million exports from other Latin American countries, with diversion of trade from other parts of the world to the tune of US$0.5 billion.

Impact on CARICOM Countries and Belize

The NAFTA will have adverse affects on the trade of Caricom countries with the USA. Despite local supports at improving productivity and quality, CARICOM states still remain at a severe disadvantage because they are small producers having to compete with larger countries benefiting from significant economies of scale. The NAFTA will further put them to disadvantage, in reducing the benefits which the CARICOM region have been receiving under the Caribbean Basin Initiative (CBI) in the US market. The same treatment to the Mexican products under NAFTA as to the Caribbean products under CBI will make it difficult for the Caribbean to face competition from Mexico for their products in the USA. This may result in declining exports from the Caribbean region. Falling exports may cause job losses in those industries which are heavily export oriented towards the US market. The specific items likely to suffer include garments, sugar, agro-products, new manufactured goods and citrus concentrates an additional item for Belize. In the case of garments, US and CARICOM garments industries are linked together through special arrangements. Many US companies have set up their offshore operations in the CARICOM region, manufacturing garments for 100 percent export to the US. Such operations have been found mutually beneficial, to the US companies cheap labour advantage in the CARICOM, and to the CARICOM, the benefit of foreign exchange earnings and creation of jobs. With NAFTA, these garments manufacturing operations may be dislocated, and may shift to Mexico, resulting in loss of foreign exchange earnings and employment avenues. Similarly, with NAFTA, CARICOM sugar industry is also likely to suffer setback. CARICOM countries export sugar to US under special quota arrangements. Under NAFTA, Mexico may obtain an increase in the sugar quota for the US, and this may lead to reduction in the sugar quota for small Caribbean countries for the US. Sugar in some of the CARICOM countries is crucial, being an important source of foreign exchange earnings, and also

providing considerable employment opportunities. For example, in Belize, sugar exports constitute nearly 40 percent of country's total exports, and nearly 5,000 farmers are engaged in the production of sugarcane.

With NAFTA, the US investment may also drift towards Mexico. This may give another blow to the Caribbean region.

Challenge is formidable, all the Caribbean countries need to be united to protect their interests in the US market by special arrangements.

For Belize, the USA is an important market as it accounts for more than 50 percent of its total exports. Not only its share is large but also the items being exported originate from certain important traditional and non-traditional sectors. Sugar and citrus are in the traditional export sector, while the garments, agro-industrial products and wooden furniture are in the non-traditional export sectors.

Similarly, several other regional countries dependence on the US market for their exports has grown significantly due to duty-free entry under CBI. Both expansion and diversification in exports has taken place. Export diversification has led to a more balanced production and export hase, reducing the region's vulnerability to fluctuations in the markets for traditional products. Expansion of exports between 1983 and 1991 by almost 150 percent has made such a significant impact on the region's total trade picture that total exports to the USA have increased since 1987, with almost 60 percent of the total exports comprising non-traditional products in 1991. The non-traditional agricultural exports have risen by 70 percent. These include pineapples, melons, frozen orange juice, ornamented plants, etc.

The impact of the Agreement on CARICOM and Belize in respect to their exports to Canada will also be adverse, as the effect of concessions given to them under Caribcan will be diluted with the same concessions provided to the mexican products in the Canadian market.