

A Comparison of the Provisions between NAFTA and GATT

George J. Gannage Jr. PhD

North Central University

PhD in International Business

USA

Abstract

In an attempt to increase greater volume of international trade among most favored nation countries both the GATT and NAFTA agreements were formed. As a result of rapid growth in exports and imports between countries throughout the world countries sought more economical ways to facilitate trade, thus, making these agreements were evitable. This paper will research the foundations of both GATT and NAFTA from conception to its current day utilization. Such topics as harmonization, tariffs and non-tariffs barriers, and protection of infant industries and general economics of these agreements will be highlighted and discussed. Also an analysis of some legal issues and challenges that have recently occurred between both customs agreements will be researched.

Keywords: NAFTA, GATT, maquiladora, globalization, NTB, MFN (most favored nations)

Although NAFTA and GATT were created many years apart their influence on international trade has caused great impact. Many critics have argued against NAFTA, saying it was akin to a “*giant sucking sound*” making reference to the many U.S. based employees that would lose jobs due to NAFTA (The Daily Paul, 2011). Others have pushed for the reformation of some specific provisions included in GATT during and after the Uruguay rounds. Still other countries have formed regional trading blocs and economic agreements far removed from any of the provisions of GATT or NAFTA. Why all the fuss over uniformity of trade relations? Simple? Countries and the people that lead them are different. Thus, the world remains faced with the many challenges presented by what should be considered fair and equitable international trade. For instance, in the early stages of NAFTA’s development there were strict proponents who would have NAFTA address only trade issues, whereas other groups (environmentalists and labor groups) wanted to see the inclusion of more regulatory mechanisms for the parties and the environment that was affected (Bognanno, 1993).

To describe GATT, one must include the word multilateralism, which under its auspices allows for multilateral trading between numerous countries. Trade liberalization was one of the central components of GATT. One of GATT’s principles, Article 1, is titled the most favored nation status which allows GATT- member countries to freely import and export trade goods and services without tariffs. This strategy utilizes reciprocity to encourage freer trade among these most favor status countries. For instance, according to GATT if the United States were to negotiate a lower tariff rate with France, say on wine imports, the lower French tariff would also be given to all GATT members who trade with France. Thus providing equalization among MFN’s. The architects behind GATT felt that lowering trade barriers was a good idea and should not simply be used for those confronting U.S. trade interests, but global interests. This strong multi-nationalistic philosophy embodied by GATT caused the U.S., Canada and Mexico to subscribe to a regional trading agreement that allows for not only freer trade but focuses on the welfare of many industries, including textiles, entertainment and automotive to name a few.

The number of countries belonging to GATT grew to over 135 by the early 1990’s, however, GATT’s enforcement against violating member-nations waned, thus individual member countries including the U.S. and Canada sought their own ways for securing trade barriers. One big issue that GATT was not equipped to handle, were institutional developments within economies in which non-tariff barriers remained. Such issues as import quotas, national standards or quality, dumping and sanitary regulations, and local content requirements are examples. The difficulty of non-tariff barriers is recognizing between legitimate interest of the host government (which is permitted under the new WTO rules) and a barrier created solely to render inbound goods noncompetitive through cost or administrative burden (Willes & Willes 2005). Further in the research, it is explained why the foundations of GATT eventually migrate to the newer rules of the WTO for survival.

GATT – Historical Perspectives

GATT was the most successful multilateral trade initiatives ever know to the modern world. GATT standing for (general agreement on tariffs and trade) was conceived in 1947.

Initially, GATT was developed to be more than a trade agreement its foundation was built upon a three pillar system, one, the World Bank (development and reconstruction), two, the IMF (financial liquidity) and three, the ITO (economic liberalization). Furthermore, the controlling arm of GATT was the UN (United Nations) who for many years earmarked financial support to countries ailing in ravages of war and famine. The mechanisms behind GATT were to rebuild and redesign both imperialistic and communistic markets by propagating democracy and free common market trading. GATT worked very well for many years until many countries criticized GATT for its lack of organizational structure, lack of broad coverage, and lack of any real dispute settlement. These areas are all important issues faced by countries involved in international trade (Willes & Willes, 2005). The spirit of GATT called for the elimination of quantitative restrictions, also as mentioned previously Article 1, the most – favored-nation status, and the assurance of national treatment. To explain in simple terms GATT allowed those MFN countries to export goods into a country, with these goods being charged no more duty than any other like imports, and, once inside the border treated no differently than domestically produced goods (Willes & Willes, 2005).

With international trade changing so rapidly, GATT was updated often with a total of eight rounds from the date of its establishment in 1947 through 1994. The central framework behind GATT was to liberalize international trade by lower or eliminating tariffs. It had become apparent in the later rounds of GATT, i.e. Tokyo and Uruguay rounds, that the real problem was the non-tariff barriers. The NTB's were frustrating many countries, even though the national treatment clause was in force. Most GATT- member countries remained self-serving and still favored their domestic producers over a foreign competitor. For instance, at one time the German government instituted regulations limiting the noise level of lawn mowers sold in Germany. It just happens to be that all lawnmowers produced by German manufacturers were quiet, while all foreign produced lawn mowers were noisy. Thus the result was a non-tariff barrier, no foreign manufacturer wanted to redesign or re-engineer their lawnmowers to compensate for this regulation.

What occurred on January 1, 1995 was a giant leap forward for GATT. The formation of the WTO (World Trade Organization) not only addressed tariffs and NTB's but also moved the agreement forward to cover such issues as “intellectual property” know as TRIPs, and general agreement on trade in services, know as GATS. With much of international trade occurring through electronic channels, i.e. the World Wide Web, this late 20th century version of GATT would become the model for the future and has provided much credibility for intellectual property rights both electronic and non-electronic. To emphasis, GATT's new provisions didn't eliminate GATT or it's the membership; it could be said that GATT was given a facelift to represent the new world order. The substance of GATT lies in the annexes or amendments to it. Because GATT had grown so large in membership over the years it needed the status of a full-fledge organization to operate effectively.

NAFTA

With the coming of age of “globalization” and potential economic powerhouses forming in Europe, i.e. the EU (European Union), a perfect backdrop for the creation of NAFTA was present. Canada, the U.S. and Mexico were already in compliance with the reduction of tariffs instituted by GATT, but GATT lacked definition of social and economic values. Namely, the environment in which manufacturing occurs. Another catalyst was fact that the economies and industries of Canada and the U.S. were very similar. Such industries as automotive trade, electronics and entertainment contributed greatly to the GDP of both countries. With Mexico becoming a member of GATT in 1986, it was apparent they were trying to improve their domestic economy and were also in a position to accept more foreign investment dollars coming into Mexico. Another issue was the labor market.

With organized labor unions dictating the U.S. market wage, many U.S. based manufacturers saw their operations handcuffed resulting in low profits, which eventually led to bankruptcy. This forced many U.S. based companies to seek lower wages; thus requiring them to close plants in the U.S. and set up new facilities in third world countries. In addition, to avoid content laws, a common practice among U.S. companies was to manufacturing half of their goods outside of the U.S. (thus benefiting from the lower wage) and then re-exporting these goods back to the U.S. for final assembly. It was the United States that had the most at stake in the formation of NAFTA. What the U.S. discovered during the Uruguay rounds of GATT that issues of intellectual property rights and trade related investments measures not being covered? In order to succeed in their quest the United States embraced bilateral agreements between willing parties, rather than enforcement of unilateral demands, and thus went on to pursue this strategy. With the success of the U.S. and Canadian initiative (called the FTA), during the 1980's, the United States moved to secure NAFTA (Bognanno, 1993).

Another issue the United States faced was the government budget deficit which continued to spiral out-of-control during the 1980's and into the 90's. The United States strategy was exasperated through borrowing money to fuel its economy, and the reliance on service sector growth, coupled with lower productivity performance resulted in an unhealthy economy. Thus, the United States looked toward international trade in particular building strong export demand to re-stimulate the economy.

In short, NAFTA is divided into six areas as follows:

- market access (tariffs and non-tariff barriers, rules of origin, governmental procurement, and other industrial sectors)
- regulations (safeguards, subsidies, trade remedies, and standards)
- services (financial, insurance, land transportation, telecommunications)
- investment (foreign and domestic)
- intellectual property (patents, domain names, copyrights)
- dispute settlement (legal and regulatory settlements)

The only real question remaining for the Bush administration who laid the foundation for NAFTA and later the Clinton administration; was not should trade occur between the three member countries but under what conditions should the increased trade and investment take place. Thus, with much political debate and even skeptics among member countries the final ratification of NAFTA occurred in 1994 (Bognanno, 1993). All three countries have gained in the years after NAFTA's inception, with Mexico doubling of their GDP as well as healthy and steady growth of exported goods from both the U.S. and Canada. Employees of American unions particularly in the automobile and textiles have lost an estimated 100,000 jobs, however, on the flip-side NAFTA has contributed to over 300,000 jobs due to the increase in exports demand.

GATT in the 1970s

At the close of the Kennedy Round of GATT negotiations, the consensus among most countries was that it would be a long time before there would be a further negotiation of similar scope and duration focused on tariffs? Non-tariff barriers, however, were another matter. Their discussions soon took on an air similar to the preparations for the original GATT negotiations. Rather than continue to cut tariffs in each new round of GATT a push was made toward reforming GATT and to recognize the changes in its membership, in the trade policies of its principal adherents, and in the nature of the international economy. Most countries were feeling the pinch of globalization starting to slowly creep into their economies (Gianaris, 1994).

Most GATT member countries felt that it would take time to create the necessary information database to make any new GATT rounds a success. The secretariat of GATT during the 1970's was empowered to begin elaborating a firmer information base for an aggressive attack on both tariff and non-tariff barriers. On the tariff side, the Secretariat was charged with developing a more uniform basis for measuring tariff concessions, while on the non-tariff side, members needed to determine precisely what was involved. It is clearly understood that this action led toward the development of the current harmonized tariffs and schedules used in international trade. By this time it was clear that trade was being affected by a much wider range of government policies, practices, and participation in the economy than had been considered within the pale at the time the GATT was negotiated. In short the world market was expanding and the old rules of GATT no longer had influence (Gianaris, 1994).

The result was an unforeseen variety of restrictions and distorting influences. This was seen very strong in the agriculture sector, but it was not absent in other areas. What was lacking was any systematic investigation and analysis of the nature of non-tariff measures and their susceptibility to negotiation. As a result of a concerted effort of cross-notification, the GATT was able to develop an inventory of some eight hundred non-tariff barriers (NTB's). This new inventory of NTB's were then catalogued these into about thirty distinct types organized into six broad categories. Both the inventory and the typology then became the subject of intense discussions among interested governments in working groups, as they attempted to flesh out what future negotiations would entail (Gianaris, 1994).

Canada's Involvement

In describing Canada, one must start by mentioning its size. Canada is the largest country in the Western Hemisphere, it has a mixed economy which includes both private and government owned business. Based on Canada's peculiar geographic and public characteristics it has grown and maintained a strong presence in international trade. Some key industries segments in Canada include textiles, automotive and broadcasting.

It was Canada that played a leading role in the many revisions of GATT that occurred during the Kennedy Rounds; these included reformatting the NTB's and Canada chaired the subgroup on technical barriers to trade. A prominent Canadian by the name of Peter Clark chaired the GATT's Budget Committee and was the first Canadian member of the newly established Textiles Surveillance Body. He was carrying on a tradition during the Kennedy Rounds of ensuring that Canada assumed an active role, using their offices to deploy the hard work, solid information, and good ideas being generated by their colleagues in Ottawa and around the world.

Many tough issues faced GATT members during the Kennedy Rounds such as the increasing importance: how to integrate the developing countries more fully into the GATT system and how to address the issue of state-trading practices and thus welcome countries with centrally planned economies into the GATT's fold. Again, Canada took a leading role in the development of these new GATT policies. The new language of GATT did take steps to accommodate one of the problems faced by developing countries. (The phrase "developing countries" replaced the phrase "less developed countries" around this time, an early example of political correctness. The old abbreviation, LDCs, however, continued to be applied.) UNCTAD and the OECD, amended GATT by adopting a waiver in 1971 allowing members to introduce preferential tariff rates in favor of LDCs. Quickly after this development occurred GATT members implemented general systems of preferences (GSP) in favor of developing countries. Canada introduced its system in 1974, generally providing to all developing country products either free entry or the lower of either the British preferential tariff or one-third off the MFN tariff. The EC had already brought its system into force in 1971. This strong Canadian involvement coupled with and a soft U.S. economy back in the 1970's this led the U.S. to take heed.

Canada was at the forefront in welcoming these countries into the GATT. Canadian experience in selling wheat and other agricultural commodities to these countries disposed officials to take a forward-looking approach. Thus, Canada now was becoming a world leader in trade with much respect given by the United States. The unique structure allowed GATT to accommodate the demands of both developing and state-trading countries also had its less attractive side. Since 1961, when the United States had successfully initiated negotiations for a special arrangement to address the problem of trade in low-cost cotton textiles, GATT members had periodically extended this temporary solution in order to allow more time for orderly adjustment. Arguing that low-cost imports caused "market disruption," GATT members had been allowed to negotiate or impose discriminatory restrictions on such imports to give their markets time to stabilize. By the early 1970s, it was clear that the problem of market disruption had spread to the full range of textile and clothing products (Gianaris, 1994).

It is interesting to note that GATT members negotiated a new, more comprehensive arrangement that is known as the Multi-fiber Agreement (MFA) during Canada's most intense involvement. The MFA, provided for an organized derogation from the GATT's nondiscrimination requirements, somewhat undermining the claim that the developing countries' desire for reverse discrimination could not be accommodated within the confines of the GATT. Basically, in a nutshell no fully developed country, i.e. Canada, U.S. or EC community, could exploit for their comparative advantage, low labor costs from a LDC.

For Canada, the problem of imports of low-cost textiles and clothing had been a relatively minor issue, easily contained within the provisions of, first, the cotton textile arrangements followed up by the MFA. In 1976, however, tighter US and EC quotas led to a rapid surge in exports to Canada and triggered the decision by the Trudeau government to impose global quotas on all imports of clothing pursuant to GATT article XIX (emergency action). The United States and the EC found the Canadian response highly offensive, since it included quotas on their exports, as well as those of developing countries. Insistent claims for compensation, as allowed under GATT article XIX, convinced the Canadian government to replace the global quotas with comprehensive bilateral restraint agreements with most of the suppliers of low-cost textiles and clothing, a network of agreements that ultimately extended to more than thirty countries (Gianaris, 1994). As mentioned earlier in my paper, another focus of GATT that was becoming more and more popular was the settlement of disputes among countries.

The U.S. government rediscovered dispute settlement in the 1970s, and brought it to a new level through the deployment of "dispute resolution" by amending into sections of GATT. In fact, this new buzz word "dispute resolution" was added to U.S. trade legislation through the enactment of the U.S. Trade Act of 1974. Basically, this new trade act provided procedures for U.S. private interests to launch complaints about foreign trade and industrial practices that "burdened" U.S. commerce, and for formal U.S. government action to address such practices, including through GATT dispute settlement procedures.

The act seemed to be an extension of U.S. sovereignty and has questioned for its application to the international trade arena. Thus, with guidance from the U.S both the EC and Canada had also begun to make greater and more strategic use of dispute settlement. All three governments began to exploring both the usefulness and the limits of the GATT's dispute settlement provisions. With the experience and heavy involvement in amending GATT behind them, Canada was now seeking new a better ways to trade in a bilateral format. Canada's inclusion into the 1980's FTA (free trade agreement) and further NAFTA seemed most logical.

By now it's easy to see why Canada's involvement in NAFTA would be a natural transition and would rid them of the laborious policies of GATT. Some of these reasons included the following:

- freer trade – less restrictive
- move toward better quality and standards
- greater need for specialization
- a liberal new Canadian government.

Mexico's Inclusion into NAFTA

Many would ask why include Mexico? Not only is our neighbor to the south, but with a population of 90 million, 47 percent of whom are the average age of fifteen, Mexico indeed has great potential. This translates into bona fide customers for a variety of U.S. and Canadian manufactured products. Mexico's economy is a mixed economy, similar to the United States and Canada. About 10% of Mexico's total output comes from their government sector which includes participation in vital industries of petroleum, electric power, air and railroad transportation and telecommunications (Gianaris, 1994). Trade between the United States and Mexico exceeds \$250 billion per year, which is more than four times that occurred during the 1980's (Hakim & Litan, 2002). Because of Mexico's warm climate, tourism is also an important industry from the standpoint of foreign revenue. Prior to NAFTA there was much skepticism regarding the instability of the Mexican economy as a result of the peso crisis of 1994?

Additionally, prior to NAFTA, Mexican trade policies were historically characterized by high tariffs; import licensing requirements and domestic content requirements. Mexico protected many of its major industries by nationalizing them; such industries included oil power generation and telecommunications. After fallout of their oil market and a worldwide debt crisis Mexico realized that foreign competition was needed to revitalize many of Mexico's key industries. The economic theory of comparative advantage if it was to be utilized by Mexico was in need of repair. Thus, the groundwork was set to privatize these key industries and the greater need for Mexico to enter into a trade agreement to help facilitate these changes.

In 1986, Mexico joined GATT, which of course permits multinational trade. The following year Mexico announced a reformation plan that called for freezing wages and prices also to privatize and deregulate many other industries. With the floodgates now open to all members GATT countries many started to set up factories inside Mexico, this is where the "maquiladora" concept was born. Included in these new entrants, was the United States, who opened maquiladora production facilities, located close to the U.S. and Mexican border. The concept behind a maquiladora production facility was to assemble goods in Mexico from U.S. made products and then re-exporting back to the U.S., thus paying only on the value added in Mexico (Bognanno, 1993). Clever? What is interesting about the *maquildora* concept is that the way the Mexican government treats the *maquila*. They profess that the *maquildora* concept actually is a vehicle to transfer technology to Mexican industry and actually upgrades the Mexican worker's skills. It worked that way for a while until the environmentalists came on the scene.

Case Study – Cross-Border Trucking Services

The following case study was used to demonstrate the application of NAFTA for the trucking industry. This dispute occurred between Mexico and the United States in which Mexico's asserts by proclamation that the U.S was in violation of Article 1202 (national treatment for cross-border services) and/or Article 1203 (most-favored-nation treatment for cross-border services). What was interesting in this dispute is the fact that the U.S. originated and signed Annex I, and was now in direct violation of this clause of NAFTA. The U.S. was discriminating against Mexican owned trucking firms by not granting them applications or authority to operate in the U.S. bordering states. Apparently, this restrictive covenant on against Mexican investment in the transportation of international cargo; expired on December 17, 1995. This restriction became part of the Annex I, which clearly stated that all three countries would allow cross-border trucking services and investment.

The language covering in this clause reads as follows: Mexican and Canadian trucking firms are entitled to the same rights as U.S. carriers under U.S. law, which is (i) consideration of their individual merits and (ii) a full opportunity to contest the denial of operating authority (Willes & Willes, 2005). The United States rebuttals the fact that Mexico does not maintain that same rigorous standards as the regulatory systems of the U.S. and Canada. Such issues of health and safety and the environment were the major contentions held by the United States. The findings and determination took place by an arbitral panel, which held out that the U.S. was in breach of their commitments to Annex I as well as articles 1202 and 1203.

Furthermore, the panel suggested that the United States take appropriate steps to bring its practices with respect to cross-border trucking services into the compliance of the provisions set forth in NAFTA (Willes & Willes, 2005). The U.S. may not restrict Mexican transportation in international trade nor ignore any further Mexican applications. The panel further urged Mexican trucking companies to upgrade their trucking services by creating more safety and protection of their drivers and the public at large. It was discovered from this dispute is the fact that “dispute resolution” rather than litigation can provide some fruitful results.

Recent Events and Outcomes

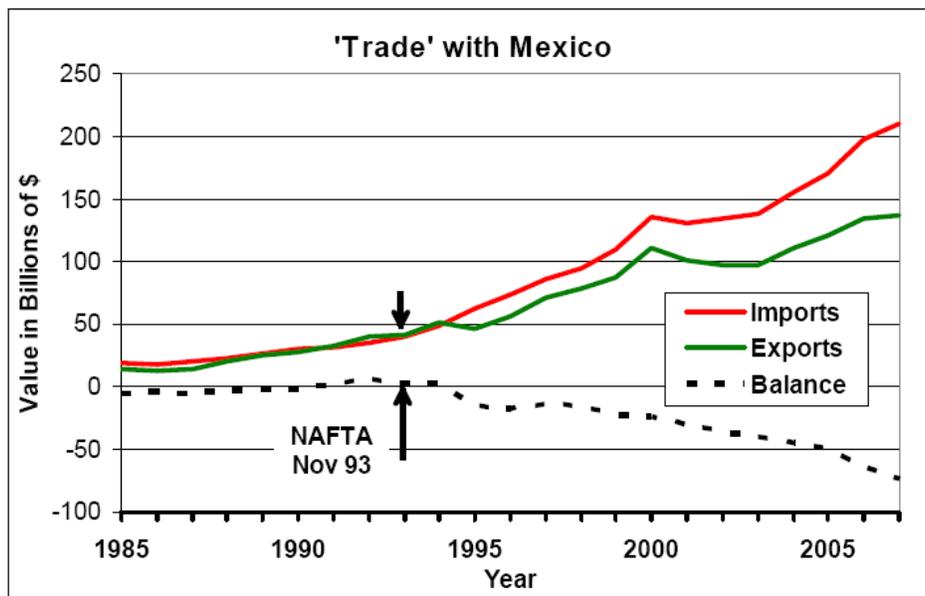
It is no secret that NAFTA has been a point of discussion and heated debate among many business leaders in both the U.S. and Canada. Most believe that NAFTA has failed miserably and as predicted by Ross Perot many U.S. manufacturing jobs have been sucked out of the country. According to blogger, Dustin Ensinger (2010), since 1993, manufacturing employment in the U.S. has decreased from 16.8 million to 13.9 million in 2007, as the trade agreement put American workers in direct competition with Mexican workers. This has encouraged a “race to the bottom” in which American companies are frequently relocating production facilities across the border. Iconic American companies such as Coca Cola, Ford, RCA, General Motors, General Electric and Nokia have all opened up assembly plants in Mexico. In fact, GE employs 30,000 Mexicans in 35 factories in the country (Economy in Crisis.org, 2010). One may ask, is this the selling out of America? Is it fundamentally wrong for profit-seeking MNC’s to find cheaper labor and lower operational costs?

Distortions

As one would suspect that there may be some political half truths tied to NAFTA. Most liberal media, Republicans, and even Libertarians brag about how NAFTA has benefited the U.S. economy and spurred an increase in U.S. exports. Let's go through a few of these distortions, one-by-one to see if any of these claims are true.

Distortion #1.

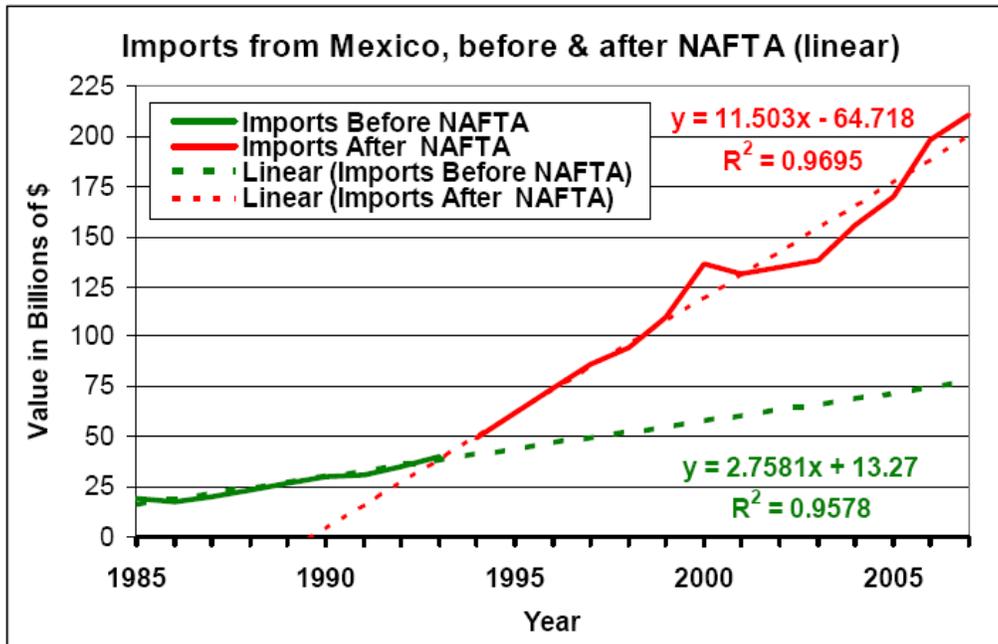
This graph tracked exports pretty closely before NAFTA. Since NAFTA imports have grown much faster than exports. By 2007 imports have overwhelmed exports \$210.8B to \$136.5B, a factor of 1.54 (The NAFTA Nemesis, 2008).



Source: The NAFTA Nemesis, Dr. Bob Powell 2008

Distortion #2

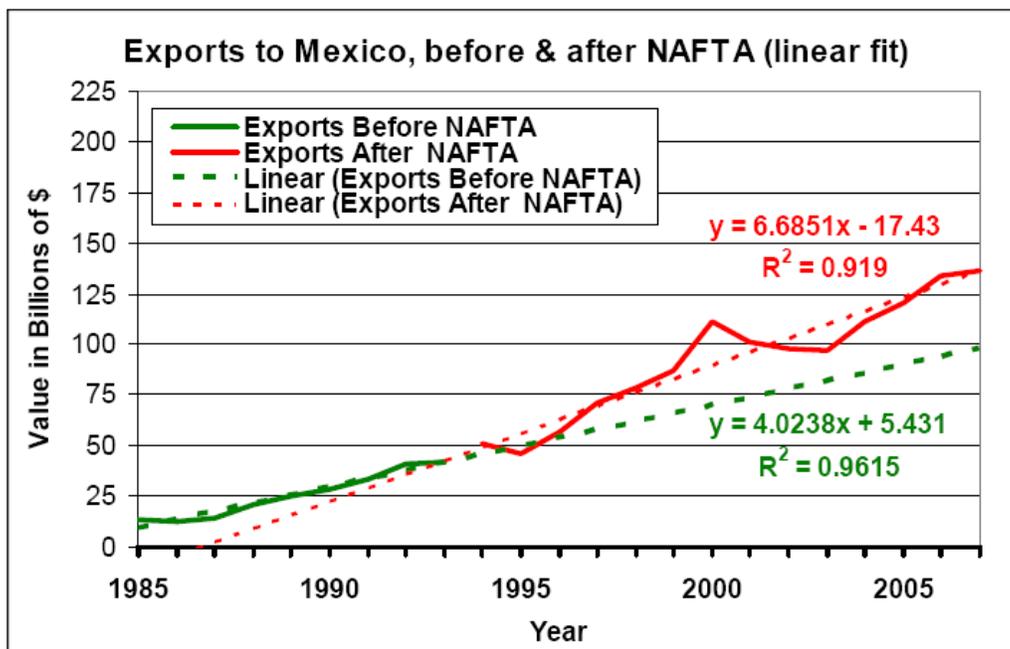
This graph shows the U.S. import activity before and after the passage of NAFTA. Again, the data refutes that NAFTA has provided a dependence on imports but instead has proved just the opposite. From a microeconomic industry review the imports are caused by the U.S. economies heavy reliance on agricultural and automotive parts from Mexico.



Source: The NAFTA Nemesis, Dr. Bob Powell 2008

Distortion #3

This graph shows the U.S. export activity before and after the passage of NAFTA. On a positive note, the U.S. exports increased to Mexico were from \$4.02B/yr before NAFTA to \$6.68B/yr. after NAFTA. However, the number is distorted due to the fact that imports are increasing four times greater than exports (The NAFTA Nemesis, 2008).



Source: The NAFTA Nemesis, Dr. Bob Powell 2008

Conclusions

Based on all the peer-reviewed articles and expert opinion it is the author's belief that GATT provided an entrée for the creation of NAFTA. With this being said, it can be further ascertained that NAFTA worked in the short run by liberalizing and strengthen international trade between the three member countries. In the opinions of conservative Republican, Liberals, and/or free trade advocates, NAFTA in particular was and is a win/win scenario for all three countries both at its time of inception and in its current state. That is, if the *maquila* factor does not stifle these opportunities.

Furthermore, and by no surprise, Mexico has gained more in the short term and the U.S. and Canada are yet to realize a significant increase in export demand for their goods and services. The "eager to work" Mexican labor pool once thought to be a human relations opportunity is now being faced stateside by stricter immigration laws preventing the hiring of illegal workers. On paper, NAFTA will continue to be a template for many countries desiring a regional trading agreement that not only encompasses trading but also touches upon the issues of social and environmental standards. Let's not forget that the catalyst behind the formulation and infrastructure for NAFTA was GATT. The longevity of NAFTA and any other regional trading agreements ultimately depends on the creation of surpluses, the distribution of those surpluses, and the rate of reduction of outstanding debts (Bognanno, 1993).

The economics behind NAFTA are fuzzy at best. The author has exposed the import/export scenario with overwhelming relevance. The gains in exports from Mexico in particular are dwarfed by the imports for this same country. The strategic implications of NAFTA will be a boon to specific industries and those early industry players have reaped the benefits offered by NAFTA, as was discovered in the research. The NAFTA story continues to unfold and now that we are well-entrenched into this 21st century, a couple of major questions loom... when will politics remain in check and when will market economics dictate free trade among the three members countries? The story is still being written. This should be interesting drama.

References

- Bognanno & Ready (1993). *The North American Free Trade Agreement, Labor, Industry and Government Perspectives*, Praeger Publishing.
- Esinger, D. (2010) *Economy in Crisis.org* retrieved on July 30, 2001 from <http://www.economyincrisis.org/content/canadian-official-wants-out-nafta>
- Gianaris, (1998). *The North American Free Trade Agreement and the European Union*, Praeger Publishing.
- Hakim & Litan, (2002). *The Future of North American Integration, Beyond NAFTA*. Brookings Institution Press.
- N.A. (2011) *The Daily Paul, 1992 Flashback: Ross Perot and the Giant Sucking Sound*.
- Powell, B. (2008). *The NAFTA Nemesis*. Retrieved on July 29, 2011 from <http://www.exponentialimprovement.com/cms/naftanem.shtml>
- Willes & Willes (2005), *International Business Law, Environments and Transactions*, McGraw Hill Publishing.