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Trade Policy Staff Committee
Office of the U.S. Trade Representative

Hearing on "Negotiating Objectives Regarding Modernization of North American Free Trade Agreement with Canada and Mexico"
June 28, 2017

Chairman Gresser and members of the Trade Policy Staff Committee of the Office of the United States Trade Representative, thank you for the opportunity to testify today. My name is Clark Packard. I'm an attorney and trade policy analyst with the R Street Institute. Founded in 2012, the R Street Institute is a nonpartisan, nonprofit pragmatic free-market think tank headquartered in Washington, D.C. We support limited but effective government. We believe that economic growth and freedom depends on the relatively free flow of goods between countries and that free trade agreements like the North American Free Trade Agreement (NAFTA) are an integral part of ensuring continued American prosperity.

The case for free trade is twofold. First, the economic benefits are crystal clear. No largely protectionist nation has ever thrived economically. Trade and comparative advantage allow for specialization, which leads to better, more efficient outcomes. A recent Peterson Institute study found that the gains for Americans from trade and globalization since World War II have been enormous.[1] The authors note that, measured in 2016 dollars, U.S. gross domestic product per-capita and GDP per-household increased by $7,014 and $18,131, respectively. There is evidence that disproportionate gains accrue to lower-income households.[2] Turning our back on this commitment to largely free, rules-based trade would dramatically decrease American standards of living.

[1] Gary Clyde Hufbauer and Zhiyao (Lucy) Lu, "The Payoff to America from Globalization: A Fresh Look with a Focus on Costs to Workers," Peterson Institute for International Economics, May 2017. https://piie.com/system/files/documents/pb17-16.pdf
[2] Ibid.

There is an equally strong moral argument for free trade. Tariffs are regressive taxes. They mostly benefit those special interests with sufficiently strong lobbies to secure protection from foreign competition at the expense of those who are forced to shoulder higher costs from restrictions on imports. Free trade also serves to expand freedom by enlarging the sphere of individual and business autonomy outside the scope of governmental decisionmaking. Allowing consumers—both individuals and businesses—to purchase legal goods from outside of the United States if they can find a better price is a net positive for society.

General comments about NAFTA

Despite dire warnings from protectionists on both the political right and left during the original NAFTA debate, the North American Free Trade Agreement has been an unqualified bipartisan success since it went into effect Jan. 1, 1994. R Street retains some skepticism that renegotiation would produce outcomes for businesses and consumers as positive as the original agreement. Though we believe the agreement *can* be modernized, the Office of U.S. Trade Representative's top priority should be to ensure no harm is done. In short, any updates to NAFTA should provide at least as much trade liberalization as the original agreement. A retreat from the high-water mark of the original agreement will be deemed a failure.

Countless studies have found that NAFTA has produced meaningful benefits for our economy.[3] A 2014 working paper from Yale economist Lorenzo Caliendo and Fernando Parro, a Federal Reserve economist, found trade within the NAFTA zone increased by 41 percent for the United States, 118 percent for Mexico and 11 percent for Canada.[4] The same study found an increase in real wages and improved economic welfare for all three countries.[5] Another recent study estimates the annual gains to the United States from NAFTA are about $50 billion in 2014 dollars.[6] A comprehensive study on the state-by-state impact of NAFTA on U.S. jobs found the agreement decreased annual unemployment growth by 4.4 percent.[7]

Though USTR is proceeding with renegotiation, the White House has suggested that, should NAFTA renegotiation fail, the United States would withdraw from the agreement. Make no mistake: this would be a catastrophic blunder, the effects of which would resonate throughout the country and touch numerous industries. A recent study on the impact of withdrawing from NAFTA, based on reasonable

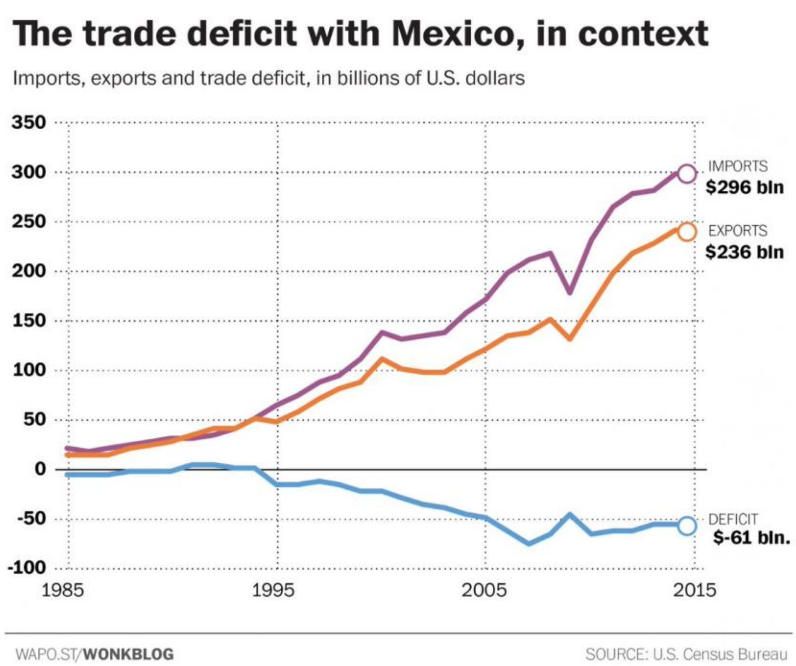
[3] U.S. International Trade Commission, "Economic Impact of Trade Agreements Implemented Under Trade Authorities Procedures, 2016 Report," June 2016. https://www.usitc.gov/publications/332/pub4614_old.pdf
[4] Lorenzo Caliendo and Fernando Parro, "Estimates of the Trade and Welfare Effects of NAFTA," Yale University, July 24, 2014. http://faculty.som.yale.edu/lorenzocaliendo/ETWENAFTA.pdf
[5] Ibid.
[6] Peter Dixon and Maureen Rimmer, "Identifying the Effects of NAFTA on the U.S. Economy between 1992 and 1998: a decomposition analysis," Purdue University, June 17, 2015. https://www.gtap.agecon.purdue.edu/resources/res_display.asp?RecordID=4657
[7] John Francis and Yuqing Zheng, "Trade Liberalization, Unemployment and Adjustment," *Journal of Applied Economics*, 2011. http://www.tandfonline.com/doi/abs/10.1080/00036840903194212

assumptions about Mexico and Canada's reactions to such a decision, found it would lead "to a decline in real GDP, trade and investment" in all three NAFTA countries.[8] Further, the authors find that:

> The reversal of NAFTA (with reciprocation) leads to 256,000 unemployed low-skilled workers in the U.S. within the short to medium run (3-5 years), with thousands more workers having to relocate to other sectors to find employment. If skilled workers are also assumed vulnerable to reversing NAFTA, then US unemployment rises by over 1.2 million.[9]

Given these costs, withdrawal should be taken off the table entirely.

Though much has been made of the United States' growing trade deficit with Mexico since NAFTA's implementation in 1994, it is important to put this trend into proper context. As the chart below from *The Washington Post* demonstrates, while the bilateral trade deficit with Mexico has increased, trade between the two countries has grown exponentially.[10]



In short, the United States still experiences economic benefits from increased trade in spite of the trade deficit with Mexico. As *The Washington Post* noted, "Since 1993, the annual trade deficit with Mexico has grown from essentially $0 to $60 billion. But over the same period, we added about $193 billion in annual exports to our neighbors to the south." This is a positive development. Bilateral trade deficits are

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[8] Ibid.

[9] Ibid.

[10] Christopher Ingraham, "The smart way to think about that trade deficit with Mexico," *The Washington Post*, Jan. 26, 2017. https://www.washingtonpost.com/news/wonk/wp/2017/01/26/the-smart-way-to-think-about-that-trade-deficit-with-mexico/?utm_term=.c6491bf64971

always a poor gauge of whether trade agreements between nations are positive on net and trade negotiators would be well-served to avoid focusing on reducing deficits in negotiations.

Thankfully, Congress has provided an adequate roadmap to cover trade negotiations, including NAFTA renegotiation, with the passage of Trade Promotion Authority (TPA) in 2015. TPA is a three-year authority granted to the executive branch, with the possibility of an additional three years if the president requests it and Congress does not disapprove. R Street worked hard to ensure passage of TPA and encourages President Donald Trump to seek the three-year extension of authority by the end of 2018. Ensuring expedited review of trade agreements, provided such agreements comport with congressional priorities, is an important tool for USTR and Congress.

Finally, R Street vehemently disagrees with President Trump's decision to withdraw from the Trans-Pacific Partnership (TPP). A high-quality yet imperfect agreement among 12 Pacific Rim nations, including Mexico and Canada, TPP easily could have been improved upon by the Trump administration. An improved TPP would have obviated the need to renegotiate NAFTA, since both Mexico and Canada are parties to the agreement. This, in turn, would have freed valuable time and resources for USTR to complete negotiations with other nations and institutions, including the Transatlantic Trade and Investment Partnership (T-TIP), the Trade in Services Agreement (TiSA) and a post-Brexit bilateral agreement with the United Kingdom. Nonetheless, all is not lost; TPP still can serve as a baseline for NAFTA renegotiation. To the extent possible, USTR negotiators should draw upon various chapters of TPP when they begin discussions with their Mexican and Canadian counterparts.

Customs and trade facilitation

R Street believes customs and trade facilitation processes should be a significant area of focus during NAFTA renegotiations, particularly with respect to the de minimis threshold (DMT) exemptions. Low DMTs pose considerable barriers to trade for small businesses, in particular, who often do not have the technical expertise or resources to comply with costly and complicated customs forms and levies. Harmonizing DMTs between NAFTA parties would benefit businesses in all three countries by reducing unnecessary costs.

The DMT exemptions vary widely between the United States, Mexico and Canada. Imports entering the United States valued at $800 or less are exempt from taxes, duties and much of the customs paperwork. Meanwhile, in Canada, the general DMT is C$20 for items shipped into the country and C$800 for items carried by individuals into the country.[11] This is the lowest DMT in the industrialized world.[12] Mexico has

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[11] Canada Border Security Agency, "Determining duty and taxes owed," Canada Border Security Agency. http://www.cbsa-asfc.gc.ca/import/courier/menu-eng.html

[12] Christine McDaniel, Simon Schropp and Olim Latipov, "Rights of Passage: The Economic Effects of Raising the *de minimis* Threshold in Canada," C.D. Howe Institute, June 23, 2016. https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/E-brief_Rights%20of%20Passage_June16.pdf

a bifurcated DMT: US$50 for goods entering the country from couriers, with a US$300 exemption for postal shipment.

In 2016, Congress passed and President Barack Obama signed the Trade Facilitation and Trade Enforcement Act. Among other provisions, the bill provided a sense of Congress that USTR negotiators should seek to "encourage other countries … to establish commercially meaningful de minimis values for express and postal shipments that are exempt from customs duties and taxes and from certain entry documentation." This is a perfectly reasonable goal for trade negotiators. NAFTA negotiators should seek to increase the DMT for American exports to both Canada and Mexico.

While R Street acknowledges that part of the reason for the lower thresholds in Canada and Mexico is that those countries levy value-added taxes (VAT) and are dependent on the customs revenue, there is reason to believe the revenue benefits are outweighed by the gains in trade that would accrue if the DMT were significantly raised.[13] Studies have indicated that the Canadian government spends almost four times as much to enforce the DMT on low-value imports than it collects.[14] [15] In fact, a very recent study from Canada's auditor general found the Canadian government spends more to collect duties on items valued under $200 CAD than it collects from the duties.[16] Increasing the DMT to $800 is ideal. Though that may be a non-starter, raising it considerably should be a priority for USTR's negotiators.

Likewise, customs harmonization would be enormously beneficial to all NAFTA parties. Transparent, easy-to-understand rules and forms will go a long way toward increasing trade flows between NAFTA nations. TPP, for instance, required countries to ensure that goods moved as quickly as possible through customs, with a target of release within 48 hours. This is a worthwhile standard.

R Street is mindful that the World Trade Organization's (WTO) Trade Facilitation Agreement entered into force in February 2017. The WTO estimates the agreement "could reduce trade costs by an average of 14.3 percent and boost global trade by up to $1 trillion per year."[17] In short, the global community is concerned that red tape could pose significant barriers to foreign trade. The success of the Trade Facilitation Agreement is demonstrative proof that multilateral negotiations can modernize outdated customs and trade facilitation processes. NAFTA negotiators would be wise to emulate this multilateral success.

Conclusion

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[13] Ibid.

[14] Ibid.

[15] Office of the Auditor General of Canada, "2017 Spring Reporters of the Auditor General of Canada to the Parliament of Canada," Office of the Auditor General of Canada, June, 2017. http://www.oag-bvg.gc.ca/internet/English/parl_oag_201705_02_e_42224.html#

[16] Ibid.

[17] World Trade Organization, "World Trade Report 2015," World Trade Organization, 2015. https://www.wto.org/english/res_e/booksp_e/world_trade_report15_e.pdf

In closing, R Street appreciates the opportunity to provide our thoughts on NAFTA renegotiation objectives. Ensuring largely unimpeded commerce flows between the United States, Canada and Mexico is vitally important to businesses and consumers. We look forward to working with USTR throughout the negotiation process and would be glad to answer any questions you may have.

Sincerely,

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