JEL: F13, F15, F53

THE DEVELOPMENT OF NAFTA, ITS TRANSFORMATION INTO THE USMCA AND TRADE RELATIONS WITH UKRAINE

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***Abstract**: The authors of the paper examine and analyzes processes of economic integration in North America. The results of NAFTA and its impact on trade between the member countries are defined. NAFTA is compared to the USMCA agreement, which is to replace NAFTA in the near future, and possible effects of this agreement are evaluated. In addition, the article analyzes the current trade relations between Ukraine and the USMCA member countries.*

***Keywords**: NAFTA, USMCA, free trade area, economic integration, CUFTA*

INTRODUCTION

Nowadays almost no country can effectively develop without interacting with other states. Current global integration processes cover all spheres of life, and international eco-integration is one of the most important factors in the development of national economies.

Integrational processes developing in North America have a relatively long history; they began long before the signing and entry into force of the NAFTA agreement. The first step towards integration was the "Abbott Plan", which was adopted in 1947 to stimulate US investments in leading sectors of the Canadian economy. In 1959, an agreement on the joint production of military equipment was signed between the states. The next step was the agreement on the liberalization of trade in automotive products in 1965. Canada and the USA introduced the free trade pact in 1989. In 1994, NAFTA has expanded the free trade area when Mexico joined the integration association.

At the present stage, NAFTA is developed and transformed into a new agreement – the USMCA, which was signed in November, 2018 and is yet to be ratified.

The *aim of our study* is to analyze the functioning of NAFTA and its transformation into the USMCA, as well as to consider the trade relations between Ukraine and the member countries of the agreement.

MATERIALS AND METHODS

American researchers from the Peterson Institute for International Economics in Washington, Brookings Institution, Center for Strategic and International Studies (Washington, DC) are deeply involved in the theoretical studies of integrational processes in North America. Papers of scientists J. Schott, G. Hofbauer, R. Blecker, I.F. Fergusson, P.P. Yakovlev et al have been researched. As well, scientific researches of Ukrainian Scholars E. Kaminsky, I. Pogorska, and S. Shergin should be noted.

RESULTS

NAFTA is currently the world's largest regional free trade area. According to the World Bank (2019), the total population of the integration group is about 491.66 million people, and the aggregate GDP equals to 22.19 trillion USD, which is approximately 27.5% of world GDP. Canada and the USA introduced a free trade agreement back in 1989. In 1994, NAFTA expanded the free trade area when Mexico joined the integration association. President Trump and leaders of Canada and Mexico signed the United States – Mexico – Canada Agreement (USMCA) on November, 30, 2018 at the summit of G-20 leaders in Buenos Aires. The new document creates an upgraded free trade system between the three parties that addresses critical issues such as the harmonization of regulatory systems, e-commerce and intellectual property protection, and should replace the existing North American Free Trade Agreement (NAFTA), which existed since 1994 (Fergusson & Villarreal, 2019). The agreement has not yet been ratified by the participating countries, so NAFTA is still in force.

We can see the most obvious results of NAFTA's activities in the fourfold growth of the US trade with Canada and Mexico after the entry into force of this agreement. As *Figure 1* shows, US trade with Canada and Mexico increased from 292.7 billion USD in 1993 to 1228.7 billion USD in 2018 (according to USITC).

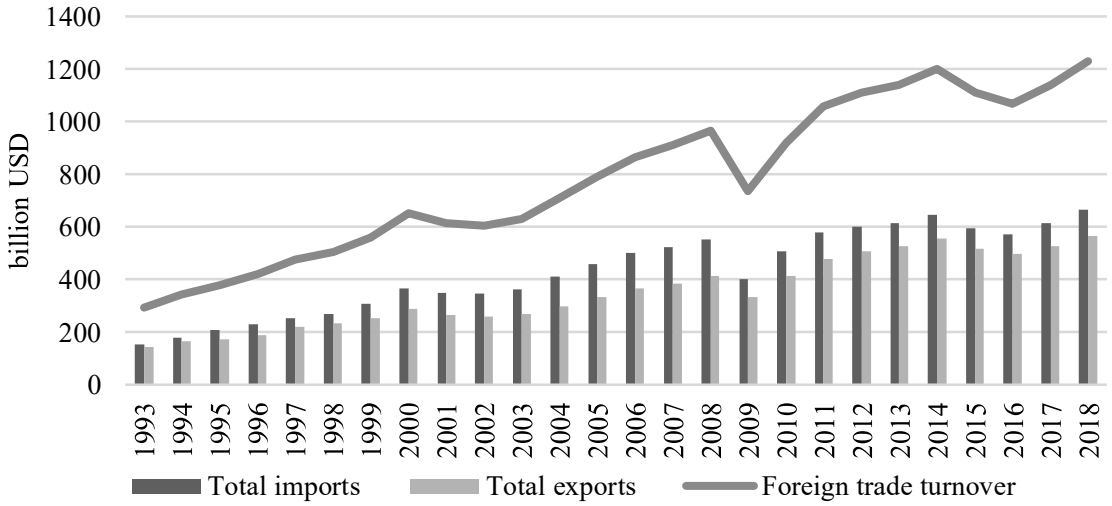

Figure. 1: US trade with Canada and Mexico (1993-2018)

Source: created by authors according to USITC (2019)

The agreement has shaped the integrated production chains between all three countries. Many experts and economists give credit to NAFTA due to the expansion of trade and economic ties between the parties, the creation of more efficient production processes, the intensification of competition, the expansion of the choice and purchasing power of consumers, farmers and entrepreneurs, the increase of the availability of goods, services and investments, which has increased the business competitiveness, as well as improved the standard of living and working conditions (Villarreal & Fergusson, 2019). Other scientists have accused NAFTA of disappointing employment trends, lowering the average wage in the US, and the fact that not enough was done to improve labor standards and environmental conditions.

NAFTA has been around for more than 25 years, and one can see it such a significant advantage as the dynamic growth of the volume of mutual trade between NAFTA member states. *Table 1* demonstrates that almost 70% of Canada's and Mexico's trade and about 30% of the US trade is within NAFTA.

However, it should be noted that there is an asymmetry among the three member countries. *Table 1* shows that the total volume of trade between Canada and Mexico and NAFTA countries is 67.9% and 65.2% respectively. And only about 5.7% and 4% stand for Canada's trade with Mexico and Mexico's trade with Canada, while the United States account for about 95% of these two countries' exports and imports.

Table 1

NAFTA trade

Countries	Exports (billion USD)	Exports (%)	Imports (billion USD)	Imports (%)	Foreign trade turnover (billion USD)	Foreign trade turnover (%)
The US trade with:						
Canada	266.76	18.39	282.96	12.59	549.72	14.86
Mexico	229.70	15.84	296.76	13.20	526.46	14.23
NAFTA	496.46	34.23	579.72	25.79	1076.18	29.10
world	1450.46	100.00	2248.21	100.00	3698.67	100.00
Canada trade with:						
The USA	296.61	76.24	210.25	52.18	506.86	63.99
Mexico	5.76	1.48	25.08	6.22	30.84	3.89
NAFTA	302.37	77.72	235.33	58.40	537.7	67.89
world	389.07	100.00	402.97	100.00	792.04	100.00
Mexico trade with:						
The USA	302.94	81.02	179.98	45.28	482.92	62.60
Canada	10.43	2.79	9.63	2.42	20.06	2.60
NAFTA	313.37	83.80	189.61	47.70	502.98	65.20
world	373.93	100.00	397.51	100.00	771.44	100.00

Source: created by authors according to WTO Statistics Database (2019)

The interaction of economic structures of Mexico and Canada is far behind the depth and extent of Canadian-American and Mexican-American integration. Canada and Mexico are more likely the competitors on the US market of goods and labor, competitors in attracting capital and technology of US corporations than partners in the integration process.

Since the NAFTA agreement was signed more than 25 years ago, some updates may be really needed, since trade between countries has changed considerably since then. It should be noted that most of the old deal remains unchanged. The new NAFTA does not change the old tariff structure or the policy of zero tariffs for most industrial and agricultural goods. The most significant changes, including e-commerce, were previously discussed within the framework of the Trans-Pacific Partnership, from which the current administration withdrew in 2016 (Zhou et al, 2018).

Table 2 demonstrates the main differences between the USMCA and NAFTA.

As we can see, the USMCA offers the benefit to US farmers, who can sell more products to Canada. And Canadian dairy producers lose their advantage, because they now have to face more competition. As for the automotive industry, it is, of course, essential for social protection and one of the most pressing challenges – combating poverty, but the new minimum wage requirements may make Mexico a less attractive place to accommodate large automotive companies.

Table 2

The main differences between the USMCA and NAFTA

Sector	*USMCA*	*NAFTA*
Automotive industry	(a) 75% of automobile components must be manufactured in North America; (b) 40% of automobile parts must be made at factories with the minimum wage of $16 an hour; (c) quota of 2.6 million cars at zero tariff	(a) 62.5% of automobile components must be manufactured in North America; (b) there is no minimum wage requirement; (c) there is no quota
Dairy industry	US farmers get access to 3.5% of the dairy market of Canada	dairy products are not part of the original agreement
Intellectual property	patents for biologic drugs – 10 years; copyright – 70 years	copyright – 50 years
Currency	member countries must maintain market exchange rates and refrain from competitive devaluation of their currencies	does not contain currency provisions
E-commerce	cross-border data flow	does not contain e-commerce provisions
Sunset clause	after 6 years member countries will decide whether the agreement is to be extended to 16 years	there is no sunset clause

Source: created by authors according to Fergusson & Villarreal (2019)

The automotive industry is the industry where the consequences of the entry into force of the USMCA agreement are most marked because of changes in the rules of origin and because of the high percentage of duty-free imports into the United States of products of this industry. In 2017, imports of US cars from NAFTA countries amounted to 102.1 billion USD or 17% of total imports from Canada and Mexico (Fergusson & Villarreal, 2019). So, the new agreement revised and modernized the conditions of NAFTA in the automotive and dairy industries, but other changes are relatively minor. There is also little evidence that the agreement will significantly alter the trade balance between the three countries.

In general, it is expected that the USMCA will not have a significant impact on trade relations in North America, since almost all US trade with Canada and Mexico, which meets the requirements of the rules of origin, is currently conducted duty-free and without barriers within NAFTA. The proposed USMCA agreement will support the elimination of NAFTA tariff and non-tariff barriers [ibid]. Economists agree that the agreement will not have a tangible impact on US investment and trade with other NAFTA member countries, on jobs, wages, overall economic growth, and on the US trade deficit. In this context, we will also consider the trade relations of Ukraine with the USMCA countries. The most extensive trade relations out of the three countries bind Ukraine with the United States. Total imports for 2018, according to the International Trade Center and the State Statistics Service of Ukraine, amounted to approximately 3.05 billion US dollars.

In merchandise imports, the United States is ranked 6th among all trade partners of Ukraine (*Figure 2*), and in merchandise exports (*Figure 3*) – 13th. While analyzing the geographical structure of exports and imports of services, it should be noted that the US position is better than with commodity exports and imports. Thus, in 2018, the US became the 2nd most important trading partner of Ukraine in the export of services (*Figure 4*) and 1st in the import of services (*Figure 5*).

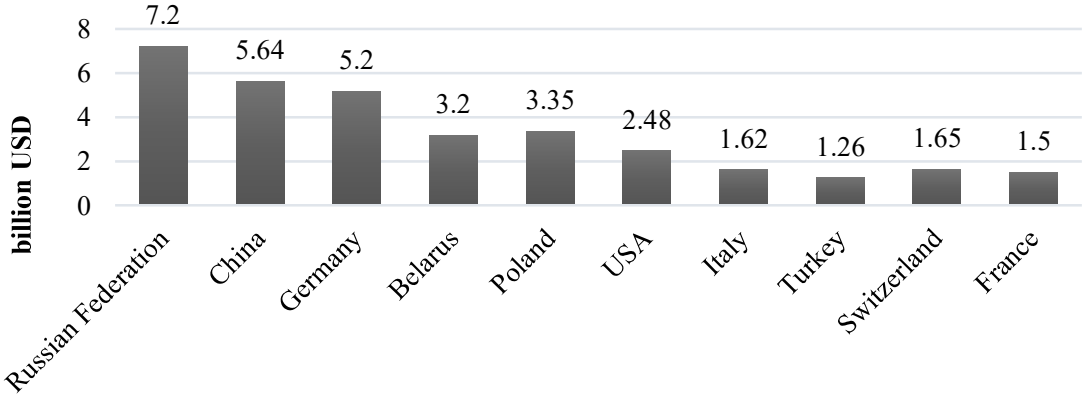

Figure 2: The main partner countries of Ukraine in import of goods in 2018, billion USD

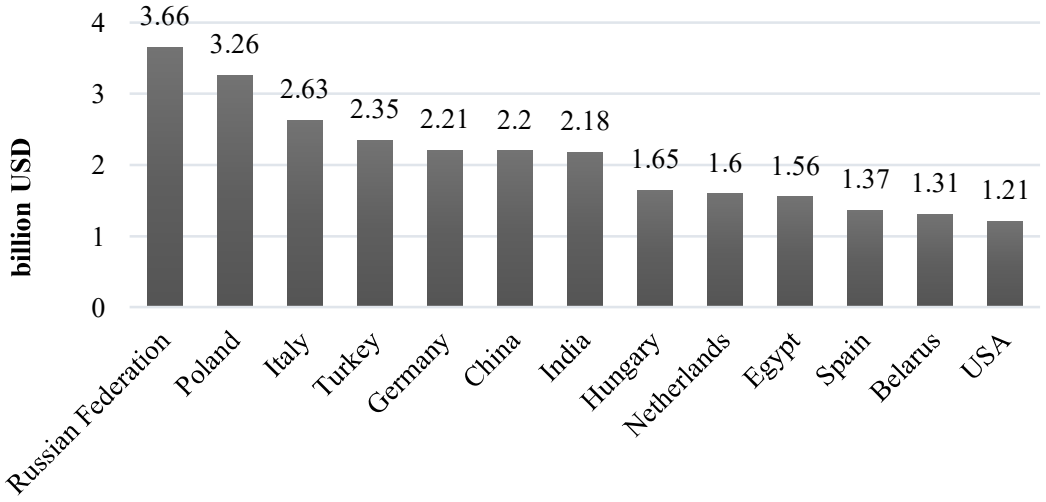

Figure 3: The main partner countries of Ukraine in export of goods in 2018, billion USD

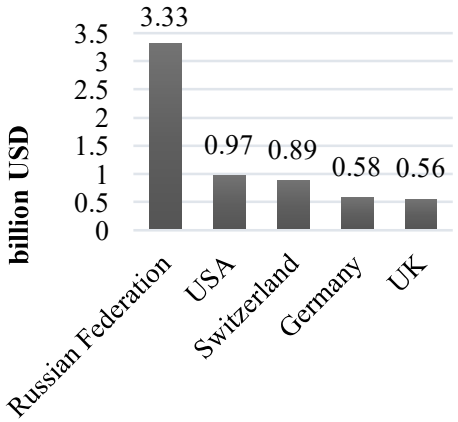

Figure 4: The main partner countries of Ukraine in export of services in 2018, billion USD

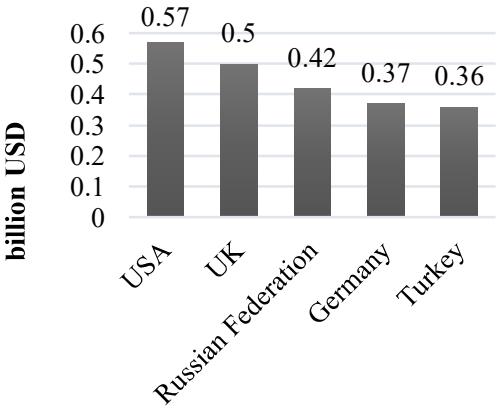

Figure 5. The main partner countries of Ukraine in import of services in 2018, billion USD

Source: created by authors according to State Statistics Service of Ukraine (2019)

As for the structure of trade in services between countries, the largest share of exports to the United States accounted for transport services and amounted to 52%. The second and third positions in the Ukrainian exports to the US are computer services (20.1%), and business, professional and technical services (11.6%). Regarding the import of services, the largest share belongs to public services (29%), financial services (16%) and transport services. Commodity structure of Ukraine's exports to the US is mainly represented by ferrous metals (63.8%) and agricultural products (honey and vegetable oil). Ukraine imports from the USA fuel (32.1%), vehicles (20.6%), industrial equipment (16.7%), as well as products of the chemical and pharmaceutical industries.

After analyzing the statistical information given above, we can conclude that the two other members of NAFTA and the future USMCA are not the main trading partners of Ukraine. However, business relations between Ukraine and Canada have been going on for many years and cover a whole range of areas. A characteristic feature of the Ukrainian-Canadian cooperation is the presence of the Ukrainian diaspora, which has 1.2 million people and is a certain pressure group that is actively involved in the process of the formation of Ukrainian-Canadian relations. Canada is a very promising trading partner for Ukraine, because in July, 2016 a free trade agreement was signed between Ukraine and Canada, which entered into force on August, 01, 2017. The signing of the agreement was preceded by negotiations that lasted for 6 years. According to the Agreement, Canada is to eliminate tariffs on 99.9% of imports from Ukraine. *Table 3* provides more detailed terms of the agreement.

Table 3

Terms of the CUFTA agreement

Indicators	CUFTA
Exports to Canada	Zero duty rates for all agricultural products. The exception is 108 tariff lines (poultry, eggs, dairy products) – a zero rate of import duty within the framework of global quotas of Canada
	Zero duty rates for all industrial products. The exception is cars (a transition period of 7 years is set for them, for which duties will gradually decrease to 0%)
Imports from Canada	Immediate cancellation of duties for 72% of Canadian goods
	Duties on the remaining 27% will be canceled gradually with a transition period of 3.5 and 7 years
	Partial liberalization in relation to agricultural goods significant for Ukraine, as well as tariff quotas for certain goods
Non-tariff questions	Trade facilitation procedures, technical assistance and information exchange, non-discriminatory access to government procurement, duty-free trade in digital products, cooperation in the field of intellectual property rights protection

Source: created by authors according to Yakovlev (2017)

Figure 6 shows the dynamics of changes in the volume of trade in goods between Ukraine and Canada from 2014 to 2018 (trade in services has changed only slightly). Thus, after one and a half years of CUFTA existence, trade volumes increased from 246.2 million dollars in 2016 to 411.28 million dollars in 2018. In the structure of Ukrainian exports of goods to Canada, ferrous metals prevail and amount to 27.5%, copper and products from it (18.6%), agricultural products (12.5%), vehicles (7.9%) and nuclear reactors, boilers and machines (7.6%). In terms of imports, the main items are fuel (49.2%), fish (10.8%), pharmaceutical products (7.4%) and vehicles (7.1%).

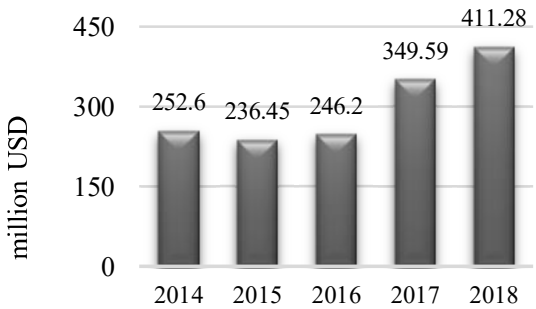

Figure 6: Volumes of trade in goods between Ukraine and Canada (2014-2018), billion US dollars
Source: created by authors according to State Statistics Service of Ukraine (2019)

Mexico ranks second after Brazil, among the main trading partners of Ukraine in Latin America and the Caribbean. According to the State Statistics Service of Ukraine, in 2018, bilateral trade in goods and services between Ukraine and Mexico amounted to 327.72 million USD. The basis of Ukrainian exports were ferrous metals and products from them (51.6%), grain crops (23.3%), fertilizers (7%), salt and sulfur (3.6%), ores, slags, ash (3.7%), nuclear reactors (3.6%), tobacco (2.1%), paper and cardboard (1.7%), dairy products (1.0%), railway locomotives (0.7%). The basis of imports from Mexico were vehicles (28.2%), nuclear reactors (17.4%), electric machines (17.4%), alcoholic and non-alcoholic beverages (8.4%), pharmaceutical products (5.8%), edible fruits and nuts (5.6%), optical devices (3.7%), salt and sulfur (3.3%), chemical products (1.3%).

CONCLUSIONS

Over the 25 years of its existence, NAFTA has proven to be a successful agreement that has contributed to economic growth, the creation of higher-paying jobs and to an increase in the well-being of the population in all three member countries, increased competition, choice and purchasing power of consumers, farmers and entrepreneurs, the availability of goods, services and investments, which increased the business competitiveness.

The USMCA agreement which is to replace NAFTA will not have a significant impact on trade relations and investment activities in North America. The USMCA countries are of interest to Ukraine as trading partners. The most extensive trade relations connect Ukraine with the US, but it is worth noting that in the commodity exports raw products prevail, while Ukraine imports mainly technological products.

As the agreement on a free trade area, which has a positive effect on exports and imports was concluded, the development of trade relations with Canada is promising.

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