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**NAFTA AND THE EU
ARE THE TWO ON A COLLISION COURSE?**

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Abstract

The paper deals with some crucial issues of the relationship between the European Union and the North-American Free Trade Agreement or NAFTA. NAFTA and its functional structure are briefly described in the paper, and possible gains and losses from a confrontation between NAFTA and the EU are discussed. The author's view of the potential benefits for Poland from a closer cooperation with NAFTA are also presented in the final section of the paper.

Keywords: NAFTA, EU Confrontation, cooperation, enlargement, Gross Domestic Product, competition.

JEL classification: F15.

Introduction

When Jean-Jacques Servan- Schreiber wrote his famous book on the American challenge¹ little did he imagine that reality would prove him right, but in reverse. Today, over 40 years later, *le défi* is still present but it is rather the European challenge to the American economic hegemony that persisted since the end of WWII, and not the other way round.

Few would doubt that the formation of the North American Free Trade Association (NAFTA) was the American response to the European Single Act that brought about the European Union (EU), which now comprises 27-nations and is still facing the prospect of a further expansion. While the European Economic Community, prior to the subsequent waves of enlargement in the 1970s, 1980s and 1990s, was still perceived on the other side of the Atlantic as a mere attempt to consolidate so far disparate economies of Western Europe, the last enlargements of 2004 and 2007 have been regarded as more a serious concern to the American economic domination.

Yet it would be wrong to suggest that the two trading blocks are poised for a hostile confrontation. There is absolutely nothing to gain from such a confrontation for either group. In addition, there are many areas where peaceful co-existence, and some forms of stricter ties between NAFTA and the EU might prove beneficial for both.

This paper is looking into these issues; rivalry and co-operation. The co-operation that may transcend the narrowly perceived short-term benefits for the sake of more global challenges and threats. It is written from the perspective of the author's research interests and his personal experience of living in North America for more than a quarter of a century. It forsakes scientific rigour and orthodoxy for pragmatism and may feature some over-simplicity. The author is solely responsible for the views and opinions expressed in this paper.

2. What is NAFTA and how it works?

While the European issues are very well-known to this distinguished audience, NAFTA is less familiar to many Europeans.

NAFTA is by no means of the same significance as the EU whose ultimate objective is to create a single economic entity in Europe, whilst NAFTA is, and will probably long remain, a trade association with the removal, now largely completed, of trade tariffs that existed between the member states as its principal objective.

There are numerous reasons for that but the *asymmetric* nature of NAFTA membership is probably one of the most important. While the EU members differ from each other in terms of

their economic potential, particularly after 2004 and 2007 when poorer nations joined the bloc, they still differ less than Mexico differs from the U.S. And even Canada, while larger in terms of geography, represents a mere one tenth of the U.S. in the number of people and economic output.

To those who are not initiated in American issues NAFTA is *not* the first free trade association on the continent. It was preceded by CUFTA or the **CANADA-UNITED STATES FREE TRADE AGREEMENT** established in 1988. The extremely encouraging results of CUFTA have prompted the two countries to expand it to include Mexico.

NAFTA was inaugurated on the 1st January 1994, after lengthy negotiations that ended with the signing of an agreement on the 17th of December 1992. The final document of several hundred pages is a very detailed list of issues covered by the agreement. It relates to the three-way trade between the United States of America, Canada and Mexico². This paper will not cover the details regarding the text itself which can be retrieved from the official sources. The NAFTA document is a public domain and every citizen of the three member-states: U.S, Canada and Mexico can request a copy.

The Agreement³ is composed of eight parts which are as follows:

- Part One: General Part
- Part Two: Trade in Goods
- Part Three: Technical Barriers to Trade
- Part Four: Government Procurement
- Part Five: Investment, Services and Related Matters
- Part Six: Intellectual Property
- Part Seven: Administrative and Institutional Provisions
- Part Eight: Other Provisions

Each part contains a large number of chapters which detail all the relevant issues.

The tone of the Agreement is set in its Preamble which stipulates, *inter alia*, that the Governments of the member-states are resolved to strengthen the bonds of friendship and cooperation among their nations, contribute to the harmonious development and expansion of the world trade and provide a catalyst to broader international cooperation. The document also provides certain details regarding the ways trade will be improved, trade distortions reduced, creativity and innovations fostered and new employment opportunities created.

These statements which are typical of most international agreements notwithstanding, NAFTA is first and foremost a free trade association that does not even pretend to resemble

anything of the sort of a supranational economic block the European Union is striving to be. Yet the EU is crucial to NAFTA the same way NAFTA is important to EU.

The first reason for that is the sheer economic power of NAFTA and its pivotal element – the United States of America. The U.S. generated in 2010 US\$ 14,624.2 billion or 23.6 percent of the world GDP, i.e. less than the EU of 27 nations which provided US\$ 16,106.9 billion – 26.0 percent of the world output.

However, when the other two members of NAFTA, i.e. Canada and Mexico are factored in, the Association becomes the world's economic leader with the combined GDP of US\$ 17,191.9 billion or 27.7 percent of the world's output. Table 1 below illustrates that.

Table 1. GDP at nominal prices in 2010: European Union and NAFTA

Country	GDP in millions US\$ at nominal prices	% of world's GDP
WORLD	61,963,429	100.0
European Union (27 member states)	16,106,896	26.0
United States	14,624,184	23.6
Canada	1,563,664	2.5
Mexico	1,004,042	1.6
TOTAL NAFTA	17,191,890	27.7

Source: Computed from data provided by the IFM Secretariat.

The sheer weight of the U.S. economy is clearly seen from another set of figures which illustrate how that economy dwarfs those of the largest EU members. The figures below show the number of dollars of the U.S. economic output per each dollar generated by these economies.

Germany 4.4

France 5.7

UK 6.5

Italy 7.2

Combined these four economies generated in 2010 US\$ 10,156.6 billion, i.e. less than 70 percent of the U.S. GDP.

2. Is NAFTA-EU confrontation inevitable?

With the two trading blocks representing over half of the world's output, few people would believe there would be no rivalry, competition and even a concealed hostility between

them⁴. Both sides criticize each other for practicing protectionism, unfair trade practices and attempts to close each other's markets to their respective goods. The Americans are very upset by the EU's practice of banning some GMO (Genetically Modified Organisms) food imports into Europe. The EU was concerned, for instance, with practices by some U.S. companies, such as Microsoft, of obstructing competition.

The latest financial crisis which is widely believed to have been "made in America", has not been well received in most of Europe, like the U.S. push for the war in Afghanistan and Iraq.

NAFTA, and before it CUFTA, was created to counter the increasing importance of the EU. For a long time the European integration which initially included the six nations of Western Europe, was a necessary way to prevent it from further Soviet expansion to the West. But The EU grew gradually stronger and the benefits of integration became all too obvious. With the existing trade barriers in North America hampering the growth of trade in North America, NAFTA became an inevitable choice.

With this phase mostly completed, and most trade barriers now removed, an important question appeared as to what should NAFTA become in the future.

With the prospects of creating FTAA, or FREE TRADE AGREEMENT OF THE AMERICAS, now put on the back burner, at least for some time, NAFTA will probably have to move beyond its initial form of a purely free trade association. The directions of such a potential move are not clear at this stage but the changing patterns of the world economy and the shift of balance from the traditional centres of economic power to the emerging world, and in particular the so called BRICS countries, is the most likely trend⁵.

The expansion of the EU eastward towards the former Soviet republics of Ukraine and Belarus, while seems rather unlikely now⁶, would shift back the balance of power in favour of Europe. The EU would emerge as the undisputed world power with over half a billion people and more than a quarter of the world economic output. That scenario is quite feasible and is closely watched in Washington, Ottawa and Mexico City.

There are two possible ways NAFTA can respond to yet another enlargement of the EU. One is by expanding south and including new members in Latin America. Strengthening the intra-NAFTA economic ties is another strategy.

Neither seems to be fully feasible in the short term. Expanding NAFTA south and creating an FTAA or any other form of a free trade zone of the Americas⁷, would require profound changes of the U.S. policy towards the countries of the region, on top of a necessary reversal of these nations' perception of the United States as the regional bully. That seems rather unlikely

in the short term. There is a growing sense of anti-U.S. sentiments among some of these nations and it will not be so easy to uproot. While such changes cannot be excluded, the process may take decades to produce any tangible effects. It is more likely that the U.S. will seek bilateral agreements with some of the more important players in the region the way it has been doing so for instance with Brazil, one of the fastest growing economies in the world in recent years.

Expansion of NAFTA is also facing another formidable hurdle, this being the disadvantage of distance and high transport costs. NAFTA has been successful among other reasons due to the proximity of markets; Canada/U.S. and Mexico/U.S. In the latter case NAFTA was a wonderful opportunity for U.S. firms to outsource their production into Mexico and take advantage of low labour costs thanks to the “maquiladoras”⁸ scheme. There is little doubt that the distance disadvantage for Argentine, Chilean or even Brazilian firms may offset their lower labour cost advantage as far as competing for the U.S. markets is concerned.

Transport costs will work into disadvantage of a pan-American free trade zone the very same way they are already working against further progress of globalization⁹. Globalization is widely regarded as having occurred thanks to low transport costs but many authors claim it was not the case¹⁰.

FTAA if created, will have to rely principally on regional trade the same way the pre-EU Europe, EFTA or even the ill-famous COMECON did. There is little doubt that the removal of trade barriers among the Latin American states would be greatly beneficial for their economies. But the transport cost disadvantage will not help them to expand into the global power. To do so will probably take a long time.

Changing NAFTA into something more like EU does not seem very likely, either. The EU was created because the member-states have forsaken some of their sovereignty for the supranational body which it has become. Such an option is not feasible in the United States. Neither is it in Canada and even less so in Mexico. The fear of losing sovereignty is strong and no one can doubt in whose favour this loss of sovereignty might be.

Yet NAFTA as a bloc has no choice but to move forward, or else it will lose its current position of the world leading economic power, not only in favour of the EU but also in favour of Asia. This may for a while seem a rather distant perspective as the greatest rival- China- has only 1/3 of the U.S. GDP, but China doubles its output every 7–8 years whilst the U.S. economy would need several decades to double its.

Returning to the question asked in the title of this section one could believe that while a hostile confrontation between NAFTA and EU need not materialize, there is little doubt that the two blocks will remain competitive to each other in less or more drastic forms. Without

entering into detailed statistics one can indicate a number of areas where rivalry will most likely occur. These areas will be agricultural exports, energy, information technology and air transport.

3. NAFTA opposing EU: what would be the gains and losses?

Confrontation will undoubtedly be harmful for both sides. Every student of international economics knows that tariff wars never benefited anyone and all forms of trade restrictions can quickly backfire. Consequently, a peaceful coexistence between the two blocks must be the case. There is too much to lose by both sides by trying to change the existing patterns in world trade.

Yet both NAFTA and the EU suffer from the same disadvantage, and that is the high labour costs as compared to the emerging countries, and the BRICS countries in particular. CUFTA needed expansion south embracing Mexico for the very same reason the EU needed expansion east and south-east to create larger absorbent markets of Central and Eastern Europe and to take advantage of lower labour costs there and create new opportunities for the West European companies.

There is, however, one major difference between NAFTA and the EU in this respect, and that is the issue of convergence. The distance between the new and old EU members will be slowly narrowing down, while the distance between Mexico and U.S. and Canada will probably remain large for a long time yet¹¹. Therefore NAFTA will definitely need further expansion. The question is in which direction.

One of possible options would be to conclude a free trade agreement between the member states of NAFTA and the EU, either bilaterally or multilaterally. Distance is not relevant in this case as both Canada and the U. S. have free trade agreements with countries on other continents¹². The question is whether NAFTA and EU can enter into closer economic and trade links as such or whether bilateral agreements would prevail.

Several years ago the Premier of Quebec – the Liberal Jean Charest – was lobbying very hard for closer links between his province and the EU. This policy has brought rather modest results as most Canadian firms turn first and foremost towards the U.S. market. Many reasons are behind this traditional push: historic, cultural, political, strategic, let alone pure economics. But this may change as Canadians are increasingly aware that they are powerless vis-a-vis giant American companies. And they have no one to associate with to counter this dominance, unlike

their European counterparts which remain on a more equal footing. Canada and the U.S. are partners for the better and the worse like a *marriage de raison*.

There are crucial differences between the very nature of NAFTA and EU as far as the scope and depth of integration are concerned. These differences are very well illustrated by Table 2.

Table 2. Elements of development policies of NAFTA and EU

Policy elements	European Union	NAFTA
Reduced government intervention	<ul style="list-style-type: none"> - Liberalization of trade and investments - Single currency - Competition policies - Labour mobility 	<ul style="list-style-type: none"> - Liberalization of trade and investments - None - Some but not binding - Visa restrictions for professionals
Increased government intervention	<ul style="list-style-type: none"> - Development funds - Support for agriculture - Social and environmental standards - Official channels for social inclusion at the regional level 	<ul style="list-style-type: none"> - None - None - Weak parallel agreements - None

Source: Compiled from Anderson, Cavanaugh (2004).

NAFTA would have gained from the EU experience in terms of regional development, social policies and cohesion policies. But nothing of the sort is present within NAFTA which increasingly comes under attack from anti-global movements in North America. Some are so disappointed with NAFTA that declare it obsolete and useless.

Clearly NAFTA has reached its limits. It has definitely been a success as a free trade zone, contributing enormously to the growth of economic exchanges between the member states through the removal of tariffs and non-tariff obstacles to trade. But unlike EU which progressively became a union, not only in economic terms, NAFTA stopped short of following that path and as such NAFTA in its present form might have lost the steam necessary for a more comprehensive integration.

The limited scope of this paper does not allow us to elaborate on main causes of that unfinished integration process which is NAFTA's. Furthermore, these issues are covered extensively in literature on the subject¹³. What is more important in the context of this Conference are the relationships between NAFTA and the EU in general, and NAFTA and Poland in particular.

4. NAFTA and Poland

This essay would be incomplete if we did not try to say at least a few words about mutual relations between Poland and NAFTA. There are some definite reasons for that:

- NAFTA, and in particular the U.S. and Canada, belong to the leaders in technology that Poland badly needs, particularly in the mining and energy sectors;
- Both countries include a sizeable population of the Polish ancestry which is very involved in maintaining close ties with their country and the land of their fathers. Polish minority there is very active in many areas and deeply cares for their motherland, even though the youngest generation of Polish immigrants may know little about Poland;
- Polish educational system is now going through a crisis which could be resolved with greater involvement of North American educational and training institutions in the process of necessary reforms in this area in Poland;
- Despite the fact that the North American market is difficult for Polish goods, there are numerous *niches* where Polish products could be successfully marketed. There are more goods *Made in Poland* which can be found in Canadian stores, for instance, than the other way round.

But as a full member of the EU Poland has her hands tied as far as direct economic cooperation with NAFTA countries is concerned. It matters therefore that new forms of such cooperation be found to turn them into benefit for both sides. But this is a separate topic for analysis.

Conclusions

NAFTA represents the largest trading block in the world and as such must enter into some kind of confrontation with the EU. But this confrontation, or rivalry, need not be violent and harmful for either part. The two entities would lose too much if they tried to fight each other on economic grounds.

There are, however, formidable obstacles to be overcome to enjoy a peaceful coexistence of the two economic blocks. In many areas particular interests of NAFTA and the EU do actually clash. A lot of good political will is necessary to overcome these difficulties.

Oddly enough a compromise may be easier than it appears, particularly in the light of the growing competition from the emerging economies. Already both NAFTA and EU members

find out that the closer they get together the greater the chances that they may confront this growing danger.

Poland has vital interests in maintaining close ties with NAFTA, and in particular with the U.S. and Canada. Without compromising the benefits she enjoys as a full member of the EU, Poland can further tighten her economic, scientific, cultural and industrial ties with the NAFTA member states.

Notes

¹ Servan-Schreiber (1968).

² The official name of Mexico is: “Los Estados Unidos Mexicanos”, i.e. the “United States of Mexico”. The latter term is rarely used due to the confusion it may create with the United States of America.

³ The Agreement can be obtained from government sources. See for instance: www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta/alena.

⁴ The latest enlargement of the EU was closely watched and commented in throughout North America. See, for instance: Chanona (2003), p. 3 and subsequent. Interesting opinions of the European integration can be found in Moravcsik (1993), and others.

⁵ This is clearly seen now with the BRICS countries, i.e. Brazil, Russia, India, China and South Africa pushing very hard for their greater say in IMF and the removal of the practice of nominating a European at the helm of this institution. The selection of the Director of IMF should be based on merit and not the nationality they claim.

⁶ There is increasing evidence that Moscow will try to create a countervailing power to EU by establishing a more workable version of the Commonwealth of Independent States. There is already a customs union between the Russian Federation and Belarus which will be extended to other ex-Soviet Republics, such as for instance Kazakhstan.

⁷ Negotiations regarding FTAA have stalled for a number of reasons. One of the most important was the disagreement over the Doha round of trade negotiations between the developed and developing nations.

⁸ Maquiladoras are Mexican factories that use imported materials to produce goods for export. Since NAFTA was inaugurated in 1994 output from maquiladoras was increasing fast. However, it has grown even faster from the non-maquiladora sector. See in this respect: Hauber, Schott (2005), p. 5 and subseq.

⁹ On that issue see, for instance, Chrzanowski in: Salmonowicz's (2011), pp. 69 and subsequent.

¹⁰ See for instance in this respect: Hummels (2007), pp. 131–154.

¹¹ Poland, the Czech Republic, Hungary, not to mention Slovenia, have more than half of the average GDP per capita of the EU; Mexico has only one fifth of that figure for the U.S. and Canada.

¹² Canada, for instance, has free trade agreements with Chile and Israel, both located on other continents.

¹³ The former President of Mexico – V. Fox – came up with a very interesting idea of “NAFTA plus”. The agenda of such an upgraded NAFTA would include for instance:

1. Integration of labour and environmental issues into the Agreement (at the moment these are minor supplementary agreements);
2. Strengthening of development strategies for less developed areas in the region;
3. Expansion of coverage and competences of NAFTA's weak institutional system;
4. Assessment of the inclusion of new sectors and issues.

For more details see: Chanona (2003), p. 8.

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