

Czech University of Life Sciences Prague

Faculty of Economics and Management

Department of Economics



Bachelor Thesis

Regional Integration – North American Free Trade Agreement

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CZECH UNIVERSITY OF LIFE SCIENCES PRAGUE

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Economics and Management

Thesis title

Regional Integration – North American Free Trade Agreement

Objectives of thesis

The aim of the bachelor thesis is to evaluate the impact of North America Free Trade Agreement (NAFTA) on the living conditions of the member states. The main aim will be fulfilled by partial aims:

- Has NATA fulfilled its primary objectives?
- Can we talk about improvement of economic situation?

Methodology

This thesis will be divided into three parts.

The first part is a theoretical one and will be based on literature search. It will define the current state of knowledge in the field of regional integration with the overlap to its history and development.

The second part will rely on the theoretical part and it is the key component of the thesis. The author will use method of quantitative research such as statistical and mathematical methods. The researcher will use secondary sources of information (UN, UNCTAF, FAOSTAT, NAFTA database, etc.).

The final part will conclude the results of the previous parts and discuss it with another author. The most important part will consist of partial conclusions outcome and finding

The proposed extent of the thesis

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Declaration

I declare that I have worked on my bachelor thesis titled "Regional Integration – North American Free Trade Agreement" by myself and I have used only the sources mentioned at the end of the thesis. As the author of the bachelor thesis, I declare that the thesis does not break copyrights of any their person.

In Prague on 15.03.2018

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Regionalní integrace - Severoamerická dohoda o volném obchodu

Souhrn

V prvních třech kapitolách se bakalářská práce zabývá teoretickým hlediskem samostatné regionalní integrace i Severoamerickou dohodou volného obchodu. Regionální integrační dohody umožňují členským státům omezit nebo úplně odstranit své obchodní bariéry z důvodu zvýšení výroby, rozvoje mezinárodního trhu a investic mezi členy. V pozdějších kapitolách se práce zabývá dopadem Severoamerické dohody o volném obchodu. Jak ovlivnila každou zemi a její ekonomickou situaci. Kvůli nedávným událostem patří poslední kapitola budoucnosti NAFTA a diskuzi o možných změnách.

Klíčová slova: Regionální integrace, NAFTA, Severoamerická dohoda o volném obchodu, zóna volného obchodu

Regional Integration – North American Free Trade Agreement

Summary

In first three chapters, bachelor thesis covers the theoretical background of regional integration itself as well as North American Free Trade agreement separately. Regional integration agreements allow member countries to limit or completely eliminate their trade barriers to help to increase production, development of international market and investment between members. In later chapters, the thesis focuses on impact of North American Free Trade Agreement. How it affected each member country and its economic situation. Because of recent events, the last chapter belongs to future of NAFTA and discussion of possible changes of it.

Keywords: Regional integration, NAFTA, North American Free Trade Agreement, Free trade zone

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1 Introduction

This bachelor thesis focuses on regional integration and its most important characteristics. In these days, regional integrations are very important aspect of our lives. Almost every country in the world is part of at least one integration and most of them more than that. These agreements are limiting or completely eliminating trade barriers between member countries to help to increase production, development of international market and investment between members.

First part is mainly about theory of regional integrations, its different forms, and advantages as well as its problems.

Practical part focuses on North American Free Trade agreement, which is a free trade agreement between the United States, Canada and Mexico. It came in force on January 1, 1994. NAFTA always used to be a topic of many conversations but since the election of U.S. president (Donald Trump) in November 2016 it became main discussion in the USA. President Trump decided to renegotiate the conditions of agreement because he thinks it's unfair to United States. As Canada and Mexico are U.S. biggest trading partners no one knows what is going to happen after renegotiating. President Trump also said that because of NAFTA many Americans lost their jobs and the overall economic situation of United States got worse. The main purpose of this thesis is to find out whether it's true. Whether was NAFTA advantageous for member countries or not. To achieve this the thesis will be comparing different aspects of member's economics including GDP, import, export, unemployment, and investment.

2 Objectives and Methodology

2.1 Objectives

The aim of the bachelor thesis is to evaluate the impact of North America Free Trade Agreement (NAFTA) on the living conditions of the member states. The main aim will be fulfilled by partial aims:

- Has NAFTA fulfilled its primary objectives?
- Can we talk about improvement of economic situation?

2.2 Methodology

The thesis will be divided into three parts.

The first part is a theoretical one and will be based on literature search. It will define the current state of knowledge in the field of regional integration with the overlap to its history and development.

The second part will rely on the theoretical part and it is the key component of the thesis. The author will use method of quantitative research such as statistical and mathematical methods. The researcher will use secondary sources of information (UN, UNCTAD, FOASTAT, NAFTA database, etc.).

The final part will conclude the results of the previous parts and discuss it with another author. The most important part will consist of partial conclusion outcome and finding.

3 Literature Review

This chapter deals with the theoretical aspects of regional integration.

3.1 Regional integration and its motives

Between 1930 and 1940 the development of processes called by theoretical businessmen “regional integration“ began. The main point of these processes was to eliminate barriers of trade between two or more countries and create terms and conditions under which the countries are going to cooperate. During the years the definition of regionalism wasn't clear and it was at the beginning of 60s, by B. Balassa (Balassa, 1961) characterized the regionalism as a processes beginning with political and economic approximation of countries, through cooperation and solidarization, to merging and uniting originally independent economics. Under this definition the regionalism stays till today. (Cihelkova, 2010)

The motives of regional integration have changed and shaped by time and areas conditions. In other words, with changes of political or any other aspect of the country, the change of regional integration is necessary. Desire of economic growth is one of the common characteristics for all world nations although we have seen an evolution of integration, which was not economically oriented. The effort to gain a safety access to the bigger markets is the main motive of regional (economic) integration.

It is possible to specify the model later on by adding the concrete profits, which are gained through the regional integration. Those are mainly:

- Higher effectivity of production
- Higher level of saving from industrial sector
- Better position at the international market
- Added effects caused by higher competition between the firms
- Changes in quantity and quality of production factors

Regional integration was starting to be more important during the 60s and spreads out from Europe to Asia, Latin America and Africa. It became a phenomena of world

economy and moving force of its development. The term „regionalism“ was started to use. (Cihelkova, 2010)

3.1.1 Nature of regionalism

Regionalism, globalization and multilateralism are together main trends of development of the contemporary world economy. But to define what really regionalism is, we have to define the meaning of examined expression. The problem is that the meaning of this expression vary depending on different opinions.

For example according to L. A. Winters (Winters, 1996) it is any politics focused on reducing the trade barriers between countries without considering the closeness of those countries. According to R. E. Baldwin (Baldwin, 1997) it is necessary to understand the regionalism as a process of integration (which is also a part of an political economy), which in a global manner leads to uniting and growing of separated parts of world's economy. But at the same time from a regional perspective it leads to tighter relationships between some national states. Also Oman (Oman, 1999) is considering the regionalism as a movement of two or more economics or more precisely movement of two or more societies to greater integration. It is also possible to find another definitions, which differ from those mentioned above, but their base is always liberalization and building of closer trade relationships between two or more countries.

With a mention above, the regionalism is possible to explain as a trade or more precisely economics politic of a state, which leads to relationship liberalization between two or more states and contribute to its tighter connections and mutual integration (Cihelkova, 2010).

3.1.2 Region as a base of regionalism

The basis for regionalism is a region, which is not meant in geographical, administrative or geopolitical terms. In regionalism theory the regions represent bloc (group) of two or more countries, which are gaining different level of integration (cooperation). It is also possible to speak about regions as a regional aggregation (Cihelkova, 2010).

“Although most RIAs (regional integration areas) are between neighbouring countries, this is no universally true – as illustrated for example, by the free trade agreements between the United States and Israel, Chile and Canada, and Mexico and the European Union (EU) and by Greece’s accession to the EU. Nor is it required for most of the analytical arguments that we make.” (Schiff, Winters, 2003).

Regions can have a form of non-formal (non-agreement) integration but more often they are created based on special type of international agreement between countries. After 1948 when GATT (General agreement on Tariffs and Trade) came into effect, the regions became mainly results of Preferential Trade Agreement (PTA). GATT define PTA as a voluntary agreement between countries in order to gain tighter economic integration and with a goal of strengthen trade liberty (WTO, 2003). There are few different types of PTAs. The older ones are Customs Unions Agreements and newer Free Trade Agreements. Even though the customs unions are stronger forms of integration, the free trade agreements are more often made in these days. These agreements also include agreements leading to the integration which are all together called Regional Trade Agreements – RTA.

Preferential trade agreements became basis to both „good neighbour model“ (countries, which has common border/are neighbours) and „happy family model“ (countries, which don’t have any common borders) (Cihelkova, 2010).

3.2 Different forms of regionalism

Different forms of regionalism are:

- State-supported regional integration
- Free trade zone (agreement)
- Customs union
- Common market
- Monetary union
- Economic union
- Political union

State-supported regional integration can be defined as regional bloc (grouping), which was created based on a governments decisions to lower the trade barriers between

countries. We are speaking only about lowering certain duties (tariffs) for specific products but not its elimination. The agreements between selected countries are much weaker than those used for free trade zone or customs union (Cihelkova, 2010).

Free trade zone (area) can be characterized as a first level of institutional regional integration. The member countries eliminate all trade barriers but at the same time they keep the control over domestic market. The barriers which are mostly eliminated includes duties (tariffs) and quotes (quantitative trade restrictions). They decide which products are included in free trade agreements and how high are the tariffs. The no-member countries are free import to any member country but each of them can have different height of duties as well as some restrictions according to their preferences. Free trade zone is also first integration which needs to be registered by WTO – World Trade Organization (Cihelkova, 2010). The North American Free Trade Area (NAFTA) and the European Free Trade Association (EFTA) are examples of free trade areas.

Customs union is second level of institutional regional integration. The product tariffs are in these cases payed only once when entering the union. The movement of the product within the union is then totally free. The member countries have also common trading policy for no-member countries (including the same level of tariffs, import quotes etc.). Customs union is well known for source efficient usage and its later specialization. Hand by hand together with this specialization comes imperfect competition (monopolies resp. oligopolies). The rules of origin are losing its importance as the tariffs for whole union are homogenous which means that there is no possibility of gaining a profit from re-exporting the products. The problem which might occur is with Common Customs Tariff. As mentioned above the trading condition are for all no-member countries the same and the height of tariffs needs to be stated by all member countries. This might take some time before all the countries are satisfied and the agreement is made. To make sure that all agreements are upheld the common institution for all members are created (might also include the commission in case of conflict) (Cihelkova, 2010). One of the most famous example of a customs union is the European Union (EU).

„According to traditional analyses of the stages of economic integration, a customs union involves not only the removal of tariff and nontariff barriers to trade for imports from the union’s members, but also the equalization of tariffs among members on imports

from non-members. A customs union usually entails a higher degree of integration than a free trade area, in which members abolish tariffs and quotas on imports from each other but maintain their tariffs and quotas against non-members.“ (Salazar-Xirinachs, Jose Manuel Robert, Maryse, 2004).

Common market is third level of institutional integration. The trading barriers are in this case completely deleted. There is free movement of production factors (mainly capital, labour and technologies) across the member countries. The main purpose of the common market is to let the factors which lead to the trade and economic development flow. Economic effects caused by common market can be bigger than in other integration forms. With higher interdependency of member countries and presumption of effective and flexible usage of common market potential, the member's economies might continue in converting which will also result in higher effectivity of common market. As well as in custom union, the functioning of common market is also controlled by developed common institution which is closely connected to the national economics (Cihelkova, 2010). The European Economic Community as the first example of a both common and single market, but it had also additionally a customs union. It was created in 1957 by Treaty of Rome and currently it's a legal entity within the framework of European Union.

„A customs union represent a lower degree of integration than a common market, which incorporates, in addition to the elements of a customs union, measures to allow free movement of factors of production among its members.“ (Salazar-Xirinachs, Jose Manuel Robert, Maryse, 2004).

Monetary union is qualitatively higher form of regional integration, which should include only those countries which already reached common market and with relatively high level of economic harmonization. With currency union agreement, the member countries solve the problem of currency exchanges rates. This agreement can have two forms. First, when one foreign currency is fixed to the other with unchanging exchange rates (this also includes no economic and currency restriction). In second case, the currencies of each country are wiped out (ceased to exist) and are replaced by one common currency for all member countries. There is one central bank on the regional level, which controls the currency policy and emissions. The bank is regulating the amount of money in circulation, interest rates and foreign exchange policy (Cihelkova, 2010). The largest

monetary union is the “eurozone” where the euro is the monetary unit in 19 out of 28 countries.

Economic union is a very high level of regional integration. It represents common market which requires total merge of monetary and fiscal policy of member countries. This is mostly only referential form of integration (Cihelkova, 2010).

Political union is the highest level of integration, which together with economic integration also includes political union of the member countries. The inside (internal) differences of countries should be minimized and its external influence maximized. At the end the political union means unification of until then independent states into one whole with common central organs, parliament and other institutions leading to the sovereignty of the union (Cihelkova, 2010).

3.2.1 Division of integrations

For better understanding of different regional integration forms we divide them according to these criteria:

- Geographical regions
- Depth of regionalism
- Number of members
- Character of members

Geographical regions doesn't necessary have to be connected to the continental geography but can be as well cross-continental. We distinguish main five geographical regions (areas):

- Region Europe-Mediterranean
 - West Europe
 - Central Europe + Baltics
 - North Africa + Middle East
- East Europe and Central Asia region
- Region Asia-Pacific Ocean
- America region
- Africa region

The integration containing countries from two or more geographical regions are called transregional.

Depth of regionalism represents the level (form) of integration as well as it is explaining how much is integration effecting the economic relationships of member countries. According to this we can divide the integrations into shallow or deep.

- Shallow regionalism is mainly represented by liberalization of external relationships. The barriers against movement of economic factors are removed. Shallow integration is most commonly represented by customs union or free trade zone.
- Deep regionalism eliminate barriers beyond the country borders. It move integration forward to the new areas including the labour, capital and services.

„‘Shallow’ integration refers to the elimination of the traditional border barriers to trade in service and factors. ‘Deep’ integration refers to policies which are ‘beyond the border’, in contrast to ‘shallow integration’ which refers to the traditional border protection measures, tariffs and non-tariff measures. Examples of deep integration are development of standards relating to the industrial products or safety or health or the environment, policies relating to particular sectors, such as agriculture or industry or transport, and business laws that are amended to remove differentiation between foreign and domestic suppliers. “ (Tran Van Hao, Charles Harvie, 2003).

„Deep integration is integration that moves beyond the removal of border barriers, and contrast it with shallow integration, that is, trade liberalization, I do not mean to imply that deeper is better. Indeed, deeper international integration could be better or worse, depending on the nature of the policies that are harmonized and the countries to which they are applied. Deeper integration could, for example, take the form of imposing measures on countries that are inappropriate for their stage of development – such as excessively stringent environmental standards, or which reduce economic efficiency – such as the Common Agricultural Policy in the European Union. Alternatively, deeper integration could enact measures that enhance efficiency – such as the international enforcement of competition policy – and help match the scope of governance with the

problem, such as the international implementation of policies to deal with global greenhouse gases.“ (Lawrence, 1996)

Depending on **number of members of integration** we can divide them into bilateral (two-sided) or multilateral (multiple-sided) agreements.

- Bilateral agreement is agreement between two sides (countries) based on the RTAs
- Multilateral agreement is made between three or more sides (countries)

Sides don't necessarily have to be countries. It is also possible that one side or even both are represented by regional integrations itself. We have special division for these situations:

- Bi-regionalism is bilateral agreement between one regional integration and one country
- Multi-regionalism sui generis is multilateral agreement between one regional integration and a group of countries
- Inter-regionalism is relationship between regional integrations

According to the **economical level of member countries** we can divide agreements into those which deals with relationships between developed or developing countries, or between both. Basis for this division is idea of 'poor' south and 'rich' north (Cihelkova, 2010).

- North-north integration is integration between developed countries. This is mainly one of older forms of integration as developed countries are driven to the better relationships earlier than developing. Most frequently it is represented by deeper integrations as new free trade agreements including liberalization of services, investment etc.)
- South-south integration is newer form of regional integration between developing countries. These agreements are mainly driven by peace desire (struggle for peace and stabilization of selected area) and economical motives comes later on. This integration is shallower and deals with elimination of trade barriers.
- North-south integration is integration between developed and developing countries. Form and depth of integration is highly influenced by strategy of developed country and by maturity of developing country. These agreements might be very helpful in growth of developing countries as mentioned by Hoekman „*North-South*

PTAs tend to be associated with transfers of finance and knowledge (technical assistance), potentially helping reduce implementation and adjustment costs. In addition, high-income partners may provide offers of assistance in the form of implicit “insurance,” as in the case of U.S. financial intervention to assist Mexico during the “tequila crisis.” (Hoekman, 2011). On the other hand developed countries often force the pace of integration according to their interest which can have devastating results upon developing countries.

3.3 Benefits and risks of integration

The discussion whatever the regional integration and the processes of globalization and multilateral liberalization are compatible with each other or whether they eliminate one another (e.g. whether the international trade and multilateral liberalization are in danger because of regional integration.

On the first sight the globalization and regionalism seems as a totally opposite processes but it's not quite true. Globalization's main goal is the placement of economic factors into area. Regional integration leads to cumulation of economic factors in area. But at the end both of these processes are heading to the common direction with the same effects.

Multilateral liberalization allows agreement between more states; regional integration allows to reach the agreement between smaller but more homogenous group of states. Because of this we can consider both multilateral liberalization and regional integration as a reaction to the globalization.

Regional integration may be understood as an effort to protect national markets against the forces of globalization. On the other hand some of the microeconomic forces are growing up with regionalism such as: increase of competition in region, enlargement of market size, support of economic factors mobility, etc. Regionalism can also became big force in hands of politicians. It can be the final push up to opening of markets on international level. (Kunesova, Cihelkova, 2006)

By decrease of number of negotiating competitors regional integration leads to easier agreement on further liberalization steps, including the most important liberalization of world trade.

However regional integration also brings some risks. One of the biggest is the possibility of decrease in global welfare in the world's economy.

A system risk is another problem which may occur. Final products of creating any regional integration are blocks, which are competitive with each other. As a result of this states could end up in the middle of trade wars and the multilateral liberalization process would be disrupted.

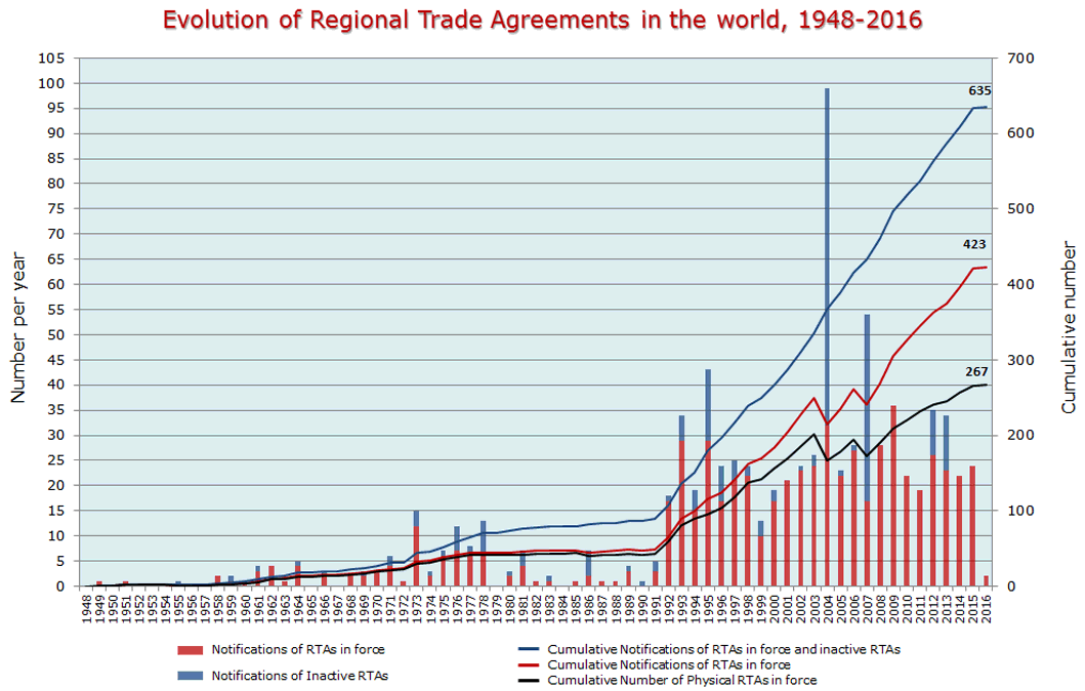
An event called „spagetti bowl effect“ is highly connected to the regional integration. It's happening because of continuous creation of RTA's. The agreements are strongly connected and they overlap each other, which leads to trade complications (every agreement has its own rules, which are most of the time not compatible with rules of others) (Bhagwati, 1995).

The discussion about pluses and minuses of regional integration is in world known as „Building Blocks versus Stumbling Stone“. (Kunesova, Cihelkova, 2006)

3.3.1 Regional trade agreements and WTO

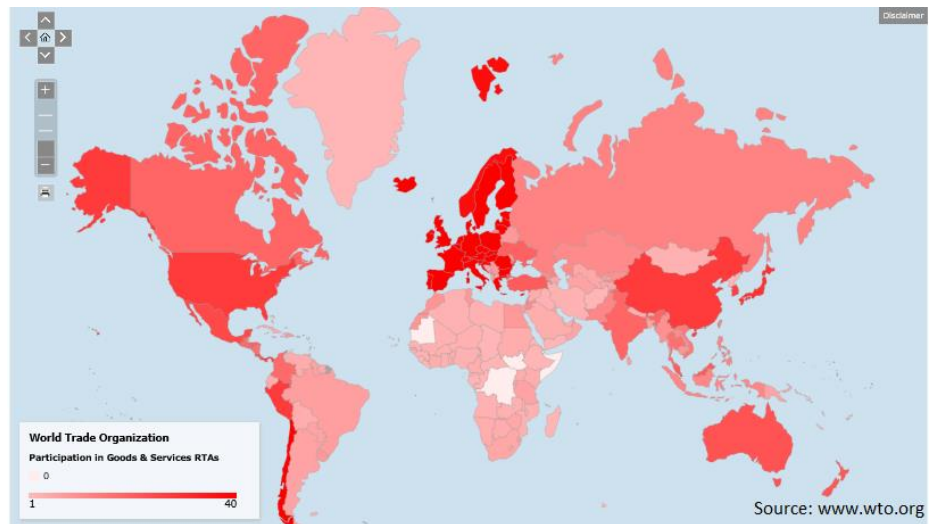
The obligation of notifying creation of new regional agreement is not valid for regional integrations. Only members of WTO (previously GATT-164 members and 22 observer governments) are obligated to announce new economic integration agreement such as free trade agreement, customs union, etc. Because of this many agreements between developing countries are not in the list of WTO. Notification also include the addition of new country to the already existing integration such as addition of Croatia in 2013 to the European Union. However the WTOs list is still the best indicator of number of regional integrations. (Cihelkova, Eva, 2010)

Between the years 1948-1994, the GATT was notified about creation of 124 regional trade agreements and after the foundation of WTO in 1995 the number of RTAs jumped to 400 (Figure 1 and 2).



Source: www.wto.org

Figure 1 Number of regional trade agreements according to WTO



Source: www.wto.org

Figure 2 Participation in RTAs

3.4 History of regional integration of North America

Change of economic and political conditions all around the world during 20th century resulted in the biggest integration change in history of the North America. The United States started to take first few precautions leading to better international relationships

(bilateral and regional relationships) with a main goal of pushing through its, until then unsatisfied, economic and political interests.

During 1980s the USA came into decision that regional integration could be beneficial for future economic and political relationships in North America. The government of USA started to negotiate with Canada about possibility of creating special regional integration agreement between both countries. As a result the Canada-United States Free Trade agreement was signed on January 2, 1988. The part of this agreement was elimination of barriers to trade in goods and services between both countries, liberalization of investment within the free-trade area, special condition of fair competition between both members of agreement. Another part of agreement was also to take first precautions possibly leading to further expansion of free trade area. (Cihelkova, 2010)

North America Free Trade Agreement was signed in 1992 by the United States, Canada and Mexico. The agreement is considered to be somewhere between deep and shallow regionalism and it came into force on January 1, 1994. The main goal of this integration was usage of all the potential of North American region by eliminating trade and investment barriers between countries. NAFTA was totally new type of regional integration which main instrument is liberalization of economic sectors, movement of services, labour and investments. Because of implementation of RTA in NAFTA we can formally consider this agreement as an unfinished common market. The liberalization of services in NAFTA is quite revolutionary as every service (except of air and marine transport) is operating without any restrictions until one of the member countries will decide otherwise. By this every new service is automatically part of liberalization. There is also free movement of capital in the NAFTA, which can be understood as a free movement of investments. The free movement of people is not part of the agreement and because of that NAFTA is not complete common market. However to support international trade and services, NAFTA is trying to find some solution which will be favourable for all member countries. Although there will be always some movement limitations because of national security as it is in European Union. Even though the NAFTA is typical complex free trade area, with high level of realization (almost considered as common market) no precautions leading to customs union are taken. Sometimes we speak theoretically about opportunities of NAFTA being a customs union but the realization of this idea would be really

complicated and it doesn't need to be necessary better than free trade area. (Cihelkova, 2010)

With signing of NAFTA lot of thing changed. The pace of integration accelerated and the three countries were started to be seen as a one single economic unit with a gross domestic product (GDP) 15 percent larger than the fifteen-country European Union (EU).

3.4.1 Problems of NAFTA

The biggest problem of NAFTA is considered to be, the ignorance of the income gap between the three countries, mostly between the United States and Mexico. In 1989 the Mexico-U.S. gross domestic product (GDP) gap widened from \$15,800 to \$26,200. The main reason for the gap widening are not the differences in capital investments as many people think but differences in technological progress. The possible gain from adopting existing technologies from the industrial economies could be profitable for everyone. This seems like one of the reasons why Mexico is so far behind the USA. Its TFP (total factor productivity-measure of the efficiency of all inputs to a production process) which is one of the biggest innovation progress indicators, doesn't show any significant growth (viz figure below). Another issue is dependency of countries on each other. Any shock in one country will have results in at least two of the three countries. Into these shocks we can include financial crisis, closing of a major border crossing or a terrorist attack. And even bigger problem is inability of the countries to react to events like this. Each country is reacting separately even though they should make some action as a whole unit. The countries are highly connected economically and geographically but regarding the political matters they are as far from each other as they can be (Hakim and Robert, 2004; Hoekman, 2006).

Period	Output value	Capital services	Labour services	Energy	Materieals	Services	All inputs	TFP
1991-1995	2.09	1.28	0.47	0.06	0.83	0.38	3.03	-0.93
1996-	7.1	1.47	0.72	0.2	2.54	1.05	5.99	1.11

2000								
2001-2005	2.39	1.61	0.29	0.08	0.55	0.61	3.15	-0.76
2006-2011	2.88	1.9	0.26	0.04	0.79	0.76	3.76	-0.87
1991-2011	3.58	1.58	0.43	0.09	1.16	0.7	3.97	-0.39

Table 1 Mexico: Absolute Contribution of Inputs and TFP to Output Growth (1991-2011) (Cepeda, Ramos, 2015)

3.4.2 NAFTA is not enough

Even though NAFTA is made as a trilateral regional integration, it mostly seems to be double-bilateral agreement. One between the USA and Canada and the other one between the USA and Mexico. NAFTA is considered as a quite narrow integration with main purpose of trade and investment improvement but it doesn't include any new social, institutional or development arrangements. It also doesn't deal with labour markets, law enforcement, and protection of environment or immigration problems. The question is whether this grouping of countries will be enough or whether some steps should be done leading to the higher level of integration as it was done in the European Union.

In July 2000 the new president of Mexico Vicente Fox was elected. During his travel to the United States and Canada he proposed to the other two NAFTA's members' idea of creating a North American Community. His idea was to take some lessons from European Union and start to form a common market. He understood that this movement forward would take many years but at the end the goal would be reached and all three countries would profit from it. There are many difficulties which might occur as for example president's Fox's ignorance of the intermediate stage between free trade area and common market which is customs union. „A customs union would dismantle the cumbersome rules of origin, and border inspections of goods would be eased and eventually eliminated. In effect, a customs union would permit the three countries to move to a periphery-based system of security and customs inspection. But that would not be easy to do. Mexico has negotiated many third-party free trade agreements, including one with European Union, and these will complicate any negotiation for a customs union.“ (Hakim

and Robert, 2004). Because of free labour movement in common market, the creation of such integration is not a solution to North America as well. Two of NAFTA countries are labour-importing (USA and Canada) and one is labour-exporting (Mexico). Considering not so big difference in GDP between the Canada and the USA the agreement of common migration is highly possible but that is totally different story than between the USA and Mexico. 70 millions of Mexican people (about 70% of Mexican population) answers in a survey that given the chance to legally immigrate to the USA they would take it without thinking. Action like this would economically devastate both countries. Not to mention the adjustment to common tariffs, which would be especially for Mexico really hard and maybe even impossible. Formation of common market in North America would probably result in higher immigration, rising number of unemployed people and dramatically changes in availability of jobs. The middle-class American would profit from cheap Mexican labour, on the other hand many people from lower class would lose their jobs because of them. The only solution to this problem is to eliminate the gap between the U.S. and Mexican salaries but even if the Mexican economy would grow three time faster than its neighbours it would take at least 20 years to reach half of the Canada's GDP per capita and to get to the half of U.S. GDP per capita Mexico would need more than 30 years. However more possible version is that the gap between countries will enlarge every year (Hakim and Robert, 2004; Newfarmer, 2006).

The reactions to this proposal were both positive and negative and even though no steps leading to the North American Community were made, Vincente Fox started a long discussion that now occupies almost every public opinion-maker in all three member countries. Although the possibility of creation of integration, which would be more than NAFTA is closely monitored neither U.S. president George W. Bush nor Canadian Prime Minister Jean Chretien responded to president's Fox's suggestion. The main progress was made at the beginning of 2000 when U.S. president G. Bush started to deal with the Mexican president about immigration issue but after September 11, all the possible agreement went out of the table. This terrorist attack in 2001 send the president's Fox's dreams about open labour market many steps back.

As visible in paragraphs above neither the customs union nor the common market is feasible solution for North America. The best option is to create a special integration

agreement with condition profitable for all member countries. One of possible condition would be acceptance of the same (unified) currency. Today's main business currency in North America is the U.S. dollar, which is used in all member countries so in case of dollarization the impact on economy would minimal. The only question is whether the USA will allow the other two countries to influence the U.S. monetary policy. According to survey, which was made during last couple of years, most people of Canada and Mexico are against acceptance of dollar as a unified currency but they are willing to consider possibility of having a totally new common currency (Hakim and Robert, 2004).

3.5 Did NAFTA help?

NAFTA had a positive impact on Mexico, which entered a process of economic convergence with respect to the United States, increasing trade, growth, and FDI. One of the most important years was 1995 when real wages quickly recovered from collapse, poverty rate decreased, and the GDP per capita gap between Mexico and United States was the best in years (the most favorable in all Latin American and Caribbean countries). But it was still not enough to ensure economic stability in North America. One of the biggest problems for Mexico remains inability to catch up with their northern neighbour's fastly growing economies due to lack of education and innovation (Newfarmer, 2006).

One of the biggest concerns for the USA was a possibility of Americans losing their jobs to immigrants. Before signing the NAFTA independent president candidate of United States H. Ross Perot (election 1992) predicted that because of creating such regional integration millions of Americans will lose their jobs. What happened was quite the opposite. The United States didn't particularly gain or lose many jobs because of NAFTA but after application of the agreement the most successful period of job creation in American history started. Because of barriers elimination the trade and investment almost doubled in quite short period of time. In these days Canada and Mexico are the largest markets of United States (about 85 percent of whole Canadian and Mexican trade is made with the USA) (Hakim and Robert, 2004).

4 Practical Part

Following chapters are discussing practical part of bachelor thesis.

4.1 Impact of NAFTA on Mexico

After the debt crisis in 1980s, Mexico entered the new century as a totally different country. After the implementation of NAFTA on January 1994 Mexico's export has been rapidly rising and the country is having the best economic situation in a long time. The export increased from \$39.9 billion in 1993 to \$131.4 billion in 2001. An example of fast growing industry would be farm exports, which almost tripled since NAFTA's implementation. The export is not the only thing effected by NAFTA. Since the agreement came into force, Mexico has shown stable currency, modest inflation and a lot of foreign investment. A lot of changes happened in political sector as well by victory of opposition candidate V. Fox in president election in 2000. Another positive effect was change in income inequality. Even though the difference is still high, it went slightly down after applying NAFTA (described in Figure 3 by using GINI INDEX). One problem which occurred is migration. After NAFTA came into force a lot of Mexicans went to work in the USA. During last two decades numbers more than tripled.



Figure 3 GINI index (Mexico)

Even though the annual % GDP varies each year, based on 2010 constant we can see that the GDP is continuously increasing since NAFTA came into force (Figure 4). The main drop occurred during 2008 crisis which we can see on annual % GDP.

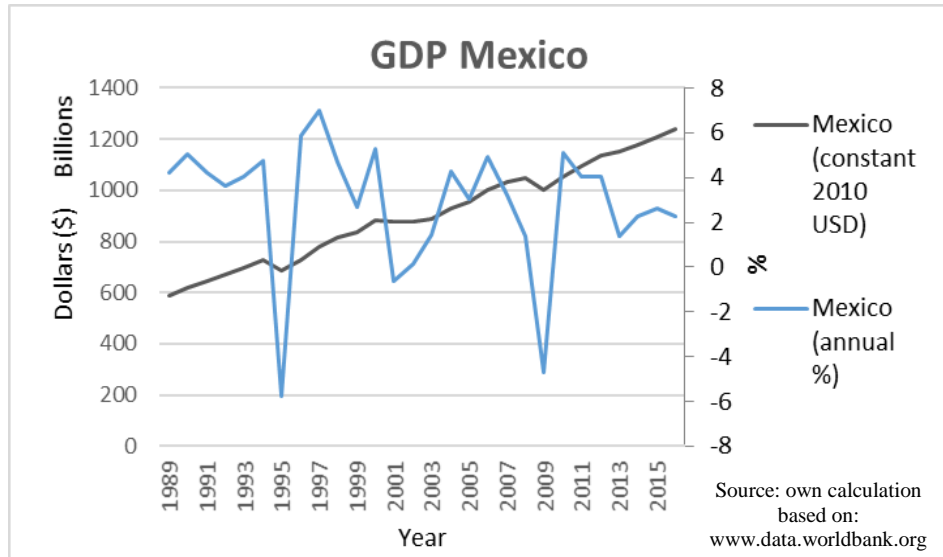


Figure 4 GDP (Mexico)

4.2 Impact of NAFTA on CANADA

As far as it seems, Canada's gains were the biggest among the three members of NAFTA. However, it is quite hard to determine that since Canada has free trade agreement with the USA even before NAFTA. Canada is the biggest exporter of goods to the USA, the U.S. and Mexican investment doubled since the implementation of NAFTA and high number of new position were founded in Canada in last couple of years (since 1993 over 4,7 million). Canadian GINI index (Figure 5) hasn't changed and remains in the line (around 33 each year with slight fluctuation). Also, number of unemployment decreases over time.

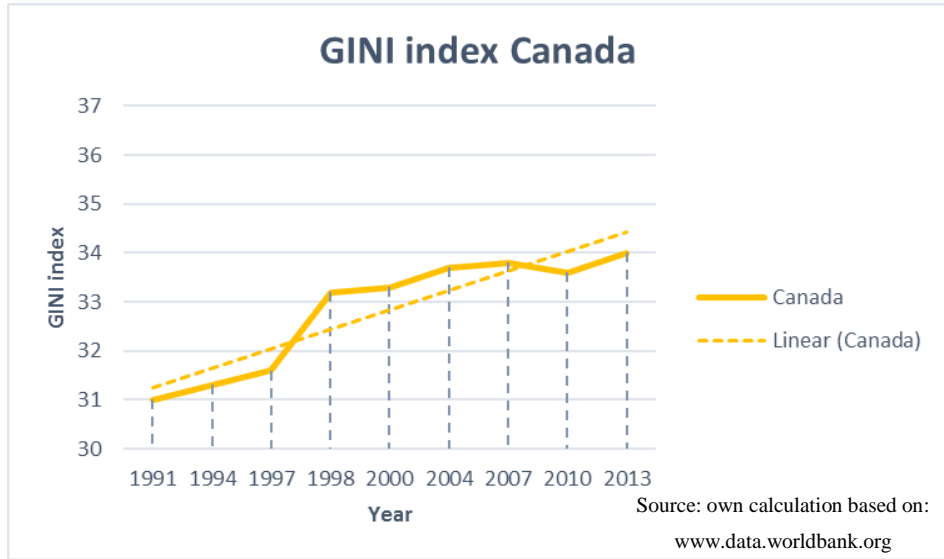


Figure 5 GINI index (Canada)

In case of Canadian GDP we can also see drop in 2008. Other than that the fluctuation looks normal. Based on constant 2010, we can see that the GDP is increasing over the years. In 1994 the GDP was around 1000 billion dollars and after NAFTA came in force the numbers went up. In 2015 the GDP was over 1800 billion dollars (Figure 6).

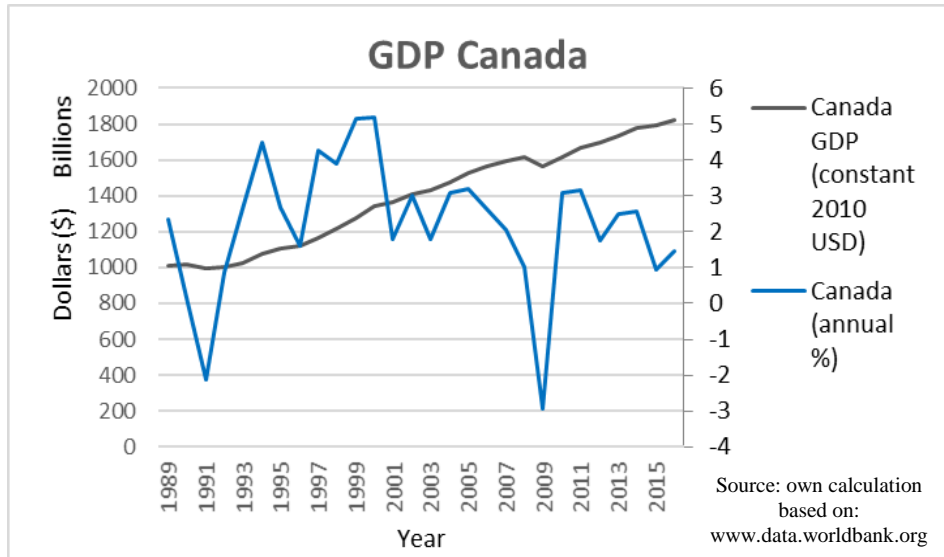


Figure 6 GDP (Canada)

4.3 Impact of NAFTA on the USA

Impact of NAFTA on U.S. companies depends on many factor including type of industry, sector of production, geographical location or size of enterprise. Some companies decided to move their productivity to Mexico with cheaper labour. Due to limitation of trade barriers many small, medium-sized or family businesses were strongly hit by higher number of cheaper multi-national competition. One of the main issues everyone was afraid about was higher number of cheaper Mexican labour in the USA. Expectations were that this might result in drop of real wages for Americans but real wages were almost not effected (Figure 7).

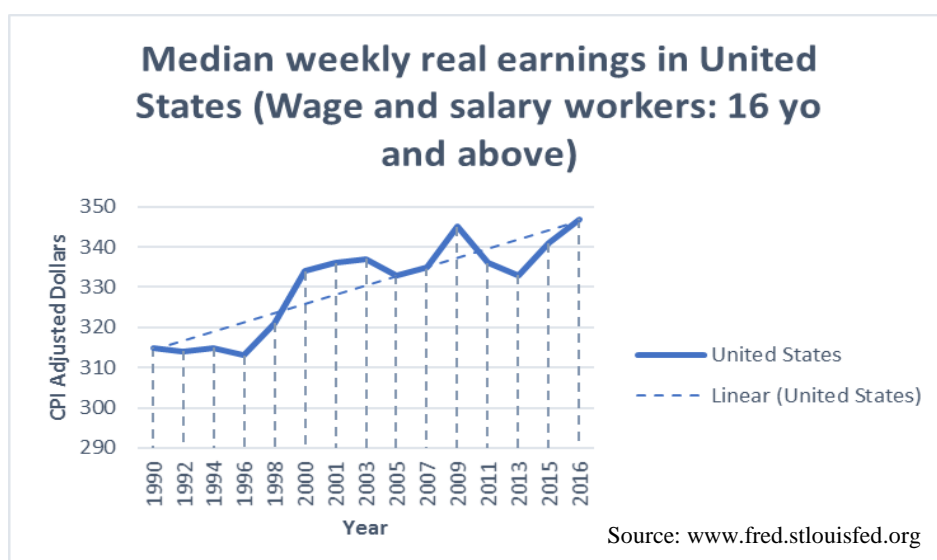
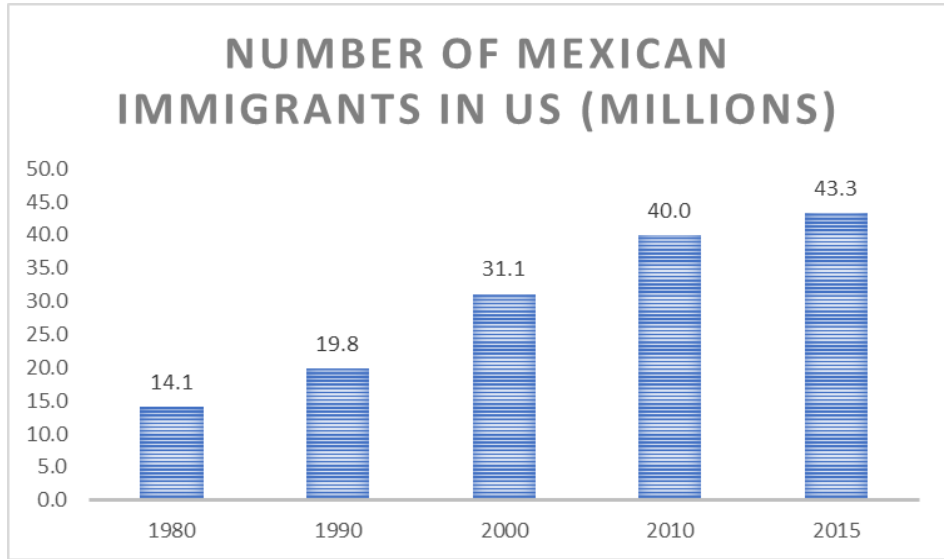


Figure 7 Median weekly real earnings (USA)

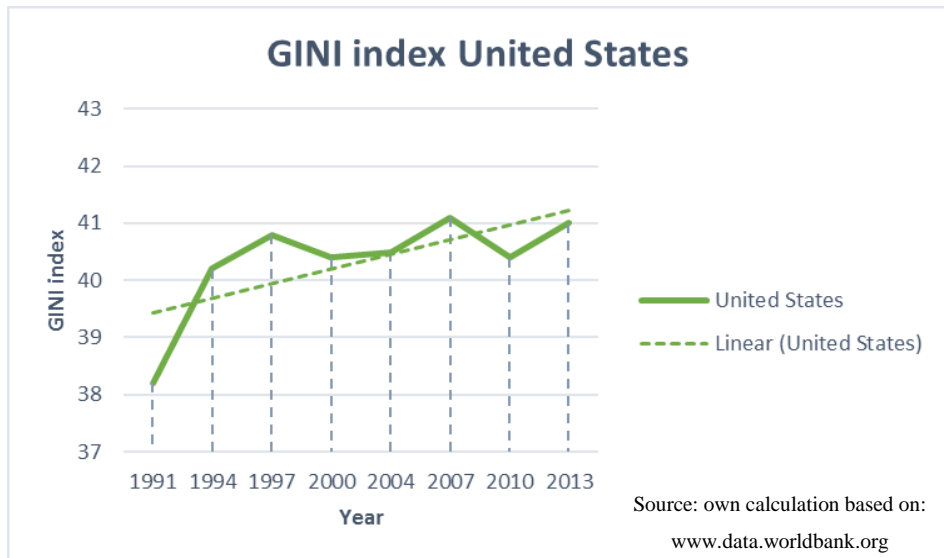
There was only slight fluctuation right after NAFTA came into force but during the years, real wages are growing without any significant change. Another possible problem is immigration. Before NAFTA, the number of Mexican immigrants living in the USA was equal to 14.1 million. After accepting NAFTA, numbers went quickly high and in 2015 the number more than tripled to amount of 43.3 millions (Figure 8).



Source: www.data.worldbank.org

Figure 8 Number of Mexican immigrants living in the USA

Based on the trendline of GINI index (Figure 9) graph we can see that it slightly increases over time but none of those changes are with big differences. This means that over all the inequality in the USA remains on the same level.



Source: own calculation based on:
www.data.worldbank.org

Figure 9 GINI index (USA)

The GDP gap in 2008 was in the USA enormous. We can see that even in 2015 the numbers are not back on the same level as before crisis. But based on 2010 constatnt we can see that GDP since 1990 to 2015 almost doubled (Figure 10).

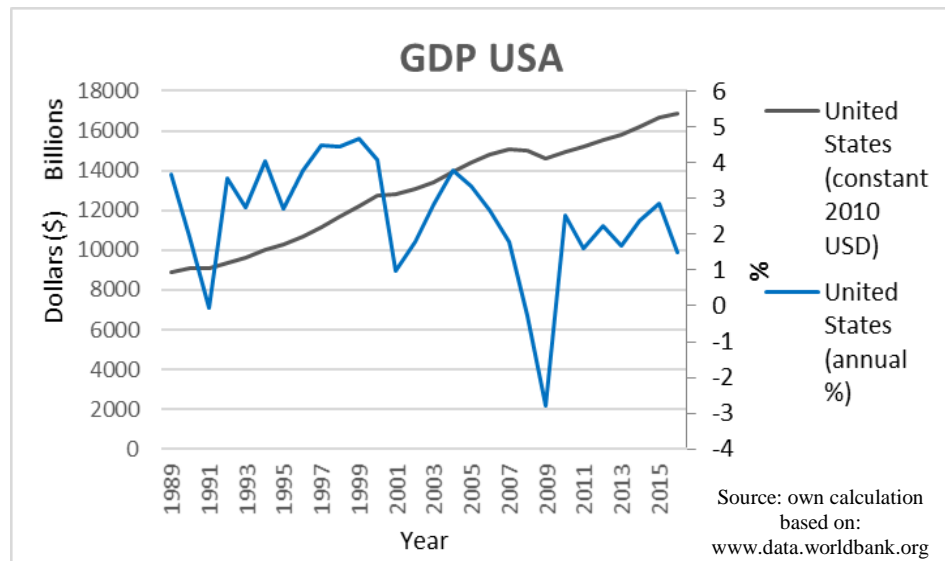


Figure 10 GDP (USA)

4.4 NAFTA's impact on unemployment

After the agreement came into force and trade barriers were lifted a lot of American companies moved their factories to Mexico where are the production costs cheaper. Thanks to this a lot of Mexicans gained new job positions. One of the most important industries that moved the production to Mexico was car industry. Main reason for this was to be able to keep up with Asian competition. There are many people arguing whether NAFTA cost Americans their jobs or it created much more opportunities for them. The comparison of unemployment rates between the years of 1993 and 1994 should tell us more (Figure 11).

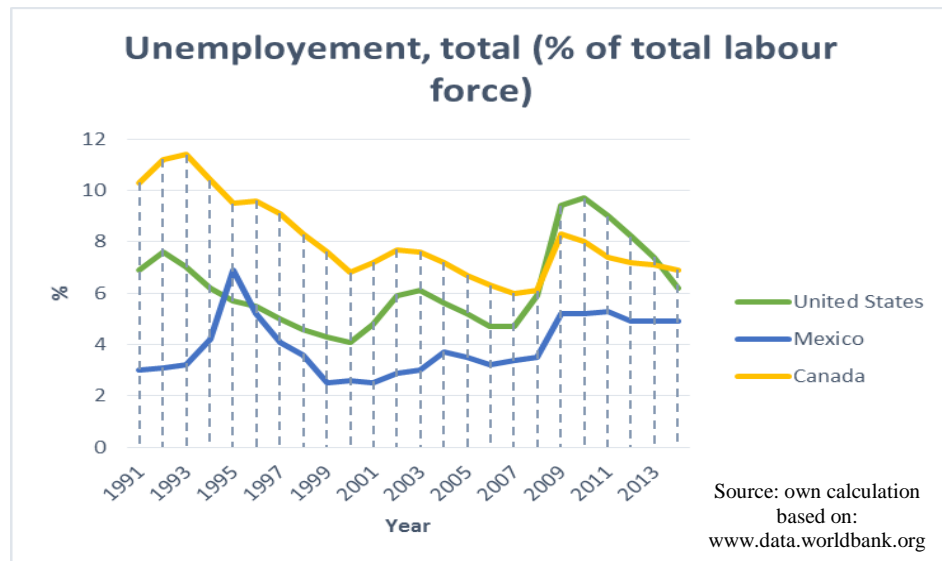


Figure 11 Unemployment (USA, Mexico, and Canada)

In January 1994, the U.S. unemployment rate went down to 4.8% from 6.5% in 1993. During another couple of years, the rate went down until 2001 when tech bubble's burst caused it to pick up a bit. In a chart above we can also notice a fluctuation cause by 2008 financial crisis in all countries but after 2011 unemployment rate is coming back down. In long term the effects on unemployment rate of all three countries were modest.

4.5 NAFTA's impact on foreign direct investment

As we can see in Figure 12 the U.S. foreign investment grew rapidly after NAFTA came into force. It grew from \$51.38 billion in 1993 to \$379.434 billion in 2015. We can see light fluctuation during 2001 and after 2008 due to unfavourable conditions but other than that NAFTA had mostly positive effect on foreign direct investment. The trendline shows us clear imagine of the evolution of foreign direct investment.

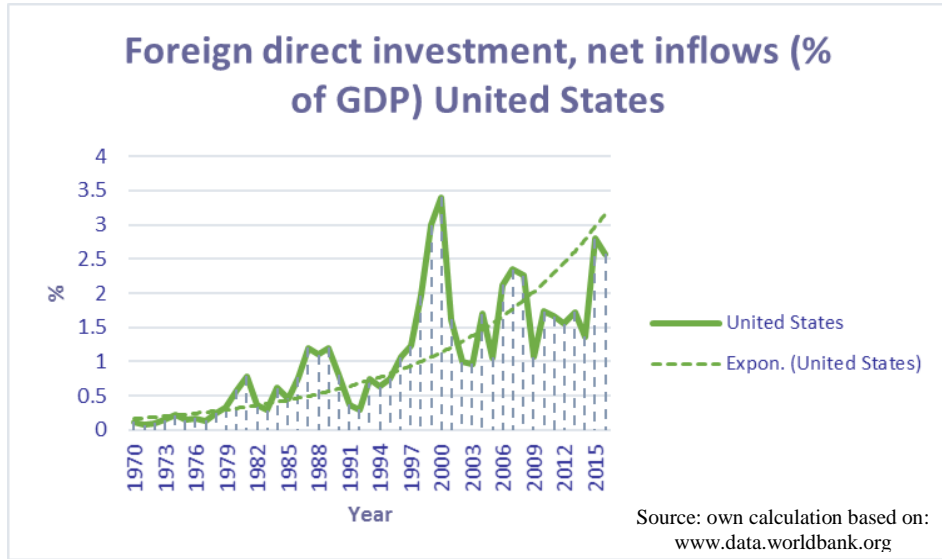


Figure 12 Foreign direct investment (USA)

Mexico’s investment increased from \$4.389 billion in 1993 to \$32.056 billion in 2015. Foreign direct investment percentage of GDP increased from 0.87% in 1993 to 3.24% in 2016 (Figure 13).

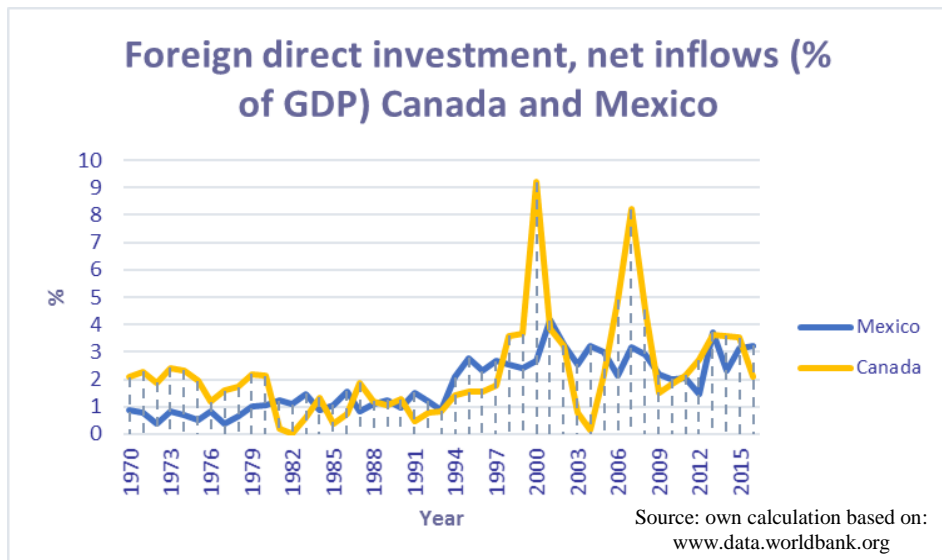


Figure 13 Foreign direct investment (Mexico and Canada)

Canada’s investment increased from \$4.749 billion in 1993 to \$55.685 billion in 2015. Foreign direct investment percentage of GDP increased from 0.82% in 1993 to 2.09% in 2016 (Figure 13).

4.6 Change in foreign trade

For all three member countries, both import and export radically changed after the NAFTA came into force. This will be discussed in the following chapters covering total trade of each country as well as trade between member states.

4.6.1 Import

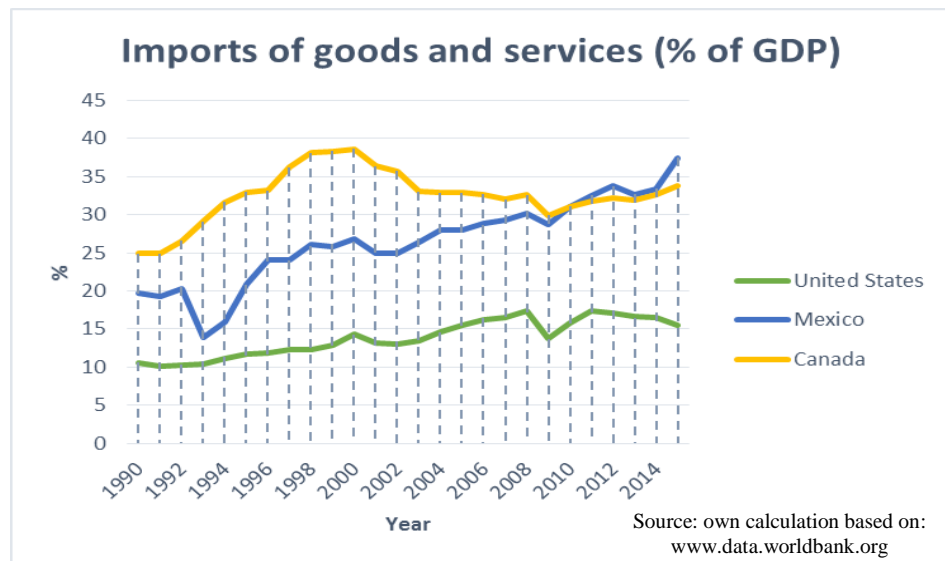


Figure 14 Imports of goods and services (% of GDP - USA, Mexico, and Canada)

Since NAFTA came into force in 1994 the U.S. trade with other two member countries has more than tripled. U.S. total import increased from \$720 billion in 1993 to \$2,786 billion in 2015. In 2015 three main importers to United States were China, Canada and Mexico from which two of those countries are members of NAFTA agreement. While Canada's export to the USA decreased since 1993 by approximately 4%, Mexico's grew from \$40 billion to \$297 billion. Together both countries count for 26% of total U.S. import.

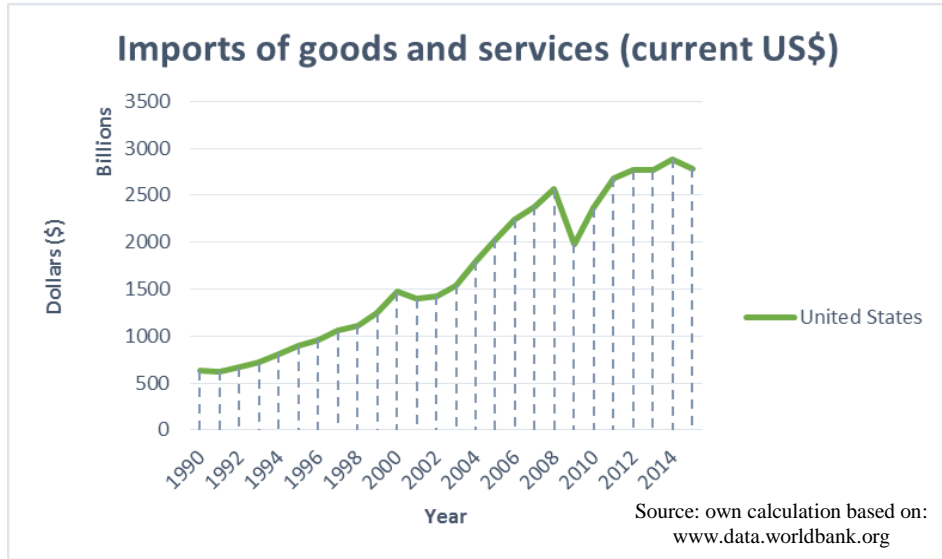


Figure 15 Imports of goods and services (current US\$ - USA)

Mexico’s import grew up most than six times from \$70 billion in 1993 to \$429 billion in 2015. About 47% of imported goods totally worth of \$187 million are from United States. Second biggest trade partner is China with 17% share of total Mexican import. One of the most important things that is being imported are petroleum oils (in 2015 petroleum oils that were imported equaled the amount of \$19 billion, in 1993 it was only \$1 billion).

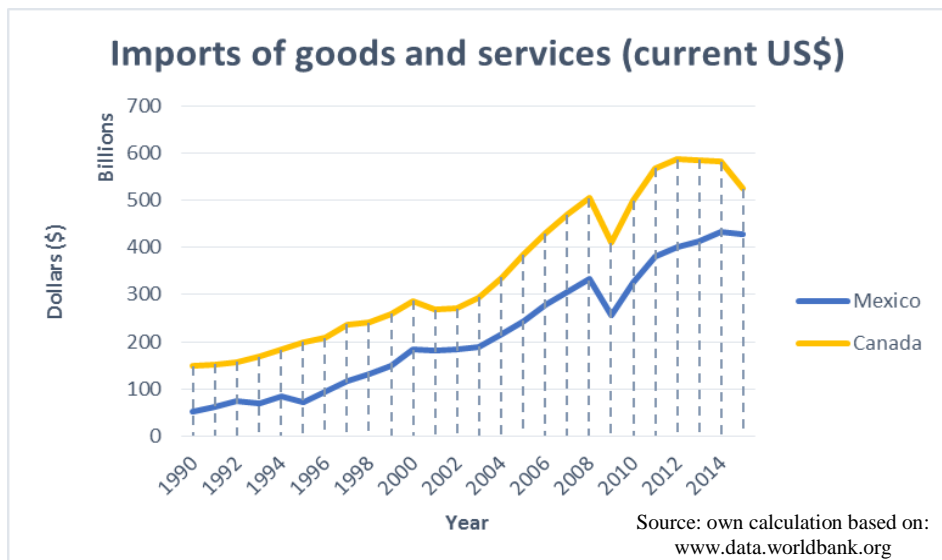


Figure 16 Imports of goods and services (current US\$ - Mexico and Canada)

Canada’s import increased from \$168 billion in 1993 to \$525 billion in 2015. About 53% of total import in 2015 to Canada came from United States. Car industry is remaining

one of the most important industries in Canada. During the years, number one imported good are still automobiles with reciprocating piston engines mainly from the USA.

4.6.2 Export

The USA export increased from \$655 billion in 1993 to \$2,264 billion in 2015. In 2015, Canada was number one leading market for U.S. export and Mexico was second. Together it's more than 34% of total U.S. export with automobiles with reciprocated piston engines and petroleum oils being the main exports in 2015.

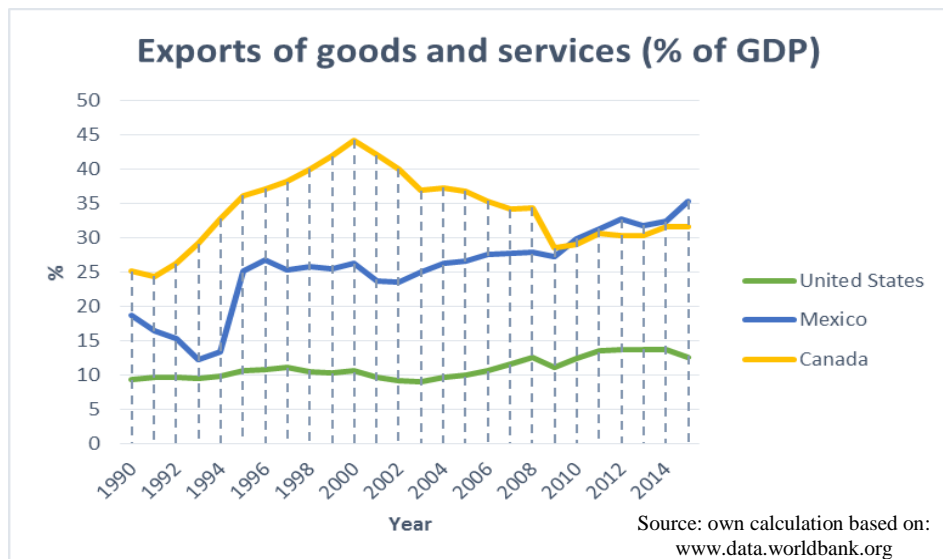


Figure 17 Exports of goods and services (% of GDP - USA, Mexico, and Canada)

Mexico's export grew from \$61 billion in 1993 to \$404 billion in 2015. The USA being Mexico's number one export market (over 80% of total Mexican export in 2015 was to the USA). Canada was ranked as a second with export worth of \$10 billion.

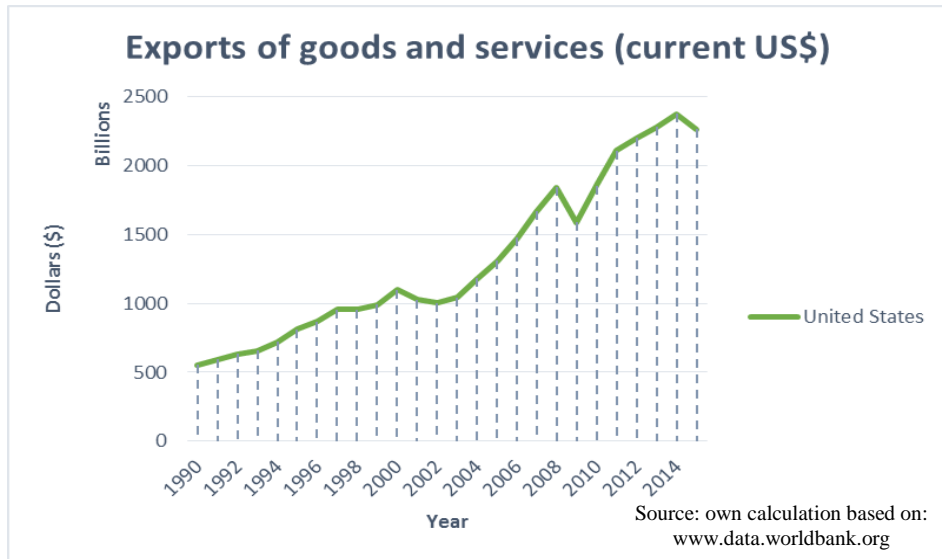


Figure 18 Exports of goods and services (current US\$ - USA)

Canada's export increased from \$168 billion in 1993 to \$489 billion in 2015 and about 76% of total export in 2015 was to the USA. Export to Mexico which almost didn't exist in 1993 grew to 5 billion a year in 2015.

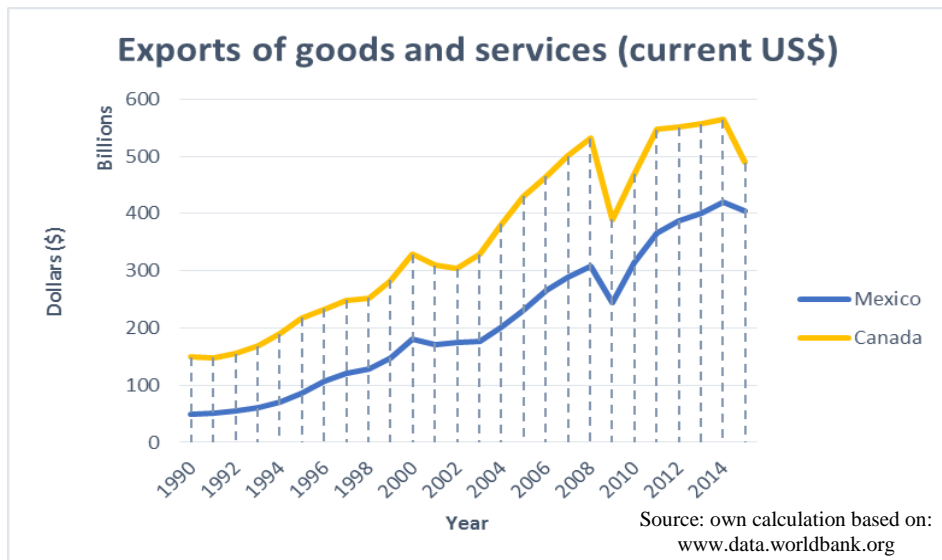


Figure 19 Exports of goods and services (current US\$ - Mexico and Canada)

5 Discussion

5.1 Change in trade volumes and economic growth

As we can see in Table 2, the real trade between all countries almost doubled. This was possible thanks to elimination and reduction of tariffs. Total trade between all countries increased from \$288,460 to enormous \$1,034,104.

Trade volumes (million USD)			
Channel	1993	2015	Real increase
U.S.-Canada	\$199,184	\$518,217	63.5%
U.S.-Mexico	\$85,224	\$481,543	255.0%
Mexico-Canada	\$4,052	\$34,344	432.5%
Trilateral	\$288,460	\$1,034,104	125.2%

Source: www.bls.gov

Table 2 Trade volumes

From 1993 to 2015, Canada's GDP per capita increased from \$20,017 to \$43,248, Mexico's grew from \$4,080 to \$9,005 and the U.S. GDP per capita went up from \$26,464 to \$56,115. Mexico's GDP per capita has grown more slowly than both other countries which is quite surprising. It is often for emerging market economies to grow faster than those developed.

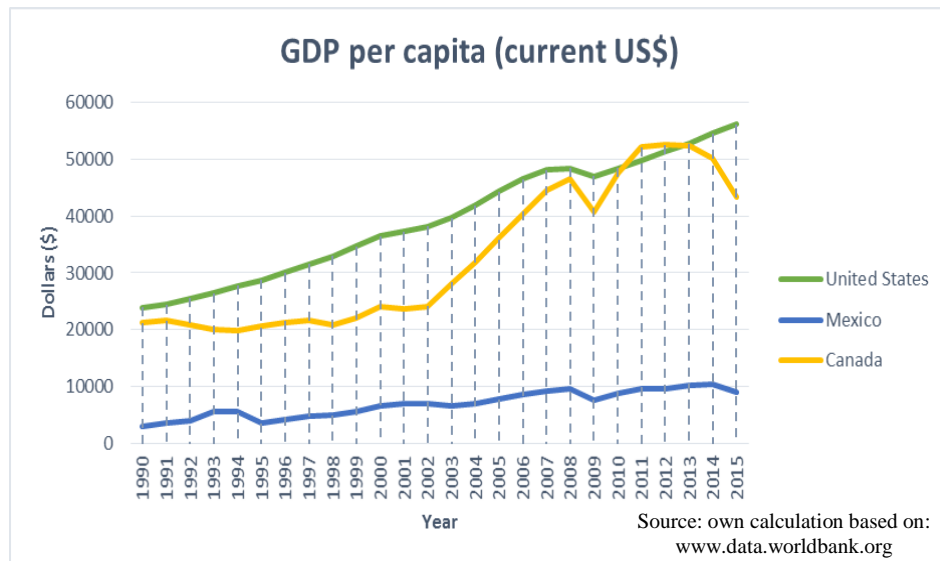


Figure 20 GDP per capita (USA, Mexico, and Canada)

5.2 Future of NAFTA

After the election of new president Donald Trump on 8th November 2016 the future of NAFTA is really uncertain. According to president Trump the North American Free Trade Agreement isn't fair and USA is suffering under it. "I have very serious concerns about NAFTA. NAFTA's been a catastrophe for our country." said Donald Trump (Dale, 2017). He also said: "I want to change it. And maybe we do it – maybe we do a new NAFTA, we put an extra F in the term NAFTA. You know what the F is for, right? Free and fair trade. Not just free trade: free and fair trade. Because it's very unfair." His plan is to rework 23 years old agreement so it would be more favorable for USA. He promised to negotiate better conditions for USA than those that are in current agreement. President's main concern is unfair trade conditions with Mexico. "The U.S. has a 60 billion dollar trade deficit with Mexico. It has been a one-sided deal from the beginning of NAFTA with massive numbers..." (Trump). The truth is that both countries have benefited from the agreement but Mexico has been the bigger winner who gained more (Bartash, 2017). On the other hand business relationships with Canada are really unique and president Trump plans to enhance them even more. The main reason are millions of job positions on both sides of borders which are all dependent on trade conditions between the USA and Canada. "It is difficult to overstate the importance of Canada's relationship with the United States.

About 2.5 million Canadian jobs are tied directly to trade with the United States, which accounts for about one quarter of Canada's gross domestic product.” (Austen, 2017)

NAFTA is not a first free trade agreement president Trump's not satisfies with. On Monday 23rd of January 2017 he withdraw from signing the TPP (Trans-Pacific Partnership or the Trans Pacific Partnership Agreement), which is a trade agreement between Australia, Brunel, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. The TPP should have been the largest free trade zone in the world but according to president Trump it was not advantageous for USA. He even called it “a rape of our country” (Wright, Blanchard, 2016).

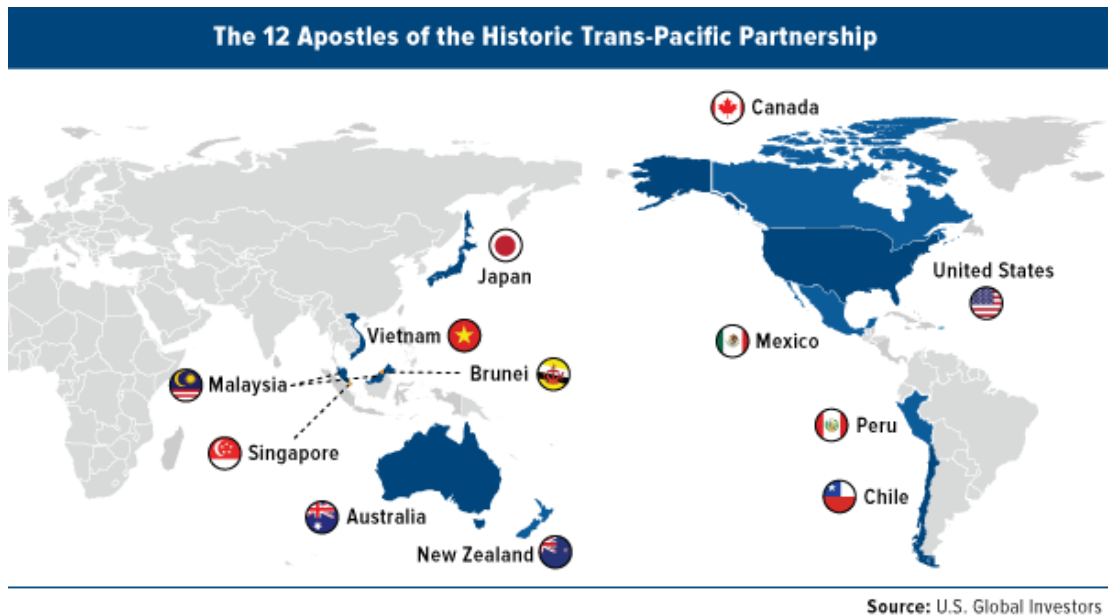


Figure 21 TPP

5.2.1 What might change with president Trump's wall?

One of the main campaign promises president Trump made was to build a wall on the USA border with Mexico. The border cuts through private lands, cities, desert, mountains and wildlife reserves. Together it's over 2,000 miles from which 650 miles has been already covered by fence most of which was built after 2006 during President George Bush's administration (mainly along western half – California, Arizona and New Mexico). President Trump also said that about 1000 miles would be covered by nature barriers but even with this the wall will be long and expensive. Which leads to one of the biggest

questions, who is going to pay for it? And how is it going to affect both countries and NAFTA? (Ingold, Whiteaker, Rojanasakul, Recht, Halford, 2017)

As mentioned above one of the biggest concerns is who is going to pay for the wall. President Trump recently proposed the idea of using a 20% tax on goods imported from Mexico to pay for it. The U.S. imported over \$300 billion from Mexico in 2015. It is not hard to calculate that 20% of that would be \$60 billion which is more than enough to build the wall. By this president Trump is trying to force Mexico to pay for the wall but it's not that simple as it looks. Even if government will support president Trump's idea the one who will most likely pay for it will be Americans. Import and export between both countries will be terribly disturbed and that is going to affect both countries. First, forcing Mexico to pay 20% tariffs will only result in increasing prices of goods imported from Mexico to the USA. At the end Americans are those who are going to pay more for everything imported from Mexico starting with avocados and Mexican beer to electronics, and cars. It wouldn't be only Mexican export that would be hit hard by the wall. Many U.S. companies are producing parts of their products in Mexico because of cheaper costs. By applying 20% tax tariffs those parts would become much more expensive and many companies won't be able to afford it. This could result in losing jobs and increase in prices even for American products. Second, over 6 million people are having jobs strongly dependent on trade with Mexico and those jobs will in jeopardy. Losing so many job positions would be catastrophic for USA. Even if the tariffs happen against the all odds the USA can expect Mexico to revenge and no one knows how strong and disruptive the reaction will be. It may cause even more problems than is president Trump trying to solve. One of the possible reaction could be removing tax benefits for US foreign investment which would be fatal for many investors as estimated foreign investment in Mexico was over \$101 billion in 2013. (Gillespie, 2017)

Another idea how to pay for the wall are remittances. Almost half of the Mexicans working in the USA are sending some money back home to their families. Together it's over \$25 billion a year. There are two different way how Americans can make remittances to pay for the wall. One is to tax them and the other is to use law enforcement to make it illegal to transfer the money. In both cases it will be really easy for Mexicans to find a

third party and not use banks for money transfer (Us and Canada rubrique - Unknown, 2017).

Another proposition is to increase travel visa and border crossing fees. This would be mainly focused on countries with multiple records of illegal immigration. This plan is really realistic and wouldn't have many bad consequences as others. Unfortunately, money earned from it wouldn't be enough to cover all the costs needed to build the wall. (Us and Canada rubrique - Unknown, 2017).

Whatever will be the end one thing is sure. Building the wall will strongly effect NAFTA and its conditions.

6 Conclusion

The main goal of this bachelor thesis was to determine whether the North American Free Trade Agreement brought more advantages or disadvantages to the member countries. And whether it helped the overall economic situation of each country. To determine this, the methodology of quantitative research such as statistical and mathematical methods were used.

After conducting the practical part and going through its results we can say, that overall effects of NAFTA were mainly positive. Based on GDP volume, import, export and foreign direct investment we can assume that economic situation in all member countries has increased. Each country had some fluctuation over the years but most of it can be reasonably explained (part of economic crisis in 2008 or other recognized variables). Even the arguments which are commonly used as bad results of NAFTA were disproved. Example of this would be increase (in real life decrease) in unemployment rate of United States as well as in other two countries.

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