

# ISSUE BRIEF

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## Advancing Economic Freedom Is the Right Way to Move Forward with Trade

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On May 18, 2017, U.S. Trade Representative Robert Lighthizer notified Congress of the Trump Administration's intent to modernize the North American Free Trade Agreement (NAFTA). Since then, six rounds of intense negotiations have taken place among the U.S., Canada, and Mexico, with the seventh round scheduled to take place in Mexico City from February 25, 2018, to March 6, 2018.

The U.S. economy would suffer a major setback if the Administration terminates NAFTA. Imperfect it may be—with fine-tuning to reflect advances in technology and energy trade needed—but NAFTA has numerous benefits. Thousands of U.S. companies have created innovative supply chains and production processes that depend on the openness of the North American marketplace. In addition, the 24-year-old NAFTA has allowed consumers to enjoy lower prices for such products as clothing, electronics, and household goods of all types, not to mention year-round access to fresh fruits and vegetables.

Given the lack of progress in the negotiations, there is a real possibility of economic harm from a reduction in economic cooperation between the U.S., Canada, and Mexico. The Administration should complete the negotiations as soon as possible, pocket the agreed-to improvements in the agreement, and

focus economic policy on further domestic reforms that build on recent achievements in tax reform and deregulation. Further efforts to liberate the U.S. economy from the government straightjacket in which it has operated over the past decade, far more than NAFTA reforms, will bring about positive economic results *and* solve many of the problems that have been attributed to NAFTA.

### **Real Solutions Begin at Home, Not Abroad**

In the popular imagination and in the U.S. political process, NAFTA has borne much of the blame for the economic malaise that the country has suffered during the past decade. In economics and politics, however, the easy answer is often not the right answer. Counterintuitive as it may sound, America's economic problems, including those attributed to trade, begin at home, not abroad. Bad tax and regulatory policies and excessive government spending crowd out private investment and initiative. If the Trump Administration wants to address the problems that American workers typically attribute to NAFTA, like job losses and factory closures, it should focus, not on the agreement itself, but on domestic reforms that will advance America's overall economic freedom and competitiveness.

The conventional U.S. trade negotiation roadmap seeks to address the competitiveness problem solely through changes to trade rules—such as tariffs, rules of origin, trade remedies, and dispute settlement. However, this approach alone does not effectively resolve the structural issues that make America less competitive.

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This paper, in its entirety, can be found at  
<http://report.heritage.org/ib4820>

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## Assessing U.S. Economic Freedom

Since 1995—when NAFTA was being put into practice—The Heritage Foundation’s annual *Index of Economic Freedom* has measured degrees of entrepreneurial capacity and competitiveness in countries around the globe.<sup>1</sup> The *Index*, a data-driven benchmark study of economic policies that evaluates key policy areas such as open trade, investment, and regulatory efficiency, is about more than just country rankings. It is an exploration into the sources of what makes an economy grow and how they relate to each other.

In terms of ensuring greater opportunity and lasting prosperity, the *Index* provides strong evidence that the forces of individual freedom, limited government, and free enterprise trump big government policies that perpetuate favoritism in economics and politics. Maintaining a high degree of economic freedom and enhancing it further have measurable positive effects. By generating more opportunities for a greater number of people to produce and work in a dynamic economy, countries achieving higher levels of economic freedom steadily outpace others in economic growth and long-term prosperity. In contrast, those countries that lose economic freedom with ill-guided policy choices are saddled with economic stagnation, high unemployment, and deteriorating social conditions.

The U.S. has not performed well in the *Index* over the past decade, largely as the result of conscious policy stances that opted for big government and more regulation during the Obama Administration. The substantial expansion of the U.S. government’s size and scope that occurred, along with increased regulatory and tax burdens in many sectors, severely undermined the U.S.’s global competitiveness.

As the 2018 *Index* reports, the backsliding of America’s economic freedom has come to a halt, with some early signs of robust economic expansion reinforced by major regulatory and tax reforms that have elevated business confidence and investment.<sup>2</sup> Unlike anything seen in 13 years, the U.S. economy

notably recorded sustained growth of around 3 percent for three consecutive quarters.<sup>3</sup> Additionally, small-business optimism is at an all-time high.<sup>4</sup>

The U.S. economy is becoming more vibrant and the coming years present an opportunity to implement economic-freedom-advancing policies.

## Capitalizing on Growth Momentum

The Trump Administration should build upon this new momentum for growing economic freedom, not disrupt it with protectionist trade policy. Reducing the corporate tax rate was an important step to freeing capital for investments in the U.S. Cutting government spending is equally critical to enhancing economic freedom and improving overall economic performance. Changes to trade policy alone are unlikely to reduce the trade deficit, and could in fact widen it if other countries respond to U.S. protectionism with trade restrictions of their own. Such a course of events would lead to lower growth and reduced prosperity for U.S. individuals and businesses.

Delivering on policies that will promote economic freedom in the U.S., whether they increase regulatory efficiency or expand market openness, will draw companies to the U.S. and make U.S. manufacturers, producers, service providers, farmers, and workers more competitive. Policy changes should aim to accomplish the following:

- **Make it easier for U.S. companies to compete globally.** The biggest threat to U.S. prosperity has come from the decline in economic freedom in the nation. In 2010, for the first time ever, the U.S. fell from the ranks of the economically free in the *Index*. An uptick in the U.S. economic freedom score in the 2018 *Index* is welcome news, and reflects the Trump Administration’s achievements in deregulation and tax reform. The critical role such policy changes have in restoring the U.S. to its rightful place as a world leader in economic freedom cannot be overemphasized. As

1. Terry Miller, Anthony B. Kim, and James M. Roberts, 2018 *Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2018), <http://www.heritage.org/index>.

2. Ibid.

3. Patti Domm, “Trump Economy’s Sustained Growth Pace Unlike Anything Seen in 13 Years,” CNBC, January 12, 2018, <https://www.cnbc.com/2018/01/12/trump-economy-sustained-growth-pace-unlike-anything-seen-in-13-years.html> (accessed February 21, 2018).

4. News release, “Small Business Optimism Hits Near All-Time High,” National Federation of Independent Business, December 12, 2017, <https://www.nfib.com/content/press-release/economy/small-business-optimism-hits-near-all-time-high-2/> (accessed February 21, 2018).

President Trump elaborated in his recent speech at the World Economic Forum in Davos, Switzerland: “America First does not mean America alone. When the United States grows so does the world.”<sup>5</sup> Keeping in mind that negative actions on trade will undercut the benefit from the recent tax and regulatory overhaul, the Administration should continue to pursue regulatory, spending, and other ongoing reforms that increase America’s economic freedom and competitiveness.

- **Collaborate with Canada to encourage Mexico to adopt policies that will advance its economic freedom.** Mexico’s economic health is critical to the prosperity and national security of the U.S. Mexico’s \$2 trillion economy, which remains “moderately free” in the *Index of Economic Freedom*, has quadrupled in size since the implementation of NAFTA in 1994. The Mexican government continues to emphasize economic restructuring. For example, it has passed and implemented sweeping energy, financial, fiscal, and telecommunications reform legislation with the long-term aim of improving competitiveness and economic growth across the economy. However, more dynamic and sustained economic growth for a greater number of Mexicans is constrained by low productivity, an informal labor sector making up more than half the workforce, fragile rule of law, and corruption. The Trump Administration should make confronting the many challenges facing our southern neighbor a priority in both foreign and domestic policy. As the economy of Mexico becomes more free and more prosperous, democratic reforms will advance as well.

## Open Trade and Investment: The Path Forward

At his final State of the Union address, in 1988, President Ronald Reagan told Congress:

One of the greatest contributions the United States can make to the world is to promote freedom as the key to economic growth. A creative,

competitive America is the answer to a changing world, not trade wars that would close doors, create greater barriers, and destroy millions of jobs. We should always remember: protectionism is destructionism. America’s jobs, America’s growth, America’s future depend on trade—trade that is free, open, and fair.<sup>6</sup>

Trade has had a major role to play throughout U.S. history. The Founders cited Britain’s “cutting off our trade with all parts of the world” as a reason for declaring independence.<sup>7</sup> The freedom to trade is the foundation of America’s modern economic system that provides unprecedented opportunities for individuals to achieve greater economic freedom and prosperity.

Pulling out of NAFTA would be a major setback for the U.S. economy. Any agreement can be improved and modernized, but politically driven negotiations will not transform NAFTA in a positive way, and might do considerable harm. At present, the U.S. economy is picking up steam. Now is not the time for protectionist policies in the guise of NAFTA renegotiation that will reduce Americans’ economic freedom and undermine the benefits of the recent tax cuts and regulatory rollback.

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5. President Donald J. Trump, “Remarks to the World Economic Forum,” The White House, January 26, 2018, <https://www.whitehouse.gov/briefings-statements/remarks-president-trump-world-economic-forum/> (accessed February 21, 2018).

6. President Ronald Reagan, “Address Before a Joint Session of Congress on the State of the Union,” January 25, 1988, [http://reagan2020.us/speeches/state\\_of\\_the\\_union\\_1988.asp](http://reagan2020.us/speeches/state_of_the_union_1988.asp) (accessed February 21, 2018).

7. The Heritage Foundation, *Solutions 2018: The Policy Briefing Book*, <http://solutions.heritage.org/promoting-economic-growth/trade/>.