Advantages, Disadvantages and the Future of NAFTA

Remarks by Luis Ernesto Derbez-Bautista
at the School of Law of the University of Colorado
October 6, 2011

Introduction

On October 11, 1998, at the height of the global economic crisis, Merrill Lynch ran full-page ads in major newspapers throughout America to drive the point home that globalization was good for the people of the United States. The ads read as follows:

The World Is 10 Years Old

> *It was born when the Wall fell in 1989. It's no surprise that the world's youngest economy – the global economy – is still finding its bearings. The intricate checks and balances that stabilize economies are only incorporated with time. Many world markets are only recently freed, governed for the first time by the emotions of the people rather than the fists of the state. From where we sit, none of this diminishes the promise offered a decade ago by the demise of the walled-off world ... The spread of free markets and democracy around the world is permitting more people everywhere to turn their aspirations into achievements. And technology, properly harnessed and liberally distributed, has the power to erase not just geographical borders but also human ones. It seems to us that, for a 10-year-old, the world continues to hold great promise. In the meantime, no one ever said growing up was easy.*

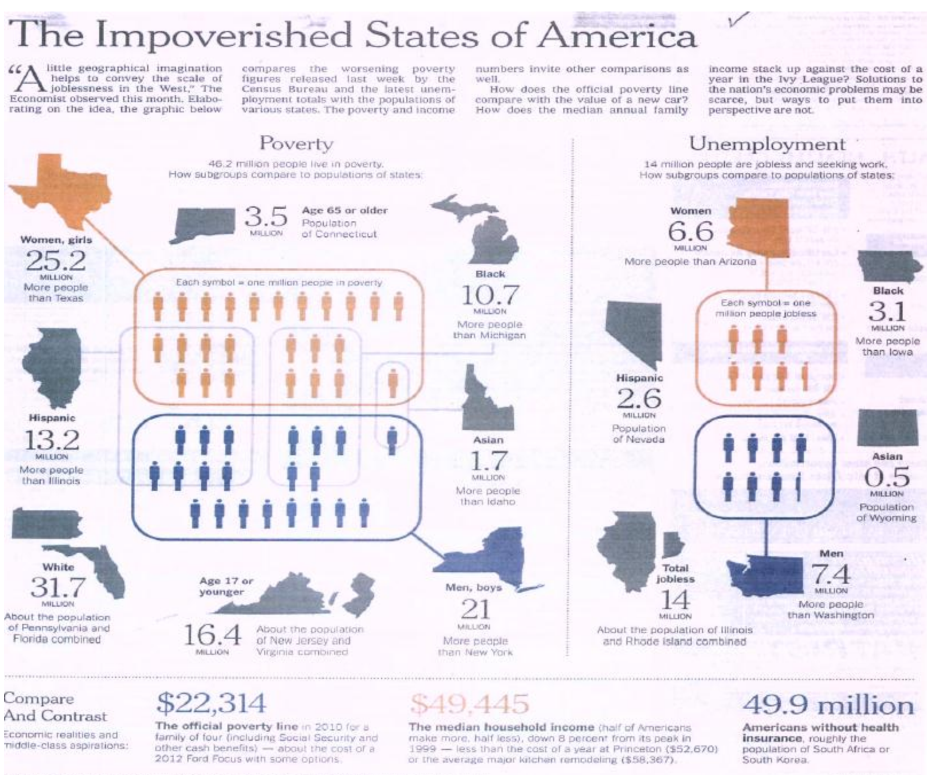
In the early hours of September 15, 2008, after 158 years, Merrill Lynch´s fate was in the hands of bankruptcy administrators; the financial firm who had run those ads had ceased to exist because of its incapacity to handle major losses from their global financial operations. Hours later, another old lady of the financial world, Lehman Brothers, disappeared after its shares dropped 94 percent at New York´s Stock Exchange. A company that in February 2008 had a market value of $46 billion was worth on that day only about $145 million. The fate of these two companies was simply the tip of a financial iceberg which started a world-wide crisis pushing the world into the deepest recession it had faced since the 1929 Great Depression. Despite government interventions, which brought fiscal disequilibria for all governments in developed nations, the financial crisis lingers, while the developed world remains burdened by the highest unemployment levels in over 70 years, unsustainable fiscal deficits and strong prospects of facing a new recession.

Why did we all miss the signals of economic fragility that the markets had sent us during the 2000-2007 boom years created by a housing bubble? Why did we think that global markets would function differently under globalization? Why did we not recognize the need to invest in new technologies to remain competitive? In my opinion not because globalization is bad for the world, but because we became obfuscated by greed!

Indeed, market globalization is good as it allows better trade and openness amongst nations, but it also magnifies the results of errors and poor judgment of individuals, firms and countries alike. It might bring great benefits for the people of any nation, but as we have witnessed, it can also transform itself into an economic disaster if those who manage governments mishandle economic policies. According to Sylvia Nasar[1], the balance of the past ten years under the Bush and Obama Administrations is:

> *"An emergency is what the US is having now, of course. Unemployment has been stuck around 9 percent for more than two years. Business is treading water. Families have less cash to spend. Markets are in turmoil. All our old anxieties have us by the throat again: the American Dream is dead; the middle class is disappearing; our children won't live as well as we do. Never mind that similar fears proved groundless in the past. When you're scared in the middle of the night, it's almost impossible to imagine morning*."

The graph below, taken from a recent issue of the New York Times, supports such words of despair.



[1] New York Times, September 17, 2011

And yet as we face the deepest economic crisis the world has confronted since 1929, we must imagine our "*morning*" by recognizing that "everything is possible, but nothing is certain"[2].

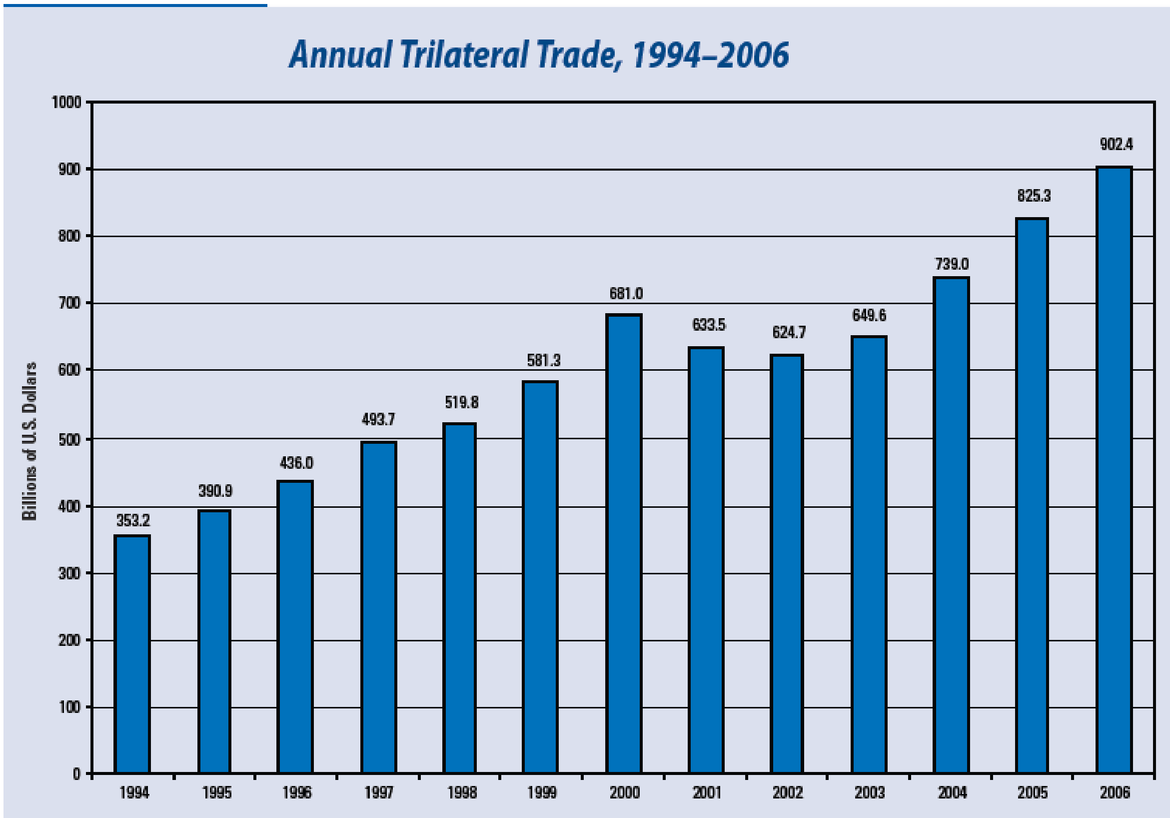
Thus it is not the time to abandon our commitment to the opening of trade, deregulation of markets, healthy public finances, responsible monetary policy, and greater involvement by the private sector in the economy. I cannot think of a better way for the United States, Mexico and Canada to achieve these goals, than by looking at NAFTA as the vehicle which will permit them to counteract successfully the effects of the current recession in the world.

First: NAFTA works!

On June 12, 1991, formal negotiations on a Free Trade Agreement between Canada, United States and Mexico, better known as NAFTA, were launched in the city of Toronto. The treaty was signed on December 17, 1992; it entered into force on January 1, 1994. One of the major objectives of NAFTA was the promotion and safeguard of foreign direct investment between nations; an important objective to reach higher levels of employment and increased competitiveness in all three countries. At the signing ceremony, the Heads of State were confident that such an agreement would lead to promoting employment through trade between its partners.

Despite its critics, NAFTA's record is clear: by lowering trade barriers, the agreement has expanded trade, increased employment, provided more choices for consumers at competitive prices, and increased prosperity for all three countries. NAFTA created the world's largest free trade area with about 450 million people and $17 trillion worth of goods and services. Since it came into force in 1994, trade has blossomed, investment has increased, and all three countries have become more competitive. Over 39 million NAFTA related jobs have been created and the benefits of expanding trade have flowed to businesses, farmers, workers, and consumers all over the region. From 1993 to 2008, trade among the NAFTA countries more than tripled, from $288 billion to $902 billion. On average, each one of the NAFTA countries conducts nearly $1.9 billion in daily trilateral trade.

[2] Those words were first said by the Czech Republic´s First President, Vaclav Havel.



NAFTA has been good for Mexico but so it has been for the United States. Although the U.S. goods trade deficit with NAFTA was $95 billion in 2010, U.S. goods and services trade with NAFTA totaled $1.6 trillion in 2009. In particular, trade in services with NAFTA (exports and imports), an important sector for the US totaled $99 billion in 2009. Services exports were $63.8 billion. Services imports were $35.5 billion. The U.S. services trade surplus with NAFTA was $28.3 billion in 2009 (latest data available for services trade). As of 2010, the United States had $918 billion in total (two ways) goods trade with NAFTA countries. Goods exports totaled $412 billion; goods imports totaled $506 billion.

An interesting success story for the United States is the role that NAFTA has played in making US agricultural goods more competitive. From the 1990s up until recently, the US share of world agricultural trade had been slipping. Thanks to NAFTA that slippage was reduced as Canada and Mexico´s demand for US agricultural goods increased. As a result, 37% of the total growth of U.S. agricultural exports since 1993 came from NAFTA and the share of US products in Canada’s agricultural imports has climbed to 65 percent, while that of Mexico reached 75 percent. This means 75 cents of every dollar’s worth of Mexican imports of agricultural products comes from the United States. Today, Mexico is the US top export destination for beef, rice, soybean meal, corn sweeteners, apples and dry edible bean exports, the second for corn, soybeans and oils, and the third for pork, poultry, eggs, and cotton.

U.S. investors have also found NAFTA an attractive destination for their businesses. Direct US investment in the manufacturing, finance, insurance, and mining sectors of its NAFTA partners reached $357.7 billion in 2009, up 8.8% from 2008. In turn, NAFTA partners FDI in the United States was $237.2 billion in 2009 (latest data available), up 16.5% from 2008.

The tariff agreements scheduled at the time of NAFTA´s signature were implemented either on time or ahead of schedule. As a result, NAFTA has evolved to a more advanced stage of trade facilitation. In 2009 the governments of the three countries defined new and creative ways to further increase trade among themselves. To make North America one of the most economically competitive regions in the world, trade officials agreed to push regulatory cooperation as the new top priority of the agreement. These actions have the potential to strongly reduce costs to businesses and prices to consumers by eliminating unneeded regulatory differences on standards.

In 2011, bilateral mutual recognition agreements (MRAs) establishing procedures for accepting test results from laboratories or testing facilities in the territory of another NAFTA country for use in the conformity assessment of telecommunications equipment were approved. This recognition agreement allows a manufacturer to test a product only in one country and have the test results accepted in the other two. Updating the NAFTA rules of origin to reflect current sourcing and production patterns is another area in which work is being done. A Working Group on Rules of Origin (WGRO) has reached preliminary agreement on a fourth set of changes to the NAFTA rules of origin; when implemented these changes will benefit goods valued at approximately 90 billion dollars.

Looking to all the progress achieved in the past ten years, one is forced to agree that NAFTA works and increases employment and competitiveness in the region. NAFTA´s progress and results underline the advantages that a fuller integration would bring to all of us living in the North American region. Why then are we hesitating so much about deepening it? I will try to answer this question now.

Alone or together?

The current economic crisis has created a sense of anxiety in the average American regarding their status as a citizen of the top country in the world. As a recent article[3] stated

> *"The effect of the loss of top-dog status on the well being of the average American is unlikely to be trivial. Britain felt similar angst at the beginning of the 20th century, noting the rise of Germany, a military rival"*.

[3] The Economist Special Report, *The World Economy*, September 24, 2011.

Philosophically the United States is a nation whose citizens pride themselves of putting ahead individual freedom and personal achievement over social welfare concepts. Individual competition and success as a nation is paramount for the American self-image of being the number one country in the world. However, global competition has shifted the process through which specialization and innovation is achieved, ultimately resulting in a reduction of average product prices in those countries capable of understanding the shift and better growth rates to benefit of all its citizens.

As globalization took hold of the marketplace, Eastern emerging economies surged ahead as the new beacons of growth and efficiency in the world, challenging America´s economic paradigm and political power. By having the fastest-growing consumer markets, more firms becoming world-class multinationals and greater science and technological stature, Asia (particularly China and India) looks set to displace Western countries as the focus for international economic dynamism. Despite that challenge, the United States is likely to remain the number one global leader up to 2030. But if it continues its present economic policies it will see its relative power position eroded and its role as the most important single country across all the dimensions of power eroded as well.

A new strategy is therefore required if the United States wishes to continue as the major economic and political power in the new geopolitical architecture being created by the crisis of 2011; one defined over the concept that the greatest benefits of globalization will accrue to countries who invest in their own basic research and technology development. The growing two-way flow of high-tech brain power between the developing world and developed nations, the increasing size of the information computer-literate work force in some developing countries, and efforts by global corporations to diversify their high-tech operations demonstrate that this strategy can only be implemented under a combination of human, technical and financial resources available in a regional integration model.

Thus, unless the United States adopts a regional economic paradigm, countries such as China and India will quickly eliminate the scientific and technological gap that still favors America in the global marketplace. China and India are well positioned to become technology leaders, and even the poorest countries will be able to leverage cheap technologies to fuel—although at a slower rate—their own development.

In my opinion the United States must adopt a regional competitiveness model if it wishes to enhance its chances of remaining "top dog", contemplating NAFTA as its platform.

NAFTA as a solution

As the economic crisis transforms itself in alarming unemployment, growth, investment and consumer´s confidence figures, dogmatic positions have taken the day in proposing public policies to bring the American economy out of its current morass. Rather than informed discussions evaluating the relative merits of different strategies, Keynesian, Neo-liberal and Monetarist theologians cross swords in an intellectual debate where preconceived beliefs leave little ground for pragmatic discussions. Thus, while Nobel Laureate Paul Krugman defends the need for aggressive and unlimited public spending to offset the fall in private investment and consumption, neo-liberals push for more austere fiscal policies fearful of unsustainable fiscal deficits like the ones in Europe today. And monetarists such as Adam Posen want central banks to print more money to revive sluggish economies.

Evidence of this struggle is provided by a recent paper[4] which contends that Mr. Obama´s request for an additional 300 billion dollars stimulus package should be evaluated against the results obtained by the 830 billion dollars package applied in America during the past two years. A package which according to the author of the paper has neither brought the American economy back on track, nor can it show a single bridge, road, airport or dam built with the money spent. The paper argues that the money was used for paying the salaries of bureaucrats to avoid politically charged lay-offs required in local, state, or government-owned entities, making it difficult to understand why another stimulus package would be a welcomed idea.

Proof against the opposite position is provided by the strong recovery of the United States automotive and electronic industries thanks to the financial packages provided by the 830 billion dollar stimulus package; both industries have created jobs and have enhanced America´s competitive position in two key industrial sectors in the global marketplace.

The relevant fact is that the American economy is on the verge of another recession. Rather than debating opposite positions, experts in the United States should be discussing a more pragmatic route to compete in today´s world economy.

By most measures—market size, stable currencies, large and highly skilled work force, stable democratic governments, and unified trade bloc—an enlarged North America region will be able to increase its weight on the international scene. The different strengths of each country would provide a combination difficult to beat in the global marketplace, staving off the relative decline expected to be suffered by each one of them if acting alone.

Why is it then that the American government, US companies and so many economic experts are willing to try economic recipes which neglect the market, rather than investing the same or lower amounts of money in a market solution such as the transformation of NAFTA in a new regional economic block?

---

[4] Jorge Suarez Velez, *Shovels and Buckets*, SP/Family Office Publication, New York, September 23, 2011

Energy sufficiency would become available by the combination of oil and gas deposits available in the three nations. Current immigration problems would be solved by such an arrangement as differences in education gradually diminish across the area. A common migration policy would eliminate current population tensions while creating a more secure regional border. Labor availability would be made plentiful with the growing numbers of young Mexicans that would continue to provide a demographic boom to the region for the coming 25 years. Research and development would be made possible by the combination of quality professionals in the three countries and the opportunity to set shop in lower cost facilities in Mexico. A single currency within a unified US Dollar zone would strengthen the dollar ability to remain as the major reference in international financial markets for a longer time period than otherwise would be, lowering interest rates and increasing financial benefits for firms and consumers in the three countries. Elimination of rules of origin and homogeneous quality standards would fuel efficiency and competitiveness in all firms established in the region.

The combination of all these factors would be felt in strong gains of the so called "*total factor productivity"*, providing firms in NAFTA an edge impossible to replicate by other firms competing with them in the global marketplace. As an added bonus, religion, family and cultural values, and the pre-existence of democratic regimes would enhance the capacity of success of a NAFTA economic model. If adopted, this strategy would provide a model of global and regional governance to be replicated by other nations in their quest to obtain the benefits of a global marketplace. Paraphrasing David R. Brousell *"these are the keys to a healthy economy and the viability of a middle class."*

The Road to Utopia

Regional integration of two developed nations and an emerging one may sound unrealistic. Yet experiences like the Security and Prosperity Partnership launched by Presidents Fox and Bush and Prime Minister Martin in 2005 show the way through which such integration may take place. Established as an informal dialogue to increase cooperation and information sharing on prosperity and security issues affecting the region, it has never attained legally binding status. Nevertheless, trilateral concerns related to private sector priorities, national sovereignty, transportation corridors, cargo security, and border security have been discussed in an open manner since its inception by the three countries. By appointing a number of working groups in both the security and prosperity components of the initiative SPP has been able to create conditions for enhancing the working of NAFTA.

Work priorities focused on increasing collaborative efforts to improve certain sectors of the economy, develop higher standards of safety and health and address environmental concerns.[5] The proposals related to trade and commerce included a signed Framework of Common Principles for Electronic Commerce; liberalization of Rules of Origin; a Memorandum of Understanding between Canada and the United States to exchange information and cooperate on activities relating to consumer product safety and health; harmonization of the use of care symbols on textiles and apparel labeling; and a document clarifying each country's domestic procedures for temporary work entry of professionals under NAFTA.

In March 2006, the three countries met again and continued to advance the agenda of the SPP by focusing on these high-priority initiatives. By August 2007 accomplishments of the working groups included (1) a North American Plan for Avian and Pandemic Influenza, (2) a Regulatory Cooperation Framework, (3) an Intellectual Property Action Strategy, and (4) a Trilateral Agreement for Cooperation in Energy Science and Technology. In addition, the North American leaders agreed upon the following five priority areas for the SPP working groups: (1) Enhancement of the Global Competitiveness of North America, (2) Safe Food and Products, (3) Sustainable Energy and the Environment, (4) Smart and Secure Borders, and (5) Emergency Management and Preparedness.

As I mentioned before, the work of this initiative has brought further progress to NAFTA through its impact in regulations and standards for the North American region that will help the three countries protect health, safety, and the environment, as well as to facilitate trade in goods and services across their borders. It has also helped on protecting intellectual property and served to initiate increased cooperation on import-safety issues, energy and science technology, and energy efficiency standards in key products and standby power consumption.

Convinced that it was through private sector cooperation that regional integration could progress at a faster pace, in March 2006 Mexico´s President, Vicente Fox, suggested the constitution of an important working group the North American Competitiveness Council (NACC), composed of top businessmen from the region.[6] The NACC provides a voice for the trilateral business community and engages the private sector in finding solutions for better integration within NAFTA. In 2008 it presented a report to the three leaders of the NAFTA countries, in which it identified priorities and key issues to further the prosperity

[5] For a detailed account of accomplishments see the Security and Prosperity Partnership of North America (SPP) website at http://www.spp.gov

[6] Description of the working group and its priorities can be found at the website of the North American Competitive Council (NACC).

components of the SPP[7]. The NACC report listed the following priorities to enhance North American competitiveness:

• Facilitating entry for cargo and reducing border congestion along the borders with Canada and Mexico;

• Establishing competitive supply chains across North America by developing efficient transportation networks, especially along the northern and southern borders of the United States;

• Working towards comprehensive integration of the North American automotive industry through more efficient border inspections and greater regulatory cooperation by aligning vehicle safety standards and regulations among the three countries;

• Implementing a trilateral Intellectual Property Action Strategy for more rigorous protection of intellectual property rights;

• Enhancing secure alternatives to a passport before the June 2009 date for full implementation of the Western Hemisphere Travel Initiative;

• Strengthening trilateral communication and cooperation to prevent the entry of unsafe food and products into North America and working to make regulatory and inspection regimes for food and product safety more compatible;

• Encouraging development of sustainable energy technologies and protection of the environment through private sector cooperation;

• Ensuring emergency management planning through increased cooperation on emergency protocols, particularly those related to border traffic and prioritization of cross-border shipments during emergencies; and

• Enhancing cooperation in financial regulation in order to provide more efficient access to capital, to improve the availability and affordability of insurance coverage for cross-border carriers, and to find new ways for cross-border collaboration on investment.

No matter what form the future regional partnership may take, the experience over the past two years of the NACC demonstrates the clear benefits of close cooperation on both strategic and specific issues among North America's business communities, as well as its governments. Other business organizations have extended this cooperation over the past year in launching productive new initiatives addressing issues such as border costs, sector

---

[7] North American Competitiveness Council (NACC), *Meeting the Global Challenge: Private Sector Priorities for the Security and Prosperity Partnership of North America, 2008 Report to Leaders,* April 2008

integration, and supply-chain development showing that a regional economic strategy is possible.

Let´s finish this section with the experience of the steel industry of the region.

NAFTA[8]established a working link with the North American Steel Trade Committee (NASTC) to draw attention to issues of importance to the manufacturing sector promoting cooperation between North American industry and governments in areas of mutual interest. The work of the NASTC has resulted in positive impacts on this sector´s competitiveness and demonstrates the importance of information sharing and policy collaboration in advancing the competitiveness of North American manufacturing. NASTC has undertaken efforts to identify specific barriers to intra-NAFTA trade in this sector, including in the area of permit requirements. As a result of this work, Canada recently removed the fees for its steel import permits, and continues to focus on the ongoing implementation of a more streamlined import monitoring system, which will improve regulatory efficiency at the border.

Conclusion

The North American Free Trade Agreement (NAFTA) has enhanced prosperity in all three countries through increased trade and investment, stronger economic growth, and lower prices for consumers. Nonetheless, NAFTA's benefits are not universally understood and the current economic environment of the United States is creating public misperceptions about the value of further regional economic integration. This misperception is unfortunate because it limits possible cooperation between the governments of the three countries in making the region more competitive, its businesses more efficient and the offer of new jobs more sustainable.

A regional approach is the only opportunity that NAFTA countries have to strengthen their competitiveness and security. Unless public misperceptions on NAFTA are turned around, our countries will become largely irrelevant by the rapid ascension of China and India, as well as other Asian nations, to leadership positions in the new global architecture. To the extent that NAFTA itself continues to be a target, efforts to "deepen the NAFTA" will be largely unsuccessful, accelerating the erosion of the United States capacity to maintain itself as the leader of the world.

Call me utopian, but I expect this trilateral partnership to evolve over time to meet changing circumstances and needs. No matter what form the partnership may take, the experience of the NACC over the past two years demonstrates the clear benefits of close cooperation on

---

[8] What follows was lifted from NAFTA´s Secretariat reports on issues of the Steel Industry and the role of NASTC.

both strategic and specific issues among North America's business communities, as well as its governments. Moving forward, the private sector will continue to offer its expertise to governments and will strive to communicate (through direct interaction and electronic dissemination of information) both the critical need for closer cooperation and the real benefits of greater openness to legislators, government officials, and the general public in all three countries.

Thank you.