

NAFTA for the Next Generation: Lessons Learned & Challenges Ahead

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Introduction

A. Purpose

As the North American Free Trade Agreement (NAFTA) passes the tenth anniversary of its formal coming into force on January 1, 1994, North Americans are engaged in a debate about what it has accomplished and what its future should be. It is thus timely to ask two questions that lie at the centre of the “NAFTA: What’s Next?” debate. First, how well has NAFTA worked for business, its other major stakeholders, and the broad public during its first ten years? Second, How will and should the effort to create a stronger North American community proceed, in ways that support and are enriched by, the ASEAN experience unfolding at the same time?

B. Arguments

This paper offers several answers to these questions, as the central arguments for the best way to build the North American community, and enrich a NAFTA-ASEAN dialogue and partnership in the years ahead. First, NAFTA has worked very well for an American, Canadian and Mexican business community now integrating on a North American basis, for environmental and labour stakeholder we are doing so as well, and for the North American publics which has come to approve the process in ways that support stronger community building efforts in the years ahead. This next generation community building effort could and should take place in ways that not only deepen, but also institutionally “thicken” and broaden NAFTA, in ways that strengthen, learn from and forge a partnership with, a strengthening ASEAN itself.

1. NAFTA’s Impact on Business: The Centrality of Corporate Strategy

A. North American Trade and Investment as Firms not Flows

In assessing NAFTA's first decade impact on the North American economy and business it is normal to describe the enormous increase in trade and foreign direct investment (DFI) among all three of the NAFTA members since the "NAFTA effect" first took hold, to evaluate these numbers a percentage of each country's economic flows with its NAFTA partners and with the outside world, and to make judgments based on estimates of what would have happened had NAFTA not come into existence at all. However such exercises, while important, miss the central reality that even in North America, where the Canada-US relationship alone constitutes the largest two way trading relationship in the world, the North American economy is less about overall macroeconomic flows and more about individual firms and the and the corporate strategies they adopt.

Seventy percent of North America trade is intra-sector. Forty percent is intra firm. Even more takes place within the business alliances that have emerged over the past decade. Indeed, about a quarter of North American trade takes place in the automotive sector, where the alliances clustered around the big three firms, and few Asian transplants dominate. The top 100 firms in North America do a majority of this NAFTA trade, and they are all multinationals with both trade and FDI as market entry choices, both within North America and around the world. It is thus the corporate strategy of these major MNC's that counts in making NAFTA work.

B. The Primacy of North America in a "Regionalizing" Age

Even in a world of globalization, where these North American based firms have a global reach, it is their home region of the triad that remains central to their corporate strategies overall. As Alan Rugman has shown, within all three poles of the triad, it is intra regional rather than transregional trade that is most pronounced. The European Union leads with 60%, followed by Asia with 53% and North America with 49%. As North America has only three countries among which international trade can take place, this figure shows the impact of NAFTA, and the 1989 Canada-US bilateral free trade agreement before it, in reshaping the corporate strategies of North American MNC's to put North America in first place.

C. American Firms' Corporate Strategies and Successes in the NAFTA Age

This shift to a North America strategy started early, especially for US firms who had long relied on miniature replica branch plants in both Canada and Mexico to inefficiently produce a wide range of products for a protected national market there but for no-one outside. As Stephen Blank shows, US MNC's facing global competition and new technology move fast to "source globally, produce regionally, and sell regionally" as well. With NAFTA the new "North America" replaced the old "US", "Canada" and "Mexico" as the dominant or even only relevant geographic unit in firm structures and strategies. Each chose one production centre for the entire region, and often one product, one price and one marketing and advertising strategy as well. There was also one strategic centre for each line of business, but it was not necessarily in the US. Rather, rationalization and integration dominated, rather than centralization and plant closure, as US firms moved to mobilize their Canadian and Mexican assets to serve the North

American region as a whole, and on this foundation at times, the global market as well. Competition increased, but often it arose within the firm, as units sought the mandate for the regional and world product for themselves.

D. Canadian Firms' Corporate Strategies and Successes in the NAFTA Age

Canada's many home-based MNC's also moved to seize the NAFTA advantage, and to "source globally, produce regionally and globally and sell regionally" as their strategic response. In macro terms, Canadian exports, but not imports, concentrated on North America. Canada in 1997 became a net outward foreign direct investor. And the US share of outward Canadian FDI dropped to 49%, while Mexico's rose almost threefold to a still small .08%. These trends are evident across the economy, in the primary, secondary and tertiary sectors as a whole.

In the energy sector, The US now import as over 50% of its oil, compared to only 35% in the late 1970's. And while Mexico is an important supplier, Canada has become America's secure Saudi Arabia right next door. Canada provides 100% of US electricity imports, 93 % of its natural gas imports, and 20% of its crude and no-crude oil combined, making it the number one supplier in each of these three fields. Canada has also become an energy supplier to Mexico, both by building plants in Mexico (as TransAlta has), and by "wheeling" electricity through a now integrated all North American grid. While Canada, unlike Mexico, did not exempt its energy sector from NAFTA's foreign ownership rules, Canada's energy sector has remained under majority Canadian ownership and control.

In the automotive sector Canadian firms took full advantage of their many competitive advantages: the head start from the 1965 Canada-US automotive pact; locational advantages near Detroit in a new world of just-in-time supply; strong second tier parts suppliers (such as Magna and Woodbridge) upon which the assemblers increasingly relied; a low dollar, smart unions, well educated workers from a strong public education system, and publicly funded health care at a time when healthcare, and prospectively pensions, for the workers cost more than steel in the making of each car. Thus Canada, without offering subsidies, has received its fair share of new automotive investment, especially in parts and from Asian transplant firms. NAFTA's new rules of origin have helped as well. The Canadian government has also been able to set higher environmental standards than those in the US and Mexico, knowing that its NAFTA partners will soon catch up, and it can see into the full NAFTA marketplace until they do.

In the services sector, Canadian firms have also flourished, especially in financial services which constitute one-third of Canadian outward FDI in the US and Mexico. Here too Canada has benefited from NAFTA's rules, such as Chapter 11, which helps protect Canadian investments abroad from measures tantamount to expropriation. But it has also benefited from its national competitive advantages: a few big banks with a national reach and few bank failures in the past; and Canadian technologies leadership in ATM's. Thus some of Canada's big banks are moving southward through the US, buying US firms in Chicago, New York and the US southeast. But one, the Bank of Nova Scotia, has gone

directly to Mexico, buying Mexico's sixth largest bank. One result is that Mexicans can now more easily get the mortgages and the car loans they could not before.

In the transportation sector, the experience of the two dominant modes in a land contiguous region— railroads and trucking — show a sharp contrast. In railroads a Canadian firm, has been buying up US railroads to become the NAFTA railroad that connects to the Mexican public national system — until the US National Surface Transportation Board refused a major acquisition on national security grounds. In trucking, where 61 jurisdictions exercise regulatory authority, and where the US has violated its NAFTA obligation to let Mexican trucks in, there has been little advance. One result has been that Canada's prairie farmers, who use trains to transport their crops to Mexico, have been the big winners in the NAFTA age.

E. Mexican Firms' Corporate Strategies and Successes in the NAFTA

Mexican firms have also started to move into North America, especially in sectors such as cement, where their firms are of world scale. The many millions of Spanish-speaking Americans provides a ready market for exports in sectors such as the media, especially after the 1994 peso crisis and devaluation have given Mexican products a boost in the booming American market right next door. And proximity is taking them into the US in outward FDI. Indeed, Mexican FDI in Canada is the only part of the triangle yet to be filled in.

2. NAFTA and its Stakeholders: From Corporations to Community

A. The Race to the Bottom Reality

NAFTA's impact on its other major stakeholders has also been largely positive. One clear result is the absence of any real "race-to-the-bottom, despite the fears that NAFTA's liberalizations would lead corporations to leave the US and Canada for lower cost and lower standard Mexico, and that the US and Canada would thus lower their own environmental and labour standards to keep those firms and their jobs at home. Ten years after NAFTA, environmental and labour standards and their enforcement are now generally much higher in all three NAFTA countries than they were at the start. Any derogations have been the result of deficit-fighting governments, or ideologically-opposed political leaders rather than any pressures NAFTA has produced. In general business has favoured a single high standard for the entire NAFTA regions, and has found ways to gain competitive advantage from a regulatory race to the top.

B. The Commission For Environmental Co-operation's Contribution

One reason environmental standards and quality have moved upward is the work of the Commission for Environmental Co-operation (CEC), the body created by NAFTA's side agreement on the environment, the North American Agreement on Environmental Co-

operation (NAAEC). Its Article 14-15 Citizens Submission process has allowed individual citizens to take action directly at a regional centre if they feel their own national government is systematically not enforcing its own environmental laws. The CEC has also pioneered a new method and process of assessing the environmental effects of NAFTA and its trade. NAFTA has also directly raised environmental standards in Mexico, through its program on the Sound Management of Chemicals and in other ways.

C. The Broader Barriers that Remain

Yet with a budget of only US\$9 million a year, the same in nominal terms as in 1994, the CEC alone is only able to do so much. Funds for cleaning up environmental problems were left to two US-Mexican bilateral bodies, with a mandate limited to the US-Mexican border alone. The lack of adequate border closings to service NAFTA's much large trade has left too many trucks idling too long at the border, spewing exhaust fumes into the air and creating both economic and environmental costs. At the same time, industry in Mexico is still concentrating close to the northern border, for Mexico lacks the roads and other infrastructure to spread NAFTA' induced production, and prosperity further south.

D. The Commission for Labour Co-operation's Lesser Contribution

North America's labour movement received an even weaker institution than its environmental counterparts, in the form of a Commission for Labour Co-operation now headquartered in Washington, D.C. Yet its citizen communication process has, when working in tandem with other political process long skillfully employed by organized labour. Led to some positive results.

E. The Tasks that Remain

Yet even so, NAFTA's labour improvement do little to meet the needs of the Many Mexican migrants now working, often illegally in the United States. More broadly, NAFTA came only with very limited labour mobility provisions, giving new opportunities to sell services in the partner countries only to those in professions where the members were already rich.

F. The Record of Winning Together

Despite these defects, an overall assessment of NAFTA's impact in creating a better balance between North America's trade and environmental communities suggest that it has made a discernable positive difference indeed. An analysis of all cases where trade and environmental values have come together between or among the three NAFTA partners from 1980 to mid 1998 shows that each country and community wins more equally, and all win more together, when the NAFTA era comes, when's NAFTA NAFTA rules and institutions are used, and above all when its strongest institution, the CEC is put to work.

G. The Importance of Intergovernmental Institutions

The results of this assessment strongly suggest that strong intergovernmental institutions make a desirable difference, for the economic community that now depends on trade with NAFTA partners and for environmentalists and all who depend on a healthy natural environment. Yet NAFTA was deliberately designed with few institutions, and none at all to manage the trade and investment relationship at the core. While many trilateral institutions have emerged over the past decade, in sharp contrast to both the EU and ASEAN, there remains this great institutional whole at its economic centre, and among the leaders of its three countries at the very top.

3. NAFTA's Impact on People: A Community of Citizens

A. Living North American

Among the mass public, it is clearly that NAFTA is also working, including for substantial portions of the poor. As Mexico has moved from high cost, low technology monopoly suppliers of consumer goods under import substitution industrialization, poor Mexicans can get the lower cost higher quality goods of their choice, including goods they never has access to before. Canadian consumers have also benefited in this way, while all North Americans have benefited from lower inflation and interest rates.

NAFTA's community creation spirit, if not its actual rules has also made it easier for poor Mexicans to live and work in America, and send much needed hard currency back home. Steve Hanke has estimated that one quarter of the adult Mexican workforce is currently employed in the United States. There are now an estimated 25 million Americans of Mexican descent, up 53% since 1990 and increasing at a rate of 500,000 a year.

Yet the flow of people goes in both directions. There are 300 million border crossings annually between the US and Mexico and 200 million between the US and Canada. 18 million of the 300 million Americans visit Mexico each year, and many stay to buy vacation homes that they will retire in. Moreover one million of the 30 million Canadians visit Mexico each year, showing it is the sun and the sense of community as well as the geographic proximity that counts. Within a decade it is estimated that over half of all Canadians will have had a first hand exposure to Mexico since NAFTA began. Within Canada, Spanish is rapidly joining English and French as the language for ambitious Canadians to learn.

B. The Public Opinion Consensus Then and Now

NAFTA's results are well known to the people of North America, who have come to support it and steps to strengthen it in public opinion polls. From 1994 to 2000 NAFTA

never secured majority support among publics in all three member countries at the same time. It hit a low in Canada in 1992, Mexico in 1995 in the wake of the peso crisis, and in the US in 1996.

But this initial reluctance has now turned into a twenty-first century conviction. Staring in the year 2000, a majority in all three countries always give NAFTA strong support. They do so even though Americans in an October 2003 poll think NAFTA has done their country more harm than good. Moreover, citizens in all three countries have a favourable view of the other member countries and their relationships within them, suggesting a firm foundation exists for stronger community-building steps to come.

Indeed, a strong two-thirds majority of citizens in all three countries now want NAFTA strengthened – 67% in Canada, 67% in Mexico, and 65% in the US. Nowhere do they think there will be a “North American union” in a decade, and in the US they don’t want one like the EU. A majority in all three countries do want a fully integrated environmental policy, for most subjects other than climate change. They want a somewhat integrated regional policy in transportation, defence, energy and banking as well. Citizens in all three countries feel this would improve their economic well being most, but their environmental and social quality of life as well. There are thus good grounds for building a stronger North American Community, and doing so not with the economy but with the environment first.

4. NAFTA’s Needs for the Next Generation

A. The Current Debates

The current debates about building NAFTYA for the next generation, however, start in a very different place. With the EU as the model, they start with the economy, and recommend large leaps forward into a customs union, common market, with a monetary and even political union at the end. The far more likely, and desirable way forward, however, is to start with the environment and related social areas, and work for continuous incremental improvements, moving from the easiest to the hardest in each case. The major movement will and should come on a fully trilateral basis, with any two speed NAFTA featuring Canada and Mexico, currently the weakest leg of the triangle, paving the way. NAFTA already has a heart and a body, as the public opinion and economic and environmental results respectively show. The challenge for the next generation is to give it a head and a brain.

B. Deepening

One line of advance involves “deepening” NAFTA, through at least ten steps. One is to catch up on complying with existing obligations, notably in tomatoes and trucks. A second is to secure the open border, by inspecting only the suspicious on each side when

they come to cross. A third is to redefine the NAFTA Chapter 11 investor state dispute cold war.

A fifth step is to create a common energy policy, with fast regulatory approval, high environmental standards, and no national subsidies for any particular project allowed. A sixth is to codify the current de facto sectoral customs unions, as a foundation for advancing common Team North America interests in trade negotiations overseas. An eighth is to expand NAFTA's labour mobility provisions, to give the poor the same opportunities to export their services that members of already rich provisions have. A ninth is to place a moratorium on the use of the NAAEC's Part Five, a thus far never used, and thus environmentally useless, provision that still threatens trade sanctions for environmental non-enforcement and thus inhibits the cross border partnerships that might otherwise take place. A tenth step is to replace the current national trade remedies regime with a common set of predatory pricing and competition policies for the region that is quickly becoming a single commercial whole.

C. Thickening

Also needed is a great deal on institutional "thickening" to give the NAFTA community the head and brain it needs. Here another ten steps take pride of place. The first is to expand the funding for the CEC and CLC, to take account of inflation and the growth of North America over the past ten years. The second is to create a permanent trilateral Trade Commission Secretariat, to produce badly needed accurate trade statistics, to give the economy an equal institutional home alongside the environment and labour and to give these latter bodies a counterpart with which to deal. The third is to produce the NAFTA "head" by holding an annual institutionalized stand alone Summit of the three leaders, as the APEC leaders long have. A fourth, a part of building a NAFTA brain, is to conduct a 10 years institutional review, to see just what else is needed by ways of "bones" to support the growing body North America has become. A fifth is to strengthen the North American Finance Ministers' Group, a body presciently born in April 1984.

A sixth step is to create a permanent North American Energy Ministers Group, and one where the environmental ministers are invited in to discuss matters of mutual concern. A seventh is to establish a North American Business Advisory Council, along the line of the ABAC that APEC has long had. An eighth is to form a North American University Network, again starting along the path that APEC, with its APEC Study Centres, has set. A ninth is to create a trilateral North American Legislators Group. And a tenth is to produce a North American Tribunal to give one stop, reliable justice to the disputes arising under NAFTA's chapters for investment, antidumping and countervail.

D. Broadening

Finally, there is a simultaneous need to broaden NAFTA, if only to catch up with the decision taken at the first decade's very start. The first step here, promised in December 1994, is to admit the "fourth amigo" of Chile as a full member, especially now that all three NAFTA members have their own full free trade and NAFTA compatible deals with

it. The next step would be to admit Costa Rica, and then the Central American four, to avoid the transaction costs which separate slightly different bilateral free trade deals impose.

5. The New North America's Implications for Asia

Once the 2004 elections in both Canada and the US are over, the task of North American community building may start to move at a rapid pace. This is especially so as Democratic Presidential nominee John Kerry is already calling, like Bill Clinton before him, for stronger NAFTA environmental and labour provisions on the campaign trail. This project could pose some dangers for ASEAN members, especially if the EU model for North American community building remains the only one to point the way. It is important to start now to consider how to design a non-discriminatory North American community that would support ASEAN and Asian interests, and would optimize the opportunities for Asians as the new North America unfolds. It is also important to consider how, within the evolving North America, Canada could take the lead in this task.

A. Deepening without Discrimination

The first step here is to guide the new North American community into deepening without discrimination, in political, economic and other ways. The emerging North America needs a political identity that is outward rather than inward-looking. Close to one tenth of Americans are of Mexican origin and well over one tenth – an estimated 38 million – trace their roots to the Hispanic Americas as a whole. In sharp contrast, in Canada, almost no-one is from the Americas, but one tenth of the population comes from the Asia-Pacific world. Thus, while demographically as well as geographically, the United States and Mexico are inherently countries of the Americas, Canada is equally a society of the Asia-Pacific world. Canada could and should thus serve as NAFTA's great Asia-Pacific connector, ensuring that the new North America looks west as well as south. Within ASEAN, the Philippines could take a lead in connecting ASEAN to the hispanic part of NAFTA further south.

To ensure increasing economic openness, it would be useful to relax some of the original NAFTA rules of origin, as suggested by Earl Fry. One should also in every case choose the lowest tariff level for codifying a sectoral customs union, confirm outsiders will be given national treatment in FDI, and encourage NAFTA's new and prospective members to engage in unilateral opening to the world, as Mexico did starting in 1986.

Also required are outward-looking environmental and social standards. At present 73% of Canadians and 62% of Americans want environmental considerations to play a "high" role in North American trade negotiations. John Kerry's call to strengthen NAFTA's environmental and labour provisions thus enjoys wide popular support. The challenge is to deliver them in ways that do not constitute regulatory protectionisms from a fortress North America for ASEAN and Asians wishing to do business in the NAFTA

marketplace. Here a NAFTA-ASEAN dialogue on environmental and labour standards as they relate to trade and investment could do much to prevent any conflicts that might come.

B. Broadening to Bolster the Trans-Pacific Link

It is equally important for North Americans to broaden their community in ways that bolster the trans-Pacific link. They means adding to NAFTA in its first expansion the Pacific powers of Chile, Costa Rica and Central America, and adding in the next phase additional pacific and Asian-oriented states such as Peru. NAFTA could also create a SE Asian hub, building on existing and prospective NAFTA members' free trade agreements with Singapore as the great connector between NAFTA and ASEAN. The transpacific link could also be strengthened up north by having NAFTA members beyond Mexico work toward free trade with Japan.

C. Supporting the APEC and WTO Process and Goals

Central to this non-discriminatory, westward-oriented North American community is to shape it in ways that directly support the APEC and WTO goals. The key APEC target is to deliver the Bogor commitment to free trade among APEC's developed country members by 2010, and with its developing country members by 2020. Any free trade agreements that NAFTA members forge with Singapore and Japan should thus be considered catalytic down-payments on this commitment that NAFTA and ASEAN members for over a decade have shared. In the case of the WTO, the existing commitment is to deliver the Doha development agenda by as close to its 2005 target as possible, and to do so in ways that work for not just trade but for development as well. The number of developing countries in the prospective new NAFTA and ASEAN make this a shared self-interested task. This could involve NAFTA and ASEAN working together to combat agricultural subsidies, to secure trade facilitation (in ways that ease entry above all into a terrorism-preoccupied US), and to conduct environmental assessments of trade liberalization, with a preventative, remedial, rather than reactive, punitive actionable purpose in mind.

D. Identifying New North American Opportunities for Asians

Another shared interest is to identify in detail the opportunities for Asians in the new North America. One general advantage is that an expanding North American community should create a second sustainable great growth engine, beyond China and perhaps again Japan to bolster Asian economies and give diversity and resilience to their economic ties abroad. A second is the prospect of "one-stop shopping" in a greater North America governed by a single set of rules and institutions, rather than the fragment regulatory maze that arises when sub-federal jurisdictions in the US, Canada and Mexico, and prospectively other NAFTA members, get into the regulatory game in ways that have substantial transaction cost and protectionist effects. This prospect would be of particular benefit to smaller firms in the smaller and more distant Asian countries.

6. The New North America's Lessons from Asia

A. The Need for Lessons from Beyond Europe

An extended NAFTA-ASEAN dialogue, led by Canada on the NAFTA side, would do more than just acquaint ASEAN members with intelligence about how the new North America might affect them, and give NAFTA members the knowledge of ASEAN's interests and their evolution that would allow the new NAFTA to be shaped in the most outward looking way. It would also bring to bear lessons from the ASEAN model to guide North Americans as they build their own regional community in the years ahead. From Vincente Fox through Robert Pastor to so many others, it is the EU model that has singularly stood as the only blueprint to date. A second, Asian model is now imperative, especially as the new North America may have more in common with ASEAN than with the evolving EU in the decade ahead. North America's need for learning more about the ASEAN model goes well beyond the obvious points that the EU is launched on an ambitious supra-national process, involving foreign policy and security co-operation, that is embracing 10 additional countries all at once. Rather it begins from the structural facts that NAFTA and ASEAN are process of regional integration non driven by a legacy of recurrent destructive war among the leading members states, that have embraced from the start developed and developing countries as equals, that have absorbed high levels of linguistic, social and cultural diversity, and that have an outward-oriented oceanic sense of connection rather than one narrowly defined by land.

B. Managing Membership Diversity

The first subject for NAFTA learning from ASEAN is about managing membership diversity, especially as NAFTA expands beyond the three land-contiguous countries of its first decade of life. Here ASEAN's rich experience is managing diversity among many members in level of development, structure of the national economy and sea based trade would be useful indeed.

C. The Advantages of Initial Institutionalization

A second subject concerns the advantages of initial and subsequent institutionalization in shaping the regional community the member countries, stakeholders and citizens want. ASEAN has featured a single Secretariat from the start, and a distinctive approach to institutional growth, including the size and distribution of budget shares. It also offers useful experience in relating to outside institutions, and in building civil society participation within.

D. Reinforcing the Sub-Regional to Global Routing

A third subject is the way sub-regional arrangements can best be shaped to support desired global processes. A NAFTA members move to create free trade spokes with other countries, consider NAFTA-plus expansion, move toward a hemisphere wide FTAA, and

come closer to their trade liberalization commitments in APEC and WTO, the experience of ASEAN and its members will be instructive indeed.

E. Adding the “Asian Way” to the Americas

A fourth valuable ASEAN lesson for NAFTA could be making the “Asian way” of dialogue-based consensus work, as a supplement to or replacement in some instances for the adversarial litigiousness on which NAFTA to date has heavily relied. To be sure, NAFTA members have had their moments of volunteerism, for example in conducting accelerated tariff reduction and in having the US and Canada provide major financial support to an embattled Mexico after the peso collapsed on December 20th, 1994. But more such volunteerism, and more inclusive, multistakeholder, consensus-oriented processes could add much to the North American community in the years ahead.

F. Integrating Social, Political and Security with Economic Concerns

Finally, ASEAN has long been well ahead on North America in integrating within the regional community social, political, and security with economic concerns. It is no longer adequate for North Americans to say that, unlike the Europeans, they have no desire for regional political and security co-operation in mind. For the influx of energy, drugs, pollutants and illegal migrants into the US have long given the North American community a real if uninstitutionalized security dimension of both a classic security and human security kind. The terrorist attacks on September 11th and the anthrax attacks that followed have brought security questions, closely linked with economic ones to the core. As such linkages are unlikely to dissipate or disappear, it is clear that members of the ASEAN and North American communities have much to learn from each other in the years ahead.