Testimony before the Subcommittee on the Western Hemisphere: NAFTA at Twenty - Accomplishments, Challenges, and the Way Forward

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Thank you, Mr. Chairman. Chairman Salmon, Ranking Member Sires, members of the committee, it is a privilege to join you today. I appreciate the invitation.

At the Mexico Institute in particular, and the Wilson Center more generally, we have worked a great deal on the development of North America, considering its successes and challenges. Recently, I partnered with Laura Dawson (of Dawson Strategic) and Christopher Sands (of the Hudson Institute) to defend the concept of North America and to call for an ambitious plan for the future. In "North American Competitiveness: The San Diego Agenda" we put forward the idea that:

"We must deepen North American economic integration in order to compete more effectively globally. That means common regulations and standards on products manufactured in North America, negotiating as a bloc with Asian and Europe, making both borders function more efficiently, investing in physical infrastructure, supporting innovation and education, facilitating labor mobility, and aligning our energy policies."

Twenty years after its formation, the North American Free Trade Agreement (NAFTA) remains a useful, if incomplete, expression of the economic ties between Mexico, Canada, and the United States. It has also proven itself to be of great importance in partially achieving the full economic potential of the North American region. In order to provide a balanced and fair assessment of NAFTA at this time, I feel it is important to ask three basic questions:

1. What was the goal of the agreement when it was negotiated?

2. What is the potential of the region today?

3. What is missing to fully realize the potential of today's North America?

In many ways, we can see NAFTA as a first generation regional free trade agreement, designed in the context of the end of the Cold War, of an international trading regime in crisis, and of great concerns about the contemporary and future competitiveness of the U.S. economy. The agreement was designed to liberalize trade between the three North American nations, to improve competitiveness, and to increase levels of foreign direct investment. Many people have since associated other goals with the agreement. For example, some have argued that NAFTA was supposed to reduce or end the massive migration of Mexicans to the United States by creating jobs in Mexico. However, although NAFTA has created hundreds of thousands of jobs throughout the region, and Mexico-U.S. migration has now fallen to a level where we can say it is net-zero, this was never an official goal of the agreement.

People also criticize NAFTA for job losses in the United States, Canada and Mexico. It is certainly true that U.S. manufacturing found it increasingly difficult in the 1980s, 90s and 2000s to remain competitive as emerging markets became an integral part of the global trading system. In particular, the emergence of China as a major exporting nation has posed a serious challenge to the manufactured goods export competitiveness of the United States, Mexico and Canada but we can point to the rise of a number of other new exporting powers as threatening U.S. and regional competitiveness.

However, we can make a convincing case that, through NAFTA, U.S. manufacturers have been able to remain competitive by importing parts and components from developing countries, thereby lowering their cost structure. This is one of the most important elements that is all too often ignored NAFTA: U.S. manufacturers were able to keep skilled jobs in the United States by importing parts and components from other countries. Openness has been good for the U.S. economy: according to Fred Bergsten, in a presentation at the Wilson Center last week, the US economy is $1 trillion better off as a result of integration with the world economy over the past 50 years, and he estimates a benefit-cost ratio of 20-1 from free trade.

And this is where Mexico and Canada have played a central role. NAFTA countries used to trade goods with each other but, in the words of my Mexico Institute colleague, Christopher Wilson, now they “build them together”. Today the integration of the manufacturing systems across the North American region has meant that imports from NAFTA partners into the United States in fact involve the repatriation of value that originated in the United States. In the case of Canadian imports into the U.S., 25% of their value, on average, originated in America; in the case of Mexican imports, that figure is 40%. Compare this with only 4% in goods imported from China. By harnessing the comparative advantage of all three economies into one integrated system, North America is able to compete effectively in the global economy, and has been able to maintain value-adding activities in the United States. Importing goods from Mexico and Canada helps to promote jobs in the United States, in comparison with importing from any other region of the world.

In fact, it can be argued that NAFTA, although a less ambitious agreement than some of the models that have marked international trade negotiations since 1994, hit the “sweet spot” by providing enough liberalization to allow for growth in trade and investment, and the integration of production processes between the three countries, without creating supranational institutions of the European kind that have been shown to be highly problematical in recent years.

As for the potential of North America today, we can see it in four main factors. The first, a fully integrated production platform has already been mentioned. This factor will continue to be crucial in ensuring regional competitiveness into the future. The second factor is energy. North America’s incredible natural endowments, from the massive hydroelectric resources and oil sands of Canada, to the huge oil and gas reserves of the Gulf of Mexico, the shale gas and tight oil fields onshore, and the world class wind, solar and geothermal resources of Mexico and the US, means that the region's energy security is guaranteed for the foreseeable future. However, it is the cost of energy that has come to be of central importance in determining North American competitiveness today. The shale gas revolution has meant that gas prices and the cost of electricity generation are remarkably low by international standards, conferring a huge boost to the cost efficiency of North American manufacturing. It is this factor that has been responsible for the return of manufacturing to the United States in recent years, and the recent reforms in Mexico should allow the same process to occur there.

The third factor is human capital. North America has a demographic profile that gives it a significant long-term advantage over Europe, China and Japan. The openness of Canada and the United States to immigration has allowed those countries to maintain a steady supply of young people who provide a workforce that can satisfy labor needs. Mexico's traditionally higher fertility rate has meant that it has been a source country for many of these young people, but its changing demographic pattern now means that it will produce less migrants than before. The challenge in all three countries is now to invest in this human capital through education and training, and to allow for greater mobility of workers to satisfy the labor needs of the region as a whole. With Mexico producing more engineers every year than the United States, the opportunity seems obvious, but we must also invest in the education and training of software engineers, doctors, managers, plumbers, mechanics and technicians of all kinds. This would be best done in a coordinated fashion between the governments, private sectors and educational institutions of the three countries.

The final factor is also related to population size and the internal market. The 460 million people of the North American economic space have a spending power that far exceeds that of any other nation or region. Total North American GDP will rise from $19 trillion today to over $50 trillion by 2050, when regional population is forecast to top 630 million and Mexico is projected to be one of the world's five largest economies. Mexico, with its relatively young population, a rising middle class, and with economic growth rates expected to surpass those in Canada and the U.S., will generate the lion's share of the North American growth. This will ensure that the "domestic" market in North America remains the most important in the world, even after Chinese GDP outgrows that of the U.S.

What is needed now, then, to secure the economic future? First, we need to modernize and deepen North American integration. As mentioned above, NAFTA was completed in 1994 and was a first-generation trade agreement, before our economies and our lives came to be dominated by things such as smart phones, tablets, biotech, e-commerce or fracking. In the intervening period, and largely thanks to NAFTA, industries have developed integrated, just-in-time supply chains across borders. We must strengthen our already considerable attributes if the region is to be able to compete against other countries and regions of the world. This means continuing to harmonize regulations and standards, and to coordinate economic policy more closely between the three partners.

Second, we must invest in our people to ensure that employers have the human resources they need to remain competitive, and we need to give them the freedom to move in the region. Third, we need to invest our borders, in both infrastructure and in procedures, to ensure that the integrated production process in the region is efficient, agile and competitive. Fourth, we need to invest in energy infrastructure so that we create a fully integrated North American energy market that will ensure supply and keep prices low.

Finally, we need to think about how a strong North America can best engage with the rest of the world. The potential of the Trans Pacific Partnership is considerable, but the negotiations must take into consideration the interests, strengths and weakness of all three NAFTA partners. This means that we have to think not only about those who win from openness and free trade, but also those who lose. How do we compensate those who lose their jobs, or whose businesses cannot compete in a globalized economy? Though thorny, this question must be answered adequately if we are to maintain political support for free markets, trade and investment.

Now is the moment for the United States, Mexico and Canada to celebrate open regionalism and to take the necessary measures to make sure that our shared regional economy is strong enough to compete on the world stage. The TPP is one path but we must recognize that there are also encouraging signs, at last, from the World Trade Organization (WTO) after 12 years of stagnation. If we take the necessary measures, we can not only enjoy a more prosperous future, but also offer an example that the rest of the world may follow.