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## Lessons from NAFTA

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The North American Free Trade Agreement (NAFTA) broke new ground in several dimensions. Among other breakthroughs, it was the first major free trade agreement between a developing country and developed countries. FTAs between developed and developing countries are now more common, so it is logical to look to NAFTA for lessons as the United States pursues FTAs with several developing (as well as developed) countries.

NAFTA, while certainly successful, has not altogether met the optimistic predictions voiced by its sponsors. In fact, the most important lessons for the United States concern areas where NAFTA has been less successful than originally hoped. Before turning to six lessons from the NAFTA experience, we note a few essential differences between NAFTA and the FTAs now under consideration.

### NAFTA Differs from the Current Batch of Potential FTAs

Foremost, both the Canada-US Trade Agreement (CUSTA), which entered into force in 1989, and NAFTA, which integrated Mexico in 1994, were far greater economic undertakings than any of the new FTAs currently envisaged.

Table 2.1 illustrates the magnitude of FTAs discussed in this volume relative to NAFTA, in terms of total trade and the stock of US foreign direct investment (FDI). The Free Trade Area of the Americas (FTAA) is the most important preferential agreement now under consideration, but most of

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**Table 2.1 US exposure to current and prospective FTA partners**  
(millions of dollars)

Country/region	Trade			
	2002		1994	
	Trade with United States	Share (percent)	Trade with United States	Share (percent)
FTAA	685,995	38.44	404,940	35.53
Canada	353,061	19.79	232,400	20.39
Mexico	220,197	12.34	97,740	8.57
FTAA minus NAFTA	112,736	6.32	74,800	6.56
ASEAN minus Singapore	87,499	4.90	54,790	4.81
Korea	56,435	3.16	37,050	3.25
Taiwan	48,841	2.74	42,830	3.76
Singapore	28,834	1.62	27,000	2.37
Brazil	26,817	1.50	16,490	1.45
CAFTA	21,268	1.19	9,824	0.86
Australia	18,692	1.05	12,630	1.11
Israel	17,741	0.99	9,586	0.84
SACU	7,303	0.41	4,326	0.38
Chile	5,901	0.33	4,461	0.39
Egypt	4,151	0.23	3,380	0.30
Morocco	970	0.05	592	0.05
Jordan	809	0.05	316	0.03

  

Country/region	Foreign direct investment			
	2001		1994	
	US FDI stock in:	Share (percent)	US FDI stock in:	Share (percent)
FTAA	311,472	22.5	146,751	23.9
Canada	139,031	10.1	74,221	12.1
FTAA minus NAFTA	120,273	8.7	55,562	9.2
Mexico	52,168	3.8	16,968	2.8
Brazil	36,317	2.6	17,885	2.9
Australia	34,041	2.5	20,196	3.3
Singapore	27,295	2.0	10,940	1.8
ASEAN-9	25,684	1.9	15,600	2.6
Chile	11,674	0.8	5,062	0.8
Korea	9,864	0.7	4,334	0.7
Taiwan	8,814	0.6	3,775	0.6
Israel	4,122	0.3	1,483	0.2
Egypt	3,068	0.2	1,090	0.2
CAFTA	3,003	0.2	1,093	0.2
SACU	2,966	0.2	1,170	0.2
Morocco	55	0.0	93	0.2
Jordan	14	0.0	13	0.0

CAFTA = Central American Free Trade Agreement; FTAA = Free Trade Area of the Americas; SACU = Southern African Customs Union

Sources: For trade data: US International Trade Commission, *Tariff and Trade DataWeb*, [dataweb.usitc.gov](http://dataweb.usitc.gov), 2003. For investment data: US Department of Commerce, Bureau of Economic Analysis, *Foreign Direct Investment (Historical Estimates)*, [www.bea.doc.gov](http://www.bea.doc.gov),

the US trade and investment exposure within the hemisphere is already governed by NAFTA. Excluding Canada and Mexico, only 6 percent of US world trade in 2002 involved a potential FTAA partner.<sup>1</sup> When NAFTA came into effect in 1994, Mexico accounted for more than 8 percent of US trade. The story on FDI is similar, although not as extreme. The United States has more investment in the rest of Latin America than in Mexico, but less than in Canada.

From the US perspective, while the economic magnitude of the FTAA is similar to that of the Mexican component of NAFTA, the bilateral FTA partners identified in table 2.1 entail much smaller trade and investment ties. In 2003, the United States concluded FTAs with Singapore and Chile, which have slightly more economic importance than the previous US FTAs with Israel and Jordan.<sup>2</sup> The United States hopes to conclude an FTA with Australia by the end of 2003, but Australia constitutes only 1.1 percent of US trade and 2.5 percent of the US FDI stock. Some of the countries and regions listed in table 2.1 are more economically important and some are less, but none, from a US perspective, approaches the economic importance of Canada or Mexico.

The debate continues over what impact NAFTA has had, but most analysts reiterate the same story they told in 1989 and 1994: while the impact may be large relative to the size of Canada and Mexico, the impact on the United States is small relative to the size of the US economy and its workforce. The most recent estimate of the effect of NAFTA on US-Mexico trade is a gain of less than \$20 billion in 2001, not counting trade diversion. The effect of NAFTA on US GDP is similarly small, perhaps on the order of \$2 billion annually in a \$10 trillion economy (see CBO 2003). We think the CBO's estimates are overly conservative, but even if the true trade and welfare effects are three times as large, the magnitudes remain small compared to the size of the US economy.

This message is doubly true for the FTAs contemplated in table 2.1. Individually, they will have almost no visible economic effect on the US economy. These FTAs could have measurable effects on certain companies or industries within the United States, and they may provide important precedents for the FTAA or the Doha Development Round. Taken one by one, however, their impact on US economic welfare (as classically measured) will be hard to detect.

It is questionable whether the Bush administration should characterize these potential bilateral FTAs as engines for US growth when their effects

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1. Moreover, a relatively large sliver of US trade with FTAA countries is already covered under the Caribbean Basin Initiative and the Andean Trade Preferences Act.

2. For more analysis of the FTAs with Singapore and Chile, see chapter 4, by Sidney Weintraub, in this volume.

will be extremely small, even once the agreements are fully in effect a decade after they are signed. One of the important lessons of NAFTA, which we will discuss shortly, was that the agreement had to be oversold to ensure its passage in the US House of Representatives. NAFTA's "failure" to live up to exaggerated expectations thereafter provided ammunition for antiglobalization groups. It makes little sense to set up similar targets with the current crop of FTAs, especially when bigger fish such as the FTAA and the Doha Development Round are within sight.

If the prospective bilateral FTAs discussed in this volume make little difference to US economic welfare, then why should the United States bother with them? That is a fair question and it is discussed in detail in each of the following chapters, as well as in the overview by Jeffrey Schott. The core answer is that the benefits of FTAs go beyond narrow economic welfare calculations. They include security considerations as well as the creation of negotiating coalitions and momentum for multilateral trade liberalization.<sup>3</sup> Bilateral FTAs can provide a model for opening investment in sheltered industries (such as insurance and water) and more liberal US visa treatment for foreign workers. They can provide a model for overcoming entrenched interests in sensitive industries, such as sugar, dairy, steel, clothing, and footwear. These alternative considerations should be paramount, since the pure economic considerations measured in terms of GDP gains and better employment opportunities are very small. That said, it is possible to draw on the lessons learned from the NAFTA experience, bearing in mind that extrapolations to other FTAs require downsizing to match their smaller economic and political scales.

## Lesson #1: Top Leadership Was Essential to NAFTA

Although CUSTA was fairly uncontroversial in the United States, it was almost derailed in April 1986 in the Senate Finance Committee until President Reagan promised to find "a rapid and effective solution to the Canadian softwood lumber problem . . . independent of the comprehensive negotiations" (Schott 1988, 12). While the negotiations were sometimes sticky (especially over trade remedies), congressional ratification was reasonably straightforward, once maritime activities and agriculture were dropped from the liberalization agenda.

By contrast, NAFTA's passage was far from a certain proposition. In 1990, President George H.W. Bush had to fight a surprisingly difficult battle in the US Congress to obtain fast-track negotiating authority, which en-

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3. Correspondingly, the *costs* of pursuing bilateral FTAs go beyond crude mercantilist calculations, such as their effect on the US trade balance and unemployment rate. In chapter 1, Schott discusses some of the more subtle, yet more relevant, costs, such as overburdening US trade negotiators and deflecting attention from bigger fish.

abled the Bush administration to negotiate NAFTA and present the agreement to Congress for an up or down vote without amendments.

Of course, President Bush never got the chance to present NAFTA to the US Congress, because Bill Clinton took office in 1993. After putting NAFTA on the back burner for a few months, President Clinton launched negotiations with Canada and Mexico on labor and environmental side agreements. These side agreements were intended to pacify nongovernmental organizations (NGOs) and labor unions but, as we will discuss later, were much too weak to accomplish anything tangible. Canada and especially Mexico insisted that these agreements be both toothless and on the side (in the sense that the text of NAFTA was not reopened); otherwise NAFTA would have been put in severe jeopardy in Ottawa and Mexico City.

NAFTA, with its two side agreements, passed the US Congress with several votes to spare, but not without an unprecedented effort by the business community, the Mexican embassy in the United States, and other advocates. The business community had a real stake in NAFTA, actively monitored the negotiations, and directly influenced the text in several areas.<sup>4</sup>

Since the ratification of NAFTA in 1993 and of the Uruguay Round in 1994, the same level of political effort by the business community has been evident only in 2000, to ensure the ratification of China's accession to the World Trade Organization (WTO). Because the FTAs discussed in this volume have relatively little economic importance to the United States, it is fair to speculate that the business community may not pull out all the stops to get those agreements ratified by Congress.

Conversely, the antiglobalization lobby sees almost every battle, no matter how economically limited, in highly ideological terms. The agreement with Jordan was delayed for more than a year over the labor and environmental language in the text.<sup>5</sup> Once fast-track negotiating authority expired in 1994, the antiglobalization lobby was able to prevent it from being renewed until 2002 (under a new name, "trade promotion authority"), even though specific trade agreements were not at issue.

Perhaps the most bizarre trade debate in the 1990s concerned whether the United States would grant "normal trade relations," also known as "most favored nation" status to China prior to its accession to the WTO. If the United States had opted not to grant China normal trade relations, China could have maintained its high barriers against US exports. Thus, the US Congress essentially voted for China to reduce *its* trade barriers; but the vote was incredibly close because of the fervent opposition of the antiglobalization lobby to any trade liberalization initiative.

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4. For example, see Hufbauer and Schott (forthcoming) on the NAFTA negotiations in the automobile sector.

5. One element of the fallout from the NAFTA debate is that labor and environmental groups insist that these issues be incorporated into the text rather than relegated to side agreements. This trend will continue.

The antiglobalization lobby may choose to depict some of the potential FTAs either as precursors to future global or hemispheric trade liberalization (a bad thing, from their perspective) or as successors to their favorite bugaboo, NAFTA. The Central American Free Trade Agreement (CAFTA) seems likely to be hit with both labels—as a precursor to the FTAA and as an extension of NAFTA. Strong opposition to several FTAs seems assured, and some may not pass the congressional gauntlet.

To get congressional approval, each FTA will need energetic backing from the White House and a close-knit group of supporters from the business community.<sup>6</sup> Foreign governments and the firms they represent—those with the largest stake in each FTA—must be geared up for a vigorous lobbying campaign.

Some countries will fare better owing to political and security considerations. The FTA with Australia is advancing rapidly because Australia supported the US war against Iraq. New Zealand's exclusion from the negotiations is attributable both to its opposition to the US war and to its break with the US security alliance in the 1980s. Conversely, an FTA with Morocco or Bahrain could advance on the back of the US need to build relations with Muslim countries.<sup>7</sup>

## **Lesson #2: Beware the *Post Hoc Ergo Propter Hoc* Fallacy**

The Romans recognized that “after this” does not prove “because of this,” but many analysts on both sides of the NAFTA debate uncritically attribute much that has happened in the US-Mexico bilateral relationship over the past eight years to NAFTA. For example, many credit NAFTA for the massive increase in US imports from Mexico, even though NAFTA reduced US tariffs by only 3 or 4 percent. Also, many have blamed NAFTA for Mexico's peso crisis in 1994 and 1995, even though NAFTA entailed very little change in the way Mexico conducted its finances. Zapatistas disingenuously told Western journalists that they were revolting against NAFTA, even though much of southern Mexico is isolated from international markets. Finally, some critics blame the influx in migrants from Mexico on NAFTA, even though NAFTA did not change migration rules in any meaningful way.

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6. Some members of the business community might decide to vigorously support an agreement because it contains particular language that could serve as a precedent for more ambitious trade liberalization initiatives. One recent example was the intellectual property rights text in the US-Chile FTA.

7. In May 2003, President Bush announced plans for an FTA that would eventually encompass most of the Middle East, starting with an agreement with Bahrain. For a discussion of FTAs in the Middle East context, see chapter 11, by Ahmed Galal and Robert Lawrence, in this volume.

FTAs make no pretense at addressing the whole range of problems that developing countries face. NAFTA contributed positively to the economic development of Mexico, but Mexico has taken many positive steps on its own over the past 20 years. Moreover, Mexico will have to make many reforms over the next 20 years, independent of NAFTA, if it is to grow at a pace that will meet the demands of the Mexican population.

The process by which FTAs are ratified encourages supporting politicians to make extreme promises. In the next round of FTAs, governments should endeavor to raise the level of debate rather than attempt to “out-fallacy” their opponents. Overhyping FTAs when they are signed sets the stage for overblaming FTAs after they are implemented. If this pattern continues, the United States will find it more difficult to muster the legislative support necessary to pass big liberalization packages in the WTO and FTAA.

### Lesson #3: Job Counts Are a Fool’s Errand

As an example of the way in which NAFTA has been poorly analyzed, consider the obsession with “job counting.” First, the media mistakes job turnover for permanent changes in the US labor market. US employment growth is largely determined by productivity and real GDP growth. The Federal Reserve attempts to tune monetary policy to balance real GDP growth against excessive inflation.<sup>8</sup> Exposure to the international economy affects how jobs are distributed across sectors of the economy, not the absolute number of jobs. An FTA may boost employment in one sector and diminish employment in another sector, but the net effect will be very small, *especially relative to the size of the US workforce and the normal amount of job turnover that occurs in a multitrillion-dollar economy.*<sup>9</sup>

The fact that the net job effects are small does not eliminate the concerns of those who lose their jobs. A worker displaced by foreign competition will almost always find another job eventually, but the pay may not be as good and the loss of wages and benefits incurred between jobs may be substantial.<sup>10</sup> A job “created” by exports is probably filled by someone

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8. Beginning in May 2003, the Federal Reserve also became concerned about preventing deflation, but this is the first time since the Great Depression that deflation has been considered a serious possibility in the United States.

9. The US workforce averaged 136 million between 1999 and 2001. In that three-year period, 9.9 million workers were involuntarily “displaced.” In 2001, there were 112 million hires and separations (over half of which were workers quitting). By one set of estimates (discussed below), US merchandise exports to Canada and Mexico may support 74,000 jobs annually, while job dislocation on account of imports from North America does not exceed 51,000 jobs annually.

10. See Kletzer and Litan (2001) for a wage-insurance proposal, which would go a long way toward ameliorating these two concerns. This proposal was adopted, in a very limited way, in the Trade Adjustment Assistance renewal, which was passed in August 2002.

who already had a different job. This process of musical chairs only indirectly results in an opportunity for a previously unemployed person. Thus, the emphasis in a trade agreement should be on the dynamics of job turnover, and the associated costs and benefits, rather than the aggregate level of employment.

Furthermore, only a relatively small share of job dislocations caused by trade are properly attributable to the trade induced by NAFTA or another FTA. When a US plant is in such precarious financial straits that it shuts down and moves to Mexico, it probably would have moved somewhere at some point with or without NAFTA. Thus, the plant's workers would very likely have been forced to find new jobs with or without NAFTA. If the United States had an adequate social safety net to help displaced workers manage the transition from one job to another, it should not matter whether a plant that closes moves to a neighboring state or a neighboring country, or whether, in the latter case, the country in question has an FTA with the United States. In reality, the US social safety net is inadequate, but the blame should not be placed on NAFTA or other FTAs. Labor groups should lobby Congress to fund trade adjustment assistance (TAA) programs more generously; but labor has historically been reluctant to support TAA, fearing that such programs would make trade liberalization more likely to pass Congress.

It is instructive to look back at some of the estimates of NAFTA's effect on labor markets, not because they are useful but because many of them are *useless*. For example, Ross Perot and Pat Choate (1993) predicted that 5.9 million US manufacturing jobs would be put at risk by NAFTA, thereby using the popular rhetorical technique of claiming that a large number of people *might* lose their jobs while avoiding the pesky detail of specifying the *probability* of such job loss. There was indeed a small risk that each of these 5.9 million jobs would be relocated to Mexico, and undoubtedly a small fraction of these 5.9 million jobs did in fact move to Mexico. But the "great sucking sound" was never heard. Instead, the "small sucking whisper" was drowned by the roar of the US economy as it steamed ahead during the latter half of the 1990s.

More recently, Robert Scott (2001) of the Economic Policy Institute has claimed that

The North American Free Trade Agreement (NAFTA) eliminated 766,030 actual and potential U.S. jobs between 1994 and 2000 because of the rapid growth in the net U.S. export deficit with Mexico and Canada. The loss of these real and potential jobs is just the most visible tip of NAFTA's impact on the U.S. economy.

The footnote associated with this quotation illustrates Scott's reliance on *post hoc ergo propter hoc* reasoning. Scott admits that "[t]he total number of jobs and job opportunities is a measure of what employment in trade-related industries would have been if the U.S.-NAFTA trade balance remained constant between 1993 and 2000, holding everything else constant."

The only way to leap from the footnote to Scott's claim in the text is to assume that NAFTA is responsible for the entirety of the change in the US-NAFTA trade balance between 1993 and 2000, which is quite a stretch.

Public Citizen, an organization founded by Ralph Nader, takes note of 525,094 workers certified for assistance under the NAFTA-TAA program between January 1994 and January 2003 (Public Citizen 2003). This figure both understates and overstates the number of workers displaced by NAFTA. The understatement occurs because not all workers that are displaced by NAFTA apply for NAFTA-TAA benefits. Some may find new jobs immediately, some are not eligible, some may apply for benefits under the regular TAA program, and some are unaware of their eligibility.

The overstatement is caused by the terms of the program: to be certified under NAFTA-TAA, the worker need only show that his or her job was adversely affected by imports from Canada or Mexico or that his or her firm moved to Canada or Mexico. The worker does not have to prove that NAFTA liberalization *caused* the imports or the firm's relocation. Moreover, there is no need to establish that the job was immune to other economic forces.

In contrast to the authors of studies such as those cited above, which consider only US imports from NAFTA partners, Raul Hinojosa-Ojeda, David Runsten, Fernando Depaolis, and Nabil Kamel (2000) claim that combined US exports and imports with Mexico have a net positive effect on US employment of about 74,000 jobs annually. However, they do not attempt to specify what fraction of US-Mexico trade is attributable to NAFTA, and what fraction would have occurred without it.

Thus, it is useful to recall the words of Hufbauer and Schott (1993, 20):

NAFTA . . . will not exert a perceptible long-run impact on overall employment levels or on the overall merchandise trade balance. In the long run, the impact of NAFTA will be offset by other changes in microeconomic policy or will be lost as noise in the background of macroeconomic events.

The same is certainly true for the FTAs considered in this volume. The lesson is that FTAs are essentially irrelevant to employment levels in the long run and that the United States is better served when FTAs are evaluated on other criteria.

## **Lesson #4: Paper Agreements Can't Create Social Miracles**

The labor and environmental side agreements were never intended to make substantial progress in addressing labor and environmental problems.<sup>11</sup> The labor side agreement is little more than a toothless list of

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11. For a more comprehensive treatment of the two side agreements, see Hufbauer and Schott (2002, 2003).

hopes and aspirations. The environmental side agreement is somewhat stronger; but no NAFTA country, especially the United States, wants intrusive surveillance of domestic environmental policies, nor is any country willing to provide large-scale funding for needed infrastructure to clean up the border zone. The two side agreements were weak by design, because Canada and Mexico would not have accepted them if they were strong enough to achieve their stated purposes.

The real purpose of the labor and environmental side agreements was to provide political cover for Democrats to support NAFTA so that they would not incur the wrath of labor unions and environmental NGOs. Viewed in these terms, the two side agreements were partially successful: NAFTA ultimately passed with the support of a fair number of congressional Democrats. However, the labor unions and NGOs have since used NAFTA “failures” as a rallying cry, and they successfully derailed substantial trade liberalization during the latter half of the 1990s.

While some in NGOs (primarily mainstream environmentalists) genuinely believe that trade sanctions can be a powerful tool to address social ills, others (in hard-core labor unions, radical environmental groups, and antiglobalization NGOs) have successfully demonstrated that social issues can be a powerful instrument to block trade agreements. The first group is wildly overambitious: they fail to take into account that long-term economic growth is the principal engine for meaningful progress on social issues. Poor countries, as a general rule, have neither the ability nor the desire to significantly address social issues before they are sufficiently developed. Once a country reaches a level of development at which it can afford to address social problems, solutions can be envisaged, but trade and investment agreements will play a minor role relative to domestic political forces.

Radical environmentalists and hard-core labor unionists in the second group seldom entertain the noble belief that trade and investment agreements can cure social ills. Radical environmentalists frequently believe that development is the cause of, not the solution to, environmental problems. Thus, their support of the environment is inseparable from their opposition to development. For their part, hard-core labor unions seek above all to reduce the chance that manufacturing firms will relocate to countries that have a comparative advantage because of low wages. Toward this goal, they champion higher wages in the export sectors of developing countries so that wage disparities might be reduced.

The goal of antiglobalization NGOs is to drive a wedge between developed and developing countries. They want developed countries to insist that trade agreements contain language on social issues that is too strong for developing countries to accept, thereby scuttling the agreement. Antiglobalization groups were able to delay NAFTA and the US FTA with Jordan, and to disrupt the WTO ministerial meeting in Seattle. But they failed to get strong language on social issues included in the Doha decla-

ration. Since Doha, FTAs between developed and developing countries are becoming more common.<sup>12</sup>

These ideological battles will continue indefinitely, but the era for side agreements has passed. New trade agreements must at least pay lip service to social issues in the text itself. The challenge for trade negotiators is to find language on social issues that all parties can accept. The lesson from NAFTA, as well as from US FTAs with Jordan, Chile, and Singapore, is that agreements are possible, but they will not come easily.

## **Lesson #5: Dispute Settlement Mechanisms Are Good but Imperfect**

NAFTA was novel in that it included a dispute settlement mechanism. Canada and Mexico were eager to rein in US antidumping (AD) and countervailing duty (CVD) actions. The dispute settlement provisions did not stop US firms from filing numerous unfair trade cases against Canada and Mexico. However, under NAFTA, national AD and CVD actions were typically vetted, after the fact, by impartial NAFTA panels.

NAFTA's dispute resolution procedures are spelled out in six different chapters. So far, there have been no disputes under Chapter 14, which pertains to financial services. By contrast, 85 cases have been handled under Chapter 19, which pertains to AD and CVD actions. With a few exceptions, notably softwood lumber and wheat, these 85 cases have been successfully handled with little fanfare.

So-called investor-state disputes under NAFTA Chapter 11 have attracted the most media attention. An impression has been created that foreign companies flagrantly abuse Chapter 11 to overturn national environmental laws. The charge is exaggerated. Of the 27 cases filed under Chapter 11, the investor has won 5 times, while the state has won (or the case has been terminated) 7 times. The remaining 15 cases remain to be concluded. The biggest controversy concerns proper interpretation of the "tantamount to expropriation" standard, and the United States has qualified this language in its recent FTAs with Chile and Singapore.

Dispute proceedings under the environmental side agreement have been mixed. A few modest decisions have been handed down, but the proceedings are hampered both by the absence of common standards and by administrative barriers. Dispute proceedings under the labor side agreement are essentially a waste of time. There are no common standards, administrative barriers create serious difficulties, and potential remedies are very weak.

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12. See chapter 1, by Jeffrey J. Schott, in this volume for a more detailed look at the composition of FTAs.

Chapter 20, which is a catch-all provision for disputes not specifically covered in other NAFTA chapters, has also been disappointing. Panel opinions under Chapter 20 are only advisory, although they put political pressure on countries to change their ways. Of the three disputes pursued to completion under Chapter 20, the one provoked by the blatant refusal of the United States to allow Mexican trucks to carry goods beyond the border zone has been the most notable. This issue is currently thought to have been “resolved” by imposing a discriminatory safety regime on Mexican trucks and drivers.<sup>13</sup> However, some members of the US Congress still object to the outcome, and Mexico will, at some point, probably contest the US safety inspection regime.

NAFTA illustrates that bilateral mechanisms designed to solve commercial disputes can succeed—but only outside the realm of high-profile cases. Dispute settlement provisions of the environmental and labor side agreements have been less successful, but that was intentional. The United States seems to have learned its lesson on investor-state disputes, and future agreements will be less ambitious in this area.

## Lesson #6: An FTA Is the First Step

Although NAFTA has exerted only a small impact relative to the large US economy, its effect on the Canadian and Mexican economies has been much greater. Still, NAFTA is simply one step forward for Mexico and Canada, as they attempt to grow their economies and cement their relations with the United States.

Measured in purchasing power terms, Mexico’s real per capita income (in 2002 dollars) increased from \$5,483 in 1993 to \$6,200 in 2002. A 13 percent increase in real per capita income over the course of a decade is decent, but the average Mexican is still very poor.<sup>14</sup> Robert Pastor (2001) persuasively argues that the principal shortcoming of NAFTA, so far as Mexico is concerned, is the absence of funding mechanisms to promote development. He contends that the United States should make Mexico’s development an explicit priority, both for the sake of Mexico and to make progress on issues that are important to the United States, especially drug trafficking and illegal immigration.

Like its predecessors, the Bush administration recognizes the importance of development but overemphasizes the role that trade and investment agreements can play in spurring economic growth. Commercial

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13. The Bush administration’s solution is now in court, challenged by NGOs on environmental grounds.

14. US real per capita income increased 21 percent over the same period (these figures are from IMF 2003).

agreements can help lock in domestic reforms, but the impetus for reforms and liberalization must come from the partner country itself. Developing countries will often require substantial financial assistance both from the United States and from multilateral institutions in order to implement ambitious visions for faster growth. The United States has not applied these lessons learned in the NAFTA context. US policy continues to emphasize the same heavy reliance on commercial agreements when negotiating FTAs with other developing countries.

Canada and Mexico are both thinking about “big ideas” to deepen their integration with the United States.<sup>15</sup> Most of the big ideas are well ahead of what might be contemplated in other FTAs for a decade or longer, but they are worth mentioning as possible harbingers. Mexico’s main big idea is amnesty for illegal immigrants in the United States; but Mexico has little to offer in return, except expanded access to its oil sector. For political reasons, this is currently a nonstarter.

Canadians outside the government are thinking about a package that involves three big ideas:

- common defense and security initiatives,
- an energy-sector agreement, and
- renewed emphasis on economic integration.

All these topics run ahead of official thinking in Ottawa and Washington. But the important lesson for the United States is that once FTAs are put into effect, some partner governments will continue to search for ways to deepen the relationship. If the United States views FTAs solely as economic arrangements, and not as stepping-stones for progress on a wide range of issues, then potential benefits from the FTA agenda will be lost.

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15. For the genesis of “Big Idea Thought,” see Dobson (2002).

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