
Recommendations for North American Economic Integration

NAFTA is unique among US free trade agreements. It involves two of America's largest trading partners—countries that share long land borders with the United States. Geography gives NAFTA enormous regional coherence, while presenting the opportunity and challenge of closer ties that are advantageous to all three parties.

As this volume has documented, NAFTA has succeeded in advancing economic integration in North America. In some dimensions, it has surpassed expectations. North American trade has increased much more rapidly than forecast by most economic models. Liberalization in the auto sector has sparked a movement toward specialization, with productivity improving in all three countries. Direct investment in Mexico has been robust. Trade disputes have been well managed, albeit with a few notable exceptions.

In other areas, however, NAFTA's footprint has been small. Attempts to draft common NAFTA rules on subsidies and antidumping (AD) and countervailing duties (CVDs) were abandoned. Side agreements on labor and the environment saved NAFTA from congressional defeat but were not backed by meaningful financial resources or authoritative judicial mechanisms. Energy policy was included in the pact, but Mexico was exempted from the most important provisions regarding investment. By opting out of these energy obligations, Mexico missed an opportunity to attract much-needed investment and technology for expanding its energy production. Mexican energy policy is causing the country two self-inflicted wounds, as

it deals with energy shortages at home while forgoing additional revenue from oil and gas exports to the United States and other countries.

While NAFTA encouraged structural reform of the three economies, it left the task of managing the adjustment process to each government. National adjustment programs have been generally limited and underfunded. In the United States, inadequate adjustment policies continue to feed worker discontent about globalization in general and US trade policies in particular. In Mexico, the adjustment burden was far greater and the resource constraints severe. Mexico compounded these problems by failing to use the opportunities NAFTA opened to build new infrastructure and create adequate alternative employment for the agricultural workforce. The Mexican political system has been unable to produce tax and energy reforms, which would generate new resources to fund investments in physical infrastructure and social services, especially education. As a result, Mexico continues to suffer from a high “TECC” problem: high transport, energy, and capital costs. These factors have limited Mexico’s ability to take full advantage of NAFTA and have put Mexican industries at a competitive disadvantage against foreign competitors, particularly China.

For some observers, our nuanced assessment of NAFTA’s benefits and shortcomings, set forth in previous chapters, will prove too complicated to digest. Many of them may continue to rely on the US media’s aggressive but simplistic sound bites that denigrate NAFTA for the “broken promises” of its political creators. Others may discount the aggregate gains because of continuing concerns about high levels of illegal immigration, slow progress on environmental problems, weak enforcement of labor standards, declining real wages in Mexico, and increased transshipments of illegal drugs. Accounts of these injustices are customarily, if loosely, associated with NAFTA and globalization.

Anti-NAFTA reverberations still echo in the US political arena. The “No More NAFTAs” rallying cry has been revived most recently in the contentious congressional debate over ratification of the Central American Free Trade Agreement (CAFTA). For better or worse, part of the NAFTA legacy is more bitter and divisive trade politics in the United States (Destler 2005). However, NAFTA also has focused attention on US trade relations with Latin America and the Caribbean, engaging the interests of a growing segment of the American electorate of Hispanic heritage. Given the sharp divisions in Congress on trade, Hispanic electoral considerations now are given greater weight. Republicans and Democrats alike energetically court the Hispanic vote in presidential, congressional, and statehouse races. NAFTA politics thus remain complex and contentious.

This chapter presents our assessment of the potential for closer ties in North America, building on the strong base of North American trade and investment, which we analyzed in the previous chapters. We neither propose nor foresee the deep integration being pursued in Europe (which is driven by the ultimate goal, among European elites, of political union) as

the model for North America.¹ Given sovereignty concerns and large disparities in size and wealth among the three countries, plus new security imperatives, we do not expect or seek extensive legal harmonization or anything approaching free migration. Rather, we take a more pragmatic approach and target the reduction or elimination of *specific* barriers to the movement of goods, services, capital, and people where the economic benefits to the NAFTA partners are almost certainly large.²

Weighing the achievements and shortcomings, we have given NAFTA a positive, but not uncritical, assessment. In economic terms, NAFTA has more than delivered what it promised, and most of our criticisms seek to strengthen and deepen the accord, not cut back on commitments. Unlike some critics who would like to reopen—and thus effectively unravel—the NAFTA compact, we look for areas where NAFTA can be expanded to address unfinished business and new challenges that arose after September 11, 2001.

Post–September 11 Challenges

Since September 11, the NAFTA partners have had to face a new and overriding challenge: addressing the added security measures to deal with potential terrorist threats. In response, the United States has erected new speed bumps on NAFTA’s superhighways and around its ports. Heightened security measures impose two burdens on NAFTA trade: They make it more costly and cumbersome to move goods and people across borders and create a zone of uncertainty around investment in Canada and Mexico. Many producers, recognizing their strongest interests are in the large US market, may tilt investment away from Canada and Mexico.

Security considerations pose a particular challenge to businesses that have integrated their operations on a regional basis—one of the great virtues of the trade association. Many manufacturers, particularly in the auto industry, closely link their production facilities in the United States, Canada, and Mexico and suffer when even temporary border delays block shipments between nearby plants. Since NAFTA, much of the increase in US-Mexico trade has been spurred by US companies that established manufacturing plants in Mexico, seeking lower labor costs for slices of the value added chain. Maquiladora exports in 2003 (about \$78 billion) represented about half of total Mexican exports of manufactured

1. The setback to European political union, delivered in May and June 2005 by “no” votes in France and the Netherlands on the constitutional treaty, hints at the much stronger opposition that even a slight move toward political union would face in North America.

2. Our recommendations in this chapter revise and extend the analysis put forward in Hufbauer and Schott (2004). See also Goldfarb (2003b), who summarizes a number of ideas other commentators propose for deeper integration.

goods (\$141 billion) (Banamex 2004). Maquiladora exports, as well as enormous quantities of merchandise arriving daily from Canada, are all vulnerable to security delays.

Moreover, in the United States, the issues of closer economic relations have been subordinated, at least temporarily, to the immediate demands of national security. Four years later, the aftershocks of attacks in New York and Washington still reverberate through public discourse. Security considerations color all aspects of regional and international relations. US-Canada cooperation has deepened as the two countries implement their Smart Border initiative (with some 35 working agendas). Similar measures have been put in place on the Mexican border.

This new reality poses additional challenges and opportunities for North America. NAFTA provides a solid foundation for new North American initiatives. The political imperative to work together has never been greater. But melding the security and economic objectives of the three countries is now more complex.

To deal effectively with security issues noted above, the NAFTA countries must reassess their go-slow approach to closer economic relations. The North American agenda is rich with proposals to support and smooth the integration of the three economies. At present, some 30-odd regional committees and working groups address NAFTA initiatives in an ad hoc manner. The new "Security and Prosperity Partnership of North America," announced by Presidents George W. Bush and Vicente Fox and Prime Minister Paul Martin at the Crawford Summit on March 23, 2005, reorganizes these specific efforts under several broad themes but treads lightly on more comprehensive and longer-run initiatives to deepen economic integration.³

What forces will catalyze political leaders to move the North American project forward? In the early 1960s, the political impetus for governmental action came from US and Canadian automakers. In the 1980s, Canadian business leaders promoted the Canada-US Free Trade Agreement (CUSFTA). In 1990, Mexican President Carlos Salinas dared the United States to accept Mexico as an FTA partner and convinced Canada to join the ensuing trade negotiations. The impetus in 2005 comes from the push for border security.⁴ The NAFTA partners must work more closely together now for two reasons: first, to prevent terror attacks, and second, in case of additional terrorist attacks down the road, to be less disposed to

3. Documents pertaining to the Security and Prosperity Partnership are available on its Web site, www.spp.gov (accessed on June 30, 2005).

4. Despite high oil prices, concerns about energy security have not yet prompted new collaborative energy projects. However, all three countries pledged at the Crawford Summit to pursue national initiatives "to increase reliable energy supplies for the region's needs and development." See Prosperity Agenda, White House Press Office, March 23, 2005, www.spp.gov/spp/prosperity_agenda/index.asp?dName=prosperity_agenda (accessed on June 30, 2005).

respond with knee-jerk actions that disrupt goods and people moving across borders and thereby spawn enduring political acrimony. But preemptive preparations need economic fuel as well. The key is to find the right combination of economic and security initiatives that will spur political leaders of all three countries into action.

Hufbauer and Vega-Cánovas (2003) argue that we need a common vision on NAFTA—one that builds on past successes and that posits a new agenda for a Common Frontier (also labeled a Security Perimeter) involving policy convergence in areas such as customs and energy regulation, migration, and even monetary cooperation. These issues have long percolated in the substratum of trilateral relations but have been deferred due to heavy resistance by powerful political constituencies in each country.

Wendy Dobson (2002) puts forward similar themes from a Canadian perspective. She argues that Canada and the United States should pursue a “strategic bargain” that would involve deepening the existing NAFTA relationship, “without full-scale harmonization” of policies of the kind that emerge from traditional customs union and common-market negotiations, which dilute the political independence of member countries.

According to Dobson (2002, 30), “only a Big Idea is likely to attract US attention.” In the context of trade politics, Dobson’s view draws from the experience of past GATT rounds (progressively bigger events), as well as the history of the CUSFTA and NAFTA. Where small proposals foundered, large bargains eventually succeeded—not because they were easy to negotiate but because they enlisted the attention of US presidents and enabled cross-sector agreements that balanced competing political interests and mobilized enough US business interest to spur congressional support. While small bargains in the form of bilateral FTAs have flourished in recent years, in most cases these accords are seen as way-stations to bigger deals like the Free Trade Area of the Americas (FTAA) or the long-run pursuit of a Middle East FTA. The balance of postwar trade history still leans heavily toward Dobson’s thesis of a Big Idea as the way to get noticed and supported in Washington.

Fitting the bill, border security has certainly attracted the attention of official Washington. However, border security alone does not give Canada or Mexico added leverage to negotiate reforms in US policies long resistant to change. Cooperation on security benefits all three countries, and the costly alternative to cooperating with the United States on security matters—for both Canada and Mexico—is less efficient and more intrusive border restrictions by the United States.

Still, the border security issue establishes a higher priority for new negotiations on an agenda of complementary economic and security concerns. In this regard, Dobson’s idea of a “strategic bargain” makes sense, especially since the two countries already have extensive economic integration in autos, steel, and energy infrastructure. To date, however, the Bush administration has given scant attention to proposals to deepen eco-

conomic integration in North America—with the notable exception of border security pacts. Big ideas have simply not resonated among Washington officials riveted on Afghanistan, Iraq, the broader Middle East, and the war on terror.

Upgrading NAFTA

After a decade of progress, the three NAFTA partners still have important unfinished business. Economic growth in Mexico has lagged well behind its potential even while the United States enjoys a cyclical recovery; the region remains vulnerable to volatile energy prices and supply shortfalls; illegal immigration still confronts political leaders on both sides of the Rio Grande; and civil society continues to demand that governments redress labor and environmental abuses, particularly along the US-Mexico border.

For better or worse, many of these issues are linked politically. For the United States, faster economic growth in Mexico is critical to strengthening security on its southern border, while deeper cooperation with Canada on border security initiatives is essential to ensure the efficient flow of goods and people across the long northern border. Mexico's economic prospects depend on reforms of Mexican tax and energy policies and extensive new investment in a sector that has been closed to foreign participation for seven decades.

Energy should be a standalone priority for Mexico, though political realities may require attention to the plight of Mexican migrants to the United States—both those settled for a long time and the annual flow of new immigrants—as an unstated *quid pro quo*. Moreover, plans for needed energy infrastructure investments will have to balance economic payoffs, sovereignty concerns, and environmental impacts.

Indeed, if Mexico is to take full advantage of NAFTA's opportunities, it will need to invest heavily in several key areas to not only redress energy shortfalls but also upgrade transport and telecommunications networks and public services like water and sewage treatment. Doing so would create better opportunities for economic development in the poorer regions of southern Mexico and would reduce the "Mexico cost" that weighs heavily on the international competitiveness of Mexican industry.

To generate the significant sums required for such investments, Mexico will need to attract both domestic and foreign funds. First, however, the Mexican government must pursue domestic economic reforms that generate substantial new revenues for the Mexican Treasury and create a more conducive policy environment for new investment. Only then should consideration be given to regional initiatives that pool contributions from the United States and Canada for Mexican infrastructure projects. Without prior domestic reforms, proposals to leverage foreign assistance to Mex-

ico—including a North American Investment Fund—would likely be rejected out of hand.⁵ Indeed, it would be counterproductive to ask Washington and Ottawa to subsidize Mexican infrastructure investment unless the Mexican government is first willing to tap its own resources.

New initiatives in the areas of trade, energy, migration, and finance could help deal with pressing problems in each country, while promoting closer security ties to better handle the aftershocks of future terrorist attacks. At the same time, more could be done to strengthen NAFTA's environmental and labor provisions, and its institutional foundations, building on the experience of recent trade pacts. We examine in brief what might be achieved on each topic.

Deepening the Trade Bargain

We have devoted an entire chapter to each of the three largest markets for North American trade: agriculture (chapter 5), autos (chapter 6), and energy (chapter 7). These chapters provide a detailed picture of the past, present, and future of the industry in North America with our sector-specific recommendations. In this concluding chapter, we go further and suggest several broad initiatives that would deepen trade in all economic areas by progressing toward a common external tariff (CET) and streamlining NAFTA rules of origin.

The CUSFTA, followed by NAFTA, went a long way toward removing border barriers to merchandise trade between the three countries. However, key problems have proven immune to negotiated fixes, most notably issues surrounding softwood lumber, wheat, and sugar, as well as the broader questions raised by agricultural subsidies and contingent protection. Negotiators may want to tilt against these windmills again,⁶ but we believe a more fruitful strategy would address a less contentious source of distortion in North American trade and investment—differences in the most-favored nation (MFN) tariffs applied against imports from third countries. Indeed, it is plausible to foresee acceptance of a CET in the NAFTA region for a wide range of merchandise by the end of this decade.⁷

5. We strongly doubt members of the US Congress would agree to finance Mexican projects, particularly given the constraints that the large US budget deficit imposes on projects in their own districts. Instead, we favor a large increase and restructuring of the North American Development Bank (NADBank) project finance, which supports new investment in both countries (see chapter 3 and below).

6. In our view, the disputes just mentioned, together with trucking, fisheries, avocados, and several others, are best addressed through mid-level dispute resolution procedures, with only occasional intervention from top political leaders.

7. For a discussion of a CET between Canada and the United States, see Goldfarb (2003a). She believes the CET would work to the economic advantage of both countries, though it faces a number of obstacles.

As a technical matter, the NAFTA partners could move toward a CET if the two members with higher MFN tariffs would lower their rates toward the level of the member with the lowest MFN rate, thereby gradually harmonizing their MFN tariffs on industrial goods. This approach has two advantages: It promotes new trade liberalization and provides the most direct way to reduce trade distortions generated by NAFTA rules of origin.

Trade Liberalization. There is already a high degree of convergence between US and Canadian MFN tariffs. Mexican levies are generally much higher, though they are applied to only a small share of Mexican imports due to Mexico's extensive network of FTAs. The notable exceptions from Mexico's FTA network are countries in East Asia, although Mexico and Japan recently concluded an FTA, which entered into force in April 2005. Mexican officials have been reluctant to discuss harmonization of MFN tariffs in the NAFTA region because of their higher-bound rates; they would therefore have to change tariff schedules more than the United States and Canada to implement a CET. In addition, Mexicans fear increased competition from China if they lower their MFN tariff shield.

Neither concern should deflect progress toward a NAFTA CET, for two reasons. First, a CET probably would be implemented incrementally over a fixed period. Initial steps could comprise World Trade Organization (WTO) commitments undertaken in the context of the current Doha Round negotiations in the WTO, which may include tariff elimination for specific sectors under "zero-for-zero" pacts. Second, Mexico has and already uses other trade policy tools besides MFN tariffs to protect domestic firms against aggressive Chinese competition. Safeguard measures and AD actions already are an integral part of Mexico's policy toolkit; in addition, like the United States, Mexico could invoke—at least through 2013—special safeguard provisions, accepted by China in its protocol of accession to the WTO, to limit import surges.⁸

We do not envisage that a CET would limit any NAFTA member from concluding additional bilateral or regional FTAs with other countries, nor would it alter the terms of existing FTAs. Thus, for example, the United States would be free to negotiate an FTA with Switzerland, Korea, or the entire Middle Eastern region. However, an FTA between one NAFTA member and a third country could raise legitimate "rule of origin" issues—namely a concern that the third country could transship goods to the other two NAFTA members by taking advantage of its FTA privileges. We address this concern in the next section.

Rules of Origin. The record-keeping and transactions costs of meeting rules-of-origin requirements are substantial. Rules of origin are included

8. The special safeguards applicable to imports from China are described in Hufbauer and Wong (2004). Paragraphs 238 and 241 of China's Protocol of Accession to the WTO authorizes these safeguards.

in trade pacts for two basic reasons. The more principled argument is that rules of origin are necessary to prevent the low-tariff NAFTA member from importing goods from third countries and then reexporting them—as is or as components of larger assemblies—to the high-tariff members (trade deflection). The political, and protectionist, rationale for rules of origin is far more crass: to throw up a nontariff barrier against imports from countries outside the trade arrangement.

A common MFN tariff at least does away with the principled trade deflection rationale, giving liberal-minded trade ministers a better chance of overriding the protectionist support for rules of origin. Technically this could be done by a NAFTA provision that says that rules of origin no longer apply after all three NAFTA members get to a stage where 90 percent of their MFN eight-digit Harmonized Tariff System (HTS) rates in any two-digit HTS group fall within plus or minus one percentage point of the average for the three countries.⁹

Moreover, to deal with the possibility of trade deflection by way of shipments from an FTA partner to a NAFTA member, we suggest the following rule. If any NAFTA member suspects that trade deflection is occurring on a substantial scale in a two-digit product group, it could invoke the old rules of origin (a “snap-back” provision). However, the snap-back would be subject to review under the provisions of Chapter 20.

Even with the FTA snap-back, to be saleable in the United States, the CET would need to exclude key agricultural imports, and it might require long phase-in periods for highly sensitive industrial products.¹⁰ Otherwise, the protected farmers and companies would overwhelm the tax-cut argument with cries of “giveaways to Brazil and the European Union” (agriculture) and “giveaways to China” (textiles and clothing). However desirable, we don’t see talks dealing with all agricultural tariffs—much less farm quotas and subsidies—even though the three countries will need to accept some liberalization of farm trade barriers in the context of WTO and FTAA negotiations. The political problems that kept these barriers intact in the CUSFTA and NAFTA are still alive. A CET may be possible for

9. Within the two-digit HTS group 87, labeled “Vehicles, other than railway or tramway rolling stock, and parts and accessories thereof,” there are 68 HTS tariff lines with eight-digit identities—such items as 8701.10.00, “Pedestrian controlled tractors,” and 8708.94.50, “Steering wheels for other vehicles.” Under our proposal, if 90 percent of these eight-digit lines (namely 61 lines) have MFN tariff rates by the three NAFTA countries that are within one percentage point of the average for the line, then there would be no rule of origin on any item within the two-digit HTS group. Shipments of any included item from one NAFTA member to another would clear customs with no inquiry as to where the item was originally made.

10. In chapter 5 on agriculture, we lay out a path that would lead to the eventual adoption of an agricultural CET. NAFTA should be able to achieve a CET in other products (primarily manufactures) well before the ground is suitably prepared for common tariffs on agricultural products.

selected farm products like Brussels sprouts, apples, and flaxseed. But to list the eligible products is to reveal the limitations. The dairy complex, field crops, cattle, and pork are all beyond the scope of a CET in this decade.

Similarly, it will be difficult to extend a CET to highly protected industrial sectors like textiles and clothing. It is a hard political fact that the US textile and clothing industries are gearing up for the fight of their lives with the removal of Multi-Fiber Arrangement (MFA) quotas. The industries are mounting at least two counterattacks. They are already confronting China with multiple safeguard suits. India and other big suppliers may soon be targets as well, not only for safeguard suits but also for AD actions. Meanwhile, the industries will insist that any reduction or elimination of tariff barriers be concentrated in FTAs and unilateral measures like the Caribbean Basin Initiative (CBI) and the African Growth and Opportunity Act (AGOA)¹¹—not the WTO—and that tariff reductions be accompanied by tight rules of origin. The two industries will do their best to ensure that only fiber, yarn, and cloth made within the preference zone (which excludes China, India, and other major suppliers) is eligible for reduced or zero tariffs. In light of these strategies, the US textile and clothing industries will resist any reduction of US MFN tariffs in a CET framework, and they will adamantly oppose the elimination of rules of origin. Similarly, Mexico is applying its own draconian safeguards against Chinese apparel imports. Mexico, like the United States, will be loath to reduce its high MFN rate structure, since it serves as the first line of defense against Asian clothing exporters. Because of the political muscle at work, a CET proposal would likely have to defer downward harmonization of textile and clothing tariffs for a long transition period.

Trade Remedies. In any event, movement toward a CET would not address Canadian and Mexican concerns about AD and CVD actions. In light of statements by members of Congress regarding the sanctity of existing US unfair trade laws, we would bluntly say that one can almost forget about AD/CVD reform in new NAFTA talks.¹² In our view, the best course is to pursue integration policies that reduce demand for AD/CVD actions rather than attempt to constrain the supply head-on.

Still, apart from the softwood lumber case—which involves a substantial amount of trade and eventually will be negotiated as a standalone set-

11. The CBI is a one-way preference arrangement for the Caribbean islands and Central America. AGOA provides similar one-way trade preferences. Tight rules of origin on textiles and clothing are integral to both agreements.

12. Recall that in May 2001, almost two-thirds of the Senate urged President Bush not to put US AD laws on the table in new WTO talks. Nonetheless, US officials agreed to include AD on the negotiating agenda to promote “greater transparency, certainty, and predictability in the ways in which the rules are administered.” See Deputy USTR Peter F. Allgeier’s testimony before the Subcommittee on Trade of the House Committee on Ways and Means, May 17, 2005.

tlement—how important is the contingent protection to NAFTA countries? As of October 1, 2004, the United States had 351 AD and CVD orders in place. Of these, only 15 are against Canada and 11 against Mexico. AD/CVD orders against NAFTA countries make up only 7 percent of all orders, despite the fact that these countries account for roughly one-third of all US trade.¹³

Granted, the potential use of AD/CVD actions may deter Canadian or Mexican firms from competing aggressively in the US market. Moreover, any firm considering a major new investment may be influenced, at the margin, to locate in the United States. Nevertheless, we are not convinced that doing something to limit the continuing troublesome impact of the AD and CVD regimes is worth the negotiating cost and effort to Canada and Mexico.¹⁴ Instead, a better strategy would rely on the calibrated use of WTO and NAFTA dispute settlement provisions to keep US AD/CVD measures in line with WTO and NAFTA obligations. In recent years, WTO panels have ruled against the United States in a number of cases (involving steel, lumber, and other products) where the US Commerce Department or US International Trade Commission contravened WTO rules by using inappropriate methodologies to determine dumping or injury. Negotiations under way in the Doha Round of WTO talks could further clarify the procedures for conducting investigations. Meanwhile, in appropriate cases, Canada and Mexico can continue to call on NAFTA Chapter 19 procedures to review final AD/CVD determinations.

If Canada and Mexico were determined to face down the United States over AD/CVDs, a plausible approach would be to negotiate time-limited (say renewable every five years) sector holidays from AD duties. The holidays would be negotiated in consultation with affected industries and would probably cover only areas that had not recently experienced a flurry of AD cases. In a sense, this proposal would codify the market demand for AD actions. However, sector holidays would provide a modest degree of assurance for new investment and plant expansion aimed at the regional market within NAFTA.

A task force report issued by the Council on Foreign Relations (2005) recommends that the NAFTA partners ensure future free trade in natural resource products (such as lumber) by concluding a new agreement.¹⁵ The new agreement would ensure security of market access and security of supply, and include rules on resource pricing that address, for example, longstanding US concerns about Canada's timber management practices.

13. By contrast, Chinese exporters were subject to 57 AD/CVD orders, accounting for 16 percent of the US total, compared with China's 9 percent share of total US merchandise trade.

14. For further analysis of AD/CVD disputes, see Macrory (2002) and chapter 4 on dispute settlement.

15. Michael Hart, a member of the task force, principally inspired this recommendation.

Since very little progress has been made on US-Canada lumber disputes, despite a quarter century of litigation, a new approach seems well worth trying.

Looking a decade ahead, it seems likely that tariff and trade remedy issues will occupy less space on the North American trade agenda, while domestic regulatory measures—with intended or unintended trade consequences—will become more important. Pharmaceutical trade between the United States and Canada is already an explosive issue in the US Congress and state legislatures; food safety and environmental standards are a perennial question; geographic indications and other labeling issues are on the horizon.

As a modest step toward mutual recognition and convergence, we suggest that leading regulatory agencies in the member countries invite senior representatives from their NAFTA counterparts to participate when they deliberate on new regulations that could affect NAFTA commerce. The farm sector is an ideal candidate for increased regulatory cooperation (Josling, Roberts, and Orden 2004). Cooperation on common standards of food health and safety (sanitary and phytosanitary measures) would spread best practices across North America, as well as reduce unnecessary barriers to trade. Joint inspection regimes would further boost confidence in the regional food supply. As a start, the three countries could establish a “crisis center” for immediate consultation on BSE (“mad cow”) and other high-profile food safety concerns.

Going with the Energy Flow

Since September 11, and especially since the Iraq war began and crude oil prices soared, US policymakers have rediscovered their latent concerns over the adequacy of regional energy supplies. Development of oil and gas fields, as well as construction of new energy distribution channels, is a high priority—though for somewhat different reasons—in both Canada and Mexico as well. Yet energy security initiatives, including expansion of North American production of oil and gas, have failed in Congress due to parochial demands of politicians. As a result, three important problems continue to fester.

First, the region is not producing enough oil and gas given its vast reserves. Coupled with a sharp decline in spare production capacity worldwide, North America is now more vulnerable to volatile energy price swings. New production in North America could help reduce the high security premium now embedded in crude oil contracts.

Second, differing product standards and inadequate investment in new refineries have led to supply bottlenecks for petroleum products, most notably gasoline. Here again, new NAFTA projects could boost local supplies and help protect against supply disruptions elsewhere.

Third, the blackout that deprived 50 million Americans and Canadians of electricity in August 2003 underscored the problems of aging electrical transmission systems. The regulatory reforms needed to spur new infrastructure investment have long been debated, but efforts to implement reforms usually run afoul of some federal or state/provincial rules. Hopefully, the electric shock of the northeast blackout in August 2003 will energize the reform process. The US-Canada Power System Outage Task Force, created after the August 2003 blackout, reported that system failure was preventable and would have been prevented if grid operators had followed voluntary reliability standards. Noting that many of the causes of the 2003 blackout had been exposed through investigations of prior blackouts but remained unaddressed, the task force laid out 46 specific recommendations for the United States and Canada.¹⁶ First among these was to make reliability standards mandatory with penalties for noncompliance.

What more could be done? Dobson (2002) proposes a constructive starting point: use the existing bilateral and trilateral mechanisms to coordinate efforts at regulatory reforms that would encourage production and distribution of natural gas.¹⁷ Working together in this area seems like a no-brainer. However, the proposed projects are big and expensive, and politicians invariably compete for the spoils. Witness the wrangling over recent energy bills in the US Congress and the US subsidies enacted to influence the route of a natural gas pipeline from Alaska's North Slope to Chicago so as to maximize US jobs (at the expense of Canadian jobs).¹⁸ Canadians initially worried that the legislated route, which bypasses the Mackenzie Delta gas reserves, would leave Canadian reserves untapped. These concerns have abated since a privately funded consortium proposed a second pipeline to connect the Mackenzie Delta reserves to the existing Alberta pipeline infrastructure.¹⁹ In contrast to US willingness to intervene and support infrastructure projects, Canadian officials argue that the market should guide planning of pipeline routes and other infrastructure "megaprojects." However, pure market forces, without the breath of government intervention, are seldom allowed unfettered play when it comes to major energy projects—in the United States, Canada, or else-

16. The full report is available at <https://reports.energy.gov/BlackoutFinal-Web.pdf> (accessed on November 1, 2004).

17. This recommendation was put forward by President Bush's task force on energy policy and got renewed attention after the Enron crisis broke. See the comprehensive analysis by Bradley and Watkins (2003). For the purpose of advancing natural gas production and distribution, the groups created in the wake of the power outage could be consolidated into the North American Energy Group, established by the NAFTA members in 2001.

18. Members of Congress also argued that their preferred route would minimize environmental damage since the pipeline would not go underwater, and large portions would parallel the Alaskan Oil Pipeline and the Trans-Alaska Highway.

19. See box 7.3 in chapter 7 for a discussion of the pipeline controversy.

where. Environmental, employment, indigenous population, and security concerns are all given voice through public officials.

The pipeline saga illustrates the current limits of US-Canada cooperation on infrastructure. While the US-Canada energy infrastructure is already fairly well integrated, distribution of energy faces numerous obstacles both within and between countries, and new interconnections are frequently contentious. Better cooperation will require more formal contacts at the regulatory level, with the clear support of both governments.

The United States will not achieve energy independence (given existing sources and reserves of energy), but it can strengthen energy security by working cooperatively with its immediate neighbors. For example, it should be possible for the United States to include Canada in its future storage plans for strategic reserves of oil and gas. Abandoned potash mines located in Saskatchewan, and similar sites, could be used for northern reserves. When public attitudes become more receptive to nuclear power (largely as a consequence of global warming), Canada and the United States might well find common interests in locating new generation facilities and disposing of spent radioactive fuel.

Progress with Mexico on the energy front will be more difficult. Fundamentally, there are two obstacles. The first of these is popular Mexican resistance to amend the constitutional prohibition against foreign participation. Unfortunately, the Mexican Congress seems reluctant to proceed on even modest reforms, even though they could boost investment in electricity-generating plants. It is even less willing to welcome foreign energy companies in developing deep Mexican oil reserves (in the Gulf of Mexico) or gas reserves (in the northern states). The second is the political clout of *Petróleos Mexicanos* (Pemex) and the *Comisión Federal de Electricidad* (CFE) workers worried about losing their jobs. Even if the petroleum sector booms, it won't relieve the featherbedding that accounts for huge excess employment and drives up costs. We think that Mexico could design transitional arrangements to guarantee the job security of many current energy-sector workers, either in their present place of employment or in new foreign ventures, then buy out others through wage insurance programs (funded by oil industry contributions), similar to those recently incorporated in the US Trade Act of 2002.

Even accompanied by labor provisions, it will be a huge political hurdle to amend the Mexican Constitution to enable limited foreign participation. Indeed, we don't believe that incremental energy reforms are saleable unless linked to other important political issues, such as migration. Despite the multiple political roadblocks, we believe that Mexico will soon have little choice but to reform its archaic energy laws, if its development strategies are to succeed and Mexican growth is to reach a consistent annual rate of 5 percent or higher. Necessity may prove to be the mother of reform.

In sum, North America has a large and growing demand for energy as it simultaneously faces stagnant or decreasing production in most of the

continent. While energy imports are destined to rise, increased investment in oil and gas field development—combined with enhanced cooperation between the NAFTA countries on energy distribution and regulation—could alleviate potential shortages and help dampen oil price pressures. The creation of a high-profile energy panel to discuss regulation, trade, and infrastructure projects would be a welcome start. Where possible, Canada and the United States should go forward in harmonizing regulatory standards and streamlining permit processes for cross-border infrastructure projects. In addition, Mexico should act in its own best interest and adjust its policies to promote greater development of its energy resources and increased investment in pipelines and power plants. Toward that end, Canada and the United States should be ready to help Mexico increase its energy production through technical assistance and the provision of advanced oilfield technologies for developing deepwater reserves.

Controls on Coming and Going

Mexico is keenly interested in the treatment accorded to migrant workers, both those already resident in the United States and those who seek entry, legally or otherwise. According to Philip Martin, in chapter 8 of this volume, the number of Mexican workers employed in the United States is about 5.5 million. Annually in the late 1990s, approximately 150,000 Mexicans entered the United States legally, mainly under family reunification visas, and 400,000 entered illegally, most in search of work.

As a cooperative prologue to the thorny problem of migrant workers, we believe that Ottawa, Washington, and Mexico City can forge common visa standards for most non-NAFTA visitors and immigrants. This goal is highly significant from a security standpoint. For people arriving from outside the NAFTA region, the North American countries need a shared system for excluding non-NAFTA nationals who pose a security threat.²⁰ Legal immigrants are already thoroughly scrutinized before they enter; the real problem is visitors. Annually, Canada admits about 4.4 million non-US visitors, Mexico admits about 3.3 million, and the United States admits about 29 million non-NAFTA visitors (Rekai 2002). These numbers are up to 30 times larger than the annual intake of legal immigrants.

20. As Rekai (2002) points out, Canada and the United States have very different systems for admitting immigrants as permanent residents. About two-thirds of Canadian immigrants are admitted on employment criteria and one-third on family reunification grounds. The proportions for the United States are reversed. In addition, Canada has a more lenient attitude toward refugees than the United States. Canada does not keep good track of refugees after they are granted asylum, prompting US concerns that some may be involved in terrorist sleeper cells.

Non-NAFTA visitors who threaten security can be better excluded if a few core measures are adopted. The NAFTA partners should agree on documentation requirements, length-of-stay requirements, visa waiver country lists, and watch lists for potentially troublesome visitors.²¹ Officials in each country should have electronic access to the immigration records of its partners. These suggestions seem obvious. However, US security agencies, such as the FBI, CIA, ATF, and Customs, have yet to agree on a common watch list for potentially troublesome visitors to the United States, so it will take political energy to forge a common North American approach.

As well, NAFTA partners should create a special force to handle all third-country immigration controls at the individual's first port of entry into NAFTA space. Common document and biometric identification standards should be applied.

Likewise, the partners should create a more efficient system for handling legitimate travelers among the three NAFTA countries. The Smart Border accord negotiated between Canada and the United States contains useful elements: high-tech identity cards for permanent residents, using biometric identifiers, and preclearance programs for frequent travelers, known as INSPASS at airports and CANPASS at land borders and bridges (dedicated commuter lanes). The same system should be extended to cover visitors arriving from Mexico.

The most difficult problem between Mexico and the United States—but one with the highest political, security, and economic payoff if satisfactorily resolved—is the issue of unauthorized Mexican workers. Within this category are two groups: those who already reside in the United States, numbering as many as 4.5 million in 2000,²² and those who will come to the United States to work. What kind of assurances could an immigration agreement provide? The place to start is with the sustained flow of migrant workers arriving in the United States. The United States should take up President Vicente Fox's challenge to substantially enlarge the annual quota of Mexicans legally authorized to enter the United States on temporary, renewable work permits. In recent years, legal immigration from Mexico to the United States has numbered about 130,000 to 170,000 people annually (US Department of Justice 2002). Illegal immigration figures are speculative, but in chapter 8 of this volume, Philip Martin places the annual number at around 400,000 in the late 1990s.

One way to tackle the flow problem is to start with an expanded number of legal visas. Martin recommends a guest worker visa that could be initiated by a US employer. Mexicans admitted under these visas would be

21. As part of the Smart Border accord, Canada and the United States have already agreed to harmonize their visa waiver lists.

22. See Pastor (2001) and chapter 8 on migration by Philip Martin. We cite Martin's figures, which are somewhat higher than Pastor's.

refunded part of their Social Security and unemployment insurance payments when they returned to Mexico and surrendered the visa. Perhaps 150,000 people, including unskilled workers, could be admitted from Mexico annually on a work-skill basis. These workers could be issued a high-tech identity card, including biometric data. However—and this is where security gets underlined—to obtain a guest worker visa, the Mexican applicant would have to undergo a background check. The overall guest worker program should be renewable, say every two years, based on progress in reducing illegal crossings, drawing on an approach sketched in the next paragraph.

Coupled with the substantial, but closely regulated, increase in temporary work permits, the United States and Mexico should embark on a joint border patrol program to reduce the flow of illegal crossings. Of great concern to the United States is not only the migration of Mexican workers illegally but also the lack of security on Mexico's southern border with Guatemala and Belize, a passage for illegal workers traversing from Central America. No border patrol program will eliminate illegal crossings, but a joint program could reduce the flow. Biennial renewal of the guest worker visa program should be conditioned, in our view, on progress in reducing the illegal flow.²³

Meanwhile, employer sanctions should extend beyond a meaningless paper chase. Inspection by the employer of a high-tech identity card would suffice to meet the firm's obligations. However, if an employer hires a worker (after a defined cutoff date) on the basis of other documentation, the firm would be at risk for substantial penalties if it were found to have accepted counterfeits that a reasonable employer would suspect to be fraudulent.

That raises the situation of perhaps 4.5 million unauthorized Mexicans who live and work in the United States. We do not have a magic solution. The foundation for our tentative suggestions is the proposition that these people have made permanent homes in the United States and are not going to pack up their lives and return to Mexico. Under a set of appropriate circumstances, therefore, they should be granted residence permits with eligibility for citizenship. The appropriate circumstances we envisage have two components—a threshold relating to the total number of illegal crossings and standards for individual applicants.

First, the resident permit program would be launched when the presidents of the United States and Mexico jointly certify every two years that the annual rate of illegal crossings—measured by border apprehensions—had not exceeded, say, 50,000 persons. In recent years, the number of

23. As part of a detailed plan for dealing with immigration to the United States from Latin America, Hanson (2005) also suggests temporary worker permits. However, he would offer permanent residence, and eventual citizenship, to all workers who enter under the plan and comply with the terms of their visas (primarily by staying employed).

apprehensions has exceeded 100,000 annually, so this would entail a dramatic reduction in illegal crossings. The resident permit program would be suspended for new applicants in years when the presidents could not make this certification. The same trigger should, in our view, apply to continuation of the guest worker visa program.

Individual eligibility for the residence permit would require evidence that the person resided in the United States before the *announcement* of the program. Applicants for a residence permit who could provide satisfactory evidence of residence in the United States before the announcement of the program would not be subject to deportation, whether or not they met other eligibility requirements, so long as they periodically reported a place of residence to the Department of Homeland Security and committed no felony after the issuance of the residence permit. These persons would be issued high-tech residence permits meeting the documentation requirements for employment. Holders of residence permits would also be immediately eligible for public Social Security and Medicare benefits, as well as private health and pension benefits, based on their contributions. They could apply for citizenship after five years.

To be sure, these proposals leave many questions unanswered.²⁴ Issuing residence permits to Mexicans covertly living and working in the United States can be said to reward illegal behavior. Not issuing residence permits to Central Americans and others living and working illegally can be said to discriminate. A guest worker program that does not offer US citizenship can be criticized for dangling forbidden fruit. A call for Mexican cooperation on border control raises Mexican constitutional issues.²⁵ After listing these and other difficulties, it is tempting to abandon proposals for migration reform and claim, with Dr. Pangloss, that we already live in the best of all possible worlds. “Don’t ask, don’t tell,” it might be said, is the only answer to the conundrum of illegal immigration. But we hold the view that piecemeal and imperfect reforms are better than letting the US-Mexico migration issues fester.

Where the Buck Stops

There is scope for deeper financial cooperation within NAFTA, but little prospect for a common currency. This conclusion stems from the predominance of the US economy in the region—accounting for almost 90 percent of North American GDP—and the reluctance of US policymakers to share control over monetary policy with their North American neigh-

24. We are grateful to Sidney Weintraub for raising these points in comments on an earlier draft of this chapter.

25. In the past, Mexico’s constitutional freedom of movement within the country has been interpreted to prohibit Mexican authorities from interfering with illegal border crossings.

bors. Simply put, the United States would insist on calling the shots on monetary policy if the three countries got together on a common North American currency.

Owing to the relative size of the three economies, currency integration would have little economic effect on the United States (Truman 2003). While the favorable effects are far larger for Canada and Mexico, they would have to cede significant monetary control to the United States in any formal monetary union. If Canada or Mexico wants to have a common currency, nothing stands in either country's way of unilaterally adopting the US dollar. But doing so would not give Canada and Mexico a say in US monetary policy. As a result, dollarization—or a new North American currency—is far from imminent.²⁶

Nonetheless, closer cooperation on monetary policy among the three NAFTA countries would be desirable. To that end, we recommend that the Federal Reserve Board of Governors invite representatives of the Banco de Mexico and the Bank of Canada to participate in its key meetings—those where interest rate decisions are made—on a nonvoting basis. Reciprocal invitations should be forthcoming from the Banco de Mexico and the Bank of Canada.

At the same time, the NAFTA partners could usefully coordinate their approaches to the regulation of financial services. Mexico has experienced a series of bank failures, while the collapse of Enron, Arthur Andersen, Global Crossing, and WorldCom, followed by a string of Wall Street and CEO scandals, starkly revealed the seamy underside of US finance. Canada has a cumbersome capital-market regulatory regime, which is run by the provinces.²⁷ Mexico and the United States are both well along on their own cleanup acts, but more could be done in a North American context. In Canada, the trend toward harmonized securities regulation among the provinces is long overdue. A single national system would help even more.²⁸

North American regulatory task forces should exchange views on the reform of accounting standards and corporate governance. They could provide a voice for convergent regulation of banks, insurance companies, securities firms, pension funds, mutual funds, and other asset management

26. For an extensive analysis of these issues, see Robson and Laidler (2002) and Truman (2003).

27. In the United States, the states have a regulatory role as well, but for securities, the Securities and Exchange Commission (SEC) is clearly the dominant voice (as the confrontation between the SEC and New York Attorney General Eliot Spitzer showed). The state regulatory voice is strongest for insurance, an anachronism that dates to the 1930s.

28. Canada's 13 provincial securities regulators have created uniform legislation and a mutual recognition ("passport") system so that securities registered in one province can be issued and traded in the other provinces. A joint body of Canadian securities administrators provides oversight. The federal finance minister has established a Wise Persons' Committee to study whether a single regulator or a perfected passport system should be the next step.

companies throughout North America. Mutual recognition of standards for issuing securities should command greater support, particularly in the Securities and Exchange Commission.²⁹ If the NAFTA members agreed in principle to mutual recognition of *federal* standards, but not state or provincial standards, it would give a useful push to rationalization of the Canadian system.³⁰

Updating Environment and Labor Provisions

The NAFTA labor and environmental side agreements were never designed to make substantial progress in addressing labor and environmental problems.³¹ Negotiated primarily to provide political cover for Democratic members of the US Congress to support NAFTA, the side agreements were far from ambitious and were never funded at the level necessary to effectively deal with labor and environmental problems. The labor side agreement is largely hortatory. The environmental side agreement is somewhat stronger, but no NAFTA country, least of all the United States, wants intrusive surveillance of its domestic environmental policies. Instead, the side agreements have managed to spotlight selective labor and environmental abuses. Labor unions and some nongovernmental organizations have seized on these shortcomings as a broad rallying cry against “NAFTA failures.”

Against this background it will be difficult to assemble a political consensus within the United States for deeper integration within NAFTA unless new measures are taken to address labor and environmental issues. We think constructive steps are possible as part of a larger bargain.

First, US and Mexican environmental groups are rightly distressed that so little has been achieved in improving the day-to-day environment in the border zone and many cities in the interior of Mexico. Fears expressed by NAFTA critics in 1993 that the pact would spur the downward harmonization of environmental and health standards, and create pollution havens in Mexico, were imaginary bogeymen. But environmental problems have been decades in the making. The missing ingredient is money: The North American Development Bank (NADBank) is woefully under-

29. Since 1991, the Canadian provinces and the SEC have had a system for mutual recognition of prospectuses and other disclosure materials, known as the Multi-Jurisdictional Disclosure System (MJDS). In the wake of the Enron debacle and other Wall Street scandals, however, the SEC has not devoted bureaucratic resources to updating the MJDS and coordinating the evolution of financial standards.

30. If NAFTA talks got under way on these matters, it would make great sense for the United States to engage the European Union on the same issues. Conceivably a transatlantic accord could result, to the benefit of North America as well as Europe.

31. For a more comprehensive treatment of the two side agreements, see chapters 2 and 3.

funded, and Mexican municipalities are starved of revenues. We think a revamped matching program is the answer. The NADBank's capital base should be increased incrementally from \$4.5 billion to \$10 billion. Instead of a 50-50 split between the United States and Mexico, the funding should be 75-25. For its part, the Mexican federal government should assist municipalities to levy and collect property taxes and dedicate the revenues to environmentally sound infrastructure improvement—basic needs like water, sanitation, and paved roads.³² NADBank loans for municipal environmental projects should be conditioned on meaningful local tax efforts. As US contributions to NADBank would increase by more than \$5 billion under our proposal, with substantial new placements directed to Mexican communities, Mexico could reciprocate by adopting tax reforms and infrastructure investments that improve regional transport networks and enhance border security.

Second, it galls Mexico that trade sanctions are held out as a remedy for persistent Mexican violations of NAFTA environmental or labor obligations. To be sure, NAFTA panels have never gotten close to recommending trade sanctions, but the theoretical remedy is written in the side agreements. This amounts to discriminatory deterrence. The United States agreed on monetary fines as the remedy for Canadian violations, and it also agreed on monetary fines as the remedy of first recourse in the US-Chile and US-Singapore FTAs.³³ As part of the new package, the United States should align NAFTA procedures with those in its new FTAs and agree to monetary fines as either the ultimate or penultimate remedy for Mexican violations.³⁴

Third, US labor advocates object that Mexico does not effectively enforce core labor standards. The US definition of core standards differs somewhat from the International Labor Organization (ILO) definition, though they have elements in common: prohibitions on discrimination based on gender, ethnicity, race, or religion; freedom from coerced labor; and prohibitions against the worst forms of child labor.³⁵ We think Mexico, as well as Canada and the United States, could agree to establish NAFTA oversight of core labor standards (appropriately defined) by an independent, trilateral monitoring board that regularly reported to the

32. In 2000, Mexican property taxes were just 0.3 percent of GDP, compared with 3 percent in the United States and 3.5 percent in Canada (OECD 2002, table 22).

33. Trade sanctions are an ultimate, and highly theoretic, backup remedy in the US-Chile and US-Singapore FTAs.

34. See Elliott (2001) for a complete discussion on using fines rather than trade sanctions in the context of labor standards disputes.

35. Some labor leaders would argue that US "right-to-work" laws do not conform to the ILO's interpretation of freedom of association. In our opinion, robust NAFTA enforcement of labor standards would need to be accompanied by explicit recognition that right-to-work laws do not contravene freedom of association.

Commission for Labor Cooperation (CLC) on an expeditious and nonpolitical basis. From the standpoint of trade politics, this reform should be highly valued by US labor unions and should more than compensate for the loss of trade sanctions.

Finally, the three countries should renegotiate the language of NAFTA Chapter 11. As we have explained in chapter 4 on dispute settlement, NAFTA Chapter 11 arbitrations in investor-state disputes have not resulted in the rollback of state and provincial environmental standards. However, sentiment is widespread in the environmental community that past and future arbitration awards will have just this result. The remedy, we think, is to update the NAFTA text to reflect the interpretive notes issued by the NAFTA Free Trade Commission as well as definitional changes developed in recent FTA negotiations (see chapter 4).³⁶

Strengthening NAFTA's Institutions

By design, most of NAFTA's institutions were constructed in a way that guarantees the primacy of national sovereignty. There is still no appetite for supranationalism in North America. We do not recommend new North American institutions to administer and implement the regional compact. However, we do counsel specific reforms of existing NAFTA institutional arrangements.³⁷ The benefit of 10 years' experience leads us to believe that bolstering NAFTA's institutions will make them more effective and pose no threat to national sovereignty. In addition, we believe revisions to dispute settlement procedures and to the labor and environment side accords merit priority attention.

First, we would consolidate the three national NAFTA sections into a single staff, which should be jointly funded. The current system of national staffs has resulted in funding disparity, with the US section chronically underfunded. The joint funding model should also be used to pay for panelists and other expenses relating to the operation of dispute settlement mechanisms. To raise the profile of NAFTA institutions, the unified staff should be housed in a single NAFTA headquarters building, where NAFTA disputes could be heard. Second, in chapter 4, we recommend that the dispute settlement provisions of NAFTA be both strengthened and simplified. Currently, NAFTA disputes are addressed in a de-

36. For example, in the CAFTA, the "measures tantamount to expropriation" test is revised, the arbitration procedures are more transparent, and a new appellate mechanism is adopted.

37. By contrast, Pastor (2001) argues for more comprehensive institutional reforms including integration of the North American transportation infrastructure, creating a development fund to address regional income disparities, a permanent North American court on trade and investment, a North American passport with a larger temporary worker program, and the eventual adoption of a common currency.

centralized system governed by four chapters (in addition to the two side agreements on labor and environment). Decentralization has caused some controversy over which chapter should be applied to a given dispute. To avoid this, we suggest consolidation of the processes. Rather than four separate methods for selecting panelists, a single roster should be selected for six-year terms. Panelists should have a broad background in international economic law and be capable of hearing cases under any chapter. In addition to panel consolidation, the hearing processes and evidentiary standards should be fine-tuned.

Second, the NAFTA partners need to reexamine both the dispute settlement provisions and how they are used. Chapter 11—on investor-state disputes—has attracted the most criticism. We note above how it should be clarified and updated. Chapters 19 and 20 also merit attention.

Chapter 19—on AD and CVD—was established before the WTO Dispute Settlement Understanding of the Uruguay Round. We believe the WTO process has helped dissuade AD/CVD initiations. In any event, Chapter 19 is handicapped by lengthy panel proceedings (often a result of deliberate inaction on the part of national governments) and the absence of a common NAFTA standard on AD/CVD reviews. Rather than addressing these concerns within NAFTA, we encourage countries to turn to the WTO dispute settlement process, which has been operating reasonably well for the past decade. While not without its own difficulties, including extensive delays in some high-profile cases, the WTO process is a better mechanism for addressing AD and CVD disputes, since it operates against a common standard that applies to all three countries (and all other WTO members as well). The most serious problem with the WTO system for reviewing AD and CVD disputes is that, unlike NAFTA, it does not lead to the refund of duties that were wrongfully assessed. However, this defect could be corrected by a NAFTA agreement that stipulates refunds in appropriate WTO cases between the NAFTA parties.

Chapter 20 is the broadest of the dispute settlement provisions; it governs the implementation of NAFTA. The focus of Chapter 20 has been on consultation rather than arbitration. While in theory a Chapter 20 award can result in withdrawal of equivalent NAFTA benefits, this has never occurred, and there is no mechanism to determine “equivalent benefits.” We suggest raising the profile of Chapter 20 “reports” to “decisions” and inserting language to indicate that Chapter 20 decisions “shall be binding.” Rather than determining “equivalent benefits,” we ask arbitration panels to impose monetary fines—which are less destructive than trade sanctions—as the preferred penalty to ensure compliance.

Finally, with regard to the side agreements on labor and the environment, we also see an opportunity for improving the institutions that make the agreement work. The side agreements were an afterthought to the NAFTA negotiations, and, as noted above, the institutions created by these agreements suffer from funding shortfalls. Many of these institu-

tions have been charged with being all things to all people. We prefer that they concentrate on doing a few things well:

- As noted above, NADBank and the Border Environment Cooperation Commission (BECC) simply do not have the funding required to do the job of environmental cleanup and sustainable development in the border region. This funding must be increased, and the United States will have to shoulder more of the burden. NADBank and the BECC should target upgrading border infrastructure to the standards of non-border communities in the United States and Mexico and streamline project finance procedures so that local communities can utilize NAD-Bank funds more effectively.
- The CLC also requires more funding. Again, we suggest scaling funding commitments so that the United States increases its contribution. We recommend that the labor review process be revamped into a monitoring system based on agreed labor standards in four areas: discrimination, child labor, coerced labor, and workplace health and safety. The monitoring should be carried out by an independent board that both reports to the CLC and publishes its findings. Published reports will put a useful spotlight on glaring deficiencies. Moreover, by focusing on the foremost tier of North American Agreement on Labor Cooperation (NAALC) standards, the CLC will have a better chance of being heard.
- The Commission for Environmental Cooperation (CEC) should concentrate on becoming a resource for North American environmental statistics, which can be used to assess environmental trends in Canada, Mexico, and the United States. In addition, concise reports and an annual “environmental report card” should replace the current longer reports, which the broader NAFTA community rarely reads. Those reports should concentrate on “naming and shaming” the worst environmental problems. The CEC should continue to run the citizen submission process under Article 14. However, the process should be streamlined and strengthened so that the “factual records” identify noncompliance and provide corrective recommendations within a reasonable period.

Conclusion

What does this all add up to? Over the near term, the agenda for North American integration is likely to be more limited than the ambitious vision of Dobson’s “strategic bargain.” In terms of trade initiatives, through 2007, the three countries probably will pay more attention to the broad-based initiatives in the WTO Doha Development Agenda and the FTAA.

After 2007, if the WTO and the FTAA achieve only modest reforms, the United States might well expand its already extensive network of bilateral FTAs. Mexico and Canada could do the same. Nevertheless, because of critical border and energy security imperatives, all three countries will need to encourage engagement on the broad North American trade and economic agenda.

As was the case with the CUSFTA and NAFTA, Canada and Mexico will need to supply the initiative. While Canadians might argue that many economic issues warrant a bilateral approach limited to Canada and the United States, domestic US politics make Mexican participation imperative. It makes sense, therefore, for the prime minister of Canada and the president of Mexico to try to reach agreement on their own major agenda items and then make a joint *démarche* to Washington. It is entirely possible that President Bush would welcome a friendly North American initiative, especially if the WTO and the FTAA are bogged down and a Middle East FTA looks like a long and difficult slog.

In large measure, our North American agenda is about enlightened self-interest. An international agreement can provide the political impetus to craft successful policies. When the United States moves to rationalize its own immigration law, it will be the primary beneficiary of a more secure border and a more accountable workforce. In Canada, improved border security measures will protect against disruptions in US-Canada trade—a matter of growing concern for firms already producing in Canada, as well as those considering additional investments. Mexican energy reforms will boost industrial production by stimulating new investment in oil and gas field development, power generation, and transmission, which in turn will provide Mexican homes and industries with more reliable sources of energy. Allaying energy shortages will spur investment in the manufacturing and technology sectors, which are critical to Mexico's development strategy. In other words, it would make economic sense for many of our proposals to be implemented on a unilateral basis. But in the real world of give-and-take politics, these reforms may be possible only in the context of a fresh round of NAFTA negotiations.

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