

The North American Free Trade Agreement

Context, Structure, and Performance

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1. Introduction and Overview

The North American Free Trade Agreement (NAFTA) came into effect on January 1, 1994, and created the world's largest regional free-trade zone. The NAFTA includes Canada, the United States, and Mexico, with a total (as of 2000) combined population of 410 million inhabitants, and combined GDP of over \$11 billion U.S. The NAFTA was constructed on the framework of an earlier bilateral agreement between the United States and Canada, which was implemented on January 1, 1989.

In terms of both population and GDP, the NAFTA zone is larger than the 15-country European Union (see Table 1), although the intensity of integration is much deeper in Europe than in North America. The NAFTA is not a customs union (that is, each member nation continues to independently set its own external tariffs and trade policies); border crossings continue to operate between the three member countries; no form of monetary union is presently considered; the NAFTA includes only minimal provisions for mobility of particular kinds of specialized labour between NAFTA countries; and there are no supranational political or democratic institutions established as part of the NAFTA. In contrast to the EU, then, the NAFTA represents a less ambitious effort to establish a common continental market for goods and services, and common protections for private investors and businesses, with little attention or interest devoted to developing a continental political or institutional dimension.

This overview of the context, structure, and performance of the NAFTA will consider the following particular topics. First, an overview of the economic and political context in which the NAFTA was negotiated is provided. Then the NAFTA's specific provisions are described, followed by a summary of the agreement's apparent effects. Finally, the discussion concludes with a consideration of the potential for future expansion or deepening of the NAFTA.

2. Economic and Political Context

The NAFTA is dominated, both economically and politically by the United States, which accounts for about 70 percent of its population, and nearly 90 percent of its economic output. Consequently, the negotiation and implementation of the NAFTA were much more important events in Canada and Mexico, than in the U.S. itself. For both of those countries, the implementation of free trade with their much-larger neighbour was an event of decisive historical importance, culminating a decades-long evolution in their respective bilateral relationships with the U.S. A former Prime Minister of Canada, Pierre Trudeau, once described Canada's relationship with the U.S. as being akin to "a mouse in bed with an elephant." Similarly, a Mexican parable asks for pity for Mexico because it is "so far from heaven, and so close to America." In both countries, choices regarding how to manage the dominant and complex relationship with the U.S. are of immense political and economic importance. And for

both countries, the decision to embark on a course of tighter continental economic integration marked a defining moment in their national histories. For the U.S., on the other hand, the implementation of a North American free trade zone represented an important but hardly epochal development, one which mostly served to reinforce its already-existing economic and strategic dominance on the continent.

Despite their increasingly tight economic relationships, great economic and political differences continue to exist between the three NAFTA members (see Table 2). The U.S. economy is the richest of the three, measured in per capita incomes, and its political-economy reflects an extreme of deregulation and market orientation that is unique in the industrialized world. Canada's economy is somewhat less developed than that of the U.S. (although it still ranks in the top ten nations of the world, according to per capita income), and has traditionally exhibited a more mixed pattern of development – with a larger economic role for the state, and a range of social programs and protections similar in spirit (if not in extent) to the social-democratic traditions of Europe. Mexico is a middle-income, industrializing economy. Its average per capita real income is roughly one-quarter that of the U.S.ⁱⁱ Income inequality (measured by the ratio of income received by the top decile of the population compared to that of the lowest decile) is twice as severe in Mexico as in the U.S., where inequality in turn is twice as severe as in Canada. Both Mexico and Canada continue to rely on the production and export of a range of natural resource staples (especially energy, and especially to the U.S. market) as an important economic activity, and both have also taken active measures to stimulate the development of value-added manufacturing industries (with Mexico relying on its abundant and relatively inexpensive labour resources, and Canada attempting to develop nascent higher-technology capacities). The U.S. economy demonstrates a more mature industrial structure, with a greater reliance on high-technology and high-value service industries as the leading drivers of economic growth. The traditional U.S. industrial base has declined in relative importance during the last two decades, producing a consequent polarization in the economy and labour market between high-wage and low-wage service industries. These important structural and institutional differences among the NAFTA partners help to explain why the NAFTA has limited its scope to the deregulation of trade and investment flows within the NAFTA zone, rather than attempting a deeper, European-style political and regulatory harmonization.

The NAFTA was created in the wake of the 1989 Canada-U.S. Free Trade Agreement (FTA). The initial push for this bilateral treaty reflected a historic shift in the thinking of Canadian business leaders. Through much of the postwar era, Canada had pursued a relatively interventionist and nationalist development strategy, relying on a range of regulatory measures to promote a pattern of industrial development that was oriented toward the country's small domestic market. This general strategy had both its successes and its failures (Eden and Molot, 1993; Clement, 1997). Through most of this period, Canada's economy grew significantly faster than its southern neighbour, and its living standards (especially considering the generous expansion of social benefits) increased rapidly; at the same time, however, the economy remained structurally underdeveloped, and was more reliant on foreign direct investment than any other major industrialized economy.

In the wake of negative experiences with inflation, fiscal imbalances, and unsettled labour relations which Canada (like most other industrialized countries) endured in the 1970s

and early 1980s, Canada's business and political elites began to cast about for a new economic and social direction. A defining point in this process was the so-called Macdonald Commission on Canada's economic future (Royal Commission on the Economic Union and Development Prospects for Canada, 1985). Chaired by a former finance minister in the Liberal-nationalist government of Pierre Trudeau, the commission issued a surprising call for the negotiation of a general free trade agreement with the U.S. The proposal was taken up enthusiastically by the newly-elected Conservative federal government of Brian Mulroney, who agreed with Ronald Reagan—at a famous “Shamrock Summit” meeting in 1985—to negotiate a comprehensive bilateral free trade deal. The proposal was strongly supported by Canadian business, indicating their rejection of domestically-oriented development strategies and their embrace of America: both of the American market for Canadian exports, and of the American model for domestic economic and social policy. A draft agreement was reached in late 1987, and put to the test in Canada in a uniquely passionate federal election in November 1988. Although the majority of Canadians voted for parties opposed to free trade (the Liberalsⁱⁱⁱ and New Democrats), the pro-free-trade Conservatives won a majority of seats in that election, and the FTA was implemented on January 1, 1989. In the U.S., in contrast, the FTA was not controversial, and was endorsed overwhelmingly by the U.S. Congress with little public debate.

In the wake of the successful passage of the FTA, the new U.S. government of George Herbert Walker Bush initiated negotiations to expand the free trade area to include Mexico. In Mexico, too, the free trade negotiations reflected a historic evolution in the economic and political thinking of that nation's business and political elite. Mexico had been governed since the 1920s by the Partido Revolucionario Institucional (PRI). During the postwar decades, the PRI had followed a heavily interventionist strategy relying on widespread state ownership of industry, an alliance with a powerful class of domestic industrialists, tariffs and other trade policies to promote manufacturing development on the import-substitution model, and the widespread communal ownership of land in agricultural regions. This statist development strategy demonstrated a strong initial vitality, generating annual average expansion in real GDP of over 6 percent between 1950 and 1980. By the late 1970s, however, the strains of this inward-focused strategy became more apparent, manifested in the form of growing external imbalances, growing public sector deficits, and rising inflation. Weakening world prices for oil (a major Mexican export) and rising global interest rates triggered a major financial crisis culminating in August 1982, when Mexico announced its inability to service its large sovereign debt. The regime of Miguel de la Madrid, which took power in the wake of this crisis, began to move the economy in a more market-oriented direction, implementing drastic reductions in public spending, weakening labour market regulations, and opening the economy increasingly to foreign investment and competition.

This broadly neoliberal direction in economic and social policy was put to the test in the 1988 Mexican federal election, which was even more historic and bitterly contested than the Canadian election of the same year. The austere policies of the PRI were challenged by an insurgent electoral campaign led by former PRI minister Cuauhtemoc Cardenas. The PRI won a narrow victory, amidst allegations of widespread electoral fraud and corruption, and the election ushered in a new and even more market-oriented administration under Carlos Salinas de Gortari, confirming the general direction of Mexican policy. The Salinas government went on to negotiate the NAFTA and implement other business-oriented structural reforms in the economy

(Lustig, 1992).

A draft NAFTA was signed by Salinas, Bush, and Mulroney on December 17, 1992. The ratification of this treaty was much more controversial in the U.S. than had been the FTA, because of widespread opposition from union members and others concerned with the potential flight of investment and employment to low-wage Mexico. Independent candidate Ross Perot made opposition to the NAFTA a major theme of his upstart campaign in the 1992 U.S. presidential election. But incoming Democratic President Bill Clinton abruptly softened his initial skepticism regarding the NAFTA and began to work energetically for its passage. To this end, the U.S. insisted on negotiating two rather superficial “side-agreements” to the NAFTA: one governing the regulation of labour standards within the NAFTA free trade zone, and one governing environmental standards. These side-agreements contain no legislative force, and have been dismissed by labour and environmental advocates as transparently symbolic; at the time, though, they were important in helping Clinton to shift his position on NAFTA and lobby Congress (backed by powerful U.S. business interests) for its ratification. Ironically, then, while the NAFTA was negotiated (from the U.S. side) by a business-friendly Republican administration, it eventually required a Democratic administration (with its ability to discipline traditional Democratic constituencies) to ensure its ultimate passage.

To sum up, the decisions by the Canadian and Mexican governments to enter into a free trade agreement with the U.S. signaled an important change of course on the part of business and political elites in both countries. A postwar tradition of more interventionist economic and social policy was largely abandoned in both countries, in favour of an outward-oriented and business-led development strategy. For Canada and Mexico, therefore, the advent of continental free trade has marked a decisive turning point in the historical evolution of those societies. In the U.S., on the other hand, the advent of the NAFTA represented no dramatic change in the domestic political-economy. The decision to forge a bilateral free trade agreement with Canada, and then to expand that agreement to include Mexico, was for U.S. elites mostly a matter of common sense in both economic and foreign policy. The NAFTA would draw both neighbours more closely into the U.S. sphere of influence, reducing the perceived geopolitical risk to U.S. interests that had been posed by occasional outbreaks of nationalist and/or interventionist sentiment in those two countries. The freedoms and protections accorded to U.S. business throughout the continent would also be enhanced—although, as discussed below, that is a quite distinct matter from whether or not the NAFTA was good for the U.S. economy.

3. Provisions of the NAFTA^{iv}

The NAFTA contains 22 chapters, several appendices, and two “side-agreements.” The effect of these provisions is summarized under the following sub-headings:

Tariff Elimination: The tariff reduction schedule provided for under the NAFTA is fully described in just one section of NAFTA’s Chapter 3. Tariffs on bilateral trade between Canada and the U.S. were already being phased out according to a 10-year timetable prescribed by the 1989 Canada-U.S. FTA; the NAFTA confirmed the continuing elimination of those residual tariffs, and virtually all Canada-U.S. merchandise trade now occurs on a duty-free basis.^v The NAFTA then set a similar 10-year timetable for the gradual elimination of tariffs on merchandise trade between Mexico and the U.S., and between Mexico and Canada. These tariffs will be fully

eliminated by 2003. To qualify for tariff-free status within North America, a product must meet North American rules of origin that are specified on a sector-by-sector basis. The relatively straightforward nature of tariff reduction, and the small amount of text required to describe it in the NAFTA document, indicate that the NAFTA in its entirety represents far more than simply the elimination of tariffs on continental merchandise trade. The other, lengthier sections of the agreement describe a more far-reaching process of integration and deregulation within the continental economy.

Reduction of Non-Tariff Barriers: The NAFTA prescribes the easing of a wide range of non-tariff barriers to trade in goods and services within the NAFTA zone. These non-tariff liberalization initiatives include strong statements of national treatment and market access; the specification of acceptable customs and clearing procedures; limits on the application of food inspection and health standards that may inhibit trade; limits on the application of other technical standards that may limit trade; and restrictions on government procurement practices (requiring federal-level, and some lower-level, governments and agencies to competitively tender their purchases without regard to the intra-NAFTA origin of competing providers).

Deregulation of Key Industries: For the most part, specified government regulations governing output, investment, and pricing in particular industries could be grandfathered under the NAFTA.^{vi} The agreement did, however, restrict the incremental policy-making leeway of national governments by prohibiting or limiting the further expansion of regulations (especially those specifying domestic content, domestic ownership, or other trade-restricting outcomes). And in some cases, the NAFTA itself required the pro-active elimination of government regulations and restrictions on private business. Most notable in this case were commitments that the Mexican government made under the NAFTA to privatize and/or deregulate sections of its energy, banking, insurance, advertizing, communications, and trucking industries. These measures indicate again that the main goal of the NAFTA, from the perspective of both the Mexican government and of foreign companies operating in Mexico, was to facilitate and solidify the broader deregulation of the Mexican economy—not just to facilitate greater two-way trade in goods and services.

Enshrinement of Investment Rights: The NAFTA contains provisions to protect the economic interests and legal status of foreign investors that are unique in international trade agreements, and which prefigured similar provisions which were subsequently proposed in multilateral fora (such as the failed OECD Multilateral Agreement on Investment, and later investment initiatives at the World Trade Organization). The path-breaking Chapter 11 of the NAFTA guarantees a wide range of protections for intra-NAFTA foreign investments, including: specified national treatment rights for investors (supplementing the broad national treatment provisions that apply to other provisions of the NAFTA); the prohibition of performance requirements on foreign investors (including those defined with respect to trade balances and other foreign trade variables); the prohibitions of restrictions on transfers of ownership, financial transfers, and capital flows; and the prohibition of restrictions on the nationality of investors and corporate directors. Other sections of the NAFTA (in particular, Chapter 12, which deals with intellectual property issues) further reinforce the cross-national rights of investors and private corporations operating in the continental free trade zone.

Dispute Settlement: The Canada-U.S. FTA had introduced a unique new form of dispute settlement, in the form of special tribunals which were empowered to rule on the acceptable use by a member country of countervail measures and other trade remedies.^{vii} These tribunals were expanded under the NAFTA, with the creation of a special dispute settlement procedure to enforce the investor rights provisions contained in Chapter 11 of the agreement. Under these provisions, which have probably proven to be the most controversial aspect of the entire NAFTA, private corporations are given the power to file complaints against NAFTA-member governments for alleged violations of the investment protections of the agreement. These complaints are then reviewed and decided upon by quasi-judicial trade tribunals, acting independently of standard legal channels in the member countries. By late 2002, a total of 24 business complaints had been filed under this NAFTA provision, involving total claims for damages from member governments in excess of \$5 billion U.S. (see Table 3). Most of these cases involve corporate objections to government rules and regulations concerning a range of important public policy issues, including environmental protection and public health. Confirmed tribunal judgements against the governments of Canada and Mexico demonstrate that the Chapter 11 tribunals are willing to interpret NAFTA commitments in a broad manner, and equally willing to impose significant monetary penalties on governments which are held to violate the business protections provided by the agreement. The operation of this unique investor-state dispute settlement mechanism, on top of the generally far-reaching investor protections contained in the NAFTA, has fueled the argument of NAFTA critics that the agreement actually represents a new “corporate constitution” for the continent—not just an agreement to promote more international trade in goods and services.

Mobility for Specialized Forms of Labour: In general the NAFTA does not address issues of migration or freedom of movement of persons between the member countries, with one exception. Chapter 16 of the agreement provides for temporary entry of certain classifications of business persons and professionals. Beyond this exception, each country’s existing immigration laws and procedures continue to apply.

Side-Agreements on Labour and the Environment: To support its efforts to have the NAFTA ratified by Congress, the incoming U.S. administration of Bill Clinton in 1993 negotiated two side-agreements to the NAFTA regarding the protection of labour and environmental standards (Bolle, 2002; Compa, 1997; Kirton and de Castro, 1997). These side-agreements contain no measures with legislative force, but rather simply commit each government to greater transparency in reporting on labour and environmental conditions, and to the enforcement of existing national labour and environmental laws. With few exceptions, the side-agreements (and the small tri-national institutions which have been set up to oversee their operation and effect) are not viewed as a meaningful or important feature of the NAFTA.

4. Effects and Performance of the NAFTA

The negotiation and implementation of the NAFTA sparked important debates, both among economists and in the public at large, regarding its likely economic effects. These discussions were influenced importantly by numerous efforts to quantitatively estimate the effects of continental economic integration using a range of different modeling techniques (U.S. International Trade Commission, 1992; Stanford, 1995). Conventional neoclassical models

generally predicted positive but small mutual trade effects, produced by the usual sector reallocations and efficiencies associated with the expansion of comparative-advantage-based trade. More critical approaches suggested that the main effects of the NAFTA would be felt through other structural channels—such as the impact of the agreement on investment decisions (a factor that was not considered by most conventional approaches), and the impact of neoliberal policy reforms within Mexico. Among economists, however, both advocates and opponents agreed that the impact of the NAFTA on overall output and employment levels in the continent would be small, and this prediction has proven to be correct. The following sub-sections consider several of the particular effects and outcomes of the NAFTA:

Structure of NAFTA Trade: Trade patterns within the NAFTA conform largely to a “hub-and-spoke” structure, with the U.S. located at both the geographical and the economic centre of the continent. Bilateral trade flows are largest between the U.S. and Canada, and are also large between the U.S. and Mexico. Bilateral flows are small between Canada and Mexico (see Table 4). Canada and Mexico are the largest trading partners of the U.S.—and, of course, the U.S. is the largest trade partner for each of Canada and Mexico.^{viii} Not surprisingly, relative to GDP intra-NAFTA trade is most important to Canada and Mexico, accounting for roughly 60 and 50 percent of national GDP, respectively, and far outstripping each country’s trade with the rest of the world. In contrast, intra-NAFTA trade flows are equivalent to just 6 percent of U.S. GDP, and account for less than one-third of America’s total foreign trade. This reinforces the conclusion that the implementation of the NAFTA was a much more significant event in Canada and Mexico, than it was in the U.S.

Expansion of Trade: Intra-NAFTA trade expanded notably in each of the three member countries following the transition to free trade on the continent, although that expansion was most dramatic for Canada and Mexico. Canada’s trade within North America has roughly doubled since the advent of the Canada-U.S. FTA, measured as a share of domestic GDP: from about 30 percent in the late 1980s, to 60 percent by 2000 (see Figure 1). Since Canada’s trade with the U.S. is about 45 times larger than its trade with Mexico, almost all of this expansion must be attributed to the post-FTA expansion in Canada-U.S. trade, rather than to the subsequent effects of the NAFTA (which may have actually undermined Canadian trade with the U.S., through trade-diversion effects). In contrast, Canada’s foreign trade flows with the rest of the world did not increase at all during the last decade (despite the general process of economic integration at the global level), indicating that for Canada the growth of intra-NAFTA trade may have been a substitute for other trade relationships. In Mexico, on the other hand, an equally dramatic expansion in the importance of intra-NAFTA trade (which doubled from 25 percent of GDP in the early 1990s, to 50 percent by 2000—see Figure 2) was complemented by a significant expansion in trade with non-NAFTA partners. This is consistent with the conclusion that for Mexico the NAFTA represents part of a broader package of deregulatory initiatives, which served to open Mexican markets in a broader sense. Finally, in the U.S. case (Figure 3), the discrete impacts of the FTA and the NAFTA are not even perceptible in trade data, which indicate a longer-term, more gradual expansion in the relative importance of foreign trade with both NAFTA and non-NAFTA partners.

Trade Imbalances: Merchandise trade flows within North America are characterized by significant bilateral imbalances. These imbalances have fueled arguments, especially in the

U.S., that NAFTA trade flows undermine domestic employment and output levels (Scott, 2001). The U.S. experiences large merchandise trade deficits with both of its NAFTA partners: some \$55 billion (U.S.) with Canada in 2000, and roughly half that much with Mexico (see Table 5). In each case, the imbalance represents over just one-tenth the total value of the two-way trade flow (indicating that the U.S. imports roughly 5 dollars from its NAFTA partners for every 4 dollars that it exports to them). Proportionately, the bilateral flow between Canada and Mexico is the most unbalanced, with Canada's merchandise trade deficit equivalent to a full 70 percent of the value of total bilateral trade (so that, in effect, Canada imports 6 dollars from Mexico for every dollar it exports there).

Employment: There has been much debate in all three NAFTA countries regarding the aggregate employment impacts of continental free trade (Campbell *et al.*, 1999; MacDonald, 2000; Scott, Salas, and Campbell, 2001; U.S. International Trade Commission, 1997). Within Canada, the Canada-U.S. FTA was widely blamed for a precipitous decline in manufacturing employment during the first years of that agreement; Canada lost nearly 20 percent of its manufacturing employment during the first four years of the FTA, in an unprecedented wave of plant closures and industrial restructuring. In retrospect, much of this decline was the result of a very aggressive anti-inflation monetary policy that was implemented in Canada during the same period (Gaston and Trefler, 1997), and while the FTA clearly sparked a one-time process of adjustment in Canadian industry (which was forced to evolve away from its previous reliance on the domestic market) it cannot be argued to have promoted a broad deindustrialization in Canada. Later in the 1990s Canadian manufacturing expanded strongly, and Canada's share of total North American manufacturing grew; by 1998 manufacturing employment in Canada exceeded its pre-FTA peak. In the U.S., labour advocates point to large trade deficits with Canada and Mexico to suggest that NAFTA trade flows have undermined domestic employment levels. On the other hand, U.S. labour market conditions (marked by low unemployment and rising real incomes) have been the strongest of the three NAFTA countries during most of the post-NAFTA period. In Mexico, meanwhile, the promise that the NAFTA would spark a wave of job-creation in export-oriented industries has been unfulfilled. Export-oriented employment did expand in the late 1990s, especially in the northern border zone of maquiladora export production facilities; but the number of new jobs created in those industries remained relatively trivial relative to the overall size of Mexico's labour market.^{ix} By 2001 export-oriented employment in Mexico began to decline in the wake of a slowdown in exports to the U.S. (Organization for Economic Cooperation and Development, 2002b). In none of the three countries, therefore, can a convincing argument be made that continental economic integration has had a major impact on labour markets, whether positive or negative. While trade and investment flows are obviously an important determinant of employment patterns, overall labour market conditions in each country continue to reflect other more important factors (such as demographic trends and macroeconomic and labour market policies).

Economic Growth: It is hard to argue that continental free trade has had any perceptible impact on real economic growth rates on the continent, which also continue to reflect primarily domestic factors (such as the stance of monetary policy and the general vitality of business investment). None of the NAFTA-member countries have exhibited stronger economic growth in the wake of continental free trade, than before it (Table 6). This finding seems particularly damaging to the claim of NAFTA proponents that pro-competitive structural changes in the

Mexican economy, implemented in conjunction with the NAFTA, would significantly enhance economic growth there (Fernandez-Arias and Montiel, 2001). Mexico's growth under the NAFTA has been no stronger than in previous periods (and remains significantly slower than during the golden years of import-substitution industrialization from the 1950s through the 1970s); indeed, Mexican growth under NAFTA has been no faster than average growth rates recorded elsewhere in Latin America during this time (Organization for Economic Cooperation and Development, 2001b).

Structural Change in Mexico: The negotiation and implementation of the NAFTA was a key part of a broader effort by Mexico's government and business leaders to restructure the national economy more closely along neoliberal lines—and to signal forcefully to the rest of the world (and foreign investors in particular) that this restructuring was both thorough and permanent. As if to demonstrate that the creation of the NAFTA did not solve all of Mexico's economic and social problems, the very day of its inauguration (January 1, 1994) marked the beginning of a campaign of armed insurrection and political mobilization by the radical Zapatista National Liberation movement (based in the southern Mexican state of Chiapas) and like-minded supporters elsewhere in Mexico. Indeed, the year of the NAFTA's implementation would be a very difficult one for Mexico, beginning with the rebellion and ending with the onset of another financial crisis in December 1995. This "peso crisis" was the culmination of large and unsustainable financial capital flows which had inundated Mexico in anticipation of the NAFTA, producing equally unsustainable current account deficits and other financial imbalances in the national economy (Blecker, 1996; Ros and Lustig, 2000). The responses of the Mexican government and monetary authorities to the crisis included dramatic (if temporary) increases in interest rates, the abandonment of a fixed peg for the exchange rate (which subsequently depreciated by over one-half), and a further retrenchment in fiscal policy. The painful consequences of this crisis on the Mexican macroeconomy swamped any initial benefits that NAFTA advocates had expected from the free trade agreement, and the country entered a recession.

Mexico's financial and macroeconomic situation subsequently stabilized, however, and by the late 1990s the real economy improved considerably. In light of the damaging effects of periodic financial crises in Mexico's recent history, the post-NAFTA stabilization of key monetary and financial indicators has been especially important. Mexico experienced a steady process of disinflation through the late 1990s, accompanied by a corresponding decline in real interest rates (Figure 4). In addition, the exchange rate stabilized at a nominal level approximately one-third its pre-1995 fixing.^x Of particular note is the fact that Mexico's financial system was not significantly affected by contagion effects resulting from the Argentine financial crisis of 2001-02, a crisis which impacted many other Latin American economies. If Mexico's membership in the NAFTA has given foreign investors and Mexican wealth-owners alike a strong assurance of a stable and predictable institutional and policy environment (and this, in fact, was a central goal of Mexico's participation in the NAFTA), then the resulting macroeconomic and financial stability may prove to be the most important and lasting benefit of the continental agreement.^{xi}

Another indirect but important impact of the NAFTA on Mexico could prove to be its influence on political and democratic processes. After seven uninterrupted decades of rule, the

PRI was defeated in the 2000 federal election by the right-wing Partido de Accion Popular (PAN), led by Vicente Fox Quesada. The largely peaceful transition to a new administration has been accompanied by other improvements in the transparency and functioning of Mexican political and legal institutions (although corruption and violence still mar democratic and government practices in many regions and sectors of Mexican society). For example, the Mexican trade union movement is making some initial progress in freeing itself from decades of state-sponsored PRI oversight and forming itself into a more authentic and independent social force. The NAFTA is often credited with playing a supporting role in these democratic improvements, since all sides within Mexico understand that perceived violations of democratic process in Mexico would have probable repercussions for Mexico's increasingly important economic links with the U.S.

5. Future Directions

Despite initial debates within each country regarding the desirability of continental economic integration, the NAFTA now seems well-established as a central fixture of the North American economy. In the U.S., broad bipartisan support exists for the NAFTA—although that support does not necessarily extend to granting the U.S. administration authority for further trade negotiations, including the potential expansion of the NAFTA. In Mexico, the newly-elected PAN strongly supports NAFTA, and even the left-wing Partido de la Revolucion Democrata, led by Cuauhtemoc Cardenas (now the mayor of Mexico City), accepts the agreement (while arguing for reforms that would recreate the authority of national governments to conduct a wider range of economic and industrial policies, and enhance the rights of Mexican immigrants in the U.S.). In Canada, only the left-wing New Democratic Party still opposes continental free trade, and few free-trade critics there suggest that the NAFTA itself could be annulled. Instead, the constituencies in all three countries which initially opposed the agreement have turned their focus to resisting the further expansion of the NAFTA, in terms of both its geographical scope and its depth of effect. Four sets of issues in particular could eventually produce a more powerful form of economic integration in the Western Hemisphere, although in each case it is clear that the further expansion of continental economic integration faces formidable political and economic barriers:

Hemispheric Free Trade: Political leaders throughout the Western Hemisphere^{xiii} have initiated negotiations to create a hemisphere-wide Free Trade Area of the Americas (FTAA), building on the framework of the NAFTA (Wise, 1998; Lee, 2001). The plan received initial tentative approval at hemispheric political summits in Miami in 1994, Santiago in 1998, and Quebec City in 2001, and working groups have been established to identify key issues for negotiation. The Quebec City summit adopted an “action plan” in which the progress of free trade negotiations would supposedly be linked to the maintenance of democratic rights through the continent. Subsequent political events, however, have cast doubt on the prospects for the FTAA. The Argentine financial and political crisis has sparked widespread opposition there to the FTAA and other forms of globalization; the electoral strength of the anti-FTAA Worker's Party in Brazil will certainly affect that nation's participation in the negotiations; and continuing political instability in countries like Columbia and Venezuela (where the U.S. government has supported groups attempting to remove the elected government of Hugo Chavez from power) undermine the claim that hemispheric economic integration will be associated with stability and democracy.

Monetary Union: Unlike the EU, the NAFTA contained no provisions for harmonization in monetary or exchange rate policy. Each member country continues to have its monetary policy determined by its own central bank, and each country's currency trades flexibly on international markets. The continued course of continental economic integration has sparked some calls in Canada, however, for a parallel process of monetary integration, which would culminate in the development of a common continental currency (or, more likely, the use of the U.S. dollar as a *de facto* continental currency). The introduction of the Euro beginning in 1999 provided additional momentum to this discussion. In this context, some prominent conservative voices in Canada have proposed that Canada should work towards a continental currency (Courchene and Harris, 1999). Unlike free trade with the U.S., however, this proposal as yet enjoys only minority support from Canada's business and financial communities (who continue to favour an independent Canadian currency), and is widely opposed by members of the general public. Unless and until there is a widespread agreement among Canada's economic and political elites of the sort that presaged free trade negotiations with the U.S. in the 1980s, the issue of continental monetary union is unlikely to become a serious political possibility in Canada. The issue has not received any serious attention in the U.S. or Mexico.

Migration: Within Mexico, more concern has been expressed regarding the absence of provisions within the NAFTA for greater mobility by persons within North America, and of measures to protect the interests and standing of Mexican migrant workers in the U.S. (Weintraub *et al.*, 1997). An estimated 8 million Mexican citizens live in the U.S., half of them illegally. The new Fox government in Mexico has made the issue a major priority in its relationship with the U.S. Here, too, however, it is unlikely that the concern will result in concrete changes in the actual provisions of the NAFTA. In the wake of the terrorist acts of September 11, 2001, the American political climate has become more inward-focused and xenophobic than usual, and there will be little political support there for measures which would allow freer cross-border flows of people within North America. For the foreseeable future, it seems, North American economic integration will continue to be effected by flows of commodities and flows of capital, more than by flows of human beings.

Borders: Another consequence of the September 11 terrorist attacks was the exacerbation of growing problems of congestion and traffic delay at Canada-U.S. and Mexico-U.S. border crossings. An immediate U.S. security crackdown in the wake of September 11 produced unprecedented backlogs in cross-border traffic, and while those disruptions were temporary they did highlight the extent to which North American businesses have been dependent on cross-border flows of inputs—and hence vulnerable to disruptions and delays in those flows. High-level initiatives have since been taken to enhance traffic flows at both borders, including the expansion of physical infrastructure and the introduction of new high-speed screening measures for regular pre-screened shipments. These measures will certainly improve the congestion problems at both borders. As yet, there is no significant discussion in North America about European-style efforts to eliminate border crossings within the free trade zone; this approach would require a prior harmonization of immigration, customs, and security policies which is not considered feasible in any of the NAFTA countries.

6. Conclusion

The implementation in 1994 of the NAFTA, building on the earlier framework of the 1989 Canada-U.S. FTA, marked a watershed in the historical political-economic evolution of Canada and Mexico. The implementation of the NAFTA was a much less important event for the U.S. The relatively simple task of eliminating tariffs on intra-NAFTA merchandise trade constitutes a modest portion of the overall NAFTA package. More important has been the NAFTA's attempt to establish a continent-wide regime of deregulated, market-oriented economic development. Indeed, the Mexican government's primary interest in the NAFTA may have been precisely to commit itself publicly and permanently to a broadly neoliberal development strategy, thus winning the confidence and approval of both international investors and domestic wealth-holders. The NAFTA has had a significant impact on the structure of trade flows within North America, but no visible effect on aggregate economic activity or employment. The prospects for the expansion of NAFTA to include other countries in the Western Hemisphere, or for the deepening of the NAFTA to include topics such as monetary integration or greater freedom of migration, seem relatively dim.

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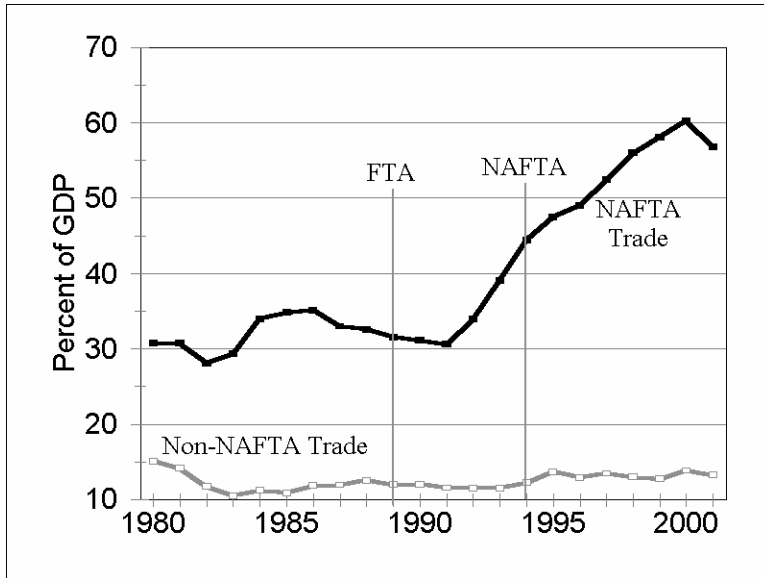
Notes

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- i. Economist, Canadian Auto Workers, 205 Placer Court, Toronto, Canada, M2H 3H9, stanford@caw.ca.
 - ii. This four-to-one cross-national gap in average living standards within the NAFTA zone is twice as wide as the corresponding gap within the EU. The NAFTA zone therefore incorporates a much wider range of living standards and income levels than does the EU.
 - iii. The Liberal party subsequently reversed its opposition to continental free trade. It regained power in the 1993 federal election, promising only to fight for changes in the draft NAFTA which had been signed the previous year; even that mild promise was not fulfilled, and the Liberal administration under Prime Minister Jean Chretien has become a staunch supporter of NAFTA and its expansion throughout the Western Hemisphere.
 - iv. A searchable text of the entire NAFTA can be viewed at the website of the NAFTA Secretariat, www.nafta-sec-alena.org.
 - v. Some tariffs are still allowed to be charged on a small number of agricultural tariffs.
 - vi. These exemptions were most important in the cases of Canada and Mexico, whose economies continued to reflect the legacy of more interventionist economic policy approaches adopted in earlier times. But important U.S. measures, such as the Buy America Act (requiring U.S. content in federally-funded public developments) and the Jones Act (requiring U.S. content in inshore shipping and shipbuilding), were also protected under this approach.
 - vii. The creation of these tribunals represented an attempt by U.S. negotiators to mollify their Canadian counterparts, who had entered the FTA negotiations demanding full exemption for Canadian products from U.S. trade remedies. The U.S. was unwilling to grant this exemption, so instead agreed to the creation of special tribunals which would determine whether existing trade remedies in one country or another had been reasonably and legitimately applied (within the grounds of the domestic laws governing those remedies). The operation of these panels since 1989 is generally viewed to have been unsatisfactory; a particularly discouraging indication has been the failure of the panels, despite repeated rulings against the U.S., to overturn punitive U.S. countervailing duties applied to Canadian exports of softwood lumber.
 - viii. Mexico ranks as Canada's fourth-largest bilateral trade partner, while Canada is Mexico's third largest trade partner.
 - ix. By 2001, the maquiladora export-processing facilities in the northern tier of Mexico employed a total of just over 1 million workers—representing a small share of total formal employment in Mexico of some 40 million workers, and a total economically active population of closer to 60 million (Instituto Nacional de Estadística Geografía e Informática, 2002).
 - x. In real terms, the exchange rate appreciated during this period, since Mexico's inflation rate—while declining—was still higher than that of its trading partners.

xi. In this context, the numerous quantitative models which were used to estimate the economic effects of continental free trade and relied almost exclusively on the inter-sectoral trade reallocation effects predicted in conventional neoclassical trade theory can be seen to have completely misidentified the likely economic significance of the NAFTA.

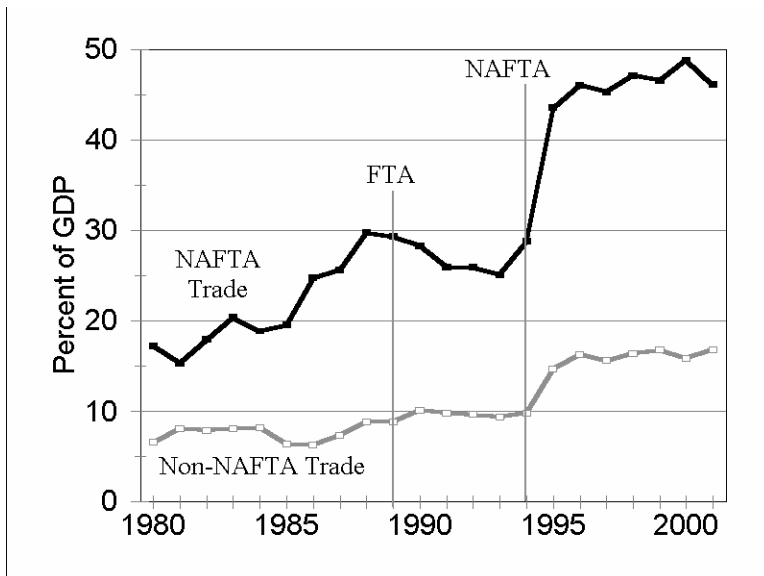
xii. Cuba has been excluded from the process.

Figure 1
Trade Shares of GDP, Canada, 1980-2001
 (% of GDP)



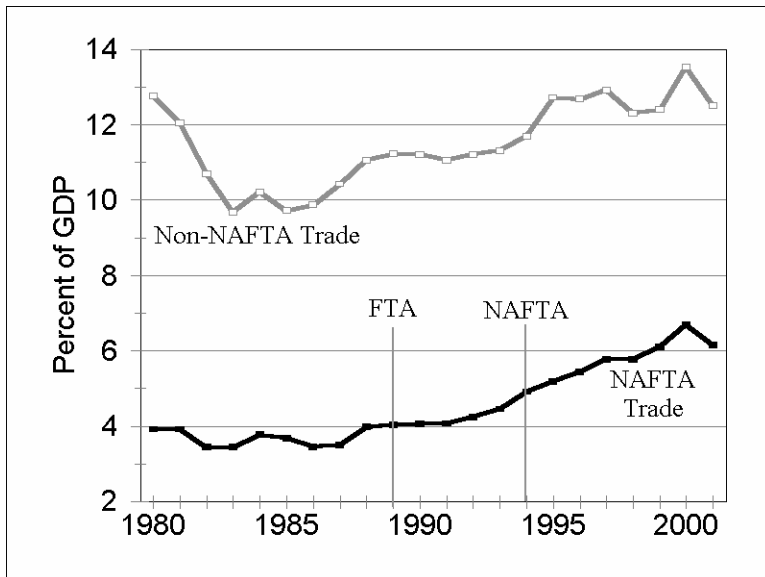
Source: Author's calculations from Statistics Canada (2002a, 2002b).

Figure 2
Trade Shares of GDP, Mexico, 1980-2001
 (% of GDP)



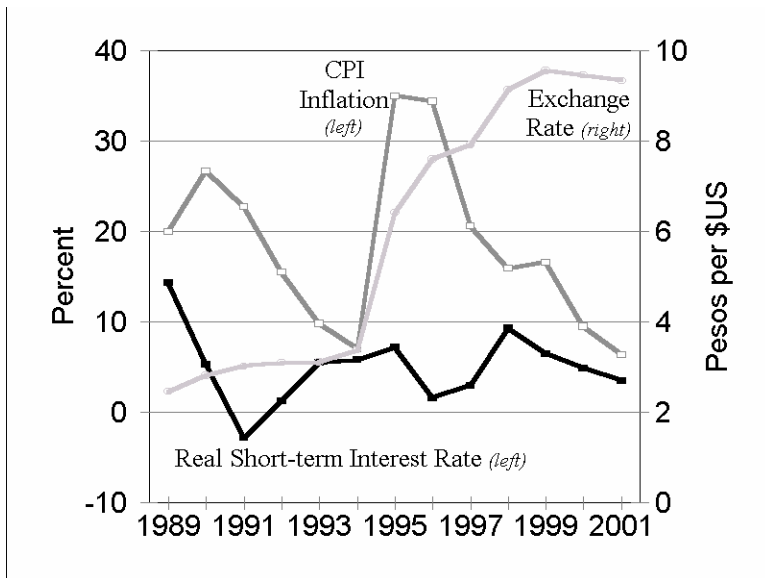
Source: Author's calculations from International Monetary Fund (2001), Organization for Economic Cooperation and Development (2002b), Banco de Mexico (2002).

Figure 3
Trade Shares of GDP, U.S., 1980-2001
 (% of GDP)



Source: Author's calculations from Bureau of Economic Analysis (2002), Council of Economic Advisors (2002).

Figure 4
Monetary Stabilization in Mexico, 1980-2001



Source: Organization for Economic Cooperation and Development (2001a, 2002b).

Table 1
Comparison of the North American and European Free Trade Areas, 2000

	NAFTA	EU
Member Countries	3	15
Combined Population (million)	410	370
Combined GDP (\$billion U.S.)	\$11.1	\$7.8

Source: United Nations Development Program (2002).

Table 2
Characteristics of NAFTA Member Countries, 2000

	Canada	Mexico	U.S.	U.S. as % NAFTA Total
Population (million)	30.8	98.9	283.2	69%
GDP (\$billion U.S.)	\$688	\$575	\$9837	89%
GDP per Capita (\$US)¹	\$27,840	\$9,023	\$34,142	
Foreign Trade (% GDP)²	86.8%	64.7%	26.2%	
Manufacturing (value-added as % GDP)³	18.4%	21.1%	17.7%	
Average Labour Cost (manufacturing, \$U.S. per hour)⁴	\$16.05	\$2.08	\$19.72	
Government Spending (% GDP)⁵	37.7%	15.8%	29.9%	
Life Expectancy (years at birth)	78.8	72.6	77.0	
Infant Mortality (per 1000 live births)	6	25	7	
Inequality (ratio of income of top 10% of population to bottom 10%)	8.5	32.6	16.6	

Source: International Monetary Fund (2001), Organization for Economic Cooperation and Development (2001a, 2002a), United Nations Development Program (2002), U.S. Bureau of Labor Statistics (2002).

1. Evaluated at purchasing power parity exchange rates.

2. Sum of exports and imports of goods and services.

3. 1998 data.

4. Includes wage and non-wage forms of compensation.

5. All levels of government, program spending plus debt service.

Table 3
Summary of Cases Filed Under NAFTA Chapter 11 Provisions
(to October 2002)

Respondent Country	Number of Cases Filed	Total Damages Claimed (\$U.S.)	Disposition¹
Canada	8	\$2.55 billion	1 settled out-of-court with payment of damages; 1 decided against Canada with damages awarded; 1 decided against Canada with damages being considered; 3 pending; 2 withdrawn by complainants.
U.S.	6	\$1.98 billion	1 dismissed; 5 pending.
Mexico	10	\$404 million	1 decided against Mexico with damages awarded; 1 dismissed; 8 pending.

*Source: Government of Canada, Department of Foreign Affairs and International Trade website (www.dfait-maeci.gc.ca), U.S. Department of State website (www.state.gov).
 1. As of late October 2002.*

Table 4
Merchandise Trade Flows Within NAFTA, 2000
(\$billion, U.S. and growth since 1994)

		IMPORTER		
		Canada	U.S.	Mexico
E X P O R T E R	Canada		\$233.7 (+78%)	\$1.4 (+151%)
	U.S.	\$178.9 (+56%)		\$111.2 (+120%)
	Mexico	\$8.1 (+167%)	\$136.8 (+173%)	

Source: Author's calculations from Statistics Canada (2002a, 2002b), Bureau of Economic Analysis (2002).

Table 5
Merchandise Trade Imbalances, NAFTA, 2000

Surplus Partner	Deficit Partner	Imbalance (\$billion U.S.)	Imbalance as % Bilateral Trade¹
Canada	U.S.	\$54.8	13.3%
Mexico	U.S.	\$25.6	10.3%
Mexico	Canada	\$6.7	70.5%

Source: Author's calculations from Statistics Canada (2002a, 2002b), Bureau of Economic Analysis (2002).

Table 6
Real Growth Rates, NAFTA Countries, 1980-2001
(average annual growth rate, real GDP, %)

	1980-89 (pre-FTA)	1989-94 (FTA)	1994-2001 (NAFTA)	1980-2001
Canada	3.1%	1.2%	3.4%	2.8%
United States	3.3%	2.2%	3.5%	3.1%
Mexico	2.4%	3.9%	2.9%	2.9%

Source: Author's calculations from Organization for Economic Cooperation and Development (2001a, 2002a).