COUNCIL on FOREIGN RELATIONS

Renewing America

POLICY INNOVATION MEMORANDUM NO. 29

Date:	Tuesday, March 5, 2013
From:	Robert A. Pastor
Re:	Shortcut to U.S. Economic Competitiveness: A Seamless North American Market

In looking abroad to promote economic growth, the United States need go no further than its two closest neighbors, Canada and Mexico. But the three governments have failed to pursue collaborative efforts to address a new generation of issues that were not anticipated by the 1994 North American Free Trade Agreement (NAFTA). Instead of tackling new transnational problems such as regulatory harmonization together, the United States and its neighbors reverted to old habits of bilateral, ad hoc negotiations. Instead of forging a unified competitiveness strategy toward the European Union and East Asia, each government has negotiated on its own. The three North American governments should create a seamless market, one in which it is as easy and cheap for a Chicago merchant to sell products in Monterrey as in San Francisco. This requires negotiating a common external tariff, eliminating restrictions on transportation and services, funding new continental infrastructure, and fostering a sense of community among the publics of the three countries that will also enhance the region's influence in negotiations with Asia and Europe. One estimate suggests that the benefits to the three countries would exceed $400 billion.

THE CASE FOR A NORTH AMERICAN MARKET

With rising competitive pressures from overseas and weak growth at home, the quickest external route to economic recovery and enhanced competitiveness is to stretch the U.S. market to include 113 million Mexicans and 34 million Canadians. The Obama administration has made it a priority to complete the Trans-Pacific Partnership (TPP) with Asia and has announced its intention to launch a new U.S.-European Union Transatlantic Trade and Investment Partnership. But the administration has neglected its two neighbors despite the fact that their combined product is more than six times that of other TPP countries and that U.S. exports to them exceed those to the EU. Mexico and Canada are already the United States' two largest export markets, its two largest sources of energy imports, and in the case of Mexico, the largest source of immigrants. The three countries also make products together. Unlike U.S. trade with most other countries, roughly 25 to 40 percent of the value of U.S. imports from Canada and Mexico comes from components made in the United States, and then assembled into finished goods in one of the two countries. Closer integration would translate into a more efficient supply chain and improved competitiveness. With labor costs in China rising to those in Mexico, and the cost of transportation across the Pacific increasing, a North American supply chain is not only more efficient than an Asian route, but it could also become a strong export platform to Asia. Moreover, if the United States seeks a unified approach to trade negotiations with Mexico and Canada, Asia and Europe will recognize that Washington has other options, and prospects for concluding transpacific and transatlantic trade deals would likely improve. For example, in the 1990s, world trade talks were stalemated until NAFTA was signed.

WHERE NAFTA WENT ASTRAY

North America was on track to create a competitive market in the 1990s. The most rapid job expansion in recent U.S. history occurred between 1993 and 2001. This coincided with the onset of NAFTA and the end of most trade and investment barriers between the United States, Canada, and Mexico. Trade tripled and foreign direct investment grew fivefold. But 2001 proved to be a turning point for North America just as the outlines of a continental market were becoming visible. Growth in trade has since declined by two-thirds and foreign investment by half.

There are multiple causes for the decline. China entered the World Trade Organization (WTO) and rapidly expanded its exports to all three countries in North America. Post-9/11 restrictions significantly raised the cost of moving products back and forth across North American borders. There has been little investment in common infrastructure, resulting in long wait times at borders and slower movement of commercial goods. But the main cause was simply the failure of leaders in the three countries to build on NAFTA's foundation and create a seamless market.

Deepening North American integration is more productive than widening it to add more free trade agreements (FTAs), but it will require the United States to address numerous domestic issues with its neighbors. Regulatory requirements should be meshed so as to eliminate trade protection while also ensuring safety and environmental concerns. National infrastructure grids—roads, railroads, electricity, and natural gas pipelines—should be built and connected. Repetitive and unnecessary border inspections should be eliminated. Labor market needs should be addressed on a continental basis.

TOWARD A SEAMLESS NORTH AMERICAN MARKET

To invigorate the three economies and forge a higher level of competitiveness, the North American governments should undertake the following measures:

Build public support for a shared vision. North American leaders should say clearly that economic progress depends on closer collaboration. The three leaders should speak often of the common North American vision and community and bring it to life with symbolic steps—such as a "Buy North American" ad campaign, instead of "Buy American." There should be more educational exchanges and support for North American research centers.

Negotiate a common external tariff. This would permit products to cross North American borders without any customs forms, inspection, or duty. Current "rules of origin" requirements mandate that goods must contain a certain level of North American content to qualify for NAFTA tariff preferences, which slows commerce and costs consumers billions of dollars.

Review and eliminate all restrictions in transportation and services. The U.S. government violated NAFTA for more than fifteen years by prohibiting Mexican trucks from entering the United States. Although the U.S. government finally relented last year after WTO rulings, Mexican shippers are reluctant to upgrade their equipment without assurance that these barriers are gone for good. Other barriers include cabotage, which prevents trucks from depositing and acquiring cargo at different points on long journeys, and the Jones Act, which subsidizes American maritime transportation. In addition, while the exchange of services (e.g., banking, engineering, consulting, and health care) is increasingly important, professional certification and parochial regulations retard their growth. All these restrictions should be eliminated.

Forge a continental plan for transportation and infrastructure. Led by each country's minister of transportation, the countries should build new trade corridors, improve railroads and ports, and construct a new highway that stretches from Canada to southern Mexico. Funding for the infrastructure could come from the common tariff, which should yield about $45 billion annually. These funds would be managed by a North American Investment Fund, which could be administered by the World Bank with decision-making in the hands of the three governments.

Create a single North American working group on regulatory issues with a comprehensive strategy. Currently there are two separate bilateral working groups—U.S.-Canada and U.S.-Mexico—that negotiate individual regulations, but they have failed to agree on a single one. A merged working group should aim for across-the-board regulatory convergence. This means that pharmaceuticals should be subject to uniform high standards and would not need to be retested in each country, that food imports should be tested just once by North American inspectors, and that regulations on the size, weight, and fuel efficiency of trucks should be the same in all three countries.

Adapt immigration policies to a wider labor market. The United States and Canada should permit their citizens to work freely in either country. This step is not possible with Mexico until the income gap narrows, but other steps should be taken. NAFTA visas for professionals should be easier to obtain and extend longer for Mexicans. An expanded guest-worker program for Mexicans should be included in comprehensive immigration reform, and to prevent abuse, biometric identification should be required for hiring all employees.

For the United States and Canada, negotiate a new energy framework. The framework should balance the region's need for energy security with the necessity of curbing carbon emissions. The two countries should also develop ways to reduce the multiple-approval process for hydroelectricity transfers and negotiate a plan for future oil and natural gas pipelines. Mexico should be invited to participate but will probably wait until it completes domestic energy reforms.

Make antitrust policies continental. In a continental market, national efforts to break up corporate monopolies will be needlessly duplicative and, as in the case of the telecom monopoly in Mexico, ineffective. A concerted trinational effort would strengthen the capacity of each government to keep North America competitive.

THE NEED FOR LEADERSHIP

There is no better path to stimulate the U.S. economy, increase U.S. competitiveness, and bolster U.S. influence in emerging markets in Asia and Europe than by deepening integration with Canada and Mexico. The three countries already trade more than $1 trillion in goods and services each year. A small but vocal group in the United States opposes any further integration, but by and large the public supports freer trade in North America. Leadership is needed from President Barack Obama, the U.S. business community, and border states and communities. Mexico's new president has already expressed support for bolder initiatives to integrate the continent. Canada is more reluctant, but would not want to be left out if there was clear leadership from its neighbors. The place to start is the next North American Leaders Summit, which Mexico will host this year. The three leaders should articulate a clear vision and pledge to create a single continental market of mostly harmonized regulations in which nearly all products, produce, and services would transit borders without impediment.

Robert A. Pastor is professor and founding director of the Center for North American Studies at American University. He is the author of seventeen books, the most recent being *The North American Idea: A Vision of a Continental Future*.

The Renewing America initiative is supported in part by a generous grant from the Bernard and Irene Schwartz Foundation.

The Council on Foreign Relations (CFR) is an independent, nonpartisan membership organization, think tank, and publisher dedicated to being a resource for its members, government officials, business executives, journalists, educators and students, civic and religious leaders, and other interested citizens in order to help them better understand the world and the foreign policy choices facing the United States and other countries.

The Council on Foreign Relations takes no institutional positions on policy issues and has no affiliation with the U.S. government. All views expressed in its publications and on its website are the sole responsibility of the author or authors.

Policy Innovation Memoranda target critical global problems where new, creative thinking is needed. Written for policymakers and opinion leaders, these brief memos aim to contribute to the foreign policy debate by providing succinct background, rigorous analysis, and specific recommendations.

The ability of the United States to influence world events rests on a robust, competitive economy. CFR's Renewing America initiative sponsors meetings, research, analysis, recommendations, and outreach on how best to revitalize the country's economic strength and build the foundations for future prosperity and influence. As part of the Renewing America initiative, the Renewing America publication series generates innovative policy recommendations on revitalizing the U.S. economy and replenishing the sources of American power abroad. Policy recommendations and research papers in this series focus on six broadly defined issue areas: infrastructure; education and human capital development; debt and deficits; corporate regulation and taxation; innovation; and international trade and investment. The Renewing America initiative is supported in part by a generous grant from the Bernard and Irene Schwartz Foundation.

For further information about CFR or this paper, please write to the Council on Foreign Relations, 58 East 68th Street, New York, NY 10065, or call Communications at 212.434.9888. Visit CFR's website, www.cfr.org.