

# North American Economic Integration

## Policy Options

Earl H. Fry

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Comments are welcome and should be directed to:

CSIS Americas Program

1800 K Street, N.W.

Washington, D.C. 20006

Phone: (202) 775-3150

Fax: (202) 466-4739

E-mail: [lpinto@csis.org](mailto:lpinto@csis.org)

Web site: <http://www.csis.org/>

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# North American Economic Integration Policy Options

*Earl H. Fry*

## **NAFTA at 10**

At the end of 2003, the North American Free Trade Agreement (NAFTA) will have been in effect for a decade, and although the accord will not be fully implemented for another five years, almost all of its important provisions are already in place. The model for NAFTA was the Canada-U.S. Free Trade Agreement (CUSFTA), which was put in motion in 1989 and was to be fully implemented within 10 years but was superseded by NAFTA after only five years in operation. NAFTA itself has created the world's largest free-trade area, encompassing the United States, Mexico, and Canada; 21.3 million square miles of territory; 422 million people; almost \$12 trillion in yearly production; and \$615 billion in annual three-way merchandise trade. North American trade, investment, government-to-government, and people-to-people exchanges have increased dramatically over the past decade and decisionmakers in Washington, D.C., Mexico City, and Ottawa will soon have to consider whether continental economic integration should move to the next level in the form of a customs and monetary union or even a common market possessing many of the attributes of the European Union (EU).

This paper will discuss what has actually transpired in the North American economy since NAFTA's inception in 1994, examine some of the political and economic linkages that have occurred far beyond the purview of government officials in the three national capitals, and analyze the policy options that may be available to the neighboring member-states during the remainder of the current decade.

### Dimensions of Economic Integration

#### Globalization

What is transpiring in North America reflects the globalization process that has been so evident in many parts of the world. Until September 11, 2001, global trade had been growing for many years at about three times the rate of individual national economies, surpassing \$7 trillion in annual cross-border movement of goods and services. Foreign direct investment (FDI), which provides investors in one country with a controlling interest in a company in another country, was growing even more rapidly than international trade and actually surpassed \$1 trillion in flows in 2000. The number of multinational corporations (MNCs) in the world, entities that account for a major segment of trade and FDI globally, has also expanded dramatically, from 7,000 in the 1960s to roughly 65,000 today. These 65,000 MNCs control 850,000 affiliates, which employ 54 million workers world wide and were responsible for producing \$19 trillion in annual sales in 2001, almost three times the value of total international trade.<sup>1</sup> Add to this the record levels of international portfolio investments, plus international currency transactions in the range of \$1.5 trillion per day, and one begins to understand what economic globalization means in concrete terms. Furthermore, both the international system of production sharing and stock markets are 24-hour phenomena, beginning with eight hours in Asia and the Pacific, moving on to eight hours in Europe and Africa, and then completing the cycle with eight hours in the Americas. In addition, the movement of people across national borders is at unprecedented levels. In spite of the tragic events of September 2001, international tourism returned to record levels in 2002, with 715 million people visiting other countries and spending over \$460 billion.<sup>2</sup> Immigration and refugee flows are also without parallel, and at least 175 million people currently reside in countries different from their place of birth.<sup>3</sup>

#### North Americanization

NAFTA is a pact bringing together 3 of the world's 10 largest economies, with the World Bank ranking the United States as number one, Canada as number eight, and Mexico as number nine.<sup>4</sup> In 2002, two-way trade between the United States and Canada surpassed \$372 billion, representing by far the largest bilateral trading relationship in the world. Indeed, last year the United States exported more to Canada than to the European Union (composed of 15 nations and almost 380 million people), and Canada has been the leading destination for U.S. exports

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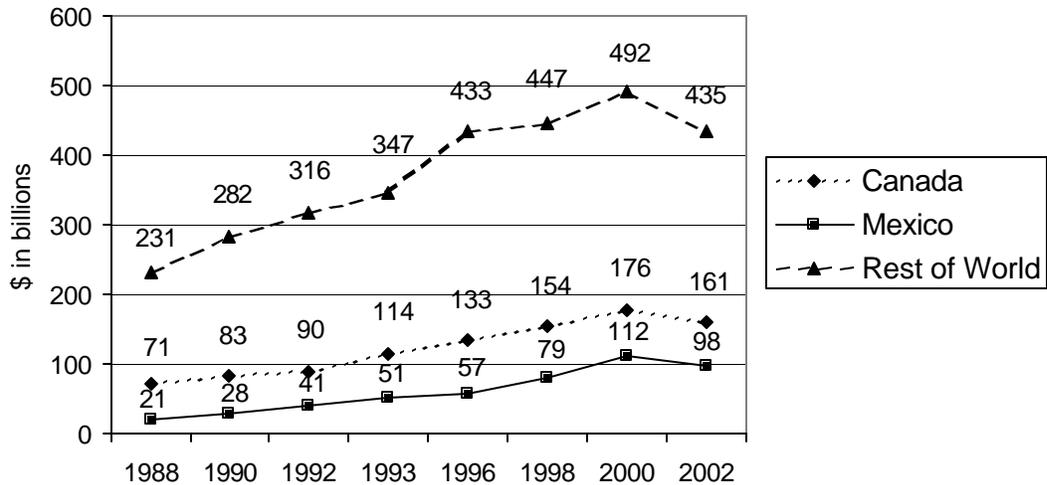
<sup>1</sup> UNCTAD, *World Investment Report 2002: Transnational Corporations and Export Competitiveness* (New York: United Nations Conference on Trade and Development, 2002), pp. 1, 4.

<sup>2</sup> Statistics compiled by the Madrid-based World Tourism Organization.

<sup>3</sup> UN Population Division, *International Migration Report 2002* (New York: United Nations, 2002). One in 35 people in the world now lives in a country where he or she was not born, and that figure increases to 1 in 10 in the most-developed nations.

<sup>4</sup> World Bank Group listings for 2001.

**Figure 1. U.S. Merchandise Exports to Canada, Mexico, and the World, 1988-2002**



**Table 1. U.S. Tourism in Canada and Mexico, 1989-2001**

(number of arrivals in millions)

	1989	1991	1993	1995	1997	1999	2000	2001
<b>Canada</b>	12.2	12.0	12.0	12.9	13.4	15.2	15.2	15.6
<b>Mexico</b>	14.2	15.0	15.3	18.8	17.9	17.7	18.8	17.2

Source: Office of Travel and Tourism Industries, U.S. Department of Commerce.

**Table 2. Canadian and Mexican Tourism in the United States, 1988-2001**

(number of arrivals in millions)

	1988	1990	1992	1994	1996	1998	2000	2001
<b>Canada</b>	13.7	17.3	18.6	15.0	15.3	13.4	14.6	13.5
<b>Mexico</b>	7.7	7.0	10.9	11.3	8.5	9.3	10.3	9.6

Source: Office of Travel and Tourism Industries, U.S. Department of Commerce.

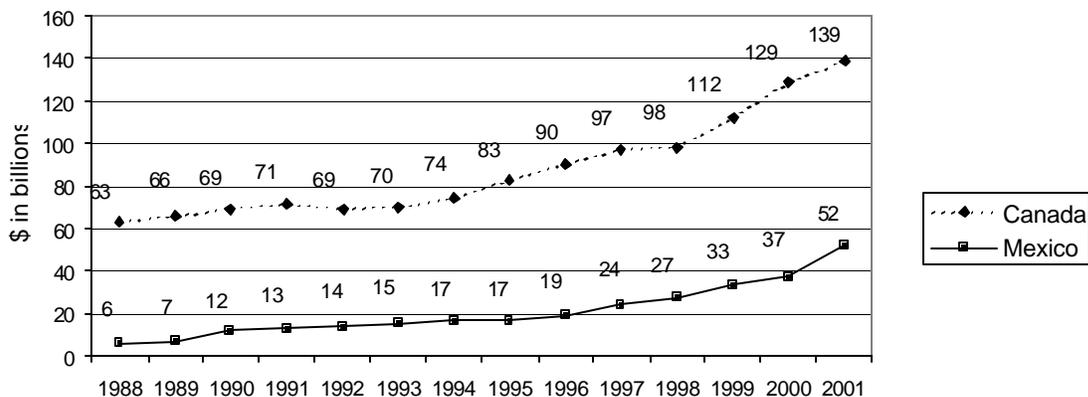
for each and every year since 1946. Mexico has recently moved up to surpass Japan as the second leading trading partner of the United States, with U.S. exports to Mexico being almost twice as large as its combined exports to Central

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America, the Caribbean, and South America. Since 1993, U.S. trade with its North American neighbors has grown much more rapidly than its trade with the rest of the world, with 31.5 percent of total U.S. exports going northward to Canada or southward to Mexico in 1993 versus more than 37 percent last year. As a unit, Canada and Mexico represent 6 percent of the world's GDP and 2 percent of the world's population outside the United States, but collectively absorb almost two-fifths of U.S. exports.

FDI flows within North America have also been very robust during the NAFTA period. The cumulative stock of U.S. direct investment in Canada increased from \$63 billion in 1988, the year before CUSFTA was inaugurated, to \$139 billion in 2001. U.S.-owned companies in Canada now produce the equivalent of 10.3 percent of Canada's GDP, control assets worth \$428 billion, and provide 1,145,000 jobs in a job market with about 15.5 million employed workers. U.S. direct investment in Mexico has increased even more dramatically, moving from \$15 billion in 1993 to \$52 billion in 2001, and Mexico has been the recipient of about \$112 billion in FDI flows from the United States and other parts of the world since NAFTA's inception. At the end of 2000, U.S.-controlled enterprises in Mexico held \$115 billion in assets, accounted for \$124 billion in annual sales, and employed 1,048,000 Mexican workers.<sup>5</sup>

**Figure 2. U.S. Direct Investment in Canada and Mexico, 1988-2001**



The cross-border movement of people in North America is also very significant. More than 200 million border crossings occur annually between Canada and the United States, and over 300 million between Mexico and the United States. Mexico and Canada rank as the top two destinations for U.S. travelers, and Americans constitute about 85 percent of all international visitors to

<sup>5</sup> Raymond J. Mataloni, Jr., "U.S. Multinational Companies: Operations in 2000," *Survey of Current Business* (December 2002): 117–127.

Mexico and 90 percent to Canada. Overall immigration to the United States has picked up dramatically in recent years, with 32.5 million foreign-born individuals living in the United States in March 2002, comprising 11.7 percent of the overall population, the highest percentage recorded since the 1930 census. One in five Americans is defined as of “foreign stock,” and about half of all immigrants in the United States have entered the country since 1990.<sup>6</sup>

Proportionally, however, Canada is home to many more immigrants than the United States, with 17 percent of the national population, and 48 percent of the population of Toronto, Canada’s leading metropolitan region, born in other countries. Immigrants accounted for 70 percent of the growth in Canada’s workforce between 1991 and 2001 and 90 percent of the growth in Ontario’s.<sup>7</sup>

Ranked by country of origin, by far the largest grouping of immigrants in the United States comes from Mexico, with almost 25 million Americans either born in Mexico or being of Mexican descent.<sup>8</sup> The proportion of all immigrants in the United States from Mexico is about 28 percent, the highest recorded for any one country since the 1890 census when 30 percent of all immigrants came from Germany. Perhaps 4 to 5 million Mexicans reside in the United States illegally, and Steve Hanke of Johns Hopkins University estimates that almost 25 percent of the Mexican adult workforce is now employed in the United States rather than in Mexico.<sup>9</sup>

## A Positive but Asymmetrical Relationship

These trade, investment, and human linkages in North America are stronger and more numerous than ever before, and all three nations have benefited in the aggregate from the economic integration spawned by NAFTA and globalization in general. Prime Minister Jean Chrétien of Canada took a leading role in the recent G-8 summit in Evian, France, because Canada’s economy has been performing so much better than any of its major counterparts. Since the inception of its survey in the early 1990s, the UN Human Development Report has never ranked Canada lower than eighth in the world. In the period from 1993 to 2002, Canada was near the top of the Organization for Economic Cooperation and Development (OECD) nations in GDP growth, and far surpassed the performance of the EU and Japan.<sup>10</sup> Its ranking as the eighth-largest economy in the world is even more remarkable when one considers that its population base of 31.5 million is far lower than that of any of the top 10 global economies. Canada has also

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<sup>6</sup> The Census Bureau defines a person as being of “foreign stock” if he or she was born in another country or was born in the United States but has at least one parent born abroad. In April 2000, 56 million U.S. residents fit these criteria.

<sup>7</sup> *Toronto Star*, February 12, 2003. Data were assembled by Statistics Canada.

<sup>8</sup> This is an approximation. The 2000 census counted 20.6 million U.S. residents as people of Mexican origin, up 53 percent from 1990. Adding in increases through mid-2003 and the fact that an unknown number of undocumented immigrants may have been missed by census takers, a total of 25 million seems to be a realistic estimate.

<sup>9</sup> Steve H. Hanke, “It’s Time for Mexico to Dollarize,” *Wall Street Journal*, May 30, 2003.

<sup>10</sup> *OECD Observer*, Supplement I, 2002.

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created about 2 million jobs since 1998, with almost all of them being full time. During the 1990s, about half of all new jobs in Canada were export related and paid an average wage 35 percent higher than nonexport-related jobs. The Canadian job participation rate is at its highest level in more than a dozen years, and 2003 will mark the twelfth consecutive year of economic growth. Canada is the only G-8 nation that has a government surplus, and its annual interest payments on the national debt have decreased from 36 cents of every revenue dollar to 22 cents, the lowest since 1981. It is also alone among G-8 nations in not facing major difficulties in financing its public pension plans.

In the 1993–2001 period, no major Western nation performed better economically than the United States. During those years, 23 million net new jobs were created, and about a quarter of U.S. economic growth was export driven. Between the beginning of the 1990s and the end of 2002, the United States added over \$4.5 trillion to its GDP. This growth alone is greater than the entire production base of any other nation in the world, including Japan and Germany. President George H.W. Bush has estimated that NAFTA has added 2 million jobs to the U.S. economy, although a joint report issued by the Office of the U.S. Trade Representative, Canada's Department of Foreign Affairs and International Trade, and Mexico's Secretaría de Economía reduces that estimate to about a million.<sup>11</sup> Most nongovernmental observers believe that anywhere from tens of thousands to a few hundred thousand new jobs may be attributed directly to U.S. membership in NAFTA.<sup>12</sup>

Mexico's economy has generally performed well since the end of the peso crisis in 1994–1995. It recovered very quickly from that crisis, helped in part by a financial rescue package pieced together by the Clinton administration and paid for by U.S., IMF, and other funding agencies. The Mexican government repaid its obligations to the United States ahead of schedule, and in June 2003 Mexico retired the Brady bonds, which were issued in 1989 in a last-ditch attempt to help Mexico cope with its previous severe debt crisis that had begun in 1982. The Mexican economy grew robustly in the 1996–2000 period, achieving 7 percent growth in 2000 alone, but then tailed off about the same time that the U.S. economy slowed abruptly in 2001. Nearly half of the 3 million new jobs created in Mexico between 1993 and 2000 were in the export sector, and export-related companies in the manufacturing sector pay wages about 40 percent higher than in manufacturing sectors that cater exclusively to domestic consumers.<sup>13</sup> The

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<sup>11</sup> See former president Bush's remarks made at the NAFTA conference held at the Woodrow Wilson Center in Washington, D.C., in December 2002. The estimate is found in *NAFTA At Eight: A Foundation for Economic Growth* (Washington, D.C.: Office of the U.S. Trade Representative, May 2002) (<http://www.mac.doc.gov/nafta/naftareports.html>).

<sup>12</sup> See, for example, the analyses made by Sidney Weintraub, "NAFTA Evaluation," *CSIS Issues in International Political Economy* (August 2000), and Raul Hinojosa-Ojeda, David Runsten, Fernando Depaolis, and Nabil Kamel, *The U.S. Employment Impacts of North American Integration after NAFTA: A Partial Equilibrium Approach*, Research Report Series (Los Angeles: North American Integration and Development Center, UCLA, January 2000).

<sup>13</sup> *NAFTA At Eight*. Also see the speech by President Vicente Fox to the Mexican-U.S. Business Committee, February 25, 2003.

opening of the Mexican economy to North America and the rest of the world, and its quest for modernization and greater interaction with other nations, arguably helped to pave the way for the victory of Vicente Fox in the December 2000 elections, marking the first time since 1929 that a leader from a party other than the Institutional Revolutionary Party (PRI) had won the presidency.

Support for freer trade in general and NAFTA in particular has mostly been positive in all three North American nations. When asked in the recent Pew Research Center survey about the impact of global trade on their country, 36 percent of Canadians, 21 percent of Americans, and 28 percent of Mexicans stated very good, and 50 percent of Canadians, 57 percent of Americans, and 51 percent of Mexicans stated somewhat good. These figures were among the most positive recorded in the survey, which covered 20 nations worldwide.<sup>14</sup>

Both Canadians and Mexicans would prefer to see closer economic ties with the United States, as long as their sovereignty and sense of national identity can be preserved. These reservations epitomize the asymmetrical nature of the relationship. The United States has certainly benefited from NAFTA in many ways, especially in the energy sector. Canada has emerged as the number one foreign source of petroleum products for the United States, and Mexico ranks as the fourth leading source after Venezuela and Saudi Arabia.<sup>15</sup> Not only does Canada supply huge quantities of oil to the United States, but it is also the leading foreign source of natural gas and electricity. Mexico is expected in the near future to generate much-needed electricity for California and may eventually build liquefied natural gas receiving terminals to provide gas for California and states in the U.S. southwest.<sup>16</sup> In the late 1970s, U.S. dependency on foreign petroleum products was about 35 percent; today, depending on the source one uses, over half of U.S. petroleum comes from abroad. The ability to receive shipments from its nearest neighbors and to rely less extensively on sources in the volatile Middle East has certainly bolstered overall U.S. economic security.

On the other hand, there are very few nations in the world whose overall economic prosperity is as dependent on access to a foreign market as Canada and Mexico depend on—unimpaired—access to the huge U.S. market. Even though Canada and Mexico rank among the 10 largest economies in the world, their GDP is, respectively, only one-fourteenth and one-sixteenth the size of the U.S. economy. The United States has three times more people than Mexico and nine times more than Canada, with California alone having a larger population base than Canada. In 2002, about 85 percent of Canadian and Mexican exports was destined for only one foreign market, the United States, and these exports constitute well over 30 percent Canada's GDP and over 20 percent of Mexico's. When one adds in the activities of U.S.-based companies in Canada, almost 40

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<sup>14</sup> Pew Global Attitudes Project, *Views of a Changing World, June 2003* (Washington, D.C.: Pew Research Center for the People and the Press, 2003).

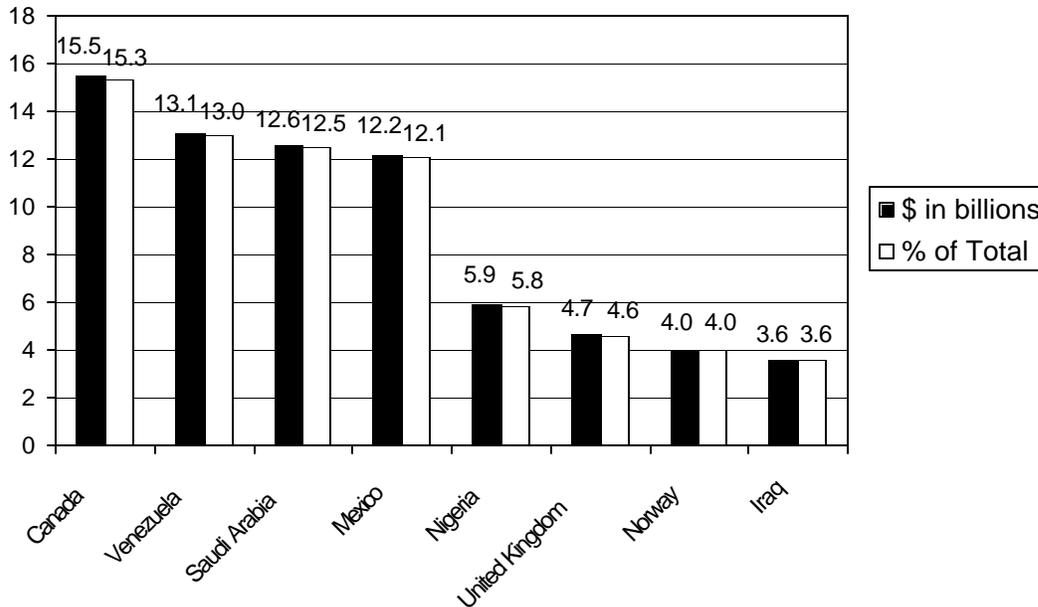
<sup>15</sup> Data for 2002 accumulated by the International Trade Administration, U.S. Department of Commerce.

<sup>16</sup> *San Diego Union-Tribune*, June 15, 2003.

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percent of Canada's GDP is linked directly to trade and economic ties with the United States, and over 30 percent of all jobs is also dependent on this linkage.<sup>17</sup> The percentage of GDP in Mexico linked to U.S. trade and investment ties is somewhat smaller but still comparatively high. In contrast, even though 37 percent of total U.S. exports go to its closest neighbors to the north and south, this represents less than 4 percent of total U.S. GDP and employment.

**Figure 3. Suppliers of Petroleum Products to the United States, 2002**



In addition, the United States is the world's only superpower and its global commitments continue to proliferate. For many Americans, U.S. intervention in Iraq was justified because of the brutality of Saddam Hussein's regime, Iraq's reputed links to Al Qaeda, and its alleged stockpile of weapons of mass destruction. In the eyes of much of the rest of the world, including most Canadians and Mexicans, Iraq was a war of choice and not of necessity, and was fought to strengthen U.S. influence in the Middle East and to safeguard U.S. economic and political interests. Both Tony Garza, U.S. ambassador to Mexico, and Paul Cellucci, U.S. ambassador to Canada, expressed deep disappointment that Mexico and Canada did not fully support the U.S. invasion of Iraq, even though both nations have long been known for championing multilateral solutions to global problems.

Behind the scenes, however, Mexico's Fox put Operation "Centinela" in place, redeploying 18,000 military troops and 12,000 federal police to guard the northern and southern borders, ports, airports, energy plants, and U.S.-owned facilities. Canada's Chrétien did the same in terms of beefing up border security.

<sup>17</sup> There is a significant overlap between export-related jobs and jobs created by U.S.-owned enterprises in Canada.

Moreover, the Canadian navy continued its patrols in the Gulf region. Ottawa also ordered more troops to be sent to Afghanistan to take some of the pressure off U.S. forces already stationed there, permitted Canadian personnel in exchange programs with the U.S. military to continue to carry out their duties in and around Iraq, and quickly offered millions of dollars in assistance to help rebuild Iraq once the period of intense conflict had subsided.

Nevertheless, being situated next to what might be the most powerful nation in modern history in terms of overall economic, military, and cultural clout has certainly prompted many Canadians and Mexicans to reflect on the pros and cons of further economic integration with their behemoth neighbor. In effect, can they achieve “assured access” to the U.S. marketplace and thereby enhance their economic well-being, or would closer economic integration cross a threshold that would inevitably spill over into political, strategic, cultural, health-care, and other important domains and severely constrain their policymaking autonomy?

## North American Integration Outside the Beltway

The casual observer might suppose that further economic integration on the North American continent will be masterminded by eminent elected representatives and government officials in Washington, D.C., Mexico City, and Ottawa. In reality, many of the cross-border interactions leading to permanent, close-knit economic ties are found far away from these national political centers.

All three countries have federal systems that divide authority constitutionally between national and regional governments. Only a small minority of the 200 nations around the world has a federal system, and three of them are concentrated side-by-side in North America.<sup>18</sup> Canada has the most decentralized system, meaning that the 10 provincial governments exercise more policymaking latitude than either the 50 U.S. state governments or the 31 Mexican state governments. For most of the twentieth century, federalism was merely a facade in Mexico with governmental authority being heavily concentrated among the PRI political elite in Mexico City. Today, however, some of the state governments are beginning to exercise real authority with their leaders making contacts and solidifying linkages with governmental, business, and other representatives abroad.<sup>19</sup> Some of the municipalities have also been granted greater authority to raise revenues and to embark on a variety of projects that have cross-border connotations.

U.S. state governments are potentially powerful actors internationally and already 37 of the states and the Commonwealth of Puerto Rico operate about 240 offices abroad for mainly economic-development purposes. These states spend about \$100 million per year on their programs, and half of the governors lead at

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<sup>18</sup> About two dozen nations around the world have federal governing systems.

<sup>19</sup> George W. Grayson asserts that some Mexican governors have been transformed into “real political dynamos.” See his *The July 6, 2003, Mexican Mid-term Elections*, Policy Papers on the Americas (Washington, D.C.: CSIS, June 2003), p. 2.

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least one international mission every year.<sup>20</sup> To comprehend the economic clout of many states, consider doing the following. Go to the World Bank Web site (<http://www.worldbank.org>), which ranks 200 nations and territories around the world by annual gross domestic product. Next, move on to the U.S. Bureau of Economic Analysis Web site (<http://www.bea.gov>), which lists the annual production of the 50 states. Using comparable figures, one will be able to list three U.S. states (California, New York, and Texas) among the 10 largest nation-states in the world—with New York and Texas each producing more than Canada, and California producing more than Canada and Mexico combined. Among the top 25 nation-states in the world, one can insert 22 U.S. states, among the top 50 nation-states, 38 U.S. states, and among the top 67 nation-states, all 50 U.S. states.<sup>21</sup> A dozen of these states now maintain their own offices in Canada and 18 states have offices in Mexico. In 2002, Canada was the leading export destination for products from 37 states and Mexico was number one for 3 states.<sup>22</sup> A variety of regional governmental associations also exist to promote cross-border interactions.

The Canadian provinces are also among the most active noncentral governments on the global stage. Ontario's annual production base is about the same as Russia's, Quebec's is equivalent to Denmark's, Alberta's to Ireland's, and British Columbia's to Malaysia's.<sup>23</sup> Provincial governments are much more actively involved than their U.S. counterparts and actually spend more on international programs and have more personnel involved than the 50 U.S. state governments combined. Indeed, Quebec, with its 7.5 million people and a GDP somewhat smaller than Louisiana's, operates 29 *délégations* abroad and spends almost as much and has as many personnel involved in international programs as the 50 states to its south. The large provincial governments have several permanent offices in the United States and Mexico and almost all of the provincial governments sponsor economic missions to the United States on a regular basis. The premiers of Alberta and New Brunswick were actually accorded visits with Vice President Cheney in Washington, D.C., in part because their provinces have huge reserves of oil or natural gas that the Bush administration would like to see supplied to U.S. customers. Both Ontario and Quebec have been granted an associate membership in the U.S. Council of State Governments, and Quebec City even hosted the annual meeting of this U.S. organization in 1999. Several of the provinces have memberships in a wide variety of U.S. or cross-border governmental organizations and meet with state representatives on a fairly regular basis. At the annual meeting of the western premiers held in British Columbia in June 2003, the provincial leaders discussed contacting directly the governors in the western United States in an effort to end

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<sup>20</sup> For an in-depth look at the international activities of the U.S. states, see Earl H. Fry, *The Expanding Role of State and Local Governments in U.S. Foreign Affairs* (New York: Council on Foreign Relations, 1998).

<sup>21</sup> These comparisons are based on 2001 data.

<sup>22</sup> International Trade Administration, U.S. Department of Commerce.

<sup>23</sup> 2001 data from the World Bank and Statistics Canada.

the ban on the shipment of cattle from Canada (put in place because one cow in Alberta had contracted the mad-cow disease). Governments in Michigan and Ontario have agreed to speed up plans to build a third transportation route between Detroit and Windsor, hoping to light a fire under federal authorities to get the project approved and built. Such a transportation route is critical to Ontario because nearly 90 percent of its exports wind up in the United States, and it is critical to Michigan because the annual trade that occurs at this border corridor surpasses total U.S. exports to Japan. Governor George Pataki of New York and then-Premier Bernard Landry of Quebec also met occasionally and even discussed the feasibility of submitting a joint bid to host a future Winter Olympics. The governments of Alberta, British Columbia, and the Yukon have joined together with Washington, Oregon, Idaho, Montana, and Alaska to form the Pacific Northwest Economic Region (PNWER), which coordinates issues on a regional, cross-border basis. The New England governors and Eastern Canadian premiers have had their own organization in place for nearly 30 years and meet annually to explore regional solutions to trade, investment, energy, environmental, and other policy challenges. The same can be said about the Great Lakes governors and premiers. Literally hundreds of compacts and accords have been negotiated between state and provincial governments, and the degree of interaction among these noncentral government entities is almost unparalleled around the world.

In many respects, the Canadian provincial governments have developed their own quasi-foreign relations with the United States, or at least regions of the United States. This policy stance is predicated primarily on economic necessity, because companies in at least 9 of the 10 provinces now produce more for consumption in the United States than in the rest of Canada.<sup>24</sup> Proximity and familiarity are other motivations for special provincial policies toward the United States. Whereas almost 3 out of 4 Americans live in a state that does not share a border with Canada, 98 percent of Canadians live in the eight provinces that do share a common border with the United States. Canada is also the second-largest nation in the world territorially, but two-thirds of all Canadians live within 100 miles of the U.S. border and four-fifths within 200 miles of this unusually long border, which extends more than 3,100 miles over land and almost 2,400 miles over water.

Because of the legacy of centralization of authority in Mexico, governmental contacts between U.S. and neighboring Mexican states along the 2,000-mile shared border have been more modest, but they have certainly existed and have picked up some steam since President Fox came to office in Mexico City. The Border Governors Conference has convened annually since 1980 and brings together the leaders of California, Arizona, New Mexico, Texas, Baja California, Chihuahua, Coahuila, Nuevo León, Sonora, and Tamaulipas. The Sonora-Arizona Commission has existed for over 40 years and attempts to formulate joint goals and coordinate joint projects for these neighboring cross-border states. Similar

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<sup>24</sup> This conclusion is based on the author's research using data supplied by Statistics Canada.

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commissions have been created by New Mexico and Chihuahua and by California and Baja California. In recent years, California has accelerated its joint activities with Mexico, with Governor Gray Davis visiting Mexico within a month of his first inauguration and then hosting President Ernesto Zedillo for three days in May 1999.<sup>25</sup> The legislatures in Arizona, California, New Mexico, and Texas all have committees that deal with cross-border issues, and the Council of State Governments West and the Southern Legislative Conference have held over the past four years annual border-exchange programs with their counterparts in northern Mexico. With such subnational governmental linkages proliferating, it is not surprising that President George W. Bush and President Vicente Fox first met while they were serving as governors of Texas and Guanajuato.

Municipal officials in the three countries also get together on an infrequent basis, with many of the contacts made by city leaders who are close to the respective borders. For example, San Diego and Tijuana representatives meet fairly often, with San Diego officials appreciating the more than \$3 billion per year that is pumped into the county's retail sector by visitors from Tijuana and northern Baja California.<sup>26</sup> Other municipal leaders have banded together in an effort to promote north-south transportation corridors between Canada and Mexico, because trucking is the major mode for the shipment of goods on a north-south basis. Kansas City officials have been particularly active in this type of endeavor, and other leaders in the west are working to promote similar North American trucking and tourism corridors.

Nongovernmental associations have also been active on a North American basis, especially industry groups and chambers of commerce. Environmental groups have generally been critical of what they consider to be environmental deterioration along the U.S.-Mexico border and have banded together to demand policy changes on the part of the NAFTA Commission for Environmental Cooperation (CEC). U.S. and Canadian labor unions allege that Mexican workers, especially those in *maquiladora* facilities, are treated unfairly and that the NAFTA Commission for Labor Cooperation (CLC) has done little to alleviate the situation.<sup>27</sup> Human rights groups deplore the conditions that some undocumented immigrants face when they cross the border between Mexico and the United States, with almost 2,000 having perished making the trek northward since 1997. These groups are urging revisions in current U.S. policy and requesting more humanitarian assistance once the immigrants have arrived. Some state governments are also going against the grain of U.S. federal policy toward undocumented aliens. Roughly 40 states are now considering bills to provide undocumented migrants with access to driver's licenses, and 18 are considering proposals to allow children of illegal immigrants to go to college. In 2001,

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<sup>25</sup> *Los Angeles Times*, June 6, 1999.

<sup>26</sup> *San Diego Dialogue* (December 2001). Purchases by Mexicans account for about 7 percent of total retail sales in San Diego County.

<sup>27</sup> For a discussion of some of these environmental and labor issues, see Earl H. Fry and Jared Ruiz Bybee, "NAFTA 2002: A Cost/Benefit Analysis for the United States, Canada, and Mexico," *Canadian-American Public Policy*, 49 (January 2002): 14-23.

California passed a law permitting undocumented immigrant students who attended state high schools for at least three years and graduated to qualify for in-state tuition at public colleges and universities. Even conservative Utah has passed a law that permits undocumented immigrants to attend state colleges and universities, provided they have lived in Utah for at least three years.<sup>28</sup>

The people-to-people contacts between Canadians and Americans, and especially between American residents and Mexicans, are also solidifying north-south economic ties. Mexicans and Mexican-Americans living in the United States remit up to \$10 billion per year back to Mexico, an amount greater than revenues generated from international tourists who visit Mexico. These *migradolares* are important for the economic well-being of scores of villages in Mexico, and in January 2003 the People's Network was created, an Internet-based system that substantially lowers the transaction costs involved in transferring the funds and insures that more of the money will ultimately end up in Mexico.<sup>29</sup> With so many Mexican-Americans and Mexicans living and working in the United States, cross-border contacts are proliferating dramatically. The governor of Oaxaca spoke in 2001 to the Oaxacan Foundation of Los Angeles and pledged to match \$3 from the local, state, and federal governments in Mexico for every \$1 sent by the Los Angeles group for infrastructure improvements in Oaxaca.<sup>30</sup> Mexican states can also send representatives to a Mexican government facility in Santa Ana, California, where cross-border projects can be discussed and developed. The governors of Yucatan and Hidalgo are among those who have recently traveled to Washington, D.C., to meet with members of the U.S.-Mexico Binational Council to share viewpoints and discuss the feasibility of future projects.<sup>31</sup> In December 2002, the Mexican government helped to create a 120-member U.S.-based advisory council for its Institute for Mexicans Abroad. The initial selections included 72 Mexican immigrants and 28 U.S.-born citizens of Mexican descent, gathered from over half of the U.S. states. The group exists to publicize the plight of those who cross the border, both with and without documents, and the challenges that they face in terms of work, health care, education, housing, and other related issues. Within the Beltway itself, the U.S.-Mexico Inter-Parliamentary Group has met annually for over 40 years and a U.S.-Mexico Caucus was created in Congress in March 2003 with 24 members from both major political parties.

The overall climate precipitated by NAFTA has spurred the creation of nearly 60 formal groups dealing with a panoply of trilateral issues, institutionalization of the unique dispute-settlement mechanism, and major governmental and societal changes in Mexico. Such developments have combined to accelerate these types of nongovernmental and noncentral governmental cross-border activities and have

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<sup>28</sup> *Los Angeles Times*, June 9, 2003.

<sup>29</sup> *Ibid.*, June 1, 2003.

<sup>30</sup> *Ibid.*, July 8, 2001.

<sup>31</sup> The U.S.-Mexico Binational Council was created by the Center for Strategic and International Studies (CSIS), the University of Texas at Austin, the Centro de Investigación para el Desarrollo, and the Instituto Tecnológico Autónomo de México.

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improved the prospects for deepening and enlarging continental economic integration.

### Policy Options

As stressed earlier, NAFTA has brought about aggregate economic gains for all three North American nations. This does not mean that individual companies or even economic sectors, especially noncompetitive manufacturing and agricultural niches, have not been hurt dramatically. Some of this damage, however, may have occurred even in the absence of NAFTA, particularly in manufacturing. As Mexico has opened itself to the rest of the world with its membership in NAFTA, the OECD, the World Trade Organization (WTO), the Asia Pacific Economic Cooperation forum (APEC), and other international organizations, it has had to face growing competition from both developed and developing economies. Even today, Mexican wages in many manufacturing sectors are three times higher than those found in certain parts of China, and under such circumstances, it becomes more difficult to secure domestic investment and attract foreign investment unless major gains are achieved in labor productivity, overall unit labor costs, and critical infrastructure modernization.<sup>32</sup>

Unfortunately, trade between the three countries decreased in 2001 and again in 2002, intra-North American direct investment flows diminished precipitously, and even cross-border tourism ebbed. There is mounting concern that the U.S. preoccupation with border security and international terrorism, combined with skyrocketing government and international debt, will hamper continental economic growth in 2003 and again in 2004. Most U.S. state governments are suffering through their worst fiscal crisis in decades, and the U.S. unemployment rate stands at a nine-year high. The U.S. Congress passed and President Bush signed a highly protectionist farm bill in 2002, which over the next decade will negatively affect agricultural trade with the NAFTA partners and in third-country markets around the world. Canada and Mexico were exempted from the new round of steel tariffs put in place by Washington in 2002 but have a litany of concerns about U.S. policies linked to softwood lumber, wheat, cross-border trucking, and numerous dumping or countervailing duty determinations enacted or being considered by federal officials.

In spite of these lingering concerns, some academics and government leaders have stepped forward to offer vigorous support for an ambitious integrative agenda for North America. Before assuming the presidency in December 2000, Vicente Fox voiced support for a European Union of North America, an institutional arrangement that would eventually result in the creation of a common market, the free movement of labor, and a common currency. Professor Robert

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<sup>32</sup> In his article, "Economic Competitiveness in Mexico: Recent Evolution, Prospects, and Repercussions for the United States," *CSIS Hemisphere Focus* (April 21, 2003), Mariano Ruiz-Funes argues that Mexico's global competitiveness has declined in recent years, in part because of inaction in the Mexican Congress and the inability of the national government to raise sufficient revenues to modernize the nation's infrastructure as a result of a flawed taxation system.

Pastor of American University supports the creation of a North American Commission, a North American Parliamentary Group, and a permanent North American Court on Trade and Investment to replace the current NAFTA panels. He also favors the introduction of the *amero* as the new continental currency.<sup>33</sup> Wendy Dobson of the University of Toronto believes that Canada should push for the “Big Idea” and propose to Washington some form of “common economic space” that would link security, defense, energy, and economics, although she suspects that such a project would have to be done bilaterally with the United States instead of trilaterally with Mexico.<sup>34</sup> Former Canadian ambassador to the United States Allan Gotlieb follows this train of thought and believes that a Canada-U.S. customs union is within the realm of possibility. Queen’s University’s Tom Courchene, one of Canada’s leading international economists, supports the creation of a monetary union between the United States and Canada, arguing that Canadian provinces have evolved to the point that regional economic linkages with U.S. states are more important than east-west economic ties across Canada.<sup>35</sup> In a recent survey, about a third of Canadian business leaders supported an EU-style integration in North America, and the Canadian Council of Chief Executives favors the creation of a North American security and prosperity zone. A 2002 report released by the Canadian House of Commons’ Standing Committee on Foreign Affairs and International Trade makes 39 recommendations related to future relations with the United States and strongly endorses closer economic and security ties, including the formation of a security perimeter and perhaps even the establishment of a North American court dealing with trade and investment issues.<sup>36</sup> Prime Minister Jean Chrétien and Deputy Prime Minister John Manley have also spoken in positive terms about the expansion and deepening of NAFTA ties.

Officialdom in Washington has been much more circumspect about major efforts to strengthen North American integration. Little attention has been paid to this issue, and top officials know that proposals leading to major deviations from the *status quo* would have to originate in Canada or Mexico and not in the hegemon that physically separates the two. Canadians historically have worried about the possibility of economic integration leading to political integration, helping explain why Canadian leaders got cold feet in 1911 and again in 1947–1948 when the United States agreed to initial Canadian overtures to implement free-trade agreements. Even when the Mulroney government was ultimately successful in persuading parliament to ratify the CUSFTA in 1988, the prime

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<sup>33</sup> Robert A. Pastor, *Toward a North American Community* (Washington, D.C.: Institute for International Economics, 2001), pp. 114–115.

<sup>34</sup> Speech by Wendy Dobson to the North American Committee, Ottawa, October 24, 2002.

<sup>35</sup> Thomas J. Courchene, “The Case for a North American Currency Union,” *Policy Options* (April 2003): 20–25, and the *Globe and Mail* (Toronto), May 31, 1999.

<sup>36</sup> Report of the Standing Committee on Foreign Affairs and International Trade, *Partners in North America: Advancing Canada’s Relations with the United States and Mexico* (Ottawa: Canadian House of Commons, December 2002). Also consult the report of the Standing Senate Committee on Foreign Affairs, *Uncertain Access: The Consequences of U.S. Security and Trade Actions for Canadian Trade Policy*, Volume I (Ottawa: Canadian Senate, June 2003).

minister was first forced by the Canadian Senate to call for new elections to the House of Commons, with a majority of senators arguing that an issue of such monumental importance for the future of Canada required a new electoral mandate from the voters. As for Mexico, its relationship with the United States has often been bitter, with the United States absorbing half of Mexico's original territory, mostly by conquest, and provoking the famous lament from a nineteenth-century Mexican leader, "Poor Mexico, so far from God and so close to the United States!" Based on historical sensitivities, a blueprint for "NAFTA plus," a customs union, a common market, or even an EU-style arrangement would initially have to be proposed by governments in Ottawa or Mexico City and certainly not by the government in Washington, D.C.

Although heavily focused on other international and domestic issues, the Bush administration has spent some time pursuing free-trade initiatives. Congress finally gave the administration fast-track or trade-promotion authority in 2002, permitting it to negotiate new bilateral, regional, or multilateral trade arrangements, which would then be voted on by both chambers of Congress on an up-or-down basis without the encumbrances of new amendments. New free-trade agreements with Jordan, Singapore, and Chile have subsequently been negotiated and signed; negotiations are in process for similar accords with Morocco, Australia, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, South Africa, Botswana, Lesotho, Namibia, and Swaziland, and will soon commence with Bahrain.<sup>37</sup> The Bush administration is also quite supportive of the Free Trade Agreement of the Americas (FTAA), which would involve every nation in the Western Hemisphere except for Cuba and would be put in motion in 2005.

Because of rather tense personal relations between Jean Chrétien and George W. Bush, nothing will be done on further Canada-U.S. economic integration until after Chrétien leaves office (no later than February 2004).<sup>38</sup> The personal ties between Fox and Bush have also cooled dramatically, and Fox's inability to deliver tangible benefits for Mexico based on his anticipated "special access" to the Bush White House helps explain the very poor showing of the PAN in the July 2003 elections. Fox pledged to create at least 1 million new jobs annually, a far too ambitious goal in light of the tepid economic performance of both the United States and Mexico over the past couple of years. With the PAN losing over 50 seats in the Chamber of Deputies, combined with major electoral gains by the PRI in the chamber and in a number of governorships, Fox has likely been relegated to a lame-duck status over the final three years of his *sexenio*. Consequently, any significant revisions in Mexico-U.S. economic relations are probably on hold until either one or both national leaders leave office.

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<sup>37</sup> The accords with Singapore and Chile have been signed by the Bush administration but are still awaiting congressional approval.

<sup>38</sup> See Sidney Weintraub, "Strains in the Canada-U.S. Relationship," *CSIS Issues in International Political Economy* (April 2003).

## Major or Minor Policy Initiatives?

Once new leaders have become familiar with their surroundings along Sussex Drive in Los Pinos and perhaps even along Pennsylvania Avenue in Washington, it is still within the realm of possibility for Canada and/or Mexico to propose to the U.S. administration major steps to increase either bilateral integration or continental integration. There is certainly a precedent for doing so, based on the watershed decisions by the Trudeau government to seek a sectoral free-trade accord with the United States in the early 1980s, the Mulroney government's initiative to broaden these discussions to a comprehensive free-trade pact in the mid-1980s, and Salinas's overtures to Washington for a Mexican free-trade agreement with the United States patterned after CUSFTA.

The first critical step would be for Canada and Mexico to determine whether they can act in unison or would ultimately act separately. In the case of Ottawa, it may have to water down some of its aspirations if it joins with Mexico, especially in terms of the freer movement of labor and the creation of a binational court on trade and investment to replace the current NAFTA dispute-settlement mechanism. Although trade between Canada and Mexico has increased at a rapid rate, it still measures little more than \$10 billion. To be blunt, Canada and Mexico are not integrated economically, nor are they likely to be in the foreseeable future. The only reason that NAFTA exists is because when Salinas asked the senior Bush for a bilateral free-trade agreement, Mulroney worried that Mexico would receive better terms than had been accorded to Canada under CUSFTA, placing Canadian companies at a competitive disadvantage in the huge U.S. marketplace. Moreover, Canada was concerned about the hub-and-spoke scenario in which the United States would have separate agreements with Canada and Mexico, giving its companies open access to the three North American markets and leading to a concentration of European and Asian direct investment in the United States. This concern about Canada's attractiveness as an investment haven was compounded at the time by the continuing political uncertainty in Quebec.

In addition, Canada has a much more positive profile in the United States than does Mexico, in spite of the personal animosity between Bush and Chrétien. In the most recent Chicago Council on Foreign Relations survey, Americans identify Canadians as their best friends in the world, just slightly ahead of the British. As measured on a temperature gauge, this warmth for Canada was 77 degrees, whereas Mexico ranked fifth and was tied with Japan at 60 degrees.<sup>39</sup> The vote on Capitol Hill for a free-trade agreement with Canada was overwhelmingly favorable, whereas the vote for free trade with Mexico was highly contested, and a majority of Democrats in both chambers actually voted in opposition in spite of strong support for the agreement from the Clinton White House. This opposition stemmed in part from concerns about the loss of jobs to Mexico and Mexico's lack of progress in cleaning up its environment. Worries about illegal immigration and drug trafficking simply solidified the argument of those who decided to vote

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<sup>39</sup> Chicago Council on Foreign Relations, *Worldviews 2002: American Public Opinion and Foreign Policy* (Chicago: Chicago Council on Foreign Relations, 2002).

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against the historic accord. On the other hand, the potentially strong political role that Mexican-Americans can play in influencing future U.S.-Mexico relations, especially in the American Southwest, far surpasses any political influence that can be wielded domestically by Canadian-Americans.

If Mexico City and Ottawa do decide to work together, a proposal might include some of the following:

- greater harmonization of competition policy to mitigate the effects of U.S. antidumping and countervailing duty actions;
- replacement of current NAFTA dispute-settlement panels with a permanent court of trade and investment, a step that would lead to the creation of North American standards for a large segment of trade and investment activity;
- modification of NAFTA's Article 11 investment provisions to take into account the concerns of noncentral governments in the three federal systems but still accord North American companies the right of establishment and national treatment;
- broadening of criteria for professionals to live and work in all three countries and a pilot provision for the movement of seasonal workers;
- concrete steps to create a North American security perimeter and further harmonization of immigration and refugee policies for those coming from non-NAFTA countries;
- creation of a North American energy accord and liberalized standards for direct investment in the energy sector;
- modification of some rules of origin for companies to qualify for duty-free shipment of goods within North America and some harmonization of tariff schedules vis-à-vis goods and services imported from non-NAFTA countries;
- further liberalization in intra-continental trade in agricultural products;
- renewed standards for the movement of commercial trucks on North American highways and a guarantee that well-maintained Mexican trucks will be permitted to use U.S. and Canadian roads;
- harmonization of phyto-sanitary regulations; and
- agreement to work together to bring about further multilateral liberalization of trade and investment activity within the structure of the Doha round of WTO negotiations. Each country would also be responsible for improving financial and other types of assistance for workers in noncompetitive industries who would be in danger of losing their jobs because of further liberalization of continental trade activity.

There will not be a North American common market nor EU-style continental integration in the foreseeable future. The chances are also very remote that the *amero* or any other North American currency will be created over the next several

decades. With the U.S. dollar already being the currency of preference for many Mexicans, with many large Canadian corporations doing their day-to-day accounting in U.S. dollars, and with the U.S. economy dwarfing the economies of its closest neighbors, it is not difficult to predict that the U.S. currency will become even more prevalent continentally. If Mexico and Canada were ever to adopt the U.S. dollar as their official currency, each nation might be accorded a seat on the Federal Reserve Board. Nonetheless, U.S. representatives on the board would continue to dominate the decisionmaking process and both Mexico City and Ottawa would be forfeiting a great deal of sovereignty over monetary policy and the setting of interest rates. Over time, the dollar, euro, and perhaps a new East Asian currency will dominate international economic transactions and begin to crowd out lesser currencies. This will not happen for many years but would be a plausible scenario explaining why Mexico and Canada may eventually embrace, albeit reluctantly, the U.S. dollar.

In the long term, North American economic integration will certainly intensify. Already, about 36 percent of global trade activity occurs within just four regional groupings: the EU, NAFTA, Association of Southeast Asian Nations (ASEAN), and Mercosur. The EU is scheduled to add 10 new members in 2004, and if the FTAA is implemented, 34 of the 35 nations in the Western Hemisphere will gradually strengthen their regional economic ties. Ideally, this regional economic integration will be occurring hand-in-hand with further trade and investment liberalization at the multilateral level so that nations outside of these regional blocs, nations that are predominantly developing economies, will not be placed at a further disadvantage in the international trading system.

NAFTA will be fully enacted in 2008, and it is now time to consider what happens next within the parameters of North America. Ottawa and Mexico City must be expected to take the lead, either in tandem or separately, in proposing new modes of economic integration with the United States or on a continental basis. North-south integration is continuing to expand and deepen in areas far away from the respective national capitals. It will be interesting to observe whether there is sufficient national political will to formalize by treaty what is already occurring in the private sector and among many of the state and provincial governments in the three North American nations.

## About the Author

Earl H. Fry is professor of political science and endowed professor of Canadian studies at Brigham Young University in Provo, Utah. He is also former director of the university's Washington Seminar Program. He received his B.A. and M.A. from Brigham Young and his Ph.D. from the University of California at Los Angeles. Among his many publications is *The Expanding Role of State and Local Governments in U.S. Foreign Affairs* (Council on Foreign Relations Press, 1998).