NAFTA AT TWENTY: ACCOMPLISHMENTS, CHALLENGES, AND THE WAY FORWARD

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*** As Prepared for Delivery ***

Good afternoon, Mr. Chairman and Members. Thank you for the opportunity to testify before you on such a timely and important topic. This hearing today continues your outstanding efforts to help build a better North America, and I congratulate and thank you for your ongoing leadership. It is a true honor to appear before you this afternoon, continuing from your important field hearing in Tucson late last year, and a particular pleasure to join other witnesses of such prominence and stature.

The Council of the Americas is a Long-Term Champion for North America

As you know, the Council of the Americas has a history of engagement in promoting a more economically integrated North America. From the time of our founding we organized and ran the U.S. section of the Mexico-U.S. Business Council (MEXUS), which was instrumental in advocating for the idea and passage of a North American Free Trade Agreement (NAFTA). After working for several years on NAFTA implementation issues, MEXUS was re-organized into the North American Business Committee. The Council also served as the co-secretariat for the United States of the North American Competitiveness Council, a group of business leaders from Canada, Mexico, and the United States formed in 2006 and active until 2009. The NACC coordinated advice from the private sector to present to the three North American leaders primarily on ways to enhance North America's competitive position.

In 2012, we established the North American Border and Competitiveness Leadership Initiative, a public-private dialogue on reducing constraints on intra-regional trade. Most recently, the Council has also been very active in the context of the U.S.-Mexico High-Level Economic Dialogue launched in September with Vice President Biden in Mexico. We continue to lead an effort to provide private sector input to U.S. and Mexican cabinet officials on actionable ideas for the two governments to improve binational economic growth and development. And we look forward to the North American foreign ministers meeting here in Washington later this week, and the next meeting of the North American leaders next month in Toluca, Mexico.

This year, 2014, is an important one for trade, and NAFTA plays an important role. Our efforts to build the US trade agenda will prove to be more successful and strategic to the extent that the United States and our trading partners have a solid understanding of the accomplishments and challenges of NAFTA and the way forward. And in my view, along with the Panama Canal whose 100 year anniversary we celebrate this year, NAFTA is one of the two most important experiments in hemispheric trade and economic growth.

NAFTA Has Been a Success both in Economic and Foreign Policy

Mr. Chairman and Members of the Subcommittee, let me give you the bottom line first: NAFTA was a true innovation in economic relations. It was first and foremost an agreement designed to increase trade and investment among its three parties; promote North American economic integration; and support a vision of open market democracy for Mexico providing that nation with a clear path toward political and economic modernization. On all three metrics, NAFTA has succeeded.

Since 1993, U.S. trade in goods and services with Canada and Mexico increased from $307 billion to over $1 *trillion* by 2012. Annual trade between the United States and Canada has more than doubled; with Mexico trade has quadrupled. Canada is the top trading partner of the United States and Mexico is our second largest export market and third largest trading partner. More than 40 states count either Canada or Mexico as their top export destination. Perhaps more importantly, beyond these tangible commercial benefits, NAFTA institutionalized a vision for North America that would have been impossible absent significant political and economic reforms in Mexico, both catalyzing such reforms and also benefitting from them.

This is one reason why we are so pleased that this hearing today is being held by this Subcommittee. Fundamentally, trade agreements like NAFTA are not just about trade and investment, they are also critical if often overlooked tools of U.S. foreign policy. On the basis of economic growth, jobs created, and other common indicators, NAFTA has been a success, even if it has not perhaps been the panacea for all ills that proponents of the agreement sometimes seemed to be suggesting that it would be in order to pass and implement the agreement. Inversely, neither has NAFTA been responsible for all the ills that are frequently attributed to it by opponents.

Unquestionably, however, NAFTA has directly supported Mexico's democratic transformation over the past 20 years by requiring legislative and regulatory changes that might not otherwise have occurred absent an external catalyst. It has also empowered new economic constituencies and a growing middle class that has demanded and received an increasingly clear political voice. Arguably, Mexico's politics are more transparent and democratic today than ever before, and the Mexican people have made clear their disinterest in returning to the ways of the past. And as we see Mexico's economy generate and offer new opportunities to its workers, coupled with the slowdown of the U.S. economy since 2008, net migration flows from Mexico have become virtually zero. A full accounting of NAFTA's impact cannot overlook these issues.

From the trade perspective, NAFTA was at the cutting edge when it was passed originally. Heretofore there had never been an effort to link the world's largest, most developed economy with an economically backward, underdeveloped neighbor that seemed to lurch from economic crisis to crisis. The gulf between Mexico and its two other North American neighbors was large and perhaps insurmountable. At the same time, the pre-existing free trade agreement that the United States had already implemented with Canada was cause for Ottawa to join the talks as a defensive move, so as not to see their own benefits eroded by a U.S. agreement with Mexico. Along with certain constitutional and political restrictions in all three countries, this meant that negotiators could move ahead only so far, excluding certain sectors such as energy or labor mobility because they were too politically controversial at the time. What the negotiators created, however, proved to be an effective framework for ordering the majority of North American trade and investment relations during the economic stresses, political transitions, and security crises of the past 20 years.

But the World has Changed in the Past 20 Years, and NAFTA has Become Dated

Since then, however, the world has changed dramatically, and NAFTA is now showing its age. It should therefore be modernized as a means to promote a joint vision of true North American competitiveness. Otherwise, NAFTA could potentially become an agreement that actually sets a virtual limit on North American trade relations rather than a powerful tool to unlock them to their fullest potential.

Three trends must be highlighted.

First, production models have changed. Canada, Mexico, and the United States do not merely trade products; we now design and make them together. In many industries, joint production and supply chains have developed to such an extent that, from the commercial perspective at least, national borders no longer define products. This is to our benefit: according to the National Bureau of Economic Statistics, every dollar of U.S. imports from Mexico, for example, includes some 40 percent of U.S. content; for Canada it is 25 percent. As a result it is no longer accurate to think in terms of U.S. or Mexican or Canadian products when North America itself has become the production platform. North America has become a true 21st century economic space, just in time to compete more effectively with China, India, and others.

Second, consider that in 1994, there was barely an internet, much less Facebook or Twitter (incidentally, follow me on @ericfarns...). One of the first emails I remember receiving, in fact, was actually from Carla Hills in 1992 when she was the US Trade Representative and I was a junior member of the NAFTA negotiation team; email itself was very new and nobody had a clue how radically and rapidly electronic communications would fundamentally alter business models around the world. But it's not just email and social media. Consider the incredible advances that technology has made possible in the auto and manufacturing sectors, energy, financial services, IT, medical products, agriculture, and virtually every other economic sector in the past two decades. Entire industries that were not even contemplated by NAFTA are now a significant part of all three economies. Yet, while there is a process to make technical fixes to NAFTA and that process continues to be utilized, the fact remains that the agreement is a 20th century trade platform undergirding our 21st century economies.

Third, there is a noticeable change in trade patterns within North America demarcated by 9/11, at which point the border "thickened" and commercial activities understandably took a second seat to security. A resulting lack of attention to commercial needs at the borders, specifically in cross-border infrastructure but in other areas too, has created unnecessary bottlenecks and wait times for commercial traffic that erode the compelling advantages of geographic proximity. As NAFTA-facilitated trade has increased, infrastructure has generally languished. In fact, the last border crossing established between the United States and Mexico was over 100 years ago. That means that our 21st century economies, undergirded by a 20th century trade framework, are utilizing 19th century infrastructure.

As trade increases, this picture will continue to get worse.

Moving Toward the Future

Our strategic opportunity, therefore, is to capitalize on our increasingly unified North American economic space and dynamism, particularly as Mexico advances concretely along its reform agenda. In this 20th year of NAFTA, the moment is ripe to think bigger and bolder about North America and regional competitiveness. If we do so, viewing North America as a more unified production platform and our borders as lines that unite rather than divide our three great nations, the way forward will become increasingly clear.

And in that regard, a path forward would include several important elements, in some areas attempting to improve challenges stemming from the original agreement, and in others taking note of changes in the North American production model and working to find ways to facilitate and enhance such activities.

As a first step we really do need to find a way to get the greatest efficiencies from the agreement as it currently exists, from trucking regulations to intellectual property protections to customs and regulatory harmonization to border infrastructure. These are not easy issues; some have been with us since the agreement was concluded, some require additional funding. The meeting of North American leaders next month would present a powerful opportunity to recommit all three governments to addressing them.

At the same time, were the original agreement to be negotiated today it likely would not look the same. For example, it would have to incorporate the incredible advances in energy that are making North America self-sufficient, improving terms of trade while igniting a manufacturing renaissance with lower cost energy supplies. It would highlight and promote the rapid growth in services that has occurred in the past generation, including the information technology revolution and cloud computing. It might incorporate some categories of labor mobility (and without doubt U.S. immigration reform independent of any trade agreement would directly contribute to economic well-being). It would seek ways to minimize the existing sand-in-the-gears of border commerce, looking for ways to safely increase border throughput as a strategic economic issue for the entire United States, not just border states. It would attempt to find effective ways to improve the rule of law, which remains Mexico's most vexing challenge according to former president Ernesto Zedillo in the forthcoming Americas Quarterly.

More broadly, the NAFTA bloc should be viewed as the basis for a more strategic trade policy generally. Mexican and Canadian entry into the Trans-Pacific Partnership negotiations—which the Council began to promote immediately after the United States announced its intent to join the negotiations—was a critical step. Now, to take full advantage of economies of scale, we should also consider negotiating together with Mexico and Canada the free trade agreement with the European Union. Similarly, an early economic association among the NAFTA and Pacific Alliance nations including Chile, Colombia, and Peru in addition to Mexico would be both timely and appropriate.

The meeting of North American leaders next month in Mexico will offer a tremendous opportunity to take stock of the NAFTA agreement to date, and to begin a process that builds on NAFTA even while updating it further. The leaders should commit at a minimum to annual trilateral meetings, which will drive the agenda and keep these issues at the forefront, and allow for greater coordination to the extent appropriate for the broader trade agenda. They should commit to a process that includes the private sector whereby the unrealized gains from NAFTA can be identified and addressed, and lessons learned from the agreement can be directly applied to the TPP and TTIP negotiations. And they should begin a dialogue with the leaders of the Pacific Alliance and other nations that will advance discussions on hemispheric economic integration even as the Summit of the Americas, which was originally conceived as the primary forum for region wide economic discussions, has lost its primary economic focus.

No negotiation ever produces a perfect result, especially when the issues under negotiation are at the vanguard of what's been done before. So it was with NAFTA 20 years ago, but the results have nonetheless proven the test of time. Now, given changed circumstances both within North America and also outside the region in the larger emerging markets such as China, India, and others, it's time to have another look to determine where further progress can be made.

Thank you, again, Mr. Chairman, for the opportunity to be with you today, and I look forward to your questions.