STATEMENT OF THE HONORABLE CARLA A. HILLS

Chair & CEO of Hills & Company, International Consultants
U.S. Trade Representative 1989-1993

Before The House Committee on Foreign Affairs
Subcommittee on the Western Hemisphere

Wednesday, January 15, 2014

"NAFTA at Twenty, Accomplishments, Challenges, and the Way Forward"

Mr. Chairman and members of the Committee, thank you for inviting me to share with you my views regarding the North American Free Trade Agreement ("NAFTA") signed by President Herbert Walker Bush in 1992, approved by the U.S. Congress and signed into law by President Clinton in 1993, and entered into force in 1994. With 20 years of experience it is timely to ask what the NAFTA has accomplished and consider whether it has significance for the future.

In making these assessments, it is important to be clear about what the agreement actually did. By joining the economies of Canada, Mexico and the United states, the NAFTA created a $19 trillion regional market with 470 million consumers. It was the first comprehensive free trade agreement to join developed and developing nations. And it has served as a template for our subsequent trade negotiations for it achieved broader and deeper market openings than any prior trade agreement anywhere in the world by:

- Eliminating tariffs on all industrial goods;
- Guaranteeing unrestricted agricultural trade between the United States and Mexico;
- Opening a broad range of services including financial services and provided national treatment for cross border service providers;
- Providing a high standard of protection for patents, trademarks, copyrights, and trade secrets, and the first international trade agreement to do so; and
- Establishing clear rules to protect the rights of investors by prohibiting barriers such as local content restrictions and import substitution requirements.

As a result of the market openings created by the NAFTA, economic activity among the three nations exploded. Today Canada is America's single largest export market, and it sends us roughly 98 percent of its total energy exports making it our largest source of energy products and services. More than eight million U.S. jobs depend on our trade with Canada. Mexico is our second single largest export market, and some six million U.S. jobs depend on our trade with Mexico.

Over the past two decades a highly efficient and integrated supply chain has developed among the three North American economies. Intra-regional trade flows have increased roughly 400 percent from roughly $290 billion in 1993 to over $1 trillion in 2012. More than $2 billion in goods and services cross our Northern border each day, while roughly $1 billion per day cross our Southern border.

About half our trade with Canada and Mexico takes place between related companies, and the resulting specialization has boosted productivity in all three economies. We not only sell things to one another, we make things together.

Quite remarkably for every dollar of goods that our two neighbors export to us, there is 25 cents worth of U.S. inputs in the Canadian goods and 40 cents in the Mexican goods. By way of comparison, with respect to our imports from Japan the U.S. input is 2 cents and with respect to China it is 4 cents.

As a result of the NAFTA, cross border investment with our two neighbors has soared as well. Canada has invested over $200 billion in the United States which makes it America's fifth largest investor, while the United States has invested roughly $310 billion in Canada to become its largest investor.

Mexico also has made substantial investments in the United States since the signing of the NAFTA in such sectors as cement, bread, dairy, and retail, which have contributed to our tax revenues and jobs. U.S. investment in Mexico has grown substantially as well, about half of it in the manufacturing sector, particularly in the auto sector. Much of the output from our investments in both Canada and Mexico comes back to us as imports of intermediate goods which adds to our competitiveness in the production of the finished product.

In spite of this very substantial intra-regional economic growth that can be traced to the NAFTA's opening of regional markets, the agreement has its critics. Most of those who attack the NAFTA on economic grounds focus on Mexico, not Canada. They claim that the partnership is one sided: that the NAFTA is Mexico's gain and America's pain. But the economic data proves that having Mexico as a NAFTA partner has served U.S. economic interests extremely well.

Last year roughly 14 percent of our nation's total exports went to Mexico, exceeding our sales to Brazil, Russia, India, and China, all of the "BRICs" combined. Indeed Mexico buys more U.S. goods than all of the rest of Latin America combined, and more than Germany, France, Great Britain and the Netherlands combined.

Although some contend that the NAFTA has depressed wages, a recent study by economists at Yale University and the Federal Reserve concluded that wages when adjusted for inflation have risen as a result of the NAFTA in all three countries. Also it is widely agreed that the market openings created by the agreement generated a substantial increase in jobs connected to exports, which on average pay 15 to 20 percent more than jobs that are purely domestically focused.

With 116 million consumers and a purchasing power of over $1 trillion, Mexico offers significant opportunity to U.S. entrepreneurs large and small, but smaller enterprises in particular benefit from Mexico's proximity and openness to our trade. Mexicans purchase about 11 percent of the exports from our small and medium size enterprises, which account for more than half of our nation's job creation.

Even Mexico's exports to others benefit the U.S. economy because of their high percentage of U.S. content and the fact that for every dollar that Mexico earns from its exports worldwide, it spends 50 cents on U.S. goods.

The economic integration that has occurred among the three North American nations in the two decades since the NAFTA took effect has made North American region one of the most competitive in the world. But the rest of the world has not stood still. Countries and regions around the world are becoming more competitive. Supply chains encircle the globe, and increasingly bilateral and regional trade agreements where the United States is not a party are giving entrepreneurs from other countries preferential access to important markets that our entrepreneurs do not have.

Continuing to open global markets to products, services, investment, and ideas originating in North American and ensuring that our supply chains work at maximum efficiency is vital to our nation's continued growth and competitiveness.

Building on the NAFTA platform, there are a number of actions that we could take that would create new commercial opportunity, cut costs, create jobs, and generate substantial economic benefits for all our citizens. Let me mention three.

First, the Trans-Pacific Partnership. In 2012 Mexico and Canada joined the United States and eight other nations to negotiate a Trans-Pacific Partnership ("TPP") to link the Asia and Pacific regions. Having our two neighbors at the table will better enable us to take positions to maintain and advance the unique competitiveness of the North American Region. It also gives us an attractive opportunity to address issues that were not relevant when the NAFTA was negotiated, like data flows and advanced telecommunications.

It also provides an opportunity to harmonize a number of conflicting trade rules that plague our entrepreneurs. Today there are eight existing bilateral trade agreements between the three NAFTA governments and other TPP participants that were negotiated after the NAFTA came into being. These eight agreements have different rules of origin, custom measures, and other border red tape that add costs and complexity to both the import and export of goods. These differences could be dealt with in the TPP agreement.

Second, the United States should consider joining the Pacific Alliance. After the NAFTA was signed in 1992, leaders in the Western Hemisphere enthusiastically talked about a free trade hemisphere by 2005, which never happened. Today, we could join an effort to restart the process.

The Pacific Alliance is an ongoing trade negotiation initiated by Mexico, Peru, Colombia and Chile in 2011. Last year Costa Rica gained approval to join. Mexico already has separate bilateral trade agreements with the four governments as do Canada and United States. Seven other governments have been granted observer status including Canada and the United States.

The stated goal of the Pacific Alliance is to create free trade among its members on a step-by-step basis. It seeks to create free trade with based on existing bilateral trade accords. The

Framework Agreements specifies that governments seeking to join must have existing bilateral trade agreements with current members. Having all of North America be part of the Alliance would shrink transaction costs by eliminating regulatory differences and set an example for the rest of the hemisphere and beyond.

Third and most importantly, a North American-European Union Trade Agreement. Last year the United States and the European Union's 28 states launched a comprehensive Trans-Atlantic Trade and Investment Partnership ("T-TIP"). The third round of negotiations occurred this past December.

Without question the T-TIP is a very big deal. Together the United States and the European Union account for more than half the world's GDP, 40 percent of global trade, and 80 percent of global capital markets. Our two way trade in goods and services tops $1 trillion supporting 13 million jobs, and our two way investment is nearly $4 trillion. Roughly half our total foreign investment goes to E.U. member states and 62 percent of the E.U.'s total investment comes to the United States.

Apart from our tariffs on agriculture, textiles, apparel, and footwear which are relatively high, our average tariffs are quite low, around 3 percent. The real potential for boosting economic growth will come from reducing the maze of different safety and regulatory standards on a long list of goods from automobiles to pharmaceuticals.

With respect to automobiles for example the European Union and the United States have a long list of different safety mandates that include lights, door locks, brakes, seats, seat belts and electric windows. Constructing separate manufacturing facilities to respond to these differences is costly. Mutual recognition that the divergent standards provide an equivalent level of safety would very substantially reduce the complexity and costs.

Even larger gains could be obtained through harmonization or mutual recognition of various rules that govern services such as engineering, finance and telecommunications. Making these rules more compatible and less cumbersome would greatly reduce the costs and complexity of doing business both across and on both sides of the Atlantic Ocean.

The European Centre for Political Economy estimates that a broad agreement that eliminated the remaining tariffs between the European Union and the United States and harmonized or mutually recognized different regulatory approaches could add $126 billion to the U.S. economy per year, $157 billion to the E.U. economy and $134 billion to the global economy.

The projected benefits are far more likely to be realized or enlarged by including Canada and Mexico. Enlarging the T-TIP to include our two neighbors would very substantially boost the benefits for all the participants in a number of ways.

First, it would strengthen the agreement by adding 150 million consumers and $3 trillion in GDP expanding market opportunities and providing a golden opportunity to improve regulatory coherence with respect to more than half the world's trading volume.

Second, failure to include all three North American economies would substantially add to the complexity of doing business across the Atlantic. That is because Mexico has had a free trade agreement with the European Union since 2000, and this past October Canada announced that it had successfully concluded one. Having to deal with three separate agreements with different rules of origin and custom measures would create a headache and an unnecessary cost burden for entrepreneurs on both sides of the Atlantic.

Third, failure to include Canada and Mexico in T-TIP would erode the unique and hugely beneficial economic integration that we have achieved with our two neighbors as a result of the NAFTA. Since the NAFTA took effect two decades ago, an integrated supply chain has developed among the three North American economies that is truly unique. Intra-regional trade flows are up more than 400 percent. Having different regulations and standards for the three North American partners would substantially erode the efficiencies derived from the NAFTA.

And finally it could facilitate President Pena Nieto's program of economic reform that is opening sectors of Mexico's economy like energy and telecommunications. Pointing to the benefits that Mexico could potentially obtain from joining this mega-agreement that involves more than half of global GDP could help him build political support for his proposed economic reforms that we strongly support.

As we move forward in this 21st century, we need to take steps to maximize our competitiveness and productivity that will bolster future economic future growth. That will require the three NAFTA governments, along with their universities, think tanks, and business organizations to educate their respective populations about the tremendous benefits that can result from thinking about and dealing with trade and investment opportunities not only as single nations but also as the highly integrated region that North American has become. There is no better time than the 20th Anniversary of the NAFTA to start the process, and I am grateful to the Chairman and members of this Committee for this opportunity to share my thoughts.