

**THE FUTURE OF THE NORTH AMERICAN
FREE TRADE AGREEMENT**

HEARING BEFORE THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FOREIGN AFFAIRS
SUBCOMMITTEE ON TERRORISM, NONPROLIFERATION,
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*** As Prepared for Delivery ***

Good afternoon, Mr. Chairman, Mr. Ranking Member, and Members. It is both a pleasure and a privilege to join you and the other distinguished panelists for today's discussion on the future of NAFTA. Thank you for the opportunity to testify on such a timely and important topic, and thank you for your leadership in highlighting these important issues from both a trade and also a security perspective.

For over 50 years the Council of the Americas has been dedicated to the promotion of democracy, open markets, and the rule of law across the Americas. We strongly believe that U.S. economic, security, and foreign policy interests are best supported with the enlightened engagement of the private sector. We also believe strongly that agreements that expand trade and investment, enlarge consumer choice and utility, create jobs in the formal sector, and promote values we share are some of the best tools that the United States maintains in order to promote sound, meaningful, and lasting engagement in the Americas and worldwide on a mutually-beneficial basis.

NAFTA is a Success 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 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. It has succeeded on all three metrics, promoting our strategic, economic, and foreign policy interests, as well as our values. Ending NAFTA would be a significant, lasting, and wholly unnecessary strategic mistake.

At the same time, it is inevitable that after almost a quarter century NAFTA has become dated and can usefully be modernized. In attempting to do so, all three parties to the agreement must understand what is truly at stake if they are unable to come to satisfactory agreement. Mending NAFTA is appropriate, and there is a landing zone if the parties want to achieve it.

Since 1993, U.S. trade in goods and services with Canada and Mexico increased from \$307 billion to well over \$1 *trillion* by 2016. 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. As China continues its inexorable march up the development ladder and becomes increasingly economically assertive, our ability to compete will continue to be enhanced from a North America platform rather than the United States alone.

In addition, agreements like NAFTA are not just about trade and investment, they are also critical if often under-appreciated tools of US foreign policy and the promotion of our values. Unquestionably, NAFTA has directly supported Mexico's democratic transformation. It required 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 NAFTA also established a framework of trust, built on stability and long-run commitment, supporting close U.S. cooperation with Mexico across a range of security issues including counter narcotics and counter terrorism, in addition to meaningful assistance to address migration flows that continue from Central America. (Net migration from Mexico itself to the United States has become virtually zero as Mexico's economy generates new opportunities for its workers). A full accounting of NAFTA's impact cannot overlook these critically important issues.

At the same time, NAFTA has done much to enhance confidence in the United States. Recent actions and rhetoric that stigmatize Mexicans or that are perceived as anti-Mexico, including inflexible NAFTA negotiating positions that are politically impossible for Mexico and also Canada to adopt, are leading to a revival of a more strident, traditional anti-U.S. posture that has taken a generation of goodwill on all sides to overcome. As Mexicans in particular go to the polls in 2018 to elect their next president, such matters will not be far from their minds and may impact both the final outcome as well as the political space that the new president, whoever he or she is, will have to cooperate with the United States on a multitude of issues—including security, counter narcotics, and immigration—going forward.

The World has Changed Since 1994, and NAFTA has Become Dated

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 over the near term. 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 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 23, almost 24 years.

Since then, however, the world has changed dramatically, and NAFTA is now showing its age and should be modernized. Three long-term trends must be highlighted, all of which continue apace even after the U.S. elections just over a year ago.

First, production models have evolved. Canada, Mexico, and the United States do not merely trade products as we did when NAFTA was first implemented; 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. As former Under Secretary of Commerce Stefan Selig has just written, putting America first therefore means putting North America first.

Second, consider that in 1994, there was barely an internet, much less Facebook or Twitter. Nobody knew 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 plus decades. Entire industries that were not even contemplated by NAFTA are now a significant part of all three economies. The original NAFTA could not possibly have anticipated these developments and a renegotiated NAFTA could potentially provide an opportunity to include them within the framework of an updated and more fully comprehensive regional agreement. In addition, it would allow the inclusion of sectors such as energy heretofore excluded for political reasons.

Third, there was 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 sufficient attention to commercial needs at the borders, specifically in cross-border infrastructure but in other areas too, created unnecessary bottlenecks and wait times for commercial traffic that erode the compelling advantages of geographic proximity. Some work has been done since then, but as NAFTA-facilitated trade increases, infrastructure has not kept up. And it goes without saying that building additional walls and barricades could only exacerbate the bottlenecks that already exist and which are so much unnecessary pressure on the a windpipe of the U.S. economy. Modernizing the agreement could also provide an excellent opportunity to take a more balanced look at border issues.

Which Future Are We Working to Create?

Negotiations to revise NAFTA beginning in August are now well underway. Five rounds have been concluded; a sixth is scheduled for January in Montreal, and negotiators are meeting right now in Washington for an interim “intercessional” gathering. Press reports indicate that the most difficult issues remain to be addressed even as negotiators race to try to conclude talks by the end of the first quarter, 2018, consistent with Mexico’s pending election campaign process.

Unless the most difficult issues are soon resolved, however, the possibility is increasing that talks may break down altogether and that the U.S. might consider withdrawal. Such a result would have meaningful negative consequences for the United States, to say nothing of the damage it would also inflict on our two closest neighbors Canada and Mexico. It would be a strategic setback for the United States.

According to the Wall Street Journal, some 80 percent of economists surveyed anticipate that a withdrawal from NAFTA would depress U.S. growth, even as Congress is right now pushing forward on a tax package designed to kick-start growth. Withdrawal would also reduce growth in both Canada and Mexico, perhaps leading to recession and creating economic conditions that are traditionally the primary cause of migration especially from Mexico to the United States. And, it would mean the abandonment of dispute resolution mechanisms that have worked for the United States, risking a return to the days when the resolution of disputes is driven primarily by politics rather than rules-based systems.

Much depends on the outcome of discussions surrounding rules of origin as a means to “fix” the trade balance, although other significant issues also remain including an ill-advised sunset provision proposal and disagreements on intellectual property, government procurement, and dispute settlement procedures. A singular focus on the trade balance in goods neglects the healthy trade surplus that the United States enjoys under NAFTA in services. But, more significantly, backward steps on these issues would also cause irreparable damage to fully integrated supply chains and the workers whose jobs depend on them, in part because companies would find it difficult if not impossible to meet the required rules of origin currently under discussion.

Assuming that agreement can even be found around these issues, steps the Administration is proposing to raise rules of origin requirements substantially would cause a re-evaluation by producers whether to utilize NAFTA provisions or whether to skip NAFTA altogether and utilize less onerous provisions. Domestic job creation could actually suffer as production is shifted elsewhere.

Meanwhile, the elimination of NAFTA would allow the parties to the agreement to return to previous bound tariff rates, Mexico's being far higher than ours. Agriculture exports would suffer immediately, giving up the significant advantage that has turned Mexico in the U.S.' second largest, \$18 billion market in agriculture, after only Canada. This is a market that can rapidly be filled by other globally-competitive producers, an overwhelming potential loss particularly for agricultural producers already hammered by lower commodities prices and income.

To escape tariff barriers raised by Mexico in a post-NAFTA environment, those seeking to supply Mexico's growing market and increasingly middle-class population, predicted to be a top-seven global economy by 2050, may seek to produce in Mexico rather than the United States. This would also allow them to avail themselves of Mexico's impressive network of trade agreements that has turned the nation into a global production powerhouse. Mexico's recent energy and other reforms have brought down manufacturing costs further, making the nation still more competitive. As a result, rather than returning production to the United States, such an outcome would actually threaten to create incentives for a migration of production from the United States to Mexico and also Canada. This is exactly opposite the intended result.

Having said all of this, even if final agreement is reached at some point in the New Year, the uncertainty that has been caused by the negotiations process has already had negative consequences. In addition to investments that have been delayed, and therefore jobs that have not been created, our closest allies and trading partners now have reason to question the reliability of the United States over the longer term. We would join the likes of others, such as Venezuela, that have unilaterally abrogated existing trade and investment agreements, followed by years of economic trials and unending legal actions.

Trust in U.S. intentions and dependability as an ally is a precious commodity, and goes well beyond trade agreements. Once lost it is unlikely to be regained at the same level for many years, perhaps ever. Doubts will linger about whether the word of the United States, even one that is confirmed on a bipartisan basis by both Houses of Congress, can ever be fully trusted again. The United States is diminished. Were we to intentionally seek ways to undermine our own global strategic interests, we might not find a better means of doing so than this.

The economic and political challenges that face that United States at this moment in time are significant. They are not to be understated or ignored. They must be addressed, effectively and soon, with sensitivity and grace, particularly for those of our citizens who may have been left behind by the global economy. But NAFTA is not the culprit, and ending NAFTA will not bring back an earlier time nor will it provide U.S. leverage to promote the values that we hold dear, including environmental protections and labor rights.

Rather, the relaunch of an updated and modernized NAFTA fully acknowledging the rapid technological advances that continue to be made, informed by a vision of a more economically integrated North America to compete effectively on the global stage, will be the far better option. This would also allow us the means to intensify the promotion of stronger environmental protects and labor rights, which we would actually lose altogether without the existence of NAFTA. And in the meantime, the strong, public assertion by Congress of its institutional prerogatives on trade and NAFTA in particular, well in advance of any irrevocable and precipitous decision made by the United States, would be a welcome and appropriate, even necessary, step.

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