**Bon Anniversaire NAFTA: The Elusive and Asymmetrical Benefits of a Decade of North American Integration**

**Daniel Drache**
Associate Director, Robarts Centre for Canadian Studies
Professor, Department of Political Science, York University

**Chapter one, Daniel Drache ed. *Big Picture Realities: Canada and Mexico at the Crossroads*, Waterloo On: Wilfred Laurier UP, 2008.**

**Bon Anniversaire NAFTA: The Elusive and Asymmetrical Benefits of a Decade of North American Integration**

**Daniel Drache**

## Next Steps: Challenges Ahead[1]

Ten years after the signing of NAFTA there is no urgent need to proceed to the next stage in integration. Increasing trade facilitation, improving the system of trade dispute panels, and reducing the transaction costs of a security-first border remain a set of generalized concerns for all three governments. Further integration projects have met with powerful opposition from the U.S. Congress. The Central American Free Trade Agreement (CAFTA) received Congressional consent by the barest majority after months of White House arm-twisting and vote-buying (Alden and Yeager 2005). The Bush Administration is preoccupied with Homeland Security, and as the quagmire in Iraq costs more American lives and consumes billions of tax dollars, there are few incentives for Washington to gear up for a battle with the Republican Congress to broaden and deepen North American integration. Public opinion in Mexico and Canada has expressed little enthusiasm for a big next step. There are a lot of doubts and reservations about a second round of North American integration (Drache 2004).

Strikingly, many Canadian businesses do not see deepening NAFTA as the preferred initiative to resolve the many strategic challenges that will reshape their operations over the next five years. High costs and a rising Canadian dollar are forcing Canadian manufacturers to look inward to respond to rapidly changing supply and demand chains (Drache 2004). In an October 2005 survey of Canadian manufacturers and exporters, improved North American market access did not even make the top ten list of strategic challenges for the roughly 1000 firms surveyed (Canadian Manufacturers and Exporters 2005). Without a strong consensus, publics in both countries would need a huge amount of convincing and arm-twisting in order to deepen NAFTA and constrain Canadian and Mexican sovereignty in new ways.

For Canada and Mexico, given these uncertainties, what is the next move in a post-NAFTA world? More integration? Integration through trade only? Or building closer ties through a new framework for economic cooperation? Will a NAFTA-plus agenda alleviate the disparities in economic development between the NAFTA countries? Does Mexico need a different economic strategy? Have most of the NAFTA effects already been captured? If this is the case, a major re-evaluation of NAFTA is needed before any new round of integration is undertaken.

**New Competitive Pressures: Market Access cannot be Guaranteed**

Significantly it is not clear what more secure ‘access’ would entail in a highly protectionist environment. With tariffs already at historic lows, the NAFTA countries have little more to gain for consumers or for industries in terms of efficiency gains. Nor is it a simple case to identify those Canadian and Mexicans industries which would benefit at the present time from further integration. Canadian and Mexican export industries are faced with changing consumer demands, widespread technological change, competition from China, and, generally higher production costs. These companies need to become more agile and diversified, and less dependent on traditional markets. Diversification and gaining access to developing markets in the global South will require a rethinking of trade fundamentals (Krugman 1995). Canada's premier business organizations such as the Conference Board of Canada and the C.D. Howe Institute could not be further apart in their thinking. The Conference Board is championing investment in new technology and high productivity growth as the top priority for Canada's private sector. The C.D. Howe Institute seems locked into yesterday's strategy calling for more North American economic integration but offering few fresh ideas to medium-sized Canadian firms battered by a $.90 dollar. The Mexican Council on North American Business is also stuck in a rut and not ready to confront the new competitive pressures facing Mexican industry (Council on Foreign Relations 2005). Right-of-centre business groups are banking on an environment of trade determinism at the very time when Washington Consensus goals are unravelling (Naim 2000).

On the political front, NAFTA, once a mid-range priority for the Clinton Administration, has been downgraded as a strategic goal for U.S. policy makers in the Bush Administration. Certainly NAFTA promised to build a new trilateral relationship in North America, but after a decade of existence, bi-lateral tensions have risen sharply with respect to immigration, softwood lumber, U.S. unilateralism, homeland security, and U.S. trade politics. Mexican illegal immigration and the debate over amnesty have replaced NAFTA as the North American question par excellence. Equally central is the fact that the dispute resolution mechanism has been badly damaged by U.S. arrogance and its refusal to comply with its NAFTA obligations on softwood lumber. Gordon Ritchie, one of the agreement's architects and main supporters, has argued that U.S. non-compliance has irreparably damaged NAFTA's legal regime for Canada and Mexico (2005). In 2006, Washington offered Canada only limited access to the U.S. market in defiance of the keystone principle of NAFTA – free trade. Under the deal, U.S. forestry interests retain $500 million dollars in illegally imposed duties. There is no level playing field in sight and the legal asymmetries continue to spin out of control.

**Regional Markets, Trade Bilateralism and Growing Policy Diversity**

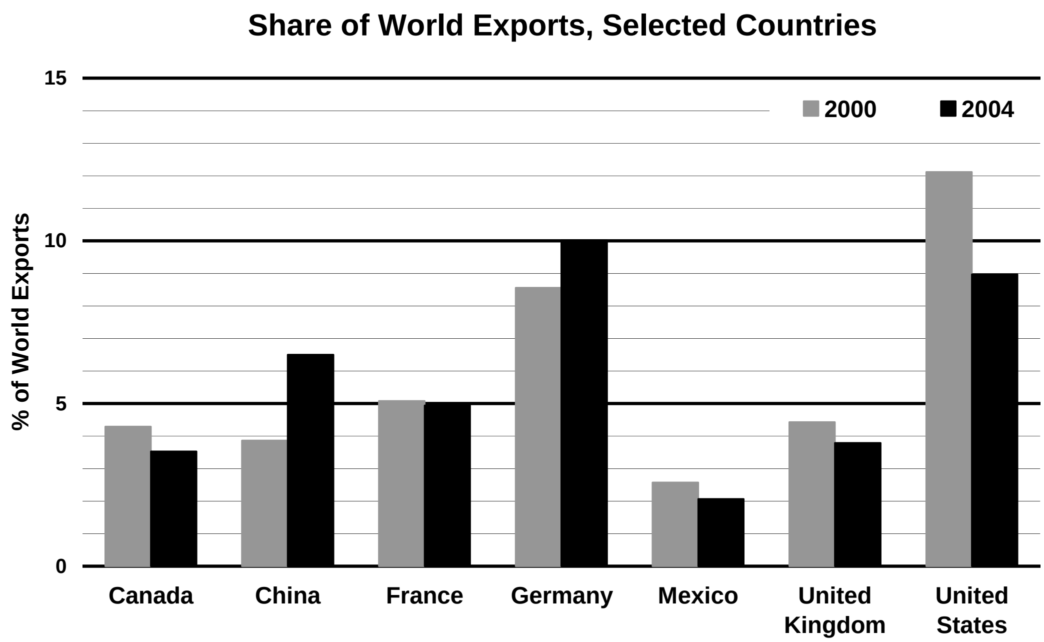
Canada and Mexico increasingly find themselves at a distance from Washington's strategy for the future of North America and a new global vision. In Canada, recent polls show that highly contentious trade issues have soured the prospect of establishing a stronger trilateral relationship. A majority of the Canadian public was critical of previous Paul Martin government for not doing enough to defend Canadian sovereignty (*Globe & Mail* June 2005). Even along the bilateral Canada-U.S. axis, relations have been rocky since Ottawa's refusal to send Canadian soldiers to fight in the U.S. war in Iraq. The decline in the North American partnership has been both qualitative and quantitative. Why?

The argument in a nutshell is that highly adverse structural adjustments will require that Canada and Mexico begin to look for other options given that access to the U.S. market is largely a *fait accompli* for many industries, and there is no likely prospect of major new gains. Any new negotiations to negotiate a NAFTA plus agreement is a second-best option when faced with a U.S. Congress that is in a protectionist phase.

Mexico has large decisions to make as it wrestles against the limits of neoliberalism – its major policy framework of the last decade. Mexico needs to rethink immigration policy; exporting a half a million jobless, rural workers to the U.S. is not a policy that can be sustained.

In a post-NAFTA era, Canada and Mexico face many more policy challenges. As security continues to trump the narrow focus of NAFTA, Canada and Mexico will have to look for a new policy platform that reflects their divergent national priorities. Firstly, in an era of regional bilateralism, the election of the conservative Stephen Harper government in Canada has made this process of building the Canada-Mexico relationship a lot more problematic and challenging. South of the Rio Grande, Mexican foreign policy is likely to shift towards a more values-based approach while Canada is looking to be an active partner of Washington inside the belt-way.[2]

Secondly, whatever the future may hold, two constants are going to shape Canada’s relations with Mexico. First, it is unrealistic to talk about the ‘normalization’ of U.S. relations with either of its NAFTA partners. There is no going back to a status quo. Secondly, despite significant economic disparities, Canada and Mexico will have to be ready to co-operate in ways they have never before entertained. The burden of this chapter is to explain that the future of North America will be organized around regional bilateralism as the next stage of the integration process. Canada and Mexico can either face their dependence on the U.S. without one another or they can look across the continent to build a partnership with a focused and strategic sense of purpose.



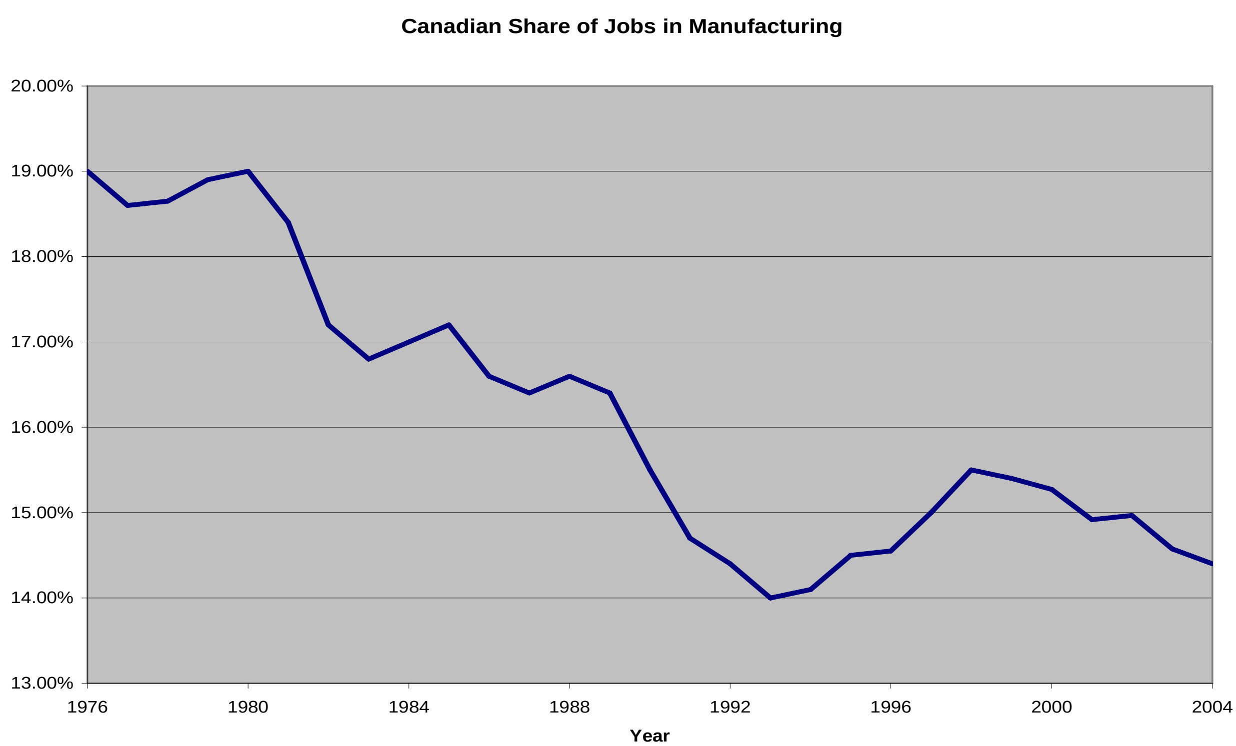

Source: World Trade Organization, 2005.

## Adding Up the Numbers: The Big Picture Overview

Since NAFTA came into effect, Canada and Mexico have become more export oriented. They have also felt the full effect of trade adversity from new competitive circumstances. Trade adversity occurred because Canada and Mexico were unprepared for the larger structural changes arising from growing competition with their most important trading partner. Paradoxically, despite becoming more export oriented, between 2000 and 2004, Canada's and Mexico's share of world trade actually shrunk as can be seen from the accompanying table ("Share of World Exports, Selected Countries"). Since 2000, belonging to a free trade zone has been no guarantee that the NAFTA partners will not be buffeted by the gale-like forces of international competition. The U.S. has seen its commanding position in the world economy dramatically decline by three percentage points; Germany has made impressive gains despite its unemployment crisis; and Mexico has been a loser in the global export winner-take-all stakes along with Canada. Belonging to NAFTA has not prepared either country for the new competitiveness of China and India, countries who are powering their way into global markets. NAFTA's share of world exports in goods and services has dropped precipitously too. In 1993, it accounted for 23 percent of total global exports; by 2003 NAFTA's share of world exports had declined to 19 percent while Europe's remained steady at 23 percent.

Concentration on a single market is no guarantee that NAFTA is providing Canada and Mexico with the competitive edge for the new challenges they are facing. In the next phase of continental integration the link between a strong export performance and job creation is definitively uncoupled in the most export-oriented sectors such as auto and IT (information technology). Productivity is way up but employment is flat or declining, and more job cuts are on their way. The global commodity boom has created new employment growth in Canadian mining, but not its forest industries. For Mexico, export success has not triggered persistently high GDP growth either. Since 1994 per capita income growth has barely kept pace with Mexico's rapidly growing labour force. In 1995, per capita income plummeted by 9.11 percent; it recovered but was hardly a sparkler at 3.28 percent in 1999. Since 2000 per capita income has barely grown at all, minus 1.49 percent in 2001, minus 0.64 percent in 2002 and minus 0.01 percent in 2003. The paradox is that export wealth is not trickling down despite the fact that Mexico has become heavily dependent on exports as the motor of the economy (Middlebrooke and Zepada 2003). For Canada a developed economy, the NAFTA model of development has been largely job negative. Access to the giant American market has not slowed down noticeably the dramatic decline in manufacturing jobs in the economy (See table "Canadian Share of Jobs in Manufacturing"). The empirical data should set alarum bells ringing. Exports can have many effects for regions and sectors, but in an efficiency-driven world the single minded pursuit of exports cannot be relied on for primary job-creation. Globalization is requiring firms to shed jobs yet increase productivity with fewer workers on the factory floor (Peters 2005).

Concentration in a single market has proven to be a double-edge sword. Neither Canada nor Mexico has yet to assimilate the full implications of their decline globally.



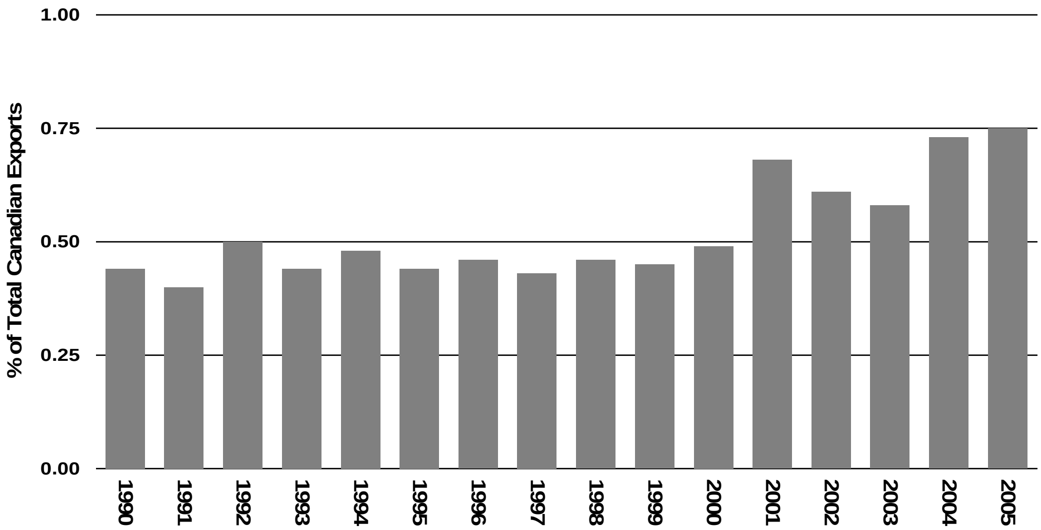

Over-reliance on NAFTA has led to a loss of industry-level flexibility on one hand, and on the other hand, the growth of energy exports has locked Canada and Mexico into the

U.S. dominated energy market framework with little ability to capture upstream and downstream benefits for their own development goals. A recent Statistics Canada study reveals that NAFTA's biggest success has been to reinforce Canada's traditional competitive advantage in energy and natural resources. The same truth applies to Mexico as it has become more locked into the U.S. energy and parts manufacturing market. Resource exports are not labour-intensive, and oil and gas exports have given both countries a massive windfall from soaring energy prices. But the energy sector is not a model for the rest of the economy.

**Canada-Mexico: The Weakest Link**

Even if the North American trade in goods to GDP output has grown markedly for both countries, Canada-Mexico economic relations can only be described as feather weight. Between 1995 and 2004, Canada's exports to Mexico amounted to roughly .5 percent of Canada's total trade picture; rising to a very modest .8 percent by 2004. This is not simply a single isolated statistic which captures the way the two economies are 'lost in translation,' but a real absence of incentives to transform Canada-Mexico relations into a dynamic collaboration. There are few linkages between the two economies, and a decade of free trade has done little to lay the basis for any next steps or closer commercial collaboration.

**Canadian Exports to Mexico, 1990 - 2005**




Source: Industry Canada, 2006.

On the Mexico side, the economic relationship has been small and limited to the export of cars and car parts to Canadian auto assemblers. This kind of arranged trade cannot properly be called a 'NAFTA effect,' since these exports are part of the negotiated 1965 Auto Pact. Detroit-based auto makers' share of the North American market is seriously under siege by Japanese imports. Even the once invincible Auto Pact is facing an increasingly uncertain future. Canada's top exports to Mexico are concentrated in agricultural products with some light manufacturing and auto related exports (See "Canada's Top 10 Exports to Mexico, 1995 - 2004).

Canada's branch plant subsidiaries are focused exclusively on the Canadian market, and U.S. corporations rely on their Mexican-based subsidiaries to produce and assemble goods for the Mexican market. It is no surprise that the NAFTA linkages between Canada and Mexico are small, largely underdeveloped, and important to only a handful of industries. Many experts have argued that NAFTA is really a hub and spoke free trade agreement based on two bilateral trade deals with the U.S. There is a lot of truth to the idea that the third bilateral never really took off. Mexico's exports to Canada have risen by what can only be described accurately as a snail's pace.

**What is a NAFTA Effect? What is a Production Process Effect?**

The single largest obstacle to a highly dynamic Canada-Mexico relationship is that there has been very little unbundling of production chains across North America other than in the automobile and energy sectors. Many experts wrongly believe that greater legal access has been determinant in creating more competitive industries. In fact, changes in the production process provide a more realistic basis for understanding the structural changes that many North American industrial clusters are currently experiencing. For instance, deep discounting by auto's Big Three in Canada and the U.S. has not turned around the sagging sales figures for GM or Ford and Chrysler has only recently recovered from a long slump. Detroit did not sufficiently reinvest the profits from surging SUV sales, for most of the past decade, into new production processes and cheaper and more efficient cars. Asian and European-based manufacturers used to account for about 10 percent of the market, but now Honda is beating Ford and Chrysler in monthly sales and GM's share has dropped by forty percent compared to little more than a decade ago. Detroit-based assemblers' share of the North American market has fallen below the historic fifty percent mark, and many experts are of the view that it is impossible for the Big Three to return to dominance. The North American auto assembly is headed towards downsizing and the closure of assembly plants on an unprecedented scale. Both countries need a proactive industrial strategy in the auto assembly sector to manage these sweeping structural changes.

**Canada's Top 10 Exports to Mexico, 1995 - 2004**

| | Annual Value of Exports (Millions CDN $) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Oil Seeds, Oleaginous Fruits, Industrial or Medicinal Plants, Straw and Fodder | 181 | 195 | 218 | 280 | 169 | 229 | 253 | 189 | 250 | 439 |
| Meat and Edible Meat Offal | 5 | 4 | 8 | 12 | 58 | 163 | 272 | 245 | 172 | 400 |
| Motor Vehicles, Trailers, Bicycles, Motorcycles and Other Similar Vehicles | 207 | 235 | 238 | 226 | 356 | 463 | 568 | 410 | 319 | 338 |
| Nuclear Reactors, Boilers, Machinery and Mechanical Appliances | 263 | 191 | 147 | 177 | 216 | 201 | 406 | 304 | 300 | 282 |
| Cereals | 112 | 148 | 168 | 195 | 189 | 202 | 257 | 209 | 195 | 191 |
| Electrical or Electronic Machinery and Equipment | 26 | 95 | 81 | 132 | 115 | 136 | 109 | 93 | 94 | 124 |
| Aluminum and Articles Thereof | 0.1 | 0.2 | 0.3 | 7 | 22 | 70 | 55 | 142 | 101 | 124 |
| Rail Transportation (Incl. Tramways and Traffic Signalling Equipment) | 0.4 | 0.3 | 0.6 | 11 | 25 | 39 | 65 | 119 | 6 | 123 |
| Paper, Paperboard and Articles Made From These Materials | 8 | 3 | 12 | 11 | 35 | 48 | 69 | 76 | 86 | 88 |
| Iron and Steel | 25 | 16 | 15 | 22 | 14 | 22 | 29 | 72 | 87 | 80 |

**Source: Industry Canada, < http://strategis.ic.gc.ca/sc_mrkti/tdst/engdoc/tr_homep.html >**

**Canada's Top 10 Imports from Mexico, 1995 - 2004**

| | Annual Value of Imports (Millions CDN $) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Electrical or Electronic Machinery and Equipment | 1211 | 1452 | 1882 | 2369 | 2922 | 3583 | 3170 | 3418 | 3095 | 4199 |
| Motor Vehicles, Trailers, Bicycles, Motorcycles and Other Similar Vehicles | 1977 | 2022 | 2157 | 2009 | 2396 | 3508 | 3644 | 3685 | 3382 | 2993 |
| Nuclear Reactors, Boilers, Machinery and Mechanical Appliances | 802 | 1029 | 1035 | 1160 | 1731 | 2084 | 2140 | 2028 | 1896 | 2096 |
| Furniture, and Stuffed Furnishings; Lamps and Illuminated Signs; Prefabricated Buildings | 245 | 245 | 317 | 359 | 457 | 495 | 538 | 742 | 755 | 761 |
| Optical, Medical , Photographic, Scientific and Technical Instrumentation | 65 | 91 | 136 | 186 | 214 | 217 | 251 | 340 | 393 | 555 |
| Mineral Fuels, Mineral Oils, Bituminous Substances and Mineral Waxes | 111 | 193 | 267 | 206 | 267 | 397 | 431 | 275 | 418 | 363 |
| Edible Vegetables and Certain Roots and Tubers | 98 | 109 | 113 | 127 | 108 | 122 | 151 | 203 | 240 | 253 |
| Woven Clothing and Articles of Apparel | 19 | 29 | 52 | 71 | 93 | 117 | 182 | 192 | 191 | 221 |
| Miscellaneous Articles of Base Metal | 32 | 36 | 26 | 39 | 81 | 106 | 99 | 132 | 137 | 158 |
| Articles of Iron or Steel | 34 | 55 | 75 | 87 | 107 | 153 | 158 | 161 | 138 | 156 |

**Source: Industry Canada, < http://strategis.ic.gc.ca/sc_mrkti/tdst/engdoc/tr_homep.html >**

Secondly, Mexico and Canada have not developed a strategy to address the limitations of the hub and spoke arrangement that has kept their export growth confined to a narrow range of opportunities. Asymmetric growth between the NAFTA partners has accelerated over the decade, not diminished. More than ever Canada and Mexico are energy and raw material exporters to the U.S. heartland and a vast market for American consumer and capital goods. Mexico is a primary exporter of immigrant labour to the U.S. service and agricultural economy. This is without question the most troubling aspect of North American free trade. It was designed to modernize Mexico's economy and provide work and employment in abundance for Mexican citizens. So far though, NAFTA has perpetuated most of Mexico's developmental weaknesses at the same time that Mexico's exports to the U.S. have soared in traditional areas such as auto parts, textiles, and agricultural products. There is nothing in the cards that suggests that either country will be able to change the division of labour without a focused and dedicated industrial strategy.

Under NAFTA rules, both Canada and Mexico are seriously disadvantaged in third way. Both countries have seen their export share of the world market decline as they have become more concentrated in the U.S. mega-market. On the world stage both countries face major structural adjustments from potential rivals in China, India, Brazil, and Eastern Europe. Mexico and Canada are living precipitously on the edge, benefiting from rising energy prices but facing enormous pressure on labour-intensive processes in manufacturing.

Many experts are of the view that foreign direct investment is on an ‘investment binge,’ but it is not clear what kind effect this will have on Canadian and Mexican industrial and service exports. Since 2000, Mexico has seen its share of global investment decline losing out to China as the preferred place for multinational corporations (MNCs) venture capital and new industrial enterprises. China is the big game globally, and Mexico has found itself on the outside of the latest investment boom. On the service side of the economy, Canada and Mexico need to look to their own capital markets for start-ups and new equity financing. So far there is little incentive for the NAFTA partners to bite the bullet and develop high performance financial services. It is not off the mark to state that Mexico and Canada have been coasting on their access to the American market and have had little incentive to rethink where they want to be at the end of the next decade. Neither country is lean, hungry, or ground-breaking in the area of financial service innovation. Since NAFTA came into effect Mexico’s major banks are now under foreign-ownership. Canadian and Mexican public law has made these takeovers, which have been encouraged by public authorities, relatively easy to effect.

The major analytical point is that complex market and non-market forces no longer respond to the simple supply and demand signals of free trade in North America – if they ever did. Sorting out the real life cause-and-effect relationships in highly open economies has proven to be hazardous. The most authoritative study performed by Industry Canada demonstrated that the low Canadian dollar, rather than new market access, was responsible for Canada’s export boom to the U.S. between 1995 and 2000.[3]

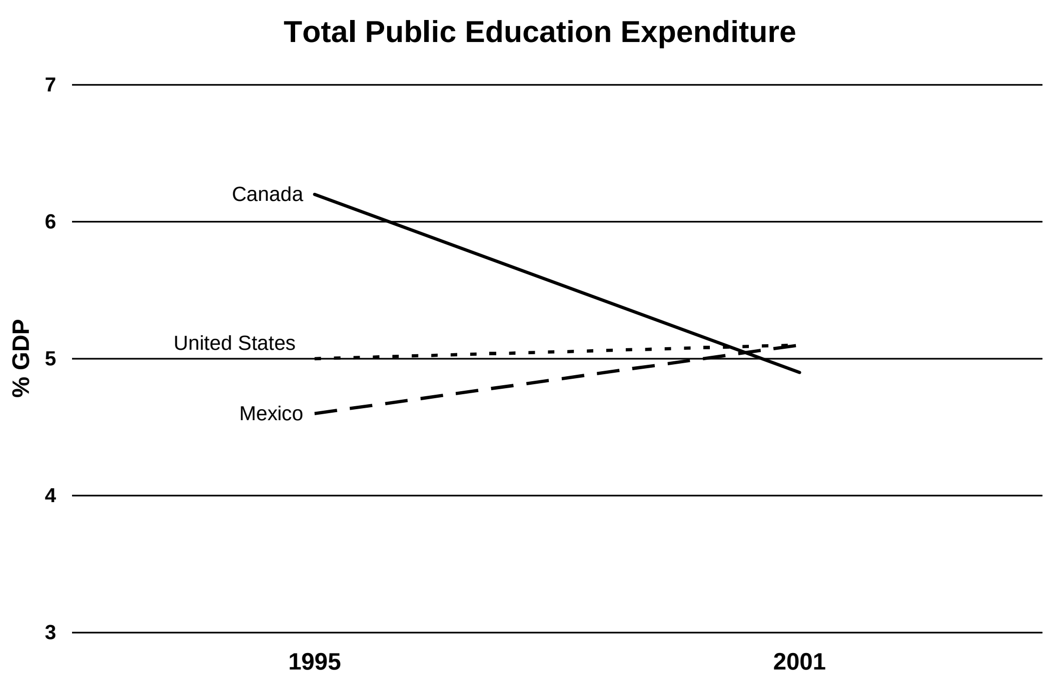
Over eight-five percent in the growth of Canadian exports was due to the unbeatable competitive $ .62 dollar.

It is far more significant that any untapped access to U.S. non-resource markets is unlikely to grow until Canada develops a clutch of homegrown multinational corporations who can power themselves into the U.S. market. Canada would be better able to increase its access to world and North American markets by doubling its investment in research and development (R & D) from less than one percent of GDP to two percent or better in the next decade. Canadian companies have to turn their attention away from traditional markets and put their effort into responding to changes in the production process, developing new products, investing in the workforce, and improving education and training. Other than promising tax relief to Canadian exporters, the Canadian government has failed to take the lead and provide a strategic vision. Cutting taxes is no guarantee that firms will reinvest their profits in innovative equipment, new processes, and badly needed job skills and training. Despite record profits from the recent export boom due to the super-competitive Canadian dollar, Canadian manufacturers did not use the high rate of return to become more competitive. The relationship between higher productivity growth and lower taxes is not well understood, and without proper institutional arrangements cutting taxes is always a high risk activity that often backfires.

**Human Capital, R&D and Innovation**

The challenge globalization represents for Canada is how to acquire the policy tools and institutions that will enable it to adapt to the rapidly changing economic landscape

(Rodrick 2001). The key to Canada's future lies in research and innovation, and Canada lags far behind the U.S., Japan, and Germany in R& D and in investment in higher learning. The macro-economic benefits of globalization have been equally mixed. To move up the competition value-added ladder in a free trade agreement, Ottawa has to invest more in social capital and skills training. According to the (Organization for Economic Cooperation and Development) OECD, Canada's spends thirty percent less on post-secondary education than the U.S. In fact, spending on human capital and education declined in the 1990s, the exact opposite of what one would expect given that skill training is so important for efficiency purposes (Boltvinik 2003).

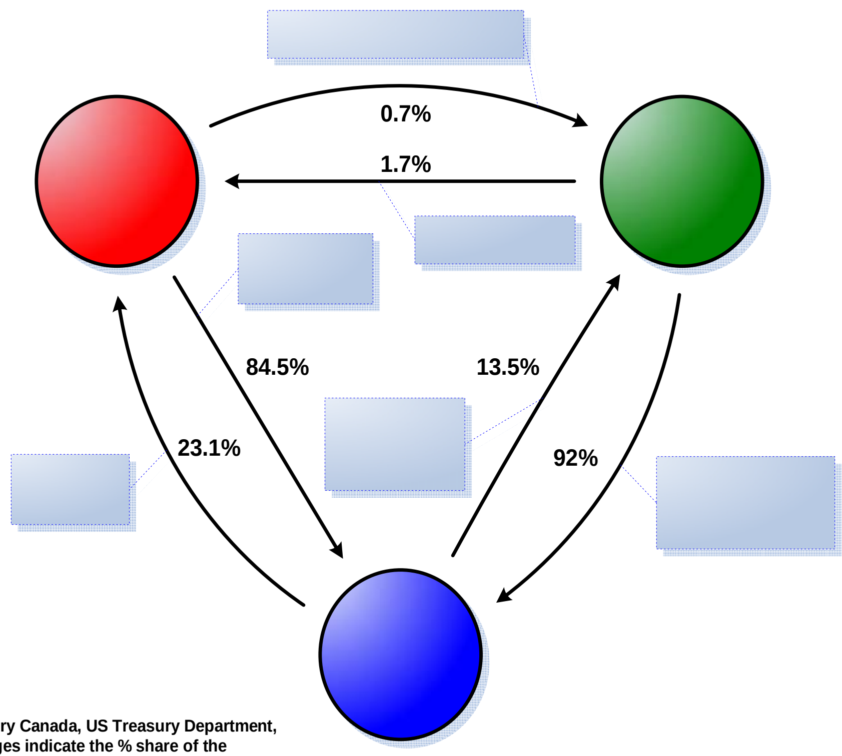



Source: OECD Factbook, 2005.

For Mexico, NAFTA was not a stand-alone policy. It was to have an equally impressive social reform dimension, but over the last decade, spending on social capital and investment in post secondary education has failed to materialize (United Nations 2005). Mexican governments forgot the other part of the NAFTA package and have not made social reform a priority. So while Mexican intra-firm exports have soared in some key sectors such as automobile and light electronics assembly, the larger picture remains skewed by the negative distributional effects of income and wealth polarization. NAFTA has provided Mexico with full duty-free access to the U.S. market; market-access which no other country shares. Mexico should have been a showcase for other developing countries. But in per capita terms, since 1992, Mexico's economy has grown at barely over one percent, a fraction of its growth-rate during the decades prior to NAFTA! (Lustig 2001). In 2004, Mexico's economy grew at a snail's pace averaging three percent growth, a rate that is not sufficient to stay ahead of the burgeoning number of people entering the labour market annually. It is small wonder that immigration is one of Mexico's leading exports. Access to U.S. markets has not made up for the domestic factors which hold back Mexico's economic growth or for the lack of a strongly articulated development strategy. The asymmetrical commercial effects are pronounced (see "The Asymmetrical NAFTA Triangular Trade").

Reliance on NAFTA has not been a silver bullet for Mexico. Like many others in the global South, those working in the most vulnerable and exposed industries such as textiles, agriculture, and primary resource extraction and processing have seen their wages decline. In Mexico's maquiladoras sectors, the drive for international competitiveness has been the incentive for many industries to shed labour rather than to create employment. Since 2000, it is estimated that over 300,000 jobs have been lost. Employment growth remains negative, and many labour intensive jobs have shifted to China and Guatemala.

## The Asymmetrical NAFTA Triangular Trade




Sources: Industry Canada, US Treasury Department, WTO. Percentages indicate the % share of the exporting country's total exports for 2004

*Natural Resources, Li*
*Tour*

Manufacturing employment has grown persistently but not enough to absorb the massive influx of displaced agricultural workers into the cities. The predictions that NAFTA

**Canada**



*Oil & Logs,*
*Cars & Parts,*
*Light Manufacturing*

could double as a trade and development strategy were wrong and have left a policy legacy of failure.

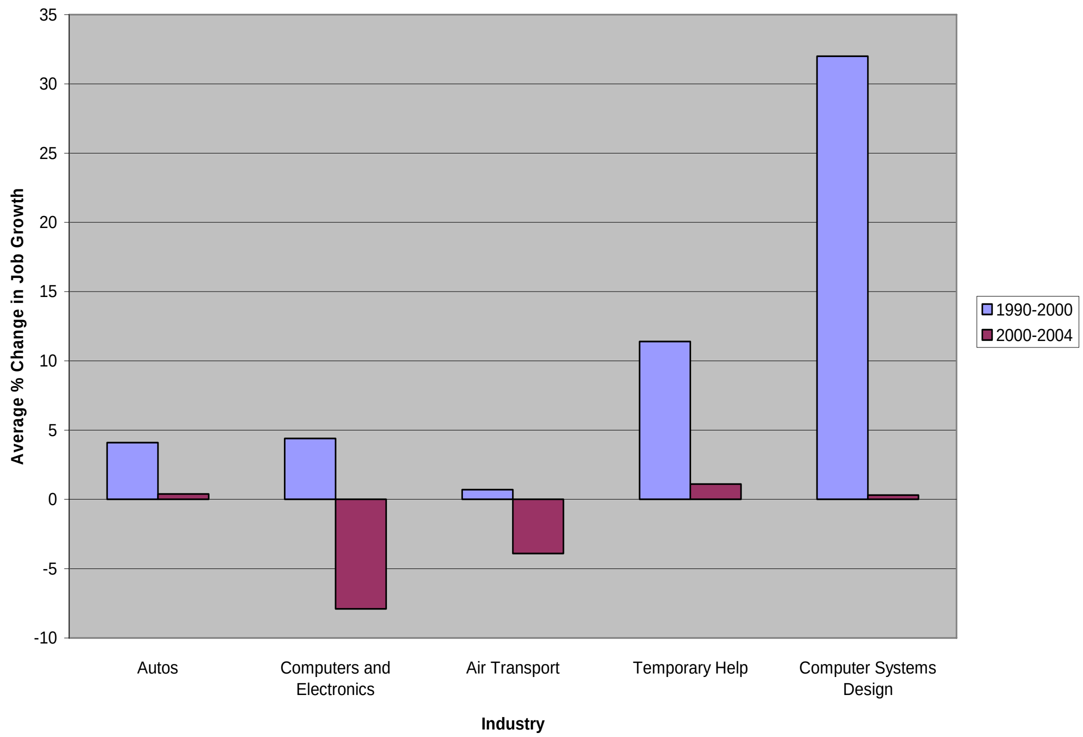
The trickle down theory, which suggested that free trade would lift the poorest out of poverty and become the great economic equalizer for the middle class, has not delivered on its basic promise. Mexico's structural problems preceded NAFTA, but the implementation of the export-led model of development is associated with the worsening of income distribution in Mexico as Boltvinik among others has demonstrated. Regions in the north and centre of the country are better off than those in the south who are disconnected from NAFTA-related production chains (Boltvinik 2003). Polarization between Mexico's regions is much worse today than a decade ago. Since 1994 Mexico has lost 1.3 million jobs in the agricultural sector and millions of new jobs in other sectors.

For Canada, NAFTA has also failed to be generate hundreds of thousands of jobs in the export side of the economy; instead auto, resources, and manufacturing have taken incentives to downsize their workforce and produce more with fewer people. The drive to be competitive has had major negative consequences on blue collar employment. In a recent article in the *Canadian Economic Observer,* Cross documents how deep the decline in Canadian manufacturing employment has been over the NAFTA book-ended decade. Manufacturing jobs peaked in 1980 at 19 percent and bottomed out in 1993 at 14 percent. Since then, manufacturing jobs have come back as the economy rebounded but are once again at an all time low. Even the auto and the information and communication technology (ICT) sectors have seen their growth stalled (Cross 2005).

It is disturbing that high levels of high tech jobs in computer design created in the 1990s collapsed in the following decade. The boom-bust cycle in high jobs is a mirror image of manufacturing and resources. More generally, volatility in the labour market, which is dependent on the demand for goods and services in the U.S., leads to instability for new entrants and older workers in particular. Export industries are the losers in the employment stakes. The winners include those working in the public sector, hospitals, education, real estate, and retail all which experienced better than average growth between 2000 and 2004 (Jackson 2005). The shedding of Canadian manufacturing jobs continues its downward trend; and while not as dramatic as in the United States, the strongest source of job creation is on the domestic side of the economy.

Arthur Donner (2005) has examined job creation in the two countries and found that the majority of new jobs in Canada are in the public sector, construction, and services. Employment in the U.S. is strong in the part-time sector and services but not in the public sector. The message here is unambiguous: exports cannot be relied on as a net creator of jobs.

## Many Canadian Industry Leaders in the 1990s are Job Laggards by 2005




Source: Cross 2005.

Aside from the commodity boom in mining, white collar domestic job growth is almost twice that of blue collar occupations. As Canada becomes more of an information economy, job creation is tied more directly to domestic conditions. A strong export performance requires a large and focused role for public authority, a lot of fortuity from rising commodity prices, and a competitive currency. Even in situations when they are advantageous to Canadian industry, NAFTA effects are largely washed out by other macro factors. Mexico is in the same situation. Export growth is strong but GDP growth is disapprovingly weak. It peaked in 1997 at 6.8 percent annually, but since 2000, Mexico's domestic growth has hovered around the 2 percent mark when the economy needs to be growing at between 6 and 8 percent annually. Mexico faces the seemingly impossible challenge of obtaining a rate of growth equal to that of Argentina and Chile both now in double digit figures.

**NAFTA Effects: Some Qualitative Measures – Growing Divergence, Institutional Constraints, and Neo-Liberal Competitiveness**

NAFTA regulatory divergence is now a fact of life in North America. The markets have not been able to impose a single template on the way Mexican, Canadian and American authorities govern the market. There is no agreement on its benefits let alone its costs. Although Canadian and Mexican exports have surged year over year, market share and changes in the composition of trade for both countries is much more revealing of the actual benefits. On this fundamental point, NAFTA has not dramatically transformed Canada's or Mexico's comparative advantage in high value-added sectors. Their traditional strengths in resources, agriculture, and, for Mexico, labour intensive industries are little different from a decade ago. A second discovery is that there is no scientific way to forecast NAFTA effects and outcomes (see How Good were the Experts Predictions).

**How Good Were the Experts' Predictions about NAFTA's Effects and Benefits?**

| Challenge | Prediction | Outcome |
|---|---|---|
| Challenges to government regulation | Significant policy harmonization with respect to taxes, social policy and macro-economic co-ordination. A new Canada-U.S. relationship envisaged with a level playing field | Dramatic reduction in federal spending driven by zero inflation and zero deficit targeting. Federal spending as % of GDP drops to 1950s levels. By 2005 Canadian social spending is more than 4 percent of GDP than U.S. in per capita terms. |
| Future of Autopact | Neutral | Global overcapacity more important. Canada maintains share of new investment and production. CAW proves an astute bargainer at the table. Global overcapacity forces job and wage concessions in 2005 |
| Investor protection | Significant increase in investor rights | Many new conflicts created by NAFTA provisions in a range of sectors with respect to national treatment. Most of the conflicts are in agriculture and cultural areas. |

| | | |
|---|---|---|
| Capital mobility | Increases | Underestimated capital volatility and reverse flows. Canada share of new investment flows no greater than previously. FDI is not driven by NAFTA text but by U.S. shareholder capital and MNC strategies. NAFTA effect dwarfed by U.S. dot.com craze |
| Mexico's economic inequality | Seen to decrease as free trade accelerates the modernization of the economy | Dramatic fall in incomes and rise in unemployment. Mexican small business does not modernize while worker productivity is up 36 percent since NAFTA was signed.Wages fell 29 percent between 1993 and 1997 and welfare gains meagre for the mass of Mexican wage earners. |
| Cost of regulation | Sharp Decrease | Little evidence of major reduction in regulatory costs. Canadian business complains about increase in users fees. |
| Wages | Significant income gains for well positioned workers in | In Canada wage polarization deeper than anticipated. Evidence is mixed. |

| | | |
|---|---|---|
| | export industries | In the U.S. the growth of wage inequality explained by the growth of union-free workplace. Exchange rate for Canada and Mexico the key variable |
| Labour restrictive practices | Diffusion of US norms and more competitive labour markets post NAFTA | Collapse of U.S. labour movement has less knock-on effects and predates NAFTA. Canadian labour has not gone down U.S. road of a union free workplace. Roughly 35 percent of Canadian workers are covered by collective bargaining compared to 15% in the US |
| Unemployment | With a stronger performance and stronger economy, unemployment levels to fall | Underestimated the magnitude of the job loss for many sectors but much job loss is not NAFTA driven. Eighty of the private sector jobs regained by 2000 when Canada outperforms U.S. economy in the job olympics |
| Union bargaining power | Increased competitiveness leads to a decrease in | Some significant decrease in collective bargaining arrangements |

| | | |
|---|---|---|
| | collective bargaining for Canadian unions | in Canada but high levels of unemployment reduce the effectiveness of Canadian labour |
| Government decision making | Constrained | Impossible to attribute to NAFTA. Too many other competing agendas. Divergence across a broad range of policy areas is pronounced. |
| Exports | Sharp Increase | The record is mixed; trade asymmetries increase and Canada and Mexico comparative advantage are not transformed but traditional competences become the drivers of their export oriented economies |

From a political and legal perspective, the final text of NAFTA did not contain a definition of a subsidy or an arms-length procedure to resolve this issue. With such a gaping legal omission, it is not clear how NAFTA's legitimacy can be restored.

NAFTA's principle weakness from a public policy perspective is that it lacks concrete provisions regarding humans rights or environmental protection. NAFTA's emphasis – to borrow Michael Trebilcock's critical distinction – has been on negative integration (2003). Negative integration sets out the rules of what countries cannot do and is largely responsible for the "less state, less tax" policy harmonization process that has led to spending cuts everywhere. By contrast, positive integration would spell out the supranational regulatory rules and domestic policy standards that the U.S., Mexico, and Canada *must* adopt. Without positive integration there is no tri-national framework which protects social standards and strengthens social inclusion. Each country will continue to decide for itself. In the absence of an institutional escalator, there is no built-in momentum that would propel all three countries to spend more on social North America, invest in human capital, and provide incentives to increase health and labour standards.

As far as public policy is concerned economic divergence has undermined many of NAFTA's principal assumptions. North American integration is market-driven but the role of national authority cannot be minimized. What Canada and Mexico have learned painfully is that North American governance is a very imprecise term. Transnational authority is not the result of common policies and a grand political bargain that limited the authority of the US Congress. Nor there ever been a single North American economy but rather many competing regional ones. Most are nationally centered and the massive growth in the trans-border traffic of people, goods, and services has strengthened the regional dimension of North America economically. Governance, meaning the policies and institutions that would co-ordinate and manage the trilateral relationship, is largely carried out by interdepartmental contacts in the three governments and at the highest level of government. Governance is not carried out through NAFTA, which has neither the institutional capacity nor political clout to give the North American idea effective policy legs. At the centre this elaborate system of interstate contacts is the U.S. Department of Homeland Security and its Canadian and Mexican counterparts in military, intelligence, transportation, immigration, and justice. The second pillar of North American integration is the management of the northern and southern border. Borders are fixed by law and geography but changed by governments through circumstance and need.

Every border has four dimensions: it is a security moat, a regulatory wall, a commercial gate and a line-in-the-sand for citizenship purposes (Drache 2004). While NAFTA is the big player economically, it controls only ten percent of the policy agenda; and since 9/11 has lost its place in the pecking order. In any event, discerning Canadians want to increase their sovereignty, not compromise it any further. Parallel policies rather than common ones have always been at centre stage in North America in the exercise of power and international co-operation. This basic policy truth is more relevant than ever in an age of security and integration.

**Conclusion: Acquiring Will Power**

So the question is: when Canadian and Mexican macro-strategies and U.S. policies go their separate ways, will Mexico and Canada acquire the will-power and conceptual tools to become effective conflict managers of North American integration?

Kissinger (1973) was prescient when he wrote that 'foreign policy is domestic policy,' and if this is true for the U.S., it doubly applies to Canada and Mexico – countries in which social diversity and multiculturalism define the national identity. They need to nurture and protect their strategic interests (Welsh 2004).

If Ottawa expects to be a more effective actor globally, it needs to connect with the Canadian public in ways that it has not chosen to do. Today, what Joseph Nye has called ‘the soft power of public opinion’ is more critical than ever to Canadian and Mexican foreign policy goals and practices. (Nye, 2004) If these NAFTA ‘twins’ expect to chart their own course in the age of the smart citizen and critical, informed counter-publics, public opinion has to be kept on side, consulted, and mobilized.[4] Ottawa and Mexico cannot change the path of the Bush revolution in foreign policy but on missile defence, peace-keeping, human rights, agricultural subsidies at the WTO, and global governance in the post-Bush era they will need to build leverage and acquire voice (Ibbitson 2005).

Increasingly, foreign policy will have to reflect the social values of Canadian and Mexican society, rather than, as in the past, the special interests of business elites. In a prescient article in T*he Globe and Mail*, Gordon Pitts argued that the Canadian Council of Chief Executives has declined in influence in Ottawa partly due to its support for outdated and economically deterministic policies (2005). [5] At present, Ottawa and Mexico City are caught somewhere between denial and taking responsibility for setting new priorities for their relationship and the future of North America. They are still banging off of every change coming out of Washington. Managing conflict will require a lot of focus and smarts from civil society. The new Harper government must accept that Canadian foreign policy and continental free trade have to constantly change, adapt, and innovate in this very charged global policy environment. Mexico’s just elected president will have to grapple with the fallout from the NAFTA decade as a top priority.

Immigration and development require rethinking from the ground up. NAFTA’s distributional effects have skewed its macro-benefits in favour of the U.S. Negative distributional effects have seriously compromised the competitive advantage that a handful of Mexican and Canadian industries have derived from an era of North American Free Trade. On the most critical issue of enhanced citizenship rights, poverty eradication and a return of public authority after the triumph of market fundamentalism there is no room for ambiguity. Deepening the North American partnership remains a far-off reality short of strategic, economic or intellectual substance.

**Notes**

[1] Thanks to Greg Smith for preparing the tables and general assistance.

[2] See Ana Covarrubias, "Human Rights and Mexican Foreign Policy" in this volume.

[3] As a driver of Canadian exports, the competitive dollar rescued Canadian industry from the economic doldrums (Poloz 2004).

[4] See forthcoming book by Daniel Drache, *Defiant Publics: the Unprecedented Reach of the Global Citizen,* London: Polity Press, 2008.

[5] Pitts writes "[D]espite this ability to command press coverage, there are questions about whether Ottawa pays much attention these days…[The] glory days are over… As a policy advocate … Mr. d'Aquino has fallen into predictable habits, sounding the same drumbeat on every issue and rarely reaching out beyond his top-executive constituency (2005; p. B10).

**Bibliography**

Alden, Edward, and Holly Yeager (2005) "CAFTA victory revives Bush's ambitions for US trade deals," *Financial Times*, 29 July, Page 9.

Boltvinik, Julio (2003) "Welfare, Inequality, and Poverty in Mexico, 1970-2000," in Kevin J. Middlebrooke and Eduardo Zepada (eds), *Confronting Development: Assessing Mexico's Economic and Social Policy.* Stanford: Stanford University Press.

Canadian Manufacturers and Exporters (2005) *CME 2005-2006 Management Issues Survey: Winning Strategies for the Future*, http://www.cme-mec.ca/national/media.asp?id=588

Council on Foreign Relations (2005) *Building a North American Community,* Independent Task Force Report No. 53, New York: Council on Foreign Relations.

Cross, P. (2005) "Recent Changes in the Labour Market," *Canadian Economic Observer* 18(3): 1-10.

Donner, Arthur (2005) *Economic Review*, August.

Drache, Daniel (2004) *Borders Matter: Homeland Security and the Search for North America.* Halifax: Fernwood.

---. *Defiant Publics: the Unprecedented Reach of the Global Citizen,* London: Polity Press.

Ibbitson, John (2005) "Trading with the 'Schoolyard Bully,'" *Globe and Mail*, 20 August, A8

Jackson, Andrew (2005) The Economy March 2005, CLC, Ottawa.

Kissinger, Henry (1973) *A World Restored,* Gloucester, MA: P. Smith.

Krugman, Paul (1995) “Cycles of Conventional Wisdom on Economic Development,” *International Affair,s* 71(4): 717-32.

Lustig, Nora (ed.) (2001) *Shielding the Poor: Social protection in the developing world*. Washington DC: Brookings Institution Press.

Peters, Jeremy (2005) “Shock and Resignation on GM Shop Floors Set to Close,” *New York Times,* November 22.

Middlebrooke, Kevin J., and Eduardo Zepada (eds) (2003) *Confronting Development: Assessing Mexico’s Economic and Social Policy,* Stanford: Stanford University Press.

Naim, Moises (2000) “Washington Consensus or Washington Confusion?” *Foreign Policy* (Spring): 74-85.

Nye, S. Joseph (2004). *Power in the Global Information Age From Realism to Globalization*. New York: Routledge.

Pitts, Gordon (2005) “Tom’s Club: Only Chief Executives Need Apply,” *Globe and Mail*, 04 July, B10.

Poloz, Stephen S. (2004) “Who is most vulnerable to the rising dollar?” W*eekly Commentary,* 01 December; https://www.edc.ca/english/docs/ereports/commentary/publications_6710.htm.

Ritchie, Gordon (2005) “Who’s Afraid of NAFTA’s Bite?” *Globe and Mail,* 15 February, A21.

Rodrick, Dani (2001) “Four Simple Principles for Democratic Governance of Globalization,” Paper prepared for the Friedrich Ebert Foundation.

Trebilcock, Michael (2003) "Trade Liberalization, Regulatory Diversity and Political Sovereignty," Faculty of Law, University of Toronto, November.

United Nations (2005) *United Nations Millennium Report*, New York: United Nations; http://unmillenniumproject.org/reports/full report.htm.

Welsh, Jennifer (2004) *At Home in the World: Canada's Global Vision for the 21St Century*. Toronto: Harper Collins.