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Distinguished Members of the Committee:

As a citizen of the United States and a resident of North America, it is a great honor to be invited to testify before your Committee. I compliment you on your leadership in exploring ways to deepen the cooperation among the three countries of North America. The time is propitious.

The tragedy of September 11th reminded us of our shared vulnerability. It also provided us with three distinct sets of choices on how we might respond. Each of the three countries of North America could choose to defend itself by retreating behind a fortress of tighter security and more barriers at the borders. This path would offer only a false sense of security, and it would reverse the remarkable progress made in the last decade in expanding trade and investment. More importantly, it would diminish the standard of living of all three countries. A second option is to act as we always have - handle one problem, one country at a time. This is the most likely course, but it is flawed, for reasons I will describe below. The third path is to lift NAFTA to a new level of cooperation. That is the direction I hope this Committee will take us.

Americans deeply appreciated the outpouring of support by the people of Canada and particularly the candle-light vigil here in Ottawa immediately after September 11th. But the first reaction by the three governments reflected old habits rather than the new promise of partnership implicit in NAFTA. The United States nearly shut down traffic on its two borders. Instead of the Canadian Prime Minister and the Mexican President joining President Bush in the White House on September 12th to express their solidarity and to plan a continental response, Prime Minister Jean Chretien and President Fox arrived separately and later. An opportunity was missed.

Today, I would like to do discuss the state of NAFTA and to offer some specific recommendations for your Committee to consider on how to deepen North America.

Let me say a word about my own background. For the past twenty-five years, I have been working on North American issues in the government at the National Security Council; in non-governmental organizations, especially the Carter Center; and in academe, at Harvard, El Colegio de Mexico, and at Emory University. Fourteen years ago, I wrote a book, entitled Limits to Friendship: The United States and Mexico, with Dr. Jorge G. Castañeda, the current Foreign Minister of Mexico, that identified the barriers to improved relations between the United States and Mexico. Ten years ago, I wrote a book, entitled Integration with Mexico, which was an expansion of a memo that I had sent to the Democratic Candidate for President Bill Clinton on ways to modify NAFTA to take environmental and labor issues into account. Four years ago, I edited a book on The U.S. Congress and North America. At the same time, I began research of the European Union in order to learn from its nearly fifty years of experience what should be avoided as well as what could be adapted for North America. The product of that research is Toward a North American Community: Lessons from the Old World for the New (Washington, D.C.: Institute for International Economics, 2001 - www.iie.com). The recommendations that I develop today will be derived from this study.

NAFTA - An Analysis

Despite misgivings and criticisms, the North American Free Trade Agreement (NAFTA) succeeded in what it was designed to do. It reduced trade and investment barriers, and nearly tripled trade and investment among the three countries. Today, the United States exports nearly four times more to its two neighbors than to Japan and China and 40 percent more than to the 15-nation European Union. In the 1990s, Mexico had the highest rate of export growth in the world, and Canadian investment in the United States grew twice as fast as U.S. investment in Canada. Two decades ago, less than one-third of the three countries' trade with the world was with each other; today, it's more than half. Our firms have become continental and more competitive, and North America has a combined gross product of \$10 Trillion, making it the largest free trade area in the world, 15 percent higher than the European Union.

NAFTA's failure has come partly from failures of compliance - related to sugar, softwood lumber, trucking, but mostly from what it omitted. The income gap between Mexico and its northern neighbors has not narrowed. Illegal migration has increased. Bureaucratic duplication on the border, combined with inadequate infrastructure and divergent regulatory policies, has raised transaction costs above the level of the tariffs that were eliminated. If Europe built too many institutions, NAFTA made the opposite mistake. It lacks institutions to anticipate or respond to crises or take advantage of opportunities. **We also lack a vision of an inclusive identity that would inspire citizens of all three countries to think of themselves also as North Americans. Indeed, NAFTA is little more than two bilateral relationships that rely on old habits and too often an unproductive paternalism by the United States.**

Canada's Contribution

Canada has long worked for an international system based on rules, rights, and responsibilities, most recently to ban landmines and establish an International Criminal Court. Since 1990, Canada has been a leader in the Organization of American States and, particularly, in shaping the Election Promotion Unit. NAFTA emerged from Canada's initiative to seek a Free-Trade Agreement with the United States.

Yet since then, we have not seen much leadership on North American issues and, indeed, it appears that Canada's principal interest is simply the bilateral relationship with the United States. One can readily understand why, given the importance of the United States for the economy of Canada, but we need for Canada to play a more far-sighted role at this time. The three governments treat each border problem as distinct without realizing that a trilateral approach could yield durable rules instead of a one-sided collision between a large and smaller country.

In brief, we need Canadian leadership and particularly in the areas in which Canada has always been in the forefront of the international system - defining rules and shaping international institutions. With that purpose in mind, let me offer some recommendations for your consideration.

Recommendations

The U.S. penchant for unilateralism combined with the Canadian and Mexican preferences for dealing bilaterally with the United States has neutralized the chance to create a true North American Community. "Dual-bilateralism" seems the default option for Canada, but it is short-sighted and corrosive for three reasons. First, the combination of American power and its neighbors' sense of inferiority often leave a residue of resentment. Second, the issues take a long time, if ever, to be resolved; soft-wood lumber comes to mind. And third, and most important, a broader continental perspective is absent. The leaders deal with one issue, two countries at a time, and therefore, rarely, if ever, ask themselves: **How can we address this problem in a generic way that will benefit the entire region and eliminate the need to return to the issue every year?**

Adding a third party to the bilateral disputes increases the chance that rules, not raw power, could be determining. For example, all three governments are struggling to adjust their agriculture to a competitive marketplace. Most farmers can manage, but the few who cannot compete – for example, in timber, corn, and vegetables – use all the legal and political channels to protect themselves. The three countries can continue aggravating each other and subverting NAFTA, or they could negotiate a North American set of rules that modify the three regulatory schemes.

The first step is to establish a North American Commission (NAC) to define an agenda for Summit meetings by the three leaders of North America and to monitor the implementation of the decisions and plans. The NAC would have an office that would gather statistics from the three governments, and it would commission

studies of different sectors, like transportation, energy, or technology. These studies would ask what could be done to facilitate economic integration in these sectors on a continental basis, and then, it would submit these analyses with specific options to the Prime Minister and the two Presidents.

Unlike the sprawling, regulatory European Commission, North America's should be lean and advisory – just 15 distinguished individuals, 5 from each of the countries. Their task would be to help the leaders think continentally. To deal with immigration and customs at the border, they could propose “North American passports” for frequent travelers, or “North American Customs and Immigration Officers” to patrol the perimeter and reduce the documentation by half.

The Presidents and Prime Minister would continue to be staffed by their own governments, but the NAC would encourage them to respond to a longer-term vision and a more panoramic view of the opportunities.

A second institution should emerge from combining two bilateral legislative groups into a North American Parliamentary Group. The U.S. Congress is the most insular and clearly the most powerful and autonomous of the three legislatures. Its approval in July 2001 of legislation to ban Mexican trucks from U.S. highways was just the latest in a string of laws that offended Mexico. Congressmen also threatened Canada if it refused to “voluntarily” restrict its exports of timber. A North American Parliamentary Group might raise the sensitivity of American Congressmen, and it could provide a chance for Mexican and Canadian parliamentarians to think hard about what they share. There is a tendency in this country to think, for example, that the border with the United States is so fundamentally different from the U.S. border with Mexico that there is nothing to be learned by merging that debate. The central problem in both borders – how to facilitate legal and stop illegitimate trade – is the same, however, and experiments on one border might be of use on the other. More pertinent, if we begin to think about a single perimeter, we will all need to respond to similar rules.

The third institution should be a Permanent Court on Trade and Investment. The dispute panels established under NAFTA are ad hoc, and it is proving difficult to recruit experts, who do not have a conflict of interest. The hearings and decision should also be open to the public in order to build public confidence in the process and the judgment. Some narrowing or clarification of the scope of Chapter 11 panels on foreign investment is also needed to prevent the erosion or perceived erosion of environmental rules.

The most glaring omission in NAFTA is the failure to recognize or respond to the huge development gap between Mexico and its two northern neighbors, and that might explain why it has widened, not narrowed, since the agreement came into effect. Since 1994, the U.S. share of North American gross product rose from 87% to 89% while Mexico's share declined from 5.5% to 4.3% and Canada's, from 7.1% to 6.5%. The per capita GDP in 1999 of the United States was \$31,000; Canada, \$20,000; and Mexico, \$4,900. The promise of a North American Community cannot be realized

until the income gap between Mexico and its northern neighbors is reduced, and illegal migration – a growing U.S. concern – cannot be reduced until that occurs. The European Union lifted its poorest countries – Spain, Portugal, Ireland, and Greece – and we could learn from their experience. From 1986-99, the per capita GDP of these countries rose from 65% to 78% of the EU average, and emigration slowed markedly. The astonishing progress was due to free trade, foreign investment, but mostly to the transfer of aid that amounted to 2-4% of the recipient's GDP. The most effective projects were in infrastructure and education.

NAFTA is deliberately laissez-faire, but the result is that most foreign investment in Mexico has concentrated in the congested, polluted border area, where it has served as a magnet attracting workers from the heart of Mexico. From there, many immigrate illegally to the United States. **In other words, the absence of a strategy has meant that NAFTA has been encouraging illegal migration, not reducing it.**

Foreign companies would prefer to invest in the interior (where the workforce would be more stable), but the roads and infrastructure are inadequate. The World Bank estimates Mexico needs \$20 billion a year for ten years, just for infrastructure. **The three leaders should establish a North American Development Fund, whose priority would be to connect the U.S.-Mexican border region to central and southern Mexico. If roads were built, investors would come, immigration would decline, and income disparities would narrow. If Mexico's growth rate leaped to twice that of its neighbors, the psychology of the relationship would be transformed.**

As you know, trade between Canada and Mexico has grown faster than between the other two legs of the triangle since NAFTA, although that was mostly because it was from a small base. Canada clearly does not have the same stake in the development of Mexico as the United States does. Still, given the growing importance of Latin America to Canada, one would hope that Canadians see the development of Mexico as one of its most important interests. There is a second reason why Canada should take Mexico's development seriously. One of the great challenges of the 21st century is to lift the middle-income developing countries into the first world and thereby give all poor countries a sense of hope. If NAFTA can lift Mexico, that would provide hope for the entire hemisphere and world.

The three leaders should not create a new bureaucracy to administer the Development Fund; the World Bank and the Inter-American Development Bank could do it. But it will need an injection of funding comparable to the Alliance for Progress. The governments could contribute in proportion to their wealth, but the United States needs to lead. Fox has focused on migration because he knows that Mexicans want respect, but the only solution to our relationship is narrowing the income disparities. That should be the building block of a new Community.

There is much more that a North American Commission could propose – a continental plan for infrastructure and transportation, a plan for harmonizing

regulatory policies, a customs union, a common currency. Let us take transportation since roads, ships, railroads, and airlines are our highways for integration.

“Crossing the border,” concludes a May 2000 report for this Parliament by Val Meredith, “has actually gotten more difficult over the past five years.” The causes are twofold. “While continental trade has skyrocketed, the physical infrastructure enabling the movement of these goods has not.” And second, the bureaucratic barriers that confront cross-border business make the infrastructural problems seem “minor in comparison.” [104 of IIE book]

While some people have been critical of the U.S. Congress for imposing U.S. safety standards on Mexican trucks, the real problem is that there are 64 different sets of safety regulations in North America, 51 of which are in the United States and 12 are in Canada. A NAFTA Subcommittee struggled to propose a uniform standard and concluded that **“there is no prospect”** of accomplishing that. The elected leaders of the three countries should have been embarrassed, and would have been if anyone had been paying attention.

The North American Commission should develop an integrated continental plan for transportation and infrastructure. The first step is for each country to harmonize its own standards on weight, safety, and configuration of trucking and then negotiate a single set of North American standards (with some variations based on weather and terrain). Second, the governments should eliminate “cabotage” restrictions and the “drayage” system, which are notorious feather-bedding schemes. Third, the governments should plan and finance new highway corridors on the Pacific Coast and into Mexico. Fourth, the regulatory agencies should negotiate a plan that would permit mergers of the railroads and development of high-speed rail corridors.

The dilemma of free trade regimes is that the reduction of trade and investment barriers also facilitates the flow of illegal goods, and conversely, efforts to prevent smuggling impede the legal flow and, when conducted unilaterally, can enrage the government on the other side of the border. This inherent dilemma was compounded by the extra-security precautions that followed the September 11 attacks. There is no simple way to resolve this problem in the short-term, but it can be managed better and in ways that make the three governments partners rather than angry neighbors. **The duplication of documents that comes with crossing the border could be simplified and reduced by half by establishing a single “North American Customs and Immigration Service.” This agency would be composed of officials from the three governments, trained together in a North American professional school. The service should be used on the borders and on the periphery.**

The United States and Canada have been experimenting with a number of procedures and gadgets to expedite commerce across the border, and these could also be used with Mexico. “Intelligent Transportation Systems” rely on transponders to relay

information from trucks to customs officials. Staging facilities and pre-arrival systems located ten miles before the border could also reduce delays.

An additional step that would do much to foster integration and eliminate impediments at the border would be to negotiate a Customs Union and a Common External Tariff. That would eliminate the elaborate and complex rules of origin.

Finally, our three governments could learn from the European Union's efforts to establish 10-15 EU Centres in the United States. These centres stimulate research and awareness in the United States of the EU. **Our three governments should sponsor Centres for North American Studies in each of our countries to help the people of all three understand the problems and the potential of North America and begin to think of themselves as North Americans.** The Centre on North American Politics and Society at Carleton University, which is hosting a conference tomorrow and Saturday on "Challenges to Governance in North America and the European Union", is a model for what these Centres can do. I would hope that the three governments would assist the expansion of such Centres.

Is a North American Community Desirable? Feasible?

Is any of this feasible? Are North Americans prepared to give up their sovereignty? The term "sovereignty" is one of the most widely used, abused, and least understood in the diplomatic lexicon. Within the last two decades, the three countries have so completely redefined the term that one wonders whether any serious policy-maker could use it to defend any position. In 1980, Canada used sovereignty as a defense to prevent foreign investment in its energy resources, and Mexico used it to maintain high tariffs and discourage foreign investment. Within a decade, both countries reversed their policies. In 1990, Mexico defended its sovereignty by rejecting international election observers; four years later, it invited them. Sovereignty, in brief, is not the issue.

The question is whether the people of the three countries are ready for a different relationship, and public opinion surveys suggest that the answer is "yes" and, indeed, that the people are way ahead of their leaders. A survey of the attitudes of people in the three countries during the past twenty years demonstrate an extraordinary convergence of values – on personal and family issues as well as public policy. Each nation has very positive feelings about their neighbors. In all three countries, the **public's views on NAFTA shifted in the 1990s. There is now modest net support, but a neat consensus: each nation agrees that the others benefited more than they have!**

The most interesting surveys, however, show that a majority of the public in all three countries is prepared to join a larger North American country if they thought it would improve their standard of living and environment and not threaten their culture. Mexicans and Canadians do not want to be incorporated into the United States, and they are ambivalent about adopting the American dollar, but they are more willing to become part of a single country of North America and of a unified currency,

like the “Amero,” proposed by Herbert Grubel.¹ The “Amero” would be equivalent of the American dollar, and the two other currencies would be exchanged at the rate in which they are then traded for the U.S. dollar. In other words, at the outset, the wealth of all three countries would be unchanged, and the power to manage the currency would be roughly proportional to the existing wealth. The three governments’ remain zealous defenders of an aging conception of sovereignty whereas the people seem ready to entertain new approaches.

Canada has played a key leadership role in so many issues. I sincerely hope your government will take the lead in defining the path toward a more collaborative relationship. I cannot say that the United States government will respond positively, but I think Mexico would consider such an approach positively, and if the two neighbors of the United States were to make a persuasive case, influential sectors in the United States would encourage the Administration to take them very seriously.

Four hundred million people live in our three countries, but few, if any, think of themselves as residents of North America. The three governments have devoted so much effort to defining their differences that the people have not seen what they have in common, or that they share a continent, values, and an agreement. I hope that is the conclusion of your deliberations and that, over time, we will begin to think of ourselves proudly as “North Americans.”

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¹ Herbert Grubel, The Case for the Amero: The Economics and Politics of a North American Monetary Union (Vancouver: Simon Fraser Institute, 1999). An October 2001 survey in Canada found that 55% favored the same currency as the United States, but 59% opposed adopting the U.S. dollar. See Allison Dunfield, “Canadians Feel Closer to the U.S., but Reject Currency,” Globe and Mail, November 6, 2001.