1

No Turning Back

Trade Integration and the New Development Mandate

CAROL WISE

Since the Uruguay Round of negotiations of the General Agreement on Tariffs and Trade (GATT) in 1986, hemispheric and subregional trade negotiations have proliferated and have interacted with this more established multilateral venue in unpredictable ways. First was the uncharacteristic willingness of the United States to venture outside of GATT in search of bilateral free trade agreements (FTAs). Frustrated with the slow pace of the Uruguay Round, the United States launched bilateral accords with Canada and Israel in the latter part of the 1980s. The Canada-U.S. deal, in turn, invoked Mexico's request to negotiate a similar bilateral agreement with the United States, which resulted in a second anomaly—and the main focus of this book: the 1994 launching of the North American Free Trade Agreement (NAFTA). NAFTA was unprecedented in that it linked a middle-income developing country seeking to lock in ambitious market reforms and thus willing to forgo developing country status at the negotiating table (Mexico) with a small but highly developed market of the Organization for Economic Cooperation and Development (Canada) and the the wealthiest and most competitive market in the world (the United States).

Concomitant with the launching of NAFTA, new subregional schemes were being created, such as the four-member South American Mercosur bloc

(Argentina, Brazil, Paraguay, Uruguay), and preexisting schemes in Central America, the Caribbean, and the Andean region were revived. A third surprise was the apparent compatibility of these arrangements, both within the Western Hemisphere and also in terms of ongoing multilateral trade goals; like Mexico, countries further to the south were ready to jettison long-standing protectionist biases in favor of trade and investment liberalization. Finally, as NAFTA's negotiators secured commitments that reached beyond GATT's accomplishments in such areas as services, investment, intellectual property rights, and dispute settlement, NAFTA spurred GATT's members to return to the multilateral negotiating table and wrap up the Uruguay Round accord in late 1993, albeit with equivocal results.

From there followed the 1995 creation of the World Trade Organization (WTO), meant to replace, expand on, and better enforce the provisions of GATT. Later that same year, the Clinton administration announced its intention to negotiate a free trade agreement among all thirty-four democratically elected countries in this region. It was envisioned at the outset that the Free Trade Area of the Americas (FTAA) would subsume NAFTA and the other emerging subregional accords into one large hemispheric bloc, while also exerting pressure for further progress at the multilateral level.[1] In less than a decade more regional and subregional deals had been negotiated than ever before.[2] These apparent synergies and virtuous cycles among global, hemispheric, and regional integration instilled considerable optimism that items on the "old" (market access for agricultural and industrial goods) and "new" (services, investment, and intellectual property rights) trade agendas could be constructively addressed by the WTO.

A new round of multilateral trade talks was thus launched in Doha, Qatar, in November 2001, the ninth in a series that dates back to the founding of GATT in 1947 and the first since the formalization of trade negotiations under the WTO. In recognition of the need to more firmly address issues of vital importance to developing countries, most of which had been sold short or ignored in the Uruguay Round,[3] this ninth set of negotiations came to be known as the Doha Development Round. This designation reflected the explosion in the number of developing countries that were now active in international trade, many of which are recent members of GATT/WTO.[4] This explains the heightened pressures from nongovernmental organizations (NGOs) for a true development orientation of the kind witnessed at the WTO's ill-fated Ministerial Conference in Seattle in 1999.

Yet despite the WTO's expressed commitment to negotiate a Doha package that would directly address North-South asymmetries and work to incorporate developing countries into the global trading system on more equitable terms, the Doha Development Round collapsed in mid-2006.[5] The outcome was the continued reticence of the developed countries to offer authentic concessions on the old trade agenda—market access for agricultural and labor-intensive manufactured goods—while insisting on commitments to deep liberalization on new trade issues. But neither were the wealthier developing countries willing to budge sufficiently on the latter. Added to this was the failure of the OECD bloc to firmly specify and commit to the kinds of assistance and exemptions—or "special and differential treatment"—necessary to bridge the North-South divide at the WTO.[6] A similar collective action standoff had stalled the FTAA negotiations a year earlier as the two most important protagonists, the United States and Brazil, failed to agree on the terms for incorporating both old and new trade agenda issues into that accord.

This dissipation in momentum and commitment toward economic integration within the multilateral and hemispheric arenas has prompted some to suggest that these logjams might once again be broken at the subregional level.[7] It is this juncture that forms the departure point for this collection of essays. From the perspective of North America, this volume unites a group of renowned specialists from the three NAFTA countries, the goal being to evaluate the different, although not mutually exclusive, options and integration dynamics from the standpoint of each NAFTA partner. While the disappointments of Doha and the FTAA may render the prospects for deeper North American integration more likely, some of these authors also elaborate on the various ways in which NAFTA itself is in need of revamping. For example, although the agreement has readily delivered on higher levels of trade and investment among the three member countries, and key sectors like autos, electronics, and computers are tightly integrated across this region, NAFTA has patently failed to move forward as a trinational integration project.

Of particular concern is the inability of Mexico to sustain any momentum in the growth of wages, formal employment, and per capita income—a trend that contradicts those neoclassical economic assumptions upon which the design and pace of trade liberalization under NAFTA were based.[8] Obviously, not all of Mexico's growth lag can be attributed to NAFTA, as the country's initially ambitious domestic economic reform trajectory ground to

a near halt under the Fox administration (2000–06).[9] But neither has there been much commitment on the part of the United States and Canada to foster regional institutions or comparable mechanisms that could directly tackle the asymmetries and promote competitiveness as part of a larger NAFTA endeavor. Thirteen years into NAFTA there is still no cohesive organizational framework to manage spillover effects in such areas as energy security and the massive northward flow of undocumented Mexican migrants into the U.S. labor market. Despite the stipulation of GATT's article 24 that membership in a subregional scheme such as this should remain open, not one new member has been admitted to NAFTA.[10]

By virtue of its NAFTA membership Mexico has gone farther than any other developing country in striking a balance between the liberalization of issues on the old and new trade agendas.[11] However, to date the prospective costs of a deep liberalization of items on the new trade agenda are more evident than the supposed benefits gleaned from greater market access in those sectors that define the old trade agenda. From the standpoint of the developing country bloc within the WTO, this demonstration effect goes to the heart of the current impasse: with the developing countries now representing a majority of the 150 countries that belong to the WTO, and with powerful emerging market economies like Brazil, China, India, and South Africa participating as never before, demands that the Doha development mandate be addressed must soon be met.

Although the chapters in this volume emphasize that NAFTA-style regionalism has been no panacea, this experiment nevertheless offers insights into possible paths forward for trade integration. This is so both in terms of Mexico's learning curve as a developing country that has aggressively integrated with the fiercely competitive North American market and in terms of assessing viable options for advancing global trade liberalization given the obstacles that have arisen. To put this differently, it seems that "big-think" proposals for deep and rapid economic integration, which marked the 1990s, are giving way to a gradual reconciliation of developing country demands for fair trade with the adjustment costs of further liberalization. In acknowledgment of this trend, and from the vantage point of North America, the authors in this volume address the following themes that have dominated the academic literature and recent trade policy debates:

—The interaction between regionalism and multilateralism, including the crucial role of institutions for enabling the developing countries to comply with their obligations, as herein lies the critical link between economic integration and development

—The question of how the "new trade agenda" (liberalization of trade in services and investment, government procurement, enforcement of intellectual property rights, and support for labor and environmental standards) has altered the classic theory of economic integration, which focuses mainly on questions of trade creation versus trade diversion and the welfare effects of regional trade

—Within North America, the importance of addressing pressing issues that directly relate to NAFTA (migration, energy security) but that were omitted from original negotiations because of their political sensitivity

Regionalism, Multilateralism, and the Development Challenge

In 1991, when the U.S. Congress gave the green light to the senior Bush administration to move forward with the negotiations for a North American Free Trade Agreement, the notion of tightly integrating Mexico with these two OECD markets was both daring and controversial. Daring, because this marked the first U.S. free trade agreement that included a developing country, and one that wanted to join the agreement badly enough to waive considerations for special and different treatment; controversial, because the very disparities between Mexico and its two prospective partners immediately raised concerns about the possible deleterious effects of NAFTA on Mexico. However, as all three member governments agreed that NAFTA would remain a free trade agreement in principle and would avoid the "Brussels bureaucracy" of supranational institutions and adjustment assistance that characterizes the European Union (EU), Mexico basically signed on to a rigorous, market-based restructuring program with the thinnest of safety nets.

At the time, labor markets and the environment were the concerns most raised by a diverse coalition that formed the core opposition to NAFTA, the result being the attachment of side accords and the creation of separate trilateral entities to oversee both of these issues. On the eve of the 1993 NAFTA vote in the U.S. Congress some last-minute doubters on Capitol Hill raised concerns about the larger development challenges engendered by Mexico's entry into NAFTA, and these were assuaged by the Clinton team's offering of the North American Development Bank (NADBank) to be funded jointly by the United States and Mexico. This was essentially it, in terms of the incorporation of a development mandate into NAFTA. Inching slowly along, the impact of the separate commissions for labor and the environment has been hampered in that the enacting legislation applies only to the upholding of national laws within each NAFTA country and not to the generation and

application of NAFTA-wide standards. The NADBank, after approving just five loans in its first five years, is gaining more steam, but its scope is limited to environmental infrastructure projects along the U.S.-Mexico border.[12]

While one can rightfully debate whether an EU-style adjustment effort would have made a dent in the enormous gap between Mexico and its partners, it can be more convincingly argued that the absence of a sound institutional framework is now prohibiting the three countries from moving forward in deepening NAFTA as a regional project. As Gary Hufbauer and Jeffrey Schott observe, "NAFTA's skeletal institutional structure has impeded the achievement of core objectives. . . . The NAFTA Commission—composed of trade ministers of each country—is neither seen nor heard. . . . The NAFTA Secretariat is responsible for administering the dispute settlement processes [and] it also provides day-to-day assistance to the working groups and the commission. It has insufficient funds to do either job well."[13]

Within North America the tendency has been to work around NAFTA in suboptimal ways, rather than to strengthen NAFTA's institutions and expand on its economic accomplishments. Such was the case with the Security and Prosperity Partnership of North America (SPP) launched in 2005, a trilateral effort to strengthen cooperation and information sharing within the region, and also with the numerous counterproductive migration and guest worker proposals. In the case of the SPP, which was basically dead on arrival, at least half of the designated issue areas (for example, manufactured goods, financial services, information and communication technologies, and agriculture) overlap with the NAFTA text and side agreements; moreover, the working groups tasked with linking prosperity and security within the selected issue areas are themselves poorly coordinated. Tellingly, the three NAFTA member governments avoided terms like *integration* and *community* in the context of the SPP and instead relied on "agenda, process, framework, and mechanisms for tri-national dialogue."[14]

In short, even though Mexico's entry into NAFTA was considered an insurance policy for locking in market reforms and NAFTA membership has been an indisputable boost for the creation of higher levels of trade and investment, NAFTA has done little to foster higher levels of productivity and competitiveness on the Mexican side.[15] In chapter 2, I explore the bases for these unfulfilled promises and argue that the record is more mixed than the negative portrait painted by NAFTA's critics.[16] In fact, I argue that macroeconomic variables (inflation, interest rates, exchange rates, aggregate growth) in North America have converged favorably toward OECD standards. Mexico, however—after doubling its per capita growth performance between 1995

and 2000—has hit a virtual plateau in the rise of real income. And although Mexico's average aggregate growth rate of 2–3 percent during the NAFTA era is respectable and in step with Canada and the United States, this rate is well below the average growth rate for other Latin American emerging markets like Argentina, Chile, and Peru during the same time period.

What accounts for the bottleneck in Mexico's growth rate of both aggregate and per capita GDP since 2000? Part of the answer is bad luck, given China's forceful entry into the U.S. market in the 2000s, but Mexico's falling behind is also policy induced. Be it cheaper costs for labor and utility inputs, a broader supplier base, or much lower corporate tax rates, China has gradually outpaced Mexico in U.S. markets once considered the cornerstone of North American integration (telecommunications, computer peripherals, and sound and television equipment). First, Mexico's microeconomic underperformance can be attributed to the gulf between neoclassical trade theory, which assumes a state of perfect competition and constant returns to scale under NAFTA, and the concrete empirical obstacles that underpinned its launching back in the early 1990s.[17] The obstacles include, for example, organizational weaknesses, deeply engrained barriers to competition, and sizable skill and technology deficits that typically characterize a developing economy like Mexico's.

Second, I part ways with those NAFTA critics who place sole blame on the agreement itself for these shortcomings and suggest that the roots of economic underperformance in Mexico lie as much in the frailties of domestic politics, political institutions, and policymaking. The pending reform tasks inherited by the Fox administration, although straightforward, were waylaid by the unexpected difficulties of managing economic liberalization in the context of a minority government and a divided Congress. Thus the delay of crucial measures toward energy sector modernization, fiscal restructuring, labor market mobility, and technical support and credit for small and medium-size firms is just as much to blame for Mexico's current growth trap. In hindsight, I suggest that Mexico's weaknesses going into NAFTA were exacerbated not only by policymakers' embrace of the agreement as a tool to lock in incipient market reforms back in the early 1990s but also by their miscalculation concerning the benefits to be gained from Mexico's geographic proximity to the U.S. market.[18]

I underline the costliness of the six-year reform hiatus that beset the Fox team and the urgency of relaunching comprehensive competitiveness-enhancing reforms by the current administration of Felipe Calderón (2006–12).[19] On this count, my analysis confirms that the classic Vinerian

justification for joining an FTA—aggregate welfare gains and trade and investment creation as opposed to diversion—has been trumped by new growth theories that emphasize the importance of an FTA in promoting scale economies, intra-industry specialization, and technological adaptation.[20] This insight goes to the heart of Mexico's willingness to sign on to the new trade agenda in 1994, which in turn helped render NAFTA an innovative model and deal maker for completing the Uruguay Round. Yet the experience since 1994 also shows that political elites and policymakers in all three countries have yet to fully seize these opportunities, which has relegated NAFTA's whole to much less than the sum of its parts.

Even if NAFTA's operational tendencies are still more akin to two bilateral deals that have basically been cobbled together, Isabel Studer reminds us that the possibilities for a more dynamic and compelling regional project remain. In chapter 3 Studer argues that the very creation of NAFTA shows that trilateral coordination is possible when it is based on the national interests of the three trade partners. She disputes the traditional explanations offered by international relations theorists, which hold that the enormous asymmetries among the North American partners explain the preference of each for a more pragmatic association with minimal institutions and supranational oversight.

As standing theories hold, under conditions of extreme asymmetry the weakest states have no interest in formalizing cooperation because formal agreements only further disempower them.[21] This standard explanation, she argues, begs the question of why Canada and Mexico were willing to negotiate and sign on to NAFTA in the first place. It also fails to account for Mexico's about-face at the outset of the Fox administration, whereby Fox proposed a NAFTA-plus strategy, which among other things would seek to constructively address the secular northward flow of undocumented Mexican migrants to the United States and establish a U.S.$20 billion development fund to invest in infrastructure corridors to better connect the North American region.

Although the NAFTA-plus proposal was widely endorsed by nongovernmental actors across the region as the most effective way to mitigate the huge asymmetries between Mexico and its two northern neighbors, it met with little success in the governmental corridors of Ottawa and Washington. The opposition of the United States, in particular, to the creation of more vibrant institutions to promote Mexico's integration with the North American market (that is, financial and technical support for the expansion of regional infrastructure, human capital investments, and industrial restructuring) is

visceral, and this has clearly slowed progress in bridging NAFTA's development gap. As a way of addressing these shortcomings, Studer argues that the three countries need to enhance the existing regional institutional structure and, based on those adjustments, to seek new forms of cooperation rooted in their respective national interests.

Along similar lines, in chapter 4 Jeffrey Schott encourages all three NAFTA countries to use the impasse at Doha and the FTAA to work together to advance their common interests. By collaborating more closely in the resolution of mutual concerns, he argues, the NAFTA countries could reap substantial gains both within the North American context and in building the requisite consensus to conclude the WTO and FTAA negotiations. In this interim, Schott emphasizes, the success of future negotiations will also depend on the willingness of each country to undertake substantive domestic reforms in areas that relate directly to the bottlenecks surrounding both the old and new trade agendas.

The remaining chapters that touch on this theme of regionalism and development are those by Jaime Zabludovsky and Sergio Gómez, Gordon Mace, and Glauco Oliveira (chapters 5, 6, and 7). Respectively, these authors explore the past efforts and perceived options for the expansion of the North American integration model into a larger hemispheric project and the possibilities for mutual reinforcement between the two. Despite the embrace of the FTAA concept in Latin America as a means for collectively countering U.S. hegemony and advancing on the old and new trade agendas with a smaller set of more homogeneous actors, Zabludovsky and Gómez characterize Mexico's initial attitude toward the FTAA as one of aloofness. With little incentive to share its privileged access to the U.S. market, Mexico instead used the advantage of its NAFTA membership to advance at the bilateral level.

The result by 2005 was Mexico's completion of an ambitious network of FTAs in the hemisphere as well as its proactive stance at the WTO. This more or less mirrored the U.S. strategy of "competitive negotiations," which sought to address some of the rules on the new trade agenda through the negotiation of bilateral FTAs in the region while simultaneously participating in multilateral negotiations. Zabludovsky and Gómez cite two main drawbacks to this bilateral approach for Mexico. First, Mexico's trade protectionism and the related transaction costs of customs valuation rose steadily in relation to countries with which it did not have a preferential FTA in place. Second, these bilateral maneuvers greatly diluted the incentives for countries to participate in FTAA negotiations. Whereas the Latin American and

Caribbean (LAC) countries originally perceived the FTAA as the fastest way into the North American market, many instead succeeded in securing a bilateral deal with the United States.

Yet after the inauguration of the George W. Bush administration in 2001, which showed a greater willingness to move ahead bilaterally with any number of interested takers, Mexico began to feel a tighter pinch from this U.S. competitive negotiating strategy. The combination of China's 2001 entry into the WTO and the rapidity with which Chinese producers began outpacing Mexican exporters in key U.S. markets confirmed that preferential access to the prized U.S. market was no longer a strictly North American perquisite. For Mexico, apart from more seriously tackling its own reform backlog, the challenge is to streamline its non-FTA trade regime and to expand its trade and investment horizons beyond the U.S. market. In this vein, Zabludovsky and Gómez present a compelling argument for the negotiation of a continental free trade zone that would join the NAFTA bloc with the nine other countries that have secured (or are in the process of securing) FTAs with the United States.

By virtue of having already negotiated these FTAs, they argue, the countries involved (from the Andean, Central American, and Caribbean subregions) have made a sound commitment to trade liberalization and regional integration. Moreover, the smaller number of actors could mean a higher probability for constructive collective action. From the standpoint of strengthening Mexico's export-led development strategy, this twelve-member continental zone could also help stanch future losses incurred by Mexico within regional markets due to the implementation of these new FTAs. Though compelling, there are at least three possible glitches to the realization of this proposal, besides the 2006 mid-term election of a congressional majority not in favor of free trade. As one of its first points of trade business the new Democratic-led House Ways and Means Committee sent a letter to the Office of the U.S. Trade Representative demanding the incorporation of binding guarantees on labor rights in the still-pending U.S. FTAs with Colombia and Peru.[22] The House of Representatives also promptly voted down a measure to establish normal trade relations with Vietnam.

In the grander scheme of things, the proposal by Zabludovsky and Gómez raises three concerns. First, it is not clear that deeper liberalization involving the proposed twelve-member zone would resolve the development shortcomings of Mexico and most of its Latin American neighbors.[23] Second are the concerns and conflicting interests of Canada, the only other developed country to sit at the FTAA negotiating table. Third, while the current political

climate in the Southern Cone may not favor the inclusion of these countries in the proposed continental zone, it is difficult to imagine the exclusion of the region's largest and most powerful economy, Brazil, from such an arrangement. Brazil, having played a pivotal role in stalling the FTAA negotiations, could help render the creation of a continental zone that is more than just a matter of maintaining perks in the U.S. market, as is the case with the current twelve-member lineup.

As for Canada, the twelve-member proposal reinforces its worst fears: the greater consolidation of the U.S. economy as the regional hub, and a regulatory framework that would accommodate U.S. preferences and interests but not necessarily those of Canada. In his chapter, Gordon Mace explains that the Canadian government originally agreed to the FTAA concept as part of its own efforts to counterbalance an increasingly asymmetrical Canada-U.S. relationship. From the start, Ottawa saw that the pursuit of a series of bilateral accords with its LAC neighbors would be insufficient given Canada's wish to craft regional rules that could help rein in U.S. trade practices and contingent protectionism.

But Canada's overriding concern at the FTAA negotiations was to establish a sound regulatory framework to govern the new trade agenda in the hemisphere (services, competition policies, investment). This is because Canadian exports to LAC have remained constant since 1994, with about 1 percent going to Mexico and 1 percent to the rest of the region, even though the value of Canadian foreign direct investment in LAC (excluding Mexico) has increased considerably. With services now accounting for 70 percent of Canadian GDP, an agreement on WTO-plus rules to govern hemispheric foreign direct investment and services was of the essence.

In light of the importance of foreign direct investment for Canada, Mace emphasizes that Mercosur—which is not factored into the Zabludovsky-Gómez proposal—is the one LAC subregion that offers any promise for expansion. For example, from 1990 to 2005 Canadian foreign direct investment increased from U.S.$125 million to U.S.$4.6 billion in Argentina, from U.S.$1.7 billion to U.S.$8.0 billion in Brazil, and from U.S.$265.0 million to U.S.$5.6 billion in Chile (an associate member of Mercosur). Between the start of the official FTAA negotiations in 1998 until the 2003 Miami FTAA Trade Ministerial, Canada participated on the grounds that the projected trade agreement would comprehensively cover the old and new trade agenda—including WTO-plus rules around foreign direct investment.

For Canada the failure of the FTAA was the shift away from striking a comprehensive accord and toward a two-tiered approach in 2003, whereby,

in tier one, participating governments would agree on a common approach to tariff reductions and, in tier two, governments could choose to address the new trade agenda within a more flexible venue, including bilateral and "plurilateral" deals. With this proposal an unacceptable option from the Canadian standpoint, and with the twelve-member FTA proposed by Zabludovsky and Gómez lacking appeal given its exclusion of Mercosur, Canadian officials are readjusting their sights on how to accomplish national goals through further integration.

As for Brazil's exclusion from the proposed continental zone, in his chapter Glauco Oliveira makes clear that Brazil has hardly given up on trade negotiations despite various impediments and setbacks. Even if a majority coalition of domestic elites has yet to see the potential for dynamic gains from conceding on the new trade agenda via closer Mercosur-NAFTA ties, Oliveira argues that the U.S.-Brazil economic bond is strong enough to bring both sides back to the negotiating table at some point. For example, manufactured products and intra-industry trade now account for 70 percent of U.S. exports to Brazil and almost 75 percent of Brazilian exports to the United States. Be it within Doha, the FTAA, or the continental zone proposed by Zabludovsky and Gómez, these higher value-added goods would be trading according to similar rules, which is a compelling case for a sizable increase in foreign direct investment in Brazil.[24]

Ultimately, Oliveira concludes, there is little structural logic to Brazil's current focus on integrating with the G20 countries, where, outside of Argentina, its economic ties are all but nil.[25] As the costs of protectionism increase for those Brazilian producers with a comparative advantage for exports to the United States, some—including powerful agricultural interests—have pushed for a more ambitious regional accord that would involve important concessions on the new trade themes. This, however, would require that the United States open up those very agricultural sectors that triggered the breakdown of the FTAA negotiations. With the George W. Bush administration moving in the opposite direction—raising trade barriers for sugar, orange juice concentrate, and cotton in the 2002 farm bill—Brazil and its Mercosur partners remain understandably wary of U.S. intentions at any of the various trade negotiating tables discussed here.

With the recent entry of the anti-U.S. Venezuela into the Mercosur bloc, the viability of the FTAA as a regional option seems remote, at least until after the 2008 U.S. presidential election.[26] The venue may not be clear, Oliveira argues, but the best strategy would be to deal with the new trade

issues while continuing to push for much more favorable terms on agriculture and market access.

Developing Countries and the New Trade Agenda

Although the new trade agenda is generally seen as a main obstacle to the conclusion of the latest round of hemispheric and multilateral negotiations, the chapters in this volume broaden this explanation and address the role of cumulative tensions between North and South. Over the long run there is a pattern of OECD dominance in the previous eight multilateral trade rounds and the perpetual postponement of issues, like agriculture, that are of primary concern to the large contingent of developing countries now belonging to the WTO. As Schott notes in his chapter, agriculture holds the key to a successful Doha Round—not because of its importance in international trade (which is less than 10 percent) but because it is the sector with the highest trade barriers and largest potential welfare gains for developing countries. For example, farm products still account for 30–60 percent of GDP in the developing world, while farm subsidies within the OECD continue to approach 50 percent of all farm production.[27]

At the same time, 90 percent of world trade is in industrial goods and services, for which developing countries face average manufacturing tariffs in developed country markets that are three times higher than those faced by other developed country exporters to these same developed country markets. Schott therefore cautions that a farm deal, however difficult, will not be sufficient to secure the Doha Round. The final accords must also include substantial results in the other key areas under negotiation: nonagricultural market access (NAMA), services, trading rules (for example, subsidies, countervailing and antidumping measures, trade facilitation), and special and differential treatment (SDT) for developing countries. These demands for SDT lie in the fact that up to ninety developing countries in the WTO have still not met the costs of their Uruguay Round obligations in areas such as customs valuation and the protection of intellectual property rights.

In fact, at both the WTO and the FTAA negotiating tables SDT has become a developing country demand for authentically tackling North-South asymmetries.[28] In the Western Hemisphere, such demands are further driven by the mixed results of the market reform programs launched since the early 1990s. The heightened participation in commercial negotiations by LAC countries at all levels reflects the crucial role that trade liberalization has

played in this overall reform scenario. Yet despite the diversity in timing, content, and implementation of these market reforms, aggregate outcomes in productivity and competitiveness conform most readily to Mexico's mediocre performance.[29] In the case of Doha, the hard economic realities of fully complying with demands for further liberalization seemed to have catalyzed a developing country consensus that no agreement would be better than one that extracts further commitments with no solid promises for the financial and technical assistance that would be necessary to fully comply.[30]

In chapter 8 Theodore Cohn highlights the complex ways in which the Doha Development Round represents new terrain for countries in both North and South. Until the early 1960s, he argues, GATT functioned as a Northern club that sought to preserve its influence over the global trading system. To this day, key issues on trade governance are discussed in the WTO's elite "green room" sessions, with participation limited to the director general and about twenty-five prominent trading states. Part of the disaster surrounding the 1999 Seattle WTO Ministerial Conference stemmed from developing country protests over their exclusion from green room sessions held beforehand, and some developing countries continue to decry their inadequate representation in draft declarations issued by the chair of the WTO General Council to facilitate negotiations in the 2001 Doha and 2003 Cancún ministerial meetings. Cohn's analysis clarifies that the new trade agenda refers not just to the substantive issues at hand but also to the need for a process that is more inclusive, accountable, and transparent.

Cohn also argues that substance and process are linked and that the North must accept that it cannot dominate Doha Round negotiations to the degree that it has controlled earlier rounds. Already the formation of the G20 developing country bloc within the Doha Round has effectively pressured the developed countries, and particularly the EU, to agree to the removal of agricultural export subsidies. To reach an agreement on these and other sensitive issues, the North will have to offer more concessions than in previous rounds. Apart from North-South cleavages over these issues, Cohn details the ways in which G20 demands have also caused rifts among OECD countries in the Doha Round. Persistent tensions between the United States and the EU over a limited-versus-comprehensive Doha agenda, respectively, have caused an attendant lack of leadership in global trade governance as well as an inability to effectively respond to the South's demands.

This is especially relevant in the realm of SDT, where Cohn cites the changes being sought by the developing countries: more flexibility in the

offering of exemptions from certain trade rules, stricter guarantees on access to industrialized markets, technical assistance to enable the South to implement WTO agreements, and procedures to monitor and enforce SDT commitments. However, a main obstacle to reaching agreement along these lines is the collective failure to define what constitutes a development agenda for the WTO. A growing body of academic evidence and trade policy analysis confirms the importance of trade for development, but there is still little consensus about the specific linkages that would constitute a prodevelopment stance at the WTO. Beyond the legal issue of discerning which government measures are WTO compliant, some of the items on the developing countries' SDT wish list resonate too closely with long-standing battles over the role of industrial policy in promoting development.

In principle, the OECD bloc at the WTO stands together in advocating open, nondiscriminating economic policies and positive technological spillovers from liberal trade and foreign direct investment as the most expedient ways to spur productivity and an efficient allocation of resources. In practice, obviously, there is wide disparity among OECD countries in their willingness to maneuver around the WTO's neoclassical economic paradigm—hefty U.S. agricultural subsidies and high EU farm tariffs being prime examples. In the case of the United States, these contradictions seem to define the inability of the George W. Bush administration to be proactive at the Doha Round. As Mac Destler argues in chapter 9, the United States has shown little enthusiasm for SDT, and despite the flurry of FTAs that it has negotiated with small developing countries, most SDTs offer minimal concessions on market access.

For Destler the collapse of the FTAA talks can be traced to U.S. intransigence on subsidy cuts for sugar and oranges; the persistence of U.S. cotton subsidies is also partly to blame for the stalemate at the Doha Round. To break this pattern, Destler says, U.S. trade negotiators will need to win new access to both goods and services markets in emerging economic powerhouses like Brazil and India. In other words, both sides will have to give much more than they have offered thus far. Destler details an erratic pattern of trade policymaking under the George W. Bush administration, which has intermittently tackled the challenges at hand, exacerbated them with protectionist concessions to domestic interests to secure legislation like the president's Trade Promotion Authority (TPA), and then dropped all efforts to promote U.S. trade strategy. In mid-2004, for example, U.S. leadership helped produce a supposedly groundbreaking WTO document that produced substantive and procedural accords on agriculture (cotton in particular),

nonagricultural market access, services, trade facilitation, and a range of development-related issues. In the months after Bush's November 2004 election victory, however, U.S. commitment to this trade agenda simply ceased.

Destler notes the considerable political groundwork that remains to be done in order to make U.S. market-opening concessions possible. At home, the Office of the U.S. Trade Representative will have to build a domestic constituency of stakeholders, much like the winning coalition that secured congressional approval of NAFTA and TPA; further, the executive office will have to bridge the rancorous ideological rifts over trade policy that have come to divide members in both houses of Congress along rigid party lines. Abroad, the completion of the Doha Round will require a revival of U.S. leadership and U.S. collaboration with nations committed to this same task. With the July 1, 2007, expiration of TPA looming, and the renewal of U.S. agriculture legislation coming due at the same time, Destler emphasizes that time is of the essence for reviving U.S. trade policy. Unfortunately, and as noted earlier, the trade wariness of the newly elected Democratic Congress runs counter to this imperative.

On the side of the wealthier emerging market countries, the chapters by Oliveira and by Antonio Ortiz Mena L. N. (chapters 7 and 10, respectively) speak not only to similar collective action bottlenecks on the domestic front in Brazil and Mexico but also to the inclination of both countries to place greater faith in the multilateral arena. As Oliveira explains, capital- and knowledge-based factors are scarce in Brazil, prompting the owners of these scarce factors to call for a gradual liberalization of those sectors that compose the new trade agenda. But Oliveira also cites studies that convincingly show considerable long-run competitive gains for Brazil, assuming the liberalization of services in selected sectors (health insurance, credit export insurance, land transportation, engineering, accounting, and legal services). The initial adjustment costs would obviously be steep, given the complex domestic regulatory framework that now governs Brazil's services sector, and this is where the calls for SDT and a two-tiered FTAA are loudest. This is also the very juncture at which the old and new trade agendas collide.

If Brazil has played a leadership role in challenging U.S. hegemony and in calling for G20 solidarity at the WTO, Mexico, as a result of its concessions on the new trade issues within NAFTA, has frequently been at odds with other developing countries at the WTO. However, Ortiz Mena also points to the pivotal role that Mexico has played in advancing developing country interests in the new trade agenda. Mexican leadership includes its chairing of the working group on trade-related intellectual property (TRIPs) at the

WTO's Fourth Ministerial Conference; its brokering a deal to allow the export of generic copies of patented drugs to the poorest countries; its endorsing efforts to reach multilateral agreement on investment rules; its resisting the linkage of environmental and labor considerations; and its opposing developed country proposals that the wealthier developing countries be excluded from technical assistance and trade capacity building.

Ortiz Mena notes that domestic pressures have increasingly pushed Mexico into the G20 camp. He cites a 2004 opinion poll that shows that just 34 percent of Mexicans view globalization as a positive force, 66 percent disagree that rich countries trade fairly with poor countries, and less than half believe that Mexico should comply with unfavorable WTO rulings on trade disputes. This public sentiment accounts for the September 2004 implementation of a law on international economic agreements that grants unprecedented oversight powers to the Mexican Senate. Because Mexico's some forty FTAs are basically faits accomplis, this law applies mainly to its future multilateral trade commitments. This said, an equally difficult dilemma for Mexico lies in the regional realm, where tough NAFTA-related issues like energy and migration have been relegated to partial and ineffectual bilateral solutions, almost in spite of the preexisting regional framework.

Energy and Migration: The Need to Endogenize NAFTA's Externalities

The final chapters analyze pressing regional concerns that center on energy security and undocumented migration, issues that have nagged all three NAFTA members to varying degrees and that will continue to do so regardless of the revival of the Doha Development Round. While understandably omitted from the original NAFTA talks and side agreement negotiations due to their domestic political sensitivities, these issues are far from extraneous; rather, they are part and parcel of the North American integration process. Yet the reluctance of political leaders and elite decisionmakers to draw on the NAFTA framework in addressing challenges that arose with regard to these key areas suggests the further marginalization of NAFTA as a regional project.

In the case of energy security, although ostensibly a pillar of the 2005 SPP, there are few signs that this particular venue will prevail in shifting the usual pattern of parallel bilateral problem solving onto a more continental track. In chapter 11, on the prospects for forging a continental energy policy, Isidro Morales analyzes the fundamentally different domestic approaches to energy

development that now characterize North America. For example, U.S. proposals for enhanced energy security are rooted in a market-oriented model that seeks to establish incentives for conventional and nonconventional resource development but with strong regulatory oversight at the federal level. This complements the Canadian energy framework, especially with the latter's emphasis on the development of nonconventional oil resources (tar sands, bitumen, and synthetic oil) in western Canada. If anything, with the emergence of Canada as an oil power and the development of its huge nonconventional petroleum resources, Canadian policymakers and private sector actors seek to deepen market integration in oil and gas with the United States.

Mexico is again the outlier in North America, as the bulk of its energy sector remains under state control. As sensible as it might be from an efficiency standpoint for Mexico to now expand the coverage of NAFTA's disciplines to its energy sector, a large swath of domestic public opinion continues to oppose market solutions in the production of oil and natural gas.[31] Felipe Calderón, the winner of the 2006 presidential race and former director of the state oil company, Pemex, has taken former President Fox's stance in arguing that NAFTA treatment must be expanded to upstream gas and oil activities but without privatizing Pemex. This proposal, although not optimal, would allow for the further integration of energy markets under an arrangement that links Pemex more closely with private firms.

According to Morales, this proposal best suits American and Canadian interests, since energy firms in these countries are eager to participate through any means in new opportunities for private energy investment in Mexico. Further, although any opening of Mexico's energy sector would require a constitutional amendment, this process could be regulated by the principles and obligations now written into NAFTA—a credibility commitment that is lacking in the SPP. Under this scenario, Mexico's energy sector would move closer to a market-based governance approach, and sales to the United States could be increased without requiring major political or strategic concessions. The question is, in what ways could U.S. and Canadian leadership reverse a long-standing and nationalist collective action stalemate that has literally run Mexico's energy sector into the ground?

The answers are surely not easy; in the continued absence of dynamic North American leadership in constructing a truly continental approach to energy security, Morales cautions that the United States can no longer take Mexico for granted as a steady energy supplier. Moreover, with a divided Mexican congress and contrasting energy proposals put forth by the three

main political parties on whether and how to open Mexico's energy sector to private participation, Mexico's own energy security is increasingly at stake. With little domestic consensus on how to fully tap the development of Mexico's energy potential, and with the central government's gutting of Pemex coffers to compensate for chronically low domestic tax collections, Mexico's energy stability merits more regional attention than it has thus far been afforded.

In chapter 12 Charles Doran reinforces these insights from the international angle, and in so doing he emphasizes that the threat to North American energy security is not just a regional one. Doran challenges the conventional notion that the U.S. energy supply is secure because U.S. energy imports come mainly from two reliable local suppliers, Canada and Mexico; in reality, only a third of U.S. energy imports come from these neighbors. According to data from the International Energy Agency, Canada provides about 24 percent of U.S. imported oil and natural gas, and Mexico provides about 8 percent of U.S. imported energy needs. That leaves some two-thirds of U.S. energy imports coming from other parts of the world, some of which are clearly less reliable than those in North America.

Given the North American supply and demand situation and the diversity in commercial and political perspectives, Doran reviews how each North American energy partner is likely to perceive the issue of global energy vulnerability. Despite a highly interdependent North American energy market, the United States is the most vulnerable of the three countries, because it alone is a net importer of energy. In Mexico, as the population and economy continue to grow, national energy supplies will increasingly be depleted, especially if domestic legislation banning foreign investment in the energy industry remains in effect. Mexico could thus become a net importer of petroleum and natural gas unless it accelerates the development of its reserves. Canada, because of its large oil sands reserves, is likely to remain a net energy exporter for some time to come. Yet Doran warns that technical and environmental constraints surrounding the exploitation of Canada's western oil sands have limited production to about a half million barrels a day.

Underlined by the reality that North America alone accounts for 29 percent of world energy demand, the problem of energy vulnerability is large and troublesome. In the face of a severe supply disruption, not all governments in North America would be affected equally. But based on the assumption that each member of the NAFTA community seeks a stable international political environment wherein the continuous supply of energy

to the global economy is a foundational principle, Doran endorses the need for both greater market efficiency and integration within the NAFTA bloc and a more aggressive energy policy, one that promotes the development and adaptation of alternative fuel sources at competitive prices as substitutes for petroleum and natural gas.

The authors of the final two chapters on migration and citizenship in North America emphasize that a myopic approach to labor mobility and citizenship rights under NAFTA has worked against productivity and political cohesion. While the main headliner on this front is the massive flow of undocumented Mexican workers into U.S. labor markets, and the accompanying acrimonious exchange between the U.S. and Mexican governments over immigration policy, in chapter 13 Tamara Woroby points to the lost opportunities inherent in the status quo. She argues that, given that Canada and the United States are net receiving countries, the differences between Canadian and U.S. immigration policies are instructive.

In Canada the most important criterion is whether a prospective immigrant has the economic skills that Canada requires. Based on a point system, some 60 percent of documented immigrants entering Canada do so based on their skill levels, whereas only one-fifth of documented workers enter the United States on these same grounds. Approximately two-thirds of documented immigrants enter the United States on the basis of family reunification criteria, although economic motives obviously drive the decision to migrate in the first place. Especially since the 2000 recession, economic pressure to migrate has exploded against a backdrop of strong U.S. labor market demand and lackluster growth in jobs and wages in Mexico. The annual inflow of undocumented migrants to the United States may be as high as 500,000 over the past five years, and it is estimated that at least half of these come from Mexico.

Along with Woroby, Christina Gabriel and Laura Macdonald (chapter 14) argue that the failures of U.S. immigration policy have exacerbated these illicit labor flows. First, the narrow fixation on border security and strengthening barriers to entry along the U.S.-Mexico border ignores the fundamental laws of supply and demand under which undocumented northward migration has flourished. This is confirmed by the heavy reliance of U.S. industrial, agricultural, and service sectors on cheap Mexican labor to fill less-skilled employment niches. For Mexico, remittances (earnings sent home by the country's foreign laborers) are greater than the total share of foreign direct investment, tourism, and agricultural exports in the country's balance of payments. These complementary trends confirm the difficulty of separating

economic development issues from migration patterns, although this reality has not fully resonated with U.S. policymakers.

Second, although there has been no shortage of proposals for how to cope with migration pressures within NAFTA, there has been little progress in the area of reforms to clarify and strengthen mobility rights. Mexico's calls for a more rational and humane legal framework to capture the benefits of labor market mobility, while also controlling its excesses, have gone unheeded by Washington. One plausible solution is to create an intermediate immigrant category, something between unauthorized and legal resident status. This could be followed by the granting of temporary status (as in a guest worker program), which would also help to bring unauthorized workers out into the open. Conditions for proof of economic contribution, such as a required number of years in active employment before applying for change of status to legal resident, could then be set forth.

The alternatives, suggest Gabriel and Macdonald, as reflected in the barrage of border security proposals emanating from Capitol Hill, run directly against the grain of NAFTA's original justification. That logic, put forward by Mexican and U.S. political leaders in the early 1990s, holds that Mexico's entry into NAFTA provides a magnet for domestic jobs and investment and thus limits the northward flow of illicit migrants. Instead, these northward flows have continued at an unprecedented pace; employer demand for migrants who lack strong skills has broadened the economic underclass in the United States. Further, unauthorized Mexican workers have been vulnerable to discrimination and workplace violations and lack many basic social rights. In the post-9/11 era undocumented Mexican migrants who are able to penetrate the U.S. border are more likely to stay rather than to engage in the circular pattern of migration that characterizes past economic survival strategies.

In the end, although vital issues like energy security and intrabloc labor migration were considered too politically volatile for inclusion in the NAFTA negotiations of the early 1990s, each of these issues has become impossible to ignore. The ability of each of the three NAFTA members to see its way toward continental solutions is imperative to the resilience and credibility of NAFTA. With decisive U.S. leadership and commitment to a regional project, the range of available solutions could easily take on an aura of viability. Without this leadership, NAFTA could easily fade into the shadows of assertive experiments with regionalism in the Asia-Pacific. Although the prospect of more competitive regional integration across Asia will most likely bring the Doha Round back to life, North America will still be left to face various regional challenges.[32]

Notes

1. Fernando Masi and Carol Wise, "Negotiating the FTAA between the Main Players: The U.S. and MERCOSUR," in *MERCOSUR and the Creation of the Free Trade Area of the Americas,* edited by Marcel Vaillant and Fernando Lorenzo (Washington: Woodrow Wilson Center for International Scholars, 2005).

2. World Bank, *Global Economic Prospects: Trade, Regionalism, and Development* (Washington: 2005).

3. Richard Steinberg, "In the Shadow of Law or Power? Consensus-Based Bargaining and Outcomes at the GATT/WTO," *International Organization* 56, no. 2 (2002): 339–74.

4. John S. Odell, "Introduction," in *Negotiating Trade: Developing Countries in the WTO and NAFTA,* edited by John S. Odell (Cambridge University Press, 2006).

5. Pascal Lamy, "What Now, Trade Ministers?" *International Herald Tribune,* July 28, 2006, p. 6.

6. Joseph E. Stiglitz and Andrew Charlton, *Fair Trade for All: How Trade Can Promote Development* (Oxford University Press, 2005), p. 88.

7. Tom Wright, "Collapse of Global Trade Talks: Regional Deals Move to the Forefront," *International Herald Tribune,* July 26, 2006, p. 1; "In the Twilight of Doha," *Economist,* July 29, 2006.

8. Timothy J. Kehoe, "Assessing the Economic Impact of North American Free Trade," in *The NAFTA Debate: Grappling with Unconventional Trade Issues,* edited by M. Delal Baer and Sidney Weintraub (Boulder, Colo.: Lynne Rienner, 1994).

9. Manuel Pastor and Carol Wise, "The Lost *Sexenio*: Vicente Fox and the 'New' Politics of Economic Reform in Mexico," *Latin American Politics and Society* 47, no. 4 (2005): 135–60.

10. Bruce Ackerman and David Golove, "Is NAFTA Constitutional?" *Harvard Law Review* 108, no. 4 (1995): 799–929.

11. Sylvia Maxfield and Adam Shapiro, "Assessing the NAFTA Negotiations: US-Mexican Compromise on Tariff and Nontariff Issues," in *The Post-NAFTA Political Economy: Mexico and the Western Hemisphere,* edited by Carol Wise (Pennsylvania State University Press, 1998).

12. As of December 2004 the NADBank had approved U.S.$697 million, from its U.S.$3 billion callable capital base, for loans and grants for eighty-five infrastructure projects, although just 57 percent of these were planned for the Mexican side of the border. See Gary Hufbauer and Jeffrey Schott, *NAFTA Revisited* (Washington: Institute for International Economics, 2005), pp. 174–76.

13. Ibid., p. 61.

14. Marcela Celorio, "The North American 'Security and Prosperity Partnership': An Evaluation," Working Paper (Center for North American Studies, American University, March 2006), p. 10.

15. Organization for Economic Cooperation and Development, *Getting It Right: OECD Perspectives on Policy Challenges in Mexico* (Mexico City: Centro de la OCDE en México para América Latina, 2007), pp. 59–63.

16. See, for example, John Audley and others, *NAFTA's Promise and Reality* (Washington: Carnegie Endowment for International Peace, 2003).

17. On neoclassical trade theories, see Kerry A. Chase, *Trading Blocs* (University of Michigan Press, 2005).

18. See, for example, Manuel Pastor and Carol Wise, "The Origins and Sustainability of Mexico's Free Trade Policy," *International Organization* 48, no. 3 (1994): 459–89.

19. Chappell H. Lawson, *Mexico under Calderón: The Challenges Ahead* (Los Angeles: Pacific Council on International Policy, 2006).

20. For more on this debate, see Jacob Viner, *The Customs Union Issue* (New York: Carnegie Endowment for International Peace, 1950); Kerry A. Chase, "Economic Interests and Regional Trading Arrangements," *International Organization* 57, no. 1 (2003): 137–74.

21. Blanca Torres, "Rowing Upstream," in *Greening the Americas: NAFTA Lessons for Hemispheric Trade,* edited by Carolyn L. Deere and Daniel C. Esty (MIT Press, 2002), p. 203; Stephen Krasner, "México y Estados Unidos," in *Interdependencia ¿Un enfoque útil para el análisis de las relaciones México-Estados Unidos?* edited by Blanca Torres (Mexico City: El Colegio de México, 1990).

22. Sibylla Brodzinsky and Peter S. Goodman, "Latin Americans Wonder if Democrats Are Traders," *Washington Post,* November 23, 2006, p. A1.

23. Kenneth C. Shadlen, "Exchanging Development for Market Access? Deep Integration and Industrial Policy under Multilateral and Regional-Bilateral Trade Agreements," *Review of International Political Economy* 12, no. 5 (2005): 750–75.

24. Albert Fishlow, "Brazil: FTA or FTAA or WTO?" in *Free Trade Agreements: US Strategies and Priorities,* edited by Jeffrey Schott (Washington: Institute for International Economics, 2004).

25. Members of the G20 (actually G21 with Uruguay's recent joining) are Argentina, Bolivia, Brazil, Chile, China, Cuba, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Philippines, South Africa, Tanzania, Thailand, Uruguay, Venezuela, Zimbabwe.

26. "Mercosur's Summit: Downhill from Here," *Economist,* July 29, 2006, p. 52.

27. Stiglitz and Charlton, *Fair Trade for All,* p. 50.

28. Norberto Iannelli, "Achievements, Prospects, and Challenges of Hemispheric Cooperation," INTAL-ITD Occasional Paper 38 (Washington: Inter-American Development Bank, June 2006), pp. 7–8.

29. Barbara Stallings and Wilson Peres, *Growth, Employment, and Equity: The Impact of the Economic Reforms in Latin America and the Caribbean* (Brookings, 2000), pp. 1–71.

30. Stiglitz and Charlton, *Fair Trade for All,* p. 60.

31. Antonio Ortiz Mena L. N., "Getting to No: Defending against Demands in NAFTA Energy Negotiations," in *Negotiating Trade: Developing Countries in the WTO and NAFTA,* edited by John S. Odell (Cambridge University Press, 2006).

32. See, for example, Fred Bergsten, "Plan B for World Trade: Go Regional," *Financial Times,* August 16, 2006.