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ECONOMIC VIEWPOINT

By Jeffrey E. Garten

At 10, NAFTA Is Ready For An Overhaul

A broader pact could address new issues of security and migration

Few people will be uncorking champagne bottles on the 10th anniversary of the North American Free Trade Agreement, which arrives on Jan. 1, 2004. After all, NAFTA was the most politically contentious trade pact signed in Washington in over half a century, and from its conception the treaty's detractors outshouted its backers. But as this birthday approaches, I would like to suggest a more dispassionate perspective on this landmark deal.

The facts are laid out in a superb forthcoming book, *NAFTA: A Ten-Year Appraisal*, by Jeffrey J. Schott and Gary Clyde Hufbauer of the Institute for International Economics in Washington. Since NAFTA was implemented, in 1994, the trade in merchandise between the U.S. and Canada has grown twice as fast as it did before passage of the legislation. U.S. trade with Mexico has expanded three times as fast. The growth in U.S. trade in services with both Canada and Mexico has been more moderate, amounting to about two-thirds the percentage increase between the U.S. and the rest of the world. U.S. direct foreign investment in Mexico has grown at more than double its rate of increase with non-NAFTA nations, and 80% as fast in the case of Canada. When it came to job generation vs. destruction in the U.S., NAFTA's impact has been pretty much a wash.

But statistics aside, NAFTA was the most extensive trade agreement between advanced industrial nations and a developing one. NAFTA brought into focus some deep-seated U.S. anxieties about loss of jobs -- of the kind we now see moving to China and India. NAFTA also pioneered the inclusion in trade agreements of labor and environmental standards, setting precedents for most subsequent multilateral or bilateral agreements involving the U.S.

The treaty helped in ways unforeseen. It enabled Mexico to lock in market-opening reforms, making it easier for the U.S. Treasury Dept. to aid its southern neighbor in recovering from its financial crisis of 1994. As former Mexican president Ernesto Zedillo said: "Had it not been for NAFTA, President Clinton never would have taken my call for help."

But NAFTA didn't get Mexico to reform its fiscal and judicial policies in order to build a more productive and egalitarian society, or to improve its energy and transportation infrastructure to take better advantage of the U.S. market. While Asia's lower wage levels give it major advantages, policy shortcomings make Mexico even less competitive and have caused more and more companies to shift production to China. Zedillo, now head of Yale University's Center for the Study of Globalization, believes the treaty shouldn't be

held responsible for these failures.

The fierce controversy over NAFTA created a protectionist backlash in the U.S. -- a coalition of economic nationalists on the right and global liberals on the left. This linkage shattered a 40-year bipartisan consensus for open trade. You can see the results in proliferating barriers to imports from China, multibillion-dollar trade disputes with Europe, the complete turn of the Democratic party towards protectionism, and a growing U.S. ambivalence for trade liberalization.

Today, both NAFTA and broader U.S. trade policy are at a low point. But here is a prediction: NAFTA may have a brighter future than more global agreements. The reason is that by deepening North American integration, Washington, Ottawa, and Mexico City could link economic needs with compelling national security considerations in ways that other trade agreements will not.

At this moment, for example, we need a new North American pact that makes the movement of trade and people across borders more consistent with homeland security needs. For both social and economic reasons there is an immediate requirement to negotiate a deal to improve handling of the millions of Mexican citizens who are in the U.S. illegally. A North American agreement on investment and trade in energy would bring a greater diversification of imports away from the Persian Gulf. More cooperation on drug interdiction and environmental protection is crucial, too.

None of this will be easy politically. Mexico would need to pass major fiscal and regulatory reforms to become more competitive vis-à-vis China. After the Presidential election, politics in the U.S. would have to become more rational. Assuming that happens, the NAFTA train could -- and should -- start rolling again.

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