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The North American Free Trade Agreement: Hemispheric and Geopolitical Implications

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When Mexican President Carlos Salinas de Gortari proposed to U.S. President George Bush in the Spring of 1990 a free trade agreement between their two countries, he shattered a national tradition. Since its revolution in the first decade of the 20th century, Mexico has sought to maximize its autonomy by minimizing its relationship with the United States. Salinas's proposal represented a profound break with Mexico's past policies of economic defensiveness.

A regional trade agreement also represented a departure for the United States from its traditional global trade policy. That change first really occurred when the United States responded positively to a proposal by Canada for a free-trade agreement. Salinas proposed to get Mexico into a new North American market. On December 17, 1992, the leaders of the three countries signed the North American Free Trade Agreement (NAFTA).

A steady process of integration between the three North American countries had led Canada, and then Mexico, to recognize, albeit reluctantly, that their welfare depended on more, not less economic interaction with their stronger neighbor, and fair and predictable rules of trade and investment. Thus, NAFTA was not a decision to integrate, but rather a decision to manage and enhance integration in a systematic fashion. As such, the agreement should be viewed not as the end of a negotiation, but rather as the beginning of a long journey by the countries of North America to harmonize their policies. [1]

NAFTA was reshaped by the 1992 Presidential campaign, with important long-term implications for the substance of trade policy. President George Bush viewed NAFTA as an issue because he understood that it placed his competitor in an awkward position. If Clinton supported NAFTA, he would alienate the labor unions and the environmentalists, who supported him. If he rejected NAFTA, Clinton could be called a "protectionist," a flaw in a presidential candidate almost as serious as being called "weak on defense." Clinton postponed a decision, but finally on October 4th, in a comprehensive speech, he announced support for ratification in the context of a changed policy. He proposed negotiating three supplementary agreements with Mexico and Canada on labor and environmental issues and on unforseen trade problems. In addition, he insisted that five sets of policies should be included in the implementing legislation to ensure that the benefits of trade would be shared. The premise of the Clinton alternative was that NAFTA was good for all three countries, but it was not good for all groups in the countries, and that special policies were needed to help those who would pay the price of freer trade. The election of Bill Clinton in November 1992 thus had the effect of changing the direction of U.S. trade policy.

While NAFTA will affect its three members the most, its impact will extend far wider than just North America. Mexico's proposal sent shock waves throughout Latin America so strong that ripples were felt in Chile as well as in Asia and Europe. Latin Americans had grown accustomed to Mexico vetoing U.S. initiatives and asserting its separateness and independence. When Mexico's President opened the door of the U.S. market, he discarded the veto, and other Latin American governments hastily tried to get through the door and secure a seat in the U.S. market as well. President Bush responded with his Enterprise of the Americas Initiative on June 27, 1990, promising to expand NAFTA if the other governments in the hemisphere opened their economies and liberalized their trade and investment as Mexico had done. The Clinton amendments will mean that environmental and social issues will be incorporated into the agenda of trade negotiations too.

The decision by the world's largest trading nation to pursue a regional agreement affected the entire world, but Europe was mainly preoccupied with the aftermath of the Cold War and the deepening and widening of the European Community. Japan was more dependent on the U.S. market than Europe was and than the U.S. was on Japan's, and it was acutely sensitive to the potential ramifications of NAFTA. Japanese manufacturers feared that North America could become an exclusive bloc impeding Japan's trade. Some countries feared that NAFTA would lead, either directly or indirectly, to a collapse of the Uruguay Round of the GATT negotiations. The questions asked most frequently by economists and policy-makers were whether NAFTA would be a stumbling block to global trade negotiations or a building block, whether it would lead to a break-up of the global trading system or stimulate GATT to surmount the many obstacles that were in its path.

This paper will explore the hemispheric and global causes and consequences of NAFTA. My thesis is that NAFTA represents a crucial development for North America, the Western Hemisphere, and the world. NAFTA does not represent an exclusive trading **bloc** but rather the deepening of the last major trading **area** in the world - North America and eventually the Western Hemisphere. It is needed by the United States and the hemisphere because it comes at a moment when the GATT is languishing, unable to resolve the many tenacious issues on its agenda. Europe is turning inward, and Japan is increasingly oriented toward Asia. NAFTA will generate needed growth in Mexico, improve the efficiency of North American corporations, and lay the foundation for a new economic edifice that will benefit the three countries.

Its extension to the rest of the countries of the Americas could modernize political and economic relations within the hemisphere; and it has the potential of making the Americas the center of the global economy and the model for North-South relations in the 21st century. Finally, at the global level, NAFTA could be a catalyst for expanding trade and improving the rules and institutions of the world trading system.

This is not to suggest that there won't be significant costs to NAFTA; there will be, as there always is with revolutionary changes. Rapid growth entails dislocations and changes in the distribution of wealth. The issue for the three governments is whether they anticipate and respond effectively to those changes and ensure that the benefits of trade are shared with those who will suffer from NAFTA's progress. I am also not suggesting that there are no risks of trade-diversion or back-sliding on global trade; there are. The issue, here, is whether the United States, Canada, and Mexico are prepared to build the kinds of institutions that will reduce the risks, minimize the costs, and improve the prospects for sustainable growth and trade. That question remains to be answered.

To understand the significance of NAFTA, however, one needs to place it in an historical and a global context. In Part I, we will begin with a discussion of the theory of geopolitics and panregions and the relationship between geopolitical power and trade. Then, we will describe the evolution of the post-World War II international economy and examine whether (a) multilateralism is exhausted, and (b) regionalism is a threat or a stimulus to global trade. With this as a background, in Part II, I will describe the NAFTA agreement and the North American trading area. The hemispheric implications and choices that NAFTA poses will be examined in Part III, and finally, in the last part, I will offer recommendations on how NAFTA can: (1) be sustained, deepened, and extended in North America; (2) stimulate freer trade and forge a democratic community in the Americas; and (3) solidify a more open and effective global trading system.

1. Geopolitics and Panregions: Theory and Reality

In the 19th century, German scholars developed the concept of "Geopolitik," a world divided by geography and politics into "panregions." The unification of Germany in 1871 and the new confidence that accompanied it gave rise to this idea. The premise of this world-view was that powerful states needed "Lebensraum" (living space).[2] The new German state sought room to expand and ideas to justify its expansion. The debate on the proper physical and ideological path to expansion continued through the 1930s.

One model was that of the United States that had a large, unpopulated territory and informal control in the Western Hemisphere and parts of the Pacific. Building on this idea in the 1930s, G. Haushofer, a German scholar, suggested that Japan and Germany should try to emulate this model, and he drew up maps that reflected three panregions: Europe and Africa with Germany at its center; East Asia with Japan as the dominant power; and the Western Hemisphere with the United States at its core. A fourth panregion composed of Russia extending west to Poland, east to the Pacific, and south to Afghanistan was noted in several studies of the period, but few German "Geopolitikers" considered the Russian panregion as powerful as the other three.

The twentieth century can be viewed as a multi-sided clash between the new powers of Germany, Japan, and the United States and the old empires of England, France, Austria-Hungary, Ottoman, and China. The major wars in this century - from the Russo-Japanese War through the two world wars and the many engagements of the Cold

War - were a struggle to rearrange the world's geography by one or more of the three core nations. The explanatory power of the geopolitical theory is not only evident in the devastating wars but in the fact that the three nations that arrived to challenge the world powers at the dawn of the 20th century stand unrivalled at the century's dusk. [3]

The relationship between geopolitical power and world trade has never been disputed although its precise nature has been subject to varying interpretations. It is obvious that world trade has never been organized at random; in other words, nations do not trade equally with others. Geography has been an important factor explaining trade patterns, but until the post-World War II era of the General Agreements on Tariffs and Trade (GATT), it has been less important than politics. Trade followed the flag. Empires were created and maintained to supply the resources and provide the markets for the imperial nation. In the cases of England and France, the empires were widely dispersed geographically with colonies on many continents. The logic of politics prevailed over that of geography as can be seen in the dominant role of France in trade in Indo-China and England in Australia.

In contrast, the United States historically relied less on trade than other industrialized countries [See Table 1], and it did not seek to carve Latin America into an exclusive trading zone. Until the first world war, U.S. trade with Latin America was often exceeded by Europe's trade in the region. But the war separated Europe from the western hemisphere, and afterwards, its devastating

Table 1

Share of Exports in GDP, 1900-1990 (%)

	(%) 1900	1915	1930	1945	1960	1975	1990
U.S.	5.62	5.76	6.04	3.47	5.80	6.84	7.23
Canada	13.41	16.36	22.51	30.41	17.62	22.90	26.47
Mexico	17.51	22.92	12.40	14.09	10.34	5.77	17.63
Latin America	20.00	18.00	19.00	9.50	7.00	5.20	7.50
OECD	12.00	13.50	11.00	8.00	12.00	16.50	18.50
Europe							
U.K.	24.17	22.11	18.87	8.14	20.00	25.26	26.15
France	na	na	10.76	16.06	14.50	19.06	20.80
Germany	na	na	na	11.32	18.99	24.80	25.41
Japan	na	na	19.43	1.02	10.71	12.80	11.18
World	9.00	12.00	7.00	6.50	9.00	13.00	14.50

Notes: Data for the composite groups are estimated from The World Bank, "World Development Report," 1992.

Sources: World Bank, "World Development Report," 1992 ; and "World Tables," 1991, 1984; and Liesner, The Economist, "One Hundred Years of Economic Statisitics," 1989; and OECD, "Main Economic Indicators, 1960-1979," 1980; and Ramirez, "Mexico's Economic Crisis," Praeger Publishers, 1981.

effect on Europe's economies compelled Britain, France, and Germany to retrieve overseas capital to pay debts and rebuild. At the same time, both the war and its aftermath caused the United States to concentrate its trade in the western hemisphere. Due to these two shifts - Europe inward and the U.S. southward - the United States emerged from the first world war with an exaggerated degree of economic dominance in the Americas. The U.S. share of the Latin American market grew from 18 percent in 1912 to 42 percent in 1920.

In addition, the U.S. went from being a debtor before the first world war to the world's largest creditor afterwards. Prior to the war, U.S. foreign investment in Latin America ranked considerably below Great Britain's. But by 1930, the United States had $5 billion of investments in Latin America (one-third of its total overseas investments), and that exceeded Europe's. [4]

The U.S. self-image, however, had not adjusted to world leadership. Indeed, the passage of the Smoot-Hawley Tariff of 1930 was yet another example of the insularity of America. It raised U.S. tariffs on more than 20,000 products to an average of more than 50%, and President Herbert Hoover defended tariffs as "solely a domestic question in protection of our own people." [5] The law exacerbated the U.S. depression and further weakened world trade. Cordell Hull, the Secretary of State in Franklin Roosevelt's Administration, was a devoted free-trader, and he marshalled support in Congress for the Reciprocal Trade Agreements Act of 1934, which delegated to the President authority to reduce tariffs by reciprocal trade agreements with other governments. The new trade policy became a key element of Roosevelt's Good Neighbor Policy. Sixteen of twenty-two trade agreements negotiated by the Roosevelt Administration were with Latin American governments.

The second world war had a similar effect on the magnitude and patterns of trade and investment within the hemisphere as the first had. The United States and Latin America were drawn closer together as European markets closed, and after the war, Europe was immersed in reconstruction. In 1945, 58 percent of Latin America's imports came from the United States, and 49 percent of its exports went to the United States. Latin America had also become more important to Washington. In 1945, 42 percent of U.S. imports came from Latin America, and 14 percent of its exports went there. [6]

During World War II, U.S. policy-makers began to contemplate trying to get Europe to accept a free-trade agreements globally. This would require breaking up the trade blocs that had existed before the war by our allies as well as by our enemies. The price that the United States extracted from Great Britain in exchange for lend-lease in World War II was an end to imperial preferences and acceptance of a non-discriminatory, reciprocal trading system of most-favored nation status. [7]

The principle of non-discrimination became the centerpiece of the General Agreements on Tariff and Trade, signed by twenty-three countries in Geneva on October 30, 1947, under the leadership of the United States. Since 1947, world trade has expanded more rapidly than world production for virtually every year, thus enhancing global interdependence.

Together with decolonization, the GATT rearranged global trading patterns around panregions, reflecting the importance of geography. [8] Between 1960 and 1980, Japan became the leading trading partner in most of non-Communist Asia; the Federal Republic of Germany became the trading center of Europe; and the United States was dominant in the western hemisphere. Two scholars of geography summarized the overall effect of these changes: "While the technical impediments to trade over long distances have largely been overcome, intense (macro-) regional trade relations, mainly shaped by a limited number of dominating centres, are becoming an increasingly salient feature of the global trade map." [9]

1.1 **The Evolution of the Global Trade System.** In theory, GATT was multilateral and nondiscriminatory; in practice, the United States made mostly unilateral concessions in Geneva and in subsequent trade negotiations in order to allow Europe and Japan time to recover economically. That was the price of leadership, and some have argued that without paying such a price, the world economy would not have recovered and the global economic institutions - the International Monetary Fund, the World Bank, and the GATT - would not have been established. [10] But by 1962, Europe had recovered, and the dollar was under pressure. The United States demanded reciprocity.

President John F. Kennedy obtained authority from Congress to pursue a new round of trade negotiations to achieve that purpose. The "Kennedy Round" concluded on June 30, 1967 with 46 nations agreeing to reduce the average tariff for industrialized countries to a point - about 9% - where it ceased being an impediment to trade. From 1946 to 1967, U.S. exports tripled from about $10 billion to about $31 billion, and world trade expanded from about $55 billion to about $235 bilion.

Tariffs continued to decline to less than 5% by 1990. By then, the agenda of trade negotiations had changed. The principal issue became non-tariff barriers, which Robert Baldwin defines as "any measure (public or private) that causes internationally traded goods and services, or resources devoted to the production of these goods and services, to be allocated in such a way as to reduce potential real world income." [11] What this entails is virtually every domestic or regulatory policy - anything that would confer an advantage on an import or a disadvantage to an export. Safety, health, labor, or environmental standards; services; intellectual property rights; agricultural subsidies; investment restrictions; tax incentives or liabilities; discriminatory procurement procedures -- all these and others become subject to negotiations. Not surprisingly, these issues have proven to be far more dificult to negotiate - particularly in forums with more than 100 countries.

The Uruguay Round of trade negotiations began in 1986 to deal with the new agenda of services, agriculture, textiles, intellectual property rights, trade-related investment measures, and dispute-settlement mechanisms - all issues that had been too difficult to address let alone resolve in the past. Although the Uruguay Round was supposed to end by December 1990, it was still far from finished by January 1993. Part of the problem was the complex agenda. Many of the non-tariff issues were hard to grasp technically and quite sensitive politically.

Another reason for the stagnation of the GATT was the relative decline of U.S. economic power. Germany overtook the United States as the world's premier exporter in 1990, and while the United States regained the lead in 1991, the point is that no nation - not the U.S., Germany, or Japan - had sufficient power to lead the GATT to closure.

The slide in U.S. leadership was evident in its change from creditor to debtor status. During the 1980s, trade deficits increased to over $100 billion, putting severe strains on U.S. manufacturers, and evoking new calls for protection. The dollar sunk in value relative to both the Deutchmark and the Yen, but the U.S. trade deficit remained chasmic. Fiscal deficits were two-to-four times larger than the U.S. trade deficit, and constrained Washington's interest in acting as the global leader.

1.2 **Universalism vs. Regionalism.** The relative weakening of the U.S. economy coincided with other changes in the hemisphere and led to the first policy dent in the global armor of U.S. foreign economic policy. In 1982, partly because of scarce resources for aid and mostly because of the security concerns about leftist influence in the Caribbean Basin, President Ronald Reagan turned to trade policy as an instrument for combatting leftist subversion. He proposed granting one-way free trade on a wide range of products from countries in the region. The countries were so small, and the motive was so patently strategic that no major nation protested, but the significance of the act was not lost on those who viewed a global trading system as sacrosanct. The next exception occurred in the free-trade treaty with Israel in 1985, but for the same reasons, no concerns were raised.

In 1986, the European Community (EC) decided to take a leap toward a single Common Market with no internal barriers to trade, investment, travel, and immigration within six years. The United States had been one of the principal sources of encouragement to the Europeans to unite. The real genuis of the Marshall Plan was not the $17 billion in aid, but the condition that Europe could only obtain the aid if it developed a common plan that promoted regional cooperation. Through a series of steps, France and Germany and subsequently five other European nations forged new institutions and bonds, culminating with the signing of the Treaty of Rome in 1957, establishing the European Economic Community.

The United States accepted a provision in GATT - Article XXIV - that allowed for exceptions in cases of customs unions or free trade areas, provided that the preferential trade reductions for the group would eventually eliminate all barriers to trade within the subset of countries. Two difficult questions were posed by the EC. First, it was by no means certain that **all** barriers to trade would ever be eliminated and, indeed, thirty-six years later, that question is still alive. Second, the EEC insisted on discriminatory preferences for eighteen ex-colonies in Africa; this also violated the GATT. Nonetheless, the United States promoted the EEC's application under Article XXIV because of the larger goal of promoting European cooperation and security, and it never deviated from its support of European integration, despite the fact that the region had become such a formidable competitor in world trade.

But the deepening and widening of the EC in the late 1980s coincided with serious economic troubles in the United States. The result was that the nations of North America began to look to each other to build a regional trading area. First, Canada proposed a free-trade agreement with the United States, and that came into effect in January 1989. Given the magnitude of the trade between the two countries - the highest between any two in the world - this exception was taken seriously. Within eighteen months, Mexico decided to join this broader trading community.

The end of the Cold War played a role in the movement toward regionalism. Indeed, it had a similar effect on U.S.-Latin American trade as the end of the two world wars. The degree of U.S. dominance in Latin American trade declined sharply betweem 1950 to 1980. But from 1986 to 1991, as the Cold War wound down, the United States increased its market share of OECD exports to Latin America from roughly 50 to 58 percent. [12] As in the previous cases, the change had less to do with the war (hot or cold) or U.S. policy than it did with European self-preoccupation. That was the point of departure for NAFTA. The idea of a free trade area for North America was hardly a new one; it was often proposed by American academics or politicians, but just as often rejected by Mexicans. What made NAFTA possible was that a Mexican President proposed it. Although his main motive was to enhance Mexico's development, an important factor was the way that the world was organizing itself.

Salinas went to Europe in early 1990 to encourage investment in Mexico, but he found Europe focused on deepening the European Community by 1992, considering a widening of the EC to Scandinavia and Eastern Europe, and sorting through the implications of the end of the Cold War. When he turned next to Japan to offset U.S. investment, he found the Japanese hesitant for two reasons. First, they were devoting much of their external energies in Asia - investing in China and Southeast Asia, trying to expand their markets there, and developing the Yen as an alternative currency. Secondly, Japan's most important alliance and market was the United States, which it knew had an awkward relationship with Mexico. Japan apparently decided not to get too close to Mexico for fear that it would create problems with its more important ally. It was only when Salinas realized that the European and the Asian options were closed that he turned to the United States.

When the Cold War ceased, world power shifted as much as it had after the two world wars. Russia declined to the economic level of the third world, and the United States found itself competing on new economic chessboard against Japan and a unified Germany, which was anchored in a wider and more integrated European Community.

The apparent trend toward regionalism has raised questions both as to which country is mainly responsible and whether the trend is beneficial or protectionist. In the judgment of Jagdish

Bhagwati, "the main driving force for regionalism today is the conversion of the United States ... As the key defender of multilateralism through the postwar years, its decision now to travel the regional route (in the geographical **and** the preferential senses simultaneously) tilts the balance of forces away at the margin from multilateralism to regionalism." [13] Bhagwati also finds the trend worrisome and unfortunate.

The Economist blames the EC as the principal culprit in the trend toward regionalism and protectionism, arguing that "America has resisted [the protectionist logic] better than most... In miserable contrast, the European Community has written the book on new methods of protection." [14] Lawrence Krause agrees that the EC represents "a huge exception to a non-discriminatory [international trade] regime." [15] Brunelle and Deblock agree that "if the fortress metaphor applies, it should be used to describe the EEC since over 58 percent of its total trade was done among the twelve member countries in 1987." [16] To advance towards its 1992 deadline at achieving a completely open market, the EC has had to make internal political compromises at the expense of the region's international obligations. The EC's inability to adapt its Common Agricultural Policy has had the effect of closing the European market to many of Latin America's crops and scuttling the GATT negotiations.

The consequences for world trade of the trend toward regionalism depend on whether the EC example - unity at the price of protectionism - proves the rule or the exception. In his classic study of customs unions, Jacob Viner argued that regional trading units are beneficial if they create more trade than they divert **over the long-term**. Part of the problem is in identifying how long is "long-term" and how one estimates the amount of trade created or diverted. But regionalism can also be beneficial to world trade if the new units develop formulas for dealing with the new trade agenda that could be tested and, if successful, used eventually by GATT. Some have suggested that the formulas devised by the U.S. and Canada for dealing with services and dispute-settlement could be extrapolated to GATT.

Thus, the answer to the question as to whether the regionalist trend is good or bad for world trade depends, in large part, on the evolution of these units - whether they become exclusive trading blocs or platforms for more internal and external trade.

2. North America - The Agreement and the Entity

The NAFTA agreement that was signed by Presidents Bush and Salinas and Prime Minister Mulroney on December 17, 1992 is a massive document that aims to reduce trade barriers at varying speeds in different sectors. The agreement will go into effect in January 1994, but it will be phased in over a fifteen-year period in order to give additional time for "sensitive" industries and farms to adjust to the effects of increasing competition. NAFTA was innovative in a number of areas, including promoting the harmonization of environmental pollution standards, eliminating quotas on textiles and apparel, creating free trade in services (including the very large telecommunications area and the insurance market), and guaranteeing total market access in agriculture, albeit after a fifteen-year transition period. [17]

2.1 The Agreement. NAFTA provides for the progressive elimination of all tariffs, although most will be eliminated in 1994 or within five years. Tight rules of origin will prevent Mexico from being used as an export platform. In agriculture, the three governments agreed to eliminate all the quotas and quantitative restrictions and 50 percent of the tariffs in 1994. In some cases, tariffs will be replaced by tariff-rate quotas. The agreement relaxes most restrictions on investment - except in the energy sector in Mexico and the cultural sector in Canada - and it establishes an advanced regime to protect intellectual property rights. To deal with disputes, a North American Trade Commission is established.

Because the debate in PRI-dominated Mexico and Parliamentary Canada was a foregone conclusion, the debate in the U.S. Congress became the principal forum for addressing NAFTA and particularly for the social, political, environmental, and economic agenda that remained outside the agreement. From the Spring of 1991, when the Bush Administration requested fast-track negotiating authority through the ratification of the agreement, it sometimes appeared as if the United States drove the wider agenda, but what was actually occurring was that groups from all three countries were using the Congressional forum to pursue shared agenda. Bill Clinton later incorporated that agenda into his own.

This wider social, environmental, and political agenda reflects a change in public attitudes in all three countries in North America. Ronald Inglehart of the United States, Neil Nevitte of Canada, and Miguel Basañez of Mexico conducted surveys in all three countries at the beginning and at the end of the 1980s, and they found that attitudes are not only similar; they have been converging in a way that makes further integration more feasible. [18] In all three countries, public attitudes increasingly support political liberalization, free market but **not** laissez-faire economic policy, and a higher priority for autonomy and self-expression in all spheres of life. The authors believe that the main cause of the convergence in value systems is that young people in all three countries are better educated and more influenced by global communications: "A narrow nationalism that had been dominant since the 19th century is gradually giving way to a more cosmopolitan sense of identity." [19]

Even as a North American orientation emerges, people in all three countries retain a certain parochialism. **The key to dealing with the current and future agenda is recognizing that both inward and outward impulses are in a delicate balance, and the words and actions by one country can reinforce their mirror image in another.** When a politician in the United States gives vent to the fears of people in California with massive waves of immigrants, such harangues are heard in Mexico City, and politicians there are likely to play on the insecurities of their countrymen about being treated unfairly by the United States. Some Mexicans might complain about U.S. corporations taking over their industries and insist that their government prevent a loss of Mexico's identity. Such xenophobia is hardly unique to Mexico; the reaction by Americans to Japanese take-overs is essentially cut from the same cloth. The point is that fears in one country reinforce fears in the other. Unless leaders or institutions step between the cycle of fear and describe the grounds for hope, the possibility always exists for a retreat from integration.

Theories developed using the Western European experience suggest that increased economic interaction does not lead to integration and political community **unless** there is an increase in trust - of shared experiences that reinforce positive feelings towards each other. [20] Polls in North America indicate that there is a high level of trust between the United States and Canada, a slightly lower level by these two with Mexico, but Mexicans are more likely to distrust Americans than trust them. Nonetheless, the experience of Europe shows that distrust can erode, as it did between the French and the Germans from the 1950s to the 1970s as a result of working together in the European Community.

In the case of North America, national historical experiences caused both Canada and Mexico to prefer distant relations, but the Inglehart study discovered that those feelings have undergone a fundamental change. By 1990, both Canada and Mexico were more inclined to support freer trade and closer ties to the United States than the latter. "To an astonishing extent, these traditional forms of nationalism seem to have vanished." [21] What replaced it is a cooperative realism; over 80 percent of the public in all three countries favor freer trade provided that it is fair and reciprocal; only 15 percent oppose it. [22]

2.2 The North American Entity. North America constitutes a formidable region. The population of the region has expanded quite dramatically since 1950 to a combined population in 1990 of 362 million. Immigration has been an important cause of the rise in population in the United States and Canada, and improved health care has been the primary cause in Mexico. Although the rate of population growth in Mexico declined quite precipitously in the period since it introduced family planning in 1974, the rate is still about twice that of its two northern neighbors. The result is a much younger population in Mexico, but complementary profiles with the U.S. and Canada. In 1990, over 36 percent of Mexico's population was under fifteen, as compared to less than 20 percent in its two northern neighbors. [See Table 2]

The gross product of the three countries multiplied by a factor of more than ten, from roughly $560 billion in 1960 to $6.2 trillion in 1990, in curent dollars. The region's exports grew even faster, from $60 billion in 1970 to $587 billion in 1991, while intra-regional trade as a percentage of the global exports of the three increased from 37 percent to 42 percent during the same period. The United States captures the lion share of the trade and the market, even though its dependence on its neighbors is a small fraction of their dependence on it. Both Canada and Mexico conduct between two-thirds and three-fourths of their global trade with the United States, whereas the United States conducts

Table 2

North America: Population and Profiles

Population	(Millions) 1950	1970	1990	2000
North America	192.29	277.55	362.70	400.27
U.S.	152.27	205.05	250.00	268.27
Mexico	26.28	51.18	86.20	103.00
Canada	13.74	21.32	26.50	29.00

	Under 15 (%)				*16-60 (%)*				*61-over (%)*			
% Distribution	**1950**	**1970**	**1990**	**2000**	**1950**	**1970**	**1990**	**2000**	**1950**	**1970**	**1990**	**2000**
U.S.	26.87	28.26	21.57	19.70	58.25	57.71	61.20	62.50	14.88	14.04	17.22	18.20
Mexico	45.60	46.50	36.50	25.00	49.30	50.00	60.50	66.00	5.10	3.50	3.00	9.00
Canada	33.50	30.20	21.40	19.30	58.20	61.90	68.60	63.50	8.30	7.90	10.00	17.20
North America *(average)*	35.32	34.99	26.49	21.33	55.25	56.54	63.43	64.00	9.43	8.48	10.07	14.80

Note: U.S. data for the year 2000 are projections from the U.S. Bureau of the Census; projections for Canada and Mexico are based on World Bank estimates.

Sources: U.S. Department of Commerce, Bureau of the Census, "Statistical Abstract of the U.S.," 1991; and The World Bank, "World Tables," 1984 and 1991; and "World Tables-Social Data," 1984; and "World Development Report," 1992.

a total of about one-quarter of its global trade with its two neighbors. Their combined intra-regional trade represents about 40 percent of their total, as compared to about 60 percent for the European Community. In 1990, the per capita GNP for the United States and Canada were comparable, $21,790 and $20,470, but Mexico's was roughly one-tenth that amount. [See Table 3]

3. Hemispheric Implications

Latin America's motive in wanting to join a wider trade area with the United States was similar to Mexico's: fear of being excluded. Fear has always been a more powerful motive than hope, particularly one as vague as joining a larger trading community. The trends in Latin America had worsened demonstrably during the "lost decade" of the debt crisis. In 1955, nearly 20 percent of all U.S. imports came from South America; by 1990, that had declined to about 5 percent; from the Caribbean, from 6.6 to 1.6 percent.[23] North American trade became more concentrated, and the rest of Latin America was slipping away and sinking. In 1989 and 1990, half of U.S. trade with Latin America was with Mexico. Failure to secure the U.S. market could mean marginalization.

In his Enterprise of the Americas Initiative, Bush promised free-trade agreements (FTA's) to hemispheric governments that implemented market reforms. The U.S. government gave priority to NAFTA, but it advised interested Latin American governments to prepare for future talks by accelerating sub-regional integration schemes and negotiating "framework agreements" similar to the U.S.-Mexican one of 1987.

Table 3

North America: Economic Indicators

	GNP ($Bil - Current)			GNP per Capita (US$ - Current)			Exports Customs Basis, fob ($Mil - Current)			Imports Customs Basis, cif ($Mil - Current)		
	1960	1980	1990	1960	1980	1990	1960	1980	1990	1960	1980	1990
U.S.	508.8	2,732.00	5,447.50	2,811.05	11,982.46	21,790.00	20,600	216,920	371,466	15,072	250,280	515,635
							24.96%	*22.89%*	*28.32%* *	*30.81%*	*21.34%*	*24.10%*
Mexico	11.98	188.74	214.64	323.13	2,680.34	2,490.02	1,245	15,308	26,714	1,515	19,517	28,063
							59.04%	*65.49%*	*71.10%* *	*64.78%*	*63.38%*	*66.24%*
Canada	39.28	258.17	542.46	2,193.45	10,737.88	20,470.19	6,573	63,105	125,056	7,031	62,838	115,882
							63.45%	*61.25%*	*75.82%* *	*65.12%*	*68.02%*	*64.12%*
North America	560.06	3,178.91	6,204.60	1,775.88	8,466.89	14,916.74	28,418	295,333	523,236	23,618	332,635	659,580

*Notes: * refers to the percentage (%) of trade within North America; and North American GNP per Capita is an average of the three countries.*

Sources: The World Bank, "World Tables," 1984, 1991; and "World Development Report," 1992; and OECD, "Monthly Statistics on Foreign Trade," July 1992; and International Monetary Fund, "Direction of Trade Statistics Yearbook," 1992.

Salinas pursued a similar approach to his neighbors. He offered the Central American governments a free trade agreement, sought and received associate membership in the Caribbean Community, and on July 20, 1991, he joined with the Presidents of Venezuela and Colombia to propose a three-way free trade zone to take effect in January 1992, a deadline that proved overly ambitious. By late August 1992, the three governments had failed to agree to a timetable, and questions were raised as to how it would be affected by NAFTA. In the meantime, however, Colombia and Venezuela adopted zero tariffs for their bilateral trade in January 1992 and were pressing their Andean partners to accelerate the integration of their pact. [24] Salinas signed a free-trade agreement with Chilean President Aylwin, and it was implemented in January 1992, and he agreed to begin negotiations with the governments of Central America aiming at a free trade agreement by 1996. In the meantime, the Central Americans began discussions with CARICOM on a free trade pact.

Latin America embraced Bush's proposal and Salinas' example. Subregional trading groups, including old ones like the Andean Pact, and new ones like Mercosur, experienced more serious consideration and made more progress since 1990 than they had for decades. In just 1991, trade within Mercosur expanded by more than 40 percent, and within the Andean Group by 35 percent. [25] By 1992, the United States signed sixteen trade and investment framework agreements with thirty-one countries in Latin American and the Caribbean.

The most surprising and exuberant response came from Latin America's other nationalistic guardian, Peronist Argentina. Argentine President Carlos Menem lavished praise on the new approach to tighten U.S.-Latin American economic relations: "We consider this [the Enterprise Initiative] not as a proposal of a philanthropic nature, based on a false paternalism. Nor does it grow out of strategic military considerations. On the contrary, it is an ambitious business proposition. Latin America is considered this time as a new entity, as a valid interlocutor able to talk in terms of mutual interests." [26]

An economic logic lurks beneath the movement toward hemispheric integration, and in some ways, the 1990s resemble the 1930s when the United States and Latin America turned to each other for bilateral trade agreements in the face of a world broken into trading blocs. The United States has found it hard to penetrate Japan, and Latin America has found similar problems exporting to a self-absorbed Europe. As in the 1930s, the U.S. and Latin America have detected a commonality of economic interests, but unlike then, neither has an interest in withdrawing from the world today. What the hemisphere lacks is a strategy of helping each other while prying open the GATT.

Just five years ago, the idea of a hemispheric option would have been inconceivable. Burdened by debt, brutalized by military dictators, defiant of or disgusted with U.S. policy, much of Latin America was no partner for the United States. Gradually, the old stereotypes are being replaced. A new image of modern, democratic technocrats is taking hold. Free, contested elections have been held in every country in South America, Central America, and all but Cuba in the Caribbean. There have been setbacks in Haiti, Peru, and Venezuela, and other countries like El Salvador, Guatemala, and Bolivia continue to struggle with despotic demons of their past. But democracy is wider, if not deeper, than ever before, and the new democracies are groping on the frontier of an old order of sovereign states to devise collective mechanisms to defend each other from authoritarian reversals. In this, the region is unique.

Economically, most governments have laboriously constructed new and firm macroeconomic bases. Hyperinflation has been brought under control; debt service as a percent of GNP declined from 64.3 in 1987 to 37.4 in 1991; capital is returning in large amounts, and the region's economies have begun to grow, 2.8 percent in 1991, the first positive change since 1987. From 1986 to 1991, the U.S. has doubled its exports (to $63 billion) and its foreign direct investment (to $72 billion). [27] With serious political problems and weak and vacillating macro-economic policies, Brazil has been an exception to this trend, but when its engine restarts, it will pull all of South America forward at an accelerating clip.

At the very end of the long NAFTA text - Chapter 22, Article 2205 - sits a very brief and vague "accession clause":

> "Any country or group of countries that may accede to this Agreement subject to such terms and conditions as may be agreed between such country or countries and the Commmission and following approval in accordance with the applicable procedures of each country."

This accession clause merely begs the question as to how to proceed with the expansion of NAFTA. Prior to his election as president of the United States, Bill Clinton endorsed the idea of extending the agreement in his address in North Carolina. "If we can make this agreement work with Canada and Mexico, then we can reach down into the other market-oriented economies of Central and South America to expand even further."

There are several questions that remain to be answered: How and when should NAFTA be expanded? Which countries would negotiate first? What if some of the governments agreed to the conditions and then failed to implement them, as has occurred in virtually all the subregional trade agreements? An even more interesting question is whether Mexico might have been trying to make itself into a "hub" rather than a "spoke" by reaching agreements with other Latin American governments. [28] Will Venezuela, Chile, or Central America, for example, be able to use Mexico as a springboard to export goods duty-free to the United States? Will Mexico, in effect, define the rules for the entry of these other countries?

These questions have generated answers across the political and policy spectrum, but the answers that count will have to be defined by all three governments under the auspices of the North America Trade Commission. Rather than try to speculate as to which of these various scenarios is more likely, let me assess alternative answers to each question.

3.1 When should NAFTA be expanded? Given the complexity of the agreement and the prospect that there will be many new problems - some anticipated and others not - it would be wise to allow an interim period of at least two years before serious negotiations ensure to expand it to the rest of the hemisphere. In the meantime, countries should be encouraged to implement unilaterally the conditions and obligations of NAFTA; that would expedite the negotiations once they officially begin.

One of the reasons that Mexico's privatization campaign was so successful was because of the meticulous preparation before each sale. Making NAFTA work will not be as simple as signing the treaty; it will require a lot of trial-and-error, new institutions, new procedures, and probably numerous mistakes. Unless these problems are addressed and resolved satisfactorily in the first years, the wider experiment could be endangered.

3.2 Who comes first? President Bush promised Chilean President Patricio Aylwin that the United States would negotiate with Chile as soon as NAFTA was ratified. Chile's economy is the most open, its trade with the United States is relatively small, and its technocrats are among the most able. If the United States decides to let other governments set its agenda, or if it chooses the agreements that would be easiest to negotiate, then Chile should come first, particularly because it already has a free-trade agreement with Mexico. But there are alternative approaches.

Beyond Canada and Mexico, the countries with the closest economic relationships with the United States are those of the Caribbean and Central America - the Caribbean Basin countries.

The dependency of these countries on the U.S. market is roughly comparable to that of Mexico and Canada; about 60-75 percent of their trade and investment is with the United States. When President Reagan proposed the Caribbean Basin Initiative - one-way free trade on certain products from the region - in February 1982, he advertised it as a way to promote the region's development.

The U.S. motive was strategic - to counter leftist influence in the region, but the program was implemented at a time when the economies of the region were suffering severe dislocations. One of the principal reasons was the brutal contraction of U.S. sugar import quotas. Between 1975-81, the region exported an average of 1.7 million tons of sugar per year to the United States. That was reduced to 442,200 tons by 1989, with further reductions in the next two years. Just from 1982-89, the countries in the region lost about $1.8 billion in potential revenue and 400,000 jobs as a result of sugar quotas. In comparison, CBI created about 136,000 jobs in manufacturing from 1983-89. [29]

Since many of the countries in the region were so dependent on the sugar industry, and since all of them had small, open economies, the adjustment was quite severe. CBI helped to cushion the shock, but NAFTA will virtually eliminate the CBI incentive to invest. The region faces a very difficult choice: whether to lower their own barriers to trade and investment and negotiate entry into NAFTA, or hope that the marginal difference in market access between CBI and NAFTA will be small enough so as not to divert current and future investments from the region to Mexico. [30] The

Caribbean might be lulled into avoiding this hard choice because it has the added advantage of access to the European Community (through the Lome agreement).

The Central American Common Market (CACM) was established in 1960. The thirteen-nation Caribbean Community (CARICOM) was founded in 1973. Both are struggling to find an answer to the question of whether or not to join NAFTA. Both trading areas had been among the most successful in the developing world in the 1960s and 1970s, [31] but the CACM fell victim to the civil wars in Central America, and CARICOM repeatedly failed to implement its goals, most notably, a Common External Tariff (CET).

The issue for the United States - and Mexico and Canada - is whether to find a transitional mechanism or delayed procedure that would permit the Caribbean Basin countries to dock on to NAFTA. From a strategic and political perspective, it would be desirable for the Caribbean Basin countries **as a group** to be the first to incorporate into an expanded NAFTA, but the North American countries would not want to allow such a broad exception to NAFTA for fear that it would function as a disencentive for Mexico to implement the agreement or for the rest of Latin America to try to fulfill its obligations.

Jamaica's Ambassador Richard Bernal offered a thoughtful proposal in suggesting that the Caribbean Basin countries be granted parity with Mexico as a way to preserve their CBI benefits and that they would then phase-in their reciprocal obligations over a long transition period. [32] Because of its small population, the region is not really competitive to Mexico, but the first decision on whether the proposal makes sense should be made by Mexic.

Beyond the Caribbean Basin, NAFTA should negotiate with whichever subregional group - either the Andean Pact or Mercosur - that is ready to take advantage of the agreement and has progressed sufficiently in terms of economic reforms so as to ensure a smooth negotiation. In general, however, the United States, Mexico, and Canada ought to encourage nations to join a western hemisphere economic area as part of a group rather than as individual governments.

3.3. How to deal with violations of the agreement? GATT's failure to answer this question effectively threatens the very institution's existence. The standard procedure for handling violations in the GATT is for individual governments to petition the GATT to investigate an alleged violation, and if one is established, to allow governments to seek compensation or to respond proportionately in another area. NAFTA has a similar dispute-settlement mechanism, but there are reasons to question whether it will work any better. The United States has more economic leverage to gain compensation for an alleged trade violation from Mexico and Canada than these two countries have on the United States, but such leverage does not always produce changes in policy. A much tighter mechanism with clearer rules of procedure is necessary, and the non-parties to the agreement have to support the aggrieved plaintive to make the system work.

3.4 Will Mexico be a hub or spoke? Almost no one would have posed this question at the beginning of the NAFTA negotiations. The only question, then, was whether the United States would be the hub or accept a different kind of relationship with the other members. NAFTA is a genuinely trilateral agreement despite the asymmetry in the trade patterns. What was not anticipated was the extent to which Mexico has pre-empted NAFTA by reaching out to its Latin American and Caribbean neighbors. One of Salinas's reasons has been political; he is eager to Mexican critics that he aligned himself solely with the United States and abandoned his Latin American neighbors. Another reason for have noticed Mexico's new trade initiatives in the hemisphere is simply because Mexico's trade in the area is so small, but the multiplicity of agreements does raise the question as to whether Mexico could become a hub for Latin America or even a platform for their exports.

NAFTA's rules-of-origin provisions were negotiated to prevent Mexico from being any other country's platform, even though the greatest fear was that Japan, not Latin America, would use it for that purpose. If violations are detected, then a common NAFTA institution - perhaps the Trade Commission - would need to impose heavy fines. But it is possible that a freer trade relationship between Mexico and Latin America could facilitate the latter's entry into an expanded NAFTA.

3.5 Potential Consequences of NAFTA. The most positive potential impact of NAFTA in the western hemisphere lies in its triple incentives for Latin American governments to: (1) consolidate needed economic reforms; (2) stimulate subregional integration; and (3) forge a democratic community of nations. Each of these goals is vital to the economic and political development of the region, but before NAFTA, the conditions did not exist and the incentives were too weak to transform those goals into reality.

A salutary effect of the debt crisis is that it forced Latin America to reassess its economic strategy. A new generation of Latin American leaders realized that while Latin America had declined, the Asian economies - particularly the "Four Tigers" - had leaped ahead of them by using export-oriented economic policies. The lesson they learned was that they should replace their protectionist strategies with international ones. The IMF, of course, "encouraged" a shift in this direction.

By 1992, there were signs that the new economic policies were bearing fruit. The debt crisis had apparently peaked several years before, and governments were able to channel their scarce resources toward investment. As a percentage of GDP, debt declined from 64.3% in 1987 to 37.4% in 1991. Hyperinflation was brought under control. The average rise in prices for the region, weighted by GNP, fell from 1,711% in 1990 to 223% in 1991. In 1991, the region grew by 3 percent - the first real growth in many years. Exports expanded at an annual rate of 12 percent from 1987 to 1991, and the percentage of manufactures rose to one-third (up from 10 precent two decades ago).[33]

Latin America seemed to turn a corner economically, but social problems were worst than a decade before. Real minimum wages in 1991 were almost a third lower than in 1980. This meant that the average labor cost in Latin America had declined to less than half of what it was in Singapore and Hong Kong, [34] but there were questions as to whether the economic policies could be sustained in a climate of social unrest, such as occurred in Venezuela in early 1992. A Western Hemisphere Free Trade Area could reinforce efforts by each country to maintain the best macro-economic policies and, as such, it could play a valuable role in helping to modernize the economies.

NAFTA also makes more attainable the goal of subregional integration. For too long, the nations of the Andean Pact, CARICOM, and CACM were unwilling to make the kinds of decisions that would have fulfilled their pledges to lower trade barriers among members of their group. In the case of CARICOM, the failure of any of the thirteen members to implement the Common External Tariff kept the entire organization paralyzed. NAFTA - and more precisely the prospect of a guaranteed market in North America - provides a substantial incentive for the governments to bite the bullet, or risk being left out of the growing regional market.

While the United States has encouraged Latin American governments to apply for free-trade agreements as members of subregional integration schemes, there are no incentives for doing so, and because of the difficulty of gaining the approval of others, the real incentives favor individual applications. Theoretically, a western hemisphere economic area would make subregional integration schemes obsolete, but for the next ten years at least, the schemes will exist, and it would be desirable for members of each to help the others satisfy the preconditions for entry. Therefore, the NAFTA countries should indicate that individual governments will be permitted to join NAFTA but that subregional groups would take precedence.

Finally, research by Inglehart and others indicates that increasing economic integration within a framework that builds trust between partners can lead to political cooperation and subsequently political integration. The process of negotiating an expansion of NAFTA could stimulate more cooperation on political issues. For example, the leaders in most of the new democracies in Latin America are aware of the fragility of their regimes and are interested in developing mechanisms to defend democracy in all of their countries. The Organization of American States has been wrestling with this issue since it was asked to observe the elections in Nicaragua, but especially since the General Assembly passed a resolution on democracy at Santiago in June 1991. Much remains to be done, and increased cooperation among like-minded leaders on economic matters could hopefully translate into new political arrangements to defend democracy. Moreover, the U.S. and Latin America could work together in GATT to stimulate needed reforms in the international trading system.

With an infrastructure and a potential market roughly equivalent to Europe at the beginning of the Marshall Plan, Latin America today could be the basis for a new and powerful economic community of democratic nations. Together with the United States, the Americas could develop a global competitive economic edge.

When Salinas said that "we want Mexico to be part of the first World, not the Third," [35] he was not only encouraging his countrymen to raise their hopes and standards, he was also implying that Mexico could exert greater influence on the international economic order if it aligned with the United States than if it joined the developing world. This represents a momentous departure for Mexico and for all of Latin America. After having resisted integration with the United States for decades, the region has apparently concluded that their economic goals are more likely to be attained in cooperation with the north.

4. Comparative Advantage and The Three Panregions

Let us examine the three panregions - the European Community, Japan and East Asia, and the North American Free Trade Area as the center of a Western Hemisphere Free Trade Area [Table 4]. The most integrated of the three areas is the 12-nation European Community, with a population of 345 million, and a gross product of $5.9 trillion in 1990. By December 31, 1992, the EC theoretically eliminated all of its internal barriers. With the Treaty of Maastricht, signed in December 1991, the twelve governments committed themselves to moving toward a federal government, that included a unified currency by the end of the century and a coordinated and unified foreign and defense policy. This leap forward was rejected by the Danes and questioned hard by the British. In all likelihood, the steps toward further unity will not be in a straight line.

Table 4

The World's Three Main Trading Areas: Basic Indicators

Region/Country	Population (Millions) 1970	Population (Millions) 1990	GNP ($Bil - Current) 1970	GNP ($Bil - Current) 1990	GNP per Capita (US$ - Current) 1970	GNP per Capita (US$ - Current) 1990	Exports Customs Basis, fob ($Mil - Current) 1970	Exports Customs Basis, fob ($Mil - Current) 1990	Imports Customs Basis, cif ($Mil - Current) 1970	Imports Customs Basis, cif ($Mil - Current) 1990
Western Hemisphere	*499.27*	*705.48*	*1,343.78*	*6,907.10*	*821.44*	*3,285.00*	*74,876*	*619,936*	*70,356*	*730,988*
North America	278.59	362.70	1,225.96	6,204.60	3,339.27	14,916.67	60,610	523,236	56,664	659,580
United States	205.00	250.00	1,105.50	5,447.50	5,392.68	21,790.00	43,220	371,466	39,950	515,635
Canada	21.32	26.50	83.58	542.46	3,919.57	20,470.00	16,185	125,056	14,253	115,882
Mexico	52.27	86.20	36.88	214.64	705.57	2,490.00	1,205	26,714	2,461	28,063
Caribbean Basin	30.55	48.28	11.80	53.63	573.38	2,366.19	2,873	10,970	4,088	17,559
Central America	16.89	28.78	6.48	30.21	424.29	1,264.29	1,231	4,929	1,623	8,350
Caribbean	13.66	19.50	5.32	23.42	647.93	2,917.14	1,642	6,041	2,465	9,209
South America	190.13	294.50	106.02	648.87	587.00	1,725.00	11,393	85,730	9,604	53,849
Andean Pact	55.53	91.20	30.02	130.93	524.00	1,318.00	5,349	30,900	3,766	17,762
Mercosur	125.10	190.10	68.02	492.33	602.50	2,180.00	4,810	46,251	4,858	29,064
Chile	9.50	13.20	7.98	25.61	840.00	1,940.00	1,234	8,579	980	7,023
European Community										
EC (1970)	*188.32*		*495.98*		*3,231.53*		*88,545*		*88,425*	
EC (1990)		*344.39*		*5,878.78*		*15,380.88*		*1,349,971*		*1,405,273*
Asia	*346.16*	*512.32*	*242.12*	*3,772.56*	*444.90*	*7,742.22*	*31,812*	*641,969*	*35,819*	*674,477*
Japan	104.00	123.50	203.30	3,140.61	1,954.81	25,430.00	19,320	286,768	18,880	231,223
ASEAN	204.21	316.77	29.88	300.71	353.83	3,240.00	6,161	140,537	7,696	160,369
Four Tigers	37.95	72.05	8.94	331.24	280.10	9,350.00	6,331	214,664	9,243	282,885

Key: Andean Pact : Peru, Colombia, Ecuador, Venezuela, Bolivia
EC (1970): Belgium, France, Germany, Italy, Luxembourg, Netherlands
ASEAN: Brunei, Malaysia, Singapore, Indonesia, Phillipines, Thailand
Four Tigers: Hong Kong, Singapore, South Korea, Taiwan
Mercosur: Brazil, Argentina, Uruguay, Paraguay
EC (1990): Belgium, France, Germany, Italy, Luxembourg, Netherlands, Denmark, Greece, Ireland, Portugal, Spain, United Kingdom

Notes: German 1990 population data after unification; German trade & GNP data are prior to unification; trade data for Belgium includes Luxembourg; and (*) Regional GNP per Capita are averages.

Sources: The World Bank, "World Tables," 1984, 1991; and "World Development Report," 1992; and U.S. Agency for International Development, "Latin American and Caribbean: Selected Economic and Social Data," April 1992; and OECD "Monthly Statistics on Foreign Trade," July 1992.

While the EC has been trying to deepen and unify its internal market, it has had to cope with numerous other issues and problems. It has had to re-work its relationship with its former colonies, the ACP (African, Caribbean, and Pacific) countries. Germany has concentrated its resources on integrating the former East Germany. Austria, Sweden, and Finland have requested membership into the EC; the European Free Trade Association (EFTA) has agreed to join with the EC to form a single unified free trade area on January 1, 1993; and virtually every old and new nation in Eastern Europe has requested some form of association with the EC. The global implications of these developments is that the EC has been inward-looking.

Japan has become the economic center of an increasingly dynamic Asia, but aside from ASEAN, a trade group of five southeast Asian nations, there is as yet no formal trade regime that could compare to that of the European Community, and the region is much less integrated than either Europe or North America. In 1990 and 1991, for example, intra-regional trade as a percentage of its total world trade was roughly 62% for Europe, 42% for North America, and 30% for Asia. [Table 5]

Most of the Asian nations are increasingly dependent on Japanese investment and the U.S. market. Lawrence Krause proposes a "Pacific Basin" community that would include Japan, the United States, and thirteen other countries. The region's real trade growth in the 1980s was 8.7 percent - higher than the EC's 6 percent - and it was more integrated, with an intra-regional trade of 65.7 percent, as compared to 58.6 percent for the EC. [36]

Table 5

Intraregional Trade as a % of Total Trade

Region/Country	Exports Customs Basis, fob 1970	1976	1980	1990	1991	Imports Customs Basis, cif 1970	1976	1980	1990	1991
North America	37.34%	37.82%	36.09%	42.91%	41.98%	40.61%	34.15%	32.53%	35.54%	36.47%
European Community	na	52.25%	53.53%	60.58%	61.89%	na	49.37%	48.31%	57.92%	57.61%
Asia	na	36.24%	17.92%	30.61%	30.01%	na	39.07%	18.93%	36.67%	36.44%

Note: 1991 intraregional trade data for Asia are based on IMF and World Bank estimates.

Sources: OECD, "Monthly Statisitics on Foreign Trade," July 1992; and "Historical Statistics on Foreign Trade, 1965-1980," 1982; and International Monetary Fund, "Direction of Trade Statisitics," 1992, 1991, 1984.

Some have argued that the United States would be making a mistake to create a trade-bloc in the western hemisphere among slow-growth economies. The Asian economies, according to this view, offer the best vehicle for invigorating the U.S. economy. "There's much more to gain by fighting for access to China, South Korea, Taiwan, Japan and the European Community than by signing free-trade agreements across Latin America," writes Marc Levinson in Newsweek. [37] The idea of looking east rather than south merits consideration, but the Pacific Basin is not a realistic trade entity in the short-term because of the tremendous differences between the U.S. and Japan on trade policies and the continued difficulty that the U.S. and Latin America have in penetrating the Japanese and Asian markets.

The North American trading area is competitive. For Canada and Mexico, which have more than two-thirds of their trade with the U.S., it is central. But even for the world's greatest trading power, the United States, which has often focused on Europe or Japan, its two neighbors have been its largest markets in the postwar period. In 1955, two years before the signing of the Treaty of Rome establishing the European Community, U.S. exports to Europe were $2.6 billion, as compared to $4 billion of exports to Canada and Mexico. [See Table 6] Thirty-five years later, U.S. exports to Asia had increased from 10 to 15% of U.S. exports, and to Europe, from 16.8 to 25%. But North America remained preeminent; U.S. exports increased to $112 billion or 28.4 percent.

Table 6

U.S. Exports to North America, Europe and Asia (1945-1991)

Year	($Mil) North America	EC	Japan & SE Asia	World
1945	1,485	3,114	1,381	10,527
1955	3,969	2,614	2,144	15,518
1965	6,763	5,252	5,180	28,461
1975	26,885	22,865	19,658	109,317
1980	55,476	58,855	44,512	225,722
1985	66,922	45,776	51,036	213,146
1986	67,904	53,222	52,981	227,159
1987	74,396	60,629	58,244	254,122
1988	92,250	75,864	88,841	322,426
1989	103,791	86,424	101,509	363,812
1990	111,953	98,129	109,054	393,592
1991	118,379	103,209	109,674	421,614

Sources: USDOC, International Trade Administration, "U.S. Foreign Trade Highlights," 1992, 1988, 1985; and USDOC, Office of Business Economics, "U.S. Exports & Imports 1923-1968," November 1970; and USDOC, Bureau of Economic Analysis, "U.S. Merchandise Trade: Exports & Imports -1965-1976," 1977; and USDOC, Bureau of the Census, "Statistical Abstract of the United States," various issues, 1950-1991.

An analysis of U.S. exports to North America, Europe, and Asia in the post-war period underscores the degree to which the United States remains the center - both in geography and in terms of the value of trade - of the world trading system. It also shows the extent to which world trade is dominated by three regions. The least integrated region - Japan and Southeast Asia - has shown the fastest growth, particularly in the last two decades. U.S. exports to Japan, ASEAN, and the "four Asian tigers" increased from less than $20 billion in 1975 to $110 billion in 1991. Of those markets, Japan's has accounted for about half, although in the last decade, the markets of the rest of Asia increased in relative importance. Still, North America has consistently remained a larger market for U.S. goods than the European Community or Asia.

The trends are similar for U.S. imports, with North America accounting for one-quarter of U.S. imports and Europe for 19 percent. The difference, of course, is the extraordinary growth of Japanese and Asian exports to the U.S., from $1 billion in 1955 to nearly $100 billion in 1990, nearly 20% of total U.S. imports.

Canada has always been the principal U.S. trading partner, and the growth rate in trade has remained relatively consistent. The highest rate of growth of U.S. exports has occurred with Mexico. With NAFTA secure, that could expand even further.

Although the South American market has declined in importance for the United States in recent years, if one adds it to North America, the new hemispheric market assumes much greater weight for the United States. [Table 7] U.S. exports to the entire

Table 7

U.S. Exports to North and South America, Europe and Asia (1945-1991)

Year	($Mil) North & South America	EC	Japan & SE Asia	World
1945	2,438	3,114	1,381	10,527
1955	6,327	2,614	2,144	15,518
1965	10,196	5,252	5,180	28,461
1975	39,265	22,865	19,658	109,317
1980	79,076	58,855	44,512	225,722
1985	84,143	45,776	51,036	213,146
1986	86,449	53,222	52,981	227,159
1987	94,617	60,629	58,244	254,122
1988	115,334	75,864	88,841	322,426
1989	127,454	86,424	101,509	363,812
1990	137,082	98,129	109,054	393,592
1991	144,967	103,209	109,674	421,614

***Sources:* USDOC, International Trade Administration, "U.S. Foreign Trade Highlights," 1992, 1988, 1985; and USDOC, Office of Business Economics,"U.S. Exports & Imports 1923-1968," November 1970; and USDOC, Bureau of Economic Analysis, "U.S. Merchandise Trade: Exports & Imports -1965-1976," 1977; and USDOC, Bureau of the Census, "Statistical Abstract of the United States," various issues, 1950-1991.**

hemisphere amount to about one third more than to Europe or Asia. Moreover, an expansion of NAFTA to include the Caribbean Basin and South America would effectively double the population [Figure 1] with a gross product that greatly exceeds Europe's or Asia's with advantages that the others do not have.

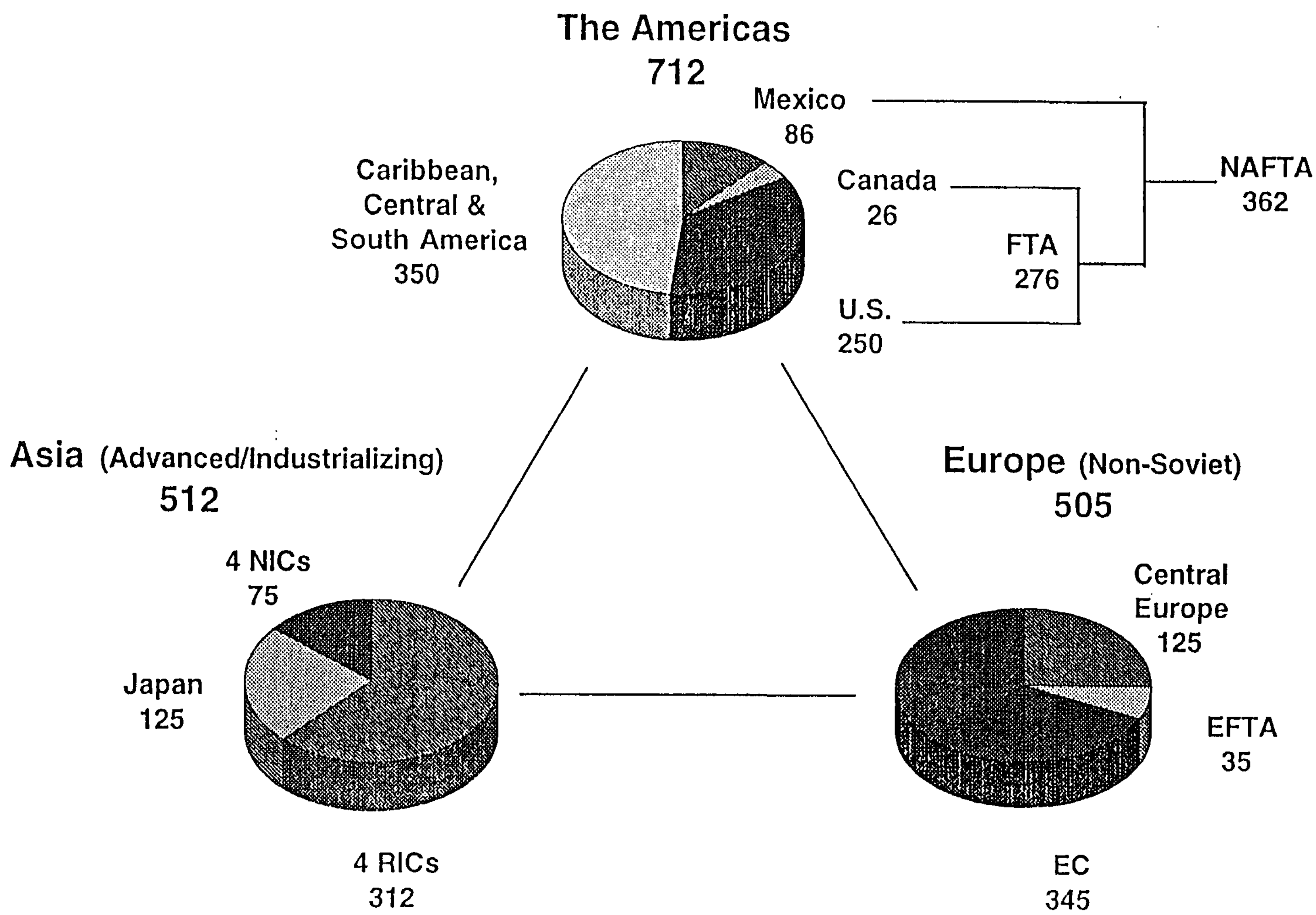
The effort by Western Europe to incorporate the east has confronted more serious problems than Latin America's economic integration presents to the United States and Canada. While Latin America is privatizing its relatively few state corporations, Eastern Europe is trying to decide how to introduce the market into state-controlled economies. After almost a decade of depression, Latin America, in many ways, is at the stage where Western Europe was after World War II. It has considerable unused industrial capacity, a highly trained labor force, and a proven capacity to grow. All it needs is capital (or reduced debt service) and a secure market. The sharp reduction of trade barriers in the western hemisphere could provide the stimulus toward an economic take-off, comparable to what occurred in the 1960s and early 1970s.

In analyzing the implications of NAFTA for the other two regional trading areas, it is useful to recall that all three areas have significant interests in world trade and in maintaining the GATT. This does not mean that they have an equal interest. The United States is the largest exporter and importer of goods in the world, but Germany and Japan are much more dependent on world trade than the United States. More importantly, Japan and, to a lesser degree, Germany is more dependent on the U.S. market than the

Figure 1

The Three Panregions

1990 Population (millions)



United States is on them. [Table 8] Japan's exports to the United States represent roughly one-third of its total exports and about 3 percent of its GDP. In contrast, U.S. exports to Japan amount to about 11 percent of its exports and less than 1 percent of GDP. Obviously, Japan has much greater reason to be concerned that NAFTA could lead to a closing of the North American market than the United States has to be worried about Japan's market. Even though Germany is more dependent on the United States than the other way, the gap is much narrower, which is yet another reason why the European Community is less worried about NAFTA than it is about making the EC work, and why Europe is less worried than Japan.

What the global configuration means is that NAFTA is likely to attract the attention of Japan and to a lesser degree Europe. How they react is another matter. I would predict that their initial reaction may be negative and fearful, but as they realize the importance of their stake in the U.S. market, they will concentrate more and more on making the GATT work. That will mean, among other things, adopting some of NAFTA's innovations - for example, on dispute settlement, services, and perhaps agriculture - and trying to incorporate them into an invigorated GATT.

It is obvious why Latin America would want to gain greater and more secure access to the U.S. market. A question has been raised as to the reason why the United States would want to consider extending NAFTA to the rest of Latin America. There are several reasons. First, the United States would gain access to a market that is much more protected than is the U.S. market. Second, if

Table 8: Trade Dependency of the Three World Powers

United States	GDP @ mkt prices ($Mil)	Total Exports (fob) ($Mil)	Exports to Japan ($Mil)	% Total U.S. Exports (%)	Exports to Japan as % of US GDP (%)	Exports to Germany ($Mil)	% Total U.S. Exports (%)	Exports to Germany as % of US GDP (%)
1960	509,000	20,600	1,341	6.51%	0.26%	1,068	5.18%	0.21%
1970	1,008,200	43,762	4,652	10.63%	0.46%	2,741	6.26%	0.27%
1980	2,684,400	225,722	20,790	9.21%	0.77%	10,960	4.86%	0.41%
1990	5,392,200	393,592	48,580	12.34%	0.90%	18,760	4.77%	0.35%
1991	5,672,600	421,600	48,147	11.42%	0.85%	21,317	5.06%	0.38%

Japan	GDP @ mkt prices ($Mil)	Total Exports (fob) ($Mil)	Exports to US ($Mil)	% Total Jap Exports (%)	Exports to US as % of Jap GDP (%)	Exports to Germany ($Mil)	% Total Jap Exports (%)	Exports to Germany as % of Jap GDP (%)
1960	50,095	4,709	1,149	24.40%	2.29%	372	7.90%	0.74%
1970	143,511	19,405	5,875	30.28%	4.09%	1,528	7.88%	1.07%
1980	1,840,335	130,441	30,867	23.66%	1.68%	5,786	4.44%	0.31%
1990	2,942,890	287,581	89,684	31.19%	3.05%	17,894	6.22%	0.61%
1991	3,642,975	338,329	91,583	27.07%	2.51%	20,631	6.10%	0.57%

Germany	GDP @ mkt prices ($Mil)	Total Exports (fob) ($Mil)	Exports to US ($Mil)	% Total Ger Exports (%)	Exports to US as % of Ger GDP (%)	Exports to Japan ($Mil)	% Total Ger Exports (%)	Exports to Japan as % of Ger GDP (%)
1960	84,481	15,394	897	5.83%	1.06%	88	0.57%	0.10%
1970	136,352	35,329	3,127	8.85%	2.29%	146	0.41%	0.11%
1980	775,667	192,861	11,924	6.18%	1.54%	2,186	1.13%	0.28%
1990	1,488,210	410,104	28,162	6.87%	1.89%	10,816	2.64%	0.73%
1991	1,728,152	439,135	26,229	5.97%	1.52%	10,745	2.45%	0.62%

***Sources:** World Bank, "World Development Report," 1992; and International Monetary Fund, "Direction of Trade Statistics," 1976-1982, 1991, 1992 and World Bank, "World Bank Tables," 1976, 1988, 1991; and U.S. Department of Commerce, International Trade Administration, "U.S. Foreign Trade Highlights," 1992; and "Statistical Abstract of the United States," U.S. Department of Commerce, Bureau of the Census, various issues, 1950-1991; OECD, "Main Economic Indicators," July 1992.*

trade could help stabilize and develop Latin America's economies and reinforce its budding democracies, such a wider market would serve broader U.S. strategic and political interests. Third, South America is a continent with enormous resources and potential. If these were developed, then the hemisphere would become a bloc with considerable weight and leverage in the international community.

5. Some Proposals

The NAFTA debate within the United States will be a difficult and awkward one. The United States is perched on the fence between risking openness and opting for an elusive defensiveness; the same kind of choice that Mexico had faced. What an irony that the United States and Mexico should have reversed roles. If U.S. legislators are arrogant and insensitive during the debate, the process of integration will be set back, but that process - whether private or managed - will continue as long as each country sees the gains from trade exceeding the cost.

The cost-benefit calculation has an objective and a subjective dimension: whether the gains exceed the costs; and whether the public perceives that the gains exceed the costs. The U.S.-Canadian agreement offers an example of a case where economists concluded that Canada gained, but only 6 percent of the Canadian public agreed. The opposition to the FTA - 66 percent - blame the agreement for the recession and for generating numerous trade disputes, which seem to be won mostly by the United States. [38] As a result, both NAFTA and the Mulroney Administration are unpopular.

There are important lessons to be drawn from the U.S.-Canadian experience, but NAFTA shows no signs that they have been learned.

Like other trade agreements, NAFTA will generate more trade problems not fewer because businesses and workers will become more dependent on the success or failure of trade flows, and are more likely to complain if they fail than credit the agreement if they succeed. Moreover, the agenda of legitimate issues will expand because of the nature of the non-tarifff issue and the logic of economic integration: all policies that could help a country's exports or hurt a country's imports are on the table.

The following tasks need to be accomplished to sustain, deepen, and extend NAFTA: (1) the collection of data and information on trade and investment policies; (2) a credible and effective body to judge disputes and to enforce judgments; (3) a separate inter-American body to consult, negotiate, and plan for future problems; (4) an inter-American body made up of democratically-elected representatives, comparable to the European Parliament, to address and debate issues and concerns; and (5) an office to disseminate information on the activities, accomplishments, and mistakes of the inter-American bodies.

(1) Information-Collection. The Special Committee for Consultation and Negotiation (CECON) of the Organization of American States was established in 1970 to collect information on trade and trade policies in the hemisphere and publish some of the information in a newsletter. In May 1992, CECON was renamed the OAS Special Committee for Trade and given some new missions, including being a vehicle for consultation on trade issues among the member governments and to promote trade liberalization and expansion. Member governments were concerned that CECON was too confrontational even though a more telling and accurate criticism is that it has been too anodyne.

To make a Western Hemisphere Free Trade Area workable, a new institution is needed to collect information on trade and investment policies and provide credible, impartial, and effective judgments on what qualifies as "protectionist." A single standard needs to be developed and applied. An annual report on protectionism - defined either as violations of existing trade agreements or government-directed reductions in trade and investment - would be a valuable document on which everyone could depend. But the information has to stand the test of public criticism, and it has to be disseminated widely.

One should not underestimate the importance of having a base of information that all view as fair. Public opinion polls show that the American public support freer trade provided that our trading partners play by the same rules. As there is a growing feeling in the United States that our trading partners are playing by different rules that are not fair, the consensus for freer trade has begun to fragment. One way to reconstruct that consensus is to have credible and fair information available to all parties. This will not eliminate political problems or trade disputes, but it will ameliorate them.

An important question is where to locate the data-collection system. CECON could do the task of data-collection, but it might not be prepared to make the controversial judgments necessary to identify the source of emerging trade problems. The United Nations Economic Commission for Latin America and the Caribbean has the capability and experience, and the Inter-American Development Bank could manage such a group as well. To the extent that the group's judgments would be controversial, it might be better for the institution to be more autonomous, composed of senior statesmen and judges from the Americas.

(2) Dispute-Settlement Mechanisms. The trade-dispute settlement mechanisms in NAFTA are quite complicated and emphasize consensus. The central institution created by NAFTA is the Trade Commission composed of Cabinet-level officers of each country. The daily work is to be done by a Secretariat. If normal consultations fail to resolve a problem within 45 days, any country can call a meeting of the Trade Commission, which should settle the dispute promptly. If it fails, then a country can call for the establishment of an Abritral Panel, either under NAFTA or GATT, which will issue a report within three months with recommendations for resolving the problem. If the parties do not accept the recommendation, then the complaining country can suspend the application of equivalent benefits until the issue is resolved. Any country that considers the retaliation excessive may seek another panel's recommendation.

The central flaw of the mechanism is the absence of collective enforcement, and that is because all three governments apparently prefer weak or non-existent institutions to ones that they could not control, or that could intrude on "sovereignty." But a weak institution is a recipe for undermining NAFTA. Problems in interpretation and enforcement are inevitable. All three governments would benefit from the enforcement of trade violations, and all would be harmed by the lack of enforcement. The United States is strong enough to accomodate virtually any decision, and Canada and Mexico need the institution to ensure that their interests would not be ignored or overridden unfairly. To a substantial degree, the GATT's weakness stems from its inability to enforce its decisions. A similar flaw in NAFTA could doom the institution even before it was firmly established.

(3) Consultation, Negotiation, and Planning. NAFTA's Trade Commission is intended to serve as a body for consultation, but it is unclear whether it will serve a similar negotiating function, and no body is charged with considering the steps that need to be taken to move from NAFTA to a Western Hemisphere Trade Area. Moreover, it would appear that the mandate of the Trade Commission - as illustrated by its very title - is too narrow to take into account the full range of problems of integration and interdependence. Perhaps, the Trade Commission could appoint a Planning Group composed of representatives of the three countries and of others in Latin America to begin to outline the timing and the steps needed to make the transition to a wider trading area.

(4) Parliament of the Americas. While it is too soon to establish a parliament of representatives of the states of the Americas, it is not too soon to begin to think about the idea and what it might do. If our premise is accurate - that a Western Hemisphere Economic Area will mean that domestic agendas will become the subject of international negotiations - then, a forum will be needed to debate norms and policies on such issues. Let us take the example of the environment. The prospect for a successful United Nations Environmental Conference in the summer of 1992 would have been far higher if all the nations of the hemisphere had an opportunity to forge a consensus ahead of time.

What is needed on these domestic-global issues is a discussion among people who can integrate domestic and international interests, and the best forum for accomplishing that goal would be an international Parliament of representatives from each of the countries. Modelled on the European Parliament, seats should be allocated to states according to the size of their population. The Planning Group should assign long-term issues to the Parliament for debate and eventually for resolution.

(5) An Office of Dissemination. Too often, governments have information offices that fail to disseminate reports to people and groups interested in learning about them. Too often, the reports are self-serving. To build a long-term relationship among the countries of the Americas based on a freer-trading system will require a wider understanding of the activities of the various institutions working on the issues. For reports to be effective, they need to describe not only the institution's accomplishments, but also its mistakes and problems, and it should be disseminated widely.

To accomplish these five tasks will require new ideas, attitudes, procedures, and institutions. None are currently contemplated, but all would be needed if the nations of the Americas are serious about wanting to extend NAFTA to the rest of the hemisphere. Consulting and negotiating the full range of issues will equip the region's leaders to begin thinking about new modes of political cooperation - both to defend democracy in the hemisphere and to shape global institutions to take into account the needs of the Americas.

The world has been long divided into trading blocs and, since the second world war, trading areas. The most highly integrated area is the European Community, but Japan's efforts to integrate Southeast Asia also suggest an emerging area in the east. The Western Hemisphere has harbored dreams of a free-trade area for over a century, but the decision to negotiate NAFTA represents the first significant concrete step in that direction. It is a step that will increase trade in North America and could be extended to the entire hemisphere. Beyond that, an expanded NAFTA could serve as a model for a new international trading system. As long as the United States and Latin America continue to recognize their stake in the global trading system, they will be able to utilize their new-found leverage to stimulate GATT to overcome its problems and to generate new trade and growth in the international economy. Together, these steps may add up to a great leap.

Endnotes

I am grateful to Michael Discenza for his assistance in collecting data and preparing the tables and figures in this paper.

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11. Robert E. Baldwin, Non-Tariff Distortions of International Trade (Washington, D.C.: Brookings Institution, 1970), pp. 2-5.

12. U.S. Agency for International Development, Latin America and the Caribbean: Selected Economic and Social Data (Washington, D.C., April 1992), p. 171.

13. Jagdish Bhagwati, "Regionalism and Multilateralism: An Overview," Discussion Paper Series No. 603 (New York: Columbia University Department of Economics, April 1992), p. 12.

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15. Lawrence B. Krause, "Regionalism in World Trade: The Limits of Economic Interdependence," Harvard International Review, Summer 1991, p. 4.

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17. For a detailed analysis of the agreement and its estimated impact, see Robert A. Pastor, Integration with Mexico, Chapter 3.

18. Ronald Inglehart, Neil Nevitte, and Miguel Basañez, Convergence in North America: Closer Economic, Political, and Cultural Ties Between the United States, Canada, and Mexico, manuscript, 1992.

19. Inglehart, Nevitte, Basañez, Convergence, Chapter 1, p. 1.

20. See particularly, Karl W. Deutsch, et. al., Political Community and the North Atlantic Area (Garden City, New York: Doubleday, 1968).

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22. Ibid, Chapter 2, p. 12, Figure 2-3.

23. This and the following data is from the U.S. Department of Commerce, Bureau of the Census, Statistical Abstract of the United States, various years.

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25. "Free Trade and Common Markets," Latin American Special Reports, June 1992, p. 1.

26. Ibid.

27. U.S. Agency for International Development, Latin America and the Caribbean: Selected Economic and Social Data (Washington, D.C., April 1992), pp. 3-5.

28. Ronald Wonnacott first developed the "hub" and "spoke" ideas with the United States as the object. See his "U.S. Hub-and-Spoke Bilaterals and the Multilateral Trading System," Commentary (October 1990), Toronto: C.D. Howe Institute.

29. Joseph Pelzman and Gregory K. Schoepfle, cited in "U.S. Sugar Qutas and the Caribbean Basin," by Stuart Tucker and Maiko Chambers, Overseas Development Council, Policy Focus No. 6, December 1989, p. 4; "Yet Another Cut in the U.S. Sugar Quota," Latin America Weekly Report, 10 September 1992, p. 8.

30. For two papers describing the full range of choices that the region faces, see Camille Nicola Isaacs, "The North American Free Trade Agreement: A Jamaican Perspective," paper presented at a seminar at the Mona Institute of Business of the University of the West Indies, 11 December 1991; and Robert Pastor and Richard Fletcher, "The Caribbean in the 21st Century," Foreign Affairs 70 (Summer 1991).

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37. Both Bhagwati and Krause make this argument. For a more popular and acerbic statement of this thesis, see Marc Levinson, "Let's Have No More Free-Trade Deals, Please: Why NAFTA is not a Model for Latin America," Newsweek, August 17, 1992, p. 40.

38. See the following two articles by Clyde H. Farnsworth in New York Times, "U.S.-Canada Rifts Grow Over Trade: Accusations on Beer, Cars, and Lumber," February 18, 1992, pp. 1, C6; and "U.S. Trade Pact a Spur to Canada," July 22, 1992, pp. C1, C6.