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After the NAFTA

Luckily, in a short conclusion like this, I cannot be expected to say anything about the text of the North American Free Trade Agreement (NAFTA) that has not already been said by the contributors to this remarkable symposium. Instead, I will undertake the more hazardous task of trying to predict the NAFTA's future.

Despite the buyer's remorse now on display in each of the countries that signed the NAFTA (I write in April 1993), it seems likely that the NAFTA will be implemented more or less as signed. There will be side deals and separate legislation relating to issues of concern to labor and environmentalists, but these should not interfere with implementation of the agreement. Rather, they will be what Mary Poppins called "the spoonful of sugar that makes the medicine go down."

But what then? What issues will dominate the NAFTA once it is in place? Here are my candidates.

I. NAFTA as a Trading Bloc

It has become fashionable to speak of the emergence of three trading blocs—the European Communities (EC), centered on Germany, the NAFTA, centered on the United States, and a vaguely defined Asian bloc centered on Japan. In fact, however, only the EC comes close to being a genuine trading bloc. EC Member States have agreed to conduct a common trade policy, enforced by common tariffs, common antidumping remedies, Communitywide subsidies, and the like. And the EC's bureaucracy has used the leverage of this common trade policy to extend the influence of European standards and policies from the Arctic Circle to Africa and beyond, via a web of concessionary trade arrangements. The EC, in short, does indeed have the makings of a trade bloc.

The other two supposed blocs are nothing of the sort. Applying the notion to Asia is silly. Japan has certainly increased its trade dramatically with other Asian

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countries, but increased trade has yet to bring a sense of common interest, let alone a coordinated effort to limit non-Asian trade. Quite the contrary. Most countries in Asia would probably be delighted to trade a bit less with Japan and a bit more with the United States and the EC.

The NAFTA falls between the Asian and the European models. There is no doubt that the NAFTA will encourage greater trade within North America, and some of the expansion may well come at the expense of countries outside North America. But this effect is likely to be modest overall, and it will be largely mitigated by the single most important economic fact about the NAFTA. Unlike the EC, which is a merger of several more-or-less equal partners (plus a batch of smaller players), the NAFTA is an agreement between one enormous economy and two small-to-medium-sized ones. Economically, Canada is about a tenth the size of the United States, while Mexico is about a twenty-fifth. Increasing globalization of industry has brought home to countries such as Canada and Mexico the extraordinary cost of trying to maintain anything like a self-sufficient economy. They must specialize in order to remain competitive. The appeal of the NAFTA is that it makes specialization safer while forcing its pace. Since signing its free trade pact with the United States, Canada has already lost many of the branch plants that once existed to take advantage of high tariff walls. Mexico's monuments to autarky are following suit.

The pressure to specialize has been less severe in this country. While American companies have felt the hot breath of global competition, and many have failed, there are few global industries that do not have at least one competitive American member.

Merging a single full-service economy with two somewhat more specialized economies works against the emergence of a European-style trade bloc. If the Canadian and Mexican economies continue to concentrate more and more heavily on industries where they have a comparative advantage, their other, less efficient, industries will become less important and may even disappear entirely. If so, those governments will have little or no interest in continuing to provide tariff or other protection for the vanished industry. If, for example, U.S. widget manufacturers were to wipe out the widget-makers of Mexico or Canada, those countries would be tempted to reduce their widget tariffs to zero. Canadian and Mexican consumers would then obtain the benefits of a bare-knuckles competition between U.S. and Japanese widget companies; neither U.S. nor Japanese manufacturers would have a tariff advantage. Not much of a "trade bloc" there.

Even if the Canadian and Mexican Governments do not eliminate widget tariffs simply to aid consumers, they can use widget tariffs as a bargaining chip in negotiations. The Canadian Government might, for example, be tempted to eliminate widget tariffs in exchange for an integrated Japanese company agreeing to turn widgets into downstream products at a new factory in Canada.

Such bargaining would not be possible if the NAFTA were a customs union

in which all parties must maintain common tariff levels. But in a free trade agreement each party retains control over its own tariffs. The drafters of the NAFTA made some effort to deal with this issue. Under annex 308.1, each party agreed to reduce the most-favored-nation duty on automatic data processing equipment to a single common rate. Once an import has paid that duty to any country, it may travel freely throughout the continent. The parties also agreed that, for data processing goods (and for color TV tubes), the duty charged by any one party will be considered a matter of legitimate interest to the others; the external rates that each applies to the rest of the world will not be changed without consultation. These limited provisions were obtained by a few savvy industries seeking to obtain the benefits of a customs union and to reduce the incentives for tariff gamesmanship. The effort may succeed for those industries, although the opportunities for seeking tactical advantages have not been entirely eliminated.

Other U.S. industries, however, will sooner or later be heard to complain that Mexico or Canada are striking bargains with countries outside North America that eliminate the advantages of the NAFTA for U.S. manufacturers. The United States will rarely be able to play the same game, since it will almost always have one domestic manufacturer seeking continued tariff protection. Nor is it likely that the United States and its partners will turn the NAFTA into a customs union, particularly if the smaller partners can get many of the benefits of U.S. tariffs without the disadvantages. While this dynamic will thus be a source of continuing low-level conflict in the NAFTA, it should give considerable comfort to those who fear the emergence of a North American trade bloc.

II. Will the NAFTA Be Expanded?

Another issue likely to recur with frequency for the parties to the NAFTA is whether to expand the agreement beyond its current three members. Although the Bush administration was contemplating additional agreements, the Clinton administration's enthusiasm for expanding the NAFTA may be more restrained; concerns raised during the NAFTA debate about Mexico's environmental and labor policies have equal force elsewhere in Latin America. The other NAFTA members may also be slow to open the club to additional countries. Mexico may doubt the value of having to compete for U.S. and Canadian consumers with countries whose economies mirror its own. And Canada was unenthusiastic even about expanding the two-nation U.S.-Canada deal to include Mexico.

Canada joined the NAFTA talks principally to avoid a "hub and spoke" relationship with the United States—one in which the United States had free trade agreements with its neighbors while neither had free trade deals with the other. Ironically, the NAFTA has not eliminated the possibility of such "hub and spoke" arrangements. Quite the contrary, now there are three possible hubs. Any of the three NAFTA countries could choose to begin free trade negotiations with a fourth country. The

proliferation of such side deals, like the risk of selective tariffs cuts by more specialized members of the NAFTA, could be a potential source of tension within the NAFTA, particularly in connection with rules of origin and similar matters.

Once again, the NAFTA addressed this issue, but sketchily. It provided in article 2205 that other countries may join the NAFTA only on terms and conditions agreed by all three current members. This provision, of course, simply begs the question of separate agreements.

Right now, Mexico seems the most likely to become a hub of its own. It has deals signed or in negotiations with Chile, Venezuela, and Costa Rica; the rest of Central America is on deck. The United States may open negotiations with Chile or Argentina, and it already has a free trade deal with Israel. Even the Canadian Government may decide there are few risks to itself in free trade arrangements with selected Latin American or Caribbean countries. The result could be an unwieldy patchwork of special deals, as each NAFTA member seeks individual advantages from separate free trade negotiations.

III. Governance and Sovereignty

The remarkable strides made by Mexico in the past ten years in such areas as democratization and elimination of corruption have quieted traditional U.S. worries about Mexico's governmental institutions. But concerns linger. One senior U.S. legislator is reported to have asked, "How can you have free trade with a country that is not free?"

While some of Mexico's electoral practices may not differ much from practices current during living memory in, say, Chicago, the fact remains that Canada and the United States have political traditions far different from Mexico's. There may well be some missteps as democratization proceeds in Mexico, and these could trigger a profound reaction north of the border.

Indeed, even without missteps, standards of conduct for government officials will be a likely source of continuing controversy. In one recent example, U.S. drug enforcement agents concluded that cooperation between Mexican officials and drug smugglers had resulted in the death of a DEA agent. Not long after, U.S. agents winked when a suspect in the murder was forcibly abducted from Mexico; and the U.S. Government persuaded the United States Supreme Court to declare such abductions consistent with U.S. law and treaty obligations. In Mexico, the resulting uproar took a form that had become surprisingly rare of late—charges of a resurgent Yankee threat to Mexican sovereignty.

While the Clinton administration has promised not to repeat the abduction episode, sovereignty will be a continuing feature of political debates over the NAFTA in all three countries. Historically, one consequence of sharing the continent with a world power was that both Canada and Mexico defined themselves in large part by emphatic differences with the United States. Attacking the United States as a threat to national sovereignty has been a staple of domestic politics in

Canada and Mexico for years. The leaders who made the NAFTA possible took advantage of a unique hiatus in "sovereignty politics." But such politics are far from dead. We can expect to see many disputes cast in precisely those terms as economic convergence begins to affect other aspects of political life.

Nor will the United States be free from sovereignty politics. Twenty years ago, a House Ways and Means Committee member was reported to have rebutted a witness's invocation of international trade law with the immortal words, "GATT, schmatt. This is America." This attitude lives on, even though the United States no longer has the economic clout to simply ignore international trade law. Sooner or later, the NAFTA will spring an unpleasant surprise on powerful U.S. interests. The disappointed industry, its workers, and their congressmen will then be vocal in condemning the loss of U.S. sovereignty.

IV. Environmental Issues

Perhaps the most likely substantive flash point for bitter sovereignty debates may be environmental protection. American environmental groups are powerful and they are not used to being thwarted by international law. U.S. environmental groups have invoked U.S. sovereignty in attacking the NAFTA, and their appeals have been matched in Mexican circles by charges of "eco-imperialism."

Environmentalists have already begun to express extreme concern about the prospect of de jure and de facto harmonization of North American environmental standards at levels below those currently prevailing in the United States. Since economic integration seems likely to foster harmonization, U.S. environmental groups will find themselves constantly pressing Mexico for higher standards, more aggressive enforcement, and faster progress.

Properly managed, this conflict is unlikely to shake the NAFTA's foundation. Mexico has the same interest as the rest of North America in a clean environment. What Mexico often lacks are the funds to carry out environmental initiatives. The most obvious compromise in disputes about environmental sovereignty is an agreement to protect the Mexican environment using funds provided by the United States and Canada.

Faced with much the same kind of issues, the EC has instituted large-scale income transfers from rich to poor members. This is a likely model for the NAFTA. The EC has shown that disputes about sovereignty become less emotional and more easily resolved if they are transformed into debates about the size and purposes of north-south transfer payments.

V. Dispute Resolution

The last likely point of friction is dispute resolution. Perhaps this is obvious. Almost by definition, dispute resolution produces surprise and disappointment for one side or the other. But the outrage of the loser will surely be heightened by the way dispute resolution panels are structured under the NAFTA. For under-

standable reasons, the United States did not want disputes settled by three-person panels with one member chosen by each of the three governments. Ganging up on the United States would have been too tempting. The solution was to have the swing vote on each panel chosen essentially by lot.

That is fine as long as the stakes are low and the panels unanimous. But what happens when a country loses an important dispute that it thinks it should have won, simply because its adversary was able to choose the deciding panel member? A decision seen as having been determined by the toss of a coin will not get much deference. The lottery aspect of the dispute resolution process will probably spark a handful of bitter controversies among the NAFTA's members over the next decade.

VI. Conclusion

I do not mean to paint a cavalcade of disaster for the NAFTA. Quite the reverse. It is important to remember in the euphoria of ratification that the NAFTA will not end trade tensions in North America. But overall, the tensions I foresee are entirely manageable. The vital fact about the NAFTA, and the best reason to support it, is that it provides a framework for resolving those tensions in favor of trade that is more free, not less.