Testimony of
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The Impact of NAFTA on the U.S. Economy
Senate Committee of Foreign Relations,
Subcommittee on International Economic Policy, Export, and Trade Promotion

Thank you, Mr. Chairman, Senator Sarbanes, and Members of the Subcommittee, for inviting me to discuss the impact of the North American Free Trade Agreement (NAFTA) on our economy since it entered into force just over ten years ago.

My testimony addresses this topic in five parts:

- NAFTA's economic impact on our economy as a whole;
- NAFTA's impact on a number of specific sectors in the U.S. economy;
- NAFTA's impact on Mexico's economy and politics and the implications for our relations with Mexico;
- Commerce's role in enhancing economic opportunities for our exporters, as well as helping foster the broader economic relationship with our two most important trading partners; and
- NAFTA's next decade and the need to focus on our collective economic competitiveness as we face the challenge of competing in a global economy.

I. NAFTA's Impact on the U.S. Economy – Trade, Growth, Productivity, and Employment

In assessing NAFTA's impact on our economy, it is important to focus on what trade liberalization really does. The argument over international trade is most commonly reduced to a simple comparison of jobs gained through enhanced exports and jobs lost through increased import competition. That is, in fact, exactly how the Clinton Administration promoted the passage of the NAFTA implementing legislation and how NAFTA's critics articulated their case and I will address the employment issues later in my testimony.

But, that equation – export jobs gained versus jobs lost to import competition – misses the real impact of trade liberalization. We often forget that NAFTA is a trilateral agreement linking our economy to those of Canada and Mexico, and theirs to each other. By liberalizing our trade, we eliminated most of the external barriers and disincentives to allocating capital and labor to their most productive use.

In the process, we improved the efficiency and productivity of each economy participating in the agreement. The real gains are from trade flow of these efficiency gains and the rationalization of production they allow. While the economic efficiencies trade creates can cause some short-term adjustment, the gains are well worth the effort. And there is no better testament to that than the fact that world trade has increased at more than double the rate of growth of the world economy for several decades.

What follows from that logic is that the best measure of NAFTA's impact on our economy, as well as on the economies of Canada and Mexico, does not flow from the comparison of jobs gained or lost solely in industries that are directly affected by exports and imports. Rather, the most important measure of NAFTA's impact, as is true of any trade agreement, is on the economic growth and productivity of the participating countries' economies. And, I would add a corollary – whether the agreement has made us more competitive in the context of a rapidly globalizing world economy.

NAFTA's tenth anniversary offers an appropriate moment to step back and assess whether the agreement has met that test. The answer, in the case of the NAFTA, is a resounding yes. Each country has grown considerably faster than it did in the previous decade and each witnessed a significant rise in productivity. Indeed, each of the three economies recovered more quickly from the worldwide recession that began in 2000 than all of our other major trading partners with the exception of China. While NAFTA was not the sole source of the success of our three economies over the intervening 10 years, there is, on the other hand, little doubt that NAFTA was an important contributing factor.

When President George H.W. Bush accepted President Salinas' offer to negotiate NAFTA, many people in the United States expressed considerable doubt about the wisdom of that decision. The skeptics predicted disaster for the U.S. economy and for Mexico. Despite the frequently repeated criticisms over the past 10 years and the effort expended to diminish NAFTA's accomplishments, however, the blunt fact is that NAFTA did not lead to the economic ruin some predicted. The numbers leave little doubt that our economy and our citizens are far better off today than they would be had we not taken the historic step of negotiating this agreement in the early 1990s. The same can be said for the economies and citizens of Canada and Mexico.

In trade terms alone, NAFTA has proven to be a remarkable success. Total trade among the NAFTA partners has more than doubled from $302 billion in 1993 to $652 billion in 2003. That's $1.8 billion in trade every day - $1.2 million per minute. That figure represents over one-third of total U.S. exports. In fact, U.S. exports to Canada and Mexico increased from $142 billion to $267 billion in NAFTA's first decade – significantly higher than the 41 percent increase of our exports to the rest of the world.

Canada, of course, was and is our largest trading partner. U.S. exports to Canada are up by nearly 69 percent since 1993 and account for 23 percent of U.S. merchandise exports. We trade more with the province of Ontario than we do with Germany. In fact, Ontario alone is our second largest export market.

Nonetheless, the more remarkable story is the expansion of trade with Mexico. Since NAFTA's entry into force, Mexico has overtaken Japan to become our second largest trading partner. Since 1993, trade with Mexico has nearly tripled in nominal terms and the share of U.S.-Mexico trade in overall U.S. trade has increased from 7.8 to 11.9 percent.

The benefits of NAFTA in the United States are, moreover, widespread. Forty-seven states increased their merchandise exports to Mexico and Canada from 1993 to 2003. Twenty-five states recorded increases of more than $1 billion. In fact, twenty-four states more than doubled exports to our NAFTA partners over the ten-year period.

Some of the fastest export growth came not from traditional export powerhouses but from states such as Wyoming whose exports to Mexico and Canada rose by more than 400 percent from 1993 to 2003 and West Virginia with growth of 187 percent. Canada is the largest export market for thirty-seven states and twenty-three states send more than one quarter of their exports north of the border. Mexico is the largest export market for three states and the second largest export market for seventeen more.

What did that mean for our economic growth and our standard of living? During the intervening 10 years since NAFTA went into force, the American economy grew by 38 percent or 3.8 percent per year on average. Similarly, the Canadian economy grew by 41 percent (4.1 percent per year) and the Mexican economy grew by 30 percent (3.0 percent per year). That growth translated into a rising standard of living. In the United States, GDP per capita rose by 22 percent. Per capita GDP grew by 28 percent in Canada and by 12 percent in Mexico.

That increase in our standard of living is fundamentally consistent with a strong upswing in productivity in all three countries since NAFTA was signed. Rising productivity is essential to a rising standard of living in any country and, by that measure, NAFTA fares extraordinarily well. Productivity rose 53 percent in the United States from 1993 to 2002, whereas productivity gains in Mexico equaled 55 percent and Canadian gains totaled 23 percent. While efficiency gains due to trade liberalization were not the sole reason for rising productivity, NAFTA undoubtedly contributed.

The U.S. gains in productivity are particularly striking when viewed against the historical backdrop of the 1980s U.S. economy – one in which productivity was lagging and our competitiveness was in doubt. When viewed as a zero-sum game, as trade is by many of its critics, it is not difficult to see why they were concerned with the prospect of NAFTA. There seemed little prospect that the United States could compete with lower wages in Mexico given its stagnating productivity.

The point, of course, is that trade is not a zero-sum game and the very gains in productivity that flowed from NAFTA were one of the reasons that the United States could continue, not only to compete, but also to succeed in regaining its competitiveness globally. That fact is borne out by the employment numbers of the past decade.

While much of the recent debate about the recovery of the U.S. economy has focused on job growth, the debate tends to ignore the fact that unemployment today, even coming out of a recession, is significantly lower than it was the year before NAFTA went into effect. The U.S. unemployment rate stood at 6.9 percent in 1993; today, that figure is roughly 5.7 percent. Canada's unemployment rate is nearly 4 percentage points lower today than it was in 1993 (11.4 versus 7.6 percent). While Mexican employment figures are estimates for urban areas only and are not, therefore, directly comparable to the U.S. and Canadian figures, they nonetheless are slightly lower today than a decade ago (3.4 versus 3.3 percent).

Significantly, the population of the three countries was growing throughout the intervening 10 years while unemployment was dropping. What that means is that, rather than witnessing significant job losses due to NAFTA, the rate of job creation in all three economies stayed ahead of increases in population.

In fact, the result is that NAFTA has been virtually job neutral. Given what most reputable economists say about the employment effects of NAFTA, that finding is not surprising. Sandra Polaski of the Carnegie Endowment wrote in the Endowment's recent publication "NAFTA's Promise and Reality," that "the best models to date suggest that NAFTA has caused either no net change in [U.S.] employment or a very small net gain of jobs." Similarly, in a December 2001 report, the International Trade Commission noted that even "the most extreme estimate of job gains or losses due to NAFTA are on the order of hundreds of thousands of jobs.

It is always important to put numbers like that in context. For example, in any three-month period, the U.S. economy both creates and loses roughly 7.5 million jobs. Seen in that light, even the most extreme claims of job losses due to NAFTA after 10 years would amount to less than 10 percent of the jobs lost or created every three months in the United States.

Those figures bear out a point made in the January 3, 2004 issue of *The Economist*. There, the authors, rightfully in my view, criticized the proponents of NAFTA for overselling their case, noting, "It was never plausible, for instance, to expect that NAFTA would be a net creator of jobs. Trade policy is not a driver of overall employment; it affects the pattern of jobs, rather than the total number."

That criticism, of course, applies with equal force to NAFTA's critics and their arguments regarding job losses. Simply put, there was no "giant sucking sound." Far from debilitating the U.S. economy, NAFTA prefigured a period of extraordinarily strong economic growth in all three economies. The argument that NAFTA spelled economic ruin is simply not sustainable.

II. Sectoral Impact

Moving from the aggregate to the specific, the evidence on the impact of NAFTA on several sectors of our economy is overwhelmingly positive. NAFTA-related trade and investment liberalization has allowed U.S. firms not just to find new markets in Canada and Mexico. They have also maximized efficiencies, gained in terms of global competitiveness, and increased sales to other world markets as well.

Examining sectors does, however, underscore certain basic and important lessons about competing in a global economy. Those industries that seized the opportunity that NAFTA afforded and made investment and employment decisions based on the expectation that trade would increase and innovation would thrive were rewarded. Those industries that bet against NAFTA and did not make needed adjustments to do business in a more competitive environment were not as successful.

The gains from NAFTA in the automotive sector offer one of the pact's most compelling success stories. Before NAFTA entered into force, exports to Mexico from the United States were artificially constrained by a host of measures enacted by the Mexican government to force firms to maintain local production in Mexico, if they wished to sell in the market.

I can testify personally to the impact that had on consumers. In 1980, when I was a junior Foreign Service Officer, I was assigned to Mexico. One of the most surprising things I was told by the State Department as I began the process of relocating to Mexico was the fact that my U.S.-made Ford could not enter Mexico. I was obliged to buy a Volkswagen Rabbit, a model that was made in Mexico, as our family car for the next two years and at a generously higher price.

NAFTA put an end to those practices and led to an amazing rate of growth in our automobile exports to Mexico. The numbers bear that out. In 1993, our shipments of new passenger vehicles and light trucks totaled less than $95 million. They jumped 500 percent in 1994, the first year of the agreement, reaching $580 million. By the end of 2003, U.S. exports to Mexico totaled $3.2 billion, a 3400 percent increase in shipments when compared to 1993.

Still more importantly, without the constraints that many times forced U.S. firms to locate in Mexico as a condition of exporting to the Mexican market, firms were able to rationalize their production on a North American basis. That frequently meant relocating some of their Mexican production to U.S. plants because they were now free to export to Mexico from the U.S. without being subject to artificial import and local production constraints.

That effect played out in numerous investment decisions. One particularly striking example was Chrysler's decision to build one of its hottest selling vehicles, the Durango, in Delaware. Without the constraints of Mexican trade barriers, Chrysler was free to locate production in the United States and still take advantage of higher demand for sport utility vehicles in all three markets – the United States, Canada, and Mexico.

NAFTA has improved the prospects for parts makers as well as original equipment manufacturers like Chrysler. For example, without NAFTA, automotive parts maker TRW would have moved its manufacturing facility in Lebanon, Tennessee, to Mexico. Instead, NAFTA's cuts in tariffs and local content requirements allowed TRW to keep production in Tennessee and to add 200 jobs since NAFTA's passage.

The growth in exports of agricultural equipment to our NAFTA trading partners reflects a similar success story. Our exports of such equipment to other NAFTA countries have exceeded growth to the rest of the world. From 1992 to 2002, U.S. agricultural firms increased exports 46 and 93 percent to Canada and Mexico respectively while exports to the rest of the world grew 37 percent.

Prior to NAFTA's entry into force, U.S. firms faced an average tariff of 12% on exports to Mexico. Now U.S. exporters enjoy duty-free access while competitors from Japan and China face tariffs of up to 23 percent. As a result of this advantage, U.S. exporters have captured more than three-quarters of the Mexican market.

The benefits of that growth extend down through the entire U.S. supply chain. For example, Elliott Tool Technologies, a small business in Dayton, Ohio, and a supplier to Caterpillar, Inc. is one of many NAFTA beneficiaries. "NAFTA certainly has helped us in marketing and selling Elliott tube tools into Mexico," said Jim Ireton, vice president for international sales and marketing.

The same holds true for U.S. chemical firms. Mexico and Canada are the first and third largest export markets, respectively, for American chemicals. The industry, encouraged by opportunities offered by NAFTA trade rules, continues to focus on expanding NAFTA markets by upgrading investment and marketing plans, especially with regard to plastics, solvents, thinners, and other chemical preparations.

For example, Eastern Color and Chemical, of Providence, Rhode Island, supplies dyes and chemicals to the textile and leather industry in Mexico, which in turn exports textiles, apparel, and footwear to the United States and Canada. According to technical manager Fred Savell, business has been expanding in recent years, and the company anticipates doing even better in the next few years.

U.S. firms exported a total of $53.6 billion in environmental technology products and services in 2002, including $11.2 billion to Canada and $7.7 billion to Mexico. Together, our NAFTA partners account for more than one-third of total U.S. exports of environmental technologies. Before NAFTA, U.S. exports of environmental technology products to Mexico and Canada faced tariffs up to 35%. Today, most U.S. exports in this sector to Canada and Mexico receive duty-free treatment. For example, U.S. exports of steam-generating watertube boilers to Mexico enter duty free, while those from South Korea and Taiwan are subject to a 22% tariff. U.S. firms also benefit from NAFTA-driven increased government transparency in environmental laws and regulations in Mexico.

Our NAFTA partners account for twenty-nine percent of total U.S. exports of information and communication technology (ICT) and are the first and second largest export markets. Exports to Mexico increased by 239% from 1992 to 2002. In addition, closer trade and investment ties due to NAFTA allow U.S. ICT firms easier access to Canada's and Mexico's growing computer markets, which have more than doubled in size since 1992 to $12.7 billion combined. The packaged software market alone in Canada and Mexico was worth $4.5 billion in 2002, triple the pre-NAFTA market size. Non-tariff barrier elimination was also important for the ICT industry, which realized NAFTA benefits through more transparent commercial dealings, removal of investment barriers, and the opening of Mexico's lucrative government procurement market for U.S. suppliers. This sector also benefits from stronger intellectual property rights protection following NAFTA, including increased protection of integrated circuit layout designs and trade secrets.

"Each year we continue to find innovative ways to use NAFTA as a means to serve our customers and remain price-competitive," said Kitty Krishnamurthy, vice president of the Panasonic facility in Troy, Ohio. NAFTA is crucial to the competitiveness of Panasonic's color television cathode-ray-tube production in Troy. It provides Panasonic's customers a source of duty-free materials, ease of logistics planning among border factories, and lower operating costs along the border trading zone.

NAFTA's elimination of virtually all tariffs on <u>medical equipment</u> has helped to increase U.S. exports to Canada and Mexico. Today U.S. medical equipment firms experience no significant tariff barriers in either country. Before NAFTA, Mexican importers of U.S. medical equipment paid nearly $100 million annually in tariff costs, including tariffs as high as 20 percent on some products.

Today, U.S. firms enjoy nearly duty-free access to these markets. U.S. exports of dental and medical chairs and parts to Mexico enter duty free, while those from Japan are subject to a 22 percent duty. Similarly, U.S. exports of ultrasonic scanning equipment enter Mexico duty free, while Japanese and South Korean exporters are subject to a 17 percent tariff. NAFTA also eliminated several nontariff barriers in Canada and Mexico. Today U.S. exporters benefit from uniform customs procedures, greater transparency in standards and government procurement, and stronger protection for trade secrets that have commercial value such as product processes, formulas, and customer lists.

Lower NAFTA tariffs on <u>pharmaceuticals</u> have fostered greater choices for the inputs needed for pharmaceutical production. A world-class patent regime in Mexico, bolstered by NAFTA's patent provisions, gives innovators a favorable environment to launch new compounds. U.S. pharmaceutical exports to Canada and Mexico combined increased 144 percent from 1992 to 2002 – greater than the 125 percent increase in exports to the rest of the world.

Wyeth Pharmaceuticals, of Princeton, New Jersey, has benefited from NAFTA driven tariff elimination, stronger patent laws and enforcement, and transparency in government decision-making in Mexico and Canada. Wyeth now enjoys increased flexibility in sourcing bulk intermediate inputs and faster approval of new products than previously existed.

NAFTA has provided U.S. processed food and beverage firms with increased flexibility. U.S. food companies have increased options regarding how to meet the "just in time" delivery requirements of customers, particularly those along the border. For example, U.S. direct investment in Mexico's processed food industry – largely in snack foods, vegetable oils, meat and poultry, and confectionery products – has quadrupled since 1987. U.S. malt beer exporters enjoy duty-free access to Mexico, while exports from competitors are subject to a 28 percent tariff. Since 1993, malt beer exports to Mexico have increased 185 percent. NAFTA has also addressed some nontariff barriers that are important to the processed foods and beverages industry, including Mexico's regulations for product testing, certification, and labeling.

NAFTA has enabled Orion Food Systems Inc., of Sioux Falls, South Dakota, to increase sales and profits across Canada. Orion exports the majority of products needed to open and maintain its fast food restaurants across western Canada. Its increased market presence in Canada has meant increased exports of pizza dough and pizza sauce, both manufactured in Sioux Falls. Orion's exports to Canada have quadrupled since 1998.

NAFTA eliminated or significantly reduced all tariffs in scientific equipment for U.S. exporters. Now U.S. scientific equipment exporters enjoy duty-free access to Mexico while exporters from competing countries such as China and Japan face tariffs up to 23 percent. For example, U.S. exports of instant cameras and photographic equipment enter Mexico duty free while Chinese and Japanese goods are subject to a 23 percent tariff. U.S. exports of precision instruments such as manostats and voltage current regulators enter Mexico duty free, while Japanese and South Korean exports are subject to tariffs as high as 30 percent. This means that our exporters have a significant price advantage when selling in the Mexican market, enabling them to capture 66 percent of this import market. NAFTA standardized customs procedures and increased transparency in both standards and government procurement, which significantly helped manufacturers in this sector.

NAFTA has had a positive impact on the increasingly significant service industries. NAFTA eliminated all of Mexico's restrictions on market share in the banking sector and permits U.S. investors to participate in the Mexican banking system through the acquisition of existing banks or the establishment of U.S.-owned and controlled subsidiaries. NAFTA allows U.S. investors to participate in the Mexican insurance market via acquisitions, joint ventures, or subsidiaries. Some 30 foreign-owned insurance companies now operate in Mexico, over half of which are owned by U.S. firms. NAFTA also eliminated Mexico's restrictions on purchases by its citizens of U.S. life and health insurance when in the United States.

NAFTA eliminated several important barriers to U.S. services trade. NAFTA established the principle of "national treatment" for services trade by which governments must treat NAFTA members' services firms as favorably as local firms. NAFTA prohibited local presence requirements and quantitative restrictions that discriminate against non-local service providers. NAFTA also called for the elimination of citizenship and permanent residency requirements for professional service providers of another

NAFTA partner. In 2002, U.S. professional services exports (e.g., accounting, legal and medical services) to Canada and Mexico reached $4 billion.

Increases in NAFTA-related assembly operations have enabled Netlink Transaction Services, of Victor, New York, to increase exports of cross-border payroll and banking services. This "virtual banking services provider" has increased the number of Mexican assembly plant workers in Mexico's border cities for whom it provides banking services from 6,000 to more than 100,000 over the past few years.

Although not specifically a component of NAFTA, passenger travel is the single most important service traded between the United States and our NAFTA partners. The substantial growth in NAFTA commerce and investment has fueled the demand for regional passenger travel. It accounted for more than one-third of total U.S.-NAFTA private service trade in 2002. During 2002, Canadian and Mexican travelers to the United States spent $11.8 billion, or 18 percent of all spending by foreign visitors.

While many of the sectors mentioned above suggest unqualified success, it is also worth examining the facts regarding sectors of the U.S. economy that have undergone the most significant economic adjustment over the intervening 10 years since NAFTA went into force. The most prominent example is that of <u>textiles and apparel</u>.

There is little doubt that the textile and apparel industry has faced considerable challenges for many years despite benefiting from protective quotas and significant subsidies (e.g., payments to textile makers through the cotton subsidy program to offset the higher cost of purchasing U.S. cotton). Indeed, the 40 years of quotas left the industry in a highly fragmented state, unable to gain economies of scale that would allow it to compete on a broader scale for world markets.

The NAFTA had two principal effects for our textile and apparel industry, both beneficial, contrary to what many of NAFTA's most vociferous critics maintain. The first is that our NAFTA partners now purchase nearly half of our exports of textiles and apparel products. The second was the opportunity offered U.S. producers to optimize production and manufacturing throughout the North American market.

U.S. exports in the sector, from cotton to yarn to fabric, benefited particularly from the NAFTA "yarn forward" rule of origin. By creating a preference for the use of U.S. fiber and fabric among Mexican apparel manufacturers, NAFTA expanded the potential customer base for American firms and lowered their average cost per unit by allowing them longer production runs. In addition, the NAFTA rules encouraged production-sharing arrangements that allowed U.S. firms to compete on a larger scale.

Those beneficial effects account, in part, for the improved performance of the U.S. textile industry in the years immediately following NAFTA's signing. From 1993 to 1997, the value of textile industry shipments grew by 13 percent. Apparel produced in Mexico, using U.S. and/or Mexican fiber and fabric remained highly competitive not only in the U.S. market, but even against Asian products in foreign markets.

The significant downturn in the textile industry's fortunes coincided with the onset of the Asian financial crisis in 1997. The crisis resulted in a radical realignment of exchange rates and trade flows, particularly in the case of textiles and apparel. To remain competitive themselves in the highly competitive world of retailing, retailers shifted their sourcing back toward Asia in that timeframe. Without competitive domestic apparel customers, U.S. textile shipments began to fall in the face of an onslaught of lower-priced Asian apparel.

The impact of the Asian financial crisis was compounded by fashion in another sense – in this case, the fashion in our own capital markets that favored investments in a variety of high technology ventures in the late 1990s. It became exceedingly difficult to obtain financing for the expansion of any traditional manufacturing enterprise, the "bricks and mortar" parts of the economy that did not show the same potential for growth that many on Wall Street calculated for initial public offerings of tech stocks.

As we now know, a fair share of those investments went bust. In addition, the boom of late the1990s was fed by what we now know were inflated income statements. In either event, however, the result was the same from the perspective of the textile industry and many other traditional U.S. manufacturers. Without the capital to finance expansions that would allow them to operate on a sustainable scale, their competitive position weakened.

With the general slowdown in the U.S. and world economies in 2000, domestic textile manufacturers were forced to adjust. Those U.S. textile companies that had invested in Mexico and built modern, state-of-the-art facilities for long runs of bottom-weight fabrics, such as twill and denim, faced a difficult choice. And that choice frequently meant that their production and employment cutbacks occurred disproportionately in their older, less efficient U.S. operations.

My point in focusing on the textile and apparel sector at length is to explain why the numbers that many of NAFTA's most ardent critics cite, particularly as to job losses, have less to do with the direct effect of NAFTA on the industry's prospects than to the failure to take full advantage of what NAFTA had to offer. Many in the U.S. textile industry viewed NAFTA as a means of survival, rather than envisioning the agreement as a vehicle for growth.

For example, the great preponderance of the yarns and fabrics exported to Mexico has been used to make apparel in export processing zones, which is sold to existing customers in the United States, not to new customers in Mexico. Moreover, textile companies did not focus on making Mexico an export platform to markets outside the Western Hemisphere, even after conclusion of the EU-Mexico Union Free Trade Agreement in 2000 created new export opportunities in Europe for textiles and apparel manufactured in Mexico.

That is not to say that we are not concerned about job loss. Nor will we, as some in the capital markets have, simply write off American manufacturing, including in the textile sector. Quite the contrary, if anything, my recent experience attending a series of roundtables across the country with American manufacturers as part of the Administration's Manufacturing Initiative suggested that the United States retains its basic strength in manufacturing. We tend to forget that, standing alone, our manufacturing sector today would be the 5th largest economy in the world – larger than China's economy as a whole.

Nonetheless, the time I spent with our manufacturers, including those in our textile and apparel industry, suggests to me that we will not address the challenges we face in making American manufacturing globally competitive if we take refuge in comforting arguments that lay the blame for economic adjustment at the door of particular trade agreements like NAFTA, and fail to address the far more fundamental issues involved.

III. NAFTA and Mexican Economic and Political Reform

As I noted, I have had the opportunity to follow economic and political developments in Mexico since I served there as a junior Foreign Service Officer some twenty-five years ago. The Mexico I knew then was remarkably different than the Mexico I return to now. The most visible changes relate to the economic benefits that have flowed from NAFTA. For instance, the brand new Jetta on the streets of Mexico City has supplanted the beat up Volkswagen Beetle. U.S. franchises from million dollar hotel chains to the ubiquitous fast food chains, and most recently even Starbucks, fill the streets of even the smallest towns.

When I worked in Mexico, the Mexican government owned more of the economy by some measures than the Soviet government owned in the way of Russian assets. The economy was so tightly controlled, that otherwise honest businessmen were forced to operate clandestine auto repair shops, rather than become trapped in the endless red tape that attended opening a business legally. The only question was to whom you paid the "mordida," not whether it would be paid. And, the Partido Revolucionario Institucional (PRI) served basically as a large political brokering mechanism among the various contending economic interests from the well-to-do and well-connected of Mexico City's intellectual elite to the ejiditarios who pressed their land claims on the government to the union leaders that ran Pemex in all but name.

By contrast, today, Mexican businesses thrive and attract business from both sides of the border. If you visit Monterrey, for example, you have to look closely to realize that you are not in south Texas. And even then, you can be easily confused because even the license plates on the cars offer a lesson in geographic proximity and economic interaction. What was a closed economy, heavily dependent on subsistence agriculture and high industrial tariffs, is now a vibrant, modern economy.

When I served in Mexico, no one would have believed that less than a quarter century later Mexico would be a member of the Organization for Economic Cooperation and Development (traditionally viewed in Mexican political circles of the time as the "rich man's club"). Nor would anyone have believed that Mexico would not only have joined the General Agreement on Tariffs and Trade, but be one of the leaders in the world trading system pressing for further liberalization as witnessed by its hosting the recent World Trade Organization ministerial in Cancun.

Even more dramatically, and I will return to this point later, no one would have expected that the Mexican president would represent a party other than the PRI. The PRI had already been in power for about fifty years when I served there. Who would have guessed that a former Coca-Cola executive from the PAN would sit in Los Pinos – the Mexican equivalent of the White House – twenty-five years later? And, who would have expected that he would face considerable opposition by contending parties in the Mexican congress?

My point in offering those personal reflections on the changes I have seen in Mexico over the past quarter century is simply to say that macroeconomic numbers and sector-specific details cited above tell part of the story of NAFTA. The Mexican economy grew in the past decade, as did many other economies in this hemisphere. But Mexico's experience, because of NAFTA, goes far deeper than simply increasing trade and economic growth.

Perhaps the best comparison is one to which I alluded earlier. Having said that trade is really about the higher economic growth that flows from more productive resource allocation, how does Mexican growth in the 1980s before Mexico undertook many of the domestic economic reforms that prepared the way for NAFTA compare with its growth in 1990s, which includes the period after NAFTA was signed? In the event, Mexico grew an average of 3.4 percent per year in the 1990s, while growth averaged only 1.9 percent per year in the 1980s.

NAFTA, as well as the domestic economic reforms that it cemented into place, also help explain how Mexico recovered more quickly from the economic crisis in 1994 than it did from the debt crisis it faced in the early 1980s. Mexican GDP reached a peak in early 1982 at the onset of the debt crisis that it did not reach again until early 1988, nearly six years later. By contrast, the economic crisis Mexico faced in the mid-1990s lasted only 6 to 9 months, and six years later the economy was up over 30 percent.

The change in the economic and political relationship between the United States and Mexico, which NAFTA fostered, contributed significantly to those outcomes. Tying the Mexican economy more intensely through trade with the United States created a partnership that was able to weather the storm better than ever before. Former Treasury Secretary Robert Rubin's recent book, <u>In an Uncertain World</u>, recounts the story. According to Secretary Rubin, President Clinton recognized quickly the potentially negative impact on our economy that could come from allowing the Mexican economy to slip further into crisis and chose, unlike in 1982, to loan Mexico necessary funds to stabilize its economy.

That loan was grounded in our own self-interest, but represented considerably more than that -- it represented an appreciation of the significant effort that Mexico had taken to put its economy on a sounder footing and demonstrated the U.S. commitment to its newest free trade partner. Mexico's ability to pay back that loan even before it was due was a demonstration of how NAFTA could help restore investor confidence and bring an early end to the financial crisis. Our close economic relationship continues to foster internal changes in Mexico partly because of the market competition in goods and services and partly because government has responded to the needs of the economy to be more flexible and competitive. This has created a much more stable economy to our south and our second most important trading relationship.

President Salinas' vision for a free trade agreement when he proposed it in 1992 was doubtless about creating the kind of economic relationship I just described. But his interest in seeking what became NAFTA was more than simply tariff reduction. He saw the agreement as a tool toward greater economic <u>and</u> political opening – as part of a broader transformation of Mexico.

President Salinas presented an opportunity and, together with our Canadian friends, we seized that opportunity to transform our economic and political ties. What flowed from that negotiation affected the economics in many ways, some of which I have outlined above. But, in my view, the far more profound impact of NAFTA and the various reforms undertaken first by President Salinas and reinforced later by President Zedillo were on politics in Mexico.

I have often made the argument that freedom is ultimately indivisible. While we often refer to it in its various guises as economic or political freedom, in the end it is simply freedom. In the United States, we live with such freedom that we frequently forget the extent to which dividing the economic interests of the individual from those of the state sows the seeds of political pluralism.

The corollary is that economic opening often leads to political opening and Mexico is one of the best examples of that theory. The expectations created by the economic opening, including steps as simple as allowing people to open a tire-repair shop in Tijuana, lead the same people to seek political reforms and to seize the political opening that comes with them. That process culminated with the election, in 2000, of Vicente Fox, the first non-PRI president in more than seventy years.

While NAFTA was not the only cause, just as held true on the economic side, NAFTA was a significant contributory factor. The individual business owner was no longer obliged to pay the local PRI political machinery for his or her right to stay in business. There was a market across the border that offered more than economic freedom in the end.

Having said that, there is also little doubt in my mind that the process of reform in Mexico remains incomplete. NAFTA has enabled Mexico to make considerable progress in modernizing its economy so it can compete in the highly competitive North American market. But as in our country, not all sectors have been able or willing to take full advantage of these opportunities.

The most poignant example is the agricultural sector in Mexico. It is perhaps the best indicator that reform has not gone far enough to make Mexico fully competitive in North America. Even in this sector, there have been gains, especially in the production of fruits and vegetables. Mexico has a competitive advantage over the United States and Canada because of its climate and the intensive use of labor in such products. Moreover, fruits and vegetables can be grown efficiently in small plots of land and thus their production can be accommodated in the smaller farms mandated by Mexican legislation. I think this shows that the opportunities to export offered by NAFTA enabled certain members of the agricultural sector to prosper in spite of Mexican regulations.

On the other hand, producers of such staple crops as corn and beans cannot compete against highly efficient mechanized agricultural producers in the United States, with or without the benefit of subsidies. The solution is for Mexico to make the needed reforms to enhance its competitiveness in those sectors where it has a comparative advantage, and not through measures such as the imposition of new taxes to hinder the import of products where the United States has a competitive advantage such as high fructose corn syrup. Not surprisingly, the greatest opposition to the NAFTA comes from the agrarian sector – the sector that was least well prepared to compete when the remaining tariff barriers fell in 2003.

But much more can and should be done in the agricultural sector and elsewhere if Mexico is to fully capitalize on the opportunities of NAFTA. Continued reform will ensure that capital flows to the areas where Mexico is most competitive. As you may know, needed economic reforms in the labor, fiscal, and energy sectors stalled in a divided Mexican Congress last December. It's during such times that some Mexicans may yearn for old style, one-party executive efficiency. But that is also exactly when the political leadership needs to step forward and do what is right for the country, rather than seeking short-term political advantage.

IV. Commerce Department's Role

I'd like to be able to tell you that NAFTA is problem-free. While it is true that the vast majority of trade crosses our borders swiftly and "just in time," there are instances when the NAFTA does not work as well as it should. Sometimes individual customs agents misunderstand the rules, sometimes exporters do not fully comply with the regulations imposed by one of our partners. And unfortunately, sometimes our partners implement regulations or policies that we believe are inconsistent with the agreement.

In the vast majority of cases, they do comply and your constituents can take advantage of all the benefits of the NAFTA. But when there are problems, Commerce is steadfast in its commitment to ensuring compliance. Our commitment to compliance is no stronger anywhere than it is with respect to the NAFTA. Nearly two years ago, A/S Bill Lash created a "NAFTA Compliance Team" to focus exclusively on the NAFTA. This team, working with staff from elsewhere in Commerce and other executive branch agencies, uses its knowledge and understanding of the NAFTA and its familiarity with the Canadian and Mexican governments to identify and resolve instances of non-compliance or impediments to market access on behalf of U.S exporters.

We have frequent and intensive discussions with our Mexican and Canadian colleagues at all levels of the government from Secretary Evans down to the staff level. The team first analyzes the complaint and then develops a strategy for resolution. The appropriate official then meets with the appropriate counterpart to raise the issue and request resolution. As one who often delivers the message to my Canadian or Mexican counterparts, I can assure you that the information is solid and the path to resolution clear. I'm proud to tell you that many of these issues are resolved promptly and successfully as a result of our team's work. In the event that we cannot reach a solution through discussions, we turn to our colleagues at USTR to pursue dispute settlement through the NAFTA or WTO procedures. We haven't had to resort to formal dispute settlement often, but we will do so whenever we feel it necessary.

Let me highlight a couple examples to give you an idea of the difficulties firms sometimes face and to describe how we seek to resolve them. In May 2002, for example, the NAFTA Compliance Team assisted U.S. companies in resuming exports for 54 U.S. beer shipments stopped at the U.S./Mexico border, in addition to subsequent shipments - preventing lost sales of over $1 million dollars. The Team determined that Mexican Customs was enforcing changes to Mexican import permit requirements not previously enforced. After the companies submitted the correct documentation, they were told it would take between 30-45 days to clear any of their shipments. The Team contacted their Mexican Customs counterparts and the shipments were resumed within a week.

Commerce was instrumental in protecting pharmaceutical patents in Mexico. The Mexican Health Ministry granted marketing approval for pharmaceuticals without first checking for valid patents. Mexico also allowed Mexican interests to rely on the test data submitted by U.S. firms. Commerce efforts were key in having Mexico publish a decree that resolved these issues, resulting in the protection of pharmaceutical patents valued in the millions of dollars.

The Canadian Parliament had been considering amendments to legislation that would have allowed for a compulsory license for the retransmission of television signals over the Internet. The U.S. and Canadian copyright industries, as well as the U.S. Government, were very concerned about the possible negative effects that this legislation would have on right holders. The Department of Commerce in tandem with the Department of State, USTR, and the Copyright Office, actively pursued several different avenues of communication with the Canadian Government in order to voice our concerns and encourage them not to pass the legislation. The bill was amended to carve Internet TV retransmission out of Canada's compulsory license regime. The bill received Royal Assent to become law in December 2002 with the Internet exemption order in place.

Let me make two final points with respect to NAFTA compliance. First of all, I want to stress that the vast majority of our trade is unimpeded. We could not have realized the gains nor the absolute volumes were this not the case. Second, we are ready and willing to help your constituents address problems they may encounter. The challenge is often in learning about those problems. So please continue to direct your constituents to us. We cannot resolve every problem, but we have an impressive track record of solving the problems brought to our attention.

In addition to the work of the NAFTA compliance team, the International Trade Administration has developed an interactive online tool available on www.export.gov to help guide U.S. exporters in filling out the North American Free Trade Agreement (NAFTA) Certificate of Origin. The NAFTA Certificate of Origin is used to show customs officials that your product qualifies for NAFTA and is therefore entitled to NAFTA's preferential tariff rates.

Because filling out the NAFTA Certificate can be difficult, ITA developed this interactive tool to provide U.S. exporters and manufacturers with line-by-line instructions and detailed descriptions of terminology on the Certificate. Your constituents can contact the Trade Information Center at 1-800-USA-TRADE for assistance.

Another important area in which the Department is actively involved that will help build on the successes of NAFTA is the U.S. – Mexico Partnership for Prosperity (P4P). This presidential initiative is designed to bring the benefits of the NAFTA to those parts of Mexico that have not fully benefited from the agreement.

The reason behind this work is not simply that we are trying to be good neighbors, although that is one of the animating motives. One of the reasons for the gains in U.S. exports to the NAFTA countries in the past ten years has been the growth of the Mexican economy and the commensurate increase in demand for U.S. goods. In addition, continued growth in the Mexican economy and creation of higher paying jobs, gives Mexican citizens a reason to stay home instead of feeling compelled to seek employment north of the border. By working with our Mexican colleagues, as well as counterparts from State, Treasury, SBA, AID, TDA, HUD, and other agencies, we are helping increase that demand.

In June, our governments will host the second P4P entrepreneurial workshop. The focus of this event is to promote networking, especially among small and medium-sized enterprises in areas such as information technology, housing construction and finance, entering the global supply chain, and infrastructure.

This event will offer an opportunity for our small businesses to make contacts and identify opportunities to sell their products to this growing market of 100 million consumers. The benefits we negotiated under the NAFTA will provide them with advantages over their foreign competitors they can use to increase sales and create jobs here in the United States. We are very excited about the opportunity to build on the success of last year's event in San Francisco. I want to talk a bit further about the Partnership in a few moments, but at this point I simply want to urge you to encourage your constituents, particularly small business representatives, to make plans to join us in Guadalajara, June 26-29. Additional information is available on the official P4P website, www.p4pworks.org

V. NAFTA's Next Decade – Focus on North American Competitiveness

Before concluding, I want to take just a few moments to suggest where we are going now after a very successful first decade of North American free trade. As I hope my comments to this point have shown, we've accomplished a great deal. As the world continues to be a smaller, and more interconnected place, we need to use the advantages of the NAFTA to ensure that we retain our high standard of living for all of our citizens.

In other words, we need to pursue measures to maintain and enhance competitiveness. The best way to do that, in our view, is not to return to the past era of high tariffs and intricate non-tariff barriers to trade, but to continue to pursue free trade. Our exporters have already proven their ability to compete in North America – the most competitive market in the world. What we want to do, working with our Mexican and Canadian colleagues, is ensure that they have access to new markets.

North America can be a platform for export to the rest of the world. We make high quality products and we do so efficiently. Our efforts to ensure, for example, that China complies with its WTO commitments are all about ensuring that our exporters have the same type of access abroad that foreign firms have in our markets. I've met with my colleagues from Canada and Mexico, as has Secretary Evans, to raise our concerns and propose joint solutions. I am pleased to report that we have a common view and approach to trade outside of North America.

We are also starting to think more broadly about competitiveness within the Partnership for Prosperity. Under P4P, American and Mexican companies have sponsored concrete projects to expand access to capital, to share technical expertise, and ultimately, to build capacity for future growth. One program has trained more than 70,000 primary and secondary school teachers in Mexico to develop students' technological skills. Another enables low-income families to buy higher-quality construction materials and receive technical assistance in homebuilding.

But the Partnership is not just about giving Mexico a hand or handout. It really is about our own competitiveness. Through the Partnership we are creating opportunities for workers and demand for products. We are also promoting a more competitive platform from which we can export to the rest of the world. A good example is the Administration's Manufacturing Initiative, which could not have been written without reference to NAFTA because our economies are inextricably linked. So even when we talk about creating an environment in the United States conducive to increased investment, it has to be done in the context of regional competitiveness. Mexico has to be part of the equation as well.

That is why we continue to meet with Mexican officials to offer our assistance and our support for the reforms that the Fox Administration has proposed. At the upcoming workshop in Guadalajara, my Mexican colleagues and I, along with counterparts from other USG agencies including State and SBA, will meet with business community representatives to hear their concerns and, I hope, their suggestions for steps the governments can take to enhance our competitiveness.

Secretary Evans often observes that governments can establish the conditions for economic expansion, but that it is up to the business community to take advantage of the opportunities. This is absolutely true in the case of the NAFTA and North American business. I mentioned the auto industry earlier as an example of integration made possible by the NAFTA.

A second example is steel. This industry has worked in the North American context to recognize and leverage common interests, and worked to improve its world position. At their urging, the three governments last year agreed to create a North American Steel Trade Committee that met for the first time last November in Mexico and will meet again next month.

This industry-government body is, in my view, the wave of the future for NAFTA. Industry has identified some steps that can help improve its ability to compete and now our governments will sit down with them to determine what is possible. I expect that other sectors may also find that they can accomplish more by recognizing common concerns and objectives and pursuing them jointly. The NAFTA Vice-Ministers, for example, have begun consideration of joint efforts within the textile industry. While nothing concrete has yet been agreed upon, I suspect this is the beginning of a trend.

Longer term, I foresee the need to promote the fact that the highest quality goods in the world are produced not just in America, but also in North America as a whole. As I can attest from my own Dodge Durango, that quality is inherent in the entire supply chain in the North American automotive sector, whether the parts and components come from the United States, Canada, or Mexico. By harnessing the competitive spirit found in this part of the world, NAFTA not only remains the most powerful economic entity in the world, but also can advance that position even in light of increasing competition from Asia.

In conclusion, Mr. Chairman, I want to reiterate that NAFTA has been a success. The impact on the U.S. economy has been broad, deep, and overwhelmingly positive. Our standard of living, and that of Canadians and Mexicans, is higher than it was in 1993. North American consumers have greater choice and pay lower prices for almost everything they purchase. The competition created by the elimination of tariffs and non-tariff barriers in North America has made our producers more efficient and productive.

As we travel the world, we will see American products in stores and homes. The ability to penetrate those markets is partly a result of the policies encouraged by the Congress and implemented by the Executive branch. But the ability to produce goods people want to buy at a price they want to pay is a result of the NAFTA and the U.S. business community's decision to take advantage of the opportunities that stem from it.

NAFTA is not perfect. We will work tirelessly to ensure that our exporters get the access to our two largest markets to which they are entitled. We will be mindful of the lessons we have learned through NAFTA as we negotiate future agreements. But let me leave you with one final thought. We've done something in North America that has not been replicated anywhere else in the world. Our people are better off than they were before NAFTA entered into force. And we stand at the beginning of NAFTA's second decade where I am certain the promise will continue to be realized and our economies and societies will grow in ways we cannot now predict.

Thank you.