



North America in the world of trade

Kent H Hughes is a Public Policy Scholar at the Woodrow Wilson International Center for Scholars

Building a competitive North America

What should North America do? Can three close neighbours with their own economies and traditions find a cooperative way to drive their collective competitiveness?

The simple answer is yes - but not in a way that ignores North America's deep ties to the global economy, other international agreements, or the reality of global businesses that cross multiple borders.

North America in economic terms

As an economy, North America is big, active, and growing. Together Canada, Mexico, and the United States have a combined population of some 474 million, 23% percent of global gross domestic product, and some 12.85% percent of world exports. Adding Central America and the Caribbean - both heavily integrated into the regional economy, would simply add to the totals.

In terms of innovation, the United States continues to stand out as world leader in terms of patents and in world changing innovations - think of the internet, Google, Apple, and a proliferating range of social media. Canada is also heavily committed to innovation, investing some 1.73 percent of GDP in research and development. At 0.43 percent of GDP (2011), Mexico currently lags behind its North American neighbours, but has a growing commitment to developing its own innovative capacity¹. In the future, the world will see Mexico devoting more resources to research and development, increasing its emphasis on STEM (science, technology, engineering, and mathematics) degrees, and sending more Mexicans abroad to acquire a science or engineering education.

In terms of economic independence, North America has ample energy resources. Canada continues to innovate in the development of its oil sands - reducing the environmental impact and raising efficiency. Mexico has taken major steps to open its oil industry to greater competition and has potential reserves in the Gulf of Mexico and as yet unexploited shale oil and gas deposits in its North. The biggest surprise is the United States, which, through new technologies, has been able to develop major shale oil and gas deposits. Although recent development has slowed in response to the sharp drop in oil prices, the American outlook for hydrocarbon supplies is bright. At the same time, the United States is continuing to push for regulations to reduce carbon emissions - a force that is already driving innovations that range from the attempt to use carbon fibre panels in everyday automobiles to boosting the efficiency of solar panels.

In the manufacturing sector, there is already a good deal of interdependence. Cars and auto parts flow regularly across North American borders. US-based manufacturing companies are heavily invested in Canada and have increased their investments in Mexico. Service industries are also increasingly integrated with Canadian banks taking a more prominent role in the wake of the 2008 financial crisis.

How competitive is North America?

Global pressure on North American wages, rising transportation costs, and the risk of distant supply chains have made North America more attractive for investment and as a source of global exports. The potential is even greater. If the United States, Canada, and Mexico make needed investments in



infrastructure, increase support for research and development, make the right choices on education, and support their respective manufacturing sectors, North America could develop into even more of a competitive force.

North America must keep its eye on the rest of the world. Competition has become a truly global game. Fluctuating exchange rates can affect import and export decisions as well where to put a new manufacturing plant. International competitors are not standing still. As an example, China is installing robots and moving up the value chain as rising wage rates put pressure on low wage, export-dependent industries. Around the world, countries are putting added emphasis on education and innovation.

Along with much strength, each of the North American economies faces its own set of challenges. In 2015, the United States is still experiencing the lingering effects of the Great Recession. While the unemployment rate has fallen below six percent, millions of Americans have simply left the workforce. Nor have wages risen. Gains from productivity have been concentrated in the upper 10 percent of the income scale. While the United States is home to many of the world's top research universities, it has mixed results in its K-12 schools. On average, Canada does considerably better but Mexico also lags in terms basic education. In addition to added pressures on the federal budget from an aging population, the United States has yet to deal with large and persistent trade deficits.

North America in the World Economy

In a world of global supply chains, international trading rules, and proliferating bilateral free trade agreements, does it even make any sense to think of regional blocs? The short answer is yes, but not at the expense of ignoring forces that will continue to drive global, economic integration.

Science has long been a largely global phenomenon and technology is now following. Major countries that are historically based in the advanced industrial countries are increasingly global in their operations and their thinking. For example, the German company Siemens and the Dutch company Phillips both have major operations in the United States. IBM currently has more employees in India than in the United States. Global auto makers from Europe, Japan, Korean, and soon, China are deeply involved in North American manufacturing, sales, and even exports.

The world of trade is now an intricate web encompassing regional and bilateral free trade agreements that complement or, some would say, complicate the global trading system. Free trade agreements often contain different rules of origin, creating supply management challenges for global companies. North America is already party to a number of trade agreements. Canada, Mexico, and the United States share the North American Free Trade Agreement and are actively involved in the Trans Pacific Partnership trade negotiations, an effort that also includes countries from South America and Asia. Mexico has a free trade agreement with the European Union and Canada has made a similar agreement with the EU. The United States and the EU are in the process of negotiating the Trans-Atlantic Trade and Investment Partnership that promises to go well beyond existing free trade pacts.

China is an important trading partner of all the North American countries as is the European Union. As major commodity exporters, all three economies are tied to global markets.

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Asian supply chains are closely linked to North American manufacturers. The three economies look abroad for rare earth minerals and other critical supplies.

Why then talk about a North American economy at all?

There are three reasons. First, strengthening and rationalizing existing ties will foster productivity growth and stimulate innovation. At present, there is little cross border discussion about how improved infrastructure links could make the three economies more competitive. As Mexico works to make its economy more innovative, increased ties with American centres of innovation and America's tier-one research universities makes very good sense. Through innovation, cooperative regulations, and future oriented incentives, intra-North American cooperation can help build a bridge to a low carbon future, secure ocean resources, and preserve water supplies. Working with Canada and Mexico, America's capacity for innovation could be harnessed to develop solutions for shared economic, environmental, and resource-based challenges.

Second, the relative independence of North America in terms of energy, commodities, and agriculture has implications for national security. Memories of 1970s oil embargos and supply interruptions still influence US energy policy. Some oil exporters have used their oil and gas supplies for geopolitical as opposed to strictly economic purposes. Saudi Arabia used the oil weapon in the 1970s. Russia has sought to use its oil and gas resources to influence European powers and, most recently, Ukraine.

The sharp drop in oil prices in the 1980s reflected a Saudi Arabian strategy that may have targeted both the Soviet Union and America's Synfuels Corporation, an early effort to develop America's shale-based resources. Today's low oil prices reflect US production, but also Saudi interest in putting pressure on oil producing rivals and discouraging further shale oil and gas production in the United States as well as its determination to build market share in Asia.

Third, Canada, Mexico, and the United States have a shared future. They are all democracies that support similar values around the world. They are all working to respond to the risk of international terrorism. Despite efforts at border control, thousand mile long borders and extensive coastlines make cooperation in security essential. Economic ties can help build closer political cooperation.

North American competitiveness and the WTO

Will greater North American cooperation and integration undercut the WTO? No. Looking back at an older set of economic blocs that limited or distorted trade ignores the whole competitiveness approach. By Competing through

investing, innovating, and educating, North America will drive progress not protectionism.

Jagdish Bhagwati, a prominent international economist, is a leading critic of the proliferation of free trade agreements. In his view, they are creating a spaghetti bowl of trade ties that complicates global economic relations and undercuts the World Trade Organization. As free trade agreements have spread to Asia, some economists have identified a second dish, a noodle bowl that adds further strands to an already complex web of trade relations.

There is another view. Started in 2011, the Doha Round of Multilateral Trade Negotiations has not yet been completed. Sadly, even selected pieces of the negotiations have not yet been made final. In addition to the intricacies of global trade negotiations, any final agreement must be agreed to by all of the 160 members of the World Trade Organization. Current tensions between Russia and the West coupled with East and South East Asian geographic rivalries make reaching a consensus on broad trade agreements even more difficult.

Outside of the multilateral negotiations, progress has been made. In contrast to the go-slow Doha Round, twenty-nine countries signed an Information Technology Agreement in 1997 covering a wide array of high-tech products. Over time, the agreement expanded to forty-six members. Current negotiations are intended to update the agreement and incorporate new members. Again there are signs of progress. In November of 2014, the United States and China reached an agreement on China's membership. The ITA agreement is overseen by the WTO.

In parallel negotiations, the Trade in Services Agreement (TISA) is designed to build on the 1995 General Agreement in Trade in Services (or GATS). It is another example of a sector specific initiative that could broaden international trade. Sectoral agreements do reduce pressures for multilateral negotiations, but they also create new rules that can inform a future global approach.

Toward a North American strategy

What should North America do? Can three close neighbours with their own economies and traditions find a cooperative way to drive their collective competitiveness?

In looking for common strengths, the North Americans cannot ignore either the diversity of the three countries and three economies or their common problems. The global shift toward inequality applies in different degrees to Canada, Mexico, and the United States. The Mexican south lags behind a rapidly growing Mexican north. The United States mixes a world leading set of universities with a K-12 system that ranges from outstanding to, at times, failing. History can always be a factor.

Canada and Mexico have some long standing questions about their American neighbour. If Americans ask their northern neighbours to define a Canadian, they are still likely to hear, 'we are not Americans.' In thinking about Mexico, it is still important for Americans to remember the much quoted phrase of the long-serving Mexican president, Porfirio Diaz. "Poor Mexico" he said, "So far from God, so close to the United States."

But the potential for building North American trade and competitiveness should not be held hostage to history. In fact, North America is already looking to a cooperative future. In 2014, the Council on Foreign Relations (CFR) released a report *North America: Time for a New Focus* that contained an ambitious agenda for North American cooperation on everything from cyber security to education. The report calls for specific North American desks at the National Security Council and the Department of State to make sure that there was a clear eyed focus on North America when the United States is setting its global policy.

To identify current or potential areas of cooperation, the CFR task force also proposes "designating a senior US official as the North American 'champion' who will press for consistent policies across agencies and topics." Sceptics will note the problems of past efforts in promoting cross-administration cooperation. President Obama's first term experiment with a series of in-the-White House czars has now faded. Coupling the high-level champion with a congressional requirement for an annual or even biennial report on how policies reflect that shared potential of North America would create periodic pressure for any administration to think in North American terms.

One measure of the scope of their visions is the call to develop a regional education and innovation strategy. The latter would include the creation of a 'North American network of laboratories for basic research. American, Canadian, and, in practice, researchers from around the world share developments in basic research.' In recent years, Mexico has been moving to further develop its own capacity for innovations. As an example, last year the Woodrow Wilson Center's Mexico Institute hosted a group of Mexican legislators who were looking at the current US innovation system for initiatives that could be adapted to the Mexican system².

In December of 2014, the Canadian Council of Chief Executives published *Made in North America: A new agenda to sharpen our competitive edge*. The report includes a list of 35 specific steps to improve North American competitiveness. The list ranged from infrastructure to improved customs procedures to cooperation in defining job skills.

In addition to the proposals of the Council on Foreign Relations and the Canadian Council of Chief Executives, the three countries could take on a shared effort to respond to specific regional problems that range from transportation blockages to water use to adopting on-line education. In a similar vein, they could explore regional aspects of global challenges such as possible flu pandemics or natural disasters.

Conclusions

America's size, dynamism, and global engagement have often led Americans to take their neighbours for granted. Yet shared interests and the potential for added growth make a compelling case for thoughtful cooperation. The three countries of North America have a clear shared interest in regional security, improved education, and an ambitious innovation agenda. In taking a regional approach to investment and trade as well as education and innovation, Canada, Mexico, and the United States could set examples that other regions could pursue to their own economic and security advantage. ■

1. Figures are from the World Bank, 2012

2. See *Fostering Innovation in Mexico: Ideas from the High-Level Innovation Forum for Policymakers 2014*