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“North America or Asia? The 21st Century Choice for the United States”

by

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Introduction

While the debate on the costs and benefits of globalization continues, the world economy seems increasingly divided into three regions - a dynamic East Asia, a crisis-prone Euro-Zone, and an uninspired North America. Each region faces formidable challenges, but only North America seems unaware that, at this time, its future competitiveness depends more on addressing its continental problems than in relating to the other markets.

At the Asia Pacific Economic Cooperation (APEC) Summit in Hawaii in November 2011, President Barack Obama sought to hitch the stalled U.S. economy to a growing East Asia. His vehicle is the Trans-Pacific Partnership (TPP), a free trade proposal with eight small Asian countries. If his purpose is to balance China or prevent it from dominating Asia economically - both sensible goals - then he's purchased the wrong car. The TPP won't take us there. Nor will it create American jobs.



If the President Obama wants to double exports and give a positive jolt to the U.S. economy, he should give priority to forging a seamless market with Canada and Mexico. Though he may be tempted to think he can do TPP and North America at the same time, he should reflect on the fact that it took **eight years** to accomplish a simpler task – free-trade agreements with Panama and Colombia. If, instead, he embarked on a concerted strategy to deepen integration with Canada and Mexico, he would not only stimulate the U.S. economy, he would strengthen our region's bargaining power with Asia.

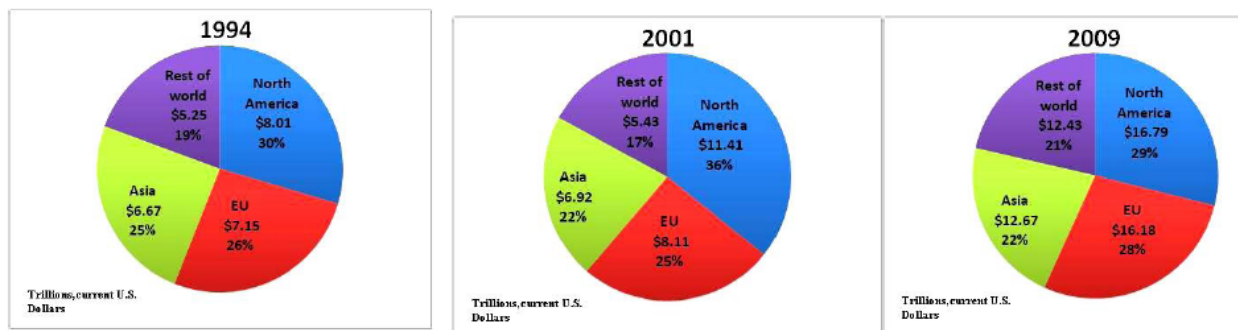
The United States needs to think strategically and sequentially. In a world of three competing regions, he should draw from the region of our greatest strength - North America - to help the economy, open Asia and reassume global leadership.

A World of Competing Regions

Together, East Asia, Europe and North America constitute about 80 percent of the world's product and trade, and most trade occurs within each region rather than between them. Even in an age of globalization, proximity matters.

During the past 15 years, the regions have performed somewhat differently than most people think. Parts of East Asia have achieved the highest growth rates, but as a whole, the region's share of world product declined from 25 percent to 22 percent. The European Union's share increased from 26 percent to 28 percent. Most surprising, the gross product of the three countries of North America soared from 30 percent of the world in 1994, as NAFTA was implemented, to 36 percent in 2001. Since then, it has declined to 29 percent, but it remains the largest economic bloc of the three.

Regional Shares of World Product: 1994, 2001, and 2009



Note: The European Union expanded from 12 to 15 countries in 1995, to 25 in 2005, and 27 in 2007. Asia includes Japan, China, South Korea, Taiwan, Hong Kong, and the ten countries of ASEAN.

Source: UN Stats Division, *National Accounts Estimates of Main Aggregates*, and World Bank, *World Databank*, 1994 and 2001. Data for Taiwan from IndexMundi. Access in 2010.

[NA/Data/Reg Shares of World Prod 1994 to 2009]



Faced with the most urgent crisis, the European Union has taken the boldest, most long-term approach. Instead of fragmenting or retreating to unilateralism, the region is forging a fiscal union that will discipline its members' budgets while investing in the region's future. When faced with a financial crisis in 1997, Asia assembled a stabilization fund and began negotiating free-trade agreements within the region.

In contrast to Europe and Asia, the leaders of North America took a few timid steps toward constructing an edifice on a NAFTA base, and then they retreated. In 2005, President Bush and his Mexican and Canadian counterparts proposed a "Security and Prosperity Partnership" (SPP). The SPP contained a broad set of goals to harmonize regulations, improve border efficiency and deepen integration using dozens of inter-bureaucratic working groups. When the SPP was criticized by the right for undermining U.S. sovereignty, and by the left for being too solicitous of business at the expense of workers, Bush lost interest in it. In 2008, with SPP languishing, the World Trade Organization (WTO) talks stalled and Asia negotiating regional agreements, Bush's Trade Negotiator Susan Schwab joined representatives of four small open economies that were negotiating the TPP.

Neither the TPP nor the SPP flourished, and when President Obama was inaugurated, he discarded the SPP, put the TPP in limbo, and placed trade policy in the deep freeze. After the Republicans won the House of Representatives in 2010, Obama rediscovered the need for a trade policy and negotiated a compromise with Congress to approve the Panama, Colombia and South Korean free-trade agreements with a trade adjustment assistance package. Then, as host of the APEC Summit, the president decided to retrieve the TPP and feature it as the meeting's crowning achievement.

Unfortunately, the policy seems to be driven more by headlines – the rise of China and the fall in jobs – than by a systematic assessment as to which strategy – TPP or economic integration in North America – was more likely to help the American economy. There is no evidence that the Administration ever did such an analysis. If it had, it would have learned that it over-estimated the TPP and under-estimated North America.

Four of the eight TPP countries – Singapore, Australia, Peru and Chile – already have free trade agreements with the United States. The other four – Brunei, New Zealand, Malaysia, and Vietnam – have very small economies. All eight countries have a combined gross product of about one-seventh of Canada and Mexico.

What is the TPP? Michael Froman, the deputy national security advisor for economic affairs, who was formerly with Citigroup and has played a leading role in the Obama Administration in giving priority to Asia and the TPP over North and Latin America, called the TPP "among the most important and historic developments in international



trade in recent years."¹ He described the TPP's "unique" qualities as being "comprehensive," meaning it would eliminate tariff and non-tariff barriers; address cross-cutting issues, like regulations and the digital economy; and encourage competitiveness, development, and small business. Of course, these qualities are not unique to TPP; they are part of NAFTA and other free-trade agreements. The TPP would be the first U.S. trade agreement with Asian-Pacific countries, and it would be unique if it eliminated **all** trade barriers without exceptions, but that is a dubious proposition.

On the eve of the November 2011 APEC Summit in Hawaii, Japan said it wanted to consult about participating in the negotiations on TPP, and Mexico and Canada followed with a similar announcement. Japan is probably trying to keep one foot on both sides of the Pacific, and Canada and Mexico are trying to defend what they had gained from NAFTA. Including these countries will undoubtedly slow down the negotiating process and could preclude an agreement. Japan and Canada would have to dismantle very high barriers on agriculture, as would the United States, but it is doubtful that any of them could overcome the pressures of their farm lobbies, particularly if Europe shows no interest in reciprocating.

If the TPP's purpose is to put pressure on China to open its market, that won't work for four reasons. Some of the TPP provisions pressed by the United States, e.g., on government procurement and neutralizing state-owned enterprises, are aimed at China, which will not accommodate Washington. Second, the United States is already open to Chinese goods, and so why would China change these policies in exchange for what it already has? Third, the other eight countries are very small and also open to China. And fourth, one week after the APEC Summit, China joined Japan and South Korea to announce steps to expedite a free-trade agreement among themselves and with the ASEAN countries. In brief, China already trumped the United States.

The North American Option

In trying to explain to his fellow Americans the importance of APEC, Obama noted that 61 percent of all U.S. exports are sent to these twenty-one countries. He neglected, however, to mention that more than half of that goes to just two countries – Canada and Mexico. Few Americans realize that the two largest markets for U.S. goods are not China and Japan, but Canada and Mexico.

Moreover, the expansion of trade with our neighbors has a more favorable impact on the U.S. economy because a much larger portion of our imports from them are actually composed of our exports to them. Both Mexico and Canada have become very open economies. As they grow – and both have grown faster than the United States in the

¹ Michael Froman, Deputy National Security Advisor for International and Economic Affairs, "Trans-Pacific Partnership: Recovery through Growth in Asia and the Next Generation of Regional Trade Agreements," address at the Center for Strategic and International Studies, Washington, D.C., January 4, 2012. Transcript on CSIS website.



last two years – our exports grow. In 2010, the United States exported almost three times as much to Canada as to China and almost two times as much to Mexico as to China.

Our total trade with our two neighbors in 2010 exceeded \$1 trillion – 30 percent more than with China and Japan. More importantly, the best markets to expand U.S. exports are not in Asia but with our neighbors. For every additional dollar that our neighbors buy from abroad, about 80 cents are spent on U.S. exports, and for every additional dollar that we import from our neighbors, a large proportion – over 40 percent – is actually our exports to them. We no longer just trade products; we make them together.

Unawareness of our neighbors' importance may explain why the Obama administration chose the TPP over North America, and it may also explain why President Obama proposed a "Buy American" provision in his jobs bill in 2009. That was a violation of NAFTA, and after negotiating for more than a year with Canada to change the provision, the president repeated the same mistake in the summer of 2011 with his second jobs bill. If the president understood the importance of Canada and Mexico, he would have proposed a "Buy **North** American" provision, and instead of a U.S. Infrastructure Fund, he would have suggested a "North American Infrastructure Fund." Both of those provisions would do more to stimulate the U.S. economy and create jobs than TPP.

North America was a formidable region by 2001, just seven years after NAFTA. By then, trade tripled among the three countries, the number of U.S. jobs expanded at historic rates, and the region's share of the world product increased from 30 percent to 36 percent. However, rather than move forward on a new, more complex agenda, the three governments turned their attention elsewhere. By 2009, the growth in trade and investment among the three countries of North America declined by more than half, and North America's share of the world product dropped.

In retrospect, North America peaked in 2001 because of new security-related barriers installed at the border because of 9/11, Chinese commercial power and a lack of investment in infrastructure. But the main reason is the lack of imagination and leadership of the three leaders of the United States, Canada and Mexico. Rather than negotiating a common approach to the North American agenda, the three governments reverted to unequal and ineffective dual-bilateralism, with the United States negotiating the same issues separately with Canada and Mexico.

The United States and Canada issued "Action Plans" on the border and on regulatory convergence on December 8, 2011. A week later, the United States and Mexico issued a similar plan on the border, and they will issue a similar plan on regulations in a month. The truth is that the plans are actually "**In**action Plans," or rather, they set terms of reference for numerous studies on the two subjects to be completed at the end of 2012. Secondly, the plans with Canada are quite similar to those with Mexico, except that Mexico's plan includes some specific decisions on expansion of border crossings and facilities, and the Canadian plan omits any reference to the most important and longest-



lasting border problem, the need for a second bridge between Windsor and Detroit. Instead of duplicating their work, U.S. officials would have used their time more efficiently if they had forged a continental approach to similar or shared problems.

To make the U.S. more competitive with Asia, we need to change the conventional paradigm of "North America." We need **to think "North American" rather than "Buy American."** Instead of altering our tax policies to encourage investment in the United States, we should promote investments in the continent. If we shift "our mind's eye," as Albert Einstein once put it, new opportunities in North America will open, but there are also a few steps that we could take that would put us on the right road:

- The three transport ministers of Canada, the United States and Mexico should negotiate a North American Plan for Infrastructure and Transportation – to create new trade corridors that would extend from Canada to the south of Mexico, building roads and communications that would strengthen the region's economies and commerce. This would be the centerpiece of a true continental market.
- The three leaders should eliminate costly "rules of origin" – an inefficient tax estimated at over \$500 million per year – and establish a common external tariff. The common revenues should then be used to establish a "North American Investment Fund," whose principal goal would be to fund, with supplements from the three governments, the North American Plan for Infrastructure and Transportation.
- The three governments should establish several lean institutions, including a North American Commission on Regulatory Convergence; a North American Advisory Group that would do research and provide options for the three governments to improve competitiveness and security in North America; and a North American Inter-Parliamentary Committee (combining the U.S.-Canadian and U.S.-Mexican Parliamentary Committees) to ensure that the elected representatives of the three countries are consulted at every stage of the process.
- The three leaders should provide scholarships for students to study in each others' countries and a small, annual fund of \$10 million to support North American research centers. These Centers could provide ideas and education to counter fears and erroneous information and to build interest in a North American community.

The three leaders have shown little imagination or even interest in dealing with a continental agenda that would regain the growth we lost. The duplicative committees that they have set up measure progress in the amount of travel and the number of meetings that they hold rather than in results.

Some might argue that the United States should pursue both the TPP and a North American initiative at the same time, but the fact that it took eight years for the United



States to ratify free-trade agreements with Colombia and Panama suggests there is a limit of political capital and administration attention. It would be ideal to do both, but the politics preclude it. The decision to pursue the TPP will divert scarce political capital and attention from North America, and to do anything significant on North America will also require a major political effort by all three countries. So the leaders need to choose. If the question is which strategy will generate the most jobs in the United States and make the U.S. and its neighbors more competitive, North America should be the option.

What about Latin or Central America or the Caribbean? The truth is that North America already constitutes a coherent economic entity representing 90 percent of the hemisphere's economy and 87 percent of the trade. South America is fractured in terms of ideology and trade patterns. If the three countries of North America can find a strategy that lifts Mexico to the first world economically, then together, they should apply that same formula to Central America and the Caribbean as two units rather than more than twenty countries. If that also succeeds, South America will be knocking on the door, and the Free Trade of the Americas can be resurrected. If North America cannot succeed in Mexico, then the model will not be attractive to the rest of the region.

A North American Strategy to Asia

The best path to freer trade in China and Asia is, paradoxically, for the United States to start in North America and create jobs and double exports by collaborating on transportation, education and infrastructure.

A reinvigorated North America is more likely to get China's attention, just as NAFTA in the 1990s persuaded Europe and Japan to complete world trade talks. Moreover, if the three governments of the United States, Canada and Mexico, representing three levels of power and development in the world, decide to approach China together on issues related to currency, unfair trade practices and climate change, North America has a far better chance of success than if each nation pursues each issue on its own.

The United States was able to play the role of world leader in the Second World War because President Franklin D. Roosevelt had spent the previous eight years repairing U.S. relations with Latin America with his "Good Neighbor Policy." By the time he dispatched U.S. Armed Forces to Europe and Asia, the United States was not just secure in its hemisphere, but Mexico and Brazil decided to fight alongside our troops.

The world is different today. We are not fighting over territory; we are seeking ways to compete for markets using global rules. But one important thread of continuity is that our ability to project power depends on the security that comes from having friendly and supportive neighbors. In the global economic contest, we need a modern partnership with Canada and Mexico in order to achieve economies of scale at the continental level.



America's choice in the 21st Century is not Asia or North America; it is a choice of strategy and sequence. We should start in North America and build a Community that will benefit not just our three countries but provide us leverage in Asia and a model for a better world.

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