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# NAFTA: A TEN YEAR PERSPECTIVE AND IMPLICATIONS FOR THE FUTURE

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BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY, EXPORT AND TRADE PROMOTION

OF THE

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# NAFTA: A TEN YEAR PERSPECTIVE AND IMPLICATIONS FOR THE FUTURE

**TUESDAY, APRIL 20, 2004**

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC
POLICY, EXPORT AND TRADE PROMOTION,
COMMITTEE ON FOREIGN RELATIONS,
*Washington, DC.*

The subcommittee met, pursuant to notice, at 2:30 p.m. in SH–216, Hart Senate Office Building, Hon. Chuck Hagel (chairman of the subcommittee), presiding.

Present: Senators Hagel and Coleman.

OPENING STATEMENT OF SENATOR CHUCK HAGEL

Senator HAGEL. Good afternoon. This year marks the 10th anniversary of the North American Free Trade Agreement, NAFTA. NAFTA has been an economic and foreign-policy success for the United States, Canada and Mexico; and as a trade agreement, NAFTA is a testament to the positive impact that trade has on economic growth, job creation and prosperity.

Since the implementation of NAFTA, total trade between the United States, Canada and Mexico has more than doubled, rising from $306 billion in 1993 to just over $621 billion last year. U.S. exports to Canada and Mexico have surged from $142 billion to $263 billion during this same period. The effects on my home State of Nebraska provide an example of the benefits of NAFTA. Last year, Nebraska exports to Canada and Mexico totaled over $1.2 billion. Those goods largely consisted of agricultural products, like beef and corn. During the past 5 years under NAFTA, Nebraska's trade with Mexico increased by 87 percent, while trade with Canada increased 28 percent.

In addition to significant growth in the agricultural sector, America's manufacturing sector has also benefited from NAFTA. Production and manufacturing over the last 10 years of NAFTA has increased by 41 percent. During the first 5 years of NAFTA, the manufacturing base in the U.S. added some 500,000 new jobs.

A major study conducted by UCLA at the North American Integration and Development Center showed that U.S. exports under NAFTA generate over 70,000 new jobs each year. Real hourly wages for U.S. workers, since NAFTA, have increased almost 15 percent. Additionally, the average American family of four now sees an additional $930 in earnings per year because of the benefits of NAFTA trade.

Mexico, like the United States, has benefited significantly from NAFTA. Exports from Mexico since 1993 have increased by 232 percent. Between 1993 and 2001, the agricultural sector in Mexico saw its productivity increase by over 50 percent. Today, one in five people in Mexico are employed in export-related jobs that pay an average 37 percent higher wages than non-export-related jobs. Overall, NAFTA has resulted in a considerable increase in the standard of living for the Mexican population. GDP per capita has grown from $3,200 in 1993 to $8,900 in 2002.

NAFTA is not only about trade in goods and services. One of the most important results of NAFTA is the increased flow of capital across borders. Today, the United States continues to be the largest source of foreign direct investment in Canada, and NAFTA has had a considerable impact on foreign direct investment flows to and from Mexico. Since 1994, U.S. investment in Mexico has increased by 259 percent, to over $58 billion. Likewise, Mexico has increased its investment in the United States by 244 percent, to about $8 billion.

Increasing levels of trade and interdependence initiated by NAFTA have had a profound societal impact on the United States, Canada and Mexico, and have greatly improved hemispheric relations over the last decade. The election of President Vicente Fox in 2000, the first opposition party candidate to be elected in 71 years, reflects Mexico's evolution from a centralized, one-party protectionist state toward a multi-party capitalist democracy.

NAFTA has set the stage for improved bilateral relations between the United States, Canada and Mexico. Since NAFTA's inception, several side agreements have been established to address issues related to the environment, labor, and market-adjustment relief. Trade agreements were never meant to be static agreements left unchanged over time. When disagreements arise between trading partners, NAFTA provides a mechanism to address the issues. Free trade agreements such as NAFTA allow nations to find cooperative solutions to ever-changing conditions in the global economy.

This hearing today will examine what has transpired over the last decade with NAFTA and what the future might hold for this agreement and its partners. The first panel will include Under Secretary of Commerce, Grant Aldonas; Assistant Secretary of State, Tony Wayne; Administrator of the U.S. Department of Agriculture Foreign Agricultural Service, Ellen Terpstra; and Assistant Administrator for the Small Business Administration, Manuel Rosales.

Second panel will include Ms. Thea Lee, chief international economist with the AFL–CIO; Dr. C. Fred Bergsten, director of the Institute for International Economics; and Mr. Frank Vargo, vice president of International Economic Affairs at the National Association of Manufacturers.

Ladies and gentlemen, we are most grateful for your time today and look forward to your testimony, and I would ask that you present that testimony in the order that I introduced you.

So, with that, Secretary Aldonas, nice to see you again. Welcome.

**STATEMENT OF HON. GRANT D. ALDONAS, UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE**

Mr. ALDONAS. Thank you, Mr. Chairman, and good to see you, Senator Coleman.

First of all, thank you for the opportunity to testify before the subcommittee on NAFTA's economic impact and the road forward. I particularly applaud the subcommittee's interest in NAFTA, and welcome your thoughts and the lessons we should draw from the experience.

If I could, I'd like to summarize my testimony and ask that my written statement be introduced in the record.

Senator HAGEL. All of the written statements will be included in the record, so any of you that want to abbreviate your statements, that's acceptable.

Mr. ALDONAS. Thank you, Mr. Chairman.

I wanted to offer three perspectives on NAFTA. First, as my testimony reflects—and I know as your opening statement reflected as well, Mr. Chairman—there's a broad consensus among economists that NAFTA has had, in broad terms, a positive impact on the U.S. economy and on our trading partners. Much of the debate about NAFTA, in my view, has focused on the wrong questions—narrowly focusing on jobs lost, jobs gained—but missing the real power and impact that trade can have on our economy as well as on those of our trading partners.

While the growth and trade that flows from a trade agreement is a powerful indicator that the agreement is working, the ultimate test is whether an agreement contributes to stronger growth, a more productive economy, and ultimately a rising standard of living. By that standard, NAFTA has stood the test of time. The numbers bear that out. Total trade with our 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, or $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.

Moreover, the benefits of NAFTA are broadly distributed throughout the United States. Forty seven states increased their merchandise exports to Canada and Mexico from 1993 to 2003, 25 states recorded increases of more than $1 billion. In fact, 24 states more than doubled exports to Canada and Mexico over that 10-year period.

Well, what has that meant for our economic growth and our standard of living if that is the acid test? Over the last decade, the American economy has grown by 38 percent. That growth has elevated our standard of living, with GDP per capita rising 22 percent. That higher standard of living is consistent with the strong productivity growth that you mentioned, Mr. Chairman, which rose 53 percent in the United States from 1993 to 2002.

What's also significant is, today's unemployment rate at 5.7 percent is significantly below the 6.9 percent unemployment rate that prevailed in 1993, prior to NAFTA. Significantly, our population was growing throughout the intervening 10 years, while unemploy-

ment was dropping, which means that the rate of job creation was and is higher than a simple comparison of those numbers reveals.

In short, North American economic integration prefigured a period of extraordinarily strong economic growth in the United States, which is once again the case today. While NAFTA was not the sole cause, it was undoubtedly a contributing factor in our success over that time.

Second, based on my experience in Mexico, I think that NAFTA's also contributed significantly to positive changes in the political environment in Mexico that you mentioned, Mr. Chairman, and caused a positive shift in our relations with our southern neighbor, as well. While I'll defer to Tony about many of the foreign policy aspects, I did want to offer just a personal thought, as a former Foreign Service officer whose first tour was in Mexico. I have a sense of the differences that existed in Mexico 25 years ago and what exists there today. In 1980, when I first worked in Mexico, the political system served as a brokering mechanism among economic stakeholders, but it wasn't what I would describe as a healthy democracy prone to healthy and open democratic debate. But today, Mexico is anything but that. The political debate takes place before the public in a functioning Congress and the media on a daily basis, rather than being decided behind closed doors.

I can also attest, as a member of the Bush administration, the positive dialog we've developed on economic matters. It is a dialog that focuses on solving our immediate differences, as you pointed out, Mr. Chairman, but also a sense of a broader shared perspective regarding our economic future, and the need to focus on North American competitiveness in facing up to competition in a global economy. The shared experience of participating in NAFTA has contributed significantly to that change in perspective.

Third, on the other hand, I always believe we shouldn't underplay the dislocations that can result from trade. A good example is one that I saw recently in the Washington Times about developments in Senator Allen's and my home State of Virginia. The article noted the changes in Martinsville, which is in the Blue Ridge, on the North Carolina border, and I think the article got it mostly right. It pointed out that the economic transition isn't easy. Martinsville's unemployment rate is currently three times the national average.

Where I think the article got it wrong, though, was blaming those conditions on NAFTA, solely on NAFTA, though I can understand how that thought developed. The fact is, even in the textile sector, which Martinsville has depended on, NAFTA had an initial positive effect. Textile shipments in our industry actually rose by 13 percent in the first 3 years of NAFTA.

Since that time, however, our textile industry has faced fierce competition from Asia, particularly after the Asian financial crisis, which, as we know, resulted in a radical realignment of exchange rates. Was the cause of these conditions in the textile industry trade related? Undoubtedly. Would it be right to lay it at NAFTA's doorstep? Absolutely not.

My point is not to take away from the impact on the daily lives, whether it's of shop owners or school teachers in Martinsville, but underscore how much of what has been blamed on NAFTA really

flows from other sources. And the point is that even acknowledging those serious examples of economic dislocation, NAFTA did not lead to the economic ruin that NAFTA's critics predicted for the United States and Mexico.

One of the reasons I think today's hearing is so important is my concern that we're generally talking past each other in the debate about trade. The proponents of NAFTA—and I'm one of them—tend to argue the aggregate case, which is positive, and broadly spread across our entire economy; whereas, the opponents of the trade often focus exclusively on the dislocations, i.e., specific instances of painful economic adjustment. Both cloud the fact that the basic lesson we should draw from NAFTA, even as a surrogate for the broader phenomenon of globalization, is the need to seize the opportunities that trade liberalization provides, while preparing to compete in a global economy. If there's ever a lesson we should draw from NAFTA, that has to be it, that work has to happen on both sides.

I'm reminded of the statement you made recently on the floor, Mr. Chairman, that focused specifically on the need to seize the opportunities that trade with NAFTA and globalization provides; at the same time, adjustment measures that really do put us in the campaign, and that what we do, at the end of the day, is have a work force that measures up to what's needed in our manufacturing sector, particularly today.

Having spent the last year focusing on manufacturing, one of the insights I took away is that while the economy has been struggling to produce jobs and now things seem to have turned around, we actually face a significant shortfall, in terms of trained workers to work in the manufacturing sector. Those two things don't square.

If we do want to take advantage of the opportunities to compete in a global economy, we are going to have to put our money where our mouth is to make sure that we've got a work force that can compete and can be employed in a manufacturing sector that still represents, standing alone, the fifth largest economy in the world.

What I'd like to do is close by pointing out just one last thing. I think the question for both Congress and the administration, whether it's about trade or it's about domestic economic policy, it actually boils down to one thing. It's a lens through which I think we need to examine what we do on trade and what we do on adjustment policies, whether it is tax, regulation, really the whole gamut of what Congress confronts. And that lens is whether the steps we take will actually make us more competitive in the global economy that we now face. That's the sole lens, really, that should guide our work as we move forward.

Taken in that context, NAFTA has undoubtedly helped the American economy, as a whole; not just in terms of the direct effects of exports and jobs, but also on how we face that question of global competition and prepare for it.

Let me stop there, and I look forward to your questions.

Thank you.

[The prepared statement of Mr. Aldonas follows:]

PREPARED STATEMENT OF HON. GRANT D. ALDONAS

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 Endow-

ment'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 *medical equipment* 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 *pharmaceuticals* 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 non-tariff 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 *textiles and apparel.*

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 the late 1990s 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 tie 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, "In an Uncertain World," 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 *and* 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 noncompliance 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, IDA, 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 Web site, *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 Amer-

ica—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.

Senator HAGEL. Secretary Aldonas, thank you.

Secretary Wayne.

**STATEMENT OF HON. E. ANTHONY WAYNE, ASSISTANT SECRETARY OF STATE FOR ECONOMIC AND BUSINESS AFFAIRS, U.S. DEPARTMENT OF STATE**

Mr. WAYNE. Thank you very much, Mr. Chairman, Senator Coleman. It's a pleasure to be before you today and to have this opportunity, on the 10th anniversary of the enactment of NAFTA, to talk about some of its effects and the lessons we've learned.

I think you'll find all of us in this first panel agreeing that NAFTA has brought many benefits to the American people and to our neighbors. It has helped to transform our economies, to create partnerships that go well beyond economic prosperity, to giving each partner a much greater stake in enhancing the national security of each other, and, thus, in protecting the lives of American citizens.

Overall, of course, NAFTA's success stems, in a good part, from its focused objectives: to eliminate, progressively, tariff and non-tariff barriers, to trade in goods and services, to establish clear rules for investment, to strengthen intellectual property rights, and, in the process, to create effective dispute settlement mechanisms.

As you well know, Canada and Mexico are now our No. 1 and No. 2 trading partners, and the value of the goods and services we trade, the numbers of people crossing the border each day, have climbed to unprecedented levels.

Since Congress reauthorized the President's trade negotiating authority in 2002, the administration has launched bilateral and sub-regional FTA negotiations with 15 countries. Eight have been concluded, and we've announced our intention to negotiate with six more nations. We believe that these FTA's, which are, in many ways, inspired by the NAFTA experience, can create significant openings in markets that are now blocked by obstacles to U.S. exports.

The larger issue is not just about trade, however. Free trade agreements support U.S. goals by encouraging needed economic reforms, as Under Secretary Aldonas pointed out in the case of Mexico. They promote economic growth, and they promote diversification. They require good governance and improved transparency, and they help to introduce the flexibility and the competitiveness which is needed to sustain development.

Since NAFTA, our trade agreements include provisions on transparency, on labor rights, on environmental protections, on financial

services, on government procurement, on investor protections, on dispute settlement, on intellectual property, and on a host of other key issues, in addition to the traditional market-access provisions. By getting host governments to confront what are often very politically sensitive issues, these trade agreements encourage reforms, which also, in turn, promote sustainable development.

Important benefits that have flowed from NAFTA include, of course, the strong growth in foreign direct investment, as you pointed out, Mr. Chairman. They include greater efforts to protect the environment. They include new provisions that seek to help improve the working conditions and the labor—and the living standards of laborers. But, to be candid, the mechanisms within NAFTA to protect the environment and improve the working conditions were never intended to solve all the forms of environmental degradation or all the labor-related problems. But what they do do is, they help foster greater public awareness and participation. As free trade helps economies grow, that growth helps middle-class societies to become larger and stronger. And these new societies demand higher standards of openness, of performance, and of transparency from their own governments.

NAFTA has also helped strengthen our national security. The extensive interagency ties between our governments, developed, in large measure, as a result and flowing from NAFTA, were instrumental in allowing us to craft quickly the smart borders accord with Canada and a border partnership action plan with Mexico, and both of those efforts right now are facilitating legitimate trade and travel, while working to improve the interdiction and investigation of illicit drugs, people, weapons, cash, and other materials that could potentially be utilized by terrorists to attack our country.

The new ties also go far beyond our bilateral efforts. Whether you're in a host of international organizations—whether it be the WTO, APEC, or OECD—the United States now regularly finds itself side by side with Canada and Mexico, working to support common policies and interests.

Now, NAFTA is not without its problems. Some critics have claimed that with globalization, NAFTA would contribute to the U.S. industrial decline and transfer jobs out of the country. But a whole range of studies now seem to agree that economic growth in the United States has increased, as it has in Mexico and Canada; and most of these studies conclude that, at worst, NAFTA has probably been neutral in increasing or decreasing job growth rates. While some U.S. companies have certainly opted to employ lower-wage workers in Mexico and elsewhere to remain competitive internationally, others have significantly expanded their activities domestically to produce sophisticated export products. Overall, studies have found that export-related activities have led to the hiring of highly skilled and educated workers and, on an average, at higher wages in the United States. And that's also true for studies that have looked at the Mexican and the Canadian economy.

There certainly remain NAFTA trade issues to be resolved, notably—and my colleague will note some of these in the agricultural sector. This is an ongoing process. The administration is deter-

mined, however, to utilize all the resources that we have at our disposal to remove these lingering obstacles.

And, of course, our NAFTA partners have their own complaints that they raise with us. But one of the very special and important things about NAFTA is that we have a trade resolution process. All three countries have access to an independent, transparent system that allows expert panels to address objectively the merits of each country's arguments, and adjudicate fairly. This emphasis on rule of law continues to be incorporated in all of our FTAs today.

Now, NAFTA does not exist in a vacuum, as Under Secretary Aldonas noted. We have to evolve. We have to establish greater linkages to ensure that our companies and our economy remain competitive in the global marketplace. There are several tantalizing opportunities as we look at North America. Energy production and trade, for example. As demands for electricity, natural gas, and oil rise in all three countries, we must ensure that energy production, shipment, and utilization is being done in the most efficient, environmentally friendly means possible, and at the least cost.

We also want to look at infrastructure constraints, for example. By promoting greater integration and improvements in road, rail, and aviation transportation, perhaps through a full North American open-skies program, NAFTA can continue to spur solid growth and development. Coupled with the increased spread of telecommunications and information technology, the North American market can anticipate continued strong growth that will benefit all of our countries.

To conclude, Mr. Chairman, I very much appreciate having this opportunity to speak before you about the valuable benefits which NAFTA has brought. While change is certainly disruptive—it's often disruptive in our personal lives and more broadly—I think there's no question that NAFTA has brought success. It's generated clear growth in trade and investment. It has reduced costs across the board for consumers and businesses. It has improved the quality of life by providing consumers with more and better choices at competitive prices. It has helped generate opportunities for valuable new partnerships among officials to enhance our security and our international cooperation. It has helped foster democratic and civil society reforms that are transforming Mexico.

NAFTA's success has been inspirational as we seek to open other markets to U.S. goods, services, and influence. NAFTA's legacy of helping other societies to develop themselves embraces reforms for improved governance as well as increased prosperity. You can be sure that the State Department will work closely with my colleagues here at the table and with others across the government to continue to remove all the tariff and non-tariff barriers to our exports, while advocating strongly for a level playing field for American business.

Thank you very much, Senators.

[The prepared statement of Mr. Wayne follows:]

PREPARED STATEMENT OF HON. E. ANTHONY WAYNE

Thank you, Mr. Chairman, Senator Sarbanes, and Members of the Subcommittee, for this opportunity to testify before the Senate Foreign Relations Subcommittee on International Economic Policy, Export, and Trade Promotion. On the tenth anniver-

sary of NAFTA's enactment, it is a pleasure to be able to address the committee on the benefits this treaty has brought to both the American people and our neighbors. NAFTA has helped transform our economy while creating synergies that go far beyond economic prosperity, especially in enhancing our national security and protecting the lives of U.S. citizens. As with any trade liberalization initiative or other economic change, NAFTA affected some U.S. sectors positively and others adversely, but there is little doubt that on the whole, the agreement produced real net benefits for U.S. workers and consumers. It has also served as a model for a number of subsequent bilateral and multilateral free trade agreements that will further extend the benefits of free trade while enhancing political and economic reforms that are fostering stronger democracies and civil societies throughout the world.

NAFTA's success has encouraged the United States to promote U.S. interests by negotiating a variety of free trade agreements with countries around the world. The Administration seeks to secure the benefits of open markets for American consumers, farmers, workers and businesses by pursuing trade initiatives globally, regionally and bilaterally. In doing so, the United States hopes to foster conditions that will help energize the economies of our trading partners and develop new markets for American goods and services.

As we contemplate the benefits of NAFTA for the United States, Canada, and Mexico, it is important to note how different our three economies might look today if we had not had a free trade agreement. As designed, NAFTA has progressively eliminated tariffs and non-tariff barriers to trade in goods, improved access for services trade, established rules for investment, strengthened protection of intellectual property rights and created an effective dispute settlement mechanism. Although no trade agreement is perfect, NAFTA has been a remarkable success at meeting its target goals. A few examples illustrate this point.

GOOD FOR THE UNITED STATES AND OUR NEIGHBORS

Virtually all tariffs on manufactured goods and practically all tariffs on agricultural products have now been eliminated, a significant improvement over the previous situation, especially in the case of our trade with Mexico. As Canada and Mexico became our number one and two trading partners, respectively, the amount of goods and number of people crossing our borders daily has climbed to unprecedented levels. Although most of Canada's tariffs applied to U.S. goods were low even before the U.S.-Canada FTA of 1989, Mexico's tariffs were significantly higher before NAFTA, averaging 10%. Now, more than 85% of U.S. goods enter Mexico duty-free, and by 2008, all tariffs will be eliminated.

The example of Mexico is dramatic: approximately sixty percent of the 500 million visitors admitted into the United States enter across the U.S.-Mexican border, as do 90 million cars and 4.3 million trucks, all contributing to the $638 million in trade conducted at our border every single day. Similarly, 70 million passengers traverse our border with Canada each year, along with 7 million commercial trucks, and 1.3 million rail containers. Every one of these crossings contributes to a total two-way trade of $394 billion in 2003. That works out to $1.08 billion a day.

This surge in commerce has created new alliances and efficiencies in our trade relationship that help define many aspects of America today. Canada sends 83 percent of its merchandise exports to the United States and receives 70 percent of its total goods imports from the United States. Since NAFTA's implementation in 1994, total merchandise trade between the United States and Canada has grown by over 120 percent, and when you count trade in services, the growth has been closer to 140 percent. Our trade with Mexico shows the same dynamism: trade between our countries has nearly tripled, from $81.5 billion in 1993 to $235.5 billion in 2003, translating to an average annual growth in trade of 11 percent. Approximately 90 percent of Mexico's exports go to the United States, while 62 percent of Mexico's imported goods come from the United States. Thus, according to the IMF, total trade among the three countries has more than doubled, growing from $306 billion in 1993 to $621 billion in 2002.

By any measure, NAFTA has promoted export-led growth in North America writ large, and the benefits have been directly felt here in the United States. Greater, more open markets allow American companies to compete better in the world economy, creating new, higher wage jobs at home. Lower barriers to trade improve the quality of life by reducing consumer and producer costs and improving economic efficiencies. NAFTA has shown that Americans can compete—and succeed—with workers from other countries, when given a fair opportunity to do so. Beyond NAFTA, opening new markets through the creation and enforcement of additional trade agreements enhances these benefits to the American people as trade helps the na-

tional economy expand. The success of NAFTA has encouraged us to conclude bilateral and multilateral free trade agreements around the world.

A TRADE MODEL FOR U.S. INTERNATIONAL ECONOMIC POLICY

Since Congress reauthorized the President's trade negotiating authority in 2002, the Administration has moved on multiple fronts. We have sought to expand free trade to a number of other countries and regions by pursuing global negotiations in the WTO, seeking to conclude subregional trade agreements such as the Central American FTA (CAFTA), as well as the Free Trade Area of the Americas (FTAA), and pursuing an aggressive agenda of bilateral free trade agreements including Singapore, Chile, Jordan, and Australia. In total, the United States has launched bilateral or regional FTA negotiations with 15 countries, of which 8 have been concluded, and has announced its intention to negotiate with 6 more nations.

When the United States free trade agreements with Chile and Singapore entered into force in January 2004, it dramatically improved market access and protections in such areas as services, e-commerce, intellectual property, transparency and strengthened anti-corruption measures, and enforcement of environmental and labor laws. These high standards promote prosperity at home and for our trading partners while helping to ensure a level playing field for American workers.

Based on NAFTA's lessons, our FTA mechanisms seek to create that "level playing field," especially in agricultural trade. As countries have increasingly employed new and more innovative non-tariff barriers to trade (such as anti-dumping orders, safeguard measures, sanitary and phytosanitary measures (SPS), unreasonable residue testing or labeling requirements to protect their markets), all governments have realized they must work together to keep trading channels open. NAFTA's SPS Committee, for example, provides a forum where all three countries can both discuss their respective animal and plant health concerns while seeking ways to keep our trade flowing. Based on its good work, the "SPS Committee example" was adopted in the Chile FTA and has been recommended for subsequent FTAs as a useful means for finding practical solutions to trade problems. This way, each country develops a broader understanding of the other country's regulatory system, how regulatory requirements affect market access, and how we can build confidence in the safety and efficacy of each other's systems.

Our free trade agreement with Chile took effect on the tenth anniversary of NAFTA's enactment, occurring at the same time that we finalized negotiations for a U.S.-Central America Free Trade Agreement (CAFTA) with El Salvador, Guatemala, Honduras, Nicaragua, Costa Rica, and subsequently with the Dominican Republic. Soon the United States will launch new FTA negotiations with Panama, Colombia and possibly additional Andean nations.

Our efforts are not restricted to just the Western Hemisphere, however. In February 2004, the United States and Australia concluded negotiation of a FTA that will eliminate tariffs on more than 99 percent of U.S. manufactured goods exported to Australia, starting on the first day of its enactment. USTR reports that U.S. manufacturers estimate that the FTA could allow them to sell $2 billion more per year to Australia. In addition, all U.S. farm exports, totaling more than $400 million annually, will go duty-free to Australia benefiting many sectors such as processed foods, fruits and vegetables, corn oil, and soybean oil. Later this spring, negotiations for a bilateral FTA will start with Thailand.

In the Middle East, following the successful completion and enactment of the U.S.-Jordan FTA in 2001, we have seen trade between our two countries triple in the last three years. We followed this by completing negotiation of an FTA with Morocco only two months ago which will remove Moroccan trade barriers to our agricultural products, such as wheat, corn and soybeans; provide new access for U.S. beef and poultry exports; allow openings for service providers in audiovisual, telecommunications and engineering companies, as well as new opportunities for manufacturers of construction equipment, chemicals and information technology.

Then in January 2004, the U.S. and Bahrain began free trade negotiations, marking another country in the region that will benefit by a liberalized trade regime. This is an important component to the President's Middle East Initiative, the goal of which is to foster prosperity by encouraging openness and deepening economic and political reforms throughout the region.

Just as NAFTA has allowed the United States, Canada and Mexico to integrate our markets, reduce tariff and non-tariff barriers, and see trade expand dramatically, so we expect to see the same results occur with our multiple bilateral and multilateral FTAs. We believe that pursuing and concluding these FTAs will create significant openings in markets that are now blocked by obstacles to U.S. exports. For example, in 2003 the combined bilateral FTA markets in countries with whom

we are now negotiating imported U.S. goods worth approximately $67 billion. Their developing economies will offer significant opportunities for additional growth and expansion in the decades ahead—in a tariff-free environment.

As we work with these and other countries to develop FTAs, the "lessons learned" are likely to help us as we continue our work with Canada and Mexico to improve the NAFTA. From harmonizing our tariffs and updating our rules of origin for manufactured products to working with our neighbors to reduce the risk of diseases such as BSE or Avian Influenza (Al), NAFTA is a trade agreement that works and our challenge is to ensure that it continues to work, providing necessary fine tuning as required.

NAFTA SYNERGIES AND ANCILLARY BENEFITS

While NAFTA's benefits are clearly discernible in some areas, in others they are more synergistic and less readily apparent, though in fact, perhaps more significant. As I have said, for consumers in all three countries, NAFTA's lower tariffs and other provisions have provided more choices in foods, goods and services at competitive prices, and increased the standard of living.

The larger issue is not just about trade, however. Free trade underpins U.S. goals by encouraging needed economic reforms, promoting economic growth and diversification, requiring improved transparency and movement towards good governance, and introducing the flexibility and competitiveness needed to sustain development. By spurring needed reforms and locking them in, the process of concluding and implementing a free trade agreement can be more important to long-term growth than the commercial benefit of the trade deal itself.

NAFTA's example was an inspiration for our efforts to promote both free trade and commensurate societal and political reforms in developing countries. The trade-related societal and political reforms dovetail with and mutually reinforce developmental goals being pursued within our overall strategy. Since NAFTA, state-of-the-art trade agreements, for example, include provisions on transparency, anti-corruption, labor rights, environmental protections, financial services, government procurement, investor protections, dispute settlement, intellectual property, and other key issues, in addition to the traditional market access provisions. By getting host country governments to confront these other, often politically sensitive issues, trade agreements reinforce our broader message of the need to undertake reforms to promote sustainable development. Conversely, reform steps taken as part of development programs also advance the cause of free trade.

While freer trade confers commercial benefits on all participants, it is clear that our interest in free trade goes well beyond these narrow gains. Considered in its broadest context, free trade is not an end in itself, but rather the means to improved quality of life, growth and stability.

NAFTA has provided significant benefits in other, sometimes unexpected, ways as well. The movement of goods and people creates stronger international linkages amongst our three countries, facilitating travel, tourism, and greater understanding through the constant exchange of ideas and cultures. As with the "Great Melting Pot" concept, all NAFTA countries benefit from the increased diversity in people, languages, ideas and energy generated by an expanding international society.

One vitally important benefit that has accrued to all three countries as a direct result of NAFTA's success has been the strong growth in foreign direct investment (FDI) since NAFTA's inception. As trade has boomed, FDI and portfolio investment have shot up. While all three countries received sizable FDI flows both before and after 1994, FDI increased from $63 billion between 1989 to 1994, to $202 billion between 1995-2000, more than a 200% increase in dollar volume. For Mexico especially, whose economy grew at an average annual rate of over 5 percent during this same timeframe, this has benefited telecom and banking industries, producing a ripple effect in additional growth opportunities in major sectors of the economy. It also helped the country recover far more rapidly after the Peso Crisis of 1994-1995, evidence that both domestic and foreign investors had gained more confidence in Mexico's long-term stability.

The NAFTA partners also recognize the importance of protecting the environment for present and future generations. We have seen that free trade helps developing countries grow, creating greater wealth and a stronger middle class, which then demands both a better environment and better working conditions. Some of NAFTA's more tangible benefits stem from its environment and labor provisions, many of which are incorporated in other FTAs currently being negotiated. The economic integration promoted by NAFTA has spurred better environmental performance by facilitating the transfer of green technologies and market-based solutions to environmental problems and, ultimately, by increasing national wealth. Through the North

American Agreement on Environmental Cooperation (NAAEC), the partners are promoting better and more effective enforcement of environmental laws in all three countries. Our trilateral Commission for Environmental Cooperation (CEC) has programs that encourage the sharing of information, data, and best practices while promoting transparency and public participation in crafting environmental policies among the three countries.

The U.S.-Mexico Border Environmental Program stems from NAFTA. Cooperation has resulted in greater sophistication in environmental management, and greater Mexican public participation in environmental policy making. Positive results include creation of a database to track polluting chemicals released to air, water, and land, and the phasing out of dangerous pesticides such as DDT and chlordane.

A major social dimension was added to NAFTA via the North American Agreement on Labor Cooperation (NAALC, i.e., NAFTA's supplemental labor agreement), which seeks to improve working conditions and living standards by committing the three countries to accept eleven labor principles to protect, enhance and enforce basic workers' rights. To accomplish these goals, the NAALC creates mechanisms for cooperative activities and intergovernmental consultations, as well as for independent evaluations and dispute settlement processes to help enforce national labor laws. With the participation of labor union representatives, employers and government officials, an important balance has been built into NAFTA's policy discussions and programs.

NAFTA also has a formal process through which the public may raise concerns about labor law enforcement directly with their governments. This process has led to the filing and review of 28 submissions under the NAALC on issues such as freedom of association; the right to organize and bargain collectively, the right to strike; child labor; minimum employment standards; employment discrimination; occupational safety and health; and the protection of migrant workers.

As the United States has pursued additional FTAs, these new agreements have applied "lessons learned" from NAFTA. Recognizing the importance of capacity building, our newer FTAs give increased priority to helping developing countries support their existing environmental and labor laws and craft enforceable dispute settlement procedures. Since non-enforcement is often due to a lack of resources, the United States is using its own aid programs and working with NGOs, the IMF, World Bank and others to ensure inadequate funding does not undermine the effectiveness of environmental and labor standards.

To be candid, these measures alone cannot prevent all forms of environmental degradation or solve all labor-related problems, but they go a long way toward developing greater public awareness and participation, higher standards for openness and transparency, lowered thresholds for joint action and, in some new FTAs, establishing new benchmarks to measure progress.

This exemplifies how, in the pursuit of ensuring a responsible, competitive and productive work environment, FTAs help lock-in political reforms and civil society developments. In Mexico, the changes have been dramatic—a more open, pluralistic society has been created with a demonstrably more accountable, democratic government, making Mexico both an economic and political success story. No longer a one-party political system, Mexico's growth has led to the establishment of more NGOs, a more independent press, a larger role in international institutions, and increased cooperation with the United States on issues ranging from the environment and drugs to law enforcement and immigration. Each of these reforms ultimately promotes stability and growth and thereby strengthens our national security.

POST SEPTEMBER 11 AND SECURE BUT OPEN BORDERS

NAFTA has had a major impact in the formulation of our post-September 11 "Secure But Open Borders" policies. As a result of September 11 and its aftermath, no higher priority exists than ensuring that our national security is strengthened so that such a catastrophe can never happen again. While our national heritage promotes open contacts with the international world, new realities dictate that we must do so with greater caution and a discerning eye, and this has naturally affected our relations with our two most important neighbors.

The good news is that both Mexico and Canada understand this, and stand four-square with us in recognizing that we must jointly defend our homelands from terrorism and security threats. The extensive interagency ties between our governments, developed in large measure as a result of NAFTA, were instrumental in allowing us to quickly craft the "Smart Borders" accord with Canada and a "Border Partnership Action Plan" with Mexico, both of which have done a remarkable job in securing our borders and keeping them open while mitigating disruptions in the flow of both goods and people. This is a significant achievement that demonstrates

the advantages of a better, more secure North American trading environment even as we further our economic integration and national relationships. This coordinated collaboration with both Canada and Mexico enables us to facilitate legitimate trade and travel while simultaneously improving interdiction and investigation of illicit movements of drugs, people, weapons, cash or materials that could potentially be utilized by terrorists to attack our country.

The ties I just referred to go beyond our joint work to improve national security. Whether it be in international institutions such as the United Nations, the World Trade Organization (WTO), or other organizations, the United States has often found itself working side by side with Canada and Mexico to support common policies and interests. It's worth remembering that in the trade arena, Mexico did not even join the General Agreement on Tariffs and Trade (GATT)—the WTO's predecessor—until 1986. In less than 20 years it has gone from being outside the world's multilateral trade regime to hosting the WTO Ministerial last September in Cancun, Mexico. In Cancun, Mexican Foreign Secretary Derbez worked extremely hard to bring developed and developing countries together in support of a text charting the way forward in our Doha negotiations. In the FTAA, the U.S., Mexico, and Canada, along with several other free trade partners in the Western Hemisphere, have worked very closely to ensure the FTAA can indeed bring the trade and investment benefits to the Hemisphere that our people need. In Monterrey, Mexico in March 2002, Mexico hosted the UN Conference on Financing for Development and worked with us to help shape a productive outcome. While we may have differences on specific points or strategies, there is no question that the U.S., Mexico, and Canada have become "like-minded" in our ultimate objectives.

NAFTA CANNOT SOLVE ALL PROBLEMS

NAFTA is not without its problems, of course. Some critics have claimed that hand in hand with globalization, NAFTA would contribute to U.S. industrial decline and a transfer of jobs out of the country. A review of the data shows that this has not been the case. A number of different studies of NAFTA agree that economic growth in the United States has increased, as it has in Mexico and Canada. Studies reach a variety of different conclusions about whether NAFTA has caused a net loss or net gain in jobs, but most conclude that, at worst, NAFTA has probably been neutral in increasing or decreasing job growth rates. While some U.S. companies have opted to employ lower-wage workers in Mexico and other countries to remain competitive internationally, other companies have significantly expanded their activities domestically and now produce sophisticated export products. This leads to hiring more highly skilled and highly educated workers at higher wages.

Gary Hufbauer at the Institute for International Economics asserts that, after NAFTA was enacted, U.S. employment grew by over 20 million between 1993 and 2000, with U.S. manufacturing output soaring in the 1990s by 44% in real terms. To the extent that NAFTA succeeds in stimulating trade and cross-border investment, jobs in each country were created in some industries and lost in others, which has been necessarily wrenching for a number of American companies, communities and families. As this transition has progressed, however, positive economic growth has been generated, efficiencies have been improved and costs have been lowered for both consumers and industries, helping to raise average incomes.

The guiding wisdom behind NAFTA was to eliminate economic barriers, particularly tariffs and quotas, at our two borders to generate increased trade among the United States, Canada and Mexico. Though the majority of economic barriers between our three countries have largely been removed, there remain a number of NAFTA trade issues still to be resolved, particularly concerning agricultural products. This is an on-going process. The Administration is determined to utilize all the resources at its disposal to effectively remove those lingering obstacles to free trade, such as Mexico's 20 percent tax on products using high fructose corn syrup, or those non-tariff barriers which prevent the proper and expeditious exports of U.S. agricultural goods. Under NAFTA's trade dispute resolution process, all three countries have access to an independent, transparent process that utilizes expert panels to objectively assess the merits of each country's arguments, and to adjudicate fairly. This emphasis on rule of law continues to be incorporated in all our FTAs around the world.

THE FUTURE OF NAFTA

NAFTA does not exist in a vacuum. On the contrary, our integrated North American market is going to see ever increasing competition from outside producers. As the United States continues its efforts to open new markets for our products, and to remove barriers to trade which retard economic growth in developing countries,

we can expect that the combined, trilateral North American economy will have to evolve to take advantage of each NAFTA country's advantages and efficiencies. In Mexico, the Government recognizes that enhancing competitiveness requires policy reform, such as fiscal reform, but also necessitates additional measures to reduce the cost of business by streamlining judicial and regulatory requirements for companies. Increasing global competitiveness is likely to spur additional innovation and growth in ways we cannot imagine but which we can anticipate. By that I mean—the need to plan ahead, in order to improve and more closely integrate our national infrastructures, and provide better means of production as well as shipment of goods. Increased globalization and competition from other countries and regions, especially China, Japan, Asia and elsewhere, could encourage greater linkages amongst the three NAFTA countries, ensuring our own products remain competitive in the global marketplace.

Energy production and trade provide a good example. It is clear that all three NAFTA countries have vast energy demands in electricity, natural gas and oil that will increase. One of our objectives should be to ensure that energy production, shipment and utilization is being done by the most efficient means possible, at the least cost, so that each country may profit and benefit by the trade generated. The electrical grid problems experienced by the United States and Canada in the summer of 2003 highlighted the need for closer cooperation, planning and integration to prevent future problems in our electrical energy generation and transmission. Under NAFTA, we have an established North American Energy Working Group (NAEWG) that is now working together to prevent such future problems. While natural competition can reduce energy costs to their lowest levels, the synergies created by the new technologies both demanded and created could also spur greater development and growth in trade.

By promoting greater integration and improvements in road, rail, and aviation transportation—where we seek full North American Open Skies—NAFTA will continue to spur solid growth and development. We need to look closely at infrastructure constraints as trade continues to increase. Coupled with the increased spread of telecommunications equipment and new information technology, the North American market can anticipate continued strong market and trade growth that will benefit each of our countries. These are just some examples of how increased integration linkages amongst the three NAFTA economies can promote efficiencies that will encourage continued, long-term growth rates and help deepen and broaden the North American market. Under the President's leadership, we are actively engaged with Canada and Mexico in reviewing areas where synergy exists, so that we may enhance our common economic prosperity and national security.

CONCLUSION

I appreciate, Mr. Chairman, having this opportunity to speak on the valuable benefits the North American Free Trade Agreement has brought to the United States over the past ten years. While change can be disruptive, whether in economic, political or developmental terms, NAFTA has been a resounding success for all three partner countries. It has generated clear growth in trade, reduced costs across the board for consumers and businesses, improved the quality of life for our citizens by providing consumers more and better choices at competitive prices, and helped foster the democratic and civil society reforms that have transformed Mexico while serving as a beacon of hope for other developing countries with whom we are negotiating FTAs around the world. The changes wrought by NAFTA in our societies have been profound, and they are still being felt and observed by other countries.

NAFTA's success has been inspirational as we seek to open other markets to both U.S. goods, and influence. In doing so, NAFTA's legacy of helping other societies to develop themselves equally embraces reforms for improved governance. All societies benefit when free trade and open markets allow competition in selling goods and services. They also benefit when the same reforms create a better, more stable and growing civil society. In support of the President's policies to liberalize trade bilaterally, regionally and globally, the State Department will continue to work with other agencies to remove all tariff and non-tariff barriers to our exports while advocating strongly for a level playing field on behalf of all American businesses.

Thank you.

Senator HAGEL. Secretary Wayne, thank you.

Administrator Terpstra.

**STATEMENT OF HON. A. ELLEN TERPSTRA, ADMINISTRATOR, FOREIGN AGRICULTURAL SERVICE, U.S. DEPARTMENT OF AGRICULTURE**

Ms. TERPSTRA. Thank you very much, Mr. Chairman, Senator Coleman. I appreciate the opportunity to be here with you today to talk about agricultural trade under NAFTA.

Let me begin my remarks with an unambiguous statement. The agricultural sector of our economy under NAFTA is an unqualified success. The United States, Mexico, and Canada are enjoying a thriving agricultural trade relationship derived from their historic decision to open our borders and break down barriers to trade. In NAFTA's 10th year, markets continue to open for freer trade of agricultural products. Producers in all three NAFTA countries benefit from the reduction of arbitrary and discriminatory trade rules, while consumers enjoy lower prices and more choices.

Our farmers and ranchers have been major beneficiaries of NAFTA's success, as exports of food and agricultural products from the United States to our NAFTA partners reached a record $17.2 billion in 2003. These exports support approximately 258,000 U.S. jobs.

When you compare the performance of our agricultural exports to our NAFTA partners with our export performance to the rest of the world, the difference is startling. In the 10-years since NAFTA was implemented, global U.S. agricultural exports increased by an average of $250 million a year as a strong dollar, numerous currency crises, and a global economic slowdown combined to slow the overall growth of U.S. exports. However, during this same 10-year period, our exports to NAFTA grew by more than $800 million a year.

A wide variety of U.S. products have benefited from that access, including processed grains, grocery products, corn, essential oils, poultry meat, soybeans, feed ingredients, beef and beef offal, cotton, wheat, sorghum, and pork.

Even in the area of horticultural products, where competition is intense, U.S. producers have benefited from NAFTA. In 1993, our horticultural exports to Canada and Mexico totaled $2.8 billion. In 2003, these had increased to $5 billion a year. Fresh and processed fruits and vegetables, tree nuts, and wines have all benefited from NAFTA's accomplishments, such as lower tariffs, the elimination of import licenses, and a more transparent business environment.

Trade is a two-way street, and it's true that agricultural imports from Canada and Mexico have also increased since NAFTA was implemented. Imports from Canada increased by an average of $590 million a year, while increases from Mexico have averaged $300 million a year. However that growth had more to do with the strength of the U.S. economy and the dollar than it did with the trade provisions of NAFTA, since our markets were already very open when the agreement went into effect.

Let me talk specifically now about each country for just a moment.

Canada is a very good example of a mature market where U.S. exports have demonstrated impressive growth in large part due to NAFTA. Today, Canada is our largest agricultural export market. Under NAFTA, our exports to Canada have increased by 75 per-

cent, reaching $9.3 billion last year. For Americans, this has meant over 140,000 jobs.

Specific products that are setting export records to Canada include vegetables, meats, soybean meal, bulk commodities, snack foods, vegetable oils, fresh fruits, and pet food. Some 71 percent of our agriculture exports to Canada are in the consumer-oriented, high-value category. Of course, this also means increased jobs in the United States as our food-processing industry adds capacity for this growing market. Last year, fresh fruits and vegetables led U.S. agricultural exports to Canada, stemming from increased demand in the food-service sector there.

Now let's look at Mexico for just a moment. Mexico today is the world's seventh-largest consumer of food by value. With recent expenditures estimated at $93 billion, that's double the level of 1995. This exceptional growth in overall food demand helps explain why Mexico has been one of the fastest-growing agricultural import markets since 1995. Our exports to Mexico have doubled under NAFTA, reaching $7.9 billion in 2003. And today Mexico is our third-largest export destination.

In 2003, we sent Mexico record amounts of processed fruits and vegetables, red meats, wheat, rice, and soybeans. Our exports to Mexico are more diversified than those to Canada—38 percent are bulk commodities, 40 percent consumer-oriented products, and 22 percent intermediate semi-processed products. Mexico is one of our largest export markets for each of these categories.

While implementation of NAFTA has not always proceeded smoothly in the agricultural area and disputes continue to affect trade in some areas, there is no doubt that NAFTA has had a significant positive impact on all three partners.

Equally as important, we've established procedures under NAFTA for handling these disputes. For both Canada and Mexico, we are actively working on trade disputes, whether they are related to SPS measures or to trade remedies. The United States and our NAFTA partners have signed bilateral memorandum of understandings to create consultative committees on agriculture, known as CCAs, to address the full range of current and future trade-related concerns. These CCAs are often complemented by high-level bilateral, and sometimes trilateral, discussions on important matters. Recent areas where we've had successful cooperation include the significant restoration of trade in beef with both Canada and Mexico.

Trade liberalization is critical to the economic future of America's agriculture. Access to growing markets is essential to the profitability of the U.S. farm sector, and NAFTA is an excellent example of how trade liberalization benefits our farmers, ranchers, and consumers. The administration is committed to American agriculture's success in world markets. NAFTA is contributing to that success. It is on track.

We will continue working closely with the Congress in addressing the trade-policy issues that remain unresolved and others as they emerge. We look forward to close collaboration and a strong partnership in building on the successes already achieved through NAFTA and our other market-opening agreements, and expanding global trade opportunities for America's farmers and ranchers.

Thank you very much.

[The prepared statement of Ms. Terpstra follows:]

PREPARED STATEMENT OF HON. A. ELLEN TERPSTRA

Mr. Chairman, Members of the Subcommittee, I am pleased to appear before you today to discuss agricultural trade under the North American Free Trade Agreement (NAFTA). This year as we celebrate that agreement's tenth anniversary, I welcome the opportunity to review the results of NAFTA and to discuss some important trade issues that currently occupy our attention.

Let me begin my remarks with an unambiguous statement—in the agricultural sector of our economy, NAFTA is an unqualified success. The United States, Mexico, and Canada enjoy a thriving agricultural trade relationship derived from the historic decision to open our borders and break down barriers to trade. In NAFTA's tenth year, markets continue to open and support a freer flow of agricultural products. Farmers in the three NAFTA countries benefit from the reduction of arbitrary and discriminatory trade rules, while consumers enjoy lower prices and more choices.

BENEFITS OF NAFTA

U.S. farmers and ranchers have been major beneficiaries of NAFTA's success as exports of food and agricultural products from the United States to our NAFTA partners reached a record $17.2 billion in 2003. These exports support approximately 258,000 U.S. jobs (every $1 billion in exports creates 15,000 jobs). NAFTA markets continue to be a bright spot for U.S. agriculture, as agricultural trade with our NAFTA partners has increased in size and importance.

When you compare the performance of U.S. agricultural exports to our NAFTA partners with our export performance to the rest of the world, the difference is even more startling. In the ten years since NAFTA was implemented, global U.S. agricultural exports increased by an average of only $250 million a year as a strong dollar, numerous currency crises, and a global economic slowdown combined to slow the overall growth in U.S. exports. However, during this same 10-year period, our exports to NAFTA grew by more than $800 million a year. Exports to Mexico grew by an average of $420 million a year while exports to Canada increased by $400 million a year, making them our two fastest growing markets by a wide margin.

What makes our export performance to Canada and Mexico even more exceptional is that it occurred during a period when the value of the U.S. dollar was particularly strong against most other currencies, including Canada's and Mexico's. A strong dollar hurt our exports in most of the world's major markets. However, in Canada and Mexico, the export losses associated with a strong dollar were more than offset by the export gains generated from significant improvements in market access provided under NAFTA.

A wide variety of U.S. products benefited from that access including processed grains, grocery products, corn, essential oils, poultry meat, soybeans, feed ingredients, beef and beef offal, cotton, wheat, sorghum, and pork.

Even in the area of horticultural products, where competition is intense, U.S. producers have benefited from NAFTA. In 1993, U.S. horticultural exports to Canada and Mexico totaled $2.8 billion. By 1997, after 4 years of NAFTA, our sales had jumped by more than 20 percent to $3.5 billion. In 2003, horticultural exports to Canada and Mexico continued their strong performance, reaching $5 billion, up approximately 8.5 percent from 2002. Fresh and processed fruits and vegetables, tree nuts and wines have all benefited from NAFTA's accomplishments, such as lower tariffs, the elimination of import licenses and a more transparent business environment.

Trade is a two-way street and U.S. agricultural imports from Canada and Mexico also increased since NAFTA was implemented. Imports from Canada increased by an average of $590 million a year while increases from Mexico averaged $300 million a year. However, that growth had more to do with the strength of the U.S. economy and the dollar than it did with the trade provisions of NAFTA since our market was already significantly open when the agreement went into effect. In fact, over the past 10 years, our imports from the rest of the world expanded as well—by an average of almost $900 million a year—with almost all major foreign suppliers significantly increasing their sales to the United States.

In addition to lowering trade barriers, NAFTA has led to a growth in cross border investment and economic integration on the North American continent. NAFTA fosters an environment of confidence and stability required to make long-term investments and partnering commitments. With a strong, certain, and transparent frame-

work for investment, North America has attracted foreign direct investment in the food processing industry in all three NAFTA countries.

U.S. direct investment in Mexico has been concentrated in highly processed products such as pasta, confectionery items, and canned and frozen meats. In Canada, U.S. direct investment has been geared toward the handling and processing of grains. Mexican companies have invested in U.S. firms engaged in bread baking, tortilla making, corn milling, and the manufacture of Mexican-style food products while Canadian direct investment has been geared to more general food processing.

The increased trade and investment that has resulted from NAFTA has spurred the economic integration of the continent. NAFTA has led to a more unified system of commercial law, the establishment of common antitrust and regulatory procedures, harmonization of product standards, and increased coordination of domestic farm, market, and macroeconomic policies which has deepened market integration and enhanced market efficiency and growth within North America. In short, larger and freer agricultural markets in North America have meant more choices for consumers.

CANADA

Canada is a good example of a mature market where U.S. exports have demonstrated impressive growth in large part due to NAFTA. Canada is our largest agricultural market. Under NAFTA, U.S. exports to Canada have increased by 75 percent reaching $9.3 billion in 2003. For Americans, this has meant almost 140,000 jobs.

Products setting export records include vegetables, meats, soybean meal, bulk commodities, snack foods, vegetable oils, fresh fruits, and pet foods.

Over 70 percent of our agricultural exports to Canada are in the consumer-oriented high-value category. Of course this means increased jobs in the United States as our food processing industry adds capacity for this growing market. In 2003, fresh fruits and vegetables led U.S. agricultural exports to Canada, stemming from increased demand in the food service sector. U.S. fresh vegetable sales to Canada have posted an annual growth rate of 4.2 percent since NAFTA implementation.

Today, Canada is the second largest export market for U.S. poultry with a 77-percent gain over the pre-NAFTA level. U.S. exports of dairy products to Canada have more than tripled. U.S. corn is used in Canada to feed livestock, to process ethanol, and to produce sweeteners. And U.S. pet food sales to Canada have surged by 40 percent under NAFTA.

NAFTA has benefited Canada as well. According to Canada's Department of Foreign Affairs and International Trade, NAFTA has brought economic growth and rising living standards to its citizens. In 2003, Canada's agricultural exports to the United States reached a record $10.3 billion. Leading agricultural exports from Canada include snack foods, red meats, live animals, and fresh and processed vegetables.

It is important to note that these Canadian imports also create jobs in the United States in the trade and transportation, services, food processing and other manufacturing sectors while at the same time giving U.S. consumers more variety in their buying options.

MEXICO

Mexico is the world's seventh largest consumer of food by value with recent expenditures estimated at $93 billion—double the level of 1995. This exceptional growth in overall food demand helps explain why Mexico has been one of the world's fastest growing agricultural import markets since 1995. The good news for U.S. agriculture is that our exporters supply 75 cents of every dollar of this import growth. U.S. agricultural exports to Mexico have doubled under NAFTA reaching $7.9 billion in 2003 supporting approximately 118,500 U.S. jobs and making Mexico our third largest agricultural export market and poised to overtake our number two market, Japan.

In 2003, the United States sent Mexico record amounts of processed fruits and vegetables, red meats, wheat, rice and soybeans.

U.S. exports to Mexico are more diversified than those to Canada with 38 percent being bulk commodities; 40 percent, consumer-oriented products; and 22 percent, intermediate semi-processed products. Mexico is one of our largest export markets for each category.

Corn, soybean, and wheat producers have increased sales in Mexico. Growth in cotton sales to Mexico has also been very impressive, due to the country's rising consumer and export demand for its textiles and apparel. However, the biggest surprise has been the strong growth of many of our consumer-oriented products to Mexico.

Before NAFTA, U.S. exports of these products were severely limited by trade barriers and weak demand. Today, with lower market access barriers and the more vibrant Mexican economy that have resulted from NAFTA, Mexico ranks as one of our top export markets for a wide range of high-value foods, including meats, fresh and processed horticultural products, pet foods, and grocery products.

As with Canada, our agricultural trade with Mexico continues to have a direct impact on the prosperity of our agricultural industry. For example, in Nebraska, the "Cornhusker State," and other large feed producing states, feed corn producers have benefited greatly under NAFTA provisions. The volume of U.S. corn exports to Mexico has risen over 42 percent since 1994, reaching 5.5 million metric tons, valued at $653 million, in 2003.

Maryland is another example of a state whose producers have benefited from NAFTA. One-fourth of Maryland's farm receipts come from broiler production. The amount of U.S. poultry going to Mexico and Canada under NAFTA has almost doubled.

Mexico's agricultural exports have also benefited from NAFTA. While Mexico has run a consistent annual deficit of around $1.5 billion with the United States, its agricultural exports into the U.S. market have nearly doubled since NAFTA's inception, reaching a record $6.3 billion in 2003. As with Canada, this trade creates U.S. jobs in the food support, distribution and processing industries and offers consumers more purchasing choices.

TRADE ISSUES

While implementation has not always proceeded smoothly, and disputes continue to affect trade in some commodities, there is no doubt that NAFTA has had a significant positive impact on the NAFTA partners. Equally as important, the agreement established procedures for handling disputes. By "locking in" key trade and investment reforms, the agricultural sectors and governments of NAFTA partners have been able to devote greater attention to resolving conflicts related to other issues such as sanitary and phytosanitary (SPS) measures. In order to facilitate the resolution of such issues the United States remains committed to using the tools available under both NAFTA and the WTO, but also has developed bilateral mechanisms.

In any trading relationship of such magnitude, problems are bound to occur. For example, since 1999, Mexico has increased its use of SPS import regulations, which has led to disruptions in some of our agricultural exports. It has also used antidumping cases to increase duties and slow or block trade. Furthermore, a lack of consistency in applying import requirements has caused problems at points of entry. Issues still unresolved include a range of phytosanitary disputes, BSE and North American harmonization, and avian influenza.

Likewise, trade disputes have arisen between the United States and Canada over such issues as wheat, softwood lumber, and dairy export subsidies. With market access issues largely addressed through NAFTA, the need to take matters to the WTO has been limited to just a few key problems.

For both Mexico and Canada, we are actively working on the trade disputes whether they are related to SPS measures or trade remedies. The United States and our NAFTA partners have signed bilateral Memorandum of Understandings (MOUs) to create Consultative Committees on Agriculture (CCAs) to address the full range of current and future trade-related concerns. These CCAs are often complemented by high-level bilateral and sometimes trilateral discussions on important matters. Recent successful cooperation efforts include the significant restoration of the trade in beef with both Canada and Mexico.

LOOKING AHEAD

When talking about NAFTA and agriculture, it is important to note that the agreement has more significance than any of the statistics I have given you today. NAFTA serves as a model and as a foundation for all our efforts to achieve trade liberalization. In this hemisphere we are using NAFTA as a building block to move toward the free flow of agricultural products between more and more countries. The recently concluded negotiations between the United States and Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua will strip away barriers to trade, eliminate tariffs, open markets, and promote investment, economic growth, and opportunity for seven countries.

Also within our hemisphere, the United States is negotiating free trade agreements with Panama and the Andean countries of Peru, Colombia, Ecuador, and Bolivia. Further, the Free Trade Area of the Americas (FTAA) talks, launched in 1998, offer an important opportunity to create the economic growth necessary to alleviate

poverty and raise living standards throughout the Americas. The FTAA will be the largest trade zone in the world, with a combined gross domestic product of over $13 trillion.

To thrive and prosper in the 21st century, U.S. agriculture must continue to look beyond the relatively mature domestic market to the expanding global marketplace.

The United States is now the world's largest agricultural exporter by value, with U.S. agricultural exports equaling 28 percent of farm cash receipts. One out of three acres are planted for export.

American farmers export 49 percent of their wheat, 37 percent of their soybeans, 65 percent of their almonds and 47 percent of their rice. High-value products generate even more additional economic activity—$370 million for every $1 billion exported.

Trade liberalization is critical to the economic future of our agricultural industry. Access to growing markets is essential to the profitability of the U.S. farm sector.

In the next 20 years, the world will gain another 1.4 billion people—a 25 percent increase in global population. The demand for agricultural goods will soar. The U.S. is well-equipped to meet this demand—our productivity increases far exceed our population growth.

USDA economists project U.S. agricultural exports in fiscal 2004 will reach $59 billion. These exports will create an additional $84 billion in support services to harvest, process, package, store, transport, and market products. Farm exports support 885,000 jobs and about one-third of these are in rural communities. Many jobs are on the farm, but most are in trade and transportation, services, food processing, and other manufacturing sectors.

Mr. Chairman, the Administration is committed to American agriculture's success in world markets. NAFTA is contributing to this success. It is on track. We will continue working closely with the Congress in addressing the trade policy issues that remain unresolved and any that emerge. We look forward to close collaboration and a strong partnership in building on the successes already achieved through NAFTA and other market-opening agreements in expanding global trade opportunities and ensuring a level playing field for U.S. agriculture.

Senator HAGEL. Administrator Terpstra, thank you.

Administrator Rosales, please.

**STATEMENT OF HON. MANUEL ROSALES, ASSISTANT ADMINISTRATOR FOR INTERNATIONAL TRADE, U.S. SMALL BUSINESS ADMINISTRATION**

Mr. ROSALES. Thank you.

Thank you, Senator Hagel and Senator Coleman, for inviting me to testify on the impact of NAFTA on trade and the U.S. Small Business Administration's role in the President's international trade agenda and export strategy.

I would like to first recognize the leadership of SBA's Administrator, Hector Barreto, a staunch advocate of active small-business participation in trade in the international marketplace.

The SBA has been working closely with the Department of State, Department of Commerce, the Export-Import Bank, Overseas Private Investment Corporation, the Trade Development Agency, and other Trade-Promotion Coordinating Committee Agencies in developing recommendations for the National Export Strategy. The cooperative agreements that we have instituted with our partner agencies will help ensure that American small businesses can be competitive in the global marketplace.

NAFTA has increased small-business participation in exporting significantly, and this growth has been larger for NAFTA than the rest of the world. According to the U.S. Department of Commerce, one third of all small-business exports go to Canada and Mexico, which is an increase from 24 percent in 1992 to 33 percent in 2001. All exporters to Canada and Mexico have benefited from NAFTA,

but small businesses have particularly seen an increase in exporting opportunities.

Compared with larger firms, small firms are especially responsive to U.S. Government initiatives to open foreign markets. Nearly 90 percent of all small exporters do business from one single U.S. location, unlike large firms, who may have offshore business affiliates, which could be used to avoid trade barriers and gain market access.

Canada has proven to be the most popular export destination for small businesses. In 2001, 94 percent of all U.S. exports to Canada were from small firms, with a value of $36.8 billion. Likewise, in 2001, 91 percent of U.S. exports to Mexico were from small businesses, with a value of $23.4 billion. This combined total of small-business exports to Mexico and Canada accounted for 33 percent of total U.S. merchandise exports for small business in 2001.

These increases in small-business exporting are important because small business creates two thirds of the new U.S. jobs, are responsible for much of the economy's innovation, and generate over half our private gross domestic product. While approximately two thirds of U.S. exporters have fewer than 20 employees, less than 1 percent of our small businesses are exporting their products.

A survey done by the U.S. Department of Commerce of more than 2,000 non-exporting firms last year indicated that 30 percent of non-exporting small businesses would be interested in exporting if someone pointed the way. In order to meet the needs of small- and medium-sized firms and create a one-stop-shop approach, over the past years we have enhanced our working relationship with our partners in such a way that we will guide and assist small businesses to have an even greater opportunity to trade abroad.

Over the past year, SBA and Ex-Im Bank are very aggressively implementing the Small Business Initiative, a memorandum of understanding. To leverage market and resources, and to raise awareness among lenders and exporters, we have done a number of things. First, we have held joint symposia throughout the United States focusing on small business, and showing a streamlined approach to exporters. We have also been working on a joint marketing initiative, which will be soon implementing the harmonization of SBA's and Ex-Im Bank's export working capital loan programs. Coordinating with our other Federal agencies is one of the best ways to achieve an increase in small-business trade participation.

Another example of interagency coordination is our work with the Overseas Private Investment Corporation. SBA participated in a trade-investment forum in Arizona that reached out to our small-business exporters and introduced them to SBA and OPIC products and services that were available. We see this as just the beginning of a very important partnership, and only see it getting stronger.

The ability to work very closely with the Department of Commerce reaching out to the small-business community has been very rewarding and has shown results. I have had the opportunity to participate with both Secretary Evans and Under Secretary Aldonas in several trade missions which focused on opening new market opportunities for small businesses.

One success story is Don Metz, owner of Metz Tool & Die, in Chicago, who received a significant order for his products as a result of a trade mission that SBA coordinated in Mexico. SBA helped the business owner participate in that mission, arranged business-to-business meeting for him with respect to Mexican SME trading partners, and subsequently provided export working capital loans as he successfully concluded contracts and delivery to Mexican buyers.

The SBA also supports the U.S.-Mexico Partnership for Prosperity initiative and its related Good Partners Program. According to our SBA field representatives, during 2003 SBA counseled and trained more than 13,000 small-business owners in opportunities in exporting, and these small-business owners then generated over $110 million in export sales. We also provided small businesses with the necessary capital through our loan-guarantee programs, to consummate their international transactions. Last year, SBA guaranteed 1658 loans to exporters, who generated another $1 billion in sales. That total, of $1.1 billion in sales, was supported by SBA through its technical and financial assistant programs. Already to this date, we are near 66 percent, as of Friday, of our goal, and we expect to surpass last year's successes.

Reaching out domestically to the export community has also been a high priority between the SBA and the Department of Commerce. For instance, we successfully participated in major domestic trade shows, trade finance seminars, direct-mail campaigns, and joint-marketing and joint-training programs. NAFTA has proven to be extremely successful in expanding opportunities for small businesses, yet more work needs to be done.

SBA looks forward to continuing its work with its TPCC partner agencies to ensure the coordination the trade promotion and finance programs meet the needs of our small-business exporters. We are also fully committed to supporting the President's overall international trade agenda as it continues to provide opportunities for small-business exporters.

There has never been a better time to make sure U.S. small business continues to be the most competitive companies in the world. In 37 states, at least 80 percent of all exporters are small to medium businesses. In every state the majority of exporters are SMEs; and in 32 states, SMEs export over $1 billion. These statistics demonstrate the important role of small business in the international marketplace, and the SBA is determined to facilitate this valuable contribution.

I look forward to the SBA's ongoing contribution to the administration's trade policy, and our commitment to evaluate and better coordinate our programs. I would be more than happy to answer any questions you may have.

Thank you.

[The prepared statement of Mr. Rosales follows:]

PREPARED STATEMENT OF HON. MANUEL ROSALES

Mr. Chairman, Ranking Member and distinguished Members, thank you for inviting me to testify on the impact of NAFTA on trade and the U.S. Small Business Administration's (SBA) role in the President's International Trade agenda and export strategy.

I would first like to recognize the leadership of SBA's Administrator Hector Barreto, a staunch advocate of active small business participation in trade and the international market place. The SBA has been working closely with the Department of State, Department of Commerce, the Export-Import Bank of the United States (Ex-Im Bank), the Overseas Private Investment Corporation (OPIC), and other Trade Promotion Coordinating Committee agencies in developing recommendations for the National Export Strategy. The Cooperative Agreements that we have instituted with our partner agencies will help ensure that American small businesses can be competitive in a global marketplace.

The North American Free Trade Agreement (NAFTA) has increased small business participation in exporting significantly, and this growth has been larger for NAFTA than the rest of the world. One-third of all small business exports go to Canada and Mexico, which is an increase from 24 percent in 1992 to 33 percent in 2001. All exporters to Canada and Mexico have benefited from NAFTA, but small businesses have particularly seen an increase in exporting opportunities. Compared with large firms, small firms are especially responsive to U.S. Government initiatives to open foreign markets. Nearly 90 percent of all small exporters do business from a single U.S. location, unlike large firms that may have offshore business affiliates which can be used to avoid trade barriers and gain market access.

Canada has proven to be the most popular export destination for small businesses. In 2001, 94% of the U.S. exporters to Canada were small firms, with a value of $36.8 billion. Similarly in 2001, 91% of the U.S. exporters to Mexico were small businesses, with a value of $23.4 billion. This combined total of small business exports to Mexico and Canada accounted for 33 percent of total U.S. merchandise exports from small businesses in 2001.

These increases in small business exporting are important because small businesses create two-thirds of new U.S. jobs, are responsible for much of our economy's innovation, and generate over half of our private gross domestic product. But while approximately two-thirds of U.S. exporters have fewer than 20 employees, less than one percent of our small businesses are exporting their products.

A survey done by the U.S. Department of Commerce of more than 2,000 non-exporting firms last year indicated that 30 percent of non-exporting small businesses would be interested in exporting if someone pointed the way. In order to meet the needs of small and medium-sized firms and create a "one-stop-shop" approach, over the past year we have enhanced our working relationships with our partners in such a way that will guide and assist small businesses to have an even greater opportunity to trade abroad.

Over the past year, SBA and Ex-Im have been very active implementing a "Small Business Initiative" Memorandum of Understanding. To leverage marketing resources, and to raise awareness among lenders and exporters, we have done a number of things. First, we held joint export symposia throughout the U.S., focusing on showing a streamlined approach to exporters.

We have also been working on a joint marketing initiative and will soon be implementing the harmonization of SBA's and Ex-Im Bank's Export Working Capital loan programs. Coordination with other federal agencies is one of the best ways to achieve an increase in small-business trade participation.

Another example of inter-agency coordination is our work with the Overseas Private Investment Corporation. SBA participated in a Trade Investment Forum in Arizona that reached out to our small business exporters and introduced them to all the SBA and OPIC products and services that are available. We see this as just the beginning of this very important partnership and only see it getting stronger.

The ability to work very closely with the Department of Commerce while reaching out to the small business community has been very rewarding and has shown results. I have had the opportunity to participate with Secretary Evans on several trade missions which focused on opening new market opportunities for small business.

One success story is Don Metz, owner of Metz Tool and Die in Chicago, who received a significant order for his products as the result of a trade mission to Mexico last year. SBA helped the business owner participate in that mission, arranged business-to-business meetings for him with prospective Mexican SME trading partners, and has subsequently provided export working capital loans as he has successfully concluded contracts and delivery to Mexican buyers. SBA has also supported the U.S.-Mexico Partnership for Prosperity initiative and its related Good Partner program.

During fiscal year 2003, SBA counseled and trained more than 13,000 small business owners on opportunities in exporting. These small business owners generated $110.4 million in export sales. We also provided small businesses with the necessary capital, through our loan guaranty programs, to consummate their international

transactions. Last year SBA guaranteed 1,658 loans to exporters who generated another $1 billion in export sales. That's a total of $1.1 billion in sales made by businesses that SBA supported through its technical and financial assistance programs. Already to date this fiscal year we are near 60% of our goal and we expect to surpass last year's successes.

Reaching out domestically to the export community has also been a high priority between SBA and the Department of Commerce. For instance, we have successfully participated in major domestic trade shows, trade finance seminars, and direct mail campaigns.

The North American Free Trade Agreement has proven to be extremely successful in expanding opportunities for small businesses, yet more work remains to be done. SBA looks forward to continuing its work with other Trade Promotion Coordinating Committee (TPCC) agencies to make sure the coordination of trade promotion and financing programs meet the needs of our small business exporters. We are also fully committed to supporting the President's overall international trade agenda as it continues to provide opportunities for small business. There has never been a better time to make sure U.S. small businesses continue to be the most competitive companies in the world. In 37 U.S. states, at least 80% of all exporters are small and medium businesses (less than 500 employees.) In every state, the majority of exporters are SMEs; and in 32 states SMEs export $1 billion or more. These statistics demonstrate the important role of small businesses in the international market place, and SBA is determined to facilitate this valuable contribution.

I look forward to SBA's ongoing contribution to the Administration's trade agenda and our commitment to evaluate and better coordinate our programs. I would be happy to answer any questions you may have. Thank you.

Senator HAGEL. Administrator Rosales, thank you.

Mr. ROSALES. Thank you, sir.

Senator HAGEL. Since presently there are just two Senators here, if it's acceptable to my friend and colleague from Minnesota we'll do 10-minute rounds, and we'll see if we can get through the questions that we need to address to the first panel. We know Secretary Aldonas needs to be out of here at 3:30 or he'll have no job.

Mr. ALDONAS. That might be a better option.

Senator HAGEL. Senator Coleman's going to be very easy on you.

Secretary Aldonas, would you address a little bit—and we heard some general references in your testimony to this point, but it would be helpful, I think, for you to go into some detail on the effect NAFTA has had in the manufacturing sector. Or have we had successes in creating jobs in the manufacturing sector? I ask that as the opening question because there has been a great amount of disinformation, misinformation, ignorance about that issue. And from your perspective, one who's had an immense amount of experience in this area over the years working in different agencies of the government, see if you can help frame this up and give us some perspective.

Mr. ALDONAS. Thank you, Mr. Chairman.

I think the best way to look at it is through the lens of some of the sectors. If you take a look at, for example, in our auto sector, one way to measure it is simply whether you have seen declining employment? Have you seen increased shipments? What are the facts that are going on there? And then how do you distinguish those from what's going on in manufacturing, generally.

I happen to be from Minneapolis originally, and right across the river, in St. Paul, is a plant that has been open for business ever since I was in high school, and pumping out Ford Ranger trucks. It happens to be the best-selling pickup truck in the world. Nobody's ever had a layoff. But the employment has gone down, even

while they were exporting more to Mexico. And, as you know, that's a phenomena that has been going on in manufacturing, globally.

In fact, interestingly enough, in the United States, we've actually had smaller job declines in the manufacturing sector than many of our major trading partners—China, Japan, Brazil included, where they're all significantly higher.

And so I think it's always important first to disaggregate the effects with respect to what's going on in the manufacturing sector, generally; because as our productivity rises, that plant in St. Paul is producing more trucks with fewer people. That doesn't mean that we're no longer competitive in that environment.

Now, what has NAFTA done to that sort of arrangement? Well, a couple of what I think are very important things. What NAFTA really allowed us to do is rationalize our production on a North American basis. It's not only just the fact that the barriers got dropped to Mexico. I know when I was a Foreign Service officer, I basically had to buy a vehicle that was made in Mexico if I wanted to drive it around down there, and that's why you had this dramatic shift upward, in terms of our exports of autos, as soon as the NAFTA went into effect.

But the far more powerful economic phenomena is that on the North American basis, our industry is now much more competitive than it ever was before. By rationalizing its production, it takes advantage of not only a broader market, but a broader platform in which to operate.

Has that meant job shifts as a part of that? Absolutely. Has it also meant increased employment, generally? Yes. And what I mean by that is the fact that you see that, for all the guys who are now producing in Mexico, what you're also seeing is an enormous amount of exported parts out of the United States. You've also seen capacity that was in Mexico come back to the United States. A good example is the Dodge Durango plant up in Delaware, where they made a choice in an investment; whereas, without having the barriers that once existed in Mexico, they no longer had to think about investing there to ship into that market. And, as a consequence, one of the hottest-selling vehicles in America is now manufactured in Delaware rather than in Northern Mexico. But, ultimately, it's about the strength that it gives us as a platform, overall.

And if I could, just to add to that, it also points to the direction that I think we need to go with Mexico. Where we haven't seized the opportunities in NAFTA is about talking about the internal reforms that have to continue, to make ourselves more capable, frankly, of taking advantage of this North American marketplace. A lot of that has to go on in Mexico, but it has to happen here in the United States, as well.

When we went across the country to 23 cities talking about manufacturing, the thing that astonished me most was the extent to which, in talking with manufacturers, large and small about the challenges they faced. They talked a lot about trade, and they talked about the advantages of NAFTA, but almost to a person what they identified, at the end of the day, as the biggest challenges were things that we most had to do to increase our competitiveness, including in our autos, were things that we have control of ourselves. It was things like tort reform. It was like a tax system

that has a rate that's higher than Sweden's. It was things like healthcare reform. It was things like the asbestos bill that I know is on the Senate floor. It's like an energy plan to bring costs down. What they were saying is, let's make this the best place in the world to invest in manufacturing. I think NAFTA has been a part of that. I think it's going to be a continuing part of it. But it still requires a push, really, among all three countries, to drive further toward putting ourselves in the most competitive position we can.

Sorry, I know that was a long-winded response.

Senator HAGEL. No, that was important, because you broadened the lens, as you noted—perspective.

Quickly take us through other manufacturing industries that have gained, and, in particular, the manufacturing industries that have lost, in your opinion, whether it was regarding specifically its relationship to NAFTA, or some other trade——

Mr. ALDONAS. Sure. Down the line, what you'd see in manufacturing is that there have been gains from NAFTA. It's true in the IT sector. There have been gains from NAFTA in the construction sector. There's a variety of things—the sore point, frankly, is in the textile and apparel industry, much of which comes out of factors other than NAFTA, which I think is important to differentiate, because NAFTA does get a bad name, in large part because of the impact on the textile sector.

I've spent a lot of time with the textile industry, both when I was here in the Senate on the Finance Committee and now in my current position, and I have to say that there were a number of companies that really did try and take advantage of NAFTA, invested on both sides of the border, rationalized their production, looked at Mexico as 86 million customers, not simply as a defensive proposition. And they're succeeding in the marketplace, even relative to Asian exports to the United States that have a very significant advantage because of what happened with the Asian financial crisis.

That said, it's also important to note that in the textile sector you had a big increase in shipments, initially based on NAFTA, but they've taken a hit recently. You still have folks who can compete. Al Frink, who was nominated recently as the Assistant Secretary for Manufacturing and Services, happens to be a carpet manufacturer. Nobody would say that California is a low-cost jurisdiction to a manufacturer in this country, right? The fact of the matter is, he's producing there, and exporting to some of the most difficult markets in the world, and is using Mexico as one of the principal markets to give him scope, give him scale, so he can compete globally. So even in those industries like textiles, there's an advantage, but you have to be prepared to seize the advantage.

For those who have looked at NAFTA much more as a defensive exercise, it's been a much more difficult road. And behind the protective walls that I think we've had in place for 40 years, you have a highly fragmented industry that has a hard time gaining the kind of scale that would allow it to compete when the quotas come off a year from now.

But almost across the board in the manufacturing sector, apart from textiles, you've seen some significant increases through this rationalization process, and the ability to set themselves up for global competition.

Senator HAGEL. Thank you.

As we are, and have been, exploring the specifics, and, in some cases, negotiating the final stages of FTAA, CAFTA, what lessons can we learn, should we learn, have we applied to those arrangements regarding looking back on the last 10 years of NAFTA?

Mr. ALDONAS. Let me talk about some of the institutional structures and then come back to a basic point about the political debate on trade.

In terms of what lessons we should apply, early is better. Frankly, the delays, in many instances—if you take Mexico's agriculture sector—by postponing the reforms and not preparing for what eventually would come, and deferring change, in fact, they, in many ways, left themselves in a worse position to grapple with the change that will now come as the tariffs finally come off on many of their sensitive products. So as we think about future agreements, while there's always an instinct to try and grapple with the sensitive products, the truth is that the dentist who pulls your tooth slowly doesn't do you a favor. It's the sort of thing where you have to grasp the nettle earlier.

On institutional structures, I have to say there are some things in NAFTA that have proved problematic that we've tried to grapple with. We have to recognize, as you pointed out, Mr. Chairman, they'll always be involvement. A good example is on the investment chapter where there were things that we need to do to make sure that the investment chapter works for our investors, but, at the same time, areas like defense procurement and things like that are covered in a way that doesn't represent a threat from the point of view of our economic interests or security interests, things of that nature.

I'd say the same thing about Chapter 19, which deals with the sensitive topic of countervailing duties and anti-dumping. It's a model that worked, I think, in the case of Canada and Mexico. It's not a model, on the other hand, we should extend. And I say that based on my personal experience as a lawyer under that framework, where I will say honestly the scrutiny that you've got under Chapter 19 is different than what you've got in domestic courts. And that wasn't the idea when we originally set this up. So as we go forward, I think the way in which we think about the structural arrangements is important.

The last thing is about the political debate. You know, I'm one who—I wasn't in government at the time—felt that the proponents of NAFTA at the time oversold it, and, in many respects, focused just on how many jobs it was going to create. And, in one sense, they set themselves up, because, in fact, what trade does, as we all know, is it shifts the pattern of production. It's not always a net-job gainer in that sense, although it has been in the case of NAFTA. The more important thing is whether it releases resources back into our own economy that will be invested more productively. And, whether we will succeed in competing globally as a result.

Increasingly, when we think about trade, I know that there is a reason why we try and distill the debate down to this level, but the most important thing we can do is always keep it at the point of saying, the goal is a more productive economy and a rising stand-

ard of living. And trade does that, even when the debate about jobs is critical, like it is right now.

Senator HAGEL. Mr. Secretary, thank you.

Senator Coleman.

Senator COLEMAN. Thank you, Mr. Chairman. And I do want to begin by thanking you for holding this very important hearing. May 20 of last year, I actually held my first hearing as chairman of the Subcommittee on Western Hemisphere, Peace Corps, and Narcotics Affairs, and also focused on some of these trade issues, so it's nice to be able to revisit.

I was going to ask Secretary Aldonas how is his hearing, and whether he has heard that great sucking sound that was supposedly coming out of this country.

I'm concerned about a number of the issues relating to trade, but I think it's important to note that—and it's in the materials here—if we repealed NAFTA today, the drain on the U.S. economy would be to the tune of about $8 billion a year. And I can't imagine anybody wanting that result. But there is so much rhetoric about this issue, and I appreciate the chairman's questions trying to kind of cut through that, and I hope we can cut through it and not throw the baby out with the bath water.

Secretary Aldonas, in your testimony you talked about the impact, dealing with the dislocations. And I appreciate that. You know, perhaps a commercial here, but Senator Baucus and I have introduced a Trade Adjustment and Assistance bill to expand TAA to services as a result of making some other improvements in the original TAA bill so that we deal with some of the problems associated with trade while continuing to move forward with trade.

I was encouraged by what I saw as some early signs from Ambassador Zoellick talking about this issue of trade adjustment, authority, and perhaps expanding it to services. I don't know whether there's an official position. I do know that the information-technology folks and the business roundtable folks have both advocated expanding trade adjustment authority to services, and I just would appreciate your reflections on that effort.

Mr. ALDONAS. A couple of things. First of all, I applaud the motivation behind it, because I think unless we are grappling with the adjustment issues—and, frankly, are perceived to be grappling with the adjustment issues—we won't maintain the public support for what is the right policy, in terms of trade liberalization. So it's essential, not only because of the practical impact on people's lives, but in the broader political impact of how you maintain support for what we should do, economically.

I haven't had a chance to look at the specifics of the proposal. Obviously, there's a lot of sympathy with respect to grappling with what's going on in the services side of the economy, as they are now facing increasing competition, as well.

The one cautionary note, I have to say—and this—take it from an old Senate Finance Committee hack as a staffer, I guess would be the best way to put it. The guts of the TAA program is pretty complex, and I'm pleased to hear that what you're thinking about is how you modify it internally. Because really what we need in the country is something that acknowledges we will continue to be adjusting—not just because of trade, but continue to be adjusting for-

ever. Things are no longer static. It's the sort of thing where I know, as my children are graduating from college and getting out into the job market, I can tell them, "Look, it's going to be five jobs"—certainly more than I've experienced—over their lifetime. To do that, and to keep them in the mix, it's going to require this continual effort over time.

And in that sense, I'm not sure that the TAA program, which can be horribly complex, and, as you know, has got these problems where you're forced out of the job market for 18 months to take the training, and then your extended unemployment insurance runs out before you can complete the training, things like that don't make sense. It's complex for the individual to get through. That's one of the reasons why I think, from the point of view of our unions, they have become the primary delivery mechanism for a lot of TAA because you need someone there who can help you sort your way through the complexity of the system.

Actually, what's needed is a system that is far simpler, so it's more easily accessible and acknowledges the fact that a lot of the transition we're going to see is not simply by virtue of trade, but much broader changes throughout the economy due to technology and a variety of other factors.

Senator COLEMAN. And there's always a challenge for our legislation to provide that kind of flexibility.

Mr. ALDONAS. Exactly.

Senator COLEMAN. I want to address one issue of concern with trade and with NAFTA. I know that Ford plant very well. I've been the mayor of St. Paul. And, by the way, it was the largest property-tax payer in St. Paul.

So that operation is very important. Minnesota is also a large exporter of pork. In fact, I think we're the No. 3 pork-producing state in the nation. I think Mexico is the No. 2 importer of U.S. pork. And, in particular, I want these trade—you know, this is the reason why NAFTA is good for us. And Administrator Terpstra talked about the impact of what's happening in the agricultural sector.

Last fall, Chairman Hagel, myself, and others were involved in a—I think 34 Senators joined myself and Chairman Hagel, expressing concern about Mexico initiating an illegal antidumping case. And we want to make sure that the administration uses all means necessary to make sure that Mexico does not illegally restrict U.S. pork exports.

I would like, Mr. Chairman, for the purposes of this record, that the copy of that letter be entered into the record.

Senator HAGEL. It will be included in the record, Senator.

Senator COLEMAN. Thank you, Mr. Chairman.

[The letter referred to follows:]

# United States Senate

WASHINGTON, DC 20510

October 29, 2003

The Honorable Ann M. Veneman
Secretary of Agriculture
United States Department of Agriculture
1400 Independence Avenue SW
Washington, DC 20250

The Honorable Robert Zoellick
United States Trade Representative
600 17th Street NW
Washington, DC 20508

Dear Secretary Veneman and Ambassador Zoellick:

We are writing to urge you to use all means, including countermeasures, to ensure that Mexico does not restrict U.S. pork exports. Pork producers, who have been losing money for most of the past two years, cannot withstand further restrictions on exports to their second largest export market.

Through the NAFTA, Mexico has increased its exports of fruits, vegetables, and many other products to the United States. And, as you know, Mexico continues to press for expanded access for its agricultural products. Unfortunately, Mexico also continues efforts to curb access for U.S. pork producers and other U.S. agriculture interests. The antidumping case initiated by Mexico against U.S. pork exports runs counter to the WTO Antidumping Code and the heavy-handed use of sanitary barriers by Mexico against U.S. pork likewise runs counter to the science-based, transparent, and fair border practices which are required under the NAFTA.

The Mexican response to U.S. agriculture exports presents a Hobson's choice for our producers. They are threatened either with a groundless antidumping order or a negotiated agreement to restrict their exports. The negotiation of a managed trade deal to limit U.S. agriculture exports not only sets a terrible trade policy precedent but is a complete non-starter for pork producers who are already struggling.

We must not cede the gains made by U.S. pork producers in Mexico. As members of the U.S. Senate, we will continue to underscore to Mexico how critical it is that it terminate its antidumping case against U.S. pork. We urge you to do the same. We believe Mexico must understand that the adverse consequences for both U.S. pork producers and Mexico itself strongly counsel against restriction of U.S. pork.

Sincerely,

Norm Coleman
United States Senate

Evan Bayh
United States Senate

The Honorable Ann M. Veneman and The Honorable Robert Zoellick
October 29, 2003
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Jim Talent

Max Baucus

Saxby Chambliss

Mark Dayton

Michael B. Enzi

Jerry F. Kenny

Jeff Sessions

Kit Bond

Chuck Hagel

John W. Warner

Mike DeWine

Lindsey Graham

George Allen

Elizabeth Dole

Pat Roberts

Zell Miller

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John Edwards

George V. Voinovich

Mike Crapo

Jim Bunning

Herb Kohl

Peter V. Domenici

Kent Conrad

George Allen

Tom Harkin

Debbie Stabenow

Byron L. Dorgan

E. Benjamin Nelson

Blanche L. Lincoln

Dick Durbin

Peter G. FitzGerald

Tim Johnson

Richard Shelby

Cc: The Honorable J.B. Penn, USDA Under Secretary for Farm and Foreign Agricultural Services
The Honorable Allen Johnson, USTR Chief Agricultural Negotiator
The Honorable Elsa A. Murano, USDA Under Secretary for Food Safety
The Honorable William T. Hawks, USDA Under Secretary for Marketing and Regulatory Programs

Senator COLEMAN. And given that, could you give me a sense of what the administration can do on—where we have those problem areas, particularly in this case of the pork and the antidumping case?

Mr. ALDONAS. Two things. One is the fact that, as both Tony and Ellen pointed out, we have this ongoing dialog, and that the environment in which we operate with our colleagues, both in Canada and the United States, is a very close one, it makes it much easier to lay our issues in front of our trading partners, and to get satisfaction, I might add.

As you may know, the particular order has been in abeyance since you wrote the letter and some of our first conversations with the Mexicans. It is problematic, in terms of the assertions it makes. We are deeply skeptical about it. And, frankly, I think our colleagues on the Mexican side have reflected that same skepticism, in terms of the way they've treated the case.

Now, would we prefer to have it shut off completely? Absolutely. And end the threat, the chilling effect—pardon the pun—with respect to our pork in terms of what's going down there? Yes. And, as a matter of fact, Secretary Evans is meeting with Minister Canales right now and raising this issue. So it is that kind of environment where I think we can meet, discuss the problems, and try and resolve them.

There's a broader point, too, about the dumping action, which I know, since both of you represent agricultural producing states, I have to say, as the person who is responsible, along with Jim Jochum, for administering our unfair-trade laws. One of the greatest causes for concern I have is the laxness in the way these things are administered elsewhere. And the place where we feel hit is in some of our most competitive areas, and those are agriculture. So whether it is pork, in the case of Mexico; whether it's chicken parts, in the case of South Africa; whether we're seeing increasing use of it in India, China, and a number of other places, this is going to become a serious issue that we're going to have to come back to, particularly through the lens of the most competitive agriculture sector in the world.

Senator COLEMAN. Thank you. I know you have to leave, and I have to question other witnesses while you're here, Secretary Aldonas, just kind of a bigger-picture question. Can you just talk a little bit about when it has worked—what has worked, what hasn't worked, and are there some missed opportunities out there that we can now focus on, begin to take advantage of?

Mr. ALDONAS. Sure. Actually, Tony referred to one that I think is critically important. And, again, there's really two components to it. It's aviation and, I would say, transportation, generally. I know we've had a debate about trucking. But the truth of the matter is, we live in a North American market, and what we have to do with things like aviation is, frankly, move toward an open-skies arrangement. And as a part of that, not only think about the benefits that that will create for people who want to invest in North America—not just the United States, but in North American production—because we'll have that advantage, in terms of how they can move goods and how they can move personnel within the North American market.

The flip side of that is, you've got the FAA and the Department of Transportation conducting a study about what our air-traffic control system will look like in 25 years and, frankly, the steps we need to be taking now to put that in place. The truth of the matter is, that's a discussion that we should be having with our trading partners in North America. It would match the regulatory side with what we should do on the trade side. And our ability to have a dialog about those regulatory issues is what's been enhanced as a result of the cooperation with both Mexico and Canada.

Senator COLEMAN. Thank you, Secretary Aldonas.

Secretary Wayne, I ran across something strange last week, and I need a little clarification, and my 6,000 Minnesota corn-growers need a little clarification. There is something called the North American Commission for Environmental Cooperation Joint Public Advisory Committee—it's a mouthful—released a letter dated April 13, 2004, advocating a moratorium on importing transgenic or biotech corn into Mexico.

Mr. Chairman, I would ask that a copy of that letter be entered into the record.

Senator HAGEL. It will be included in the record.

[The letter referred to follows:]

JOINT PUBLIC ADVISORY COMMITTEE (JPAC)
COMITÉ CONSULTIVO PÚBLICO CONJUNTO (CCPC)
COMITÉ CONSULTATIF PUBLIC MIXTE (CCPM)
*13 April 2004*

The Honorable DAVID ANDERSON
*Minister of the Environment (Canada)*

Ingeniero ALBERTO CÁRDENAS JIMÉNEZ
*Secretary, Secretariat of the Environment and Natural Resources (Mexico)*

Administrator MICHAEL O. LEAVITT
*Administrator, United States Environmental Protection Agency*

RE: *Maize and biodiversity symposium of the Commission for Environmental Cooperation*

DEAR COUNCIL MEMBERS:

The Joint Public Advisory Committee (JPAC) was pleased to participate in the CEC symposium on maize and biodiversity, held on 11 March 2004, in Oaxaca, Mexico. The event drew hundreds of participants, many of whom were indigenous peoples and campesinos who are directly affected and very much concerned with the issue of transgenic maize in Mexico. The organizers are to be congratulated for facilitating this broad representation.

The symposium succeeded in bringing a "human face" to this very complex and controversial subject. Discussion at conferences and similar gatherings often tends to focus on scientific and technical aspects rather than human impacts and consequences. What we learned from our participation is that the conservation of biodiversity cannot be separated from the protection of cultural diversity. A better understanding and respect for the human and social context is called for in this debate. Indeed all analyses should be based on a broad understanding of sustainable development and the interplay of environmental, economic, social and cultural impacts.

In this context, we have several important thoughts and observations to share with you as the report is being finalized.

The first is that the emphasis on "scientific method" and "science based" conclusions can work to exclude indigenous peoples. The scientific method is based on a western worldview that is predomiantly limited to the physical world that sees its objects of study as inanimate things. Since most of the Western World is based on the scientific method, its institutions of government, industry, business and academia are, for most part limited to this worldview. Although scientists often claim

that their study is objective, they express their values through their work. Unfortunately when western scientific methods interact with indigenous worldviews, its own institutional biases and ethnocentric values become apparent. The indigenous worldview, as we were told, includes the spiritual, the emotional, the intellectual and, of course, the physical. The arguments expressed by participants at the symposium clearly articulated how traditional food production and consumption are expressions of cultures that have been sustained by a respect for nature rather than a desire to control it.

It was also quite apparent at the symposium that the authors of the various chapters were unable to respond to the many indigenous presenters who attempted to discuss and articulate their relationship with maize as sacred, the center of life, their brother and part of their dignity and identify. We must also not underestimate the intellectual capability of the indigenous people in the region. Their understanding of maize biodiversity is based on 6,000 years of practice, observation and spiritual insight. Their opinions on the effects of transgenic maize should be carefully considered and evaluated.

Secondly, there is an obvious imbalance in the composition of the Advisory Group. The majority of the members are from academia, industry and NGOs. Indigenous people are a minor component of the Committee. This imbalance fails to recognize the importance and the significance of indigenous thought in addressing this question. Disqualifying indigenous people on the basis of language and scientific credentials is, in our opinion, a form of institutional discrimination. Ideally, there should have been an equal balance of indigenous peoples and scientists on the Advisory Group.

This imbalance may result in the promotion of a position that is directly contrary to the views of the indigenous peoples in the area. Western institutions have great faith in the scientific method. Indigenous peoples, for most part, are sceptical of western science and, instead, they have great faith in their own traditional practices and methods.

We learned much about scientific uncertainty at the symposium, both from the formal presentations and from the public interventions. JPAC is expecting that the final report will address the scope of this uncertainty. There is a very strong case to be made here for governments to apply the precautionary principle in their decision-making processes, to require that industry be comprehensive when submitting rationale and to create space for public debate. Minimally, a moratorium on imports of transgenic corn to Mexico should be put in place until the risks to human health, cultural integrity of maize producers in Mexico and the environment generally are better understood and appropriate long-term decisions can be made.

Finally, we are very concerned about the analysis of benefits and risks discussed at the symposium. It appears that the corporations share most of the benefits and the producers and the environment share most of the risks. It can be argued that the identification of benefits and risks is a value judgment, thus great care should be taken about how these benefits and risks are described.

We are looking forward to the publication of this report and a fulsome discussion on the contents of the final report and identification of specific follow-up actions during the June Council Session in Puebla, Mexico.

Sincerely,

[Original signed]

DONNA TINGLEY
*JPAC Chair for 2004*

Senator COLEMAN. Now, apparently this CEC JPAC is composed of 15 members, five of whom are from the United States and appointed by our government. And these members act independently, as I understand it, and their responsibility is to provide the CEC, which is comprised of environmental ministries from each country, with their advice on all matters within the scope of the North American Agreement on Environmental Cooperation.

My concern is that we seem to have five U.S. members on this committee who are part of a letter taking a position that is totally contrary to official U.S. policy and, I would think, to my Minnesota farmers' economic interests, and what I think is contrary to sound science. And——

Senator HAGEL. Senator Coleman, may I interrupt just a moment? Pardon me. I wanted to thank our expert witness and friend, Secretary Aldonas, who I know you know well, and we acknowledge your, as always, contributions and input. Thank you for your good work.

Senator COLEMAN. He's a proud product of Minnesota, Mr. Chairman. Thank you very, very much.

Senator HAGEL. You can escape.

Senator COLEMAN. And I would ask, then, a series of questions to Assistant Secretary Wayne, and perhaps Administrator Terpstra might help me better understand what's going on here.

Does JPAC, or CEC, have any role relation to NAFTA? That would be my first question. Why don't I just kind of lay out the three questions. You could, kind of, pull this together for me. Is there any other information you're aware of provided by the JPAC to the CEC? And if so, how is that information being used? And a third question, what steps are you taking, what steps need to be taken, if any, to ensure that biotech products approved for commercialization in the United States have access to Mexico?

Mr. WAYNE. Well, thank you, Senator. In fact the JPAC is an advisory committee, and that's what it is. It's an advisory committee to the NAFTA environmental ministers.

They have put forward a letter with which we have a number of serious problems and questions as it describes transgenic corn and shipments to Mexico. This is the same corn that we all eat on a regular basis, safely, from both a human-health perspective and from an environmental perspective.

I understand that, indeed, right now some of our colleagues in the Environmental Protection Agency are working on a response to that letter, which would be a U.S. Government response. We will, of course, coordinate with the governments of Mexico and Canada in this response, pointing out what we think are the shortcomings in this advisory opinion. And I know that Under Secretary Terpstra may have a few other comments on that.

In general, however, I can say we are extremely vigilant in supporting the use of a scientific basis for judging any genetically modified crops that are out there. We have a very good system in the United States. We work, on a regular basis, not just in North America, but around the world, to explain the benefits of that system and that when we are using corn and other approved genetically modified organism [GMO] products, we do believe them quite safe, and we use a very rigorous scientific method in pursuing that.

And so we, on a regular basis—in fact, I have a gentleman who works for me who travels around the world on a regular basis explaining this to other countries, and a number of colleagues at USDA and elsewhere have exactly the same mission, and we're certainly doing it in the context of NAFTA.

I don't know, Ellen, if you want to——

Ms. TERPSTRA. I would just add that we have a very concerted effort, working with our NAFTA trading partners, to gain a common view and export opportunities around the world common positions for biotech products, and that's a very productive, good relationship.

Senator COLEMAN. It just seems to me—I know my time's up, Mr. Chairman, but if I may, one brief comment on this, and that is that if you read the letter, it talks about minimally—minimally—a moratorium on the imports of transgenic corn to Mexico should be put in place until the risks to human health, culture integrity, et cetera, et cetera, environment, are generally better understood and appropriate long-term decisions can be made. To me, this is an issue that we have studied, that we have very clear policy. We struggle with the Europeans to clarify some of the decisions and judgment that they've made, and they seem to be moving now in the right direction.

So to have folks who are representatives of our government working in an advisory capacity, raising questions about issues that I think we have put a lot of time into trying to clarify, and say this is sound science, and that these GMOs do not present risks to human health, I just find it very troubling.

Ms. TERPSTRA. If I could just add, our understanding is that the U.S. members of that advisory committee did not support that letter and that was largely a personal opinion written by the author of the letter.

Senator COLEMAN. That's very helpful, Administrator Terpstra, thank you.

Thank you, Mr. Chairman.

Senator HAGEL. Senator Coleman, thank you.

Secretary Wayne, you noted, in your prepared remarks, the impact NAFTA has had on U.S. border security in the post-September 11 environment. Could you elaborate on your points? How, in fact, has NAFTA impacted and achieved better security on our border with Mexico?

Mr. WAYNE. Thank you, Senator. Well, first, I would note that, of course, long before September 11 took place, we were paying a lot more attention to our borders. I had the privilege of being the Deputy Assistant Secretary overseeing Canadian relations at one point in the mid-1990s. And, of course, there, as on the southern border, we were already paying a tremendous amount of attention to the Customs issues, to the border-crossing issues, because there was a lot of great importance going on—both the criminal threat; of course, the illegal immigrant threat, especially in the south—but also the importance of having commerce flow effectively, smoothly, and effectively.

So we already had this great deal of dialog on both borders—in different contexts, and working in different ways. So there was a basis there that after the tragic events of September 2001, people really knew each other. They knew what the problems were, they knew what the challenges were, and they were able to take a new look at what this now meant in the post-September 11 period.

So in December of 2001, the United States and Canada had already gotten together, and they launched a 30-point action plan to create a secure and "smart" border, a border where we could be more secure in the people and the goods that were crossing, and, at the same time, do it in a smart way, a way that was eventually going to get us a more efficient way, that would be economically efficient, that would save money, but we'd also have a real sense

that there was a check on what was crossing, both people and goods.

We deployed additional immigration officers, we worked more closely to start discussing our visa policies and see if we could move closer together. We expanded information-sharing, started developing common standards for passenger screening. Canada was the first country to join us in our container security initiative.

So an awful lot very important happened in that area, and that includes—there was this innovative program called a NEXUS program of "trusted travelers" that we already had going for high-volume border crossings. And so we started looking at that to make that more serious as we went forward.

Similarly, on the Mexican border, we started, in March of 2002, a U.S.-Mexico border partnership that—with the same notion—we're going to improve the infrastructure at the ports of entry, we're going to look at ways to expedite legitimate travel while identifying illegitimate travel, and to increase the security in the movement of goods.

So both of those processes are going on in a very intense way. I don't participate in those, but a number of my colleagues do. And I know that there are regular meetings, regular exchanges. There are—of course, in any exchange, there are things that they can do easily, and there are things that take longer to do. But this is making an important contribution to our homeland security. And the fact that we already had NAFTA there and were working built the relationships and reinforced the interests on both sides of the border to making this work.

Senator HAGEL. Thank you.

Administrator Rosales, you noted, in your testimony, some specific examples of availability of trade finance programs for small and medium enterprises. Would you focus on that area here, for the next minute or so, in explaining some of these programs that are available for the small and medium enterprises to take more of an advantage of, specifically targeted within the framework of NAFTA and other FTAs.

Mr. ROSALES. Yes, Senator, thank you very much.

The Small Business Administration's export financing programs are broken down into three groups. They're all subset of our 7(a) program. One is the Export Working Capital Program that guarantees up to 90 percent of the loan, up to a million and a half. I think we just raised the cap on that. The other is an IT loan, international trade loan, with a million-point-one. And then the other is what we call the Export Express. It allows an exporter to use financing for any export purposes not related strictly to working capital. It would mean—as an example, we've got a firm out of Los Angeles who utilized that particular product to go to a trade show in Korea, and he came back with $8 million worth of orders. So it's a very flexible product. I think the Express has been very well received by our bankers.

The other aspect, though, sir, is that we also provide a lot of training and technical assistance to our small-business exporters, particularly to the banks, the lenders. As you can imagine, some of our rural-area bankers are not experts in trade finance, so our ability to assist them in developing the loan packages and the re-

quirements to have an export backing by the SBA is very crucial to those banks.

The field representatives tell us that major problems with the banks is the consolidations, that consolidations are going on. So if the SBA was not there to provide that trade financing and that trade counseling, it would be very difficult for some of these small businesses to be able to execute those transactions.

Senator HAGEL. Thank you.

Mr. ROSALES. Thank you, sir.

Senator HAGEL. Administrator Terpstra, what role, if any, did NAFTA play with regard to the resumption of the post-BSE [bovine spongiform encephalopathy] trade with Canada?

Ms. TERPSTRA. I think fundamental to NAFTA is the foundation it gives us to have strong working relationships with our counterparts in Canada and in Mexico. Everyone, from the Secretary on down to the working level, to our scientific experts, has quite a bit of experience in interacting with our counterparts in Mexico and Canada. Thus, when you have something occur, like the case in Canada last summer, and then our case, just before Christmas, we're able to, I think, coordinate, communicate, talk about policies, talk about remedies, talk about opportunities to move ahead.

One of the first actions the Secretary took, in terms of addressing the $3.8 billion worth of our beef exports that were put at risk by the finding of the BSE case here was to call our counterparts—Secretary Usabiaga and the new Minister Speller, in Canada—and to bring all of the experts together and talk about, how do we move forward in a coordinated position? So it's established relationships where I think you can very seriously, very quickly communicate to address very serious problems like we had with BSE.

With Mexico, we feel that we've made probably the most progress, in terms of having trade resume for all of our markets. Today, about 70 percent of the value of our normal trade in beef and beef products has been able to be resumed with Mexico.

We're working, I'd say on a weekly basis, with our counterparts in Canada to make sure that we coordinate our policies, our regulations, our view on trade affected by BSE, and we're looking at ways to move ahead in the international organizations to have a NAFTA-coordinated approach that we think would serve as a model to our other trading partners around the world.

Senator HAGEL. If I understood what you said, with your specificity, if we had not had a structure, a forum, like NAFTA, it is very unlikely that we would have made the kind of progress in dealing with not only BSE, but some of these other big issues we've had to deal with. Is that right?

Ms. TERPSTRA. Absolutely.

Senator HAGEL. Does that summarize it correctly?

Ms. TERPSTRA. Absolutely.

Senator HAGEL. Thank you very much.

Secretary Wayne, what impact would you say, maybe two or three issues, in your opinion—NAFTA has had on political change in Mexico, specifically with the Fox administration? Good reform? Change? Open? Bad? Downside? What do you think?

Mr. WAYNE. I think, basically, it's created the open door, where reformers from all sides of the political spectrum could move for-

ward and press for what they saw as needed economic reform. And I think President Fox took full advantage of that, within the limits of Mexico's system, to try to push forward on a number of fronts. He was more successful in some areas than in other areas, and that's the way politics are in every nation.

But what we've found is that NAFTA, in and of itself, raised the debate of a number of issues. It raised the whole debate of transparency in the economic system. It raised, very clearly, the issues of competitiveness. It raised the issues of having to deal with all the cross-border issues, and, thus, what kind of facilitation was needed, and it forced decisions to take place. And it was in the interest of individuals within Mexico, from various sectors, to find good solutions to those issues .

One of the interesting things, when I go to other places and talk about the possibility of having FTAs—and this holds true for NAFTA, too—is remembering that the FTA, NAFTA, is one tool that creates a set of opportunities. It's then up to the society and the economy to respond and use those opportunities well.

We can see that there were a number of those opportunities taken up in Mexico. We also know that there is still a debate going on, and there's a whole other layer of challenges that still need to be faced. Of course, that's true in every economy, and ours, too, as Under Secretary Aldonas was pointing out. But what this did was really open up opportunities and create the interest in making changes. It helped get different parts of society behind reform.

Senator HAGEL. Thank you.

Senator Coleman.

Senator COLEMAN. Thanks, Mr. Chairman.

Secretary Wayne, One of the issues with NAFTA is, there's still a lot of folks who have a lot of doubts about it. And I think it was in your testimony, you talked about being careful about overselling. Have we oversold? And I am just going through the staff memo, if you look at the staff memo, NAFTA—modest affect on U.S. trade growth, one of several factors in the widening trade deficit, a slight increase in growth and productivity, has not greatly affected aggregate employment levels in all countries, but at least a half million jobs have been lost as a direct result of NAFTA; small effect on real wages. That's the staff memo, summary.

How do we deal with the issue of overselling NAFTA? And if you can—I know you walked through this, but if you can give me the concise message to the folks who are saying "slight impact on real wages," you know, "negative impact on employment, slight impact on growth and productivity." Is it worth it?

Mr. WAYNE. The short message would say, yes, it is worth it, because—I'm going to echo Grant Aldonas here—what it has done is made us more competitive in a number of sectors, more able to compete in the world. Even though—for example, jobs—even though the total number of jobs—you can debate, did it add or subtract—there's a lot of evidence that what it did is created higher-paying jobs in a number of areas. It created opportunities that wouldn't have been there for all three partners had we not started building this relationship so we could create the openings for our private sectors to work together. And that's the big difference.

It's true, the United States has a massive economy, so the main mover in our economy is going to be what we do domestically and how the whole economy is moving, and trade is relatively small, especially with two partners, even though they're next-door partners. There is only a small impact, compared to the large trends in our economy. But it still is a net-plus for us as we go forward. And as we're working in this more-globalized world where we're really competing everywhere, it has been positive for us.

Senator COLEMAN. And I would presume that you would agree with the assumption that it's in our interest to have a stronger Mexican economy, an economy in which there is greater transparency, greater adherence to the rule of law, which is required if you're going to compete in the global community.

Mr. WAYNE. I think that NAFTA has very much helped reinforce the reforms that are going on in Mexico, and those are all very much in our interest. It hasn't solved everything. That's why we're looking at other tools. We created the Partnership for Prosperity to start trying to help address some of the needs that are still out there, to help create growth in other parts of Mexico, not just in the parts that have really clearly benefited from NAFTA. There's a lot else to do, but this has been a plus, and it is very much in our interest. Senator, you're exactly right that we have a strong, prosperous—a democratic government with increasing prosperity in our neighborhood.

Senator COLEMAN. Administrator Rosales, I am impressed by the upside potential for small business in trades. It's just kind of like we're scratching the surface. Have you had a chance to—I've obviously got a self interest in Minnesota—are there any stats that you know of the percentage of exporters in Minnesota classified as small businesses? Do you have any data on that?

Mr. ROSALES. Yes, sir, we do. Matter of fact, in 2001 Minnesota had over 6,600 total exporters, of which 5,654 were small- to medium-sized businesses, or 84 percent, and it ranked 15th in the Nation as a percentage of exporters.

Senator COLEMAN. Any value of that, dollar value, of those exports?

Mr. ROSALES. The dollar value of merchandise and services show that Minnesota exported over $10.5 billion. May I also add, too, that NAFTA, for small businesses, if you look at the world of exporters in 1990, pre-NAFTA, you only had 60,000 exporters totally in the United States; now, we're roughly 220,000—97,000 are exporting to Canada and Mexico, and these are just SMEs.

Senator COLEMAN. It would appear to me—you touched upon it in your testimony—there is this huge upside potential, but, for the small business who's just kind of struggling to make it, that need help in the marketing and the coordination and that kind of stuff. And obviously, it's something you do.

Are there other folks in the private sector involved in facilitating that?

Mr. ROSALES. With the Commerce Department, you have the District Export Councils that are, appointed by the Secretary, who advise them on export-related issues from the private sector. Some states and municipalities do have international trade facilities within the states. My home state of California, unfortunately, just

dissolved its trade agency. And in some instances, our SBDCs, the Small Business Development Centers, which are a resource partner of the SBA, as part of their goal and objective is to train and facilitate training on trade. And around 35 of those SBDCs are dedicated to international trade assistance. So we do—plus, our field force in our field offices, of over 70 in every state, have a component of international trade that they provide for our small businesses who are looking for counseling in that area.

Senator COLEMAN. If I could suggest perhaps something else to look at, when I was mayor of St. Paul I worked with my colleges and universities, and the University of St. Thomas set up a small business advisory group to do many of the things that government does, but they were doing it through the university setting, providing advice, counseling—again, small-business people—training. I don't recall us getting them involved in the trade-opportunity discussion. But, if you use St. Paul as an example, we've got ten colleges and universities there, and I would think that if small business has opportunity and we haven't maxed it, we've got a lot of upside potential, that it may be worth getting in touch with the academic side so that we can, kind of, bring more resources to the table to help better educate small business how to take advantage of this.

Mr. ROSALES. Yes, Senator, we are definitely doing that, and particularly with—like I said, our Small Business Development Centers are affiliated with universities, and what they do is, they provide the counseling on all aspects of small businesses—or how to get into business, or how to expand your business—but also in the international arena.

That is one of the most crucial aspects, is to know how—not just so much the financing of it, but how to. Because the international business is a little bit more complicated than your domestic business.

Senator COLEMAN. And, last—it's a comment, rather than a question, for Administrator Terpstra—and USDA and USTR take a fair amount of beating on the Hill. We confess, on occasion, if I think that we're not being aggressive enough and doing all we can to unfair fair-trade practices, I raise some of those concerns. But I do know that the administration has encouraged the U.S. industry's sugar, corn, corn refiners, to get together and work with their Mexican counterparts, and I just want to express my appreciation for that effort. You know, you're obviously taking this seriously, and continue to work with the industry, but I find it very, very helpful, and I find it a very positive step, so I want to say thank you.

Ms. TERPSTRA. Thank you.

Senator COLEMAN. Thank you, Mr. Chairman.

Senator HAGEL. Senator Coleman, thank you.

Lady, gentlemen, thank you for your taking the time today to offer some very helpful advice and very relevant summary testimony as we look back on this important trade agreement over the last 10 years, and what we've been able to explore in the way of what's ahead, what is in store for the future. Please convey to your colleagues in your respective agencies how much we appreciate your good work.

Thank you.

Mr. WAYNE. Thank you.

Ms. TERPSTRA. Thank you.

Mr. ROSALES. Thank you.

Senator HAGEL. If the second panel would please come forward.

Welcome, nice to have all three of you here, and we appreciate very much you taking time, each of you.

Some were here when I presented my opening statement. I introduced each you. But let me do that again, for those who were not here.

We will ask the three of you to present your testimony in this order: Mr. Frank Vargo, vice president for International Economic Affairs, National Association of Manufacturers; Dr. C. Fred Bergsten, director, Institute for International Economics; and Ms. Thea Lee, chief international economist, AFL–CIO. Thank you.

Again, thank you each for coming today and presenting your testimony. And if you would begin, Mr. Vargo, we'll take your testimony, the three of you, and then get into some questions.

**STATEMENT OF FRANKLIN J. VARGO, VICE PRESIDENT, INTERNATIONAL ECONOMIC AFFAIRS, NATIONAL ASSOCIATION OF MANUFACTURERS**

Mr. VARGO. Thank you, Mr. Chairman. And let me thank you enormously for holding this hearing, because there's been so much mythology, so much that has been misleading about NAFTA that we really need to turn the spotlight on so people can take a look at the facts and see what's going on.

You know, it's so bad, Mr. Chairman—I was watching a movie the other night—great movie, by the way—called "The Italian Job." And for no reason at all, in the middle of the movie, this character says, "What's this country coming to when NAFTA can overrule the Supreme Court?" Well, it can't. But you see that everywhere.

You know, I'm convinced that there's going to be an outbreak of acne that's going to be——

Senator COLEMAN. You should read my mail.

Mr. VARGO. But, Mr. Chairman, you know, I think we can all agree that, in the years after NAFTA, if manufacturing jobs had gone down, if real compensation—the real hourly compensation had gone down, if productivity had gone down, we'd have to say, well, we've got to rethink this thing. But that's not what happened.

You know, it—I want to break time in the year 2000, because—for reasons I'll get to in a moment—but up until that time, after NAFTA, we added about 500,000 manufacturing jobs; whereas, in the years before NAFTA, we had been losing them. Real hourly compensation—wages and benefits—grew twice as fast after NAFTA, as before. Productivity went up. We had an economic boom.

Now, the detractors of NAFTA say, well, NAFTA had nothing to do with this. Well, you know, exports are important to this country, and, after NAFTA, the NAFTA countries, the two NAFTA countries, accounted for half—one out of every two—dollars of our export growth in that time period. That's not trivial. So NAFTA did contribute.

Now, after the year 2000, manufacturing really took it on the chin. We've lost almost three million manufacturing jobs. That's about one out of every six. That's a calamity. Too many people say, well, that's because of our trade agreement. You know, we have lost these jobs to NAFTA. It's not so. And the most simple way to understand that is our imports of manufactured goods from NAFTA countries today are lower than they were in 2000. They're smaller, Mr. Chairman. So the popular image that America's factories are moving across the border to Mexico, and they're stopping production here, they're starting in Mexico, and they're shipping those goods across the border, why isn't it in our import figures? Presumably Customs is doing an accurate job. I believe they are. Those imports are smaller. NAFTA is not guilty in this.

Now, our trade deficit with NAFTA did increase after 2000, but it's because our exports plummeted, and I don't have an answer for that. I do know it's not in the NAFTA agreement, because the NAFTA agreement lowered trade barriers, didn't raise them. And it's something that we, at the NAM, need to take a closer look at. And I hope you'll ask the Congressional Research Service and others, because we need those exports back. I think that it gets to, maybe, something that Senator Coleman said about doing more for export promotion. But it wasn't because of the NAFTA agreement.

Now, we have all seen these ridiculous figures that the Economic Policy Institute has shopped all around and broken down by state, saying, "700,000 jobs lost to NAFTA." It has nothing to do with the NAFTA agreement. Their analysis talks about the totality of imports from Canada and Mexico, and exports to Canada and Mexico, without making any effort at all to say, how much larger or smaller were they because of the NAFTA agreement? They leave the impression that these 700,000 jobs were lost because of the NAFTA agreement, and that's absolutely untrue. Whether or not they were lost because the trade deficit with Canada and Mexico grew, I don't know. But I can tell you, Mr. Chairman, that since our imports from the rest of the world doubled during that time period it's logical to expect that they would have about done that from the NAFTA countries.

Now, in fact, our imports from the NAFTA countries did grow somewhat faster than from the world, about 30 percent faster. But our exports to them grew twice as fast. So I draw the conclusion from that that NAFTA had more of an effect on our exports than our imports. I'm willing to get into debate and look at economic analysis, but I'm not willing to take seriously anybody's figures that say, "700,000 jobs lost because of the NAFTA agreement," when they didn't even look at the NAFTA agreement.

The second point on their analysis is, they say, well, phoof, this was all disguised until 2000 because the U.S. economy was doing so well, and NAFTA had nothing to do with that. Aha. But after 2000, that's when the effect showed up. But, Mr. Chairman, our imports of manufacturers from Canada and Mexico fell after 2000; they're smaller in 2003 than they were in 2000.

Now, as far as investment, let me just bring out three figures. In 1983, Mexico accounted for 4.1 percent of our overseas direct investment in manufacturing. In 1993, just before NAFTA, that had grown to 4.8. It grew—in 10 years, it grew seven-tenths of 1 per-

cent. What happened in the ensuing years? The latest figures show it grew from 4.8 percent in 1993 to 4.9 percent in 2002. You know, there's no sucking sound.

Our manufacturing direct investments in Mexico run a little over $2 billion a year, and that's something like 1 percent of the $200 billion a year that NAM members invest right here in the United States every year. There's no sucking sound.

Certainly, American manufacturers did expand production in Mexico, but not as much as they did here in the United States. In the auto industry, for example, we created two jobs in the United States for every job that was created in Mexico, up to 2000. And after 2000, the employment in U.S. manufacturing affiliates in Mexico began to fall, not rise, which is further evidence that the NAFTA agreement is absolutely the wrong thing to look at in looking for, "Where did we lose our jobs?"

Where did we lose them, Mr. Chairman? Well, our worldwide decline in exports of $70 billion is a good place to start looking. Seventy billion dollars is a lot of U.S. manufacturing production—had nothing to do with the NAFTA agreement. It was a lot to do with the overvaluation of the dollar, and I do want to credit the Economic Policy Institute for hitting that one on the head. They're exactly right.

Mr. Chairman, the United States is a very open market. Our average manufacturing duties are less than 2 percent. That's not a trade barrier; it's a speed-bump, if that. Two thirds of our imports from the world come in duty free already, yet we face high barriers all around the world. The way we level the playing field, the way we make it easier for us to compete in the world is more trade agreements, not less.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Vargo follows:]

PREPARED STATEMENT OF FRANKLIN J. VARGO

Mr. Chairman and Members of the Committee:

I am pleased to testify today on behalf of the National Association of Manufacturers (NAM) to provide a perspective on the North American Free Trade Agreement (NAFTA). The NAM represents 14,000 American companies, including 10,000 small and medium-sized companies. All of our members are affected directly or indirectly by trade and have a keen interest in the factors affecting our trade and international economic relations.

I want to commend you, Mr. Chairman, for holding this hearing, for no other trade issue has been as misunderstood as NAFTA and no other trade issue has been subject to as much myth and hyperbole. My testimony today will show that not only has NAFTA not been responsible for all—or even any significant part—of the loss of nearly 3 million American factory jobs in the last three years, but also that NAFTA has been a plus for the U.S. and North American economies.

My testimony highlights three extremely important facts: (1) up to 2000, the U.S. manufacturing industry and manufacturing jobs did better after NAFTA than before; (2) U.S. manufactured goods imports from Mexico and from NAFTA did not contribute to the big job loss that started in 2000, for these imports are lower today than they were in 2000; and (3) there has been no huge outpouring of U.S. investment or jobs to Mexico.

THE NAFTA AGREEMENT

It is useful to begin by reviewing briefly just what NAFTA is. NAFTA, the North American Free Trade Agreement, is an agreement among Canada, Mexico, and the United States to liberalize virtually all restrictions among them in both trade and investment. NAFTA is basically about Mexico, as the United States and Canada already had a free trade agreement that had substantially eliminated barriers be-

tween our two countries. NAFTA aimed at eliminating almost all of the remaining trade and investment restrictions in North America within ten years of its entry into force, which was in January, 1994.

It is not generally recognized that the United States was already very open to imports from Mexico before NAFTA even went into effect. Prior to NAFTA, half of our imports from Mexico already entered the United States duty-free. And the average U.S. duty on all Mexican imports was only 2 percent. That 2 percent figure is now down to virtually zero, as one would expect from a free trade area.

U.S. exports to Mexico, however, faced an average duty of 12 percent prior to the formation of NAFTA—a figure six times as high as U.S. duties on Mexican products. U.S. producers also faced a variety of other barriers in Mexico as well. Mexico's 12 percent duties on U.S. products have now been almost totally phased out. Mexico also eliminated many restrictions on foreign investment and made the country a more attractive place to invest. On the other hand, Mexico also ended a number of practices that had virtually compelled companies to invest in Mexico prior to NAFTA.

THE U.S. ECONOMY AND JOBS SINCE NAFTA

NAFTA was intended to increase trade and commerce among the North American economies and, in the process, to build a stronger foundation for economic growth and innovation. In looking at whether it achieved this, it is useful to compare the seven years prior to NAFTA (1986-93) with the first seven years after NAFTA (1994-2000), and then look at the 2000-2003 period when the huge U.S. job loss took place.

*Jobs*—Looking first at the job situation, what happened to manufacturing jobs during these time periods? Bureau of Labor Statistics (BLS) data show that in the seven years *prior* to NAFTA, U.S. manufacturing jobs didn't fare very well. In fact manufacturing employment fell by 778,000 jobs. However, in the seven years after NAFTA, U.S. manufacturing employment *rose* by 489,000 jobs. Yes, America's manufacturers *added* 489,000 jobs after NAFTA—reversing what had happened during the previous seven years.

Now what about the 2000-2003 period? During those three years, U.S. manufacturing employment dropped an astonishing 2.7 million jobs—meaning that one in every six men and women working in America's factories lost his or her job. Reversing this trend and restoring healthy growth to the U.S. manufacturing industry is the NAM's top priority. I will return to this priority at the end of my statement, to focus the subcommittee's attention on some initiatives that are needed to revitalize American manufacturing.

How much of the 2.7 million job loss is due to the NAFTA agreement? NAFTA's detractors state that a significant share of the loss can be blamed on the NAFTA agreement and particularly to rising imports from Mexico as U.S. jobs have been shifted away from U.S. factories.

A number of statements indicating how detrimental NAFTA has been are based on statistics in "The High Price of Free Trade," a paper authored by Robert Scott of the Economic Policy Institute. Scott claims that the NAFTA agreement resulted in the loss of 879,280 U.S. jobs, disaggregated by state. However, he discounts the pre-2000 period, saying that NAFTA's impact was obscured in those years by economic growth, and the negative effects of the NAFTA agreement manifested themselves after 2000 when jobs began to fall.

Similarly, the American Manufacturing Trade Action Coalition (AMTAC) mission statement says, "These job losses have been created, in large part, by trade deals such as NAFTA . . ." And a group called Save American Manufacturing Now says, "The current agreements are *causing* the rapid decline in the American economy."

I think you will agree, Mr. Chairman, that in order for the NAFTA agreement to have been a significant cause of the job loss since 2000, imports of manufactured goods from Mexico would have to have grown rapidly. In order for "outsourcing" or "offshoring" or any job displacement to have occurred, imports from Mexico would have to have grown rapidly. If American manufacturing firms closed their doors and moved production to Mexico in order to supply the U.S. market, this would have to be reflected in rapidly rising imports from Mexico.

Now, Mr. Chairman, how much do you think U.S. imports of manufactured goods from Mexico have grown since 2000, when the huge manufacturing job loss started? From what Robert Scott and others are saying, you would probably expect that the growth had been large indeed. However, the fact is that they did *not* grow rapidly. They did not grow moderately. They did not even grow *slightly.* The fact is, they *fell.*

U.S. imports of manufactured goods from Mexico, following the so-called "NAICS" (North Atlantic Industrial Classification System) definition which is used for calculating U.S. production and jobs, were $114.5 billion in 2000, and were $113.2 billion in 2003. Since our manufactured goods imports from Mexico fell, how could they have been responsible for being the principal cause—or even a significant cause—of the loss of nearly 3 million manufacturing jobs?

The answer, Mr. Chairman, is that they were *not* responsible for our job loss. Nor were imports from Canada. U.S. imports of manufactured goods from Canada also fell during this time, and total U.S. imports of manufactured goods from the NAFTA area fell from $295 billion in 2000 to $280 billion in 2003. Thus, rising imports from NAFTA did not contribute so much as a single nickel to the increased U.S. manufactured goods trade deficit nor were they a contributor to the U.S. job loss.

We must look elsewhere for the answer to the question of where the jobs went. A good place to start looking, Mr. Chairman, is the $70 billion collapse of American manufactured goods exports to the world since 2000. That figure in itself could account for the loss of close to a million jobs.

*Compensation and Productivity*—NAFTA's detractors also frequently state that NAFTA resulted in a "race to the bottom" in worker compensation to the detriment of American workers. That, however, is not what the U.S. Government's labor statistics show. According to BLS data, real hourly compensation (wages and benefits) in U.S. manufacturing from 1994-2003 grew 18 percent, more than twice as fast as the 7.5 percent they had grown in the ten years prior to NAFTA. Claims that NAFTA hurt U.S. compensation growth are unsupported, and the only conclusion possible from the actual data is that the effect of NAFTA was positive.

Moreover, U.S. manufacturing productivity (output per hour) grew 65 percent faster in the 10 years since NAFTA than in the 10 years prior to NAFTA. And it is productivity growth that enables real compensation increases.

Was NAFTA the principal factor behind the excellent economic performance of U.S. manufacturing during the 1990's? Certainly not. But NAFTA cannot be dismissed as irrelevant to this accomplishment. U.S. exports were a key driver of the economy, and since 1993 the NAFTA countries accounted for as much U.S. export growth as the rest of the world combined.

TRADE DEFICITS WITH THE NAFTA COUNTRIES

The trade deficit with the NAFTA countries grew rapidly after 1993, leading many to conclude that it was the NAFTA agreement that created the deficit growth. The deficit with Canada and Mexico widened from $9 billion in 1993 to $95 billion last year. With Mexico it went from a small surplus of $2 billion in 1993 to a deficit of $42 billion last year.

However, this deficit increase took place in the context of a worldwide U.S. trade deficit that increased from $115 billion in 1993 to $535 billion last year. In fact, the growth of the trade deficit with the NAFTA countries was not in proportion to the size of U.S. trade with NAFTA.

In 2003, the NAFTA countries accounted for about one-third of U.S. global trade (both exports and imports) but for only 18 percent of the U.S. global trade deficit. In fact the largest increase in the U.S. trade deficit since 1993 was not with the NAFTA countries—it was with the European Union, where the U.S. trade deficit worsened by $90 billion. Critics of trade agreements should take careful note of this fact, for no trade agreement was signed with Europe, yet it accounted for the largest increase in our deficit with any world region.

An important reason for the U.S. trade deficit, which will be close to $550 billion this year is not the NAFTA agreement or any other trade agreement—but is the overvalued U.S. dollar. As the Economic Policy Institute, whose report on NAFTA I criticized earlier in my statement, notes, "the overvalued U.S. dollar has been the single greatest contributor to the crisis in manufacturing . . . this rise in the dollar's value led to an increase of $408 billion in the manufacturing trade deficit. . . ." I think they hit the nail on the head with that analysis.

The principal difficulty with the Economic Policy Institute's analysis of the NAFTA deficit is that it appears to assume all of the increase in U.S. imports from Canada and Mexico and all of the increase in exports to Canada and Mexico resulted only because of the NAFTA agreement. In other words, had it not been for the NAFTA agreement, imports from Canada and Mexico wouldn't have increased at all. Since imports from the world have more than doubled since 1993, I am at a loss to explain why someone would believe imports from Canada and Mexico wouldn't have grown considerably even in the absence of any NAFTA agreement.

Reasonable people can differ as to how much larger exports and imports might be because of the NAFTA agreement, but the Economic Policy Institute study makes

no such estimate. It just attributes all the increase in imports, exports and the trade deficit with Canada and Mexico to the NAFTA agreement.

*StronRer Effect on U.S. Exports Than Imports*—NAFTA appears to have boosted both U.S. exports and imports—that is what one would expect from the reduction of trade barriers in a free trade area. However, the effect seems to have been stronger on U.S. exports than on imports. Since 1993, U.S. exports to NAFTA grew more than twice as fast as U.S. exports to the rest of the world. This growth was so rapid that the NAFTA countries accounted for about 50 percent of the U.S. export increase to the entire world. Think of it—the growth in our exports to Canada and Mexico was as large as the growth in our exports to the rest of the world combined.

Imports from the NAFTA countries, on the other hand, grew only 30 percent faster than imports from the rest of the world. Imports from the rest of the world have grown 109 percent since 1993—more than doubling in value, while imports from NAFTA countries grew 140 percent. Thus, even without the NAFTA agreement, it is reasonable to assume that imports from the NAFTA countries would have doubled as well—meaning that about 80 percent of the import growth from the NAFTA countries would have occurred anyway. If U.S. exports to the NAFTA countries had grown at the same rate as the world as a whole, only 50 percent of actual U.S. export growth to the NAFTA countries would have been accounted for.

If exports to, and imports from, the NAFTA countries had grown at the same rate as exports to, and imports from, the rest of the world, the U.S. trade deficit with the NAFTA countries would have been $115 billion—$20 billion larger than it actually was. Now, there is no guarantee that this is what would have happened in the absence of the NAFTA agreement, but it is not an unreasonable supposition.

*Small Companies Received Big Benefits*—Another criticism frequently raised about NAFTA is that the agreement only benefited a few large companies. This is absolutely untrue. In 2001 (latest data from the Census Bureau), 130,000 U.S. companies exported to the NAFTA countries—124,000 of which were small and medium-sized firms. Thus 95 percent of all U.S. exporters to the NAFTA countries are small and medium-sized firms, and they account for about 30 percent of the value of all U.S. exports to Canada and Mexico. Moreover, in the last four years, the number of U.S. exporters to the NAFTA countries grew by 17,000 firms—and small and medium-sized firms accounted for all of this increase. Thus the trade liberalization resulting from the NAFTA agreement has been enjoyed by small companies as well as large. Fully 95 percent of all the beneficiaries, in fact, were small and medium-sized U.S. firms.

## INVESTMENT

Let me now turn to what is probably the most misunderstood aspect of the results of the NAFTA agreement. NAFTA is widely criticized for costing U.S. jobs because of a perception that a massive wave of U.S. manufacturing investment poured out of the United States and into Mexico. As NAFTA got underway, there were dire warnings of a "great sucking sound." Robert Scott's recent paper, "The High Price of Free Trade", says that NAFTA was, ". . . designed to stimulate foreign direct investment and the movement of factories within the hemisphere, especially from the United States to Canada and Mexico."

This huge outpouring of investment from the United States, though, did not occur. There was no "sucking sound." Looking at investment in Mexico, for example—in 2002 the total stock of U.S. direct investment in manufacturing in Mexico was $19.2 billion, up from $9 billion in 1993. But during that same time period the total stock of U.S. manufacturing investment around the world grew from $192 billion to $393 billion.

Mexico accounted for 4.1 percent of the book value of U.S. direct investment in manufacturing abroad in 1983, 4.8 percent in 1993 and 4.9 percent in 2002. From 1994 to 2000, U.S. manufacturers invested an average of $2.4 billion annually in Mexico, an amount that is less than 1 percent of the $200 billion that manufacturers invest annually in the United States. This is hardly a sucking sound. Mexico attracted considerably more investment from other countries, as third-country producers sought to get inside the NAFTA area and export to the United States duty-free. In many cases, this production likely displaced earlier exports to the United States directly from third countries.

Through 2001 (latest data available), U.S. manufacturing affiliate employment in Mexico had grown by 271,000 since 1993. Over 40 percent of that—113,000 jobs—was in the automobile industry. Note that during that time, the U.S. auto industry created 236,000 new jobs in the United States—two U.S. jobs for every one created in Mexico.

The rest of the job growth in U.S. manufacturing affiliates in Mexico, an increase of 158,000, works out to 20,000 jobs a year. These jobs in Mexico reflected the stronger North American economy that resulted after the NAFTA agreement, and were accompanied by the far more rapid growth of manufacturing jobs created in the United States since 1993—a total of 489,000 new U.S. manufacturing jobs. Some of those jobs, it should be pointed out, were created to meet the added U.S. production needs resulting from the rapid expansion of U.S. exports to Mexico. Additionally, it is important to note that U.S. affiliate employment in Mexico fell after 2000, further evidence that NAFTA has not been a major factor in the U.S. job loss.

The situation in Canada shows even less job expansion by U.S. manufacturing affiliates. Employment by Canadian affiliates of U.S. manufacturing firms grew from 403,000 in 1993 to 460,000 in 2001—an increase of 57,000. Similar to the situation in Mexico, employment in U.S. manufacturing affiliates in Canada fell after 2000.

NAFTA: A PLUS

Thus, Mr. Chairman, it is clear that the NAFTA agreement did not result in any huge loss of U.S. jobs. What NAFTA did was to remove barriers to trade in North America and allow the expansion of trade and commercial activities among the three countries. Trade increased, and along with it the opportunities for greater production specialization and rationalization.

It is difficult to look at the 1993-2000 period and conclude anything other than that NAFTA contributed to economic growth and to the growth of the U.S. manufacturing industry. It is also difficult to look at the 2000-2003 period and conclude that the NAFTA agreement was a contributing factor in the decline in U.S. manufacturing employment, since manufactured goods imports into the United States from both Canada and Mexico fell after 2000.

While it is true that the U.S. trade deficit with the NAFTA countries increased after 2000, this was entirely due to a significant drop in U.S. exports to the two countries. U.S. exports to the NAFTA countries fell $21 billion from 2000 to 2003, which more than accounted for the $18 billion increase in the U.S. trade deficit with Canada and Mexico during that time.

In part this reflects the increased integration of the North American economy—when demand in the U.S. economy falters, the effects spread to Canada and Mexico and reduce demand in their economies, including their demand for imports from the United States. The decline may also reflect the overvaluation of the dollar that took place during that time, a factor which led to the fall in U.S. exports globally.

IMPLICATIONS FOR THE FUTURE

Mr. Chairman, I believe that the NAFTA agreement, which has helped create a stronger and more integrated North American industry, will continue to enable the rationalization of production and contribute to the future increase in productivity that we must have in order to be able to compete in the world. NAFTA helped level the playing field for American manufacturers, and we need to see more leveling in the future—for we face a lot of trade barriers around the world.

But in answering the question of how to restore American manufacturing jobs, we have to recognize that the two biggest factors have been the drop in domestic demand for manufactured goods—largely in capital goods; and in the $70 billion drop in our exports of manufactured goods globally. The export drop is largely a function of the excessively high value of the dollar, which peaked in 2002 at a level 30 percent above normal levels. The dollar has since been moving back toward a more normal level—at least vis-à-vis currencies whose values are allowed to be set by the marketplace. This beneficial movement is already beginning to be reflected in an export turn-around, and I expect our exports to grow robustly this year and next—enough to begin a significant decline in our trade deficit.

Additionally, however, we must address the domestic factors that are making the United States a more expensive place in which to produce. The NAM, together with the Manufacturers Alliance, has found that the higher costs of taxation, regulation, litigation, medical care, and other factors on average put U.S. producers at a 22 percent production disadvantage relative to their competitors. We must address this as well as taking the steps necessary to assure a continuation of sound macro-economic growth.

The NAM looks forward to working with this subcommittee and the rest of the Congress in taking the steps necessary to revitalize American manufacturing and enable it to continue its vital role in the U.S. economy. Last month the NAM Board of Directors approved a resolution that sets out the path we believe must be followed, including taking steps to:

- Promote and encourage economic growth as the single most important fundamental to promoting the nation's interests and improving the standard of living for the American people;
- Reduce the cost of producing in the United States by containing health care costs, reducing taxes on business, enacting legal reforms, ensuring adequate and affordable energy supplies and reforming the regulatory process to more effectively assess costs and benefits and the impact on industry land employment;
- Level the international playing field by ensuring that foreign countries, particularly China and other major trading partners, reduce trade barriers, comply with international trade rules and allow markets to determine exchange rates;
- Promote innovation investment and productivity through tax reforms that encourage investment and R&D, domestic and international tax rules that keep U.S. manufacturers competitive and promote pro-growth investment, and strengthened government R&D programs; and
- Ensure an adequate supply of skilled workers through greater emphasis on quality education, including math, science, and engineering; strengthened implementation of the Workforce Investment Act; expanded business-government partnerships; and a redirecting of federal programs to better assist displaced workers.

Thank you, Mr. Chairman.

Senator HAGEL. Mr. Vargo, thank you.
Dr. Bergsten.

**STATEMENT OF DR. C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS**

Dr. BERGSTEN. Mr. Chairman, as you know, I'm substituting today for my colleague, Gary Hufbauer, who had a serious family illness. Just to mention, he and my other colleague, Jeffrey Schott, are completing a 10-year evaluation of NAFTA. We look forward to sharing that with the committee. The statement from Dr. Hufbauer that I've submitted today gives you some initial results on that.

In my oral remarks, I'd like to make three brief comments. First, the main impact of NAFTA on the United States, of course, occurs via Mexico. The United States and Canada already had a free trade agreement. Trade with Mexico is a very small share of the U.S. economy, whatever the aggregate numbers. The smaller country in a trade agreement is always, by far, the most affected. So in asking what has been the impact of NAFTA on the United States, we really have to rephrase the question and ask, what has been its impact on Mexico?

As you suggested a moment ago in a question to the former panel, a strong Mexico, in both economic and political terms, is obviously very much in the U.S. interest. And I want to submit that NAFTA has had a powerful and dramatically positive effect on Mexico, in both economic and political terms, and therefore on the United States.

In economic terms, the impact of NAFTA on Mexico is unambiguously positive. When I started working on Mexico, 30 or 40 years ago—even 20 years ago, in 1980—Mexico was one of the most closed economies in the world. The share of trade in the Mexican economy as recently as 1980 was minuscule. When you added up exports and imports, compared it with Mexico's GDP, the number was 8 percent as recently as 1980. Last year, it was over 25 percent. In short, Mexico has tripled its openness to the world economy over a very short period of time, less than 25 years.

That is critically important because every analysis of development ever done shows a powerful correlation between the increasing international integration of an economy and its economic success. Indeed, it remains true that no country has ever achieved sustainable development without having integrated in the world economy—that is, globalized. Indeed, the faster you globalize, the better you do.

A recent study from the World Bank compared the globalizing and non-globalizing developing countries based on changes in their share of trade to their economy. The globalizers had shown dramatic growth, averaging 6 or 7 percent a year and had actually cut the gap with the rich countries. The non-globalizers—and, unfortunately, this includes a lot of small African countries—had shown an absolute deterioration in their per-capita incomes and had lost ground not only to the rich countries, but also to the globalizing developing countries.

Mexico is one of the most powerful cases of how openness has correlated with economic progress. Indeed, in many senses Mexico has become a poster child of globalization. We know that the Mexican Government, in first contemplating and then enacting NAFTA, used the agreement to achieve sweeping reforms of its domestic economy as well as its international economic policy. The succeeding governments in Mexico used NAFTA to lock in the liberalizing reforms, and today there is no question of whether Mexico will continue with the opening policies of the past, in large part because of NAFTA and the lock-in effect. So, in economic terms, it is absolutely unambiguous and a huge gain to Mexico.

When I say this, I don't mean to suggest that every last individual Mexican has gained from NAFTA. Like with any dynamic economic change, there are costs and there are losers; therefore, we cannot simply assume that every Mexican has gained, because many demonstrably have not. But when you look at the different income groups in Mexico, the different regional groups, you find that all have gained; some less than others, but they all have benefited as a result. And so most people, even the poorest in Mexico have been beneficiaries of NAFTA. I think the outcome from that is very clear.

Second, what about the politics? Even more important than these economic gains—but, I think, undoubtedly related to them—have been the dramatic changes in the Mexican political situation. They had their first honest election ever in 2000. They had a peaceful transition from the PRI to the opposition. These are the true tests of democracy: honest elections, peaceful transitions. We can be very proud of this dramatic change on our southern border and we can feel confident that it has been due, at least in part, to the economic opening and liberalization on that count which inexorably leads to an opening on the political and social sides as well.

Third, what about the direct effects of NAFTA on the United States? It has to be favorable. Think back to when we negotiated NAFTA. The United States had an average tariff against Mexican products of about 2 percent, and we got rid of it. We had very few other barriers to get rid of. Mexico had an average tariff against the United States of about 12 percent and a lot of non-tariff barriers, virtually all of which they've gotten rid of. In short, it's a no-

brainer. We got a six-to-one benefit in terms of changes on the tariffs and an even bigger ratio of benefits on the non-tariff barriers so we had to gain.

Indeed, Mexico was the first case, and a kind of prototype, of the asymmetrical trade liberalization strategy that the United States has been pursuing with all the major developing countries—be it Brazil, through an FTAA; be it China, as it entered the WTO; be it the various countries with which we are now negotiating at the global, regional, or bilateral level. They all have much higher barriers than we do. So we obviously gain by an agreement that reduces, and preferably eliminates, barriers on both sides. Indeed, the United States can gain only by getting as close as possible to global free trade, by reducing the much larger barriers in the other countries than the very low barriers that we started out with and which we reduce as the quid pro quo. And Mexico, again, was the first case in point; there's no doubt, as I'll indicate in a minute, what the benefits of that have been.

It seems to me if we want to ask, "What have been the net effects of all this on the U.S. economy," we have to look at the aggregate performance of our economy over the last 10 years. With the admitted blip of the mild 2001 recession, and the admitted disappointments of the slow pickup in job growth in 2002-2003, the U.S. economic performance over the last decade has been dramatic. Our economic growth in the second half of the 1990s averaged close to 5 percent. We're now back to 5 percent growth. My own forecast, for what it's worth, is that we've probably got another decade of very rapid growth in front of us. The reason is simple: our productivity growth, depending on how you define it, has doubled or tripled since the mid-1990s from what it was in the previous 25 years.

It's very hard to quantify the impact on that productivity pickup of globalization, trade liberalization and the like, but studies at our Institute for International Economics suggest that as much as one half of the total improvement in U.S. productivity growth, which underlies our overall economic spurt, is due to globalization. This is because of the pressures that it brings to bear on our economy and the greater competitive impetus that it gives to improved economic performance by American firms and workers.

This increases the adjustment pressures and the adjustment costsas well and that's why we need better safety nets, better TAA programs, as Senator Coleman and you have both advanced, and that's why we need to pay more attention to the costs and losers. But, again, the net effect on our economy is unambiguously positive, and that's why we were able to reduce unemployment below 4 percent for several years in the late 1990s without igniting inflationary pressures, an unprecedented level that no economist, myself included, would have thought possible 10 years ago.

We've tried to quantify the impact of NAFTA alone and Dr. Hufbauer mentions it in his statement. Something like three-tenths of a percentage point a year of U.S. economic growth can be directly attributed to the improved productivity, lower costs, and competitive pressures that arise from that component of our overall trade policy. I wouldn't put huge weight on any specific number but the point is that NAFTA—as one of the key elements of our overall

trade strategy—which, in turn, has led the U.S. economy to triple its reliance on world markets over the last 40 years has been part and parcel of this dramatic improvement in productivity growth, job-creating potential and overall performance of our own economy.

The result of that increase in U.S. globalization has been a huge increase in U.S. job creation all through the 1990s and, again, a very sharp increase in our income levels—another clear economic benefits to the United States.

So whether we want to look at it through the Mexican lens, whether we want to look at it more directly through our own economy and the effects of globalization, including NAFTA, I think the verdict on "NAFTA at ten" is unambiguously positive.

Thank you.

[The prepared statement of Dr. Hufbauer follows:]

PREPARED STATEMENT OF DR. GARY HUFBAUER

Mr. Chairman, thank you for inviting me to testify at this important hearing. Globalization has become a lightening rod for multiple discontents, and NAFTA is the very tip of the lightening rod. NAFTA thus attracts a great deal of misguided criticism. "Failed NAFTA" has entered the lexicon of political sound bites.

"Successful NAFTA" would be more accurate. Is Mexico first among its peers in the ranks of emerging countries? Certainly no. But is Mexico better off because of NAFTA? Certainly yes. Has NAFTA contributed to U.S. economic growth? Certainly yes. The central purpose of NAFTA was to promote the economic integration of North America. It was not intended to redesign Mexican, Canadian or American institutions. It was not an all-purpose treaty to address macroeconomic policy, financial surveillance, infrastructure, migration, drug trafficking and corruption. NAFTA has succeeded brilliantly in promoting trade and investment. Looking to the future, the North American partners can build on NAFTA's successes to make progress on new issues.

*Trade record.* NAFTA contributed to a sharp expansion of regional trade in the 1990s. Since 1993, the year before NAFTA came into force, U.S. merchandise exports to Mexico have increased by 134 percent and imports have increased by 246 percent. Total two-way U.S.-Mexico merchandise trade has grown 189 percent; during the same period, U.S. non-NAFTA two-way trade increased only 92 percent. Before NAFTA was launched, U.S.-Canadian trade integration was already very deep (thanks to the 1965 Auto Pact, and the 1989 Canada/U.S. Free Trade Agreement). Since 1993, when NAFTA was ratified, U.S.-Canadian two-way merchandise trade has increased by 87 percent, slightly slower than U.S. non-NAFTA trade. As a result of faster trade growth within North America, merchandise trade with NAFTA partners accounted for 32 percent of total U.S. merchandise trade in 2003, up from 29 percent in 1993.[1]

The NAFTA effect is less obvious in services, and perhaps missing. Between 1993 and 2003, U.S. cross-border services trade was up 69 percent with Canada and 51 percent with Mexico (2002 figure, the latest year available). Both figures are lower than the rise in U.S. two-way services trade with non-NAFTA countries, up 82 percent.[2]

*Investment record.* While the United States has not heard a "giant sucking sound", U.S. foreign direct investment (FDI) in Canada and Mexico has been strong. At historical cost, the U.S. investment position in Mexico was $58 billion at yearend 2002, up from $17 billion in 1994. Other countries have likewise increased their investment in Mexico; total inward FDI stock was $154 billion in 2002, up from $41 billion in 1994. U.S. investment growth in Canada has been slower, but began from a much larger base. The U.S. investment position in Canada rose to $153 billion in 2002, up from $74 billion in 1994.[3]

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[1] U.S. International Trade Commission. Tariff and Trade Dataweb. *http://dataweb.usitc.gov* (last accessed April 13, 2004).

[2] Bureau of Economic Analysis. U.S. International Accounts. *http://www.bea.gov/bea/di1.htm* (last accessed April 13, 2004).

[3] Bureau of Economic Analysis. U.S. Direct Investment Abroad: Balance of Payments and Direct Investment Position Data. *http://www.bea.gov/bea/di/di1usbal.htm* (last accessed March 26, 2004), and Organization of Economic Cooperation and Development. OECD Direct Invest-

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*Jobs gained and lost.* To most economists, the debate over NAFTA and jobs is surreal. Trade pacts make little if any difference to the overall level of employment. They do affect the composition and quality of jobs by shifting output from less productive sectors into more productive ones. This process contributes to the normal churning of job destruction and creation in the huge U.S. economy. Between 1994 and 2002 (when NAFTA-TAA was subsumed into the larger TAA program), NAFTA-TAA certified approximately 525,000 workers who lost their jobs on account of *all* trade and investment with Mexico and Canada (not just NAFTA-induced commerce). This works out to roughly 58,000 displaced workers per year.[4] Considering that U.S. employment is over 135 million, and that, on average, 7.6 percent of workers (10.5 million jobs at the most recent employment level) change their jobs *every quarter,* the loss of 58,000 jobs *per year* seems fairly small.[5] Nonetheless, U.S. public policy could do far more—through wage insurance, retraining, and job placement—to assist dislocated workers, whether the cause is NAFTA, globalization more generally, or simply fast productivity growth.

Even though the NAFTA-TAA figure probably exaggerates the adverse impact of NAFTA, no comparable figure is available on U.S. jobs created owing to larger exports to Canada and Mexico. Using 1999 data, the Departments of Commerce and Agriculture estimated that about 12,000 jobs are supported by every billion dollars of U.S. exports.[6] This coefficient seems high, and a more conservative for 2001 would be 8,500 jobs per billion dollars of manufactured exports.[7] Applying this coefficient to the average annual gain in U.S. exports to NAFTA countries between 1993 and 2003, about $12.5 billion per year, over 100,000 additional U.S. jobs have been supported each year by the expansion of North American trade.

*Economic gains.* But the economic contribution of NAFTA should not be measured in terms of jobs gained and lost, but rather in terms of the higher productivity of the U.S. export sector and efficiency gains to the overall economy. On average, U.S. export jobs pay 13 to 16 percent more than average jobs in the U.S. economy.[8] Moreover, the growing intensity of U.S. merchandise trade with Canada and Mexico, up from 4.4 percent of U.S. GDP to 5.7 percent between 1993 and 2003, can be attributed with $29 billion of GDP gains to the U.S. economy each year.[9]

The automotive industry exemplifies NAFTA efficiency. Auto trade accounts for a fifth of all merchandise trade among NAFTA partners. Supply lines now routinely cross national boundaries, as each country pursues specializations based on to its comparative advantage and all benefit from the larger scale of the NAFTA market. While the Big Three (GM, Ford, and DaimlerChrysler) were the first to benefit from NAFTA, foreign auto producers are now investing in all three countries. Other industries will follow the auto industry, provided that borders remain reliably open.

*Border security.* In the wake of 9/11, the United States negotiated "Smart Borders" with Canada and the "Border Partnership Action Plan" with Mexico. These initiatives are designed both to improve security and minimize delays. The basic structure of border inspections remains in place however, and it was designed to collect tariffs and detect smuggling, not combat terrorism. More must be done to plan for the eventuality of an attack—rather than betting North American integration on 100 percent effective defense. We need a new system of security management: inspections where trucks and trains are loaded rather than at the border should be at the core. This would relieve inspectors at the borders from monitoring the growing volume of routine and legitimate trade. Moreover, it would mean that most trucks and trains could still move in the aftermath of an attack from other quarters.

*Challenges ahead.* NAFTA has visibly succeeded in its central goals—boosting trade and investment, thereby integrating the economies of North America. But

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ment Statistics, 2003. *http://www.oecd.org/dataoecd/62/26/2635829.xls* (last accessed April 13, 2004).

[4] This number has elements of overstatement, because workers need only show that that their job was *affected,* not caused, by trade with Canada and Mexico. It also has elements of understatement, because not all NAFTA-affected workers apply for the benefit.

[5] Bureau of Labor Statistics, Business Employment Dynamics, *http://www.bls.gov/bdm* (last accessed March 12, 2004).

[6] See United States Trade Representative, United States Exports, *http://www.ustr.gov/outreach/states/us.pdf* (last accessed April 13, 2004).

[7] In 2001, the manufacturing sector employed 15.9 million employees while manufacturing value added was $1,853 billion (U.S. Census Bureau, *Statistical Abstract of the United States: 2003* (123rd edition), Washington: US Government Printing Office, table 987). This calculation assumes that $1 billion of exports equates to $1 billion of manufacturing value added (taking into account shipments of components between manufacturing firms). This method, in contrast to the Commerce and Agriculture method, ignores labor employed in non-manufacturing sectors that supply inputs to the manufacturing sector.

[8] United States Trade Representative, *op cit.*

[9] See OECD, *The Sources of Economic Growth in OECD Countries,* Paris: March 2003.

much more can be done. Since 1996, NAFTA has been on autopilot, relying on the inspiration of its creators, rather than initiatives from their successors. The list of possible new initiatives is long. Rather than dither over exactly the right menu, the next administration in Washington, in consultation with Mexico City and Ottawa, should chose a good menu, and get started. Here are a few ideas.

- *Migration.* This is a thorny topic, but it is high on Mexico's agenda. Congress ought to consider President Bush's proposals. The United States and Mexico need to cooperate in regulating the northward flow of Mexican workers, and the United States needs to ensure minimum rights for all immigrants.
- *Energy.* The United States and Canada should agree on natural gas pipeline routes and the nature and extent of public subsidies. Mexico needs to welcome private investment throughout its energy sector. LNG terminals in the Gulf of California would be a good place to start.
- *Financial surveillance.* All three countries should agree on minimum standards for supervision and surveillance of banks, insurance companies, mutual funds, mortgage-backed securities, and stock exchanges. The goal should be financial integration within a decade.
- *Agriculture.* Within a decade, NAFTA promises free trade between the United States and Mexico in agricultural products. Canada should join the party.

Senator HAGEL. Dr. Bergsten, thank you.

Ms. Lee.

**STATEMENT OF THEA M. LEE, CHIEF INTERNATIONAL ECONOMIST, AFL–CIO**

Ms. LEE. Thank you very much, Mr. Chairman.

I very much appreciate the opportunity to testify today on behalf of the 13 million working men and women of the AFL–CIO. I appreciate the invitation to talk about an issue that's so important to our members.

I think it won't surprise anybody that I have a different perspective on this issue than the one that has been presented so far today. When our members look at NAFTA, we see a lot of disappointments and a lot of areas in which it's fallen short.

It was sold to the American public and to American workers as a market-opening agreement that would create high-paying export-related jobs here in the United States, bring prosperity to Mexico, and spur economic growth and political stability throughout North America. But, in our view, the outcome has been quite different.

Certainly we don't dispute that trade and investment flows between the three countries have grown very dramatically during the decade since NAFTA was put into place. I guess what I'd like to do today is put my focus, not so much on whether total trade has grown, or even whether investment flows have grown since NAFTA was put into place, but on a few other things. First is the trade deficit that the United States has had with Mexico and Canada and second what the distributional impact has been, especially the impact on workers in all three countries. I'd also like to take a look at some of the particular rules in NAFTA that, in our opinion, have been problematic and shouldn't be replicated in future trade agreements.

One of the things we've seen in the decade since NAFTA has been put in place is that workers in the three countries have seen their wages either fall or stagnate. The key issue for us is the gap between the growth in productivity in all three countries and the growth in wages: wages have not kept up with productivity increases. This, to us, is troubling, and it goes to the heart of what

NAFTA is about: shifting the balance of bargaining power within the continent from workers in all three countries to multinational corporations.

Advocates of NAFTA promised better access to a market of 90 million consumers on our southern border, and prosperity for Mexico, which was to yield the win-win outcome. But 10 years later, our combined trade deficit with Mexico and Canada has ballooned from $9 billion to $95 billion. And I want to emphasize this point because I think it's important. If we go back to the prediction that was made before NAFTA by IIE, which was one of the most often-cited predictions used by both the Clinton administration and the previous Bush administration, we remember that IIE predicted that NAFTA would create 200,000 jobs. This was based on a prediction that the United States would run a trade surplus with Mexico of between $7 billion to $9 billion for the next 15 years or so, and that that would create 200,000 jobs.

Now, the Economic Policy Institute study that Frank Vargo mentioned actually uses pretty much the same methodology, the same yardstick: EPI calculates the change in net exports and then attaches a job multiplier to that. And on the basis of that, the trade-related job losses come out at around 879,000 jobs. I disagree with Frank that this is not a relevant way of looking at this issue. We're looking at the trade balance between the countries and what the overall net change has been in the 10-years since this agreement was put into place. It's very different from the outcome that was predicted.

I'd also like to address a point that Dr. Bergsten made, that NAFTA was a no-brainer or a slam-dunk because Mexico's tariffs were so much higher than U.S. tariffs. That was the basis for the prediction that the United States would have an increase in net exports with Mexico, and yet it didn't work out that way. This is just a puzzle that certainly the U.S. Trade Representative needs to address, that if the idea of these free trade agreements is supposed to be to increase net exports to gain better access to other markets, it's not working. It didn't work in NAFTA, and, in fact, in all the free trade agreements that the United States has ever signed—with Israel, Canada, Mexico, and Jordan—we've seen a deterioration in our trade balance after the agreement was signed, not an improvement.

Another point that I think is extremely important has to do with the bargaining-power question. Professor Kate Bronfenbrenner, at Cornell University, has done some research and has found that since NAFTA was put into place employers have increasingly used the threat of shifting production to stifle union-organizing drives or to block first contracts. The prevalence of these threats rose from 29 percent in 1986-1987 to 51 percent in 1998-1999. And, of course, if you look only in mobile industries, like manufacturing, that threat increases to 71 percent. So you see, increasingly, employers are using a threat of shifting production as a way of busting unions or blocking first contracts.

I want to emphasize this point, because I think it goes a long way to explaining some of the difference in views between workers and business on the issue of whether NAFTA has been good or bad. To the extent that NAFTA makes the threat of moving production

more credible and it helps employers use that threat more effectively, I think it's certainly something that is going to be perceived negatively by American workers. These threats are illegal under U.S. labor law. It's illegal to threaten to shut a factory down in order to block a union-organizing drive, and yet it happens all the time, and the laws are not enforced.

But if American workers are going to increasingly face these illegal threats when they try to exercise their right to form a union or to bargain a decent contract, I think they will continue to view the trade agreements that facilitate these threats with suspicion and hostility.

There's been a lot of discussion about Mexico and whether there have been huge advantages to NAFTA for Mexico. I would argue that on this front NAFTA has also fallen short in looking at a couple of key statistics. Real wages in Mexico are actually 7 percent lower today than before NAFTA was put in place. I think that's a striking finding, that no matter how much economic growth, no matter how much trade liberalization, no matter how much investment went into Mexico, the average worker in Mexico has not benefited. And that's 10 years later, with tremendous productivity growth, tremendous economic growth. Why is it that the workers have not gotten their fair share of the wealth that they create?

The number of people in poverty has apparently grown from 62 million to 69 million. The number of people crossing the border illegally is estimated to have doubled, contrary to the predictions of some of the NAFTA boosters, including then-President Salinas. And there's one more figure, which is somewhat contradictory to the one that Dr. Bergsten raised. According to the Carnegie Endowment study, the top 10 percent of households in Mexico increased their share of national incomes since NAFTA, while the other 90 percent lost income or saw no change. I think those are fairly troubling numbers and really go to the heart of whether NAFTA has been a big boon for Mexico. It's obviously not been popular among Mexican farmers. It's not popular among Mexican unions or workers either.

Finally, in terms of the NAFTA model, the NAFTA Chapter 11 provisions on investment have been deservedly controversial. There was a front-page article in the New York Times this Sunday that highlighted some of the challenges to U.S. court cases under NAFTA. We've also been very concerned to see corporations using the power to sue governments under NAFTA Chapter 11 to challenge environmental and public-health laws that we think are legitimate and certainly are put in place democratically.

We're concerned about the restrictions under NAFTA on the ability of governments to regulate services that are delivered across borders and by foreign investors. We have a lot of concerns about the government procurement provisions in NAFTA that have very narrow criteria attached to them.

One of the key issues has been whether workers' rights or human rights considerations can be a factor in a government procurement decision. In 1999, when President Clinton put into place an Executive order to stop government purchases of goods made by the worst forms of child labor—that is child slavery, hazardous work, and child prostitution and pornography—the U.S. Govern-

ment had to exclude Canada and Mexico from that order because that would have potentially violated our NAFTA government procurement obligations.

That seems, to us, the wrong kind of obligations to be making, that we are not allowed to say the Federal Government shouldn't buy goods made with child slavery. We shouldn't be putting provisions into our trade agreements that prevent us from making that commitment.

And, finally, the NAFTA Labor Side Agreement has utterly failed to protect workers' rights. None of the 28 cases filed under the Side Agreement has progressed beyond the initial stage of cooperative consultations, and no labor rights violators have faced any penalties whatsoever under the accord. A recent UCLA study of the Labor Side Agreement found, "Its inherent weakness and a lack of political will among the parties to implement it may doom the accord to oblivion."

And the last point I want to make has to do with whether NAFTA has improved overall U.S. competitiveness. Certainly, Under Secretary Aldonas and Secretary Wayne both mentioned this as one of the key advantages of NAFTA. Again, if you look just at the trade figures, our overall trade deficit has ballooned from $75 billion in 1993 to $489 billion in 2003. To me, that doesn't look like an economy which is doing a good job competing with the rest of the world.

Frank Vargo mentioned the declining U.S. exports, which we're very concerned about, as well, but I think part of the issue has to be purchasing power in some of the countries with whom we trade, and whether we are, in fact, doing a good job distributing the benefits of the trade agreements.

So let me just conclude by saying that the AFL–CIO is not opposed to the concept of international trade and investment, in principle, but we do believe that trade agreements must include enforceable protections for workers' rights, must preserve our ability to use our domestic trade laws effectively, protect the government's ability to regulate in the public interest, use procurement dollars to promote economic development and other legitimate social goals, and to provide high-quality public services. And we do want to see workers, their unions, and other civil-society organizations able to participate meaningfully in our government's trade policy process on an equal footing with corporate interests.

We believe our government should be negotiating trade agreements that appropriately address all the social, economic, and political dimensions of trade and investment, not just those of concerned to corporations. But, unfortunately, in our view NAFTA is precisely the wrong starting point to achieve that.

I thank you very much for your attention. I look forward to any questions you might have.

[The prepared statement of Ms. Lee follows:]

PREPARED STATEMENT OF THEA M. LEE

The North American Free Trade Agreement (NAFTA) was sold to the American public and American workers as a market-opening agreement that would create high-paying export-related jobs here in the United States, bring prosperity to Mexico, and spur economic growth and political stability throughout North America. The outcome has been quite different.

While it is true that trade and investment flows between the three North American countries have grown rapidly since NAFTA was implemented in 1994, on measures of much more importance to the average North American citizen, NAFTA has been a dismal failure. Workers in all three NAFTA countries have seen their wages fall or stagnate (failing to keep pace with productivity increases), as job insecurity and inequality have grown. At the same time, NAFTA rules have disadvantaged North American family farmers, consumers, and the environment relative to multinational corporate interests.

Rather than encouraging sustainable and equitable growth, NAFTA has contributed to the loss of jobs and incomes of workers, while enriching the very few. NAFTA's main outcome has been to strengthen the clout and bargaining power of multinational corporations, to limit the scope of governments to regulate in the public interest, and to force workers into more direct competition with each other, while assuring them fewer rights and protections. The increased capital mobility afforded by NAFTA has hurt workers, the environment, and communities in all three NAFTA countries.

LOSS OF AMERICAN JOBS

Advocates of NAFTA promised better access to a market of 90 million consumers on our southern border and prosperity for Mexico, yielding a "win-win" outcome. Yet in ten years of NAFTA, our combined trade deficit with Mexico and Canada has ballooned from $9 billion to $95 billion. The Labor Department has certified that more than half a million U.S. workers have lost their jobs due to NAFTA, while the Economic Policy Institute puts the trade-related job losses at almost 900,000.

Even workers who have kept their jobs have seen wages, benefits, and bargaining power eroded under NAFTA. Professor Kate Bronfenbrenner at Cornell University found that since NAFTA was put in place, employers have increasingly used the threat of shifting production to stifle union organizing drives or to block first contracts.

BENEFITS FOR MEXICO?

One of the main advantages of NAFTA was supposed to be that it would alleviate poverty and low wages in Mexico, helping bring the U.S. and Mexico closer together. However, on this front also, it has fallen short. Real wages in Mexico are actually 7 percent lower today than before NAFTA was put in place, and the number of people in poverty has grown from 62 million to 69 million.[1] The number of people crossing the border illegally is estimated to have doubled, contrary to predictions of NAFTA boosters, including then-President Salinas.

Furthermore, Mexico now faces difficult transitions in its farm sector, as the last round of NAFTA's agricultural tariffs are phased out. And the rapid maquiladora employment growth of the 1990s is fading fast, as multinational corporations shift more production to China and other low-wage locations, where workers' rights are severely repressed. These are the logical consequences of a free trade agreement that relied solely on lowering trade barriers and protecting corporate interests, but failed to build an adequate social dimension.

THE NAFTA MODEL

NAFTA undermines our laws by allowing corporations to sue governments and challenge statutes protecting the environment, public health and consumers. In some cases, corporations have even collected compensation from governments for lost profits or other damages. Legislators and ordinary citizens have no effective voice in the dispute resolution process, even though it is the laws they have voted for that are under attack.

NAFTA restricts the ability of governments to regulate services delivered across borders and by foreign investors. Under NAFTA, we have had to open the border to Mexican trucks even though we cannot ensure that each of these trucks meets our health and safety standards. Public services have been threatened as well—a case against Canada's postal service under NAFTA is still under way, and has disturbing implications for our governments' ability to regulate and support other essential public services.

NAFTA doesn't allow governments in Canada, Mexico and the U.S. to include local preferences or workers' rights criteria in making purchasing decisions. In fact

[1] John J. Audley, Demetrios G. Papademetriou, Sandra Polaski, and Scott Vaughan, "NAFTA's Promise and Reality," CEIP, 2004.

when, the U.S. government decided to stop procuring goods made with the worst forms of child labor in 1999, it had to exclude Canada and Mexico from the order.

Finally, the NAFTA labor side agreement has utterly failed to protect workers' rights. None of the 28 cases filed under the side agreement has progressed beyond the initial stage of cooperative consultations, and no labor rights violators have had to face any penalties under the accord. A recent UCLA study of the labor side agreement found that its inherent weaknesses, and a lack of political will among the parties to implement it aggressively, may doom the accord to "oblivion."[2]

NAFTA IN THE CONTEXT OF BROADER U.S. TRADE POLICY

One often-cited argument for NAFTA was that it would improve U.S. competitiveness with the rest of the world. However, since NAFTA was put in place, our overall trade deficit has also ballooned, from $75 billion in 1993 to $489 billion in 2003. The current account deficit hit a dangerously high 5 percent of GDP, slowing any possibility of strong economic recovery and undermining future job growth. The high import propensity of the U.S. economy means that even as economic recovery gets under way, a large proportion of every dollar spent by consumers goes to purchase imports, undermining the economy's ability to generate good jobs at home.

These figures are very real to working Americans who are losing family-supporting jobs and benefits as manufacturing and even service jobs are lost overseas.

U.S. goods exports actually fell in 2001 and in 2002, exposing the falsehood that current U.S. trade policies are enhancing our competitiveness in overseas markets. In 2002, total U.S. goods exports were only $694 billion, down almost $90 billion from the 2000 level. In 2003, exports recovered weakly, to $714 billion, still well below the 2000 level.

This year's trade figures also reveal other startling weaknesses in the U.S. economy, even in those areas which have traditionally been considered U.S. strongholds, like services and advanced technology products. The trade surplus in services has fallen from $92 billion in 1997 to $60 billion in 2003. In advanced technology products, similarly, the U.S. surplus of $4.5 billion in 2001 turned into a whopping deficit of $17.5 billion in 2002, rising to $27 billion last year. These trends call into question the conventional wisdom that the United States enjoys a permanent and growing comparative advantage in the export of services and high-technology goods.

In general, the experience of our unions and our members with past trade agreements has led us to question critically the extravagant claims often made on their behalf. While these agreements are inevitably touted as market-opening agreements that will significantly expand U.S. export opportunities (and therefore create export-related U.S. jobs), the impact has more often been to facilitate the shift of U.S. investment offshore. In fact, the agreements' far-reaching protections for foreign investors directly facilitate the shift of investment, and such shifts can fairly be considered an integral goal of these so-called "trade" agreements. Much, although not all, of this investment has gone into production for export back to the United States, boosting U.S. imports and displacing rather than creating U.S. jobs.

The net impact has been a negative swing in our trade balance with every single country with which we have negotiated a free trade agreement to date. While we understand that many other factors influence bilateral trade balances (including most notably growth trends and exchange rate movements), it is nonetheless striking that none of the FTAs we have signed to date has yielded an improved bilateral trade balance (including Israel, Canada, Mexico, and Jordan).

If the goal of these so-called "free trade" agreements is truly to open foreign markets to American exports (and not to reward and encourage companies that shift more jobs overseas), it is pretty clear the strategy is not working. Before Congress approves new bilateral free trade agreements based on the outdated NAFTA model, it is imperative that we take some time to figure out how and why the current policy has failed.

FREE TRADE OR FAIR TRADE?

The AFL-CIO believes that increased international trade and investment can yield broad and substantial benefits, both to American working families, and to our brothers and sisters around the world—if done right. Trade agreements must include enforceable protections for core workers' rights and must preserve our ability to use our domestic trade laws effectively. They must protect our government's ability to regulate in the public interest, to use procurement dollars to promote eco-

[2] Linda Delp, Marisol Arriaga, Guadalupe Palma, Haydee Urita, and Abel Valenzuela, "NAFTA's Labor Side Agreement: Fading into Oblivion?" University of California at Los Angeles, March 2004.

nomic development and other legitimate social goals, and to provide high quality public services. Finally, it is essential that workers, their unions, and other civil society organizations be able to participate meaningfully in our government's trade policy process, on an equal footing with corporate interests.

NAFTA is a model that has utterly failed to deliver the promised benefits to ordinary citizens in any of the three North American countries. Yet our government is in the process of negotiating new trade agreements with dozens of countries, using NAFTA as a template.

The success or failure of any future trade and investment agreements will hinge on governments' willingness and ability to negotiate agreements that appropriately address all of the social, economic, and political dimensions of trade and investment, not just those of concern to corporations. Unfortunately, NAFTA is precisely the wrong starting point.

Senator HAGEL. Ms. Lee, thank you.

Ms. Lee, let me ask you, is there anything about NAFTA that is good?

Ms. LEE. As I said, the concept that we would lower trade barriers between countries is not, in itself, objectionable. The question is what sort of conditions we attach to that. I would agree with what a lot of people said, that a strong and healthy and prosperous Mexico is very much in the interest of the United States. We don't see that the particular rules contained in NAFTA have really achieved that end. They have certainly created pockets of wealth in Mexico, but that wealth has not been well distributed.

We do think, in principle, the concept of having enforceable rules, multilateral rules, for trade is useful, and more transparency is useful, that governments ought to have to put on the table what their procurement policies are, what their investment policies are, and so on, but that the balance of interest in NAFTA was wrong. It was an agreement that was negotiated in order to increase the mobility, the flexibility, the profits of multinational corporations. It's succeeded very well in doing that. But it hasn't done a good job for workers in the three North American countries.

Senator HAGEL. Would you give this panel an idea of a trade agreement that is now in existence that's good?

Ms. LEE. Yes. The AFL–CIO did support the Jordan Free Trade Agreement. I understand it's a very small agreement with a small country. But we worked very closely with the Clinton administration strengthening the workers' rights and environmental protections in that agreement. And even though they weren't perfect, from our point of view, we thought they were a really important step forward. We also worked with our Jordanian union counterparts to come up with those provisions. So we thought that was a good starting point, and we had hoped to be able to build on that foundation. Unfortunately, that hasn't been the case.

We also were very supportive of the Cambodia agreement, on a much smaller scale, with respect to textile and apparel quota that was, I think, put in place around 1999. Again, that was an agreement that tied increased textile and apparel quota to compliance with internationally recognized labor standards. Our assessment of that agreement is that it's been very effective in protecting the rights of Cambodian workers, and also in serving the needs of the corporations that have invested there. The Cambodian Government and the U.S. Government have worked closely together to make sure that workers' rights are respected. And, in that case, we have been very supportive of that model.

Senator HAGEL. Do you believe NAFTA is salvageable, or, in your opinion, would we start all over, or can you amend it, can you adapt it?

Ms. LEE. We would like to see NAFTA reformed and fixed. We'd like to see the workers' rights and environmental provisions strengthened. We'd like to see Chapter 11 revisited, and the government procurement and the intellectual property rights possibly revisited. But, yes, I think it certainly would be possible to negotiate a good trade agreement between the United States, Mexico, and Canada.

Senator HAGEL. Let me ask you about consumers. Do you believe American consumers have gained over the last 10 years because of NAFTA?

Ms. LEE. I believe prices have come down somewhat and that that has been an advantage for consumers; however, when you look at the real wage trends, that takes into account the fall in consumer prices, whatever changes in inflation have occurred over that time. On that front, even though as Fred Bergsten said, there were some important wage gains in the late 1990s for American workers, many of those have eroded, and we see very slow wage growth again now in the last couple of years.

So for American workers, the real wage numbers already factor in the consumer gains, and those numbers have been very disappointing for American workers, overall.

There's been quite a bit of research on the growth in wage inequality. Most of the conclusions are that trade is not the only factor contributing to the growth in wage inequality over the last 20 or 25 years, but it is a significant factor that has, in fact, exacerbated wage inequality in the United States over that period.

Senator HAGEL. And you would apply this to both non-union and union workers——

Ms. LEE. That's right.

Senator HAGEL [continuing]. Slash, consumers.

Ms. LEE. Yes, that's the real wage figures don't stop at union workers.

Senator HAGEL. Thank you.

Let me ask our other two panelists to respond to some of the things that you've said, because I see that they have been writing notes furiously, and I would not want to disabuse them of an opportunity here. But in a couple of specific areas, the points that Ms. Lee brings out, I think, need to be addressed.

One is the issue that she mentioned regarding large trade deficits with Mexico and Canada, and that will be one of the issues I'll want each of you to respond to. Does it matter? Does it hurt? Is it important? Is it right? Is it wrong?

And the second is what we just talked about, about not just the American worker/consumer. As Ms. Lee has said—I think I'm generalizing here correctly—that when you factor it all in, maybe they haven't—the consumer hasn't come out that well. But also—that part, but she also mentioned that the Mexican worker has not benefited, I think. Isn't that right? So those areas, gentlemen, if you could address, I would appreciate it.

Dr. Bergsten.

Dr. BERGSTEN. Ms. Lee raised the issue, which is something of a puzzle and a conundrum to most people, of the relationship between the big increase in our trade deficit and the employment situation in the United States. But think of it the following way.

In the 1990s—take the decade as a whole—our trade deficit grew from virtually nothing to almost half a trillion dollars. Simultaneously, we created 40 million new jobs and the unemployment rate dropped from 7½ or 8 percent early in the decade to less than 4 percent at the end of the decade. So there was an obviously huge inverse correlation between the growth of the trade deficit and the employment situation.

I tried to explain part of that conundrum in my remarks by suggesting that the dramatic increase in the level of trade—U.S. engagement in the world economy—was a major factor underlying the productivity growth that enabled us to run economic growth of 4 percent or more for most of the second half of the 1990s. That, in turn, enabled Alan Greenspan and the Federal Reserve to let the unemployment rate go down without fear of inflation and without a need to raise interest rates, as had always occurred over the previous 20 years or so when U.S. unemployment got below 6 percent.

Even with the increase in the trade deficit—and I come to that in a minute—the sharp increase in U.S. involvement with the world economy was a central factor generating the productivity growth which generated the economic growth that generated the non-inflationary job creation that was a huge benefit for American workers and everybody else in our economy.

What caused the growth in the trade deficit was almost primarily two things. One was the enormous overvaluation of the exchange rate of the dollar that occurred during that period. Because we were growing fast, because we were doing much better than any other economy in the world, huge amounts of capital flowed in, drove the dollar to overvalued levels, priced our firms out of many world markets, and shifted us from a rough current account balance in the early part of the 1990s to a huge deficit. The problem was the exchange rate of the dollar.

The second problem was simply the fact that we were growing so much faster than everybody else and that our demand was thus growing so much faster than everybody else. Part of that spilled over into imports; our market grew much faster than the foreign markets for our exports grew.

So those two things together explain—or, in fact, in most models overexplain—the increase in the trade deficit. It has nothing to do with a reduction of trade barriers through NAFTA, the WTO, or anything else. And I'll stick with my statement that—everything else held equal, the economist's crutch—we gained, even in trade-balance terms, from the changes in trade barriers, which was the issue of NAFTA.

One could go back and say that NAFTA made a huge error: it did not address the exchange rate and it did not address macroeconomic policy. Doing so would be a big change in trade legislation, trade policy, and trade negotiations. Some people have proposed that. It's not a ridiculous idea. It ought to be considered in the future. But I would submit that the large positive job and economic growth effects of the 1990s were partly due to the trade pol-

icy liberalization of that time and that, I think, explains to some extent the conundrum that Ms. Lee was talking about.

What about the effect on the Mexicans? I'm not sure of the numbers that she mentioned. I'm not sure if they're in dollar equivalents or local-currency equivalents.

Ms. LEE. Local currency.

Dr. BERGSTEN. If they're local-currency equivalents, I've got to be skeptical of them.

In the second half of the 1990s, Mexico experienced its best growth performance of the 20th century. Despite the peso crisis in 1994-1995, Mexico, in the second half of the 1990s, averaged over 5 percent economic growth per year under the Zedillo presidency. It was the most rapid sustained economic growth in the history of Mexico in the 20th century.

I'm prepared to accept that there was an increase in income inequality in Mexico, that the highest 10 or 20 percent of the population grew more and had better results. That is, indeed, one of the results of globalization almost everywhere, including in our own economy. But to suggest that 90 percent of the population saw no improvement and that average real wages were down by 7 percent in the face of economic growth of that type does not sound logical. You can probably find a time period, if you base your calculation just before the peso crisis and then take into effect the big hit from the peso crisis for a couple of years; when the comeback won't fully offset it and that may be the result that Ms. Lee was talking about. But I think an equally plausible base would be to say that they had a huge peso crisis that was due to bad macroeconomic policy and had nothing to do with NAFTA and, from that base, what has been the change in performance over the last 6, 7, or 8 years? On that count, the result has got to be very positive.

Senator HAGEL. Mr. Vargo.

Mr. VARGO. Mr. Chairman, you cannot simply look at a change in the trade deficit with Canada and Mexico, because our trade deficit with the world grew from $115 billion to $550 billion. Our largest increase in our deficit was not with NAFTA, it was with Europe. And there's no U.S./European Free Trade Agreement. The same factors that led to that—and I agree with Fred Bergsten—that is the overvalued dollar, and it is a more rapid growth rate in the U.S. economy.

But in looking at the NAFTA agreement, one has to ask, what would have happened in its absence? And here, I commend an excellent study by the Congressional Budget Office, which concluded that the bulk of the trade flows would have happened pretty much the way they did, although our exports after the NAFTA agreement picked up somewhat more than our imports.

And as I do a less sophisticated analysis and just look at what happened, and say, you know, our exports to the NAFTA countries grew twice as fast after the NAFTA agreement than our exports to the rest of the world did, while our imports only grew 30 percent faster. One has to ask, would the trade deficit with the NAFTA countries have been worse without the NAFTA agreement? And I think they would have been. So just saying, the deficit grew, is absolutely not enough.

I'd like to point out, on the real Mexican wages, you know, right after the NAFTA agreement came into effect, there was a collapse in the peso, not because of the NAFTA agreement, but because of a variety of political and economic factors, including maintaining an overvalued peso too long. And there was a crisis in net investment inflows. It wasn't that investment flowed into Mexico; it suddenly virtually stopped. The Bank of Mexico could not maintain the value of the currency, didn't have the reserves to maintain it, and the peso went way down. And this had a dramatic effect on our trade with Mexico, and a dramatic effect on real wages in Mexico. But you have to go a couple of years past that to look at the rapid rate of recovery in Mexico after that.

Dr. BERGSTEN. Could I just add one point? There is one episode where we know that NAFTA had an effect on the U.S. trade balance with Mexico in a favorable direction. It was in the wake of the peso crisis.

In the wake of the peso crisis, Mexico responded to non-NAFTA partners as it had to all partners after the debt crisis in the early 1980s—namely, it restricted imports very sharply. It could no longer do so toward the United States or Canada because of NAFTA. And clearly it would have done so otherwise. That was the lock-in of reforms I was talking about. In that case, it occurred preferentially in our favor. Indeed, the U.S. share of Mexican imports jumped sharply in the wake of the peso crisis because they put controls on imports from China, Japan, Europe, and almost everybody else. But they couldn't do it to us because of NAFTA. So we gained—or lost less—in the wake of the peso crisis, in terms of our exports to Mexico, because of the NAFTA commitments. That's the one unambiguous effect we know about and it was favorable for the United States.

Mr. VARGO. Mr. Chairman, could I make one additional point—just another way of looking at our trade deficit with Mexico, which has grown a lot. If you exclude just two product areas—crude oil, our trade balance in crude oil, and in motor vehicles and parts—you'll see that we have balanced trade with Mexico. The entire deficit is in those two areas. So if there has been a huge—and I don't think most people are going to argue that the increased imports of crude oil from Mexico have cost us jobs—so then you'd have to look at the auto sector, and that's one that's worth looking at more closely. But when I look at it, I see that we had a more rapid increase in automotive jobs in the United States after NAFTA than before. And even today, after the 2000 to 2003 difficulties, serious difficulties, in manufacturing, we have more people employed in the U.S. auto industry even today than we did before NAFTA.

Senator HAGEL. Ms. Lee.

Ms. LEE. I'd like to come back on a couple of issues. One is that I actually don't disagree that the overvalued dollar and the unequal growth of the U.S. relative to the rest of the world and our trading partners were some of the major factors behind the growth in the overall U.S. trade deficit, and even with Mexico and Canada, as well.

The point I wanted to make was a little bit different, and maybe more subtle, which is that NAFTA was supposed to increase our ability to sell to Mexico and Canada, and I don't believe it suc-

ceeded on that front. Even given the dramatic difference in initial tariffs between the United States and Mexico, it didn't deliver. My argument would be that the reason it didn't deliver is that it was never designed to be a market-opening agreement so much as it was an investment shifting agreement: that NAFTA was actually designed to shift production from the United States to Mexico and maybe, to some extent, to Canada to rationalize production, as was discussed earlier. The outcome of that certainly is very favorable for multinational corporations, but the workers don't have the ability to cross the border the way the companies do. They're stuck here in the United States; they've got to take what's left for them, and on that front, this hasn't been good.

I also want to talk a little bit about the peso crisis, because I think it's an important question, whether there was any connection whatsoever between the peso crisis and NAFTA. Certainly, people have argued that one of the reasons that the Mexican Government kept the peso overvalued was to get NAFTA past the U.S. Congress, that it was convenient for Mexico to have a trade surplus with the United States while NAFTA was being debated. But even if you put that aside, I think it's not—that was a real impact. A lot of proponents of NAFTA said that if we passed NAFTA, there wouldn't be a peso crisis. And that was wrong. That was another of the arguments made by NAFTA boosters that turned out to be wrong. I have a lot of the pre-NAFTA editorials and op-eds, and so on, and here are a lot of wrong arguments that were made at that time. The overselling of NAFTA was conceded, in a very minor way, by Secretary Aldonas and Secretary Wayne, but I think maybe not to the extent that was necessary. And the free trade agreements that USTR is negotiating now are being sold in exactly the same terms, that they are going to open markets and miraculously lift countries out of poverty and improve the U.S. trade balance, and so on. I think it's important that we look honestly at the 10-years of experience with NAFTA and admit to ourselves that it really didn't deliver on many of those fronts.

And there were a lot of other things happening. The world is a complicated place. NAFTA is only one small piece of the changes that happened in the United States and Mexico over that period of time. But I think we all have to be careful that we don't either take everything good that happened in the United States, including the rapid job growth of the 1990s, and attribute it to NAFTA, or take everything bad and put it at the feet of NAFTA, as well.

Senator HAGEL. Thank you.

Dr. BERGSTEN. Mr. Chairman.

Senator HAGEL. Dr. Bergsten.

Dr. BERGSTEN. I would just make two quick points. On the point that Ms. Lee made about U.S. exports to the NAFTA countries, I was struck by a sentence in Frank Vargo's testimony that he didn't say orally but I want to quote it: "Since 1993, the growth in our exports to Canada and Mexico was as large as the growth in our exports to the rest of the world combined." So it was an export expansion engine. I won't go back and try to figure out what the motives were, but the effect has clearly been to expand our exports to the NAFTA partners much faster than to the rest of the world. So I'd say that one certainly succeeded.

On the point about the peso crisis, I, as a NAFTA supporter, certainly never said at the time that there would never be a devaluation of the Mexican peso. Indeed, I remember saying frequently that I was worried by the lack of any link in NAFTA to exchange rates and the financial side because we know, from the history of economic development, that whenever a developing country opens up its trade regime and liberalizes its imports that a deterioration in its trade balance is likely to result, which will, in fact, require a devaluation of its currency. That is almost standard development theory. I guess it was convenient for people to ignore that when they were discussing NAFTA and its ratification in both countries. I, for one, recall talking about that at the time, believing in fact there should have been such a link—maybe this is just my Treasury background coming to the fore because I renegotiated the U.S.-Mexican swap agreement while I was at the Treasury and knew it might have to be used in this context.

Ignoring the exchange-rate side is a gap in our trade policy. We have never been very good at linking our trade policy with our exchange rate and international financial policy. We're seeing that in spades now with the massive trade deficit caused, in large part, by currency misalignments. The failure of our Treasury to implement U.S. law requiring it to hit countries that manipulate their currencies, as several East Asians are now doing, and the failure of the IMF to implement its own statutes to call those practices to the table, is a big problem and I'd certainly be the last to deny that changes there are badly needed.

Senator HAGEL. Mr. Vargo.

Mr. VARGO. Mr. Chairman, Thea and I are old friends, but I have to disagree on the investment point, that NAFTA was designed to move production out of the United States. And if that's what it was designed to do, it didn't succeed very well.

I want to reiterate that the large increase in Mexico's share of U.S. foreign direct investment—at least in manufacturing—occurred before NAFTA, not after. If you'll recall, I said in 1983, 4.1 percent of our foreign direct investment in manufacturing went to Mexico; in 1993, it had risen to 4.8. That's a seven-tenths of a percent increase. And then now it's 4.9.

Now, why has it increased proportionately less? Mexico is a better place to invest. Why wouldn't it have grown faster? And the answer to that is because Mexico also had to get rid of a lot of investment performance requirements. If you wanted to do business in Mexico before NAFTA, you had to invest there. Afterwards, you did not. So the combination of these two forces has led to a very modest increase in U.S. investment.

Now, Mexico, on the other hand—and I think this is important to point out—has attracted a lot of investment from other countries in the world—Japan, Korea, others—as they put production facilities in Mexico to export to the U.S. But much of that trade almost certainly was in lieu of the exports that they were shipping from their countries earlier.

Senator HAGEL. Let me ask one last question of each of you—in fact, stay on this subject of investment, because Ms. Lee had raised it a couple of times, and you each have raised it.

In your opinions, are the investment mechanisms within NAFTA working as they should work? There's been some, I think, reference here to the fact that maybe we should review some of that, adjust some of that. We know trade agreements are not static; they're dynamic, they reflect markets; and so they are evolving.

But, in particular, stay on the issue of the investment mechanisms within NAFTA. Have they worked? Have they provided the kind of forums that we need in order to adjust to markets?

Mr. VARGO. Well, I think, Mr. Chairman, they have. I think that they have ensured that American investors will be treated more favorably than they otherwise would have been in investment disputes, and the ability to go to arbitration is a very important one.

Now, there have been a lot of concerns raised here. It's absolutely not so that NAFTA can overturn U.S. law. Only U.S. courts can do that. Now, the only thing a NAFTA panel can do is to award a compensation for expropriation. Now, there is a feeling that, oh, this puts a chilling effect on the U.S.—or state or local ability to legislate. There's no such evidence. But there has been this fear. And largely in response to this fear in the Trade Promotion Authority Act, the Trade Act of 2002, a lot of adjustments were made. They were made, in terms of seeing that the possibility for cases without foundation could not be brought, that there would be an appellate mechanism, that there would be a much greater transparency. And certainly as an association, the NAM agreed with those. We note that there was really no foundation for them, but that they would improve the perception. And those have gone into future—into trade agreements since NAFTA.

We have to have the ability to go to third-party arbitration, Mr. Chairman, in other countries, because other countries' court systems are not the same quality as the U.S. system. And under the Constitution, a foreign investor really gets the same rights with or without the third-party arbitration or the so-called investor state dispute, but we don't in other countries, so we have to have it.

Senator HAGEL. Dr. Bergsten.

Dr. BERGSTEN. I'm going to be uncharacteristically uncertain in responding to that one because I haven't personally studied as much as I should. My colleagues Hufbauer and Schott have looked at it carefully in their overall review of NAFTA. Another of my colleagues, Monty Graham, who studies investment for us, has looked at it carefully, particularly Chapter 11 on investor-state disputes. I'd like to submit our thoughts to you on that for the record.[1]

Dr. BERGSTEN. I would just make two quick observations. One, I'm not as impressed as Frank Vargo is by the flatness in the share of U.S. total foreign direct investment in Mexico since the creation of NAFTA. The reason for that is—as I've studied economic integration experiments throughout the world—that you tend to find that the big investment effects actually occur prior to the installation of the new trade liberalization agreement. They come from anticipation of the new agreement by the private sector trying to get in at the early stage, in order to get a leg up on the process. NAFTA started being negotiated in 1990-1991. It was well known for 2 or 3 years that it was going to happen. And so by the time

[1] Dr. Bergsten's subsequent response can be found on page 83.

it happened a lot of the investment that could be attributed to NAFTA, and the associated Mexican reforms to qualify for NAFTA, had already taken place. So I'd want to look at the numbers in a little more comprehensive way. If they occurred in the early 1990s, I'd say it's still a NAFTA effect. So it may well be that the outcome was quite pro-investment.

The other thing is, just to repeat, Mexico's own policy toward foreign investment was opened up dramatically by NAFTA. It was one of the reforms that were part and parcel of the deal. And I think, again, for Mexico—and, through Mexico, for us—that was unambiguously a good thing.

Indeed, Mexico did something quite interesting. They were only required, under the NAFTA, to open up their investment regime to the United States and Canada, as NAFTA partners. But Mexico chose to open its investment regime on a global basis, to generalize to all of its international trading partners and investment partners the same newly liberalized rules that applied to the United States and Canada. And so the bang for the buck, in terms of getting Mexico to open up and, thereby, improving its economic prospects, was actually even greater than just vis-à-vis the NAFTA partners themselves.

Senator HAGEL. Thank you.

Ms. Lee.

Ms. LEE. On the NAFTA investment provisions, we have a very strong objection to the inclusion of investor-to-state dispute resolution in any trade agreement. It's something which is not necessary for a trade agreement. Some of these disputes could be adjudicated in a government-to-government forum, as everything else in the trade agreement is done. But giving a private corporation the right to sue governments and to potentially have large taxpayer liability seems, to us, extremely problematic and not necessary. Companies can get their rights taken care of by their own governments as they do through the other portions of the trade agreements.

And I would disagree with Frank Vargo. I know, obviously, a NAFTA tribunal cannot itself overturn a U.S. law, but the ability to impose compensation, which could be on the order of a billion dollars in tax liabilities and tariffs and so on, is a pretty significant impact, and has, of course, had a huge impact on governments in all three of the NAFTA countries.

There have been laws that have been overturned in Mexico. One of the most well known was a case where a U.S. company, Metalclad, challenged a Mexican locality that had refused to give permits for a toxic-waste dump on a locality where they felt that would be damaging to the groundwater. And the government was forced to pay—was ordered to pay $17 million to the U.S. company. So this is a government paying a company for a failure to grant a permit that might have had an environmental impact.

Some of the other cases, I think, also show that there's clearly been a chilling effect on domestic regulation. Whether you think that's important or not, I guess, depends on whether you think the regulation was worthwhile in the first place. But our preference is to allow domestically elected legislators to make the laws, and not to allow a private company to challenge those laws because its profits were damaged or impaired.

The other example that is really interesting is one that doesn't get a lot of attention, but demonstrates the chilling effect very well. This was back in 1995, when the Canadian Government was contemplating putting in place a provision that would require cigarettes to be sold in plain packages. This was a public-health initiative. The idea was to make cigarettes less attractive to teenagers and children—make smoking less attractive, overall. The U.S. tobacco companies used Chapter 11 to bring a case—it was written by Julius Katz, one of the negotiators of NAFTA—to challenge the Canadian Government, to ask for millions of dollars in damages. The Canadian Government withdrew the provision, not wanting to go through the dispute settlement. They don't know whether they would have won or lost, but they weren't willing to face the risk.

When NAFTA was being negotiated, people didn't tell us that public-health legislation that democratically elected legislators wanted to put in place would be found illegal under NAFTA. It was talked about as a trade agreement. I think we have to be very careful about where we draw the line between trade agreements having an impact on totally legitimate domestic, environmental, public-health, and labor protections. I think NAFTA Chapter 11 goes way over the line.

One final quick example has to do with that article that was in the New York Times on Sunday. It was about a U.S. jury award that was challenged by a Canadian company, the Lowen case, where there was a very high jury award given against a Canadian company. At some point, the Canadian company changed hands and was now owned by an American, and they were told, well, as an American company, you couldn't bring this case. Only a Canadian company could bring a case. This demonstrates the argument that critics of Chapter 11 have made, which is that Chapter 11 actually gives greater rights to foreign investors than it does to domestic investors, and I think there's something wrong with that picture.

Thank you.

Mr. VARGO. Mr. Chairman.

Senator HAGEL. Mr. Vargo.

Mr. VARGO. Thea keeps saying that these panels under Chapter 11 can find laws illegal. That's not so. All they can do is to have a financial finding of compensation.

Thea also says that she disagrees that American corporations have the right to sue the U.S. Government. But that's a constitutionally guaranteed right, whether or not we have a trade agreement. There is—the choice of venue is available for foreign investors. Do you go through the domestic court system, or do you go to third-party arbitration? But this is relevant only if you're going to get a different finding by going through arbitration than you do through the domestic court system. And in the United States, there's no evidence that that is so.

But there's a considerable body of evidence saying that U.S. investors are at risk in the court systems of many other countries, because, unfortunately, they are not as honest and well developed as ours.

Senator HAGEL. Well, each of you has helped enlighten this panel on NAFTA and questions, concerns, future, and we greatly appreciate your time here and your thoughtful presentation.

Dr. Bergsten, we would keep the record open for your colleagues to submit a statement in reference to the last question, if you'd care to do that.

Again, the panel is very appreciative of your good work. Thank you.

The subcommittee is adjourned.

[Whereupon, at 4:55 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

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## SUBSEQUENT RESPONSE OF DR. BERGSTEN FOR THE RECORD

### INVESTMENT PROVISIONS UNDER NAFTA*

#### INTRODUCTION

The United States sought improvements on the 1989 Canada-US Free Trade Agreement (CUSFTA) investment provisions by providing for international arbitration of investment disputes, by broadening the coverage of dispute procedures, and by prohibiting additional performance requirements not addressed in CUSFTA. US officials were generally satisfied with the Chapter 11 dispute settlement mechanism that enabled private investors to seek a binding arbitration of disputes with NAFTA governments.[1]

#### ENFORCEMENT OF GOVERNMENT OBLIGATIONS

The NAFTA dispute settlement process (DSP) is unique in allowing private investors to enforce government obligations under NAFTA Articles 1116 and 1117. For DSP purposes, the definition of investment is broadened to include minority interests, portfolio investment and real property.[2] In the event that a state breaches one of NAFTA Chapter 11's substantive obligations, the investor may initiate an *ad hoc* arbitration tribunal, pursuant to Article 1120. The tribunals operate under the arbitration rules of either the International Center for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL).[3] Chapter 11 tribunals award monetary relief to the winning party.

By contrast, the WTO does not grant substantive rights to private parties or give them access to the dispute settlement mechanism. The WTO is designed as an interstate agreement. Non-parties to a dispute, such as private firms and NGOs, are limited at most to submitting *amicus curiae* briefs in panel hearings.[4]

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*Extract prepared by Yee Wong from a full chapter on dispute settlement, "NAFTA: A Ten Year Appraisal," by Gary Hufbauer and Jeffrey Schott.

[1] US Intergovernmental Policy Advisory Committee (1992).

[2] NAFTA Article 1139. In the *S.D. Myers* case, for example, investment in US-based waste disposal operations was compared to investment in similar Canadian waste-disposal operations. Cosbey (2002).

[3] NAFTA arbitration rules allow investors to bring claims under the following conditions: the investor has suffered loss or damage due to the breach in NAFTA obligations (Articles 1116, 1117); the disputing parties have attempted but failed to settle the claim through consultation or negotiation (Articles 1118, 1120); arbitration was initiated within six months of the events giving rise to the claim (Article 1120); and the investor waives the right to initiate similar proceedings for compensation before domestic courts and other tribunals (Article 1121).

[4] WTO Article V, as interpreted by the Appellate Body. Third parties may submit *amicus curiae* briefs but the Appellate Body has no legal obligation to accept non-WTO member submissions. Since its ruling in the EU-Peru sardines case (October 2002), the policy of the Appellate Body is to consider *amicus curiae* briefs on a case-by-case basis, and accept them if the briefs are pertinent and useful to that particular case. If an *amicus* brief interferes with the "fair, prompt and effective resolution of trade disputes," the Appellate Body can reject the consideration of any *amicus curiae* brief. Prior to the WTO EU-Peru sardines case, the Appellate Body had not considered an *amicus curiae* brief pertinent to any WTO case. Most developing countries opposed the acceptance of *amicus curiae* briefs by WTO panels, arguing that *amicus* submissions give NGOs and private parties a greater role in dispute proceedings than WTO members acting as third parties, without corresponding obligations. Correspondence with Amy Porges of Sidley,

Continued

For reasons not anticipated when Chapter 11 was drafted, protection of investor rights has since become the most contentious feature of the NAFTA dispute system. NAFTA's substantive rules on investor rights were carried over from CUSFTA. These include investment liberalization rights for foreign investors (Article 1101), as well as guarantees to protect existing investments established under conditions more favorable than those scheduled in the national reservations of individual NAFTA members (Article 1108).[5] However, the investor provisions that have sparked the most disputes filed under Chapter 11 are: national treatment rights (Article 1102); MFN rights (Article 1103); minimum international standards of treatment (Article 1105); performance requirements (Article 1106); and especially provisions for compensation in the event of expropriation (Article 1110).

Articles 1102 and 1103 stipulate that a host country must treat foreign investors and their investments "no less favorably" than domestic investors or investors from any other country "in like circumstances." Article 1103 is an extended version of the national treatment provisions contained in CUSFTA. This provision ensures that foreign investors based in North America will enjoy the best possible treatment among all foreign investors, even when one of the parties scheduled a NAFTA reservation against national treatment.[6] Article 1105 requires that NAFTA members meet minimum standards of "international law, including fair and equitable treatment and full protection and security." This provision is the functional equivalent of most-favored-nation (MFN) treatment. Article 1106 prohibits governments from imposing certain types of performance requirements on investors.[7]

The most criticized provision, Article 1110, is controversial because it attempts to balance investor rights against government measures to protect public welfare. Article 1110 of NAFTA states that a host country cannot expropriate a foreign investor directly or indirectly, unless the expropriation is explicitly done for a public policy purpose, on a nondiscriminatory basis, in accordance with due process of law. These restrictions apply to measures "tantamount to nationalization or expropriation." Moreover, the government must provide fair compensation for any expropriation.

OUTCOME OF CHAPTER 11 CASES

Through August 2004, 31 investor-state disputes were initiated under Chapter 11.[8] The details are summarized in appendix A. The number of cases filed has steadily increased over time.[9] Fourteen cases have been initiated against Mexico, nine against Canada, and eight against the United States. US investors account for two-thirds of the cases initiated; only two cases have been initiated between Mexico and Canada.[10] The frequency of cases roughly mirrors the amount of FDI and bilateral trade between the disputing parties (see table 3 comparing the number of disputes between countries and the corresponding bilateral FDI).

As of August 2004, US investors and the US government have been wholly or partly successful in ten Chapter 11 cases that have been decided. However, in none of the cases has the investor been awarded an amount close to its initial (probably overblown) claim. The cases in question are: Ethyl Corporation vs. Canada, Metalclad Corporation vs. Mexico, Azinian vs. Mexico, Marvin Feldman vs. Mexico, S.D. Myers vs. Canada, Pope & Talbot vs. Canada, Mondev International vs. United States, ADF Group Inc. vs. United States and USA Waste vs. Mexico (submitted

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Austin, Brown & Wood LLP, Washington, DC, and Debra P. Steger of Thomas & Partners, Ottawa, Canada.

[5] Under Article 1108 (4), no party may "require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective." Other rights and obligations covered under Chapter 11 are: compensation for acts of war or civil strife (Article 1105(2)), prohibitions on senior management nationality requirements (Article 1107), and an environmental protection provision—members are not allowed to reduce environmental standards as a way of attracting investment (Article 1114).

[6] Vega and Winham (2002).

[7] As an example, governments cannot demand that firms use domestic inputs. The complete list of prohibitions on performance requirements include government thresholds on: exports of a given portion of production; using a given level of domestic content; making foreign exchange available based on the firm's levels of imports or exports; showing preference for domestic goods or services; requiring a firm to transfer its technology; or requiring a firm to locate production, provide employment, or offer specific services within its domestic territory.

[8] For a complete description of cases, see Canada Department of Foreign Affairs and International Trade at *www.dfait-maeci.gc.ca/tna-nac/nafta-e.asp* (accessed August 2004).

[9] Mark Clodfelter at the US State Department NAFTA Arbitration Division, notes that one concern is the high proportion of Chapter 11 cases that are disguised as trade disputes rather than investment cases. Another concern is that significant increases in investor-state disputes created threatens the availability of arbitrators in Chapter 11. Based on Mark Clodfelter presentation, Canadian-American Business Council and CSIS, June 16, 2004.

[10] See Appendix A and table 2.

twice). Five cases have been withdrawn and another 16 cases are pending determination. Tribunal awards to successful claimants have so far totaled around $35 million (see appendix A).[11] Arbitral awards are small relative to initial claims—on average, they amount to only 11 percent of the original claim. In the most extreme case so far (*Pope & Talbot*), the final NAFTA arbitral award represented only 0.5 percent of the original claim.[12] Nevertheless, the process shows that private investors can hold NAFTA governments accountable to their Chapter 11 obligations.

As of August 2004, nine environment-related disputes had been brought under Chapter 11, eight of which were filed by US investors and one by Canadian companies. Among these cases, four each were filed against Mexico and Canada, and one against the United States. Currently about one-third of all Chapter 11 cases are environment-related.

Nearly half of all investor-state cases claimed violations under NAFTA Articles 1102 and 1105 (see table 4). National treatment provisions in Articles 1102 and 1103 require governments to treat foreign investors based in any NAFTA member country no less favorably than domestic investors. Article 1105 requires members to observe the minimum standards of "international law." In an effort to address the criticism that arbitration panels had overextended Article 1105, in August 2001 the NAFTA Commission issued an Interpretive Note stating that "[a] determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1 105(1)."[13] The third most frequently cited breach of NAFTA obligation is Article 1110, which provides the basis for "regulatory takings" claims.

## EVALUATION

Several principles embodied in NAFTA Chapter 11 established precedents for the WTO Agreement on Trade Related Investment Measures (TRIMs) (as well as the OECD's ill-fated Multilateral Agreement on Investment or MAI).[14] Neither the CUSFTA nor the WTO Trade Related Investment Measures (TRIMs) agreement grants private foreign investors the right to directly invoke and participate in dispute settlement cases (nor was such direct access contemplated in the MAI). But private investors are expressly given direct access to the NAFTA dispute settlement system under Chapter 11, and this has become one of its contentious features.[15] As a result, NAFTA member governments publicly narrowed the scope of foreign investment protections under Chapter 11 and the US government adopted more restrictive language in recent free trade agreements with Chile, Singapore and Central America.[16]

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[11] About $35 million plus interest for damages and cost of tribunal proceedings.

[12] *Pope & Talbot's* initial claim was $130 million but the NAFTA tribunal awarded final costs and damages totaling $581,766 plus interest. For details, see Canada Department of Foreign Affairs and International Trade at *www.dfait-maeci.gc.ca/tna-nac/NAFTA-e.asp* (accessed August 2004).

[13] For more information about the NAFTA Commission's interpretation of Article 1105, see Canadian International Trade Minister Pettigrew's press release at *webapps.dfaitr-maeci.gc.ca/minpub/Publication.asp?FileSpec=/Min*__Pub__Docs/104441.htm (accessed August 2004).

[14] The WTO accord prohibits (apart from scheduled exceptions) discrimination between foreign and domestic investors (national treatment) and between foreign investors from different countries (most-favored-nation treatment). It also requires host states to compensate foreign investors for direct and indirect expropriations. See Kurtz (2002). By contrast, the MAI would have required similar treatment of foreign investors in every province of Canada and every state of Mexico and the United States. NAFTA only requires that investors receive the best treatment provided in that province (or state). Barry Appleton, "Comparing NAFTA and the MAI." For complete details, see *www.appletonlaw.com* (accessed August 2004).

[15] Some practitioners, like Mark Cymrot of Baker & Hostetler LLP, argue that NAFTA governments are only beginning to see the potential implications of Chapter 11 as investment disputes face independent tribunals rather than governments. See Mark Cymrot, presentation at Canadian-American Business Council and CSIS, June 16, 2004.

[16] Former Chair of Senate Finance Committee, US Senator Max Baucus (D-MT), has called for an appellate mechanism in investor-state arbitration under future free trade agreements. The perceived overreaching influence of Chapter 11 led Congress to limit investor-state arbitration clauses in the US Trade Act of 2002. At Australia insistence over potential sugar, dairy and beef disputes, the recent Australia-US FTA excludes an investment chapter. See Baker & Hostetler LLP (2004).

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**Table 1. Investor-State Disputes Under Chapter 11**

| Claimant | Respondent | | |
|---|---|---|---|
| | Canada | Mexico | United States |
| Canada | ... | 1 | 8 |
| Mexico | 1 | ... | 0 |
| United States | 8 | 13 | ... |
| Total | 9 | 14 | 8 |

Source: US State Department (2004), Canada Department of Foreign Affairs and International Trade (2004), Todd Weiler (www.naftalaw.org, 2004).

**Table 2. Outcome of Investor-State Disputes Under Chapter 11**

| Disposition | Country | | |
|---|---|---|---|
| | Canada | Mexico | United States |
| Total Won by the Investor/Claimant | 0 | 0 | 5 |
| Total Won by the State/Respondent | 0 | 0 | 0 |
| Joint Termination of Case | 4 | 2 | 4 |

Source: US State Department (2004), Canada Department of Foreign Affairs and International Trade (2004), Todd Weiler (www.naftalaw.org, 2004)
Notes:
Winning is defined as a monetary award in favor of the claimant or respondent.

**Table 3. FDI Stock Related to Chapter 11 Disputes (1994-2003)**

| Countries | Bilateral FDI Stock [a] (billions of dollars) | Chapter 11 Cases | Cases per $billion FDI |
|---|---|---|---|
| US-Canada | 173 | 16 | 0.09 |
| US-Mexico | 36 | 13 | 0.36 |
| Canada-Mexico | 2 | 2 | 1.08 |

Source: BEA, US Commerce Department (2004), Mexico Ministry of the Economy (2004)
Notes:
[a] Average 1994-2003, based on FDI stock.

**Table 4. Types of Measures Disputed Under Chapter 11**

| Article Number | Contest Measures | Total | Percent |
|---|---|---|---|
| Article 1102 | National Treatment | 15 | 25 |
| Article 1103 | Most Favored Nation Treatment | 7 | 11 |
| Articles 1104 and 1105 | Standard of Treatment | 19 | 31 |
| Article 1106 | Performance Requirements | 5 | 8 |
| Article 1110 | Expropriation | 11 | 18 |
| Articles 1116 and 1117 | Obligation Under Chapter 15 (Monopolies and State Enterprises) | 4 | 3 |
| Total | | 61 | 100 |

Source: US Department of State Office of the Legal Advisor (2004), Canada Department of Foreign Affairs and International Trade (2004), Todd Weiler (www.naftalaw.org, 2004).

**Appendix A. Chapter 11 disputes under NAFTA (Environment-related cases in bold)** [1]

| INITIAL FILING/ TERMINATION [2] | PETITIONER and NATIONALITY | DEFENDANT COUNTRY | SUBJECT OF DISPUTE | STATUS/ OUTCOME |
|---|---|---|---|---|
| August 95/No claim filed | Halchette Distribution Services U.S. | Mexico | Claim unknown. | Notice of Intent to Arbitrate filed. No further action taken. |
| March 96/No claim filed | Signa S.A. de C.V. Mexico | Canada | Canadian regulations injured Mexican company's investment in Canada. | Notice of Intent set claim for $36.8 million. No further action taken. |
| **September 96/ Settled July 1998** | **Ethyl Corporation U.S.** | **Canada** | **Canadian ban on MMT imports. Claimed $250 million for damages and expropriation.** | **Case settled for $ 13 million. Ban on MMT imports eliminated by the Government of Canada prior to tribunal decision.** |
| **October 96/Settled August 2000** | **Metalclad Corporation U.S.** | **Mexico** | **Government actions preventing the opening of a hazardous waste landfill. Claimed $90 million.** | **Tribunal ordered Mexico to pay Metalclad $16.7 million in damages.** |
| **December 96/Settled November 1999** | **Desechos Solidos de Naucalpan C.V. (Azinian) U.S.** | **Mexico** | **Claim for $17 million for seizure of property and breach of contract.** | **Resolved in favor of the Mexican Government. No award of costs made.** |
| February 98/ Settled December 2002 | Marvin Feldman U.S. | Mexico | Claim for $50 million for lost profits due to refusal to rebate excise taxes on cigarette exports. | Tribunal ordered Mexico to pay Feldman $982,901 plus interest. |
| **June 98/Settled June 2000** | **USA Waste U.S.** | **Mexico** | **Claim for $60 million.** | **Resolved in favor of the Mexican Government but no award on costs incurred by Mexico. US ordered to pay for costs of arbitration proceedings.** |

[1] Sources: (Mann and von Moltke 1999), (Soloway 1999b); Canada Department of Foreign Affairs and International Trade (http://www.dfait-maeci.gc.ca/tna-nac/dispute-e.asp); US Department of State (http://www.state.gov/s/l/c3433.htm); NAFTA Claims (http://www.naftalaw.org 2004).
[2] Date of initial notice of intention to arbitrate (whether or not a claim was filed) and date of award or settlement (unless still active).

| INITIAL FILING/ TERMINATION [3] | PETITIONER and NATIONALITY | DEFENDANT COUNTRY | SUBJECT OF DISPUTE | STATUS/ OUTCOME |
|---|---|---|---|---|
| **July 98/ Settled November 2000** | **S.D. Myers U.S.** | **Canada** | **Claim for $20 million for losses due to export ban on PCB waste.** | **Tribunal affirmed in part and remanded in part. Resolved in favor of SD Myers for $3.87 million plus interest.** |
| July 98/Active | Loewen Group Inc. Canada | U.S. | Claim for $725 million for discrimination and expropriation due to a $550 million damage sentence in civil case. | Tribunal determined that NAFTA did not give jurisdiction over an investor that was founded in Canada and reincorporated in the United States (June 2003). Tribunal also noted that undue intervention in domestic matters by international arbitrators could "damage…the viability of NAFTA itself." |
| **November 98/Withdrawn 1999** | **Sun Belt Water Inc. U.S.** | **Canada** | **Claim for $220 million for biased treatment by government of British Columbia in joint venture.** | **Appears that claim is withdrawn.** |
| December 98/November 2002 | Pope & Talbot Inc. U.S. | Canada | Claim for $130 million[4] for discriminatory implementation of Softwood Lumber Agreement. | Tribunal dismissed 2 of the 4 claims made by Pope & Talbot Inc. Tribunal ordered Canada to pay Pope & Talbot $461,500 plus interest for damages and cost of tribunal proceedings. |
| **June 99/Active** | **Methanex Corp. Canada** | **U.S.** | **Claim for $970 million in damages due to California state ban on the use of MBTE (gasoline additive).** | **Panel dismissed some claims (August 2002) but allowed Methanex to refile and present additional evidence. Panel decision from Methanex jurisdiction and merits hearing expected in late 2004.** |
| September 99/ October 2002 | Mondev International Canada | U.S. | Claim for $16 million plus interest and legal costs for a failed 1978 mall development deal in Boston. Mondev sued and won a jury trial in 1994 but the verdict was reversed by the Massachusetts Supreme Judicial Court (SJC). Mondev contested SJC's decision. | Panel unanimously rejected each of Mondev's claims (October 2002). No award on costs were made. |
| May 00/Active | UPS of America Inc. U.S. | Canada | Claim for $100 million. UPS accuses Canada Post of subsidizing its courier services with revenue from its regular letter delivery service. | Tribunal dismissed UPS Article 1105 claim and rejected Canada's jurisdictional challenge under Article 1102. Consultations ongoing. |

[3] Date of initial notice of intention to arbitrate (whether or not a claim was filed) and date of award or settlement (unless still active).
[4] The damages claim ranges from $30 million to $500 million depending on the source.

| INITIAL FILING/ TERMINATION [5] | PETITIONER and NATIONALITY | DEFENDANT COUNTRY | SUBJECT OF DISPUTE | STATUS/ OUTCOME |
|---|---|---|---|---|
| July 00/January 2003 | ADF Group Inc. Canada | U.S. | Claim for $90 million. ADF protests U.S. Department of Transportation enforcement of U.S. Federal Surface Transportation Assistance Act (1982) that requires federally-funded state highway projects to use only U.S.-produced steel. | Tribunal dismissed ADF claims against the United States. Tribunal ordered the United States government and ADF to split the costs of the proceeding. |
| **September 00/ Settled June 2002** | **USA Waste U.S.** | **Mexico** | **Resubmitted claim that the tribunal's initial decision would prevent USA Waste from bringing any additional claims relating to a possible breach of NAFTA obligation.** | **Tribunal dismissed Mexico's argument that the tribunal lacked jurisdiction on this case No award on costs were made.** |
| November 00/ Active | Adams et al. U.S. | Mexico | Claim for $75 million for expropriation of land developed by Adams et al. | Notice of arbitration filed February 2001. |
| December 00/ Withdrawn 2000 | Ketcham Investments, Inc. and Tysa Investments, Inc. U.S. | Canada | Claim for CA$30 million as compensation for damages caused by Canada's regulation on softwood lumber. | Claim withdrawn |
| December 01/ Withdrawn April 2002 | Trammel Crow Company, U.S. | Canada | Claim for $32 million. Trammel Crow alleges Canada's control over the Canada Post Corporation breaches its NAFTA obligations. | Claim withdrawn. |
| Filed in 2001/ Active | Fireman's Fund Insurance Company U.S. | Mexico | Claim for $100 million. Fireman's Fund accuses Mexican Government of facilitating the purchase of debentures denominated in Mexican pesos and owned by Mexican investors, but not facilitating the purchase of debentures denominated in U.S. dollars and owned by Fireman's Fund. | Award on jurisdiction filed July 2003. The tribunal ruled that it could allow the Fireman's Fund expropriation claim to proceed, but that it lacked jurisdiction to examine the investor's claims of violation of Chapter 11's rules on national treatment and minimum standards of treatment, as well as Chapter 14's rules on national treatment. |
| Filed in 2002/ Active | International Thunderbird Gaming Corporation Canada | Mexico | Claim for $100 million for losses associated with the Mexican government's regulation, enforcement and closure of gaming facilities | Notice of arbitration filed in 2002. Consultations ongoing. |
| Jan 02/ active | Calmark Commercial Development Inc. U.S. | Mexico | Claim for $400,000 for actions taken by Mexico's judiciary that amounted to measures tantamount to expropriation. | Notice of Intent to Submit Claim to Arbitration filed January 2002. |

[5] Date of initial notice of intention to arbitrate (whether or not a claim was filed) and date of award or settlement (unless still active).

| INITIAL FILING/ TERMINATION [6] | PETITIONER and NATIONALITY | DEFENDANT COUNTRY | SUBJECT OF DISPUTE | STATUS/ OUTCOME |
|---|---|---|---|---|
| Feb 02/ Active | Robert J. Frank<br>U.S. | Mexico | Claim for $1.5 million as compensation for damages caused by Mexican government's expropriation of land occupied and developed by Robert J. Frank. | Notice of arbitration filed August 2002. |
| April 02/ Active | GAMI Investments, Inc.<br>U.S. | Mexico | Claim for $55 million. GAMI says the Mexican government expropriated sugar mills owned by five subsidiaries of Grupo Azucarero México, S.A. de C.V., a company in which GAMI claims to hold a 14.18% ownership interest. GAMI also alleges the Mexican government regulated the sugar industry in a discriminatory and arbitrary manner. | Notice of arbitration filed April 2002. Preliminary hearing on rules and jurisdiction held September 2003. |
| May 02/ Active | Doman Industries Ltd.<br>Canada | U.S. | Claim for $513 million. Doman accuses the U.S. government of preventing it from selling softwood lumber products in the U.S. | Notice of Intent to Submit Claim to Arbitration filed May 2002. |
| May 02/ Active | Tembec Corporation<br>Canada | U.S. | Claim for $200 million. Tembec accuses the United States of violating NAFTA Chapter 11 provisions when the U.S. ITC imposed antidumping and countervailing duties of 29% on Tembec'softwood lumber exports to the United States. | Notice of Arbitration and Statement of Claim filed December 2003. |
| July 02/ Active | Canfor Corp.<br>Canada | U.S. | Claim for $250 million. Canfor alleges losses as a result of U.S. antidumping, countervailing duty determinations on softwood lumber in March 2002. | Notice of arbitration filed July 2002. Consultations ongoing. |
| Aug 02/ Active | Kenex Ltd.<br>Canada | U.S. | Claim for $20 million. Kenex claims injuries resulting from the Drug Enforcement Administration's interpretation of the Controlled Substances Act as prohibiting the sale of products that cause THC to enter the human body. | Notice of arbitration filed August 2002. The US Court of Appeals for the Ninth Circuit granted Kenex petition and affirmed enforcement of NAFTA Chapter 11 obligations. |
| Jan 2002/ Active | Corn Products International<br>U.S. | Mexico | Claim for $250 million. Corn Products International alleges the Mexican government's tax on high fructose corn syrup represented a breach of Mexico's NAFTA obligations. | Notice of Arbitration filed in October 2003. Consultations ongoing. |
| **September 02/ Active** | **Crompton Corp.<br>U.S.** | **Canada** | **Claim $100 million for lost profit due to Canadian government's export ban of the pesticide, Lindane.** | **Amended Notice of Arbitration filed in September 2002.** |
| Oct 03/ Active | Archer Daniels Midland Co. and A.E. Staley Manufacturing Co.<br>U.S. | Mexico | Claim in excess $100 million. ADM and Staley allege the Mexican government's tax on high fructose corn syrup has forced it to stop production in Mexico and halt exports to Mexico. | Notice of Intent to Submit Claim to Arbitration filed October 2003. Consultations ongoing. |

[6] Date of initial notice of intention to arbitrate (whether or not a claim was filed) and date of award or settlement (unless still active).

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