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CHAPTER II: UNITED STATES/MÉXICO/CANADA FREE TRADE AGREEMENT

EXPECTED PROVISIONS OF THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

*Shelly P. Battram*¹

What I am going to address in this talk is the political rhetoric in the North American Free Trade Agreement (NAFTA) negotiations, what has happened in the Canada/United States Free Trade Agreement (FTA) and why these issues are important.

First there are the concerns from the Canadian negotiators, that México is overbargaining and is dragging things out to the last minute. México is leaving many issues to the eleventh hour. Another problem in reaching an agreement quickly is the fact that the Canada/United States Free Trade Agreement has a government procurement chapter and México is not a signatory to the General Agreement on Tariffs and Trade (GATT) Procurement Code. The question is, how do we get México up to the level of obligations that Canada and the United States have already entered into given the differences in the sophistication of the economies?

To set the current landscape, both Canada and the United States are original signatory parties to the GATT and México has recently signed to it. The GATT has in many ways become a victim of its own success. The marketplace today is much more sophisticated and subtle in regulating trade. Years ago when you entered into a trade agreement you really had two issues: 1) getting your goods into the market and 2) resolving disputes. If you take a look at the Canada/United States FTA, it really involves four things. The first three are market access. The Canada/United States FTA deals with the movement of people, the movement of capital and the movement of goods. The fourth item is, of course, dispute resolution. We have gone way beyond trade agreements solely involving trade in goods.

The GATT is why Canada and the United States originally entered into negotiations. It is Canada's initiative that the GATT was not serving Canada's needs. Seventy-five percent of Canada's trade is with the United States. The United States was effectively using the

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GATT to govern its multilateral trade disputes and negotiations, while Canada was using the GATT to govern its trade relations with the United States. This system was not working.

Then we have the whole rise of regional trade blocks. Given this rise, I think the Canada/United States FTA was inevitable. It really codified and formalized the economic integration that occurred post-World War II and in many ways made it an economically easier, although certainly not politically easier, agreement to negotiate. It has had profound effects politically, legally and economically in both countries. It also introduced a significant modification of the body of international trade and economic law as we had known it, and entailed significant revision of domestic laws at the same time. Finally, at Canada's behest, it created important new institutions to facilitate the joint management of trade agreements.

It has been said that foreign policy lies in geography. I think this saying is often true. What more obvious place to start or to expand and evolve the Canada/United States FTA than with México and eventually the Americans? I think the question is where do we go now that we have created the largest bilateral trade relationship in the world?

In looking at this relationship, before I go on, one aspect that should not be undersold is the international legal regime that until three years ago governed the two-way trade between Canada and the United States. It was the Auto Pact and the GATT that really led to develop the most massive bilateral trade relation the world has ever known. I am going back to the reasons Canada entered the relationship even though it was so large. This issue almost tore the country apart. There was an election held on this issue.

The reason I am going into the Canadian issues is that México has a lot of the same dependency on the United States that Canada had, and there are a lot of lessons to be learned from this dependency. In Canada, the economy is vitally dependent on trade; it is a trading nation. If it does not trade, it will not survive.

Firstly, merchandise exports account for one third of the Canadian gross domestic product. In the United States, a comparable figure is approximately 8%. Secondly, Canadian exports are highly concentrated to the United States and they tend to be goods without a lot of value added such as raw materials. Part of the Canadian syndrome is that Canadians feel they are hewers of wood and drawers of water with their exports. Thirdly, trade was tied so closely to the automotive industry that you had large fluctuations in the economy. Whenever Michigan suffered, the whole of Canada suffered.

There is also the perception that the United States was becoming increasingly protectionistic and that the world itself was becoming

increasingly protectionistic. Whether or not a lot of these perceptions are real does not matter. Perceptions and opinions do affect business behavior and business attitudes.

Finally, from a positive sense, the fifth reason Canada looked to the United States for a free trade agreement was the growing body of opinion in Canada, as in México and in the United States, which really proclaimed the benefits of a free market. Many studies were shown, done and produced that demonstrated that an agreement was what Canada needed as a stimulus to its economy, to shock it into being able to compete in the 1990s. I think it is too soon to tell whether or not the Agreement has had this effect. Any effects today have been skewed by the unanticipated recession.

There are four areas that this Agreement really affects. The first is our pre-existing GATT qualification. The ultimate agreement will affect the unique legal regimes that will be applied to each other regarding subsidies and countervailing duties. The second affected area involves obligations pertaining to energy. Certainly in the Canada/United States FTA that is a major issue. It was a major and very important controversial chapter. They certainly clarified and went beyond the existing GATT requirements the two countries had. Thirdly, it established a dispute settlement process which is clearly superior to that available in the GATT. It added provisions on investments, broke down investment barriers for United States/Canada investment and expanded services and business travel. All of these obligations fall outside the scope of the GATT.

At a conference about four years ago when the draft agreement came out I said that I thought the agreement was very good, but I had a lot of questions on dispute settlement. After three years of seeing it work, I am not so sure about the business provisions of the agreement. Again that could be an impact of the recession. I am very impressed, however, with how the dispute settlement provisions have worked with regard to appeals from antidumping cases. Whether they favored one country or not is not the issue. The issue is, are they facilitating the businessman that wants to get his goods into the other country? They are speeding up the process. They are lowering the legal costs involved. I think the dispute resolution provisions have worked well beyond what anybody anticipated.

When the agreement was in place and there was talk of the United States entering negotiations with México, the whole question of Canada's participation in trilateral talks came up. This topic has been, and continues to be, controversial in Canada. It tends to be taking a lot of the bad press because of the existing constitutional crisis. The critics in Canada feel the main issue involves labor concerns. Canadian

critics of the United States feel that the United States is not truly interested in free trade with México, rather it is part of their geopolitical mandate to take over the Americas. There is a lot of negative criticism in Canada, but it is not nearly as negative as it was during the bilateral talks.

The Canadian government, in response, has determined that México has the potential to become an important export market to Canada. The government feels that a trilateral agreement with México is not a threat to Canada, but should be viewed as an opportunity. Canada is México's largest trading partner in the hemisphere after the United States. In the last two and a half years the countries have experienced a bilateral 25% increase in trade.

The three countries together will contain 355 million people compared to the EC's 324 million. The combined GNP will be just under \$6 trillion United States dollars, which is substantially more than the EC's \$4 trillion. In economic terms, the potential is quite large. The benefits will be seen more quickly by México. One of the studies by the United States government says that given the size differential, the benefits to the United States would certainly not be as significant dollar for dollar as they are to México. Where do I see the trilateral negotiations leading? If they are successful and we have a good balanced agreement, where do we see it leading to hemispherically?

Entering into the negotiations, Canada had five objectives stated by the deputy chief negotiator. First was free Canadian access to the Mexican market for goods and for services. Second was improved access to the United States market in areas such as financial services and government procurement; and again I mention that there is a problem because México is not a signatory to the GATT Procurement Code. Third was an assurance of Canada's preferred status for foreign investment. I will come back to this point because there are several models the agreement could take and there is concern on investment diversion. Fourth was greater access to cost effective inputs. I felt that objective was to be achieved through strategic alliances. Fifth was a fair, transparent and expeditious trade dispute resolution mechanism.

We wanted to keep what we have intact and modify and enhance it. As a third party to a NAFTA, and any other larger agreement, Canada would want a reduction or elimination of tariff and nontariff barrier rules. One thing that is on the agenda now, that was on last time, is intellectual property protection. At the last minute the chapter on intellectual property was pulled during the last round. This action was quite important for both countries. Just because we have facilitated improved border crossing under the Canada/United States FTA,

does not mean that it is happening. We need harmonization of relative standards.

An issue I think that should have been added, is a common set of rules relating to competition and antitrust law. This issue is very important and is something that has to be addressed. It should be addressed and to my knowledge it is not on the table this time. It certainly was not last time. I think there are three lines in the existing Canada/United States FTA that are conspicuous by their absence in the agreement.

Commentators in Canada do assert that the gains for Canada are to be small, particularly for the first few years. Therefore, why is Canada involved? I think there are compelling theoretical and practical reasons why Canada has to be. The first is more theoretical, it is the law of comparative advantage. Anything which leads to more and greater open trade is desirable. The second reason Canada is involved is on the practical side. Canada cannot afford to sit on the sidelines while the United States enters into a bilateral trade agreement with any other country and not be part of it. To do so may erode the gains given under the Canada/United States FTA and would create a model which, as I will come back to, is referred to as the Hub-and-Spoke model, as opposed to trilateral regionalism.

Canada feels that if it allowed the United States to go into a bilateral agreement with México, or with any other country, it would put the United States in a privileged position in North America for both investment and job opportunities and would turn the disadvantage to the other countries. Therefore, to a certain extent, it is in México's interest that Canada be in there also as a balancing part or party to this round. The two models I spoke of are trilateralism and the Hub-and-Spoke. There is an excellent study by the C.D. Howe Institute in Toronto comparing the two models. The hub of the wheel would be the United States and the spokes would be a series of agreements and then some side agreements between the various countries. This model would really mean that the United States would be the only country in the Americas with free access to all the participating parties.

The United States would benefit, in one critic's viewpoint, from investment diversion and would have a superior bargaining position in future rounds of negotiation. The position that was put forth by Canada, and what the agreement would lead to, was the concept of prolateral regionalism. This position would mean all parties and all members have the same privileges and the same obligations as the others. The obligations may not be exactly the same, there may be specific schedules between each of the countries, but there are four

very important components. This agreement should probably be the ultimate agreement that will be reached. There is a concern that the negotiations may break down, in particular given the political light. There is a lot of concern about whether or not Bush will go to the polls with it this year, and if it will go to the public. If it is put off to 1993, that is an election year in Canada. It is going to be a very major election over a constitutional issue. I think if the agreement is not signed before then, it would not pass the Canadian Parliament. It looks pretty likely that there may even be a different government after the election unless the economy changes and the constitutional crisis calms down in the next year.

Objections to the proposed NAFTA in the United States are really in three main areas. The objections are pretty much the same in Canada, with the exception of the perception of American imperialism. The strongest concern in Canada has been expressed by organized labor, particularly by the automobile and agricultural sectors because of the lower wage rates and investment diversion. This concern is fairly strong in Canada right now because coupled with the recession they see a barrage of mid-sized Canadian owned businesses moving to the American border.

There are new environmental concerns. There was an interesting article in a recent *London Times*, "Dexella: The Trade Monster," expressing environmental concerns over the tuna case, among other things, and the draft of the Uruguay Round. It indicated that the environmental groups are pretty well unanimous in their opposition to the GATT Uruguay Round, but they are split on NAFTA. Finally, there is concern as far as investment diversion.

The United States Administration, relying on studies, indicates that an expanded Mexican economy would raise wages. Therefore, the concern should not be labor. In fact, the study indicates that Mexican wages have risen 14% since 1988. Secondly, a concern over illegal immigration would stop if there was a better level of living. From a higher wage back in México, the studies somehow concluded there would be an increase in American jobs. I am not an economist. I am not being critical, but who knows.

In Canada, as I said, there is a widely held view that Canadians have been done out and have had a raw deal out of the Canada/United States FTA. I think this view is exacerbated by the recession. It is exacerbated by the fact that the government in power now reached an all time low public opinion since they started keeping polls in Canada. I am not sure what it is now, but I know it was 12% at one point in time.

There is a lot of anger about being overtaxed. They have a 15% sales tax and so they have not seen any immediate benefits of the

Free Trade Agreement other than that it is easier to get in the car on Sunday if you live in Toronto, go down to Buffalo, buy your groceries and save a lot of money. There are a lot of companies moving south of the border, outside of Canada, and so there is some concern about investment diversion.

There is concern over how the Canada/United States FTA has worked thus far. It is hard to tell. A progress report in the handout addresses tariffs, rules of origin, procurement, trade rules, services, intellectual property, investment disputes, institutional arrangements and autos. It is worth looking at if you want to see what is being deferred to the multi-round and bilateral round and what is being kept here. As I said, I think the GATT and the GATT dispute resolution process has fallen into considerable dispute or disrepute in the last few years and is not really servicing the needs of our trading relationships in the Americas. Modifications to the legal framework of the Canada/United States FTA certainly have improved dispute resolution. Further modifications certainly should lead to more open, and particularly transparent, trade.

My concern is that if this trilateral round does fall apart, what will happen to the existing Canada/United States FTA? Will we end up with a series of bifurcated agreements? In the meantime the Canadian and United States governments should continue to look at the GATT as the legal underpinning and, at the same time, take considerable pride that in North America we have designed and hopefully will continue to expand a trading regime which promotes the further enlargement of what is already the world's most intense economic relationship. It is also probably one of the world's most transparent trade relationships. The governments should expand this, and manage it, through increased reason and rule of law. As I said, we can take considerable pride in what we have achieved so far. I hope the political rhetoric does not bog down achievements that were obtained four years ago.

UNITED STATES/MEXICAN/CANADIAN VIEW OF AGREEMENT BENEFITS AND DRAWBACKS

*Miguel Noyola*²

I will be speaking on the benefits and drawbacks of the proposed free trade agreement or the free trade treaty as we refer to it in México. I will speak from the point of view of an attorney who for the last five years has represented or advised United States clients on how to conduct business in México from a legal point of view and as an individual who has worked and lived in both the United States and México for substantial amounts of time. I would like to point out that my views do not and are not intended to represent the views of any country or any public official. At first I will refer to the benefits and second to the possible drawbacks a free trade agreement might have.

To understand the benefits the Free Trade Agreement (FTA) or the North American Free Trade Agreement (NAFTA) will have on México one will have to review México's past economic trade policy. I will compare the México pre-1985 and México post-1985 and you can more or less have a feel for the dramatic change that has occurred in such a short period of time. Up until 1985 when México joined the General Agreement on Tariffs and Trade (GATT), México was essentially an isolated inward looking country. For many years México had adopted and strictly followed a closed border foreign policy based on an import substitution philosophy which did not permit the importation of foreign manufactured products. The only way you could bring foreign manufactured products into México was by obtaining an import license. For those who try to obtain that import license you would probably know that it was extremely difficult to obtain. For some this import substitution "order model" worked and some protected industries, such as the textile industry and the automotive industry, did learn during that era. However it became evident in the late 1970s and early 1980s that this model was not providing the necessary results for México's modern developments. The protected economy had turned Mexican industrialists in large part into a spoiled group. While there are some laudable exceptions, they were not concerned with producing

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high quality products at competitive prices. The market protection model in some sense corrupted economic decision and turned an investment analysis into a speculative maneuver.

Beginning with the de la Madrid administration, and now more forcefully than ever with the Salinas administration, the Mexican government realized the economic models of the past had turned obsolete and it was time to leave them. México could not stand on the silence of economic development. The first important step México took to join the commercial trade world was to join the GATT in 1985. This step was followed by the Salinas administration completely abandoning this closed border constitution model. In 1988 and 1989 Salinas opened the borders to foreign manufactured products and dismantled, to a great extent, the import licensing system. The system was in turn replaced with a system based on duties and tariffs. Under this new system the existing tariffs were reduced dramatically. Tariffs that were in the range of 100% were reduced to a maximum amount of 20%, but the average import duty on non-United States manufactured products is about 10%. In view of this trend of openness, I believe the NAFTA will result in important benefits to México. These benefits can be summarized into what I believe are seven basic areas.

First, under the NAFTA, México would benefit from a set of clear and permanent trade policies which should foster a climate of certainty for economic factors such as inflation, supply and demand, and thus the market should stimulate local savings and productive investments and attract foreign capital to México. Second, the NAFTA should give México access to a wide span of technology thus permitting local industry to adapt to increasing changes in consumer demand and educate and train a workforce in state of the art technology. The third and best benefit México will derive from the NAFTA is that local industry will be able to concentrate on comparative advantages based on the availability of local resources, technology and know how. Hopefully industry will be able to develop special niches in the world marketplace. The fourth benefit will be that México will be able to operate in an economy of scale. It is very important that industry will have access to an economy of scale because for the first time local businessmen will be able to maximize their production level, minimize costs and become more competitive. The fifth benefit will be that under the NAFTA a stable market should arise and thus long term planning will be something that Mexican businessmen will be able to engage in. Hopefully no longer will they engage in just mere speculative and short term investments. In other words, hopefully they will be able to look at investments from a five, ten, fifteen or twenty year term. A very important sixth benefit is that México should be able

to raise its general standard of living for all Mexicans. Hopefully economic growth will exceed population growth. It was said that last year economic growth was in the range of 4.5%, while population growth was only in the range of 2.5%. For México, which is a very young country, it is essential that its government create an atmosphere that will permit job creation so that future generations will be employed in México. Finally, the seventh obvious benefit for México will be that it will be part of one of the largest economic areas of the world.

The North American free trade market will represent a market of approximately 360 million consumers with a total output of about \$6 trillion United States dollars. This market will compare with what is now being created by the European economic area which is a combination of eight countries and the EC countries. Possibly because of the demographics of the North American market, it could be that in the next century our market will be larger than that of the Europeans. It is a view of many Mexicans that the benefits will be reflected in México, but they also will be reflected in the economies of both Canada and the United States. As has been the experience with other economic areas, not only one country benefits but all of the countries gain from the union. Of course since México is a smaller economy, the proportion of benefit for México will be on a greater scale than for the economies of the United States or Canada.

It is clear that joining a free trade market will not only represent benefits to México, it will also bring certain drawbacks. However, we believe and hope that these drawbacks and detriments will be only short term. The greatest detriment, and the one I would make reference to right now, will stem from the trauma that the Mexican industrial base will suffer from being shoved at first into world class competition. Gone will be the days of maternalistic protection. Only the companies that are competitive will survive. Many companies will disappear and along with them many jobs. Many Americans have expressed fears that joining a free trade agreement will mean loss of many jobs in the United States. I do not believe that those job losses will compare to the number of job displacements that will occur in México. However, we believe that job displacements will serve to redirect the Mexican workforce to more sophisticated, more skilled, more rewarding and higher paying jobs.

In general, from a Mexican point of view, we believe that a free trade agreement will have benefits that will outweigh the detriments, it will serve to elevate the standard of living for Mexicans and it should turn México and Mexican industry into an industry of world class caliber. I think that it is very important for those who are thinking of México as a future market to understand that a NAFTA

will open a vast scope of opportunities, whereas in the past distributing foreign manufactured United States and Canadian manufactured products by importing them or exporting them into México was something that could not easily be done. Now it can be done with a Free Trade Agreement. Companies which want to make a direct investment in México will find that a free trade agreement will make it even easier to have access to wholly owned subsidiaries. Whereas in the past one was reluctant to license technology to México because of the risk of losing that technology, with a free trade agreement there should be greater protection to those owners of that industrial property. The Mexican Industrial Property Law, which was recently enacted, will give greater protection to those concerned.