

Trade blocs: The steep learning curve

TRADE LIBERALIZATION TODAY IS ABOUT FAR MORE THAN TRADE

Trade plays a role so important in our economies that it affects, not only economic policy, but also a country's social and political framework. The degree to which a country is able to realize benefits from trade liberalization depends on both the capacities of these frameworks to change and the degree to which policies in these domains are coherent and mutually supporting.

In Quebec City, leaders agreed that the positive energy of free trade would be snuffed out if it were introduced into a policy vacuum or into an unreceptive or unsupportive policy environment. The investments necessary to develop exports will not be attracted or sustained without good governance and good governance is not sustainable in the poverty engendered by a closed economy. Without the fullest participation of citizens as producers, innovators, entrepreneurs, consumers, and social actors, neither economic efficiency nor good government is possible.

Free trade, therefore, is a desirable way of stimulating positive systemic change, but it is of itself no more than an opportunity. The capacity to take advantage of this opportunity lies in the strength, openness, and adaptability of the economy and of the political and social systems. That would be the overriding "lesson" that was drawn by leaders in Quebec City. We must pursue the FTAA (Free Trade Area of the Americas), but not in isolation. It is and must be part of a broader agenda for sustainable, positive change in our societies. Otherwise it could become the scapegoat for failures elsewhere. Free trade is not a panacea. Often far-reaching and politically difficult adjustments are necessary to gain the benefits from a free trade agreement.

Even though we have benefited powerfully from NAFTA, some say that Canada has not made sufficient adjust-

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ments to benefit fully from it. They argue that our floating currency, for instance, has had the effect of cushioning the economy from the pressure for adjustment. Perhaps the adjustments required of Canada for satisfactory returns were too easy. Mexico, on the other hand, has certainly made painful adjustments, which have been transformative. The industrial economy of northern Mexico has become closely integrated with the North American system. Fiscal policy adjustments allowed Mexico to overcome the '94 peso crisis in short order, while the adjustment in the political system permitted a peaceful, credible, and democratic transition to the Fox administration.

LESSONS FROM NAFTA

The second "lesson" is that the less (or more) the distance among the parties in terms of their domestic policy frameworks (for the economy, governance, and social organization), the easier (or

tougher) is the politics of negotiating free trade. The Canada/US FTA was politically uncontentious in the United States because Canada was seen to be part of a shared system of values, with credible public institutions and a complementary economy. On the other hand, the FTA was challenged in Canada.

NAFTA proved to be far more controversial in the United States because of the sense of systemic differences that triggered American fears of both policy contagion (for example, with regard to lower, shared environmental standards) and protectionist concerns about loss of jobs in a stilted competitive environment. The transformative benefits of NAFTA for Mexico carried relatively little weight in American public discourse, even though they featured heavily in the administration's calculations. If NAFTA was a tough political sell in the United States, the FTAA is likely to be tougher still given the diversity of systems and the less obvious nature of US interest engaged in the hemisphere.

FRAMEWORK DIFFERENCES

It is clear that part of the FTAA bargain, as it was for NAFTA, has to be an agreement to address the framework differences on issues like environmental protection and labour standards. This does not necessarily have to be done within an FTAA, and certainly not in a way that involves sanctions, but the issues have to be addressed somewhere for three main reasons.

First is the need to satisfy public opinion in the United States, Canada, and Mexico that free trade does not mean the dilution of existing national frameworks in these areas or the perpetuation of two standards, one for the North and one for the South. The second reason is tactical. Southern parties could use the concessions they make here to satisfy northern demands for higher standards in these areas for constructive bargaining on a comprehensive agreement. Such concessions

would, after all, also be in their long-term social interest. Third is that however they are formulated, agreements in favour of improved standards can be used to lever cooperation and to stimulate the North/South transfer of resources in these areas.

There is one final observation directed at those who think that “side” agreements cause more trouble than they are worth. They do not. Labour standards and environmental protection were addressed in NAFTA side agreements. Doing so calmed public criticism and the provision calling on NAFTA states to respect their own national legislation, while a useful discipline, has not been troublesome for the parties. Secretariats are in place to handle disputed cases, but there have been none. In the case of Canada and Mexico, the side agreements have led to an intensified cooperation in improving Mexican governance capacity and the United States and Mexico established the North American Development Bank to finance environmental improvements in the border region between them.

This then is the second “lesson” from NAFTA that systemic differences inevitably intrude in the politics of free trade. We need to accept this fact and deal with it.

The third “lesson” is that the impact of free trade on different parties varies according to the degree of difference in size relative to the dominant party. The fragile capacity of small states to accept FTAA disciplines, and there are some very small states involved, must be respected. They need special and differential treatment, something that was recognized at Doha. They also need technical assistance both in negotiating the agreement (learning and applying the rules to their own situation) and in implementing it.

The fourth lesson is that the very process of negotiating free trade helps everyone think more clearly about trade-related policy. The FTAA negotiations have already been of value as a powerful learning experience for all the parties. Support for learning will con-

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tinue to be needed, and there will be opportunities for the legal profession to share in providing it.

The fifth “lesson” is that, even for mature trading relationships, free trade agreements do not remove all of the problems. The areas not covered by the agreement, are, by definition, those that are politically the most contentious. They will continue to be so until either the level of integration is so high that there are no systemic differences left that would justify protection, or compensating mechanisms have been provided to offset the political power of those interests demanding protection.

UNINTENDED CONSEQUENCES

The sixth “lesson” derives from our experience with chapter 11 of NAFTA, where sophisticated litigants turned an instrument intended to assist one partner to apply the necessary disciplines for investor protection into a commercial tool. The lesson here is to be careful about the law of unintended consequences.

The NAFTA experience teaches another lesson. Free trade is a process and based on present experience, at least, one that is irreversible. Success demands more success. Opened access demands more access. As Helmut Schmidt described the European construction process, building free trade is like riding a bicycle—it is essential to keep moving forward to avoid the risk of falling off.

This has certainly been the case in

North America where the success of NAFTA has increased our interdependence. To put it another way, it has raised our mutual vulnerability. NAFTA allowed us to manage a certain level of trade interdependence well. That success has encouraged our economies to commit to long-term investment and other strategies that assume guaranteed unimpeded flows within North America. Whatever safety net might have existed for the Canadian economy “in case free trade fails,” it is now gone. Given the lack of real options, the economy demands new instruments to provide greater certainty within the North American economic zone.

Mexico and the United States are now attempting to advance the liberalization of labour markets between them to take advantage of and sustain increased economic activity. Mexico is arguing for a shared approach to regional development to spread the benefits of open markets. For their part, Canada and the United States are building an “area of mutual confidence” to safeguard their shared security in the face of global challenges. In part, this is to ensure that the border between them does not become a barrier to the flows that now unite the two economies. In merchandise trade alone, these flows amount to \$1.5 billion per day. In this effort, Mexico would also become a partner. In short, while free trade needs plateaus of time during which the effects of liberalization are absorbed, the process cannot stop without catastrophic disruption.

THE QUID PRO QUO OF THE FTAA

Free trade, to be sustainable, requires a clean *quid pro quo*. The trade-off between partners with modest systemic differences is relatively straightforward and will focus on issues of access. Although it was tough to define the Canada-US FTA *quid pro quo*, ultimately, it involved a narrow range of policies and has been easy to sustain. The case is very different among econo-

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mies with significant systemic differences and great asymmetry in size.

The *quid pro quo* in the case of NAFTA was very different and it is far more complex still in the FTAA. The FTAA process is based on a bargain articulated in 1990 and codified in Miami in 1994. In exchange for free access to US markets, the countries of the hemisphere will liberalize their economies and democratize their societies.

While the FTAA negotiations have advanced since Miami, there has been a significant time lag in the parties' fulfilment of their commitments. Countries of the Americas have moved unevenly toward liberalization and embedded democracy. The United States has only recently demonstrated the political will to provide guarantees of free market access. Even now, the Trade Facilitation Authority that the House has provided falls short of fully achieving this goal. Firm and comprehensive guarantees of access are needed to support sustained reform in the often tenuous economies and poorly integrated societies of the Americas. Access in sensitive sectors like citrus, sugar, and textiles, as well as trade remedies will have to be on the table.

The US partners need to approach the negotiations as "negotiators." They cannot demand pre-agreement on US concessions before they engage. It won't work. Canada's experience in the FTA is illustrative. "Nothing is agreed until everything is agreed" and that might not happen, quite literally, till the last minute. The FTAA *quid pro quo* then will be a challenging one to strike when Brazil and the United States assume responsibility for the final stage of negotiations.

THE ROLE OF CIVIL SOCIETY

A final "lesson" is that the parties cannot wish away the involvement of "civil society" in the negotiating process. Civil society actors claim, for better or worse, to be the vocal proxy for public opinion. They are organized, have access to mass media, and they do exercise politi-

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cal power, although we should not exaggerate it.

The questions "Who is civil society?" and "Whom does civil society represent in a democratic society?" are both interesting, but are ways to avoid the real issue. Civil society has to be engaged. Canada has had considerable experience with civil society's involvement in public policy. Some have been very painful, for example in the MAI (Multilateral Agreement on Investment), some positive, and some both (Quebec City Summit). We have learned from the experience. Civil society opposition to free trade, and more generally to "globalization," is based on fear and the mistrust of governments, whom they suspect of colluding in an agenda to diminish sovereignty and the state's capacity to protect national societies. Civil society represents a spectrum of constituencies including protectionist lobbies who transmute narrow self-interest into the language of altruism and the marginally violent for whom international conferences provide a sanctioned opportunity for self-indulgent thuggery. But the majority are well intentioned individuals and organizations concerned about real issues.

We address ourselves to this majority with a coherent message and in the spirit of the greatest possible transparency. Free trade is instrumental to but only a part of much broader efforts at change in favour of economic freedom, political

democracy, and social equity. That *was* the message of Quebec City, and the message, clearly articulated there, simply washed away the confused rhetoric of the critics. We also saw the impact of transparency after the trade ministers' breakthrough agreement to release the draft FTAA text in Buenos Aires.

The gesture, which would have been even more effective if it could have been acted on immediately, took the wind out of the critics' sails. It obliged them to assume responsibility to engage the issues, rather than exercise their prerogative to criticize without regard to the facts. For the FTAA to move forward now, and to be sustainable for the longer term, we will continue to have to act in this spirit.

ECONOMIC LIBERALIZATION, GOOD GOVERNANCE, AND SOCIAL PARTICIPATION

Others will undoubtedly draw on their experience for additional "lessons" for the FTAA. The most important is that public policy making cannot be compartmentalized. Economic liberalization, good governance, and social participation are three legs of one stool. Pursuing any one, independent of or unmindful of its impact on the others is a recipe for failure. Ignoring one similarly unbalances the system. The consequences of failure are no less tragic today than in the past. They include losing the real progress the hemisphere has made on all three fronts in two decades of determined effort. 