

# Trading free trade after NAFTA: Do parties play by the rules?

One major reason for both Canada and Mexico in joining NAFTA was to make the United States play by agreed-upon rules in terms of trade. The abuse in the implementation of trade remedy laws by U.S. agencies and the protectionist legislation passed by Congress during the 1970s and the first part of the 1980s became the context under which Canada first, and Mexico thereafter, joined the free trade credo promoted by Washington. “Guaranteed market access for goods and services under transparent rules” became the banner under which the U.S. neighbours entered negotiations with Washington. As for the White House, it was clear from the beginning that free trade diplomacy had less to do with economic gains and more with political calculations.

## TRADE POLITICS

For the United States, the signature of bilateral, in effect, “minilateral” trade agreements with its most important trade partners had become an opportunity for advancing and reinforcing its major goals pursued at the unilateral and multilateral fronts. Since the *Trade Act* of 1974 and the *Omnibus Trade Act* of 1988, an aggressive Congress, concerned by the widening of the U.S. trade deficit and the decline of the competitiveness of the American economy, made trade retaliation a legitimate tool for promoting what Americans have called “fair trade.” By the latter, Washington has understood that U.S. trade partners must compete with the United States on the same basis that the United States is competing with them. To “level the playing field” became the buzzword under which Washington promoted its “free trade” diplomacy in bilateral and multilateral fora. Indeed, this was one of the major policy goals pursued during the negotiations with Canada and Mexico.

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Though NAFTA was justified in terms of economic gains, it is better to analyze the effectiveness of the trilateral trade regime according to the policy goals it really conveys. To assess NAFTA solely according to trade performance could be misleading. Take, for example, Canada-U.S. trade before and after the bilateral trade agreement signed in 1988, the so-called CUSFTA. Total Canadian exports to the United States witnessed a major growth both before and after the agreement. In other words, the CUSFTA itself did not create any significant change in Canadian export trends from those already witnessed, at least since the early 1980s.

However, at the sectoral level, some industries performed differently. While fuel and oil exports increased significantly in relation to the pre-CUSFTA period, exports in the transport sector witnessed the opposite trend. Should we conclude from this that free trade with the United States has become disadvantageous for a Canada-based automobile industry?

## WINNERS AND LOSERS

If we take imports into account, U.S. exports to Canada have increased significantly in relation to the pre-CUSFTA period. Does this mean that NAFTA has been more beneficial to American industries than to Canadian ones? It would be wrong to say that. We know that Canadian and Mexican trade with the United States is mainly intra-industry and that multinational corporations have internalized cross-border markets through intra-firm transactions. We also know that tariff rates between Canada and the United States and tariff rates between the United States and Mexico were already low before the agreement, and monetary and exchange-rate policies have had a bigger impact on trade flows than the sole phaseout of tariffs. Mexico’s booming exports after NAFTA could be partially explained by the major currency devaluation of early 1995 and the strength of the U.S. economy.

Thus, NAFTA should be assessed according to the main policy goals anticipated by its members when they signed the agreement. To this end, we should ask whether NAFTA has guaranteed access to the American market for both Canada and Mexico—that is, whether NAFTA has levelled the “playing field” for the three partners.

## CAN ACCESS BE GUARANTEED?

To be sure, NAFTA has made protectionist policies coming from the United States more manageable. The incorporation of alternative dispute settlement mechanisms, designed to operate on either adjudicatory or conciliatory bases, have modified the institutional context in which protectionist policies had taken place before the trade agreement was signed. Of the three cases arbitrated and finalized under Chapter 20,

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panel awards confirmed the complaints of Canadians (one complaint) and Mexicans (two) against the United States. Arbitrage panels under Chapter 19—that is, those reviewing the imposition of antidumping and countervailing duties by national administrative agencies—have been more popular. As of May 2001, 76 cases have been submitted; of those 22 have had an award and 21 have been suspended or the claiming party has declined its complaint. The remaining cases await decision. Most of the disputes under this chapter are related to dumping procedures, rather than subsidies, and most of the reviews target U.S. agencies.

Though panel procedures concerning dumping and subsidies have not been as speedy as anticipated, awards have not been challenged and panelists have proven to be professional and balanced. Seven out of 13 cases that reviewed U.S. agencies' decisions have been completely remanded. The rest have been either fully confirmed or remanded in part. That is, 50 percent of all awarded cases reviewing the administrative decisions of U.S. authorities have been judged as non-consistent with U.S. legislation. This rate of "success" benefiting either Canada or Mexico was much more elusive in a pre-NAFTA scenario, according to the empirical record shown by some studies (see, for example, Judith Goldstein in *International Organization*, Fall 1996). We could even say that, at least in the field of unfair trade practices, the playing field has been levelled vis-à-vis the other NAFTA partners. Two out of ten final awards reviewing Canadian agencies have been fully remanded, two have been remanded in part, and the rest of them fully affirmed. One out of five cases involving Mexico has been fully confirmed, and the rest of them have been fully remanded or remanded in part. In other words, Mexico is still on the learning curve for managing its rather recent unfair trade legislation.

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To judge NAFTA solely in relation to the final decisions of those disputes that passed through the whole panel procedure could be as partial as assessing the agreement focusing on trade performance. Many other trade-related disputes have emerged among the NAFTA partners without being resolved under the formal dispute settlement mechanisms. Take, for example, the tomato and avocado disputes between Mexico and the United States, or the *Helms-Burton Act*, which involved both Canada and Mexico against the United States. In the first case, price or quota undertakings were negotiated. In the second one, consultations were activated under Chapter 20 and the White House eventually declined to enforce the extraterritorial consequences of the Act. NAFTA's institutional obligations and enforcement mechanisms helped to defuse the problems and facilitated a compromise. Thus, can we say that at the policy level NAFTA has been a complete success? Such an optimistic conclusion should be tempered against some less optimistic evidence.

### THE LESS OPTIMISTIC VIEW

We could say that NAFTA has corrected some protectionist biases of the administrative agencies of the three partners; however, it has failed to deter strongly rooted protectionist interests in the region, in particular those coming from the United States. The saga of the

softwood lumber trade dispute between Canada and the United States epitomizes the nature of such conflicts among the partners. Though a panel decision under the CUSFTA agreement affirmed the Canadian stand, American lumber producers have been very successful in reactivating this case, eventually forcing a compromise on a classic managed-trade policy basis.

The U.S. government has also threatened to use unilateral measures as justified under section 301 of the *Omni-bus Trade Act*, a device that remains immune to the arbitrage mechanism of NAFTA. A recent case involving cross-border trucking traffic between Mexico and the United States shows how domestic protectionist pressures could compromise the United States' principled obligations with its partners. The panel simply rejected the way that U.S. authority abusively interpreted clear principles such as "national treatment" and "most favoured nation" as a mask for protectionist interests. The struggle of the Mexican avocado for access to the United States market presents a similar pattern of conflict and managed-trade solution. Furthermore, the recent Byrd amendment threatens to make dumping and subsidy complaints coming from United States producers more rewarding, due to the fact that producers will be allowed to directly collect the levied taxes if their complaints are confirmed.

These instances reveal that a level playing field is far from being attained. This is not because Canada and Mexico are not as market-oriented as the United States wishes they were, but because the United States remains the most protectionist party of the three countries.

After years of U.S.-led free trade diplomacy, Canada and Mexico are still learning to cope on two fronts opened by this venture. NAFTA not only promotes U.S. foreign trade interests abroad, it also attempts to work as an institutional constraint to deter protectionist pressures at home. The first goal has been successful so far, as witnessed not by trade performance but by the institutional changes it has provoked in Cana-

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da's and Mexico's economic organization. As for the second goal, NAFTA is still far from levelling the playing field among its partners, this time vis-à-vis U.S. practices.

To be sure, U.S. protectionism has become more manageable under NAFTA, but it is still far from being policed under

trilaterally agreed-upon rules. If Washington wants to make its commitments toward the principled regime it is promoting more credible, it should campaign at home and abroad for the creation of a trade tribunal ruled by common trade legislation to which the three NAFTA partners abide on an equal basis. ❖

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especially after the 1982 crisis made tax collecting more difficult.

The government of Vicente Fox is well aware of the need to raise revenues. It has the advantage of enjoying the legitimacy of having sacked the PRI in clean elections. One of its first important initiatives has been a tax reform based on eliminating most exemptions in the VAT and income tax laws, while lowering income tax rates. While technically correct, because it would create a less distorted and easier to manage tax system, such a reform is difficult to sell to the public and to Congress. Particularly as the two most visible features are taxing food and medicines, while diminishing the rate paid by the richest Mexicans from 40 to 32 percent.

Although Fox's popularity has been dented, the president seems determined to achieve tax reform. The new government, however, has exhibited its lack of experience. Before demanding higher taxes, more efficient and transparent government expenditure would have been helpful. Increasing VAT while lowering income tax for the richest at the same time made it an easy target. The president has carried most of the weight in his effort to promote the

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reform, but, in spite of his undeniable talent, he has been unable to convince society of its virtues. Moreover, the president's party does not have majority in any of the Chambers, so his popularity is not easy to transform into legislation without a careful negotiation with the PRI, an element that, so far, seems to have been absent. Fox's government has even been unable to convince his own party, the PAN, of the need to defend tax reform.

Fox had expected to have the reform approved quickly by Congress in April, before Congress was dismissed. He then thought an extra period could be agreed upon easily. However, it seems that without major changes, tax reform

will not be ready for an extra period and will have to wait until September, when Congress is obliged to meet again. Without any major change in the government's strategy and if the PRI remains united, it will be very difficult to pass Fox's reform in both chambers.

If the new government does not devise a different strategy to raise revenue, the Mexican state will continue to be unprepared to face the innumerable challenges of public safety, infrastructure, education, health, and justice. These challenges, all Mexicans agree, require strong public attention, but have not agreed upon the way to raise the much-needed public revenues to confront them. ❖