BON ANNIVERSAIRE NAFTA-- THE ELUSIVE AND ASYMMETRICAL BENEFITS OF A DECADE OF NORTH AMERICAN INTEGRATION,

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Daniel Drache, Associate Director Robarts Centre for Canadian Studies and Professor of Political Science, York University

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ADDRESS ANY COMMENTS TO: DRACHE@YORKU.CA

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Next Steps: Challenges Ahead

Ten years after the signing of NAFTA there is no forward momentum nor urgent need to proceed to the next stage in integration. Increasing trade facilitation, improving the system of trade dispute panels, and reducing the transaction costs of a security-first border remain a set of generalized concerns for all three governments. Further integration kinds of projects have met powerful opposition from the US Congress. The Central American Free Trade Agreement (CAFTA) received Congressional consent by the barest majority after months of White House arm-twisting and vote-buying. The Bush Administration is preoccupied with Homeland Security and, as the quagmire in Iraq costs more American lives and consumes billions of tax dollars, there are few incentives for Washington to gear up for a battle with the Republican Congress to broaden and deepen North American integration. Mexican and Canadian public opinion has expressed little enthusiasm for a big next step and have a lot of doubts and reservations about a second round of North American integration.

Strikingly, many Canadian businesses do not see deepening NAFTA as the preferred initiative to the many strategic challenges that are reshaping their operations over the next five years. High costs and a rising Canadian dollar are forcing Canadian manufacturers to look inward to respond to rapidly changing supply and demand chains. In the most recent October *Survey of Canadian Manufacturers and Exporters*, improved North American market access did not make the list of their ten top strategic challenges of the roughly 1000 firms surveyed. Without a strong consensus, publics in both countries would need a huge amount of convincing and arm twisting to deepen NAFTA and constrain Canadian and Mexican sovereignty in new ways.

For Canada and Mexico given these uncertainities, what is the next move in a post-NAFTA world? More integration? Integration through trade only? Or through economic cooperation? Will a NAFTA plus agenda alleviate the disparities in economic development between the NAFTA countries? Does Mexico need a different economic strategy? Have most of the NAFTA effects already been captured? If this is the case, a major re-evaluation of NAFTA is needed before any new round of integration is undertaken.

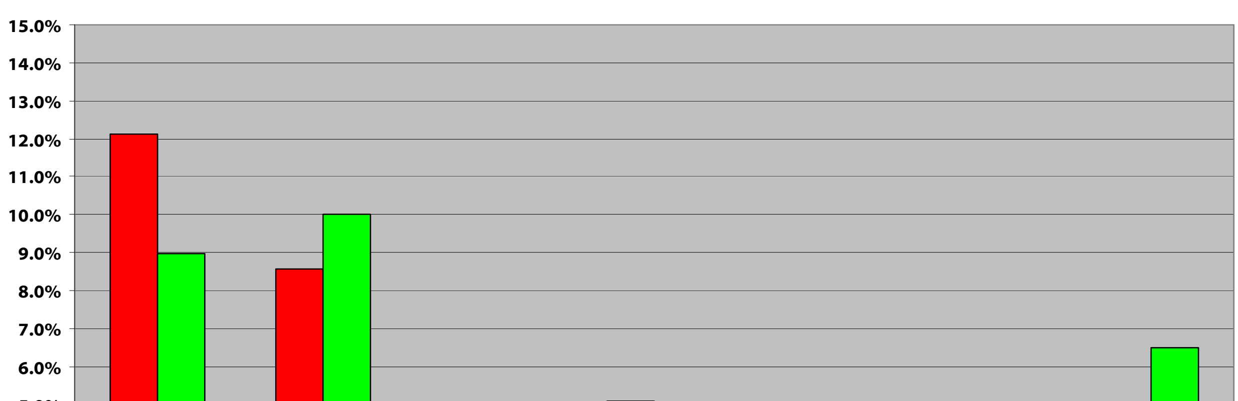
Significantly it is not clear what more secure ‘access’ would entail in a highly protectionist environment. Nor is it a simple case to identify those Canadian and Mexicans industries which would benefit at the present time. Canadian and Mexican export industries face changing consumer demand, widespread technological change, competition from China and, generally, higher production costs. Companies need to become more agile and diversified and less dependent on traditional markets. Diversification and access to developing markets in the Global South require a rethinking of trade fundamentals. The Conference Board of Canada and the C.D. Howe Institute could not be further apart in their thinking. The Conference Board is championing investment in new technology and high productivity growth as the top priority. The CD Howe Institute seems locked into yesterday's Mulroney's kind of strategy with little fresh to offer. It is banking on an environment of trade determinism at a very time that the Washington Consensus goals are unravelling.

On the political front, NAFTA, once a mid-range priority for the Clinton Administration, has been downgraded as a strategic goal for US policy makers. Certainly NAFTA promised to build a new trilateral relationship in North America. After a decade of existence bi-lateral tensions have risen sharply with respect to immigration, softwood lumber, US unilateralism, homeland security and US trade politics. The dispute resolution mechanism has been badly damaged by US arrogance and its refusal to comply with its NAFTA obligations on Softwood Lumber. Gordon Ritchie, one of its architects and main supporters, has argued that US non-compliance has irreparably damaged NAFTA's legal regime. The list of shortcomings and acts of commission by the Bush Administration in the area of free trade appear but to be lengthening rather than shortening in the Devil Water Diversification and at UNESCO on the Universal Declaration on Cultural Divesity. The promise of a new legal standard was NAFTA's major selling point and we are far from building a level playing field . In Canada recent polls show that highly contentious trade issues have soured the prospect of establishing a stronger trilateral relationship. A majority of the Canadian public is critical of the Martin government for not doing enough to defend Canadian sovereignty. (*Globe & Mail* June 2005) Even the bi-lateral Canada-US axis, relations continue to be rocky dating from Ottawa's refusal to send Canadian soldiers to fight in the US war in Iraq. The decline has been both qualitative and quantitative with respect to NAFTA effects. Why?

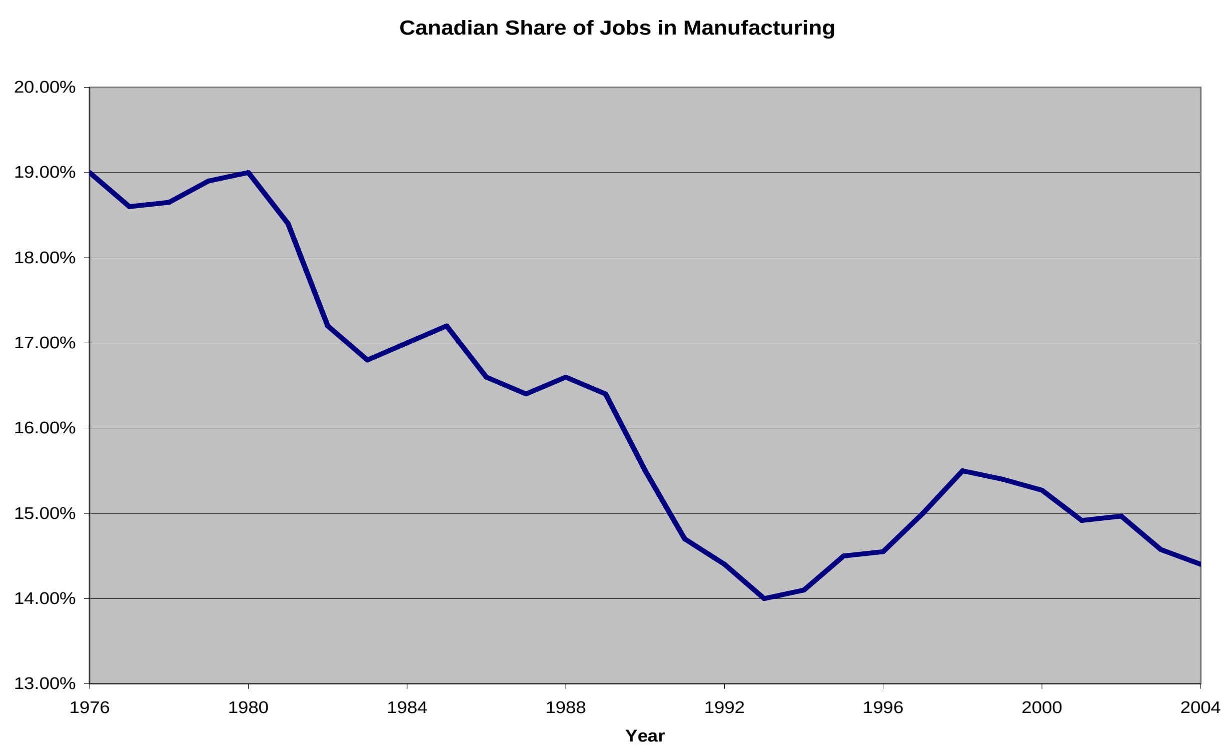
Adding Up the Numbers: The Big Picture Overview

The analysis that follows focuses on NAFTA's competitive vs its distributional effects which have skewed the macro-benefits in the US favour. Negative distributional effects have seriously compromised the competitive advantage that a handful of Mexican and Canadian industries have derived from an era of North American Free Trade. Trade adversity from new competitive circumstances can be defined as occurring when Canada and Mexico are unprepared for larger structural changes arising from growing competition with their most important trading partner. Highly adverse structural adjustment is forcing Canada to begin to look at other options when access to the US market is largely a fait accompli for many industries and there is no likely prospect of major new gains. Legal access is a second best option when the US Congress is in a protectionist phase. Equally Mexico has large decisions to take as it wrestles with the limits of neoliberalism as the major policy framework of the last decade. It needs to rethink its immigration development policies.

Share of World Exports



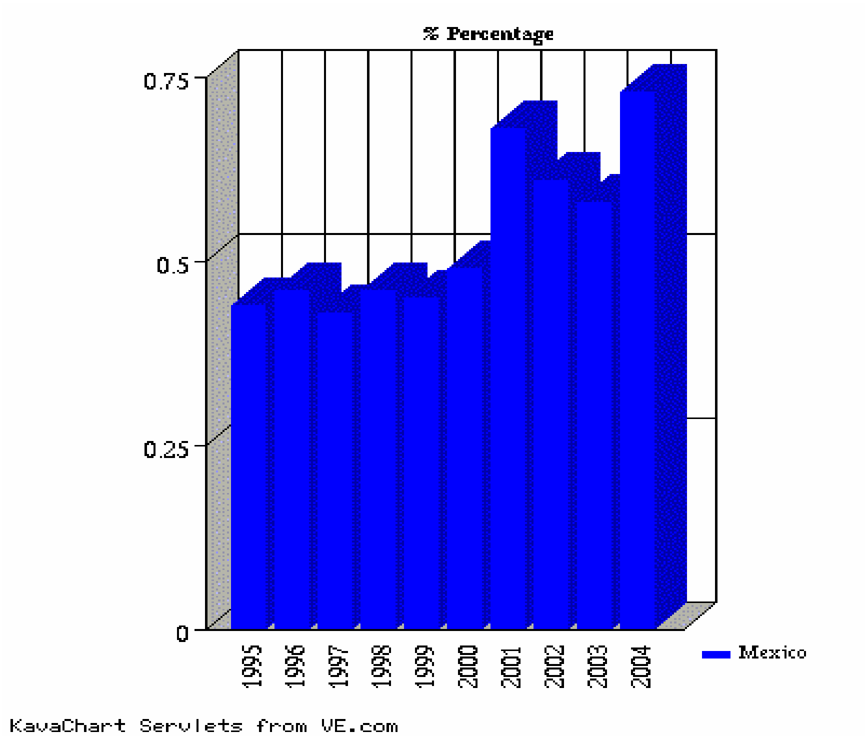
Since NAFTA came into effect, Canada and Mexico have become more export oriented. The major paradox is that in terms of their percentage of world trade between 2000 and 2004, Canada's and Mexico's share of world trade has actually shrunk as can be seen from the accompanying table. Since 2000, belonging to a free trade zone is no guarantee that NAFTA partners will not be buffeted by the gale-like forces of international competition. The US has seen its commanding position in the world economy dramatically decline by three percentage points; Germany has made impressive gains despite its unemployment crisis; Mexico has been a loser in the global export winner-take-all stakes along with Canada. Belonging to NAFTA has not prepared either country for the new competitiveness of China and India, countries who are powering their way into global markets. NAFTA's share of world exports in goods and services has dropped precipitously too. In 1993 it accounted for 23 percent of total global exports; by 2003 NAFTA's share of world exports had declined to 19% while Europe's remained steady at 23 percent. Concentration on a single market is no guarantee that NAFTA is positioning Canada and Mexico for new challenges they are facing. The link between a strong export performance and job creation is definitively uncoupled in the most performant sectors such as auto and IT. The global commodity boom has created new employment growth in Canadian mining, but not its forest industries.



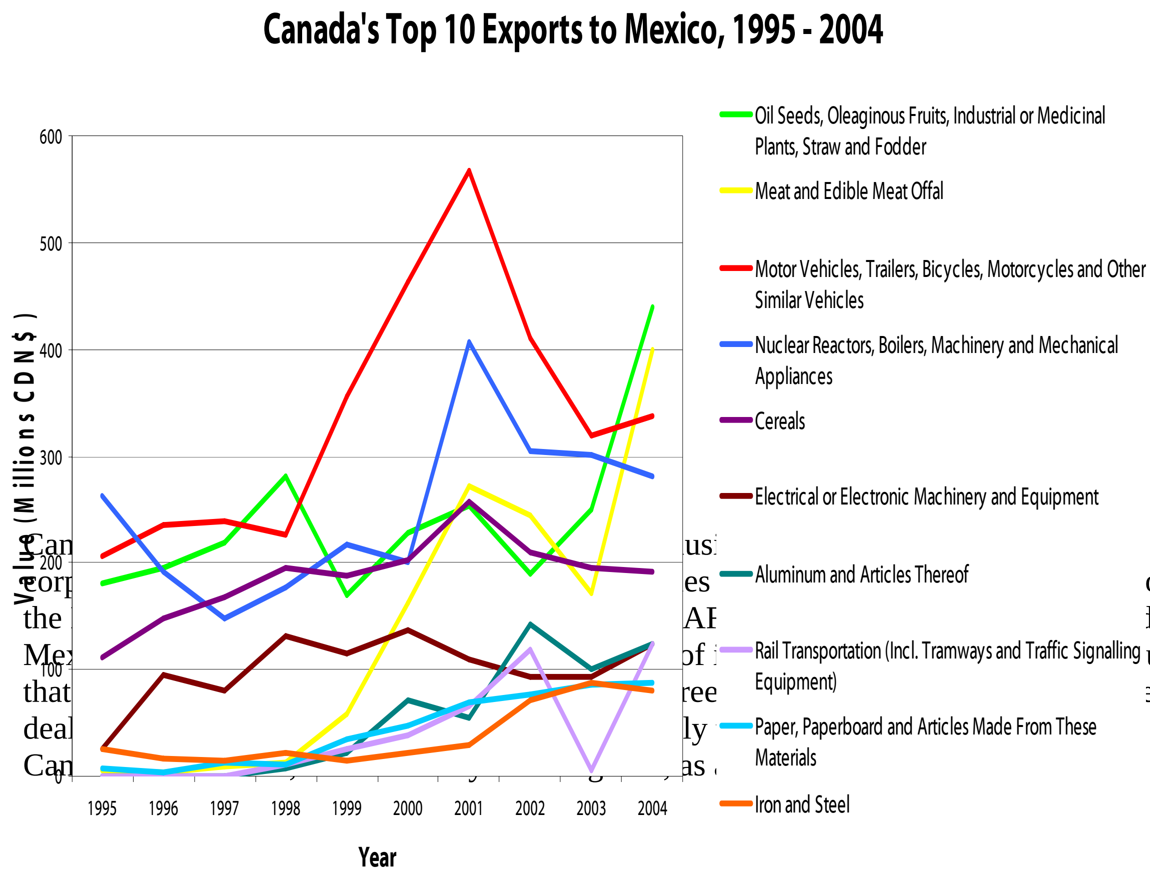
Concentration in a single market has proven to be a two edge sword. Neither Canada nor Mexico has yet to assimilate the full implications of their decline globally. Over-reliance on NAFTA has led to a loss of industry level flexibility and on the other hand, the growth of energy exports has locked Canada and Mexico into the US dominated energy market framework with little ability to capture upstream and downstream benefits for their own development goals. Resource exports are not labour-intensive and oil and gas exports have given both countries a massive windfall from soaring energy prices. The energy sector is not a model for the rest of the economy.

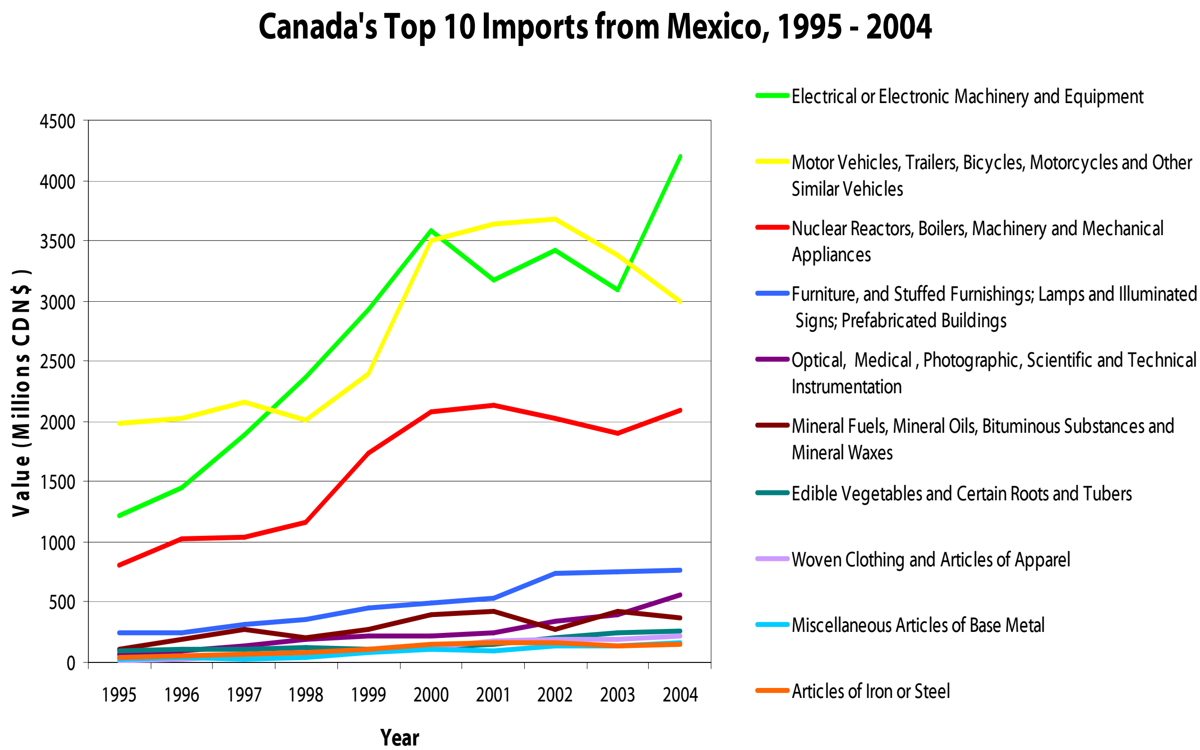
Even if the North America trade in goods to goods to GDP output has grown markedly for both countries, Canada-Mexico economic relations can only be described as feather weight. Between 1995-2004 Canada's exports to Mexico amounted to roughly 1/2 percent of Canada's total trade picture; rising to a very modest 8/10ths percent at the end of the decade. It is not simply a single isolated statistic which captures the way the two economies are 'lost in translation', but the absence of incentives to transform Canada-Mexican relations into a dynamic collaboration.

Canada's Export Trade with Mexico



On the Mexico side, the economic relationship has been small and limited to the export of cars and car parts. This kind of arranged trade cannot be properly called a 'NAFTA effect' since these exports are part of under the Auto Pact. Detroit based-auto makers share on the North American market is seriously under siege by Japanese imports. Even the once invincible auto pact is facing an increasingly uncertain future. Canada's top exports to Mexico are concentrated in agricultural products with some light manufacturing and auto related exports. (See figure below).


Canada's Top 10 Exports to Mexico, 1995 - 2004
Value (Millions CDN $)
600
500
400
300
200
100
0
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
Year
Oil Seeds, Oleaginous Fruits, Industrial or Medicinal Plants, Straw and Fodder
Meat and Edible Meat Offal
Motor Vehicles, Trailers, Bicycles, Motorcycles and Other Similar Vehicles
Nuclear Reactors, Boilers, Machinery and Mechanical Appliances
Cereals
Electrical or Electronic Machinery and Equipment
Aluminum and Articles Thereof
Rail Transportation (Incl. Tramways and Traffic Signalling Equipment)
Paper, Paperboard and Articles Made From These Materials
Iron and Steel



What is a NAFTA Effect? What is A Production Process Effect?

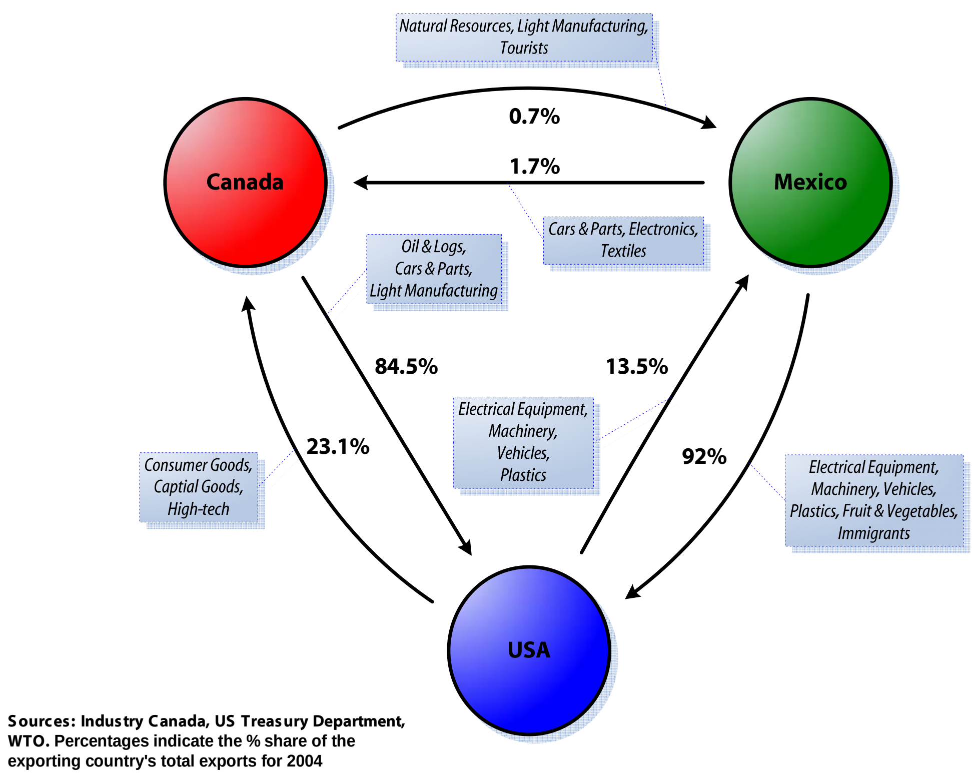
There has been very little unbundling of production chains across North America other than automobile and the energy sectors. Many experts wrongly believe that more access has been determinant in creating more competitive industries. In fact, changes in the production process provide a more realistic basis for understanding the structural changes that face many North American industrial clusters. For instance, discounting and a very strong sales figures have not turned around the future prospects for GM nor Ford. Detroit has not reinvested sufficiently in the profits from surging SUV sales for most of the decade. Asian and European-based manufacturers used to account for about 10 percent of the market. Now Honda is beating Ford and Chrysler in monthly sales and GM share has dropped by fifty percent of what it was little more than a decade ago. Detroit-based assembler share of the North American market has fallen below the historic fifty percent mark and many experts are of the view that it is impossible for Detroit-based three to return to dominance. The North American auto assembly is headed towards downsizing and assembly plant closures on an unprecedented scale..

Secondly, the asymmetric growth between NAFTA partners has accelerated. Canada and Mexico are energy and raw material exporters to the US heartland and a vast market for American consumer and capital goods. There is nothing in the cards that suggests that either country will be able to change the division of labour without a focused and dedicated industrial strategy. Under NAFTA rules both Canada and Mexico are seriously disadvantaged. Thirdly, both countries have seen their export share of world market decline as they have become more concentrated in the US mega-market. On the world stage both countries face major structural adjustment from potential rivals in China, India, Brazil and Eastern Europe. Both Mexico and Canada are living precipitously on the edge benefiting from rising energy prices but facing enormous pressure on labour-intensive processes in manufacturing. (Martin Wolf, FT, October 19, 2005). Finally many experts are of the view that foreign direct investment is on an ‘investment binge’, but it is not clear what kind effect this will have on Canadian and Mexican industrial and service exports. In the service side of the economy Canada and Mexico need to look to their own capital markets for start-ups and new equity financing. So far. there is little incentive to bite the bullet and develop high performance financial services.

The major analytical point is that complex market and non-market forces no longer respond to simple supply and demand signals of free trade in North America if they ever did. Sorting out >the real life cause-and-effect relationships= in highly open economies has proven to be highly hazardous. The most authoritative study performed by Industry Canada demonstrated that the low Canadian dollar, rather than new market access has been responsible for Canada’s export boom to the US between 1995-2000 (see Helliwell, 2000). Far more significant is that any untapped access to US non-resource markets is not likely to grow until Canada has a clutch of home-grown multi-national corporations who can power themselves into the US market. Canada would be better off to increase its access to world and North American markets by doubling its investment in R& D from less than one percent of GDP to two percent or better in the next decade. Canadian companies have to turn their attention away from traditional markets and put their effort into responding to changes in the production process, developing new products, investing in the workforce and improving education and training. Canada’s government has not been much of a leader in having any strategic vision other than promising tax relief to be implemented over the next five years.

The challenge presented by globalization for Canada is to acquire the policy tools and institutions enabling it to adapt to the rapidly changing economic landscape. The key to Canada’s future lies in research and innovation and Canada lags far behind US, Japan and Germany in R& D and in investment in higher learning. For Mexico, the macro-economic benefits have been equally mixed. Its intra-firm exports have soared in key sectors, but aside from some success stories, Mexico’s economic growth is skewed between competitiveness and the negative distributional effects of income and wealth polarization. NAFTA has provided Mexico with full duty-free access to the US market; market-access which no other country shares. Mexico should have been a showcase for other developing countries. But in per capita terms since 1992, Mexico's economy has grown at barely over 1%, a fraction of its growth-rate during the decades prior to NAFTA![1] Access to markets has not made up for the domestic factors holding back Mexico's economic growth and the lack of a strongly articulated development strategy. The asymmetrical commercial effects are pronounced. (see figure below)

The Asymmetrical NAFTA Triangular Trade



Over-reliance on NAFTA has not been a silver bullet for Mexico. Like many others in the Global South, those working in the most vulnerable and exposed industries such as textiles, agriculture, and primary resource extraction and processing have seen their wages decline. For example, in Mexico's maquiladoras sectors, the drive for international competitiveness has been an incentive for many industries to shed labour rather than to create employment. Since 2000, it is estimated that over 300,000 jobs have been lost. Employment growth remains negative and many labour intensive jobs have

1 Nora Lustig (ed). Shielding the Poor: Social protection in the developing world. Washington: Brookings Institution Press, 2001.

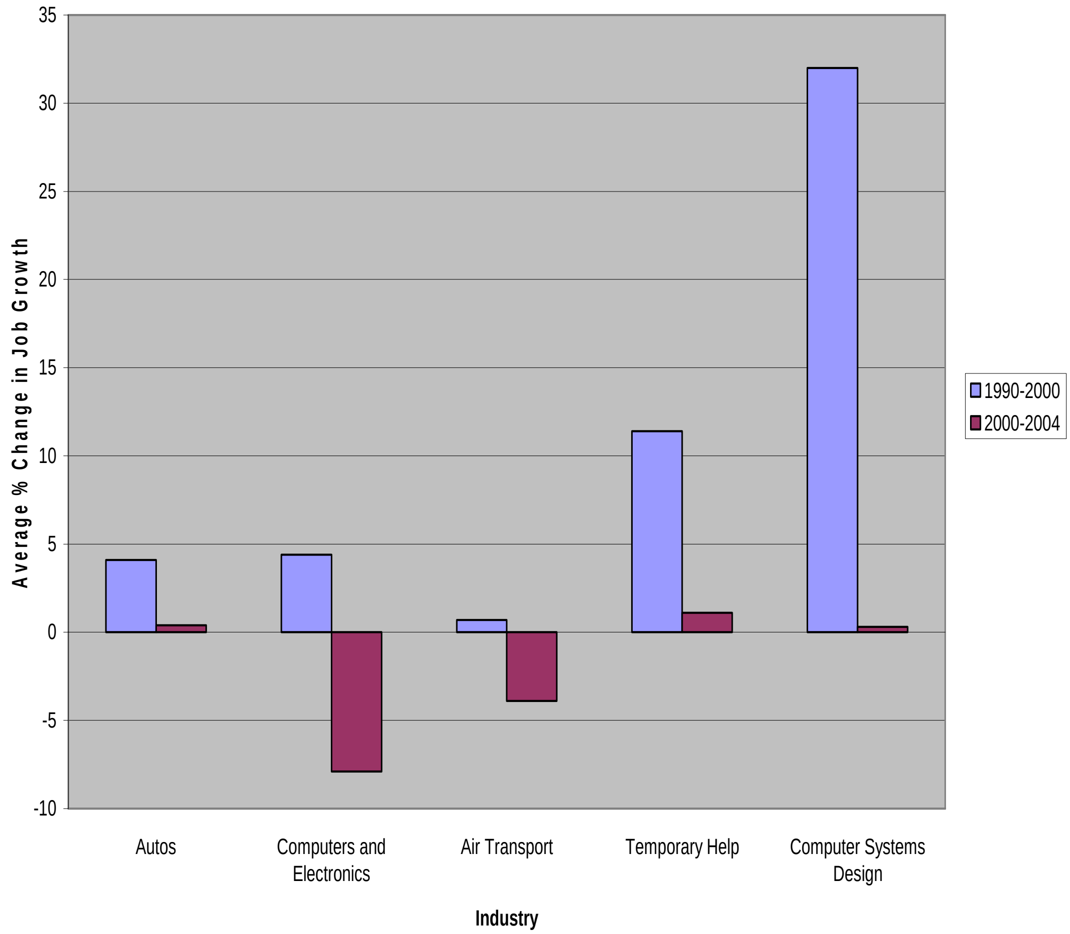
shifted to China and Guatemala. Manufacturing employment has grown persistently, but not enough to absorb the massive influx of displaced agricultural workers into cities. The predictions that NAFTA could double as a trade and development strategy are wrong and have left a policy legacy of failure.

The trickle down theory that free trade will lift the poorest out of poverty and become the great economic equalizer for the middle class has not delivered on its basic promise. Mexico's structural problems preceded NAFTA, but the implementation of the export led model of development is associated with the worsening of income distribution in Mexico as Boltvinik among others has demonstrated. Regions in the North and Centre of the country are better off than those in the south who are disconnected from NAFTA related production chains. Polarization between Mexico's regions is much worse today.

Since 1994 Mexico has lost 1.3 million jobs in the agricultural sector and millions of new jobs have not been created. The export sector has barely made up the difference with jobs lost in agriculture due in part to cheaper imports. While there has been some reduction in poverty in the last decade, income polarization is as great or greater according to the empirical studies of different experts.

For Canada, NAFTA has failed to deliver significant job creation in the export side of the economy. Auto, resources and manufacturing have an incentive to downsize their workforce and produce more with fewer people. The drive to be competitive has had major negative consequences on blue collar employment. In a recent article in the *Canadian Economic Observer* Cross documents how deep the decline in Canadian manufacturing employment is over the NAFTA book-ended decade. Manufacturing jobs peaked in 1980 at 19% and bottomed out in 1993 to 14%. Since the domestic recovery manufacturing jobs grew again but are now at an all time low. Even auto and the ICT sectors have seen their growth stalled. (Cross, 2005) Export industries are losers in the employment stakes. Winners include those working in public sector, hospitals, education, real estate and retail all which experienced better than average growth between 2000 and 2004. (Jackson, 2005) The shedding of manufacturing jobs continues its downward trend; while not as dramatic as in the US the strongest source of job creation is in the domestic side of the economy.

Many Canadian Industry Leaders in the 1990s are Job Laggards by 2005



Arthur Donner has examined job creation in the two countries and found that the majority of new jobs in Canada are in the public sector, construction and services. US employment is strong in the part-time sector, services but not the public sector. The message here is unambiguous: exports cannot be relied on as a net creator of jobs. Aside from the commodity boom in mining, white collar job growth is almost twice blue collar occupations. A strong export performance requires a large and focused role for public authority, a lot of fortuity from rising commodity prices and a competitive currency. NAFTA effects are largely washed out by other macro factors.

Novelty and What No One Anticipated

Qualtitatively, NAFTA's performance to date is far more complex with respect to new state practices, labour market reform and playing a level playing field for trade disputes. The one area where there is novelty and surprise is the growing divergence on social values and political priorities. In North America the emphasis—to borrow Michael Trebilcock's critical distinction—has been on negative integration.[18] Negative integration sets out the rules of what countries cannot do and is largely responsible for the "less state, less tax" policy harmonization process that has led to spending cuts everywhere. By contrast, positive integration would spell out the supranational regulatory rules and the domestic policy standards that the US, Mexico and Canada *must* adopt. Without positive integration there is no trinational framework to protect social standards and strengthen social inclusion. There is no built-in escalator that requires all three countries to spend more on social North America and invest in human capital. In fact, under market fundamentalist principles, program spending has been cut to meet artificially imposed deficit reduction targets. Nor does this framework provide incentives to increase health and labour standards. Not unexpectedly, negative integration provides the US with the legal clout to shape the policy environment to advantage US actors. As a result, positive integration remains on permanent hold, and access to the US market for Canada and Mexico remains contingent, limited, unpredictable and subject to US trade law and the trade politics of the US Congress.

Too Many "Thou Shalt Nots": Privileging US Interests

One of the most important obstacles to political and social integration is the very large "home bias effect," the way the US Congress privileges US interests and, as a result, American corporations have derived the largest share of the benefits from economic integration. Paradoxically, giving US corporations privileged access to the continental market undermines support for a larger agenda of political integration.

This bias can also be found nestled amongst many rules in the NAFTA agreement, including rules of origin, national presence and national treatment, and in the legal culture that prevents Mexico and Canada from using national presence and national treatment for developmental or regional programs. Legislators must think twice whether new programs may potentially run afoul of NAFTA rules, which are themselves not definitive, but in need of interpretation. Since they are subject to legal challenge from US lobbyists and industries, public policymakers face a great deal of uncertainty and risk.

The US Congress has disregarded NAFTA's rules in the case of softwood lumber, unilaterally imposing punishing tariffs on Canadian producers. Canada has filed three disputes at the WTO and three before NAFTA panels, challenging US protectionist practices. There is no guarantee of congressional compliance. The US Congress will decide whether or not to end its illegal practices, and if it appears that the WTO or NAFTA decision will go against it, it will try to force Canada to accept a settlement that protects its wrongdoing. It is keeping five billion dollar duties it has collected under the Byrd Amendment declared illegal by the WTO. The most likely scenario is that Canada will compromise its legal rights, impose an export tax and limit its share of the US market. For the Bush Administration NAFTA is only a bargaining chip, not an inviolate high standard. A compromise that does not defend the legal regime's integrity would undermine further NAFTA's troubled rule based system. Some experts such as Michael Hart, Lawrence Herman and Garry Haufbauer are actually advocating this kind of political deal. (*Globe and Mail*, November 3, 2005) They continue to refuse to address underlying issues.

These structural and policy constraints are dampening any dynamic for a further phase of North American integration. The principal stumbling block remains the negative model of integration embodied in NAFTA that presents state/market relations as a series of "thou shalt nots" rather than regulatory "shoulds." . Institutionally the NAFTA agreement has established networks for private actors and for the development of administrative law that largely excludes public accountability and transparency. Chapter 11 has proven unsatisfactory as it allows private actors to sue governments in the exercise of their democratic mandate. This is not only worrisome, but raises more fundamental questions about NAFTA's democratic deficit.

NAFTA Effects: Some Qualitative Measures
The Four Principal Elements of NAFTA

Trade and Investment Flows >The Trade Boom=	Dismantling tariffs and other state barriers is the major rationale of trade agreements for export expansion and promoting foreign direct investment . The new dimension is to enhance investment rights and to give private investors national treatment status to invest and divest without state regulatory oversight. <u>Empirical Measure</u>: growth of exports year over year but market share by sector and changes in the composition of trade are more revealing of the actual benefits of free trade.
Labour Market Reform >Stronger but More Competitive Industries=	Adjustment is the heart of all trade agreement. In theory, job growth, higher incomes and lower consumer prices result from efficiency and welfare gains when industries have to become more efficient and competitive. Assumes optimal employment of all factors and that firms will reinvest rather than move. <u>Empirical Measure:</u> Job loss/new employment opportunities; changes to work and employment conditions; employment levels pre- and post-NAFTA.
New State Practices >Harmonization and Convergence=	The regulatory response to economic integration and harmonization pressures creates new standards for state practices across the broad front of government programs and initiatives. <u>Empirical Measure</u>: Test for convergence (divergence) is change in state spending as well as maintenance of non-market policies. Special attention to the organization of labour market and social policy reform.
Trade Disputes >Building A Level Playing Field=	The administrative legal and non-legal procedures for adjudicating trade disputes are a mainstay of any trade agreement. Comprehensive agreements are authoritative but since the rules require interpretation trade agreements are themselves the source of new disputes between signing partners. <u>Empirical Measure</u>: Number of new disputes;

	win/loss rate before trade tribunals; penalties assessed.

NAFTA's Legal Culture: More Contested than Ever

The legal obligation to enhance market access dramatically by enlarging investment rights and limiting government regulation of disinvestment has been highly criticized. An equally strongly-held belief in the need to link employment growth and social policy reform to success in export markets has lead to cuts in social welfare to the most vulnerable in the years following its implementation.. (See Figure Principal Elements of NAFTA) Since 2003 the Martin government has been forced to reinvest in social Canada in a minority government setting, Social spending in health and income security as well as infrastructure has dramatically increased.

Still NAFTA lacks concrete provisions regarding humans rights or environmental protection. NAFTA's legal standards arguably have had little effect on private employers' policies or effecting legal oversight of government policies. By contrast, the crown jewel of the agreement granted national presence and national treatment to US financial industries. US industries received enhanced access to the Mexican and Canadian markets. Particularly with respect to its energy provisions, Canada gave up the right to a two-price system charging US customers a higher price for Canadian oil and gas. Significantly Mexico did not concede sovereignty over its resource sector, but has been under constant pressure to open it partially or totally to US investors. This was an enormous setback for US investors and companies. So far the Mexico's Congress has been hostile to changing its laws to deregulate and privatize Pemex and the rest of the sector.

Chapter XI creates the new standards to increase capital mobility at the same time as it guarantees the investments coming from NAFTA partners. This has to be read along side Chapter XVII further protecting property rights; Chapter X, deregulating government procurement; Chapter XII, requiring the deregulation of services; and, finally, Chapters XIX and XX, establishing an enforcement mechanism to prevent government unilateral interpretation of the Agreement. By contrast, Canadian governments are not able to discriminate between foreign and domestic capital (Chapter XIV and XVII); nor are they able to introduce policies that allow government to use its legislative authority (if it wished to) to Canadianize sectors of the economy such as auto insurance or to enlarge the state presence in the economy as it had in the past in the area of public utilities. The investment provisions in Chapter XVI act a safeguard against this eventuality.

In such circumstances NAFTA, directly and indirectly, was to set in motion harmonization and integration dynamics with respect to labour market policy, social policy and state fiscal practice. A large part of the legal text focussed on redrawing the lines of state authority with respect to resource pricing, foreign investment, agricultural management boards, state subsidies and public ownership. NAFTA makes other across-the-board changes possible. For instance, taken as a whole, the legal text can be considered as a new legal standard that imposes new obligations on the Canadian state. Many of the specific subjects covered are not about trade but about promoting structural change through the market. More than anything else, what the NAFTA accomplished was to create new rules and norms. These would not be definitive, but they would establish benchmarks for >commercially oriented state practice=.

How Good Were the Experts' Prections about NAFTA's Effects and Benefits?

Challenge	Prediction	Outcome
Challenges to government regulation	Significant policy harmonization with respect to taxes, social policy and macro-economic co-ordination. A new Canada- US relationship envisaged with a level playing field	Dramatic reduction in federal spending driven by zero inflation and zero deficit targeting. Federal spending as % of GDP drops to 1950s levels By 2005 Canadian social spending is 4 percent more of GDP than US in per capita terms.
Future of Autopact	Neutral	Global overcapacity more important. Canada maintains share of new investment and production. CAW proves an astute bargainer at the table. Global overcapacity forces job and wage concessions in 2005
Investor protection	Significant increase in investor rights	Many new conflicts created by NAFTA provisions in a range of sectors with respect to national treatment. Most of the conflicts are in agriculture and cultural areas.
Capital mobility	Increases	Underestimated capital volatility and reverse flows. Canada share of new investment flows no greater than previously. FDI is not driven by NAFTA text but by US shareholder capital and MNC strategies. NAFTA effect dwarfed by US dot.com craze
Mexico's economic inequality	Seen to decrease as free trade accelerates the modernization of the economy	Dramatic fall in incomes and rise in unemployment. Mexican small business does not modernize while worker productivity is up 36 percent since NAFTA was

		signed.Wages fell 29 percent between 1993 and 1997 and welfare gains meagre for the mass of Mexican wage earners.
Cost of regulation	Sharp Decrease	Little evidence of major reduction in regulatory costs. Canadian business complains about increase in users fees.
Wages	Significant income gains for well positioned workers in export industries	In Canada wage polarization deeper than anticipated. Evidence is mixed. In the US the growth of wage inequality explained by the growth of union-free workplace. Exchange rate for Canada and Mexico the key variable
Labour restrictive practices	Diffusion of US norms and more competitive labour markets post NAFTA	Collapse of US labour movement has less knock-on effects and predates NAFTA. Canadian labour has not gone down US road of a union free workplace. Roughly 35 percent of Canadian workers are covered by collective bargaining compared to 15% in the US
Unemployment	With a stronger performance and stronger economy, unemployment levels to fall	Underestimated the magnitude of the job loss for many sectors but much job loss is not NAFTA driven. Eighty of the private sector jobs regained by 2000 when Canada outperforms US economy in the job olympics
Union bargaining power	Increased competitiveness leads to a decrease in collective bargaining for Canadian unions	Some significant decrease in collective bargaining arrangements in Canada but high levels of unemployment reduce the effectiveness of Canadian labour
Government decision making	Constrained	Impossible to attribute to NAFTA. Too many other competing agendas. Divergence across a broad range of policy areas is pronounced.

Exports	Sharp Increase	The record is mixed; trade asymmetries increase and Canada and Mexico comparative advantage are not transformed but traditional competences become the drivers of their export oriented economies

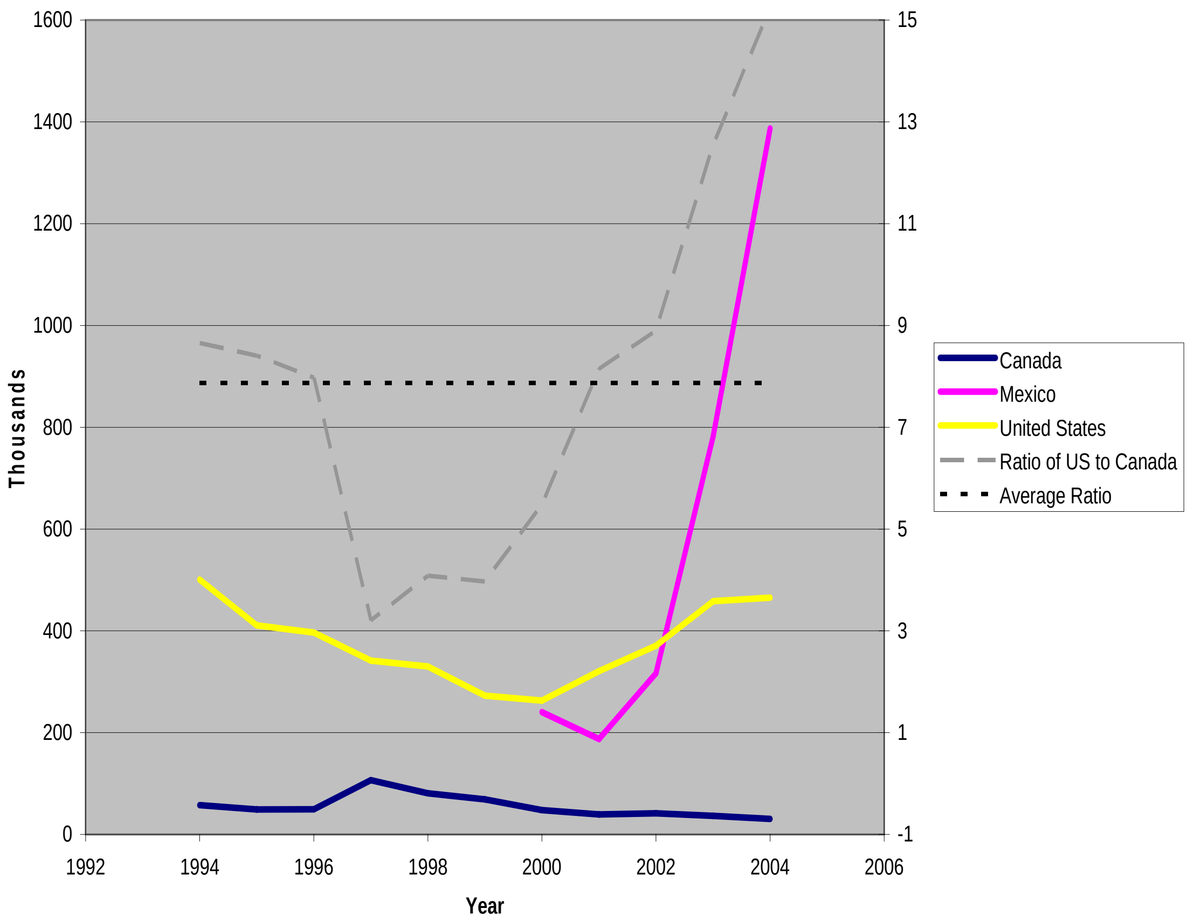
Growing Divergence, Institutional Constraints and Neo-Liberalism Competitiveness

In terms of goals and outcomes, divergence in state policy and market practices have actually grown over the decade. The number of unemployed and discouraged workers has grown throughout the first NAFTA decade. There is no single reason but many factors have contributed to growing trade imbalances, new inflationary pressures, cost-push pressures and wholesale change in the labour market. In North America high paying jobs are in short supply and part-time contingent work is one of the growth sectors in the labour market. Canada and Mexico are part of a single economy but their markets and consumer demand are separate and growing more distinct. We have yet to account for the singularity of divergence. There is no scientific method to forecast NAFTA effects and outcomes.

From a political and legal perspective the NAFTA final text was riddled with grey areas and legal uncertainties. The biggest was the final text itself. It did not contain any definition of a subsidy nor any arms-length procedure to resolve this issue. Nor was the weakness of the enforcement mechanism properly understood should a US Administration refuse to comply with its NAFTA obligations. US defiance of the NAFTA extraordinary panel was a crisis long in the making and now that it is visible to all it is not clear how NAFTA's legitimacy can be restored. US Congress will overview provisions in the Agreement that conflict with US law and interest.

Ottawa has been hostile to the practicality and effectiveness of having an industrial strategy, and have instead preferred to let NAFTA carry the burden. The major challenge that both pro- and anti- NAFTA sides agree on, is the need to shrink NAFTA's asymmetries (see Doran, 2000; and Drache, 2000)

Discouraged Workers (Both Sexes, Aged 16-64)



Conclusion

So the question is: will Mexico and Canada acquire the will-power and conceptual tools to become effective conflict managers when Canadian and Mexican macro-strategies and US policies are likely to go their separate ways? Today, what Joseph Nye has called 'the soft power of public opinion' is more critical than ever to Canadian foreign policy goals and practices. If Ottawa expects to chart its own course in the age of the smart citizen and critical, informed counter-publics, public opinion with all its surprises has to be kept on side, consulted and mobilized [2.] Ottawa cannot change the path of the Bush revolution in foreign policy but on missile defence, peace-keeping, protection of Canadian citizens, agricultural subsidies at the WTO, and global governance Canada needs to build leverage and acquire voice.

Kissinger was prescient when he wrote that 'foreign policy is domestic policy'[3,] and if this is true for the US, it doubly applies to Canada, a country in which social

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2 see forthcoming book by Daniel Drache. The Manufacturing of Dissent and its Counterpublics. London: Polity Press, forthcoming 2006.
3 see Henry Kissinger. A World Restored. Gloucester: Mass P. Smith, 1973.

diversity and multiculturalism define our national identity and are the strategic interests that must be nurtured and protected[4].

If Ottawa expects to be a more effective actor globally, it needs to connect with the Canadian public in ways that it has not chosen to do. Increasingly, foreign policy will have to reflect the social values of Canadian society, rather than, as in the past, the special interests of business elites. In a prescient article in the Globe and Mail, Gordon Pitts recently argued that the Canadian Council of Chief Executives has declined in influence in Ottawa partly due to its support for outdated and economically deterministic set of policies[5]. At present, Ottawa is caught somewhere between denial and taking responsibility, and it is still banging off of every change coming out of Washington. Managing conflict will require a lot of focus and smarts from Canada's policy elites. The Martin government must now accept that Canadian foreign policy and continental free trade have to constantly change, adapt and innovate in this very charged global policy environment.

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4 Jennifer Welsh. op cit.

5 Gordon Pitts. "Tom's Club: Only chief executives need apply". Globe and Mail, Toronto: July 5th 2005. Page B10 for example, he writes "[D]espite this ability to command press coverage, there are questions about whether Ottawa pays much attention these days…[The] glory days are over… As a policy advocate … Mr. d'Aquino has fallen into predictable habits, sounding the same drumbeat on every issue and rarely reaching out beyond his top-executive constituency."