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**SPP and the Way Forward for North American Integration:  
North American Solutions**

**by**

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## ABSTRACT

During the past year, relations among the NAFTA partners took on an increasingly two-tier structure. More visible were a widening array of disagreements over issues including BMD, Iraq, US demands on passports, the Senate's vote to keep the border shut to Canadian cattle, alleged American gun trafficking and, above all, Washington's efforts to evade the NAFTA ruling on softwood lumber. Yet, despite this mix of genuine grievances and political posturing, we saw substantial movement toward a more efficient North American economic system. Reports from the Security and Prosperity Partnership Working Groups set up after the Bush-Fox-Martin meeting in Waco, Texas, illustrated a wide array of activities under the politico-journalistic radar. Perhaps more important are the myriad of business- and community-driven initiatives underway to expand and improve cross-border links. How much of all of this will actually lead to concrete results is unclear. But several conclusions are evident. One is that this movement is driven by deepening interdependence. The second is that the current two-tier process in which national leaders kick each other in the shins while businesses and bureaucrats in federal, state, and municipal governments and community groups squirrel away to repair problems in the North American system will not work. Third is that "integration-by-stealth" is also unacceptable. The time has come to examine carefully what is happening in North America, to explore what our interests are in this emerging continental system, and to open a dialogue about different, even competing, visions of North America. The dialogue should involve perspectives from different regions, different economic and social sectors, and those who oppose as well as support integration. The process must get outside of the beltways — it must give voice to community and economic leaders who are most deeply involved in this new system.

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Other than the expression of anger at the Liberals, it is still too early to tease out the deeper implications of the January election in Canada. With regard to relations with the United States, we can reasonably anticipate some change in the government's style, but given Harper's minority position as well as the views of most Canadians on Iraq, Bush and an array of other matters, we should not expect dramatic change in substance. Even on issues (Kyoto, Ballistic Missile Defense [BMD]) where Harper's views may be closer to Washington's, the new Prime Minister has no political interest in reaching out to the current US administration. If anything, Harper's first exchange with Washington, over the arctic passage, suggests that he will seize the opportunity to stand on guard to protect Canada's national interests.

What we are likely to see, therefore, for the foreseeable future, is the continuation of the two-tier arrangement that developed over the past year.

During 2005, the media, usually oblivious to North American developments, focused on increasing tension among the NAFTA partners. In March, after Ottawa's decision not to join the BMD program, *Time* columnist Stephen Handelman wrote, "Canada's stock seems be hovering at North Korea level in Washington." US demands on passports, the Senate's vote to keep the border shut to Canadian cattle, alleged American gun trafficking, and, above all, Washington's efforts to evade the NAFTA ruling on softwood lumber led to a Canadian tsunami of righteous indignation. While former Foreign Minister Lloyd Axworthy urged Canadians to consider withdrawing from NAFTA, others suggested shutting down hydrocarbon exports until America shaped up on softwood. As the Canadian election campaign opened, it seemed that Prime Minister Martin was running against the United States – and that US Ambassador David Wilkins was deep in the fray.

Yet, despite this mix of genuine grievances and political posturing, there was substantial movement toward a more efficient North American economic system. Reports from the Security and Prosperity Partnership (SPP) Working Groups set up after the Bush-Fox-Martin meeting in Waco, Texas, illustrated a wide array of activities taking place under the political-journalistic radar – some associated with existing NAFTA Working Groups, some apparently newer.<sup>1</sup> These include, for example, a new framework agreement to encourage trans-border online business, the implementation of modifications of rules of origin covering many products, a memorandum of understanding on information exchange and cooperation on public health and safety protection of consumer products and even a harmonized approach to BSE. There were agreements to develop a trilateral Regulatory Cooperation Framework by 2007, to pursue a North American Steel Strategy, to create a trilateral Automotive Partnership Council of North America, and to undertake an accelerated program to promote mutual recognition of results from testing laboratories.

Perhaps more important is the myriad of business and community driven initiatives underway to expand and improve cross-border links. Specialist groups such as the Can-Am Border Trade Alliance provide a critical voice insisting that security and efficiency are not

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<sup>1</sup> Security and Prosperity Partnership of North America; Report to Leaders (June 2005)

incompatible. From the Detroit River International Crossing Project to the improved Lacolle-Champlain Border Crossing and the East-West Maine Highway Study – to name a very few – business and local groups are pressing for new transportation and border infrastructure. The same goes for developments along trade corridors – such as deepening entrepreneurial ties among Winnipeg, Kansas City, Guadalajara, Monterrey, and Mexico’s deep-water Pacific ports. Indeed, Mexico plans to open its first foreign-based customs clearing facility in Kansas City in 2006, 1000 miles from the border.

How much of all of this will actually lead to concrete results is unclear. But three conclusions are evident.

**One conclusion** is that this movement is driven by deepening interdependence. The political economy of North America is no longer composed of three national economies, but rather of links among production clusters and distribution hubs across the continent – links resting on new cross-border alignments among business, communities, and local and state-provincial governments.

The constantly repeated mantra that North America is the world’s largest trade bloc, with the world’s largest bilateral trade relationships, is misleading. The traditional trade paradigm, which encourages us to think of the exchange of finished goods across national borders, is simply not a productive way of imaging the substance of the North American economic system. We are not just trading partners. What flows across our borders are not mainly finished goods. We collaborate in complex, cross-border production systems. For example, a quarter of the more than a billion and a quarter dollars of goods crossing the US-Canada-Mexico borders daily is automotive. But we don’t sell cars to each other. That’s the key: We build them together. What is unsaid, however, is that the cumulative result of cross-border trade and investment is for most practical purposes an integrated economy.

We also share increasingly integrated energy markets; service the same customers with an array of financial services; use the same roads and railroads to transport jointly made products to market; fly on the same integrated airline networks; and increasingly meet the same or similar standards of professional practice. This is what economists call “deep” or structural integration.

This degree of collaboration between countries is unprecedented. But for the result—a new system with levels of integration that often surpass that of the European Union—there is no adequate social science vocabulary. Efforts to force this North American system into standard economic integration paradigms confuse more than they illuminate. Much work on Canada-US relations, for example, draws conclusions based on economic integration as trade theory understands it—that is, as led by trade liberalization and harmonization, moving progressively from free trade area to customs union, to a common market. But North America is already very much a single market without having passed through these subsequent stages.

One vivid example of how North America works today is electricity. Joseph Dukert, an independent energy consultant, observes that “with scant attention from the public or the press,

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North America has become the largest integrated energy market the world has ever seen.”<sup>2</sup> This is not just one-way trade between Canadian and Mexican suppliers of energy and energy hungry US consumers. Several Canadian provinces are net importers of electricity from the US, while others are net exporters, and the US is now a consistent net exporter of gas to Mexico.

The three countries of North America did not start out in the early 1990s to create trilateral energy interdependence, yet that is clearly what we have now. How did this all come about? A lot of push came from business and from changing perspectives on resource availability and markets. Deregulation and its impact on the structure of the industry and markets were vital elements in stimulating change, as was technology. Organizational innovation was also important – the formation of The North American Energy Reliability Council and, of course, NAFTA.

National electrical systems composed of vertically integrated companies no longer exist in North America. Deregulation and technology forced fundamental change in corporate, industry and market structures within a new continental framework.

Agriculture is another example of the complex integration that characterizes large segments of the North American economy. One expert says “agriculture is one of North America's most integrated industries.”<sup>3</sup> In many sectors, products move back and forth across the border all along the value chain. In the cattle and beef sectors, for example, Mexico exports feeder calves to the U.S. market and before BSE, Canada exported fed steers. The United States ships feeders to Canada and breeding stock to Mexico and exports US beef to Mexico and Eastern Canada, while Canadian beef is exported to the western United States.

Why do we still view North America in terms of a trade block? One reason is that resources have not been devoted to studying how things actually work. Neither firms doing business in North America nor research institutions have felt it was in their interest to encourage this kind of in-depth analysis of supply chains and logistics. Nor have governments: Viewing North America as relations among trading partners shelters perceptions of national sovereignty. Trade is less threatening than the reality of structural interdependence, of three nations sharing a single economic system.

**The second conclusion** is that the current two-tier process in which national leaders kick each other in the shins while businesses and bureaucrats in federal, state, and municipal governments and community groups squirrel away to repair problems in the North American system is unacceptable – unacceptable because, the step by step approach (embodied in the SPP) lacks the coherence that is needed now not only to advance economic integration in North America, but even to maintain existing levels of integration.

Building this new North American economic system was very much a bottom-up process, driven largely by corporate perceptions of changes in global and national markets and

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<sup>2</sup> Joseph Dukert, “The Quiet Reality Of North American Energy Interdependence,” Study Group on Mapping the New North American Reality, IRPP. The next paragraphs are drawn from this paper.

<sup>3</sup> Parr Rossen, Director of the Center for North American Studies in the Department of Agricultural Economics at Texas A&M, Interview, December 17, 2004.

environments. Trade liberalization in the GATT and the impact of the collapse of oil prices on Canada and Mexico made changes in the structure of business in North America both necessary and possible, but the process itself was the result of strategies put in place by many individual companies. The flexibility of this process, with little government control, encouraged rapid economic growth and job creation.

From this perspective, NAFTA (and the earlier CUSFTA) can be viewed as responses by governments to developments already underway in the North American economy, efforts to bring regulatory frameworks into line with this emerging economic system and to encourage investors to continue to deepen these new arrangements.

Flows of goods and capital across North America's internal borders increased dramatically following NAFTA, the Mexican financial crisis of 1994 notwithstanding. More and more goods moved within companies, reflecting the deepening of corporate cross-border production, distribution, and supply systems.

But even before 9/11, limits to bottom-up growth began to emerge. In some cases, the limits were political, as in the case of softwood lumber and in disagreements about the cross-border movement of some agricultural goods. Other blockages were vices of virtues. The increase in volume of goods moving across our internal borders outran the capacity of North American physical infrastructure – roads, bridges, railroads, and border crossings. The impact of dysfunctional regulations – the “tyranny of small differences” – increased, too, as the scale of integration increased and as easier gains from bottom up integration had run their course.

“Too many (sometimes purposeless) differences in regulation in the two economies,” George Haynal observes, “may create too much room for systemic friction within an integrated economic zone....”<sup>4</sup>

The bottom line here is that it can no longer be assumed that spill-over from economic integration will be automatic or efficient.

Let us focus on just one example among many. Today, our transportation and border infrastructure barely suffice to support our economy; there is little margin left for future expansion.

Substantial efforts have been made to improve the physical infrastructure at border crossings, particularly since 9/11. The US-Canada Smart Border agreement and the parallel agreement with Mexico marked significant commitments to improve border management. Organizations such as the Border Trade Alliance and the Can-Am Border Trade Alliance and various border communities have initiated dialogues with government agencies that have achieved significant incremental improvement in processes at the borders. Many who work in these agencies understand the problems of complexity and delay and seek better answers. But the pyramiding of requirements and programs, each of which can significantly inhibit quick border processing and all of which together require high degrees of inter-agency coordination

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<sup>4</sup> George Haynal, “The Next Plateau In North America: What’s The Big Idea,” Study Group on Mapping the New North American Reality, IRPP.

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(and typically involve federal, state, and even local governments), as well as new levels of cooperation with business and border communities has created tumult in some instances and threatens what Stephen Flynn calls “a potential train wreck.”<sup>5</sup>

While attention is at least focused on border issues, it is less certain that there is any sense of a North American transportation and logistics structure.

People have talked about “NAFTA Superhighways” for a decade, and it has been clear since the mid-1980s that increased volumes of goods flowing north and south demand new approaches to transportation infrastructure.

The US Intermodal Surface Transportation Efficiency Act (ISTEA) in 1991 was aimed at alleviating bottlenecks along highways and at border crossings. The Act identified 21 “high priority corridors,” and included funding for studies of border congestion as well as highway feasibility studies. The National Highway System Designation Act of 1995 (NHS) added eight more high priority corridors. ISTEA evolved into the 1998 Transportation Equity Act for the 21<sup>st</sup> Century (TEA-21), which created an additional 14 high priority corridors. This Act contained specific directives on trade corridor planning and border facility improvements.

Entrepreneurial enthusiasm and the prospect of new funding encouraged the formation of various “trade corridor” organizations – typically groups of businesses and metropolitan and often state government agencies that would create an organization to capture some part of the new north-south flow.

The highway funds became a pot into which Congressional etiquette encouraged everyone to dip his fingers. The number of designated high priority corridors increased quickly, and everyone sought to earmark funds for his/her own corridors. The result is that the latest map of high priority corridors looks like a plate of spaghetti. Highways and border crossings have been improved here and there, but no movement is visible toward developing a true North American highway system, and certainly nothing like the bruited about plans for super multimodal corridors, wired with fiber-optics and the latest digital frills, has come about. If anything, the general state of major highways in the US has declined over the past decade and it is hard to imagine that Mexico or even Canada have done better.<sup>6</sup>

Trucks carry some three-quarters of North America’s freight traffic, but the volume, if not the share, carried by rail has grown greatly. Mergers and alliances in the railroad industry in the mid-1990s seemed to be building networks that would provide seamless rail service from Canada to Mexico. From a security perspective, railroads are easier to monitor and control; it is much easier, once technology is in place, to get trains across borders. But no discussion has taken place on expanding the North American rail system, nor is there any sense of where, how, or with whom such discussions might begin.

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<sup>5</sup> See Stephen Flynn, “The False Conundrum: Continental Integration Versus Homeland Security,” in Peter Andreas and Thomas J. Biersteker, eds, *The Rebordering of North America: Integration and Exclusion in a New Security Context* (New York & London: Routledge, 2003).

<sup>6</sup> The “2003 Report Card” by the American Society of Civil Engineers, for example, awards a D- for maintaining existing roads and bridges. (<http://www.asce.org/reportcard/index.cfm?reaction=full&page=6#roads>)



Warning flags are up. Mary Brooks from Dalhousie University, Halifax, Nova Scotia, a specialist on road and rail transportation, warned the Study Group that “there is a danger of stalling the integration of the manufacturing sector if transport harmonization is further delayed. Rising security concerns post 9/11 have resulted in increased border delay, which has damaged the credibility of the just-in-time system. The result has been to boost buffer stocks, and force just-in-time supply chain managers to re-examine their sourcing options; it is of concern to Canada that many US companies will source domestically rather than within NAFTA due to border uncertainty.”<sup>7</sup>

Similarly, an automotive specialist, Isabel Studer, writes “The auto industry is widely seen as one of the most integrated North American industries. But the protectionist environment in the United States, the continued existence of costly rules of origin, expensive regulations, and different standards – particularly between Mexico and its two North American partners – are undermining the competitive potential derived from achieving further integration in the North American auto industry.”<sup>8</sup>

The SPP may mark a significant step forward in this situation. From one perspective at least, the SPP working group report suggests that elements within the three NAFTA governments do understand that the North American economic system is not simply a trade bloc but a deeply integrated economic system, and that governments must be more active in creating the conditions for further integration. Certainly agreements on a trilateral Regulatory Cooperation Framework and on sectoral strategies in steel, autos, and energy suggest a new view of North America. (Another perspective, of course, is that the report represents a great pile of things that are partially underway, that might be underway, or that possibly could be underway – all compiled to put as good a face as possible on the project.)

Yet, even in the most optimistic reading, the SPP provides little sense of what we really want from all of this or how we can get there. In each of the cases we have described, opportunities to resolve impediments to integration are best – indeed, perhaps only – found within a wider North American framework. It is difficult to seize these opportunities, however, because we lack a vision of what North America might become. The result is that efforts to resolve problems are fragmented and lack coherence. Where progress occurs, it is almost always piecemeal. The SPP does not change this situation; it offers no vision of why we are doing this or what we hope to accomplish.

North American economic integration has been driven by corporate strategies and structures. Now, limits to this bottom up process have been reached and clear decisions are required on key issues of security, borders, transportation, energy, and immigration. At this point, the incremental approach is simply not enough.

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<sup>7</sup> Mary Brooks, “Mapping the New North American Reality: The Road Sector,” Study Group on Mapping the New North American Reality, IRPP.

<sup>8</sup> Isabel Studer, “The North American auto industry,” Study Group on Mapping the New North American Reality, IRPP.

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**The third conclusion** is that integration-by-stealth is also unacceptable. NAFTA became very quickly the lightning rod for all fears about globalization. If we hope to get beyond this, these concerns must be confronted. At the political level, there has been widespread failure to understand, let alone articulate and support, this new environment. Governments have lacked the appropriate conceptual tools and vocabulary to adequately address the new North America in policy terms. North American prosperity is intimately linked to the continent's economic flows, but economic policy makers in the NAFTA countries continue to downplay this reality. Instead, they continue to act as though North America and NAFTA is the same thing: a three-way trade agreement among three sovereign countries. Politicians are reluctant to redefine national interests in North American terms, raising questions of our capacity to seize the opportunities offered in this new environment. NAFTA itself laid no foundations for identifying or solving problems that would emerge from deeper integration. It provided no vehicles for planning, or even thinking about what might come next. That's why the SPP process seems to hang in mid-air.

The danger is that without some overall sense of where we are going and why, the many steps now underway may not lead anywhere.

The time has come to examine carefully what is happening in North America, to explore what our interests are in this emerging continental system, and to open a dialogue about different, even competing, visions of North America.

We need to create a new, "North American" way of viewing policy options. We need a vision of North America that establishes objectives for deliberate actions to supplement the bottom-up process of North American integration, a vision that shapes discussions among the NAFTA nations, economic interests, and groups of civil society.

The core of this vision would be the clearest understanding of the interests North Americans share in a freer continent-wide economic system and in an effective, cost-efficient, and secure infrastructure that supports this system.

This vision would provide the context that the SPP process so clearly requires. It would focus attention on seeking ways to solve problems such as eliminating roadblocks and dismantling barriers to continuing integration, reaching out to groups that have not yet participated in the benefits of integration, sharing information, coordinating policy in key issue areas, and capturing new gains from deeper integration. It would guide us in thinking about new institutions. Here, Robert Pastor has written most eloquently, for example, about a North American Court on Trade and Investment and a "North American Parliamentary Group" composed of members from the three national legislatures.<sup>9</sup>

Efforts to revitalize the movement toward economic integration in North America should not be perceived as the negotiation of a grand new bi- or tripartite trade deal zero-sum trade negotiation but as a collaborative effort to enunciate an accurate and compelling vision of the

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<sup>9</sup> Robert Pastor, *Toward a North American Community; Lessons from the Old World for the New* (Washington, DC: Institute for International Economics, 2001:119-135).

North American economy, of the interests we share in this system and of steps that will make it safer, freer, more inclusive and more productive.

Instead of compressing the wide range of distinct issues into a single negotiation, discussions should involve many participants – in think-tanks, universities, expert commissions, and groups of “wise people” and government agencies across the continent. It should involve perspectives from different regions, different economic and social sectors, and those who oppose as well as support integration. It should anticipate, given the regional architecture of North America and our federal systems of government, that proposed solutions might differ from region to region.

We need desperately to stimulate research on this new North America. While some work has been done (for example, on a North American customs union), we need to promote much more investigation that probes more deeply into the evolving shape of the North American system.

The process must get outside of the beltways – it must give voice to community and economic leaders who are most deeply involved in this new system. If efforts to build a new North American system imply the creation of a new Otto-Wash-Mexico City corridor, they will lack legitimacy in many parts of the continent.

The process would serve another valuable purpose. It would accustom leaders and publics to think in terms of North American answers to critical economic and social issues, and to legitimize the notion that key issues that affect communities throughout the US can be resolved best by North American solutions. It is vital to identify key leadership constituencies that drive efforts to maintain open borders and to increase the efficient operation of the North American economy. The impetus for making the political decisions that are needed to build a more open, efficient, and representative North American system must come from constituencies that feel directly the impact of economic integration.

Jean Monnet, the “father of the European Community,” felt that people could only unite behind a vision they shared. Monnet also understood the importance of building informed and committed constituencies, groups that would press governments to realize the vision. Through the Action Committee, Monnet sought to mobilize constituencies that would support a European Community. He describes the “constant outside pressure” that the Action Committee brought to bear, and “the moral influence the Committee exerted on the established authorities in each country.”<sup>10</sup>

In North America, constituencies already exist. They consist of companies that run continental production, supply, and marketing systems; cities where jobs depend upon efficient North American transportation and logistics networks; and communities living on the borders. Most of their leaders understand how these systems and networks operate.

The task is to mobilize these groups to educate their representatives in state and national capitals about the impact of North American economic integration on jobs and economic

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<sup>10</sup> Jean Monnet, *Memoires* (1978: 408).

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development in their own communities. To apply the “constant outside pressure” and “moral influence” Monnet described—to create a true voice for North American integration in our governments. To create a voice in our governments that enunciates the goals of North America integration and inclusion and presses for new policies to achieve these objectives.

There is a North American reality – a complex North American system, many sectors of which are characterized by deep structural integration – that is deeply misunderstood. Canadians, Mexicans, and Americans, too, depend profoundly on this system. After a decade of rapid growth, however, and in the wake of the events of 9/11, we see evidence that integration has slowed and that the North American economic system is becoming more fragile. To reinvigorate the process of integration requires the mobilization of informed and active constituencies that will press the three NAFTA governments to take new, constructive steps forward.