As prepared for delivery

Statement of
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For North America
before the
Committee on Finance
of the
United States Senate
September 11, 2006

Mr. Chairman, Members of the Committee:

Thank you for the opportunity to appear before the Committee today. I am pleased to represent the Office of the United States Trade Representative and provide an overview of our trade and investment relationship with our NAFTA partners, Canada and Mexico.

The North American Free Trade Agreement (NAFTA) has defined our commercial relationship with Canada and Mexico since its entry into force on January 1, 1994. The NAFTA is a comprehensive trade agreement, covering trade in goods, services and investment, as well as government procurement, intellectual property rights, standards, and dispute settlement. Twelve years after implementation of the NAFTA began, essentially all of the agreement's transitional implementation periods are now complete with the exception of a handful of tariffs that fall to zero on January 1, 2008.

In evaluating the impact of the NAFTA on both the United States and its partners, the appropriate place to start is with trade and investment flows.

- For goods, our total trade (imports plus exports) with Canada and Mexico has more than doubled from pre-NAFTA levels. Growth in trade with our NAFTA partners exceeds growth with the world as a whole. Mexico has passed Japan to become our second largest trading partner and export market, trailing only Canada.

- There has also been a qualitative transformation in goods trade; in the 1980s, 80 percent of Mexico's exports were oil and raw materials. Today, value-added manufactured goods account for 90 percent of Mexico's exports, an indicator that Mexico has joined the United States and Canada as part of a continent-wide market of producers and consumers.

- Much of the recent concern about NAFTA is with agriculture. In fact, growth in agricultural trade has paralleled growth in total trade since 1994. U.S. agricultural exports to Canada and Mexico have grown by 98 percent since 1994, nearly matching the 101 percent total growth in U.S. total exports to those countries over the same period. Canada and Mexico are our top two agricultural export markets.

- Many of the most impressive export successes for the United States are also agricultural. Mexico is our largest market for a wide range of products – beef, dairy, swine, rice,

turkey, apples, soymeal, sorghum, and dry beans among them. Our share of Mexico's imports is above 90 percent, due in part to the preferential access we have under the NAFTA for five of these seven products. In 2005, Mexico was also our second largest market for corn, port, poultry meats, soybeans, wheat, and pears.

- NAFTA has solidified Canada's position as our largest trading partner. More trade crosses the Ambassador Bridge between Detroit and Windsor than moves between Spain and France.[1]

- U.S. exports of services to Canada and Mexico have grown by 75 percent since 1993. In 2004, the last year for which we have complete data, the United States exported $47.7 billion in private commercial services to our NAFTA partners, and maintained a trade surplus of $14.2 billion.

As a result of the NAFTA and the earlier bilateral free trade agreement, the phase-out of tariffs between the United States and Canada was completed on January 1, 1998, except for tariff-rate quotas which Canada maintains on certain supply-managed agricultural products. Nearly all of the NAFTA tariff cuts with Mexico have been implemented, except for the handful of remaining items whose tariffs will be eliminated in 2008. Since 1994, the average U.S. duty on Mexican goods has fallen to about 0.1 percent in 2005. Mexico's duties on U.S. goods are even smaller -- 0.003%.

By establishing a framework to promote a secure and predictable environment, investment in each of the NAFTA countries have grown. The NAFTA partners are investing more in each others' economies, and the rest of the world is also investing more in our economies.

- This change is especially important for Mexico. Since 1994, annual Foreign Direct Investment (FDI) inflows have averaged $15 billion, compared to less than $3 billion in the 1980s. Mexico's outward FDI flows have increased fourteen-fold since 1990, and it is now one of the largest developing country overseas investors.

- The United States accounts for approximately two-thirds of total foreign direct investment in Canada. U.S. investment is concentrated in the manufacturing, finance, and mining sectors.

- Investment growth in Canada and Mexico has not come at U.S. expense. Even excluding housing, U.S. business investment has risen by 104% since 1993, compared to a 37% rise between 1981 and 1993.

How much the NAFTA affected the changing trends in goods and services trade and investment cannot be measured precisely. This is especially true when looking at broader measures of economic performance since the NAFTA entered into force. However, there are a wide range of economic indicators that have grown more rapidly since the NAFTA was implemented.

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[1] Derived from GAO report 02-595R, page 1 and the CIA World Factbook.

- For the United States, job creation, industrial production, real compensation for manufacturing workers, business productivity and investment have all increased by higher rates in the period since 1993 compared with prior years.

  - -- U.S. employment rose from 112.2 million in December 1993 to 134.4 million in December 2005, an increase of 22.2 million jobs, or nearly 20 percent. The average unemployment rate was 5.1 percent in the period 1994-2005, compared to 7.1 percent during the period 1982-1993.

  - -- U.S. industrial production – 78 percent of which is manufacturing – rose by 49 percent between 1993 and 2005, exceeding the 28 percent increase achieved between 1981 and 1993.

  - -- Growth in real compensation for manufacturing workers improved dramatically. Average real compensation grew at an average annual rate of 2.3 percent from 1993 to 2005, compared to just 0.4 percent annually between 1987 (earliest data available) and 1993.

- U.S. business sector productivity rose by 2.6 percent year between 1993 and 2005, or by a total of 36.2 percent over the full period. Between 1981 and 1993 the annual rate of productivity growth was 1.8 percent, or 24.3 percent over the full 12 year period.

- Mexico has seen consistent GDP growth - 40 percent since 1993 - and annual real wage growth since 1995. This has been accompanied by much lower interest rates and rapid development of consumer finance services, such as home mortgages that have created a boom in consumer lending and home purchases.

- Real GDP in Canada grew from C$773.5 (1997 Canadian dollars) in 1993 to C$1,157.7 in 2005, an increase of nearly 50 percent. Real Canadian GDP per capita surged by 33 percent over the same period. Canadian unemployment fell from 11.2 percent in 1993 to 6.7 percent last year.[2]

<u>NAFTA's Ability to Respond to Changes</u>

The NAFTA remains a vibrant agreement, one that has been able to respond to changes in production methods and sourcing arrangements. For example, the NAFTA establishes schedules for the elimination of tariffs, but the agreement also allows the Parties to accelerate the elimination of tariffs. Since the entry into force in 1994, the NAFTA partners have accelerated the elimination of tariffs four times, in 1997, 1998, 2000 and 2001. The total value of trilateral trade covered by these four rounds of tariff cuts is approximately $28 billion.

Over time, manufacturers often change the way they design and build products. They choose new suppliers, change the materials used in the production of a good, or improve their products by using new parts. Since 2002, the NAFTA partners have worked to update the NAFTA rules

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[2] See "Economic Indicators," on the website of the Department of Foreign Affairs and International Trade, http://www.international.gc.ca/eet/pdf/economic_indicators-en.pdf

of origin, the regulations that specify which goods are eligible for preferential treatment under the agreement. These changes have allowed U.S. companies to export their products duty-free to our NAFTA partners, saving thousands, sometimes millions of dollars in duties. The NAFTA partners have implemented three sets of changes to the rules of origin, in 2002, 2004 and 2006. The total value of trade covered by these changes exceeds $39 billion. We are working to implement a fourth set of changes in 2007.

Recent Successes

In 2006, the United States has resolved a number of our thorniest trade issues with Canada and Mexico.

- In January, the United States and Mexico signed a bilateral agreement on trade in tequila, which will ensure that U.S. bottlers can continue to import tequila in bulk form. The agreement imposes no obligations on the United States beyond current practice.

- In March, the United States and Mexico signed an agreement to promote bilateral trade in cement. The agreement will allow for additional supply of cement at a time of strong domestic demand following the devastation of Hurricanes Katrina and Rita. The agreement also ends all NAFTA and WTO litigation on cement from Mexico, which had stretched back 16 years.

- In July, the United States and Canada reached final agreement on softwood lumber, a dispute that has dogged trade relations for 20 years.

- In August, the United States and Mexico reached an agreement on trade in sweeteners, which puts the two countries on a glide path towards full implementation of the NAFTA sugar provisions in 2008. Mexico agreed to remove its beverage tax and duties on drinks sweetened with high fructose corn syrup and other non-sugar sweeteners, and the United States agreed to an increase in the amount of duty-free sugar that Mexico is allowed to export to the United States. Mexico is providing duty-free access for an equivalent volume of high fructose corn syrup (HFCS).

Current Challenges

To address the challenges the NAFTA framework faces today and in the future, there are three circumstances to consider.

The first is implementation of the remaining NAFTA commitments by January 1, 2008.

As I mentioned earlier, all tariff cuts between the United States and Canada have already been implemented, and the remaining tariffs between the United States and Mexico will be eliminated on January 1, 2008. While less than one percent of our NAFTA trade with Mexico remains subject to duties, final removal of these duties has raised concerns in some sectors. As the three NAFTA trade ministers made clear at their annual oversight meetings in Mexico this past March, they are committed to full implementation of the NAFTA and will not consider any reduction to our NAFTA obligations.

A second set of challenges must take into account the changes in global trade since the NAFTA entered into force. Simply put, each of the NAFTA partners have been reducing trade barriers with other countries, meaning the margins of preference provided by the NAFTA are shrinking.

- In 1993, for example, the average United States duty on imports from all countries in was 3.2 percent. By 2005, it had fallen to 1.4 percent. Mexico still has a larger margin of preferential access today than it did before NAFTA implementation began, but it has begun to fall.

- The United States also faces more competition in the Mexican and Canadian markets: Mexico has free trade agreements with 42 other countries today, compared with one (Chile) in 1994. Canada has concluded three additional FTAs since 1994, and is currently engaged in negotiations with the Republic of Korea.

- And, of course, all three countries face the challenge of increased competition with economies such as China and India.

A third set of challenges is how to best address today's security concerns while not creating trade barriers. This is the fundamental challenge of the Security and Prosperity Partnership of North America, a trilateral initiative launched in March 2005. The SPP seeks to enhance the security, prosperity, and quality of life for the citizens of all three countries while respecting the sovereignty and unique cultural and legal heritage of each country. The SPP builds on and complements the NAFTA, and we can use both processes to advance common strategic North American goals. For example, under both the NAFTA and the SPP, USTR is soliciting proposals from U.S. industries to liberalize and simplify NAFTA Rules of Origin, making it easier to use the benefits of the duty-free access that the NAFTA provides.

To conclude, with the NAFTA firmly in place, the United States and its NAFTA partners have not only become better customers for each other but better neighbors, more committed partners, and effective colleagues in a wide range of trade-related international organizations.

I am pleased to answer any question you may have.