

# The Strategic Importance of North America to U.S. Interests

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## Hearing on The Strategic Importance of the Western Hemisphere: Defining U.S. Interests in the Region

Mr. Chairman, Ranking Member, and Members of the Subcommittee: Thank you for the invitation to testify today. I am grateful for the Subcommittee's interest in the Council on Foreign Relations' Independent Task Force on North America's report and pleased to have this opportunity to discuss the strategic importance of North America for U.S. interests. If it would be acceptable to the Chair, I'd like the entirety of the referenced task force report to be entered into the record. As always, I am eager to hear your advice and counsel.

North America today is a global economic powerhouse, home to almost five hundred million people living in three vibrant democracies. Together the three nations account for over 26 percent of global GDP. Totalling roughly \$20 trillion, their combined economies outpace the European Union in economic production. And though the United States makes up the majority of the economic weight (in terms of GDP and as the home to almost a third of the

world's largest companies), both Canada and Mexico rank among the top fifteen largest global economies. North America is also one of the most economically dynamic regions of the world today—the World Bank predicts the region will outperform average global GDP growth in 2015.

Because of geography, markets, and the choices of millions of individuals and thousands of companies, North America has become one of the most integrated and interdependent regions in the world. Sharing 7,500 miles of peaceful borders, Canada and Mexico now play vital roles in the United States' stability, security, and prosperity. It is time to build on past work and advance this partnership to a new stage. If the three North American countries deepen their integration and cooperation, they have the potential to improve the standards of living of their citizens and to shape world affairs for generations to come.

Several recent developments make a North American vision particularly attractive. These include advantageous demographics, a shared skilled labor force, and recent economic reforms in Mexico. Today, I want to focus on two particular areas of opportunity: energy and economic competitiveness.

## **Energy**

North America's energy landscape is changing dramatically. In 2005, net imports made up 60 percent of U.S. fuel consumption. The growing gap between the United States' energy demand and domestic supply added to worries about the U.S. trade deficit, economy, and security.<sup>1</sup> Today, U.S. oil import dependence has dropped to less than one-third of total consumption, and the country is shifting rapidly from energy scarcity to opportunity. Rising shale oil and gas production in the United States, increasing exploration and development in the Canadian oil sands, and landmark reforms in Mexico's energy sector have led many experts to predict the potential—especially for North American natural gas—for self-sufficiency and even surplus in the coming decades. The growing production and regional diversification of energy sources will boost North America's energy security and competitiveness.

As this energy renaissance evolves, the decisions the United States, Canada, and Mexico make about energy will have major implications for their own and their neighbors' economies, national security, foreign policy, and environments. As a result, energy should become a fundamental pillar of North America's new partnership.

One area for cooperation is the integration of energy matrices and the strengthening of continental energy infrastructure. The United States should work with its neighbors to increase energy connections. From gas and oil

pipelines to electricity grids, deeper integration of cross-border infrastructure would make supply more stable and resilient, benefiting companies, workers, and communities more broadly.

North America can also lead the way in energy efficiency. Harmonizing environmental standards and policies, and cooperating in the development and diffusion of technologies to promote energy conservation and lessen carbon costs should also be part of developing a regional energy strategy.

## **Economic Competitiveness**

Over the past two decades, North America's economic ties have deepened dramatically by almost all measures; they have the potential to develop even further. The region's trade grew from less than \$300 billion in 1993 to over \$1.1 trillion in 2013, making the United States, Canada, and Mexico each other's most important trading partners.<sup>ii</sup> Today, the United States exports more than four times as much to Mexico and Canada as it does to China and more than twice as much as to the European Union.<sup>iii</sup> Cross-border investment also skyrocketed, rising fivefold since 1993 to total an investment stock of some \$791 billion by 2012.<sup>iv</sup> While the majority comprises U.S. foreign direct investment in its neighbors, \$333 billion of it reflects Mexican and Canadian investments in the United States—particularly in the manufacturing, insurance, banking, and consumer sectors.<sup>v</sup>

The type of trade in North America has also changed—shifting from primarily finished goods, to pieces and parts that move back and forth across borders as part of regional supply chains. A study by the National Bureau of Economic Research reported that on average 40 percent of the value of products imported from Mexico and 25 percent of those from Canada actually come from the United States; the comparable input percentage with the rest of the world is about 4 percent.<sup>vi</sup> This means that of the \$280 billion in goods that the United States imported from Mexico in 2013, some \$112 billion of the value was created in the United States; for the \$332 billion that the United States imported from Canada, the value created in the United States was \$83 billion. In comparison, less than \$20 billion of the value from the \$440 billion of U.S. imports from China came from U.S. workers.<sup>vii</sup>

A large part of North America's economic dynamism stems from its interdependence, which accelerated following the 1993 North American Free Trade Agreement (NAFTA). As the continent has moved closer to becoming a joint innovation, design, production, and service platform, the United States, Canada, and Mexico have become more efficient and competitive together. This has mattered for companies and workers—supporting profits and employment. A recent Peterson Institute for International Economics report estimates that U.S. exports to Canada

and Mexico supported 2.6 million and 1.9 million U.S. jobs respectively.<sup>viii</sup>

“Made in North America” should be a foundation for U.S. foreign policy. This means working toward the free and unimpeded movement of goods and services across North America’s common borders.

Today there are two main types of barriers. The first are physical limitations at the border. Investment in infrastructure lags far behind the increased flows of people, cars, trucks, and goods, hindering the competitiveness of North America as a region. More investment is needed in auxiliary roads, rail infrastructure, bridges, airports, and ports that enable cross-border flows and then connect them with the larger U.S. economy. Congress has an important role to play in making infrastructure investment a priority and passing funding legislation. In addition, it should support the expansion of successful preclearance programs that expedite the movement of trusted goods and travelers across borders, as these too speed commerce.

Along with physical barriers are regulatory and bureaucratic ones. Rules of origin, non-tariff barriers, and multiple customs filings slow or impede regional trade. The U.S. government, working closely with the private sector, should review and revise NAFTA’s rules of origin provisions to lower the cost for companies operating in the region. The United States should address divergent regulations, working toward mutual recognition or harmonization through the U.S.-Mexico High-Level Regulatory Council and the U.S.-Canada Regulatory Cooperation Council.

Bureaucratically, the United States should accelerate plans to introduce a North American “single window” customs system that eliminates multiple filings. Together these changes would streamline regional commerce further, benefiting producers and workers in all three nations.

As NAFTA reaches its twentieth anniversary, there is much to applaud in terms of advances in trade, investment, and productivity. By expanding regional exchanges in goods and services, boosting cross-border investment, deepening the integration of production processes, it helped maintain and create many jobs, while also producing higher quality goods at lower prices, benefiting North American businesses, workers, and consumers.

Still, the gains have not been spread evenly. NAFTA left some better and some worse off, and it has yet to lead to the promised economic convergence between the three nations. In part, these shortcomings stem from the initial overselling of the trade agreement. But they also reflect the need for a twenty-first century upgrade in the economic relationship between the three partners—addressing the issues that were left off the table (energy and the movement of people, among others), as well as the new issues that have emerged or transformed over the last two decades, from

intellectual property rights to regulatory coherence, and from e-commerce to cyber security. The Trans-Pacific Partnership (TPP) negotiations, of which both Canada and Mexico are a part, provide an opportunity to address many of these limitations, strengthening the North American production platform.

Finally, North America increasingly shares a workforce, as companies and corporations make products and provide services across all three countries. Within these integrated supply chains, employees in one country depend on the performance of those in another; together, they contribute to the quality and competitiveness of final products that are sold regionally or globally.

Led by the United States, the region boasts many of the top academic institutions in the world. But ensuring quality education at the elementary and secondary levels has been a struggle—the Program for International Student Assessment (PISA) test scores put Mexico at the bottom of the thirty-four Organization for Economic Cooperation and Development (OECD) countries in reading, science, and math, and the United States mired in the middle. Only Canada makes it into the top five in each category.

Given the interlacing of North America's workforces, the United States should work with Canada and Mexico to develop a regional education and innovation strategy. This strategy should include a diversity of public and private education and technical training programs, incorporate new technologies, increase affordability, expand skills certification, and connect students to private employers. It should also promote regional research through professional academic exchanges and the creation of a North American network of laboratories for basic research.

## **Conclusion**

Unlike so many U.S. foreign policy priorities that strive to reduce differences and hostilities, North American relations focus primarily on identifying and building upon similarities and shared interests. One promising area is energy, where the changes occurring are already giving North America a global competitive advantage, and where further coordination can ensure reliable, affordable, and environmentally sustainable energy production, strengthening each country and North America as a whole. A second vital area is economic competitiveness. As the United States works to jumpstart its own economic growth, North American production provides one of the most promising paths forward. And the benefits of a stronger and more integrated region extend beyond energy and commerce, influencing basic security, stability, and prosperity. Working more closely with Canada and Mexico, the United States today has an opportunity to promote a positive agenda, benefiting citizens in all three nations.

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- <sup>i</sup>. U.S. Energy Information Administration, “AEO2014 Early Release Overview,” U.S. Energy Information Administration, December 16, 2013, [http://www.eia.gov/forecasts/aeo/er/early\\_production.cfm](http://www.eia.gov/forecasts/aeo/er/early_production.cfm).
- <sup>ii</sup>. U.S. Census Bureau, “U.S. Trade in Goods with Mexico,” U.S. Census Bureau, accessed March 19, 2014, <http://www.census.gov/foreign-trade/balance/c2010.html>; U.S. Census Bureau, “U.S. Trade in Goods with Canada,” U.S. Census Bureau, accessed March 19, 2014, <http://www.census.gov/foreign-trade/balance/c1220.html>.
- <sup>iii</sup>. U.S. Census Bureau, “U.S. Trade in Goods with China,” U.S. Census Bureau, accessed December 4, 2013, <http://www.census.gov/foreign-trade/balance/c5700.html>; U.S. Census Bureau, “U.S. Trade in Goods with European Union,” U.S. Census Bureau, accessed December 4, 2013, <http://www.census.gov/foreign-trade/balance/c0003.html>.
- <sup>iv</sup>. Organization for Economic Cooperation and Development, “FDI Positions by Partner Country,” accessed August 11, 2014, <http://www.oecd.org/corporate/mne/statistics.htm>.
- <sup>v</sup>. Bureau of Economic Analysis, “Foreign Direct Investment in the U.S.: Balance of Payments and Direct Investment Position Data,” U.S. Department of Commerce, accessed July 6, 2014, <https://www.bea.gov/international/di1fdibal.htm>.
- <sup>vi</sup>. Robert Koopman, William Powers, Zhi Wang, and Shang-Jin Wei, “Give Credit Where Credit is Due: Tracing Value Added In Global Production Chains,” National Bureau of Economic Research, p. 38, September 2010, <http://www.nber.org/papers/w16426.pdf>.
- <sup>vii</sup>. U.S. Census Bureau, “U.S. Trade in Goods with Mexico,” U.S. Census Bureau, accessed March 19, 2014, <http://www.census.gov/foreign-trade/balance/c2010.html>; U.S. Census Bureau, “U.S. Trade in Goods with Canada,” U.S. Census Bureau, accessed April 28, 2014, <https://www.census.gov/foreign-trade/balance/c1220.html#2013>; U.S. Census Bureau, “U.S. Trade in Goods with China,” U.S. Census Bureau, accessed March 19, 2014, <http://www.census.gov/foreign-trade/balance/c1220.html>.
- <sup>viii</sup>. Gary Clyde Hufbauer, Cathleen Cimino, and Tyler Moran, “NAFTA at 20: Misleading Charges and Positive Achievements,” Peterson Institute for International Economics, p. 2, May 2014, <http://www.piie.com/publications/pb/pb14-13.pdf>.