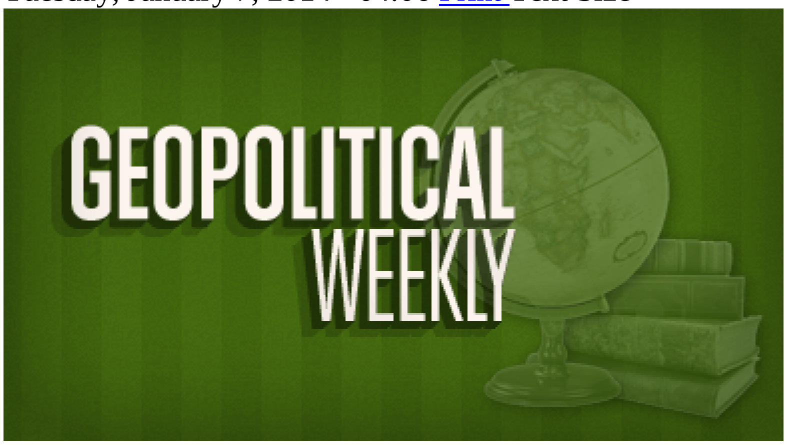
NAFTA and the Future of Canada, Mexico and the United States

Geopolitical Weekly
Tuesday, January 7, 2014 - 04:06 Print Text Size



Stratfor

By Marc Lanthemann

The 20th anniversary of NAFTA's implementation on Jan. 1 has revived some of the perennial arguments that have surrounded the bloc since its inception. The general consensus has been that the trade deal was a mixed bag, a generally positive yet disappointing economic experiment.

That consensus may not be wrong. The history of the North American Free Trade Agreement as an institution has been one of piecemeal, often reluctant, integration of three countries with a long tradition of protectionism and fierce defense of economic national sovereignty. While NAFTA was a boon for certain sectors of the economy, particularly the U.S. agriculture industry, the net effect of the world's second-largest trade bloc remains somewhat unknown.

The debate over NAFTA can, however, obscure some fundamental realities about the future of North America and its three major countries. While the formation of the trading bloc represented a remarkable political achievement, NAFTA has remained a facilitating institution whose success has mirrored the ebb and flow in the slow but inevitable economic integration of the United States, Mexico and Canada. What lies ahead for the three countries will not so much be the result of NAFTA as NAFTA will be the result of the strong geopolitical imperative binding the three together. Washington, Mexico City and Ottawa are tied into major global and regional trends that Stratfor has been following over the years, trends that continue to point to a comparatively bright future for the North American triad.

Core North America

North America proper extends from the Arctic reaches of Canada to the Darien Gap, a thin, swampy strip of land linking Panama with South America. But given the idiosyncratic and fundamentally different geopolitical realities of the Central American isthmus -- encompassing Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama -- a simpler and more appropriate definition of North America would be the continental landmass from the Arctic to the southern Yucatan Peninsula in Mexico.

There is little question that North America, by this definition, has been blessed by geography. There are only three countries in an area more than twice the size of Europe. Each of them enjoys a coastline on both of the globe's major oceans, providing critical buffers and serving as jumping-off points for domestic and international trade. Natural resources are abundant, as are overall arable lands, all facilitated by naturally integrated river transport networks at the heart of the continent.

The overwhelming beneficiary of these geographic advantages has, of course, been the United States, but its meteoric rise as a global hegemon was also in great part due to the fact that neither of its neighbors has posed a threat. The wealth of the United States, combined with the physical barriers of the three northern Mexican deserts and to a lesser degree the Great Lakes, ensured that America's military power could preserve the borders dividing the three countries -- yet those boundaries are not so insurmountable as to hinder trade. The definition of those borders with Canada and Mexico during the 19th century allowed Washington to concentrate on dominating the world's oceans, eventually giving it control over most of the world's trade and the ability to deploy its power to any corner of the globe.

Canada was not always a friendly neighbor. During the War of 1812, Canada was the launching pad for a British military campaign that resulted in, among other things, the burning of the White House. This stance changed definitively in the aftermath of World War II, when the British Empire -- Canada's previous patron -- began its decline in earnest and Ottawa had to become more integrated with and dependent on the booming U.S. economy. By the time the United States and Canada signed a bilateral free trade agreement in 1988, the two countries had been each other's largest trade partners for decades. Today, China is Canada's second-largest export destination, and yet China takes just 6 percent of the goods that the United States does.

Mexico's role and history in North America are a bit more complex. The country controlled the largest territory and had been the dominant economic and military power on the continent for centuries under the aegis of the Spanish Empire. But the Mexican War of Independence fragmented the already-weakening country and shifted the balance of power in favor of the United States. With the United States having received Florida from Spain earlier in the 19th century**,** the Texas War of Independence and the Mexican-American War allowed Washington to gain the vast swath of land between Louisiana and the Pacific Ocean -- including the strategic ports of California and the approach to the Mississippi River. With the border settled (figuratively and literally), the two countries finally began economic cooperation in earnest.

With its large pool of cheap labor and its geographic proximity to the United States, Mexico became a vital economic variable for Washington. Setbacks did occur over time, in particular Mexico's expropriation and nationalization of its oil industry in 1938 and the immigrant repatriation crisis of the 1930s. But geography and the economic complementarity between the world's largest consumer market and its neighboring low-end manufacturing economy continued to make the relationship inevitable. Today, Mexico exports about $1 billion worth of goods per day to the United States, making it the United States' single-largest source of imports and its third-largest trading partner. Issues do remain, particularly over the question of immigration, legal or otherwise, with both countries trying to find a balance between competitive growth and stable domestic employment.

Key Geopolitical Trends

The three North American countries find themselves at the epicenter of key geopolitical trends, which outline a relatively bright future for the group. Many of these trends have been playing out for decades, while others have been set in motion only in the past few years.

Stratfor has identified three major pillars that defined the global system following the Cold War. The first was the integration of Europe into the massive supranational entity known as the European Union. The second was the emergence of China as the center of global industrial growth. And the third was the uncontested U.S. position as the world's only superpower.

Since 2008, two of these pillars have become increasingly fragile. The European Union continues to be mired in an existential economic, political and social crisis. It is unable to harmonize the divergent interests within itself, yet it also is unwilling to pay the price of rupture. The European Union has in fact become a cautionary tale for the proponents of a beefed up, more organized version of NAFTA.

Meanwhile, China has all but accepted that the time of double-digit growth rates based on cheap labor is gone. Beijing is now focusing on the delicate task of transitioning a 1.3 billion-strong nation with staggering economic disparities to a more sustainable model.

The United States, battered by the 2008 crisis, continues to recover economically and remains the strongest of the three pillars. It also remains the world's overwhelmingly dominant military power. But Washington has also begun adopting a more nuanced (and cost-effective) foreign policy that shies away from direct entanglement in favor of creating balances of power to stabilize strategic regions of the world, particularly the Middle East, which has consumed U.S. attention for much of the past decade. It remains a near certainty that the United States will continue to dominate the global system for the foreseeable future, a position that will benefit its two neighbors as they continue to be tightly integrated with the American economy.

But while the United States' continued global pre-eminence is a key provider of stability for North America, one must look south for the continent's source of dynamism in the decades ahead.

Mexico's Bright Future

Mexico's demographic profile is among the world's most promising. Its labor pool has been expected to grow by 58 percent between 2000 and 2030 while China's is slated to decrease by 3 percent over the same period.

From aerospace engineering in Queretaro to footwear assembly in Guanajuato, Mexico is shaping up to be a competitive and flexible manufacturer. Mexico's geographic proximity to the United States and high levels of internal wage and skill disparity made its manufacturing sector more competitive than China's after 2012. Yet Mexico also seems to have found a way to avoid the Chinese curse of depending on low-cost manufacturing. High-tech exports accounted for 17 percent of Mexican gross domestic product in 2012, while cars amounted to a quarter of all Mexican exports that same year. The high tariffs on high-tech products manufactured outside of NAFTA give Mexico a notable advantage. Particularly noteworthy is Mexico's booming aerospace industry. This sector has received the most foreign direct investment in the global industry for the past four years thanks in great part to the construction of a massive manufacturing plant by the Canadian company Bombardier in the central highlands of Mexico.

Challenges do remain for Mexico. Income disparity is a double-edged sword, and while the middle class grows at a slow pace, the country's poor education system continues to create a shortage of skilled labor for high value-added manufacturers considering a shift to Mexico. Organized crime continues to be a high-visibility issue that slows foreign investment, even as the current Mexican administration seems to have toned down some of its predecessor's more aggressive policies.

Still, progress seems to be on the horizon. In a rare display of political unity, the Mexican government passed a host of constitutional reforms in 2013 that may begin to address some of the country's systemic issues, particularly those in the education, fiscal and energy sectors.

The importance of the last one cannot be overstated: Since the nationalization of oil in 1938, Mexico has been blighted by a steadily ossifying energy sector. The Mexican Constitution made it nearly impossible for foreign companies to participate in any part of the country's energy supply chain, leading to technological stagnation and decreasing production and efficiency levels. The constitutional reforms passed in late 2013 are one of the first concrete signs that Mexico may be on the eve of a much-needed revitalization of its hydrocarbon sector -- boosting the country's competitiveness in the global arena. U.S. companies are likely to be deeply involved in this process, especially since they command the best technical expertise for the deep-water offshore and unconventional onshore production that Mexico will need most -- yet again reinforcing formal and informal ties between the two countries.

Meanwhile, though Mexico's energy revolution may still be some time away, energy revolutions are in full swing in its two northern neighbors. Canada is the sixth-largest global oil producer after its decadelong process of unlocking its unconventional oil sands deposits. Close to two-thirds of Canada's oil production is exported via pipeline to the United States, making it by far the largest supplier of crude to the United States. As for the United States, the story of the shale revolution is well known. Advanced extractive techniques have revitalized mature fields and opened up unconventional plays at an astounding rate over the past five years. While revitalized oil production has served to shore up some U.S. energy trade balances, the greatest boon has been the tapping of immense natural gas reserves that have driven down domestic prices of the commodity (a helpful tailwind for the recovering economy) and put the United States on the path to becoming a global exporter of liquefied natural gas.

There are, however, limits to the benefits of such an energy boom. True energy independence, even on a North American scale, is unlikely to take place anytime soon. The Unites States will continue to depend on a reduced but still significant volume of oil imports from potentially volatile regions, particularly if Canada begins to export additional oil to the more lucrative Asian markets. In addition, any potential overseas hydrocarbon exports by either the United States or Canada would tie the two countries deeper into the global commodity market. The true benefits to the United States and Canada will be, as they have been so far, economic rather than geopolitical. Trade balances are likely to improve, yet again boosting the interlinked economies of the three North American nations.

Twenty years after its formation, NAFTA remains a useful, if incomplete, expression of the economic ties among these three countries. It has not been, and will not be, on par with the establishment of NATO and the 1803 Louisiana Purchase as one of the fulcrums of U.S. history, despite Al Gore's hyperbolic claim in 1993.

The true bonds between the three countries are their aligned and complementary interests born of their shared geopolitical fate. Though the future of the United States, Mexico and Canada is by no means set in stone, there are strong indicators that the triad has what it takes to be both a stable and dynamic geopolitical grouping in the long term -- something that currently seems out of reach anywhere else in the world.

Editor's Note: *Writing in George Friedman's stead this week is Marc Lanthemann, a geopolitical analyst at Stratfor.*

Send us your thoughts on this report.