The Solution to North America's Triple Problem: The Case for A North American Investment Fund

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ABSTRACT

Despite the expansion of trade and investment achieved by the North American Free Trade Agreement, challenges remain. The most serious is the persistence of an "income gap" between Mexico and its northern neighbors. Unless this gap is narrowed, other challenges, including immigration, trade, and security, will persist. The solution is the creation of a viable North American Investment Fund, which will be possible only if the three governments articulate a North American Community and pledge to contribute, each in its own way, to a strategy that will close the income gap and build institutions to resolve old problems and address new opportunities.

Key words: NAFTA, investment, North American Community, free trade, immigration, income gap, debt, monetary policy, regulation

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INTRODUCTION: THE PROBLEMS OF SECURITY, IMMIGRATION, AND TRADE

The North American Free Trade Agreement (NAFTA) came into effect on January 1, 1994 and, in 13 years, trade among Canada, Mexico, and the United States tripled and foreign direct investment quintupled, making North America the largest free trade area in the world. Despite this success, relations among all three countries deteriorated, and a swirl of problems led many to view NAFTA as a failure.

A major cause of the deterioration of relations is the failure of the three governments to find agreement on immigration, trade, and security. None of these problems can be solved easily or soon, but serious progress is not possible until the three governments begin to construct a "community of interests" in which each of them commits significant resources and undertakes reforms to close the income gap between Mexico and its two neighbors and forge institutions and procedures to sustain trust.

Why is the income gap so important to each of the three issues? Contrary to conventional wisdom, more than 90 percent of the undocumented workers from Mexico do not come to the United States seeking jobs. They leave jobs in Mexico for much better wages in the United States. Unless the income gap is significantly narrowed, migration from Mexico will continue to expand. Securing the United States after 9/11 depends on a secure continent and that is difficult when one of the weakest links is Mexico's poverty. Finally, free trade policies have become unpopular because of chronic disputes, the view by some in the United States that jobs are lost because of free trade, the failure of the United States to comply with NAFTA courts, and the view that Mexico would be more developed if free trade worked.

All three problems point to the same solution: a North American Investment Fund which invests US$20 billion per year for a decade to close the income gap by grants to build infrastructure –roads, communications, railroads, ports– to connect the poor center and south of Mexico to its northern neighbors. Ten billion dollars would come from additional taxes by Mexicans, US$9 billion would come from the United States, and US$1 billion from Canada. But these would only be part of an arrangement whereby Mexico undertakes the kinds of reforms that would allow it to make effective use of these resources.

Such a fund is only possible if the three governments articulate a North American Community and pledge to contribute, each in its own way, to a strategy that will close the income gap and build institutions to resolve old problems and address new opportunities. That is the solution. Now, what exactly is the problem? If immigrants contribute to the U.S. economy so much, why is immigration a problem?

During a state visit by Mexican President Vicente Fox in September 2001, just days before the September 11 tragedy, President George W. Bush agreed to reform U.S. immigration laws as they affected Mexico. There are about 11 million "undocumented workers" in the United States, of whom about 6.3 million are Mexicans. Fox wanted to regularize the status of the Mexicans and ensure a large and steady flow of temporary workers. Despite Bush's pledge to address the issue, four years passed before he sent his cabinet to Congress to outline his administration's approach. On October 18, 2005, U.S. Homeland Security Secretary Michael Chertoff testified, "The president believes —and I agree— that illegal immigration threatens our communities and our national security." He proposed more funding for the border patrol, even though the number of officers tripled and the budget increased 10-fold during the previous two decades (Massey, 2005).

While the U.S. was concerned with security, the immigration issue is primarily an economic and social issue. The U.S. wants cheap labor and Mexicans want better wages in the United States. There is nothing wrong with that, except that Mexicans who are in the United States illegally are easily exploited and, thus, are compelled to work harder at wages too low for most Americans. Even during the boom years of the 1990s, when the income of most Americans improved, the wages of native-born unskilled workers declined by about 10 percent, due, in part, to more competition by illegal workers. There is also a humanitarian issue of dealing with 11 million illegal migrants in the country.

The United States has embarked on a long journey to cope with these problems, and while there are many proposals to "regularize" the 11 million undocumented workers in the country, none can do so without provoking a new wave of illegal migration. None of these proposals will solve or even reduce the flow of undocumented migration to the United States. Indeed, regularizing the status of those who are here illegally may well encourage greater flows in the future. This is what occurred after passage of the 1986 Immigration Reform and Control Act, which combined legalization, which was implemented, and employer sanctions, which were largely ignored. This was one of the reasons why immigration reform failed to pass the Senate in June 2007.

The American people are increasingly frustrated and worried about the inability of the U.S. government to control the borders. A *New York Times*/CBS poll in October 2005 found that 75 percent of Americans think that the government should do much more to keep out illegal aliens, and by May 2007, 82 percent of Americans felt that way (*New York Times*, 2007). However, no one has proposed an effective strategy to address the challenge. The reason is that it would be very expensive to solve this problem, and there is only one way to dramatically affect the flow. The development

gap between the United States and Mexico must be narrowed. A strategy aimed to accomplish that goal would not only reduce illegal migration; it would solve several other chronic problems in North America and beyond.

Many in Mexico viewed the North American Free Trade Agreement (NAFTA) as a vehicle to achieve a first-world economy and close the development gap that separated it from its northern neighbors. Many in the United States supported NAFTA in the hope that it would reduce undocumented migration from Mexico. Many in Latin America and the Caribbean looked at NAFTA as a model for a Free Trade Area of the Americas (FTAA), which would allow them to board a train to the first world. Although NAFTA expanded trade within North America, neither the development gap nor undocumented migration diminished, and, as it became clear that free-trade did not achieve the promise of development, many in Latin America and beyond questioned the utility of free trade. Until free trade can be viewed as beneficial to its poorer members, the prospect of expanding its boundaries will remain small.

Unless and until the development gap between Mexico and the U.S. can begin to close, the prospect of having a genuine partnership among the three countries of North America will remain distant. There are other compelling reasons for the three governments to consider the development gap as the paramount challenge facing North America. NAFTA, at best, has run out of steam; the continental relationships are in danger of going into reverse. The policy responses to 9/11 and the creation of the Department of Homeland Security have constructed a formidable speed bump on the two borders that impedes trade.

NAFTA may be viewed as a problem but "North America" is actually a magnificent opportunity. Stimulating Mexico's economy might be one of the best ways to promote competitiveness for the entire continent. The most effective response to competition from China, for example, is one that merges the comparative advantages of each unit of North America. Developing a community of interests in which the three governments take steps to make the continent more secure and their relationships fair would establish the region as the model.

DEVELOPMENTAL EFFECTS OF NAFTA

The disparity in income between Mexico and its northern neighbors is the most salient feature of North America. John Audley and Sandra Polaski note that for most Mexicans, real wages have fallen since NAFTA, though they recognize that the peso crisis might be a more important factor than NAFTA. While acknowledging that foreign direct investment added 400 000 jobs in manufacturing, they also point out that

this did not keep pace with the growing supply of labor (Audley et al., 2003: 5-6). There is no disputing the income gap, though there is no agreement as to how to measure it. Below are four ways to measure it. Table 1 uses GDP per capita in current dollars. The ratio of U.S. to Mexico begins at 4.03 in 1980 then rises to 5.6 in the year before NAFTA and to 6.27, a decade later. It declined to 5.5 in 2006 but that still is about 36 percent worse than in 1980. Table 2 measures GDP per capita with constant 2000 dollars and shows more consistency, though the gap is still about 10 percent wider in 2005 than in 1960. Table 3 looks at GDP per capita based on purchasing power parity (PPP) in current dollars. The PPP measure shows that the gap is about 36 percent worse in 2005 than in 1980.[1]

Table 1
RATIO OF GDP PER CAPITA (CURRENT PRICES, US$)
BETWEEN THE RICHEST AND THE POOREST NAFTA COUNTRY, 1980-2004

Group*	1980	1990	1993	2000	2002	2004
NAFTA (1994)	4.03 (U.S./Mexico)	7.35 (U.S./Mexico)	5.58 (U.S./Mexico)	5.84 (U.S./Mexico)	5.66 (U.S./Mexico)	6.27 (U.S./Mexico)

Source: International Monetary Fund, World Economic Outlook Database, September 2004.

Table 2
U.S. AND MEXICO: GDP PER CAPITA (CONSTANT 2000 US$), 1960-2005

Country	1960	1970	1980	1990	1993	2000	2002	2004	2005
Mexico	2 554	3 576	5 114	4 966	5 174	5 935	5 853	6 056	6 172
United States	14 134	18 150	22 568	28 263	28 747	34 599	34 669	36 451	37267
Dev. gap ratio	5.53	5.08	4.41	5.69	5.56	5.83	5.92	6.02	6.04

Source: World Bank, World Development Indicators database, http:devdata.worldbank.org/dataonline/

[1] The source for these tables is the U.S. Department of Labor, International Comparisons of Hourly Compensation Costs for Production Workers in Manufacturing–Table 2, ftp://ftp.bls.gov/pub/special.requests/ForeignLabor/ichccsuppt02.txt.

Table 3
U.S. AND MEXICO: GDP PER CAPITA - PURCHASING POWER PARITY
(CURRENT INTERNATIONAL US$), 1980-2005

Country	1980	1990	1993	2000	2002	2004
Mexico	4 279	6 280	7087	9 197	9 451	10 240
United States	12 186	23 064	25 409	34 599	36 126	39 772
Dev. gap ratio	2.85	3.67	3.59	3.76	3.82	3.88

Source: World Bank, World Development Indicators database, http:devdata.worldbank.org/dataonline/

Table 4
HOURLY WAGES (US$) FOR PRODUCTION WORKERS
IN MANUFACTURING, 1980-2005

Country	1980	1990	1993	2000	2002	2003	2004	2005
Canada	8.87	16.33	16.97	16.48	16.72	19.53	21.77	23.82
US	9.63	14.81	16.37	19.65	21.33	2.22	22.82	23.65
Mexico	2.2	1.57	2.36	2.07	2.49	2.44	2.44	2.63
Ratio of highest to lowest	US/Mex. 4.4	Can./Mex. 10.4	Can./Mex. 7.2	US/Mex. 9.5	US/Mex. 8.6	US/Mex. 9.1	US/Mex. 9.4	Can./Mex. 9.1

Source: U.S. Department of Labor, International Comparisons of Hourly Compensation Costs for Production Workers in Manufacturing-Table 2, ftp://ftp.bls.gov/pub/special.requests/ForeignLabor/ichccsuppt02.txt

Emigrants do not bother to examine the aggregate data. Their motives for moving probably are diverse. The conventional view is that they come to the United States in search of jobs. But several surveys of Mexican immigrants in the United States during the past 20 years found that the overwhelming majority had jobs before leaving Mexico. According to the Mexican Migration Project (a 15-year bi-national project directed by Jorge Durand at the University of Guadalajara and Douglas Massey at the University of Pennsylvania), the percentage of immigrants who were unemployed before leaving Mexico for the United States declined steadily from 13 percent in 1970 to 6.4 percent in the 1990s. Another survey found that since the 1990s, more than 93 percent of Mexican immigrants to the United States –legal and illegal– left jobs in Mexico (Durand et al., 2001: table 4, 121). This data is consistent with several other large data sets from both the Mexican statistical agenda and the U.S. Census

Bureau. Research on the causes of migration from the Caribbean in the early 1980s also found that the emigrants left jobs (Pastor, 1985: 14).

They are coming in search of higher wages, and in Table 4, the gap in hourly wages for production workers in manufacturing between 1980 and 2005 more than doubled, rising from 4.4 to 9.1. Still, another study suggests that current wage differentials are 10 to 1 and are expected to grow to 13 to 1 (Ibarra and Soloaga, 2005: 11). What this means is that the average Mexican worker in a manufacturing plant can earn perhaps 10 times or more working in the United States than he or she could in Mexico. Although family networks play an important role in determining where immigrants locate, the most powerful magnet is the economy.

Other studies have shown that the higher U.S. wages are relative to Mexican wages, the higher the probability of migration (Jewell and Molina, 2004). Using regression analyses based on data collected by the Mexican Migration Project (MMP), Jewell and Molina estimate that a 10-percent increase in the Mexican wage leads to a 6.9 percent reduction in migration, while a 10-percent decrease in the Mexican wage leads to a 4.6-percent increase in migration. However, a 10-percent rise in the U.S. wage increases migration by 8.8 percent. If the wage gap narrowed as a result of a 10-percent reduction in U.S. wages, migration would be reduced by 13.1 percent. If the wage gap were closed, the probability of migration sinks to practically zero (Jewell and Molina, 2004). As long as Mexicans can earn much more in the United States for the same work, the lure of migration will remain compelling. In a poll on migration, Alducín y Asociados (2003: 17) found that 81.4 percent of Mexicans would emigrate to the United States if they could. A Pew Hispanic Center study found fewer –46 percent– ready to move if given the chance.

While the numbers differ in the four tables and the estimates of the impact of the wage differential on the magnitude of migration differ on the margin, the pattern is similar and persuasive. With every measure and table, the gap has worsened since 1980. Mexico's goal of convergence has slipped further away since NAFTA began and the impact on migration to the United States is indisputable. The larger the gap in income, the more immigrants will come.

Two Other Gaps

It is true that average wages for all Mexicans have not improved since NAFTA came into force. But a more instructive conclusion emerges when one looks below that fact to sector and geographical gaps, both of which opened wider because of the trade agreement and its first (peso) crisis. The first gap was between the country's

growing export sector and its domestic market and the second gap was geographical, between the northern and the center-south of the country.

The reduction in barriers to the flow of capital induced a surge of short-term loans to Mexico in 1993. When two political assassinations, including of the leading presidential candidate, unsettled the market and lenders began to withdraw their money, the Mexican government took dramatic steps to keep the funds. It sharply raised interest rates and promised to pay the loans in dollars, but this only made a difficult debt problem worse. When the government finally devalued, during Christmas 1994, the bottom fell out of the market and the country tipped on the edge of bankruptcy. The failure of either the United States or Mexico to anticipate such a crisis and create a substantial swap arrangement further exacerbated the problem and the Mexican economy sank 6.2 percent, its sharpest and worse decline since the Great Depression. Because of NAFTA and the expansion of an export-oriented manufacturing sector, the impact on the economy was uneven. The domestic side of the economy declined by 14 percent, while the export sector grew.[2]

NAFTA also contributed to Mexico's geographical disparities, which were already serious. About half of all domestic production is concentrated in Mexico City and the states of Mexico, Jalisco (Guadalajara), and Nuevo León (Monterrey). After the 1994 crisis, the disparities between regions became even more pronounced. The southern states of Chiapas, Guerrero, and Oaxaca have the weakest infrastructure: a quarter of the households there are without water or electricity; roads are unpaved; the telecommunications infrastructure is less than half of the national average (Fay, 2003). An analysis of the eight regions of Mexico by the Confederation of Industrial Chambers of Commerce (Concamin), using data from Mexico's statistical agency (INEGI), concluded that the social and economic gap between the regions widened since NAFTA. Another analysis found that the gap widened because the northern states, connected to the U.S. market and with more foreign investment, grew 10 times faster than the southern ones, which do not have the infrastructure to bring goods to market.[3]

The two gaps that opened wider since NAFTA suggest that Mexico's economic problem was not due to the treaty, but rather to its absence. In other words, the Zapatistas got it backwards when they launched their uprising in Chiapas to protest NAFTA. They were right that NAFTA would not help Chiapas but this was not due to free

[2] For an excellent analysis of the impact of the 1994 crisis, see González Gómez, 1998: 37-66.

[3] Tamayo-Flores, 2000: 21. The estimates on the gap between regions vary. Luis Ernesto Derbez, a World Bank economist, estimated that during the 1990s, the export-oriented North grew at annual rates of 5.9 percent, while the South barely grew at .4 percent, more than 10 times faster, as cited in Tricks, 2001: 6. Based on data from INEGI and Conapo, the North American Development Bank estimated that the northern part of Mexico was growing more than twice as fast as the south or center.

trade; it was because of the lack of it. The south and center of Mexico were not connected to the markets of the north. The success of the export sector and the northern part of the country are proof that NAFTA succeeded where it connected. For the rest of Mexico to develop, a new strategy is needed.

NAFTA's flaw is that it had no explicit development strategy. Its implicit strategy is to encourage foreign direct investment in the already congested border areas. Not surprisingly, the states closest to the United States attracted workers from the heart of Mexico. Most businesses on the border report a turnover each year of nearly 100 percent, meaning that workers from the south stay in the northern part of Mexico only long enough to learn how to get across and earn more money. Notwithstanding the arguments of NAFTA's proponents, NAFTA encouraged –however unintentionally– illegal migration to the United States. Foreign firms would prefer to invest in the interior where the workforce is more stable and there is less congestion, pollution, and turnover. But they do not because roads and infrastructure are inadequate.

How to Narrow the Income Gap? Lessons from the Literature and Europe

Theories of economic convergence predict that the gap in incomes between richer and poorer states or sub-regions in a free trade area will narrow because capital will invest and deploy technology where it can gain greater returns. The United States offers proof of the theory. After the Civil War, the difference in income between the northern and southern states was very large. With the benefit of a single currency and free movement of labor, capital, and goods, that gap narrowed significantly, though it took a century and involved a massive migration of six million African-Americans northward between 1916 and 1970 (Kim, 1997; Postrel, 2004; Foner, 1991). In other words, under the most optimal conditions of free movement of factors of production within a single nation-state, more than 100 years were needed to achieve real convergence in income between rich and poor regions.

In contrast, the European Union significantly closed its income gap between the richer and the four poorest countries in just 15 years. North America represents a very different model from Europe's, and few in the United States would consider replicating the model, but failing to learn from 50 years of experience with regional economic integration would be a serious mistake.[4] The issue for North America is not

[4] For a detailed analysis of the similarities and differences between the European Union and North America and an evaluation of the EU's regional and cohesion policies, see Pastor, 2001: Chapters 2-3.

whether to adopt the European model; the two cases are too different. The question is: What can be learned and adapted from Europe's experience?

Europe defined one of its principal goals as reducing disparities among members, but it did not allocate serious resources to achieving it for nearly 30 years. The rationale for closing the gap was that "wide disparities are intolerable in a community, if the term has any meaning at all." The EU narrowed the gap between its four poorer "cohesion" members (Spain, Portugal, Greece, and Ireland) in a remarkably short time. From 1986 to 2003, the per capita GDP in the four cohesion countries rose from 65 percent of the EU average to 82 percent by 2003 (European Commission, 1996: 13; European Commission, 2003).

While all four cohesion countries have made substantial progress since entering the EU, an analysis of the differences in their rates of growth is useful for assessing the relative effectiveness of the EU's regional policies. Ireland has been the most successful with its per capita income turning it from the poorest country in the European Union in 1980 into one of its richest today. Although some believe Ireland succeeded because it reduced taxes and did not receive aid, for the decade beginning in 1989, Ireland received €10.2 billion –equal to 2.8 percent of its GDP– from EU Structural and Cohesion Funds and the government matched that amount with counterpart investments, which raised the total investment to 5 percent of GDP (European Commission, 1997: 73-75). The EU funds began to arrive in 1989, just when there was a substantial backlog of projects and urgent infrastructural needs. "Without the support of the structural funds," a report by the Economic and Social Research Institute in Dublin concludes, "congestion in public infrastructure and constraints in third level education would have limited the recovery." Using several models, the institute concluded that the combined effect in the period 1995-1999 raised GNP by 3 to 4 percent above the level it would have been without the EU funding (Honohan, 1997: xv-xxi, especially at xviii). Ireland's trajectory was astonishing but the other three poor countries (Spain, Portugal, and Greece) also made substantial progress for much the same reasons. The European Union transferred more than €450 billion during the past 20 years to them (European Commission, 1996; European Commission, 1997: 45).

To what extent did these funds contribute to growth in the four cohesion countries and to the reduction of income disparities? Using regression analyses, Robert Leonardi of the London School of Economics tested various explanatory variables and concluded that structural and cohesion aid "made a substantial contribution to economic investment and overall GDP in the three nations. [It] acted as a significant stimulus to the national economies, explaining in part the surge of these countries toward convergence" (Leonardi, 1995: 133, 170-176).

In its "Third Report on Economic and Social Cohesion," The European Commission found that the structural funds boosted the gross domestic product in Spain by 1.5 percent more than would have occurred without such funds. The funds increased growth in Greece by 2 percent, in Ireland by almost 3 percent, and in Portugal by 4.5 percent more than would have occurred in the absence of such support (European Commission, 2004: xviii).

What specific lessons should be drawn from the EU experience for North America?

a) *Goals and Institutions*. Europe's leaders defined a goal of solidarity and community for security and economic reasons. These goals inspired member states and provided a benchmark from which they could measure progress. The EU established too many supra-national institutions that continue because it is too hard to eliminate them. The lesson is that some institutions are necessary to promote development, but policy-makers should incorporate a "sunset" provision into every new institution and, in the case of North America, it might be better to use an existing institution, such as the World Bank, rather than create new ones.

b) *Convergence and Conditionality*. Among the many factors responsible for narrowing the gap were a single market, foreign investment, and massive aid programs from the EU. An analysis of the difference in growth rates among the four "cohesion" countries –between Ireland and Greece, for example– leads to the inescapable conclusion that national policy is a fourth, critical determinant. The most effective "national policies" were those that utilized the incentive of conditionality to maintain stable macro-economic policies and transparency. The lesson is to use the first three factors as an incentive for the recipient government to adopt the appropriate economic policies that would make best use of the resources.

c) *Projects and Personnel*. The EU has funded almost every imaginable kind of project through many structures, but most analysts agree with Rainer Martin that investments in two areas were most effective: infrastructure and human capital (Martin, 1998: 66-72).

d) *The Magnitude and the Focus of the Commitment*. The task of closing the gap between richer and poorer countries in a free trade area is a formidable one, but the EU has demonstrated that it can be done, provided that its members make a serious commitment and appropriate significant funds for that purpose. Europe has transferred € 30 billion per year (US$40 billion). About half –the investments in infrastructure and human capital– had a multiplier effect on development. Much of the other half went to the poorer provinces in the richer countries as "side payments."

A PROPOSAL TO NARROW THE GAP

In contemplating an approach for reducing the gap in North America, let us recall the development trajectory of two countries on two continents: Mexico and Spain. The per capita income of Mexico was higher than that of Spain in 1950. By the year 2000, Mexico's was roughly half that of Spain (Rodríguez Barocio, 2005: 4). There are, of course, many reasons for this turnabout but, during the last 20 years, two factors stand out: the magnitude of the EU's aid to Spain and the reforms Spain undertook to be an EU member. The aid was essential but the donors would not have contributed without a vision of community, and the recipient would not have undertaken the reforms without understanding their necessity and without a framework of external support.

A proposal to reduce the income gap in North America, therefore, requires several fundamental elements that need to be woven together: 1) a vision and a goal; 2) a new development strategy; 3) an institution or mechanism to transfer funds; 4) a commitment by all three countries to deliver substantial aid and reforms; 5) a strategy for negotiating and implementing the package.

1) Vision and Goal. While the development of Mexico and its integration with its neighbors is the focus of the proposal, a new cooperative relationship among the three governments is a prerequisite to achieving that goal. The vision needed to begin moving in this direction is not one of a union or even a common market. A common market requires the free movement of labor but that is not possible, given the income gap, and a union suggests a merging of sovereignties and all three governments oppose that.

A "North American Community" may be the best option. It evinces an idea that is more than three separate nations but it allows its members to define what "more" they want. The premise of such a community is that each of the three countries benefits from its neighbors' success and pays a price for its neighbors' failure, crisis, or setback. At some level, this is widely understood and explains why the U.S. helped Mexico deal with its debt crisis in 1982 and peso crisis in 1994-1995. Of course, Canada and Mexico are directly affected by events in the United States, whether a countervailing duty or 9/11. In the post- NAFTA world, the economies of the three countries are so inter-connected that a recession in one country will harm the others and a boom in one will lift the others.

When the value of a neighbor's house rises, that has a positive effect on one's own house. When a neighbor's house burns or is vandalized, then all the houses in the community are in danger. Those are the two sides of a vision of a North American Community. Increasing interdependence requires more active involvement by all three

governments to ensure that the public is protected from a more integrated but less regulated market.

A community means that the two bilateral relationships should be transformed into a continental one. Any negotiation in North America reflects the weight of asymmetry. By the sheer size of its economy, the United States could –and does– ignore the complaints of each neighbor. This allows problems –like softwood lumber or sugar– to fester and trust to be eroded. The argument for a continental approach is that it could help correct some of the imbalance inherent in the two bilateral relationships. It could do so by focusing on rules rather than raw power.

If this is true, then why do Mexico and Canada not pursue such a community, and why would the United States accept it? Canada feels that it could do better in a bilateral relationship, though there is scant evidence to prove that, and Mexico has tried a continental approach but has been rebuffed by Canada and the United States. The United States faces a classic trade-off on the issue: should it negotiate bilaterally where it can dominate, or would it be wiser to sacrifice short-term interests in order to create a community respected by its neighbors? After World War II, the United States faced the same choice in Europe: it could have negotiated separately with each country and assured its dominance, or it could take a long-term approach and provide aid to Europe on the single condition that Europe would unite. The U.S. chose the more enlightened approach with the Marshall Plan. The time has come for the United States to follow a similar path in North America.

A second question is: why should Canada contribute to a fund for the development of Mexico? Canada, of course, had difficulty seeing Mexico over the United States but, with the approval of NAFTA, it began to develop its relationship with Mexico. As its trade and investment increased, Canada recognized that Mexico's development will yield economic benefits. Canada has an increasing number of emigrants from Mexico, particularly in the west. Canada does not have a stake in Mexico's development comparable to that of the United States but it does have a sizeable foreign aid program. The question is whether that aid should continue to be aimed at the poorest countries or whether it should be part of a new North American strategy.

In addition to economic interests, there are three reasons why Canada should want to build a North American Community and contribute to a fund to narrow the development gap. First, Canada is a multilateral institution builder, and there is no relationship more important to Canada than the one with the United States (James et al., 2007: ch. 1). It follows that a tri-national institution could be constructed in a manner that would serve Canada's long-term interests in assuring that the U.S. negotiates fairly and complies with the rules of an agreement. Secondly, Canada wants the U.S. to pay attention to its concerns and is frustrated that it does not. A

joint approach with Mexico, which can gain U.S. attention because of the large Mexican-American population, would certainly assist Canada. But Mexico and Canada are likely to be more effective if they pursue fair rules rather than appear as if they are conspiring against the U.S.

The three governments should set the goal of helping Mexico achieve a sustained rate of growth for at least one decade of at least 6 percent per year. If one assumes that the U.S. and Canada maintain a growth rate of 3 percent, the income gap would be reduced by 20 percent in the first decade and, hopefully, provide the momentum to close the gap within 40 to 50 years. While it would be desirable for the gap to be closed, the trajectory may be as important. If Mexicans see the gap closing in a consistent way, self-perceptions could change, and that could mean that fewer Mexicans would emigrate.

2*) A New Development Strategy*. How can Mexico grow at twice the rate of the United States and Canada? Using a computable general equilibrium model of Mexico, Robinson, Morley, and Diaz-Bonilla conclude that the current export model is unlikely to generate sufficient growth to begin to close the income gap. Instead, Mexico needs a fundamental change in development strategy, and they propose two options. Capital formation would need to be raised to the level of 30 percent or more of GDP. Without a significant increase in domestic savings, Mexico would need US$30 billion more per year of foreign capital, net of interest payments. An alternative would be to channel US$17-20 billion in new capital, net of interest payments, each year into infrastructure and human capital. As Mexico cannot sustain more debt, grants are needed from abroad. With these investments, they estimate that Mexico could grow at an annual rate of about 6 percent (Robinson et al., 2005).

Others have pointed to Mexico's declining competitiveness and attribute it to Mexico's inability or unwillingness to undertake essential tax and fiscal, labor, energy, and electricity reforms. An IMD World Competitiveness Survey attributed declining competitiveness to poor infrastructure. Of the 30 largest economies in terms of their infrastructure, the IMD survey found that in just three years –2000-2003– Mexico had slipped from eighteenth to twenty-ninth place, while U.S. infrastructure competitiveness remained the top ranking and Spain slipped from ninth to tenth place (IMD, 2004).

The World Bank initially viewed large infrastructure projects as key to development and, after its start in 1960, the Inter-American Development Bank also invested heavily in infrastructure. But beginning in the mid-1970s, there was a gradual shift away from such projects toward those aimed at education, health, and poverty-reduction. More recently, the World Bank has begun to re-evaluate the importance of infrastructure and a number of studies have concluded that lagging performance

in infrastructure "has cascading negative effects throughout the economy. It increases the cost of doing business, decreases international competitiveness, and hinders the country's growth and poverty alleviation prospects" (World Bank, 2003: 1).

Mexico has long under-invested in infrastructure but government investment in infrastructure as a percentage of GDP fell precipitously from about 8 percent in 1980 to 1.2 percent in 2003. In 1960, Korea had less than half of Mexico's paved road density. In 2005, it had 11 times that of Mexico. Similarly, in 1969, Korea had one-third the power infrastructure per capita of Mexico but, in 2005, it had three times as much. While the comparison with Korea is particularly sharp, Mexico also compares poorly with other major Latin American countries. For example, Mexico's road density is currently about one-half that of Brazil. Moreover, the costs of railways and ports in Mexico are higher than in Brazil and the U.S (World Bank and Inter-American Development Bank, 2005; World Bank, 2005; Rodríguez Barocio, 2005: 15).

The lack of infrastructure and its poor quality and reliability have added significantly to the cost of doing business in Mexico. It also has encouraged foreign investment to concentrate on the border. Therefore, one effective way to reduce geographical disparities within Mexico while reducing pressures for out-migration would be to improve the road system from the U.S. border to the center and southern parts of the country. Because of foreign investment, the northern border economy is booming and attracting labor from the poorer parts of the country. However, in many cases, workers stay on the Mexican side of the border only long enough to learn how to cross into the United States, where they can earn a lot more. U.S. firms do not like to invest in the border area because of the pollution and the inefficiencies associated with such a high turnover rate, but they do so because the roads from the border to the center of the country are bad or non-existent.

If roads were built or improved from the border to the center of the country, investors would locate there for three reasons. First, the center and south of the country –Oaxaca, Zacatecas, Michoacán, Guanajuato– have the highest rates of unemployment and, indeed, are the principal sources of immigrants to the border and to the United States. Secondly, the wage level is much lower in these areas but the workers are no less educated than those on the border. Indeed, they are often the same workers. Finally, the region is not the polluted, cramped border. The government has incentive systems to encourage investors to locate there but the problem is a lack of infrastructure: roads, electricity, etc. Build them, and investors would come, immigration levels would decline and so would disparities in income.

Mexico has been criticized for subsidizing higher education at the cost of elementary and secondary schools and that is true (Kogan, 1987: 56-78). But Spain and Portugal discovered that investments in technical and community colleges in rural

areas had a large multiplier effect. College-educated students returned from the capital to their small towns to teach at these colleges and, as they raised a family, they insisted on improvements in elementary and secondary schools that their children attended. The community colleges proved to be the catalyst for improving the level of education at all levels in the rural areas.

3) Mechanism/Institution. In the interest of using scarce resources most effectively and keeping bureaucracy to the minimum, the three governments should establish a "North American Investment Fund" as the principal instrument for channeling money to narrow the income gap. North America should not create a new bank. Rather, it should deposit money in a fund that would be administered by the World Bank (and/or the Inter-American Development Bank) under the supervision of a board appointed by all three governments. To avoid the EU's problem of perpetual institutionalization, the fund should have a "sunset" provision. It should have a 10-year term, and it should be continued beyond that date only by decision of all three governments.

Some have proposed using the North American Development Bank (NAD Bank), but that institution's mission is to invest in environmental and small infrastructure projects near the border, and it does not have the capability for the large infrastructure projects needed to close the development gap. Rather than provide funds and personnel to give the bank such a capability, it would make more sense to use an existing institution with proven capability. To establish such a fund, the leaders of the three countries would need to make such a request of the president of the World Bank.

4) Magnitude and Focus. How much money would be needed for such a fund, and how should it be allocated? The World Bank has estimated that Mexico has a 10-year infrastructure deficit of US$20 billion per year. This is separate from the additional US$10 billion that Mexico needs to invest annually in the exploration and development of its natural gas and oil fields (Guigale, et al., 2001: 2, 10-11, 357-376). The computer model suggests a similar amount: US$17-20 billion in new capital each year, net of interest payments, to grow at an annual rate of 6 percent for a decade in order to close the income gap by 20 percent. On the other hand, they note that Mexico cannot service new debt of that magnitude but that half of that could come from domestic savings –an increase in taxes. The rest would have to come from its neighbors. Thus, the North American Investment Fund should be prepared to provide US$20 billion in grants per year for 10 years in order to help Mexico grow at a rate of 6 percent for a decade.

How should the funds be spent? The fund should invest in two areas: infrastructure that would connect the center and south of Mexico to its northern neighbors and education in the poor rural areas of Mexico. Eighty-five percent of the funds should be

spent in infrastructure, building roads from the northern border to the cities in the center and south, bypassing Mexico City. The projects should include ports, railroads, airports, telecommunications, etc. Thirteen percent of the funds should be used to build community colleges in Mexico's rural areas and two percent to serve as matching funds for each country to promote research and educational exchanges.

Europe, of course, has spent more than twice as much as is proposed here for more than 20 years, but it was spent in too many areas, which, however commendable, diluted the impact. If the funds are to provide a needed jolt for the Mexican economy, then the three nations need to avoid three temptations. They should not spend the money: a) in the poorest part of Mexico; b) on the border; c) on other commendable projects, whether related to the environment, justice, poverty, etc. Although these are all worthwhile projects or areas, the funds would be most effective if they were concentrated. Using the funds on the U.S.-Mexican border will exacerbate, not solve, its problems. It would increase the power of the magnet, which is emptying the most enterprising labor from the southern and central parts of Mexico. Some funds are, of course, needed on the border but this job should be left to the North American Development Bank, not the North American Investment Fund.

Considerable funds have been expended in the poorer, emigrant-sending regions of Mexico, but these investments often fail because they lack a strategy for connecting them to the markets to the north. In other words, the North American Investment Fund should begin with a strategy of connecting Mexico to the markets of the north, and funds should be spent in the poorer regions only as a part of that strategy.

As the EU found, once there is a fund, many groups will want to spend the resources in many areas. This would work if there were an inexhaustible supply of funds, but that is never the case. Therefore, the lesson is to concentrate the money where it is most needed and will have the greatest effect on the community as a whole. That means investing in infrastructure (connecting the poorer countries to the richer ones) and education in the poorer regions. This will require great leadership as the American political system combines the political need to embrace all perspectives with a chronic attention-deficit disorder. North America needs to resist legitimate demands to divide up the funds into small projects and focus on the most important continental projects.

5) A Community and Conditionality. Of the US$20 billion each year for the North American Investment Fund, Canada and the United States should pay half, with the U.S. –with about nine times the economy of Canada– accounting for 90 percent of that. Mexico should contribute the other US$10 billion. The United States and Canada are unlikely to contribute funds unless both countries feel that they would be used wisely and that Mexico would undertake serious long-term reforms. Mexico

understands that it needs to undertake fundamental reforms in sensitive sectors such as energy, taxes, pensions, electricity, and the judicial system, but the political system has been stalemated. If its partners were to define, together, a community of three nations in which each would contribute to that future, then that might alter the political balance in a way that would make both the reforms and the fund possible. Absent those changes, the U.S. and Canada might very well conclude that their funds would not be put to good use and would not want to contribute. Spain and Ireland understood the need for reforms, but they could only implement them with the support of the EU.

On fiscal reforms, Mexico relied on its oil monopoly to save its people from paying taxes. In 2003, Mexico received 18 percent of its gross domestic product in federal tax revenues. Of that, 6.5 percent came from oil revenues and 11.8 percent from the federal income tax. That tax rate is the lowest in the OECD countries. Because the tax revenues are so low, the government needs to make up that huge short-fall by taking funds from Pemex, the oil company, leaving it with a bloated, inefficient bureaucracy that lacks funds for its own investments. As a result, Mexico, rich in natural gas and other fossil fuels, finds itself importing about 25 percent of its natural gas from the United States, itself a net importer.

Mexico needs to increase its fiscal revenue as a percent of GDP from 11.8 percent in 2003 to about 18 percent.[5] With a gross domestic product of US$668 billion in 2006, the additional revenue would amount to US$41.4 billion, which would meet its Investment Fund obligations and permit Pemex to have substantial funds for exploration. President Felipe Calderon recognized the importance of fiscal reform and, on June 20, 2007, his finance minister unveiled a proposal for an alternative minimum flat corporate tax of 19 percent, which is designed to increase federal tax revenues by 1.5 percent of GDP in the first year, increasing to 2.8 percent by 2012. Leaving aside the question as to whether the Mexican Congress will approve that much of the proposal, in the first year, additional revenue would amount to US$10 billion, rising to US$18.7 billion by 2012. This would represent a major step forward, though not as much as needed.

The formula both for narrowing the development gap and creating a genuine partnership in North America is defined as "a community of interests," in which all three contribute in their respective ways. How will the United States and Canada benefit from such a program? In the short term, Canadian and U.S. companies will have new opportunities to build the infrastructure in Mexico. For every dollar of growth in the Mexican economy, trade with the U.S. and Canada will increase by

[5] For a superb analysis of the tax issue, see Ramírez de la O., 2004: 9.

about US$0.40. If Mexico's growth rate increases from 3 percent to 6 percent, that means US$20 billion more for the economy and US$8 billion more in trade with its two neighbors in one year. Compounded annually for a decade, that will not only contribute to Mexico's development but to North America's.

This will not affect undocumented migration in the short term, but it is the only solution in the long term. It will take decades to close the gap but, if Mexico begins to grow faster than its northern neighbors, this will affect the perceptions of people in all three countries. Mexicans might begin to believe in their country's future, and, instead of calculating ways to cross the border, they might invest in their region.

At the end of the World War II, the United States turned on its head the approach that the victors of great wars had taken. After every war, the victors pillaged the defeated or, in modern parlance, "imposed reparations" and shared the spoils with their allies. Perhaps the worst example occurred at the end of World War I, and Nazism and fascism were the bitter fruits of that approach. Presidents Franklin Roosevelt and Harry Truman and Secretary of State George Marshall fashioned the opposite policy: instead of plundering the vanquished, they offered a "Marshall Plan," the largest foreign aid program in human history to both allies and enemies and on the condition that they present a common plan that would lead to prosperity and peace for all.

It is that kind of vision aimed at lifting its weakest neighbor that North America needs from its leaders today. In the absence of a cooperative vision of North America's future, the request for resources or reforms by one party or another will look like foreign aid or special pleading and is unlikely to attract support. With a shared goal for a community of three sovereign nations, it would be easier to ask members to contribute.

The first draft was enunciated in Guanajuato, Mexico, in February 2001 at the conclusion of the first summit meeting between Presidents Fox and Bush when they pledged, "After consultation with our Canadian partners, we will strive to consolidate a North American economic community whose benefits reach the lesser-developed areas of the region and extend to the most vulnerable social groups in our countries" (Presidencia de la República, 2001).

While the promise of that statement was not realized, the fact that a Republican president accepted this goal is not inconsequential, and this could be the platform for a genuine North American Community. If North America cannot achieve that goal of narrowing the income gap, then the hopes that many poor and middle-income countries have had of finding a path to modernization through free trade would be dashed. If North America succeeds, then it will provide an example and an inspiration for the entire world.

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