A Compact for North American Competitiveness

A Strategy for Building Competitiveness Within North America

U.S. COUNCIL of the
<u>MEXICO-U.S. BUSINESS COMMITTEE</u>

A COMMITTEE OF THE COUNCIL OF THE AMERICAS

About MEXUS

Founded in 1948, the Mexico-US Business Committee (MEXUS) is the oldest bi-national private sector business organization with a focus on economic, commercial, and political relations in North America. As a forum for senior business leaders to interact regularly with their counterparts in government, MEXUS was critical in the conceptualization, promotion, passage, and implementation of the North American Free Trade Agreement. Since the passage of NAFTA, MEXUS has focused on promoting integration and cooperation within North America as a means of improving competitiveness, achieving economic growth, and building social prosperity throughout the region. It has published regular documentation supporting NAFTA, including the popular "NAFTA Works" series of state-based analytical reports, and other materials that have proven useful to policy makers, business leaders, and academics alike.

The US Council of MEXUS is a standing committee of the Council of the Americas, and plays an active leadership role in public policy discussions that shape North American economic relations. Its mission is to strengthen the North American Community by advancing economic integration and promoting democratic stability, transparency, the rule of law, and cooperation throughout North America. The Mexico Council is a committee of the Consejo Mexicano de Comercio Exterior (COMCE).

MEXUS is focused on developing and implementing a winning program for economic integration and development throughout North America. Increasing competitiveness remains the key, taking into account the dramatic changes that are occurring rapidly in the global economy. Working together, the United States, Canada, and Mexico will be best positioned to address these changes and to shape them according to the best interests of all North Americans. MEXUS remains a leader in the implementation of this vision, and continues to work for its success.

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Introduction from the Chairmen

There is perhaps no relationship between the United States and any other nation so encumbered by history, geography, and culture—and so graced with opportunity—as the US relationship with Mexico. Yet despite the complex nature of this relationship, or perhaps as a result of it, virtually every attempt historically to put the bilateral relationship on a sound footing for the longer term has been frustrated by missed signals, mutual provocations, and external events unrelated to a common agenda.

It was with this in mind that in the second half of the 20th century the US Council of the Mexico-US Business Committee (MEXUS), in conjunction with its counterpart Mexico Council, committed to formulating and advancing a common agenda that would be mutually rewarding for the people and governments of the United States and Mexico. Only by rationalizing the existing relationship, it was felt, would both nations be able to direct their energies toward mutually rewarding activities, rather than constantly working to overcome the latest real or perceived slight. After all, with a shared border of almost 2000 miles, the United States and Mexico were going to be neighbors, whether they liked it or not. The only question was whether they would also be partners and friends.

Out of such thinking during the 1980's came the idea for a set of common goals and principles for both governments to observe in regulating cross-border trade and investment. In just a few years this initiative resulted in the US-Mexico Framework Agreement, and then, with the addition of Canada, blossomed into the North American Free Trade Agreement. Negotiation of NAFTA was a signature achievement of the first Bush Administration, and passage on a bipartisan basis was a signature accomplishment of the Clinton Administration. Not only did MEXUS play a critical role in the conceptual work that led to NAFTA, its members also wore out significant shoe leather on Capitol Hill, ultimately leading to successful passage. It was an achievement of which MEXUS is justifiably proud.

But the agenda is far from complete. In fact, as much remains to be done in the next ten years of NAFTA, if not more, than the first 10 years. In particular, as China comes on line economically, MEXUS will continue to seek new and creative ways to advance the North American competitiveness dialogue. At the beginning of 2005, that is the right place to be.

We wish to thank our counterpart in Mexico, Chairman Eugenio Clariond of Grupo IMSA, who has provided visionary leadership. As well, we thank the New York-based Council of the Americas and its President and CEO, Susan Segal. The Washington office of the Council under the leadership of Vice President Eric Farnsworth serves as the MEXUS Secretariat. Special recognition and thanks must go to Executive Director Jennifer Fernandez, who with all of us, is working to make this vision a reality.

Ambassador James Jones	Secretary Robert Mosbacher
Chairman, US Council	*Chairman Emeritus, US Council*
Washington	*Houston*

April 2005

"A Compact for North American Competitiveness"

A Strategy for Building Competitiveness within North America

EXECUTIVE SUMMARY

The emergence of China, India, and others in the global marketplace has caused anxiety among observers, but only in relatively few instances are coordinated steps being taken to gain full economic and political advantage of this new world. That is particularly true within North America, defined as the United States, Canada, and Mexico. Since NAFTA went into effect in 1994, only rarely have North American leaders envisioned and sought the competitive benefits accruing with greater regional economic integration. To the extent such efforts have occurred, it has generally been within the context of "making NAFTA work better."

To be sure, NAFTA can work better, and it should, particularly in terms of the dispute resolution process. But the original trade agreement was only the first step. If North American economic integration ends with NAFTA, we will soon find ourselves at a competitive disadvantage with Asia, because the relative gains from NAFTA have already largely been eroded by the Chinese and, to a lesser extent, Indian economic explosions.

Significant work must be done in the face of the looming competitiveness challenge from Asia. In response and consistent with the Security and Prosperity Partnership of North America announced by Prime Minister Paul Martin, President George Bush, and President Vicente Fox on March 23, 2005, the US Council of the Mexico-US Business Committee proposes a Compact for North American Competitiveness as a means to address these issues.

At the heart of the Compact lies a grand bargain: the United States and Canada will work closely with Mexico to mobilize additional public and private sector resources to advance Mexico's development. In exchange, Mexico will commit to a robust program of second-generation reforms in regulatory harmonization, the rule of law, and infrastructure improvements, including education, which will create conditions necessary to attract the long-term domestic and direct foreign investment that ultimately drives development. Within this general framework, specific (non-exclusive) areas for concentration would include border security and efficiency, energy security, and increasing labor mobility. The Compact would have at its core the following:

- Promotion of policies in all three nations designed to unlock the full development and job creation potential of the private sector.

- Establishment of a Development Fund for Mexico, with proportional contributions from all three nations, so long as Mexico commits to implementation and benchmarking of a mutually-agreed reform agenda.

- Support for the integration of all factors of production, including labor, through a robust, enforceable temporary worker program.

- Aggressive promotion of research and development through the identification of specific opportunities for joint cooperation and cross-border investment.

The key question is, why? Why should the United States and Canada care about Mexican development beyond a general humanitarian instinct or a fear of the potential of increased export of illegal activities (migration, narcotics, security threats) brought on by potential economic uncertainty on our southern border? The answer is simple to articulate, but extraordinarily difficult to achieve. If the United States and Canada plan to compete with China and other emerging economies by the time Asia reaches greater economic maturity in 2020 or 2030, both nations will have to put in place now the economic and commercial frameworks to take full advantage of economic efficiencies that would naturally accrue with creation of a larger internal North American market, harmonization of cross-border business practices and regulations, and a reduction in both risk and the cost of capital. Labor must also be seen increasingly as the irreplaceable input in global economic production and knowledge-based economies, and trained and utilized fully at its most effective potential use. Doing so will bring economic benefits to all three North American nations.

But this paradigm requires increased development in Mexico. Put another way, Mexico's development directly impacts US national strategic objectives. Both national security and economic security—which is itself a national strategic imperative—require our southern neighbor to be democratic and politically stable, economically healthy, and increasingly to see its own interests aligned more fully with ours. Canada faces similar realities with Mexico, if less intensively. It is in each of our interests to find ways to work more fully together so that, in the global economy, we will be able not just to survive, but to flourish. We cannot succeed absent greater North American integration, or without more rapid Mexican development, which, as a consequence, is in our strategic interests to promote.

MEXUS is committed to improving North American competitiveness as a strategic imperative for the United States. The time to begin is now.

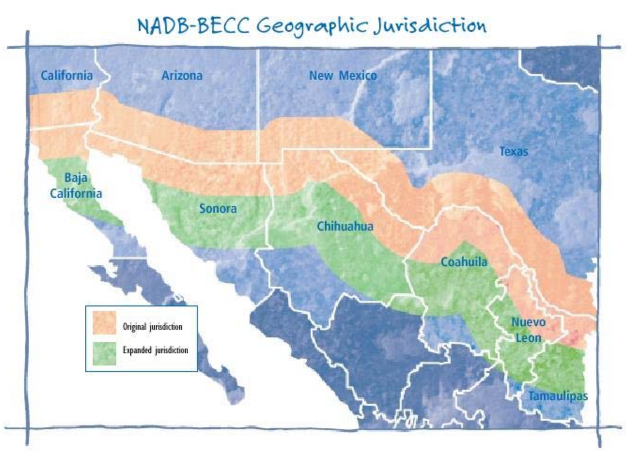
“A Compact for North American Competitiveness”

A Strategy for Building Competitiveness within North America

The US Council of the Mexico-US Business Committee (MEXUS), under the auspices of the Council of the Americas, has promoted commerce and the bilateral relationship for over 50 years. As the first truly binational business committee, MEXUS has played an important role in identifying and promoting the economic and commercial interests inherent in greater cross-border integration, working at the most senior levels of the private and public sectors to forge a common agenda for regional economic development. The willingness of far-sighted leaders on both sides of the border to re-examine years of economic orthodoxy and to envision the two nations as part of a natural economic partnership has made a significant contribution to regional integration, most notably the successful negotiation and passage, with Canada, of the North American Free Trade Agreement.

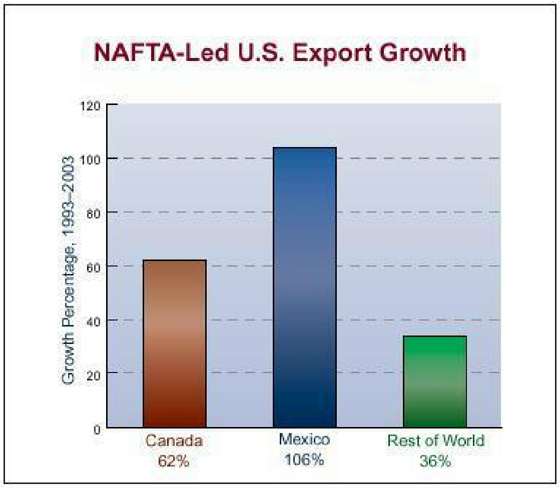
In many respects, NAFTA was just the first step. As a trade agreement, NAFTA has been a strategic and commercial success. It has greatly facilitated cross-border commerce, as it was designed to do, bringing order to the trade and investment climate while reducing barriers to trade and investment. It has provided checks and balances on detrimental governmental actions that might otherwise have been taken, particularly during the Mexican peso crisis in 1995. And it has dramatically altered the strategic relationship between the United States and Mexico, linking the two nations more closely together than ever before, while supporting democracy by providing an irrevocable opening to the outside world that gave impetus to the historic 2000 elections in Mexico.

NAFTA can be made to work better, to be sure. Trade and investment disputes can be resolved more rapidly and transparently. NAFTA institutions including the North American Development Bank (NADBank) and the Border Environment Cooperation Commission (BECC) can play a more effective role in North American economic development, and environmental safeguards must be strengthened. As well, there have been unintended consequences, limited in scope but concentrated in impact, transaction costs that have fallen disproportionately on certain sectors in all three nations.



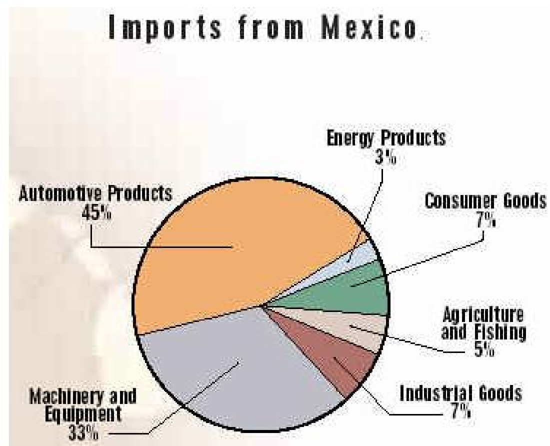
Source: NADB Bank

Nonetheless, NAFTA was not designed to address issues beyond trade and investment, and in fact it has not done so. Several critical areas were excluded from NAFTA, while other sensitive areas were only addressed in a limited manner. For example, broad-based education generally, and training for displaced workers specifically, are areas for further investigation and work. As well, the overriding US focus on border security and terrorism since September 11, coupled with long-standing concerns about illegal narcotics and immigration, have impeded deeper economic integration with Mexico, while complicating the border relationship with Canada.



U.S. exports increased 62% to Canada and 106% to Mexico between 1993 and 2003.

Source: NAFTA Secretariat



In 2002, U.S. firms captured 63% of Mexico's total import market and 61% of Canada's total import market.

In addition, in the 10 years since NAFTA went into force, the world has changed, and continues to change. One of the most significant global events over the past decade has been the enormous aggregation of wealth and political influence that has accrued to Asia, particularly China and India, as those economies surge and their leaders begin to steer them with greater determination onto the world stage. The long-term implications of this fundamental shift in global realities are worthy of consideration.

China's insatiable demand for natural resources, for example, has permanently altered global energy markets, while its leaders scour the globe for investment opportunities in strategic sectors. In 2002, China became the number one recipient of foreign direct investment, surpassing the United States. In 2003, China replaced the United States as the world's largest consumer of many industrial raw materials, and economic development projections suggest that its share of global metals consumption could approach 40 percent by 2025. China's labor market and practices have displaced patterns of global trade. Nations long-accustomed to favored trading relationships based on geography, language, history, and common business practices have been startled to see that they no longer have inherent advantages, but are truly competing within a global marketplace.

For its part, India's focused development of a strategic high-tech industry to work and in some cases compete with traditional Western producers has caused a re-think about issues such as white-collar job security in the United States, and led directly to the "outsourcing" firestorm during the 2004 US election campaign.

Asia's emergence is not only impacting the United States. In 2003, China replaced Mexico as the US' second largest trading partner. Mexican *maquiladoras*, uniquely positioned to take advantage of proximity to the US market, have actually lost some 250,000 jobs since 2000, in part because firms have moved to Asia to take advantage of price and labor competitiveness. As well, unlike many Latin American nations such as Argentina, Brazil, or Peru, Mexico is not a significant producer of those commodities that China actively seeks in order to fuel its explosive growth, thus making it unable to benefit significantly from China's economic expansion. The exception is petroleum, but inefficiencies in Mexico's energy sector have limited production, most of which goes in any event to the United States or is used by Mexico itself. Those items Mexico does export—auto parts and textiles, in particular—compete directly with Chinese exports in the global market place. As a result, the advantages Mexico once had under NAFTA are quickly being whittled down.

The NAFTA relationship, with only limited attention at the margins, has not responded to these new realities. Leaders in all three nations still see North America primarily as a region subdivided by boundaries, histories, languages, cultures, and social mores. This is understandable and appropriate, and will likely always be the case to some degree. At the same time, however, it is time to reconsider the North American relationship based on new global realities.

As a means to build economic competitiveness for all three North American economies, it is imperative to consider a more focused agenda leading ultimately to economic convergence. North America must become more competitive in the global marketplace. A primary driver of this agenda over time will be Mexico's own development, and the break down of intra-regional barriers, with a commensurate reduction in the enormous disparities of income and wealth within Mexico and also among the three nations of North America. As a matter of strategic importance for the United States and Canada, we must find ways to help Mexico develop more rapidly. By helping others, we in fact will do even more to help ourselves.

A Compact for North American Competitiveness

Now is the time to fortify the North American economy by increasing regional strength through cooperation, reform, and strategic alliances. To do this, MEXUS proposes the establishment of a Compact for North American Competitiveness among the three NAFTA countries. The Compact for North American Competitiveness would complement existing initiatives, including the Partnership for Security and Prosperity announced March 23, 2005, the Partnership for Prosperity, and the Millennium Challenge Account (MCA).

The purpose of the Compact would be to provide the impetus for further North American integration, strengthening the global competitiveness of North American producers while generally lifting living standards in all three countries over the next 10 to 15 years. It would have as its core the following ideas for consideration:

- Promotion of policies in all three nations designed to unlock the full development and job creation potential of the private sector by strengthening the investment climate, including the rule of law, harmonizing regulations, and identifying strategic development objectives including infrastructure improvement that will encourage national economic development through high-quality, long-term investments and increased trilateral trade.

- Establishment of a Development Fund for Mexico, with proportional contributions from all three nations, that would be used to finance the costs of reforms and infrastructure in certain areas, so long as Mexico commits to implementation and benchmarking of a mutually-agreed program of specific next-generation reforms designed to encourage additional long-term domestic and international capital flows that will build productive capacity and create wealth.

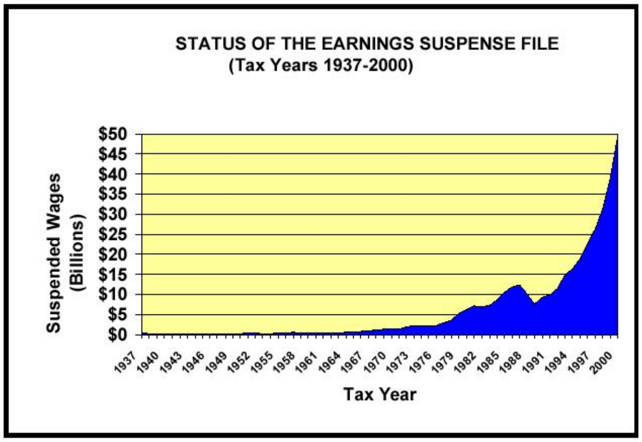
- Support for the integration of all factors of production, including labor, through a robust, enforceable temporary worker program that will match willing workers with willing employers, bringing order and increased security to current haphazard patterns of immigration.

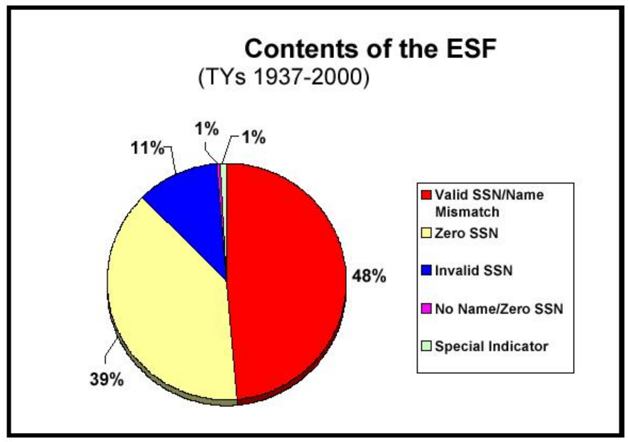
- Aggressive promotion of research and development through the identification of specific opportunities for joint cooperation and cross-border investment in all three nations, including technology incubation zones and sector-specific research parks, and the commitment by federal, state, and local government authorities to create the legal, regulatory, and tax environments that will allow innovative research and development activities to flourish.

Building a stronger and more stable North America requires that Mexico's systemic economic weaknesses must be considered and addressed. In a fiercely competitive global economic environment, North American economic success requires that each of its partner nations take concrete steps to reach their full economic potential, collectively and individually. And in that regard, institutional reforms, better infrastructure and investment in human capital are keys to helping Mexico foster a domestic and foreign investment climate for opportunity and growth.

A Development Fund for Mexico would assist these efforts. Funding for a Development Fund could be secured through various channels. Among these is the Social Security Administration's Earnings Suspense File (ESF), an account of mismatched names and numbers to which unauthorized Mexican workers in the United States, among others, already contribute while working under false social security cards. Senate Provision 743 in the Social Security Act of 2004 states that noncitizens are ineligible to access their contributions unless they can prove that at some point they were authorized to work in the

United States. In 2004, the GAO reported that since 1937 the ESF included over 246 million records involving over $463 billion reported earnings that could not be posted to valid worker records. Since 1990, the ESF has been increasing by an average of five million records and at least $17 billion in taxable earnings annually. Of course, not all of these wages come from illegal Mexican workers, and it is unclear from where specifically these wages originate because current privacy laws forbid the IRS and the SSA to share data. What is certain is that some of the fund is due to payments made into the system by unauthorized Mexican workers who are unlikely even to receive benefits. That is why a portion of this fund, say, one percent annually of the total fund, could be allocated to the Development Fund for Mexico dedicated to improving physical infrastructure, education, training, and healthcare. Quite apart from *social* security, this annual contribution would be an investment in *regional* security and economic growth.





Source: SSA

In addition, the MCA should also be amended to establish Mexico's eligibility, particularly since the program was created and launched in Monterrey, Mexico, specifically to reward governments that uphold democracy and implement beneficial economic and political reforms. By definition, this is the concept behind the Compact for North American Competitiveness. Though Mexico's national income is higher than other eligible countries, its strategic importance to the United States is such that this one exception should be made. As well, the United States and Canada can do more to contribute to Mexico's development through existing programs sponsored by multilateral lending organizations such as the World Bank and the Inter-American Development Bank.

Alternatively, if US leaders choose not to amend the MCA, the three North American nations should establish a state-level program based on the MCA concept, perhaps under the umbrella of the existing Partnership for Prosperity. Working together, the three nations would set criteria for Mexican state eligibility, monitor conditions, and condition assistance on state government performance. This would establish a framework for promoting reform at the state level, where in many cases it is most needed, while allowing the flexibility to adapt requirements to local conditions. This would also provide incentives for state level competition to attract and keep direct foreign investment, much as already occurs in the United States and Canada.

MEXUS is committed to supporting and promoting policies over the long-term that will strengthen Mexico's private sector and create more desirable jobs. With significant structural reforms, greater trilateral coordination that will foster an environment for competitiveness and private sector-led growth, sustained remittances from abroad, and a Development Fund designed to unlock investment that will provide additional resources for education, job training, healthcare and infrastructure development, Mexico would experience additional opportunities for economic growth. More than a decade after NAFTA, it is time to take the next step toward greater economic integration. Otherwise, the promise of NAFTA will remain unfulfilled, with profound implications for the global competitiveness of North America.

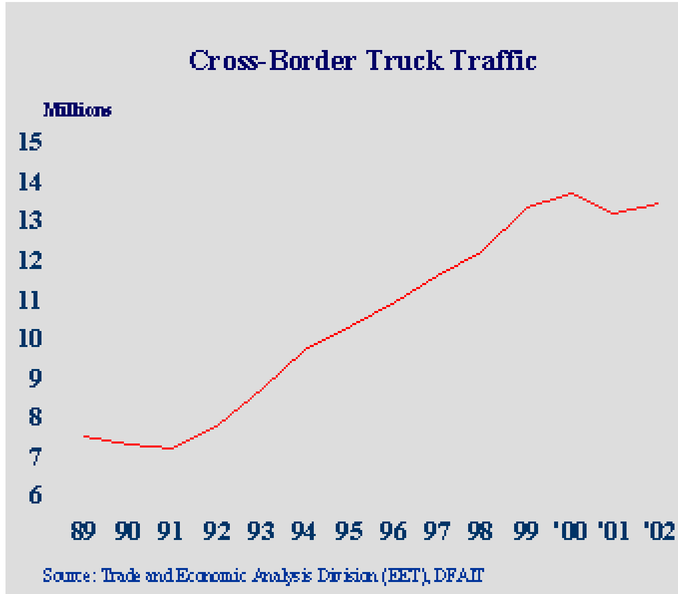
Three Potential Areas for Deeper Investigation

There are numerous areas where greater attention and coordination would make a significant impact on North American competitiveness. The list is long, and non-exclusive. Initially, MEXUS proposes three areas for inclusion in the "post-NAFTA" agenda, fully recognizing the political sensitivities of each, and understanding further that there are other areas that would also lead to mutually beneficial results.

The three areas for emphasis—border security and efficiency, energy integration, and labor mobility—have been chosen in part due to the broad, positive impact that each area would have on commercial relations generally, in part on the long-term, positive implications for North American competitiveness specifically. Each area is politically and economically complicated, with deep historical roots. It should be assumed that fundamental changes in these areas will take significant time, sustained attention at the most senior levels of government and business, and heightened political will. Unless they are each addressed, however, individually and as part of a larger whole, the idea of a qualitatively more competitive North America will be difficult to achieve.

The status quo is acceptable, perhaps, for a world that has remained unchanged. But the rise of globally competitive nations such as China and India means that those nations that stand still will rapidly fall behind. Already, Mexico's levels of education, research and development, technology penetration, physical infrastructure, and growth remain far too low to maintain competitiveness. But it's not just Mexico. By taking no further steps to deepen cooperation and economic integration throughout North America, the United States, Canada, and Mexico will all leave significant gains from further trilateral economic integration on the table, even as the fulcrum of the global marketplace shifts toward Asia. That would have long-term, deleterious consequences, and it is a risk that the United States, and North America, can ill afford to take.

Border Security and Efficiency



Already operating at full capacity, US borders are under pressure to guarantee speedy passage of goods while keeping terrorists, unauthorized persons, and illegal goods out. Lack of coordination, personnel, and equipment contributes to long delays and keeps the US-Mexico and US-Canadian borders porous (likewise, the US border with the Caribbean Basin). This reality is often at odds with the requirements of globally competitive industries, which require "just in time delivery" to reduce inventory costs while increasing customer satisfaction and the ability to respond to fast-moving consumer trends. In order to gain the full advantage of North American productions, quick and efficient supply chains are critical for companies operating in the three NAFTA countries. Border delays due to congestion, inefficiency, and security requirements increase time to market, costing money and ultimately, jobs.

One estimate suggests that border crossing delays cost the Canadian economy $8.3 billion a year, and that figure is expected to increase to $18 billion each year unless measures are taken now. Delays at the US-Canadian border are primarily due to poor and outmoded infrastructure, shortages of customs staff, and increased US security requirements after 9/11. The US-Mexico border faces these same issues along with the added hyper-pressure of keeping unauthorized workers and illicit goods out of the United States. Recently implemented programs such as the Free and Secure Trade (FAST) and Secure Electronic Network for Travelers Rapid Inspection (SENTRI) have proven helpful but insufficient. Individual states are attempting to fill the breach; recently, Texas and New Mexico agreed to share the cost of $31.2 million to add eight new truck inspection stations in Texas and one in New Mexico. The facilities are intended to modernize the border, and speed the flow of traffic while keeping the border safe.

Even so, in order to increase efficiency of trade between the United States, Canada and Mexico, more modern standards to process imports must be adopted. Current border procedures are inefficient and result in high costs for shippers, importers, and consumers while reducing the natural advantages of geographic proximity. Express carriers, for example, face cumbersome procedures that require an extra day of processing and extra costs that are not typical in other countries. Higher costs mean less efficient production, and a reduced advantage in global markets. More generally, greater border efficiencies will reduce transportation costs, augmenting Mexico's main comparative advantage (proximity to the United States and Canada) in ways that will make intra-regional trade more competitive with products that come from China and elsewhere which may have lower labor costs but higher transportation costs.

To reduce costs and increase the flow of goods, the United States, Canada, and Mexico, should adopt measures to coordinate and streamline the customs process. Border inspection stations should increasingly be located away from the borders themselves, and pre-clearance procedures should be increasingly utilized. More than anything, perhaps, this will reduce congestion at the border for legitimate traffic, while allowing greater law enforcement activities in areas where a stronger focus is needed, for example to stem the flow of illegal narcotics, cross-border terrorist activities, and people trafficking.

In the long run, NAFTA countries should move toward establishing the functional equivalent of a borderless economy for goods and services produced therein. This vision may not be practical today, but it is a goal worthy of working toward over time. In a borderless North American economy, each country would retain its identity and sovereignty, of course, but qualifying NAFTA goods and services would be treated essentially as, say, goods and services moving between California and Illinois. Barriers to entry and exit would be streamlined and reduced, with the ultimate goal being the free movement of goods and services within North America. Better cross-border coordination of law enforcement and intelligence sharing would help address concerns about illegal activities.

Recommendations on Border Security and Efficiency

- In the first instance, the United States must honor its NAFTA cross-border trucking commitments. Current trucking requirements are among the greatest causes of inefficiency and pollution at the border because they force the transfer of cargo from truck to truck operating on each respective side of the border. There is little justification for the continued refusal to implement NAFTA fully.

Source: AASHTO

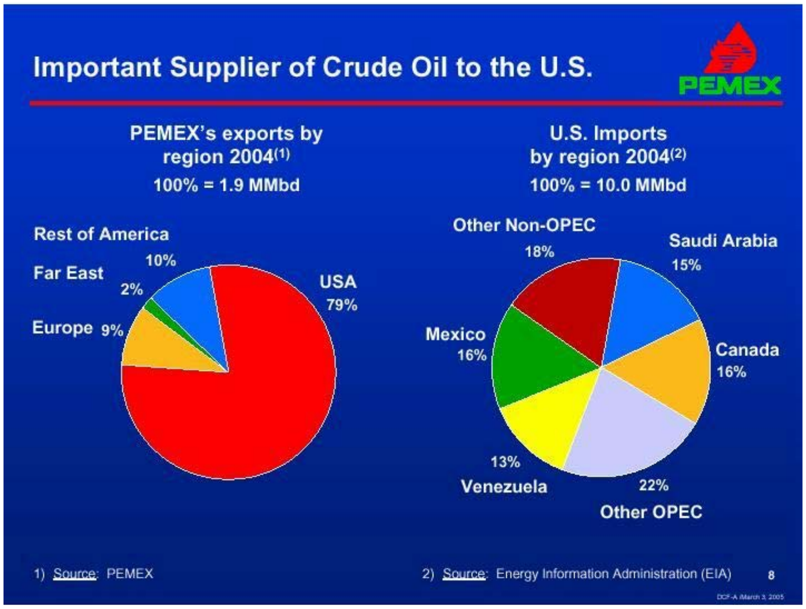
- A greater emphasis on locating inspection stations away from the borders themselves, plus a greater reliance on pre-clearance procedures, will speed cargo while providing conditions whereby the border itself can be more effectively sealed. Until then, greater investments in technology, equipment, and infrastructure at the border by all three nations would better support the volume of goods and services that cross internal North American borders. More and faster implementation of technology is needed to limit the wait time of trucks crossing the border on a regular basis. Joint, cross-border research and development projects to improve border technology should be pursued with the support of venture financing such as that provided by In-Q-Tel and DARPA. Public-private partnerships, for example turnkey border infrastructure projects, should explicitly be explored and implemented to help finance the huge infrastructure costs required to make borders more effective and efficient. Additional border crossings should be established in order to reduce pressures on existing facilities while improving border security and management. The CANAMEX corridor—a NAFTA highway linking Canada with Mexico via the Western United States—should be evaluated as a means to greater trilateral economic integration.

- Increased coordination among NAFTA customs agencies is necessary to reduce paperwork and streamline the clearance process, and NAFTA country shipments should be allowed pre-clearance privileges to maximize geographic advantages. Additionally, Mexico should shift liability for the accuracy of cargo manifests to the importer and away from customs brokers, adopting a more transparent and efficient plan for checking high-risk shipments. This would speed the clearance process significantly because Mexican customs brokers would no longer be required as a matter of routine to open and inspect every package or translate every document, rather than simply focusing on higher risk shipments. This particularly impacts the express delivery industry where prompt border procedures are, by definition, a key to effective service.

Energy Security

Energy security is a national security priority in the post-9/11 environment. The ongoing access to cost-efficient energy supplies is of strategic significance to all three North American economies, particularly as the Middle East continues to be unsettled, Venezuela's investment climate is increasingly subject to political intervention, and China and India continue their strategic movement into global energy markets. The United States is the world's largest energy user. Domestic supplies of energy are insufficient to meet demand; increasing energy imports will continue to be required. "Self-sufficiency" is an impractical goal. Rather, our goal should be to deepen our relationships with friendly external energy suppliers, to ensure the continued access to energy from stable and politically compatible sources.

Canada and Mexico are among the top suppliers of energy to the United States, along with Saudi Arabia and Venezuela. To date, however, energy partnership within North America has largely been ad hoc, with little thought of the implications for national security and global economic competitiveness of a more strategic approach to North American energy. Current inefficiencies in the North American energy market must be addressed if the region is to benefit fully from its enormous energy endowment, producing, consuming, and conserving energy in the most efficient, productive, and market-friendly manner possible.

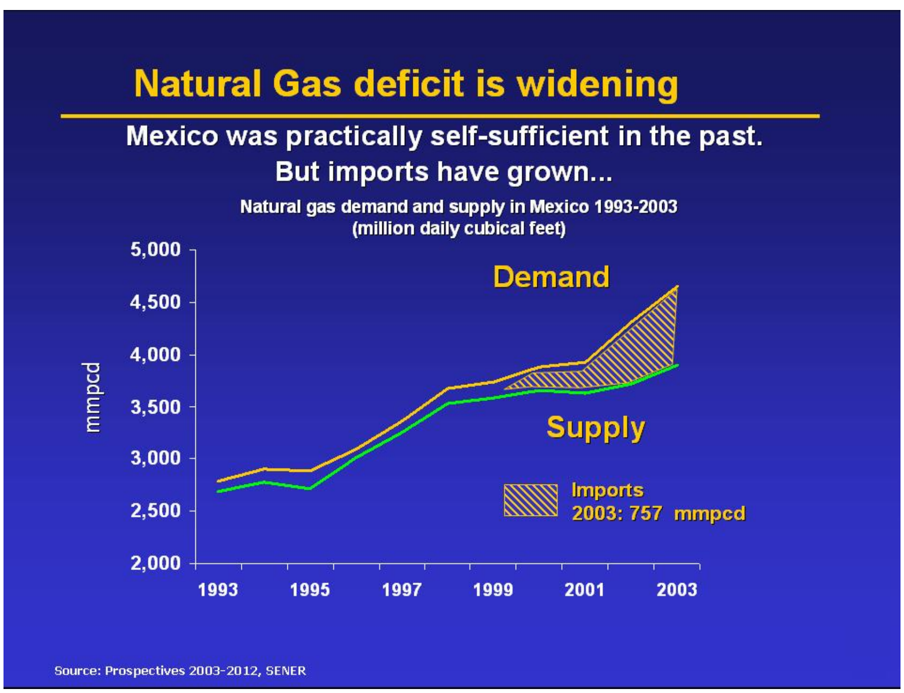


With the fourth largest crude oil reserves in the Western Hemisphere, Mexico nonetheless *imported* $2.4 billion of gasoline and $1.5 billion of natural gas in 2003. This staggering reality, the result of Constitutional requirements that restrict foreign investment in the hydrocarbons sector, was exacerbated in 2004 by higher import volumes and international prices. As a result, Mexico's energy sector, central to the country's economy and a legitimate source of national pride, faces the challenge within the framework of its Constitution of drawing substantial foreign investment flows to modernize, expand, and improve production. Increased production would help Mexico meet its growing domestic demand for energy, while allowing increased exports to augment the inflow of revenues and to realize corresponding benefits. Without making conditions more attractive for private investors in the near term, PEMEX, Mexico's national oil company will be unable to sustain its role as the primary underwriter of Mexico's annual budgetary needs over time. Additionally, unless Mexico finds cost-effective means to raise production, overall security and competitiveness within North America will be impacted.

Energy costs and availability are among the critical challenges facing Mexican industries as well as US and Canadian companies operating in Mexico. This is a much broader discussion that must take place, because the high cost of energy in Mexico directly impacts industries well beyond the energy sector alone and is a critical component of overall North American competitiveness.

Currently, the Mexican Congress appropriates funding to energy utility companies, and taxes more than 60% of revenues. A lack of funds and technology, coupled with a heavy tax burden, have prevented PEMEX from optimum levels of exploration and development of the Mexican energy sector. Energy costs that are higher than they would otherwise be under a more liberal energy environment raise the costs of production in all energy-dependent sectors, reducing competitiveness while under-generating employment. Moreover, direct energy costs and availability impact Mexican citizens on a daily basis. It is estimated that Mexico lacks approximately $100 billion to modernize its infrastructure to meet domestic demand over the next ten years. In response to these urgent needs, President Fox and the Mexican Congress are currently working to increase PEMEX's ability to reinvest by freeing up cash flow that would otherwise go to the general government fund. It is anticipated that these reforms could be completed as early as April 2005 pending final Congressional action. This is an internal matter for Mexico; nonetheless, the end result will have implications for North American energy security and competitiveness.

The business community respects and deeply appreciates the political sensitivities toward private investment in the Mexican state-owned energy sector, even as we believe that Mexico would greatly benefit by liberalizing its energy sector. By partnering with US and Canadian energy companies, Mexico can position itself to meet domestic demand as well as increase its reserves and revenues while contributing to growth in energy dependent sectors. US and Canadian energy companies are interested in becoming actively engaged in Mexico's energy market and are willing to invest much needed financial, management, and technological resources to increase energy availability and efficiency in North America. Specifically, recent claims to vast deepwater oil reserves in the Gulf of Mexico could be a boost to the country's total energy output and national income. Tapping into these new sources, however, will require Mexican Congressional approval and increased cooperation with foreign companies that have the technical and financial strength required to undergo such complicated explorations. Without such cooperation, Mexico will be unable to reap the full benefits of deep-water drilling in the Gulf of Mexico. As well, US and Canadian companies tend to promote a culture of philanthropy including support for schools, hospitals, and the arts that would bring benefits to Mexico beyond sector-specific investments. The first step would be to create an appropriate investment framework to allow for such foreign investment on market terms.



In recent years Mexico's domestic demand for electricity has also soared, especially, along the border with the United States and around other industrial and tourist areas. Demand levels, generation inefficiencies, and the use of natural gas to power electricity plants are the main reasons behind the high cost of electricity in Mexico. Although Mexico has the sixth largest natural gas reserves in the Western Hemisphere, its demand for natural gas has exceeded production. In 2003 Mexico imported 28% of its natural gas from the United States. The Mexican government estimates that it will need $50 billion in investment over the next decade just to meet the country's growing demand for electricity. Additional generation capacity is required. Private companies can provide technology and financing needed to expand transmission networks to supply Mexico’s growing market.

In addition, Mexico could reduce the cost of imported natural gas by diversifying its sources. US and Canadian companies can help supply the local Mexican market by importing liquefied natural gas from third countries, working with the Mexican government which has moved quickly to build a number of LNG regasification terminals and has permitted such terminals in four strategic locations around the country. These terminals are expected to be completed between 2008 and 2010. Once built, they will replace most of the pipeline gas imported from the United States.

Recommendations on Energy Security

- Trilateral energy coordination focused on regulatory and standards harmonization, improved infrastructure, and an increase in Mexican energy production is a fundamental requirement for strengthening regional security and competitiveness. Regulators and interested parties from each country should seek to incorporate best practices from within North America, working toward the full integration of North American energy markets and the efficient, market-based matching of supply with demand.

- The United States should begin to view North America as an integrated energy marketplace, seeking to bolster its own security by developing strategic relationships with Canada and Mexico. Transport costs are lower and security of supply is unquestioned. As well, a North American energy alliance could well be the spark that ignites deeper regional economic integration, much as the coal and steel community was the anchor that led to broader European integration.

- Mexico should find ways to attract foreign investment within the requirements of its constitutional framework. Without private direct investment, it is unlikely that deepwater exploration and technology transfer will be optimized to take full advantage of new reserves in the Gulf. It is also unlikely that necessary infrastructure will be developed, including additional refineries allowing Mexican crude oil to be processed domestically, reducing the cost of gasoline for Mexican industries and consumers. Additional LNG terminals would increase the supply and cost-effective utilization of natural gas, without which, natural gas will continue to be under-supplied, increasing the costs of electricity, and burdening productive capacity with higher input costs in all industries. Increased production of both oil and gas would strengthen exports, improving national income accounts.

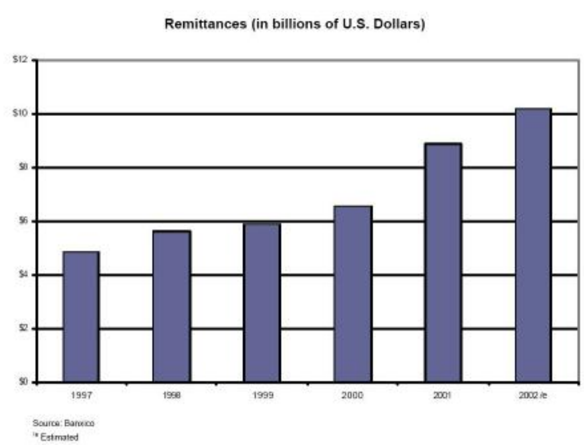
- Unless Mexico finds ways to obtain the technology and financial resources it needs for energy sector development, North America generally will be negatively impacted. Mexico itself may be the North American country most negatively affected, sovereignty issues aside, but Mexico's well-being directly impacts our own. More imaginative and attractive contracts to receive greater participation in the non-associated gas sector would help monetize resources, reversing the trend toward energy dependency, while respecting constitutionally protected national interests. The Canadian foreign investment model that permits foreign direct investment without transferring ownership of resources might serve as an appropriate benchmark.

- Though this is an internal Mexican matter, unless the government's dependence on revenue from PEMEX is reduced, Mexico will continue to under invest in energy development. Tax reform is necessary, while a Development Fund for Mexico could help finance the near-term transition costs for education, job training and healthcare that are impacted by a loss of PEMEX tax revenue.

Increasing Labor Mobility

The wage gap between the United States and Mexico, and between Canada and Mexico, is wide and growing, providing continued economic impetus for Mexican nationals to leave their homeland. Until the relative income gap narrows, which will take years, if ever, to accomplish, this situation will likely continue. Massive flows of unauthorized persons from Mexico (and third-country nationals through Mexico) are politically charged. Illegal immigration is perhaps the most difficult matter in the bilateral relationship. Unless migration flows are better understood and channeled more appropriately, they will continue to be a vexing aspect of the relationship, perhaps holding back progress across the board.

To illustrate the magnitude of this issue, in 2004, for the second consecutive year, remittances of money from migrant workers (legal and illegal) in the United States back to Mexico exceeded foreign direct investment as a source of foreign currency. In 2004 alone, remittances totaled $16.6 billion, against $16.6 billion of recorded foreign direct investment. If the trend continues, remittances will reach $20 billion in 2005. By comparison, crude oil exports earned Mexico $21.2 billion in 2004.



As a means to partially address and better manage a problem that is perhaps unsolvable, MEXUS supports immigration reform through implementation of a temporary worker program. The current immigration system is broken and must be fixed, and a better vision is needed. Migrants are essential for the health and well being of the US and Canadian economies, forming the backbone of entire segments of the economy including the unskilled agriculture, construction, and hospitality industries. At the same time, Mexico has not been able to provide the number of well-paying jobs required to provide for their own citizens; "el Norte" has traditionally been a safety valve for Mexico economically. In the post-9/11 world, however, it is simply untenable on national security grounds to have such significant cross-border flows of unauthorized persons. A better way must be found to allow needed workers into the United States, and to treat them fairly and with dignity, while keeping US borders secure and discouraging non-legal entrants.

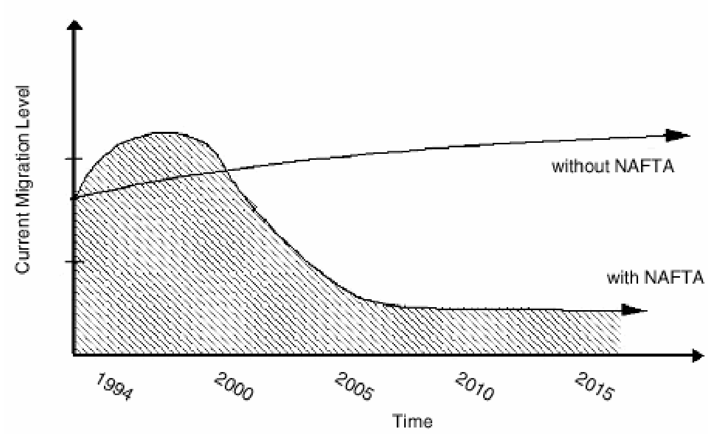
NAFTA (TN Visa) Admissions, 1996-2003

	1996	1998	1999	2000	2001	2002	2003	Total:
Canada	34,438	76,053	85,704	110,740	113,654	86,664	65,739	**572,992**
Mexico	243	824	1,737	2,720	3,341	2,366	1,268	**12,499**
Total:	**34,681**	**76,877**	**87,441**	**113,460**	**116,995**	**89,030**	**67,007**	**585,491**

Note: Data for 1997 are unavailable. Total TN admissions include workers, and their spouses and children.
Source: Office of Immigration Statistics, U.S. Department of Homeland Security

To ameliorate the security and social problems illegal immigration cause, North America should allow non-professional Mexican nationals to work temporarily in the United States or Canada. This would be with the understanding that it would nonetheless be extraordinarily difficult to issue enough visas to meet the demand and would therefore not completely cut off illegal immigration from Mexico. The administrative burden would also be huge. Still, such a program would equally benefit Mexican nationals seeking a better life in the United States and the industries that need to hire them for hard to fill jobs. Under this proposal, both Mexican workers and their US and Canadian employers would be held accountable for taxes and compliance with the law. Willing workers would be matched with willing employers. Aside from creating economic opportunity for Mexicans under legal status in the United States and Canada, this program would increase security by allowing national security agencies to keep better track of who is entering and exiting the United States, Canada, and Mexico and allow law enforcement agents to focus on criminal activities.

It must be stressed that this arrangement would not grant US or Canadian citizenship, but would eliminate most negative aspects of being an illegal immigrant living in the shadows of a formal economy, reduce cultural stigmas, and increase regional security. And unlike an amnesty program, this proposal would reduce incentives of working in the United States or Canada illegally, because it would allow people to return home to Mexico without fear of being apprehended at the border, and it would also ensure that, as legal residents, workers would be entitled to the benefits of participating in the legal economy, including the rights and protections afforded all workers in the United States and Canada. As well, penalties and enforcement for employers hiring unauthorized workers would increase dramatically.



Source: U.S. Immigration & Customs Enforcement

Recommendations on Increasing Labor Mobility

- Implementation of a temporary worker program for Mexican nationals should be a top priority. Unauthorized Mexicans already working in the United States or Canada should be included in the program—they will need to regularize their status or remain illegally and be subject to law enforcement.

- Under the program, Mexican workers would be guaranteed minimum wages and benefits. Workers and their children would be entitled to use local schools, including in-state college tuition, and basic hospital services. They would be required to pay income taxes for the time they remain in the United States. They would, however, be exempt from paying US or Canadian social security taxes, because as non-citizens of the United States or Canada they would not be eligible to collect Social Security or other federal pension benefits. Rather than pay into social security for their temporary workers from Mexico, employers would be required to pay the equivalent of social security into the Development Fund for Mexico, which, as discussed previously, would be dedicated to the improvement of physical infrastructure, education, and healthcare in Mexico. This way there would be no financial incentive for US employers to hire legal Mexican workers over US workers as might occur if US employers were not required to make matching social security payments, since US and Mexican workers would both cost the same for businesses to employ. Currently, unauthorized workers often pay taxes under false names or numbers, thereby ensuring they are unable to receive certain services. This built-in tax is unjust, and as a matter of fairness, it should be addressed.

- To make this plan viable, Mexico must commit to stronger, more pro-active protections of its own borders: it should actively work with US authorities to seal the US-Mexico border to illegal activities, while working in addition to seal its own southern borders with Belize and Guatemala, a significant entry point of third-country migrants heading to the United States. Ultimately, the establishment of a North American security perimeter is the most desirable outcome.

- Vigorous enforcement against US employers who knowingly and willingly hire illegal workers should be a significant part of this new immigration reform. Only by removing the economic incentives for illegal migration, e.g. the possibility of a job, will such illegal activities slow or even halt.

- Finally, delays in visa issuance for legitimate business activities have proven unnecessarily burdensome and anti-competitive. Business visa delays should be expeditiously addressed.

Conclusion

Clearly, the issues on the trilateral agenda are complex and politically difficult to address. That will not change. But we do ourselves a disservice if we do not begin to view these issues and others within the context of North American security and competitiveness. Unless North America finds ways to link more closely together, unlocking the full promise of its citizens through appropriate structural, regulatory, and political and economic reforms, each nation will have to find its own way in the global economy.

For the United States and perhaps Canada, promotion of the status quo would be adequate—just—for success in the global economy if the global economy remained static. But the rapidly changing international economic environment means that we cannot stand still. Working together, we will all benefit, taking full advantage of available opportunities to build global competitiveness further. With significant cross-border adjustments such as those detailed above, Mexico’s economy will develop further, with all that implies for the management of problems within North America more broadly.

In reality, the choice is a stark one: whether to focus on the opportunities that mutually present themselves, or to spend our time and efforts attempting to manage the difficulties that will continue to divide us. MEXUS is working to ensure that competitiveness increasingly becomes the watchword of the North American community. At stake is nothing less than the economic security of North America itself.

Appendix I

US-Council, MEXUS Leadership Team

ChevronTexaco Corporation

Eastman Kodak Company

First Data Corporation

Ford Motor Company

Kissinger McLarty Associates

Manatt Jones Global Strategies

Merck & Company

MetLife

Miller & Chevalier Chartered

Nextel International/NII Holdings

The Procter & Gamble Company

The views expressed in this report are the collective opinions of individuals representing companies associated with the US-Mexico Business Committee and/or the Council of the Americas. They are not necessarily the views of the companies themselves.

Appendix II

MEXUS Chairmen (US and Mexico)

1951-1952	W. L. Hemingway, US Chairman Jose Rivera, Mexican Chairman
1952-1953	W. L. Hemingway, US Chairman Edmundo J. Phelan, Mexican Chairman
1953-1954	William B. Wright, US Chairman Arturo Bueno, Mexican Chairman
1954-1955	William B. Wright, US Chairman Clemente Serna Martinez, Mexican Chairman
1955-1956	William B. Wright, US Chairman Eduardo Prieto Lopez, Mexican Chairman
1956-1957	William B. Wright, US Chairman August Dominguez, Mexican Chairman
1957-1958	Louis R. Lundborg, US Chairman Eduardo Prieto Lopez, Mexican Chairman
1958-1959	Louis R. Lundborg, US Chairman Arturo Bueno, Mexican Chairman
1959-1960	H. Ladd Plumley, US Chairman Arturo Bueno, Mexican Chairman
1960-1961	Louis R. Lundborg, US Chairman Arturo Bueno, Mexican Chairman
1961-1962	Norman T. Ness, US Chairman Arturo Bueno, Mexican Chairman
1962-1968	Frank A. Kemp, US Chairman Heriberto Vidales, Mexican Chairman
1968-1969	Glenn C. Bassett, US Chairman Antonio Ruiz Galindo, Mexican Chairman
1970-1972	John R. Kimberly, US Chairman Javier Bustos, Mexican Chairman

1972-1976	Richard G. Landis, US Chairman Alejandro Medina, Mexican Chairman
1976-1980	Joseph H. Jones, US Chairman Claudio X. Gonzalez, Mexican Chairman
1980-1981	Rodman C. Rockefeller, US Chairman Manuel J. Clouthier, Mexican Chairman
1981-1985	Rodman C. Rockefeller, US Chairman Carlos Rojas Magnon, Mexican Chairman
1985-1988	Rodman C. Rockefeller, US Chairman Enrique Madero Bracho, Mexican Chairman
1988-1990	Rodman C. Rockefeller, US Chairman Juan Elek Klein, Mexican Chairman
1991-1993	Rodman C. Rockefeller, US Chairman Juan Gallardo Thrulow, Mexican Chairman
1993-1997	Robert A. Mosbacher, US Chairman Jacobo Zaidenweber, Mexican Chairman
1997-1999	James R. Jones, US Chairman Jacobo Zaidenweber, Mexican Chairman
1999-2000	James R. Jones, US Chairman Henry Davis, Mexican Chairman
2000-2003	James R. Jones, US Chairman Jaime Alatorre Cordoba, Mexican Chairman
2003-2004	James R. Jones, US Chairman Carlos Fernandez, Mexican Chairman
2004-Present	James R. Jones, US Chairman Eugenio Clariond, Mexican Chairman

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