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NAFTA Renegotiation: Recalibrating North American Economic Relations

by Michael McKeon

The U.S. Senate voted to confirm Robert Lighthizer as United States Trade Representative last week, rounding out President Donald Trump's cabinet and giving momentum to his trade agenda. At his swearing-in ceremony on May 15, Ambassador Lighthizer predicted that President Trump would permanently reverse "the dangerous trajectory of American trade," and in turn make "U.S. farmers, ranchers and workers richer and the country safer." This policy shift will begin in earnest in the coming weeks, when Lighthizer meets with congressional trade leaders to discuss the administration's plan to renegotiate the North American Free Trade Agreement (NAFTA).

NAFTA renegotiation may move forward as early as August. Ambassador Lighthizer notified Congress of the administration's intent to initiate negotiations on May 18, and Congress now has 90 days to review the developing plan before talks with Mexico and Canada can begin. The United States' first significant trade agreement has fundamentally reshaped the economies of North America over the past two decades, and any attempt to change its parameters will present risks and opportunities alike. If renegotiation yields an updated, 21st century agreement to account for new technology and continually changing labor forces, U.S. industry will become more competitive in the global market, thereby creating jobs and lowering consumer prices at home. Conversely, a new NAFTA that creates barriers to imports and investment will disrupt cross-border supply chains that undergird North American manufacturing, resulting in job losses, higher prices, and diminished export opportunities for millions of U.S. businesses, workers, farmers and service providers.

In its March 28 draft notice to renegotiate NAFTA, the Trump administration laid out objectives that mirrored many of the outcomes achieved by President Barack Obama in the Trans-Pacific Partnership (TPP), from which the United States withdrew on January 23, 2017. President Trump has since stated that the draft does not represent the administration's policy positions and goals, so his approach to renegotiation remains, in effect, a mystery. As the leaders of the United States, Canada and Mexico prepare to rejigger the interdependent economies of North America, they must ensure that any new arrangement will not harm business, labor or consumer interests within the continent, and that the bloc – which trades more than $1 trillion each year – will operate competitively in the modern global trading system.

Catching up with the 21st Century

When finalized in the early 1990s, NAFTA was the most complex trade and investment deal of its kind. International trade relations have matured significantly since then, rendering several areas of the agreement outdated, if not obsolete. Although the Trump administration is still formulating its objectives, these areas call for fundamental updates and will undoubtedly be the focus of major debate.

The United States is highly competitive in services, which account for the majority of U.S. economic output and have become far more diverse and complex since NAFTA entered into force. Although the agreement made strides in opening cross-border access to services such as finance and telecommunications, it did little to liberalize their provision, which effectively blocks trade partners' access to growing markets. Given the ever-increasing interconnectedness of the North American economy, NAFTA renegotiation should also address more definitively the mobility and mutual recognition of service professions, such as law, architecture and engineering. Finally, NAFTA provisions in this area should be brought up to speed with the digital economy, for example, with the removal of barriers on mobile communications, international roaming rates and audiovisual services.

Investment has become a highly contentious element of international trade agreements over the past several decades. NAFTA was the first free trade agreement to include Investor-State Dispute Settlement (ISDS), which allows foreign investors to seek a remedy against a host country for unequal treatment or violation of its investment obligations. Trial and error over the past 20 years has identified flaws in the system, which negotiators would be wise to address in an updated NAFTA. Potential improvements include the creation of mechanisms to deter the filing of frivolous claims, more transparent procedures for the selection of arbitrators, and effective assurance of civil society participation. In order for dispute settlement to be effective and fair, the negotiating parties should address unjustified barriers to the establishment and operation of foreign investments, and generally strengthen provisions to guarantee that investors receive treatment no less favorable than their domestic counterparts.

Criticism of NAFTA in the United States is commonly geared toward its perceived effects on labor markets. Many claim that the agreement has allowed U.S. firms to move manufacturing operations to Mexico, where labor costs are relatively low and employers do not contend with strict worker protection laws, as they do in Canada and the United States. NAFTA's provisions on labor were codified in a side agreement prior to ratification in order to garner wider congressional support, and are often criticized as lax and unenforceable. This area is particularly ripe for improvement, and presents an opportunity for the United States, Mexico and Canada to raise standards that will diminish concerns of job flight and serve as a model for other parts of the world. For example, the United States, together with Canada, may push aggressively for workers' rights to organize, requiring commitments from companies as a condition for operating within North American supply chains. The Mexican government may be reluctant to accept such a condition without meaningful concessions from its trading partners, such as greater access to federal procurement markets or more favorable tariff-rate quotas for commodities like sugar. The country has made strides through its own labor market reforms over the past several decades, and therefore may in fact welcome the opportunity to leverage such a commitment in negotiations.

A modern, comprehensive trade and investment agreement is incomplete without agreed-upon rules in areas such as intellectual property rights (IPR), rules of origin (ROO), and public procurement. NAFTA currently contains provisions in these areas, but they should be updated to account for internet commerce, the diversity of government acquisitions, and advancements in technology that have changed the components and methods we use in producing goods from automobiles to textiles.

NAFTA predates many of the technologies we use today, so digital trade and cross-border data flows should be among the administration's top priorities in renegotiation. The original agreement does not address customs duties for digitally delivered products, and includes no guarantee that such products originating in one market will receive non-discriminatory treatment in others. NAFTA has no defined framework for electronic transactions – such as payments, authentication, and e-signatures – or provisions on data localization requirements for companies operating in jurisdictions outside their own. Digital goods, such as laptop computers and smartphones, and services such as digital music and streaming video, did not exist when the agreement was negotiated, but now make up a substantial and growing sector of the U.S. economy. For example, digital trade has added between $517-711 billion to U.S. GDP in recent years, and digitally delivered services account for more than half of total U.S. services trade. Global spending on information technologies and services is expected to exceed $4 trillion in 2017. The updated agreement should address this new reality of the global marketplace, and provide space for evolution as new technologies develop.

A Rocky Road Ahead

President Trump has predicted that NAFTA renegotiation will be swift and easy, but the number and complexity of issues that the parties will necessarily discuss suggest, instead, a long and difficult process. The road ahead is complicated by other diplomatic and trade tensions with Mexico and Canada, as the United States and its trading partners have lobbed threats to raise tariff or other barriers against each other in the coming months. By the time negotiations begin, members of Congress will be preparing for mid-term elections, and Mexico's presidential campaign will be in full swing. Domestic and international politics will unquestionably shape policy, which does not bode well for NAFTA negotiations. It is therefore incumbent upon all stakeholders – national governments, congressional and parliamentary leaders, industry and civil society – to ensure that the upcoming renegotiation of NAFTA will first do no harm, and ultimately improve the economic welfare of North America.

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