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Article

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NAFTA on the Brink

During the last presidential campaign, Donald Trump repeatedly attacked the North American Free Trade Agreement (NAFTA), labeling it “the worst trade deal ever” and promising to renegotiate the pact should he be elected. Although presidents do not always follow through on their campaign rhetoric, Trump’s aggressive and uncompromising approach to international trade was one of the few policy areas in which he held deep-seated preferences. Thus there was reason to believe that this would be a top priority for the administration.

Over the first year and a half of his presidency, however, Trump’s efforts to revamp North American trade proceeded only in fits and starts – and more fits than starts. The first fit came just a week into Trump’s administration, when he floated the idea of imposing a 20% tariff on Mexican imports to pay for a border wall between the two countries. A few months later, there was another fit when we learned that Trump planned to withdraw from NAFTA on his 100th day in office. Intense lobbying along with pleading phone calls from Canadian Prime Minister Justin Trudeau and Mexican President Enrique Peña Nieto, helped dissuade him. A third fit came earlier this year, when – after an initial reprieve – Trump imposed tariffs on Canadian and Mexican steel and aluminum imports, citing national security issues. For Canada in particular, the notion that it represented a security risk to its closest ally was seen as a grievous insult.

Meanwhile, off the front page and mostly behind the scenes, negotiations between the three parties have plugged along. Formal talks kicked off a little over a year ago, but progress has come very slowly. More recently, however, things have been picking up. The current urgency is driven by the latest self-imposed deadline acknowledged by the parties, September 30 – a product of Mexico’s political calendar and the US bureaucratic procedural rules. Mexican President Peña Nieto will leave office on December 1, and for political reasons both he and President-elect Andres Manuel Lopez Obrador would rather the former officially sign the deal than the latter. Additionally US Congressional rules require that the text on any new trade agreement is released at least 60 days before signature; therefore, the text needs to be finalized by the end of September.

At the time of writing, in mid-September, we do not yet know if this deadline will be met:¹ the parties are in the midst of talks and though real progress has been made, there are still many outstanding issues that could trip up negotiations. Moreover, even if an agreement is reached by the end of September, there are still a number of additional questions that need to be answered before the new pact comes into force.

Will the new agreement be bilateral or trilateral? Earlier this summer, in an effort to break out of the stalemate plaguing trilateral talks, Mexico and the US began bilateral negotiations. While the US-Mexico talks were originally expected to focus on a relatively narrow set of issues related to automobiles, ultimately the US and Mexican teams announced they had reached a much more comprehensive agreement, covering almost all aspects of NAFTA. The US and Mexico now claim that if Canada is unwilling to reach a deal by the end of September, the two parties will go ahead with a bilateral agreement. While this strategy is designed to increase pressure on Canada, it may ultimately backfire: though Trump is happy with a treaty that only includes the US and Mexico, the US Congress – who will ultimately have a say in any NAFTA successor – strongly prefer a trilateral deal and may refuse to ratify a bilateral one.

How will the new NAFTA differ from the old NAFTA? Many changes from the old NAFTA to the new NAFTA are relatively uncontroversial, and simply reflect the need to update a treaty that is now 25 years old. On these issues, such as the environment and digital trade, the text of a new

¹ Due to Intereconomic’s editorial calendar, the article does not include any negotiation developments that have occurred after this date.

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deal will likely look very similar to what was included in the Trans Pacific Partnership Agreement signed in late 2015.

There are, however, two big issues where the new NAFTA may be substantially different from the earlier version. The first is autos and auto parts, one of the most important industries in North American trade. The Trump administration wants to shift more auto production back to the US, and so is pushing for higher rules-of-origin requirements in the sector and demands that more production is completed by higher wage labor. The result of these changes will likely be less auto trade among the NAFTA partners.

The second issue relates to how disputes about treaty implementation and interpretation will be resolved. The United States wants to substantially scale back NAFTA's Chapter 11, which allows private investors to sue governments if governments breach any of NAFTA's investment rules; Canada and Mexico both appear likely to agree to this request. The US also wants to curtail (or possibly remove altogether) NAFTA's Chapters 19 and 20, which set resolution procedures for state-state disputes related to NAFTA trade. Canada is fighting to preserve these rules, which it views as essential for protecting its interests relative to the larger, more powerful US.

How will Congress respond? Even if a deal is reached by the end of September and signed by December 1, it will still need to be ratified by all three countries. In the US, this will mean a vote in Congress sometime in 2019 – and the prospects for approval look slim. Last year, US trade negotiators argued the new NAFTA would have bipartisan support, but at the moment bipartisan disapproval seems more likely. Republicans are wary of Trump's protectionist instincts, and view the major substantive reforms of the new NAFTA as steps in the wrong direction. Democrats, meanwhile, will be very reluctant to help Trump achieve a political victory, even if they agree on some of the specific trade measures. Getting a new trade agreement through Congress is always difficult; in today's hyper-partisan environment, it might be nearly impossible.

If Trump can't get a new deal, will he seek to withdraw from NAFTA? Trump has repeatedly threatened that he will withdraw the US from the existing NAFTA pact if the renegotiation efforts stumble. This posturing is meant to gain leverage, both internationally and domestically: if the only alternative to Trump's new NAFTA is no NAFTA altogether, then both Canadian and Mexican negotiators and potential opponents in Congress will be more likely to acquiesce to the administration's demands.

In practice, however, such a withdrawal would entail substantial economic and political costs, and would be difficult to execute. US constitutional lawyers continue to debate whether Trump has the authority to unilaterally withdraw from NAFTA without Congress' assent. While Trump could officially declare the US is no longer a party to the treaty, the implementing legislation for NAFTA – the laws that give effect to everything in the treaty – is in Congress' hands.

Ultimately, whatever happens in the coming weeks, it is unclear if the energy and political capital that have gone into renegotiating NAFTA will have been worth it. After a year and a half of demanding and often contentious talks, we do not appear to be moving toward an outcome that will advance a more dynamic, more internationally competitive and integrated North America. At this point the best potential outcome is probably more or less the status quo.

Yet there is an opportunity cost for all three countries of investing their time and efforts in these talks. The trade world is shifting, with the center of gravity moving toward Asia. And while the Trump administration has imposed a series of tariffs on China and threatened many more, it has failed to articulate a clear strategy for America's long-term trade interests in the region. Instead of squabbling with its allies over existing trade pacts, the US would have been better off spending this time building support for a broader, multilateral response to China's trade practices. Time will tell how costly a mistake this was.