

## NAFTA: US to Pursue ‘Tweaks’ to Modernize North American Trade Pact

- Today’s letter from USTR Lighthizer to Congress triggers a 90-day notice period ahead of formal talks to renegotiate NAFTA that could begin as early as late-August.
- The priorities in today’s letter appear even more modest than those outlined in a March draft of the document and are consistent with President Trump’s earlier indication that he would pursue only ‘tweaks’ to NAFTA that could produce benefits for all three member countries.

### A RESTATEMENT OF THE STATUS QUO

Earlier today, newly-confirmed US Trade Representative (USTR) Robert Lighthizer delivered to the US Congress a long-anticipated [letter](#) indicating the Trump Administration’s intent to initiate negotiations with Canada and Mexico to ‘modernize’ the North American Free Trade Agreement (NAFTA). This letter starts the 90-day notice period required under the [2015 Bipartisan Congressional Trade Priorities and Accountability Act](#) before formal talks can begin. Today’s notice implies that trilateral negotiations could start as early as August 17th.

At face value, the US objectives spelled out in today’s letter are broadly consistent with the ‘tweaks’ to NAFTA foreshadowed by President Trump in his February 13 press conference with Canadian Prime Minister Trudeau rather than a wholesale reworking of the agreement. At just over a page, the letter is significantly shorter than the preceding eight-page [draft](#) by then-acting USTR Stephen Vaughn that was leaked at end-March. The list of identified US negotiating priorities has been made more modest and less detailed (see table), while closely mirroring the objectives spelled out in Section 102 of the aforementioned *Act*, which the letter also cites. Any trade talks in which the US engages are guided by Section 102’s negotiating objectives, which renders today’s letter an effective restatement of the pre-Trump *status quo* rather than a hardening of the US administration’s positions.

### ‘TWEAKS’ NORTH AMERICANS CAN SUPPORT

US priorities also remain broadly consistent with topics that both the Canadian and Mexican governments are likely to be open to discussing to ensure that NAFTA remains in line with recent economic and technological developments. Mexico’s President Peña Nieto has already identified the inclusion of telecommunications, energy, and e-commerce in a modernized NAFTA as one of his key [objectives](#) for negotiations with the US.

Most notably for Canada and Mexico, a reference to ‘rules of origin’—the provisions in NAFTA that spell out how much of a good’s content must have been generated within North America in order for the product to move tariff-free between NAFTA countries—no longer appears in the USTR letter. It has been thought that the US may insist on raising these thresholds, which could reduce the cost-effectiveness of North American supply chains, or demand more detailed rules that specify minimum US content requirements. While the omission of rules of origin from the US list of negotiating priorities does not preclude discussions on

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ways to make it easier for North American companies to comply with these standards, today's letter may signal that tightening these rules is now a lower priority for the US administration.

Natural resources and energy trade, which accounts for the lion's share of the US trade deficit with its NAFTA partners, also escaped any mention in the USTR's letter. There is no incentive for the US to compromise its already stable and secure access to these key drivers of US economic growth.

The letter's promise to improve the "effective implementation and aggressive enforcement of commitments made by (US) trading partners" in the context of NAFTA could prove less pointed than it sounds. Under NAFTA's existing investor-protection dispute-settlement process, US interests have prevailed in every complaint they have brought forward. Trade disputes between NAFTA members often end up at the World Trade Organization (WTO), where changes to NAFTA won't have any effect.

Parties in all three NAFTA countries may welcome the apparent US interest in bringing NAFTA's side pacts on labour and the environment into the heart of the agreement. This would mirror the integral way in which provisions on both fronts have featured in the core of bilateral and regional trade agreements signed since NAFTA's inception in 1994.

Today's letter does not touch on the ongoing softwood lumber dispute between the US and Canada because this issue falls outside of NAFTA. This matter has been dealt with under successive stand-alone agreements and it is being treated under a separate, but concurrent, set of talks. Similarly, recent US concerns about trade in 'ultrafiltered' milk escape reference as the product has not been covered under previous dairy regulations and Canada-US agricultural trade is regulated under a side agreement to NAFTA that would likely be treated in bilateral rather than trilateral talks.

No mention was made today of the possible executive order that President Trump indicated in late-April had been drafted to begin NAFTA's required six-month notice period for a member's withdrawal. Under NAFTA's Article 2205, such notice does not compel a member to withdraw: it merely gives the member the option to do so. By keeping this move off the table for now, the Trump Administration has further avoided ratcheting up pressure on these negotiations.

Finally, today's short letter avoided the March draft's reference to the US withdrawal from the Trans-Pacific Partnership (TPP). The TPP agreement includes concessions by Canada and Mexico on many of the priorities raised by the USTR in today's letter. There has been much speculation that the TPP agreement would provide a basis for US demands to renegotiate NAFTA. While today's correspondence doesn't remove that possibility, the absence of any mention of TPP may be a tacit signal of a softer approach to rethinking North American trade.

## **NEXT STEPS**

If formal NAFTA talks begin in the second half of August, they are unlikely to conclude before campaigning begins in greater earnest for the Mexican Presidential election in July 2018 and the US Congressional mid-term and state-level elections in November 2018; that is, unless the changes proposed to NAFTA on the priorities outlined today are kept quite modest. Under a more ambitious agenda for revisions, these elections could extend NAFTA negotiations—and the political risks and uncertainty they are likely to engender—well into 2019.

It's important to place today's action by the USTR in context: it was never intended that NAFTA should be frozen for all time on its entry into force in 1994. In fact, NAFTA has already been revised and updated several times. All in all, today's USTR letter appears to represent a constructive basis on which the US, Canada, and Mexico can begin fresh talks to modernize North America's free-trade agreement.

**Table: Specific US objectives for NAFTA negotiations**

March 2017 leaked draft USTR letter	USTR letter to Congress, May 18, 2017
Trade in goods	In Section 102 of the <i>Act</i>
Agriculture	In Section 102 of the <i>Act</i>
Sanitary & phytosanitary measures	<b>Sanitary &amp; phytosanitary measures</b>
Rules of origin	...
Customs matters & enforcement cooperation	<b>Customs procedures</b>
Technical barriers to trade	In Section 102 of the <i>Act</i>
Intellectual property rights	<b>Intellectual property rights</b>
Trade in services	<b>Trade in services</b>
Investment	In Section 102 of the <i>Act</i>
Digital trade	<b>Digital trade</b>
Cross-border data flows	In Section 102 of the <i>Act</i>
Government procurement	In Section 102 of the <i>Act</i>
Transparency	In Section 102 of the <i>Act</i>
Regulatory reform	<b>Regulatory practices</b>
Anti-corruption	In Section 102 of the <i>Act</i>
Competition	In Section 102 of the <i>Act</i>
State-owned enterprises	<b>State-owned enterprises</b>
State-controlled enterprises	In Section 102 of the <i>Act</i>
Antidumping & countervailing duty	In Section 102 of the <i>Act</i>
State-to-state dispute settlement & institutional provisions	"Aggressive enforcement"; In Section 102 of the <i>Act</i>
<i>Labour (passing mention, no detail)</i>	<b>Labour</b>
<i>Environment (passing mention, no detail)</i>	<b>Environment</b>
<i>Small &amp; medium businesses (passing mention, no detail)</i>	<b>Small &amp; medium enterprises</b>

Sources: Scotiabank Economics, US Trade Representative's Office.

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