TRADE

NAFTA: RENEGOTIATE—OR SCRAP?

The U.S. is on the verge of the most sweeping changes on the trade front in nearly a quarter-century as it seeks to renegotiate or possibly scrap the North American Free Trade Agreement.

In several rounds of often-contentious talks during 2017, NAFTA's three partners were not able to agree on changes the U.S. proposed that now have it squaring off against Mexico and Canada.

The three have agreed that the negotiations should extend into at least the first quarter of 2018. But that is only delaying the inevitable reality that NAFTA is going to be changed or scrapped, says Ambassador Robert Holleyman, president and CEO of C&M International and a partner in Crowell & Moring's International Trade Group.

So if U.S. companies haven't already started, they should look now at how what is being dubbed "NAFTA 2.0" will affect their North American and global operations.

A CHILD OF THE '90S

The original NAFTA was hammered out under President George H.W. Bush and signed into law in 1994 by President Bill Clinton. It eliminated most tariffs on trade between the U.S., Mexico, and Canada. At the time, proponents praised its potential to add a million or more jobs and be a major source of growth for the U.S. economy.

But during his campaign for president, then-candidate Donald Trump called NAFTA and the Trans-Pacific Partnership unfair to the United States and promised to end or renegotiate the trade agreements. True to his word, the U.S. withdrew from the 12-country TPP three days into President Trump's term. Then, last June, President Trump announced he would demand a renegotiation of NAFTA or the U.S. would walk away. Mexico and Canada, having previously agreed to renegotiate NAFTA through the TPP, joined in formal NAFTA-only talks that began in August.

Mexico and Canada are among the 11 nations still in the TPP. Holleyman says the two are using some strategic gamesmanship in their current NAFTA negotiations. While the U.S. demands causing the most controversy are new, many other elements in NAFTA 2.0 are not. Mexico and Canada are now refusing to commit to many provisions that they had already agreed to with the TPP.

The Canadians and Mexicans want to see how the

KEY POINTS

Trade facing changes
Companies should look at possible impacts to global operations.

No agreement yet
The U.S. is squaring off against Mexico and Canada.

The main event
Digital trade is no longer a sideshow, though it's largely escaped the attention of regulators and lawmakers.

" The new proposals from the U.S. are far outside the norm from what the U.S., Canada, and Mexico have sought and agreed to in the past." —*Ambassador Robert Holleyman*

U.S. handles items it has placed on the negotiating table that may be too difficult for them to accept, Holleyman says. The two "essentially said no, this is a new negotiation," he says. "Yes, we agreed to some of these things in prior TPP negotiations in 2015, but the landscape has changed."

NEW U.S. DEMANDS BRING CONTROVERSY

It's possible that before or soon after the March 31 deadline, the U.S. will decide that the talks have reached an impasse and the Trump administration will signal its intent to withdraw from NAFTA altogether.

"The odds of that happening now are at least 50-50," says Holleyman, who served as deputy U.S. trade representative from 2014 to 2017, holding the rank of ambassador. "For the longest time, I didn't think that was likely. But the new proposals from the U.S. are far outside the norm from what the U.S., Canada, and Mexico have sought and agreed to in the past; it's unclear whether the Canadians and Mexicans can or will agree to those things."

Specifically, the U.S. reportedly is seeking to ensure that a guaranteed percentage of production in the NAFTA region, particularly for autos and auto parts, will come out of the U.S. and not North America as a whole.

The U.S. also has reportedly proposed restricting the overall ability of Mexican and Canadian companies to supply U.S. government procurement—transferring significant shares of government procurement opportunities away from Mexican and Canadian companies to U.S. companies.

And for any trade disputes among the three countries, the U.S. wants to end the current arbitration process and instead have these matters handled in domestic courts.

BE PREPARED

The auto industry has much at risk in the new trade negotiations. The Trump administration blames NAFTA for adding to the U.S. trade deficit and costing more than 700,000 American jobs. A coalition of automakers, auto parts makers, and auto dealers argues that NAFTA is responsible for more than $1.2 trillion in annual trade and that undoing it would put auto industry jobs at risk.

What Ambassador Holleyman says is clear is that companies in the auto, agriculture, food products, textile, and other sectors should put contingency plans in place, assessing their North American manufacturing and supply chains, and be prepared to react to any tightening of trade barriers in what has long been a free trade zone.

Companies should prepare for three scenarios, Holleyman says. The first is a modest adjustment to the status quo. The second is a substantial reordering of their supply chain if the U.S. is able to get Mexico and Canada to accede to its proposals. The third, and critical for contingency planning, is an outcome in which the U.S. withdraws from NAFTA and companies have to decide where to locate their primary source of production.

The country that companies ultimately pick will be a test of whatever the new trade relationship is, Holleyman says. Companies are going to have to decide if the U.S. market is large and important enough for them to have tariff-free, ready access to the U.S. in exchange for higher tariffs in Mexico and Canada. On the other hand, a company might decide that Mexico and Canada have such favorable trade relationships with other countries outside of North America that it makes sense to locate manufacturing in either Canada or Mexico. Then they would access the U.S. by accepting the relatively low rate of U.S. tariffs, as a trade-off to having duty-free or low-tariff access to other markets outside the U.S.

THE DIGITAL REALITY

If the squabbling NAFTA partners can agree on one thing, it's that age is probably one of the trade pact's biggest weaknesses, because the internet barely existed in 1994 when NAFTA was signed into law.

Fast-forward 24 years. Digital trade has gone from a quiet sideshow to the main event as an area of explosive growth for all countries. Yet it's also something that has largely escaped the attention of regulators and lawmakers.

That changed with the Trans-Pacific Partnership, an agreement between 12 countries that Crowell & Moring's Robert Holleyman says was the first global agreement with a robust blanket of digital trade provisions.

Holleyman would know. He was the deputy United States trade representative from 2014 to 2017 and on the front line in TPP and digital negotiations.

A rare bright spot in the rocky NAFTA 2.0 negotiations is that everyone recognizes the need to cover digital trade.

The TPP has a framework of groundbreaking digital initiatives that Canada, Mexico, and the U.S. all signed off on to enable cross-border data flows and promote a free and open internet. Holleyman thinks those will be incorporated into NAFTA 2.0, if there is one.

Holleyman suggests the U.S., Mexico, and Canada need to be leaders. "It is important that any modern trade agreement recognizes the digital economy and that the NAFTA countries go on record in favor of open, barrier- and tariff-free digital trade," he says.