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Executive Summary

On Jan. 23, the first Monday after being sworn in as president of the United States, Donald Trump signed a presidential memorandum that laid the groundwork for exiting the Trans-Pacific Partnership (TPP). The TPP was the elegant solution to a host of hold-over irritants from the North American Free Trade Agreement (NAFTA) as well as a way to address wholly new issues of trade and commerce. In the wake of this decision, Trump also promised a wholesale reworking of NAFTA, in which everything would be on the table.

In the days since, the Trump trade team has been off to a rocky start. Finally, after months of discussion, the notification incumbent for use of the Trade Promotion Authority (TPA) was provided to Congressional leaders on May 18, 2017. Mexico has taken it all in stride, as it took almost immediate advantage of the blusterous U.S. rhetoric to outline its demands for any NAFTA discussion. Canada meanwhile plays the sphinx, open about its willingness to negotiate, but not much else. The U.S. may find that it's less ready for this round of negotiations than it wanted to be, but its partners are well placed to unite and drive a hard bargain.

A 20th Century Agreement in the 21st Century

The world has changed dramatically since the North American Free Trade Agreement (NAFTA) negotiations began in 1990. The now-ubiquitous smartphone, which drives 21st century commerce and has spurred entire new sectors, was science fiction when the first round of meetings commenced. Groundbreaking, even revolutionary in its time, NAFTA has since become outdated and in need of an overhaul, not merely a tweak.

In the years since NAFTA was enacted, advances in automation have fundamentally changed the manufacturing and energy sectors. The combination of the now fully integrated supply chain and the degree to which automation drives advanced manufacturing processes, has led to job losses, notably in the U.S., but also in Canada. While it is popular to blame NAFTA for these job losses, the reality is that at least 14 million U.S. jobs rely on the trilateral trade environment.[1]

Innovations in the extractive industries have moved North America from an OPEC-dependent energy environment to a largely self-sufficient one. The establishment of a globally competitive petroleum industry in North America has tilted the global balance of power and insulated Canada, Mexico and the U.S. from the effects of destabilization in the Middle East. The constitutional reforms undertaken by President Enrique Peña Nieto have allowed Mexico to enter the global energy market, meet international labour standards and establish anti-corruption measures that were negotiated hand-in-hand with civil society groups.

The introduction of the iPhone in 2007 has been a disruptive force throughout almost every sector in the global economy. It has changed the way we consume information, entertainment, goods and services, creating global data flows and commerce for which NAFTA was unprepared. E-commerce in the U.S. alone was just under a $400 billion industry in 2016 and is forecast to increase to $680 billion by 2020.[2] In Canada, the industry has increased by 415 per cent in the past five years, from $6.6 billion in 2011 to $34 billion in 2016.[3]

While Canada under the Trudeau government has endeavoured to prepare for the next generation of the innovation economy, the fundamentals of the trade agreement that accounts for the bulk of Canadian trade need the same level of attention. It is time for a renegotiation of the trilateral agreement that gave birth to the regional encompassing trade agreement — an evolution within global trade that eventually led to the Trans-Pacific Partnership (TPP).

The Trans-Pacific Partnership: The Best Deal that Never Was

The TPP was the product of a globalist vision that trade agreements could create stabilizing relationships and establish more secure economic environments, not just for the cornerstone large economies involved, but for emerging economies as well. Starting out as the P4, this partnership among four Pacific economies— Brunei Darussalam, Chile, Singapore and New Zealand — connected the Asia-Pacific with the Americas and established the beginnings of a trade corridor. Eventually, the TPP grew to 12 countries, including all three of the NAFTA partners. It endeavoured to be more than just an agreement on tariffs and economic trade barriers by establishing labour and environmental policies, as NAFTA did through the North American Agreement on Environmental Cooperation (NAAEC) and the North American Agreement on Labour Cooperation (NAALC). The TPP was also the first free trade agreement to take on the digital economy.

In many ways, the TPP is believed to be the template for the discussion on updates to NAFTA. In fact, the letter the USTR sent to congress used the term "modernization" of NAFTA, as opposed to negotiation, indicating much of the work is already done. The process will likely go beyond what the original NAFTA agreement did and codify pieces that need inclusion. The TPP was an agreement for a 21st century economy, addressing issues that were not conceived of during the 1990s and the original NAFTA negotiations. Any discussion or renegotiation of NAFTA would be incomplete without consideration of what happened in the TPP negotiations.

All of that said, this will still be a difficult negotiation. The TPP was an exercise in diplomacy as much as anything else. The TPP team under former president Barack Obama, led first by ambassador Ron Kirk and then by ambassador Michael Froman, brought all the issues to the table in an exhaustive (and exhausting) process. Obama decided early in his presidency that any real shot at updating NAFTA would be in a multilateral context that went beyond the three original partners. The use of the already robust agreement infrastructure should be instructive as the NAFTA partners embark upon their update.

It's worth remembering that Canada especially was not eager to join in on the TPP, seeing itself giving up access to protected sectors in its own economy, protections it had managed to hold onto in NAFTA. Spooked by the potential of U.S. access to the cheaper Asian supply chains, Mexico signed on, and then it was just a matter of time before Canada came on board. In fact, it was in advance of the G20 summit in Los Cabos, Mexico that then-Mexican president Felipe Calderon signalled his country would join in the talks, leaving former prime minister Stephen Harper to consider what might happen to a Canada isolated from a behemoth agreement when its largest trading partner was at the centre.

While many aspects of the TPP may be easily incorporated into a NAFTA update, Obama's negotiating team used the pressure of the broader multilateral dialogue to convince Mexico and Canada to make concessions on issues that lingered as irritants from the original NAFTA negotiations. Whether the U.S. can secure similar arrangements to those in the TPP without the pressure of the multilateral process is an open question. The chapters on e-commerce, transparency, anti-corruption and regulatory coherence all address aspects of the trade relationship that NAFTA has yet to tackle. But multi-party negotiations are a package deal — perfect for some old-school horse-trading tactics — and it's hard to predict where they will go until they begin.

Mexico's Position Heading into NAFTA Renegotiations

Just days after Donald Trump's inauguration, Peña Nieto gave a speech that took on the new administration's "America First" rhetoric. He said that as Mexico comes to the negotiating table, all aspects of the relationship will be open for discussion. Mexico sees the upcoming NAFTA reboot as a chance to address concerns on the treatment of migrants, security issues and deportation procedures.

Mexico has crafted a document outlining its principles for negotiating with an aggressively nationalistic United States.[4] It demands humane treatment for its citizens residing within the U.S., and that the U.S. follow established protocols on deportation. The Mexicans want co-operation and support on the issue of Central American migration north, and guaranteed passage for remittances sent by family members working in the U.S. to generally impoverished relatives in Mexico. Early on, Trump pledged to tax these remittances to pay for a wall; worth $24 billion overall, the average remittance is less than $300. Mexico has also called on the U.S. to work co-operatively to stem the tide of illegal weapons and cash south, demanding a joint effort on interdiction.

On the trade side, Mexico has outlined goals of tariff-free trade that support a globally competitive supply chain, and asked for new chapters in the agreement to address telecommunications, energy and e-commerce. In Brussels, Canadian Prime Minister Justin Trudeau gave a speech highlighting the importance of making the benefits of free trade agreements tangible to the people who live and work in the countries that have engaged in these agreements. Mexico recognizes this as well, and its list of demands includes one for better salaries for Mexican workers. Mexico is presenting itself in this round of negotiations as a country with a professionalized workforce, the equivalent of Canada and the U.S. Finally, Mexico wants to see certainty in the investment environment and the protection of its investment flows. As the 10th demand, Mexico establishes itself as the antithesis of the protectionist administration in the U.S. and declares that it believes in bridges, not walls.

The Mexican assertiveness partially speaks to the country's need to get the renegotiation of NAFTA moving to mitigate the effects of prolonged uncertainty on economic growth and investment. The peso fell dramatically upon Trump's election and even precipitously on inauguration day, but has since rebounded as the American rhetoric has softened. A looming election with a populist front-runner (Andrés Manuel López Obrador) gaining ground with anti-trade rhetoric doesn't help the long game for Mexico, but does provide an argument for some urgency. The embattled Peña Nieto has not backed off, and there's little doubt that he will hold his position regardless of when the negotiations begin. He understands his timeline better than the Americans do and has nothing to lose, as Mexico's term limits make him a one-term president.

In addition to everything else, NAFTA has provided Mexico with an opportunity to move towards a secure, normalized, first-world economy. The U.S. and Canada have provided a level of investment in Mexican civil society and rule of law that would have been hard to secure without the trade agreement creating the web of interconnectivity. The value of having a stable democracy with a growing middle class at the southern tip of North America, at the gateway to Central America and the rest of the world, is difficult to overstate. Mexico has stemmed the tide of economic migrants into the U.S. and Canada. The Mexican army and navy have been like rocks in a stream, blocking the inevitable movement of displaced persons to its northern partners and in the process, absorbing much of the burden of relocation themselves.

The U.S. Position on Free Trade

There have been many indicators of what the U.S. position on negotiations may be. The leaked draft of the letter from the office of the U.S. Trade Representative gave one set of clues, the executive orders on trade issues and the Robert Lighthizer confirmation hearings provided others, and the Foreign Trade Barriers report offered yet another. Meanwhile, the president himself tells the media he is only interested in "tweaks" and Secretary of Commerce Wilbur Ross appears unsure of what the president's vision on NAFTA includes. The only possible conclusion is that the true position is somewhere in between tweaks and a complete overhaul.

Trade aspirations have been put on hold by a bumpy confirmation process for Lighthizer, and as a result, the 90-day notification required to start the clock for the Trade Promotion Authority (TPA) has been delayed. In the interim, Trump has focused on his domestic agenda and has begun to hear more about the pitfalls of abandoning NAFTA. As congressional leaders have had the time to ensure their constituencies' issues are heard, and Mexico and Canada are able to demonstrate their value to the U.S. economy through stakeholders, the administration has softened its initial position.

In the March letter leaked to Republican leaders in Congress,[5] part of the Trump trade team (including Peter Navarro, the lead on the Trump-initiated National Trade Council, and Ross, but notably not Lighthizer or Sonny Perdue, who will be the actual leads on negotiations), indicated some key areas for negotiation. The list looked similar to the areas that the TPP advanced in the larger multilateral discussion in years past. Specifically, the focus on trade in services belies the rhetoric coming out of the White House that has highlighted protecting manufacturing jobs.

Within the trade in goods, the U.S.'s position is to expand market access for itself, eliminate non-tariff barriers, address unfair tax treatment and realign rules of origin. Notably, the fact that discussions in the Lighthizer hearings focused on agriculture and textile trade in goods, rather than automotive or other manufacturing, demonstrates where Congress believes the talks should be concentrated.

While the *Executive Order Regarding the Omnibus Report on Significant Trade Deficits* garnered more attention than the companion *Executive Order on Establishing Enhanced Collection and Enforcement of Antidumping and Countervailing Duties and Violations of Trade and Customs Laws*, the latter should be of more concern to the NAFTA partners. Specifically, the concerns the U.S. has on lack of enforcement in the trade of counterfeit goods was outlined in the World Trade Organization's (WTO) regular review of Mexico's trade policies. Additionally, neither Mexican nor Canadian customs officials have the authority to seize counterfeit goods that are transiting through their borders for final consumption in a third country. Canada was listed in the top five provenance countries for counterfeit goods in an OECD study on trade in counterfeit information and communication technology (ICT) goods released in March 2017.[6]

The 2017 National Trade Estimate Report on Foreign Trade Barriers[7] highlights a number of remaining barriers in the agriculture and agri-food sector limiting U.S. market access in Canada and Mexico. The primary concerns in Canada are seeds, dairy and grain; and in Mexico, stone fruit, potatoes and raw milk. Also of concern in Canada are the personal duty exemption and de minimis thresholds, both of which are long-time irritants. The report also identifies access to the telecommunications industries in both countries and broadcasting limits (Canadian content) in Canada. The Americans flagged digital trade as an area of increasing concern as well.

In short, the Americans' position will likely be that any barrier to market access will need to be on the table for renegotiation, from subsidized industries (aerospace in Canada and extractive industries in Mexico) to regulatory coherence and barriers to investment. But the real value in this renegotiation is preserving much of the work done in the TPP negotiations, particularly on trade in services, investment, intellectual property and e-commerce. The initial assessment that the Trump administration was willing to walk away from NAFTA altogether has tempered as business leaders have weighed in on the agreement's importance, only to be brought up again as White House officials battle for ideological primacy.

In the last week of April, as countervailing duties on softwood lumber were announced, Trump took aim in Wisconsin at the Canadian dairy industry. He also signed an executive order focused on nationalist procurement policies and a review of the H-1B work visa program. He followed this up the next day with another threat to walk away from NAFTA. At the end of the day, the administration walked itself back on the threat as lawmakers from agricultural states and newly confirmed Secretary of Agriculture Sonny Perdue provided persuasive evidence that NAFTA is a net benefit to the U.S. economy.

Where Canada Can Win

Both Mexico and the U.S. have released documents giving their partners a glimpse of their cards. Canada's negotiating team has always held that it will not negotiate in the public square and so far, it has been the only party to remain tight-lipped about its goals. This restraint is part of a negotiating strategy that worked for the Canadian team in the Canada-European Union Comprehensive Economic and Trade Agreement (CETA), the TPP and other bilateral negotiations. There's absolutely no reason to believe they will abandon this tactic this round.

The continental energy relationship was well underway through the North American Leaders Summit (NALS) process. The three leaders signed memorandums of understanding that focused on co-operation in creating a sustainable North American energy future. Regulatory pieces and data gathering were large parts of the initial agreement. The most significant work was done in Winnipeg, on the heels of the Paris agreement, when the three energy ministers agreed to co-operate on a suite of initiatives to decrease North America's carbon footprint and increase its energy self-sufficiency. A follow-up in Ottawa four months later included specifics on goals to increase cross-border energy transmission, the use of energy efficiency technologies, and limiting the emissions of methane and black carbon. While the U.S. has backed away from regulations that enact pieces of this agenda, Canada and Mexico have not.

Many people take comfort in the platitudes from American officials who promise that Canada is not seen as a problem, but the reality is that the trade environment is competitive. The Mexican component to NAFTA is as important to the U.S. as is the Canadian, so the notion of going it alone carries more risk than reward. The Canadians have increasingly acknowledged the importance of the agreement's tripartite nature, but their customary discretion leaves the door open to any number of possibilities.

Going into negotiations, Canada should align itself with Mexico to ensure that specific sector protections necessary to their smaller economies are maintained. Mexico has engaged in labour reforms that both Canada and the U.S. had stipulated were necessary. In addition, Mexico is trying to distance itself from its reputation as a source of cheap labour, and is looking for guarantees that its labour force will be protected and ensured fair wages. Mexico's goal is a robust middle-class economy that looks a lot more like Canada than the U.S. — Canada is well placed to align itself in ways that protect the labour force in all three countries.

In addition, Canada has much to gain by increased labour mobility. Chapter 16 provides for the temporary entry of business persons and professionals, but the list of professionals eligible for NAFTA visa status has long been outdated. Canada and stakeholders on both sides of the border have pushed to update this list. This is undoubtedly the best chance and a real opportunity to manage the efficient flow of people across the border in order to facilitate business in all three countries. In addition, there is the opportunity to better codify the procedures at the border and reduce uncertainty for entry of these professionals.

Canada will likely have to be prepared to provide some additional access to tightly guarded markets, but more importantly, will want to bring solutions to the table, especially to e-commerce, intellectual property, regulatory coherence, customs procedures, state-owned enterprises, small and medium sized businesses, and the dispute resolution processes. NAFTA-watchers will be disappointed with the level of visibility into the Canadian game plan, but they should also be assured that there is an aggressive plan to protect the smaller market from the elephant next door. Negotiation shares skills with poker. With CETA under its belt, Canada has a good hand to play and an inscrutable poker face — a powerful combination.

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[1] Source: U.S. Chamber of Commerce, *Opening Markets, Creating Jobs: Estimated U.S. Employment Effects of Trade with FTA Partners*, May 14, 2010. Data for 2008.

[2] Source: U.S. Department of Commerce, *Quarterly Retail E-Commerce Sales 4th Quarter 2016*, Feb. 17, 2017.

[3] Statista, Statistics and Facts about E-Commerce in Canada, retrieved on April 14, 2017 from https://www.statista.com/topics/2728/e-commerce-in-canada

[4] The President of the Republic, Government of the United States of Mexico, "The Mexican Government's 10 Goals in the Negotiation with the United States," Jan. 23, 2017, retrieved from https://www.gob.mx/presidencia/en/articulos/the-mexican-government-s-10-goals-in-the-negotiation-with-the-united-states?idiom=en

[5] Stephen Vaughn, Acting United States Trade Representative, Draft letter to United States Senate/United States House of Representatives from March 30, 2017.

[6] OECD, *Trade in Counterfeit ICT Goods,* (Paris: OECD Publishing, 2017).
DOI: http://dx.doi.org/10.1787/9789264270848-en

[7] U.S. Trade Representative, *2017 National Trade Estimate Report on Foreign Trade Barriers*, March 31, 2017, retrieved from https://ustr.gov/sites/default/files/files/reports/2017/NTE/2017%20NTE.pdf

About the Author

Sarah Goldfeder is a Principal at the Earnscliffe Strategy Group in Ottawa, where she provides high-level insight on the inner workings of the U.S. and Canadian governments, including how they work together on important issues. With 15 years of experience in the U.S. federal government, Sarah most recently served as Special Assistant to two U.S. Ambassadors to Canada, fostering bilateral relationships at the most senior levels. Her understanding of the interplay between state and federal governments complements her service within the U.S. federal bureaucracy. She has expertise in a wide range of policy issues, which has enabled her to provide practical short and long-term advice on managing the economic, cultural and political dynamics in North America.

Prior to her arrival in Ottawa, Sarah spent three years in Mexico as a Foreign Service Officer, cultivating a deep understanding of U.S./Mexico border issues and appreciation for a region revitalizing itself after years of violence and fear. Her experiences have convinced her of the potential for a stronger, more cohesive partnership across the North American continent. In her work, she seeks to maximize the region's ability to advance the movement of people, goods, and services; the supply, production, and use of energy; and balancing the energy and environment equation. Sarah has also served in Southeast Asia, giving her a global perspective on North American policy development and an appreciation of the opportunities available both within and beyond the Western hemisphere.

Sarah is a North American nomad, with a father from Brooklyn, a mother from Chicago, and a life lived in eight states, six countries, and three continents. She calls the West her home, having studied at the University of Oregon in Eugene, Oregon and Colorado State University in Fort Collins, Colorado.

Canadian Global Affairs Institute

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