WRITTEN TESTIMONY

NAFTA Negotiations
Docket No. USTR 2017-0006

Written Testimony of the Coalition for a Prosperous America

June 12, 2017

The Coalition for a Prosperous America (CPA) appreciates the opportunity to provide testimony to the Office of the United States Trade Representative about "Negotiating Objectives Regarding Modernization of the North American Free Trade Agreement with Canada and Mexico". CPA is a national, non-partisan organization focusing upon improving American trade performance, eliminating our persistent trade deficit, and growing domestic supply chains as a means to achieving broadly based prosperity in the US. Our members are organizations, companies and individuals involved in or representing manufacturing, agricultural and worker interests.

1. SUMMARY

The US needs to rethink trade agreements and unilateral trade policy options to better connect them with improved trade performance through increased US production, wages, and broadly shared economic prosperity. The NAFTA renegotiation process is a chance to do so.

NAFTA, the North American Free Trade Agreement, has caused significant economic harm to the United States. America's trade deficit with both NAFTA signatory countries has mushroomed and US wage growth has stagnated for non-college educated workers. This result shows that mere reciprocal tariff reduction, or even disproportionate tariff reduction by Mexico, does not automatically translate into improved trade performance.

Currency manipulation/misalignment and global consumption tax distortions are more meaningful to US trade deficits and economic health than trade deals and should be addressed first. America's overall objectives for NAFTA renegotiation should include (a) reducing the trade deficit, (b) growing the US goods production base, (c) improving wages and (d) growing our economy. CPA suggests more detailed objectives below.

The United States should not be afraid to walk away from and terminate NAFTA if our national economic interests are not achieved. Tariff rates will not rise due to mere NAFTA withdrawal without further government action. US law, which was supplanted by NAFTA and other trade agreements, can fill most all gaps left by any elimination of NAFTA rules especially given America's market power derived from being the world's largest economy and importer.

CPA's testimony below includes an economic review of NAFTA (Section 2), recommended renegotiation objectives (Section 3) and a discussion of post-NAFTA trade policy options in the event of withdrawal (Section 4).

2. ECONOMIC BACKGROUND AND EFFECTS OF NAFTA

2.1 ESCALATING TRADE DEFICITS DESPITE MEXICAN TARIFF CUTS

The NAFTA agreement went into force in January 1994. It provided for a reduction in tariffs between the US, Canada and Mexico. Because Mexico reduced tariffs more than the US, with already low tariff levels, proponents argued that the US would benefit greatly and disproportionately. However, multinational corporations took advantage of the opportunity to use cheap Mexican labor and enjoy free access to the large US market thereby eroding our wages and trade performance.

Our trade deficit with Mexico is now our fifth largest. The Mexican deficit alone represents some 600,000 lost US jobs. In addition, competition with cheap Mexican labor has depressed US wages. Our agricultural trade with Mexico has swung from a small surplus in the early 1990s to a substantial deficit today.

As Table 1 shows, US goods exports into Mexico rose by 452% in those 23 years, far faster than US total exports, which rose just 212%. But US imports from Mexico rose even faster, by 637%. That was much faster than total US imports.

Table 1: NAFTA Leads To Huge Mexican Trade Deficit

	1993	2016	Total % Change 1993-2016	Annual Avg. % Change
US Goods Trade Balance				
Exports (Total Exports)	$465.1B	$1,451.B	212.0%	5.1%
Imports (Total Imports)	$580.7B	$2,187.8B	276.8%	5.9%
Balance	-$115.6B	-$736.8B	537.5%	8.4%
US-Canada Bilateral Goods Trade Balance				
Exports (Total Exports)	$100.4B	$266.8B	165.6%	4.3%
Imports (Total Imports)	$111.2B	$277.8B	149.7%	4.1%
Balance	-$10.8B	-$11.B	1.7%	0.1%
US-Mexico Bilateral Goods Trade Balance				
Exports (Total Exports)	$41.6B	$229.7B	452.4%	7.7%
Imports (Total Imports)	$39.9B	$294.1B	636.7%	9.1%
Balance	$1.7B	-$64.4B	nm	nm
US-Mexico Bilateral Goods Trade Balance (excluding re-exports)				
Exports (Domestic Exports)		$176.2B	NA	NA
Imports (Imports from Consumption)		$292.7B	NA	NA
Balance		-$116.5B	NA	NA

Source: US Census

The result was the transformation of a small surplus with Mexico in the early 1990s into a huge $64 billion deficit last year. The figures look even worse if we exclude re-exports, which are US exports into Mexico of goods that pass through the US but have no value added to them here. In that case, the deficit was $116 billion last year.

Using the common rule of thumb developed by private and government economists that each $1 billion of imports represents some 6,000 jobs, our deficit with Mexico costs the US some 696,000 lost jobs today. In a recent analysis, Public Citizen pointed out that the US government's Trade Adjustment Assistance (TAA) database identifies more than 900,000 jobs that were lost due to either Mexican imports or companies shifting production to Mexico.[1] That figure is likely an underestimate since reporting job losses to the TAA database is not mandatory under US law.

As Table 2 below shows, transportation equipment (mainly motor vehicles) overwhelmingly dominates the 2016 US trade deficit with Mexico. This is the result of a surge in manufacturing production south of the border, much of it directly substituting for what was once US production.

Imports and the offshoring of US manufacturing production have led directly to job losses. Since 1993, US manufacturing employment has fallen by some 4.5 million jobs or 27%. While manufacturing employment was declining slowly as far back as the 1970s, few economists now deny that import penetration and offshoring have played a significant role in the sharper decline in manufacturing employment since the year 2000.

2.2. WAGE DECLINES

NAFTA caused wage declines for non-college educated workers. Unemployment is a common topic of debate when politicians and economists discuss the effects of free trade agreements like NAFTA. Trade agreements' effect on the wage levels of those who keep their jobs is less often discussed, yet it is very real. By putting US workers in direct competition with Mexican workers in certain industries, NAFTA has exerted downward pressure on US wages. This accords with standard economic theory, which holds that competitive pressures will determine wages. It also accords with one of the most respected milestones in international trade theory, the so-called Stolper-Samuelson theorem of 1941, which says that if two economies begin to trade with each other, the factor of production that is relatively scarce in one country but plentiful in the other (for example high-paid wage labor in the US versus lowpaid, plentiful wage labor in Mexico) will tend to suffer reduced income due to competition from its trading partner.

The experience of US auto industry workers bears out this proposition. We looked at the change in real

Table 2: Transportation Equipment Dominates US-Mexico Trade Deficit

336 Transportation Equipment	-$64,587.2M
334 Computer & Electronic Products	-$15,027.M
335 Electrical Equipment, Appliances & Components	-$9,222.7M
312 Beverages & Tobacco Products	-$3,571.1M
339 Miscellaneous Manufactured Commodities	-$2,844.8M
315 Apparel & Accessories	-$2,791.7M
337 Furniture & Fixtures	-$1,866.8M
316 Leather & Allied Products	-$1,379.5M
327 Nonmetallic Mineral Products	-$1,204.7M
314 Textile Mill Products	-$198.8M

Source: U.S. Bureau of Labor Statistics

(i.e. inflation-adjusted) wages for production and non-supervisory workers in the top three industrial sectors impacted by Mexican competition. The steepest decline in real wages for any industrial sector was felt by those in the auto industry, a staggering 27% cut in real wages since 2002. This is not surprising when one considers the wage differentials involved, and the fact that most automakers and auto parts makers are actively considering multiple international locations—and employees know it. US auto production workers generally earn in the low $20s per hour (with some workers in the more heavily unionized Midwest states earning considerably more).

According to a well-researched Bloomberg Business Week article published in May, a BMW facility in Mexico launched in 2014 had a starting wage of $1.10 per hour and hour (with some workers in the more heavily unionized Midwest states earning considerably more).

According to a well-researched Bloomberg Business Week article published in May, a BMW facility in Mexico launched in 2014 had a starting wage of $1.10 per hour and a top wage of $2.53 for assembly line workers. According to a Mexican academic quoted by Bloomberg, the average auto plant wage in Mexico is $2.04 an hour.

Production workers in the computer industry also suffered a significant wage reduction of 4.3%. All production workers in the entire manufacturing sector did relatively better, although they too have seen a decline in real earnings per worker of 1.1%.

The wage decline story does not end there. In an i portant academic paper [3] published in 2010, economists John McLaren and Shushanik Hakobyan showed that penetration of Mexican imports in 543 local US regions negatively affected not only those employed in affected industries, but even workers employed in service industries in regions that were heavily affected by industrial decline caused by Mexican imports. "Thus, a worker waiting on tables in a town heavily dependent on NAFTA-vulnerable jobs, although he or she is not employed in an industry producing tradable output, is nonetheless harmed indirectly by NAFTA, plausibly due to workers who are in a contracting tradables industry and seek employment in local non-traded industries, pushing those wages down." [4]

Some economists have argued that the impact of Mexican competition on US workers is small by comparison with the effect of Chinese competition, since our

Table 3 Wage Losses for Production and Nonsupervisory Workers Competing with Mexico

Industry	Employment 2016 (000)	Average Hourly Earnings 2016	Previous Peak Earnings Year	Change from Peak
3361,2,3 Motor Vehicles and Parts	940.1	$21.63	2002	-26.8%
334 Computer and Electronic Products	595.3	$24.56	2010	-4.3%
335 Electrical Equipment and Appliances	258.9	$19.44	2015	-0.1%
All Manufacturing	8667.1	$20.63	2003	-1.1%

Source: U.S. Bureau of Labor Statistics trade deficit with China is some three times the size of our Mexican deficit. However, McLaren and Hakobyan found significant impact from Mexican imports on both employment and wage levels in affected industries, even when controlling for the impact of Chinese imports. McLaren and Hakobyan attributed to Mexican imports slower wage growth for 1.3 million American workers. While college-graduate level workers were largely unaffected by the import competition, high-school or lower-level educated workers were severely affected: "For the maximum rise in an industry's Mexican import share, 35 percentage points, the implied drop in cumulative wage growth for a high-school dropout is 35.5 percentage points—an enormous deficit for a worker whose wages are already low." 6

2.3. MEXICO'S ECONOMY AND WORKERS DID NOT BENEFIT

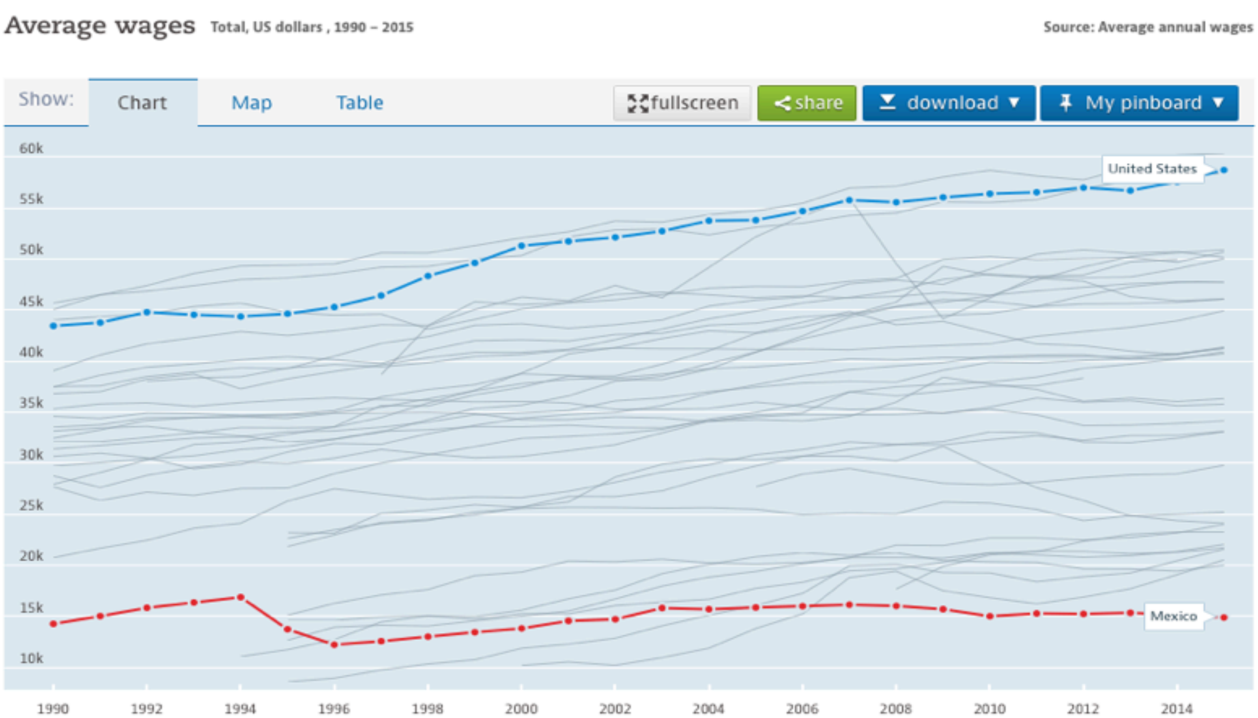
When a smart tennis player plays doubles, he or she is careful to choose a good partner. The player will win more often if her partner is Roger Federer or Serena Williams than if she partners with an overweight bumbling beginner. In choosing to partner with Mexico and believing that a free trade agreement could solve Mexico's problems, the US government made a monumental error of judgment.

At the time NAFTA was negotiated and ratified, by the first Bush and then the Clinton Administration, US officials and economists argued that NAFTA would spur the economic growth of Mexico, lead to a prosperous new consumer market for US goods, and reduce illegal immigration into the US It was a Pollyanna-ish view of a foreign nation, and typical of the naïve views that have surrounded other free trade agreements too.

Figure 1 tells the story of what really happened. In the early 1990s, Mexican average wages were rising slightly faster than those of the US, according to OECD data. A certain amount of optimism was arguably justified. However, soon after NAFTA was adopted, Mexico was hit by a peso crisis, which depressed the level of Mexican wages when translated into dollars. Since then a combination of shaky democracy, rising drug- and gang-related crime, national and local corruption, a large informal economy that deprives the government of much-needed revenue, and a lack of independent labor unions to fight for better worker incomes has ensured that the Mexican economy languished in perennial underperformance.

Indeed, Mexican wages fell in the mid-1990s and are now the lowest of all 35 OECD nations. Despite the promises made by both American and Mexican leaders at the time of NAFTA, Mexico has done relatively worse than other OECD members. And even worse than the level of Mexican wages is their rate of increase, which is effectively zero in Figure 1. This means that NAFTA-driven wage convergence between (low-educated) American workers and Mexican workers is likely to continue to drive down real incomes for the poorest, most struggling US citizens.

Figure 1. Mexican workers: worst paid in the OECD



2.4. US AGRICULTURAL TRADE PERFORMANCE WITH MEXICO DECLINED

American agricultural economic health has not improved from NAFTA or modern trade agreements. US-Mexico agricultural trade has followed a similar pattern to that of the manufacturing industry. Our agriculture sector generally lost domestic market share that was not offset by increased export market share. Farmers and ranchers, the raw input suppliers to our agriculture sector, are almost exclusively domestic sellers and suffered the most harm from increased import penetration.

Before discussing the trends, it is worth noting that gross agricultural trade with Mexico is only 8.9% of non-energy goods trade. And gross agricultural trade with Canada is only 13.3% of non-energy goods trade.[7]

From a trade surplus of $748 million in 1993, our agricultural trade with our southern neighbor has deteriorated to a deficit of $3.76 billion as of 2015, the latest available data. The deficit is mostly due to a very large deficit of $9.9 billion in fruit and vegetables. That deficit is in turn dominated by large deficits in tomatoes, cucumbers, and avocados. As in manufacturing, the implementation of NAFTA encouraged investment in Mexican industries. The tomato industry saw a rise in investment in greenhouses and shadehouses, with most of that production targeted at the US consumer. Allegations of Mexican government subsidies to its tomato industry led to an international settlement to put restraints on the level of tomato imports into the US

The live cattle and beef sectors also saw worse trade performance. Imports far exceeded exports helping cause a continuing erosion in domestic cattle producer market share in the US market.

Some US agricultural sectors have done well out of NAFTA: corn, soybean and pork producers have all increased exports and the US trade balance in those products improved dramatically. However, those increases have come at the cost of increasing domination of American agriculture by corporate producers. According to the National Farmers Union, a CPA member organization, small farmers and family farmers have been squeezed by the higher investment levels required by these larger, international farming operations. In addition, it has been estimated that some two million Mexican corn farmers were pushed off their farms due to increased US corn exports. This led in turn to an unexpected upsurge in Mexican immigration into the US.

Table 4 US-Mexico Agriculture Trade

Sector	1993	2015	% Change 1993-2015	Annual Average % Change
All Agriculture				
Exports	$4,196.4M	$19,024.5M	353.4%	7.1%
Imports	$3,447.9M	$22,783.6M	560.8%	9.0%
Balance	$748.5M	-$3,759.1M	nm	nm
Fruit & Vegetables				
Exports	$198.7M	$1,173.1M	490.5%	8.4%
Imports	$1,464.9M	$11,050.5M	654.3%	9.6%
Balance	-$1,266.3M	-$9,877.5M	680.1%	9.8%
Corn				
Exports	$42.7M	$2,325.4M	5347.3%	19.9%
Imports	$.4M	$18.3M	4406.5%	18.9%
Balance	$42.3M	$2,307.1M	5356.4%	19.9%
Soybeans				
Exports	$421.M	$1,432.2M	240.2%	5.7%
Imports	$.03M	$.03M	3.1%	0.1%
Balance	$420.9M	$1,432.2M	240.2%	5.7%
Pork & Pork Products				
Exports	$104.8M	$1,238.8M	1082.4%	11.9%
Imports	-	$42.5M	nm	nm
Balance	$104.8M	$1,196.4M	1041.9%	11.7%
Beef & Beef Products				
Exports	$164.8M	$971.6M	489.4%	8.4%
Imports	$3.3M	$1,041.34M	31594.0%	29.9%
Balance	$161.6M	-$69.8M	nm	nm
Wheat				
Exports	$135.7M	$650.9M	379.8%	7.4%
Imports	-	-	nm	nm
Balance	$135.7M	$650.9M	379.8%	7.4%

Source: USDA

3. OBJECTIVES IN THE EVENT OF RENEGOTIATION

The US needs to rethink what works in terms of improving trade performance, US production, wages, and broadly shared economic gains with regard to trade agreements. Reciprocal tariff reduction, or even disproportionate tariff reduction by other signatories, does not translate into improved trade or economic performance.

Plentiful, low cost labor in Mexico and exchange rate changes are extremely important factors causing trade balance and production location changes as we partially "merged" the US and Mexican economies for purposes of labor, services and goods. Reciprocal tariff reductions perversely increase the potency of those non-tariff factors, eliminating tools that could solve problems of imbalance. Border adjustable consumption taxes in other countries, like Mexico and Canada, often act as tariff and subsidy replacements that negate the reciprocity intended in agreements.

3.1 RECOMMENDED US LAW CHANGES PRIOR TO RENEGOTIATED AGREEMENTS

Improved trade performance seems unlikely without the US addressing exchange rate and border tax issues. Remedies are squarely within the realm of US law and regulations.

Exchange rates have lost their connection with trade balancing equilibrium prices, thus causing and exacerbating global current account imbalances. This should be addressed in three ways.

First, and most importantly, a capital flow management tool called the Market Access Charge (MAC) should be implemented to push the US dollar towards its trade balancing equilibrium rate, increasing U.S. exports and reducing imports. CPA's recent analysis, using the IMF Fundamental Equilibrium Exchange Rate (FEER) method, corrected to target a zero current account balance in 5 years, shows the dollar is about 25.5% overvalued today.

Second, countervailing currency intervention, proposed recently by senior economists at the Peterson Institute, should be adopted by the Treasury Department or the Federal Reserve to offset and neutralize foreign country exchange rate intervention that drives the dollar up and the foreign currency down. Third, the Commerce Department should consider foreign currency manipulation a countervailable duty under US trade laws and define "manipulation" more broadly than current US law or the International Monetary Fund defines it.

Foreign border adjustable taxes, including value added taxes (VAT) and goods and services taxes (GST), are lawful under international trade rules despite functioning as a tariff and subsidy replacement in cases where they replace or offset other purely domestic taxes and costs of production. The US should enact a goods and services tax at, for example, 12% to fund a full credit against the 15.3% payroll tax. This unilateral action would neutralize any negative impact of foreign consumption taxes on US trade performance, especially in combination with the Market Access Charge mentioned above. It would reduce the cost of labor for employers and increase wages for employees both of which would offset the increased cost of goods domestically.

3.2. NAFTA RENEGOTIATION OBJECTIVES

CPA recommends these objectives for NAFTA renegotiations.

3.2.1. Balanced Trade: NAFTA must contribute to a national goal of achieving fully balanced trade over time

A positive trade balance, which can only be achieved by a reduction in imports and an expansion of exports, is needed to offset the cumulative trade deficits of recent decades to ultimately achieve a long term, manageable trade balance. This is a results oriented, quantitative goal. Trade agreement negotiations focused upon procedural, tariff and subsidy concessions often ignore trade balance outcomes. Further, an "export only" goal ignores the net trade balance. The US national interest lies in reducing and eliminating its currently massive trade deficit and resulting foreign indebtedness. If the U.S. had run a positive or even a zero trade balance for some or all of the last 41 years, instead of a persistent deficit, many industries would be many times larger today, in terms of revenue and employment than they are today. There would be millions more well-paying jobs in many parts of the nation, including many of today's most deprived areas.

3.2.2. National Trade, Economic and Security Strategy: NAFTA must strive to optimize value added supply chains within the US - from raw material to finished product - pursuant to a national trade and economic strategy that creates jobs, wealth and sustained growth. The agreements must also ensure national security by recapturing production necessary to rebuild America's defense industrial base.

The US has tended to pursue trade liberalization as an end in itself. Instead, trade negotiations should be conducted to further a national trade, economic and security strategy. The US has lacked a strategy to produce more of what the nation consumes, in both the civilian and defense markets. Conversely, our major trading rivals pursue strategies to ensure persistent trade surpluses and promote the offshoring of US manufacturing. As a result, the US is losing critical mass of production capacity and skilled workers. The term "optimize value added supply chains" is intended to establish that the full supply chain has more value than the sum of its parts in terms of increased production, employment, innovation and growth. Trade negotiations should further - and their success should be measured by achievement of - those goals not just for selected sub-parts but for the supply chain as a whole.

3.2.3. Reciprocity: NAFTA must ensure that foreign country policies and practices as well as their tariff and non-tariff barriers provide fully reciprocal access for US goods and services. The agreements must provide that no new barriers or subsidies outside the scope of the agreement nullify or impair the concessions bargained for.

Reciprocity is a fundamental tenet of trade law. This principle rejects the proposition that the US should lead with trade barrier reductions, even without equivalent concessions from the other country, as a strategy to persuade other countries to eventually and voluntarily lower their barriers. The best approach is to extract those concessions during bargaining to ensure fully reciprocal access. Further, past trade agreements have permitted the other country to erect substitute trade barriers, which are not explicitly covered by the terms of the agreement, that nullify the benefits of the concessions. Any new agreement must address the problem of substitute barriers or subsidies through explicit, enforceable language.

3.2.4. State Owned Commercial Enterprises: NAFTA must encourage the transformation of state owned and state controlled commercial enterprises (SOEs) to private sector enterprises. In the interim, trade agreements must ensure that SOEs do not distort the free and fair flow of trade - throughout supply chains - and investment between the countries.

The growth of state owned or state controlled commercial enterprises (collectively SOEs) in global commerce is a substantial and disruptive trade challenge. SOEs are inherently subsidized, ungoverned by and/or resistant to market forces. They crowd out private commerce and are often government policy tools. SOEs should not gain the benefits of new trade agreements or be allowed to disrupt commerce or investment in the private market. By their nature, SOEs disrupt downstream competition, which must be addressed. Trade agreement language should (1) deny new preferences to SOEs and (2) include provisions - whether duties, quotas or other means - that restrict the impact of SOEs commercial and investment activities.

3.2.5. Currency: NAFTA must classify prolonged currency undervaluation as a per se violation of the agreement without the need to show injury or intent.

Fair and market determined exchange rates are fundamental to realizing the benefits of a trade agreement. Persistent currency undervaluation nullifies and impairs concessions obtained through bargaining.

3.2.6. Rules of origin: NAFTA must substantially strengthen rules of origin to maximize benefits for US based supply chains and minimize free ridership by non-contracting countries. Further, all products must be labeled or marked as to country(s) of origin as a condition of entry.

Rules of origin determine whether a product or its components "originate" within a contracting country(s) and thus qualifies for favorable tariff treatment. Without rules of origin, any product could be trans-shipped from third countries without restriction, causing free ridership problems where third countries benefit without negotiation-extracted concessions. Stronger origin rules will tend to benefit supply chains within the US while disincentivizing the utilization or trans-shipment of third country products. Rules may vary by product; however, the preservation and/or expansion of the US supply chain should be a substantial governing principle.

3.2.7. Enforcement: NAFTA must provide effective and timely enforcement mechanisms, including expedited adjudication and provisional remedies. Such provisional remedies must be permitted where the country deems that a clear breach has occurred which causes or threatens injury, and should be subject to review under the agreements' established dispute settlement mechanisms.

Effective enforcement is key to political support for trade agreements and the trading system itself. Current enforcement mechanisms are too expensive, time consuming and beyond the means of many affected industries to be effective. The problem is exacerbated by the lack of transparency of the details of other countries' compliance. Provisional remedies would permit a contracting country to take immediate action in applicable cases, while preserving the right of the other country to challenge the provisional action through ordinary dispute settlement mechanisms.

3.2.8. Border Adjustable Taxes: NAFTA must neutralize the subsidy and tariff impact of the border adjustment of foreign consumption taxes.

Foreign consumption (indirect) taxes are charged by foreign governments on US exports entering that market, but these taxes are rebated to foreign companies when they export to the US Because of our historic reliance upon income (direct) taxes, the US is unable to reciprocate. The result is that US exports are double taxed and foreign imports to the US are largely untaxed. This is a major cause of offshoring and our persistent trade imbalance. The U.S. must neutralize the effects of foreign border adjustable taxes. This principle must apply equally to negotiation, performance and enforcement of all trade agreements.

3.2.9. Perishable and Cyclical Products: NAFTA must include special safeguard mechanisms to address import surges in perishable and seasonal agricultural product markets, including livestock markets.

The WTO and past trade promotion authority statutes recognize that producers of perishable and seasonal agricultural products are particularly susceptible to trade surges arising from over-production, adverse weather or other causes. Short shelf life and/or short selling season characteristics result in producers being unable to store the products until prices rise. Immediate and automatic relief based upon price and/or quantity measures are necessary to prevent irreparable industry harm in these sectors.

3.2.10. Food and Product Safety and Quality: NAFTA must ensure true import compliance with existing US food and product safety and quality standards and must not inhibit changes to or improvements in US standards. The standards must be effectively enforced at US ports of entry.

Past negotiations have often treated health, quality and safety standards as trade barriers without sufficient regard for important public safety and quality goals. The result has sometimes been downward harmonization of safety and quality measures under a trade facilitation rationale. Enforcement as to imported products should effectively equal enforcement as to domestic products.

3.2.11. Domestic Procurement: NAFTA must eliminate any restrictions of domestic procurement thus allowing US federal, state and local governments to favor domestic producers in government, or government funded, procurement.

Domestic taxpayers, globally, expect their tax dollars to be spent on domestic production. Government procurement is, in large part, a policy tool rather than true free market commerce. The federal, state and local governments of the United States are, collectively, the biggest consumers in the world. True reciprocity cannot exist because there is a mismatch in the size of - and transparency of - the large US government procurement market versus the smaller government procurement volumes of other countries.

3.2.12. Temporary vs. Permanent Agreements: NAFTA must be sunsetted, subject to renegotiation and renewal. Renewal must not occur if the balance of benefits cannot be restored.

Trade negotiators agree to language based upon expectations and judgment in pursuit of national goals. However, goals may not be achieved or expectations may not be met. Just as business contracts do not last forever, neither should agreements between countries. Therefore, it is important to make such agreements time-limited to ensure that they continue to provide balanced benefits as circumstances change. If a balance does not continue or materialize, the agreement should be renegotiated or discontinued.

3.2.13. Wage Rates and Labor Standards: NAFTA must include enforceable provisions to ensure productivity weighted wage rates in low wage countries rise substantially. Agreements should also ensure that lax labor standards and enforcement by contracting countries do *not result in hidden subsidies to the detriment of US-based workers and producers.*

We discussed above the impacts of plentiful, low wage labor in other countries to US economic and trade performance. Without substantial wage improvement, those countries cannot become true consumers of US goods and services. Further, leaving wage rates unaddressed will exacerbate American wage stagnation while providing offshoring incentives for producers.

Fair labor standards will simultaneously improve US competitiveness and increase worker prosperity in other countries, enabling them to become consumers of US goods. In the 2002 Trade Promotion Authority (TPA) statute, Congress instructed trade negotiators to pursue goals including: "to promote respect for worker rights and the rights of children consistent with core labor standards of the ILO...and an understanding of the relationship between trade and worker rights". Congress further defined those core labor standards as: "(A) the right of association; (B) the right to organize and bargain collectively; (C) a prohibition on the use of any form of forced or compulsory labor; (D) a minimum age for the employment of children; and (E) acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health."

3.2.14. Investor-State Dispute Settlement (ISDS): NAFTA should eliminate, or significantly limit, direct investor rights to bring causes of action against contracting countries.

State to state dispute settlement is common and proper in international agreements. ISDS, in contrast, allows direct action by private investors, though not other parties, to dispute settlement. ISDS should be considered for elimination thereby relegating investors to domestic law or pre-existing dispute settlement between states to resolve alleged violations of the agreements.

If ISDS is retained, its provisions should explicitly carve out, and make meaningful, exceptions for regulation in the public interest. Further, claims should be limited to direct expropriations only, not regulatory or indirect takings, so as to avoid giving foreign companies greater rights than domestic companies to challenge government actions.

4. WITHDRAWAL FROM NAFTA SHOULD BE CONSIDERED

If NAFTA were to end, the tariff and trade balance impact would be minimal. However, government leaders could begin shifting to their focus to domestic policy tools proven to improve trade performance and counter the practices of persistent current account surplus countries.

4.1. TRADE AGREEMENTS ARE A DISTRACTION FROM THE PROBLEM OF GLOBAL IMBALANCES OF WHICH THE US ECONOMY IS A VICTIM

Global current account imbalances are the 21st Century trade problem. Persistent surplus countries have national strategies to maintain their surpluses. They use monetary, fiscal, and industrial policy tools to do so. They do not use trade agreements.

There is an oversupply of labor, capital and goods in the surplus countries (Germany, China, Japan, South Korea, Taiwan). They export their oversupply and their unemployment to deficit countries. Deficit countries like the US tend to be the most open economies with no immune response to absorbing surplus country oversupply. Thus the US absorbs the majority of China's oversupply while Germany, Japan and South Korea do not and therefore have a surplus with China.

Trade agreements have a poor track record in producing economic gains for the US or achieving global current account balance. Indeed, trade agreements often take the focus from, and sometimes restrict our ability to use, domestic policy tools which can cause growth and rebalancing of trade. The policy focus upon tariff reduction is outsized and undeserved in relation to overall economic performance. The tariff reduction efficiency gains claimed by proponents are proportionately miniscule in relation to other factors. The focus upon exports only ignores, and sacrifices, the vast domestic consumer economy that creates the majority of American wealth.

Tariffs (and their subsidy counterparts) are more directly relevant to composition of trade, an important factor, than balance of trade. Government officials can reduce and eliminate the US trade deficit through a focus upon trade competitive exchange rates, wage rates in relation to productivity (Germany and China as high and low wage examples) and taxation systems.

Targeted tariffs, subsidies and other industrial policy tools can perform the important function of advantaging preferred industries in relation to non-preferred industries in the trade mix. These tools, as a trade enforcement remedy, can also offset foreign nation's policies that give their industries an advantage. Preferred industries, such as advanced technology industries, are generally the more value added or strategic industries that can absorb large quantities of capital, workers and innovation to continue growing productivity and wages over the long term. The US has, however, a persistent trade deficit ($82 billion in 2016) in advanced technology, often with less developed countries which could not compete with us in the absence of their targeted policies.

4.2. TARIFFS WOULD BE UNLIKELY TO INCREASE AFTER A NAFTA WITHDRAWAL

Tariffs are unlikely to rise substantially in the event of NAFTA withdrawal for legal, political and economic reasons.

> *A mere NAFTA withdrawal would not raise tariff levels without more action by the President or Congress.*
>
> *By itself, US withdrawal from NAFTA (or other FTAs) would not raise US tariffs on imports from Canada, Mexico, or other FTA partners from the preferential rates (mostly zero) to the (bound) most-favored-nation (MFN) rates specified in column 1 of the Harmonized Tariff Schedule of the United States (HTS)… 8*

The President could raise tariffs on Mexican or Canadian products using executive authority, but not beyond MFN (most favored nation rates as per our World Trade Organization commitments) rates which are quite low with exceptions. Further tariff increases, above MFN rates, could not be declared without withdrawing from the WTO or facing hard-to-win trade cases brought before WTO tribunals.

While CPA believes a rational system of tariffs has a place in US trade policy, Congressional opposition to tariffs remains high.

4.3. US LAW CAN FILL THE GAP, WITH FEWER COMPROMISES

Modern trade agreements go far beyond the traditional tariff and quota issues of the past. They cover issues such as food and product safety standards, domestic procurement, state-owned enterprises, enforcement, regulatory coherence, and product labeling. In expanding their scope, trade agreements displaced or changed substantial portions of pre-existing US law. Decision making became more distant from the voting citizenry as international forums gained importance and clout.

The President and the Office of the US Trade Representative could reasonably take the position that US law and regulations are the first choice for setting trade and economic policy. Renegotiations of NAFTA, or any other trade agreement, renegotiations should only cover issues that domestic rules cannot effectively address. US law is able to have extraterritorial impact on other countries' behavior by connecting US market access to compliance with our laws. Because other countries are disproportionately export dependent upon the US market in relation to our dependence upon their market, this is not an unreasonable view.

A US-law-centric view to trade policy would re-examine the scope of rules and norms in trade agreements to determine whether the same or better function could be performed through domestic rules. Some rules should be scrapped, like restrictions on labeling or allowance of foreign suppliers to domestic procurement markets.

Tariffs could be set at, for example, a low US target level or the other countries' tariff levels, whichever is higher. This formulation would embed reciprocity in our law and violations would be addressed through our institutions. The same goes for quotas or other forms of market access.

State-influenced enterprises (SIEs) could be restrained by our domestic laws using conditional market access as the lever. We would not need to negotiate or compromise with a foreign government that profits, strategically or financially, from the operation of the SIE.

Labor, environmental and human rights standards could also be enforced through laws allowing access so long as they comply with our values. The same principle goes for competition policy or intellectual property protection.

The US-law-centric approach would enable more nimbleness to respond to new challenges rather than relying upon trade deals that are static for decades. Democracy and sovereignty would be preserved as our government is not divested from authority by global or transnational institutions.

To the extent international agreements are needed for certain issues, those agreements could be far more limited in scope than recent trade deals.

5. CONCLUSION

The Office of the US Trade Representative should not be bound by the ossified and misleading trade policies of the past during NAFTA renegotiations. Global imbalances are a threat to the world economy. Trade deficits are a threat to the US economy. Trade agreements have helped cause these problems, or have distracted government officials from true problems and solutions.

Currency misalignment and manipulation as well as trade competitive tax reform are more important than NAFTA for rebalancing trade, creating good paying jobs and growing the US economy. The principles outlined above should provide a strong guide to a potentially modernized NAFTA which serves the interest of American workers and producers.

However, negotiators should feel free to walk away from negotiations and terminate NAFTA if an agreement that substantially improves economic and job outcomes for the US cannot be achieved. It is reasonable to pivot towards a stronger focus on US laws and regulations to govern future trade policy while relegating international negotiations to a much smaller scope.

Respectfully submitted,

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Brian O'Shaughnessy, Vice Chairman
Michael Stumo, CEO

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[3] Mclaren, Hakobyan, Looking for Local Labor Market Effects of NAFTA, NBER Working Paper no. 16535, November 2010.

[4] Ibid, pg. 19-20.

[5] This figure was not in the original article, but was provided to Gary Hufbauer and Jeffrey Schott of Peterson Institute by McLaren and Hakobyan. See Correcting the Record on NAFTA, Peterson Institute, footnote no. 8.

[6] Ibid, pg. 18.

[7] USA Trade Online and USDA FAS GATS

[8] Hufbauer, et al, "Assessing Trade Agendas in the US Presidential Campaign," Peterson Institute for International Economics, pp 6-7, September 2016.