Renegotiating NAFTA in the Era of Trump: Keeping the Trade Liberalization In and the Protectionism Out

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Abstract

When the North American Free Trade Agreement (NAFTA) came into force in January 1994, it was a groundbreaking achievement. It eliminated nearly all tariffs among three significant trading partners and achieved liberalization on a wide range of other issues (some of which had never before been included in trade agreements). Now the United States, Canada, and Mexico are about to begin a historic renegotiation of NAFTA.

The proposal to renegotiate NAFTA may have been motivated by protectionist objectives. But there is potential to minimize or even avert protectionist outcomes. In the end, renegotiation presents the opportunity to modernize, fix, and expand the rules of NAFTA, and produce a "freer" free trade agreement, which would be good for the North American economy.

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INTRODUCTION

When the North American Free Trade Agreement (NAFTA) came into force in January 1994, it was a groundbreaking achievement. It eliminated nearly all tariffs among three significant trading partners and achieved liberalization on a wide range of other issues (some of which had never before been included in trade agreements).

The impact was extremely positive. Total U.S. trade in goods and services with Canada and Mexico reached over $1 trillion in 2016, growing 125.2% in real terms from 1993.[1] NAFTA's liberalization not only encouraged more trade, but more cross-border investment leading to deeper integration of production networks. On a historical cost basis, foreign direct investment in the United States from Canada increased from $40.4 billion in 1993 to $269 billion in 2015, and from Mexico it increased from $1.2 billion to $16.6 billion.[2] The United States remains a top destination for their investments. Furthermore, 40 cents of every dollar of U.S. goods imports from Mexico and 25 cents of every dollar imported from Canada is U.S. value added.[3] NAFTA not only increased cross-border exchange. It facilitated the development of regional supply chains, most prominently in the automobile sector.

Despite this success, the three countries are about to embark on a historic renegotiation of NAFTA. After consultations with Congress and the public, the Office of the United States Trade Representative (USTR) released its NAFTA negotiating objectives in July 2017. Many of the objectives seem to be consistent with those of previous administrations, but some are vague, making it difficult to predict which direction the administration will go once negotiations begin. Additionally, some of the objectives seem out of sync with the generally pro-trade thrust of the document, such as the language regarding trade balance and the tightening of rules of origin.

Although renegotiating NAFTA would not have been our priority for U.S. trade policy, there certainly is scope for modernizing and further liberalizing the agreement, which was first implemented nearly a quarter of a century ago. Moreover, there is potential for fixing provisions that were flawed initially. Meanwhile, there are still other sectors that were excluded from the original round of liberalization, as well as issues that have been the subject of ongoing friction and protectionism, which could and should be addressed in the renegotiation. Finally, the administration's negotiating objectives include some vague goals that seem to have potential, ultimately, to negate the benefits of NAFTA. That must be avoided.

The proposal to renegotiate NAFTA may have been motivated, to some extent, by protectionist objectives, but there is potential to minimize or even avert protectionist outcomes. In the end, a NAFTA renegotiation could produce a "freer" free trade agreement, which would be good for the North American economy.

MODERNIZING NAFTA

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[1] David Floyd, "NAFTA's Winners and Losers," Investopedia, July 18, 2017, http://www.investopedia.com/articles/economics/08/north-american-free-trade-agreement.asp.

[2] M. Angeles Villarreal and Ian F. Fergusson, "The North American Free Trade Agreement (NAFTA)," Congressional Research Service Report, May 24, 2017, Table 4-A. U.S. FDI in Canada has also grown ($69.9 billion in 1993 to $353 billion in 2015) and in Mexico ($15.2 billion in 1993 to $92.8 billion in 2015). Figures from most recent data from the Bureau of Economic Analysis database at http://www.bea.gov.

[3] Robert Koopman, William Powers, Zhi Wang, and Shang-Jin Wei, "Give credit where credit is due: Tracing value added in global production chains," National Bureau of Economic Research, No. w16426 (2010).

The modernization of NAFTA can be separated into three categories of tasks: (1) Incorporating new issues that were not included in the original agreement; (2) Fixing the flaws that became apparent over time; and (3) Liberalizing trade in areas where liberalization was not politically possible at the time. We address each in turn.

New Issues: Bringing NAFTA into the 21st Century

When NAFTA was originally negotiated in the early 1990s, tariffs were still the major focus of trade agreements. E-Commerce constituted an insignificant portion of global trade, disciplines on state-owned enterprises (SOE) were limited or nonexistent, and what is now called regulatory cooperation and trade facilitation had not yet become prominent matters of trade policy.

Since then, changes in technology, growing concerns over the potentially distorting impact on trade of government supported entities, and greater recognition that domestic regulations and other domestic policies could have protectionist intentions or effects have led to a broadening of the scope of most modern trade agreements. NAFTA, and the North American economy, could benefit from new rules in these areas.

E-Commerce

NAFTA was drafted in the pre-Internet era, when E-Commerce was virtually non-existent. Since then, we have seen the growth of online product sales, the conversion of certain products into services delivered electronically, and the development of various online "platforms." E-Commerce is now a standard way of doing business for many companies, in both domestic and international trade. The free flow of information is essential to free trade in electronic commerce, as well as to the industries for which data are crucial components of the product or service. While governments have grappled with various responses to the growth of E-Commerce, trade policy has been slow in keeping pace with the changes. But in recent years, U.S. trade negotiators have been making some progress.

The most recently completed trade agreement involving (or once-involving) the United States, the Trans-Pacific Partnership (TPP), includes a chapter on E-Commerce, which imposes both "negative obligations" (prohibitions) and "positive obligations" (requirements) on member governments. The prohibitions in TPP are laudable. Among them are prohibitions of customs duties on electronic transmissions; prohibitions of restrictions on "the cross-border transfer of information by electronic means, including personal information, when this activity is for the conduct of the business of the covered person"; prohibitions on conditioning the right to do business in the territory on use of local computing facilities; and prohibitions on requiring the "transfer of, or access to, source code of software owned by a person of another Party, as a condition for the import, distribution, sale or use of such software, or of products containing such software, in its territory."[4]

It is less clear whether the positive obligations in the TPP E-Commerce chapter represent progress. The parties are required to have "consumer protection laws to proscribe fraudulent and deceptive commercial activities that cause harm or potential harm to consumers engaged in online commercial activities." They must have a "legal framework that provides for the protection of the personal information of users of electronic commerce." And they must implement measures that limit the ability of companies to use spam e-mail.[5]

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[4] TPP Articles 14.3, 14.11, 14.13, and 14.17.
[5] TPP Articles 14.7, 14.8, and 14.14.

At this point, the effectiveness and enforceability of those provisions remains to be seen. In many areas, the scope of the obligations is uncertain and a variety of exceptions apply. Nevertheless, given the importance of E-Commerce in the modern economy, some provisions like those described are likely to be incorporated in a renegotiated NAFTA. The TPP template is a good starting point, although a fresh look at the issues may be useful, given the pace of technological change and the evolving domestic policy debate.

State-Owned Enterprises

State-owned enterprises are commercial enterprises in which the state has majority ownership, controlling ownership, or the ability to appoint a majority of the board of directors. SOEs have become more prominent actors in the global economy in recent years. Concerns about trade distortions and unfair competition have grown, as SOEs that had previously operated almost exclusively within their own territories are increasingly engaged in international trade and cross-border investment. According to the Office of the U.S. Trade Representative, there was only one SOE on the list of the Fortune Global 50 largest companies in the world in 2000. By 2015, there were close to a dozen. The purpose of trade agreement rules on SOEs is to curtail their market distorting effects.

The TPP dedicates a separate chapter to SOEs, with the most advanced set of SOE rules ever included in a trade agreement. The three broad SOE mandates in the TPP are the requirements that: (1) SOEs not discriminate against foreign suppliers; (2) SOEs operate in accordance with commercial considerations; and (3) SOEs not receive certain subsidies that cause harm to other TPP parties. Although a positive development for efforts to liberalize trade, the TPP SOE chapter is not especially ambitious, in the sense that it fails to address the distortions of existing SOEs, by largely exempting them from the rules.[6]

NAFTA includes some provisions on SOEs, but they are limited in scope.[7] Renegotiation offers a real opportunity to deepen commitments on SOEs and develop provisions that can address their market-distorting practices. There is certainly room to expand coverage and tighten the rules, particularly in addressing non-commercial practices and preferential treatment given to SOEs by their governments.

Regulatory Cooperation

Since NAFTA reduced almost all tariffs to zero, some of the largest remaining barriers to North American trade take the form of non-tariff barriers, or so-called "behind the border" measures. Differences in standards and regulations are frequently cited as key obstacles to trade, and many of these regulatory divergences are often the result of regulation occurring in domestic silos, without giving much thought to how those rules may impede trade.

As a result, regulatory cooperation has become a prominent component of new trade agreements. Regulatory cooperation refers broadly to attempts at achieving some degree of harmonization of domestic rules that affect trade and investment. They include efforts to establish binational or multinational fora to improve process transparency and to discuss and possibly resolve differences over existing or emerging regulations. Ultimately, the objective of regulatory cooperation is to reduce compliance and production costs, without reducing the efficacy of regulations that often have unintended (or not) consequences.

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[6] Daniel J. Ikenson, Simon Lester, Scott Lincicome, Daniel R. Pearson and K. William Watson, "Should Free Trader's Support the Trans-Pacific Partnership? An Assessment of America's Largest Preferential Trade Agreement," Cato Institute Working Paper no. 39, September 12, 2016, https://object.cato.org/sites/cato.org/files/pubs/pdf/working-paper-39_3.pdf.

[7] NAFTA Article 1503.

There are several ways governments can increase cooperation and reduce the costs of these barriers. One way is to pursue “harmonization” (adopt the same regulation). Another way is through “mutual recognition agreements” (accepting third-party conformity testing) or “equivalence” (accepting different certification procedures that meet the same end goal).[8] Mutual recognition agreements, such as the U.S-Israel Mutual Recognition Agreement for Conformity Assessment of Telecommunications Equipment allows for U.S. labs to conduct conformity assessment procedures to ensure U.S. products meet Israeli technical requirements, and vice-versa.[9] This prevents duplicative testing where the product would have to be tested both in the United States, and then again in Israel to check that it conforms to Israeli requirements.

Equivalency agreements are slightly different, and can reduce costs without materially changing the social outcome (environmental, product safety, worker safety, etc.) by allowing a product or service to be eligible for sale in *both* markets after meeting the requirements in *either* country. Equivalence agreements, such as the U.S.-EU Organic Equivalency Arrangement, which allows USDA certified organic products to be sold in the EU under the organic label, is one example. Although each jurisdiction has different organic labelling requirements, they are functionally equivalent, meaning they meet the same social objectives.

Canada and the United States have made progress addressing some issues through the Regulatory Cooperation Council, which was launched in 2011, outside of the NAFTA framework. Through annual work plans, both governments have held open consultations with businesses, associations, and citizens to help craft priorities for areas of cooperation, and have had notable success in a number of areas.[10]. Including something similar to the RCC in the NAFTA would constitute progress toward addressing and, ultimately, resolving long-standing regulatory barriers. It is important to note that these cooperative activities are entirely voluntary, and involve governments consulting with interested stakeholders to ensure transparency and public engagement.

Trade Facilitation

In broad terms, trade facilitation includes reforms aimed at improving the chain of administrative and physical procedures involved in the transport of goods and services across international borders. Countries with inadequate trade infrastructure, burdensome administrative processes, or limited competition in trade logistics services are less capable of benefiting from the opportunities of expanding global trade.

Like tariff cuts, improvements in trade facilitation procedures can help reduce the cost of trade and increase its flow. One study suggests that a one-day improvement in the average time it takes to move

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[8] Simon Lester and Inu Barbee. "The challenge of cooperation: Regulatory trade barriers in the Transatlantic Trade and Investment Partnership." *Journal of International Economic Law* 16, no. 4 (2013): 847-867.

[9] See Office of the United States Trade Representative, “New United States-Israel Telecommunications Agreement Eases Way for U.S. Exports,” (October 15, 2012) https://ustr.gov/about-us/policy-offices/press-office/press-releases/2012/october/us-israel-telecomm-mou-eases-way-for-exports.

[10] For instance, the RCC helped facilitate a common electronic submission process between the U.S. Food and Drug Administration and its Canadian equivalent, Health Canada, that allows for a single application to both agencies for testing pharmaceutical and biological products, eliminating some duplicative procedures for drug applications. See, Treasury Board Secretariat of Canada, “Canada-United States Regulatory Cooperation Council Joint Forward Plan August 2014,” April 15, 2016, https://www.canada.ca/en/treasury-board-secretariat/corporate/transparency/acts-regulations/canada-us-regulatory-cooperation-council/joint-forward-plan-august-2014.html. Progress was also made in establishing mutual recognition of foreign animal disease zoning, as well as a joint review process for crop protection products.

U.S. cargo from a warehouse to the port of export and inbound cargo from the port to a domestic warehouse could increase U.S. trade by almost $29 billion per year.[11]

There is ample scope for improving performance in many different facets of logistics, the provision of trade-related services, and administrative procedures. The rules governing import and export procedures can be difficult to understand or too opaque for businesses to navigate easily. Customs procedures should be applied in a predictable, consistent and transparent manner.

NAFTA does not have a separate chapter on trade facilitation, but it does cover some aspects of customs procedures and the publication, notification and administration of laws. Customs administration is an area that genuinely can benefit from advances in digital technology, which now make it possible to expedite the process of moving goods across borders (while making it easier to detect customs evasion and corruption). These changes should reduce the costs of importing and exporting, with disproportionate benefits flowing to small and medium-sized enterprises.

For instance, a single-window for submitting customs declarations would help simplify compliance with different customs procedures that exist among the three countries; a full roll out of the Automated Commercial Environment (ACE) would be useful in facilitating shipments into the United States, and Canada and Mexico should be encouraged to implement a similar system as well.

There have also been efforts which have gone beyond international rules to ensure the free flow of goods from our most trusted trading partners. For example, in 2001, the U.S. launched the Customs-Trade Partnership Against Terrorism (C-TPAT), which now includes over 11,000 "certified partners" that are given expedited clearance at ports of entry.[12] The United States and Canada have also conducted numerous pilot-programs on pre-clearance that could also be considered for inclusion in NAFTA, which would help to ensure Mexico is part of this process, as well.[13]

Much of this was in response to the thickening of the U.S. border following the terrorist attacks of September 11, 2001, which had a negative impact on both borders. For Mexico, additional border delays resulted in an estimated $7.5 billion in production losses, and about 300,000 jobs in Nogales, Ciudad Juarez, Nuevo Laredo, and Tijuana. Meanwhile, a report by the Department of Transportation shortly after 9/11 noted that management of the northern border was costing both Canada and the United States upwards of $10.3 billion per year.[14] Given the volume of trade that crosses both our northern and southern borders, and our shared security concerns, finding ways to cooperate on these issues would be beneficial to all three countries.

<u>**Lessons Learned: Updating NAFTA Based on Two Decades of Experience**</u>

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[11] Stephen Creskoff, "Trade Facilitation: An Often Overlooked Engine of Trade Expansion," *Global Trade and Customs Journal*, 3,1 (2008), p. 2.

[12] This is done through information sharing agreements with Customs and Border Protection. See U.S. Customs and Border Protection, "C-TPAT: Customs Trade Partnership Against Terrorism," https://www.cbp.gov/border-security/ports-entry/cargo-security/c-tpat-customs-trade-partnership-against-terrorism, visited July 7, 2017.

[13] In 2015 the U.S. and Canada signed the "Agreement on Land, Rail, Marine, and Air Preclearance," which outlines a single approach to addressing preclearance.

[14] El Colegio de la Frontera Norte, "U.S.-Mexico Ports of Entry: A Capacity Analysis and Recommendations for Increased Efficiency: Executive Summary," (Tijuana, Baja California, December 19, 2007), and John C. Taylor, Douglas Robideaux, and George C. Jackson, "The U.S.-Canada Border: Cost Impacts, Causes, and Short to Long-Term Management Options," for the Michigan Department of Transportation, the U.S. Department of Transportation, and the New York State Department of Transportation, (21 May 2003).

NAFTA has been in effect for almost 24 years, long enough to determine whether and how well its various provisions have been working in practice. Two areas that stand out as ripe for improvement are dispute settlement and rules of origin (RoO).

To date, three dispute settlement provisions in NAFTA have been utilized, and each of them has experienced problems or come under criticism: Chapter 20, which governs state-to-state dispute settlement; Chapter 19, which provides for special binational panels to adjudicate disputes stemming from antidumping and countervailing duty measures; and Chapter 11, which concerns investor-state dispute settlement.

Rules of origin establish the specific requirements to determine whether a product "originates" within the free trade area, and thus qualifies for the preferential treatment accorded under the agreement. It is well known that NAFTA has some of the most restrictive RoO of any trade agreement.

Dispute Settlement

The enforceability of the rules of a trade agreement is of great importance because if governments cannot be held to honor their commitments, the value of those commitments is significantly diminished. Inevitably, disputes arise over the meaning of the obligations in trade agreements. Typically, dispute settlement involves ad hoc panels of experts who hear claims from either governments or private actors, and then issue rulings on those claims. Essentially, these panels act as the judicial arm of the trading system. If trade agreements are to be reliable and effective, they must include enforcement mechanisms. The degree of enforceability varies depending on the design of the particular system. In this section, we discuss how Chapters 20, 19, and 11 may be addressed in the NAFTA renegotiation.

Chapter 20 (State-to-State Dispute Settlement)

In the early years of NAFTA, there were three disputes that proceeded all the way through the process, from initial complaint to panel report to implementation.[15] Implementation of the last one, related to trucking services, has been a challenge, but some progress has been made there.

However, in the early 2000s, Mexico brought a complaint against U.S. barriers to trade in sugar and a flaw was exposed in the adjudication process, as the United States blocked the panel from being composed.[16] At the WTO, if the parties cannot agree on panelists, the Director-General can step in to appoint a panel. Under NAFTA, there is no such possibility. Since the sugar dispute exposed this

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[15] Scholars have identified up to 11 complaints in total. See David A. Gantz, "Dispute Settlement under the NAFTA and the WTO: Choice of Forum Opportunities and Risks for the NAFTA Parties." *American University Int'l L. Rev.*14 (1998): 1025; Gary Clyde and Jeffrey J. Schott, Hufbauer, *NAFTA Revisited: Achievements and Challenges*, Peterson Institute for International Economics, 2005.

[16] This problem was described by Mexico in its submissions in a related WTO dispute (Panel Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/R, adopted 24 March 2006, as modified by Appellate Body Report WT/DS308/AB/R, DSR 2006: I, p. 43). Mexico argued: "The uncontradicted evidence is that it has been almost five years since Mexico requested the formation of an arbitral panel under NAFTA Chapter Twenty and that the United States refused to cooperate in naming arbitrators. The United States even gave instructions to its NAFTA Secretariat Section to abstain from appointing them," and "The US has provoked an unfair interaction between the NAFTA and the WTO Agreement, resulting from the automatic operation of the WTO's DSU and Chapter Eleven of the NAFTA, and the corresponding lack of automaticity in the operation of NAFTA's Chapter Twenty, due to the US refusal to appoint panelists in a proceeding that presently requires the good faith and cooperation of both disputing Parties." (paras. 4.398 and 4.475). See also: Joost Pauwelyn, "Adding Sweeteners to Softwood Lumber: The WTO–NAFTA 'Spaghetti Bowl' is Cooking," *Journal of International Economic Law* 9: 197 (2006).

problem, no new NAFTA panels have been established, despite the existence of several new, unresolved complaints.

Recent trade agreements have set out a more detailed process intended to help ensure that parties cannot block panels in this manner. The TPP includes a number of improvements, such as the use of independent third parties to make appointments.[17] And the CETA envisions a random selection procedure that can be invoked where a party has not participated in good faith in the creation of a list of panelists.[18] The TPP and CETA provisions could be a good source of inspiration for improved NAFTA dispute rules. Ultimately, without strong enforcement, in the sense of a functioning dispute panel process, the rules in a trade agreement will not have the liberalizing impact that they could and should.

Chapter 19 (Binational panels for AD/CVDs)

During the Canada-U.S. free trade negotiations in the 1980s, one of Canada's concerns was whether U.S. courts would be impartial when asked to rule on trade remedy decisions by U.S. trade agencies. In Canada's view, U.S. courts were biased in favor of domestic industries. To address this concern, the Canada-U.S. agreement included a provision for a special review process, through which parties to trade remedy proceedings could challenge agency decisions in a special bi-national panel, made up of experts from both countries, rather than before a domestic court. When NAFTA superseded the Canada-U.S. agreement, the bi-national panel process was brought into NAFTA Chapter 19.

Over the years, U.S. industry groups have complained about the bi-national panel process and some have filed claims in U.S. court, arguing that Chapter 19 violates the U.S. Constitution. None of those challenges were fully resolved by the courts on their merits, however, so the question of constitutionality remains unresolved.[19]

Chapter 19 remains an anomaly, never having been duplicated in other trade agreements. With U.S. objections to the bi-national process both bipartisan and strong, it is no surprise that elimination of Chapter 19 is one of the USTR's NAFTA negotiating objectives. Removing it might be the kind of "tweak" that could be sold by the Trump administration as a significant change, while not fundamentally altering the economic integration established by the NAFTA. However, Canadian business groups strongly support the mechanism, viewing it as crucial to resolving important cases such as softwood lumber. Whether the Canadian (and Mexican) negotiators see Chapter 19 as essential to the agreement, or whether they will leverage that position to obtain other U.S. concessions, remains to be seen.

But it is worth noting that Chapter 19 is invoked much less frequently nowadays than it was in its early years.[20] Moreover, an alternative for resolving disputes over domestic trade remedies that didn't exist when NAFTA was first negotiated exists today: The WTO dispute settlement system (which is more effective than the GATT was in the 1980s, when Chapter 19 was developed).[21]

[17] Simon Lester, "Can TPP Dispute Panels Be Blocked?" International Economic Law and Policy Blog, June 12, 2017, http://worldtradelaw.typepad.com/ielpblog/2017/06/can-tpp-dispute-panels-be-blocked.html.
[18] CETA Article 29.7.6
[19] Jeanne J. Grimmett, "NAFTA Binational Panel System: Second Constitutional Suit Dismissed," CRS Report to Congress (February 10, 1998) https://digital.library.unt.edu/ark:/67531/metadc815321/m2/1/high_res_d/98-102_1998Feb10.pdf (visited August 9, 2017).
[20] "List of all NAFTA/CUSFTA Chapter 19 and ECC Decisions," WorldTradeLaw.net, http://worldtradelaw.net/databases/naftastats.php (visited May 17, 2017).
[21] In terms of its actual impact on domestic trade remedy decisions, one scholar has suggested that through 2005, Chapter 19 panels were more likely to favor foreign interests than U.S. courts would be. See, Juscelino F. Colares, "Alternative Methods of Appellate Review in Trade Remedy Cases: Examining Results of U.S. Judicial and

Chapter 11 (Investor-State dispute settlement)

One of NAFTA's most lasting achievements was bridging the investment and trade regimes. Until NAFTA, investment treaties and trade agreements were separate, with different dispute procedures and sometimes with separate government departments responsible. By incorporating the investment treaty model as a chapter in a trade agreement, NAFTA brought the two regimes together. This innovation caught on, and has become standard practice in trade agreements around the world.

While it might not have been anticipated at the time NAFTA was signed, when investor-state complaints were rare, the inclusion of investment provisions led to increased criticism of trade agreements. Indeed, investor state dispute settlement (ISDS) has become one of the most controversial features of trade agreements in recent years. But it was a handful of NAFTA cases that raised concerns and generated early criticism in the United States and Canada.[22]

The NAFTA investment rules were drafted many years ago. Since then, various modifications to rebalance investor rights and obligations have been crafted and adopted in more recent trade agreements. If the ISDS provisions in NAFTA Chapter 11 are to be modified, the TPP investment chapter text would be a good model. The United States, Canada, and Mexico agreed to those provisions in TPP and they reflect the most recent attempt at balancing the demands of business groups and civil society.[23] It is worth noting that Canada has been working with the European Union to create a new investment court as part of CETA, but it is unlikely that the United States would support such a change to the ISDS regime.[24]

Meanwhile, there are strong objections to ISDS more generally these days, and it will be more difficult to reach a new agreement that includes ISDS than it was to complete the original NAFTA, when ISDS was relatively unknown.[25] NAFTA provides an opportunity to reconsider whether trade agreements even should include investment protection and ISDS.

NAFTA Binational Review of U.S. Agency Decisions from 1989 to 2005," *Journal of Empirical Legal Studies* 5(1) 171 (March 2008). However, those who have been involved in the system present a more nuanced picture, with some evolution of the results over time. While early Chapter 19 panel decisions may have been more likely to go against the United States than similar decisions from the U.S. Court of International Trade were, it is not clear how different the results are today. *Authors' conversations with practitioners and NAFTA Chapter 19 panelists.*

[22] See, e.g., Guillermo Aguilar Alvarez William W. Park, "The New Face of Investment Arbitration: NAFTA Chapter 11," 28 Yale J. Int'l L. 365 (2003).

[23] For example, in its summary of the investment chapter, USTR noted that "TPP explicitly clarifies that an investor cannot win a claim for breach of the MST obligation merely by showing that a government measure frustrated its expectations (for example, its expectations of earning certain profits)." See, USTR, "TPP Chapter Summary: Investment," https://ustr.gov/sites/default/files/TPP-Chapter-Summary-Investment.pdf (visited May 5, 2017). One important caveat is that the "tobacco carveout" was the subject of strong criticism from many Republicans, including Senate Majority leader Mitch McConnell, and therefore might not make it into a new NAFTA. See, Bernie Becker and Vicki Needham, "McConnell warns Obama against tobacco carve-out in trade deal," *The Hill* (July 31, 2015) http://thehill.com/policy/finance/249913-mcconnell-warns-obama-against-tobacco-carveout-in-trade-deal (visited May 5, 2017).

[24] See, e.g., Inside U.S. Trade, "Commission Official Defends EU Investment Court Appeals Mechanism," (June 16, 2016) https://insidetrade.com/inside-us-trade/commission-official-defends-eu-investment-court-appeals-mechanism (visited May 5, 2017).

[25] See, for example, Simon Lester, "Liberalization or Litigation? Time to Rethink the International Investment Regime," Cato Policy Analysis no. 730(July 8, 2013) https://www.cato.org/publications/policy-analysis/liberalization-or-litigation-time-rethink-international-investment; Daniel Ikenson, "A Compromise to Advance the Trade Agenda: Purge Negotiations of Investor-State Dispute Settlement," Cato Free Trade Bulletin no. 57 (March 4, 2014) https://www.cato.org/publications/free-trade-bulletin/compromise-advance-trade-agenda-purge-negotiations-investor-state.

Rules of Origin

Rules of Origin (RoO) establish the parameters used to determine whether an imported good "originates" within the region, thereby qualifying for the preferential treatment accorded under the agreement. Generally, a product is considered originating if it was wholly made within the region (in the countries party to the agreement), if it was significantly transformed within the region from imported materials and components, or if the relative value of originating materials and manufacturing performed in the region meets a specific threshold.

RoO are necessary components of preferential trade agreements. When products from different countries receive different tariff treatment, importers, exporters, and customs officials must have a way to determine which tariff rates apply. Rules that permit greater use of non-originating inputs or broader definitions of what constitutes product transformation tend to be more trade liberalizing than more proscriptive rules, which impose greater restrictions on qualification for the agreement's preferential tariff rates.

In today's globalized economy, strict rules of origin impede the evolution and operation of more efficient supply chains and can be used to privilege existing producers by limiting competition. They increase the likelihood and cost of trade diversion, which occurs when less efficient producers are chosen simply for the tariff advantages they receive. Moreover, complicated rules of origin tend to generate higher compliance and verification costs, which erode the benefits of preferential duties causing importers to simply forego their claims to preferences.

It is well known that NAFTA has some of the most restrictive rules or origin compared to other trade agreements.[26] NAFTA preferences are based on whether a product undergoes substantial transformation (a change in tariff classification) before importation, meets a product-specific threshold for regional value content, or both. Tariff classification is based on the harmonized system (HS) which breaks up products into chapters (2-digits), headings (4-digits), subheadings (6-digits), tariff lines (8-digits), and statistic sub-headings (10-digits), which is the most granular specification of a commodity description under the HS system.

NAFTA preferences are considered restrictive because the substantial transformation rules often require a change in both chapter and heading, with 54% of tariff lines requiring a change in chapter. For example, a Canadian bakery that wants to sell cakes (HS 1905.90) in the United States, but imports its flour from Europe qualifies for NAFTA preferences because of a change in classification from Chapter 11 (flour) to Chapter 19 (breads, pastries, cakes, biscuits), which occurs during the manufacturing process. There is a substantial transformation. However, if that company were to purchase cake mix from Europe, which falls under Chapter 19, the cakes would not qualify for the preferential tariff treatment because the inputs and final product both fall under the same HS chapter. For other products, there are regional value content requirements. For example, cars must have 62.5 percent North American content to qualify for NAFTA preferences.[27]

Since NAFTA has many product-specific rules and requirements, it is often challenging for businesses to navigate. Oftentimes, they simply pay the higher MFN rate because the cost of complying with the rules

[26] Antoni Estevadeordal, "Negotiating Preferential Market Access: The Case of the North American Free Trade Agreement," *Journal of World Trade*, *34* (2000).

[27] This is for HS 8703.21- 8703.9, and utilizes the net-cost method. For more on this methodology and auto requirements, see Caroline Freund, "Streamlining Rules of Origin in NAFTA," Peterson Institute for International Economics (June 2017) p. 2.

to obtain preferential status is too high. An examination of NAFTA preference utilization during the period 2009-2011 found that slightly over 50 percent of imports from Canada and Mexico claimed NAFTA preferences.[28] In other words, nearly half of the value of trade foregoes the beneficial tariff treatment.

As these complicated rules are more burdensome to smaller businesses that lack the resources to invest in understanding how they work, negotiators should focus on reformulating the RoO chapter to make it more accessible to exporters and importers alike. One way to do so would be to adopt a general regional value content threshold for the majority of tariff lines. For example, footwear (HS 64.01-64.05) require:

> A change to heading 64.01 through 64.05 from any heading outside that group, except from subheading 6406.10, provided there is a regional value content of not less than 55 percent under the net cost method.

This rule includes a requirement for a change of heading, a regional value content requirement of 55 percent, and the use of net-cost method.[29] Satisfying these requirements involves a significant amount of administrative work. It could be simplified by eliminating the requirement for a change in heading, or by having a regional value content threshold that applies to all products (or a broader category of products). The variation in content requirements for different products makes navigating these rules difficult, particularly for businesses that may make more than one item. Therefore, having a single regional value content would help simplify calculations for businesses.

A second reform would allow for a cross-cumulation provision, which would qualify as originating value any inputs that come from our shared trading partners. For example, all three countries have trade agreements with Chile, but intermediate inputs from Chile are not considered "originating" under current NAFTA rules.[30] A provision on cross-cumulation would recognize shared trading partners, preserving the preferences that have already been extended to them. This is an important RoO innovation, which helps disentangle the "spaghetti bowl" of overlapping rules by crafting content requirements that better reflect the realities of production sharing and global supply chains.

Stalled Liberalization

Although NAFTA succeeded at liberalizing vast amounts of North American trade, a number of products and industries were either left out of the original agreement or have failed to respond favorably to the reforms. Two significant issues that come to mind are Canada's supply management system for dairy, poultry, and eggs, and the U.S.-Canada softwood lumber dispute, which has lingered unresolved for decades. A third matter worthy of mention here is services liberalization. While NAFTA achieved some services liberalization, which was considered cutting edge at the time, the rules are now outdated given the progress made in more recent trade agreements.

Canada's Supply Management System

[28] Maria Donner Abreu, "Preferential Rules of Origin in Regional Trade Agreements," World Trade Organization, Economic Research and Statistics Division (March 22, 2013), p. 22, https://www.wto.org/english/res_e/reser_e/ersd201305_e.pdf (visited April 13, 2017).

[29] The net-cost method excludes sales promotion, marketing and aftersales service costs, royalties, shipping and packing costs, and non-allowable interest costs that are included in the total cost of all such goods.

[30] Countries that the United States, Canada and Mexico all have a trade agreement with are: Chiles, Colombia, Costa Rica, Honduras, Israel, Panama, and Peru.

Canada's supply management system for dairy, poultry, and eggs was excluded from NAFTA. The renegotiation offers an opportunity to bring these highly-protected sectors into the agreement, so as to increase market access for U.S. producers, but also to improve purchasing choices for Canadian consumers. For instance, Canada maintains a 270 percent tariff on milk, and the above-quota tariffs on cheese and butter can reach as high as 245 percent and 298 percent, respectively.[31]

The recently concluded Canada – European Union (EU) Comprehensive Economic Trade Agreement (CETA) hardly made a dent in the Canadian supply management system. The EU received 16,000 tons of additional market access for cheese, though Canadian producers still retain 96% of the market.[32] Meanwhile, under CETA, poultry and eggs retain their current levels of protection.

If the new NAFTA is to achieve significant liberalization in Canada's dairy, eggs and poultry markets, it should aim to go beyond CETA. The goal should be the full elimination of remaining TRQs and above-quota tariffs, with phase-out periods if necessary. Another issue that will need to be resolved is the Canadian milk quota administration system, especially a new rule implemented in 2015 which effectively shuts out U.S. exports of ultra-filtered milk (which was outside the quota system) that should be entitled to duty free treatment.[33]

Politically speaking, the Canadian dairy market will be a tough nut to crack, but it remains an important area for reform. A 2013 study found that the current supply management system for dairy in Canada is overly restrictive, and that the government's objective for achieving a fair return for farmers could still be achieved with increased foreign imports.[34]

Softwood Lumber

Lumber trade between Canada and the United States has been a source of tension for many decades.[35] The issues trace back to 1982, when U.S. producers of softwood lumber sought to limit Canadian imports through countervailing duty measures. The main focus of U.S. producers' complaints at that time and today has been the forest management practices of certain Canadian provinces. According to the U.S. industry, the fees charged by the Canadian national and provincial governments to harvest timber on government-owned lands—so-called stumpage fees—fall below market rates and thus bestow unfair subsidies on Canadian lumber producers. Other programs, such as log export controls in certain

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[31] USTR, *2017 National Trade Estimate Report on Foreign Trade Barriers*, p. 66. Canada's tariff schedule is available at Canada Border Services Agency, http://www.cbsa-asfc.gc.ca/tradE-Commerce/tariff-tarif/2017/menu-eng.html.

[32] Laura Dawson, "How Soon until we get Cheaper Cheese? Managing Expectations for the CETA" Fraser Institute (November 11, 2013) http://www.fraserinstitute.org/research-news/news/commentaries/How-soon-until-we-get-cheaper-cheese–Managingexpectations-for-the-CETA/ (visited July 7, 2017).

[33] Barrie McKenna, "A guide to understanding the dairy dispute between the U.S. and Canada," *The Globe and Mail* (April 25, 2017) https://www.theglobeandmail.com/report-on-business/a-guide-to-understanding-the-dairy-dispute-between-the-us-andcanada/article34802291/ (visited April 25, 2017).

[34] Colin Busby and Daniel Schwanen, "Putting the Market Back in Dairy Marketing," C.D. Howe Institute, Commentary No. 374 (March 2013) https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/Commentary_374_0.pdf (visited July 26, 2017).

[35] For a brief history of the lumber dispute, see Daniel Ikenson, "America's Credibility Goes "Timber!" Cato Free Trade Bulletin no. 20 (October 28, 2005) https://www.cato.org/publications/free-trade-bulletin/americas-credibility-goes-timber, and Daniel Ikenson, "Tilting at Sawmills: America's Shameful Approach to the Softwood Lumber Dispute with Canada," *Forbes.com* (November 29, 2016) https://www.cato.org/publications/commentary/tilting-sawmills-americas-shameful-approach-softwood-lumber-dispute-canada.

provinces, have been challenged as unfair subsidies by artificially inflating the supply and reducing the price of timber to Canadian mills.

The U.S. industry's first effort to convince the government to impose countervailing duties failed in May 1983, when the U.S. Department of Commerce (DOC) concluded that stumpage did not confer a countervailable subsidy to Canadian lumber producers. In 1986, the U.S. industry again petitioned the government for countervailing duties and that time the DOC changed its tune. It found that the Canadian stumpage system conferred a subsidy to lumber producers averaging about 15 percent. But in lieu of imposing the duties, the two governments entered into a Memorandum of Understanding (MOU), which required that the Canadian government collect an export tax of 15 percent. A stipulation was included to allow for reduction of that rate if the stumpage fees or other provincial charges increased. The forest management policies of some provinces did change, and as a result their mandated export charges were reduced. But Canada terminated the MOU in September 1991, prompting new rounds of trade remedies litigation, which ultimately were suspended with an agreement to a managed trade arrangement knows as the Softwood Lumber Agreement (SLA).

Immediately after the 1996 SLA expired in 2001, the U.S. imposed a new set of countervailing and antidumping duty orders, which were subsequently found by a NAFTA Chapter 19 panel to be inconsistent with U.S. law. Eventually, a new agreement was reached in 2006, which expired in 2015. After a one-year standstill period, during which new trade remedy investigation could not be initiated, the U.S. industry filed new cases. In January 2017, the ITC concluded a preliminary investigation, finding "a reasonable indication that an industry in the United States is materially injured by reason of subject imports of softwood lumber from Canada that are allegedly subsidized and sold in the United States at less than fair value." [36]

The use of trade remedy laws to coerce the Canadians into a new SLA is nothing new. Nor will a new SLA—if one is reached—do much to alleviate this long-running problem.[37] As usual, the losers will be Canadian lumber producers, who will have difficulty competing in the U.S. market; U.S. lumber-consuming industries, who will face higher costs; and U.S. home buyers, who will face higher prices. Meanwhile, according to the National Association of Homebuilders, home prices have already gone up by an average of $3,600 this year.[38]

The United States should do the right thing and live up to its NAFTA and WTO obligations to open its market to lumber imports. If Canadian government practices remain a concern, the U.S. government can file a dispute under the WTO Agreement on Subsidies and Countervailing Measures to have the issue settled once and for all. However, the current approach, which is to negotiate export-restrictions under threat of ever-changing rates of duty, generates uncertainty in the marketplace, which has a negative impact on both the lumber industry and consumers.

Services

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[36] See the full ITC report, Softwood Lumber Products from Canada, Inv. Nos. 701-TA-566 and 731-TA-1342 (January 2017) p. 39 https://www.usitc.gov/publications/701_731/pub4663.pdf (visited July 21, 2017).
[37] Daniel J. Ikenson, "Tilting and Sawmills: America's Shameful Approach to the Softwood Lumber Dispute," (November 29, 2016) https://www.forbes.com/sites/danikenson/2016/11/29/tilting-at-sawmills-americas-shameful-approach-to-the-softwood-lumber-dispute-with-canada/#32649120acf0 (visited July 21, 2017).
[38] "Proposed Lumber Duties Will Harm Consumers, Housing Affordability," National Association of Home Builders Press Release (April 25, 2017) https://www.nahb.org/en/news-and-publications/press-releases/2017/04/proposed-lumber-duties-will-harm-consumers-housing-affordability.aspx (visited July 21, 2017).

NAFTA was the first international trade agreement with significant commitments to liberalize trade in services, and one of the most prominent NAFTA disputes concerns the provision of trucking services in the United States by Mexican firms. However, in the ensuing years, services liberalization in other trade agreements has evolved to include broader obligations covering more areas of trade, leaving NAFTA's rules insufficient and outdated. In the NAFTA renegotiation, there is as an opportunity to take a fresh look at services, such as legal, medical, and educational services, that are more easily traded across borders than was the case in the early 1990s. With growing concerns over the absence of sufficient competition in the provision of U.S. healthcare services, the United States could benefit by allowing more foreign competition in the medical services and health insurance markets.

In addition to liberalizing in these new areas, there are a number of services sectors where remaining barriers are ripe for deeper reform. USTR has cited a number of market access problems in Canada and Mexico. For example, Canada's telecommunications market has a 46.7 percent limit on foreign ownership, which is "one of the most restrictive regimes among developed countries" for telecom services;[39] Mexico undertook major reforms in its telecom market in 2013 and 2014, but issues remain with regard to transparency in the issuance of permits to set up telecom infrastructure;[40] and Canada has also retained strong Canadian content requirements in broadcasting, which is managed by a quota system, and has restricted the level of competition in the Canadian marketplace.

NEGOTIATING IN THE SHADOW OF TRUMP'S TRADE AGENDA

While there is potential for positive developments in the NAFTA renegotiation, it's important to recall that the catalyst for reopening the agreement in the first place was a belief, common among trade policy advisors in the Trump administration, that the deal was unfair to Americans and needed to be redone to level the proverbial playing field. In other words, some of the Trump administration's objectives are not necessarily in keeping with the goals of trade liberalization, but are geared more toward rebalancing the distribution of the agreement's benefits. Meanwhile, some objectives appear to be outright protectionist. These issues, and how they are handled, threaten to derail the talks—even the agreement altogether.

Trade Deficits

President Trump and members of his administration seem to believe that trade is a zero sum game played between Team USA and – in the case of NAFTA – Team Canada and Team Mexico. They consider exports to be Team USA's points, imports to be the foreigners' points, and the trade account to be the scoreboard. Since the United States runs a persistent deficit with Mexico (and an occasional deficit with Canada), they conclude that America is losing at trade. And it's losing because of poorly negotiated trade deals or outright cheating on the part of the foreign teams.

Secretary of Commerce Wilbur Ross and National Trade Council advisor Peter Navarro have suggested that our trade agreements should include some sort of trigger mechanism, so that if trade balance or some other objectives related to reducing deficits or increasing surpluses are not reached, the deal would be reopened and renegotiated.[41] That idea, frankly, is absurd. What would motivate businesses to invest in cross-border relationships or to commit to capital investments if the terms of the underlying trade agreement were prone to such uncertainty and potential upheaval?

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[39] USTR, *2017 National Trade Estimate Report on Foreign Trade Barriers*, 70.
[40] USTR, *2017 National Trade Estimate Report on Foreign Trade Barriers*, 307.
[41] Jordan Weissman, "Trump's Advisers Have an Idea That Would End Trade Deals as We Know Them," *Slate.com*,February 27, 2017,
http://www.slate.com/blogs/moneybox/2017/02/27/trump_s_advisors_have_an_idea_that_would_end_trade_deals_as_we_know_them.html.

Moreover, the bilateral trade balance is not a measure of the success or failure of a trade agreement. It is a meaningless statistic. A better measure of the success of a trade agreement is its effect on *total* trade and investment, and its effect on economic growth. By those metrics, NAFTA has been an unbridled success. Furthermore, "despite" 41 straight years of registering annual trade deficits, the U.S. economy has grown significantly, in part because it has benefitted from the capital account surplus (foreign purchases of U.S. assets exceeding U.S. purchases of foreign assets) that goes along with a current account deficit.[42]

The Trump administration's obsession with trade deficits—especially bilateral trade deficits—is misguided. The point of trade agreements is to reduce artificial impediments to trade and to provide greater certainty. It would create vast uncertainty and be a serious mistake to push for any provisions in NAFTA that use the trade account as a trigger of some future action.

Border Taxes

Another problematic suggestion from the Trump trade team is that they would like to use trade agreements to take on the "border adjustment taxes" associated with value-added taxes used by many countries.[43] Trump advisors have expressed concerns over alleged advantages bestowed upon Mexican producers by way of the rebate of value-added taxes upon export and the assessment of taxes on U.S. products upon import.[44]

A proper understanding of these border adjustment taxes is that their impact on trade is much more benign. The general understanding, according to WTO rules, is that value-added taxes are a consumption tax, similar, in nature, to a sales taxes, and thus a non-discriminatory application of such taxes to domestic and imported products is permitted. Not that it would necessarily be a good idea, the U.S. government is free to adopt a similar VAT system with rebates upon export or some variation, such as a destination based cash flow tax, which was under consideration in Congress (although such a measure would, of course, have to be applied in a non-discriminatory way). As of this writing, that controversial proposal seems to have been abandoned.

Regardless, this is not a NAFTA problem or a Mexico problem. Much of the world uses value-added taxes or some similar form of consumption taxes. If the U.S. government has concerns, it can address them at the WTO. There is a long history of disagreement over this issue in the GATT, and finding a way to raise it again at the WTO would not be out of line. Raising it in NAFTA, on the other hand, would be a pointless distraction.

Currency Manipulation

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[42] Daniel J. Ikenson, "41 Straight Years Of Trade Deficits Yet America Still Stands Strong," *Forbes* (August 23, 2016) https://www.forbes.com/sites/danikenson/2016/08/23/41-straight-years-of-trade-deficits-yet-america-still-stands-strong/#17b819f02d4c (visited July 19, 2017).

[43] Recent events suggest that the Republican leadership is dropping the idea of a border adjusted tax, but like any proposal pushed by the Trump administration, it may be too soon to call it dead entirely. See, Anna Edgerton, Sahil Kapur, and Matthew Townsend, "Ryan Gives Up on Border-Adjusted Tax on Imports After Attack," *Bloomberg* (July 27, 2017) https://www.bloomberg.com/news/articles/2017-07-27/ryan-is-said-to-be-telling-republicans-border-tax-is-dead (visited July 29, 2017).

[44] Peter Navarro and Wilbur Ross, "Scoring the Trump Economic Plan: Trade, Regulatory, & Energy Policy Impacts," (September 29, 2016) https://assets.donaldjtrump.com/Trump_Economic_Plan.pdf, p. 13 (visited August 9, 2017).

Another controversial issue the Trump administration is likely to press is currency manipulation. While economists are divided in their opinions about how to define currency manipulation and whether it constitutes an especially pernicious offense worthy of counteractions, even many of those who think currency manipulation should be discouraged are skeptical of the wisdom of including punitive provisions in trade agreements. Even though Canada and Mexico do not generate much concern in the United States as likely currency manipulators, the Trump administration sees NAFTA as an opportunity to set a precedent for future agreements by crafting and incorporating such provisions without much resistance in this agreement.

China and Japan are the countries most often cited as the reasons for including currency manipulation provisions in trade agreements. But we should be skeptical about the assumptions underlying the relationship between currency manipulation and trade flows. Given that intermediate goods trade predominates total trade, as a result of the proliferation of global supply chains, the relationship between currency values and trade is not straightforward.

If only 50 percent of the value of a country's exports is domestic content and labor (and the other 50 percent is foreign value), as is the approximate case with China, the impact of currency values on trade flows is mitigated. This helps explain why, despite a 38 percent appreciation of the renminbi against the dollar between 2005 and 2013, the bilateral U.S. trade deficit with China didn't decrease. Rather, it increased by 46 percent.[45] Even if deemed desirable, crafting the right currency manipulation provision would be more difficult than the administration thinks. There is vast disagreement among economists as to how to identify and measure the effects of currency manipulation.

Meanwhile, U.S. government agencies have conflicting views about incorporating currency provisions in trade agreements. While the Commerce Department—with its mission to protect U.S. industries in the global market place—might favor another weapon in its trade remedy arsenal, the Treasury Department, which has long held sway over financial and economic issues related to currency, is less inclined to take actions in currency markets to achieve trade objectives.

And while the Canadian and Mexican governments might not be overly concerned that their actions would be the targets of such provisions, they will certainly have their own opinions about whether and how such rules should be crafted. Thus, balancing domestic and international views on this issue will take time. If the Trump administration chooses to push this issue, the NAFTA renegotiation may not go as quickly as it wishes.

Buy America

Trump and his trade team have spent a lot of time promoting the idea of Buy America, and have criticized trade agreements that restrict the ability of the U.S. government to buy exclusively from Americans. In the leaked draft memo about NAFTA, it was suggested that the NAFTA renegotiation would provide more flexibility for such Buy America programs.

What those pushing for expanded Buy America do not seem to realize is that this issue works both ways. Cordoning off more of the estimated $1.7 trillion U.S. government procurement market to U.S. suppliers would mean higher price tags, fewer projects funded, and fewer people hired. In today's globalized economy, where supply chains are transnational and direct investment crosses borders, finding products

[45] Daniel J. Ikenson, "Currency Manipulation and the Trans-Pacific Partnership: What Art Laffer, Fred Bergsten, and Other Hawks Get Wrong," *Forbes.com*(January 26, 2015) https://www.forbes.com/sites/danikenson/2015/01/26/currency-manipulation-and-the-trans-pacific-partnership-what-art-laffer-fred-bergsten-and-other-hawks-get-wrong/#4141f175f25d (visited August 8, 2017).

that meet the U.S.-made definition is no easy task, as many consist of components made in multiple countries. And by precluding foreign suppliers from bidding, any short-term increases in U.S. economic activity and jobs likely would be offset by lost export sales – and the jobs that go with them – on account of copycat protectionism abroad. If Americans are compelled by law to buy more U.S. product from U.S. firms, then the Canadians and Mexicans will insist on the same.

Buy America may sound good in a campaign speech or on a bumper sticker, but in practice it just means higher price tags for taxpayer funded projects and fewer opportunities for U.S. exporters.

CONCLUSION

To the surprise of most trade policy experts, the Trump administration has made NAFTA renegotiation is top trade negotiating priority—after the president withdrew the United States from the TPP, a deal that was, in effect, the renegotiation of NAFTA. Certainly, there is scope for improving NAFTA. After nearly a quarter century in operation, some of the agreement's provisions have become outdated and could benefit from modernization. The renegotiation presents an opportunity to incorporate rules on E-Commerce, State-Owned Enterprises, Regulatory Cooperation, and Trade Facilitation.

Some NAFTA rules, which have been flawed from the outset, could be fixed. Two important candidates in this regard are provisions governing Dispute Settlement and Rules of Origin.

Renegotiation also offers potential to broaden NAFTA's rules to cover sectors of the economy that were excluded from the original agreement, such as broad swaths of services trades, as well as Canada's supply management of dairy, poultry, and eggs. It also affords the opportunity to finally resolve issues that have dogged relations for decades, such as the Softwood Lumber Dispute.

Indeed, there is plenty of upside to the NAFTA renegotiation. However, the Trump administration has identified, among its negotiating objectives, some ideas that seem ill-suited to an agreement that is intended to liberalize trade. Some of those ideas, if incorporated, could reduce or negate the benefits of a new agreement, or even derail the negotiations altogether.

Provisions that set targets for bilateral trade accounts and trigger certain outcomes if those targets are not met would not only make a mockery of an agreement intended to liberalize trade, but they would deter trade and investment. Meanwhile, "strengthening" Buy American rules would diminish the agreement's benefits and would be adamantly opposed by the Canadian and Mexican governments. Likewise, provisions for border adjustment taxes or to redress currency manipulation seem inherently protectionist, and would prolong—and potentially subvert—the negotiations. That must be avoided.

The idea of NAFTA renegotiation was borne of protectionist motives. But there is potential to minimize and even avert protectionist outcomes. Indeed, there is plenty of scope for changes that further liberalize regional trade. In the end, a NAFTA renegotiation could produce a "freer" free trade agreement, which would be good for the North American economy.