

What to Expect From NAFTA Renegotiations

Skadden

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On July 17, 2017, the office of the U.S. Trade Representative (USTR) released a report on U.S. goals to modify the current North American Free Trade Agreement (NAFTA). The report provides insight into the issues that will be at the top of the agenda when the United States, Mexico and Canada convene on August 16, 2017, in Washington, D.C. to begin formal NAFTA renegotiations.

The report was mandated by Trade Promotion Authority (TPA) legislation passed by Congress in 2015. TPA guarantees that Congress will hold a straight up or down vote (without amendments) on legislation that approves and implements trade agreements in exchange for imposing certain substantive and procedural requirements on the executive branch's trade negotiators. Among other mandates, TPA requires USTR to meet a number of statutory deadlines before and after the start of negotiations, including providing 90 days' advance notice to Congress of the administration's intent to engage in trade negotiations. That deadline determined the August 16, 2017, start date for the NAFTA negotiations.

TPA also requires USTR to engage in frequent consultations with Congress in the lead up to and following the start of trade negotiations. In particular, USTR must consult on a regular basis with the leadership of the House Ways and Means Committee and Senate Finance Committee and provide regular updates and briefings to select members of these committees comprising House and Senate "advisory groups on negotiations." Under TPA, the members of these advisory groups will have unprecedented access to USTR throughout the course of negotiations.

USTR and Congress have also been holding hearings and receiving comments from industry, nongovernmental organizations and members of the general public on the negotiations process and priorities for a renegotiated NAFTA. Congressional hearings on NAFTA started July 18, 2017, with a hearing convened by the House Ways and Means trade subcommittee. Separately, USTR received over 12,000 comments in response to a request for comments on NAFTA negotiating objectives and held three days of hearings on the subject at the end of June 2017. Additional public comments to USTR on the benefits and disadvantages of the current NAFTA and other U.S. trade agreements were allowed through July 29, 2017. USTR has also requested comments on the U.S. bilateral trade deficit with Mexico and other countries and is expected to release a report on that topic by the end of July 2017. The issues from the USTR report on negotiating objectives reflect in part the input received through these various hearings and consultations.

Key US NAFTA Negotiating Objectives

- **Reduce the US Merchandise Trade Deficit.** USTR has emphasized the importance of bilateral trade deficits as an indicator of the success or failure of trade agreements and bilateral trade relationships that may need to be rebalanced. It is not surprising, therefore, that USTR has placed the need to "improve the U.S. trade balance and reduce the trade deficit with the NAFTA countries" at the top of its list of NAFTA negotiating priorities.
- **Increase Agricultural Market Access.** USTR proposes to further reduce tariffs and nontariff barriers on U.S. agricultural goods within NAFTA while maintaining existing reciprocal duty-free market access for agricultural goods. Based on comments submitted to USTR in recent NAFTA hearings, NAFTA has been generally favorable for U.S. agricultural producers and exporters, but some sources of trade friction remain,

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including certification and testing requirements and regulatory differences. USTR seeks to address these issues in the NAFTA negotiations by including provisions that promote regulatory harmonization and sanitary and phytosanitary requirements based on sound science and transparent rule-making procedures.

- **Update NAFTA Rules of Origin.** Currently, intricate product-specific rules of origin determine whether imported goods will be eligible for duty-free treatment under NAFTA. USTR has proposed updating these rules to “incentivize the sourcing of goods and materials from the United States and North America.” One way in which this might be accomplished would be to increase requirements for the percentage of total content in duty-free NAFTA goods that must originate entirely within the United States, Canada or Mexico. In addition, USTR is seeking enhanced cooperation between NAFTA members on customs enforcement to prevent evasion of the NAFTA rules of origin. USTR has not provided specific recommendations for adjusting NAFTA rules of origin, but this topic is likely to be one of the most contentious areas in the negotiations.
- **Investment Protection.** USTR has indicated its intention to “establish[] rules to reduce or eliminate all barriers to U.S. investment in all sectors in the NAFTA countries” and “[s]ecure for U.S. investors in the NAFTA countries important rights consistent with U.S. legal principles and practice, while ensuring that NAFTA country investors in the United States are not accorded greater substantive rights than domestic investors.” It bears emphasis, however, that the negotiating objectives of the USTR since 2002 have not necessarily reflected the wide scope of investment protection rights found in Chapter 11 of NAFTA, under which U.S. firms enjoy protection — including arbitration rights as to their investments in Canada and Mexico. (The same is true of Canadian and Mexican firms in respect of other NAFTA countries.) As such, companies with Canadian and Mexican investments may wish to evaluate the more recent U.S. investment protection standards (such as found in the 2012 Model U.S. BIT) on their investments, as compared to the protections afforded in Chapter 11 of NAFTA.
- **Eliminate Anti-Dumping and Countervailing Duty Dispute Settlement.** USTR has proposed eliminating the dispute settlement provisions of Chapter 19 of NAFTA. That chapter permits private parties in Canada, Mexico and the United States to challenge the outcome of anti-dumping and countervailing duty proceedings before a quasi-judicial panel convened by the NAFTA Secretariat. If Chapter 19 is eliminated from NAFTA, it will require changes to U.S. trade remedy laws that will, in turn, require USTR to provide notice to Congress at least 180 days prior to the conclusion of NAFTA negotiations. As a result, the proposed changes to Chapter 19 of NAFTA will also influence the timeline for concluding and implementing a new NAFTA.
- **Energy and Energy Services.** In comments on NAFTA renegotiation, members of the administration and industry representatives have highlighted cross-border trade in energy and energy services, and Mexico’s liberalization of the energy sectors since NAFTA entered into force, as a particularly bright spot in the 25-year history of NAFTA. On July 13, 2017, in Mexico City, Energy Secretary Rick Perry emphasized NAFTA’s importance in North American energy markets and highlighted the importance of concluding an updated NAFTA agreement that furthered trade in energy. Consistent with this position, USTR has stated that it intends to “preserve and strengthen” current NAFTA provisions on investment, market access, and the operation of state-owned and controlled enterprises (SOEs) in the energy sector while continuing to promote market-opening initiatives for U.S. energy investors in Canada and Mexico.
- **Promote Digital Trade in Goods and Services and Cross-Border Data Flows.** Another NAFTA negotiating objective highlighted by USTR is the expansion of digital trade in cross-border digital services such as online media, cloud computing and other technology services, and the removal of barriers to such trade, including data localization laws that require certain data to be housed entirely within the territory of a single country. A related area affecting digital trade and internet-based sales are the current Canadian and Mexican customs limits on duty-free imports of lower-valued consumer items, such as packages shipped directly to consumers by online retailers. NAFTA, which was negotiated in 1992 before the advent of the modern internet, does not currently address these and other digital trade issues. USTR has proposed to secure commitments from Canada and Mexico not to impose duties on digital products and to ensure nondiscriminatory treatment of digital products and services. USTR has also called for expedited customs treatment of express delivery shipments and raising the de minimis Canadian and Mexican customs limits to at least \$800 — equivalent to current U.S. de minimis levels.
- **Add Chapters on Labor and Environment.** NAFTA has long been widely criticized for relegating standards on labor and environmental regulation to side agreements and failing to take a comprehensive approach to these issues. USTR has proposed including new chapters on labor and environment in the core of the NAFTA agreement that will introduce binding standards and allow for dispute settlement to resolve alleged violations of these standards.
- **Prevent Manipulation of Exchange Rates.** USTR seeks to include in NAFTA a provision aimed at ensuring that Canada

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and Mexico do not manipulate their exchange rates to gain an unfair trade advantage. This negotiating goal — which is a first in the history of U.S. trade agreement negotiations — appears to be aimed more at establishing a baseline for future U.S. trade negotiations with countries outside NAFTA and insuring against the possibility of future exchange rate manipulation than addressing issues in the current U.S. relationship with Canada and Mexico, which historically have not been accused of relying on exchange rate adjustments in support of distortive trade policies.

- **Reign in SOEs.** USTR has proposed new mechanisms to ensure that private companies and investors can better compete with SOEs on a level playing field, including by identifying the level

of government ownership and control in SOEs, requiring SOEs to act in accordance with commercial considerations, regulating SOE activities in the commercial sector and restricting the provision of government subsidies through SOEs. These proposals build on similar provisions that were included in the Trans-Pacific Partnership agreement and again appear aimed more at setting the stage for U.S. trade negotiations with other trading partners than with Mexico and Canada, where SOEs do not play a dominant role in most sectors of the economy.

Companies that have operations and investments in the NAFTA region should engage with relevant stakeholders to advance and protect their interests in the NAFTA negotiations.

Upcoming Webinar

Skadden will hold a webinar on August 16, 2017, that will focus on important issues in the NAFTA negotiations in greater detail. We will separately send an invitation and instructions on how to join the webinar.