**The Implications of Renegotiating NAFTA**

**Introduction**

The negotiation and enactment of the North American Free Trade Agreement (NAFTA), and its January 1, 1994 implementation, dramatically altered the trade debate across North America. Fifteen years later, the presidential primaries are renewing this debate, as the Democratic candidates call for renegotiating NAFTA.

This article sets forth some background, analyzes the potential U.S. negotiating agenda and the possible reactions of Canada and Mexico, touches on the opportunity costs of NAFTA renegotiation, and considers the consequences of success and failure of a renegotiation. This article explains the call for renegotiation has been hard to resist on the campaign trail, but the U.S. would be wise to tread very carefully before considering a plunge into NAFTA re-negotiation.

**Background**

NAFTA broke new ground and remains a unique FTA for the United States. In addition to covering two of our largest trading partners, it is the only FTA that eliminates all tariffs on agriculture goods between the United States and a significant producer and exporter of agricultural goods (Mexico). Secondly, it was the first agreement to incorporate a number of disciplines in the context of an FTA, including labor and environment provisions. At the same time, provisions within U.S. FTAs since the NAFTA have been modified, while other provisions that were in the NAFTA have not been repeated. For example, none of the FTAs since the NAFTA contain an independent anti-dumping and countervailing duty oversight mechanism.

Trade and investment flows among the United States, Mexico and Canada have greatly expanded since NAFTA was implemented. Between 1993 and 2007, trade among the three countries more than tripled, from $297 billion to $930 billion; it is expected to reach $1 trillion this year. A fact not heard on the campaign trail: from 1993 to 2007, U.S. business sector real hourly compensation rose by 1.5 percent each year; during the pre-NAFTA years from 1979 to 1993, this factor increased by an average of only 0.7 percent per year.

The trade relationships among the U.S., Canada and Mexico are not free of disputes, but none of the three has threatened to fundamentally re-align the NAFTA deal. In fact, trilateral efforts -- most recently, the fourth annual April 21-22 North American Leaders meeting -- focus on using and building on NAFTA to improve economic opportunities, efficiencies and security. Although little noticed, the NAFTA and its related agreements have built-in mechanisms to advance beyond the original language of the agreements. Some of these provisions have been utilized, and additional adaptations are possible as our economies change and our policy needs evolve.
The Potential U.S. Negotiating Agenda

NAFTA’s labor and environmental provisions have been focal points on the U.S. presidential campaign trail. If a Democrat wins the White House, he/she will have to decide whether to follow through on campaign promises to renegotiate NAFTA. The focus of such an effort would likely be the trade objectives that Democrats in Congress outlined in the May 10, 2007 memorandum, “A New Trade Policy for America” (May 10th Deal).

With respect to labor, the May 10th Deal calls for FTAs to include specific commitments from countries to “adopt, maintain and enforce” the five basic International Labor Organization (“ILO”) standards:

- The freedom of association;
- The right to collective bargaining;
- The elimination of forced or compulsory labor;
- The abolition of child labor; and
- The elimination of employment discrimination.

NAFTA’s labor side agreement -- the North American Agreement on Labor Cooperation (NAALC) -- sets forth the five standards, but does not make them enforceable to the extent envisioned in the May 10th deal. Dispute settlement (and ultimately fines and/or trade retaliation) are limited under both the NAALC and the May 10th Deal to practices in the labor rights area only when they implicate trade. However, the May 10th Deal seeks to broaden access to dispute settlement to include denial of the right to organize and bargain collectively when trade is implicated. (The NAALC, in contrast, limits dispute settlement to trade-related matters regarding occupational safety and health, child labor and minimum wage standards.) Furthermore, the May 10th Deal would require that the same dispute settlement provisions apply to labor as to other chapters of the FTA; the dispute settlement provisions of the NAALC are procedurally different. At the same time, the NAALC has set forth a framework for labor-related cooperative activities very much like the most recent FTAs. Furthermore, it does require all parties to ensure workers have domestic access with procedural guarantees to transparent enforcement mechanisms, including with respect to the right to organize and bargain collectively.

The May 10th Deal contemplates that FTAs will contain certain environmental commitments. NAFTA’s side agreement on the environment -- the North American Agreement on Environmental Cooperation (NAEEC) -- broke new ground, but the distinctions between it and the May 10th Deal parallel in many respects those noted above between the NAALC and the May 10th Deal. The most notable relate to: dispute settlement mechanisms; the ability to pursue the enforcement of specified multilateral environmental agreements (MEAs); and a prescription against using FTAs to undermine MEA obligations. On this latter point, however, the NAAEC already has a similar “conflict of laws” provision for specific MEAs, including two of the seven major MEAs referenced in the May 10th Deal, and also includes mechanisms by which the countries could add the remaining five MEA’s. Furthermore, the NAAEC created a significant cooperation program and, as in the case of the NAALC, created institutions to facilitate a consistent work effort. The NAAEC also provides an opportunity for persons and NGOs to make submissions alleging that a party is “failing to effectively enforce its environmental law” and have that
submission reviewed by the parties publicly as a way to encourage changes in practices where appropriate.

In short, as compared to NAFTA and the side agreements, the May 10th Deal largely parallels the labor standards in the NAFTA labor side agreement, and the substantive framework of the NAFTA environment side agreement is also similar to the May 10th Deal. Where the May 10th deal more significantly differs is in the scope and procedural elements pertaining to dispute settlement, which in the May 10th Deal parallel the standard FTA dispute settlement provisions.

The Likely Reactions of Canada and Mexico to a NAFTA Renegotiation

The U.S. will not easily convince Mexico and Canada of the substantive need to conform the NAFTA and its related agreements to the May 10th Deal. Since 1994, Mexico and Canada have worked cooperatively to promote the standards in the NAFTA’s labor and environment side agreements. Canada and Mexico likely would argue that, on balance, their records are at least as good as the U.S. regarding adherence to international labor and environment conventions (the May 10th Deal benchmark). For example, Mexico, Canada and the United States are all signatories to the ILO “Declaration on Fundamental Principles and Rights at Work,” but both Mexico and Canada are adherents to more of the underlying ILO conventions than is the U.S. Furthermore, Mexico has now ratified five of the seven MEA conventions listed in the May 10th deal, while Canada has ratified six. Both Mexico and Canada have ratified the 1996 Protocol of the Convention on Marine Pollution, while the U.S. has ratified only the 1972 Convention, but not the more recent Protocol.

Moreover, the U.S. likely would focus more on Mexico than Canada, which by itself would create political obstacles within Mexico. Mexico also would argue that, as a developing country, its institutional capacities understandably are not as developed, so a more productive focus would be on capacity building in Mexico under the existing NAALC and NAAEC. For example, Mexico could again suggest the need to strengthen the North American Development Bank (NADBank), which seeks to enhance border-related environmental infrastructure.

Finally, any changes obtained by the United States would carry a stiff price. Mexico and Canada have their own trade agendas and would use the renegotiation as an opportunity to further them.

The Price of Success

Assuming Canada and Mexico would agree to incorporate into NAFTA the labor and environment prescription of the May 10th Deal, two questions arise:

• What would they ask of the United States?; and
• From the U.S. perspective, would the “price” be worth the result?

Canada’s Likely Goals

Canadian Prime Minister Stephen Harper has indicated he already has a wish list:

Of course, if any American government ever chose to make the mistake of opening [the NAFTA], we would have some things we would want to talk about as well.

Canada has long sought fundamental changes to U.S. trade remedy law and policy, but the United States consistently
has rebuffed its attempts. Since September 11, 2001, Canada has become increasingly concerned about “border thickening” (i.e., border policies that impede people and product flows and increase the expense involved). It might well seek significant modifications to aspects of “homeland security” border policy. Canada also might seek modifications to the Softwood Lumber Agreement to increase its access to the U.S. market. In addition, Canada has long been concerned about the U.S. export control regime. There are myriad other issues that Canada might raise, including many that would be resisted by U.S. agriculture stakeholders.

In short, many of the changes Canada could seek present formidable political challenges and likely would be unacceptable to the U.S.

**Mexico’s Likely Goals**

Mexico will have demands as well, and some options. U.S. labor interests oppose implementation of NAFTA’s land transportation provisions regarding trucking, but could face a demand for the U.S. finally to implement them in exchange for Mexico’s acceptance of additional labor or environmental strictures. Also, although Mexico has not yet retaliated, it has the right to do so for the U.S. failure to implement the land transportation provisions.

While Mexico wants to avoid a discussion about re-opening the NAFTA agriculture market access provisions, Mexican agriculture interests have long sought restraints on shipments of certain U.S. agriculture products (corn, beans, dairy, sweeteners, etc.) for which Mexico is a top U.S. export market. Related to this, many in Mexico (and Canada) are pushing the U.S. to dismantle what they believe are trade-distorting U.S. agriculture support programs.

Mexico likely would also put non-trade issues on the table like immigration reform. It also might seek a more robust effort by the U.S. to limit demand for illegal narcotics and more assistance for Mexico’s efforts to combat the scourge of drug-cartel-related domestic violence.

As in the case of Canada, Mexico would put issues on the table that present difficult political challenges in the U.S.

**The U.S. Response**

Of course, the U.S. Administration would not be able to control fully the scope of a renegotiation, even from the U.S. side. U.S. private sector interests and their backers in Congress would play a large role in any renegotiation and likely would seek to load it up with a host of issues beyond labor and the environment.

For example, powerful U.S. agriculture interests, including U.S. sugar growers and refiners, want limits on shipments from Mexico. Were NAFTA to be re-opened, they would seek their objectives, thus threatening the politically sensitive market access gains achieved in recent years by the U.S. corn refining industry and others.

A review of even these few potential demands by Canada and Mexico strongly suggests that the price for conforming NAFTA to the May 10th Deal could be very high, even if one assumes the U.S. could convince Canada and Mexico of the merits of its position.

**The Opportunity Cost**

Renegotiating the NAFTA would involve large opportunity costs. The political challenges of a NAFTA re-negotiation will be formidable and time consuming. At the same time, the U.S. international economic agenda is not without many other time consuming major challenges.
Are the gains that would come from a NAFTA re-negotiation based on elements of the May 10th Deal sufficiently important to push aside other major elements of the U.S. global economic agenda? It is a question worth asking.

**The Price of Failure**

If the next U.S. Administration were to attempt to renegotiate NAFTA, at best, the negotiations would run smoothly and conclude relatively swiftly (“relatively swiftly” in trade negotiations can mean “years”). More likely, the negotiations would open, immediately spread beyond the initial U.S. labor/environment agenda and, eventually, encompass the balances affecting the entire agreement. If, as seems likely given the complexities involved and the politics behind a renegotiation, the three parties were unable to put the agreement back in the bottle, what then? The renegotiations might be based on the understanding that the original terms of NAFTA would control in the event the renegotiations failed. However, this result would hardly satisfy the interested constituencies the Democratic presidential candidates have been addressing. Presumably, a failure would strengthen the call for the U.S. to exercise its right to withdraw upon six months’ notice.

Were the U.S. to withdraw, the consequences would be enormous. U.S. goods exports of nearly $390 billion (as of 2007), which currently enter Canada and Mexico duty free (with a handful of exceptions in Canada in agriculture), would face an average ad valorem tariff of 5.5% in Canada (an average rate of 17.9% for agricultural goods and 3.7% for non-agricultural goods) and 12.6% in Mexico (an average rate of 22.1% for agricultural goods and 11.2% for non-agricultural goods). Roughly a third of all U.S. exports would suddenly face billions of dollars of additional duties, and U.S. consumers, including industries that source in the NAFTA’s open market, would pay a heavy price in duties as well.

Furthermore, a range of disciplines and mechanisms designed to eliminate or reduce many obstacles to trade and investment across North America would be wiped away or diminished. The same would be true of mechanisms to ensure collaboration to facilitate commerce and other valid activities.

The countries would lose the benefits of a host of NAFTA provisions that go beyond existing World Trade Organization (WTO) disciplines. For example, NAFTA termination would undermine the privileged access the U.S. has to Canada’s energy resources -- Canada is the largest supplier of oil to the U.S. The special access the U.S. has to the Mexican and Canadian automobile sectors would be reduced and with it the advantages of an integrated North American production platform in a global market. In addition, the advantage the U.S. has in Mexico’s government procurement market would disappear, because Mexico is not a signatory of the WTO Agreement on Government Procurement. More broadly, the privileged rights of U.S. service providers and investors in the markets of Canada and Mexico would be diminished. Furthermore, the protection provided to U.S. intellectual property rights owners would be reduced, particularly in the area of enforcement.

In short, re-opening NAFTA puts at risk fifteen years of collaboration and concrete progress in the largest U.S. trade relationship in the world across the 22 chapters of the NAFTA and the related environmental and labor cooperation programs.
A Better Idea -- Use the Built-In Mechanisms

Even if one accepts the premises of the Democratic candidates’ NAFTA critique, renegotiation may not be necessary. NAFTA contains mechanisms that allow improvement of existing disciplines. More than 20 different committees, working groups and sub-committees regularly address implementation and negotiating issues. In several cases, they have improved NAFTA:

- The NAFTA countries accelerated tariff elimination on hundreds of tariff lines covering tens of billion of dollars in trade on four separate instances.
- The Working Group on Rules of Origin improved the origin requirements for obtaining duty-free treatment on many items, affecting over $100 billion in trilateral trade and demonstrating the NAFTA’s ability to adapt to new competitive conditions; this agenda is ongoing.
- Under the NAAEC, the NAFTA countries continue to collaborate in new ways to strengthen environmental protection. For example, they recently created a unique public website that pinpoints over 30,000 facilities that release or transfer pollutants across North America (including the type of pollutants and how the facility handles them), thus providing critical benchmark information to inform policymaking. This builds upon a little-known track record of accomplishments under the NAAEC (nearly $1 billion provided for leveraging 135 environmental infrastructure projects with a total estimated cost of $2.89 billion).
- NAFTA’s investment chapter, including its expropriation and investor-state trilateral agreement on interpreting the dispute settlement provisions, were revised and made more transparent through provisions in light of stakeholder concerns and the experiences of the parties.

Much of the heavy lifting has been less visible, but it has helped achieve the goals of the NAFTA. For example, members of the Committee on Standards have encouraged Mexico to improve its efforts in standards-setting procedures (which were viewed as a serious trade obstacle in a number of sectors, including telecommunications and automobiles). Similarly, the Committee on Government Procurement has encouraged more open and transparent bidding procedures. Furthermore, the Committee on Sanitary and Phytosanitary Measures has worked to facilitate safe trade in food and the related improvements in animal and plant health.

The NAFTA Free Trade Commission -- composed of Cabinet-level officials responsible for trade policy and negotiations -- oversees NAFTA and seeks to resolve disputes over interpretation or application. It meets annually to discuss any aspect of the NAFTA and consider modifications (subject, of course, to the consent of the legislatures where necessary). In the last four years, the Commission’s work has been augmented by an annual North American meeting with the heads of government of the three countries which has spearheaded additional efforts.

The countries could achieve major additional progress via enhanced efforts utilizing these and other mechanisms. For example, the potential for collaboration under the NAALC and the NAAEC has not been fully exploited. They have both laid a basis for more far-reaching work on a trilateral basis to benefit both the environment and workers in all three countries.
Thus, existing mechanisms can address many, if not all, of the concerns that have led to the calls for NAFTA’s renegotiation. The parties can and should make better use of them.

**Conclusion**

The NAFTA has catalyzed the integration of the North American market, creating a deeper and more complex web of economic, cultural, social and political ties. Re-opening NAFTA under threat of withdrawal to strengthen NAFTA’s labor and environment rules would place tremendous stress on two of our most important economic relationships. And to what end?

Assuming a smooth negotiation (unlikely), the cost to the U.S. of obtaining its limited agenda on labor and environment could be enormous. What, exactly, is the U.S. willing to give up?

Given that, in each country, a wide range of domestic constituencies would aggressively pursue their interests, how would the negotiations be contained and limited?

The risk of failure would be high and, given the magnitude of the trade and investment relationships, the impact of failure on U.S. businesses and workers would be profound. Given the stakes, any talk of renegotiation should be carefully vetted from a broad substantive and negotiating perspective.

Finally, like the NAFTA negotiation before it, any effort to re-negotiate the NAFTA has the potential to generate a confusing set of “messages.” Policymakers owe the citizens of the three countries something better than the original NAFTA debate, which has plagued the public trade discussion ever since.

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