



# How to Modernize and Strengthen NAFTA

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If there is one thing that negotiators from the United States, Mexico and Canada agree on, it is that NAFTA should be updated and improved to the mutual benefit of the three partners. The question is how to do so. To grapple with that question, the University of California and Tecnológico de Monterrey, the largest not-for-profit private university in Mexico, in partnership with the Progressive Policy Institute and COMEXI (the Mexican Council on Foreign Relations), convened a gathering of high-level North American government and business leaders, diplomats and trade scholars at the university's Washington, D.C. conference center on September 21, 2017.

Negotiators from the U.S., Mexico and Canada convened in Washington on October 11th to resume talks on modernizing and strengthening the 1994 North America Free Trade Agreement (NAFTA). The impetus for these talks comes from President Trump, who has fiercely criticized NAFTA and is demanding changes aimed at reducing U.S. trade deficits and “bringing back” U.S. manufacturing jobs. The Trump Administration wants to wrap up an agreement on a modified treaty by the end of the year.

That's an ambitious timetable, considering the White House's lengthy list of negotiating objectives — and concerns in Canada and Mexico that President Trump views trade as a zero-sum game. The unspoken question hovering over the talks is this: Can Trump find a way for America to “win” in trade without Mexico and Canada losing?

The economic and political stakes are enormous. A failure to reach agreement could prompt Trump to make good on his threats to pull the U.S. out of NAFTA. This would have devastating consequences for all three partners. For the U.S., it could mean derailing today's economic expansion; losing well-paying jobs that depend on trade with Canada and Mexico; souring relations with our nearest neighbors and principal trading partners; and undercutting North America's ability to hold its own in competition with Europe and Asian markets increasingly dominated by China.

What follows are the key takeaways from the conversation that took place among thought leaders from academia, government and industry on September 21.

## **NAFTA NEEDS UPDATING**

There was widespread agreement among the speakers that NAFTA requires key reforms after 23 years.

Most notably, because the digital economy barely existed in 1994, NAFTA needs modern rules for cross-border data flows, e-commerce, digital security and privacy. Michael Froman, the U.S. Trade Representative under President Obama, noted that the Trans-Pacific Partnership (TPP) that Trump scuttled upon taking office contains strong provisions on digital trade that could readily be incorporated into NAFTA. Moreover, adding a “digital chapter” to NAFTA should be a top priority for negotiators, as it would create a liberal template for modernizing other existing trade agreements and new pacts on this key issue.

Froman also argued that the parties should add to NAFTA TPP provisions on energy, environment, Intellectual Property Rights (IPR), labor rights and the reform of Mexican labor practices. Thomas d’Aquino, Canada’s co-chair on the North American Forum, said Canada’s new agreement with the European Union (EU) might also be a model for new NAFTA provisions on gender equality and the rights of indigenous peoples — provisions that could broaden public and political support for NAFTA. Additionally, the parties should incorporate new customs facilitation provisions to improve NAFTA trade flows, especially for e-commerce.

## **DO NO HARM**

There was also broad agreement among the participants that negotiators should “do no harm” in revising NAFTA and should avoid revisions that limit trade or reduce the investment certainty that businesses require. Several Mexican leaders, including former Ambassador to the U.S. Arturo Sarukhán, warned that Mexico is willing to walk away from a bad deal.

## **BUILDING A BROADER REGIONAL PARTNERSHIP**

The importance and value of a more ambitious expansion of the North American economic partnership — beyond TPP-like revisions to NAFTA — was a key theme of the event. As underscored by the two principal organizers of the conference, University of California President Janet Napolitano and Tecnológico de Monterrey Dean Alejandro Poiré, expanding the three-way relationship in this way will require deeper engagement and a longer timeline than the countries are currently pursuing.

There was broad agreement that Canada, Mexico and the U.S. should emphasize the common objective of building a North American trade and commercial powerhouse. Participants offered a number of ambitious ideas to enhance regional cooperation and competitiveness, including expanding digital connectivity, eliminating dumping rules in many sectors, eliminating restrictions on all forms of transport in the region, and cooperating on Latin American development. Speakers also noted the importance of much greater regulatory harmonization and convergence and cross-border cooperation on entrepreneurship and innovation. And despite the Administration’s decision to pull out of TPP,

North American agriculture also has a huge opportunity to sell surplus production to China, India and other key markets.

## **A NORTH AMERICAN ENERGY SUPERPOWER**

Several speakers highlighted another new development since NAFTA took effect — surging development of conventional and renewable energy across North America, and particularly the shale boom in the U.S. The continent could become the global leader in natural gas and clean energy if it utilizes digital technologies and modernizes regional infrastructure and transportation. Efforts to buttress the rule of law throughout the region, along with the region’s ample supply of relatively low-cost natural gas, would make North America the leading global platform for manufacturing a wide range of products — and a stronger competitor against China.

Adopting state-of-the-art trade provisions would also enable North America to exert greater influence in shaping global trade rules. An improved NAFTA could become the “gold standard” for global trade agreements, providing a counterweight to both China’s mercantilist trade practices as well as to the EU’s less welcoming approach to digital trade and innovation.

## **HELPING WORKERS**

Many speakers underscored the challenge of sustaining public support for open trade and globalization. While expanded trade is broadly beneficial and manifestly in the overall interest of each NAFTA partner, some workers and regions are harmed disproportionately by changes in trade and production patterns. There was general agreement that governments need to do more for those workers and regions that bear the brunt of economic change, whether from trade, automation or the changing nature of work in this knowledge-based economy.

In the U.S., said Sen. Mark Warner, solutions might include portable benefits for contingent workers and generous “human capital tax credits” that give employers stronger incentives to boost their workers’ skills. For Mexico, incorporating stronger, fully enforceable labor standards within NAFTA, along with other mechanisms, could boost real wages for Mexican production workers — a step that would increase their buying power without adversely impacting Mexico’s international competitiveness. Business and government in the region must also do a better job of creating new career pathways for workers who don’t need or want a college degree, and of using digital platforms to deliver relevant skills to workers at lower cost.

## **NAVIGATING POLITICS**

There also was widespread agreement that the partners face formidable political challenges in hammering out a mutually beneficial revision of NAFTA — and even greater challenges in expanding the scope of the North American economic partnership amid rising nationalism and anti-globalization populism.

What are the most likely “deal breakers” that could thwart progress toward forging a NAFTA 2.0 for the 21st Century? Among the top concerns are U.S. demands to cut bilateral trade deficits, which seem squarely aimed at Mexico. (America has an overall trade surplus with Canada, but a \$63 deficit in goods trade with Mexico). The Administration’s “real and deep” focus on bilateral trade deficits and tighter rules of origin potentially poses a major hurdle to revising NAFTA, especially in light of detailed research that shows that bilateral deficits can be considerably lower when viewed on a value-added basis.

Mexico and Canada are also leery of proposals to sunset NAFTA (which would freeze business investment and cause serious trade uncertainty), tighten “Buy American” requirements, and expand labor mobility. U.S. calls to eliminate Chapter 19 dispute resolution panels is a “red line” for Canada. And Froman warned that businesses might simply choose to ignore NAFTA trade preferences — and pay standard duties — if tightened rules of origin caused costly disruptions to supply chains.

Deteriorating U.S. relations with Mexico were a major and recurrent theme of this conversation. As a result of recent events, 65 percent of Mexicans currently have a negative view of the U.S. And this number could get even worse if U.S. negotiators insist on changes viewed as one-sided and insulting to Mexico. And as Poiré noted, with a presidential election coming up next year, Mexican officials are under pressure from populists to “stand up” to Washington.

The U.S. also has an important midterm election next year. In an interesting role reversal, support for NAFTA among Democratic-leaning voters has surged since 2008, while dropping sharply among Republicans and, especially, blue-collar voters who were Trump’s strongest supporters. On the other hand, business, which normally leans Republican, largely favors continuing NAFTA with constructive updates. In this environment of scrambled political lines, it’s hard to gauge the impact of failing to reach a deal on a revised agreement.

## **WORKING TOGETHER**

Napolitano noted that achieving a positive result on NAFTA and maintaining good neighborly relations isn’t just the responsibility of presidents and prime ministers. The U.S. Congress — which is increasingly complaining about inadequate consultations with the White House — can assume a larger role in steering talks toward a successful and responsible outcome. State and regional governments already are promoting regional cooperation in a variety of constructive ways. People to people relationships — through business and civic organizations, universities and think tanks — can form a bulwark against the impulse to erect trade and other harmful barriers between the three countries.

If there was a central message to the conversation, it was this: Canada, Mexico and the United States should reject a “zero-sum” approach to the NAFTA relationship and, instead, pursue a broader “collaborative or positive sum” North American-wide approach in which all our countries can win.