Political Miscalculations and Bad Policy Threaten NAFTA Renegotiations

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U.S. trade representative Robert Lighthizer (right) with Canadian foreign minister Chrystia Freeland and Mexican economy minister Ildefonso Guajardo at the close of NAFTA talks in Ontario, September 27, 2017. *(Chris Wattie/Reuters)***Adapting the trade agreement to the 21st century is a good idea, but the administration is poised to botch its execution.**

American trade policy has been schizophrenic in 2018.

Between hitting allies with steel and aluminum tariffs on dubious "national security" grounds, slogging through renegotiations of the North American Free Trade Agreement (NAFTA), and targeting Chinese theft of intellectual property, the trade agenda is full. While clear-eyed focus is not this administration's strong suit, China's trade policies deserve its full attention. In order to devote sufficient time and energy to confronting Beijing, the administration should resolve NAFTA quickly. But a toxic mix of political miscalculations and bad policy is threatening to push that goal out of reach.

U.S. Trade Representative Robert Lighthizer wants to remove the investor–state dispute-settlement process (ISDS) from NAFTA 2.0. ISDS provides neutral arbitration to settle disputes between private investors and governmental parties to NAFTA. For example, if the Mexican government expropriated an oil field owned by an American firm, ISDS would permit the American firm to seek compensation from the Mexican government in an arbitration process rather than seek redress in a

Mexican court. The concern that prompted creation of ISDS is that local courts are biased when foreign investors sue home governments.

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Free traders of good faith come down on different sides of the ISDS debate, but removing the process from NAFTA 2.0 would be a political miscalculation. For starters, ISDS enjoys broad support from members of Congress, including influential members — such as Ways and Means Committee chairman Kevin Brady (R., Texas) and Senate Finance Committee chairman Orrin Hatch (R., Utah) — who will ultimately decide the fate of NAFTA 2.0. In a March letter to Ambassador Lighthizer, 99 House and Senate Republicans warned that, without ISDS, the administration would jeopardize Republican support for any renegotiated agreement. If a large swath of congressional Republicans balk, does the administration really believe it can rely on Minority Leader Nancy Pelosi (D., Calif.) to corral the votes and give the president a victory on a signature issue? That seems unlikely.

Mexico and Canada both insist on preserving ISDS. The arbitration process also enjoys support from the American business community, which historically has played an integral role in passing trade agreements. More fundamentally, however, trade-promotion authority, or TPA, which sets congressional objectives for the administration's trade negotiations, requires a process to meaningfully resolve investment disputes. Over the long term, a healthy debate about ISDS is warranted, including whether to include investment-dispute provisions in future TPA efforts. But right now, salvaging an imperfect NAFTA should be the paramount concern.

Another troublesome demand the United States is making in NAFTA negotiations is the inclusion of a so-called sunset clause that would terminate the agreement after five years unless all three countries affirmatively renew it. This is an unpopular idea on Capitol Hill and is a non-starter for Mexico and Canada, with good reason. Investment thrives in predictable environments. The fundamental value of trade agreements like NAFTA is that they provide the certainty necessary for investment and economic growth to flourish. Since the agreement went into effect, an incredibly sophisticated web of supply chains has developed around North America, enhancing competitiveness and driving economic growth. If NAFTA's tariff cuts and elimination of other barriers could be overturned hastily, its basic economic benefits would be undermined.

The various NAFTA proposals put forward by Lighthizer would even cut against the Trump administration's primary goal of increasing domestic manufacturing in the automotive industry. The United States initially proposed to increase the share of content that must come from NAFTA parties for an automobile to qualify for duty-free status, under what are known as "rules of origin." The U.S. proposal would up the regional-content requirement from 62.5 percent — already the most stringent automotive rule of origin in any trade agreement in the world — to 85 percent, with a 50 percent American-made-content requirement.

After that change was rejected by Mexican and Canadian trade negotiators, the United States suggested lowering the regional-content threshold to 70 percent and requiring that 40 to 45 percent of an automobile must be produced by autoworkers making at least $16 per hour. It is estimated that Mexican automotive-assembly workers make an average hourly wage of about $8. Under the U.S. proposal, non-truck automobiles that fail to meet this requirement would face most-favored-nation tariffs of 2.5 percent when entering the country.

If manufacturers complied with this proposed requirement, their costs would skyrocket and consumers would face higher prices at the dealership. A more likely scenario is that manufacturers would forgo duty-free trading under NAFTA by sourcing parts from non-NAFTA countries and paying wages below $16 an hour, and then simply paying the small U.S. tariff on automobiles. That may make more economic sense than doubling certain wages and reworking complicated supply chains.

It's been 24 years since NAFTA went into effect. With the rise of the Internet and integrated global supply chains, commerce has changed but NAFTA hasn't. By focusing on adapting the agreement to meet the needs of the 21st-century economy, trade negotiators can build on NAFTA's strengths. But the Trump administration is making political and policy miscalculations that could prove fatal.

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