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NAFTA NEGOTIATIONS: FIVE STEPS TO IMPROVE NORTH AMERICAN TRADE AND COMPETITIVENESS

<u>Introduction</u>

The United States, Mexico, and Canada are "all in" to raise our economic game as a region. As the three governments consider approaches to NAFTA, we would do well to be clear about what trade agreements do and what they don't do. Trade agreements don't create an obligation to trade; they create opportunities for individuals to make choices about what to buy, and for firms to seek out commercial partners who bring value to their business. The fact that $2.4 billion in goods moves between Canada, the United States, and Mexico every single day speaks volumes about the attractiveness of our markets to one another.

Advances in transportation, logistics, and digital trade have dramatically lowered the costs of doing business globally, but proximity still confers advantage. The Bush Institute's research on competitiveness and economic integration (www.bushcenter.org/scorecard) shows that North America outperforms other regions. Why? Because reducing economic barriers through NAFTA encouraged American manufacturers and service providers to create regional supplier relationships.

The coproduction models that evolved and deepened over time enable North American producers to achieve globally competitive positions. Regional trade represents about 5 percent of our GDP and supports millions of jobs in the United States. The North American character of products and services also gives us access to key markets outside North America by virtue of the free trade agreements initiated by Mexico and Canada with other trading partners.

Our research also shows, however, that there are numerous areas where we could strengthen our competitiveness as a region. Together with a number of areas where U.S. trade policy has evolved significantly since 1994, these represent a built-in negotiating agenda for any effort to renovate NAFTA. NAFTA isn't a tear down or a fixer-upper; it offers a solid foundation and frame on which to build.

So What Should We Do About NAFTA?

Wherever you come out in the debate about whether NAFTA was overwhelmingly positive for the U.S. economy or fell short, the one thing most of us agree on is that negotiators could not twenty-five years ago have envisioned how advances in technology and the Internet of Things would fundamentally alter the products and services available to us today and the way we do business with one another.

The foundational commitments in the trade agreement are enduring – indeed they gave rise to similar core obligations in hundreds of trade agreements around the world – but many newer, innovative provisions have been developed since then. Given how deeply intertwined our economies in North America are, it behooves us to commit to a serious upgrade in the agreement that paved the way for our trade and investment relationships. Done right, we have an opportunity, together with our Canadian and Mexican partners, to exercise global leadership on trade in 2017, just as we did in 1992.

First, Set an Intention

Trade negotiations, like any transaction between willing partners, are a positive-sum game; the goal is to make all participants better off by growing the economic pie, not divvying up fixed benefits. Nor are the parties meant to be worse off than prior to the negotiation; no government will sign an agreement whose purpose is to make its people less prosperous. Therefore, it's best at the outset to ensure a shared vision and begin negotiations under some common principles:

- North America is a successful community. We have important historical, cultural and social values in common and we work well together. Withdrawal from NAFTA is always a possibility but it shouldn't be a threat – and we should keep in mind that we are neighbors in North America forever, no matter what happens to NAFTA. That said, strong economic cooperation through a well functioning NAFTA is an asset to working together to address matters of national security such as counter-terrorism efforts.

- Despite the bilateral nature of some issues, the agreement involves three countries so all three should be at the negotiating table together. The trilateral nature of the basic commitments under NAFTA is one of the reasons we are competitive – NAFTA is, in effect, greater than the sum of its parts.

- An updated agreement should do more, not less. As the most competitive region in the world, NAFTA should lead with the world's highest standards and set the foundation for global trade rules.

- We should endeavor to resolve longstanding disputes without letting them impede incremental progress. Because we are neighbors, we can find short- term wins and let go of the outdated notion that "nothing is agreed until everything is agreed".

Second, Achieve Meaningful Quick Wins

Our governments have been working closely at all levels on trade and related issues for nearly three decades. As a result, many issues are clearly understood and need little more than strong political commitment to bring to a conclusion. With clear focus, it should be possible to reach agreement in a matter of weeks on a meaningful set of commitments. Among these, we should liberalize trade and investment in the energy sector as critical to North American manufacturing and security; address opportunistic exports of subsidized commodities; and implement targeted upgrades to border procedures and infrastructure to accommodate increasing volume while effectively managing risks.

- Energy: Mexico's recent reforms were a game-changer for the entire region. By including NAFTA's "missing chapter," we can lock in reforms; remove remaining barriers to cross-border trade in energy in all its forms, including eliminating the U.S. Presidential Permit process for cross-border infrastructure; and set safety and environmental regulations on a converging path. Expanding the pact to include energy cooperation not only generates new market opportunities for U.S. goods and services, it would enable North America to position itself as an energy-abundant superpower.

- Enforcement: The circumvention of anti-dumping duties on products for which importers have falsely claimed NAFTA origin is a concern to all three countries, most particularly the United States, which is often the final destination. A strong commitment among all three customs agencies to strengthen capacity and share the enforcement burden is necessary to combat and dissuade illegal transshipments that harm both producers and users of these inputs.

- Trade Facilitation: North American trade is growing with or without a NAFTA upgrade. The United States, Canada, and Mexico should agree to pursue state-of-the-art border crossing experiences that feature paperless, fully automated transactions and integrated single windows to capture cost savings for North American businesses. Data systems should be interoperable with appropriate sharing of information so that each agency can allocate resources efficiently to assess and address risk. The governments should initiate a review of the ease or complexity of using NAFTA preferences, and survey preferred/trusted trader program users for improvements. A win for smaller exporters and individual consumers, we encourage Mexico and Canada to match the US *de minimis* value of $800.

<u>Third, Beg, Borrow and Steal</u>

The NAFTA influenced and formed the basis of trade agreements all over the world that followed in its footsteps. It's ok to beg, borrow, and steal provisions from agreements negotiated later in time. NAFTA should incorporate newer provisions that the United States helped forge, covering: the removal of barriers to digital transactions and cross-border data flows; market access to telecommunications investment and services; regulatory cooperation in sanitary and phytosanitary requirements and procedures; improvements to dispute settlement procedures; prototype commitments to transparency and reporting on currency policies; and enhanced intellectual property protections and enforcement.

Incorporating these policy innovations would promote more commerce within the region while putting NAFTA on par with more recent agreements negotiated by the United States, Canada, and Mexico with other trading partners.

Fourth, Pursue Stretch Goals on a Longer Timetable

Global competition is only intensifying. An upgraded NAFTA is a prerequisite to maintaining regional advantage. The agenda is large and progress must be made while working on longer-term strategic objectives. Otherwise, the risk is great that a "comprehensive" package fails to materialize or produces an omnibus agreement with something everyone can oppose.

We will need some modest institutions to manage the NAFTA project, keeping work focused and on track, pushing for completion of deliverables when they are ripe. Many intergovernmental NAFTA committees were created over the years. We can dust them off and put them to work, but in so doing, we should rationalize the current alphabet soup of committees, councils and working groups that sprouted up or got renamed when new political leaders entered the scene. As we do so, we should structure them informally enough that they can never infringe on national sovereignty but ensure they meet at a sufficiently high policy level to enable coordinated action.

The detailed work of aligning and streamlining procedures and regulations requires the involvement of both government and private sector experts from all three countries. A blueprint for this approach can be found in forums like the US-Mexico CEO Dialogue and the APEC Automotive Dialogue where pragmatic, sector-specific discussions can produce meaningful recommendations for how to improve the operating environment for North American businesses.

Here are a few useful topics for expert groups to take up:

- Pursue global acceptance of North American automotive safety standards
- Map heavily used North American supply chain corridors to identify freight transportation demands and bottlenecks
- Develop applications for non-intrusive border inspection equipment such as RFID, transponders, and x-ray technologies
- Identify pathways to harmonize trusted traveler programs, visa requirements, and achieve mutual recognition of professional credentials
- Prioritize areas for sanitary and phytosanitary cooperation

- Advance a roadmap for expanding access to sub-federal procurement opportunities
- Review rules of origin to reduce complexity and improve ease of validation and compliance by traders

Fifth, Color Outside the Lines of the Trade Agreement

There are many creative ways to improve economic and commercial relations in North America that do not need to be codified inside the trade agreement.

Infrastructure: The three governments should agree to underwrite a regional infrastructure bank that can provide objective and dynamic traffic projections that facilitate planning; offer catalytic financing that attracts private capital; and coordinate the execution of border infrastructure projects.

Trade accounting: The three governments should pilot the collection and publication of trade in value added data. This approach would encourage digitized border transactions, a common approach to data collection, and support the ability to collect hard-to-get firm level data (which could be incentivized by participation in trusted trader programs). Trade in value added data provide better insights into supply chain relationships, and illuminate the gains to U.S. cities and states from both imports and exports.

Public-Private Dialogue on North American Competitiveness in Advanced Manufacturing: From aerospace to automotive to electronics, advanced manufacturing is highly integrated across North America and we face a common challenge from China, which is investing billions under its Made in China 2025 plan to develop high-tech sectors. We should shift from the mindset that we are competing against one another and into the position of competing effectively as a region in the global economy by remaining nimble and innovative.

Create a troubleshooting track: Our trading relationship is too big and complex to think we won't have new problems to solve as commerce evolves. But it is high time to put some longstanding issues onto paths for resolution without allowing them to hinder progress on the new NAFTA.

The Limits of NAFTA

Upgrading or modernizing NAFTA will not address the underlying structural concerns with the U.S. economy. On the contrary, it is difficult to see how trade policy can be used to influence structural change in the U.S. economy. There are certainly policy tools available to encourage firms to invest in regions of our country that have lost jobs, and to facilitate retraining of the affected workers. But if the U.S. government acts to reduce imports from Canada and Mexico in an attempt to reduce the trade deficit, firms will seek out alternatives; given the cost pressures in the global marketplace, these are likely to be in other countries, not the United States. The U.S. trade deficit is driven primarily by the U.S. government's fiscal deficit; changes to trade policy alone are unlikely to reduce the trade deficit (and could widen it). Reducing the corporate tax rate is an important step to freeing capital for investments in the United States, but increased federal borrowing will only push the trade deficit higher.

Globally competitive producers in North America have built regional manufacturing and service clusters in advanced manufacturing, where technical skills are in high demand. As companies expand and deepen these North American supply chain investments, they are generating demand for skilled frontline workers, but there aren't enough qualified candidates. We must focus on ensuring our current and future workers are competent with the technologies and information systems required to create and build today's products. "Fixing" NAFTA can neither accomplish this nor substitute for this investment.

As economists Gary Clyde Hufbauer and Jeffrey Schott once wrote, "Trade pacts create opportunities; they don't guarantee results." Our five steps for how to improve North American trade and competitiveness are offered in the spirit of creating an environment where companies and individuals in North America remain well positioned to compete anywhere in the world because of their North American relationships.