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Going Forward With NAFTA 2.0

As President Trump famously stated in his campaign: “We’re going to renegotiate NAFTA, probably the worst trade deal ever agreed to, signed, in the history of the world,” and, “If we don’t get the deal we want, we will withdraw from NAFTA and start all over... .” But what might that look like? In recent weeks, White House actions and statements have begun to identify the parameters of a renegotiated North American Free Trade Agreement, often referred to in the media as NAFTA 2.0.

Agreement Has Shaped North American Trade

A few key points about NAFTA:

NAFTA is a bipartisan free trade agreement negotiated under the George H.W. Bush administration and passed by Congress during the Clinton administration. The agreement became effective January 1, 1994.

In 1993, exports to Canada and Mexico totaled approximately US\$142 billion (US\$100.4 billion to Canada and US\$41.5 billion to Mexico), whereas imports totaled approximately US\$151 billion (US\$111.2 billion from Canada and US\$39.9 billion from Mexico). By 2016, exports to Canada and Mexico were approximately US\$498 billion (US\$266.8 billion to Canada and US\$230.9 billion to Mexico), whereas imports totaled approximately US\$572 billion (US\$278 billion from Canada and US\$294.1 billion from Mexico).

NAFTA has spurred creation of a highly integrated North American supply chain where companies are careful to source NAFTA-eligible parts and raw materials and perform all types of production (industrial manufacturing, various assembly processes, agricultural, etc.) to ensure that goods being sold

from one NAFTA partner to another meet the required NAFTA rules of origin so the goods can qualify for NAFTA duty-free importation.

Consequently, regardless of politics surrounding NAFTA, there is no question that since the trade agreement became effective, trade among the NAFTA countries has grown immensely and international supply chains have made significant accommodations to ensure that companies and consumers receive all available NAFTA benefits. It should also be mentioned that the customs authorities of all three NAFTA countries routinely conduct “NAFTA audits” to ensure that companies claiming NAFTA benefits are truly exporting and importing NAFTA-eligible goods.

Scenarios for the Future

With the above points as context, the following scenarios for a NAFTA 2.0 have begun to emerge:

“Modified” NAFTA with essentially the same rules of origin. All three NAFTA parties agree there is a need to update the agreement to address issues such as e-commerce, paperless supply chains, environmental issues, currency manipulation concerns, intellectual property and certain labor issues. To a large degree, all of these issues were addressed in the Trans-Pacific Partnership (TPP), whose language was agreed upon by the United States, Mexico and Canada, so all three NAFTA countries have not only confirmed the need for updates in these areas but have negotiated acceptable standards as well.

In large part, though, the major benefits of NAFTA – the duty-free importation of NAFTA-eligible goods – rest on the current NAFTA rules of origin, including the numerous and product-specific tariff shift rules and regional value content requirements. As such, an easy win for the Trump administration and our NAFTA partners would be to renegotiate NAFTA to address standards such as those referenced above and update the agreement to conform with current commercial practices, but leave the existing NAFTA rules of origin largely intact, with the possibility of minor modifications to the rules of origin affecting specific goods (televisions, computers, etc.) generally manufactured in Mexico with some non-NAFTA parts.

“New” NAFTA with new rules of origin. Under this option, the administration would seek to renegotiate a larger universe of issues and push for standards that are significantly different or more stringent than those generally agreed upon (for example, in the TPP or elsewhere). As an example, the

AFL-CIO has been adamant that TPP labor standards are weak and unenforceable, and should not be viewed as a model for a NAFTA 2.0 agreement.

Additionally, the NAFTA parties could keep the same framework for the rules of origin conferring NAFTA eligibility (including the framework encompassing tariff shift rules and regional value content requirements for goods produced with non-NAFTA inputs). However, they could dramatically change the individual rules within that framework for key products, with apparel and consumer electronics figuring most prominently. As examples, regional value content requirements could be raised for these goods, tariff shift rules could be modified to disqualify certain foreign components or materials, and the de minimis percentage for various products could be lowered. The result would very likely be protracted negotiations among the NAFTA partners and pushback from companies and industry groups that have tailored their supply chains for NAFTA purposes.

Withdrawal from NAFTA. Although we believe this option is unlikely given the immense volume of trade under NAFTA and the highly integrated international supply chains developed to manufacture and distribute NAFTA-eligible goods, it bears repeating that the administration has been clear that NAFTA withdrawal is an option. Legal experts and industry analysts differ as to what might be needed for a full withdrawal, specifically, to what extent Congress would need to ratify executive actions. Moreover, the Trump administration has conflated NAFTA with other issues (such as immigration and border tax adjustments), which raises the possibility that a final decision on NAFTA might be driven by non-NAFTA concerns.

Nevertheless, a NAFTA withdrawal would result in the United States imposing duties at the column 1 rate in the tariff on goods from at least Mexico. Almost certainly there would be reciprocal retaliatory duties on U.S. goods from the affected country/countries. Some U.S. experts believe that U.S. column 1 duties would be approximately 3 percent and that retaliatory duties from Mexico would be approximately 8 percent on non-agricultural goods. In our opinion, though, these estimates are misleading. First, any column 1 duties would be product-specific and could easily range from “free” for various consumer electronic goods to amounts in excess of 20 percent for certain soft goods (apparel, footwear, etc.). Second, this option would almost certainly be accompanied by retaliatory

assessments, whether in the form of border taxes on certain goods or certain duties permitted under the World Trade Organization or even NAFTA itself. Suffice it to say, a NAFTA withdrawal would be part of a much larger and acrimonious trade dispute to the detriment of more than \$1 trillion in trade among all three NAFTA countries.

What This Means to You

The takeaway is that change to the agreement appears likely, given that the United States, Canada and Mexico agree that NAFTA needs to be updated and that certain provisions can be improved. However, even small changes to the agreement could affect very large trade flows and prices. The scope of changes and the particular areas affected remain hazy and will likely depend on a basket of NAFTA and non-NAFTA factors that have yet to be determined.

Contact Us

For more information on how changes to NAFTA may affect your business, please contact Robert Stang, Jeffrey Neeley, Cortney Morgan, Michael Holton, Grant Leach or Jennifer Jin on the International Trade & Supply Chain team or your Husch Blackwell attorney.