International trade brief: Trump administration takes aim at Chapter 19 of NAFTA, U.S. wish list for NAFTA renegotiations and more

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In our last international trade brief, we talked about President Trump’s trade enforcement budget, Robert Lighthizer’s confirmation hearing as U.S. Trade Representative and Canada’s NAFTA Chapter 11 win. In this week’s brief, we look at the U.S. administration’s wish list for NAFTA renegotiations — along with the draft notice and its parallels to the Trans-Pacific Partnership — the Trump administration taking aim at Chapter 19 of NAFTA, the U.S. border tax proposal, as well as the NAFTA Rules of Origin.

THE U.S. ADMINISTRATION’S WISH LIST FOR NAFTA RENEGOTIATIONS

By: Riyaz Dattu, Peter Glossop, Taylor Schappert, Gajan Sathananthan

On March 28, acting U.S. Trade Representative Stephen Vaughn sent a draft notice to the Senate Finance and Ways & Means Committees itemizing the Trump administration’s position on deficiencies and renegotiation objectives for NAFTA. The draft notice contains 19 objectives, each with specific goals, one of which is the elimination of Chapter 19 of NAFTA. Chapter 19 was one of the most important achievements in NAFTA for Canada, as it provides a binational dispute settlement process for challenging anti-dumping (AD) and countervailing (CVD) measures. Canada’s experience and success rate under the Chapter 19 process has been positive. Other objectives in the draft notice include changing the Rules of Origin to access duty-free rates under NAFTA, and border tax provisions (purportedly “to level the playing field on tax treatment”).

The draft notice is the first step towards NAFTA renegotiations, which will commence upon the issuance of the final notice. On the heels of issuing the draft notice, statements from the White House and the
Commerce Department suggest that the administration will continue to reassess its stance, having stated that the draft notice isn’t an entirely accurate reflection of its current position, and should therefore be viewed as indicative of the types of amendments that may be proposed by the U.S. administration during renegotiations, but not a final list.

THE TRUMP ADMINISTRATION TAKES AIM AT CHAPTER 19 OF NAFTA

By: Riyaz Dattu, Taylor Schappert, Gajan Sathanathan

The draft notice lists as one of its main objectives the complete elimination of Chapter 19 of NAFTA, stating that “[Chapter 19] panels have ignored the appropriate standard of review and applicable law, and... aberrant panel decisions have not been effectively reviewed and corrected.” Addressing trade remedies more generally, the draft notice also calls for a mechanism to allow for increasing tariffs, often known as “snapback” tariffs, if imports are injuring or threatening to injure the U.S. domestic industry.

Historically, Chapter 19 has provided an effective mechanism for exporters and importers subject to AD or CVD measures imposed by trade regulatory bodies (in the U.S., the Department of Commerce and the International Trade Commission, and in Canada, the Canada Border Services Agency and the Canadian International Trade Tribunal) to seek review from a binational NAFTA panel. These panels are comprised of trade experts from the two countries involved in the dispute, with a mandate to re-evaluate the legal basis for imposition of such measures. For both Canada and Mexico, Chapter 19 was a critical component of NAFTA that ensured U.S. law could not be applied in a protectionist manner, particularly by the U.S. Department of Commerce, to block fairly traded goods. Since the implementation of NAFTA, the U.S. has been the target of most cases brought before Chapter 19 panels, with 43 of the 71 matters heard by the panels being directed against the U.S. Canada’s success rate under Chapter 19 has been positive. Without Chapter 19, Canadian companies would need to rely on U.S. courts to conduct reviews of U.S. measures, where the success rate has been limited.

If it occurs, the elimination of Chapter 19 would likely be a significant loss for the Canadian softwood lumber industry in its attempts to settle cases. This industry has had its position consistently vindicated under the Chapter 19 process.

The Trump administration’s proposal to re-introduce snapback tariffs is a retrograde move that would add another tool to the U.S. protectionist armoury. The draft notice contemplates the application of snapback tariffs on any goods imported from a NAFTA country that causes, or threatens to cause, serious harm to U.S. industry. As a result, even Canadian exporters that compete fairly with U.S. goods could be the subject of retaliatory snapback tariffs aimed at further promoting President Trump’s “America First” policies.

THE U.S. BORDER TAX PROPOSAL REVISITED

By: Riyaz Dattu, Corinne Xu

It appears that House Republicans are bending to the political push-back against their proposed new border tax adjustment (BTA) plan, which taxes imports into the U.S. while exempting exports. On Wednesday, March 29, House Ways and Means Committee Chairman Kevin Brady stated in an interview with Fox Business News that he is “contemplating significant modifications” to the BTA.

The BTA sparked criticism from major American businesses, some launching lobbying efforts and attack ads denouncing it as a system that will raise consumer prices. The destination-based tax system also
raised concerns among trade policy experts and economists that it may violate World Trade Organization (WTO) rules, as discussed in our March 22, 2017 international trade brief.

Brady’s willingness to revisit the BTA could be in reaction to the unsuccessful efforts to repeal and replace President Barack Obama’s Affordable Care Act, which failed due to divisions within the Republican Party’s own ranks. An inability by the White House and the rest of Congress to present a unified front could derail the tax overhaul process as well. President Trump previously expressed reservations about the BTA as being “too complicated.” Both White House National Economic Council director Gary Cohn and Treasury Secretary Steven Mnuchin have publicly stated that the administration is actively working on a variety of different tax alternatives. [2]

As with other aspects of President Trump’s trade policy proposals, the specifics of the BTA are a moving target that we will continue to monitor and address in the future.

RULES OF ORIGIN UP FOR RENEGOTIATIONS

By: Riyaz Dattu, Margaret Kim

As noted above, one of the issues listed in the March 28, 2017 draft notice for renegotiating NAFTA, released by the U.S administration, is amendments to the Rules of Origin (RO), which will potentially require the use of increased U.S. content.

Under NAFTA, RO specify that products, in order to benefit from zero or preferential tariffs, must meet minimum tariff classification shifts for the foreign components contained in the exported product or regional (NAFTA-wide) content requirements. The purpose of the RO is to ensure that benefits of preferential tariff treatment accrue to NAFTA exporters, and to avoid products and significant components of a third country creeping into the preferential tariff supply chain. The draft notice states that the U.S. intends to renegotiate RO in order to: “support production and jobs in the U.S.”; implement procedures for applying these rules; and include provisions to avoid circumvention such that preferential duty rates under NAFTA apply only to NAFTA products eligible to receive such treatment.

While the draft notice states it will meet these goals “without creating unnecessary obstacles to trade,” the changes to NAFTA RO can be expected to have a significant impact on the North American manufacturing sector. Manufacturing businesses in North America have for more than 20 years developed supply chains based on the existing RO, which could become disrupted by changes to the RO. While riddled with technical details and therefore often overlooked by senior executives of businesses, our experience is a failure to understand the technical requirements of RO and to implement strategies in advance of any substantial changes could result in a significant loss of market share and competitiveness.

It is therefore critical that Canadian businesses become involved with the potential amendments to the NAFTA RO in order to ensure continued ability to access the U.S. and Mexican markets duty-free. For a general list of key issues to consider in light of NAFTA renegotiations, see our previous post here.

CONTENT OF THE DRAFT NOTICE AND PARALLELS TO THE TPP

By: Riyaz Dattu, Lipi Mishra

The draft notice circulated to U.S. Congress on March 28 details potential NAFTA renegotiation priorities, which we also discuss in accompanying briefs. The draft notice strikes a diplomatic and
measured tone as compared to President Trump’s previous speeches on “tearing up NAFTA” in its entirety. It recognizes Canada and Mexico’s positions as the United States’ two largest export markets, also noting the countries have “shared borders...shared goals, shared histories and cultures, and shared challenges.” The draft notice includes references to reforming a number of areas of NAFTA, including trade in goods and services, agriculture, tax policy, intellectual property, rules of origin, telecommunications, government procurement, and dispute resolution.

Among the many objectives listed in the draft notice, a few noteworthy ones (in addition to those discussed in our other briefs) include:

- **Investor-state dispute settlement:** Notably, the draft notice does not explicitly call for eradicating the investor-state dispute settlement mechanism in Chapter 11 of NAFTA (unlike Chapter 19 of NAFTA, which the notice seeks to eliminate altogether). Rather, the notice proposes to “maintain and [...] improve procedures” for resolving disputes between U.S. investors and NAFTA countries. In particular, it seeks “mechanisms to deter the filing of and eliminate frivolous claims; procedures to ensure the efficient selection of arbitrators and the expeditious disposition of claims; and procedures to ensure transparency and public participation in dispute settlement proceedings”. Interestingly, these three objectives were also listed in Trans-Pacific Partnership (TPP) fact sheets issued by the Obama administration.

- **Market access:** The draft notice proposes objectives to expand market opportunities for the U.S. in a range of areas from financial services, telecommunications, government procurement, and agriculture.

The Trump administration’s draft notice suggests that elements of the TPP may be used as a guide for renegotiating NAFTA (despite President Trump’s Executive Order issued in January withdrawing the U.S. from the TPP). In particular, negotiations in newer subject areas since NAFTA was implemented may draw on the TPP template, such as digital trade, increased intellectual property enforcement, more robust rules concerning state-owned enterprises, and labour and environmental obligations.

President Trump must now consult with Congress before issuing a formal 90-day notice of his intent to revisit NAFTA. As such, it is too early to draw conclusions about the administration’s vision for NAFTA on the basis of this single draft notice, particularly as the White House has already indicated that its position on renegotiating NAFTA continues to evolve. Nonetheless, the draft notice indicates that the U.S. administration may not follow through on the previous aggressive posture espoused by President Trump during the election.

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Among the many objectives listed in the notice, a few noteworthy ones (in addition to those not specifically pointed out) include trade in goods and services, agriculture, tax policy, intellectual property, rules of origin, and regional (NAFTA-wide) content requirements. The purpose of the RO is to ensure that benefits of trade in goods and services, agriculture, and tax policy are not eroded.

The Trump administration’s notice suggests that elements of the TPP may be used as a guide for NAFTA renegotiations. Nonetheless, the notice indicates that the U.S. President Trump must now consult with Congress before issuing a formal notice of his intent to renegotiate NAFTA.

The notice is the first step towards achieving the Trump administration’s wish list for NAFTA renegotiations and more.

As with other aspects of President Trump’s trade policy proposals, the specifics of the BTA are a moving target that we will continue to monitor and address in the future.