

Intelligence MEMOS



From: Gilles Gauthier
To: Canada's NAFTA Negotiators
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Re: **THE NAFTA TALKS. TOWARDS A NEW PARADIGM? (PART TWO)**

Yesterday, we explored the difficult terrain for the renegotiation of NAFTA. Today: What are the possible scenarios?

If we were in a traditional trade negotiation and if the parties were really trying to find the necessary trade-offs, we could imagine that an agreement would emerge within six to 12 months. One can expect that the pressure to reach a deal is more intense on all sides, now that tariffs on steel and aluminum have been imposed, and retaliatory measures announced.

Solutions certainly exist for most of the fundamental issues. For example, one could imagine that a compromise is possible on automotive rules of origin that increases the eligible content and makes a link with wages. Canada could make concessions on US demands around supply-managed products, such as a new 5 percent market quota and, for example, increasing the de minimis, duty-free threshold on goods brought in by returning travelers to \$200 from the current \$20.

Canada, despite these concessions, would preserve the essential, namely the durability of the entire agreement. The United States would have to backtrack on its most radical ideas, such as the sunset clause and getting rid of the Chapter 19 dispute settlement mechanism.

This scenario presupposes not only a willingness to compromise on both sides, but also a desire to preserve the philosophy of NAFTA as a set of rules of rights and obligations, which leave economic agents freedom of action in a common economic space. But it is far from clear that the US really wants such a rules-based agreement.

It is much easier to criticize the current agreement than to defend a new agreement, especially if the effects of the latter will only be measured in the medium or long term. Uncertainty is far less damaging to the US than to Canada, due to the relative size of our two markets.

Instead, there seems to be a dramatic shift in the goal of renegotiating NAFTA and the means to achieve it. Protectionist tendencies have taken a whole new turn with the unilateral US imposition of tariffs on steel and aluminum, ignoring the rules of trade agreements of NAFTA or the WTO. We can anticipate a decision on cars that would go in the same direction. With its aggressive (and misguided) use of trade remedies, the US administration has adopted the definition of unfair trade as a justification for unilateral action.

Already, some of the countries have won exemptions from tariffs on steel and aluminum (such as Korea, Brazil, and Argentina) by accepting import quotas. There is no doubt that the administration would like to do the same in the context of the renegotiation of NAFTA.

It is no longer necessary to brandish the threat of ending the agreement. The US administration can be content with its slow death, which will leave room for the creation of a new business paradigm that involves the establishment of several sectoral "managed trade" agreements. Steel, aluminum, automotive, lumber, products under supply management and possibly other products (such as paper) would be affected. Of course Canada has to resist, but will we have a choice? The pressures will be enormous if the auto industry becomes a target. The auto sector accounts for 20 percent of Canadian exports, and if we add the other sectors mentioned, we get almost a third of Canadian exports.

In conclusion, there is nothing to be optimistic about. There is a US groundswell of protectionism. As long as the US economy is doing well, and the Canadian dollar provides a competitive cushion, Canada will be able to withstand this economic onslaught. But basically, I am afraid that we are moving towards a paradigm shift and that does not bode well.

If we are ever forced to accept managed trade agreements, I hope that we will put under the nose of the Trump administration our own sunset clause proposal that would allow a return to a rules-based trade in a few years, to a time when the storm will have passed.

Gilles Gauthier is a former federal trade official, who served as economic affairs minister at the Canadian embassy in Washington, chief agriculture negotiator with the department of agriculture and four years at the Canadian mission at the WTO.

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