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# The pitfalls of renegotiating NAFTA

*A revision of the North American trade deal will not give Donald Trump what he wants*



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From the print edition | The Americas

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DONALD TRUMP called the North American Free-Trade Agreement (NAFTA) with Mexico and Canada the “worst trade deal ever approved in this country”. Soon it will become clearer what he intends to do about it. He has three choices: tear it up, bully the United States’ partners into making concessions that merely damage the agreement or go for a renegotiation that benefits all three.

The process for making big changes to NAFTA has started. On February 3rd the Mexican

government began a 90-day consultation with businesses on what its negotiating position should be. Wilbur Ross, who will lead the American negotiators after the Senate confirms him as commerce secretary, says NAFTA is “logically the first thing for us to deal with”. Notification to Congress, which must happen 90 days before talks can start, could come soon.

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NAFTA is not the failure Mr Trump claims it is. Trade in goods among its three partners has more than trebled since it took effect in 1994; 14% of world trade in goods takes place under its rules. Cross-border supply chains have made American firms more competitive. The manufacturing jobs it has created in Mexico have slowed migration to the United States.

All three governments agree that it could be made to work better. “Any agreement can be improved,” said David MacNaughton, Canada’s ambassador to the United States, the day after Mr Trump won the election. The 23-year-old agreement could be modernised in ways that benefit the United States.

But a normal renegotiation may not be possible under Mr Trump. He has battered the United States’ relationship with Mexico by insulting migrants and demanding that Mexico pay for a border wall. He has threatened to impose tariffs as high as 35% on Mexican cars, which would violate NAFTA (and breach the rules of the World Trade Organisation). No conceivable renegotiation of NAFTA will bring what Mr Trump wants most from it: lots more factory jobs in the United States and a dramatic reduction of its \$63bn merchandise-trade deficit with Mexico.

Mr Ross’s language is less alarming than that of his soon-to-be boss. Yet he may do no more than put a friendlier face on Mr Trump’s protectionism. A billionaire investor in old-technology companies that benefit from protection, Mr Ross is no free trader. According to a report by the *Globe and Mail*, a Canadian newspaper, he has identified two priorities for NAFTA renegotiation: the dispute-settlement process and “rules of origin”. These rules put a ceiling on the value of inputs that an exporter to another NAFTA country can buy from

outside the area. Both ideas are contentious.

The United States has long grumbled about the independent NAFTA panel that rules on anti-dumping duties, which a country imposes when it thinks that its trading partner is competing unfairly. It has ruled, for example, that duties on softwood lumber from Canada are a violation of American law. Mr Ross is likely to demand changes that weaken the panel.

Tightening rules of origin, which determine how porous the walls are around a free-trade area, is another goal. In the case of transport equipment, the biggest category of goods traded within NAFTA except for oil and gas, as much as 62.5% of the value of components must be made in North America if they are to be exported freely. Mr Ross probably wants to raise that requirement and close loopholes within it, which could encourage carmakers to source more parts from suppliers in the three countries.

Mexico and Canada might not object to that. In negotiating the Trans-Pacific Partnership (TPP), a 12-country agreement from which Mr Trump has now withdrawn, both countries pushed for tougher rules of origin than did the United States. “We’re trying to see if there is a creative way of raising the regional value added in North America,” says Jaime Zabłudovsky, head of the Mexican Council on Foreign Relations, who is helping the Mexican government in its consultations with business.

But the idea poses dangers. If North American firms had to buy more inputs within NAFTA they might become less competitive against the likes of China and Japan, both at home and abroad. Tighter rules in industries with low tariffs, like cars, could become self-defeating; if they are too tight, companies could simply decide to pay tariffs, rendering NAFTA irrelevant. Another idea that might tempt Mr Ross—allowing individual NAFTA partners to set their own rules of origin—could disrupt supply chains as much as imposing tariffs within the group. It is a non-starter as far as the Mexicans are concerned.

Making NAFTA more like the TPP might help placate Mr Trump, even though he rejected the bigger deal. The TPP strengthens workers’ rights, for example to strike and bargain collectively. That is a good thing from Mr Trump’s point of view because it should help

Americans compete with Mexican workers on a more equal footing. NAFTA also has a workers'-rights component, but it is in a side agreement and maybe less enforceable. The TPP has America-friendly rules for technology trade, which NAFTA lacks. It punishes online piracy and bars governments from imposing customs duties on digital devices, for example.

Mr Ross may also try to knock down the remaining barriers to American exports and investment put up by its NAFTA partners. Mexico, for example, imposes cumbersome testing procedures on imports of electrical equipment and limits purchases of residential property by foreigners near its coasts. The list of complaints about Canada is at least as long. It includes protection for dairy and poultry farmers, limits on foreign ownership of telecoms firms and provincial monopolies on the sale of alcohol.

If that is Mr Ross's agenda, negotiations will be difficult enough. Mexico, the world's fourth-largest car exporter, will be reluctant to agree to tighter rules of origin that would make its manufacturers less competitive. Canada will resist any watering down of its ability to appeal against American anti-dumping duties. Making NAFTA more like the TPP is harder than it sounds. Mexico accepted stronger protection for labour only because the TPP offered access to the enormous Japanese market. The United States, which already gives Mexico entry to its market, is offering no extra inducement.

Even if Mr Ross prevails on such questions, his new boss is not likely to be satisfied. Enforceable labour standards cannot eliminate the cost advantage of Mexican manufacturing workers (see chart). Tougher rules of origin might shift some production from Asia to NAFTA, but would not ensure that the investment goes into American factories rather than Mexican or Canadian ones. No revised trade deal can reverse the decline in manufacturing employment over the past few decades. Nor will it erase the United States' trade deficit with Mexico, says Jeff Schott of the Peterson Institute for International Economics in Washington.



So the chances are that the confrontation with which Mr Trump began his presidency will continue. His attempts to browbeat Mexico into submission may have the opposite effect. After recovering from the initial shock of Mr Trump's onslaught, Mexico is beginning to fight back. Its government now says it would rather walk away from NAFTA than accept a new deal that is worse than the current one. Enrique Peña Nieto, Mexico's deeply unpopular president, received rare acclaim after he cancelled a meeting with Mr Trump planned for January 31st. He knows that the shattering of NAFTA would cause hardship. But Mexican voters will rightly blame Mr Trump.

*This article appeared in the The Americas section of the print edition under the headline "Reshape or shatter?"*



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