

Trudeau Must Stand Strong for Canadians Over NAFTA

*By Sheldon Birkett,
Research Associate at the Council on Hemispheric Affairs*

The North American Free Trade Agreement (NAFTA) must be renegotiated to establish a more-fair and equitable free trade relationship, which is essential for increasing the welfare of Canadian and American working classes. On July 17, the Trump administration released the *Summary of Objectives for the NAFTA Renegotiations*. The 17-page document entails an aggressive “Buy America” trade policy, securing American interests at the cost of Canada’s and Mexico’s minimal gains attributed from NAFTA. In a recent interview with Scott Sinclair of the *Canadian Centre for Policy Alternatives* we discussed the challenges facing Canada in the NAFTA renegotiation, some policy responses for improving NAFTA, and the importance of NAFTA’s non-trade aspects.

NAFTA, a 23-year-old trade agreement, has been a frictional free trade agreement (FTA), in contrast to the popular perception of it being a frictionless free trade agreement. NAFTA has encountered continuous challenges throughout its tenure. Trade disputes in which the U.S. has responded to low Canadian “stumpage” feesⁱ by imposing countervailing duties have occurred five times since 1982.ⁱⁱ Most of America’s disputes over trade with Canada have been met with resistance from the World Trade Organization (WTO) in accordance to default most favoured nation (MFN) statusⁱⁱⁱ in international trade. However, the WTO dispute settlement process over accusations of Canadian industry subsidization by the U.S. Department of Commerce costed the Canadian lumber industry CDN \$1.5 billion in 2003.^{iv} Canadian exports to the U.S. are equivalent to 25 percent of Canada’s GDP, amounting to USD \$278 billion exports to the United States and USD \$262 billion of imports into Canada, with the United States having a trade surplus of USD \$11 billion in 2016.^v From the quantity of trade conducted it would be logical to assume that NAFTA has benefited both Canada and the United States, but what is often stated in the mainstream media is often far from the reality of Canada’s trade relationship with the United States.^{vi}

In a recent study the *Canadian Centre for Policy Alternatives* estimates the impact on Canadian exports if President Trump made good on his repeated threats to terminate NAFTA. The impacts of reverting to WTO tariff rates are surprisingly modest. Just over 40 percent of Canadian exports would continue to enter the U.S. market duty-free even without NAFTA. A further, 40 percent of Canadian exports to the United States would

face *ad valorem*^{vii} tariffs, but most would be below 3 percent. Only 3 percent of all goods exported (US\$2 billion worth) would face a tariff greater than 10 percent. The value of the total amount of trade reduced by removing NAFTA would only be equivalent to USD \$4.1 billion per year, which is roughly 1.47 percent of Canada's total exports.^{viii} For 96 percent of Canadian exports to the United States the effective cost of losing NAFTA would be a modest USD \$4.2 billion.^{ix} Out of USD \$540 billion, the value of trade between Canada and the United States, USD \$4.2 billion is a drop in the bucket.

Trump's "America First" NAFTA

The main threat to the Canadian economy from Trump's new trade policy would be the application of trade remedies (i.e. countervailing duties^x and protective measures), "Buy America" rule of origin, strengthening of NAFTA's investor-state dispute (ISDS) clause, and government procurement policy that shuts out Canadian companies. There are also issues concerning intellectual property rights, telecommunications, and financial services between NAFTA members, but they are not direct issues concerning trade policy.

In the *Summary of Objectives for the NAFTA Renegotiation under Customs, trade facilitation, and the rule of origin*, the Trump administration states "[to] Update and strengthen the rules of origin, as necessary, to ensure that the benefits of NAFTA go to products genuinely made in the United States and North America."^{xi} The rules of origin do not provide any solutions to how the United States would be able to incentivize more exporters to take advantage of the minimal saving incurred under NAFTA. Currently 20 percent of Canadian exporters that can qualify for NAFTA's preferential treatment do not do so because they would rather choose to swallow the small differences in savings to not partake in NAFTA's preferential treatment.^{xii}

On environmental regulation, Trump's proposal seeks no palpable change to the North American Agreement on Environmental Cooperation (NAAEC), a parallel agreement to NAFTA. NAAEC as administered by the Commission for Environmental Cooperation (CEC) is much weaker than the Investor-State Dispute Settlement (ISDS) clause within Chapter 11 of NAFTA. For instance, NAAEC Article 22(1) states that "Any Party may request in writing with any other Party regarding whether there has been a persistent pattern of failure by that other Party to effectively enforce its environmental law."^{xiii} Conversely, Chapter 11 of NAFTA's ISDS clause states that "each NAFTA Party must accord investors from the other NAFTA Parties national (i.e. non-discriminatory) treatment and may not expropriate investments of those investors except in accordance with international law."^{xiv} Certainly the use of passive language in the NAAEC clause entails a lack of emphasis on the need to sustain environmental protection over investors' capital gains.

The industry-friendly-self-regulated policy model is detrimental to the health and safety

of American and Canadian communities. In 2013, the allowance of a single operator to handle regulation concerning rail shipments of hazardous goods “was a cause and contributing factor to the [Lac-Mégantic] accident”^{xv} according to the Transport Safety Board (TSB), which played into the 2013 Lac-Mégantic explosion that killed 47 people.^{xvi}

Trump’s government procurement policy prioritizes “Buy America” trade policy, the Trump administration plans to override a non-partisan trade dispute policy in favour of an “America First” stance towards negotiations. Specifically, the Trump administration wants to eliminate Chapter 19 dispute settlement in NAFTA. Chapter 19 allows “an exporter to go to an independent binational panel to review final anti-dumping and countervailing duty rulings.”^{xvii} Allowing disputes to go through an independent panel, and not domestic courts, provides room for an objective analysis of discriminatory trade practices. If the regulating panel agrees that the trade practice goes against any NAFTA regulations, or the MFN status by WTO standards, the panel can remand domestic trade authorities to align with the panel’s ruling.^{xviii} It is imperative for Canada to not let the United States terminate Chapter 19 within NAFTA, as it is one of the only protective trade clauses within the trade agreement. Chapter 19 is also one of the few reasons why the Canadian government was willing to sign onto NAFTA in 1992 when it was discussed under the Mulroney government. However, Canada failed to gain secure access into the U.S market in 1994 because U.S. trade remedy laws allowed the United States Department of Commerce to apply full countervailing duties and anti-dumping measures to Canadian exports without Canada’s consent.^{xix} Trump’s “American First” renegotiated NAFTA would be detrimental to the Canadian economy because it would give Trump unconditional control over trade, without any consideration for Canadian consumers or producers.

CCPA’s Policy Recommendations to Improve NAFTA

On May 18 President Trump sent a letter to Congress announcing his intention to begin the 90-day waiting period before opening formal negotiations.^{xx} The renegotiations should be an opportunity for the Canadian government to gain an upper-hand and apply pressure to Trump’s “Americanized” NAFTA. Since the initiation of NAFTA in 1994, labour’s share of income has declined considerably in Canada,^{xxi} and Canadian productivity has not kept pace with that of the United States.^{xxii} This is the chance for Trudeau to strive towards establishing a more-fair and equitable NAFTA, by implementing policy recommendations to revitalize lagging productivity and ensure more inclusive growth. Such recommendations are discussed in the following interview with Scott Sinclair.

Sheldon Birkett is a Research Associate at the Council on Hemispheric Affairs, and Scott Sinclair is a Senior Research Fellow and the Director of the Trade and Investment Research Project at the *Canadian Centre for Policy Alternatives* in Ottawa, Ontario.

The interview was conducted on July 24, 2017.^{xxiii}

Transcript Follows...

Sheldon: Only 2 percent of Canada’s current exports would face an MFN (Most Favoured Nation) duty rate of 10 percent or more if NAFTA was terminated (reverting back to WTO rules), and given the reality that 20 percent of current exporters (that qualify for NAFTA preferential treatment) opt for WTO tariffs, why is NAFTA important to small businesses in Canada?

Scott: NAFTA is surprisingly unimportant to small businesses in Canada, you probably know that only one percent of Canadian small businesses export anything at all, to anywhere, trade is pretty much dominated by the largest businesses in Canada. I think the broader point of our report is that the impacts of going back to WTO tariff rates on Canadian trade, if Trump were to make good on his threat to terminate NAFTA, would be surprisingly small. Snapping back, or reverting to WTO tariffs, would mean an extra 1.5 percent cost on the value of Canadian exports, using 2016 figures. We call that a “speed bump,” that certainly wouldn’t bring trade to a screeching halt. The take-home message is that Canada has a much stronger negotiating position than is often appreciated, and if we are pushed around on issues, such as NAFTA Chapter 11, higher drug costs, and intellectual property rights, we can afford to walk away from that deal.

Sheldon: So, you are saying that Canada should change their stance on Chapter 11 ISDS?

Scott: Yeah, in our brief we argue that the ISDS should be eliminated from NAFTA. Canada has had a pretty negative experience with that, we are the most sued country in this regard. There have been 39 claims against Canada, a lot of those cases have to do with environmental protection and natural resource management disputes. So, I would say, that wasn’t what Canadians thought they were signing on-for when NAFTA was negotiated. When the ISDS system was included it was justified as necessary because of problems in the Mexican courts, but very few disputes have anything to do with the administration of justice in Mexico. A large chunk of them have been about environmental protection and resource management. We think Canada could afford to take a pretty assertive position against ISDS.

Sheldon: Given NAFTA’s scope and outline, and given your conclusions drawn in your report, the decline of labour’s share of income, and as well as Canada’s productivity growth has actually lagged behind the U.S. since the 1990’s; is NAFTA more focused on delivering the benefits of trade or intellectual property rights for multinational conglomerates?

Scott: Well, that’s a good question. I think it is really important to focus on the non-

trade elements of NAFTA. NAFTA is a set of rules, but it is a set of rules that overwhelmingly favours the largest multinational corporations and richest individuals. You can see that most clearly in elements like the investor state dispute settlement mechanism, which is used overwhelmingly by large multinationals and in excessive intellectual property protection, which results in Canadians and Americans paying the highest drug costs in the developed world. Now some interests, particularly Republicans in the U.S Congress, would like to impose that model (of intellectual property protection) in NAFTA 2.0, moving Canada even further towards the U.S model, but also impose that on Mexico. It would have quite devastating consequences.

I think it is important to look at those non-trade elements, but it is also important to say that the Canada-U.S. trade relationship is pretty healthy actually, it's certainly mutually beneficial, it's pretty balanced, and unlike Canada's trade with the rest of the world; in fact, trade with the U.S. trade is balanced both qualitatively and quantitatively. So, what I mean by qualitatively is with the rest of the world we are mainly selling unprocessed and semi-processed natural resources and importing higher value-added manufacturing goods, but with the U.S. it's a mix. Obviously we sell a lot of energy but we export a lot of manufactured goods mainly in the automotive sector, and import them too, and the same is true from a U.S. perspective. So, the trade relationship is balanced and mutually beneficial. But the problem with NAFTA, as a set of rules, is that the benefits of that trade flow almost exclusively to the top 10 percent or even the top one percent in all three countries

Sheldon: Yeah, I think you put that the majority of actual benefits is a 2-3 percent reduction in tariffs for 60 percent of goods and services traded between Canada and the United States. If I am not mistaken?

Scott: Yeah, that's right. 40 percent of Canada's current exports to the United States would continue to enter the United States duty free, under WTO rules, even if NAFTA was to be terminated by the Trump administration.

Sheldon: This is another question to move on, in this article I am taking a more proactive stance, so what is the most important policy recommendation that is necessary to implement within NAFTA to improve the welfare of the Canadian economy, if not, are there any alternatives to NAFTA given Trump's summary report released last week, which is basically to have "Buy American" goods, get rid of Chapter 19 dispute clause and so-forth. So, if Canada can't negotiate adequately with the Trump administration in Washington, what is the most pressing recommendations in-order to improve NAFTA, or what are the other alternatives?

Scott: I think the priority is to change NAFTA's rules so that the benefits of trade are distributed more fairly, and I think that the one key element is obviously to ensure high levels of labour standards in all three countries, and to ensure that those are fully

enforceable, so that workers and unions can bring complaints in all three countries. Those complaints must be heard, unlike the current situation, and that there will be penalties and sanctions for employers and jurisdictions that don't respect labour standards. That's really critical.

I mentioned other elements of the non-trade aspects of NAFTA that shift wealth and power to the largest corporations and the richest individuals. That's why we are focused on eliminating investor state dispute settlement, which gives too much power to corporations to attack regulation or even kill them if they feel they will harm their interests. We certainly don't want to be moving towards the U.S. model for intellectual property protection, especially in the area of pharmaceuticals, but also in the area of copyright, and some other areas it would be a mistake for Canada to move in that direction. Again, it would just exacerbate the inequalities we are already experiencing.

Sheldon: What particularly about intellectual property rights would be damaging for Canada?

Scott: Well, the U.S. is pushing for longer terms of what is called data protection for biological drugs. The U.S. standard is 12 years, which is the longest period of protection in the world. In Canada we are at 8 years, which is also very high. Mexico, as a developing country, doesn't have a fixed term of data protection for these biological and non-chemical based drugs. There's also pressure for patent term extensions beyond the 20 years that are required under the WTO-TRIPS agreement. So, all those things would increase the cost of drugs in Canada, Mexico and the U.S. where it's already the highest.

Sheldon: And that would increase the cost of drugs for Canadians, right?

Scott: Yeah, by delaying the availability of generic drugs. Those costs by the way are large, and they would be billions of dollars annually, they would totally swamp any NAFTA tariff preferences, totally negating trade benefits. They are very large costs, they are a cost burden that would be borne mainly by consumers and the public healthcare system.

Sheldon: It's interesting, I don't really hear much about intellectual property rights in the mainstream media about NAFTA. It seems like the Canadian government is really proactive about trade but they don't really discuss the non-trade aspects of NAFTA, which can be more damaging to Canadians and Americans.

Scott: Yeah, as you know NAFTA is a set of rules, and is certainly not the only set of rules that could govern trade, and a lot of issues covered by NAFTA are only marginally related to trade. They have been shoe-horned in there by corporate lobbyists.

Sheldon: Do you think Canada would be able to use its trade relationship with the U.S. as "leverage" to conforming American environmental regulations in accordance to the Paris Climate Agreement? So, could Canada give up some of its protective industries, like dairy and lumber, in

exchange for the U.S. and Canada to benefit from the renegotiation process?

Scott: Well, I don't think it's realistic that Canada will be able to leverage the Trump administration into reversing its deregulatory agenda around the environment. It's not just pulling out of the Paris Accord, but it is also hamstringing the EPA, reversing commitments made jointly with Canada around reducing methane emissions, and stronger fuel efficiency standards for the auto sector, which they also reversed. I don't think that it is realistic to assume Canada could make any concessions that would change the Trump's administrations' mind about that. I think that on the environment Canada has to take a very defensive point of view. We have to protect our policy flexibility to adopt high environmental protection standards, and that means things like getting rid of investor state dispute settlements that have been used to attack environmental regulation, and ensuring any regulatory cooperation process is based on moving to the highest common denominator, and improving standards, and not weakening them to now unacceptable U.S. levels.

Sheldon: What can be done to fairly and equitably improve NAFTA and general trade relations between Canada and the United States, that would both benefit the Trump administration promises and well as Trudeau's promises, coming up to the NAFTA negotiations starting in August 16th-20th in Washington DC?

Scott: Well, we tried to set out our ideas on that in the brief that you have seen, so I have mentioned that adopting stronger labour rights and standards - much stronger - is key. We have tried to recommend a new approach to government procurement issues, instead of Canada whining about "Buy America" and trying to get an exception.

Sheldon: You did state in the report, that I found was interesting, if Canada can't get a "Buy North America" policy, Canada should get a "Buy Canadian" policy?

Scott: Well, we should offer to cooperate with the United States on new infrastructure investments, and you know Canada is planning hundreds of billions of dollars of new infrastructure investment at both federal and provincial levels. We should offer to work with the U.S. and Mexico to leverage the most economic and environmental benefits we can from new infrastructure investment, and ensure all three countries have a fair share of benefits in proportion to how much they each invest in infrastructure, but if the U.S. is not interested in that, then we should go the "Buy Canada" route. Basically, if you can't beat them, join them.

Conclusion: NAFTA, what to do next?

Because of the Trump's administration hardline "America First" rhetoric, it has put Canada into a tough negotiating position on NAFTA. However, many of the non-trade

elements within NAFTA have been detrimental for Canadians and Americans. It is essential for the Trudeau government to take a tougher negotiating position when it comes to NAFTA's industry-friendly environmental regulations, intellectual property rights, and labour standards. It is also important for Canada to maintain the benefits received from free-trade, despite only 40 percent of the total goods that qualify under NAFTA get preferential tariff treatment. There have been many losers from NAFTA, particularly on the working classes in North America affected by sectoral change in the macro-economy. Trudeau will have to take advantage of this negotiating opportunity to create a better deal for Canadian and American working classes, implying higher regulatory standards and turning away from volatile liberalization reforms. Certainly, when it comes to NAFTA negotiations with a hostile American administration, it may be beneficial for Canada to walk away from a bad deal if negotiations turn sour.

By Sheldon Birkett,

Research Associate at the Council on Hemispheric Affairs

Additional editorial support provided by Scott Sinclair, Senior Research Fellow and the Director of the Trade and Investment Research Project, at the Canadian Centre for Policy Alternatives, Jordan Bazak, Research Fellow, Felipe Galvis-Delgado and Liam Timmons, Research Associates at the Council on Hemispheric Affairs

ⁱ Stumpage Fees: The price a private firm pays to harvest lumber from an area of land.

ⁱⁱ Sheldon Birkett, "Canada and the United States: Trade, Softwood, and Uncertainty," *Council on Hemispheric Affairs*, May 11, 2017, <http://www.coha.org/canada-and-the-united-states-trade-softwood-and-uncertainty/>.

ⁱⁱⁱ Most Favoured Nation (MFN) Status: The principle of non-discriminatory trade practices administered by the World Trade Organization (WTO), in which every nation treat every other nation as their own in trade policy.

^{iv} Ibid.

^v Pierre Laliberte and Scott Sinclair, "What is the NAFTA advantage?" *Canadian Centre for Policy Alternatives*, June 2017,

https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2017/06/What_is_NAFTA_Advantage.pdf.

^{vi} Ibid.

^{vii} Ad Valorem: tariffs charge as a percentage of the price, versus, a specific tariffs charge with a fixed quantity.

^{viii} Pierre Laliberte and Scott Sinclair, "What is the NAFTA advantage?" *Canadian Centre for Policy Alternatives*, June

2017, https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2017/06/What_is_NAFTA_Advantage.pdf.

^{ix} Ibid.

^x Countervailing Duties: import tax imposed on a certain good to serve as a protective measure against dumping.

-
- ^{xi} “Summary of the Objectives for the NAFTA Renegotiation,” *Office of the United States Trade Representative*, July 17, 2017, <https://ustr.gov/sites/default/files/files/Press/Releases/NAFTAObjectives.pdf>.
- ^{xii} Pierre Laliberte and Scott Sinclair, “What is the NAFTA advantage?” *Canadian Centre for Policy Alternatives*, June 2017, https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2017/06/What_is_NAFTA_Advantage.pdf.
- ^{xiii} “North American Agreement on Environmental Cooperation,” *Commission for Environmental Cooperation*, 1993, <http://www.cec.org/about-us/NAAEC>.
- ^{xiv} “NAFTA Investor-State Arbitrations,” *U.S Department of State*, July 2017, <https://www.state.gov/s/l/c3439.htm>.
- ^{xv} Bruce Campbell, “Little progress on rail safety in wake of Lac Megantic,” *Toronto Star*, April 14, 2016, <https://www.thestar.com/opinion/commentary/2016/04/14/little-progress-on-rail-safety-in-wake-of-lac-megantic.html>.
- ^{xvi} Scott Sinclair, Stuart Trew, and Mertins-Kirkwood, “Submission to Global Affairs Canada on the renegotiation and modernization of the North American Free Trade Agreement (NAFTA),” *Canadian Centre for Policy Alternatives*, July 2017, <https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2017/07/CCPA%20NAFTA%20renegotiation%20submission.pdf>.
- ^{xvii} Ibid.
- ^{xviii} Ibid.
- ^{xix} Ibid.
- ^{xx} Bruce Campbell, “Trump launches NAFTA renegotiations,” *Canadian Centre for Policy Alternatives*, July 1, 2017, <https://www.policyalternatives.ca/publications/monitor/trump-launches-nafta-renegotiations>.
- ^{xxi} Scott Sinclair, Stuart Trew, and Mertins-Kirkwood, “Submission to Global Affairs Canada on the renegotiation and modernization of the North American Free Trade Agreement (NAFTA),” *Canadian Centre for Policy Alternatives*, July 2017, <https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2017/07/CCPA%20NAFTA%20renegotiation%20submission.pdf>.
- ^{xxii} Ibid. Canada’s Productivity was 91 percent of the United States’ in the mid-1980’s and declined to 70 percent of the United States’ by 2012.
- ^{xxiii} Scott Sinclair (Senior Research Fellow and the Director of Trade and Investment Research Project at the Canadian Centre for Policy Alternatives), interview by Sheldon Birkett, July 24, 2017.