

May 18, 2017
2017-0820

Trump Administration issues NAFTA renegotiation notice letters

US Trade Representative (USTR) Robert Lighthizer has notified Congress of the Trump Administration's intent to renegotiate the North American Free Trade Agreement (NAFTA). The May 18, 2017 letters to majority and minority leaders of Congress mark the start of a 90-day period before formal NAFTA renegotiations may begin in accordance with the provisions of the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA). Given the 90-day notice requirement, formal negotiations with Canada and Mexico could begin as early as August.

The case for renegotiation

In the letters, the Administration notes that "NAFTA was negotiated 25 years ago, and while our economy and businesses have changed considerably over that period, NAFTA has not." The May 18 letters emphasize the need to modernize NAFTA by including "new provisions" on the following topics:

- Digital trade
- Intellectual property rights
- Regulatory practices
- State-owned enterprises
- Services
- Customs procedures
- Sanitary and phytosanitary measures
- Labor
- Environment
- Small and medium enterprises

The May 18 letters also call for stricter enforcement, stating that "establishing effective implementation and aggressive enforcement of commitments made by our trading partners under our trade agreements is vital to the success of those agreements and should be improved in the context of NAFTA." The letters assert that the Administration is "committed to concluding these negotiations with timely and substantive results for U.S. consumers, businesses, farmers, ranchers, and workers."

Notably, the May 18 letters are much shorter and less detailed than the eight-page draft letter circulated to Members of Commerce last month, and do not detail negotiation objectives. More detailed objectives are expected to be provided following additional consultation with Congress and the public.

Actions for businesses

NAFTA has set the rules for trade and investment among the US, Canada and Mexico for 23 years, leading to integrated supply chains with an expectation of NAFTA benefits under the current rules.

Many companies have not reviewed their "NAFTA profile," understanding the benefits tied to specific provisions, in quite some time. Consequently, establishing a NAFTA profile is critical to assessing the effect of possible changes. Topics to be addressed will likely include more than those specifically referenced as needing new provisions. Businesses will want to identify those aspects of NAFTA that currently benefit the business, as well as those specified for modernization that could provide additional benefit. With a greater emphasis on compliance enforcement, importers and exporters would be well-served to assess their NAFTA procedures and internal controls.

Rules of origin

Changes to the NAFTA rules of origin were not specifically referenced in the May 18 notice letters, but were referenced in the draft letter, and have been widely discussed by both businesses and government officials in all three countries. Changes to NAFTA's rules of origin could significantly affect many businesses trading in North America. Rules of origin determine when a product qualifies for duty-free treatment when exported from one NAFTA country and imported into another. For manufactured items, the rules typically evaluate the regional value added, or the type of processing, that occurs in North America. Rules of origin are product specific, and vary.

It is widely expected that the US will wish to "tighten" the rules of origin so that more North American "content," for example the value of North American components used to manufacture an item, will be required in order to qualify goods for preferential treatment. This in turn is intended to encourage the use of more North American, and especially US, content when manufacturing products in order for those products to receive NAFTA benefits. The NAFTA partners may be amenable to the changes; the question is how "strict" any particular rule may become. Consequently, for businesses that currently rely on NAFTA duty-free treatment, it will be important to determine how products currently qualify, and model scenarios that impose stricter rules.

For example, if current rules require 50% North American regional value content in order to qualify a good for NAFTA duty-free treatment, what happens if the requirement goes to 60%? What about 62.5%? If the current rule of origin evaluates the amount of processing done in North America by measuring the change in tariff classification of the imported component parts when assembled into the finished product (a "tariff shift" rule), what is the effect of also requiring a specific percentage of North American value? Would the product continue to qualify for NAFTA duty-free treatment if both a tariff shift and specified regional value content are required? Understanding the effect of possible changes will allow a business to develop a strategy to "preserve or improve" current treatment. With this understood, businesses can plan how best to communicate with any or all of the three NAFTA countries, keeping in mind the negotiating objectives of each.

Participating in the process

Each NAFTA country will be seeking input from businesses on potential changes; Mexico began public consultations in February in anticipation of the US request to revise NAFTA. The USTR announced that it will soon publish a Federal Register Notice requesting public input on the direction, focus and content of NAFTA negotiations.

Input can be provided throughout the process, but the input provided during the development of negotiating positions could have the most impact. As part of the TPA process, for example, the USTR will release more detailed negotiation objectives 30 days before negotiations begin.

Businesses will want to use this window of opportunity to express their points of view on whether specific changes are beneficial, problematic or acceptable. At the same time, they will want to establish lines of communications so they can continue to provide input as the negotiations progress. In other free trade agreement negotiations, the US, Mexico and Canada have engaged with stakeholders throughout the process. Businesses that have a firm understanding of their NAFTA

profile, and remain engaged during the process, may have an opportunity to have their concerns heard.

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