

January 6, 2017

## **NAFTA Now: Four Questions as the Trump Administration Takes Office**

By [Edward M. Lebow](#) and [Michael J. Scanlon](#)

During the recent presidential campaign, Donald Trump criticized multilateral trade agreements as bad deals that harm American workers. To protect jobs in the United States, he promised to abandon the Trans-Pacific Partnership (“TPP”),<sup>1</sup> a trade agreement signed by representatives of the United States and eleven Pacific Rim countries on February 4, 2016, but not yet ratified by Congress.<sup>2</sup> He also indicated a willingness to withdraw the United States from the North American Free Trade Agreement (“NAFTA”), calling it “the worst trade deal maybe ever signed anywhere, but certainly ever signed in this country . . .”<sup>3</sup>

Now that the election is over, it is essential for businesses to know whether the law will allow the President to withdraw the United States from NAFTA without an act of Congress, and to what extent the incoming administration intends to use the possibility of withdrawal to leverage a better trade deal with Mexico and Canada. Accordingly, we address below some basic questions concerning NAFTA withdrawal or renegotiation.

### **Could President Trump unilaterally withdraw the United States from NAFTA?**

President Trump probably will not need Congressional approval to start the withdrawal process. NAFTA is not a treaty made pursuant to Article II, Section 2 of the U.S. Constitution that provides Presidents the power “to make treaties, provided two thirds of the Senators present concur.”<sup>4</sup> Instead, it is a congressional-executive agreement based on the power granted to Congress in Article I, Section 8 of the Constitution to “regulate commerce with foreign nations”<sup>5</sup> and delegated to the executive branch through legislation.

Nowhere does the legislation implementing NAFTA inside the United States speak to whether the President must obtain Congressional authorization before withdrawing the United States from that agreement. However, the authority to withdraw the United States from NAFTA is governed by Section 125 of the Trade Act of 1974,<sup>6</sup> which provides that “[e]very trade agreement entered into under this chapter shall be subject to termination, in whole or in part, or withdrawal, upon due notice, at the end of a period specified in the agreement.”<sup>7</sup> NAFTA Article 2205 provides that a “Party may withdraw from this Agreement six months after it provides written notice of withdrawal to the other Parties.”<sup>8</sup> Thus, President Trump probably could start the withdrawal process simply by giving notice to Canada and Mexico of the United States’ intent to leave the agreement.

### **How much freedom will President Trump have to raise tariffs and impose other trade restrictions if he withdraws the United States from NAFTA without Congressional approval?**

There are a few things that we know for certain. There will be a time lag before the United States can impose any new duties or other import restrictions on goods or services from Mexico or Canada. At minimum, the Trump Administration will have to maintain the status quo for six months until withdrawal becomes official under NAFTA Article 2205. In addition, Section 125 of the Trade Act of 1974 provides that the tariff rates under a terminated trade agreement remain in effect for one additional year, “unless the President by proclamation provides that such rates shall be restored to the level at which they would be but for the agreement.”<sup>9</sup>

If the Trump Administration does withdraw the United States from NAFTA, the law would allow it to raise tariffs significantly. Section 125 of the Trade Act of 1974 allows the President to raise tariffs up to 50 percent above the highest rates in the Tariff Schedules of the United States in effect as of January 1, 1975 or 20 percent ad valorem above the rates existing on January 1, 1975, whichever is higher.<sup>10</sup> Moreover, other provisions allow a

President to raise tariffs or otherwise restrict imports on the grounds of national security, unfair trade practices, or balance-of-payments deficits.

Other commitments, however, could limit the President's ability to raise tariffs. Prior to the negotiation of NAFTA, the United States and Canada had entered into a bilateral free trade agreement,<sup>11</sup> which will return to effect if the United States were to withdraw from NAFTA.<sup>12</sup> Therefore, a withdrawal from NAFTA will not allow the President very much room to raise tariffs on Canadian goods or services.

Similarly, although there is no pre-NAFTA trade agreement between Mexico and the United States, both countries are members of the World Trade Organization ("WTO"), which generally requires its members to accord most-favored nation ("MFN") treatment to all other members. Thus, if the United States were to impose tariffs on Mexican goods in excess of U.S. MFN rates, which are quite low, Mexico would be authorized under WTO rules to retaliate against U.S. exports. In summary, the Trump Administration could raise tariffs on Mexico after withdrawing from NAFTA, but only at the risk of inviting retaliatory tariff increases by Mexico on a wide range of U.S. exports, including, for example, U.S. agricultural products or natural gas.

## **What are the chances that the Trump Administration will withdraw from NAFTA?**

At this point, given the wide chasm between the candidate's promises and the commercial conditions facing important U.S. business sectors such as autos and energy, it is difficult to predict what will happen. It may, in fact, be that President Trump will use the threat of withdrawal as leverage in renegotiations with Mexico and Canada—and perhaps in negotiations with Congress about immigration reform.

A complete rejection of NAFTA would result in serious economic disruptions. In 2015, U.S. goods and services trade with Mexico totaled an estimated \$583.6 billion, with \$267.2 billion in exports and \$316.4 billion in imports.<sup>13</sup> Moreover, cross-border supply chains have developed to the point that perhaps "40% of the content of U.S. imports of goods from Mexico consists of U.S. value added content."<sup>14</sup> Similarly, many U.S. manufacturing industries have come to "rely on the assistance of Mexican manufacturers" to bring their goods to market.<sup>15</sup>

Thus, important elements of the U.S. business community are likely to lobby against a withdrawal and, if that fails, challenge the Trump Administration's actions in court.<sup>16</sup> Moreover, the Canadian government has stated that it is prepared to renegotiate NAFTA, while the Mexican government has indicated that it is willing to discuss the agreement. Therefore, there is a real possibility that the Trump Administration will seek to renegotiate and improve NAFTA, rather than scrap the agreement altogether.

## **If NAFTA is renegotiated, how will it change?**

Given the concern expressed for the plight of U.S. workers on the campaign trail, some areas ripe for renegotiation include those dealing with labor rights and settlement procedures for labor disputes. Furthermore, a renegotiation of NAFTA might be useful because the once-cutting edge agreement no longer reflects the latest provisions now typically found in trade agreements and thus could use updating.

Ironically, despite the harsh words President-Elect Trump had for the TPP during the campaign, his administration might push Mexico and Canada to adopt provisions included in that more recently negotiated agreement on:

- Labor Rights

# haynesboone

- Environmental Protection
- Tighter Dispute Settlement Mechanisms for Labor, Environment
- Digital Trade
- State Owned Enterprises
- Intellectual Property Protections

In addition, the Trump Administration likely will seek more restrictive rules of origin, demand that all NAFTA countries require open proceedings when developing regulations, and look to modify the investor-state dispute settlement procedure.

Conversely, there are also issues that the Mexican and Canadian governments might themselves want to renegotiate. For instance, Canada might request increased access to the U.S. market for its softwood lumber, while Mexico could ask for higher sugar quotas or a reduction in the scope of the United States' Buy American Act.<sup>17</sup>

Finally, a renegotiation might even strengthen coordination among the United States, Canada, and Mexico on border security or on supply chain coordination and other industrial policies addressing the China challenge. Therefore, rather than simply dig in to maintain NAFTA as it now stands, concerned businesses and other stakeholders should be prepared to articulate what in NAFTA is worth saving, and how NAFTA could be amended to the benefit of all three NAFTA countries and their citizens.

Should you have any questions, please contact any of the lawyers listed below.

[Edward M. Lebow](#)

ed.lebow@haynesboone.com  
+1.202.654.4514

[Michael J. Scanlon](#)

michael.scanlon@haynesboone.com  
+1.202.654.4570

---

<sup>1</sup> [Donald J. Trump's 7 Point Plan To Rebuild the American Economy by Fighting for Free Trade.](#)

<sup>2</sup> The 11 non-U.S. countries to sign the TPP are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam.

<sup>3</sup> Tim Hains, [Clinton to Trump: "You Live In Your Own Reality,"](#) REALCLEARPOLITICS (Sept. 26, 2016).

<sup>4</sup> U.S. CONST. art. II, § 2, cl. 2.

<sup>5</sup> U.S. CONST. art. I, § 8, cl. 3.

<sup>6</sup> See 19 U.S.C. § 3311(a); 19 U.S.C. § 2904(a).

<sup>7</sup> 19 U.S.C. § 2135(a).

<sup>8</sup> North American Agreement on Labor Cooperation, Can.-Mex.-U.S., 32 I.L.M. 1499, 1514 (1993).

<sup>9</sup> 19 U.S.C. § 2135(e).

<sup>10</sup> 19 U.S.C. § 2135(b).

<sup>11</sup> Free-Trade Agreement, 27 I.L.M. 281 (1988), *implemented by* The United States-Canada Free-Trade Agreement Implementation Act of 1988, Pub. L. No. 100-449, 102 Stat. 1851 (1988).

---

<sup>12</sup> U.S. DEP'T OF STATE, TREATIES IN FORCE: A LIST OF TREATIES AND OTHER INTERNATIONAL AGREEMENTS OF THE UNITED STATES IN FORCE ON JANUARY 1, 2016, at 73 (2016). (“This agreement is suspended, subject to certain transition arrangements with respect to dispute settlement proceedings under Chapters 18 and 19, for such time as the United States and Canada are parties to the North American Free Trade Agreement signed at Washington, Ottawa, and Mexico City December 8, 11, 14, and 17, 1992.”).

<sup>13</sup> OFFICE OF THE U.S. TRADE REPRESENTATIVE, U.S.-Mexico Trade Facts.

<sup>14</sup> M. ANGELES VILLARREAL, CONG. RESEARCH SERV., RL32934, U.S.-MEXICO ECONOMIC RELATIONS: TRENDS, ISSUES, AND IMPLICATIONS, at 5 (2016) (citing ROBERT KOOPMAN, WILLIAM POWERS, AND ZHI WANG, *et al.*, NATIONAL BUREAU OF ECONOMIC RESEARCH, WORKING PAPER 16426, GIVE CREDIT WHERE CREDIT IS DUE: TRACING VALUE ADDED IN GLOBAL PRODUCTION CHAINS, at 8 (Sept. 2010)).

<sup>15</sup> *Id.*

<sup>16</sup> For instance, although implicit in the context, the plain language of 19 U.S.C. § 1935(a) does not explicitly delegate to the President the authority to withdraw from trade agreements, and thus a legal challenge to his doing so might be anticipated.

<sup>17</sup> 41 U.S.C. §§ 8301-05.