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Will NAFTA Renegotiation Bring Joy to Retailers?



Retailers are looking ahead to the holiday season, but many are also watching

the North American Free Trade Agreement (NAFTA) renegotiation, which is ambitiously (and improbably) slated to conclude around the holiday season. Many in the retail sector have urged the Trump administration to preserve NAFTA's basic structure, while advocating changes that could help retailers begin sourcing more items from NAFTA countries—Canada, Mexico and the United States—rather than Asia. As explained below, the outcome of NAFTA renegotiation also will signal the future direction of U.S. trade law and policy.

Summary of NAFTA Renegotiation

The formal initiation of NAFTA's renegotiation showed that President Donald Trump approved less drastic action than other potential options. Early in his administration, President Trump reportedly was on the verge of withdrawing or terminating NAFTA. President Trump continues to threaten to withdraw or terminate NAFTA. Pulling the United States out of NAFTA could raise tariffs on at least some imports into the United States from Canada and Mexico, but congressional action would be required to undo a complex web of statutory provisions in U.S. law that implemented NAFTA. The Trump administration talks of "modernization" of an "outdated" NAFTA, and it began formal negotiations by declaring its intent to seek fundamental changes to the agreement.

The Trump administration's focus, therefore, seems to now be on improving NAFTA rather than starting from scratch in a redo of the entire agreement. As part of the renegotiation process, the Trump administration has solicited input from the public. The U.S. retail sector has been active in this process.

Retailers Urged NAFTA's Basic Framework Remain, With Changes

In their comments to the Trump administration, many in the retail sector have urged that a renegotiated NAFTA not alter fundamental aspects of the current NAFTA. The Retail Leaders Industry Association (RILA) and National Retail Federation (NRF) have requested that the administration "do no harm" to the current NAFTA and that the process to achieve a modernized NAFTA be quick and "seamless." Likewise, the Food Marketing Institute has stated that renegotiation should "maintain and build on the success" of NAFTA. Many others have similarly talked up NAFTA's current benefits. These positions reflect the importance that retail trade associations attach to NAFTA in its current form.

At the same time, many in the retail sector are urging that NAFTA address new commercial realities. E-commerce retailers, an industry that did not exist at the time NAFTA was negotiated, note that NAFTA represents an opportunity to limit prohibitions on the free flow of information and to discourage customs procedures that delay or tax internet transactions.

NAFTA contains complicated and product-specific rules of origin to determine whether an imported product is eligible for duty-free or reduced duties upon import. If a Mexican company imports Chinese-origin inputs and produces a finished product for shipment to the United States, NAFTA determines whether the imported product receives NAFTA (preferential) or Chinese (standard) tariff rates. In the footwear and apparel sector, RILA advocates rules of origin that would preserve existing supply chains while permitting new sourcing from NAFTA countries. This could allow, for example, fabric from Asia to be converted to a finished product in Mexico and then be eligible for NAFTA's preferential rates upon importation. Efforts to expand preferential rules of origin, however, are opposed by certain labor interests.

Other contentious areas could affect retailers indirectly. Some of the most controversial issues in NAFTA's renegotiation include whether the agreement should contain enforceable labor standards, requirements for consumption of domestically made inputs, stronger intellectual property protections, and sanitary, phytosanitary and technical product standards among the NAFTA countries.

Post-Renegotiation Business Trends to Watch

Fundamental tenants of U.S. trade policy are being reconsidered right now, with NAFTA's renegotiation representing the fore of this debate. Thus, NAFTA's renegotiation likely is the best indicator of what is to come next in U.S. trade. In particular, we see NAFTA's renegotiation as signaling trends that the business community, and retailers in particular, can expect moving forward under the Trump administration, including the following:

1. **The possibility that free trade agreements will become vehicles for encouraging U.S. manufacturing.** Retailers rely on preferential tariff rates for many items sold in their stores. NAFTA's renegotiation could set a precedent for using free trade agreements to encourage more U.S. manufacturing, discourage investment in non-U.S. manufacturing and reorient supply chains to source from the United States and other free trade partners. The extent to which NAFTA renegotiation attempts to encourage U.S. manufacturing will signal the baseline for future free trade agreements. We expect that the outcome will be product or industry specific.
2. **Changes accompanying NAFTA's renegotiation could address antidumping and countervailing duty enforcement.** Retailers can face rapid and profound changes in supply chains as the result of new AD/CVD cases. U.S. trade policy over the past 40 years has used free trade agreements to reduce trade barriers while permitting AD/CVD relief to protect domestic industries injured by imports. Domestic manufacturers, the Trump administration and U.S. Congress now are urging that AD/CVD enforcement be strengthened, either through NAFTA itself or by legislation that would be enacted along with a revised NAFTA.
3. **The speed of renegotiation will show the political will to change the direction of trade.** NAFTA implicates broad swathes of the U.S. economy, including retail businesses, agriculture and manufacturing. The Trump administration and Congress will have to balance many competing interests in reaching a renegotiated NAFTA. How quickly the Trump administration is able to conclude the renegotiation, and perhaps most importantly, Congress' reaction to a renegotiated deal, will demonstrate whether the United States is willing to change fundamental aspects of U.S. trade law and policy.

In short, the outcome of the NAFTA renegotiation will show where U.S. trade law and policy is heading. If finalized quickly, other significant changes are a realistic prospect. If the renegotiation gets bogged down either at the international level, or in Congress, this will signal a limited appetite for fundamental changes and will narrow the universe of potential outcomes over the next four years.

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