A Macdonald-Laurier Institute Publication

True North in
Canadian public policy

Straight Talk

August 2017

Straight Talk: Christopher Sands

For the latest edition of MLI's *Straight Talk* Q & As, the Macdonald-Laurier Institute spoke with Christopher Sands, Senior Research Professor and Director of the Center for Canadian Studies at the Johns Hopkins University School of Advanced International Studies and a member of MLI's Research Advisory Board. We discuss the latest developments in the NAFTA trade negotiations and how negotiators could proceed on issues of trade liberalization, regulatory harmonization, labour mobility, and dispute resolution.

Christopher Sands is Senior Research Professor and Director of the Center for Canadian Studies at Johns Hopkins University's Paul H. Nitze School of Advanced International Studies (SAIS). Before joining the SAIS faculty in 2009, Dr. Sands taught in the School of Public Affairs and the School of International Service at American University, and from 2012 until 2017, Dr. Sands was the G. Robert Ross Distinguished Visiting Professor of Canada-US. Business and Economic Relations in the College of Business and Economics at Western Washington University, where he taught courses in the undergraduate economics and MBA programs. In preparation for his academic career, he worked for more than twenty years in Washington DC think tanks, including the Center for Strategic and International Studies (CSIS) and the Hudson Institute.

MLI: We've seen the Trump administration's list of objectives for the upcoming NAFTA (North American Free Trade Agreement) negotiations. Which do you think are the most important for Canada's interests?

Sands: Well, at some level, all of the negotiated objectives are important because they reflect congressional priorities. In the US, trade negotiation is always a careful balance between Congress, which has authority not only over trade under the constitution, but also implementing legislation that gives effect to US agreements. And so, they're pretty important partners. What the Trump administration has done is to make sure leaders on Capitol Hill – both Republicans and some Democrats – can see their priorities reflected in the NAFTA 2.0 agenda.

Now, how many of those will end up in the final agreement? It's hard to say. There are clearly some priorities that rank higher than others. For the administration, I think the bottom line is that the agreement *looks* good. And that requires two things. First, some tangible improvement over what people perceive the old NAFTA did, such as an elevation in the rule of origin, advancing "buy American" for certain infrastructure projects, and maybe a gradual movement towards a trade balance that favours the US. Second, Trump has to get it through the Congress. For that reason, he's giving deference to congressional priorities.

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MLI: Do you spot anything that will be of particular concern for Canadian negotiators?

Sands: Some of the things that the Trump administration has embraced were in the agenda of the Trans-Pacific Partnership (TPP). From the US point of view, that agreement is now defunct. But they're not surprises to the Canadians. Whether it's about supply management, softwood lumber, or intellectual property rights, all these things go back to longstanding conversations between Canada and the US. Liberalizing in these areas would be good for Canadian consumers, although people who receive subsidies or protection now might not like it so much.

At the same time, some things are going to be very difficult. For example, Canada has long embraced policies that promoted Canadian content, whether in culture or in automotive products, while the US made getting rid of Canadian content a priority. For that reason, in the Canada-US Free Trade Agreement, we replaced "Canadian content" with a notion of "North American content" that included Canada and the US. When NAFTA came around, we made it Canada and the US plus Mexico. The rule of origin was established for figuring out the threshold limits for a good to qualify as originating under the terms of NAFTA in order to get carefree treatment. That was a US priority.

Now, the US appears to be turning 180 degrees and saying, "Wait, we want 'buy American' back again." Of course, Canadians saw "buy American" provisions in the stimulus legislation during the Obama administration. It's not the first time this has been raised since NAFTA. But it suggests maybe a formal codification of this provision is returning. And, if the US insists on "buy American," then certainly Canadians may want to go back to some "buy Canadian" or "Canadian content" provisions. I'm hoping there's some way to acknowledge the US priority without completely liberalizing government procurement and national content – perhaps by establishing a threshold of "buy American" at 50 per cent and "buy Canadian" at 50 per cent, but not higher.

MLI: And what about contentious issue of a dispute resolution mechanism?

Sands: I think Canadian negotiators are really concerned about dispute settlement. Canada fought hard to ensure a dispute process that wasn't in an American court. They wanted a binational panel process. That process was developed for the Canada-US Free Trade Agreement under chapter 18, eventually becoming chapter 19 in NAFTA, which allowed us to create an ad hoc, binationally appointed panel to hear a case and disband after the case was completed. In theory, those cases have no precedential value – they are only decided on the merits in question.

That process has been with us now for some time. Arguably, the WTO dispute settlement process established just two years after NAFTA contained many of the same elements. But they also allowed for a permanent set of judges. This addresses a concern that trade lawyers who might normally sue governments and defend industries would be selected for panels where they'll somehow represent the interests of the governments. Can we really expect them to be impartial or take the broader interests of the national economies if they do so?

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It's also related to concerns over another dispute resolution mechanism, which is the chapter 11 mechanism in NAFTA on investor-state dispute. So, if an investor feels they haven't received national treatment or fair treatment, they can directly sue a government. Canada has been sued in recent years, most notably by Eli Lilly on Canada's treatment of its patents for pharmaceutical drugs. Canada may have won that case, but critics have been concerned that this threat of an investor suing a government will have a chilling effect on its ability to regulate in the public interest. I think both of these together may become an important agenda item in the NAFTA 2.0 talks.

I think most Canadians would begin with the position that they don't want to give up dispute resolution for nothing. But, if there is a system that could be substituted, that may be an acceptable way to improve on NAFTA. So, for example, many investors have chosen not to use NAFTA chapter 11 to challenge the US government, and instead opt for an Article III court under the Treasury Department's investment review. This allows foreign investors to have standing to bring a case to challenge their treatment. That permanent national court handles hundreds of cases a year, thousands overall, and has been seen by foreign investors to be a fairly good body.

That process might be substituted for chapter 11. In the same way, you could see a process that granted standing to firms to bring a case in the US Court of International Trade or in front of the Canadian International Trade Tribunal. This would put the sovereignty of each domestic system firmly at the centre of dispute resolution and would also mean that the panelists – and in this case, judges – would be accountable to legislatures. So, in the case that you had a widely unpopular decision, elected officials would have the ability to sanction, remove a judge, or change the way the court operates. That addresses some of the concern over chapter 11.

MLI: The Canadian government hasn't publicized its own objectives, although Foreign Minister Chrystia Freeland elaborated some priorities in a speech in Ottawa on August 14. What do you see being high on the Canadian agenda?

Sands: The US publication of objectives was mandated by Congress in the interest of transparency. In 2015, when the Congress was debating giving trade promotion authority to the Obama administration, Republicans and many Democrats didn't fully trust the Obama administration's interest in trade liberalization. President Obama had campaigned as a critic of NAFTA and trade liberalization more generally, only to discover in his second term an interest in the TPP and the Transatlantic Trade and Investment Partnership with the European Union (EU). As a result, they wrote a trade promotion authority with conditions that demanded some transparency and additional congressional oversight.

Admittedly, I was convinced that the Trump administration would seek its own trade promotion authority legislation from Congress. It appears, however, that the White House has decided they wouldn't get more lenient terms, potentially even more restrictions. This creates a new dynamic that may make a final NAFTA 2.0 deal difficult, or even plain impossible because of the airing of so many trade negotiation drafts and trace positions.

"I think that we have some idea of what the Canadian negotiating position broadly will be – to preserve as much of the status quo as possible."

In that sense, Canada is being quite traditional, being open to talk but not putting its cards on the table too soon. I think that we have some idea of what the Canadian negotiating position broadly will be – to preserve as much of the status quo as possible. NAFTA was never as controversial in Canada as it was in the United States. Moreover, it was never as controversial as the Canada-US Free Trade Agreement was in Canada. And, in the years since NAFTA, the Canadian economy has done quite well, not just in the energy sector but also in manufacturing, agriculture, etc. The integration of the two economies has generally been seen as positive for Canada.

A few things Canada had wanted could end up as part of this negotiation. Certainly, some in the softwood lumber sector have seen NAFTA negotiations as providing a potential way of resolving softwood disputes over the long-term. We never dealt with softwood in the context of Canada-US Free Trade or NAFTA. If it was folded into a NAFTA 2.0, there could be a settlement that wouldn't have to be renewed every 10 years, like in the past. Not only that, it might be more favourable since Canada could make concessions in other areas (even if other industries might not like that very much).

Another area is labour mobility. On the face of it, this seems very difficult because of President Trump's harsh rhetoric on immigration and Mexico. But, as the US and Canada's economies both evolve, it's important to be able to move people and information fluidly across the border. One possibility is a conversion of the NAFTA visa program from a set list of professions that are covered to one open to any worker with a willing employer on the other side of the border. The NAFTA visa is a fairly generous grant of work permission, since it provides the right to work for an individual for up to three years, is extended to domestic partners, and is reciprocal. A more open, flexible approach would be better suited to the needs of our economy.

Canada should also explore a creative upgrade to the way in which we handle regulation. The NAFTA agreement originally anticipated 12 working groups that were sectorial in nature, with officials at the federal level from Canada, Mexico and the United States working towards common standards, common guidelines for products, etc. But NAFTA working groups largely failed. During the George W. Bush administration, a second process – the Security and Prosperity Partnership for North America – was intended to advance this agenda. It made some progress but also largely failed. President Obama had

launched a series of dual bilateral discussions with Canada and Mexico on separate but parallel tracks, starting with the issue of regulatory cooperation. But, once again, a lot more work needs to be done.

Governments should seriously consider an agreement on the mutual recognition of the functional equivalency of our domestic regulatory system. Simply put, we don't need to converge on one standard or adopt each other's standards. We simply need to recognize that both standards, while slightly different, have the same goal: public health and safety and an efficient operation of the economy. This is something that Australia and New Zealand did with the Trans-Tasman Agreement.

I'm not sure Canada or the US could do this with Mexico, which has a different regularly system and one not quite at the same level. But I think that Canada and the United States would be able to do this much more quickly, perhaps setting a pattern that Mexico could work toward achieving.

There are obviously going to be some areas where we simply disagree, that we feel the other country's standards are just not up to scratch. And in most cases, we would put them on a negative list without mutual recognition, and then put our government negotiators to work to see if we can narrow the gaps or resolve the issue.

"For Mexico, however, the challenge won't be the standard per se, but rather the inspection and verification of meeting those standards."

MLI: Do you envision such a list for the Canadian and the US regulations or are you speaking more of Mexico in that case?

Sands: Canada and the US have a few areas where we would simply disagree. But we can narrow that. I think for Mexico, the gaps are much larger. But we might do something like the inverse, where we would recognize agreement for certain sectors. A good example is the highly integrated automotive industry, where all three countries largely have the same standards. For Mexico, however, the challenge won't be the standard per se, but rather the inspection and verification of meeting those standards. We can work towards that. That's a gap that can be overcome with some goodwill.

MLI: Do you think there's interest in regulatory harmonization in the Canadian government? How do you think Ottawa would handle those politics domestically?

Sands: There has been a lot of pushback from activists against this kind of idea, which has made the current process so slow. By trying to converge standards at a new level, critics say, "Oh, you're going to take us to a race to the bottom, you're going to lower the standards." Part of the benefit of mutual recognition is that domestic standards stay in place, we simply recognize they're functionally equivalent. If the US is doing something that Canadians don't like, they simply withdraw mutual recognition in those areas until the US gets its act together. Many standards are set by the states or by the provinces, so we could have some of that give-and-take. But the important thing is that the standards remain accountable to elected officials.

Indeed, rather than resulting in a race to the bottom, gaps that emerge could engender a race to the top – as governments challenge each other to keep up. Canada has an advantage in that the Canadian regulatory and legislative systems are a bit more efficient or at least quicker to act.

But the key is that the accountability is democratic. Most of the regulatory differences that we have were bought and paid for by lobbyists who fought hard to make that regulation work a certain way because it

was beneficial to their firms and sector. That's part of the inefficiency of both of our systems. And we've always found it difficult to make changes or to change regulatory systems because business pushes back.

The benefit of mutual recognition is that you try to create the most benefit for the most people very quickly. Of course, you're going to find a weird twist in the regulatory system clearly benefitting some firms. I hope that that would lead the governments to focus on trying to resolve that. But I'm sure exceptions will persist; for example, the Jones Act that requires shipping between US ports to be done in American flagged vessels – a regulation that has no benefit other than to preserve a handful of American jobs. That being said, within the NAFTA context, I think you just chip away and try to liberalize where you can.

"So long as negotiations proceed without a lot of interference, the more chaotic White House operation wouldn't necessarily be a problem."

MLI: How would you say Canada should approach Congress over NAFTA? And what impact will the personalities at the top have? Trudeau and Trump seem to have a reasonably good relationship. How important is that and do you think it'll continue?

Sands: Well, there are several important dynamics here. Congress has given itself a very big role in the negotiations but they may come to regret that. One of the things we've just watched has been Congressional difficulty in repealing the American Affordable Care Act, commonly known as Obamacare. The Republicans have run for years on trying to repeal and replace this act. But almost every congressman and senator had proponents and opponents of Obamacare in their constituency, which pulled each member in opposite directions. So change became very, very difficult.

NAFTA is much the same. You have people who don't like NAFTA and who don't see themselves benefitting from NAFTA. Then you have most of the business community who feels strongly that NAFTA has been good for them, having invested million of dollars to take advantage of the North American market. That combination may make it very difficult for us to move towards a NAFTA 2.0 agreement. Canada has been smart to cultivate congressional leaders and state leaders, governors, and state legislators. Members of Congress may represent their constituents, but those same constituents are represented by state governors and state legislators who are often a lot closer to their local community. Not only could Congress slow, derail or even reject radical changes from a proposed NAFTA 2.0, but pressure from the states could lead to similar rejection.

I think two things are interesting in this double line of defense. The first is the role of the leadership. Even with the near chaotic drama in the White House, the US Trade Representative's office has been relatively predictable, professional, and I think concrete in what it sets forward, partly guided by the trade promotion authority requirements in the legislation of Congress. That could be the key to having a good negotiation. So long as negotiations proceed without a lot of interference, the more chaotic White House operation wouldn't necessarily be a problem. It's just on closing the deal that the Trudeau-Trump dynamic might come into play.

But it's going to be very difficult to do a dramatic deal, as a lot of interests are aligned against change. Importantly, however, if NAFTA 2.0 comes into being, it creates a potential for an eventual NAFTA 3.0. When we negotiated Canada-US Free Trade and NAFTA, we had the benefit of a Macdonald Commission

that had spent months – years even – generating studies from some of the best academics in the country and a debate about what liberalizing trade would mean for the future of the Canadian economy.

The current negotiation struck everybody a little bit by surprise, except perhaps for Donald Trump. And so, Canadians have approached this in a more defensive way, without necessarily thinking outside the box about potential opportunities. If successfully concluded, the current round of NAFTA 2.0 talks might create some modest changes to the agreement. But some of the potential ideas, including what we've discussed here, may simply be beyond the reach of current negotiations – but they might be on the agenda with a future prime minister or a future president.

"I think it's in our best interests to have a system that can adapt to the needs of the economy that's coming in the next century or so."

To me, that's quite healthy. For years, we kept saying, "Oh, we could never do that because you'd have to reopen NAFTA." And we've now broken through that. The EU never wrote one agreement and said, "Well, that's it, we're just going to leave it the same." It's not like a constitution, it has to adapt. I think it's in our best interests to have a system that can adapt to the needs of the economy that's coming in the next century or so.

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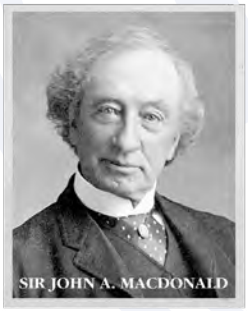
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