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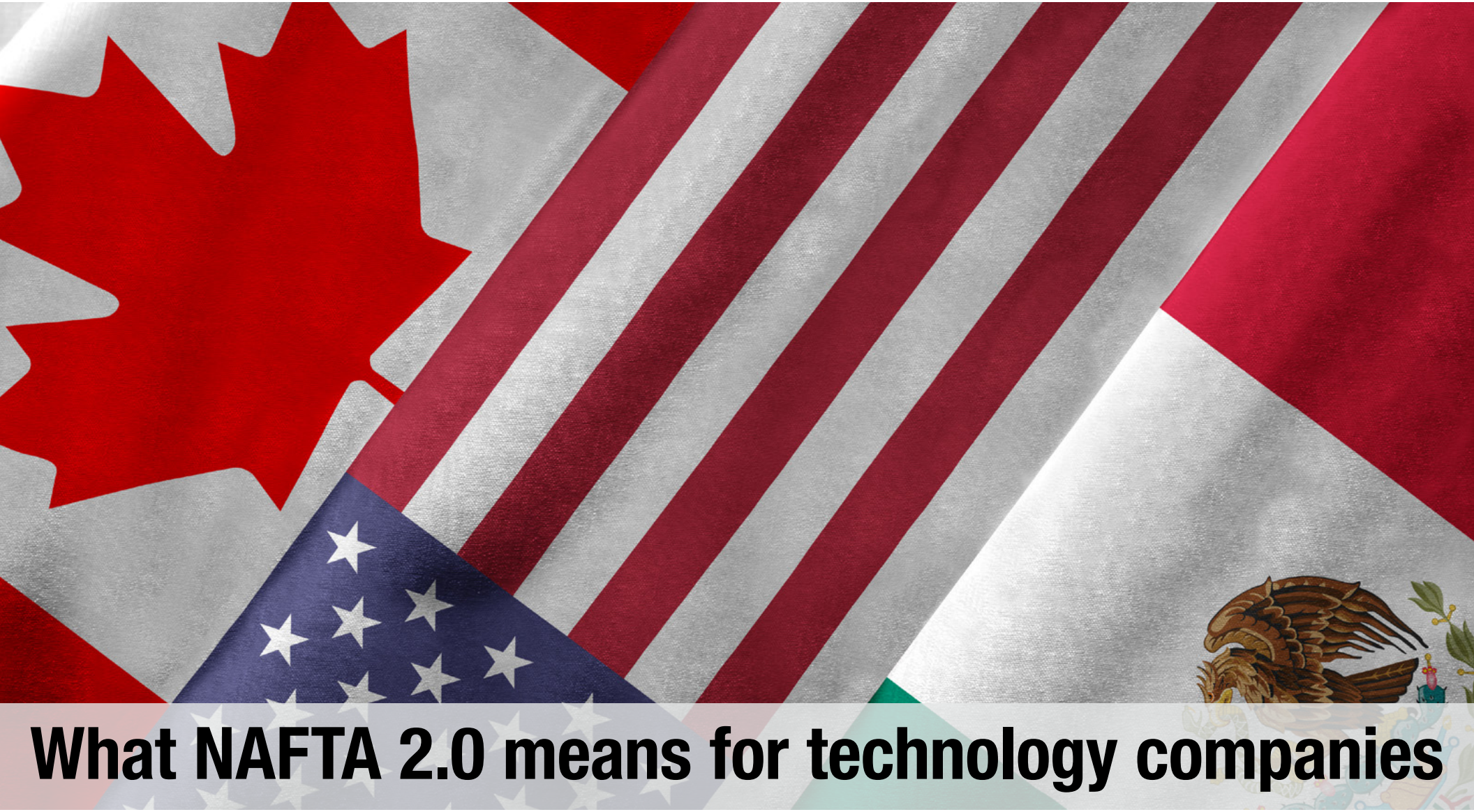

What NAFTA 2.0 means for technology companies

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Renegotiating the North American

Free Trade Agreement (NAFTA) was a major campaign promise of candidate Donald J. Trump in 2016. He blamed NAFTA for the loss of jobs in the U.S. manufacturing sector and argued forcefully for an overhaul of the agreement. “NAFTA is the worst trade deal maybe ever signed anywhere, but certainly ever signed in this country,” he declared during a debate with Hillary Clinton in September 2016.

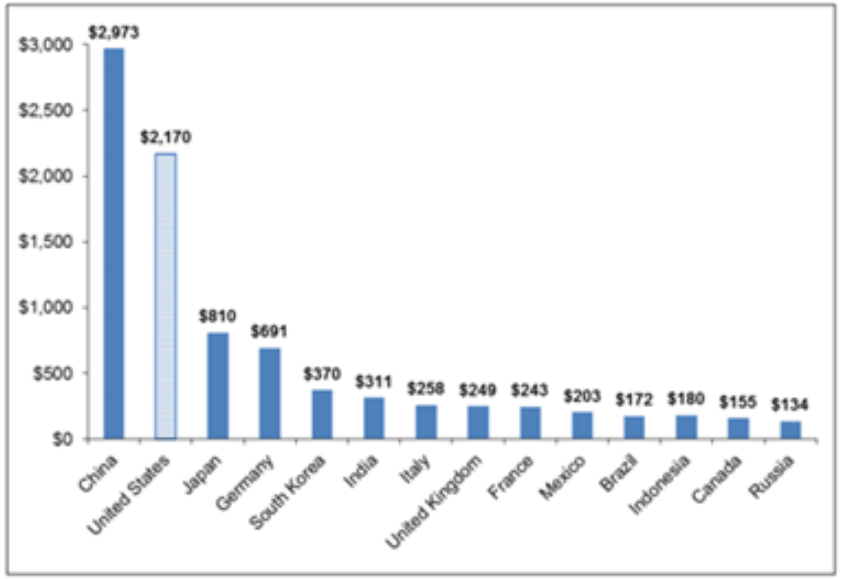
True to his promise, President Trump announced in May his administration’s intention to renegotiate—or if negotiations fail, to withdraw from—NAFTA, which covers one of the world’s largest free trade areas.

The implications of upgrading NAFTA have far-reaching consequences for all sectors of the three national economies and their global supply chains. The U.S. is ranked as the second largest value-added manufacturer in the world, producing $2.2 trillion in 2015, behind only China, which manufactured nearly $3 trillion, according to the United Nations.[1] Canada is the number-one destination for U.S. exports, and Mexico is ranked second. Regarding imports into the U.S., Canada and Mexico are, respectively, the second and third largest sources of goods and services behind China.[2] (See Figure 1 and 2.)

President Trump’s motivation to renegotiate NAFTA centers around concern for the loss of U.S. manufacturing jobs. He’s right: the number of manufacturing workers in the U.S. has shrunk from 17.3 million in 2000 to 12.3 million today, according to the U.S. Bureau of Labor Statistics. However, not all 5 million jobs were lost to low-wage workers in China, Mexico, Bangladesh, and elsewhere. Improvements in technology—factory automation, robotics, and information management—were an important factor in the decline of U.S. manufacturing employment, which in turn has resulted in an improvement in U.S. manufacturing productivity. Adjusted for inflation, U.S. manufacturing output is up slightly since 2000, even with a smaller workforce, according to the Bureau of Labor Statistics.

Figure 1. Leading Countries, Value Added in Manufactring

Billion dollars, 2015



Source: United Nations National Accounts Main Aggregates Database, value added by economic activity, at current prices—U.S. dollars.

While being a contributor to these economic gains, the technology sector and its complex global supply chains have a lot at stake in the NAFTA renegotiation process. That’s because the industry has changed so dramatically in the 23 years since NAFTA came into effect. The internet, wireless technologies, and smartphones were little more than R&D projects. And the likes of Amazon, Apple, Facebook, and Google were years away from emerging as transformational global digital corporations that have so profoundly impacted how we buy, consume, and interact with products and services, both physical and digital.

Negotiating NAFTA 2.0

There are plenty of issues for the technology sector to focus on as NAFTA 2.0 is negotiated. Even subtle changes in the rules may turn out to have long-term sourcing and supply chain implications, with consequences for e-commerce, data privacy, and protection of computer code and intellectual property. So, it's important for everyone from the C-suite to product development teams, production management, and supply chain and procurement professionals to pay attention.

Many of the issues of importance to the tech sector were included in the priorities for reforming NAFTA that the Trump Administration released in July.[3] Beyond the intent to improve the U.S. trade balance, promote greater regulatory compatibility, and maintain existing reciprocal duty-free market access, the Trump administration's tech-specific priorities include:

- Promoting cooperation with NAFTA countries to ensure that goods that meet the **rules of origin** receive NAFTA benefits, prevent duty evasion, and combat customs offenses.
- Securing commitments not to impose **customs duties on digital products** (e.g., software, music, video, e-books).
- Ensuring non-discriminatory treatment of **digital products transmitted electronically** and guarantee that these products will not face government-sanctioned discrimination based on the nationality or territory in which the product is produced.
- Establish rules to ensure that NAFTA countries do not impose measures that **restrict cross-border data flows** and do not require the use or **installation of local computing facilities**.
- Establish rules to prevent governments from mandating the **disclosure of computer source code**.

Interestingly, many of the Trump administration's priorities were part of the Trans-Pacific Partnership (TPP) that the President withdrew from in January, just days after his inauguration. This is the set of rules and guidelines for governing e-commerce and intellectual property and managing cloud-based infrastructure that makes life today possible. Specifically, TPP prohibited restrictions on cross-border data flows and limited the use or installation of local computing facilities. It also prevented governments from mandating the disclosure of computer source codes and levying duties on digital products. *(Continued on page 5.)*

Figure 2. Top Seven US Trading Partners, %

	Imports to the US	Exports from the US
China	18.2	7.3
Canada	11.9	15
Mexico	11.6	11.9
Japan	5.9	4.7
Germany	5.7	3.5
UK	4.1	5.5
South Korea	3	2.8

Source: US Census Bureau, Bureau of Economic Analysis, 2015; CNN Money, December 7, 2016
money.cnn.com/interactive/news/economy/how-us-trade-stacks-up/index.html

1 Marc Levinson, "U.S. Manufacturing in International Perspective," Congressional Research Service, January 18, 2017.
2 "These are America's top trading partners" CNN Money, December 7, 2016, money.cnn.com/interactive/news/economy/how-us-trade-stacks-up/index.html
3 "Summary of Objectives for the NAFTA Renegotiation," Office of the United States Trade Representative, Executive office of the President July 17, 2017.

Timeline for Renegotiating NAFTA

In June 2016, then-candidate Donald J. Trump made a promise to the American people that he would renegotiate NAFTA or take the U.S. out of the agreement.

On May 18, 2017, President Trump provided written notice to Congress that his administration would initiate negotiations to modernize NAFTA.

Written comments were submitted June 12, 2017, and public hearings were held at the U.S. International Trade Commission in Washington, D.C., June 27-29. The Commission received more than 12,000 responses and heard from more than 140 witnesses.

The Trump administration published a detailed summary of its negotiating objectives on July 17, 2017.

Renegotiation of NAFTA involves seven rounds of negotiations that the three parties agreed would be concluded by the end of the year before the Mexican presidential election heats up. So far, four rounds have been conducted, and three remain before the final draft of the revised treaty will be ready for review and approval. However, after some differences of opinion during Round 4, the negotiations are expected to now continue into the first quarter of 2018. Official comments from the four rounds are summarized below:

Round 1, August 16-20, Washington, D.C. "The first round of the negotiation reflects a commitment from all three countries to an ambitious outcome and reaffirms the importance of updating the rules governing the world's largest free trade area," according to a joint release. "While a great deal of effort and negotiation will be required in the coming months, Canada, Mexico, and the United States are committed to an accelerated and comprehensive negotiation process that will upgrade our agreement and establish 21st century standards to the benefit of our citizens."

Round 2: September 1-5, Mexico City. "Important progress was achieved in many disciplines, and the Parties expect more in the coming weeks," according to a joint release. "The Ministers from Mexico, the United States, and Canada reaffirm their commitment to an accelerated and comprehensive negotiation, with the shared goal of concluding the process towards the end of this year."

Round 3: September 23-27, Ottawa. "…discussions were substantively completed in the area of small and medium-sized enterprises (SMEs), effectively concluding negotiations on that chapter pending specific outcomes in related discussions," according to a joint statement. "NAFTA partners continue to be guided by a shared desire to create jobs, economic growth and opportunity for the people of our countries. Canada, the United States, and Mexico remain committed to an accelerated timeline for negotiations."

Round 4, October 17-20, Arlington, Virginia. "Building on the progress made in prior rounds, the United States, Canada, and Mexico have now substantively completed discussions in the Chapter on Competition," according to a joint statement. However, Round 4 brought differences of opinion between the parties regarding a few issues prompting this statement: "New proposals have created challenges, and Ministers discussed the significant conceptual gaps among the Parties. Ministers have called upon all negotiators to explore creative ways to bridge these gaps. To that end, the Parties plan on having a longer inter-sessional period before the next negotiating round to assess all proposals."

Mexico will host the fifth round of talks in Mexico City from Nov. 17-21, 2017. Additional negotiating rounds will be scheduled through the first quarter of 2018." ■

Digital Goods and Data

Adding regulations to accommodate the free trade of digital products, the flow and management of data across international borders and protecting computer source code is new ground for NAFTA, and an area of importance for the technology sector, specifically the likes of Amazon, Apple, Google, and Facebook.

Testimony during the NAFTA public hearings in June from technology industry groups addressed many of these issues, including the Semiconductor Industry Association (SIA), the Computer & Communications Industry Association (CCIA), and the Telecommunications Industry of America (TIA). The majority of comments from these and other organizations were aligned with the Trump administration's stated positions, with some caveats.

"The U.S. semiconductor industry supports the U.S. government's efforts to modernize NAFTA to establish rules in evolving areas but urges caution to preserve the positive elements of the existing agreement," said Falan Yinug, Director of Industry Statistics and Economic Policy, Semiconductor Industry Association (SIA), during the hearings. The SIA is rightly cautious about disruptions in the global balance as semiconductors are America's fourth-ranked export product, and more than 80% of U.S. semiconductors are sold to overseas customers.

Yinug urged the U.S. Trade Representative to:

- Ensure access to global markets for **innovative encryption products**.
- Strengthen safeguards and increase penalties to **protect trade secrets** and other forms of IP.
- **Prevent forced localization of digital infrastructure** and technology transfer.

Matt Schruers, vice president of CCIA, which owns the Consumer Electronics Show (CES), focused his testimony on the challenges to digital trade, the importance of protecting online intermediaries, maintaining a balanced system of copyrights, and protecting technology innovators.

Schruers recommended mandating prohibitions on local infrastructure, local residency of data, and duties on digital transmissions, which either directly or indirectly constrain digital trade. He also raised the issue of ensuring copyright protection, specifically protection for technology innovators under Section 107 of the Copyright Act.

"That's our fair-use provision," Schruers said. "That protection has enabled everything from the VCR to the MP3 player, to search, to cloud computing, to innovative new forms of machine-learning today."

Kathleen Swanson, director of global policy at the Telecommunications Industry of America, which represents 250 manufacturers and suppliers of telecommunication networks and services in the U.S., testified that at the top of the TIA's list of new provisions is the free cross-border transfer of data and a ban on forced localization of infrastructure, which align with the Trump agenda. These issues are a big deal to TIA given that in 2017 North America will have almost as much IP traffic as all of Asia Pacific, Japan, and China combined, according to the global IP forecast from Cisco Visual Networks, said Swanson.

Swanson recommended codifying the APEC Cross-Border Privacy Rules System (CBPRS) into NAFTA, which the U.S., Canada, and Mexico all support. "This system serves to align high standards [in] privacy frameworks in all three countries so data can move easily across borders once privacy protection is certified," she said. "Actions here could set an especially meaningful precedent given North America's outsized global footprint in data traffic."

Rocky Road Ahead?

None of these issues have been red flags in the first four rounds of NAFTA negotiations. The most contentious and problematic issue so far has been the rules of origin. These rules apply to many industries in varying forms including automobiles, electronics, and textiles. Electronics includes computers, telecommunications equipment, televisions, machine tools, and semiconductors.[4]

In the automotive industry, for example, rules of origin determine the percent of the car that is manufactured in North American. The current NAFTA rules dictate that 62.5% of an automobile's parts be made in North America to avoid border taxes, regardless of whether the parts are made in Canada, Mexico or the U.S. The makes NAFTA's regional-content requirement for autos the highest of any of the 12 free-trade agreements that the U.S. currently has, according to the American Automotive Policy Council (AAPC).[5]

During Round 4 of negotiations in mid-October, the U.S. Trade Representative Robert Lighthizer proposed raising the threshold of rules of origin for autos to 85%, of which half of the parts that come from North America must originate in the U.S. Lighthizer proposed to incentivize manufacturing companies—automakers and their supply chain partners—to build factories and create more manufacturing jobs in the U.S. This change means that by adding a unique rule for U.S.-only manufacturing content, there would no longer be a common rule for all three trading partners.

Canada's Foreign Minister Chrystia Freeland pushed back saying the proposal would "turn back the clock on 23 years of predictability, openness, and collaboration."

Another contentious issue raised by the U.S. in Round 4 was the suggestion that the trade agreement should require renewal every five years. Both Canada and Mexico opposed the five-year provision, known as a sunset clause, arguing that it would create uncertainty about the long-term commitment of the parties and perhaps undermine the trade agreement.

U.S. auto manufacturers tend to agree, according to Matt Blunt, president of AAPC, who gave testimony at the NAFTA hearings in June. AAPC counts Fiat Chrysler, Ford, and General Motors as members. "The current rules of origin strike the right balance," Blunt said. "It discourages free riders who might use NAFTA as a conduit for outsourcing while allowing those who have invested in the region to enjoy the agreement's duty-free benefits."

"Some may claim that the NAFTA rules of origin encourage the use of imported auto parts from non-NAFTA countries such as China. This is just not the case," said Blunt. "In fact, based on the dollar value of total auto parts consumption, less than 6% of the auto parts consumed in the United States and Mexico are imported from China. We encourage the administration to examine all aspects of the automotive supply chain before accepting these kinds of claims and making any changes to the NAFTA rule of origin."

The contentiousness of the U.S. proposal to change the auto rules of origin has effectively extended the timeline for negotiations beyond the end of 2017 and into the first quarter of 2018. Mexico had requested the trade negotiations conclude by the end of the year to accommodate the country's presidential election, which begins in earnest after the New Year. That now looks unlikely.

For now, though, all three countries have publicly stated they are committed to continuing the negotiations.

RECOMMENDATIONS

- Pay close attention to the next three rounds of NAFTA negotiations. The discord at the conclusion of Round 4 may spill over into subsequent rounds.
- Start to prepare the business for the possible inclusion of the priorities the Trump administration has proposed.
- Communicate with supply chain partners internationally to discuss the progress being made in the NAFTA renegotiation and develop a list of likely scenarios and a coordinated plan of action to adapt to the new NAFTA.

4 Electronic Products, Rules of Origin, U.S. Customs and Border Protection www.cbp.gov/trade/nafta/guide-customs-procedures/provisions-specific-sectors/electronic-products#
5 Don Lee, "Trump's push for American-made could disrupt NAFTA supply chains and raise consumer prices," *LA Times*, February 28, 2017.

By Bruce Rayner, Contributing Editor

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