

# The Rise of Populist Nationalism and the Renegotiation of NAFTA

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## ABSTRACT

Countries that have traditionally led the way in promoting economic globalization and its institutions have seen a recent surge of populism and nationalism, calling into question the liberal international economic order. The rhetoric of these critics is often vague, however, and it is unclear what a populist or nationalist approach to international economic policy would look like. The North American Free Trade Agreement (NAFTA) renegotiation initiated by the Trump administration could give us the first clues. Will their proposals destroy the trading system as we know it, or merely tweak it? This article examines these issues by discussing the concepts of nationalism and sovereignty, and then viewing the Trump administration's specific NAFTA proposals through those lenses.

## Issue Section:

Original Article

## I. INTRODUCTION

An historic referendum in the UK, the rise of nationalist sentiment in Eastern Europe, a near victory for the far right in France, and the 'populist'<sup>1</sup> rise of Donald Trump in the USA were events that defined 2016. This new wave of populism has presented a serious challenge to the post-war liberal international economic order.<sup>2</sup> One way this has manifested itself is in calls to reopen old agreements and re-evaluate the role of international institutions. A prominent example is the North American Free Trade Agreement (NAFTA). The 2016 US presidential campaign brought renewed focus to NAFTA, with candidate Donald Trump calling it 'the worst trade deal maybe ever signed, anywhere'.<sup>3</sup> He repeatedly blamed NAFTA for the loss of manufacturing jobs in the USA and promised to renegotiate the treaty, or even withdraw completely if the terms of the new deal were not to his liking.

Beyond NAFTA, the Trump administration has put forward a number of statements in support of a more closed and aggressive trade policy. The administration's arguments can be grouped into two categories: economic and institutional. Trump and his advisers claim that, first, the USA is

being taken advantage of economically by other countries through ‘unfair’ trade deals; and as a corollary, since non-Americans cannot be trusted, multilateral institutions put the USA at a disadvantage. The concept of national sovereignty is central to these arguments and heavily influences their proposals.

Can any workable international system be constructed in this context? Is there a feasible ‘populist’ trading system? Utilizing NAFTA as a case study, we explore the possibilities and limitations for completing a 21st century trade agreement in the context of the recent surge of nationalism, and in particular, the rhetoric and proposals from both Trump and his top trade advisers. The NAFTA renegotiation process began in August 2017, and has been fraught with challenges and uncertainty, in large part because of the Trump administration’s approach.

Regardless of the ultimate outcome, however, the NAFTA renegotiation presents a unique opportunity to examine the proposals put forward by the populists when they are given a chance to govern, and see what their nationalist worldview might look like in practice. While a full application of nationalism to trade policy would lead to economic isolationism and a deterioration of international relations, the proposals put forward so far are more limited and nuanced. The Trump administration has raised a number of foundational questions about NAFTA in particular, and the trading system in general, some of which are worth considering. At the same time, there is the risk that this approach could backfire and lead to NAFTA’s demise.

Ultimately, we conclude that there are a number of important lessons to be learned from the populist–nationalist turn in US trade policy. First, a strict emphasis on sovereignty erosion and returning power back to national governments severely limits the potential for a true upgrade of the NAFTA and a workable model for trade agreements. Second, what the Trump administration manages to do with NAFTA should be closely followed by other trading partners, because the same principles will eventually be applied to them as well. This goes not only for bilaterals, but the multilateral system as well. And finally, while the nationalist worldview is at odds with the current realities of global commerce, it nevertheless reveals some potential weaknesses in current agreements, which could be improved to foster greater legitimacy and support from the public.

The article proceeds as follows: first, we provide an overview of the nationalist view of trade rules and trade institutions as expressed by the Trump administration; second, we explain the central role of sovereignty in this line of argument; third, we explore NAFTA as a test case for Trump’s populist trade policy, and evaluate recent proposals to reform the agreement; and we conclude with implications of the rise of nationalism for future trade liberalization.

## **II. THE NATIONALIST VIEW OF TRADE RULES AND TRADE INSTITUTIONS**

Since taking office in January 2017, the Trump administration seems to be pushing for a more closed and aggressive trade policy (although how much of the talk will be converted into actual policy is unclear). There are two aspects to the administration’s case for change, economic and institutional. There are two key premises on which these arguments are based: first, that the USA is being taken advantage of by other countries; and as a corollary, since others cannot be trusted,

multilateral institutions serve to put the USA at a disadvantage. We examine each of these in turn.

The main thrust of the economic argument is centered on a zero-sum view of international trade, where any country's win is considered another's loss. The trade deficit is the scorecard they use to measure this, which is why the administration has identified lowering the trade deficit as one of its main priorities, even though economists generally agree that a trade deficit is not the proper metric by which to gauge a country's economic performance.<sup>4</sup> Regardless, Trump and his top advisers believe it. US Trade Representative, Robert Lighthizer, commented that '[o]ne can argue that too much emphasis can be put on specific bilateral deficits, but I think it is reasonable to ask, when faced with decades of large deficits globally and with most countries in the world, whether the rules of trade are causing part of the problem.'<sup>5</sup> In a trip to Vietnam in November 2017, President Trump also noted that the 'trade imbalance is not acceptable'.<sup>6</sup>

The themes that emerge from this kind of rhetoric are that a trade imbalance equals losses, and that these losses are a result of other countries cheating or gaming the system. In response, Commerce Secretary Wilbur Ross announced early on that the administration would study violations and abuses of US trade agreements by US trading partners, particularly in relation to the trade deficit.<sup>7</sup> He lamented the US commitment to low most favoured nation (MFN) tariffs through multiple rounds of multilateral liberalization, while criticizing countries such as Mexico that have higher average bound rates. He also argued that the USA is the least protectionist country in the world, and that being so open puts it at a disadvantage.<sup>8</sup>

A better way to think about whether trade commitments are balanced is, as Doug Irwin describes,<sup>9</sup> to look at the structure of trade agreement rules, rather than the trade balance. Looked at in this way, the picture is quite different. US tariffs are relatively low, but not much different than those of other developed countries.<sup>10</sup> As for Mexico, NAFTA brings virtually all US and Mexican tariffs to zero for trade between the two countries. There are some structural imbalances with a few countries, of course, and complaining that Korean or Chinese tariffs, for example, are higher than corresponding US tariffs makes sense. But a situation where all tariffs between two countries are zero, and a bilateral trade deficit exists, is not something to worry about. There is a long tradition of asking for reciprocity in trade relations, but it must be about structural reciprocity as opposed to trade balance reciprocity. Addressing other countries' trade barriers is fine, but attacking trade deficits misunderstands the issues.<sup>11</sup>

This mistrust of other countries in trade negotiations due to trade outcomes naturally leads to the second key argument from the trade nationalists, that the rules of the game are stacked against the USA. In a speech at the United Nations General Assembly, President Trump remarked:

For too long, the American people were told that mammoth multinational trade deals, unaccountable international tribunals, and powerful global bureaucracies were the best way to promote their success. But as those promises flowed, millions of jobs vanished and thousands of factories disappeared. Others gamed the system and broke the rules.<sup>12</sup>

This sentiment has translated into a general dislike for multilateral and megaregional agreements, and a preference for bilateral deals. In fact, similar arguments were used to explain why

President Trump withdrew the USA from the Trans Pacific Partnership (TPP),<sup>13</sup> a 12-country trade agreement that would have made up 40% of global economic output; and in the criticism of NAFTA, there were also early suggestions that the USA might seek to negotiate two separate bilaterals with Canada and Mexico.<sup>14</sup>

Along with arguing for greater leverage through increased use of the US asymmetrical power, the Trump administration has ramped up its criticism of the World Trade Organization (WTO) as the culprit for its domestic economic woes (real or imagined). Though such leverage is regularly used by the USA in other areas, such as global financial governance,<sup>15</sup> the WTO has long been regarded as a forum where the rules apply evenly.<sup>16</sup> Ambassador Lighthizer argued that the WTO's dispute settlement mechanism has been unfair to the USA, and has called for a return to General Agreement on Tariffs and Trade (GATT)-style nonbinding dispute settlement, in which countries have the power to disregard findings of violation, giving more powerful countries the upper hand.<sup>17</sup> However, evidence has shown that WTO dispute settlement is not biased against the USA. For example, before WTO panels, the US wins on 78% of its claims when it is a complainant, and 36% as a respondent (the figures for other members are 69% and 35%, respectively).<sup>18</sup> In appeals, the USA has also succeeded in having the Appellate Body overrule panel decisions for 35% of its cases. Despite this, however, Trump has claimed that, 'we have not been treated fairly by the World Trade Organization'.<sup>19</sup>

Though a great deal of this negativity toward the WTO may be aimed at the adjustment from the accession of China to the organization in 2001,<sup>20</sup> as well as US losses in trade remedy disputes, the problem has been diagnosed by the administration as a systemic one. To that end, proposals for reform have either come in the form of suggestions for a complete overhaul of the dispute settlement system, as noted above, or in increasing penalties on countries that do not abide by basic reporting requirements.<sup>21</sup>

In criticizing the WTO, Trump has also stated that 'the WTO can only function properly when all members follow the rules and respect the sovereign rights of every member.'<sup>22</sup> That sovereignty, he has suggested, is further eroded by the makeup of the institution itself. For instance, Trump argued that the reason the USA was losing so many disputes at the WTO was because of the lack of US panelists: 'And I say to my people, you tell them, like as an example, we lose the lawsuits, almost all of the lawsuits in the WTO – within the WTO. Because we have fewer judges than other countries. It's set up as you can't win. In other words, the panels are set up so that we don't have majorities. It was set up for the benefit of taking advantage of the United States.'<sup>23</sup>

The crux of the argument in support of less engagement and increased enforcement (or penalties for derogation) at the multilateral level is essentially based on a fear of a loss of sovereignty and suspicion toward foreigners. Consequently, key advisors,<sup>24</sup> and the Trump administration more generally, have embraced the idea that 'globalism' is to blame for the erosion of US power in economic affairs, and ultimately the plight of the American worker who has lost out to foreign competition.<sup>25</sup>

In the next section, we unpack the claims for the purported loss of sovereignty that is driving the various trade policy proposals put forward by the Trump administration.

### III. THE ROLE OF SOVEREIGNTY IN NATIONAL AND GLOBAL AFFAIRS

In an October 2016 speech, British Prime Minister Theresa May stirred controversy when she said: ‘if you believe you’re a citizen of the world, you’re a citizen of nowhere. You don’t understand what the very word ‘citizenship’ means.’<sup>26</sup> Though her statement was undoubtedly provocative, the underlying message is nothing new. In fact, arguments for a connection between national identity and the state have long been a feature of modernity,<sup>27</sup> and find resonance in the concept of the nation–state. A nation can be defined in either a primordialist or constructivist sense, with the former focusing on ethno–linguistic and cultural similarities, and the latter on a shared sense of belonging.<sup>28</sup> For example, Anderson described the nation as an imagined community, in which no single individual could know all the members of the community, yet felt connected to everyone nevertheless.<sup>29</sup> He described such a community as having finite, if elastic, boundaries, a shared sense of comradeship, and as being sovereign in the sense that there is no larger authority that could define it.<sup>30</sup>

In international affairs, the state is largely considered to be the primary organizing unit, characterized above all by the principle of sovereignty. Although there is substantial debate on the origins of state sovereignty,<sup>31</sup> many point to the Peace of Westphalia in 1648, which marked the end of the 30 Years War, as the origin of the modern concept of sovereignty where states practice noninterference in the affairs of other states. This builds on the Weberian concept of sovereignty, under which the state has exclusive control over its territory, through a monopoly on the legitimate use of force.<sup>32</sup> Stephen Krasner describes Weberian sovereignty as *domestic sovereignty* and argues that it ‘refers to the formal organization of political authority within the state and the ability of public authorities to exercise effective control within the borders of their own policy’.<sup>33</sup> He contrasts this with Westphalian sovereignty, which is marked by a recognition of authority and legitimacy that is ‘extended to territorial entities that have formal juridical independence’ and ‘the exclusion of external actors, whether de facto or de jure, from the territory of the state’.<sup>34</sup> Thus, while domestic sovereignty ‘involves both authority and control,’ the key principles of Westphalian sovereignty are ‘authority and legitimacy, but not control’.<sup>35</sup> It is the latter concept of sovereignty that is utilized to describe the rights of states in international affairs. As organizing units, states are recognized to have both authority and legitimacy, which is respected through the practice of noninterference by other states in its domestic affairs.

While it is true that states have become more interdependent since 1648, and it may appear that there is some degree of interference in domestic affairs by other states, we are nowhere near a Kantian world government,<sup>36</sup> and the state still remains a central actor on the world stage. Even in the European Union, the most highly integrated economic space, where its Members States have delegated power to the European Commission (its supranational executive), the individual countries still retain a great deal of control over their domestic affairs.<sup>37</sup> This is true across all major economic areas, for example, in global regulatory affairs, and also for international institutions whose decisions often rely on domestic implementation and voluntary compliance, with limited possibilities for international enforcement.<sup>38</sup> Nevertheless, a more connected world,

some argue, has led to the erosion of the state's ability to control its own domestic affairs in some spheres.<sup>39</sup>

An area in which this may be most visible is international commerce. Richard Baldwin describes the process of globalization as marked by two instances of 'unbundling'.<sup>40</sup> The first unbundling occurred in the 1820s, as lower trade costs gave people access to a variety of products from more distant places. This fostered the growth of production clusters, and what Baldwin terms the 'old globalization'. The second, and more significant unbundling, occurred in the 1990s with the Internet and communication technology revolution, which lowered the cost of moving knowledge across vast distances, prompting the growth of multinational supply chains.

International trade could not have flourished, however, without the establishment of international institutions to ensure the predictability and stability of these transactions.<sup>41</sup> The GATT and its successor, the WTO, as well as the numerous preferential trade agreements countries have signed, have served this role. To enforce these rules, there are dispute provisions in the agreements, which establish judicial bodies to resolve complaints. While some would argue that the WTO dispute settlement system has exercised a high degree of judicial economy, with the Appellate Body limiting its interpretation of the agreements strictly to what the treaties outline without participating in judicial activism,<sup>42</sup> others have noted that the WTO regularly hands down rulings that fundamentally challenge domestic regulation, and thus undermine another fundamental aspect of state sovereignty, formulating laws.<sup>43</sup>

On the other hand, it may be that institutions have done less to erode sovereignty than transnational advocacy networks, which in the realm of regulatory politics have collaborated on setting global or regional standards.<sup>44</sup> For instance, Egan describes the emergence of regulatory convergence at the European level, and explains that one of the strongest drivers was the European Roundtable of Industrialists that lobbied for greater convergence and market opening in the 1980s.<sup>45</sup> This phenomenon is not limited to trade in goods, however. Others have noted the growth of 'citizen lobbying' on a host of social and environmental issues, as well as the diffusion of other activists networks such as NGOs and private foundations.<sup>46</sup>

Conventional notions of the state have thus been regularly challenged, and at times, transcended. This is one reason why Ruggie argues that there is a postmodern understanding of the state we must take into account, because the key agents are not necessarily national governments.<sup>47</sup> The rules based order, though largely founded by the USA, has in many ways taken on a life of its own.<sup>48</sup> This system of 'global governance' has led some to suggest that the process of globalization has gone too far, and they have argued for scaling back the power of these institutions and bringing more power back to the state.<sup>49</sup>

At the same time, the reality of global power may be much less exciting than some of the critics and supporters believe. The institutions themselves have little power. Actions they take are usually initiated and controlled by states.<sup>50</sup> There is no global or supranational government, but rather weak international governance in a handful of areas where states have agreed to act together.<sup>51</sup> In addition, if a particular state decides to opt out of the system, it actually lessens its own power, as it can no longer shape the system and the rest of the world moves on without it.

In the next section, we examine how the Trump administration's nationalist worldview and fear of a loss of sovereignty is having an impact on US trade policy. We utilize the ongoing NAFTA renegotiations as a framework for examining how the administration is translating its vision into policy. Through this exercise, it becomes clear that even the most unconventional proposals from the administration (referred to by some as 'poison pills') make sense when considered in the context of the above described worldview.

#### **IV. THE NAFTA RENEGOTIATION: A TEST CASE FOR POPULIST TRADE POLICY**

There has been no shortage of nationalist rhetoric from the Trump administration, but what will it mean in practice? For trade agreements, the administration has chosen the NAFTA as its first forum to experiment with constructing new international rules. In this context, it has proposed a number of sovereignty-enhancing changes, falling into both the economic and institutional categories. In this section, we consider how each proposal fits within this framework, in the sense of how the proposals aim to transfer power back to the national level from the international level. We examine the impact of these proposals on both economic and institutional sovereignty.

##### **A. Economic sovereignty**

###### **1. Rules of origin**

Rules of origin (RoO) are used to determine whether a product originates in an FTA partner, and whether it, therefore, qualifies for preferential tariff treatment. Rules of origin requirements are set out in Chapter 4 of the NAFTA, with additional details on product-specific rules in Annex 401. NAFTA applies rules of origin based on three different calculation methods: a tariff shift, where a product undergoes a change in tariff classification; or regional value content, which calculates regional value by subtracting all nonoriginating inputs (which also requires a minimum percentage of local value added for certain products); or a combination of both.

Under the tariff shift rule, a product needs to undergo some form of *substantial transformation* in the country it is coming from in order to be considered originating. NAFTA RoO are particularly restrictive because they often require a change of heading and a change in chapter to qualify for preferential treatment.<sup>52</sup> In fact, 30% of NAFTA tariff lines require a change in chapter to qualify for NAFTA preferences.<sup>53</sup>

Determining origin with regional value content utilizes two methodologies—the transaction value method or the net cost method.<sup>54</sup> Both are considered to be relatively strict methodologies to qualify for originating status. In fact, a study by Estevadeordal found that NAFTA has some of the strictest RoO requirements of any trade agreement.<sup>55</sup> The requirements are so stringent that in many cases companies will choose not to even bother figuring out how to qualify for NAFTA preferences and will opt to pay the MFN duty instead.<sup>56</sup>

In addition to transformation and regional value content rules, there are often *de minimis* requirements for specific products as well.<sup>57</sup> For example, NAFTA includes yarn forward and fiber-forward provisions that require use of North American yarns and fibers in the textile industry.<sup>58</sup> In addition, automobiles require at least 62.5% NAFTA originating components.

Despite the strictness of the existing NAFTA rules in this area, the Trump administration would like to strengthen them further. In the auto sector, it has proposed increasing the regional value requirement to 85%, along with an unprecedented request that 50% of the content be of US origin. These proposals, particularly the latter one, have been met with skepticism or outright opposition from Canada and Mexico, and also from the US business community.<sup>59</sup>

These proposals appear to be part of an effort to return to a more nationalist approach to the economy, with goods and services produced inside the nation and not traded across borders as much. A 50% US content requirement would seem to give a boost to US producers, and a higher overall regional value content is an effort to make it more difficult for Chinese and other producers to take advantage of NAFTA's low tariffs. Thus, they fit nicely within the Trump administration's nationalist agenda.

In reality, there may be a way to make these proposals less onerous than they appear, for example, by including new elements, such as engineering services, in the calculation of the value.<sup>60</sup> In this way, the existing international structure of production could actually be maintained despite the appearance that nationalism has been increased.

## **2. Government procurement**

Like most trade agreements, NAFTA opened up a certain amount of government procurement to competitive bidding by foreign companies. There are no guarantees that foreign companies will be selected for government contracts, but at least they are allowed to compete. This competition benefits governments, and therefore taxpayers, by improving quality and lowering costs.

In its NAFTA proposals, the Trump administration is looking to rebalance the existing commitments that have been made in this regard, in order to expand the use of Buy America as part of US government procurement.<sup>61</sup> Buy America is an expression of its broader program of economic nationalism, through which goods and services are traded more on a national basis, with international trade less of a priority. Buy America programs take a simplistic view of national economic success, choosing to focus only on benefits to the American seller in that particular transaction. The costs to the buyer, e.g. the taxpayer, and any lost sales in foreign countries, are ignored.

In terms of a specific proposal, the USA is looking to base market access on dollar-for-dollar reciprocity, meaning that, in each country, the same nominal amount of procurement contracts should be available to foreigners. Commerce Secretary Wilbur Ross explained his concern with the current approach in this way: 'our market is 10 times the size of either of those markets, so if you gave equal percentage market share we'd be giving them 10 for one, how is that good arithmetic?'<sup>62</sup> In reality, the US proposal would not constitute reciprocity in any meaningful sense. Real reciprocity would take into account the share of the procurement market in each country that is open to foreign competition, as well as the size of the respective countries' economies, which will affect how many companies can compete for these contracts in the first place. In the fifth round of negotiations, Mexico challenged the US proposal by tabling the same idea in reverse, suggesting that the USA could have 'reciprocal' access to the Mexican market based on how many Mexican companies are awarded US procurement contracts, which is zero.<sup>63</sup>



The reality of trade in the procurement area is that US companies benefit substantially, and the Trump administration simply wants to benefit more.<sup>64</sup> The Trump administration may ultimately realize that pulling back on procurement liberalization would harm Americans more than help them, but for now they are seeking to scale back on the existing US commitments while expanding those of Canada and Mexico.

### **3. Trade deficit**

The more general economic sovereignty issue of concern to the Trump administration is the US trade deficit. In the administration's view, the existence of the trade deficit means fewer American jobs and a slower growing domestic economy. Virtually all economists disagree with this, but the administration seems to truly believe it. It has talked about using the trade deficit as one metric in the NAFTA sunset clause proposal discussed below.

In the imagination of Donald Trump, the decline of the US economy and worker follows a certain pattern. A US factory closes and moves to Mexico; the factory exports its production to the USA; this causes a trade deficit and job losses. In this way, US economic power is undermined. The reality is very different. Companies produce in multiple locations for sale in multiple markets. More efficient production benefits consumers. Furthermore, the trade deficit is caused not by the structure of trade agreements, but by macroeconomic factors.<sup>65</sup>

The impact of the administration's trade deficit talk on actual trade agreement obligations is unclear. If the administration uses it to ask for the removal of foreign trade barriers, and therefore, more economic integration, that is a positive. If instead it becomes the basis for higher US trade barriers, and more 'economic sovereignty', that is a negative.

## **B. Institutional sovereignty**

### **1. Bilateral versus regional trade arrangements**

On a number of occasions, President Trump and his trade advisers have insisted that trade negotiations should be done bilaterally, rather than with multiple countries. In their view, the USA gets better deals this way. With regional/multilateral deals, they say, 'you get picked apart by the first country ... then you negotiate with the second, you get picked apart. And you go with the third one, you get picked apart again'.<sup>66</sup> The basic premise here is that the USA is able to have more negotiating leverage if it negotiates one-on-one instead of with many countries. This is in line with the administration's general skepticism toward multilateralism and any perceived dilution of sovereignty through international cooperation.<sup>67</sup>

One problem with this logic is that multilateral negotiations are often made up of many bilateral bargains. For instance, even within the current NAFTA, there are specific rules that have been bilaterally negotiated between the USA and Canada and Mexico separately. And negotiators who work on trade negotiations do not suggest that they get a worse deal in multilateral negotiations. Finally, this rationale is also at odds with research in political science that addresses the rational design of institutions,<sup>68</sup> as well as the benefits of issue linkage.<sup>69</sup>

Nevertheless, a formally bilateral approach fits with the restrictive attitude the administration has taken with regard to trade in general. Their goal has not been to expand trade, but to target particular foreign markets where they believe there is ‘unfairness’. This preference for bilateralism is out of sync with the reality of trade in the modern economy, but they appear to be focused more on negotiating leverage.<sup>70</sup>

In the NAFTA context, a completely bilateral approach would mean the USA negotiating separately with Canada and Mexico, unraveling NAFTA into separate USA–Canada and USA–Mexico trade agreements.<sup>71</sup> Back in May 2017, Commerce Secretary Wilbur Ross stated that the administration ‘[has] not yet decided whether to go the trilateral route or whether to pursue two matching bilaterals’ for NAFTA renegotiations,<sup>72</sup> but the negotiation has been trilateral so far, albeit with some issues discussed on a bilateral basis.

## **2. Sunset clause**

One of the administration’s most controversial NAFTA proposals is some sort of ‘sunset clause’, through which the NAFTA would automatically expire after five years unless all the parties affirmatively decide to continue it. This expiration decision could be tied to a number of factors, such as the impact of the agreement on the trade balance. Modern trade agreements do not generally have such a clause, and US trade agreements never do, which makes this proposal fairly radical.

The purported goal of this proposal is two-fold. First, it aims to weaken the permanency of trade agreements and in this way remove a constraint on national power. Second, it takes away ‘political risk insurance’ from companies that seek to relocate production abroad.<sup>73</sup> The two ideas fit within the administration’s general worldview that international agreements usurp US power, and that this loss of sovereignty through integration weakens the American economy and worker. Of course, governments already have the power to withdraw from trade agreements at any time.<sup>74</sup> This proposal does not affect that power, but it creates a kind of presumption to end an agreement, with governments having to take specific action to continue it. Ultimately, how this works in practice may depend in part on which branch of government—legislative or executive—is responsible for reviewing the agreement.

This proposal has been very contentious, and seems unlikely to make it into a final agreement. Mexico has proposed a less intrusive alternative, in which the performance of the agreement is simply reviewed every five years, without a vote on staying in the agreement. Some have argued that a sunset clause would be useful in addressing the grievances over the impact of trade agreements on labor, but that instead of a five-year sunset, a generational review may be more helpful.<sup>75</sup> Though a thoughtful review of how to update trade agreements every few years is not necessarily a bad thing, trade agreements already provide mechanisms for this,<sup>76</sup> and it is worth thinking about whether these other institutions should be strengthened, instead of creating artificial deadlines.

## **3. Chapter 20 (state–state dispute settlement)**

The core state-to-state NAFTA dispute settlement procedure was carried over from the Canada–US Free Trade Agreement (CUSFTA). At the time these provisions were drafted, GATT dispute settlement was the state of the art for trade disputes, and CUSFTA/NAFTA dispute provisions were written with the GATT as the main source of experience. GATT dispute settlement was updated during the Uruguay Round, with the creation of the WTO and its Dispute Settlement Understanding (DSU). However, the various refinements included there, such as an appeals mechanism and an interim report, were not part of NAFTA.

In the early years of NAFTA, there were three disputes that proceeded all the way through the process, from initial complaint to panel report.<sup>77</sup> Implementation of the last one, related to trucking services, has been a challenge, but some progress has been made. However, in the late 1990s, Mexico brought a complaint against US barriers to trade in sugar, and flaws were exposed in the panel composition process, as the USA blocked the panel from being set up.<sup>78</sup> At the WTO, if the parties cannot agree on panelists, the Director-General can step in and appoint a panel. In NAFTA, by contrast, there is no such possibility.

Despite the weakness of the current structure, the Trump administration is proposing a further weakening, by making the process ‘softer’ or ‘non-binding’. In this regard, US Trade Representative Robert Lighthizer has talked about establishing a mechanism by which parties could disregard panel rulings that were clearly in error.<sup>79</sup> Such an approach would weaken the role of trade agreements, and shift power to national governments, by making dispute settlement less judicialized and more reliant on diplomacy. Enforceable international rules mean that states are subject to the rule of law, whereas an emphasis on diplomacy puts the power back in the hands of states.

#### **4. Chapter 19 (binational panels for AD/CVD)**

During the Canada–US trade negotiations in the 1980s, one of the big concerns for Canada was effective oversight by US courts of certain trade remedy decisions by US trade agencies. US courts were seen as slow, and biased in favor of positions favorable to domestic industries. To address this issue, Canada and the USA agreed in the CUSFTA to a separate review process, through which parties to trade remedy proceedings could appeal agency decisions to a special binational panel, made up of experts from both countries, rather than to a domestic court. When the CUSFTA was brought into NAFTA, the binational panel process was extended to that agreement, and is found in Chapter 19.

Over the years, US industry groups have objected to this process, and have filed several claims in US court arguing that the US Constitution does not allow international panels to interpret and apply US law in this way. None of those challenges were fully resolved by the courts on their merits, however, and the question of constitutionality remains uncertain.<sup>80</sup>

In the NAFTA renegotiation, the USA has demanded that Chapter 19 be ‘eliminated’.<sup>81</sup> This proposal fits squarely within the narrative of restoring national sovereignty. The Trump administration does not want international courts taking the place of domestic courts in reviewing and applying US law. In this area, the US concerns seem more substantiated than is the case with some of its other issues, as no other trade agreement has a similar review

mechanism. Thus, arguably, the Trump administration proposal simply brings NAFTA into line with international norms on the balance of national and international power.

### **5. Chapter 11 (investor–state dispute settlement (ISDS))**

One of NAFTA’s most lasting achievements was to initiate the partial merger of the investment regime and the trade regime. Previously, investment treaties had been separate from trade agreements, with different dispute procedures and often with separate government departments responsible. By incorporating the investment treaty model into Chapter 11, NAFTA brought the two regimes together. This innovation caught on, and has become standard practice in trade agreements around the world.

While it might not have been anticipated at the time, as there had been very few investor–state complaints yet, the inclusion of investment protection led to increased criticism of trade agreements. ISDS is controversial generally, but it was a handful of NAFTA cases that generated early criticism in the USA and Canada.<sup>82</sup>

Here, too, the Trump administration appears to object to an international court reviewing domestic laws. Unlike Chapter 19, where it has proposed complete elimination, the administration’s proposals for Chapter 11 are more nuanced. It has called for ISDS to be ‘optional’, and has suggested scaling back some of its substantive obligations. As with its other dispute settlement proposals, these changes would shift some power away from the international level, toward the national. However, whether ISDS and investment protection support or undermine the international rule of law is open to debate. Some governments have tried to move toward a more judicialized international system in this area, whereas others are pushing domestic law protections for foreign investors. The Trump administration’s proposals here could be seen as a restoration of sovereignty, but the debate is more complex than a simple nationalism versus globalism dichotomy.

## **V. IMPLICATIONS OF THE RISE OF NATIONALISM FOR FUTURE TRADE LIBERALIZATION**

The populist–nationalist turn in US trade policy is still in its infancy, and it is not yet clear what it will look like in practice.<sup>83</sup> However, there are already some important lessons that can be learned from the NAFTA renegotiation process and the approach the Trump administration has articulated through a number of proposals and general speeches on trade policy. We suggest that there are three main takeaways.

First, a strict focus on sovereignty and returning power back to nation states severely limits the potential for a true upgrade of the NAFTA. Second, what the Trump administration manages to do with NAFTA should be closely monitored by other trading partners, because their agreements may be up next. This goes not only for bilaterals, but also the multilateral system as well. And finally, while this worldview is at odds with the current realities of global commerce, it reveals some potential weaknesses in current agreements that could be improved to foster greater legitimacy and support from the public. We address each in turn.

The discussion above of the NAFTA renegotiation highlighted how the Trump administration's sovereignty-focused worldview is being translated into actual policy proposals. What we showed is that these proposals, which address both economic and institutional concerns over sovereignty erosion, are either at odds with the reality of global commerce (such as the administration's proposals on RoO, government procurement, and the trade deficit) or present a fundamental challenge to the stability of North American trade (sunset clause, state-to-state dispute settlement). The assessment of each of these reveals that a true upgrade of NAFTA may not be possible in the current state of affairs. For instance, state-to-state dispute settlement (Chapter 20) is not perfect, but the way to improve it is not to make it nonbinding, but to find a way to solve the problem of empty rosters and delays in panel selection.<sup>84</sup>

Of course, the administration's sovereignty obsession is a bit selective and nuanced. Despite their critique of international law and institutions, they support intrusive rules in areas that they see as benefitting the USA. For example, the official negotiating objectives point out that the administration wants to increase the enforceability of both the environmental and labor agreements (they are currently side letters) and bring them into the main text. Along the same lines, they are looking to broaden the rules on Sanitary and Phytosanitary (SPS) measures and intellectual property protection.<sup>85</sup> At first glance, this may seem completely at odds with the administration's concern with sovereignty, but it highlights an important dimension of their worldview. Preserving US sovereignty is of utmost importance, but infringing on other countries' sovereignty in order to achieve American objectives is fine. The objectives in question are targeted at Mexico or Canada, and since US laws already comply with the demands, they have no impact on current US obligations (although they do constrain decisions to change course in the future).

This brings us to the second core lesson, which urges other trading partners to remain vigilant on how the NAFTA process unfolds, because if the USA is willing to treat its closest trading partners with threats of withdrawal and 'poison pills', imagine how poorly it could treat the rest. This goes for both bilateral and multilateral partners. The other bilateral trade agreement up for discussion is the Korea-US Free Trade Agreement (KORUS), where the USA has made ambitious demands for additional Korean trade liberalization.<sup>86</sup> Korea might not be able to deliver, and KORUS may be in even more trouble than NAFTA. If the Trump administration ever gets to the new bilateral agreements it has promised, all the same issues will arise there as well. And at the same time the USA is rattling Canada, Mexico, and Korea, it is making the rest of the world nervous with threats to undermine the WTO dispute settlement process, or even the WTO itself. The recent WTO Ministerial Conference was reassuring to some extent, in the sense that the WTO survived. However, the prospect of future progress is dim, despite positive statements from Ambassador Lighthizer at the end.<sup>87</sup>

Lastly, though numerous polls show that Americans generally support free trade,<sup>88</sup> and research indicates that the economic benefits of such agreements accrue across the board,<sup>89</sup> the rhetoric on the 2016 campaign trail, and the further pronouncements of the populist-nationalist ideals of trade policy by Trump and his key advisors presents an opportunity to reflect on the weaknesses of the current trade regime and how it can be improved. The NAFTA renegotiation could be used

to modernize the agreement and fix its flaws. Reopening the agreement thus gives us the chance to evaluate what aspects of the agreement worked, remove the rules that have not, and focus on what could be made better.

## **VI. CONCLUSION**

We are in the midst of an era of populist bluster, strident nationalism, and calls for more sovereignty. When voiced as part of a political campaign, it is difficult to figure out what this means in practice. The NAFTA renegotiation is the first attempt at translating this loose talk into concrete policy. We have seen a few proposals, and we have heard the skeptical responses of many other actors—the Canadian and Mexican governments, the business community, and members of the US Congress. At this time, the outcome is unclear.

Whatever your perspective, the relative balance of power between the national and the international is an important policy question. Some of the distinctions are subtle and hard to decipher. But they matter for both politics and policy, and are worth considering. The Trump administration's obsession with these issues has forced a reconsideration of the current balance, and triggered an important debate. One way or the other, the NAFTA renegotiation will reach a conclusion, but the larger debate over sovereignty will continue in various fora around the world in the coming years.

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