



## International Centre for Trade and Sustainable Development

### **Fixing NAFTA's institutional deficit**

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*The renegotiation of the North American Free Trade Agreement (NAFTA) provides a path for institutional innovation. This post argues that the institutions that were created by NAFTA have either not functioned well, or been insufficiently used, and that the opportunity to improve the institutions that exist and to create new avenues for continental cooperation should not be missed.*

Fulfilling one of Donald Trump's key campaign promises, the United States, Canada and Mexico are currently renegotiating the North American Free Trade Agreement (NAFTA). During the course of the talks, the United States has taken tough, and at times controversial, negotiating positions. The most alarming posture, however, has been the periodic threats to withdraw from the agreement entirely. In times of political instability, people look to institutions for reassurance. As the rhetoric around NAFTA, and the precariousness of the talks make North American trade feel less stable, it is worth thinking about how NAFTA's institutions might be strengthened to provide a bulwark against future uncertainty.

The possibilities for how to structure trade institutions vary considerably, but with NAFTA we are not starting from scratch. NAFTA, along with its predecessor, the Canada-US Free Trade Agreement (CUSFTA), has been a source of wide ranging institutional innovation in trade governance. New bodies, both permanent and *ad hoc*, have been established to oversee the functioning of North American trade and investment, covering dispute settlement and overall governance of the agreement. In addition, there are institutions outside of NAFTA, but related to shared continental issues, which deal with various aspects of deepening integration. We address these three sets of institutions in turn and discuss how they can be improved so as to strengthen NAFTA for the long haul.

## Dispute Settlement

Dispute settlement in international trade agreements typically involves *ad hoc* panels of experts who hear claims from either governments or private actors. These panels act as the judicial arm of the international trading system. There are three main types of dispute settlement in NAFTA, all of which have experienced problems or come under criticism: the core dispute procedures for state to state complaints in Chapter 20; the special trade remedy review procedures in Chapter 19; and the investor-state dispute procedures in Chapter 11.

### *Chapter 20 – State-to-state dispute settlement*

In the early years of NAFTA, there were three Chapter 20 disputes that proceeded all the way through the process, from initial complaint to panel ruling. 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 US blocked the panel from being appointed.

More recent trade agreements have set out a detailed process that helps ensure that parties cannot block panels in this way. The Trans-Pacific Partnership's (TPP) approach to the problem is very thorough in this regard, and the EU-Canada Comprehensive Economic and Trade Agreement (CETA) also makes important innovations in this area. These provisions could be a good source of inspiration for improved NAFTA dispute rules.

Unfortunately, press reports suggest that the Trump administration has called for "softening" Chapter 20, by making it "non-binding." This would be a big mistake. If governments cannot enforce trade agreement obligations, their impact would be significantly undermined.

### *Chapter 19 – Binational panels for anti-dumping/countervailing duties*

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. To address this issue, Canada and the US agreed in the CUSFTA to a special 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.

One of the major US demands for renegotiating NAFTA is to "eliminate" Chapter 19. Canada and Mexico have resisted this proposal. In terms of the usefulness of Chapter 19, it is worth noting that it is invoked much less frequently now than it was in its early years, and that there is a somewhat effective alternative to challenge trade remedies at the WTO (more effective than the GATT was in the 1980s, when Chapter 19 was developed).

Chapter 19 remains an anomaly, never having been replicated in other trade agreements. Removing it might be the kind of "tweak" that could be marketed by the Trump administration as a significant change, while not fundamentally altering the economic integration established by NAFTA. At the same time, Canadian business groups strongly support the mechanism, as they

view it as crucial to address important cases such as softwood lumber, and they will not part with it lightly.

### *Chapter 11 – Investor-state dispute settlement*

One of NAFTA's most lasting achievements was to initiate the partial merger of the investment regime and the trade regime. This has proved extremely controversial, as investor-state dispute settlement (ISDS) has critics from across the political spectrum. While an update of the NAFTA investment rules, along the lines of the TPP, might have been anticipated, the Trump administration has reportedly proposed making ISDS "optional." The precise contours of this proposal are not clear at this point. Canada and Mexico have both objected.

Some kind of reform of ISDS from the existing NAFTA provisions is inevitable. This reform could be anywhere from an update to reflect modern rules such as those in TPP, to the "investment court system" now favoured by Canada, to complete removal of the mechanism.

### **Governance**

NAFTA created institutions for oversight and review of the agreement, including a Free Trade Commission and a Secretariat. It also established various working groups, which, lacking direction, have remained largely ineffective. This deficit in institutional leadership can be remedied.

#### *Free Trade Commission*

The Trump administration has proposed a "sunset clause" for NAFTA, under which the agreement will expire after five years unless all three countries affirmatively decide to continue it. The administration argues that this will address the problem of trade agreements that don't live up to expectations. By itself, however, a sunset clause does not offer the tools to adequately review the functioning of the agreement. It is just a deadline. What is needed instead is a set of institutions that can evaluate the performance of the agreement and propose reforms.

Article 2001 of NAFTA establishes the Free Trade Commission (FTC), which is made up of cabinet-level representatives. On paper, the role of the commission is quite broad, but in practice, irregular meetings and the lack of a fully functioning, independent secretariat have limited its effectiveness. Since the FTC is made up of high-ranking officials, it can provide political guidance to the secretariat and working groups, ensuring that they are addressing the highest priority issues. Committing to holding annual meetings can provide an opportunity for the three countries to identify issues that need to be addressed. In fact, Canada recently proposed utilising the FTC to conduct an annual review of how the agreement is functioning as a counterproposal to the Trump administration's sunset clause, a suggestion that should be welcomed.

#### *Secretariat*

At the time of the creation of CUSFTA and NAFTA, the GATT secretariat was already well established as a permanently staffed trade institution, assisting with dispute panels, negotiations, and general oversight of the trading system. However, while CUSFTA and NAFTA also establish a secretariat, it is of a different, and much more limited nature.

At the GATT, the secretariat was an independent organisation, headed by a Director General, and with several legal, economic, and other experts. The GATT secretariat staff served all the GATT contracting parties, but were not directly employed by the governments. By contrast, CUSFTA established a secretariat that was housed within national government agencies. Each party to the agreement was to designate someone within its own government as the secretary responsible for various tasks associated with administering the agreement.

NAFTA mostly carries over the CUSFTA vision for the Secretariat. Unlike at the GATT/WTO, where a permanent secretariat provides legal support to dispute panels, CUSFTA/NAFTA panels do not rely on the secretariat for legal advice. Instead, the panellists hire assistants on an *ad hoc* basis. NAFTA also gives the Secretariat a role in providing assistance to the FTC, which can also ask the secretariat to support the various working groups. In theory, the secretariat could also assist with the preparatory work before the annual North American Leaders Summits to establish an agenda for discussion.

After NAFTA, US FTAs did not include a secretariat of any sort. Perhaps as a result, these other FTAs have been somewhat frozen in time. To avoid this fate for NAFTA, the parties should consider establishing a more independent secretariat to facilitate the administration of the agreement.

### **Continental Cooperation**

As tariffs were lowered virtually to zero among the three NAFTA countries, regulatory barriers rose in importance. At the same time, criticism of NAFTA has not gone away, but there is no adequate forum for discussion on areas of contention. It has become apparent that there were a number of issues that were left outside of NAFTA, and require ongoing dialogue. Below, we highlight the Regulatory Cooperation Council and the Inter-Parliamentary Group as two options to fill this gap.

#### *Regulatory Cooperation Council*

Given the prominence of non-tariff barriers to trade, a Regulatory Cooperation Council (RCC) would be an important feature of any regulatory chapter of the NAFTA. Rather than starting from scratch, the three countries can simply institutionalise the current structure of the Canada-US RCC, which was launched in 2011. Ottawa has generally taken the lead on these efforts, a fact that has been noted as a particular challenge for the ongoing work of the RCC, with a heavier burden falling on Canada, though interest from the White House and support from the Office of Information and Regulatory Affairs (OIRA) are essential to its functioning. In addition, as there has been less progress on the US-Mexico High Level Regulatory Cooperation Council, it could be absorbed into a trilateral RCC, where each party is given the flexibility to decide which activities it wants to participate in.

The RCC could then have rotating leadership assignments between the three countries, on an annual basis, as they draft new work plans, but also potentially maintain a presence in a NAFTA Secretariat so that there could be regular support for the three governments in helping agencies and stakeholders connect to the right people across the border.

### *Inter-Parliamentary Group*

A little known aspect of the US -Canada and US-Mexico relationships are two Inter-Parliamentary Committees, established in 1959 and 1961, respectively, that allow for information exchange and collaboration at the legislative level. Delegates meet once a year in the capitals to discuss both bilateral and multilateral options for cooperation. The two bilateral committees could be merged, or at the very least, they could meet every other year to discuss trilateral and NAFTA-wide issues and help provide input on proposals and agenda items for FTC meetings and the North American Leaders Summits.

This could be valuable for a number of reasons. First, it would regularly engage the US Congress and the legislative branches of Canada and Mexico in ongoing NAFTA concerns. Ensuring that the legislative branches are routinely part of the conversation is imperative to concerns regarding sovereignty erosion, as a public and open dialogue on these topics could help alleviate concerns over transparency, and provide an avenue for participation of affected groups. Second, making these committees more visible, and directly part of the NAFTA framework would elevate the importance of inter-parliamentary collaboration. Finally, meeting on a trilateral basis would eliminate any duplicative work on NAFTA-wide issues, such as border infrastructure and security, a single electronic window for customs clearance, and other such topics.

### **Looking Forward**

The renegotiation of NAFTA provides a unique opportunity for institutional innovation. The institutions that were created by NAFTA have either not functioned well, or been insufficiently used. In addition, the current institutions lacked a vision of where North American integration could go, and thus the agreement has remained virtually unchanged over the years. Much can be done to improve the institutions that exist, and the opportunity to create new avenues for continental cooperation that can take NAFTA into the 21<sup>st</sup> century should not be missed.

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