A Positive NAFTA Renegotiation

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Adam Posen: Good morning, everyone. It's my pleasure to welcome you back to the Peterson Institute for International Economics. Today, we are trying to be current and forward-looking and positive, which frankly is not that difficult, hard to believe.

We're here today to talk about a positive renegotiation for NAFTA. I choose those words very consciously. We accept the reality and in fact, even the opportunity that there will be a renegotiation of NAFTA. We do not accept all of the things that were contained in the one-pagers that have been issued by the Trump Administration. And we do not accept many of the preconceived notions that people have about NAFTA.

Now, this Institute as everyone, I think is aware, particularly the roles of Fred Bergsten, Gary Hufbauer, and Jeffrey Schott. 25 years ago, we played a critical role in the passage of NAFTA. We have done a lot of reflection since that time and not just in the last year, but in the last decades.

Gary and Jeff have done a number of updates and specific work. I have been on record arguing very strongly the idea that talking about jobs numbers and bilateral trade deficits at that time was a mistake, but that the rest of the arguments carry through. And I think any fair assessment of the reality of NAFTA sees that.

So today we're going to look forward because frankly, there is an empty hole where the positive NAFTA agenda should be in Washington. Our counterparts and colleagues in Canada and in Mexico have come forward where they have complete teams, they trust their civil servants and experts. And they have come forward with some actual positive constructive proposals. We modestly wish to set what those actual proposals should be from the US side ahead of the notice going to Congress.

I am delighted to thank and acknowledge certain people who have made this possible in particular, Fred Bergsten and Monica de Bolle, senior fellows here at the Institute who are coordinating this multi-author effort for us including some outside scholars, experts, as well as many of our in-house people.

And they are pursuing the publication and the rolling basis with our colleagues in publications, our vice president for publications and communication, Steve Weisman, a series of policy briefs much as we did on the border tax to try to present serious arguments and proposals in an accessible way.

And so today we have coming out not only Cullen Hendrix on agriculture in the NAFTA renegotiation, Gary Hufbauer and Euijin Jung on NAFTA renegotiation in Canada. Fred

Bergsten on trade balances in the NAFTA negotiation, and about to have a revised release of Carolyn Freund's policy brief on rules of origin in the auto industry and NAFTA. This is a full house, but we have much else to offer.

I'm grateful to our colleagues at the Centre for International Governance Innovation in Canada who are partnering with us on this event. And in particular on a second event we will be holding because one day is not enough to cover the positive aspects of NAFTA.

We are going forward to have a discussion of NAFTA in the broad. Getting my notes to make sure I don't mess this up, on July 17th in this venue, also under the leadership of Monica and Fred, a broader perspective on NAFTA renegotiation.

In that session we will cover issues in addition with partnership with the Center for Strategic and International Studies as well as CG. We'll cover issues like the value-added perspective on trade by Chad Bown, on the environment by the noted scholar, Dan Esty, on security by CSIS President John Hamre, on migration by our new colleague Sherman Robinson, as well as perspectives on energy and labor.

There's a lot here, and it's because NAFTA is totally essential to the lifeblood of the economy of the US, of Canada, and Mexico and even to the politics particularly of Mexico. And we are here to engage and be of the positive message about the substance. We're not cheerleaders. This is the reality.

We're not going to re-litigate all the battles and frankly lies that have been told about NAFTA through the decades. If you actually care about the truth, you can go to two recent publications. A publication by my colleagues, Jeff Schott and Gary Hufbauer, correcting the record on NAFTA which we put on our trade and investment policy watch in May. And also a long essay in Vox by my friend, Brad DeLong. NAFTA and other trade deals have not gutted American manufacturing, period.

These represent the mainstream economic view, the fact-based view, the evidence. And if you care to go look at the evidence, I encourage you to read those and the many references to our or another's work therein. But today is about looking forward.

NAFTA renegotiation can be a win-win and it's necessary to be a win-win. If the wrong ideas about trade policy that see it as zero-sum bilateral focused on trade bilateral trade deficits, about little corporations getting individual jobs allocated by a domineering government, ignoring the security effects, the health effects, the environmental effects, and the labor effects of disrupting the largest market in the world, then it is to all our cost including especially the cost of the working people of Mexico, Canada, and the US.

There have at times in the proliferation of one-liners from the Trump Administration been mentioned of creating a North American powerhouse. We commend that vision. We hope they live up to it. And we're going to tell you how you get there through this negotiation.

It is my pleasure to have the opening session be a keynote by my predecessor and the founding director of the Peterson Institute, Fred Bergsten. As mentioned, we released his paper today as I sort through the wealth of publications, Trade Balances and the NAFTA Renegotiation.

But we are additionally fortunate to have as the opener, not only to Fred's speech but to our conference, the Honorable Thomas F. McLarty. Now, Tom, or Mack I should say, to his infinite number of friends, is chairman and co-founder of McLarty Associates, former

White House Chief of Staff, Counsel to the President under President Clinton and, of course, in many ways is best known and made an enormous contribution as special envoy for the Americas under President Clinton.

He continues to be incredibly active on US trade, energy, and foreign policy on the US-Latin American relations, US-Mexico relations. Just last month, he and former Commerce Secretary Penny Pritzker published an op-ed, how to Improve NAFTA, in the Los Angeles Times, one which I think echoes in spirit and theme much of what we're trying to do here today, although he was first.

And so I would like to invite Mack to lead us off with the big picture that matters and bridge us into Fred's keynote. Mack.

Thomas McLarty: Good morning. Adam, thank you very much for your warm words. And it is truly a pleasure and I consider it a privilege to be here today. I want to thank Adam and everyone here at the Peterson Institute for giving me this opportunity to kick off a speech of positive NAFTA renegotiation.

Having had the opportunity to be engaged in and to help shepherd the North American Free Trade Agreement passage during my time in the Clinton Administration as Adam kindly noted, it is a topic that is truly close to my heart both personally and professionally. And of course, as Adam also acknowledged, the issue could not be more timely with this new administration in Washington.

Now having said that, I am mindful if my wonderful wife Donna were here, she would be tugging at my coattails reminding me my job is not to make a speech. My job is to introduce the peerless C. Fred Bergsten, a legend, a living legend truly, a friend, a collaborator, and someone that most of us in this room have learned from over the years. So I am resolved to follow her advice at least mostly. But I can't resist offering just a few observations to hopefully appropriately set the stage.

And the first is that the NAFTA, at the very beginning in my judgment, has offered a superb example of sustained bipartisan engagement in leadership. The first Bush Administration negotiated it. The Clinton Administration secured its passage. And the Congress overcame significant challenges to see it through. And many in this room were part of that effort. And that is the kind of sustained bipartisan engagement that we should never take for granted. And frankly, I believe it's the kind of spirit our country badly needs right now.

Second, the NAFTA has been a clear and resounding positive impact on all three countries. Now we can arm-wrestle as Adam alluded to about the job impact, jobs gains and loss, and statements and over-statements. And I think all of us would agree that a new paradigm is needed in terms of trade and how we talk about it in a very different world.

But I think it is undeniable that last year the US total goods trade with Mexico and Canada was more than $1 trillion almost a 300 percent increase of where we were in 1993. And both Garry Hufbauer and Jeff Schott have recently noted that since 2005 two-way trade with Mexico has strengthened the US GDP by $26 billion dollars per year.

Third, beyond the economic impact which Fred will focus on today, in my view NAFTA has been a foreign policy success and an important one. Mexico's progress in particular has been impressive and sustained from the strengthening of their democratic institutions particularly their central bank and the meaningful rise of the middle class.

As with every nation including our own, our southern neighbor's journey is an ongoing one. But I would submit that NAFTA has been a powerful catalyst encouraging the people of Mexico and their leaders to look outward, and to look forward.

And likewise, and I've seen this firsthand as so many in this audience have as well. The North American Free Trade Agreement has set a tone over the last 20 plus years for a deeper, a more mature, a more trusting relationship between the United States and Mexico. It's reinforced the natural ties of friendship and partnership with our neighbor to the north as well.

And finally at a time when we kind of, hear and see these tectonic plates shifting around the world, the North American Free Trade Agreement was the impetus, as Adam underscored, of the North American Compact and being now a third generation in a fourth-generation automobile family business endeavor, I see a number of the automobile companies here today, and understandably so.

Because the North American Compact for that industry and so many others has put in motion and integrated, tightly integrated an efficient supply chain and it has made the United States, Mexico and Canada much more competitive, particularly our country. And at this time of these tectonic plates shifting, the NAFTA is more than 20 years old.

And I went on record several months ago saying, indeed it does need to be renewed to meet contemporary realities. Just like in business, contracts are updated, renegotiated, that is standard operating procedure. But I believe it would be a mistake, and a serious mistake, if anything other than a positive renegotiation were to take place. We should modernize the NAFTA in a way that makes America more globally competitive, not less.

Now, of course, no one can speak about these issues with more authority and clarity than Fred Bergsten. It is not an overstatement to say Fred is indeed one of the most influential thinkers in the field of international economics. He's the founder and director of this extraordinary Institute for more than 30 years.

But as all of us know, Fred is more than just a thinker. He is a hard charger and a doer. He can get things done. He served in several senior government positions from the White House to the Treasury. His name is on more than 45 books, and too many articles to count, and they're still coming as we heard today.

He has chaired a host of blue-chip groups from the Shadow G-8 to the Competitiveness Policy Council. And in every capacity he brings a great spirit, energy, and zest to the work. After being with Fred you come away feeling not only has your IQ been raised, but your level of enthusiasm and commitment as well.

Now since we're in the aura of the NBA Championships, finally as many of you are aware, Fred is a basketball fanatic. As one colleague put it, he is a basketball theme. And that's true whether he's cheering from the stands or playing actively in league with his friends.

And even as a senior statesman, he has been described as deadly from the 20-foot line. So without a doubt, whatever arena he's in you can bet the players, whether they'd be in the economic and trade and political field or on the basketball court are following his every move.

So Fred, we are looking forward to hearing from you this morning. And so without further ado, I'll try to pass the ball to you.

Fred Bergsten: Mack, that was both very kind and very thoughtful. But it turned out, Mack did not know the most relevant fact about my basketball career, which is that it's now in hiatus because a little over two months ago I ruptured my Achilles tendon.

My strategy into these advanced years of my life had been to keep playing until the market told me that I could no longer do it. Well we'll see if I come back from this one. But I'll certainly try and I thank Mack for reminding all of us of some of my most joyous and ongoing activities.

As both Adam and Mack said, the objective of our conference today is to pave the framework for a positive renegotiation of NAFTA. To fill gaps from the original like energy e-commerce, to update and modernize, taking largely from the TPP negotiations, which the administration itself says it wants to use in many cases as baseline, though it foolishly rejected the TPP.

But our later presentations today are going to outline specific components of the new NAFTA that could emerge from this negotiation. The outcome could be quite positive. Canada and Mexico have both said they will cooperate with initiatives in that direction. And so the outlook should be quite favorable. And this is going to be the thrust of my remarks.

That positive outcome can only emerge if the Trump Team aims in the correct directions. Now it should do so. Its basic goals are to strengthen the American economy, boost US output, boost US employment. Those basic goals are, of course, the right ones.

But the methodology that the administration has enunciated to date would not, in my view, effectively or perhaps even successfully pursue those objectives and could indeed well undermine them, and even lead to a blow-up of the existing NAFTA, which as I will describe, would be extremely bad news for all of us.

Why do I say that? As Mack alluded and Adam did too, the administration's focus, though it's not very precise at this point has seemed to be to use trade policy, trade agreements and the renegotiation of NAFTA in particular, to reduce the US bilateral trade deficits with a number of key trading partners, China, Japan, Germany, and in this case of course, Mexico. In addition to address unfair trade practices, which sometimes seemed to be defined as creating those bilateral trade deficits from the US side.

So the cardinal question going into this whole enterprise is whether the Trump strategy will enable a successful NAFTA negotiation to proceed or will it fail to achieve its basic goals and even lead to a very, very costly rupture, not of my Achilles tendon in that case, but of something much more serious to the world as a whole.

My theme is going to be that there are three fundamental flaws in the Trump approach that will have to change to enable a successful NAFTA negotiation.

The first of these is very practical. The Trump Administration wants to reduce the US trade and current account deficit, which of course requires other countries to reduce their current account and trade surpluses.

But the facts on the ground are that Canada and Mexico, the NAFTA renegotiation partners, are deficit countries themselves. I purposely put this slide up on the screen so you could see it and ponder it as you came in, if you noticed it at all.

But what the slide shows is that far from being surplus countries like China, Germany, Japan, from which the US could at least within a Trumpian context seek to extract some reduction in imbalances, these countries by contrast are deficit countries themselves.

Indeed, in three of the last four years including 2016, both Canada and Mexico had bigger deficits than the United States. So again, even within the Trumpian mental set and framework itself, they're barking up the wrong tree. You can hardly expect countries who are and think of themselves as deficit countries to take steps to further increase their deficits so that we can cut ours to a lower level.

In short, if the Trump Administration wants to proceed down this path of bilateral imbalances, they've started with the wrong countries. In fact, they've addressed the wrong countries, because those countries just don't fit their own framework as they themselves have enunciated.

If it's true, as the Trump people sometimes say, that trade deficits are an indicator of unfair trade practices, then Canada and Mexico of course, are big victims of the current system. And they'd have to go after a lot of countries with whom they run big deficits in order to right the balance.

So point number one, and very practical, is that these are countries which far from looking different and therefore in some sense logically attacking each other, looked like having very similar positions. And I think the logical inference is that the three NAFTA partners, as Mack said, ought to be working together to improve their overall ad joint competitiveness in the world economy if, in addition to other reasons, to reduce their global imbalances.

Now yes, Mexico runs a bilateral surplus with the United States. But all that says is that it runs much, much larger deficits with the rest of the world leading it to a global current account imbalance of sizable magnitude as a result of triangular trade in the normal way the world trading system works. And therefore, we have to start with basic facts, which belie one of the fundamental precepts of the Trump approach.

Now if Trump really wanted to reduce the US deficit, as I say, he's picked the wrong countries to start with. And in fact, ought to be collaborating with Mexico and Canada to strengthen North American competitiveness as a whole.

But even if Trump had picked the right countries to deal with, there's a second fundamental flaw in the approach that seems to be underway. Namely, the administration's effort to increase U.S. production, U.S. jobs, through changes in trade agreements or changes in trade policy more broadly, as opposed to doing it through macroeconomic and broader economic policy measures.

That's a misplaced view because we know from basic economics that a country's international economic position is determined by macroeconomic factors, not the specifics of trade agreements or any other trade policies.

On the real side of the economy, what of course counts, is the relationship between domestic absorption, consumption plus investment plus government, call it domestic demand. The relation between domestic demand and domestic production. It's as simple as that. If domestic demand exceeds domestic production, we spend more than we produce. And the difference is made up by imports and we run a current account deficit.

That is the perennial U.S. case for the last 35 years. And it explains our persistent current account deficit. Trade agreements have come and gone with many of the countries that we run these big deficits we have no trade agreements whatsoever in any way. So it can't be trade agreements that are the problem. The persistent theme is of course the macroeconomic imbalances.

On the financial side of the economy, what counts is the relationship between saving and investment. If we Americans save less than we invest, we have to import capital from the rest of the world. That has the effect of financing current account deficits and that too is the perennial U.S. case. Inadequate domestic saving with finance needed to fund levels of domestic investment that we both need and want in our economy.

So the bottom line is that we can address these two interrelated macroeconomic causes only through macroeconomic means. The main policy instrument is the budget deficit. The main instrument available to government is the budget deficit. Cutting the budget deficit would reduce aggregate demand.

On the real side, it would reduce the demand for capital on the financial side. That's the standard remedy. Trade agreements cannot remedy the external imbalances, because they simply do not affect these fundamental economic variables. And therefore, the Trump approach is fatally flawed.

In fact, if we look to what's likely to happen in the immediate future, the macroeconomic policy as projected by the current administration is likely to make the situation a lot worse. The proposed tax cuts, the proposed expenditure increases particularly on the defense side, are likely to provide somewhere between a modest and a substantial increase of the budget deficit, a further fiscal stimulus, at a time when the economy is already at or very close to full employment. Meaning that our excess demand, our need for foreign funds is going to go up not down. And we're going to need more foreign funding and more external deficits.

In that context, the Federal Reserve will continue to normalize monetary policy, may even accelerate it if the budget deficits look like going up a lot. That will raise interest rates. That will strengthen the exchange rate of the dollar. That will hurt our competitiveness. And our trade imbalance will go up even more.

My colleague, Bill Cline here at the Institute, every six months as you know, projects fundamental equilibrium of exchange rates, U.S. current account positions. His projection even on the current macroeconomic situation is that the US imbalance is going to go up from a little under 3 percent where it has been lately, up to four, or even five percent over the next three or four years. That would be a current account deficit of $1 trillion per year against the $20 trillion GDP by about 2020 or 2021.

And that's going to be a very acute dilemma for the Trump Administration if it comes in promising to reduce or even eliminate the current account deficit. But that deficit goes up very substantially, that's going to create a very acute dilemma and changes in trade agreements are not going to do anything to correct it.

It's instructive I think, to link this conceptual foundation that I mentioned to the relevant post-war U.S. History. As one thinks back over that history there have been two occasions, only two occasions since World War II in which the U.S. Government has gotten serious about reducing the U.S. external imbalances. One with the Nixon shocks in 1971 and the other were the Jim Baker second Reagan Administration in 1985 going forward.

In both those cases, this is often forgotten, in both those cases the administrations of the day did launch very aggressive trade policies. The Nixon shock included an across-the-board import surcharge and demands on the G-10 partners as they were then, to unilaterally reduce their trade barriers against the United States.

In 1985, the day after the Plaza Agreement, President Reagan gave a big speech launching a whole series of Section 301 cases. The Congress passed Super 301. A lot of tough trade measures were taken in both those contexts when there was worry about the U.S. external imbalance.

But in both cases, the administrations of the day paired those trade policy steps, we're saying you weren't going to do much about the imbalances, with macroeconomic and exchange rate initiatives. The Nixon shocks, of course, took the dollar off gold, launched the era of floating exchange rates and brought the dollar down by about 20 percent.

Jim Baker at the Plaza, fortunately cooperatively with our trading partners, brought the dollar down by about 30 percent over the succeeding two years. And those were the initiatives, not the trade steps but the macroeconomic changes that did lead to major adjustment of the U.S. external position and strengthened the U.S. economy. And I would suspect that the current administration is going to have to add something like that if they want to get serious about dealing with the U.S. external imbalance.

That brings us to the final Trump fallacy, its focus on bilateral imbalances. Trade agreements certainly can alter the geographical composition of trade flows and even of trade imbalances. But even a successful reduction of our bilateral deficits, e.g. with Mexico, are very unlikely to have any net impact on our overall trade position.

Secretary Ross has complained about country hopping as he calls it, in response to anti-dumping duties. When we put in an anti-dumping duty on firms from China, that those firms move to Vietnam or Bangladesh or somewhere else, and the imports continue to flow.

Same thing here. If we were able, through some mechanism, to reduce imports from Mexico, the production would shift elsewhere in Latin America, maybe to Asia. And after a short adjustment period, there would be very little if any change in the aggregate imbalances. So as long as the bilateral focus continues, we cannot expect any kind of net gain overall.

In light of these rather basic flaws in the administration's current approach, of which I've enumerated three, I think we have to acknowledge honestly that the renegotiation effort could fail. If the administration sticks with those approaches, pushes them hard, tries to bully the other countries into agreeing with them, then the whole renegotiation could fail. The President could withdraw from NAFTA as he in fact threatened to do before even launching the renegotiation a couple of weeks ago.

What would be the effects of that? Well if NAFTA disappeared, at least between the U.S. and Mexico, then Mexican tariffs would of course, go up to the most favored nation level of about 7.5 percent from currently zero. That's about double incidentally what we could raise ours.

But in addition, Mexico has only bound its most favored nation tariffs at an average of about 35 percent under the WTO. And therefore if it wished, at least in some sectors and products, it could raise its tariffs 10 times as much as we could raise ours. And that, to put it mildly, does not sound like a great deal for America.

In addition, U.S. would then face huge discrimination in the Mexican market. Mexico has 19 other FTAs, counting European Union as one, so it’s got the European Union, Japan, the NAFTA preferences with Canada would continue, Mexico is now negotiating with Korea and others. So in addition to the disparity in tariffs it would open up, the U.S. would face a whole passel of discrimination.

In addition, of course, the Mexican economy would be weakened by all this. So total imports would sag. The Mexican peso would weaken so our competitiveness would be worsened. So for a whole variety of reasons, the outcome would be the opposite of that which is the purported goal of the administration.

Secretary Ross and Ambassador Lighthizer have both said when pressed by members of the Congress that their fundamental objective in this whole exercise is to do no harm. They claim to be taking the trade equivalent of the Socratic oath. Well here's a key way not to do harm, because if they failed it could go in a very bad direction.

So I've argued that the Trump Administration ought to change its approach and in fact will have to change its approach if it wants to get to the positive NAFTA that we're going to be talking about throughout the course of today and I think we would all like to see. But the chances that they will not go that direction forces to raise a question.

Suppose they stuck to their guns, and suppose they went down the path that they've been talking about, what might it look like? Well one immediate implication I think is that the trilateral NAFTA talks would quickly split into at least one bilateral talk namely with Mexico. Mexico and Canada obviously being very different in terms of trade balances at everything else. So that would be one immediate operational implication.

But the most relevant U.S. History in the entire post-war period that might shed a little light on this is the period of Japan bashing in the 1970s through early 1990s. Now Marcus Noland and I, here at the Institute did a couple of books on that topic back in the midst of it in 1993 and again to appraise it in retrospect in 2001. And we came to several conclusions that I want to close with, lessons that might be drawn from that U.S.-Japan experience that might apply to the U.S.-Mexico case now.

Now obviously Japan then and Mexico now are very different, advanced economy, emerging-market, Japan did run global surpluses as well as bilateral surpluses with the U.S. Though interestingly, it was not the focus of the U.S. in those negotiations to reduce the imbalances.

Those were rather sectoral initiatives based on the concept, again very different from Mexico today, that Japan was a highly managed economy with unfair trade practices, that could only be dealt with through trade negotiations. So lots of differences. Nevertheless, several possible lessons.

Lesson number one. The main outcome assuming Mexico accommodates at all and is willing to talk with the U.S. in these terms. Lesson number one is that the outcome would be managed trade of three types. The first, voluntary export restraint agreements famously in autos but in other sectors as well. We've just had a case with Mexico, the sugar renewal, which includes VERs. So Mexico has kind of accepted the principle. And you might say VERs might be [inaudible 00:38:06] the outcome if this negotiation goes down the managed trade track.

Secondly, VIEs, voluntary import expansion agreements, most famously done in semiconductors and auto parts where the importing country in today's case, Mexico, would say, Okay. We'll buy more from you guys. And third, market share agreements, again in semiconductors as well as some others that were negotiated with Japan.

I want to pause at this point and refer you to what I regarded as a stunning statement. Just two weeks ago by Secretary Ross. Read it and Weep. The way that we think is the easiest would be to divert to U.S. sources, products they are already buying from abroad, but from a country other than the U.S. For example, some of the agricultural products they buy come from Brazil. Well, they could just as well give us a better market share than we have now. And that's just one example of many.

Now that's reminiscent to me as an old-timer in this business, of Secretary John Connally when he was implementing the Nixon shocks back in 1971. He famously said, all I want is a fair advantage. And Ross is talking about trade diversion with a vengeance, which obviously would have huge implications for third countries, other U.S. suppliers, et cetera, et cetera.

Mexico however, has again kind of fed in to this notion, because Mexico in reacting to Trump's initial bullying comments said, well we could shift our AG purchases away from you guys and we'll go buy more from Brazil. Well, if I'm Secretary Ross I would say, hmm, you've noted you could buy more from Brazil that presumably means you could buy less from Brazil and more from us. Ala his statement. So again, it's not clear where all this would go, but I'm predicting that's the path it would go down.

Lesson number two, U.S. sales can increase via measures of the type I mentioned. Noland and I did a very detailed analysis. Mainly Noland, blame him if you don't like them. This was looking at a whole range of sectors that the U.S. negotiated with Japan over the course of 15 to 20 years.

Sometimes it was liberalizing their markets. Sometimes it was VERs, VIEs, managed trade. But in a number of sectors, there were explicit increases in either the sales of U.S. exports or of the overseas subsidiaries of U.S. companies in some cases.

We tried to add all that up. These were speculative estimates, we don't claim any precision. But it added up to something like $4 billion dollars of additional sales from the U.S., maybe another couple of billion from overseas affiliates of U.S. firms. So in that sense, it works. You can get some additional sales through measures of the type that the U.S. pursued with Japan, and could conceivably pursue with Mexico.

Lesson number three, however, is that very careful work that we did suggested no net reduction in either the U.S. global deficit or even the overall bilateral deficit with Japan. You got sectoral shifts, some sectoral gains, but you did not get any overall improvement.

And therefore, lesson number four, to go back to what I said a minute ago in the historical context, you have to pair, if you want to do something about the overall imbalances and their effect on the U.S. economy, you have to take steps on the macroeconomic and exchange rate front, which in the Japan context of course, was done with the Plaza Agreement where Japan was in fact, the centerpiece of the whole operation.

Now at the moment the NAFTA negotiation does not contemplate, of course, going to broad macro or exchange rate matters. The administration has indicated that it will try to include disciplines on currency manipulation in the NAFTA renegotiation. Doing so, I immediately indicate, would have no practical effects whatever.

Neither Canada or Mexico had ever been accused of manipulating their currencies. And as I mentioned before, they're of course big deficit countries. So they would not be indicted anyway, under the current U.S. law or any concept of who gets indicted for currency manipulation.

The whole idea would be to put something in the renegotiated NAFTA as a precedent for later deals with Japan or maybe reviving TPP, and to deal with the domestic politics in the Congress, some of which place a very high value on doing something with currency manipulation including in NAFTA.

But, again, it would have no practical effect on the imbalances. It would have to be negotiated by different officials, namely, the macro and monetary officials in the countries. And it would raise another possible hurdle to bringing the whole negotiation to a successful conclusion.

I want to wind up finally then by suggesting, having gone through all these negatives and contentious problems, that there are some constructive alternatives to the misplaced Trump inclinations that have so far seemed to cover the waterfront. Although, since they haven't yet gotten into the negotiations, we hope and believe there may still be time to turn things around.

If they really want to reduce the U.S. external deficit, of course, and this goes way beyond trade negotiations, they would have to reduce the budget deficits rather than increase them as looks likely. If they wanted to do something internationally to bring down the U.S. external imbalances, you'd have to do a Plaza II or something like that, which would try to correct the exchange rate misalignments.

Bill Cline's latest analysis is that the dollar is now overvalued by about 8 percent. To reach his target of limiting U.S. deficits to less than 3 percent of the economy, if you wanted to eliminate the U.S. external deficit, you'd have to bring the dollar down by at least twice that amount. And that, of course, would require a major international initiative.

Within the NAFTA context itself, there are some constructive steps Mexico could take. The World Bank's trade restrictiveness index shows that Mexican non-tariff measures essentially average about 15 percent of their economy compared with 5 percent here. So, if Mexico was inclined to do some unilateral or non-reciprocal liberalization in order to make this thing work out, it could do so constructively by reducing some of its import barriers particularly on the non-tariff measures side.

But the final point is that if we really want to increase U.S. exports to Mexico, what we really want to do is strengthen the Mexican economy as much as possible. The main driver of a country's imports from us or anybody else is its development pace, its economic growth rate. And so you want to maximize that. They'll buy more from us. The peso would strengthen, which would help our competitiveness.

So the best U.S. strategy to achieve the stated Trump goals is to push for the maximum liberalization in the new NAFTA, to strengthen the economies of all the countries, and particularly in this context, Mexico itself.

The bottom line is that the best new NAFTA, even in Trumpian terms I believe, is an updated and modernized old NAFTA and the rest of our conference is devoted to figuring out how best to do that. Thank you very much.

Thomas McLarty: Thank you. Thank you. Can you hear me all right out there? I feel like I'm back in the Clinton White House trying to run things on time here. And we've got a limited time and we don't want to impose on the next two panels, which are important.

Dr. Bergsten, I think Perry Mason would have been proud. You made your case to the jury. It was a persuasive and substantive one as we anticipated. I hope it somehow permeates to the White House and to the Commerce Department and USTR.

Fred, let me just ask one quick question, I want to open it up the audience. We certainly want to engage people that have come this morning and that are clearly knowledgeable to this issue, understand it and have a few thoughts.

Let me just pose one question, but let me kind of take a sharp turn and go to the political side because you clearly outlined the elements from an economic and a serious and depth-full approach to it and how to kind of have the right art of the deal to get to the right place and what would be the consequences if that's not achieved.

But given that, and given the U.S. economy as you noted, which is performing reasonably well, certainly on a relative basis to other economies in the world. Talk about the trade paradigm and politics in the U.S. which goes to this trade deficit, and was a big part of the campaign and a big part of both of the primaries. And to me that's where the messaging here from an institute that is so well respected has to be mindful of kind of, the real world out there, which is influencing the White House and the Congress.

Fred Bergsten: Well, Mack, that's obviously a very big question. Let me try to answer it succinctly. First, we just need much better understanding in the country and in the political leadership of the benefits to the U.S. of globalization and trade.

My colleague, Gary Hufbauer, and his associates have done a series of studies over the years, updated it just within the last couple of months, that show very persuasively, methodology has never been attacked. The U.S. economy is $2 trillion per year richer as a result of the globalization of the last 50 or 60 years.

Now you can quibble about you know, a couple of decimal points. But the conclusion is absolutely clear these are huge benefits. $20,000 dollars per household, 10 percent of all national income, these are huge benefits. President Clinton used that earlier version of what we did in some of his remarks. I suspect you put them into his speeches. Presidents have used it, secretaries of the Treasury, USTRs. But we've never had political leadership that really went out and aggressively told the American public the truth, which is, this is big, big benefit for the country. And it would be folly to throw it away.

Point two, however, is that set against that $2 trillion of gains are some significant costs. There's no free lunch in economics. So as best Gary and colleagues could estimate, something like $50 billion dollars per year of adjustment costs. So that's a huge benefit cost ratio, like 40 to 1. So who would turn that down?

But $50 billion dollars is not chump change. It means a lot of people are adversely affected. And here I think, is where U.S. policy has failed miserably. Bipartisan critique, both parties went in the White House winning control of Congress have failed to take seriously the political problem as well as the underlying social problem, the humanitarian problem, of the costs and downsides of globalization.

People do get thrown out of work. People are forced to take lower income jobs. Again, it's a very small minority of the labor force. I mean, we figure at most 500,000 people a year and a labor force of 140 million and monthly job churn of a couple of million. So it's a tiny blip. But it's not insignificant and it makes a lot of political noise. And as we know, the losses and downsides are concentrated. The gains are to a large extent diffused across the economy. And so you get a political asymmetry.

I believe that in order to restore a sustainable political foundation for open trade and globalization in the U.S. We're going to have to do a much better job of dealing with the costs, the downsides and the losers. And it's not mainly Trade Adjustment Assistance, though I support that.

It's got to be two things. The safety nets more broadly. Unemployment insurance is lousy. Obamacare actually helped by making health insurance more portable. But much more is needed on the safety net side. And in addition, we've got to do a much better job of helping workers adjust in the real economy, retraining, lifetime education, all that.

The U.S. has been singularly inept among all high-income countries in doing that. Many of us feel Europeans may have gone too far with safety nets and Welfare states, but they have certainly addressed the problem I'm talking about.

We've talked for decades, I remember President Clinton and you talked about it a lot, the German Apprenticeship Program trying to increase the capabilities of the non-PhDs in the economy to find viable jobs. But we haven't done anything serious about it.

So I'm afraid that until, and unless, we do get serious about that set of problems that the basic stalemate that we've got over what you just raised Mack, the politics of trade policy, globalization more broadly, is going to stay stalemated.

Now you get an administration like the current one, not at least at the moment likely to take the lead on either of those steps that I talked about. But until we get that, I'm afraid we've got stasis at best. And since I believe in the bicycle theory, if you're not moving forward, you may slide back, and the kind of things that I talked about in my remarks are all too possible.

Thomas McLarty: That's a serious and thoughtful response and I appreciate it. I think that's a key issue. Steven Weisman and I were kidding, that did take four floors on the elevator, but that was a good elevator speech about the politics of trade. And in terms of leadership, and we'll get right to the questions, there is a real juxtaposition and difference between the governors of states, Republican and Democrat, their views on trade, and their popularity versus the Congress. That's where some of the leadership hopefully can come from.

Let's open it up for questions please if you'd like to raise your hand. David.

David Short: Thank you. David Short with FedEx. Dr. Bergsten, I'd be interested to hear a little bit more about your thoughts on this trade diversion idea that as you indicated Secretary Ross alluded to.

It seems like the U.S. has leverage over Mexico by virtue of being the customer for something like 70 percent of their exports. Moreover, the policy of the current administration, as we heard in the Inaugural Address and elsewhere, is America First. So I take it that if there were to be an encouragement in Mexico to buy more from the U.S. and less from Brazil or Europe, or other resources that are currently supplying them that would be bad for those other countries.

But if the policy of this administration is we don't care about those other countries anymore, and we have the wherewithal to leverage, to encourage Mexico to do this, and it would be good for our economy, because it would create more manufacturing jobs, create more wealth in the United States, what's wrong with that approach?

Fred Bergsten: Well basically what's wrong with it is it violates all the precepts on which the global trading system is based. First of all, Mexico itself would be diverging from normal sort of market oriented philosophy by saying, we're buying from somebody else now. By definition that means it's more efficient to do so or else why would we buy from them. But now we're going to shut them off and buy from you. That's managed trade which violates explicitly some international rules, certainly violates the norms involved. But then what about the countries that get diverted from?

Suppose Mexico very bluntly says, we'll buy more American agriculture and less Brazilian agriculture. Well why wouldn't Brazil retaliate against Mexico? They certainly would be within their rights to do so. If Mexico made a governmental or public policy decision to shift away from somebody who had met the market test and was you know, selling through normal economic channels, that other country would have full right then to retaliate against Mexico. So Mexico has got a third country problem doing anything of that type.

In some of the famous Japanese cases that I mentioned where the Japanese agreed with these voluntary "import expansions," it was widely rumored that they bought more U.S. semiconductors and dumped them in Tokyo Bay. They didn't actually divert them to somebody else. They didn't use them. They just capitulated to the U.S. for the reason you said, raw power, and didn't even use the procured products.

That may be apocryphal but I suspect the metaphor is largely accurate. So there are some basic reasons to doubt the wisdom, not to mention the practical reality of doing that kind of thing.

Now there is a way through that in a sense. I didn't talk at all, Mack did, about the global supply chains that are now so extensive between the U.S. and Mexico. President Trump could lean on you. Other companies in this room, he's leaned on some already in the past and said, well you guys have these supply chains. So instead of producing those 17 components in Mexico, bring them back here.

And the US companies for whatever reason might decide to comply with doing that. And then it would be less of a problem for Mexico in the trade policy terms I mentioned. Though in terms of economic impact, there'd be some hell to pay.

But maybe Trump's company by company strategy could be inserted into this kind of program to try to make the numbers look better. Whether that would have any beneficial net impact on the U.S. economy as a whole, I have severe doubts for the reason I indicated. But if the idea is to claim a couple of victories and cite some thousands jobs, saved or procured, I suppose they could pursue it.

Thomas McLarty: We'll see. Next question.

Tom Duesterberg: Tom Duesterberg, Hudson Institute. Fred, you I think rightfully emphasized macroeconomic structural reforms as being more important to addressing the issues that this administration wants to address.

Paul Ryan and his colleagues have put out a rather well-articulated, I think, tax reform plan which they argue strenuously will actually do a lot more to address trade imbalances by addressing the incentive structure to produce in the United States versus producing abroad. Do you think that's a valid way to approach this overall problem? And would it actually have some result in reducing some of the trade imbalances?

Fred Bergsten: Well this is the famous border adjustment tax that's been part of the Ryan-Brady Bill all the way through. We've done a huge project on that here at the Institute. We published lots on it. The bottom line is that it would not be effective in helping to deal with the trade problem. And there are two reasons for that.

One is it's almost certainly illegal under the WTO, the way it's been structured. And that would open the U.S. up to retaliation against its application, which would obviate any gains.

But even if you didn't get full retaliation, we've done some serious analysis that shows that if you did put a tax of that type on, and if it did reduce your imports as a result, the exchange rate of the dollar would appreciate in result and provide an offsetting loss to your competitive position. So the whole thing would tend to net out.

Two of our colleagues actually studied cases where other countries have applied tax changes of that type. And the evidence, while not 100 percent sure, is pretty convincing that you'd get an exchange rate offset that would tend to obviate most of the gains.

Now the Trump people have talked about the flip side of that. Maybe Mexico, which does now rebate at the border as a value-added tax, maybe they should stop doing that. Maybe they should stop doing it vis-à-vis the United States and give us the discriminatory benefit. Well that of course, would again violate fundamental precepts not only to Mexican law, but of international law.

My own preference incidentally, would be for the U.S. to adopt a plain vanilla value-added tax as a substitute for much of our current income taxation. Then you could without any ambiguity adjust at the border and it would be a kind of ersatz currency devaluation. It again, might be offset by moves in the exchange rate itself, but at least it would give you a leg up. And I actually hope that the tax policy debate moves in that direction.

Thomas McLarty: Good. Thank you.

Tom Duesterberg: What about the other elements of the proposal reducing corporate taxes going to a territorial tax and going to full expensing?

Fred Bergsten: Good things. Good things. They'd improve U.S. competitiveness, all for that.

Thomas McLarty: Good. Congressman Boustany, we'll give you last question here before we get to Monica and her panel.

Charles Boustany: Thank you. Very good presentation. Fred, I'm curious. One of the things that could complicate this would be these section 232 investigations. I'm deeply concerned about it. I had a recent conversation with one of my former colleagues on the Ways and Means Committee trade subcommittee and asked him, have you guys had any conversations with Secretary Ross or USTR Ambassador Lighthizer with regard to the impact of this on NAFTA renegotiation or any other trade discussions we're having? And there's been no push back. This is relative to the politics of trade policy right now. But it seems to me that this is a dangerous slippery slope to go down invoking national security broadly, or even somewhat narrowly, in the context of trade negotiations. To what extent do you think this will complicate the renegotiation?

Fred Bergsten: Well it's a very good question, Charles. And I think it complicates the NAFTA talks enormously because much of the process protection that the administration has already initiated winds up heavily hitting Canada. The objective of the 232s, the steel and aluminum global over-capacity problems, are sort of aimed basically at China. But in fact, the bulk of the U.S. imports, particularly of aluminum, but also of steel to some important extent, come from Canada.

Our colleague, Chad Bown, has just published another paper. I don’t know if it's out here but it's on our website, which traces with some quantitative specificity the impact of the steps that the Trump Administration has already taken that could lead to new trade barriers. It turns out that the biggest hit by far is to Canada. Mexico is also hit for a few billion dollars. So Canada is about $20 billion dollars of trade coverage under the steps that have been initiated already.

So to put it mildly, it does not start off the NAFTA renegotiation on a very positive footing. You could say, well this is upping the ante showing how tough the U.S. is going to be if you guys don't comply. It depends how Mexico responds. But it certainly indicates the potential, underlying what I said in my remarks, to go down this managed trade route using whatever domestic legal devices are possible, and that I think does not augur well for any of this.

Thomas McLarty: Fred, thank you very much. You've clearly set the table for the next two panels for the discussion. I think you've done it in a, as we anticipated, a serious, depth-full way, realistic, but you had a hope there at the end of how we could get this done. And I hope you're right. I think you are. And Monica, we'll turn it over to you to the next panel to proceed with our discussion. Fred, thank you very much. Final word.

Fred Bergsten: And I'll now dribble away into the sunset.

Thomas McLarty: Hitting a three pointer.

Fred Bergsten: Thanks, Mack.

Unknown Male: Test, test.

Monica de Bolle: Okay everyone, if I could ask you to please take your seats so that we can resume our discussions going into the first panel.

So it is sort of serendipitous, I guess, in a way that we're having this conference on the day after the public comments have been submitted to the USTR. As some of you probably know, the USTR site on NAFTA comments crashed yesterday with the amount of comments received.

Some of these comments were, from what I have seen in the press, very positive, which is what we're looking for in this conference today. Others not so much, as expected. In any case, to further continue our discussion we have a panel of very distinguished speakers and I will introduce each in turn.

Our first speaker is Antonio Ortiz-Mena. Dr. Mena is a senior advisor at the Albright Stonebridge Group where he provides strategic counsel and assistant to clients across Latin America. Prior to joining the Albright Stonebridge Group, Dr. Mena served for over eight years as the head of economic affairs at the Embassy of Mexico in the United States. And in this role, he served as the embassy liaison with the IMF, the World Bank, and the Inter-American Development Bank, as well as the G-20 and the Mexico-U.S. high-level economic dialogue.

He was also responsible for U.S.-Mexico energy telecommunications and aviation issues and oversaw trade and investment promotion. From 1999 to 2007, Dr. Ortiz-Mena was a professor of the international political economy at one of Mexico's leading research and policy analysis institutions, the Center for Research and Teaching in Economics in Mexico City.

Dr. Ortiz-Mena began his career in the Mexican Government where he held multiple senior advisory roles in the NAFTA negotiation office of the Ministry of Trade and Industrial Development, the Ministry of Fisheries and the Budget and Programming Ministry. And we're very honored to have him here today.

Our second speaker is Dr. Daniel Trefler. Dr. Trefler is the J. Douglas and Ruth Canada Research Chair in Competitiveness and Prosperity at the Rotman School of Management and a senior research fellow at the Canadian Institute for Advanced Studies.

Professor Trefler is an internationally respected trade economist known for his path-breaking contributions to fundamental research. This research has been instrumental in the design and pursuit of trade agreements that promote productivity, innovation, and investment while minimizing the harmful effects on workers and the most disadvantaged. He has also helped to frame the document that launched the Canada-EU Trade Agreement.

In 2016, he won the Killam Prize in Social Sciences, which is Canada's Nobel Prize, the 2016 Bank of Canada Fellowship Award, and a Canada Research Chair, all three major awards of the Canadian Economics Association. He is the co-editor of the Journal of International Economics.

Our third speaker is our very own Gary Hufbauer. Dr. Hufbauer is the Reginald Jones Senior Fellow since 1992 at the Institute. He was formerly the Maurice Greenberg Chair and Director of Studies at the Council on Foreign Relations, the Marcus Wallenberg Professor of International Finance Diplomacy at George Washington University, amongst a host of other positions.

He has written extensively on international trade, investment, and tax issues, co-authoring a number of books notably on NAFTA, many, many articles and books, NAFTA Revisited: Achievements and Challenges in 2005 being one of them, and others with his colleagues at the time of the NAFTA, the original NAFTA negotiations, Western Hemisphere Economic Integration in 1994, Measuring the Cost of Protection in the United States, 1994, and NAFTA: An Assessment, in 1993 and another in 1992.

So with that I will ask Antonio to please come to the podium first. Each speaker will come and speak at the podium. And then we will all move to the dais. Thank you.

Antonio Ortiz-Mena: Thank you, Monica, for that kind introduction. And thank you, Fred and Adam, for this also very kind invitation. I've had a long-standing relationship with the Peterson Institute. I must say that when I was a member of the NAFTA negotiation office, I was a consumer of Peterson Institute products, specifically North American Free Trade issues and recommendations authored by Gary Hufbauer and Jeff Schott. So I'm glad to be here on the producer side of things.

And I'm usually not a huge fan of PowerPoint presentations, but we are not living in normal times. And I'm going to cover a fair ground. And I wanted to be very explicit of where I stand on these issues, and to address them in the Q&A session, and later on in a paper I'm working on also for the Peterson Institute.

So I want to start by saying what I think is a positive NAFTA renegotiation, and then what I think is a negative NAFTA renegotiation. And then I'll give some specific recommendations on how NAFTA can be upgraded.

First of all, I wouldn't say that this is a Mexican view, not the Mexican view. This is Antonio's view. This is just my own personal view. And first of all, I think that NAFTA status quo has to be seen as the floor for negotiations.

That means as some of you at this room might remember. Read my lips, no new taxes. That is to say, no new tariffs which are a type of tax. No quotas. And I think that the approach should be modernization rather than renegotiation.

Sometimes those words are used interchangeably. But I think it's important to focus on modernizing rather than renegotiating NAFTA and using as far as possible TPP as a template. I think that a positive renegotiation implies a trilateral agreement, not two bilateral's. It implies a prompt agreement and this is fairly atypical. When I was in the NAFTA team, the mantra was that the content will determine the timing. And whenever we were asked about the timing, the content determines the timing.

In this instance, as I said, we're not living in normal times. And I think the timing is very important because summer of next year there will be presidential elections in Mexico. And it is politically very difficult to keep negotiating emotional and contentious and complicated issues while there's a presidential race going on in Mexico. So I do think it is very risky to kick the can down the road and see what happens later on.

I think it's important to have a prompt agreement. And I also think it's important to have a flexible agreement. NAFTA is pretty rigid. It is difficult to be modified, to be amended, and I think we got to rethink how we do these things in the future.

Now how does a negative NAFTA renegotiation look from my point of view? As I said, as a full renegotiation rather than a NAFTA modernization. An attempt to include new tariffs and quotas, managed trade, and Fred spoke about the slippery slope, about the dangers of managed trade. We have that issue with sugar. When I was at the embassy, it was all about tomatoes. But it is a very dangerous slippery slope.

Another panel will talk in detail about rules of origin. But I'm concerned about overly restrictive rules of origin that might disrupt supply chains. I think that an attempt to restrict trade depending on trade balance is a bad idea. It's a terrible idea. So I don't that should be contemplated. I think that limited liberalization would also be a bad idea.

I think that it's in Mexico's interest, and by the way, in the U.S.'s interest to have a deep renegotiation, a deep modernization of NAFTA, including much more coverage in terms of trade and services and doing away with non-tariff barriers in the case of the U.S., regarding procurement and sub federal restrictions by American et cetera, et cetera.

And negative renegotiation would also be a long-winded negotiation. Again, I think it is very dangerous to say let's do this later. I think that the status quo is unsustainable. I think that NAFTA does need to be modernized. But if it takes too long, we made end up with plenty of nothing and that's not good enough.

And finally, I would say that no agreement is preferable to a bad agreement. And I hope this is understood. Sometimes it is felt that given that Mexico exports more than 70 percent of the exports to the U.S., therefore it must cave to what the U.S. wants. I think this is just a wrong political reading of how things are working in Mexico. And I think it is true that no-agreement would be preferable to a bad NAFTA agreement.

Now that we have sort of a good negotiation and a bad renegotiation template, I will address four issues in terms of how NAFTA can be modernized. First, through updates, and by updates I mean doing now what should have already been done in this over two decades that NAFTA has been enforced. Secondly, upgrades incorporating actually new disciplines. Thirdly, the architecture of the agreement. And then complementary regional measures. These are outside the scope of the negotiation, but I think they need to be taken into account.

So let me just provide some examples. This is not an exhaustive listing of things that I think the three countries should focus on when updating NAFTA.

First in government procurement. According to a NAFTA article, there should be a joint program for small businesses. I think this is important for employment purposes and for political support of the agreement in all three countries. But the advances in this area have not been very significant.

Likely another NAFTA article, the countries committed to further negotiations to liberalize government procurement and there has not been a great deal of further realization. Mexico is still dealing with a lot of buy American restrictions. It limits opportunities for small businesses and for large businesses likewise. It generates uncertainty even though there's supposed to be some NAFTA exceptions. Once you try that in practice, it doesn't work in practice. And I think it limits fair competition. I understand that the U.S. Government wants free and fair trade. Well this would help to start fair competition.

Talking about competition, let me address competition policy. Again, over two decades ago, the countries committed to establishing a working group on trade and competition to issue recommendations on the link between competition laws and trade in the region. And what I've seen so far from my perspective, is perhaps excessive use of AD/CVD remedies. And I think it would be much better to start focusing on national and regional anti-competitive practice determinations instead of only using the AD/CVD arsenal. This has been somewhat of a controversial issue, but I think we need to push the envelope.

Something that's even more controversial is Chapter 19 that allows the establishment of bi-national panels to review AD/CVD determinations. Again, the three countries were supposed to develop more effective rules and subsidies and to assess the possible reliance on a substitute system to deal with unfair trade practices. Well I think a competition policy would be a great way to deal with this.

And I think that for Mexico there is really a red line. I don't see why it would be in Mexico's interest to accept doing away with NAFTA Chapter 19 just at a time when the U.S. is pushing very strongly for enforcement and with a mercantilistic outlook. So I would I would definitely put a red line on Chapter 19.

Now let me talk about upgrades. So these are actual upgrades, rather than getting up to speed with what you should have already been done. First, let me start with modernizing existing commitments. I consider that the TPP should not be used as a floor or a ceiling. That is to say, as the minimum that should be contemplated in the agreement or the maximum. I think it's a very useful template.

But I also believe that there are different trade-offs in plurilateral versus regional negotiations. And I'm not sure that you'll always get more or better concessions in a bilateral way than in a plurilateral way because there are more trade-offs possible in a larger setting. This is just to follow some assumptions that have been made by some persons in the U.S. government.

So first, rules of origin, I think that will be a main focus of negotiations. But there is a risk of putting them at too high a level. That means that if they're too high they will disrupt supply chains or they will be completely ignored. And some companies might prefer to use MFN tariffs and just forget about NAFTA. They can pick and choose. So it is important to strike the right balance. And should they be changed, I think you need a transition phase just like when you reduce tariffs so that supply chains can adjust.

In terms of trade remedies, I looked up the TPP chapter, and there's nothing like NAFTA Chapter 19. So sorry to be obsessive here but it's a NAFTA Chapter 19 or bust. I don't see why Mexico or Canada would accept doing away with that, or in fact, why the U.S. If the U.S. wants to make sure that Mexico keeps its economy open and it does not abuse its own AD/CVD rules, then the U.S. might well use this policy instrument. So let's stick with Chapter 19. If it needs to be perfected, fine. But don't do away with it.

In terms of cross-border trade in services, I think that the aim should be TPP plus. And here I think it might be easier to do it in a regional setting as opposed to a plurilateral setting.

The same with financial services. The coverage under NAFTA was very limited because Mexico first nationalized the banks in 1982. Then it started to privatize the banks. Then it had the famous tequila crisis in December of 1994. So through the crisis, it ended up unilaterally liberalizing financial services. So now they're pretty open and there's greater scope for international agreement.

One thing that I'm concerned about and I haven't seen a lot of talk about this is anti-money laundering. So all three countries, Mexico, the U.S., and Canada have very strong anti-money laundering. But no one has, as far as I know, focused on the opportunity cost of very strong anti-money laundering provisions and what that means for financial integration in the region. That must be a good way, yes, to combat illicit financial flows. But so far, it's been a very blunt instrument. And I think it's real important to address this. And I don't see this in the radar.

I assume that the large banks in the U.S. are sort of concerned about the fallout from the 2007-2008 crisis and all that. They're keeping very quiet. But this issue needs to be addressed. How can we have a regional production platform if financial services flows are hindered? I think this is a very strong point. And then also what about the prudential regulations? The U.S. at least seems to be trying to backtrack and I think it's important to have a very strong regional prudential regulations.

Still with modernizing existing commitments similar to what happened in financial services, Mexico unilaterally opened up its energy sector. So there's great scope to incorporate this now that Mexicans, that we did it ourselves, we were not pushed into doing it to incorporate commitments here.

I think it would be very difficult for Mexico to accept any energy supply commitments. That was a part of the bilateral US-Canada FTA agreement. And I think that hydrocarbons as well as renewables should be addressed and to focus on regulatory coherence. This is where MTBs really get in the way.

There's a bilateral body that focuses on regulatory cooperation. But advances so far have been very limited. I think we really need to push the envelope especially in energy. And, of course, it's key for regional competitiveness and the resource endowment of Mexico, the U.S., and Canada is superb in terms of both renewables and non-renewables. And I think we should make the most of it.

The third item where Mexico sort of unilaterally liberalized is Telecom again during the NAFTA negotiations. The public monopoly was turned into a virtual private monopoly. Teléfonos de Mexico right now, well, there's much more competition in telecoms and also I think greater scope to include this in the agreement, I think we need a networked region and Telecom is an essential part of having a networked region. That's one way, at least the way I look at it. And I think there's no place for complexity.

And I remember the NAFTA: Revisited book by Gary Hufbauer. And he has, I think, a footnote. But just in passing, he mentions the complexity of dialing from Mexico into the U.S., that you need a PhD from MIT to figure out all the combinations of the fixed lines, the mobile line. It might seem like something trivial. But I think it's a mindset. And it's important to do away with this pretty unique non-tariff barrier. You can't dial. You've got to know the special codes.

Again, procurement, I think that U.S. protectionism, especially at the sub-federal level, needs to end. And I think this would be positive because there is frankly a lot of corruption in Mexican states. And this would be a way to combat corruption, to push for greater transparency in Mexican government purchases. And it would also provide a greater market for the U.S. But, of course, Mexico would ask for reciprocal treatment in terms of access to U.S., some federal government tenders.

In terms of a competition, if NAFTA is to be a model, that is to say, if NAFTA is going to be what TPP was supposed to be, the model for international trade and other countries would join, maybe it would be a reason to really double down on using competition policy as far as possible instead of AD/CVD remedies.

Again, another idea that's been floating around for decades, can and should Mexico, Canada, U.S. move at least sector by sector towards a common external tariff? If they do that, that would dovetail nicely with a greater use of competition policy.

In terms of labor, this was a big deal for the U.S. It was sort of an offensive aim during the TPP negotiations. I think it's very important for U.S. domestic politics in the fair trade part of the equation. And Mexico has made some inroads, first a Constitutional reform during the early phase of the current Pena Nieto Administration, and of the Constitution, and then a Mexican labor law reform that is being worked.

Basically the first reform covered the policies governing hiring and firing of workers. It makes it easier and more flexible, which I think works in favor of workers not against them. Because if you cannot fire, you do not hire, or you do it in an underhanded manner. And the second set of reforms have to do with how to deal with labor disputes and union transparency and things like that.

The environment I think, it's also important for a different segment of the electorate in the U.S., but we do have a problem. The U.S. has announced it will withdraw from the Paris Agreement. Mexico is fully committed to doing it. And this is not only a government policy. I think this is a civil society pressure to do it.

The problem is that U.S. withdrawal can create negative externalities. And you might have Mexican companies complaining that there's no level playing field, because they have to comply with different regulations than their U.S. counterparts, U.S. competitors. And I think that the way to resolve this is not a race to the bottom, but race to the top. How you do that, I've got no idea. But I think that's what you need to do.

On dispute settlement, NAFTA panel selection was very complicated and it got stuck in terms of interstate dispute. So it's important to address this and to privilege consultations and conciliation mediation to try to see if negotiated solutions are possible. Should they not be possible, I think there should be quick and effective enforcement. Again, the current U.S. administration loves the word enforcement, right?

Okay, let's have a very strong interstate dispute settlement mechanism. I'm pretty sure that it would also help Mexico so as not to spend decades dealing with some trucking issues or tuna-dolphin issues or you name it.

In terms of exceptions, this might seem like something trivial. Why would I put a slide here giving exceptions? Well given that tariffs are at zero, I think that there should be no new safeguard commitments between the WTO because this is usually where the safeguards crop up. And in the draft letter from USDA that was leaked last March, there was mention about this. I don't think it would be in Mexico's interest to have new safeguard mechanisms.

And in terms of final provisions, there's some accession clause. I'm sure that not a lot of people know that there's an accession clause in NAFTA. It's brand new, never been used in almost a quarter century. If NAFTA is going to be sort of the new TPP, a template, then I think the countries must do much better in terms of accession procedures. I think Chile at one point was close, but nothing has happened. So this needs to change.

In terms of new issues, a lot of people talk about e-commerce. But I would say that e-commerce, it's an ecosystem. I mean, the focus is multifaceted. A big issue has to do with taxation and taxation is not a part of Trade Agreement. And the OECD has done interesting work in this regard. That would be a very important complementary measure. It's just part of the digital economy.

I think that the focus should not be on e-commerce, but the digital economy more broadly that the aim should be for TPP plus. And I see several friends from carriers here, that's been a push on Mexico to increase its *de minimis*. I mean this has been going on for years and years.

So my practical suggestion would be to see how far you can move along just focusing on regulatory cooperation, because if it's just a push on *de minimis* it'll just take forever. I'm just trying to see a different way to get hopefully at a similar outcome.

In terms of SOEs, I think it would be positive for Mexico because it would bring transparency to state-owned enterprises like Pemex or CFE. I don't see any problems here.

In terms of cooperation and capacity-building, I think it's important to be specific and pragmatic. Otherwise, this is sort of a politically correct chapter that has no meaning. The temporary entry of business persons is crucial for capacity building. So there have to be much deeper agreements in terms of temporary entry. And I think that it should be easier to do this just in the North American region than for the whole of the TPP.

In terms of competitiveness and business facilitation, I think that the opportunity cost of limited commitments in terms of a business facilitation and customs cooperation is much higher in NAFTA than in the TPP. And we should therefore be much more ambitious.

In terms of development, again, I've been in these debates for a couple decades. And I think that when development comes into trade debates, it tends to lead to endless philosophical discussions. And some countries might feel happy because it's there. But I'd say let's not focus on political correctness and agree on substantive issues. So let's not get distracted on this. That's my point.

In terms of SMEs, I've mentioned how they're important for employment and to get some political support for the agreement.

In terms of regulatory coherence, it was not seen as a huge deal during the initial NAFTA negotiations. Most of the talk was about tariffs and tariff reduction. But now that tariffs are at zero, this is extremely important.

Fred mentioned a World Bank study about the cause of Mexican NTBs. And I think this should be addressed. And it's in Mexico's own interest to reduce a lot of NTBs to provide for better access to its market and also better for Mexican access to other markets.

Okay, in terms of future up upgrades, as I said, NAFTA is a rigid agreement. And right now, we're seeing the beginnings of the convergence of physical, biological, and digital technologies. That will transform how we produce and trade. So it could be the case that three years from now we could have an obsolete agreement again, and a huge uphill battle to deal with it. I think that issues such as rules of origin and regulatory cooperation have to be addressed. And we must find a way to upgrade it in a more easy manner.

I think it would be interesting to see how the Pacific Alliance can at least be in the sidelines or accede to this agreement, how we will deal with cumulation of rules of origin. In the Q&A session, the exchange rate manipulation was mentioned. I personally don't think it's a good idea to bring it into this agreement, because it would really complicate negotiations, as would be issues dealing with trade balances.

Let me conclude with this. The priorities I set out are not zero-sum. I think that deeper trade and investment links favor regional competitiveness and job creation. And as Fred mentioned, a more prosperous Mexico is positive for U.S. exports and for Mexican investments in the U.S., which are sometimes disregarded.

I think that pushing too hard from a zero-sum perspective really risks unraveling the NAFTA negotiations and making deep cooperation on security and migration politically difficult. So let's hope for a very deep, and ambitious, and prompt NAFTA modernization. Thank you.

Dan Trefler: Well this has been an absolute pleasure being here today. I thought this Antonio talk is just amazing in the richness of detail. Fred, was an eye-opener to me the way you approach things from the macro side. I tend to think of things much more from the micro side.

And then finally just I have to say that as a Canadian far away from Washington, the Peterson Institute has been a real beacon. I have read uncountable numbers of books that have come out of this Institute. So just tremendous kudos to what's been accomplished by this organization. And so it's a super pleasure to be here.

I think we all get the idea that NAFTA can really take one of two approaches. And the first of those approaches, which is not going to be very productive is that we are going to finger point at each other and we're going to blame each other for the plight of our workers in each of our countries. Even though kind of surprisingly, the plight of workers in each of these three countries is quite similar.

And the other approach, the one that I think we have to take, is to think about a united NAFTA trade bloc focused on competitiveness and focused on winning globally as a large single block. So how we're going to get there, for me, you start competitiveness by talking about innovation. I don't think you have to sell that to Americans.

The U.S. has been the world's powerhouse in innovation since forever. So any modernizations of NAFTA must ensure that it promotes rather than discourages innovation. Unfortunately, I'm worried that it may do the latter. And so let me try and make that point to you.

Since the early 1980s, the United States has steadily strengthened the rights of patent holders. And since that is what TPP tried to do and hence will probably come out of the USTR in negotiations with NAFTA. We should ask ourselves the difficult question, whether four decades of strengthening of IP laws in this country have produced more innovation.

So here is the usual picture that we use to discuss that issue. It's a macro picture that is called the patent puzzle. The red line if you look at the horizontal axis. You'll see it will go from 1960 to 2015 so a half a century of data.

The red line is the number of patents granted by the U.S. each year. And you can see in the latter half of this period it explodes. On the other hand, the blue line is the ratio of R&D to GDP expenditures, which has hovered at around 2.5 percent throughout all of this period. So from a macro perspective, there's only one conclusion and that is strengthening of rights of patent holders has not produced more innovation.

And indeed when you go to the micro studies, this is now the absolute consensus of academic economists that strengthened rights of patent holders, is a system that has become out of whack. So numerous studies have shown that extended rights, the rights of IT companies with patent rules reduce innovation rates.

This is hard, hard evidence now. Further, the extended rights have been shown to raise the prices of all sorts of products. I think most notoriously in this city is the price of pharmaceutical products, right. And this is a direct hit to consumers.

Now it's clear that U.S. policymakers are beginning to see this as a significant problem, because when you take a look at what's happening in Congress, at least in the Lower House, State legislatures, the Supreme Court, FDA publications, the Justice Department; all of them are concerned about this issue.

They're concerned that the system has drifted too far in protecting one, the rights of patent holders, two, the rights of data holders which includes biologics and the data-exclusivity provisions that TPP discusses, and the rights of copyright holders.

So what do these mean for modernized NAFTA? Because if we're going to be a competitive bloc, we need to make sure that NAFTA is contributing to our innovation rates. We need to make sure that NAFTA is going to make us able to stand up to an increasingly innovative China.

Okay. So let's start with what I think is sort of the key notion that we have to get at which is policy flexibility versus international treaty. So as I said, competitiveness is based on innovation. So unfortunately for trade negotiators, it is simply very difficult to regulate innovation. Even the most modest attempts by the U.S. to scale back the rights of patent holders has met with, has required enormous policy flexibility from the many organizations, you know, Congress, FDA, Justice, et cetera.

And it's been an uphill battle for reasons that there are lots of vested interests in this country that don't necessarily want to see scaling back of their rights. So the first point is we need policy flexibility because there's vested interests who want to push back on what is good for the entire bloc.

The other reason that we need policy flexibility is that it's hard to regulate new technologies like biologics. How do you do it? What is the right standard? Well the answer to that is the standard really depends on the state, where the technology is, how mature is the technology. And in early stages of technologies, you want a lot of very healthy competition not monopolization.

Okay. So with that sort of background, this is sort of how I see the world. We might want to take a look at what we should expect in NAFTA negotiations about policy effectiveness. Are we going to have policy flexibility built into this agreement? Or are we going to try to lock in vested interests’ positions through international treaties, which are very inflexible and almost impossible to change, as Antonio said, 25 years without a change the NAFTA.

So based on what we've already seen in TPP, let's just think about what NAFTA is going to look like, okay. So here I'd like to go sort of into the weeds here. And I know that's frustrating. But without going into the weeds, you don't get a sense of just how much was buried in TPP, lots of good stuff in there, but also some negative stuff. So let's just try patents alone in TPP.

For example, the U.S. is sort of unique in how it treats post-filing evidence. Most of us think, hey, when I file a patent I need to provide evidence that it works. If I don't have evidence at the time of filing, I'm not going to be granted a patent. But in the U.S. 10 years down the line, you could still be introducing under extendibility rules, post filing evidence. This is a real issue that Eli Lilly has unsuccessfully taken Canada to task in an after panel, but could be pushed in a TPP.

No patent extensions. So there's this issue that seems to be pervasive in the U.S. that Canada granted two-year patent extensions to the EU as part of the negotiations, and that the U.S. should have the same rights. Well, it's not true.

What happened was under a specific area, pharmaceuticals, EU and Canada have very different regulatory environments. But Canada and the United States, and I suspect Mexico, do not have very different regulatory environments. We live on what's called an orange book in the U.S. That is to say, we agree on how to manage pharmaceutical lists. And yet, these issues are coming up and being pushed.

Patent restoration, the TPP talks about this this terrible thing called regulatory delay and how that hurts, erodes the length of patents. And you think to yourself. Well didn't we only have this discussion under TRIPS, where we said where it's very clear from most legal scholars that the reason that we see regulatory delays in patent office is because firms want those delays in order to extend their patents?

So much of the regulatory delay that we see is actually strategic decision by firms. And that's why under TRIPS we made sure that patents started their dates not when the patent was granted, but when it was filed. TPP is trying to unravel that.

Likewise, limits on secondary patenting, which is a host of tricks that firms use to try and block out the ability of firms to come into the market as soon as the patent is finished. Particularly, it's pharmaceuticals and generics.

In the realm of competition policy, pay for delay, big pharma companies when they see their drugs coming off of patent will pay upwards of several hundred million dollars a year to a generic company that they feel could enter the market to keep them out of the market. The U.S. Supreme Court has taken a very dim view of that and yet it still happens. So here's an area where competition policy could be very helpful.

The point of going to the weeds here is that these are all things the TPP is entertaining. These are all things that I don't think are in the interest of the U.S., and they're not in the interests of Canada, or Mexico, or building an effective and competitive trade bloc here. Let me then quickly go through some other areas, because I know this can get very, very technical.

So let's just do biologics quickly. Companies are looking to extend patent life via the FDA regulatory approval process. And this is something that is known as data exclusivity, which is to say what data are we talking about. It's the data generated during clinical trials in the regulatory process. In the United States, companies get to keep that data exclusively for their own use for 12 years. No other country on the planet has 12 years. Canada has 8. EU has 8. Many countries have less.

Well this brings us to this area of policy and flexibility. If we write in hard numbers like this into an agreement, then we have no policy flexibility to change it over time as this industry, which is rapidly changing, develops and matures.

So we need to think about scaling it back, making that data exclusivity limited to eight years, maybe less. We need to think about sunset clauses to make sure that we're forced to rethink this. We force it to lapse so that we're forced to renegotiate. And these are not these are not minor things. This policy flexibility is something that this country, the United States, needs not just Canada or Mexico.

The FDA is very hard at work in thinking about the regulatory environment for biosimilars. What are they going to do once all of that is locked in by treaty? What's going to happen with pharmaceutical drug prices? I believe that we have a quote from the President of the United States saying that pharmaceutical companies are getting away with murder. How do you reconcile that position with locking into long-term international treaties? So we have to be very careful on this front. I'll go through very quickly the last of these because there are so many areas of the agreement that are important.

Under TPP, the world extended, the TPP members extended the Mickey Mouse Patent Protection Act or Copyright Protection Act, beyond not just life, beyond not just Berne which is life plus 50, but they added another 20 years on. Which you might think, oh so big deal, it's a few million bucks that Disney is going to get. But since TPP has been negotiated we now have very clear evidence that there's a much more pernicious effect of this, and that is that it's created what's called the 20th century black hole.

We're dramatically under citing recent innovations and much more likely to cite innovations that are published in journals, which are off copyright. We're shooting ourselves in the foot. So we have to think about these things.

Digital economy is the same. It's not clear that the TPP delivered a really great digital economy agreement. And working within a much narrower set of countries like Canada, and the United States, and Mexico, I think we can write a much better digital economy, a chapter which would be much better on issues of data localization, cyber-security, privacy, et cetera.

I'm guessing that it's time to finish up, right? So let me tell you what the main message is. We're at a great and important time in terms of IP. IP is changing dramatically. Digital commerce is changing dramatically. We need policy flexibility. So we need to make sure that our international treaties do no harm.

That's the mantra that I hear that comes out of Washington. I think that mantra is the right one. I would call it make sure you retain policy flexibility in the most dynamic sections of the economy. And those are the parts of the economy that are going to make us ultra-competitive in the world economy.

The other thing to remember that this is not just about Canada versus Mexico versus the United States. This is a lot to do with American consumers. So let me just like finish up with one thing that really, really worries me, and that's the position of the USTR.

So as drug companies and other special interests use the USTR to push for strengthened IP rights, and I can give you loads of examples of exactly how that's being done, there's a gap developing between what the USTR demands and what is good for the American people. And if that gap gets too wide, for example, on issues like pharma pricing, and that's what happened in TPP, the gap got too wide. We will simply lose NAFTA.

So the message to me is very clear and the message should be even clearer to the USTR, that you have to be very careful about what you ask for. Thank you.

Gary Hufbauer: Well, thanks very much to the organizers, Monica and Fred, and thanks to my colleague, Euijin Jung who helped me with this.

I take away one point from my predecessors, Antonio and Daniel, that this is not going to be a quick negotiation. Whatever else you distill from this, the notion that it can be prompt, which I know is one of Antonio's points, covering these issues would together with a lot of time lines, is not going to be quick. So let me see if I can try to be quick myself.

The Trump Administration really has two new elements of fairness and they do emphasize fairness as well as the old element. The old element which I'm going to come to at the end on my brief remarks, is the familiar litany of anti-dumping, countervailing duty, safeguard and now Section 232, which are all clustered under the notion of fairness to the U.S. or ensuring that our national security is preserved.

Those are the themes of the Trump Administration. How does that fit with Canada? Leave Mexico out. Well on the first one, on bilateral trade balances and I know that Fred wants to keep them even from looking at these, they're pretty wedded to them. So let's just look at it briefly with respect to Canada if the Trump Administration cannot be sold on looking at global current account positions.

On the trade with Mexico and Canada as you can see, there is no bilateral trade deficit problem that the United States has with Canada. It's virtually balanced. And if you subtract out energy, and I'm reading off the statements from the administration, in particular Secretary Ross. He didn't really want to put energy in this bilateral balance calculation.

Once you subtract energy from the bilateral balance calculation, the United States has a big trade surplus with Canada. So Canada is in a very good position even an offensive position as long as we want to talk about bilateral trade balances, which I suspect the administration will want to do even though they shouldn't as Fred has pointed out.

Okay. That leaves the two other elements of fairness in the administration's view. And one is the kind of notion that if we do it, if we have a certain level of barriers and you have a higher level of barriers, that's unfair. And the other is that if you seem to be violating our trade remedy laws written broadly, that's unfair.

So let's look at some of the things that the United States might put to Canada. And I didn't mention intellectual property. I'm quite sure that United States will add intellectual property. I put it some place. But it will not put it in a way that Daniel urged.

Okay. First of all is this notion of a trade balance chapter. Possibly through echoing what Fred has said, and using some just sound argumentation, if there's a trade balance chapter, it will refer to global current account positions and therefore be much less punitive especially with respect to Mexico. I mean that would be the way that Canada and Mexico would want to shape that chapter if we have it.

Next would be a currency undervaluation chapter. Now, clearly all the TPP countries have agreed on kind of this annex on currency that was crafted at the end of the TPP negotiations.

What the U.S. might want in addition would be some kind of surveillance mechanism, and some kind of arbitration mechanism. That goes a lot further, a lot further, even if we could say that today neither Mexico nor Canada has any manipulation history or intent. So that's a question mark. But if it's just the TPP chapter, no problem.

Then we come to the rules of origin. The reason that's a blockbuster is that none of the auto companies want it. Mexico and Canada don't want it. But if you read what the labor organization in this country submitted to the USTR, you can see it wants it, it wants it a lot. And it wants to raise the rules of origin in a way that will increase production in the United States. Well that's a heavy demand.

Then we come to Chapter 19, which for the reasons Antonio talked about will not be an enthusiastic ask of Mexico or Canada, especially given the new initiative on AD and CVD in the United States.

And then finally, I put in this blockbuster, and we don't know that it's going to happen because it's all kind of up in the air, but that the administration could ask Mexico and Canada as Fred mentioned, to desist from their border tax adjustment.

Now here I have to differ with Fred. Border tax adjustments are not required by the WTO. They are permitted by the WTO, permitted. It's optional. They are permitted for taxes, which it's a long discussion, but taxes which qualify as indirect taxes.

But the famous Canadian economist Harry Johnson resurrected David Ricardo when I was in graduate school and pointed out that it really makes no difference whether you have an origin principle or a destination principle. All countries do follow, practically all countries follow destination principle.

But the origin principle for tax adjustment, that is you do that adjustment at the border, has over time, but there's a transition period, the same economic effects. So I mean it's not a matter of religious opposition that Canada and Mexico should oppose this. But there would be transition costs to them depending on how fast they were asked to desist.

Let me turn now to more traditional U.S. interests that are likely to come up. And many of these would be actually very good for Canada. Just as Daniel was saying, maybe it would be good for the U.S. to relax a bit on its patent policies.

Well Canada is quite protective on agriculture or sectors of agriculture, all of which is to the disadvantage of Canadians and, likewise, for alcoholic beverages. There's a long story there. But basically, Canada is very protective on alcoholic beverages. And it would certainly help the Canadian mood as well as the prices if they could relax on that.

The *de minimis* exemptions both Canada and Mexico, we'll concentrate on Canada, are extremely low, $20 bucks. And further, the Canadian who wants to cross from Vancouver to Seattle to buy some stuff for the day and go back if he or she goes back within the day gets no exemption. So that's a problem. And it's not to Canada's advantage or the Canadian consumer's advantage. It's obviously to the retailer's advantage.

The data flow and privacy, Daniel mentioned this a little bit, but Canadian restrictions on data flow and privacy are really quite onerous. They really freeze out U.S. companies. The utility test, which Daniel did mention, is there. I won't go into that in any detail. I take a somewhat different view than Daniel on whether the utility test is a wise contribution which Canada has made to international patent policy. And then we have the domestic support which is quite familiar in aircraft and Canada does it just like the U.S. does, and Europe.

So we have our defensive interests as well, which are going to be in a—and again, basically, the U.S. defensive interests are against U.S. national interests and they should be surrendered. So we had a whole list of things that Canada should modify. I've just listed a few of the things that the U.S. should modify. And the penalty duties we can start with that. But I'll come back to that at the end of my remarks on the whole AD/CVD complex.

The country of origin labeling, it's now migrated down to the state level. And there's some suggestions that have been submitted to USTR that we ought to resurrect country of origin labeling at the federal level. Well that's of course nonsense.

And then we have the Hire American and Buy America which is complete nonsense and completely against U.S. interests. On the Buy American side, we have the Jones Act which is kind of an article of protectionist faith in the United States and raises the expense tremendously. The Investor-State Dispute Settlement mechanism has been updated in TPP and that should be added.

And then there's this final question of whether we're going to let provincial and state representatives come into the discussion at least from some states in renegotiating NAFTA. There are a lot of issues at the state level and maybe it would be good to have some of those state folks there. The Canadians allow their provinces to be in.

Okay. There are common interests. And in the interest of time, I'm not going to go through them, because I think my predecessors have gone through quite well. But there are these common interest which we should be able to agree on pretty quickly.

And then finally is this matter of traditional remedies. As Fred said at the beginning and was mentioned, this is the actual trade policy of the Trump Administration here and now. And Chad Bown has the paper, which Fred mentioned, it's on our website. In fact, there are copies outside. Take a look at this.

This is what's actually happening. If I'm right that the negotiations are going to go on for quite a while on NAFTA, you do have the here and now of these cases. And this is possibly just the beginning. And most of them, apart from sugar, hit Canada right now. So there are a couple of questions about these. It's been recognized by my colleague Jeff Schott and many others that really all this trade remedy stuff should be folded into a safeguard, a broader safeguard pact, because that's what it's about. It's not about fairness, but using the language of fairness helps to keep these laws in place.

The impact is very large. Just yesterday, or the day before, Secretary Ross tossed in semiconductors being another issue. And there will be others. And so a couple of questions whether any of this AD/CVD 232 can be modified within the renegotiation of NAFTA, that's a big reach. And then secondly, will they be folded into the NAFTA talks? I don't see why Canada would not want to fold them in. But again, if folded in, that's even more complexity than we already have. Thank you very much.

Monica de Bolle: So thank you very much. This was a very, very interesting discussion. Thank you to our distinguished speakers. We are running a little bit out of time. So we're not going to have too much time for questions. But I will in a moment pass the word onto you, into your questions.

Let me just say that we have been citing the Hippocratic Oath here today for many, many times over. And we have been speaking of positive negotiations. There's one aspect of the

Hippocratic Oath that reads I will not be ashamed to say I know not, nor will I fail to call on my colleagues when the skills of another are needed. So here's something else from the Hippocratic Oath that we should heed.

So with that, let me open the floor to questions. We have a microphone up in front. We have another one in the back. Please do state your name and your affiliation when you ask a question.

Kim Frank: Yes, hi. Hi, I'm Kim Frank. Can you hear me? Okay. You spoke about having a trilateral versus a bilateral negotiation. And I was interested in talking a bit more about why that's important and what does that mean for the United States? I mean what's in it for us, so to speak?

Monica de Bolle: Let me take a couple more questions from the audience. There's one over there and another.

Dave Nelson: Hi, thank you. Dave Nelson with GE. I'd like to go back to the point that Gary started out making early on, which is that you've outlined some very ambitious suggestions, some ambitious ideas, a fairly extensive list, and some very complicated difficult issues. How do you score that with the goal of getting this done by the end of the year? Is there a path to actually achieve an agreement by the end of this year?

Monica de Bolle: Anybody else so that we can open? So, Fred.

Fred Bergsten: Antonio, you said no deal is better than a bad deal. You sound like Theresa May on Brexit. But here's my question. If no deal means no NAFTA because Trump responds to a failed negotiation by withdrawing, do you stick with your dictum?

Monica de Bolle: So please, and then we'll take one other question afterwards. Please go ahead anybody who wants to in order.

Antonio Ortiz-Mena: Okay. I'll do the trilateral. First of all, I would say this has to do with the way markets are already working. A lot of times, trade agreements follow markets rather than lead markets. So there is a deep integration of trade and investment links in the North American region. And I understand there will be a future panel on value-added on trade. They will get at this issue.

So if you do not take a regional perspective, you risk segmenting, cutting off existing supply chains and also doing away with the potential of the region working jointly. From a more structural perspective, you have a demographic complementarity. Mexico is younger than the U.S. and Canada. So there's a demographic complementarity. And then lastly in terms of energy, the three countries are blessed with both renewable and non-renewable resources. And by working together, they could radically increase the productivity. So I do think we should keep a trilateral focus.

Dan Trefler: Dave, you asked a tough one. You want to try it first or should I?

Gary Hufbauer: Go ahead. Go ahead.

Dan Trefler: I live in a very different environment where I have an effective government that will get things done quickly if it needs be. It’s not sort of locked up in Congress.

Adam Posen.: Sorry, we can't hear. Can you adjust the microphone?

Dan Trefler: Am I on? Is it on? Is this better? All right. So, Dave asked a question about whether we can get it done. S o I guess the thing that went through my head is just thinking about organizational change management that we're not going to get it done in six months or a year. That's absolutely inconceivable.

But what might be conceivable and what we try to do in business is you set out some short-term goals. So if the president needs to win on specific issues, you try to make sure that he gets those wins early on so he can show something that will then take the spotlight off of the negotiations.

And so we set out, we say we'd like to accomplish this. We don't need to sign in six months. Maybe we need to sign in three years. But we need to accomplish this, this, and the other. And we had examples of that in TPP too where we had, for example, Canada came in where we settled certain chapters, locked them down, and then went on to negotiate other chapters with a firm commitment not to revisit those other chapters. So maybe we could do this chapter by chapter.

Gary Hufbauer: I agree with what Daniel has just said. And I'll reiterate that given everything that's on the table. And David Short just told me that when he submitted his comments on NAFTA for FedEx last Thursday there are already 3000 submissions. And so probably today probably by the time they close the window, it's 4000, 50000 submissions.

Well there's a lot of repetition there, but there are a lot of demands that represent particular companies and so forth who are going to be unhappy if theirs are not dealt with. That on top of the statutory time lines in the U.S. statute on top of all the agenda items which were mentioned, I think mean that a prompt path is, that's just not on.

But as Daniel said, if we have deliverables, look how happy President Trump is and Secretary Ross with the beef to China. Well we can have a lot of those kinds of deliverables that can be the subject of PR statements. And we can have also this corporate business including GE itself. I don't know. Maybe David is already writing an announcement about what GE is doing to put up a new plant in the U.S. instead of in Mexico or Canada. That kind of thing, each of those announcements, that's the kind of deliverable that would please the administration.

And then I want to come to the final which I think is the real crunch point. Now if Trump actually listens to Fred and shifts his goals from a bilateral deficit to maybe global deficits or maybe stops talking about deficits in the context of trade negotiations, then that makes the path much easier. But President Trump has had these views which he's expressed for at least 30 years. So I think it's unlikely that he will shift.

And here's the problem that that makes. If you have a prompt negotiation, you're not going to get the kind of reduction in bilateral deficits which he has promised to the battleground states. So why do you want to wrap up a negotiation when Schumer and the other Democrats who are totally mercantilists as well will tell him [inaudible 02:15:51], so forth, tell him you failed. Trump could tell them, you failed. You didn’t deliver it. So why go through that pain?

Antonio Ortiz-Mena: Yes. In terms of no deal is preferable to a bad deal, I would say there is both a political component to this and a sort of technical trade policy component to this. In terms of the politics, President Pena Nieto has stated that his aim for the negotiations is to have tariff-free quota-free access to the U.S. He's on record of saying that. And there will be presidential elections next summer in Mexico. So it will be very difficult to draw red lines and then to erase them, although it's been done in the past. I just think it'll be a very heavy lift to do that.

And from a more trade policy perspective, I would say that's the main aim in NAFTA for Mexico was to create policy certainty, stability, and clarity and rules that would favor both domestic and foreign investment into Mexico to produce in Mexico to export to the U.S. and to other markets. And if you end up with a very convoluted agreement that is a sort of modern version of managed trade, I think that would not fulfill that purpose.

And it could be the case that Mexico might prefer to live with WTO rules and MFN tariffs. It's got already pretty good access to the U.S. market whereas the U.S. would have much more difficult accessing the Mexican market. And the supply chain is already established. So any sort of disruption to those supply chains would be felt very strongly in the U.S. It's not the ideal world, but I don't think it's an impossibility. I hope we get a good NAFTA modernization, but it's not impossible.

Dan Trefler: Fred, we really should throw the question back at you which is that's what transposition is as well. If I don't get a good deal, I'm going to walk away from it. What I fear about that most clearly that's going to wreak havoc and that would be an absurd outcome for this.

But looking to the next step is the world has changed fundamentally. We now have a China which is this close to doing things like inventing a quantum computer that will break every single cyber-security code in this country. They will be able to launch smart missiles at the U.S. Navy.

China is now a significant player in high tech. And then we have these petty disputes about things like Bombardier versus Boeing or about whether the state should buy American or not, when companies like the CRRC, China's rail company, it employs as many people to produce rails in China as all of GM worldwide. We're living in this fictitious world as if all that matters is what happens trilaterally. And really what matters is establishing the trilateral competitiveness vis-à-vis the rest of the world.

So all of us have to ask that question. Would we want to step out of a bad deal or not because the alternative is not just the havoc it disrupts trilaterally. It's that the rest of the world is not playing statically. They're going to come right at us dynamically.

Monica de Bolle: So let me take one final question from the gentleman over there who is standing up before.

Male Speaker: I'm Rob Vigfusson from the Federal Reserve. I was wondering if Gary could expand a bit more because he seemed to have a different take on patents than Dan in terms of the benefits of the patent policy in these policy agreements?

Antonio Ortiz-Mena: In some sense – Gary may I try? In some sense it's a moot point because the NAFTA panel has ruled very, very clearly on the differences between Gary and I on this. So I think for me the reason that I brought up some of this is to give you a sense of some of the pressures that the USTR is facing from special interest.

That is to say, for example, Gary on one of his slides put up that utility doctrine has led to the disruption, invalidation of many U.S. patents in Canada. The USTR claims 28. The NAFTA panel when it looked at that number said, it's a fiction created by Eli Lilly. That at most there's been three of these.

So just to be clear here, there is a lot of misinformation about this. But my main point is not that we have to harmonize our regulations. Part of it is we just have to recognize that the USTR is under a lot of special interest politicking. And we want to make sure that the USTR is doing what is in best interest and speaking as a Canadian in the best interest of American consumers.

Gary Hufbauer: Well, I'll try to give a 30 second to 1-minute response. There's the big picture and then there's the patent utility issue. The big picture is that at least half the value of S&P 500 companies is what they have in their heads trade secrets, patents, copyrights, and so forth because you look at the value as much larger than book value. So for the U.S., this is an enormous proposition. I mean you're not going to wipe away a set of laws which essentially protects U.S. intellectual property globally. That's the big picture.

Okay. Coming down to this very particular issue on patent utilities, patent utility doctrine. The Patent Utility Doctrine internationally is that there's got to be some use of the product, but it's been very mechanical. What the Canadian Supreme Court decision said is that for these pharmaceuticals if you couldn't prove the use of the particular pharmaceutical at the time you filed the patent, then the patent is no good.

The problem is that these tests to establish the utility phase 1, phase 2, phase 3 take time. So if the company couldn't file the patent in the early time, it runs the risk of it being preempted by some other patent filer while it's conducting these tests. Dan is completely right that the panel found that this is not a violation of NAFTA. That does not mean that the patent utility test as applied by the Canadian Supreme Court is any good.

Dan Trefler: So Gary, let me add one more thing which is not to—this is about American perspective. This has nothing to do with Canada. American doctrine has largely been shaped not by statute but by drift in the Federal Circuit Court. And that drift is driven by—I don't want to get into it. But if you want to read about it, there's a terrific book about the political economy of intellectual property in the United States by two leading legal scholars, which is Landes and Posner.

And you'll see what is happening in this country is really not necessarily in the interest of this country. That's independent of the dispute that Canada and the U.S. had. So we need to really think about how firms are using this drift to their own advantage.

Adam Posen: Thank you all very much. Thank you to Gary, to Dan, to Antonio, and to Monica for chairing. We are now going to take our belated lunch break. In 15 minutes, we will reconvene for our final panel with Cullen Hendrix, Caroline Freund, and Jeffrey Schott. Please get your food. And please those of you watching on-line tune back in, in 15 minutes.

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Adam Posen: Good afternoon everyone. Thanks to all our guests who made time and who so quickly served themselves of our elegant lunch. Thank you for not engaging in a food fight in the middle of the hall. And thanks especially again to Monica, Antonio, Daniel, and Gary for the excellent last panel.

As you could probably tell for those of you following the program, we're sort of taking a matrix approach. We had, of course, Fred and Mack McLarty, giving us the big picture up front on strategy and values. We had a perspective from various national takes, Mexican and Canadian both implicitly and explicitly, US in the last panel.

But now, we're turning to the issue of critical sectors looking at particularly autos and agriculture and then the modalities of how this will go forward. And I'm very grateful that under Monica and Fred's coordination and leadership, we have three of my colleagues here at the Peterson Institute to lead our discussions on this.

First up will be Caroline Freund who, I think, is almost to the point of needing no introduction in today's trade world. She's been a senior fellow at the Peterson Institute since May of 2013. Prior to that, she was chief economist from Middle East of North Africa at the World Bank after nearly a decade being a leader in international trade research in the research department there and prior to that at the IMF and the Federal Reserve Board.

We published her very influential and, I would say creative frankly, study, Rich People Poor Countries: The Rise of Emerging Market Tycoons and their Mega Firms." But many of you have seen her steady stream of very solid interesting work on current trade issues including release this morning her new policy brief, "Streamlining the Rules of Origin in NAFTA," which particularly focuses on the auto sector. And she will be leading off.

She'll be followed by our colleague, Cullen Hendrix, who is a non-resident senior fellow here and is associate professor at the famous Josef Korbel School of International Studies at the University of Denver. Cullen is a rare find, a political scientist who can talk econometrics with economists and who is able to talk environment, food, and conflict. In fact, that is what the lab he directs in Denver. We also just published his new policy brief, "Agriculture in the NAFTA Renegotiation." And it is hard-hitting, I think, to say the least.

Finally, for this panel, we have batting cleanup, Jeffrey Schott. Jeff has, of course, been one of the mainstays of trade work here at the Peterson Institute nearly from its founding. And along, as I mentioned earlier, with Gary Hufbauer and Fred Bergsten, one of the creative forces behind our analysis and behind NAFTA, and more recently played a leading role, of course, in chorus. He led our work on TPP and its legacy and it isn't dead yet, but also has done numerous studies on NAFTA and particularly having to do with the environment in NAFTA.

Since 2003, he has been a member of the Trade and Environment Policy Advisory Committee with the US government. He's also a member the State Department's Advisory Committee on International Economic Policy. And, of course, also along with Gary Hufbauer and others is a leading voice on economic sanctions. Jeff will be taking us through, at the end of this day, of talking about the agenda how this agenda goes into practice in the modalities of the negotiation.

So, again, thank you all. I think this is a great project. Thanks to Fred and to Monica, but first to Caroline Freund.

Caroline Freund: Thanks, Adam. So let me start by saying I wrote this policy brief initially intending to focus entirely on autos. Roughly 20 percent of trade in NAFTA is a result of the highly integrated vehicle auto supply chain or vehicle supply chain. The transport sector is also a large share of the trade deficit with Mexico. So it's clearly an area that's going to be important.

The administration has focused on rules of origin. So I took it more broadly to discuss rules of origin. And then I'm going to discuss a bit about the vehicle supply chain because it seems like that's the direction that they're going to go in. I'm going to make two points.

The first is they're right. Rules of origin do need some fixing. Unfortunately, the direction is a bit different from the way they want to take it. So they don't necessarily need to be tightened. They need to be loosened. So this is what I'm going to try and convince you and hopefully the administration of.

So let's just start by thinking about what Ross has already said what we know they're thinking. So Secretary of Commerce Wilbur Ross has said in various interviews with CNBC, Wall Street Journal, et cetera. They're not a very sturdy one. They need some tightening. They're holes where people from the outside can benefit.

So this is what I'm going to say is wrong that in fact the direction is the opposite. The rules of origin in NAFTA are probably the tightest of any free trade agreement in the world so that IDB did an extensive study of rules of origin. And when they calculate how tight they are based on looking at product-by-product restrictions they find that they're actually the tightest in the world.

So let's just take a step back and ask why we even have rules of origin in free trade agreement. It's simply to protect against tariff arbitrage. So that's the reason. So, for example, the tariff in the US on peanuts is over 100 percent. Without a free trade agreement, exporters export to US or to Mexico. But with a free trade agreement if there weren't rules of origin, you could transport peanuts via Mexico then duty-free into the US and escape that tariff. So that's why we have rules of origin purely to prevent this kind of tariff arbitrage. Unfortunately, they're also used as a form of protection and that's what we need to be careful of.

So what did they look like in NAFTA? As I said, they're product-by-product. If you're really interested, you can read an incredibly dense 304-page annex on the topic that goes—it has a page and a half just on men's boxer shorts describing the type of fabrics that can be used in order for products to qualify.

There are three types. One is originate in so that would be like the peanuts they have to completely grow; change in tariff heading so that's a change in the type of product; and then regional value content. Note: This is not US value. This is regional value. So there's nothing about US content in these rules of origin. As I've already said, the rules are very tight and the trend is more flexibility over time in US free trade agreements. And TPP actually would have simplified the NAFTA rules of origin and lowered the regional value content in particular for autos.

Mexico and Canada objected in part because their part suppliers rely very heavily on these rules of origin to get more content through. So this suggests that it's actually them that are going to benefit much more so than US from tighter rules of origin.

So to give a very specific example, this is the rule of origin for a car is it has three parts. It requires a change in tariff heading to ensure that cars are actually produced in in the country they're coming from. It requires the regional value content of 62.5 percent. You can imagine trade negotiators are arguing. 60. No, 65! It had had to have somehow gone to 62.5.

And the method, so even the method of how you calculate this is described. And it goes into specific parts and so on. Again, it does not require US content.

So they're designed to protect against trans-shipment. But in fact, they're used as a kind of protection. So there are two problems. One, they raise—there are two distortions they create. They put protection on the final good onto the intermediates used to produce them. Because, one, they force firms sometimes to use more costly regional inputs. So in the car example if it would be optimal, say, to have 60 percent, they use a few more regional inputs that are more costly than foreign ones. And that raises costs for producers, makes companies less competitive, and raises prices to consumers.

In addition, there are administrative costs because you have to fill out all this hefty paperwork in order to comply. And for the car companies, you have to trace in really extensive Excel spreadsheets all these parts coming from all over the world. And with global supply chains where things are going back and forth, it's become very complex. These were designed in 1994 well before supply chains got so complex.

And they're especially burdensome for small firms because these are kinds of fixed cost. And for a small firm wanting to export a small quantity and there's this hefty fixed cost you have to pay, it can even discourage them from trading.

Just to show you how they're part of the whole kind of trade protection system, this is a ranking of rules of origin by the IDB, the one I mentioned, where they did it product-by-product. And it ranks the rules of origin in NAFTA from one which are the products with the least restrictive rules to seven which are the most restrictive rules. And what you see is that the average tariffs are higher on the ones with the more restrictive rule because these things tend to move together. These are the products that the US was really trying to protect.

But they don't guarantee more -- and I should have written regional not even local there. They don't guarantee more regional content because at some point because they're costly, what our companies going to do. They're just going to go through the MFN. The MFN tariff on autos is 2.5 percent. So if you keep making it more and more and more costly to comply with rules of origin, at some point, it's cheaper simply to import via the MFN tariff.

So on the horizontal axis here what I'm showing is the rules of origin requirement what's on the books. And the vertical axis is what companies are actually doing in an industry. And what you can see is that when they're too low to bind simply it's the optimal regional content. As they get a bit stricter, there's a point at which regional content goes up because of the rules of origin. It's not necessarily good for welfare because the firms are using more expensive inputs. But maybe if you care about local production or you do want some regional content, then it's good.

But at some point, it becomes too expensive to comply and regional content falls. And there's a real danger. What I've done is I've looked at how firm or how products within NAFTA are complying with rules of origin and the imports are coming in via NAFTA or via MFN. And what you see is that sometimes these rules of origin are too costly. And firms are simply issuing preferences and coming in through MFN.

So this is what I'm going to show here just to show. Remember, the low tariff products actually have less rules of origin. And yet, more products are issuing preferences to come through MFN because you know what? That tariff is low. I might as well just go through MFN and not bother with all the extra paperwork or have to comply. So just to show at an average level, not all of our trade with Mexico, with Canada, is through NAFTA. Some of it comes through MFN precisely because these rules of origin are in place.

Now let me just turn quickly to the auto sector. This is just a picture to show that there are so many parts used in a car these days. And so change of rules of origin can disrupt these supply chains where these parts are coming from all over the world.

And the NAFTA supply chains are especially important. Fully three-quarters of US exports to Mexico and two-thirds of imports are either intermediate goods or trade within firms. So this is just to give you a sense of how important supply chains are in the NAFTA. And in the transport sector, they're even more important. So, again, you see extremely high shares of trade either in intermediate or in a related party trade.

So supply chains have been designed around the existing rules of origin. And in autos, most of the trade actually does go through NAFTA. So if you look at it by value, more than 95 percent. But if you look at it by product on average, it's actually pretty low. It's lower than that. About 23 percent doesn't go through NAFTA. And there's some really big products that aren't going through NAFTA because these rules are getting so complicated. So, for example, 20 percent of drive axles which is trade of a billion-and-a-half enter through MFN similarly for car radiators just to give you two examples. And higher import prices will ultimately make our firms less competitive.

So if the goal of this trade agreement as we said in the previous session is to make factory in North America more competitive, the last thing we want to do is constrain the use of intermediate inputs, which are so important in productivity. Obviously, there should be regional content in goods that are traded freely. But arbitrarily setting it at 62.5 percent and then saying we should actually raise it and having all these complicated tracing rules is already too much, not too little.

So to conclude to fix rules of origin, I propose three fixes. One is a uniform rule applying to all products with a simple regional content of 40 to 50 percent. And one thing I didn't mention, and this goes towards the point three here, is that because these rules are different on products and in different regional agreements, it's very hard for a company that wants to take advantage of two different agreements.

So the other reason having a simple rule would be so much better is then we can move towards a global norm that can be applied across regional agreements. And firms won't have to sometimes decide just to export through one agreement because it's way too costly to try and take advantage of two agreements that your country may have.

And also expanding the *de minimis* threshold to help small businesses. So there is a threshold which is set now at $2500 under which you don't have to abide by the full rules of origin. You just need to send a letter not the full form to say it was made regionally. Maybe that threshold could be raised to help small businesses that are disproportionately hurt. And I'll stop there. Thanks.

Cullen Hendrix: Good afternoon. Agriculture makes up about 7 percent of US bilateral trade with both Canada and Mexico and contributes roughly 8 percent to the United States modest trade surplus with Canada and deficit with Mexico. The contributions to member country GDPs are similarly modest ranging from 3.6 percent in Mexico down to 1.3 percent in the United States.

Now as I've said already, these contributions are modest in terms of their shares of trade and their shares of GDP. However, I think you should expect outsides wrangling around agricultural issues in even a productive renegotiation of NAFTA. You will hear a lot more about US sugar, Canadian dairy farmers parading their cows through Ottawa as you see here, and small-plot Mexican corn farmers protesting. You'll hear a lot more about that than you would think given the contributions to employment GDP or intra-NAFTA trade.

The political economy here, I think, is pretty straightforward. Unless your farm happens to be on the outskirts of an expanding metro area as my childhood home, which was built on a recently retired fig orchard was. Farm land is essentially fixed in its current use. And thus farmers face massive costs of adjusting to changes in the policy environment, which is one of the reasons they fight so hard in capital buildings but also in the streets and jungles even to preserve their interests.

In my time, I'd like to make four brief points regarding agriculture in NAFTA and close with some remarks about what a productive renegotiation might look like. First, North American agriculture by and large likes NAFTA and has benefited immensely there from. Second, NAFTA has created cross-border supply chains that exploit efficiencies and provide value for customers and consumers. Third, any disruptions to agricultural trade would disproportionately affect states that vote for president Trump in the 2016 election. So fourth, given all of this, what would a productive renegotiation of NAFTA's agricultural provisions look like?

Ironically and as others have noted, it would probably look a lot like the TPP from which President Trump withdrew the United States on his third day in office. That trade deal addressed most of the outstanding issues related to market access, export subsidies, and coordination around an establishment of sanitary and phytosanitary standards. The TPP set the bar for what could reasonably be expected from a productive renegotiation of NAFTA.

So NAFTA has been a boon to agriculture in all three-member state. Since its introduction, US exports to NAFTA partners have grown significantly in absolute terms and much faster than exports to the rest of the world and grown much faster than prices have increased for agriculture and raw materials. While Mexico's exports outside of NAFTA grew more rapidly than intra-NAFTA exports, this is due in large part to the minimal contribution of non-NAFTA partner agricultural exports to total exports in the earlier period.

Farmer opinion of NAFTA in the United States and Canada is generally positive. Both the US Farm Bureau, the largest lobbying organization on farm interest in the United States, and the Canadian Federation of Agriculture are decidedly pro-NAFTA and deeply concerned about potential downside risk from reopening the negotiation.

Opinion in Mexico is more ambivalent and regionally divided. Unlike the United States and Canada, a sizeable share roughly 14 percent of the Mexican workforce is still in agriculture. Much of this employment is concentrated in Mexico's poorest southern states; Guerrero, Oaxaca, and Chiapas, the benefit very little from cross-border market integration, compete with corn imports from the United States, and where there are still significant pockets of rural poverty and food insecurity primarily affecting indigenous communities.

However, sentiment in the south is balanced by more commercial export-oriented interest in the north. Sinaloa, a northern agricultural powerhouse with access to abundant fisheries, employs about as many 27,000 commercial agriculturalists as Guerrero and Chiapas combined. The northern states account for more than half of Mexico's agricultural GDP and provide significant employment opportunities.

Second, market integration does not just mean more Mexican consumers eating US beef or the Peterson Institute serving Mexican avocado-based guacamole on salmon as you've just eaten. NAFTA has created complex cross-border supply chains that provide benefits to producers and consumers across borders.

The example of pork is illustrative here. In 2014, the United States imported almost 5 million Canadian pigs roughly 4 million of which were feeders so 8 to 12 week old pigs weighing 10 to 60 pounds. They're then finished on inexpensive corn and soybean meal in states such as Iowa, Minnesota, Illinois, and Indiana and then slaughtered and processed in US facilities. This pork is then exported back to Mexico and Canada.

In Canada, cheaper US pork products have allowed Canadian pork producers to focus on higher-value pampered pork exports to places like Japan where their products command a significant market premium. Mexico's pork industry has grown as well in part due to inexpensive feed grain from the United States. Pork, I think, is illustrative of a broader trend of cross-border integration both in supply chains and in investment.

The largest bakery in the United States formerly Sara Lee is now owned by group of Bimbo, which is headquartered in Mexico City. Any disruptions to intra-NAFTA trade would hurt states that strongly supported President Trump in the 2016 election.

This figure plots the share of agricultural products in the state's top 25 exports against exports to Canada and Mexico as a share of that state's total exports. States carried by Clinton are in blue and Trump are in red. Trump-voting states are both more dependent on agricultural exports and more dependent on intra-NAFTA trade than those that vote for Clinton. Moreover, many of these states have senate delegations that are well represented at the highest levels of the US senate and leadership and whose support will be pivotal in getting a renegotiated NAFTA through the senate.

For many of these GOP-leaning states especially the grain belt states of the plains and beef-exporting states of the west and southwest, reopening NAFA entails mostly downside risk as the status quo largely favors their products. In terms of presidential politics, however, these states are comparatively safe GOP states. And recent spats over dairy market access in Canada may signal a pivot by the Trump administration to focusing on issues and products concentrated in swing states like Michigan, Pennsylvania, and Wisconsin.

So given all this, what would a productive renegotiation look like? Ironically, it would look a lot like TPP. If we look to then acting USTR Stephen Vaughn's March 30th draft letter for guidance, the administration has four main agricultural priorities. Seeking to reduce or eliminate non-tariff barriers to US agricultural exports; maintain commitments to eliminate export subsidies on agricultural products, and address issues related to sanitary and phytosanitary standards including provisions that address GMOs. All of these headline issues were successfully negotiated in the TPP including expanded market access into Canada's highly protected dairy market, phase-outs of Mexico's tariffs on beef and pork, elimination of export subsidies, and addressing SPS issues and US producer concerns about GMO products being barred on sanitary and phytosanitary grounds. The TPP encompasses and addressed most of the outstanding agricultural issues and represents the more or less best-case scenario for a productive renegotiation, at least as far as agricultural interests are concerned.

So in closing, I'd like to speak very briefly about what an unproductive renegotiation might look like. It would likely take one of two forms. In the first, agricultural interests especially those that are heavily concentrated in electorally safe blue or red states get used as a bargaining chip in wrangling over non-agricultural issues like domestic content or the restriction of government procurement to national firms.

The Trump administration might, for example, wager that there's more political hay to make in crucial swing states like Mexico and Ohio by pushing issues like rules of origin and threatening loss of agricultural market access in order to force concessions from Canada and Mexico. Threats of reciprocal market access restrictions by Canada and Mexico could then make US agricultural exports a casualty over an argument over the auto industry especially if Mexico can make good on some of the threats that we've heard about to turn southward to Argentina and Brazil for corn and soy.

And the second, the Trump administration might seek to renegotiate many of the contentious issues like dairy market access in Canada and re-litigate issues like country of origin labeling where the United States has recently lost in the WTO. Sugar may wind up being a significant bonus contention as well, the recent US-Mexico agreement in principle notwithstanding. US sugar is especially entrenched and politically influential. So this becomes a significant point of friction possibly.

Because of these complex political economies, agricultural interests will likely loom larger in NAFTA renegotiations than their purely economic contributions to intra-NAFTA trade would suggest. NAFTA has created a large market for member country agricultural products that has boosted exports and farm incomes in each country. Given the Trump administration's dependence on agricultural states for political support and the senate votes necessary to pass any renegotiated NAFTA, the status quo ex ante I believe is likely to be preserved and some TPP related gains should be realized. And I even get to cede some time back to the floor. Thank you.

Jeffrey Schott: Well, thank you very much except to Cullen who has set a bar impossibly high to match. We've had a lot of rich discussion today, and there are a few loose threads. So I'm going to try to tie them together in this final presentation on updating NAFTA.

Just to be clear and I think this came out very forcefully in the first session, the NAFTA record is on balance very positive and there's been a rapid expansion of trade and investment. It doesn't deserve unfettered praise, but it doesn't deserve the bad rep it has gotten in this town over the past 25 years.

It was state of the art when it was drafted, but it's been improved substantially in subsequent trade agreements among other countries. But NAFTA is the only agreement the US has done that hasn't been changed to any significant extent. And that's why we're here today talking about why it needs to be changed. And those changes will primarily involve rule-making changes because most tariffs and quotas have been eliminated long ago. And those that remain are going to be very difficult to address.

Rule-making can be very easy in some areas because of the work that's been done in TPP and elsewhere. And it will be very difficult in other areas like intellectual property. And the previous panel gave you a good demonstration of that set of issues.

Congress insists that all of these issues are covered. And they insist that they be involved in the discussion, preparation, and negotiation of all of these issues. And so Congress will insist that this is a protracted and difficult negotiation.

But it is clear and I think Fred made this case very persuasively this morning. The ultimate aim of the talk should be to boost regional competitiveness. And that's what we have to keep in mind. It's a little different from America First though they can be complementary. You can have America First if you realize that America needs to use the regional market to boost American productivity and competitiveness.

I think it's important just to put a few numbers on the table. You can look at this later. I'm not going to give you the significance of all of this.

But it's interesting that the Trump administration focuses on one small number in the bottoms panel the trade deficit with NAFTA while probably you should focus on much more important numbers in this table; the growth in trade up three times over the period of 1993 to 2016; the growth in foreign direct investment in each other's market. This is really the integration that pulls it all together. That's up more than five times.

And focus on the market share. And you'll see that US export market share in NAFTA has gone up, better partners, better customers for US goods except in services where our market share has gone down. And that tells you something about the area of NAFTA that has been inadequate and deserves much more attention.

So negotiating objectives, I think it's clear from what we've heard today that NAFTA doesn't require major structural reforms. It's done a good job. It just needs to come up to code, 21st century code. It's a lot different than when the House was built in 1993. And that's the way you need to look at the reforms that are needed.

You can have a -- in the very comprehensive agenda that the Congress has set out in the trade promotion authority. You can look at a more discreet agenda, which could be done relatively quickly. And here, there were some talk about doing things sooner rather than later. Some of these rule-making initiatives could be done quickly because a lot of the work has been done over the years in NAFTA building on the experience that we've had working together and in the experience we've had working together in the trans-pacific partnership.

So I've laid out four areas that I think are the subject or should be a subject of priority early discussion though the Congress will insist other issues are dealt with overall as well. The first and here I think there seems to be broad consensus on the need to have a new chapter on e-commerce digital trade certainly to preempt the new restrictions and to include new intellectual property protection and enforcement.

This was spelled out very well in the trans-pacific partnership. But as I think Daniel mentioned in the first panel, there are areas where the three countries in North America can refine that in the context of North American trade certainly to set a template or precedent for broader negotiations or other negotiations that will take place both bilaterally, regionally, and hopefully in the World Trade Organization in the future.

Upgraded and enforceable obligations on labor and environment that also has been a theme for a long time has been included in US free-trade agreements for a long time. NAFTA is way out of date on this. The TPP established probably the best chapters on labor and on environment that have been done in trade agreements anywhere.

That's not to say just copy it because there are areas where those chapters can be improved. We have additional works in this project that are looking at the labor chapter. And the environment chapter I think starting from the TPP baseline is a good place to start and there will be important modifications.

But there is one—critical one—in the area of environment that hasn't been mentioned today and deserves a lot of attention. Antonio raised the Paris Agreement but that's really irrelevant because the United States is in the Paris Agreement until at least the end of 2020. But there is the problem of dealing with the potential distortions that come about when Mexico and Canada institute carbon taxes and we do not.

It's exactly the inverse of what was going on in Washington when we were legislating the Waxman-Markey climate change legislation seven years ago, six or seven years ago, when we were thinking of imposing penalty duties against dirty carbon trade coming into the United States. We have to think about this. It should be the subject of something going forward. And indeed, it could be tied up with cooperative discussions on how to build and strengthen North American energy cooperation particularly in the area of renewables.

The final area of quick and useful rule-making reforms would be in dispute settlement. Chapter 11 investor-state dispute settlement building on the TPP reforms as well as those in the Canada-EU free trade agreement which also have interesting additions with regard to appeals mechanism.

Now this more discrete agenda is not going to yield the big dividends to US and North American growth that would occur from a broader expansion of NAFTA rights and obligations with regard to services, intellectual property, and the other. But it would be a very good start.

Now in the last minute, I think, important to avoid NAFTA landmines and we've had some discussion of this. These are areas where the US might and arguably is thinking very seriously of deviating from past practice. The US trade deficit and rebalancing trading relationships would be more than a landmine. It would be a bazooka at the negotiating table. I think Gary and Fred talked about that extensively.

Restrictive rules of origin as Caroline just mentioned would raise production costs and impair competitiveness of US producers and really isn't necessary. Indeed, in the auto sector, I don't think there's a great demand for it compared to other types of reforms that would be actually beneficial to the competitiveness of North American industry.

Gary talked about the risk of import restrictions to counter the border tax adjustment differences. And here I think that also is an unlikely scenario now but one that needs to be kept in mind.

But probably the issue that hasn't been discussed in terms of a landmine that is dangerous is the Buy American because there are great demands to do more on Buy American. It is a great cost as Gary said to the US economy in terms of raising the cost of US purchases. You get less bang for the buck and causing delays in the contracting and construction of important US projects, which we saw during the 2009-2010 period. And it reduces US exports of goods and services.

Now why would that be? Because if the US restricts Buy American compared to the current situation, Canada and Mexico will do the same. Mexico doesn't sell very much to the US government, but US firms particularly service firms sell a lot to the Mexican government. And any change in Mexican government policies that would inhibit or cancel those opportunities for US firms would result in lost exports. So it is really a very significant landmine that is underappreciated I think here in Washington.

And finally and I think Congressman Boustany talked about other actions that could complicate and even spoil the politics of any trilateral deal and that would be more than dairy and softwood lumber but the 232 national security investigations because if you look at steel, we buy steel from Mexico and Canada. We don't buy steel from China because almost all of that steel is blocked by anti-dumping cases. We bought less than 1 million tons of steel from China last year down sharply from previous years. And any import restriction that doesn't include Mexico and Canada and steel would be worthless.

So this is something I think we have to carefully look at in the days and weeks ahead. And this could be something that undercuts the negotiations before they even start. And I think once the administration realizes that this may be a way of finding different approaches for dealing with real overcapacity issues in important industries. So I'll end on that. Thank you very much.

Adam Posen: Thank you, Jeff. Thank you, Cullen. Thank you, Caroline. All tight presentations not just from time, but from focus and content. Thank you for your contributions.

As we're still playing catch-up on time, I will yield the chair's privilege to ask any questions and turn to our distinguished audience. Again, we have Jessica with the roving mic up front, a standing mic for those of you in the back for whom it's easier. And we will ask you to identify yourself when making a question or a comment. Please, the floor is open.

Sherry Stephenson: Sherry Stephenson ICTSD Geneva. Thank you very much, panel. Very quickly to Jeff, you said that one of the areas where the US could do much more with a lot of potential benefit would be in the area of services. But could you elaborate a little bit how that might play out given that in the TPP US basically put exactly its existing regulatory regime on the table without any opening whatsoever?

Jeffrey Schott: I didn't say it was going to be easy, Sherry. But there is another complication. And too often in trade negotiations, the United States does not put US restrictions on the table. And therefore, the size of the potential deal is much smaller.

There are a number of areas where we can seek and we would benefit from reforms in Canada and in Mexico. But there are also many areas where we would benefit from reforms in the United States. Gary had a few of those in his presentation.

I think focusing on North America would make it easier to drill down into the more regulatory policies that create the distortions in the service sector, easier to do among three partner countries than the larger TPP context. And I'm hoping that that would be the case.

Kim Frank: I had two questions. Kim Frank. First of all, on government procurement, the focus has been on the United States in terms of what people have talked about. Do you see that there's a reason to think that we have opportunities in Canada and Mexico? Because GAO has done some recent work on this and I think there was sort of an idea that there was a lot more market access provided by the US than those countries.

And the second question has to do with the rules of origin. And particularly, you mentioned that there isn't much use of trade agreement—different like the rules of origin are so specific to different regions that it's hard to be a global supplier. And I would think that with Mexico having attracted a lot of investment that that would be a real interest on their part to be able to have that kind of flexibility. Do you have any idea how that would if there's an opportunity there based on the desire to be a global producer for Mexico?

Caroline Freund: Well, I can start with the second question. I think there should be an interest on the part of Mexico for that because exactly as you said that there— I mean right now VW exports all its Beetles to basically to Europe from Mexico. So there should be an interest in having some sort of more unified framework for rules of origin.

Now to the extent there's a large share of Mexican content obviously. It can count towards both agreements and the fact that the share in Europe is lower makes it a little bit easier for them. I think it's more from a global perspective somehow streamlining these rules and getting away from this product by product specificity and having one rule that all regional trade agreements have just as they're all supposed to go to substantially all free trade. They should all be supposed to go to one rule of origin for most trade would make it so much easier for firms.

I think it's something that probably affects small firms much more than the big car firms that can really organize their production around this. That pretty much just decide, okay, I'm going to take advantage of this regional agreement and figure out how to work it. So really for our small businesses it would be a huge boost to get to some sort of global norm. I haven't yet seen either side come out strongly from the political perspective for this. But it would certainly be in their interest to do so.

Adam Posen: Jeff or Cullen.

Jeffrey Schott: Yeah. On the government procurement issue, market access is a strange term to use for government procurement. What you're talking about is the opportunity to bid on government contracts in a non-discriminatory way. And in the case of the United States market federal government procurement market, it is a very competitive market. So you can have the opportunity to bid but it still can be very challenging to win bids if you are not a very competitive foreign or domestic supplier. So you can't just do the equation of market access being the same.

But from a US point of view, NAFTA actually gives us a better deal than most countries have in the Mexican market because Mexico is not part of the government procurement agreement in the World Trade Organization. And therefore, we are getting preferences in terms of getting in the queue. And once we're in the queue and have the right to bid, we have firms that can take advantage of those opportunities. And they have been particularly some of the service companies have done very well. So that's why I say we stand to lose a bit of business if we are not careful in this area.

Adam Posen: One more question, anyone? Really? All right. Let me throw one last question to the panel and let's go in reverse order; Jeff, Cullen, and Caroline.

All of you in various ways have had to confront the political realities in the sense Cullen's argument is all about the overweight of these agricultural interests. Caroline just published a paper on the voting patterns in respect to trade in the US. And Jeff is trying to navigate what's feasible and what's not.

So it's sort of in the spirit of Fred and Antonio's exchange in the previous session. What is your advice to our Canadian and Mexican friends about what they should come to the table with? Not to bribe the Trump people because even though it works, we don't advocate bribery. But in terms of a substantive negotiation, what do you think the Canadians and the Mexicans should offer in the areas you're writing?

Jeffrey Schott: Well, I think Canada and Mexico should be very forthcoming in putting their restrictions on the table because that's what's important for Mexican and Canadian economic growth.

In Mexico, I think the biggest risk to Mexico of all of these different scenarios is if there is some breakup in the supply chains which then puts a cloud over future investment in the Mexican economy. So they have energy reforms that have been promulgated in Mexico. They could be locked in in NAFTA international obligations which would benefit both Mexico and the investors in the Mexican market and some of the leading energy suppliers to the Mexican economy, i.e., the United States. So that would be one important area.

Cullen Hendrix: Thank you. With respect to I guess an eye towards kind of the political economy around all of this. I think that the two things I would say would be on Canada side I think that it may be important to revisit some of the rollback of the supply management system and opening market access for dairy eggs and poultry.

I think about 3.25 percent market opening to all TPP party producers that was going to be phased in over five years. I think it was dairy, a little bit less than that for eggs and for poultry. I think that that's something that should be brought back to the table as well. I know that that's a very politically difficult thing to do in Canada because they have an electoral geography that is complicated just like our electoral geography is here in the United States. But I think that that would be one way productively moving forward.

I think that on the Mexico side in terms of becoming productively, it might be accepting or abiding by this kind of recently negotiated voluntary export restrictions on sugar. I think those would be two good-faith ways of getting the negotiation open on agricultural and market access issues.

Caroline Freund: I think that the biggest interests of all three parties would be to move forward on services in digital. And US would have a lot to gain. So it would be something great to bring forward. But what I talked about today was rules of origin. And actually what I'd say is I'm worried about it. And I became more worried during this conference because I think if what we're talking about is a quick win, rules of origin is an easy quick win.

So they raise it and Canada and Mexico actually might even gain somewhat from it. It's more the US that's going to lose because our firms will become less globally competitive. And it looks like a quick win. Or they do something really crazy and they raise it and then change some of the other rules like tracing rules and other things. So really there's no big difference, but it's all just a waste of time to have a big win at the end of the day.

So I'm not sure there's—I guess what I would hope to see the Canadians and Mexicans do is say if we go in any direction let's let loose. But given their positions during the TPP, I find that unlikely.

Adam Posen: Sobering. Thank you all. So just to quickly wrap up, I'm not going to try to summarize the very deep insights from my colleagues not only on this panel but by Daniel, Antonio, and Gary on the previous panel and by Fred and Mack on the opening.

What I would say is again my thanks and my praise to Monica de Bolle and Fred Bergsten for shepherding this project and mobilizing not only our internal colleagues but many guests to produce such a great stream of work, which will continue. And frankly, we encourage all of you to make use of the policy briefs and the various smaller pieces that we're going to be rolling out continually on the website well into the negotiating period and help us get the message out that a win-win renegotiation of NAFTA is both necessary and doable.

Finally, just a reminder that this is a project in the policy area which is a gift that keeps on giving. In a few weeks, we will have our second conference looking at a broader perspective on NAFTA renegotiation again featuring John Hamre of CSIS. And CSIS has helped with regard to the security issue with our colleagues from CIGI (Centre for International Governance Innovation) in Canada and featuring Dan Esty, Chad Bown, Sherman Robinson, and others.

Today, however, go forth. You're armed with knowledge. Do good. Thank you very much.