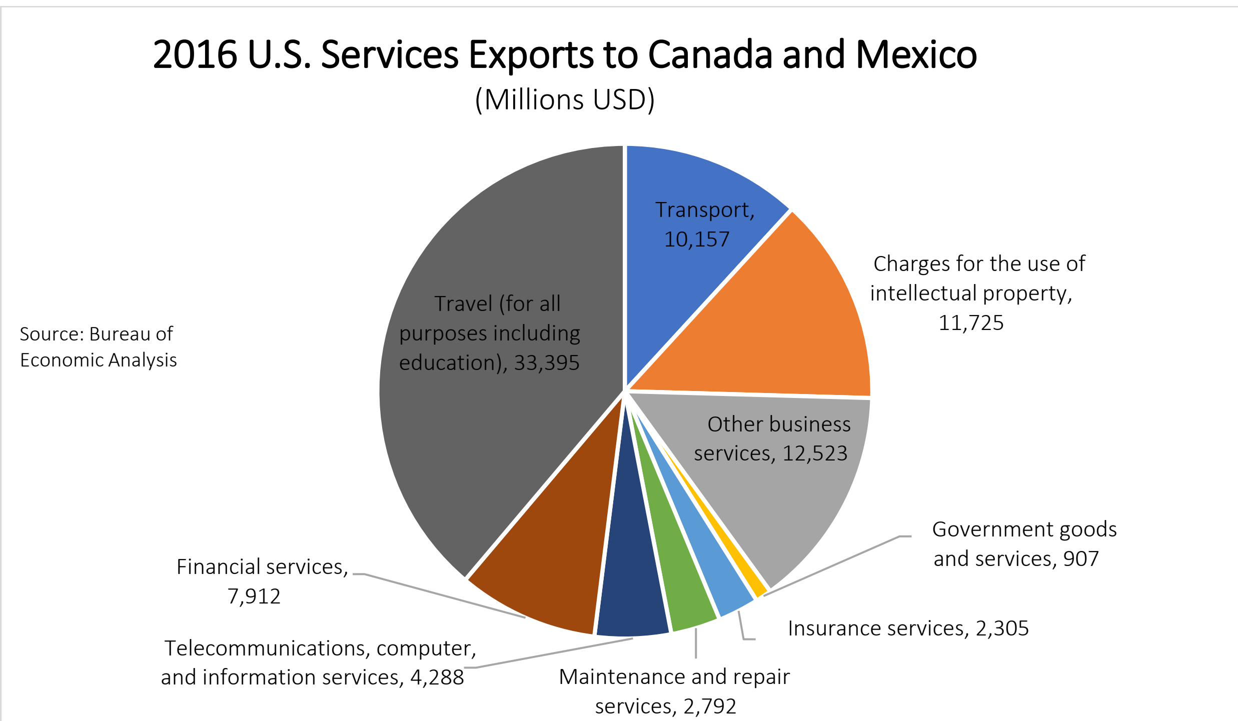
RISKS OF NAFTA WITHDRAWAL FOR U.S. SERVICES AND DIGITAL TRADE

Negotiations of the North American Free Trade Agreement (NAFTA) have entered a critical stage where modernization of the agreement may come to a standstill and U.S. withdrawal looms. As U.S. services providers have reaped significant successes since NAFTA's implementation, they remain some of the more vulnerable industries to a potential U.S. withdrawal. The below analysis outlines the risks of a U.S. withdrawal from NAFTA to U.S. services providers, including jobs and inward investment, as well as sector specific highlights of the lower standard of trade rules and commitments that U.S. service suppliers will have to rely on in the event of NAFTA withdrawal.

LOSS OF U.S. SERVICES EXPORTS AND JOBS

NAFTA withdrawal will jeopardize trade, investment, and jobs in most major U.S. services sectors from financial services, information and communication technology, logistics, distribution, media and entertainment, to professional services and digital trade.



Note: travel excludes airline ticket purchases.

NAFTA withdrawal will put at risk:

- $88 billion in U.S. services exports to Canada and Mexico and the nearly 600,000 high-paying American jobs they support;
- $24 billion services trade surplus with Canada and $7.5 billion services trade surplus with Mexico;
- $277 billion in U.S. investment in Canada and Mexico and with no investment rights or protections except those provided under customary international law; and

- 476,800 American services jobs (and 716,000 total services and manufacturing jobs) supported by investment in U.S. affiliates of Canadian and Mexican multinational enterprises (MNEs).[1]

A SERIOUS SETBACK FOR U.S. DIGITAL TRADE

In 2016 alone, "potentially" ICT-enabled (PICTE) services accounted for 54 percent of all U.S. services exports, 48 percent of all services imports, and 64 percent of the trade in services surplus. Withdrawal from NAFTA puts a significant portion of the PICTE and digital trade at risk, damaging trade relations that would jeopardize a substantial and growing market for the United States.

Canada

- Canada was the United States' second-largest services trading partner in 2016, behind only the United Kingdom in total volume.
- In 2016, the United States exported $54.0 billion in services to Canada, of which $27.8 billion, or 52 percent, were PICTE services. This equates to 7 percent of total U.S. trade with Canada.
- U.S. PICTE services exports to Canada increased at an average annual rate of 4.0 percent from 2006 to 2016.

Mexico

- Mexico was the United States' seventh-largest trading partner in 2016, accounting for 5 percent of the total volume of U.S. services trade.
- In 2016, U.S. PICTE service exports to Mexico totaled $8.8 billion, or 27 percent of all U.S. services exports to Mexico and 2 percent of total.
- The growth of U.S. exports of these PICTE services to Mexico was even faster than PICTE exports to Canada, at 5.5 percent.[2]

NORTH AMERICAN SUPPLY CHAINS DISMANTLED

The loss of NAFTA's preferential trade treatment for U.S. services companies and their workers will undermine the ability of U.S. services to participate in the North America and global supply chains, harming not only services but all sectors that depend on those supply chains.

- There is $466 billion in Canadian and Mexican investment in the United States, primarily in manufacturing, financial services, distribution services, and banking. Much of this investment supports supply chains.
- Withdrawal from NAFTA threatens jobs sustained by participation in the North American supply chain. Studies have estimated that after U.S. tariffs on former NAFTA partners are enacted, declining employment in heavy manufacturing, extraction, and services would result in a net 68,000 job loss.
- As Canada and Mexico enact reciprocal tariffs on the United States, further job losses in services, crops and livestock, meat, food, and textiles, bringing the total net loss of jobs due to tariffs resulting from NAFTA withdrawal to 256,000.[3]

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[1] Bureau of Economic Analysis

[2] U.S. Department of Commerce, Economic and Statistics Administration, Office of the Chief Economist. "Digital Trade in North America." January 2018.

[3] Walmsley, Terrie; Minor, Peter. "Reversing NAFTA: A Supply Chain Perspective." ImpactECON LLC. 2017.

COMPETITIVE DISADVANTAGE FOR THE UNITED STATES

U.S. withdrawal will give European and Asian services providers, and their workers, a major advantage over the U.S. in Canadian and Mexican markets, since they have or are in the process of negotiating preferential trade agreements with Canada and Mexico. Because Canada and Mexico will still be NAFTA partners after the United States withdraws, their firms will to continue to get the preferential NAFTA treatment in each other's market that will be denied to not only U.S. services companies and workers, but across sectors.

Canadian Trade Relations[4]

	SIGNED	NEGOTIATING	PROSPECTIVE
EUROPE	Comprehensive Economic and Trade Agreement; European Free Trade Association		
ASIA	Trans-Pacific Partnership; Canada-China Foreign Investment Promotion and Protection Agreement; Canada-Korea Free Trade Agreement	Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP); Canada-Japan Economic Partnership Agreement	Canada-China Free Trade Agreement; Canada-ASEAN Free Trade Agreement
AMERICAS	North American Free Trade Agreement		Canada-MERCOSUR Exploratory Trade Discussions; Canada - Pacific Alliance Free Trade Agreement

Mexican Trade Relations

	SIGNED	NEGOTIATING	PROSPECTIVE
EUROPE	EU-Mexico Global Agreement; European Free Trade Association	EU-Mexico Global Agreement Modernization	
ASIA	Trans-Pacific Partnership; Japan-Mexico Economic Partnership Agreement	Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)	Mexico-China Free Trade Agreement
AMERICAS	Pacific Alliance; North American Free Trade Agreement; MERCOSUR-Mexico Economic Complementation Agreement; Mexico-Central America Free Trade Agreement; Mexico-Panama Free Trade Agreement		

[4] Government of Canada, "Trade Negotiations and Agreements," December 2017.

LOSS OF BENEFITS BY SECTOR

Government Procurement

- With a loss of NAFTA and Chapter 10, the U.S. will need to rely on the WTO's Agreement on Government Procurement (GPA) for access to Canada's procurement market. In doing so, the United States will lose the benefit of coverage for financial services since Canada did not include commitments on financial services in the GPA.
- The U.S. will have no protection in procurement in Mexico since it is not a member of the GPA and Mexico has not made any procurement commitments to the U.S. under any other trade agreement to which the U.S. is a party.
- The harm to the U.S. insurance sector will likely be the most severe as the sector insures four out of five Mexican government employees, and supplies pensions, surety and auto insurance to the Mexican government.
- A loss of NAFTA and Chapter 10 will be a loss of Mexico's first commitment to eliminate discriminatory government procurement practices with respect to foreign goods, services and suppliers.
- It will also be a loss of the important institutional framework NAFTA established in government procurement for U.S. services providers, which included transparent and open bid procedures in all three governments.

Financial Services

- The U.S. financial services sector has substantial investment, which will be at risk as the result of a U.S. withdrawal, and is of particular concern for financial services providers that are regulatorily required to maintain a local presence (and thus invest in country) in order to do business.
- U.S. insurers could lose the protection of a Mexican commitment eliminating its 30 percent foreign investment cap, which has permitted U.S. insurers to acquire Mexican insurance companies on a wholly-owned basis.
- U.S. banks will lose the benefit of an increase in the equity cap in holding companies and commercial banks to 30 percent (up from the 20 percent commitment of Mexico in the General Agreement on Trade in Services, GATS).
- Banks could also once again be subject to a Canadian requirement that they establish as subsidiaries.
- U.S. financial services providers will lose the chance of benefiting from a modernized Financial Services Chapter, including commitments on information transfer and prohibitions on data localization, which go beyond what is provided in the GATS.
- NAFTA withdrawal will also mean the loss of the Financial Services Committee established by the agreement, which has been instrumental in implementation of NAFTA's related provisions, as well as consider issues of importance by each party's regulators.

Delivery Services

- U.S. delivery services firms will benefit greatly from a modernized NAFTA that contains a sectoral services annex dealing with anti-competitive postal practices in line with modern U.S. agreements that is absent from the original NAFTA agreement. The NAFTA Customs Chapter presents an opportunity to achieve higher *de minimis* levels in Canada and Mexico, which will grow U.S. exports and create new U.S. jobs. A renegotiated NAFTA can address long-standing obstacles to the flow of goods across U.S. borders, particularly Mexico's informal entry process and requirement to use Mexican brokers, as well as rules on cross-border trucking. In contrast, a withdrawal from NAFTA allows Canada and Mexico to continue to unfairly protect their brick and mortar retailers from the competition U.S. "e-tailers" seek to offer, and foregoes the chance to remove these barriers to increase U.S. exports.

- NAFTA has created value chains across all three countries that include suppliers and component manufacturers contributing to major manufacturing operations. Many of these suppliers are SMEs. Canada and Mexico are two top export destinations for U.S. SME's. Much of this commerce moves through delivery services networks. Withdrawal will disrupt these networks and reduce these logistics flows causing the economic activity to migrate to other, lower cost countries.
- Without NAFTA, U.S. goods will face an average tariff of 7.1% in Mexico and 4.2% in Canada. But many of the goods carried by delivery service members will encounter much higher tariffs, over 15%. The corresponding decrease in trade will have a negative impact across the U.S. economy.
- The fall back commitments applicable to the delivery services sector of the GATS, General Agreement on Tariffs and Trade (GATT), and Trade Facilitation Agreement (TFA), while serviceable, represent a minimal level of ambition and are not a substitute for a robust NAFTA agreement.

Media and Entertainment

- U.S. media and entertainment firms stand to potentially lose substantial gains achieved through NAFTA, as well as the potential for further access through NAFTA modernization.
- NAFTA withdrawal means Canada will have a permanent cultural carve out and be free to discriminate against U.S. media and entertainment firms, including online content. In turn, European and Asian content suppliers will have preferential treatment over U.S. suppliers.
- U.S. firms will also lose the market access gained in Mexico under NAFTA, which agreed to open its film and television sector far beyond what it had agreed to in the WTO. Mexico lifted the 49 percent equity cap on film production and in the advertising sector, lifted the foreign investment restriction in the cable television sector, lifted the ban on foreign television programming in its cable television market, and lowered its screen quota from 30 to 10 percent.

Distribution Services

- NAFTA opened the door to significant investment of retail distributors exporting from the U.S. into Canada and Mexico, and greatly integrated the North American marketplace, strengthening the U.S. role in the regional and global supply chain.
- U.S. meat exports to Mexico have doubled in the last two decades; U.S. retailers export millions in pork and beef product across the southern border.
- American farmers are also major winners in NAFTA, with Mexico being the largest export market for U.S. apples and pears due in part to produce imported from the United States by U.S. retailers.
- Without NAFTA, U.S. retailers, distributors, farmers and ranchers will all lose this tremendous access they have had in Canada and Mexico, which have become some of the largest export markets for the United States, also leaving their investments in retail and distribution centers unprotected without NAFTA’s Chapter 11 protections.
- While Canada made several commitments on distribution services related to agriculture and meat products under the GATS, NAFTA greatly expanded access and investment protections, further propelling U.S. retailers’ ability to conduct business on a cross-border basis and increase exports from the United States.
- Direct sellers stand to gain from a modernization of NAFTA, with the inclusion of a new annex specific to direct selling. Under the GATS, Canada requires direct sellers to maintain a local presence in Nova Scotia and British Columbia while Mexico made no commitments on direct selling, making inclusion of new commitments on direct selling critical to expanding U.S. industry presence in Canada and Mexico.

Computer and Related Services

- Another potential win for NAFTA modernization is the inclusion of a chapter on digital trade, which is absent from the original agreement.
- All U.S. services firms stand to gain from the inclusion of a digital trade chapter, including provisions ensuring the free flow of data and prohibiting forced data localization, prohibiting forced technology transfer, requiring compliance with global technology standards, providing intermediary liability protections, and modernizing customs procedures to streamline and expedite e-commerce shipments.
- Without a successfully modernized NAFTA, the United States will continue to depend on GATS commitments, which were minimal. Canada's commitments covered consultancy services, software implementation services, data processing services, and maintenance and repair. Mexico's commitments were even less, covering only systems analysis and data processing.

Telecommunications

- NAFTA withdrawal risks a significant setback for U.S. telecommunications suppliers who will no longer have the benefit of the NAFTA "bill of rights" for the providers and users of telecommunications services.
- These rights include access to public telecommunications services; connection to private lines that reflect economic costs and are available on a flat-rate pricing basis; and the right to choose, purchase, or lease terminal equipment best suited to their needs.

Professional Services

- NAFTA greatly expanded on commitments made in the GATS on professional services, including temporary entry for covered professionals.
- While Canada's GATS commitments cover legal, accounting, taxation, architectural, and engineering services, significant limitations on market access and national treatment were included. Mexico's GATS commitments are even more limited, only covering accounting, consultancy services for engineering and architecture, and medical and dental services, all with significant market access and national treatment restrictions on commercial presence and movement of professionals.
- Without NAFTA, U.S. providers of professional services will be significantly restricted; NAFTA's Mutual Recognition Agreements (MRAs) could also be jeopardized, which affect professional services providers in architecture and engineering, as well as in telecommunications.
- Withdrawal will also eliminate the ability of service suppliers to facilitate temporary entry into Canada and Mexico under the Trade NAFTA (TN) program, which is critically important to U.S. services firms in all sectors. There is no comparable set of commitments in the GATS.