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POLICY BRIEF

17-22 NAFTA Renegotiation: US Offensive and Defensive Interests vis-à-vis Canada

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Previous US administrations—whether Republican or Democrat—have focused on reducing barriers to trade and investment during trade negotiations, but the Trump administration will prioritize reducing the US trade deficit when it renegotiates the North American Free Trade Agreement (NAFTA).[1] While President Trump has frequently stressed the US trade deficit with Mexico (about $60 billion annually), NAFTA talks will necessarily revisit US-Canada commercial relations. Trade barriers remain between the United States and Canada, so a new agreement holds the potential for fresh liberalization. The benefits from mutual reforms will be forgone, however, if Trump insists on extreme and one-sided concessions from Canada.

In NAFTA talks, Trump will emphasize "fairness" and cite both trade balances and mirror image reciprocity to distinguish between "bad deals" and "good deals." These litmus tests will generally put US commercial relations with Canada in the "good deal" column. As table 1 shows, two-way US trade with Canada, approaching $700 billion, is practically balanced and, if energy trade is excluded from the tally, the United States enjoyed a goods and services trade surplus with Canada in 2016.[2] Moreover, thanks to NAFTA, nearly all tariffs are zero for three-way trade between Canada, Mexico, and the United States, in this respect satisfying the mirror image reciprocity test.

But a feature that conspicuously fails Trump's mirror image reciprocity test is Canadian and Mexican border adjustment of taxes in the value-added tax (VAT) family. The Canadian goods and services tax (GST) averages around 13 percent, counting both provincial and federal charges, while the general Mexican VAT rate is 16 percent. Mirror image reciprocity calls either for Mexico and Canada to stop adjusting these taxes at the border (in other words, stop imposing the taxes on imports and exempting exports from the taxes) or for the United States to adopt a similar tax in the VAT family and adjust it at the border. In Trump's perspective of fair trade, GST and VAT adjustments at the border with Canada and Mexico might be put on the negotiating table. However, while Trump has specifically complained about Mexico's adjustment of its VAT, he has not leveled a similar complaint against Canada's adjustment of its GST.

At the negotiating table, each country will advocate its own objectives, using a mercantilist handbook to separate "offensive" and "defensive" interests. In the US offensive column, Trump will seek to lower Canadian barriers to US exports; in the US defensive column, Trump will oppose changes that would lower US barriers to Canadian exports. The *2017 National Trade Estimate Report on Foreign Trade Barriers* (USTR 2017a) lists old and new Canadian barriers that discourage US exports. Other sources identify US barriers that discourage Canadian exports.[3]

1. "Commerce Sec. Ross: 'One Size Doesn't Fit All' When Dealing with Trade," *Fox News Insider*, March 12, 2017, http://insider.foxnews.com/2017/03/12/wilbur-ross-commerce-secretary-mexico-nafta-free-trade (accessed on March 17, 2017).

2. Complementing large two-way trade flows is a large stock of two-way foreign direct investment (FDI), about $622 billion in 2015, which undergirds and reinforces the trade relationship.

3. Other sources include McDaniel, Schropp, and Latipov (2016) and comments from Lawrence Herman and Jeffrey Schott.

Table 1 US trade balance with Canada and Mexico, 2016 (billions of US dollars)

Component	Canada	Mexico
Exports of goods and services	322	262
Exports of energy	17	22
Imports of goods and services	314	324
Imports of energy	56	9
Trade balance on goods and services	8	–62
Trade balance on goods and services excluding energy	47	–75

Note: Energy includes coal, crude oil, petroleum products, electric energy, and other energy products, using the North American Industry Classification System (NAICS) codes.

Sources: US Bureau of Economic Analysis and US Census Bureau.

The US trade surplus with Canada in nonenergy trade is a card that Canada can play during negotiations. Citing Trump's logic about trade balances, Canada can emphasize its trade deficit with the United States as a reason for retaining provisions that shield certain sectoral interests from US competition. On the other hand, the United States would rather steer the conversation to Canadian barriers that limit US exports of agricultural and digital products. In recent speeches, Trump has targeted Canadian practices, repeating his characterization of NAFTA as a "disaster."[4]

This Policy Brief first calls out a few "blockbuster" demands that the Trump administration might raise. The term "blockbuster" refers both to unconventional issues that have not been covered in previous free trade agreements (FTAs) and to sticky points that are very difficult to resolve. This section speculates on elements that might match Trump's concept of unfair trade. The second section examines "traditional" Canadian barriers to agriculture, intellectual property rights, services, investment, cross-border data flows, and a few other sectors. The third section lays out US defensive interests in softwood lumber, beef, government procurement, cabotage, and a few other sectors. The fourth section identifies topics where the United States and Canada perhaps share a mutual interest in improving NAFTA. To take advantage of the scope for the United States and Canada to liberalize trade in goods and services, to their mutual benefit, the Trump trade team should drop its obsession with trade deficits, at least in talks with Canada, and instead enhance NAFTA through fresh and reciprocal trade liberalization.

4. "Trump promises 'big changes' or withdrawal from NAFTA, calls TPA 'ridiculous'," *Inside US Trade*, April 18, 2017.

BLOCKBUSTER DEMANDS

The Trump administration is not a traditionalist when it comes to negotiating trade agreements. Consequently, it's worth speculating on "blockbuster" demands that might be put on the negotiating table with Canada. The first three demands in this section may seem less relevant to Canada since Canada has not been criticized for the US trade deficit. Nevertheless, it is worthwhile highlighting those potential demands because US demands on Mexico may be symmetrically proposed to Canada. Unconventional demands will, however, prolong the negotiation and some will provoke strong opposition in Canada.

Border Tax Adjustments

Trump has still not declared whether he supports the border tax adjustment (BTA) component of the "cash flow" tax advocated by House Speaker Paul Ryan and Ways and Means Committee Chairman Kevin Brady.[5] The BTA would impose the 20 percent "cash flow" tax on all imported goods and services and exempt all exports. If Trump decides to support the BTA, and if it is enacted by the House of Representatives (two big "ifs"), the US trade team will ask Canada, Mexico, and other countries not to launch cases in the World Trade Organization (WTO) or retaliate in other ways.[6] The unstated threat will be "or else."[7]

If the BTA dies in the US Senate, the US trade team could ask Canada and Mexico to desist from border adjustments for their GST and VAT, respectively, for trade with the United States. Acceding to this request would have huge repercussions in both Canada and Mexico, especially in their business communities. The Canadian dollar and the Mexican peso would probably depreciate by a substantial fraction of the erstwhile GST and VAT border adjustments.

5. For more details on the border tax adjustment (BTA), see Hufbauer and Lu (2017); Cline (2017); Bown (2017); Freund and Gagnon (2017); and Caroline Freund, "PIIE Debates Border Adjustment Tax," PIIE RealTime Economic Issues Watch blog, February 9, 2017, https://piie.com/blogs/realtime-economic-issues-watch/piie-debates-border-adjustment-tax (accessed on February 27, 2017). Even in his address to Congress on February 28, 2017, President Trump skirted the BTA debate.

6. Shawn Donnan and Demetri Sevastopulo, "Trump team looks to bypass WTO dispute system," *Financial Times*, February 27, 2017, www.ft.com/content/7bb991e4-fc38-11e6-96f8-3700c5664d30 (accessed on February 27, 2017).

7. Specifically, the United States might threaten to impose Section 301 penalties, equal to the amount of VAT remissions, on imports from partner countries that bring WTO cases.

Trade Balance Chapter

Trump and his trade team are fixated on bilateral trade balances, especially US trade deficits. Multilateral balances and macroeconomic analysis do not appear to enter their calculations. Accordingly, China, Mexico, Germany, Japan, and Korea have been singled out as taking advantage of the United States.[8] Canada escapes criticism both because the bilateral trade balance (all goods and services) is near zero and because the United States runs a bilateral surplus in nonenergy trade (table 1).

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Nevertheless, to create a template for other trade agreements, and to guard against future imbalances, the United States might seek a trade balance chapter in the new agreement with Canada. The chapter could (1) place a burden on the trade surplus partner (above a certain threshold) to take measures to reduce its bilateral surplus and (2) allow the trade deficit country to "snap back" to its most-favored-nation (MFN) tariffs if the deficit persists for an undue period.

Currency Undervaluation Chapter

No one has accused Canada or Mexico of "currency manipulation" (meaning large one-way intervention in the foreign exchange market), but at some point, Canada or Mexico could be accused of "currency undervaluation" (meaning a currency value that strongly favors trade surpluses with the United States). Moreover, to establish a template for other trade negotiations, US trade negotiators might seek a binding currency chapter in agreements with Canada and Mexico. The chapter might cover both manipulation and undervaluation and might contemplate both surveillance and arbitration. Although Canada and Mexico agreed on the Declaration of the Macroeconomic Policy Authorities in the Trans-Pacific Partnership (TPP), designed to promote cooperation on macroeconomic and exchange rate policies, the declaration does not include an arbitration mechanism.[9] Coverage of that nature, accompanied by remedial measures, would intrude on turf historically claimed by central banks, finance ministries, and the International Monetary Fund (IMF). If pursued, these ideas would entail a landmark departure from trade agreements enacted since the Second World War.

To be sure, Article XV of the General Agreement on Tariffs and Trade (GATT) declares, "Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement," but the practical application of this exhortation has long been consigned to the IMF. Putting teeth in language akin to Article XV in a bilateral or trilateral trade agreement would break a great deal of institutional crockery. This obstacle might be resolved by consigning surveillance and arbitration to the US Treasury and the Canadian and Mexican finance ministries.

Rules of Origin

Trump is extraordinarily concerned with the fate of the US auto industry, partly for iconic reasons, partly for political reasons ("battleground states"). He has aimed numerous tweets at auto executives urging them to retain and enlarge US plants. In 2016, the US bilateral trade deficit in autos and parts was $54 billion with Mexico and $10 billion with Canada. Trump wants to change this picture and ensure that more autos and parts purchased by Americans are produced by Americans. The Trump team could advocate a rule of origin for US auto production within the overall NAFTA rule of origin (currently 62.5 percent, with special rules for large components like transmissions and engines—but all these would likely be tightened). If US demands take this route, the revised rules would be fashioned to shift more auto parts and assembly production to the United States. An obvious limitation of the rule of origin approach to bolstering US production is that the US MFN tariff on autos is just 2.5 percent, and tariffs on auto parts are generally less than 4 percent, so auto companies might choose to pay the tariffs and ignore the tighter rules of origin. To cut off this response, the Trump team might advocate a higher MFN tariff, despite US bound tariff obligations in the WTO.

8. Gary Hufbauer and Euijin Jung, "US Bilateral Trade Balances: A New Guide to Trade Policy?" PIIE Trade and Investment Policy Watch blog, November 15, 2016, https://piie.com/blogs/trade-investment-policy-watch/us-bilateral-trade-balances-new-guide-trade-policy (accessed on February 27, 2017). In 2015, the respective bilateral surpluses in trade with the United States were: China ($334 billion); Mexico ($58 billion); Germany ($77 billion); Japan ($55 billion); and South Korea ($19 billion).

9. See Joint Declaration at www.treasury.gov/initiatives/Documents/TPP_Currency_November%202015.pdf (accessed on April 17, 2017).

Rules of origin for textiles and apparel and electronic goods could likewise be "tweaked" (Trump's phrase with respect to Canada) to foster US production.[10]

Review of Antidumping and Countervailing Duty Determinations

NAFTA Chapter 19 provides a mechanism to review final determinations in antidumping (AD) and countervailing duty (CVD) cases. Under this mechanism, binational panels of five experts can be established to review whether CVD and AD cases have been decided in a reasonable manner consistent with a country's national laws. The United States was never enthusiastic about this "second look" at US trade remedy determinations and frequently resorted to delaying tactics when Canada or Mexico sought a Chapter 19 review.

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In the renegotiation of NAFTA, the United States may seek to drop Chapter 19 and instead consign all disagreements over AD and CVD determinations to the WTO Dispute Settlement Body. However, in its *2017 Trade Policy Agenda and 2016 Annual Report,* the US Trade Representative (USTR 2017b) essentially declared it would ignore WTO rulings that it regards as unreasonable. Given the likely surge in US AD and CVD cases, with the encouragement of Commerce Secretary Wilbur Ross,[11] both Canada and Mexico will resist any attempt to jettison Chapter 19. From the standpoint of Canada and Mexico, a big advantage of Chapter 19 is that a favorable resolution under that chapter leads to a retroactive refund of wrongly imposed AD or CVD duties. Retroactive relief is not available under the WTO dispute settlement system.

10. Andrea Hopkins, "Trump expects only 'tweaking' of trade relationship with Canada," Reuters, February 13, 2017, www.reuters.com/article/us-usa-trump-canada-idUSKBN15S14S (accessed on February 27, 2017).

11. "Commerce could resume self-initiation of AD, CVD cases if Ross confirmed," *Inside US Trade*, January 18, 2017. In recent cases, the US Department of Commerce issued its preliminary determination to impose CVDs on Canadian softwood lumber and initiated an AD and CVD investigation on Canadian aircraft producer Bombardier.

Telecommunications

The Canadian threshold for foreign ownership in telecommunications is one of the most restrictive regimes among advanced economies. If a facilities-based telecommunications service supplier has more than 10 percent market share, Canada applies a 46.7 percent limit on foreign ownership of the supplier; further, more than 80 percent of members on the board of directors must be Canadian citizens. These restrictions prohibit the presence of US firms in the Canadian telecommunications market in the legal form of wholly US-owned operators, instead forcing them to rely on Canadian operators. By contrast, in the United States, telecommunications service providers are not subject to foreign ownership restrictions. With approval from the Federal Communications Commission (FCC), common carrier wireless licensees may have more than 25 percent foreign ownership. The United States could ask for mirror image reciprocity in this sector.

Canadian Broadcasting Content

The Canadian Radio-Television and Telecommunications Commission (CRTC) imposes quotas on Canadian programming expenditure (CPE) and Canadian programing hours (Exhibition quotas). Large English language private broadcasting groups must spend at least 30 percent of their gross revenue on CPE. They must show a minimum of 50 percent Canadian programming during primetime hours (6pm to 11pm). Non-English broadcasting groups face a lower quota: 35 percent Canadian programming to air throughout the day. For cable television and direct-to-home broadcast services, the ratio of Canadian programming services must be more than 50 percent of the channels. Non-Canadian channels are required to obtain preapproval from the CRTC.

A new Wholesale Code released by the CRTC took effect in January 2016, to the discomfort of US stakeholders. The Wholesale Code governs commercial arrangements between broadcast distribution, programming, and exempt digital media. The previous Wholesale Code was designed for Canadian programming suppliers who own video distribution infrastructure and programming in Canada. The new code applies to foreign programming suppliers: They are not allowed to own such distribution facilities. In renegotiation talks, the United States might seek to scrap these rules, which would, however, provoke a strong Canadian backlash.

In short, Trump's potential blockbuster demands have both market closing and opening features. His rhetorical support for some form of border taxation, equivalent bilateral imports and exports, and rules of origin that ensure greater automotive production in the United States all portend more protective fences around US markets. On the

other hand, potential demands to relax Canadian telecommunications and broadcasting rules have a market opening character. Trump appears to advocate a "give nothing and take everything" approach. If so, and if coupled with blockbuster demands, the renegotiation of NAFTA could take years to conclude.

TRADITIONAL US OFFENSIVE INTERESTS[12]

Apart from such blockbuster demands, the United States can be expected to pursue a long list of offensive requests that have been on the table for years, if not decades.

Agricultural Barriers

Canada's supply management system regulates its dairy, chicken, and egg industries and imposes tariff-rate quotas (TRQs) on imports to buttress high domestic prices. Claimed as a means of shielding Canadian farmers (especially those in Quebec) from price volatility, the supply management system is controversial within Canada because consumers pay much higher prices for dairy products than consumers in other countries.[13] Imports from the United States (and elsewhere) in excess of quota levels are subject to steep MFN tariffs, raising prices for Canadian consumers and deterring sales by US farmers. Notable examples include above-quota tariffs of 245 percent on cheese and 298 percent on butter.

Seeds and Grains

Under the Canadian Seeds Act, varietal sales are prohibited unless the variety is registered in a prescribed manner. The registration system is claimed to serve health, safety, and antideception purposes. However, registration generally takes six to eight weeks, which can be burdensome. Unlike Canada, the US federal government does not operate a seed variety registration system.

The Canadian Grain Act probably hinders US wheat and barley exports. Under the Act, the Canadian Grain Commission establishes distinct grades for "western grain" and "eastern grain." The grades translate into grains grown within Canada, which implies that only Canadian grains are eligible for official grading, not imports from the United States. Without the benefit of a Canadian grade, high-quality US wheat and barley are classified as feed grade (the lowest grade), which leads to price discounts.[14] In addition, most Canadian grain sales benefit from bulk handling through grain elevators, while most US grain imports are blocked as a consequence of the grading system. In short, the Act effectively discounts the value of high-quality US grain. By contrast, the US grading system is based on grain quality characteristics, not on geographic location, and provides equal access to bulk facilities and grain elevators for imports.

Proposed legislation would reform the Canadian Grain Act. The Modernization of Canada's Grain Industry Act, introduced in the House of Commons in December 2014, would enable US grain varieties to receive an official Canadian grade. However, the bill has been stalled.

Dairy Standards

Canada's regulations on compositional standards require that cheese derive a minimum amount of casein from milks that meet or exceed designated percentages for their total protein content. US dairy exporters complain that this regulation amounts to a technical trade barrier since US dairy producers use different technologies.[15]

The Canadian dairy industry has also pushed a national ingredient strategy that allows Canadian dairy processors to purchase domestic ingredients at discounted prices (namely world market prices).[16] This program was originally intended to reduce a price gap between Ontario and other provinces. The background story is that Ontario first launched its own program that offered lower prices for dairy ingredients for dairy manufacturers. The Ontario program placed other provincial dairy products at a disadvantage in the national Canadian market. Consequently, Canada's federal Milk Supply Management Committee (CMSMC) introduced a tentative program to provide competitive prices for dairy ingredients to all Canadian dairy processors, categorizing such ingredients under Milk Class 4(m).

Under NAFTA, Canadian cheese manufacturers have increased their consumption of ultra-filtered milk (also called nonfluid protein) imported from the United States. It is a cheaper substitute for liquid skim milk because it enters Canada tariff free and quota free. However, the new CMSMC program would add liquid skim milk to dry and liquid milk protein concentrate under Milk Class 4(m) and

12. This section is largely based on the Canada chapter in USTR (2017a).

13. Findlay (2012) finds that Canada's supply management system costs $276 per family per year more.

14. Under the Canada Grain Act, grain of varieties registered under Canada's Seed Act may receive a grade higher than the feed grade.

15. Very early, Felt, Larue, and Gervais (2012) suggested that cheese compositional "standards may have had an impact on the ability of foreign firms to compete in the Canadian market."

16. Contrary to this strategy, domestic dairy ingredients are generally set at prices well above world levels, controlled by Canada's national supply management system.

include a wider range of Canadian dairy ingredients under Milk Class 7, thereby providing discounted prices for dairy processors and undercut US exports.

This initiative prompted a surge of criticism from US dairy exporters, claiming that it violates NAFTA and would put US exports at a disadvantage.[17] Speaking in Wisconsin, President Trump amplified these complaints.[18] At the moment, implementation of the Canadian national ingredient strategy has been delayed.

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In a similar vein, Canada established the Special Milk Class Permit Program (SMCPP), which allows Canadian dairy processors to purchase domestic milk components at discounted prices (again, world prices). This program makes Canadian milk more competitive and thus could limit US exports.[19]

Wine, Beer, and Spirits

In Canada, provincial import barriers on alcoholic beverages are deliberately more restrictive than federal barriers. When Canadians return from the United States, their personal imports of US wine, exceeding one bottle duty free, face high provincial taxes (e.g., 85 percent in British Columbia).

Most Canadian provinces have their own liquor control boards, which are the sole authorized sellers of wine, beer, and spirits. The boards implement their own market access restrictions. In British Columbia, imported wines are banned from grocery shelves, unlike local wines. In January 2017, the USTR launched a case against Canada in the WTO, claiming that British Columbia's regulation discriminates against the sale of US wine in Canadian grocery stores.[20]

Geographical Indications

Geographical indications (GIs) are names that designate specific places where goods are made and convey reputational value for the products in question. Many GIs for wines, spirits, meats, and cheeses originated in European countries, and the European Union has long sought their recognition and protection worldwide. Champagne, Bordeaux, Roquefort, and Parma Ham are well-known examples. Canada and the European Union concluded the Canada-EU Comprehensive Economic and Trade Agreement (CETA) on August 5, 2014, which was ratified by the EU Parliament on February 15, 2017, and is now provisionally applied pending ratification by the EU member states.[21] Under CETA, Canada granted the highest level of protection to the great majority of the European Union's proposed list of 145 GI names. Accordingly, US agricultural and food products will not be allowed to use the 145 protected GIs for export to Canada.

Other Barriers

Personal Duty and Tax Exemptions

Canadian personal exemptions are much more restrictive than their US counterparts. If a Canadian resident's foreign trip lasts more than 48 hours, up to C$800 of goods purchased abroad are exempt from duties and the Canadian GST. If the value of the goods exceeds C$800, then duties and taxes are applicable only on the amount of the imported goods that exceeds C$800. If a Canadian's trip abroad lasts more than 24 hours but less than 48 hours, the duty-free and tax-free allowance is up to C$200. If the value of the purchases exceeds C$200, duties and taxes are applicable on the entire amount of the imported goods.[22] This is similar to the US

17. "Canada delays implementation of dairy strategy as US criticism mounts," *Inside US Trade*, November 11, 2016; the interest group estimates that companies in Wisconsin and New York lose $150 million worth of ultra-filtered milk exports. See www.nmpf.org/latest-news/press-releases/jan-2017/jan-11-canada%E2%80%99s-protectionist-policies-will-harm-us-economy (accessed on March 21, 2017).

18. White House, "Remarks by President Trump on Buy American, Hire American Executive Order in Kenosha, Wi," April 18, 2017, www.whitehouse.gov/the-press-office/2017/04/18/remarks-president-trump-buy-american-hire-american-executive-order (accessed on May 19, 2017).

19. The main objective of this program is to increase the competitiveness of local dairy products against foreign products. The discounted prices of milk components are calculated each month based on US milk and dairy product prices published by the US Department of Agriculture, and on a pricing formula created in a consultative process. For more details, see Canadian Dairy Commission, www.milkingredients.ca/index-eng.php (accessed on February 9, 2017).

20. United States Trade Representative, "United States Challenges Canadian Trade Measures That Discriminate Against U.S. Wine," January 18, 2017; the British Columbia government plans to grant a limited number of new licenses that permit the sales of only local wines in grocery stores. See www.straight.com/food/813541/california-wine-producers-claim-bc-liquor-reforms-violate-nafta-gatt-and-eu-canada-agreement (accessed on February 9, 2017).

21. European Commission, "European Commission welcomes Parliament's support of trade deal with Canada," press release, February 15, 2017, http://ec.europa.eu/trade/policy/in-focus/ceta/ (accessed on February 22, 2017).

22. Canada Border Services Agency, "Residents Returning to Canada," www.cbsa-asfc.gc.ca/travel-voyage/ifcrc-rpcrc-eng.html.

allowance. US duties are imposed on the total purchased goods over $200 if a traveler has been abroad less than 48 hours (for a traveler spending longer than 48 hours abroad, personal duty exemption is allowed for $800).[23] The major difference affects very short trips. If a US traveler's trip abroad lasts less than 24 hours, he or she can bring home up to $200 duty-free goods, but similar Canadian travelers must pay both duties and taxes on their purchased goods. Clearly this discourages Canadian travelers from shopping in US stores.

Likewise, the low Canadian *de minimis* threshold discourages internet purchases from US sellers. The *de minimis* threshold sets a maximum value for imported goods (by post or express delivery) below which tax and duty are not charged and the customs declaration is very simple. Canada's threshold is C$20, one of the lowest among advanced economies. In comparison, the US *de minimis* threshold was raised to $800 in February 2016. A higher Canadian threshold would benefit not only US firms, including online retailers and express delivery companies, but also Canadian consumers and many business firms in terms of lower prices of goods and greater efficiency by reducing time and costs of delivery at customs. A higher threshold would increase the volume of low-value (and small sized) shipments between the United States and Canada. Total direct economic benefits to Canadians from raising the *de minimis* threshold are estimated between C$202 million and C$648 million (see McDaniel, Schropp, and Latipov 2016).

Intellectual Property Rights (IPR)

The USTR objects to the patent utility test adopted by Canadian courts, namely the "promise doctrine."[24] It means that a patent applicant must demonstrate that its invention provides sufficient usefulness as of the Canadian filing date to be patentable. The problem with this doctrine is that the usefulness of pharmaceuticals may be demonstrated only by clinical trials conducted after the patent application. Yet Canadian courts have invalidated patents held by US pharmaceutical companies, finding that the "promise" of the patent was insufficiently substantiated on the filing date. Notably, Canadian federal courts ruled that two Eli Lilly patents were invalid because the drugs did not satisfy their "promised" utility on the filing date.[25] "Promise" is something of a Catch 22 doctrine because if Eli Lilly had waited to file its patent until clinical trials had been completed, it might have lost out to a rival firm. In late 2012, Eli Lilly brought a case against the Canadian government asserting violation of NAFTA. In March 2017, the tribunal convened by the International Centre for the Settlement of Investment Disputes (ICSID) rejected Eli Lilly's claims and awarded about $3.7 million in costs to Canada.[26] Nevertheless, the United States might seek to overturn the "promise doctrine" in a revised NAFTA text.

As for IPR enforcement, Canada's Combating Counterfeit Products Act, enacted December 9, 2014, did not enable Canadian customs officers to inspect and detain pirated and counterfeit goods that travel through Canada on their way to the United States. Accordingly, Canada remains on the Watch List in USTR's *2016 Special 301 Report* (USTR 2016), regarding country IPR protection.

Domestic Support Measures

The Canadian federal government funds the Strategic Aerospace and Defense Initiative (SADI) for R&D projects in the aerospace, defense, space, and security areas, having authorized C$1.53 billion since 2007. Meanwhile, the Quebec provincial government persuaded Bombardier to maintain its aircraft manufacturing operations in Quebec for 20 years, by purchasing 49.5 percent of the equity in a CSeries joint venture for C$1 billion in 2015. In the future, the Canadian federal government could support commercial sales of CSeries aircraft in the US market.

Aircraft and aerospace design and production have a long history of public subsidies worldwide. From time to time these subsidies provoke trade battles. Canadian programs may fall into that pattern. No US-Canada disputes had erupted in aerospace until Boeing filed an AD and CVD petition with the US Department of Commerce (DOC) against Bombardier on April 27, 2017. Boeing alleged that Bombardier has received massive government subsidies in the form of "launch aid," which distorts trade by removing development risks and, as a result, Bombardier can sell the CSeries aircraft to US air carriers at below the relevant market price.[27] When DOC initiated the AD and CVD investigation on Bombardier, the Canadian government threatened to cancel its plan to purchase Boeing fighter jets.[28]

23. See US Customs and Border Protection, "Types of Exemptions," at www.cbp.gov/travel/international-visitors/kbyg/types-exemptions (accessed on June 8, 2017).

24. This section is largely drawn from USTR (2016), which covers more detailed concerns about intellectual property rights protection with regard to Canada.

25. "US sides with Canada on NAFTA interpretation in Eli Lilly ISDS case," *Inside US Trade,* April 24, 2016.

26. International Centre for the Settlement of Investment Disputes, "Final Award," Case No. UNCT/14/2, March 16 2017, www.italaw.com/sites/default/files/case-documents/italaw8546.pdf (accessed on March 29, 2017).

27. "Boeing files AD and CVD complaint against Canada's Bombardier," *Inside US Trade*, May 4, 2017.

28. "Analysts: Canada getting 'tough' by linking defense procurement to Bombardier AD, CVD case," *Inside US Trade*, May 22, 2017.

Investment Barriers

The Investment Canada Act (ICA) requires prospective foreign investors to notify Industry Canada or the Department of Canadian Heritage. Direct or indirect acquisition of Canadian firms by foreign investors are then subject to review and ministerial approval if the investment in acquiring the Canadian firm equals or exceeds a threshold of C$600 million.[29] Proposed investments should demonstrate the likelihood of "net benefit" to Canada. Net benefit criteria include effects on employment, productivity, R&D, competition, and the compatibility of the investment with national industrial, economic, and cultural policies.[30] These criteria are more subjective than the "national security" test in US legislation that governs the Committee on Foreign Investment in the United States (CFIUS). Trump could seek to emulate the more subjective Canadian approach when vetting foreign investments in the United States, especially from China. However, investment barriers do not appear to be an issue in Canada-US relations, since complaints have not been voiced by US firms trying to acquire Canadian firms.

Cross-Border Data Flows

As a major information technology (IT) services exporter, the United States strongly supports the free flow of data across borders. However, many countries prevent the transfer of certain data abroad, for national security, privacy, and industrial development reasons. Canada is one of them.

At the provincial level, British Columbia and Nova Scotia have set privacy rules that require personal information collected by schools, universities, hospitals, government-owned utilities, and public agencies to be stored and accessed in Canada. The purchase of US services that could store personal information in the United States is prohibited. Privacy rules of this type would be a bigger problem for US service providers if other Canadian provinces decided to adopt them.

US service providers are prevented from bidding on the Canadian federal government project under the Shared Service Canada Act. Created in August 2011, Shared Service is designed to ensure more efficient, reliable, and secure IT infrastructure for the delivery of Canadian government programs and services.[31] Under this procurement project, the Canadian government requires firms to store and process data within the Canadian territory. The prohibition of cross-border data flow prevents some US service exporters, such as "cloud" computing suppliers, from participating in the Shared Service project. To qualify as bidders, US service providers would need to establish data storage and processing facilities in Canada, an expensive proposition. But US government procurement is also highly restricted for foreign firms.

TRADITIONAL US DEFENSIVE INTERESTS

Canada has its own list of US barriers that prevent Canadian exports or otherwise disadvantage Canadian commerce. From the US perspective, these are defensive interests.

Softwood Lumber

Lumber is an important industry in both Canada and United States, and trade disputes can be traced back more than a century. To resolve the latest chapter in the modern but long-running "softwood lumber wars," which started in the 1980s, Canada and the United States signed the fourth Softwood Lumber Agreement in 2006. A key provision established export charges and/or quota limits on Canadian lumber exports to the United States when the price of US softwood lumber products falls below $355 per thousand board feet.[32]

After the agreement expired on October 6, 2016, the Obama administration launched bilateral negotiations to establish a new chapter but no conclusion was reached. Canada sought more flexibility in applying export charges while the United States demanded a market share quota

29. The threshold rose to C$800 million in April 2017 and will rise to C$1 billion in 2019. See Government of Canada, "Regulations Amending the Investment Canada Regulations," *Canada Gazette*, March 25, 2015, www.gazette.gc.ca/rp-pr/p2/2015/2015-03-25/html/sor-dors64-eng.php (accessed on February 15, 2017); Oliver J. Borgers and Michele Siu, " Investment Canada Act Review Threshold increases to C$800 Million," *Canadian M&A Perspectives*, April 24, 2017, http://www.canadianmergersacquisitions.com/2017/04/24/investment-canada-act-review-threshold-increases-to-c800-million (accessed on June 2, 2017).

30. For more details, see Government of Canada, "Investment Canada Act," www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00007.html#q8 (accessed on February 15, 2017).

31. The Shared Service priorities are to migrate 43 government agencies and departments from various email services into a single platform, to consolidate data centers, and to strengthen the security of government data and technology assets.

32. Under the agreement (now expired), if the price of US softwood lumber ranged between $336 and $355 per thousand board feet (MBF), Canadian softwood exports had to pay a 5 percent export charge, or a 2.5 percent export charge with volume restraints, for shipments to the US market. If the price ranged between $316 and $335 per MBF, Canadian softwood lumber had to pay a 10 percent export charge, or a 3 percent export charge plus volume restraints. If the price dropped below $315 per MBF, the export charge rose to 15 percent, or 5 percent and volume restraints. See Hoover and Fergusson (2016).

not to exceed 22 percent for Canadian softwood lumber exports.[33]

In the absence of a new agreement, the US lumber industry filed petitions with the US International Trade Commission (USITC) and the US Department of Commerce (DOC) against Canadian producers, claiming Canadian subsidies and dumping practices. On January 6, 2017, the USITC issued a preliminary determination finding material injury to the US lumber industry.[34] DOC announced its preliminary determination that Canadian softwood lumber producers have received countervailing subsidies ranging from 3.02 to 24.12 percent. In response to the US tariff on lumber, the Canadian government is considering a federal ban on US thermal coal shipments transiting British Columbia ports and considering imposing duties on exports from Oregon.[35] Also, preliminary antidumping determination that Canadian companies sell softwood lumber in the United States at less than its fair value is scheduled in June 2017. Once DOC and USITC make final determinations, DOC will issue a countervailing duty order on Canadian softwood lumber producers.[36]

Canada has its own list of US barriers that prevent Canadian exports or otherwise disadvantage Canadian commerce.

In renegotiation talks, the United States could use preliminary DOC and USITC determinations as leverage to impose its quota solution in the next chapter of the "softwood lumber wars." Alternatively, Canada could play other bargaining chips as leverage for a modified export charge solution.

Beef and Pork

Recently Wyoming and South Dakota launched efforts to reinstate mandatory country of origin labeling (COOL) requirements at the state level. On February 3, 2017, Wyoming introduced a bill to require COOL for retail beef products sold in the state.[37] South Dakoda is contemplating a similar COOL bill.

Under the 2008 Farm Act, COOL was implemented as a national measure in March 2009, requiring retail stores to label the country of origin for food products such as fresh fruits and vegetables, fish, and ground and muscle cuts of beef, pork, lamb, chicken, and other items. Under this Act, a US origin mark was awarded only to an animal that was born, raised, and slaughtered in the United States. If cattle are born and raised in Canada and slaughtered and processed in United States, they receive two country of origin marks, both US and Canadian origin.

While somewhat useful for consumers, COOL requirements discriminate against imported products, especially beef and pork, owing to the high cost of monitoring a separate supply stream in slaughterhouses. Canadian objections led to a WTO case against the United States. The WTO Dispute Settlement panel and the Appellate Body ruled that the federal COOL requirement violated US trade obligations.[38] On December 18, 2015, the US Department of Agriculture halted enforcement of COOL requirements for muscle cut and ground beef and pork.

State-level COOL requirements conflict with the WTO ruling and decisions by the US federal government. Canada could seek federal preemptive legislation in renegotiation talks.

Government Procurement

The US public sector is one of the largest procurement markets in the world, since US federal and state government procurement account for 10 percent of US GDP.[39] However,

33. "ITC to continue lumber investigation as Canada rejects latest US proposal," *Inside US Trade*, January 12, 2017. Hoover and Fergusson (2016) find that, since 2006, the Canadian share of the US softwood lumber market has averaged 28 percent annually. President Carter endorsed the penalty duties supported by the White House and the Commerce Department. See Jimmy Carter, "Trump is right. Canada's lumber trade practices are unfair," *Washington Post*, May 9, 2017, www.washingtonpost.com/opinions/jimmy-carter-trump-is-right-canadas-lumber-trade-practices-are-unfair/2017/05/09/249c7bb4-31b8-11e7-8674-437ddb6e813e_story.html?utm_term=.fa099addfbd6 (accessed on May 19, 2017).

34. US International Trade Commission, "USITC Votes to Continue Investigations on Softwood Lumber Products from Canada," January 6, 2017, www.usitc.gov/press_room/news_release/2017/er0106ll702.htm (accessed on February 14, 2017).

35. "Ross to Canada: Threats of retaliation for lumber duties 'inappropriate'," *Inside US Trade*, May 11, 2017.

36. The final determination on CVD is expected on September 7, 2017. See the press release from Department of Commerce on April 24, 2017, www.commerce.gov/news/press-releases/2017/04/us-department-commerce-issues-affirmative-preliminary-countervailing (accessed on May 3, 2017).

37. "Two States Move to Require COOL Labeling for Beef: Country of Origin," *National Law Review*, February 6, 2017, www.natlawreview.com/article/two-states-move-to-require-cool-labeling-beef-country-origin (accessed on February 22, 2017). For in-depth analysis on COOL, see Bown (2016).

38. For more details, see Greene (2015).

39. Canadian government procurement represents 13 percent of Canadian GDP. See Organization for Economic Cooperation and Development (OECD), *Government at a*

the United States is far more protective than Canada with respect to government procurement. The protective edge was recently sharpened by President Trump's call to "Buy American and Hire American."[40]

The Buy American Act of 1988 (an amended version of the original Buy American Act of 1933) and related executive orders limit foreign participation in the US federal procurement market through bid preferences for US firms and other discriminatory tests.

The Act allows the president to waive discriminatory requirements in order to comply with US liberalization commitments under the WTO Agreement on Government Procurement (GPA) and procurement chapters in US FTAs. Under NAFTA, the United States scheduled 53 government entities and 6 government enterprises for liberalization.[41] Covered procurements valued at or above specified US dollar thresholds are open to bids by Canadian and Mexican firms. US federal government entities, such as the Department of Defense, have a $77,533 threshold for goods and services and a $10 million threshold for construction contracts open to Canadian and Mexican bids. For government enterprises, the US thresholds are set at $387,667 for goods and services and $12 million for construction services.[42]

The American Recovery and Reinvestment Act of 2009 (ARRA, also known as the stimulus act) disrupted these NAFTA commitments. Under ARRA, Buy American requirements for projects needing iron, steel, or manufactured goods were waived only if the mandatory use of made-in-USA products would increase the total cost of a project by more than 25 percent. The immediate effect of this measure was that ARRA-financed procurement at the state and local levels for iron, steel, and manufactured products was effectively shut down to Canadian bidders. The ensuing debate was resolved by a 2010 agreement between Canada and the United States that allowed Canadian iron, steel, and manufactured goods to be used in future ARRA-financed procurement projects.[43] Bearing this episode in mind, Canada might seek a restatement of the 2010 agreement, especially since Trump's economic plans contemplate major infrastructure spending (see Robertson 2017).

Jones Act

The Jones Act (originally called the Merchant Marine Act of 1920) requires vessels that carry goods between US ports be built in the United States and owned and operated by Americans. The Act applies both to coastal ports and Great Lake ports and is an extremely protective and costly piece of legislation. US Senator John McCain has been a tireless advocate for repeal, arguing that abolishing the Jones Act could lower shipping costs by 22 percent.[44]

Canada might renew its request to exclude the Great Lakes from Jones Act coverage and also ask to be included under the Jones Act as a permitted shipbuilding country. The Canadian minister of public services and procurement stated, in March 2016, that the National Shipbuilding Strategy (NSS) for Vancouver Shipyards Co. Ltd. would provide funding of $65.4 million.[45] This type of government project is more likely to succeed if vessels could be used in US coastal trade.

Investor-State Dispute Settlement

Canada has lost several investor-state dispute settlement (ISDS) cases and for that reason many Canadians resent Chapter 11 of NAFTA. By contrast, to date the United States has lost no ISDS cases. Hence in renegotiation talks Canada might call for sharp modification of the Chapter 11 arbitration rules. It might seek to replicate the ISDS mechanisms set forth in the EU-Canada CETA mechanism, which call for permanently appointed arbitrators and an appeals process. US representatives of business interests, such as the Chamber

Glance—2015 edition: Public procurement, http://stats.oecd.org (accessed on February 21, 2017).

40. White House, "Presidential Executive Order on Buy American and Hire American," April 18, 2017, www.whitehouse.gov/the-press-office/2017/04/18/presidential-executive-order-buy-american-and-hire-american (accessed on April 18, 2017).

41. The six government enterprises are Tennessee Valley Authority, Bonneville Power Administration, Western Area Power Administration, Southeastern Power Administration, Southwestern Power Administration, and St. Lawrence Seaway Development Corporation.

42. Office of the United States Trade Representative, "Procurement Thresholds for Implementation of the Trade Agreements Act of 1979," in *Federal Register Notice with 2016-2017 Thresholds* 80, no. 240, December 15, 2015, https://ustr.gov/issue-areas/government-procurement/thresholds (accessed on February 21, 2017).

43. However, the federal government allocated the bulk of ARRA funding to US suppliers before the 2010 agreement entered into force. For more details, see Hufbauer et al. (2013).

44. Larry Luxner, "US Sen. McCain sets sights on Jones Act," Joc.com, December 5, 2014, www.joc.com/regulation-policy/transportation-regulations/us-transportation-regulations/us-sen-mccain-sets-sights-jones-act_20141205.html; Senator McCain filed the amendment to repeal the Jones Act on January 13, 2015, www.mccain.senate.gov/public/index.cfm/press-releases?ID=F7198ACD-C54E-4595-987A-1D76410742C9 (accessed on February 22, 2017). Grennes (2017) provides in-depth analysis of the Jones Act, arguing that the total cost of the Act exceeds the total benefit.

45. Government of Canada, "Government of Canada makes important shipbuilding investment," press release, March 14, 2016, http://news.gc.ca/web/article-en.do?nid=1039769 (accessed on February 22, 2017).

of Commerce, would oppose such an initiative. The views of the Trump administration on ISDS are unknown.

Oil and Gas Pipeline

US defensive interests in the energy sector might center on the construction of new cross-border pipelines. In the NAFTA era, Canada and the United States have greatly expanded bilateral energy trade. US imports from Canada of crude oil and petroleum products increased three-fold from 1.2 million barrels per day in 1993 to 3.8 million barrels per day in 2016.[46] However, the construction of transborder and national pipelines sparked US political opposition from environmental groups. The Keystone XL Pipeline project and Dakota Access project are major contributors to this debate.

Canada could raise legitimate concerns over policies regulating US pipelines and transmission lines. One concern is uncertainty embedded in the approval process. Pipelines and transmission lines that connect with a foreign country, such as Keystone XL and Dakota Access, must obtain a presidential permit for construction. The Keystone XL Pipeline connecting Alberta to Houston was under construction until President Obama refused to issue a permit in 2015. While President Trump issued a permit,[47] the delay inflicted financial damages on TransCanada, the pipeline owner. In renegotiation talks Canada could seek immediate approval for current pipeline and transmission line projects, as well as an expedited process for future projects.

A second concern is the "Buy America" requirement for future pipeline construction. Under Trump's memorandum of January 24, 2017, pipelines laid in US soil must use materials and equipment produced in the United States.[48] This violates NAFTA and WTO obligations that prevent discrimination between domestic and foreign goods. In any event, Canada might seek a fresh waiver of "Buy America" requirements with respect to Canadian iron and steel products under the new NAFTA.

Steel Capacity

Trump's campaign headlines called for bringing back US manufacturing jobs, "Buy American and Hire American," and a 45 percent tariff on imports from China. Against this background, the steel industry will be a model US defensive interest in renegotiation talks. The most recent action of the Trump administration was to instruct the Department of Commerce to investigate the national security implications of steel imports, triggering Section 232(b) of the Trade Expansion Act of 1962.[49] Following the investigation, President Trump will likely impose quotas on imported steel products from a number of countries, possibly including Canada.

Excess global steelmaking capacity is a serious concern of the US government. The USTR claims that excessive global supply of steel, largely caused by overproduction in China, resulted in falling steel prices, closing of steel factories, and loss of over 12,000 US jobs in 2015.[50] To mitigate this problem, the United States filed six enforcement actions against China at the WTO and agreed with Mexico and Canada to address global excess steelmaking capacity. The United States and Canada are members of the OECD Steel Committee and cochair the Global Forum on Steel Excess Capacity (set up by G-20 and interested OECD countries), which analyzes challenges resulting from excess capacity such as trade frictions and structural imbalances.[51] Based on their mutual understanding, Canada and the United States might propose a framework centered on steel export quota. Or Canada might request its exemption from trade restrictions imposed by the outcome of the Section 232(b) investigation.

Provincial and State Representation

A distinctive feature of the EU-Canada CETA negotiation was that the Canadian negotiating team was composed of federal, provincial, and territorial governments, upon the

46. Data are from US Energy Information Administration.

47. Obama's rejection prompted TransCanada to file an ISDS case seeking $15 billion in damages against the US government. After Trump's approval, the case was dropped. "Approval of Keystone XL's presidential permit ends NAFTA claim," *Inside US Trade*, March 24, 2017.

48. Keystone XL pipeline is exempted from this condition. See "Trump won't require Keystone XL pipeline to use American steel after all," *Los Angeles Times*, March 3, 2017, www.latimes.com/politics/washington/la-na-essential-washington-updates-trump-won-t-require-keystone-pipeline-1488585551-htmlstory.html (accessed on March 24, 2017).

49. "Trump orders Ross to expedite 232 investigation into steel imports," *Inside US Trade*, April 20, 2017; see Memorandum for the Secretary of Commerce, April 20, 2017, https://insidetrade.com/sites/insidetrade.com/files/documents/apr2017/wto2017_0119a.pdf.

50. The OECD projected that global steelmaking capacity would be 700 MMT in excess of global steel demand in 2015 due to Chinese overproduction of steel. Office of US Trade Representative, "Fact Sheet: Addressing Steel Excess Capacity and Its Impacts: Ensuring a Level Playing Field for American Businesses and Workers," April 2016, https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2016/april/addressing-steel-excess-capacity-its (accessed on March 27, 2017).

51. OECD, "82nd Session of the OECD Steel Committee—Chair's Statement," www.oecd.org/sti/ind/82-oecd-steel-chair-statement.htm (accessed on March 27, 2017).

request of the European Union. It asked for Canadian subfederal representatives because some of the EU negotiating demands directly or indirectly involved provincial and territorial jurisdiction such as financial services, agriculture supply management, and public procurement (Goff 2016). US state-level regulations sometimes restrict Canadian exports, particularly in public procurement and agriculture. Following the CETA format, Canada might ask the United States to include selected state representatives in the negotiation.

POSSIBLE COMMON INTERESTS

The United States and Canada may find a few topics that do not fall squarely in the offensive or defensive columns but instead might be endorsed by both countries. Such topics would align with the approaches adopted in the Trans-Pacific Partnership (TPP) agreement.

A possible item of mutual interest would be the establishment of new rules for e-commerce and digital information exchange. The McKinsey Global Institute (2016) reported that the volume of global data flows increased by 45 times from 2005 to 2014, by far the fastest growing segment of world commerce. E-commerce has become deeply integrated with economic activity via Google, Facebook, Amazon, Netflix, and other internet firms. To establish rules for this rapidly growing segment, TPP Chapter 14 on Electronic Commerce offers a good template. The TPP chapter prohibits customs duties on digital goods and services, although sales or value-added taxes may be imposed. The chapter fosters cross-border data flows and eliminates requirements for the establishment of physical facilities to run an e-business. However, one weakness of the TPP chapter is that it does not create uniform standards to ensure data privacy. The United States and Canada could design common consumer privacy standards in their talks.

Second, Canada and the United States might share an interest in establishing guidelines for state-owned enterprises (SOEs). While both countries have few SOEs (though some are giants, such as the Tennessee Valley Authority), their partner Mexico has a large state-owned sector (mainly energy), with about 70 SOEs in 2012, valued at over $80 billion.[52] According to NAFTA Article 1503, state enterprises should provide fair and equal treatment to foreign investors in procuring goods and services and exercise regulatory authority delegated by government in a consistent manner. The new NAFTA could embrace the SOE obligations set forth in TPP Chapter 17 on State-Owned Enterprises. Under this chapter, member countries are prohibited from discriminating against other members in SOE procurement and sales of goods or services and from using noncommercial public assistance. Additionally, they are required to reveal detailed information of SOE operations upon the request of another member and to subject SOEs to the dispute resolution mechanism.[53]

Next, Canada and the United States could enhance the NAFTA labor and environment side agreements by adopting features from the TPP text.[54] On the environment, NAFTA members could strengthen obligations subject to the binding dispute settlement procedures and reinforce their commitments not to erode their domestic environmental standards to boost investment. Also, they could add new obligations to reduce fishery subsidies, suppress illegal trafficking in wildlife and illegal logging, and enforce multilateral environmental agreements (MEAs). On labor, NAFTA could adopt the ambitious provisions set forth in the TPP. These provisions include domestic enforcement of labor standards agreed by the International Labor Organization (ILO) and dispute resolution procedures with recourse to trade sanctions. Canada and the United States could reinforce the protection of workers' rights by adding obligations to establish a minimum wage level, set maximum working hours per day, and regulate the occupational health and safety environment.

Fourth, NAFTA could add a chapter for trade facilitation that promotes cross-border trade by expediting shipments and streamlining customs procedures. Canada and the United States have already ratified the WTO Trade Facilitation Agreement (entered into force in February 2017) and in 2011 announced their "Beyond the Border Declaration: A Shared Vision for Perimeter Security and Economic Competitiveness."[55] The Declaration institutionalizes bilateral cooperation to improve security and facilitate trade and travel. Under this Declaration, various action plans expedite customs procedures at the US-Canada border.[56] Particularly, the Agreement on Land, Rail, Marine, and Air Preclearance was signed in 2015. This agreement will provide a consistent approach to preclearance operations covering all modes of transportation. When renegotiating NAFTA, the two countries could integrate key issues of the Declaration into a new trade facilitation chapter of NAFTA.

52. SOE data from the OECD, http://stats.oecd.org (accessed on March 13, 2017).

53. For detailed analysis, see Miner (2016).

54. Schott (2017) and Cimino-Isaacs (2017) provide in-depth analysis on the environment and labor chapters of the TPP.

55. Department of Homeland Security, "Beyond the Border," www.dhs.gov/beyond-border (accessed on March 14, 2017).

56. Major accomplishments in 2015 under the Declaration are fully described in the Department of Homeland Security's *2015 Beyond the Border Implementation Report*.

Fifth, NAFTA could increase the coverage of small and medium-sized enterprises (SMEs), which have been major beneficiaries of the regional pact. Some 50 percent of US exporters sold their goods to Canada and Mexico in 2014, and of these 94 percent were US SMEs.[57] Regional supply chains in sectors such as autos and electronics have indirectly created markets for additional SMEs. When engaged in direct cross-border trade, SMEs face high fixed costs.[58] In the NAFTA renegotiation, Canada, Mexico, and the United States could propose a chapter similar to the one in the TPP to benefit SMEs. If ratified, TPP Chapter 24 on Small and Medium-Sized Enterprises would require member countries to make information on customs procedures, investment rules, taxation, and business regulation available to SMEs and to address difficulties that SMEs might face in entering Pacific trade.

Last, Canada and the United States could further integrate the energy market in North America. Hufbauer and Schott (2005) argue that NAFTA Chapter 6 on Energy and Basic Petrochemicals had a limited influence in harmonizing energy policies and prices, even though NAFTA contributed to the rapid growth of energy trade between Canada and the United States. Canada now supplies almost half of US energy imports. But energy regulatory policies still differ between federal, state, and provincial jurisdictions. Trilateral efforts to create an integrated energy market, outside the NAFTA framework, led to the North American Electric Reliability Corporation (NERC) to develop and enforce reliability standards for electrical grid connections in North America.[59] Canadian and US negotiators might expand the NERC model to other parts of energy infrastructure.

CONCLUSION

This Policy Brief identifies well-known US and Canadian trade barriers and speculates on possible "blockbuster" demands that the Trump trade team might make on Canada. NAFTA renegotiation gives the Trump administration an opportunity to resolve longstanding trade grievances with Canada, provided the United States makes its own concessions. Both countries can benefit from updating NAFTA to address issues not foreseen in the early 1990s, such as digital commerce and SOEs. In renegotiation talks, several questions might be resolved in a reciprocal fashion that allows each country to claim victory. On the other hand, US insistence on "blockbuster" demands could put not only the talks but also the entire relationship between Ottawa and Washington at risk.

NAFTA renegotiation can cover a wide range of issues between Canada and the United States to the benefit of both countries. Trade liberalization pays off as much, if not more, for the importing country as for the exporting country. To realize potential gains, the Trump administration should put aside its obsession with trade deficits, at least in talks with Canada. Instead, in these talks, the US trade team should emphasize basic principles: The purpose of a Canada-US trade agreement is to create an integrated market that fosters the free flow of goods and services and establishes the norms for fair competition. Trade across the US-Canadian border should meet no greater obstacles than trade between British Columbia and Alberta or between California and Texas.

57. In 2014, 152,349 US exporters sold goods to Canada and Mexico, and 143,915 US SMEs exported goods to NAFTA countries. See "Exhibit 5a: 2014 Exports by Company Employment Size to World Areas and Selected Countries," www.census.gov/foreign-trade/Press-Release/edb/2014/exh5a.pdf (accessed on April 18, 2017).

58. The International Trade Centre (2015) listed relevant fixed costs, including "accessing information about export opportunities, overcoming nontariff barriers, coping with border procedures, establishing delivery system to foreign customers, and contracting for network infrastructure (ICT, electricity and water)."

59. For background and analysis on electricity reliability, see Ek and Fergusson (2014).

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