

18-11 NAFTA Termination: Legal Process in Canada and Mexico

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President Donald Trump has repeatedly threatened to withdraw from the North American Free Trade Agreement (NAFTA) if Canada and Mexico do not meet his demands to curtail their merchandise trade surpluses with the United States and to renegotiate the agreement every five years or let it expire. Notwithstanding the president's decision to exempt NAFTA trading partners from US tariffs on steel and aluminum, imposed March 2018, Canada and Mexico must consider the possibility that the United States will indeed withdraw from the pact. No one knows when that could happen.¹ The mechanics of US withdrawal have been widely explored (Hufbauer 2016),² with an emerging consensus among legal experts that Trump does have the authority to pull out of the accord.

1. At times, Trump has been less hostile to NAFTA. See, for example, "Transcript of Donald Trump Interview with the Wall Street Journal," *Wall Street Journal*, January 14, 2018.

2. Trump could, of course, use the notice of withdrawal as a tactic. See David Lawder, "Trump could use NAFTA withdrawal letter as negotiating leverage," *Reuters*, January 10, 2018.

But if Trump does pull the trigger, what might be the response?

Chapter 22 of NAFTA allows any member to withdraw from the agreement by giving six-months' notice.³ The notice, however, triggers a grace period at the end of which the initiating member may decide not to withdraw. From a legal standpoint, there would be no need for Canada or Mexico to terminate NAFTA vis-à-vis the United States—unilateral US termination would put an end to the trilateral pact between itself and Canada and Mexico. Most importantly, even if the United States were to withdraw after six months, Canada and Mexico would be relieved from their NAFTA obligations vis-à-vis the United States, but the pact would remain in force between the two remaining members.⁴ Both countries would be able to retain a bilateral NAFTA without approval from their own legislatures after US withdrawal. If Canada or Mexico did not want to keep NAFTA as a bilateral deal between themselves, either of them would have to terminate the pact. However, it seems unlikely that either country would do so, and if they did, their termination actions would only be with respect to the United States (for instance, following futile and acrimonious negotiations).

In general, Canada, Mexico, and the United States, as member countries of the World Trade Organization (WTO), can apply either most favored nation (MFN) tariffs or preferential tariffs on imported goods. MFN tariffs are nondiscriminatory tariffs that WTO member countries impose on imports from all member countries that are not entitled to preferential tariffs. MFN tariffs fall into two categories: bound or applied.⁵ Bound tariffs are the highest MFN tariffs that WTO members can impose on imports from other WTO members. When a country enters the

3. See NAFTA Article 2205: Withdrawal, "A Party may withdraw from this Agreement six months after it provides written notice of withdrawal to the other Parties. If a Party withdraws, the Agreement shall remain in force for the remaining Parties."

4. Note that Canada and Mexico will be bound together in a new free trade agreement (FTA), the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), signed on March 8, 2018.

5. For details, see Types of Tariffs, https://wits.worldbank.org/wits/wits/wits/help/content/data_retrieval/p/intro/c2.types_of_tariffs.htm (accessed on April 19, 2018).

WTO, it usually negotiates bound tariffs on nearly all its imports. Applied tariffs can be lower than MFN bound tariffs, at the discretion of a member country, but all other WTO members are entitled to ship exports to that member at tariffs no higher than the same applied rates. Preferential tariffs are still lower tariff rates (usually zero) that a country commits to impose on imports from its specific partner countries in a preferential trade pact (such as NAFTA). They are almost always lower than MFN tariff rates. For example, Mexico's simple average bound tariff is 36 percent, and its simple average applied tariff is about 7 percent. Its simple average preferential tariff on imports from the United States is zero, which is the preferential treatment under NAFTA.

Canada and Mexico would be able to retain a bilateral NAFTA without approval from their own legislatures after US withdrawal.

Assuming that the United States withdraws from the Canada-US FTA at the same time as it triggers withdrawal from NAFTA (an unlikely scenario) and simultaneously imposes its MFN tariffs, Canada and Mexico would likely respond by imposing their own. Canada's MFN bound tariffs are about 2.4 percent higher than its applied tariffs, and Canada would likely impose its MFN applied rate on imports from the United States.⁶

In the case of Mexico, however, MFN bound rates are generally much higher than MFN applied rates. Given its WTO obligations, Mexico cannot impose its higher MFN bound rates on imports from just one WTO member (such as the United States) and its lower applied rates on imports from all other (nonpreferential) members. However, for selected imports, where the United States is the dominant supplier, Mexico might revert to its higher MFN bound rates for imports from all (nonpreferential) WTO members. For example, Mexico has a 32 percent simple average bound tariff rate and a 1 percent simple average applied tariff rate on parts and accessories for automobiles (specifically, those categorized as Harmonized System Code [HS] 8708). Those items are key US exports to Mexico, and in the event of NAFTA termination, Mexico might revert to the bound tariff rate on all its imports of HS 8708, thereby penalizing the United States.

6. According to the World Trade Organization (WTO) tariff profiles database, for imported goods, the simple average MFN bound tariffs of Canada and the United States are 6.5 percent and 3.4 percent, respectively, and the simple average MFN applied tariffs of Canada and the United States in 2016 were 4.1 percent and 3.5 percent, respectively.

In light of these various tariff options for Canada and Mexico, this Policy Brief summarizes Canadian and Mexican legal processes to terminate NAFTA, either in total or just with the United States. The prime minister in Ottawa and the president in Mexico City play decisive roles. Nevertheless, the Canadian Parliament and the Mexican Senate would need to approve any change to their own NAFTA obligations. Similarly, the US Congress would need to assent to any changes that necessitate modification of US statutes.

CANADA

Power to Terminate NAFTA

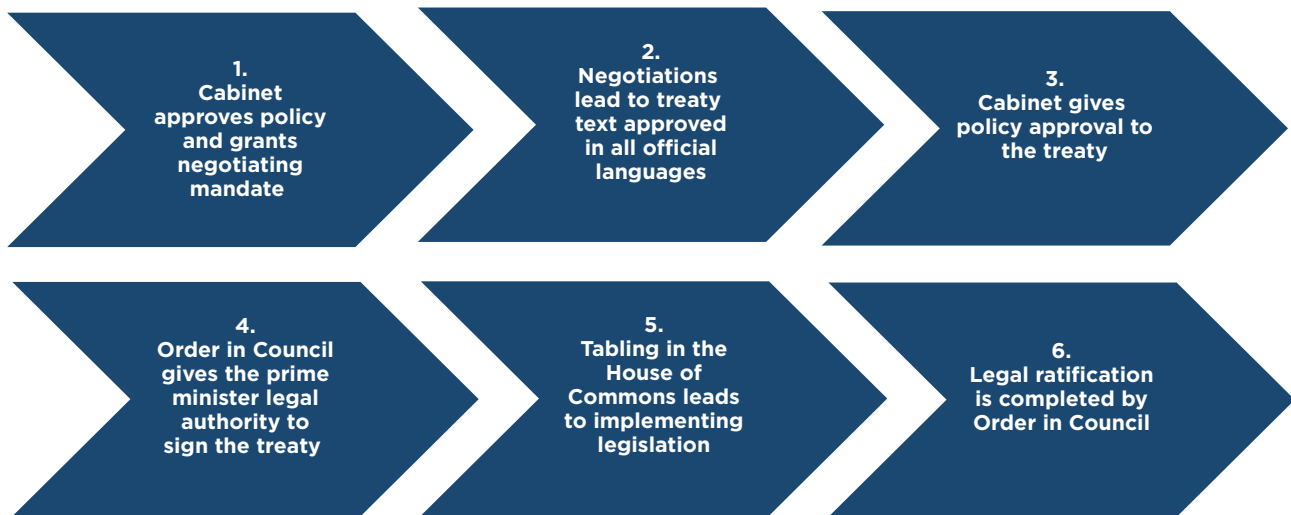
Historically, powers to engage in international treaty-making on behalf of the Dominion of Canada were reserved to the British Parliament (see Dupras 2000). When Canada gained independence in 1931, it acquired full authority over its external affairs as an essential component of its independent status. The Constitution of Canada⁷ does not contain explicit provisions on the separation and assignment of powers in international treaty-making (Matas 1947, Cyr 2009). But in practice, the federal executive dominates the field of foreign affairs, acting as the Queen's representative (see Dupras 2000). The minister of foreign affairs is vested with powers related to the conduct of the external affairs of Canada, including the power to negotiate international treaties.⁸ But other appointees (e.g., ministers or diplomats) can also lead negotiations. In the field of international trade and commerce, the minister of foreign affairs is assisted by the minister of international trade.⁹ When an international treaty requires the amendment of Canadian legislation, both chambers of Parliament must pass an implementing act.¹⁰ Such acts are usually prepared upon instructions from the respective ministers; after the Cabinet approves them, they are tabled in the Parliament (see Barnett 2008). Apart from the Implementing Act, provincial and territorial legislatures may require additional implementing legislation when

7. The Constitution of Canada consists of the Constitution Acts, 1867 to 1982. Section 132 of the Constitution Acts reads as follows: "The Parliament and Government of Canada shall have all Powers necessary or proper for performing the Obligations of Canada or of any Province thereof, as Part of the British Empire, towards Foreign Countries, arising under Treaties between the Empire and such Foreign Countries."

8. The Department of Foreign Affairs, Trade and Development Act, S.C. 2013, c. 33, s. 174, Section 10(1).

9. *Ibid.*, Section 3.

10. Such an Implementing Act was adopted in the case of NAFTA: North American Free Trade Agreement Implementation Act, S.C. 1993, c. 44.

Figure 1 International treaty-making in Canada

Sources: Authors' summary based on Ministry of Foreign Affairs: *Policy on Tabling of Treaties in Parliament*, Annex A, "The Treaty Making Process."

the treaty addresses issues within subfederal jurisdiction (Monahan and Shaw 2013).¹¹

Like the typical treaty-making process, the Department of International Trade would initiate the termination of NAFTA by submitting a notice in line with Article 2205 of NAFTA upon approval by the Cabinet and the Order in Council.¹² Subsequently, the notice, along with an Explanatory Memorandum, would be submitted to the House of Commons. Potentially, the minister of foreign affairs along with the lead ministers might seek approval from the prime minister to exempt NAFTA termination from the tabling procedure for treaties.¹³ Finally, NAFTA termination would clearly require changes in the federal legislation—e.g., adjusting tariffs to the WTO MFN levels—and correspondingly both chambers of Parliament would need to pass an Implementing Act. The governor

general, who completes the legislative process after the bill is passed by both chambers, must confer the royal assent (formal approval), but in modern times this step is a formality (Hogg 2011).¹⁴

Power to increase tariffs

Unlike the United States, where the president holds statutory executive powers to increase tariffs, in Canada most of these powers are vested with the Parliament and therefore would require amendment of the federal statutes. The legislative authority of the Parliament is broad and residual to the exclusive powers of Canadian provinces.¹⁵ The Parliament legislates on matters of national importance, enumerated in the Constitution, including the regulation of trade and commerce.¹⁶

Termination of NAFTA would require amendment of several federal statutes, including the Customs Tariff and the Customs Act.¹⁷ The amendments of these acts would have to go through a regular legislative procedure, which

11. According to the *Labour Conventions* case (Canada (A.G.) v. Ontario (A.G.), [1937] A.C. 326 (P.C.)), the authority to implement treaties is divided between federal and provincial legislatures according to the respective legislative jurisdiction. There is, however, a broad agreement that implementation of comprehensive free trade agreements generally falls within the federal power of the Parliament in relation to international trade or general regulation of trade.

12. Figure 1 provides a summary of the treaty-making process in Canada. See the detailed procedure prepared by the Ministry of Foreign Affairs of Canada: *Policy on Tabling of Treaties in Parliament*, Annex A, "The Treaty Making Process," <http://www.treaty-accord.gc.ca/procedures.aspx?lang=eng> (accessed on January 8, 2018).

13. Ministry of Foreign Affairs of Canada, *Policy on Tabling of Treaties in Parliament*, para. 6.3., <http://www.treaty-accord.gc.ca/procedures.aspx?lang=eng> (accessed on January 8, 2018).

14. The governor general is a representative of the Queen in Canada and formally the head of the state. Although his/her role in the legislative process is now ceremonial, he or she has certain reserved powers, among others to call a new prime minister, when the previous one resigns.

15. Legislative powers of provinces are indicated in Sections 92, 92A, and 95 of the Constitution Acts, 1867 to 1982. The division between federal and provincial powers in Canada is the reverse of the division between federal and state powers in the United States.

16. *Ibid.*, Section 91(2).

17. The Customs Tariff, S.C. 1997, c. 36 and the Customs Act, R.S.C., 1985, c. 1 (2nd Supp.).

entails three readings in both the House of Commons and the Senate, and finally the royal assent before the amendment can enter into force.¹⁸ In addition, there are several regulations, including NAFTA specific regulations, enacted by the governor general in council in line with the Customs Act.¹⁹ The amendment or repeal of these regulations does not need to go through the regular legislative procedure.

If Canada terminated NAFTA with respect to the United States, the Canada-US FTA would still remain in force, providing zero tariffs for most of the products formerly covered by NAFTA.

It is important to note that if Canada terminated NAFTA with respect to the United States, the Canada-US Free Trade Agreement (CUSFTA) would still remain in force, providing zero tariffs for most of the products formerly covered by NAFTA. In the spring of 2018, it seems highly unlikely that either the United States or Canada would terminate CUSFTA.

MEXICO

Power to terminate NAFTA

The president of Mexico has the power to lead diplomatic negotiations and conclude international treaties, subject to ratification by the Senate.²⁰ In practice, international treaties can be signed not only by the president but also by the minister of foreign affairs.²¹ In effect, the same procedure

applies to the termination of international treaties, including NAFTA. Thus, while the president can notify partner countries of Mexico's withdrawal from NAFTA under Article 2205, the Senate would have to approve.

Power to increase tariffs

Termination of NAFTA would require subsequent amendment of federal legislation, including the Customs Law and respective regulations.²² However, unlike in Canada, termination would not require an additional implementing act. After a bill to amend federal legislation is introduced either by the president or by either chamber of the Congress, it goes through a regular legislative procedure in the Congress: It must be approved by the Senate and the Chamber of Deputies and then signed into law by the president and the interior secretary. Since 2012, the president has the power to initiate a "priority legislative procedure" for up to two bills at the opening of ordinary sessions of the Congress (Serna de la Graza 2013, 64). The respective regulations to implement the amendments are then prepared by the ministries in charge of the question at issue and signed by the president and the secretary of commerce and industrial development (possibly also by the secretary of foreign affairs).²³

The Constitution of Mexico grants exclusive powers to the Congress to levy taxes on foreign commerce.²⁴ Furthermore, the federation has exclusive power to levy duties on imports, exports and goods in transit, or introduce other restrictions on trade in goods.²⁵ Although the ultimate power rests with the Federal Congress, also referred to as the Congress of the Union, it can delegate its powers to increase, decrease, or abolish tariff rates on imports or exports, or introduce new tariffs. In 1993, Congress delegated its powers to the president when it passed the Foreign Trade Act.²⁶ The secretary of commerce and industrial development is responsible for preparing and proposing tariff changes to

18. Parliament of Canada, Compendium of Procedure, Legislative Process: https://www.ourcommons.ca/About/Compendium/LegislativeProcess/c_g_legislativeprocess-e.htm (accessed on January 18, 2018).

19. Section 164 of the Customs Act enables the governor general in council to issue regulations on several customs-related matters. The NAFTA-related regulations passed within this power include: NAFTA and Canada-Chile Free Trade Agreement (CCFTA) Verification of Origin Regulations (SOR/97-333), NAFTA Marking Determination, Re-Determination and Further Re-Determination Regulations (SOR/98-49), NAFTA Prescribed Class of Goods Regulations (SOR/93-608), NAFTA Rules of Origin Regulations (SOR/94-14).

20. Article 89, Section X in conjunction with Article 76, Section I of the Constitution of Mexico. The ratification of international agreements on economic matters is governed by a separate law; see *Ley Sobre la Aprobación de Tratados Internacionales en Materia Económica*, Diario Oficial de la Federación el 2 de septiembre de 2004.

21. The Supreme Court of Mexico decided in 1998 that the minister of foreign affairs may also sign international

treaties, based on delegated powers according to Article 28(I) of the Law on Public Federal Administration. See P. XLV/98, Amparo en revisión 2830/97, 24 de febrero de 1998, *Semanario Judicial de la Federación y su Gaceta*, Tomo VII, Mayo de 1998, p. 133; Ricardo Mendez Silva, "Treaty Making, Genealogy and the Constitution Today," *Mexican Law Review* no. 4, 2005, <http://info8.juridicas.unam.mx/cont/mlawr/4/arc/arc7.htm#N73> (accessed on January 18, 2018).

22. *Ley Aduanera*, Diario Oficial de la Federación el 15 de diciembre de 1995, Última reforma publicada DOF 09-04-2012.

23. Article 92 of the Constitution of Mexico.

24. Article 73, Section XXIX (1) of the Constitution of Mexico. This would follow the regular legislative procedure.

25. Article 117(6) and (7) of the Constitution of Mexico.

26. Article 4 of the Foreign Trade Act (*Ley de Comercio Exterior*, Diario Oficial de la Federación el 27 de julio de 1993, Última reforma aplicada 13-03-2003).

the president.²⁷ The president may also submit for approval by the Federal Congress, as a part of the annual fiscal budget, measures in exercise of delegated powers “when [the Executive] deems this expedient for the purpose of regulating foreign commerce, the economy of the country, the stability of domestic production, or for accomplishing any other purpose to the benefit of the country.”²⁸

Without NAFTA, Mexico might have an alternative way to obtain duty free treatment under US trade law, namely the Generalized System of Preferences (GSP).²⁹ This program allows 3,500 tariff lines from 120 beneficiary countries to enjoy duty free treatment in the United States, with the aim of fostering economic growth in developing countries.³⁰ Under the Trade Act of 1974, the US president is authorized to grant, withdraw, or suspend the GSP treatment for any beneficiary country. Given GSP criteria, Mexico is theoretically still eligible for the program. In the event of NAFTA termination, Mexico might be designated as a beneficiary country, if the Trump administration so decided. However, since Trump’s overriding concern is the US trade deficit with Mexico, it is doubtful that Mexico would be designated a GSP beneficiary following the termination of NAFTA.

UNITED STATES³¹

To enter a free trade agreement (FTA), the United States enacts implementing legislation by a majority vote in both houses of Congress. To implement NAFTA, the US Congress ratified H.R. 3450 in 1993. To withdraw from NAFTA, the president can invoke NAFTA Article 2205. H.R. 3450 does not require the president to obtain congressional approval to withdraw; accordingly, it seems likely the president can take the United States out of NAFTA on his own initiative.³²

Article I, section 8 of the Constitution grants Congress the power to regulate foreign commerce, including the

imposition of tariffs. In legislation implementing FTAs, the Congress authorizes the president to proclaim tariff rates that reflect the terms of the agreement. After US withdrawal from NAFTA, the tariff concessions would most likely expire and revert to the previous level, namely the MFN bound tariffs under the WTO. As a backstop, Section 125 (e) of the Trade Act of 1974 authorizes the president to restore the tariff rates (i.e., the MFN rates) that existed prior to the FTA, but he must recommend to Congress appropriate tariff rates for affected imports within 60 days after withdrawal.

CONCLUSION

This Policy Brief provides a brief look at the legal procedures in Canada and Mexico in the event that either country decides to withdraw or terminate NAFTA. Relative to the United States, Canada and Mexico have clearer legal procedures. To terminate NAFTA in Canada, the Department of International Trade would send the notice to withdrawal upon approval by the Cabinet and the Order in Council. In Mexico, the president can notify withdrawal from NAFTA under Article 2205, following Senate approval. To raise tariffs to the MFN level, Canada requires amendment of federal statutes (an Implementing Act) that requires passage in both chambers of the Parliament through regular procedures. To raise its tariffs, Mexico requires a bill to amend federal legislation that has the approval of the Senate and the Chamber of Deputies.

While the legal powers to withdraw from NAFTA commitments are very broad in all three partner countries, political and economic constraints greatly narrow the scope of action. Canada conducts about 64 percent of its two-way merchandise trade with the United States; the figure for Mexico is 63 percent; and the United States depends on Canada and Mexico for 29 percent of its global commerce.³³ Thousands of firms in each partner country depend on sales to or purchases from the other two partners for their survival. Millions of workers and farmers owe their jobs and paychecks to NAFTA commerce. President Trump’s repeated threats to terminate NAFTA have galvanized these firms, workers, and farmers to demand that their local politicians—congressional representatives, senators, parliamentarians, governors, and premiers—do everything possible to preserve the pact. The voices of these second-tier politicians are heard not only by President Peña Nieto of Mexico and Prime Minister Trudeau of Canada but also by President Trump.

27. Article 5 of the Foreign Trade Act.

28. Article 131 of the Constitution of Mexico.

29. For details, see Jones (2017).

30. The number of beneficiary countries and products is based on the record as of July 2017. The House renewed the GSP program for three years on March 22, 2018; the Senate has yet to act but is expected to do so.

31. The paragraph is largely based on Murrill (2016).

32. There is disagreement between legal scholars whether Trump can unilaterally pull the United States out of NAFTA. See Hufbauer (2016) and Joel Trachtman, “Trump can’t withdraw from NAFTA without a ‘yes’ from Congress,” *The Hill*, August 16, 2017, <http://thehill.com/blogs/pundits-blog/international-affairs/346744-trump-cant-withdraw-from-nafta-without-a-yes-from> (accessed on March 14, 2018).

33. Two-way merchandise trade data are sourced from the World Bank’s World Integrated Trade Solution database.

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