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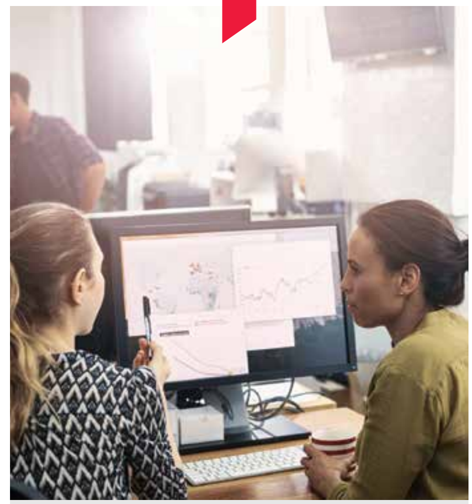

THE CHANGING FACE OF NAFTA: CONSIDERATIONS FOR TECH

By Aftab Jamil

Tech isn't shy when it comes to politics.

Over the past year, Washington D.C. has witnessed both the approval—and disapproval—of tech executives as they voiced their opinions over the Trump administration's policies and mandates. When the January and March travel bans were announced, for example, Google's CEO Sundar Pichai and Co-Founder Sergey Brin spoke openly about their concerns. Similarly, before the U.S. finalized its decision to withdraw from the Trans-Pacific Partnership (TPP) in January, tech companies expressed hope that the trade agreement could lessen regulations and help them enter new Asian markets.

Now, the sector has turned its attention toward another pressing issue: the renegotiation of the North American Free Trade Agreement (NAFTA). The 23-year old treaty, which facilitates the free movement of goods between the U.S., Mexico and Canada by eliminating most tariffs, duties and quantitative restrictions, has played a significant role in tech's growth. Out of the more than $200 billion in technology goods exported by U.S. companies in 2016, $43 billion and $24 billion respectively went to Mexico and Canada—two of tech's largest export markets, according to the Information Technology Industry Council (ITIC).

Nevertheless, trade negotiators from all three countries, along with several business and technology industry groups, agree that NAFTA is in serious need of a modern refresh—especially when considering how significantly technology developments over the past two decades have changed the economic landscape. As a result, most tech companies view the talks as an opportunity to address key issues and bolster sector growth. In the second quarter of 2017, tech companies and trade organizations disclosed they had 48 arrangements with lobby groups that discussed NAFTA with administration officials or lawmakers, according to the Center for Responsive Politics.

In this month's alert, BDO examines some unique issues facing tech when it comes to reevaluating NAFTA.

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PUSHING DIGITAL TRADE POLICIES

With tech companies producing, collecting, storing and transferring a record amount of data each day, it's little surprise that cross-border data flow is one of the industry's primary concerns in the NAFTA discussions. This concern has only heightened after the U.S. withdrew from the TPP, which brought with it the loss of provisions that enabled companies to move data freely across borders. As a result, many tech groups, including the BSA | The Software Alliance, are **pushing** to include language that would advocate free data flow and bar partner nations from implementing data localization requirements that could slow digital trade. This issue will grow more critical in the coming years, as aggressive growth in cloud technology, the Internet of Things (IoT), artificial intelligence (AI) and predictive analytics continue to fuel the data boom.

PROTECTING INTELLECTUAL PROPERTY

Another key issue on the table is the "adequate and effective protection of intellectual property (IP) rights," as outlined by the Trump administration. While NAFTA was the first international trade agreement to include obligations to protect IP rights, the U.S. suggests that member countries also fully implement and enforce the World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). It also expressed the need to update NAFTA's current IP rights provisions to reflect a "standard of protection similar to that found in U.S. law."

By strengthening IP rights provisions, the U.S. government hopes that it can more effectively protect new and emerging technologies and the works of rightholders from unauthorized use. However, there remains the question of how far copyright protection should extend. In the TPP, as well as in prior bilateral trade agreements, the U.S. had included a provision that allowed rightholders to either authorize or prohibit all reproductions, "including temporary storage in electronic form."

Krista Cox, the Director of Public Policy Initiatives at the Association of Research Libraries, notes in *Above The Law* that there can be far-reaching implications for both individuals and tech companies if similar provisions are included in NAFTA. If rightholders had this type of control, they could claim licensing fees every time a temporary reproduction is made. This could increase costs of accessing licensed content on online streaming companies, such as Netflix or Hulu, which make a temporary reproduction of the downloaded content in the computer's random-access memory (RAM) every time a video is buffered. Nevertheless, it remains to be seen whether these stronger provisions will come to pass.

BATTLING OUT TARIFFS AND DUTIES

In a quest to put U.S. businesses on a more level playing field with their North American counterparts, the Trump administration has called for Canada and Mexico to raise their *de minimis* level for the payment of duties on e-commerce sales. At the current levels, Canada starts imposing duties on foreign-based products at $20, and Mexico begins taxing items at $50; in contrast, the U.S. doesn't impose duties until items reach $800. Advocates argue that these stark differences put U.S. goods at a disadvantage, since most U.S.-produced items shipped to Canada and Mexico often encounter extra border delays and taxes.

Tech companies especially are eager for technology goods, such as software and other electronic files, to remain tariff-free. While these conditions exist under the current NAFTA agreement, the industry would like to see all three countries join a broader international agreement to eliminate tariffs on a broad range of information technology goods.

RULES OF ORIGIN COMPLEXITIES

Under the existing NAFTA agreement, the rules of origin establish that products are eligible to be sold to other NAFTA countries duty-free if a specific fraction of their parts are assembled within the NAFTA region. One of the Trump administration's goals is to "update and strengthen the rules of origin, as necessary, to ensure that the benefits of NAFTA go to products genuinely made in the United States and North America." While the administration has not yet released details on what this would entail, analysts have offered their thoughts on what the outcome of the NAFTA renegotiations might be. Dean Pinkert, a partner in Hughes Hubbard's International Trade practice, for example, believes that "a likely outcome of the negotiations on NAFTA rules of origin is that the agreement will be modified to improve the balance of trade for the NAFTA countries, *as a group*, versus the rest of the world, by requiring the increased use of *regionally* produced inputs."

The debate surrounding the implications of changing the rules of origin varies, with some analysts believing that an attempt to increase the required fraction of North American parts in a product to make it eligible for the preferential rate under NAFTA could surface undue complexities and potentially disrupt tech supply chains. Caroline Freund, a senior fellow at the Peterson Institute for International Economics, additionally **reflects** how the rules of origin in NAFTA impose substantial compliance costs on small businesses; thus, "pursuing stronger rules of origin, either as way to attack the trade deficit or to protect American producers, could raise costs."

BDO INSIGHTS

Negotiators have an aggressive timetable for reaching a new NAFTA deal by the end of the year, with plans to meet every few weeks to continue discussions. In the meantime, the future remains

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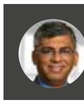
uncertain, as industry leaders continue to push their own issues and agendas forward. Cybersecurity, for example, hasn't been a specific agenda item for the discussions yet; however, the ITIC, along with several major cybersecurity companies, have called for the renegotiations to include an alignment of cybersecurity standards between the member countries.

Other topics on the table include the issue of data localization and the transfer of source codes. On the latter issue, tech companies would like to see language that protects private industry from disclosing proprietary source code in an investigation or similar legal situation. What's expected to be discussed is relaxed government regulations that require certain data to be stored in the country from which it originates.

With every option on the table and few notable developments to date, tech companies remain in the dark about how supply chain investments or global expansions will need to adjust course. Making strategic investments will require careful scenario planning and calculated risk-taking. However, the riskier bet is making no movement at all and risk falling behind more intrepid competitors.



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