



We are pleased to present *NAFTA NEWS*, a periodic newsletter offering information and insight as the renegotiation of the North American Free Trade Agreement takes shape in 2017.

Through Manatt's and Monarch's offices in Washington, D.C. and Mexico City, and TACTIX' head office in Ottawa, the firms are collaborating to provide their respective clients with the critical data and experienced judgment global companies and North American industry associations need to help navigate the NAFTA process. Each edition of *NAFTA NEWS* provides our readers with need-to-know information and political insights from the three NAFTA national capital cities.

## Highlights

For this edition of *NAFTA NEWS*, we posed the following questions regarding the ongoing renegotiation of NAFTA to our partners in Ottawa, Mexico City, and Washington:

1. How important, and realistic, is the goal to conclude the NAFTA negotiations by, at the latest, the end of February 2018?
2. What constitutes a "fair trade agreement" from the perspective of the three NAFTA countries?
3. How would each country define success for Round 3 in Ottawa?
4. What are country objectives in two key sectors?

## Canada

### **How important, and realistic, is the goal to conclude the NAFTA negotiations by, at the latest, the end of February 2018?**

Canada's negotiators understand the political agenda driving the accelerated pace of negotiations and are willing participants in the attempt to meet the deadline. Whether or not it is realistic to conclude the negotiations by February 2018 remains to be seen. A successful conclusion within the next five months is largely dependent upon all three countries proposing text for the most contentious issues at the various tables, including dispute resolution, rules of origin, and increasing labour mobility among service-based professionals. In the absence of such text in the near future, all bets are off.

We note that the Canada-U.S. Free Trade Agreement negotiations in the 1980s, as well as the original NAFTA negotiations, took approximately one year of heavy lifting. The Canada-European Union Comprehensive Economic and Trade Agreement (CETA) negotiations and the Trans-Pacific Partnership each took several years to conclude. Of course, these latter trade deals were de novo as opposed to the renegotiation of an existing agreement amongst the same three parties.

At the end of the day, concluding the NAFTA negotiations by the end of February 2018 will test the time-worn adage that "politics is the art of the possible."

### **What constitutes a “fair trade agreement” from the perspective of the three NAFTA countries?**

In her August 14, 2017 speech at the University of Ottawa Foreign Affairs Minister Freeland stated that “the modernized NAFTA will not only be an exemplary free trade deal, it will also be a fair trade deal.” The Minister noted that fairness would be achieved “if the gains of trade are fairly, broadly shared.” She went on to identify Canada’s core objectives exemplifying fairness, including:

- Bringing strong labour safeguards into the agreement; and,
- Integrating enhanced environmental provisions.

With regard to labour safeguards, Canada’s objective is to protect Canadians from being put at an unfair disadvantage because of Canada’s high labour standards. The fairness test would also be met if workers in all three NAFTA countries enjoyed higher wages and improved working conditions. As for including progressive environmental provisions, Canada’s aim is two-fold, namely to ensure that no NAFTA country weakens environmental protection to attract investment and to support efforts addressing climate change.

### **How would each country define success for Round 3 in Ottawa?**

Not to put too fine a point on it, Canada would define success for the third round of talks as ensuring they lead to a fourth round. A sudden end to the negotiations triggered by, for example, U.S. President Trump following through on his repeated warnings that he may terminate NAFTA – which he has described as “the worst trade deal ever made” – would create confusion and uncertainty across North America, not to mention deliver economic harm to a highly integrated market. As Minister Freeland noted so starkly in her August 14 speech, NAFTA is “foundational” to Canada’s economy. Canada’s economy is 2.5 percent larger every year than it otherwise would be due to NAFTA, which the Minister said is “as if Canada has been receiving a \$20 billion cheque each year since NAFTA was ratified.” In sum, Canada’s negotiating team wants to return to Washington for Round 4 in October.

### **What are country objectives in two key sectors?**

Energy: NAFTA has been instrumental in forging a strong, integrated North American energy market from which Canada has benefitted. Canada’s oil, gas and electricity exports represent approximately twenty-five percent of Canada’s total goods exports to the U.S.. From Canada’s perspective, therefore, the benefits generated by the integrated market in energy need to be, at a minimum, preserved. Moreover, Canada will be looking for measures supporting “clean energy” and climate mitigation tools. From a defensive perspective, there are two potential irritants Canada will be watching out for:

- A demand by the U.S. for American-made steel to be used in all pipeline projects; and
- Duties payable on the diluent needed to move oil sands bitumen through pipelines.

Agriculture: A great deal of noise has been generated in recent months relating to one sub-set of the agriculture-agri-food industry – dairy – drowning out the extremely positive story about

the impact of NAFTA on this vitally important sector in all three NAFTA countries. As noted in a letter to President Trump prepared by the U.S. Food and Agriculture Dialogue for Trade (representing the who's who of the U.S. agriculture-agri-food industry),

“In the 20 years since NAFTA was implemented, the U.S. food and agriculture industry has become increasingly efficient and innovative – growing to support millions of jobs. ...Although some important gaps in U.S. export access still remain, increased market access under NAFTA has been a windfall for U.S. farmers, ranchers and food processors.”

The clear message? Do not mess this up. Canada readily concurs with this sentiment. And, when it comes to the “gaps” referenced above, the Government of Canada and the two main opposition parties remain firmly committed to retaining Canada’s long-standing supply-management system.

## **Mexico**

### **How important, and realistic, is the goal to conclude the NAFTA negotiations by, at the latest, the end of February 2018?**

For Mexico, it is essential that the negotiations continue on what is a historically rapid pace. With the caveat that this is a modernization or renegotiation and not a new agreement, no trade negotiation in which Mexico has participated previously has held three negotiating rounds within roughly five weeks. The pace is essential if there is a chance to complete the modernization prior to the commencement of Mexico’s presidential election campaign. Economy Minister Guajardo has suggested that negotiations must be concluded not later than February given the campaign cycle. One of the greatest impediments to meeting the ambitious cycle is the absence, thus far, of proposals from the United States on how to address some of the most challenging issues identified in its negotiating objectives including rules of origin (especially for autos), dispute resolution, and reduction of the U.S. trade deficit with Mexico.

### **What constitutes a “fair trade agreement” from the perspective of the three NAFTA countries?**

Mexico does not subscribe to the view that NAFTA has been unfair even though it has not seen some of the promised results, especially in terms of increased wages. That said, Mexico would likely view a renegotiated NAFTA as “fair” if current market access was not reduced and expansion of the agreement into new disciplines such as e-commerce provided opportunities for its citizens as well as for those of the United States and Canada.

### **How would each country define success for Round 3 in Ottawa?**

Mexico would likely consider Round 3 to be successful if the following criteria are met:

- The United States tables text to address those objectives for which text has not already been introduced (e.g.: automotive rules of origin, dispute settlement, trade balance, currency manipulation).

- Negotiations continue to be respectful and proceed in an accelerated and comprehensive fashion to achieve new rules that will generate important economic opportunities for all three countries (as stated in the communique issued at the end of the second round).

### **What are country objectives in two key sectors?**

***Energy:*** Mexico views the modernization of NAFTA as an opportunity to further solidify the reforms to the energy sector approved early in the Peña Nieto Administration. It is important to recall that Mexico’s energy sector was a state-owned monopoly when NAFTA was first negotiated and the idea of allowing foreign investment or ownership of the country’s natural resources was almost inconceivable. Twenty-five years later, foreign companies are participating in bids for exploration and production of oil and gas, and for electricity generation (including through renewables). None of this could have occurred without energy reform and the current government will want to codify these changes through an international agreement. Mexico also considers increased energy trade, in which the U.S. has a considerable surplus with Mexico, as a means to reduce the bilateral U.S. trade deficit with Mexico.

***Agriculture:*** For Mexico, agriculture exemplifies the notion of “do no harm” as well as any sector or chapter could. Agricultural trade between the United States and Mexico has grown substantially since NAFTA entered into force. Mexico is the number one source for U.S. imports of agricultural products. Furthermore, complimentary growing seasons for many products allows U.S. consumers to enjoy year-round access to fresh produce. As a result, U.S. annual per capita consumption of fresh vegetables has increased by 14% since NAFTA entered into force. U.S. - Mexico agricultural trade is not unidirectional, however. The United States exports large volumes of fructose, corn, beef, and pork to Mexico making Mexico the #3 export destination for U.S. agriculture. With a few exceptions, agricultural trade between the United States and Mexico is complimentary and not competitive. While Mexico has indicated it would like to gain greater access to the U.S. dairy market, its overall objective would be to have the current agricultural trade patterns remain undisrupted and unaltered.

## **United States**

### **How important, and realistic, is the goal to conclude the NAFTA negotiations by, at the latest, the end of February 2018?**

Looking at the twenty FTAs that the United States currently has in place, the average negotiating time is one and a half years from launch to signing and over three and a half years from launch to the implementation stage. Additionally, the range between the fastest and slowest is vast. The U.S. – Jordan FTA, signed in October 2000, took only four months to negotiate and eighteen months from launch date to entry into force. On the other end of the spectrum, the U.S. - Panama Trade Promotion Agreement took thirty eight months from launch to signing and a further 102 months until implementation. The U.S. – Canada bilateral agreement that was superseded by NAFTA took twenty months to negotiate and thirty-two months to implement.

The current negotiations are not starting from scratch, so it is a reasonable assumption that NAFTA renegotiations, if successful, will not take as long as some previous FTAs. Despite this, reaching an agreement by the end of February 2018 is optimistic. USTR Lighthizer recently observed “We're moving at warp speed, but we don't know whether we're going to get to a conclusion. That's the problem. We're running very quickly somewhere.”<sup>1</sup> Lighthizer’s seeming lack of confidence combined with the breadth and complexity of the negotiations (spanning 28 working groups) make completion of a comprehensive modernization by February seem unlikely.

### **What constitutes a “fair trade agreement” from the perspective of the three NAFTA countries?**

For the Trump Administration, the focus has always been on reducing the U.S. trade deficit. It is unknown how they intend to accomplish that within the confines of these negotiations, especially since another goal is to “break down trade barriers.” According to most economists, even slapping tariffs on imports from Mexico will likely do little to reduce the \$64 billion deficit with Mexico. Yet USTR Lighthizer and Commerce Secretary Ross have been clear in their view that U.S. competitiveness is constrained by unfavorable terms in existing agreements which allow U.S. trading partners unfettered access to the U.S. market while continuing to restrict access to their own markets. Changes that would create a more level playing field, in the eyes of the Administration, are required for the negotiations to lead to a “fair trade agreement.”

However, if the USTR wants the NAFTA negotiations to come to a satisfactory conclusion, he may need to abandon Trump’s zero-sum attitude towards free trade agreements (i.e.: measuring their value based solely on trade flows) and come to terms with the fact that each nation involved must be willing to compromise.

### **How would each country define success for Round 3 in Ottawa?**

The first two rounds have been marked by a reluctance to bring up more contentious agenda items. Discussion on issue like labor reforms (pushed by Canada) and dairy access in Canada (desired by both the U.S. and Mexico) has been put off for later rounds as have U.S. priority issues such as changes to rules of origin and possible abolition of dispute settlement provisions (especially Chapter 19). All new language will purportedly be tabled in Ottawa later this week. Negotiations on the contentious issues will have to begin promptly if an agreement is to be reached.

With President Trump continuing to flirt with the possibility of pulling out of NAFTA entirely, his administration needs progress towards achievements they can claim as definitive “wins” for the U.S.

### **What are country objectives in two key sectors?**

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<sup>1</sup> Remarks delivered at the Center for Strategic and International Studies, Washington, DC, September 18, 2017.

**Automotive Industry:** Reportedly discussed during the second round of negotiations in Mexico City was the issue of rules of origin for automakers. President Trump and USTR Lighthizer have made the automotive sector a priority and are expected to push for language stating that a minimum percentage of North American vehicles be produced in the United States. This is obviously an issue for Mexico, whose automotive industry accounts for a sizable share of its trade with the United States. U.S. automakers have also pushed back strongly against tightened rules of origin.

**Dairy:** With Canadian tariffs on some U.S. dairy products at nearly 300 percent, the U.S. dairy industry pushed for its priorities to be included in the USTR NAFTA negotiating objectives released in July. Beyond the tariffs, Canada's new "Class 7" milk pricing regime is a major issue for U.S. stakeholders. Created as part of the National Ingredient Strategy to deal with a surplus in "non-fat solids" due to increased demand for butterfat, Class 7 milk is comprised of skim milk components, including milk protein concentrates, skim milk and whole milk powders, edible casein, rennet casein, and various powders derived from milk products. Class 7 has allowed Canadian companies to sell their products below world market prices. Dairy interests in the U.S. argue that this program is designed to unfairly benefit Canadian dairy producers to the detriment of foreign importers and is a violation of NAFTA. U.S. producers are eager to see this issue resolved during the renegotiations.

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