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 2017/2018.

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, our partners in Ottawa, Mexico City, and Washington took stock of where things stand in the negotiations as they head into the 7th round in Mexico City later this month.

Canada

It is no coincidence that, almost immediately following the Montreal Round of the NAFTA negotiations, Prime Minister Trudeau devoted four days to traveling in the United States to promote Canada's position on NAFTA and as an attractive destination for foreign capital; Foreign Affairs Minister Chrystia Freeland spoke about NAFTA at the Council on Foreign Relations in New York; and, former Canadian Prime Minister Mulroney, whose government negotiated the Canada-U.S. Free Trade Agreement and the original NAFTA, appeared before the U.S. Senate Committee on Foreign Relations to talk about the state of the current negotiations. These efforts are part of an ongoing Canadian campaign to encircle the U.S. administration with U.S.-based NAFTA supporters. Canada needs allies.

And here is why.

"[T]here is more distance there." This was Minister Freeland's frank assessment following the Montreal Round of where matters stand between Canada and the U.S. on the more challenging issues at the bargaining table. This distance between the two neighbours, whose relationship was once described by Sir Winston Churchill as "an example to every country and a pattern for the future of the world", is troubling and confounding. Each believes the other is being unreasonable and unyielding.

From Canada's perspective, the root of this noticeable distance is the stark difference in the core vision of why countries trade. Canada's objective is to deepen a trading relationship, to increase trade between the parties. On the other hand, Minister Freeland has characterized the U.S. administration as "explicitly protectionist" whose "objective quite explicitly is to shrink the trading relationship." The challenge facing the negotiators from all three countries is finding a way to narrow this distance.

The irony is that both countries are coming at these negotiations from the same general place, and perhaps that is where a meeting of the minds might begin to take shape. President Trump received considerable electoral support from middle-class Americans whose jobs were lost to a combination of the technology revolution and globalization, people genuinely concerned that they, and their children, are being squeezed out of the benefits of both.

For its part, the Trudeau government firmly believes that the anxieties of the hollowed-out middle class are real. This is why the Canadian approach in all of its trade negotiations is aimed at inclusiveness, seeking to ensure that Canada's middle class does not miss out on economic growth and opportunity flowing from free and fair trade. Recognizing this commonality and working out how it can be leveraged in the NAFTA negotiations would be a good place to get to in Mexico City at the end of February.

And if the negotiations go sideways …

Words matter. It is worth noting, therefore, the slightly nuanced alteration in the messaging deployed recently by Canadian representatives. In his testimony before the U.S. Senate Committee, Mr. Mulroney broadened the scope of the Canada-U.S. relationship beyond trade, noting how important the bi-lateral relationship is to shared national security concerns and defence arrangements, including the longstanding North American Aerospace Defence Command (NORAD) organization, NATO, and the fight against ISIS. Minister Freeland has made similar references to the broader relationship linking the two countries.

This approach is remarkably similar to that adopted early on in the negotiations by Mexico. The message is clear. The United States' two trading partners have put the U.S. on notice that the repercussions of terminating NAFTA extend far beyond the economic disruption such a move would cause.

Mexico

As the three governments prepare for the upcoming seventh round of the NAFTA modernization negotiations in Mexico City, the Mexican presidential campaign is heating up prior to the July 1 election. A negotiation initially planned to have concluded by that time will most likely now extend into and beyond the election. Since the NAFTA negotiations began in August, Mexico has taken important steps to diversify its trade and commercial relationships beyond North America. The extension of the negotiation timeframe and these diversification efforts prompt (at least) three topics for further discussion and analysis as follows:

1) Impact on the presidential campaign: NAFTA has not been, and is unlikely to become, a campaign issue in Mexico absent a major disruption in the negotiations (i.e. a U.S. withdrawal).

Mexican presidential elections, like those in the United States, are primarily fought on domestic issues. In 2018, corruption, security, and the economy will be the dominant issues. The broad consensus in Mexico of the benefits of free trade means that candidates cannot make sharp policy distinctions in this area. Indeed, the designated lead for future negotiations should current front-runner (and left-leaning) Andrés Manuel López Obrador (AMLO), be elected, recently confirmed that AMLO supports continuation of NAFTA which "is very important for the welfare of Mexican citizens." If, however, the U.S. announces a withdrawal from the agreement, the main opposition candidates, AMLO and Ricardo Anaya, will almost surely seek to insert the "who lost NAFTA" issue into the campaign. This would force the governing PRI's candidate, José Antonio Meade, to defend the Peña Nieto Administration's negotiating strategy. Whether such an attempt would actually change voters' intentions is, at this juncture, unlikely. Conversely, the statements made by President Trump over the past two years regarding Mexico and immigrants will likely constrain the ability of the next Mexican president to cooperate with the U.S. on trade or other matters even if NAFTA remains in force.

2) Timing: The objective of concluding the renegotiations prior to the start of the Mexican presidential campaign will most likely not be achieved. Mexican Secretary of Economy Ildefonso Guajardo recently said he believed negotiations could be concluded as late as November, following the U.S. mid-term elections. Should AMLO lose the July elections, a November deadline will become less urgent and negotiations could extend into 2019, albeit with the possibility of the Democrats winning a congressional majority in the 2018 U.S. midterm elections (thus potentially complicating ratification of a revised NAFTA). A López Obrador victory, however, will make the November date more urgent. In that case, rapid conclusion of the talks would permit the Mexican Senate to approve the agreement before Mexico's December 1 inauguration of the new president and the entire Congress. Doing so would limit AMLO's freedom of action on economic policy by locking in Mexico's trade-based growth model and its energy reform in an international treaty which, according to the Mexican constitution, takes precedence over national law.

3) Mexico's trade policy: Mexico has long been engaged in an effort to diversify its trade relationships. Its network of free trade agreements, covering 45 countries, is the world's largest. The conclusion of the TPP-11 agreement (formally known as the CPTPP) will provide Mexico with preferential access to new Asian markets while also creating additional incentives for foreign investment, especially while the United States remains outside the agreement. Since August, Mexico has also made important progress in the modernization of its free trade agreement with the European Union. A revised agreement may be initialed later this month. Mexico has also been negotiating agricultural sector agreements with Argentina and Brazil to create alternative sources for grains and meat for which Mexico currently relies heavily on the United States. Finally, Mexico continues to strengthen its relationships within the Pacific Alliance (Chile, Colombia, Mexico, and Peru). While none of these options are ideal or would fully mitigate the impact of a U.S. withdrawal from NAFTA, they may strengthen Mexico's hand in the negotiations.

United States

Following the sixth round of NAFTA negotiations in Montreal at the end of January, it might be a good time to take the temperature of all the interested parties on the U.S. side of the table.

While the sixth round did have a markedly better tone and many reasons for optimism, including statements from USTR Robert Lighthizer stating that “some progress was made” and that the parties “finally began to discuss some of the core issues,” such optimism has dampened in recent days. Part of this is due to the slow pace of the ongoing talks. At the current rate, talks look to extend far beyond the March target for completion. Talks could even stretch into the upcoming U.S. midterm elections, to say nothing of the July 1 presidential election in Mexico. Trade promotion authority (“fast track”) in the U.S. also expires on July 1, and the administration has already announced that President Trump will ask Congress to extend it for an additional three years.

Ambassador Lighthizer also strongly criticized Canada over filing trade complaints challenging the United States' anti-dumping and anti-subsidy duties, calling the action “frivolous” and “spiteful,” during his closing statement. Overall, it appears the USTR and Trump administration “target” for these negotiations has seemingly shifted from Mexico to Canada over the last few rounds. Regardless, the sixth round saw the closing of the anti-corruption chapter (although continued disagreement on dispute resolution potentially weakens this chapter) and progress on several others including customs issues and the telecommunications industry.

One major change in the last few months is the increased level of Congressional engagement on the NAFTA renegotiations. The two Congressional committees with tax writing responsibilities, the House Ways and Means Committee and the Senate Finance Committee, also have oversight authority on international trade agreements. With the passage of the Republican tax bill at the end of 2017, members of Ways and Means and Finance are free to focus on NAFTA negotiations in a way not seen in the process thus far. During the Montreal round, Rep. Dave Reichert, chairman of the Trade Subcommittee in Ways and Means, led a bipartisan group of lawmakers to the Round. A week later, the committee held a closed-door meeting with USTR Lighthizer in which members made their frustrations at the lack of congressional consultation on NAFTA known. Among Democrats on the committee, Mexican labor standards and enforcement provisions remain at the top of the agenda.

Likewise, in the Senate, both leadership and members of the Finance Committee have been more active in advocating for NAFTA. In a recent visit to the White House attended by nearly every Republican member of the Committee, Senators stressed the enormous benefits of the trade pact to the President and cautioned that any announcement that the U.S. would pull out of the NAFTA would result in economic hardship. Specifically, these Senators told the President that a five-year sunset provision would signal a lack of confidence in the agreement. Since the President took office in January 2017, there has been a concerted effort from the traditional pro-trade wing of the Republican Party to educate Trump on the economic benefits of NAFTA in contrast to his criticism of the trade deal on the campaign trail. Following this meeting, Senator Tim Scott of South Carolina released holds he had placed on the nominations of two USTR top officials. Scott placed those holds due to what he felt was a lack of congressional consultation on trade issues, while Ambassador Lighthizer argued that those unfilled positions make it more difficult for USTR to fulfill its responsibility.

Looking forward, a growing concern from Capitol Hill is the possibility that Trump will direct Lighthizer to issue a termination letter in an attempt to use the six-month exit clock as a negotiating tactic, particularly as Ambassador Lighthizer has been rumored to say he is answerable to only one. Such a tactic would be a "grave mistake" according to the U.S. Chamber of Commerce, a major Republican pro-business group, as it could force Mexico and perhaps Canada away from the negotiating table to avoid losing face. The Chamber's message has been echoed by other business groups in the U.S., including the agriculture industry.

Nevertheless, in the case of the agriculture industry and others, focus over the course of negotiations has shifted from their initial stance of urging Trump not to pull out of the agreement to focus on USTR proposals and specific improvements. This change indicates some optimism in certain sectors that the biggest threat of a unilateral pull-out has passed, though withdrawal remains possible as the process goes on without agreement.

TACTIX Government Relations and Public Affairs

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