NAFTA NEWS

(click the flag for the country of interest)

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 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 provided a snapshot of the political pressures facing an agreement in each of the three NAFTA nations.

Canada

The political imperatives driving the United States and Mexico to push for a fast resolution of the NAFTA negotiations – mid-term elections and a general election, respectively – are not present today in Canada's political milieu. In true Canadian fashion, as pressure mounts from the others at the table to conduct the negotiations at warp speed, Canada's NAFTA negotiators are going along to get along. This is not to say, however, that Prime Minister Trudeau and his colleagues do not have significant political skin in the game. They most decidedly do.

In short, the governing Liberals cannot afford to be seen to lose on the NAFTA file. While the next Canadian election is 18 months away, either the termination of NAFTA or a new agreement that is perceived to be negative for Canada would seriously diminish the governing Liberals' re-election prospects in 2019. Prime Minister Trudeau must demonstrate to Canadians that he can stand up to U.S. President Trump; a majority of Canadians have an unfavourable impression of the President.

To that end, Global Affairs Minister Chrystia Freeland, the Minister responsible for the NAFTA negotiations, and Canada's Chief Negotiator, Steve Verheul, have remained steadfast in their opposition to the following so-called "poison pills" put on the table by the United States at the outset of the negotiations:

- Elimination of the independent dispute resolution mechanism in Chapter 19 of NAFTA
- A five-year sunset clause
- Lack of reciprocity in government procurement
- Elimination of Canada's supply management system in dairy, eggs and poultry
- Higher U.S. and North American content in rules of origin in the automotive sector.

From Canada's perspective, negotiations will not be sped up with any chance of success unless and until there is significant movement on these five items.

The auto sector is vitally important to the Province of Ontario's economy. If the rules of origin negotiations go sideways, it would be viewed dimly by voters in that province. This could have important electoral implications, both federally and provincially, as outlined below.

Ontarians go to the polls to elect a new provincial government on June 7th. Embattled Ontario Premier Kathleen Wynne, who operates under the Liberal banner, as does PM Trudeau, has been a key player in the Government of Canada's approach to dealing with the United States on NAFTA. She has been part of the Canadian team ring-fencing the White House by forging positive relationships with members of U.S. Congress and with state Governors and legislators.

Moreover, Premier Wynne has responded strongly to "Buy American" provisions in New York and Texas with legislation – the *Fairness in Procurement Act, 2018* – which gives Ontario the flexibility to respond to discriminatory procurement actions of U.S. subnational governments. The outcome of the June 7 election is unknown but the potential is high that a new government will emerge, with an uncertain impact on the NAFTA negotiations and on the Canada-U.S. relationship writ large.

Ontario is not the only Canadian province with an election in 2018. In addition to Canada's largest province going to the polls this year, our second largest province, Quebec, has an election scheduled for October 1st. Of note, Quebec's dairy lobby is particularly powerful, both in its dealings with the provincial government and with Ottawa. Missteps by the federal government on the issue of supply management – one of the poison pills confronting Canada's NAFTA negotiators – could have serious consequences for Prime Minister Trudeau's re-election plans in October of 2019. It also bears noting that, as is the case in Ontario and Ottawa, Quebec Premier Philippe Couillard carries the Liberal banner.

In sum, while Canada's NAFTA negotiating team is going along with its U.S. and Mexican counterparts in speeding up the negotiations, the potential political consequences to the Trudeau government are so high that they will not be rushed into signing a deal that would be perceived as a loser, especially in vote-rich Quebec and Ontario.

Mexico

Mexico's presidential campaign officially began on March 30 and culminates on July 1 with the presidential election (Note: Mexico does not have a second round or run-off election). In this election voters will also replace the entire federal Congress, 9 governors, 27 state legislatures and over 1600 mayors. This will be the largest and most complex election in Mexican history.

In the presidential campaign, left-leaning Andres Manuel Lopez Obrador (known by all as AMLO) leads the five-candidate field by a 13-point margin according to the Oraculus poll of polls. This is AMLO's third attempt to win the presidency. AMLO, and the Morena party he founded following the 2006 election, are part of an electoral coalition that includes the left-leaning Workers' Party (PT) and the socially conservative Encuentro Social. The ruling PRI party has nominated Jose Antonio Meade, a technocrat who has held a number of senior positions in both PRI and PAN administrations including: Secretary of Foreign Affairs, Secretary of Social

Development, Secretary of Finance (twice), and Secretary of Energy. Meade is not a member of the PRI – a key selling point given Peña's exceedingly low approval ratings. Nevertheless, the PRI's and Peña's poor reputations have tainted Meade's candidacy leaving it to wallow in third place. The PRI leads a coalition that also includes the Green Party and the PANAL, a party founded by the former head of the teacher's union. The conservative PAN has nominated Ricardo Anaya, the 39-year-old party secretary-general who rested control of the party away from former president Calderon's faction (thus leading to the independent candidacy of former first lady Margarita Zavala). The target of purportedly politically inspired corruption charges, Anaya's ascent in the polls has stagnated, leaving him in a distant second place. Anaya and the PAN are running in coalition with the leftist PRD party (of which AMLO is a former member) and the Movimiento Ciudadano (a smaller, leftist political party). Finally, and for the first time ever, there are two independent candidates running for president. While neither Zavala nor Nuevo Leon governor Jaime Rodriguez (known as "El Bronco") have a meaningful chance of winning, they appear to be pulling votes away from the Anaya and Meade coalitions, thus strengthening the likelihood of an AMLO victory.

NAFTA and the U.S. – Mexican bilateral relationship were not campaign issues during the "pre-campaign," which began last fall, nor were they expected to be salient points as the formal campaign began. This changed when President Trump announced the deployment of national guard troops to the U.S. – Mexico border to defend against alleged inflows of illegal migrants. On April 5, President Peña Nieto (EPN) broke his past silence in response to inflammatory comments by President Trump to deliver a widely-praised national address in which he criticized Trump for taking out his frustrations with the U.S. Congress and domestic laws and policy on Mexico, insisting that Trump should "talk to them, and not to Mexicans." He also noted what has already become evident: "If there is one thing all Mexicans agree on, it is that nothing, and no one, is above our dignity as a nation." All of the Presidential candidates immediately supported the President's speech, including AMLO. Promises to defend Mexican honor and stand up to the United States will be expected of all candidates going forward, but voters will likely not base their decisions on the bilateral relationship or NAFTA.

Though NAFTA is not likely to be a campaign issue, AMLO's possible victory (and conflicting comments about his views on NAFTA and the bilateral relationship) has prompted the current EPN Administration and Secretary of Economy Ildefonso Guajardo to work toward a speedy conclusion of the negotiations. Mexico's objective is to conclude prior to April 30, after which the presidential campaign will force the Mexican government to step away from the negotiations. Coincidentally, concluding an agreement by this date would allow the Mexican Congress to be sworn in in September to ratify a new agreement prior to the December 1 presidential inauguration. (Note: there is no legislative or regulatory timeline akin to the U.S. TPA provisions in Mexico.) As recently as April 17, Guajardo has suggested that late April is a viable target for conclusion.

Yet Guajardo has never been willing to be steam rolled into agreement. The presidential campaign further reduces his ability to maneuver by raising the profile of the negotiations and amplifying the need to demonstrate that Mexico has defended its interests. As has been reported elsewhere, negotiators are making good progress through an extended 8th round of negotiations—among principals—now underway in Washington. Mexico has purportedly agreed to an automotive rule of origin requiring 75% North American content (up from the current 62.5%) and possibly to the development of a series of tiers for parts and inputs that would be subject to varying content requirements. Guajardo has held the line, however, with respect to labor. USTR Lighthizer has proposed special consideration for products produced by laborers earning at least $15/hour – a sum substantially higher than the average Mexican wage. Mexican officials have insisted that while higher wages remain an aspiration, they will not negotiate such increases through a free trade agreement. Further, Mexico's private sector is strongly opposed to inclusion of wage rates in NAFTA.

Mexico's interest in concluding the negotiation for domestic political reasons aligns well with a recent and surprising sudden interest by the Trump Administration to reach an agreement on NAFTA. Whether it's because of a desire to maintain important markets for U.S. farmers, who face steep retaliatory tariffs from Trump's latest trade rift with China, or because of the fear that a new Democratic Congress won't approve any new NAFTA deal (and the deadlines imposed by the U.S. Trade Promotion Authority require a deal be struck by May if there is any hope of a vote in this Congress), it is clear that Washington is now working hard on getting the negotiations to yes.

However, for the negotiations to end successfully within the next couple of weeks, several key issues must be resolved. What concessions Mexico, Canada or the United States have made (or will make) on the sunset provision, investor-state dispute settlement, and government procurement are unknown. We have reported on Mexico's positions on these topics previously and do not believe these positions have changed.

Conclusion of the NAFTA 2.0 negotiations and the signing of an agreement in principle prior to the July 1 election would address several Mexican and Peña Nieto objectives. As noted above, ratification of an agreement that further codifies the energy reforms (and other reforms and commitments) adopted under EPN would boost the confidence of domestic and international investors even if AMLO is elected. Further, successful conclusion of the negotiation would potentially buttress the PRI's campaign; a failed negotiation would definitely harm it.

At this stage, it is still too early to tell what will happen, and whether ANY deal that may be reached by the trade principals will be politically palatable to President Trump himself. The President has continued to bash NAFTA and Mexico at every opportunity, especially on the campaign trail. As his political fortunes deteriorate, it's simply unclear if he will be willing to sign off a revised NAFTA he doesn't feel he can sell politically to his base.

United States

Talk of reaching a NAFTA agreement in principle over the next few weeks has everyone in Washington scrambling to consider the ramifications in the current political environment. Beyond the still-unfinalized text of such an agreement, the primary obstacle facing U.S. adoption of a renegotiated NAFTA is time and, ironically, Trade Promotion Authority (TPA).

While TPA represents the only realistic framework for passing trade agreements through the often fractious U.S. Congress, the statutory consultation, notification, and reporting requirements of TPA present a distinct challenge for the Trump administration.

Under TPA-2015 (P.L. 114-26), the administration must give Congress 90 days' notice of its intent to sign an agreement and release the text of the agreement publicly 60 days before signing. If the parties were to reach agreement on May 1, the earliest date for a signing ceremony would be July 30, three months before the midterm elections.

Once the agreement is signed, the U.S. International Trade Commission, an independent, quasi-judicial federal agency, has 105 days to produce an assessment of the potential economic impact of the agreement that will be made public. While the ITC can technically finish this sooner than 105 days, historically they have taken the full time. This brings us to November 12, six days after the midterm elections. Additionally, the administration is required to present a statement of administrative action at least 30 days before passage of implementing legislation.

Taken altogether, the earliest date on which the Trump administration can present legislation to Congress is December 12. The final scheduled legislative day for the House is December 13, and the Senate is scheduled to adjourn for the year on December 14. While leadership could (and likely would) extend the "lame duck" session, the 115th Congress must come to a close on January 3, 2019 when the new 116th Congress is sworn in.

Given the political headwinds facing Republicans, especially in the House of Representatives, and the traditional loss of Congressional seats for a president's party in midterm elections, the probability of a Democratic take-over of one or both chambers is high. In the House, a significant number of Republican retirements has also put more seats in play. While the terrain in the Senate is more favorable for Republicans, President Trump's unpopularity and a motivated Democratic base could lead to losses in that chamber as well. Should either occur, passage of a NAFTA bill negotiated by the Trump administration becomes problematic if delays cause ratification to fall to the next Congress. With general opposition both to trade agreements and Trump himself, it seems unlikely that NAFTA approval legislation would proceed swiftly through a Democratic House of Representatives.

As such, speculation is rampant that, in an attempt to bypass this situation, President Trump could announce that he is withdrawing the U.S. from NAFTA at the same time as an agreement in principle is reached. This move would launch a six-month withdrawal timer (Article 2205) that roughly coincides with the aforementioned timeline for ratification, the gambit being to force Congress into a zero-sum game: agree to the deal, whatever it might be, or lose NAFTA.

Aside from the complicated timing and political climate, there are several policy issues that continue to divide President Trump and U.S. Trade Representative (USTR) Robert Lighthizer and the conservative mainstream, jeopardizing consensus among Congressional Republicans. The most prominent of these issues is investor-state dispute settlement (ISDS), which protects the interests of U.S. companies in investment disputes with foreign countries. If the Trump Administration's final goal truly is passing a renegotiated NAFTA through the Congress, jettisoning ISDS is problematic. Two Members of Congress essential to the success or failure of any NAFTA 2.0 deal, Senator Orrin Hatch, Chairman of the Finance Committee, and Representative Kevin Brady, Chairman of the House Ways and Means Committee, have not been shy about their support for ISDS and their opposition to any agreement that does not include it. As chairman of the committees with jurisdiction over trade agreements, Hatch and Brady have important advisory and leadership roles, including as chairmen of the Congressional Advisory Groups established under TPA-2015. They, along with more than 100 of their colleagues, have warned the USTR that removing ISDS would endanger Republican support. On the other hand, dispensing with ISDS to garner votes from trade-skeptical members (Democratic and Republican) may be misguided. ISDS alone may not sway those who are traditionally opposed to free trade agreements into supporting NAFTA.

However, despite their current opposition to any NAFTA 2.0 that lacks ISDS, the speculation is that it's equally unlikely that House or Senate Republicans will take a stand against the Trump administration if the alternative is a full withdrawal from the pact or handing over the keys to a new Democratic majority in either chamber.

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