

## NAFTA: Announcement of US-Mexico Trade Agreement Positive for Canada

- Today's Oval Office announcement of a preliminary understanding on a new 'US-Mexico Trade Agreement' is a fundamentally positive development in the NAFTA talks for the US, Mexico, and Canada. It should significantly reduce market-pricing of NAFTA risks.
- The apparent resolution of major US demands for tighter rules of origin on tariff-free trade in North American automobiles addresses the most important sticking points in the negotiations. Canada should find it relatively simple to join the US-Mexico consensus on automobiles.
- Canada may find it harder to sign up to US-Mexico understandings on other key US demands—but the pressure for Canada to get on board quickly may also hand it more leverage. Discussions on a trilateral deal could nevertheless well extend beyond the end of this week and miss the US Congress' procedural deadline for signature of a revised NAFTA deal under the current Mexican administration.

### IT'S MAINLY ABOUT AUTOS

It appears that the US and Mexico, as expected, have mainly reached an accord on tightening the rules of origin (ROOs) on trade in automobiles—changes to which Canada should find it relatively easy to agree. The main change—raising the North American regional value content for tariff-free trade in automobiles from 62.5% to 75%—would already be met by nine of 16 vehicle models currently produced in Canada. Overall, about 71% of the value of Canadian auto exports to the US currently originates in North America; North American content stands at 80% on Canadian exports to the US for the Detroit Three: GM, Ford, and Fiat Chrysler. The other major change, which would require 40–45% of automobile production to come from plants that pay greater than USD 16/hr to workers would not generally bind on Canadian production where wages are, on average, even higher. The proposed changes appear designed principally to push any marginal additional auto production out of Mexico, but by making North American manufacturing less competitive, they could nudge new manufacturing offshore rather than northward to the US and Canada.

Understandings were also reached in a number of other areas, though the announcements so far are short on detail. The new agreements on agricultural goods are limited and in some cases (i.e., sanitary and phytosanitary standards, SPS) were previously reported to have been reached months ago. The US and Mexico also agreed to new provisions for tighter enforcement of intellectual property (IP) protections, greater freedom for digital trade, an increase in the Mexican *de minimis* threshold for the application of tariffs on inbound shipments, national treatment of financial-services firms, a prohibition on local data storage requirements, enhanced labour rights in Mexico, and tighter environmental standards. Several of these points fulfill goals laid out in the US Trade Representatives negotiating *Objectives* for NAFTA and the wording in some cases is nearly identical to the US Trade Representative's (USTR's) document. Detailed fleshing-out of the practical application of these points likely remains to be done.

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**No new information was provided in the Oval Office event on the US demands for a sunset clause, revisions to the dispute-settlement processes, Canadian and Mexican access to US government procurement processes, and/or Canadian agricultural supply management, but subsequent interviews and press conferences cast some more light on these issues.** USTR Robert Lighthizer, in a conversation with the press, added additional colour on a few of these issues that implies that some discussion on these points has taken place with Mexico.

- **Sunset clause.** Mexico and the US apparently reached preliminary understandings on a ‘sunset’ review of the new trade pact after six years. Problems found under the review would trigger subsequent annual reviews until the issues are resolved. The new deal could not be terminated earlier than 10 years after the initial finding of problems. This timetable provides additional certainty and aligns better with many sectors’ capex cycles than the initial US proposal for an option to withdraw automatically from the agreement every five years unless the pact is affirmatively renewed by all three members.
- **Dispute settlement mechanisms.** USTR Lighthizer said that Mexico has agreed to eliminate NAFTA’s chapter 19 dispute settlement provisions on anti-dumping, countervailing duty, and subsidy cases, but this has not been confirmed by Mexico. Mexican Economy Minister Guajardo did, however, confirm that NAFTA’s chapter 11 on investment is preserved with a sectoral focus and chapter 20 remains.
- **NAFTA not terminated.** Although Pres. Trump indicated that the existing NAFTA agreement would be terminated and replaced by a new, renamed pact with Mexico, and possibly Canada, he did not invoke NAFTA’s Art. 2205 withdrawal clause.
- **Steel and aluminum tariffs.** The US Sec. 232 so-called ‘national security’ tariffs on Mexican steel and aluminum have not been lifted.
- **Government procurement and supply management.** No new information was conveyed on US demands to limit access to US government procurement or to limit Canadian supply management, although at the beginning of the event, Pres. Trump did make reference to Canada’s dairy tariffs.

## **CANADA TO REJOIN THE TALKS ON TRILATERAL ISSUES**

**The trilateral nature of the remaining key US issues implies that the next steps toward agreement on them need to be taken in three-way discussions that will include Canada.** Mexico’s President Peña Nieto indicated today that it was ‘important’ that Canada rejoin the talks with the goal of concluding a trilateral deal this week. Pres. Trump attempted to increase pressure on Canada by threatening the imposition of auto tariffs if it doesn’t negotiate ‘fairly’.

**Canadian Foreign Minister Freeland is reported to be heading to Washington, DC on Tuesday to join talks with the US and Mexico.** USTR Lighthizer called on Canada to accept by the end of the week the points of agreement announced today with Mexico, and to settle outstanding discussions on the other key US demands. USTR Lighthizer said in the Oval Office that this could permit signature of a deal by the President at end-November following a 90-day notice period to the US Congress. This timetable appears unrealistic: Canada is sticking to its line that it will not accept a bad deal. We expect talks could extend well beyond this weekend and miss a procedural deadline for finalizing a deal under the current Mexican administration.

**In principle, the White House cannot sign a bilateral deal with Mexico under its current trade-promotion authority (TPA) from Congress.** Nevertheless, USTR Lighthizer appeared to indicate that the White House believes the existing authority would cover both a trilateral NAFTA deal and/or individual bilateral deals with Canada and Mexico. Previous USTRs under past US administrations, such as Carla Hills and Bruce Hirsch, have repeatedly indicated that this is incorrect. Moreover, Sen. Orrin Hatch, chair of the US Senate’s Finance Committee, which would have to approve a revised NAFTA deal, has voiced his support for NAFTA’s inherently tripartite foundations. Finally, four Democrats on the House Ways and Means Committee sent a letter to USTR Lighthizer a few weeks ago that noted, “Given recent press reports, we write to remind you that your notification letter only conveyed the intention to renegotiate the trilateral NAFTA, not an intention to negotiate a bilateral trade agreement with Mexico.” It is not at all clear that a bilateral US-Mexico deal could go ahead without re-starting months of process with the US Congress to secure a new TPA.

**Mexico has sent mixed messages on whether it would sign a bilateral deal that excludes Canada. For now, the Mexican administration appears satisfied with a bilateral understanding that provides assurances of stable trade with the United States, while stating that their preference remains for a trilateral deal.** In the past, Mexican authorities have repeatedly reiterated their commitment to a trilateral NAFTA, but today Mexican Foreign Minister Videgaray indicated that while a trilateral agreement is ideal, Mexico can't control the Canada-US relationship and would proceed with a US-Mexico bilateral if an understanding can't be reached with Canada. Min. Videgaray and Mexican Economy Minister Guajardo both noted that they will put "all of their effort" into making Canada part of the deal and would remain in Washington for three-way talks.

**This new pressure on Canada may give Ottawa more leverage as it rejoins the talks.** The US and Mexico's urgency on finalizing a deal, combined with the apparent constraints under TPA that may prevent conclusion of a quick US-Mexico bilateral, could mean Canada now faces less pressure with respect to the US's outstanding demands on agricultural supply management and government procurement.

### **A BIG DEVELOPMENT, BUT NOT A FINAL AGREEMENT**

**Overall, today's announcements from Pres. Trump and USTR Lighthizer imply changes to NAFTA that should ultimately preserve the three-way trade deal in a slightly modified form, albeit with a cosmetic change to its name that would allow the White House to sell the revised pact as a significant departure from its predecessor.** Today's announcement should substantially lighten market-pricing of NAFTA risk for all three countries, but a great deal of work remains to be done to conclude a new trilateral NAFTA 2.0. Nevertheless, today's event provides the White House with a strong talking point ahead of the mid-term election: Pres. Trump doesn't need a signed and sealed new NAFTA to campaign on his 'success' in renegotiating the trade agreement.

**Canada may find it harder to sign up to US-Mexico understandings on key US demands beyond tighter rules of origin for autos, but the new pressure for Canada to get on board quickly hands it more sway in the talks.** Discussions could well extend beyond the end of this week and miss the US Congress' procedural deadline for signature of a revised NAFTA deal under the current Mexican administration.

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### **APPENDIX. THE DETAILS: LESS THERE THAN THE HEADLINES IMPLY**

**Pres. Trump did not discuss details of the draft consensus with Mexico, but the US Trade Representative's (USTR) office later provided three fact sheets that outlined the preliminary agreement's key features for manufacturing, agriculture, and other sectors, such as the environment, IP, and financial services.** Note that NAFTA's agricultural and environmental provisions are currently contained in bilateral accords and side agreements between the US, Mexico, and Canada. In principle, Canada need not agree to the agricultural and environmental provisions announced today for finalization of a revised trilateral NAFTA agreement to proceed.

### **ON MANUFACTURING, NEW ROOS ON AUTOS AND A CHAPTER ON TEXTILES**

- New rules of origin on automobiles were agreed that raise the regional value content for tariff-free trade of vehicles from 62.5% to 75%, but details on the phase-in timetable were not provided.
- A new provision is added that requires 40–45% of automobile content be made by workers earning more than USD 16/hr, with details on phase-in pending.
- No details were provided by Pres. Trump or the USTR on earlier reports that Mexican vehicles that do not meet these new requirements would be subjected to a 25% US tariff if they are assembled in plants that do not already exist. The tariff for non-conforming vehicles produced in existing Mexican plants would be the standard US most-favoured nation (MFN) tariffs of 2.5% on autos and 25% on trucks. Min. Guajardo, however, noted in his press conference that 70% of Mexico's current light-vehicle exports to the US would be compliant with the new ROO. For the remaining 30%, Mexico negotiated a five-year phase-in period starting January 1, 2020. Min. Guajardo also indicated that Mexico secured some protection for new auto plants: they will be protected under existing NAFTA ROOs until the new rules come into effect.

- New enforcement procedures are envisaged to certify and verify sufficient and significant US and Mexican materials and parts content, likely aimed at ensuring increased use of US steel and aluminum in automobile parts and other goods.
- Agreement was also reached to end requirements that force the use of local distributors for imports.
- A new textiles chapter will be established for US-Mexico trade that will provide stronger incentives for North American production. In principle, this chapter could be extended to include Canada, or, as is the case with NAFTA's agricultural provisions, remain contained in a bilateral side-agreement or letter.

#### **ON AGRICULTURE, MINOR CHANGES, SOME OF WHICH WERE AGREED MONTHS AGO**

- Agricultural tariffs remain unchanged at zero, with a re-commitment to avoid use of export subsidies or safeguards for agricultural products traded between the two countries.
- Alignment of grading standards and services between the US and Mexico to ease trade.
- Increased transparency and alignment on sanitary and phytosanitary measures, an issue on which all three countries are reported to have reached agreement months ago.
- An understanding on geographic indications and common names for cheeses, wines, and spirits that should avoid barriers to trade on these goods.
- Protection for proprietary food formulas.

#### **INTELLECTUAL PROPERTY: NEW PROTECTIONS AND ENFORCEMENT PROVISIONS**

- New obligations to fight counterfeits, enforcement protections, and impose penalties on violators.
- Enhanced and extended copyright and trademark protections.

#### **GREATER FREEDOM FOR DIGITAL TRADE**

- Prohibition of duties on e-products, guarantees on enforceable consumer protections, and protection of proprietary source code.

#### **INCREASE ON THE MEXICAN *DE MINIMIS* THRESHOLD**

- Mexico agreed to raise its *de minimis* threshold for the application of duties to inbound shipments of US goods from USD 50 to USD 100.

#### **FINANCIAL SERVICES LIBERALIZED**

- Mexico and the US agreed to national treatment of their respective financial services firms.
- Introduction of a prohibition on local data storage requirements where a financial regulator can otherwise have access to data it needs to fulfill its mandate. Provisions are also added to allow for cross-border data transfer.

#### **LABOUR RIGHTS ENHANCED IN MEXICO**

- Recognition of collective bargaining rights and other internationally-identified labour rights in Mexico.

#### **TIGHTER ENVIRONMENTAL STANDARDS**

- Agreement on new obligations to combat trafficking in wildlife, timber, and fish; to strengthen law enforcement networks to stem such trafficking; and to address environmental issues such as air quality and marine litter.

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