NAFTA Update

10/18/2017

**Fourth round update**

* Timeline: The fourth round of negotiations was completed Tuesday (10/17) in Arlington, VA. The next round will be back in Mexico City, MX in mid-November. This is a delay of two weeks over previous plans. The overall timeframe for the negotiations has been extended 3 months in March 2018. Presumably this reflects both the difficulty of the negotiation and the logistical challenge of the fast pace so far.
* Text: Virtually all proposals have been tabled as of this round, mostly by the US.
* Atmosphere: The final press conference by the three trade ministers can be described as contentious. The Canadian and Mexican Ministers indicted rejection of the unorthodox US proposals. USTR Lighthizer expressed surprise that the others were not willing to accept the US desire to reduce US investment in their countries (he was explicit on that goal) and reduce the US trade deficit (implicitly by reducing their exports to the US).
* Canadian and Mexican negotiators appear more pessimistic due to the unorthodox US

proposals. The negotiators say that they see these proposals as a way for USTR/Trump Administration to blow NAFTA up. They describe many proposals as non-starters that are distracting attention from issues that are actually negotiable.

* There has been some talk about MX and CA negotiators walking out, but that seems unlikely at this point – unless provoked by other issues outside the negotiations.

**Three baskets for topics**

* First basket: There are a set of issues that have either been agreed or have a clear path to agreement. These issues include:
  + competition, SMEs, digital, customs facilitation, financial sector, regulatory, possibly others.
* Second basket: These are the traditional U.S. asks in FTA negotiations and topics that are traditional disputes among parties. Some of these are difficult asks, while others might have solutions. However, progress on those seems to be sidetracked due to concerns about ‘basket 3’ issues. Topics include:
  + IP, Agriculture (seasonal vegetables), textiles.
  + No agreement yet on whether to include an energy chapter (was in NAFTA 1.0 but not in most other FTAs).
  + SOE chapter is ‘traditional’, but US proposal reportedly goes beyond the draft TPP chapter in ways to which CA and MX object. For example, the CEO of PEMEX told us the broader definitions proposed would mean that if GE formed a partnership with PEMEX for a specific project, GE would be classified as a State-Owned Enterprise, and subject to all the reporting and procurement rules obligations. (We are looking in to this.)
* Third basket: This basket holds the non-traditional issues where USTR has tabled proposals that are unorthodox, often directly contrary to traditional US trade policy, and likely impossible for MX or CA to accept. The US business community is also strongly against many of these proposals. Topics include:
  + ISDS: the US is proposing an ‘opt-out’ which would allow any party at any time to withdraw from its obligations for this Dispute Settlement mechanism. This would make the mechanism irrelevant, reducing the security for big investors including energy companies. If the US opts out, CA and MX almost certainly would do the same. Some US companies, including the IOCs and financial institutions are adamantly opposed to this USTR proposal. But it is in line with the stated US goal of reducing US investment abroad.
  + Sunset clause: The US proposes that NAFTA would have to be actively reapproved every five years or it would disappear. This is unacceptable for both CA and MX (and US companies).
  + Government procurement: USTR proposes to limit CA and MX access to the US Government Procurement market to the same dollar value as the size of their government procurement markets. Both MX and CA object strongly to this, and almost certainly would retaliate, reducing US access to their GP markets (including energy and healthcare).
  + Rules of Origin: Under current NAFTA, there are different ROOs for each sector governing the percent of content that must originate in a NAFTA country to qualify for NAFTA duty free treatment. The US has proposed new ROOs for the automobile sector, raising the overall ROO from 62.5% to 85%. Also adding a totally new concept that 50% of the value must originate in the United States. This is unacceptable to CA and MX—especially the second clause. So far, the US has not proposed new ROOs in other sectors, but there are rumors around electrical machinery and healthcare devices.

**Going forward**

* Political analysis:
  + Canada point of view: Canada has little to gain in these negotiations because CA-US relationship can fall back on the CUSFTA bilateral trade agreement if NAFTA disappears. CA is not Trump’s target – Minister Freeland highlighted the fact that the US has a trade surplus in manufactured goods with Canada - but many of the ‘traditional’ issues that have been brought to the table have been primarily CA issues (ex: IP, dairy).
  + Mexico point of view: These negotiations are important but not life or death. If negotiators succumb to Trump threats, the PRI would suffer dramatically at the polls next July. MX already has FTAs with 50 countries and is actively pursuing others to diversify its export markets.
  + US point of view: Very odd negotiations because the US business community opposes much of what USTR is putting on the table. USTR does not appear concerned to win Congressional support, adding to suspicion that they want to blow the deal up.
* Possible scenarios:
* At least by March but possibly sooner the US will face a decision point – when the talks stalemate around the Basket 3 issues. At that point, there may be three options:
  + Trump withdraws from NAFTA
    - GE and the rest of the business community needs to understand and analyze both the impact on our business, and whether Congress could do anything to prevent this (it would be tough).
  + Slow the timeline.
    - Recognition that the issues are hard could lead to a decision to slow roll the talks during 2018, to get past the MX and US elections. This is risky given the uncertainty of the election outcomes in both countries, and the ever-present threat that Trump could suddenly pull the plug, in order to appeal to ‘his base.’
  + Declare victory and sign a more limited deal.
    - Congress, business community, additional stakeholders get Trump to understand that what has been agreed on so far (basket 1 and parts of basket 2) is a good deal and he can call this “NAFTA 2.0” a win.
    - This seems to run contrary to the impression that Trump really wants to withdraw, but would be consistent with the idea that perhaps his negotiating tactics so far involve significant bluster.
    - Congressional approval would still be a challenge, but would not have to be achieved before the elections.

**Issues for GE to consider going forward**

* If there is a US withdrawal, could CA and MX keep it and preserve an option for the US to rejoin under a future US President?
* Supply chain: tariffs would revert to WTO/MFN rates, with CA it would revert to CUSFTA
  + Impact on products moving in both directions
* How would our competitive position change viz competitors from countries that have FTAs with CA and MX (eg EU, Japan)
* gas exports to MX would require specific US regulatory approval, unlike current FTA status
* Government procurement and sales: the US would lose status as an FTA partner with MX and GE would therefore lose out on government procurement opportunities (from US production)
* Sourcing products in 3rd countries (ex: gas turbines from France instead of South Carolina to take advantage of other FTAs).