

A closer look at round four of the NAFTA negotiations

October 25, 2017

Round four of the NAFTA negotiations in Arlington, Virginia concluded on October 17, 2017. This round has been marked by significantly more tension now that the United States has formally released demands and tabled proposed text on some of the more controversial issues, such as modifications to auto rules of origin, attacks on Canada's supply management system and a "sunset review" provision that would require the countries to opt-in to the agreement every five years. These demands have been rejected by Canada and Mexico, raising the most serious doubts so far about the odds of a successful renegotiation.

According to the Trilateral Statement on the Conclusion of the Fourth Round of NAFTA Negotiations from United States Trade Representative Robert Lighthizer, Canadian Foreign Affairs Minister Chrystia Freeland, and Mexican Secretary of the Economy Ildefonso Guajardo, one of the few positive outcomes from this round of the negotiations is that the United States, Canada, and Mexico have now substantively completed discussions regarding the Chapter on Competition.¹

With respect to the dairy industry and supply management, the United States has finally articulated a clear demand that Canada increase market access for United States' exports. The United States is asking that the supply management system be progressively removed over the course of a decade, with annually increasing market access granted to the United States.² John Melle, the lead negotiator for the United States, confirmed that the United States has requested an end to the supply management system quotas for poultry and eggs as well.³ Canadian Minister of International Trade, Francois-Philippe Champagne, called the proposal "obviously unacceptable" to Canada.⁴ It is estimated that the value of all the supply management quotas issued was about CA\$35 billion last year.⁵

The United States has also stated that it wants to raise the automobile rules of origin up to 85 percent from 65 percent.⁶ All trucks, automobiles and large vehicle parts will also have to contain 50 percent American content to avoid being subjected to a 2.5 percent tariff,⁷ with a requirement that this policy be implemented within one year.⁸ The new proposal would also include sophisticated automotive electronics, electric vehicle batteries and other parts that are not presently on the origin tracing list because they did not exist when the NAFTA was originally negotiated in the early 1990s.⁹ Likewise, the United States proposed, for the automobile and auto part sector, the inclusion of a regional value content requirement for aluminum, steel, copper and resins of 100%. This proposal was also rejected by Mexico and Canada.

At this time, the NAFTA prioritizes North American origin in this industry and there is no rule that currently mandates American content specifically.¹⁰ Most of Canada's auto sector is based in Ontario, and Ontario Premier Kathleen Wynne said Canada's vehicle "industry cannot tolerate such extreme, punitive measures, divorced as they are from the economic reality of an integrated continental auto sector operating in a fiercely competitive global economy."¹¹ Mexico's deputy economy minister, Juan Carlos Baker, called them "difficult proposals."¹²

The United States has also proposed that the dispute resolution panels under Chapter 11, 19 and 20 should be made

either non-binding or voluntary, which would effectively render these mechanisms toothless.¹³ Another controversial provision tabled by the United States would decrease the access that Canada and Mexico have to United States' government contracts.¹⁴ Finally, the United States has also put forward a sunset clause that would terminate the NAFTA after a five year period, unless all three member states agree to extend the free trade agreement beyond that period.¹⁵

Uncertainty has continued to mount as the lack of confidence in the possibility of success of the renegotiation of the NAFTA grows, and Mexico's Finance Minister Jose Antonio Meade has even attributed a recent decline in the Mexican peso's exchange rate this month in part to "concern surrounding the [NAFTA] trade agreement."¹⁶ Lighthizer has said that he is "surprised and disappointed" by the resistance from Canada and Mexico in these rounds.¹⁷ However, in a press conference held earlier in the month, the United States Chamber of Commerce cautioned that the administration was making excessive demands that it was unlikely to achieve.¹⁸ Tom Donohue, who is the head of the Chamber of Commerce, has been highly critical of the "unnecessary and unacceptable poison-pill proposals" from the Trump administration thus far.¹⁹ Others suggest that these proposals reflect an effort to insert unpredictability in the negotiation as a tactic to obtain additional concessions.

Frustration with the negotiations has become increasingly evident in Mexico as well. "I am tired of explaining that trade deficits are not a public policy objective, but a result: we do not have time to be teachers in the world, we can help [the United States] to rebalance its trade," said Mr. Ildefonso Guajardo, Mexican Secretary of the Economy, during his participation in a Business Summit held on October 22 in San Luis Potosi, Mexico.

Despite the tension, Mexican and Canadian officials have stated that their governments will not abandon the negotiations.²⁰ NAFTA talks are now expected to go well beyond the new year deadline that the parties were hoping to meet, with upcoming rounds likely to last seven to ten days as well.²¹ Ambassador Lighthizer has also stated that talks could continue until March 2018.²² Mexico is set to host the fifth round of talks in Mexico City from November 17-21, 2017.²³

The fact that the parties have accepted to extend the negotiating calendar and take more time between rounds is one of the few glimmers of hope emerging from round four. At the Dentons NAFTA 2.0 Summit held on October 11, 2017 in Washington, United States Secretary of Commerce Wilbur Ross said that some of the demands reflect what was already agreed to in the Trans Pacific Partnership, as well as emphasized that the bottom line in the revised NAFTA is ultimately to "do no harm." The new United States ambassador to Canada, Kelly Craft, has also just arrived in Ottawa, and an engaged ambassador can certainly have a positive impact on the negotiations. Tax Reform will be at the top of the agenda over the next two months in the United States, which may provide some additional breathing room for negotiations to unfold at a more sustainable pace.

Speculation surrounding the end of the NAFTA and the contingency plans that Canada and Mexico should pursue has increased significantly following round four. Concerns that the negotiations will fail seem to have increased and there are increasing calls for the governments of Canada and Mexico, and the business community in all three countries, to be prepared for the unwinding of the NAFTA. Companies involved in integrated North American supply chains are looking more seriously at the effect that the end of the NAFTA may have on their operations. This includes reviewing the impact of duties on their cross-border trade flows, ensuring that their critical supply and sales contracts adequately deal with the risk of losing the benefits of the NAFTA and reviewing the impact of the end of the NAFTA on proposed investment decisions, among other things.

As the negotiations continue to unfold, our Dentons NAFTA team will monitor and report on major developments. Our team is also able to assist clients in developing customized tools to assist them in assessing and mitigating risks associated with the termination or amendment of the NAFTA. Please reach out to any of our Key Contacts for more information.

¹ "Trilateral Statement on the Conclusion of the Fourth Round of NAFTA Negotiations", *Office of the United States Trade Representative* (October, 2017), [Trilateral Statement on the Conclusion of the Fourth Round of NAFTA Negotiations].

² See, e.g., Katie Simpson, "U.S. makes 'aggressive' demands to access Canadian dairy market, wants end to supply management", *CBC News* (October 16, 2017), [Simpson].

³ Josh Wingrove, "U.S. Seeks End of Canada Dairy System as Latest Nafta Talks Wrap", *Bloomberg* (October 17, 2017), [Wingrove].

⁴ *Ibid.*

⁵ Canadian Press (Canada) "Canada's supply management a flashpoint in nafta talks: Here's why", *BBNA Convergence* (October 17, 2017).

⁶ Elena Holodny "The Mexican peso is tumbling as the US comes out with tough NAFTA demands", *Business Insider* (October 16, 2017), [Holodny].

⁷ Jessica Vomiero, "U.S. auto part content proposals could sink NAFTA talks, experts say", *Global News* (October 16, 2017), [Vomiero].

⁸ Simpson.

⁹ David Lawder, "U.S. demands regional steel, aluminium in NAFTA auto rules – sources", *Reuters* (October 13, 2017).

¹⁰ Daniel Dale, "Another Trump poison pill for NAFTA? Ottawa slams demand for 50% U.S. content in cars", *Toronto Star* (October 13, 2017).

¹¹ Wingrove.

¹² Vomiero.

¹³ Simpson.

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ Holodny.

¹⁷ Robert Lighthizer, "Closing Statement of USTR Robert Lighthizer at the Fourth Round of NAFTA Renegotiations", *Office of the United States Trade Representative* (October, 2017).

¹⁸ Sean Higgins, "NAFTA talks intensify as fourth round of negotiations extended", *Washington Examiner* (October 11, 2017).

¹⁹ Katie Simpson, "U.S. tables NAFTA's 'poison pill' with auto sector demands", *CBC News* (October 13, 2017).

²⁰ David Lawder and Dave Graham, "NAFTA negotiators trade barbs, indicate wide differences", *Reuters* (October 17, 2017).

²¹ Katie Simpson, "NAFTA rounds to last longer, plans in the works to negotiate past new year deadline, source says", *CBC News* (October 17, 2017).

²² Don Lee, "NAFTA talks bog down over U.S. demands as latest round concludes", *Los Angeles Times* (October 17, 2017).

²³ Trilateral Statement on the Conclusion of the Fourth Round of NAFTA Negotiations.

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