NAFTA Renegotiation: Agreement in Principle Between the United States and Mexico

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PRACTICES Mexico, Mexico Energy Reform, International

After almost 13 months of negotiations, on August 27, 2018 the United States and Mexico reached a preliminary commercial understanding, which they have termed an “agreement in principle,” to modernize the North American Free Trade Agreement (“NAFTA”). Canada has not yet joined in the agreement, and the question of Canada’s ultimate participation will affect the substance of the deal, its posture under the U.S. Trade Promotion Authority (“TPA”) law, and its prospects for Congressional approval.

No specific language of the agreement in principle has yet been released by either the United States or Mexico, though the U.S. Trade Representative (“USTR”) has published a series of fact sheets containing some of the main points of agreement. According to these fact sheets and other published reports, the agreement in principle includes the following:

1. Automotive Sector

- The current 62.5 percent requisite level of regional value content will increase to 75 percent in order for a vehicle to be eligible for duty-free access. (No details have yet been made available regarding an expanded tracking list of parts and components for which the origin of every subcomponent must be identified when making the 75 percent calculation.)
- Forty percent of the content of an automobile must be made by workers earning at least $16 per hour, which in practice would mean workers in the United States or Canada if it latter joins the new agreement.
- Where a producer does not comply with such content percentages, a tariff at the most-favored nation (“MFN”) rate of 2.5 percent will be applicable. According to some reports, however, the United States has insisted that there be a limit on the availability of the MFN rate in the event of substantially increased Mexican exports to the United States.

2. Agricultural Sector

- Current duty-free treatment will continue. The United States dropped its request for special trade remedy investigation procedures aimed at seasonal products.
- A biotechnology section is included to promote the use of new agricultural technologies.

3. Dispute Settlement

- Although there was considerable discussion regarding the elimination of NAFTA Chapter 11 investor-state dispute settlement (“ISDS”) arbitration rights, the agreement in principle only makes limited modifications. Full ISDS protections are to be kept for investors in infrastructure, telecommunications, and energy (including power generation and oil and gas) sectors, the latter being the most politically sensitive. ISDS will, however, be limited in most other sectors to issues of physical governmental expropriation or failure to grant national treatment or MFN duty status.

- NAFTA Chapter 20 "Institutional Arrangements and Dispute Settlement Procedures," which provides procedures for resolution of disputes between the member country governments, has not been modified.
- The United States and Mexico agreed to do away with NAFTA Chapter 19 "Review and Dispute Settlement in Antidumping and Countervailing Duty Matters." Inasmuch as Canada has relied heavily on Chapter 19 panels to ameliorate what it sees as excesses in U.S. trade remedy cases (most notably on softwood lumber), this issue will factor significantly in the on-going negotiations between the United States and Canada.

4. Intellectual Property (IP)

- The chapter on IP was modernized to enhance protection for intellectual property rights, including increased enforcement at the border, the imposition of meaningful penalties for pirating of movies, and strengthened safeguards against theft of trade secrets.

5. Digital Trade

- A new chapter will prohibit customs duties and other discriminatory measures from being applied to digital products which are electronically distributed (e-books, videos, music, software, games, etc.)
- This chapter limits governments' ability to require disclosure of proprietary source code or to restrict the use of electronic authentications.

***6. De Minimis* Import Value**

- To facilitate cross-border trade, the United States has reached an agreement for Mexico to raise its *de minimis* shipment value level to $100. Shipment values up to this level would enter Mexico without customs duties or taxes, and with minimal formal entry procedures.

7. Financial Services

- The updated Financial Services chapter includes commitments to liberalize financial service markets and facilitate equal conditions for financial institutions of both countries.

8. Labor

- The parties are to adopt, maintain and allow enforcement of standards recognized by the International Labor Organization.

- This chapter includes new provisions which prohibit the importation of goods produced by forced labor and addresses importation of goods produced under violation of labor rights.
- Mexico also promises to enact legislation to allow effective worker representation in collective bargaining.

9. Environment

- The Environment chapter includes agreements to combat trafficking in wildlife, timber, and fish and to strengthen law enforcement networks to stem such trafficking.
- It addresses pressing environmental issues such as air quality and marine litter and supports sustainable forest management.
- This chapter also modernizes mechanisms for public participation in environmental protection.

10. Energy

- The initial USTR fact sheets have not disclosed the terms of the agreement, if any, with respect to energy. The Trump Administration, however, had previously identified opening of the Mexican energy sector as a negotiating priority. Details will likely be revealed in due course.

11. Sunset Clause

- The United States backed away from its controversial proposal for a five-year review and possible termination of the agreement. Instead, it was agreed that the agreement shall be for a set term of 16 years. At the end of six years the parties can review and revisit areas of the agreement that have proven problematic and can continue such reviews annually or, once outstanding issues are resolved, the term of the agreement can be extended to continue 16 years thereafter.

Canada Considerations

If Canada does not sign onto the agreement, there will persist the legal question whether the President is authorized to submit a deal only with Mexico to Congress for an up-or-down vote, as TPA was granted by Congress to the Administration to negotiate a tripartite agreement. Given the preference expressed by many members of Congress, by U.S. business and labor and by the Mexican government for a full North American agreement, rather than a bilateral arrangement with Mexico, failure to reach a deal with Canada could seriously threaten the ultimate approval by Congress of an agreement between the United States and Mexico.

Congressional Considerations

Even with Canada on board and with an agreement completed and signed by November 29, 2018 (within 90 days after notification of Congress by President Trump of his intention to enter into an agreement and thus also within the last month of the Peña Nieto government in Mexico), the U.S. International Trade Commission ("ITC") would be required to prepare and publish a report for Congress on the likely impact on the U.S. economy of the proposed agreement. TPA gives the ITC 105 days within which to complete its report, so the vote on any modified NAFTA will take place in the new Congress that may have fewer Republican and more Democratic members than the current Congress. U.S. Trade Representative Robert Lighthizer has said that he hopes tougher labor provisions in the U.S.-Mexico deal will win over Democratic lawmakers who have opposed previous trade agreements.

Mexico Considerations

From a Mexican perspective, an agreement signed and approved by the Mexican Congress before President elect Lopez Obrador takes powers on December 1 would nevertheless have the added benefit of enabling the new President to concentrate on his domestic agenda, including but not limited to reforms of the oil and gas sector, rather than contentious bilateral negotiations with the United States.

Details Still Forthcoming

No official text of the agreement between the United States and Mexico has yet been published. Much of the foregoing, including details of the terms of the rules governing trade in the automotive sector, will be fleshed out, expanded and clarified in the text. Until then, the agreement, while accepted in principle, is not final. And, of course, there can be no implementation of any agreement without Congressional approval.

If you have any questions, please contact a member of our NAFTA Task Force.