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The Mexican government is preparing for the possibility that the North American Free Trade Agreement (NAFTA) could become the bilateral Mexico-Canada trade agreement amid growing concerns that the US could leave the trilateral accord. Representatives from the three countries met for a fourth round of discussions in Arlington, Virginia, on Oct. 12-17, but they appeared no closer to an agreement than when discussions began in August.

A major stumbling block appears to be the insistence by US President Donald Trump that any revisions to NAFTA reduce the US trade deficits with Mexico and with Canada significantly (SourceMex, Aug. 23, 2017, and Sept. 20, 2017).

According to sources close to the negotiations, the Trump administration appears to have added other demands that have drawn strong objections from Mexico and Canada and could derail the agreement.

"As difficult as this has been, we have seen no indication that our partners are willing to make any changes that will result in a rebalancing and a reduction in these huge trade deficits," US Trade Representative Robert Lighthizer told reporters at the end of discussions on Oct. 17.

US demands called 'Poison pills'

Sources close to the negotiations said these new US demands include several "poison pills" that are certain to be rejected by Mexico and Canada. These include a five-year sunset clause that gives the US the option of terminating its participation in NAFTA, restrictions on government procurement, a weakening of the dispute-resolution mechanism, and increased US access to the Canadian dairy market as well as restrictions on imports of Canadian softwood lumber. Canada is the world's largest softwood lumber exporter and sends the majority of its exports to the US.

Furthermore, the Trump administration has put forth proposals to implement new restrictions on long-haul trucking from Mexico, a source close to the negotiations said in an interview with Reuters. President Enrique Peña Nieto's administration is likely to object to this plan, as Mexico fought hard to gain access for its truckers to US highways (SourceMex, Jan. 17, 1996, Jan. 19, 2000, July 13, 2011).

"We will not be walking away from the table based on the proposals put forward," Canadian Prime Minister Justin Trudeau said at a news conference in Mexico City following a meeting with Peña Nieto.

"[This agreement] cannot be good for just one country, and we can't be hostage to only one position," Peña Nieto said.

Trudeau and Peña Nieto met in the Mexican capital while their respective negotiating teams, led by Canadian Foreign Minister Chrystia Freeland and Mexican Economy Secretary Ildefonso Guajardo were meeting with the US delegation, led by Lighthizer.

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"Proposed new USA national content requirements would severely disrupt the supply chains, make North American producers and manufactures less competitive relative to imports from outside the region, and put in jeopardy tens of thousands of jobs across North America," Freeland told reporters in response to the proposals put forth by the US negotiators.

Still, Peña Nieto and Trudeau attempted to put a positive spin on the talks. "I would not pay much attention to any statements other than those that happen at the negotiation tables," Peña Nieto said, pointing out that there are some areas where the three countries can work together, such as electronic commerce.

"We are pleased to be talking about ways we can improve NAFTA," Trudeau said. "We will discuss those proposals, we will counter those proposals, and we will take seriously these negotiations."

Despite the positive stance put forth by the Mexican and Canadian leaders, sources with direct knowledge of the talks described the atmosphere at the meeting in Virginia as "horrible" and highly charged.

One source noted that some of the members of the US team, who were receiving direct instructions from high-level officials in the Trump administration, were uncomfortable with the demands they were presenting to their Mexican and Canadian counterparts. "They don't like what they are doing," a source said in an interview with the Canadian Broadcasting Corp. (CBC).

Many US business leaders are also unhappy with the stance of the US administration in the NAFTA negotiations. One strong critic is John Murphy, senior vice president for international policy at the US Chamber of Commerce.

"We see these proposals as highly dangerous, and even one of them could be significant enough to move the business and agriculture community to oppose an agreement that included them," Murphy said in reference to the Trump administration's five-year termination clause.

Murphy also raised concerns about the US proposal to reduce Canadian and Mexican companies' access to US public procurement contracts, and to include a US-specific content requirement for autos and auto parts.

The Trump government's proposals have also raised a red flag among members of the US Congress. According to several experts, a decision of this magnitude might require Congressional approval. The attempt to leave NAFTA could "at the very least … lead to lengthy court battles that could delay the US departure for years," said the Chicago Tribune.

There is opposition from members of both parties in a key panel of the House of Representatives, the House Ways and Means Committee. According to Rep. Richard Neal, a Democrat from Massachusetts and the ranking member of the committee, Congress would intervene if Trump "even suggests that the United States should leave NAFTA." Meantime, committee chair Rep. Kevin Brady, a pro-trade Republican from Texas, bypassed the administration and reached out to Trudeau to address the committee to discuss trade issues.

Because of the difficult talks, the three came up with a plan to give the negotiators more flexibility. They agreed to consider extending each round of talks beyond the five-day period and to add another round of negotiations in February. The three countries had hoped to complete negotiations

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by the end of 2017 to avoid creating distractions during the upcoming electoral season, but they are unlikely to meet that deadline. Mexico is scheduled to hold presidential and congressional elections on July 1, 2018, while the US will hold mid-term elections for Congress on Nov. 6, 2018. Canada does not have a national election scheduled in 2018.

For now, the three countries are scheduled to meet for the fifth round of negotiations in Mexico City on Nov. 17-21.

A bilateral accord?

The Toronto Globe and Mail, in an editorial entitled "Memo to Ottawa: Aim to Save NAFTA—but Start Planning for its Failure," praised Trudeau for reaching out to corporate America, US mayors and governors, and others who would stand to lose from the withdrawal of the US from NAFTA. "Ottawa is working all of the levers of influence, and yet it may not get what it wants and what Canada needs, namely the survival of NAFTA," the editorial said. "That's because the protagonist of this show is not Mr. Trudeau, or the US Congress, or even US big business. This is a play with a lot of supporting actors, but only one lead. The guy driving the plot is President Donald Trump. On NAFTA, everyone else is reacting to his narrative."

Whether the US Congress would have the muscle to block the administration from leaving NAFTA remains to be seen. The possibility of a US exit has led Canada and Mexico to discuss Plan B: maintaining the current accord as a bilateral US-Canada agreement. This possibility was one of the topics of discussion during the meeting between Peña Nieto and Trudeau in Mexico City.

"I think that Canada and Mexico share that the NAFTA agreement is a good mechanism, not the only one, but it is a good mechanism to boost the development of the region," Peña Nieto said.

In an address to the Mexican Senate, Finance Secretary José Antonio Meade Kuribreña offered some insights about what the two leaders discussed at their meeting. "We have the possibility of identifying tariff measures, we have the possibility to identify other markets to be our providers and other markets that we can turn to," he said.

According to Meade, the Mexican government has been working on a strategic plan to support the sectors and the specific companies that would be affected directly by a US departure from NAFTA.

Still, the ongoing uncertainty about NAFTA has created some volatility in Mexican financial markets, especially the currency markets. Meade has said that the depreciation of the peso, which has fallen to its weakest level in about five months, can be attributed at least in part to ongoing uncertainty about NAFTA. The Mexican currency was quoted at 18.8 pesos per US$1.00 on Oct. 18.

Some experts anticipate a short-term impact on the Mexican economy if the US leaves NAFTA, since Mexico relies on the US market for 80% of its exports.

"The possibility that the US would leave the agreement is very real," financial columnist Luis Enrique Mercado wrote in the daily newspaper Excélsior. "Even if this doesn't create a crisis in the Mexican economy, there will certainly be turbulence and an impact on the exchange rate, which will pressure interest rates and public finances."

According to Agustín Carstens, chief governor of the central bank (Banco de México, BANXICO), a short-term downturn in the Mexican economy would be followed by a recovery.

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"I hope that NAFTA prevails, but if not, I think we will be resilient, look for other markets and see what the environment is to export to the US," Carstens said in a question-and-answer session at the headquarters of the International Monetary Fund (IMF) in Washington.

Carstens criticized the Trump government for its stance on trade negotiations. "I think the approach [of the Trump administration] is wrong," he said. "I think that the administration should look to operate in a multi-country world, and it doesn't make sense to focus on your bilateral relationships."

Carstens announced last year that he would be leaving the central bank for a post as general manager at the Bank for International Settlements (BIS) (SourceMex, Dec. 7, 2016).

Some observers argue that Mexico has other issues of concern if NAFTA were to unravel.

"Even if trade does not suffer much with an increase in tariffs, there will be a negative impact on the climate for business and investment," economist Rogelio Ramírez de la O said in a column in the daily newspaper El Universal.

Ramírez de la O also noted that many econometric models had promised that NAFTA would increase Mexico's GDP between 4 and 7 percentage points. "The predictions were not met, mostly because of failures in Mexico's macroeconomic models and the absence of measures to promote industry, which is the natural vehicle to bring us higher levels of development and increased salaries," he said.

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