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After Two Rounds

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Two rounds of NAFTA renegotiation have been held and the three participants have been sizing each other up. While the three nations laid out their objectives in the first round, the second round was more about consolidating the things all three can agree on and cutting out the things that will be more difficult or impossible.

When we look at the most strident rhetoric from President Trump and compare it to the statements of Commerce Secretary Wilbur Ross and U.S. Trade Representative Robert Lighthizer who agreed to first “do no harm,” there are obvious contradictions. Trump has referred to NAFTA as a terrible agreement and said the U.S. will likely have to pull out. Meanwhile a parade of U.S. agricultural and manufacturing trade groups have expressed to everyone in the administration that the agreement is crucial to their business.

Canada and Mexico have so far been united in wanting to keep the dispute settlement mechanism in NAFTA, while the U.S. wants to scrap it. Since dispute settlement is critical to all the rest of the agreement, that could be the most worrisome conflict. Chapter 19 panels draw expert members from both countries involved to examine anti-dumping and countervailing duty disputes. Simon Lester of the Cato Institute suggested some compromises might be possible, including allowing countries the option of using Chapter 19 dispute panels or the accused countries’ trade agencies and domestic courts, then conducting studies to compare the results. Another option, says Lester, would be to appoint a joint working group to develop an entirely new dispute resolution system.

In other issues, like the percentage of auto parts required to be sourced in NAFTA countries, the three parties can start out with differing percentages and work their way to a compromise. However, that process might depend on Trump’s apparent insistence on a percentage for U.S. parts, the effect on consumers if the percentage of cheaper Asian parts is lowered and the possible upward pressure on auto parts prices if Canada and the U.S. insist on labour reform in Mexico.

Low labour costs are not the only reason manufacturers have located in Mexico. Mexico’s Free Trade Agreements with 45 countries, including the EU, is another crucial factor.
But labour advocates from all three countries say Mexico’s minimum wage of $4.50/day, with $1/hour plus benefits being typical for manufacturing and $100/week being the best manufacturing wage, is unfair competition for U.S. and Canadian workers and hobbles Mexico’s economic growth. Peter Navarro, one of the most protectionist of Trump’s trade advisers, has

said without wage increases Mexico will “never have a robust middle class and (the U.S.) middle class will wither and die.”

U.S. and Canadian trade officials want Mexico to institute labour reforms such as the right for workers to organize unions without reprisal. But there are other factors involved in Mexico’s low wage rate, including a 75 per cent increase in population in the last 30 years, low productivity in the 80 per cent of the economy not involved in manufacturing exports and 60 per cent of workers working off the books, according to the Wall Street Journal. Competition from Asia is another pressure holding down wages.

The *Globe and Mail* reports Canada is asking the U.S. to pass federal legislation banning right-to-work laws. Such laws, which prohibit unions from forcing employees to join a union to take a job, exist in 28 states and are spreading. I would expect that to be a non-starter with U.S. officials.

Trump’s comments regarding “being taken advantage of” and Lighthizer’s first round comments that NAFTA had “fundamentally failed many, many Americans and needs major improvements,” apparently refer mainly to manufacturing jobs, especially auto makers and parts manufacturers, mostly lost to Mexico. However, while NAFTA is a convenient whipping boy for leftists and unions, it is hard to separate the effects of automation, robots and computerization on manufacturing of all types from the effects of NAFTA. Unions typically ignore the effect their rules and restrictions have on manufacturing costs and efficiencies. Put that together with environmental rules, and they can have a big impact on manufacturing costs.
Another factor overshadowing the negotiations is the U.S. trade deficit with Mexico that is somewhere around $60 billion plus. The U.S. had a small trade surplus (US$7 billion) last year with Canada. Hopefully, trade deficits will fall off the agenda for they are a very poor measure of the benefits from trade agreements.

Mexico has said before that it would leave the table if it didn’t get a fair deal. But Mexico and Canada have made it known recently that should the U.S. actually pull out of NAFTA, they would stay in.

Rarely mentioned in NAFTA discussions are the impact high taxes and onerous regulations have on operating profitably for some U.S. companies, which encourages relocation to Mexico. It doesn’t help that promised tax reform legislation has not even been introduced in Congress, let alone finalized and passed. If tax reform happened this fall, that might make it easier for the U.S. administration to agree to a NAFTA deal without the draconian changes Trump has trumpeted. With important tax reforms in hand alongside Trump’s regulatory reductions, U.S. businesses small and large would celebrate.

Both the U.S. and Mexico want NAFTA renegotiated before their 2018 elections.