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A Strong NAFTA 2.0 Can Counteract Mexico's Leftward Lurch

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During his long political career, Mexico's new president-elect, Andrés Manuel López Obrador, has criticized private foreign investment in Mexican oil and gas assets. These state-owned natural resources had been off-limits to such investment until López Obrador's predecessor, President Enrique Peña Nieto—cognizant of Mexico's declining oil production—began a process of liberalization and privatization in 2013, which was the beginning of the end of state-owned Pemex's seven-decade monopoly.[1]

López Obrador's long-time protectionist stance toward Mexico's energy sector meshed with his general proclivity toward greater state intervention throughout the economy. Now that López Obrador and his National Regeneration Movement (MORENA) party will have the presidency and control of the legislature after an historic landslide election, however, what can the Trump Administration do to prevent a leftward lurch by López Obrador that could inflict significant economic harm on America and Mexico?

One answer stands out: Move quickly to complete negotiations for a strengthened and improved North American Free Trade Agreement (NAFTA)—version 2.0.

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A Strong New NAFTA Could Steer López Obrador Toward Pragmatism

MORENA's substantial new majorities in both houses of Mexico's Congress could remove checks on the new president's agenda and herald more radical policy changes. MORENA's "303 of 500 seats in the lower house…and 70 of 128 in the Senate" will give López Obrador a legislative majority "for the first time in 24 years," according to the *Mexico News Daily*.[2]

Upon assuming the presidency on December 1 of this year, however, López Obrador is likely to hear a phrase similar to the one that Ronald Reagan's conservative base often uttered in 1981 after his groundbreaking election—"let Reagan be Reagan." In this case, it will be "let AMLO [López Obrador] be AMLO."

Yet, it is unclear which version of López Obrador will take office—the common-sense pragmatist or the leftist revolutionary. During his decades-long quest for the presidency, López Obrador has changed his political persona to appeal to Mexico's far Left as well as to business constituencies.

It is in Washington's interest to take positive actions during the transition period leading up to the transfer of power in December to encourage López Obrador to pursue a pragmatic relationship with the United States. López Obrador is likely to tilt toward pragmatism, as he surely realizes that the success of his six-year presidency will hinge in large part on the strong Mexican economy that will result from an improved relationship with his country's largest trade and investment partner.

The fact that both López Obrador and President Donald Trump were elected partly on populist campaign promises to clean up perceived and real corruption by the few at the expense of the many could, in the end, work to the advantage of both countries in negotiations on NAFTA 2.0.

What Is at Stake If the "Wrong AMLO" Pushes NAFTA to Collapse?

The collapse of NAFTA would destabilize markets and disrupt entrenched North American supply chains across a multitude of sectors. It could also result in the displacement of the United States from its current role as the single-most-important international economic actor in Mexico's economy. During the campaign, López Obrador signaled that he might take a "go it alone" non-interventionist approach whereby Mexico would leave NAFTA and otherwise disengage from the world.[3] Such an action would have grave consequences for the Mexican economy. It would put in jeopardy, for example, Mexico's free trade agreement with the European Union through which tariffs on most products have been lowered to zero. While, since the election, López Obrador has adopted a more moderate tone and signaled a willingness to continue the current NAFTA negotiations, the mixed signals he has sent overall on NAFTA and trade have been destabilizing.

Another serious potential consequence of a more autarkic trade policy by López Obrador would be the very substantial loss of revenues from Mexico's exports to the U.S. of manufactured goods, a vast array of agricultural products, and other goods and services if NAFTA collapses. Currently Mexico enjoys a NAFTA-based trade surplus with the U.S. that is larger than that of any other single American trade partner (including Japan and Germany) except China.[4] The United States, meanwhile, counts Mexico as its third-largest export market.

For example, the United States "imports about 30 percent of its medical devices and supplies, and Mexico is a leading supplier. And some major American [medical-device] manufacturers have opened factories in Mexico in recent years."[5] In the absence of NAFTA, consumers in both nations could also bear the burden of higher prices for other everyday products, such as automotive vehicles that are currently manufactured in Mexico, as well as a wide variety of Mexican agricultural products that are now widely available in American grocery stores.

The Investor State Dispute Settlement (ISDS) provisions in NAFTA have been another positive feature that would be lost if NAFTA is terminated. ISDS has protected significant U.S. private investments in Mexico, as well as job-creating investments by Mexican firms in the U.S.[6]

Mutually Beneficial NAFTA Trade in Energy Is also at Risk

Growing global U.S. dominance in energy production and sales is inextricably linked with NAFTA. U.S. and Mexican energy companies' mutual dependence on various segments of the energy supply chain in North America—as sellers, buyers, or investors—means that the consequences of any breakdown of NAFTA would be complex and overall detrimental to companies and energy security in both countries.

That is especially true in the case of U.S. energy exports to Mexico—such as gasoline, diesel, natural gas, and liquefied natural gas (LNG)—which were more than twice the value of energy imports (primarily heavy crude oil) from Mexico in 2016 ($20.2 billion vs. $8.7 billion).[7] U.S. natural gas exports to

1. James M. Roberts and William Tucker, "Additional Reforms Can Boost Mexico's Hydrocarbons Industry," Heritage Foundation *Backgrounder* No. 2971, November 12, 2014, https://www.heritage.org/international-economies/report/additional-reforms-can-boost-mexicos-hydrocarbons-industry.
2. "Mexico Has Been Painted in a Sea of Maroon, the Colors of Morena," *Mexico News Daily*, July 3, 2018, https://mexiconewsdaily.com/news/mexico-has-been-painted-in-the-colors-of-morena/ (accessed July 9, 2018).
3. Richard G. Miles, "Get Ready for a Mexican Left Turn on Foreign Policy," *Foreign Policy*, June 19, 2018, https://foreignpolicy.com/2018/06/19/get-ready-for-a-mexican-left-turn-on-foreign- policy/?utm_source=newsletter&utm_medium=email&utm_campaign=sendto_newslettertest&stream=top (accessed June 27, 2018).
4. Victor Davis Hanson, "Mexico—What Went Wrong?" *National Review*, June 26, 2018, https://www.nationalreview.com/2018/06/mexico-what-went-wrong-economy-based-on-exporting-poor-people/ (accessed June 27 2018).
5. Ana Swanson and Kevin Granville, "What Would Happen if the U.S. Withdrew From NAFTA?" *The New York Times*, October 12, 2017, https://www.nytimes.com/2017/10/12/business/economy/what-would-happen-if-the-us-withdrew-from-nafta.html (accessed June 27, 2018).
6. James M. Roberts, "NAFTA's Investor Dispute (ISDS) Provisions Are Good for Americans," Heritage Foundation *Issue Brief* No. 4772, October 13, 2017, https://www.heritage.org/economic-and-property-rights/report/naftas-investor-dispute-isds-provisions-are-good-americans.
7. Owen Comstock, "U.S. Energy Trade with Mexico: U.S. Exports Value More Than Twice Import Value in 2016," U.S. Energy Information Administration, February 9, 2017, https://www.eia.gov/todayinenergy/detail.php?id=29892 (accessed June 27, 2018).

Mexico were more than twice the size of total global exports of U.S. LNG,[8] and U.S. pipeline capacity for natural gas exports to Mexico currently stands at 7.3 billion cubic feet per day,[9] while the country is also an emerging new market for U.S. LNG exports.[10]

NAFTA has been instrumental in allowing the natural gas trade relationship to blossom. Because Mexico is a free trade partner with the U.S., natural gas imports and exports do not face an additional and unnecessary bureaucratic hurdle. In the case of natural gas imports and exports, U.S. statutes mandate that if the U.S. does not have a free trade agreement with the country receiving or sending the natural gas, the U.S. Department of Energy (DOE) must make a public interest determination.[11] U.S. producers should be allowed to export to any country they see fit. The distinction that exports to free trade agreement countries are somehow deemed to be in the "public interest" while others are not is rather arbitrary. No concrete definitions exist for national or public interest determinations, which introduces subjectivity into the determination. Nevertheless, the existence of NAFTA removes the DOE from the equation so that projects can move forward with the environmental review and permitting.

During López Obrador's tenure as president, U.S. capacity and investment in natural gas will be increasingly important for Mexico, as electricity generation and infrastructure are needed to help benefit exactly the people in Mexico that López Obrador claims to represent. Numerous projects are in the works to expand cross-national and Mexican domestic pipeline infrastructure but, since López Obrador's election, it is an open question as to whether U.S. companies will have the confidence to invest in producing and transporting energy within Mexico.

That is because it is unknown whether López Obrador will extend opportunities to lease Mexican federal lands and offshore waters for oil and gas production and thereby continue the partial energy-sector privatization that was started by President Peña Nieto. Absent those new leases—and without ISDS investment protections under NAFTA—the prospects of future oil and gas investments in Mexico by U.S. and other multinational energy companies would be dimmer.

NAFTA 2.0—What the Trump Administration Should Do

President Trump has expressed an antagonism to NAFTA that is similar to that of López Obrador—and also rooted in economic nationalism—during his 2016 campaign, and in the many months since his Administration began talks to re-negotiate NAFTA last year. Although López Obrador has said that he supports NAFTA and acknowledges its benefits for Mexico, during his presidential campaign, López Obrador also took anti-free trade positions, such as calling for greater protections for Mexico's agricultural and manufacturing sectors as well as for a higher minimum wage.

The ongoing uncertainty about the future of NAFTA, however, is beginning to undercut the robust U.S. economic growth that President Trump hopes will lead to Republican victories in the U.S. mid-term elections this fall. In order for the Trump Administration to continue advancing its economic agenda, it should move expeditiously in the months before AMLO's inauguration to:

- Pursue a quick resolution of talks and an agreement on a strengthened NAFTA 2.0;
- Seek to include in the new agreement provisions to open up service sectors (such as accounting, insurance, and overnight delivery) where U.S. firms lead the world, as well as new provisions covering e-commerce and other digital industries that had not been invented when the original NAFTA was negotiated; and
- Use NAFTA 2.0 to push for restrictions on unfair competition from state-owned enterprises and safeguards for U.S. intellectual property.[12]

8. U.S. Energy Information Administration, "U.S. Natural Gas Exports and Re-Exports by Country," October 2017 to March 2018, https://www.eia.gov/dnav/ng/ng_move_expc_s1_a.htm (accessed July 9, 2018).
9. Institute for Energy Research, "U.S. Natural Gas Pipeline Capacity to Mexico Continues to Increase," December 7, 2016, https://instituteforenergyresearch.org/analysis/u-s-natural-gas-pipeline-capacity-mexico-continues-increase/ (accessed July 9, 2018).
10. American Petroleum Institute, "North American Energy," 2017, http://www.api.org/~/media/Files/Policy/Trade/North-American-Energy-Onepager.pdf (accessed June 27, 2018).
11. Natural Gas Act, Section 3, 15 U.S. Code § 717(b) (1938).
12. Bryan Riley, "9 Ideas for Negotiating a Better NAFTA," Heritage Foundation *Commentary*, November 15, 2017, https://www.heritage.org/trade/commentary/9-ideas-negotiating-better-nafta.

The Administration should also work with its NAFTA counterparts in Canada and Mexico to incorporate a chapter on energy trade and investment. Doing so would help López Obrador to deliver on his campaign promise to root out corruption in Mexico's energy industry, and would benefit all three NAFTA countries.

The energy chapter should be structured to ensure that future foreign investment will make Mexico's energy sector stronger and more efficient in order to "benefit the Mexican people and not go into the hands of corrupt officials or the economic elite."[13]

Finally, the Trump Administration should affirm its support of the inclusion of ISDS provisions in a renegotiated NAFTA, while pushing to remove existing provisions on labor and environmental regulation that are unrelated to trade.

If the U.S. and Mexico, jointly with Canada, can seal a deal on NAFTA 2.0 soon, the new agreement will be a winner for the United States and the American economy.

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13. David R. Mares for Amy Myers Jaffe, "Why Mexico's Energy Reform Needs AMLO," Council on Foreign Relations, June 20, 2018, https://www.cfr.org/blog/why-mexicos-energy-reform-needs-amlo (accessed June 27, 2018).