

LatAm

# MEXICO: LEGISLATIVE PUSHBACK, NAFTA 2.0

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This month, the government has made unexpectedly slow progress on its top legislative priorities, as President Andrés Manuel López Obrador (AMLO)'s formidable allied base ran into opposition from friends and foes alike in both houses of the Congress. While AMLO retains the strong upper hand in the legislature, the hurdles he is facing are a telling sign that forging the necessary consensus to pass controversial constitutional amendments remains a challenge, even for the highly popular President during his honeymoon period.

In this note we take a closer look at the top three bills on the government's front burner: nationwide referendums, education and labour. Ongoing delays in the planned passage of the labour bill could have knock-on implications for the looming fight over NAFTA 2.0 (USMCA) approval in the US Congress.

## Key judgments

- Ongoing resistance to proposed constitutional changes is a positive sign that the seemingly all-powerful AMLO cannot always get his way.
- After sailing past the Lower House, the nationwide referendum bill faces an irate Senate opposition bloc, raising the odds that the text will be modified.
- A mild education counter-reform has also run into obstacles – this time from AMLO's base; how the government responds will be a key test ahead.
- Legislative delays have stalled progress on the labour bill, adding to doubts in the US about Mexico's ability to meet its NAFTA 2.0 commitments.
- Dwindling odds of NAFTA 2.0 ratification in the US Congress this year will raise risk perceptions for Mexican asset prices and feed uncertainty.

# Speed bumps in the legislature

**After breakneck advances in its first 100 days, the government has hit some hurdles on its top legislative priorities this month.** Despite firm control of both houses of the Congress, President Andrés Manuel López Obrador (AMLO) continues to face difficulties in ramming through controversial constitutional amendments, notwithstanding his formidable legislative juggernaut and his average approval rating of roughly 80%. We see this as a positive sign not only for the opposition but for civil society at large, indicating that even a seemingly all-powerful President during his honeymoon period cannot always get his way – especially if he fails to forge the necessary consensus to win the minimum two-thirds votes he needs in the Congress.

Below, we take a closer look at the government's top three priorities with investor implications in the current legislative session: a constitutional amendment to lower the bar for nationwide referendums, an education counter-reform and new labour legislation. Delays on the labour bill could have knock-on implications for the looming debate in the US Congress on the ratification of NAFTA 2.0 (USMCA), as we discuss below.

## 1. Referendums/revocation of mandates

**After sailing through the Lower House on 14 March, the bill to lower the bar for nationwide referendums has hit stiff resistance from the Senate opposition.** Under the current version of the bill (see Table 1 below for full details), the bar for holding such votes would be lowered significantly and the results binding if the total participation in the vote is a minimum 25% of registered voters (down from 40% today). In addition, referendums could be held at any time, instead of only on federal election days, as is the case under current legislation. However, we note that because the original bill from AMLO's Morena party proposed that nationwide referendums be held just once a year, the government could ultimately opt for a similar timeline, even if this clause is not changed in the Senate bill.

**More troublingly for the opposition, the bill would open the door to the possible revocation of the mandates of the President and governors halfway through their terms,** with binding results if a minimum 40% of registered voters participate in the vote and an absolute majority votes for the motion. In what is its most contentious point, however, the bill proposes that the first referendum for the revocation of mandates be held on the same day as the 2021 mid-term federal elections. The opposition is adamantly opposed to this, fearing that if AMLO's name were on the ballot, he would boost attendance at mid-term elections, rally the Morena faithful, help the President's allied base maintain or extend its ample legislative majority in the Lower House and bolster its chances of winning in the 13 gubernatorial elections that will be held the same day.

**Interestingly, most of the criticism on the bill to date has focused on the revocation of the mandate clause,** rather than on the lower bar for nationwide referendums. This could well be because AMLO has already demonstrated that he is perfectly willing to hold informal and "binding" public consultations with a mere 1% of the electorate participating (notably for the new Mexico City airport project last October and a second popular consultation the following month) – if nothing else, the current proposal sets a higher bar than those informal ballots. But at the same time, it illustrates to what extent the President has already warped the parameters of politics in Mexico if a once divisive point has received such scant attention. Perhaps the biggest

fear expressed by the opposition centre-right PAN and PRI parties is related to the spectre of AMLO's re-election, which is currently prohibited under the Constitution. While the President has pooh-poohed this idea and tried to quash it by recently signing a document saying that under no circumstances will he seek to extend his mandate beyond 2024, that document has no legal value. For this reason, it has done little to diminish opposition concerns that a future referendum on the revocation of AMLO's mandate – assuming that it is overwhelmingly rejected by voters – could yet pave the way for a future constitutional amendment to allow his re-election.

**Table 1: Proposed changes to nationwide referendums**

	Final Lower House bill	Existing legislation
<b>Referendums</b>		
<b>Proposal</b>	Can be proposed by a minimum 1% of registered voters, the President or one-third of either legislative house	Can be proposed by a minimum 2% of registered voters, the President or one-third of either legislative house
<b>Date</b>	Can be held on any date stipulated in the announcement of the referendum	Can be held only on federal election days (i.e. every three years)
<b>Results</b>	Will be binding if at least 25% of registered voters participate	Will be binding if at least 40% of registered voters participate
<b>Fiscal issues banned on referendums</b>	Taxes (both their bases and rates), amounts of public financing and the federal budget	State revenues and expenditures
<b>Other issues banned on referendums</b>	Same as existing legislation	Human rights; electoral matters; national security; and the organization, discipline and functioning of the Armed Forces
<b>Revocation of mandates of the President, governors and Mexico City mayor</b>		
<b>Proposal</b>	Can be proposed by a minimum 3% of registered voters, the President or one-third of either legislative house	Is not included in current legislation
<b>Date</b>	Will take place on the same date of federal elections of Lower House legislators*	
<b>Results</b>	Will be binding if at least 40% of registered voters participate and an absolute majority votes for it	

\*If the revocation of the mandate is proposed by either the President or one-third of either legislative house, it must be solicited in the first legislative session of the second year of the standing legislature.

Sources: Senate, Constitution.

**Looking ahead, should the Senate opposition continue to stand firm and withhold the nine votes that AMLO is missing today, it will be able to alter the current bill for the better** (as it did with the recent constitutional amendment to create a National Guard). In an encouraging sign, Senate Morena leader Ricardo Monreal this week was forced to abandon his plan to hold a floor vote on the bill as the opposition rebuffed all his attempts to muscle it through. We believe this bodes well for revisions that will improve the current bill. Foremost on the opposition's wish list is changing the date for the revocation of the mandate referendum to one that is different from that of the 2021 mid-term elections. However, other optimal changes would include limiting the number of referendums each year in order to avoid excessive costs, raising the bar for binding results and further limiting the scope of fiscal matters that could be allowed on referendums (i.e. trade deals, the use of international reserves, Banxico policy and energy reform could all be referendum topics under the current bill).

What happens in the next few weeks will be important to monitor. Should the four-party opposition bloc do its job, the bill would eventually be modified and then sent back to the Lower House for a vote. But if it were to splinter and fail, the President would chalk up another early victory in his long-term political game plan to extend Morena's dominance (for more background, see our 27 February 2019 note [Mapping the AMLO revolution](#)).

## 2. Education counter-reform

**The government's oft-repeated campaign vow to roll back education reform has hit some turbulence, too – this time from AMLO's allies.** As signs have grown that the AMLO administration is in favour of a modest to moderate rollback to this reform rather than a full-fledged reversal, the dissident teachers' union CNTE – which recently staged a one-month rail blockade in Michoacán state which caused supply chain shortages to the auto sector and other industries – has led the charge against the government on this issue. Section 22 of the CNTE slammed the bill for making only "cosmetic changes" while maintaining the "neoliberal intentions" of the 2013 education reform enacted by the Peña Nieto administration. It also successfully blockaded legislative entranceways and delayed Lower House committee votes for three legislative sessions in recent days in a bid to extract more concessions from the government.

But in its fourth attempt to stave off a vote, the CNTE failed. This Tuesday, both the Education and Constitutional Points committees in the Lower House approved the draft bill to revise the education reform (see Table 2 below for details) in a vote that itself exposed a rift in AMLO's allied base. Afterwards, while some defenders of education reform cheered the fact that the draft bill kept the essence of the reform intact, the CNTE roundly rejected the bill and vowed to stage more protests. Its announcement forced Lower House Speaker Porfirio Muñoz Ledo to cancel this Thursday's floor session, with the next session now scheduled for Tuesday (2 April). Afterwards, AMLO also waded into the fray, publicly instructing the Education Ministry to continue its talks with the CNTE even though he insisted at the same time that the government would not cede its current control of the teacher selection process and payrolls back to the unions.

**Although the initial signs from the government on the bill are heartening, the negotiations ahead will be key to watch.** Thus far AMLO has handled the CNTE with velvet gloves – in a clear attempt to distinguish his administration from his predecessor's. In addition to constant dialogue and an open door to Education Ministry officials, the government has thus far steered clear of using either the police or military to confront the protesting teachers. Yet part of the problem that the administration faces is that during AMLO's presidential campaign, he allowed the CNTE (and, in particular, the union's most radical sections from the southern states) to believe that he would indeed revoke the entire education reform should he win the election. Now, nine months later, the government must live with the consequences.

Looking ahead, the real test for the bill will once again come – not in the floor vote of the Lower House – but rather the Senate, where the opposition is stronger. Paradoxically, while AMLO's allied base has fractured on this issue, the government is hoping to convince the opposition PRI and PAN to support the bill on the grounds that it indeed maintains the backbone of Peña Nieto's reform. Important points to watch in the negotiation are: 1) whether teacher evaluations will continue; 2) whether a truly independent organ will assess them; and 3) how much power will ultimately be ceded back to teacher unions. The more modest the rollback is in the final text, the more positive it will be for investor sentiment; yet the more likely it is that a riled-up CNTE will stage more protests that could weigh on already slowing economic growth.

**Table 2: Key points of the education counter-reform proposal**

<b>Current draft bill</b>	<b>Existing legislation</b>
<b>Federal organ</b>	
<ul style="list-style-type: none"> <li>New decentralized federal organ with technical and budgetary autonomy will be created to conduct studies and diagnostic evaluations</li> <li>The current organ (INEE) will be extinguished</li> <li>Because the new organ lacks full autonomy, critics warn that it will be subject to more political pressures</li> </ul>	<ul style="list-style-type: none"> <li>A fully independent federal organ with its own budget – the National Institute for the Evaluation of Education (INEE) – is in charge of evaluating the quality, performance and results of the national education system</li> <li>The INEE is responsible for assessing teacher performance</li> </ul>
<b>Teacher evaluations</b>	
<ul style="list-style-type: none"> <li>While teachers must still undergo diagnostic evaluations, job security is fully guaranteed now, even if performance is poor</li> <li>But a certification process remains in place for teacher training in order to improve skills</li> </ul>	<ul style="list-style-type: none"> <li>Teacher evaluation tests are mandatory; salaries and bonuses are linked to student performance</li> <li>If the teacher fails three times, he/she can no longer teach but can be transferred to administrative duties</li> </ul>
<b>Competitive selection process</b>	
<ul style="list-style-type: none"> <li>Appears to maintain this process in general, similar to the 2013 reform</li> <li>But the criteria for the selection, promotion and bonuses of teachers is unclear, making this a key point to watch in the text or secondary legislation</li> <li>Another controversial point is that the National Union of Education Workers (SNTE) may have a big say in job promotions, in a partial return to the pre-2013 days</li> </ul>	<ul style="list-style-type: none"> <li>The 2013 reform established a competitive and merit-based selection process for all hires and promotions, ending the common practice of inheriting or selling posts</li> <li>This change was a huge blow to teacher unions, as they previously had full control over hiring</li> </ul>
<b>Teacher payroll</b>	
The government will retain control of this	The 2013 reform centralized this under the federal government, removing control from the states and unions
<b>University education</b>	
<ul style="list-style-type: none"> <li>A university education will be mandatory, universal and free for all students</li> <li>Critics warn this will add pressure on public finances and erode the quality of existing public universities</li> </ul>	Is not included in current legislation

Sources: Lower House, local press reports.

### 3. New labour legislation for NAFTA 2.0 (USMCA)

**Planned changes to Mexico's labour legislation that would address key NAFTA 2.0 concerns remain stalled in the Lower House but are set to be voted on next month.** As we highlighted last month, the new labour reform bill that the government is planning to pass is focused on the secondary legislation to guarantee workers' rights to organize and collective bargaining (as defined in the International Labour Organization's [ILO] Convention No. 98, which the Senate ratified last September). It will also set more detailed rules for the gradual creation and implementation of new labour courts, which will replace the current arbitration and conciliation boards.

**Yet with four different proposals being debated and considered by the Lower House Labour Committee, it is still unclear what the final version will look like.** Under the NAFTA 2.0 agreement, Mexico has agreed to adopt specific steps, including the renegotiation of all

collective labour agreements within four years to address salary and working conditions, a new independent entity to oversee collective agreements and the guarantee that workers will be able to cast personal, secret and free votes for union representation among other issues. Beyond these basic points, however, there are various sticking points for political parties.

These include: 1) whether freedom of association for workers will be institutionalized quickly or whether union leaders will continue to have the power to vet, select, veto and fire workers via exclusion clauses over a longer period of time; 2) what the parameters are for union representatives to be elected and how long their terms will be (one Morena proposal would centralize this process and allow workers a say in setting the duration of their union leadership's terms, while a PRI proposal would let each union set its own rules); and 3) the parameters and minimum threshold needed to initiate an official strike (Morena and the PRI have different proposals).

**While the outward rhetoric is all about enforcing workers' rights, there is a huge power struggle being waged below the surface** between new Morena-allied labour groups and the traditional PRI-dominated labour unions, as we have previously written. This means that what the final text says will shape the rules of the war ahead – with longer-term ramifications for workers and employers alike.

**According to a recent forecast by the President of the Lower House Labour Committee,** Congressman Manuel de Jesus Baldenebro Arredondo, the committee bill is likely to be finalized and voted on in the first half of April; this means the Lower House floor vote could take place before Easter. In a separate and positive signal for local businesses, Baldenebro Arredondo added that he is not planning to include a clause in the draft bill to sharply restrict outsourcing – a possibility that has sparked major concern among local businesses, especially as this is supported by several members of AMLO's allied base. Yet while the government has highlighted that restricting outsourcing is not a top priority at the moment, there is still great anxiety that a clause on this issue could still slip through in the final bill.

**Regardless of how it plays out, the timeline for the labour bill's passage in both houses of the Congress will be key to monitor** as it is seen as a prerequisite by several Democrats for the US Congress to be able to move forward for a vote on NAFTA 2.0 ratification. Assuming that the new labour legislation is passed next month, it will not be an issue; but if the vote in the Mexican Senate were to be postponed until after 30 April (when Mexico's current ordinary legislative session ends), the AMLO government would have to call an extraordinary session to pass it. Although this would be easy for the President to do, it could nonetheless elevate the political noise, stoking uncertainty in the US about the country's ability to meet its new labour rights commitments.

**Adding to the pressure, there are other demands stemming from US labour unions on Mexico.** In a Bloomberg interview last week, the President of the AFL-CIO, the US' largest federation of labour unions, said that the federation will oppose a vote on the trade deal unless Mexico first makes progress on three fronts – 1) the passage of its new labour laws; 2) a start to effectively enforcing that legislation; and 3) dedicated resources for its enforcement – alongside other changes that it wants to see. This dovetails with similar statements from other US labour unions that the enforcement mechanism in the new trade deal to raise Mexican wages must be beefed up. The silver lining to such demands is that the AMLO government is itself broadly in favour of improving workers' rights, raising wages and strengthening collective bargaining rights, so there is far less ideological resistance in these areas than was the case for past Mexican administrations. Even so, the devil will be in the details; and meanwhile, the odds are already falling for US ratification of NAFTA 2.0 this year.

# Uphill battle in the US Congress

**The optimal window for USMCA approval in the US is before the August legislative recess; if it is not passed by then, it could languish until after the 2020 elections.**

Meanwhile, the Trump administration must navigate a complicated obstacle course in order to persuade House Speaker Nancy Pelosi and a sizeable number of Democrats to vote for the deal, especially as the Democrats are understandably loath to hand Trump a "win" ahead of his re-election bid. The flip side of the coin is that Pelosi will only move to put the deal to a House vote if she is convinced that passing an altered deal will help the Democrats in the November 2020 presidential and legislative elections. But if the trade deal is not approved by the summer recess, it will run into more legislative complications ahead, notably the 2020 budget debate and the all-important US electoral calendar.

**Given the current political and economic headwinds and the quickly shrinking legislative window, we do not expect US ratification this year in our base-case scenario.** If so, this will have corresponding implications for Mexican asset prices, feeding market volatility, adding to ongoing investor uncertainty and likely capping already declining investment inflows. Still, investors should monitor the following four leading indicators to gauge the deal's progress (or lack thereof) in the critical four months ahead. These are:

1. **Starting gun in April – the ITC report.** The long-awaited report on the deal's economic impact by the US International Trade Commission (ITC) is currently expected by or around 19 April, after its publication was delayed by the 35-day US government shutdown. Once the ITC report is issued, the Trump administration can submit implementing legislation to the US Congress, where it will be sent to the relevant committees for discussion. However, the ITC report is unlikely to help Trump's case that it is the "most important trade deal" ever made by the US government. Many trade experts are predicting that, at best, the report will project only a minimal boost to economic growth and could even show a minor decrease. If this is the case, the deal will be an even a tougher sell ahead than it already is to Democrats, who are already clamouring for key changes to sections on labour, the environment, pharmaceuticals and enforcement before they can get on board.
2. **Removal of the Section 232 steel and aluminium tariffs on Mexico and Canada.** Another sticking point to ratification is the Trump administration's refusal to date to lift the 25% steel tariffs and 10% aluminium tariffs on its neighbours even after they signed the revised NAFTA deal on 30 November. Both Mexico and Canada this week once again urged the US to lift the tariffs – a move that has bilateral support from a growing number of Democratic and Republican legislators, including Senate Finance Chairman Chuck Grassley. While the Trump administration has offered to substitute the tariffs for import quotas, Mexico's Deputy Economy Minister Luz María de la Mora flatly rejected this proposal this Monday, arguing that they "make no sense" and "are not justified". Canadian Foreign Minister Chrystia Freeland went even further, slamming the tariffs as "illegal," "absurd" and "unacceptable". Both countries have also indicated that they could withhold ratification of the deal in their respective legislatures if the tariffs are not lifted.

As tensions have grown on this issue, US Treasury Secretary Steve Mnuchin told the Senate Finance Committee earlier this month that lifting the tariffs is part of the administration's plan to pass the trade deal. Meanwhile, bills to rein in Trump's ability to use Section 232 tariffs are also being drafted, ratcheting up the pressure on this front

too. Assuming the tariffs are – sooner or later – eliminated, one key obstacle to the deal's ratification timeline would be removed. Yet the clock is ticking on this issue; and the longer it takes the Trump administration to finally lift the tariffs, the harder it will be to finalize other complex negotiations that are also needed to secure support for the deal.

3. **Eventual shift in stance from labour groups and moderate Democrats?** Support from the Democratic party's core constituencies – notably the AFL-CIO and moderate Democrats – will be paramount to gaining sufficient Democratic votes in favour of the agreement. Because a change in these groups' current oppositional stance could be the catalyst that would allow Speaker Pelosi to green-light a floor vote, this is a vital indicator to monitor. Still, as we underlined above, the AFL-CIO has already warned that it will oppose USMCA approval unless changes are first made to key issues, including the enforcement of key labour and environmental provisions, the arbitration process, intellectual property and pharmaceuticals. This means that if the labour federation were to change its tune and announce its support for a "yes" vote, it would be a positive sign for the ratification process. But before this can happen, there is still a lengthy negotiation process to be completed.
4. **Threat of NAFTA withdrawal.** US President Trump has time and again threatened to initiate the six-month timeline for a formal withdrawal from NAFTA to force the Democrats' hand in fast-tracking the new deal. While this option remains on the table, it is a high-risk process that could easily backfire against the Trump administration at a time of already slowing US growth. Also, because there is rampant legal uncertainty as to whether the executive branch has the unilateral power to withdraw from the trade deal, any move of this sort is likely to end up in the courts. In our base case, we expect some form of NAFTA to continue even if Trump were to take the nuclear option (i.e. a "zombie" NAFTA via court order). Even so, such a development would exacerbate the near-term outlook for Mexico, aggravating market volatility, weakening the peso and raising the odds of future rate hikes from Banxico aimed at stemming a currency rout.

## Conclusion

**Despite slow advances in the Congress this month, the AMLO government retains the strong upper hand in the legislature.** The recent lack of progress on its top priorities should therefore be seen as temporary obstacles only and not real setbacks. The good news is that if the Senate opposition can continue to act as a proper institutional counterweight – refusing to pass contentious constitutional amendments unless key changes to the text are made first – not only will the quality of the legislative debate over AMLO's *sexenio* be enhanced; ultimately, investor worries about eroding institutions in the era of AMLO's imperial presidency could be partly alleviated as well.

How long the opposition can remain united is another question altogether. For now, the signs bode well on the issue of nationwide referendums, but the education counter-reform remains a key test ahead. The vote count for AMLO's legislative base and the opposition alike will be instructive to watch, as a chess game of shifting alliances and unexpected choices or betrayals could easily emerge. And while our hope remains that the final education reform rollback will only be a mild one, the economy could take a further hit this year if the CNTE step up its strikes and blockades as a result.

**In the meantime, headwinds from the NAFTA 2.0 timeline for ratification in the US**

**Congress will likely begin to cloud market sentiment in Q2/19.** With the clock quickly ticking down north of the border, the odds are proportionately declining for ratification of the deal this year, as we underlined above. This means that even if there is ultimately positive news on the removal of the Section 232 steel and aluminium tariffs on Mexico and Canada, it could come too late to make a big difference. The upshot is that – unless there are major breakthroughs soon – the market will increasingly begin to price in the likelihood of a delay on the deal's ratification to 2021, which would have negative implications for investor confidence and the Mexican economy over the next two years.