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How a Divided Congress Could Affect Trade

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KEY POINTS:

- **A divided Congress will make progress on any policy initiatives, including trade, difficult.** Moreover, hinted distractions of Congressional investigations could compromise any focus on trade policy.
- **President Trump views the resounding Senate win as a validation of his policies,** including trade, **and will be emboldened to continue to adopt a hardline approach** in upcoming trade talks with the EU and Japan and in dealing with China.
- **Democratic takeover of the House is expected to complicate USMCA approval** as Democrats push for additional labor and environmental commitments upon the backdrop of a possible Trump withdrawal to pressure for passage.
- The outcome **will not mitigate US-China trade tensions,** although Democrats may choose to politicize the impact of “Trump tariffs” on constituents.

Political Analysis

Yesterday's midterm elections resulted in **Democrats gaining control of the House and Republicans expanding their majority in the Senate,** leading to a divided Congress. As of Wednesday morning, Democrats had won 222 seats in the House (218 is needed for control), with 14 races still to be called. Meanwhile, Republicans are poised to gain up to three seats in the Senate, affording a comfortable 54-seat majority. **A Democratic controlled House should lead to increased oversight of the Trump administration and potential gridlock between the two chambers, complicating progress on policy initiatives.** Some House Democrats on oversight committees have already begun calling for subpoenas into the President's tax returns and further investigations.

Voters were split on President Trump's trade policies. CNN's [exit poll](#) found about a third of voters said new tariffs imposed on foreign countries and NAFTA updates had no impact on their local economy, 30% said these trade policies have hurt them, while about a quarter said they benefited from Trump's trade policies. As he held rallies in key battleground states leading up to the election, **Trump's closing campaign arguments included holding China accountable for its trade practices, attacking auto imports, and highlighting the USMCA as a win for American workers. In his Wednesday press conference on the midterms, the President reinforced the importance of USMCA and his 232 steel and aluminum policy.**

Starting today, House Democrats and Republicans will launch **leadership races**. By the end of the week, the field of candidates for top posts will narrow. Nancy Pelosi likely will be elected Speaker of the House. Democrats largely campaigned on healthcare, immigration, and investigating the Trump administration, leaving trade as a lower priority issue. Republican leadership is less certain.

Two key congressional committees with jurisdiction over trade are House Ways and Means and Senate Finance. With Democrats taking control of the House, **Rep. Richard Neal (D-MA) will likely take over Ways and Means**. Neal has a pro-trade voting record, including support of South Korea and Peru FTAs. **He is known as a dealmaker who could help shepherd a bipartisan vote in favor of ratifying USMCA**. Rep. Bill Pascrell (D-NJ) will likely take control of the Ways and Means Subcommittee on Trade. He has a mixed record on trade but is expected to work closely with Neal.

Ways and Means is currently composed of 24 Republicans and 16 Democrats. Democrats are expected to balance this out, with 10 of the 24 Republicans not returning to Congress and only 2 of the 16 Democrats returning. **The Democratic leadership will have the opportunity to fill this powerful Committee with a host of new faces, although we do not believe this will cause a notable shift in US trade posture toward China or other trade issues.**

Although Republicans have retained control of the Senate, Senate Finance will see changes regardless with the retirement of current Chairman Orrin Hatch (R-UT). Agriculture-friendly **Senator Chuck Grassley (R-IA) is favored to chair the Committee**. Grassley was previously ranking member and chair of the Senate Finance Committee 2001-2010. New faces are also expected on the Committee as Dean Heller (R-NV) and Claire McCaskill (D-MO) lost their re-election bids.

A Check in the House, but Endorsement in the Senate

President **Trump made clear in his press conference today that he views the midterms as a validation of his policies, including trade**. Given the successful completion of trade negotiations with Korea, Mexico, and Canada, as well as the unorthodox use of Section 232 and 301 tariffs as a tactic to bring partners to the negotiating table, we expect the administration will **continue undeterred in its trade policies**, despite Republican loss of the House of Representatives.

Potential Impact on USMCA Ratification

Trump and Lighthizer believe that the USMCA's labor and environmental provisions, the inclusion of wage-levels as a component of Rules of Origin, and the limitation of ISDS should contribute to Democratic support of the agreement, expected to move forward under TPA rules for congressional approval in March 2019. Certainly, Democrats and Republicans began to grasp the downside of walking away from the integrated North American market during the 13 months of NAFTA renegotiations. However, **trade votes are always difficult for Democrats**, to say nothing of a Trump-branded agreement. Hard-to-ignore labor unions and environmental groups are already agitating for additional concessions.

Both to pressure for passage and to show strength, it is **possible that President Trump would withdraw from the agreement** next year under NAFTA Article 2205, starting a 6-month clock after which the United States may exit the deal. The stark choice between blowing up intertwined North American supply chains and taking a hard trade vote should push Congress to approve USMCA, though with some drama attached. House **Democrats are already foreshadowing an effort to revive/reinforce the types of commitments made in the bipartisan “[May 10th Agreement](#)”** from 2007, which gave Democrats cover to vote on Bush-era FTAs. Representative Levin (R-MI), an original May 10 co-author, has stated, “The challenge became to take the clear language in May 10, which was a breakthrough, and make it real.” This will take time and political capital. But as US farmers and ranchers continue to suffer under 232 and 301 retaliatory tariffs, **preserving free trade in North America should be a (reluctant) priority of most lawmakers, despite intense political pressure.** Republican control of the Senate should help.

Potential Impact on US-Japan Trade Negotiation

There appears to be **divergence in interpretation of the September 26 Joint Statement.** Japan continues to emphasize that this is merely a Trade Agreement on Goods, with the US respecting Japan’s previous agreements’ limits on market access for agriculture. Meanwhile, Agriculture Secretary Purdue has stated that he wants improved concessions. Services were mentioned in the joint statement, but it is unclear how/if/when services would be included. There is **pressure on the US side to expand the scope.** In addition, the **Japanese Government hopes to resolve potential 232 auto tariffs** – and potentially steel and aluminum – through this process. Meanwhile, Trump mentioned Japanese auto tariffs in his Wednesday press conference, and autos will be sensitive for Democrats as well.

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (**CPTPP**) has now been ratified by six countries (Australia, Canada, Japan, Mexico, New Zealand, and Singapore) and will enter **into force December 30, 2018.** The **Japan-EU Economic Partnership Agreement is on track for Q1 2019** start date. This means **American exporters – especially farmers – will soon be significantly disadvantaged vis-a-vis CPTPP and EU trading partners.** This will lead to **pressure on the administration and Congress to move quickly** on the US-Japan talks, all among uncertainty over coverage.

Meanwhile, Japan prefers a narrow scope and likely a more gradual pace. The debate over the reach and speed of the negotiations should be clarified somewhat when the administration is expected to present its **negotiating objectives in mid-December.** With Senator Grassley likely taking the reins of Senate Finance, the impact of lobbying by the agricultural community is expected to be significant.

Potential Impact on US-EU Trade Negotiation

The US-EU talks are likely to first focus on a few key regulatory areas, and then on a zero tariffs industrial goods accord, likely minus autos. This scenario is somewhat dictated by the EU’s own political calendar, which includes the upcoming European Parliament elections in May 2019. But it will raise concerns in Congress about the lack of inclusion of agriculture. Thus, as with Japan, the possible enhancement of the **agricultural sector’s voice**, should Grassley take over Senate Finance, will be **important. The Europeans initially stated that agriculture would be outside the scope of negotiations** agreed in

July between Trump and EU President Juncker. The EU has since hinted that non-tariff barriers for agriculture could be included, except for phyto-sanitary (i.e. GMOs, beef hormones), but not agricultural tariffs. The **US already is trying to edge agricultural market access onto the table, and this should intensify.**

Potential Impact on US-UK Trade Negotiation

US-UK trade negotiations are expected to start after Brexit Day on March 29, 2019. However, the UK is expected to be in a transition period at least until December 2020, and unable to sign any accord. It is possible that the UK will try to negotiate trade accords with both the US and EU simultaneously. The scope of these accords is expected to be ambitious. However, given the long and uncertain timeline, **the impact of the new Congress will be limited.**

Potential Impact on US-China Trade

House Democrats are likely to be sympathetic to Trump's hardline approach on China and may raise the heat on declaring China a currency manipulator, a favorite talking point of Senator Schumer (D-NY) over the years. The deployment of tariffs in the China battle may come under Democratic scrutiny, however, with many mid-term candidates railing against the economic impact of "Trump Tariffs." However, this line of argumentation was not consistently successful, as in the case of Senator Heitkamp's loss in North Dakota.

Meanwhile, the **future of China talks**, next scheduled on the margins of the G-20 in Argentina at the end of the month, are **unclear**. In Trump's Wednesday press conference, he erroneously stated that "China got rid of their China '25 because I found it very insulting," leaving **questions as to the next move in the resolution of the 301 dispute** over Chinese intellectual property practices. Experts agree that **China is unlikely to give up its industrial policy roadmap** of Made In China 2025, but believe there is room for China to ease forced technology demands, speed up market opening to foreign investors, further improve IP protections, and significantly ramp up agriculture and airplane purchases to address the deficit. We may see a shift in focus to these IP issues vs. the tariff war, although the **midterms will not dissuade the President from issuing the next tranche of retaliatory tariffs against China.**

Many Democrats were **critical of President Trump's decision to ease sanctions on ZTE and may be on lookout for other "bad actors."** We also expect a **push for clarification of the China endgame strategy.**

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