

# Re-engaging with NAFTA in the 21st Century: A Mexican Perspective

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# Introduction

- ❖ The 2017 NAFTA renegotiation proposed by United States has been an intense 7 rounds process generating uncertainty along the way, but also a hope to revitalize North American integration to the XXI century trade dynamics.
- ❖ The attempt of modernizing NAFTA was not a surprise for the three countries. Over the past years, the slowdown of the economic integration of North America given several factors such as the 9/11, the Chinese entrance to the WTO, the Great Recession, and just the sheer passage of time led the three countries to look for new ways to revitalize regional trade. Attempts such as the SPP initiative, or the TPP were formulas to modernize NAFTA.
- ❖ However with the decision by the new US administration not to ratify the TPP, the three countries have a new opportunity to modernize NAFTA, but the process has been difficult given the protectionist leanings of the US administration .
- ❖ Although the restrictive and protectionist views of US administration have created uncertainty to Mexico and Canada, and even if we recognize that NAFTA could potentially fail, the baseline of this presentation is that the parties will reach an agreement on a revised treaty by the end of 2018 that will include updated and essential disciplines for the 21st century trade based on the provisions embodied in the TPP as a starting point. Nonetheless, this presentation considers three possible scenarios in case the baseline isn't achieved: 1) a revised NAFTA treaty for mid-2019, 2) a withdrawal of US from the Agreement which will make WTO rules and tariffs applicable to Mexico-US trade and the NAFTA for Mexico-Canada trade, 3) the third case might be that US applies barriers to trade higher than the allowed in the WTO framework that will unchain potentially escalating tariffs.

# Introduction

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❖ This presentation:

1. Examines the importance of NAFTA and trade relations with United States to Mexican trade.
2. Next, it identifies Mexico's official position, objectives and interests in the renegotiation for NAFTA 2.0.
3. Finally, it will discuss what might be the scenarios and effects for Mexico in case of a US withdrawal from the negotiating table.

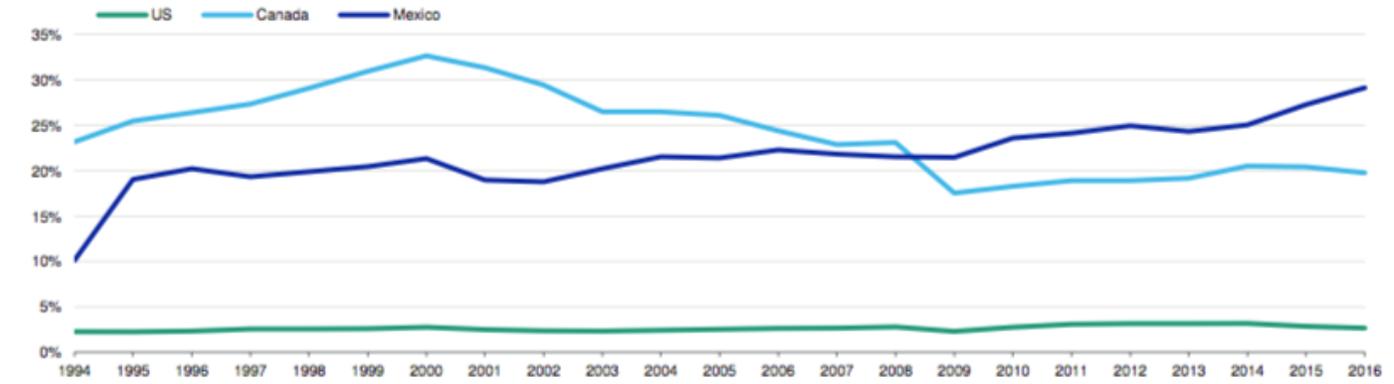
# Importance of NAFTA

NAFTA has been a key element for Mexico's economy

## TRADE

- ❖ Trade between NAFTA partners grew substantially since 1993 to 2016 at an annual rate of 6% from 288.5 billion dollars to 996.1 billion dollars.
- ❖ Mexico-US trade went from 85.2 to 473.6 billion dollars with an increase of 5.6 times the value of trade. Mexico-Canada trade went from 4.1 to 34 billion dollars which means an increase of 8.5 times the value.

NAFTA has the largest footprint on Mexico's economy  
Merchandise exports to NAFTA trading partners, % GDP

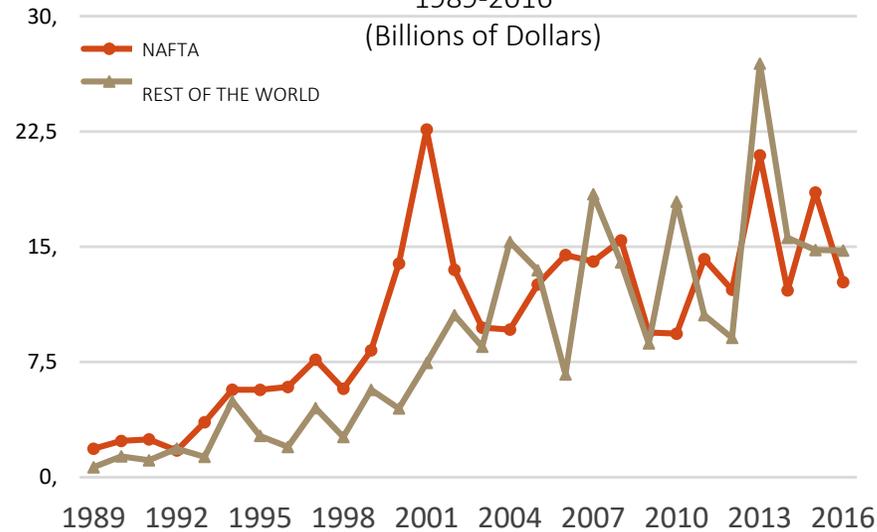


Sources: IMF DOT and Haver Analytics

Trade between NAFTA Partners  
1993-2016  
(billions of dollars)



FDI Flows to Mexico  
NAFTA and the Rest of the  
World  
1989-2016  
(Billions of Dollars)



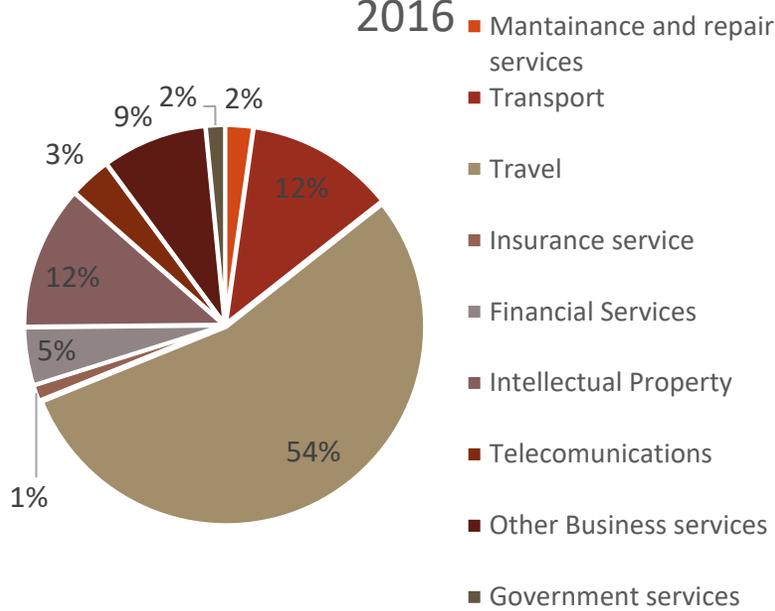
## Mexico-US Foreign Direct Investment

- ❖ The investment flows of Mexico, grew particularly the first 8 years.
- ❖ The United States is the main investor in Mexico with 213,533.9 million dollars, which represents 46% of the accumulated FDI in the period 1999 – 2016.
- ❖ 48.9% of the investment went to the manufacturing sector.

Source: Prepared by the author on the basis of data from Secretary of Economy, Foreign Direct Investment Office, 2016.

## Mexico's services imports from US

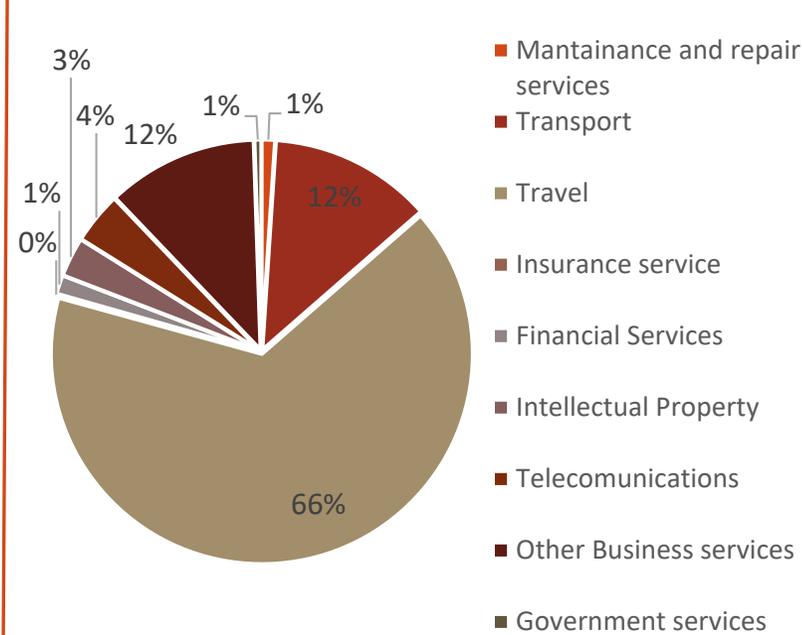
2016



Source: Prepared with data form U.S Bureau of Economic Analysis

## Mexico's services exports to US

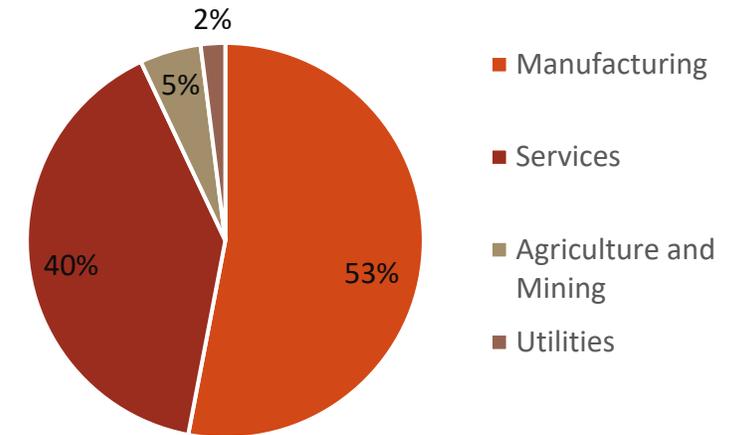
2016



Source: Prepared with data form U.S Bureau of Economic Analysis

## Mexican Exports to US by type

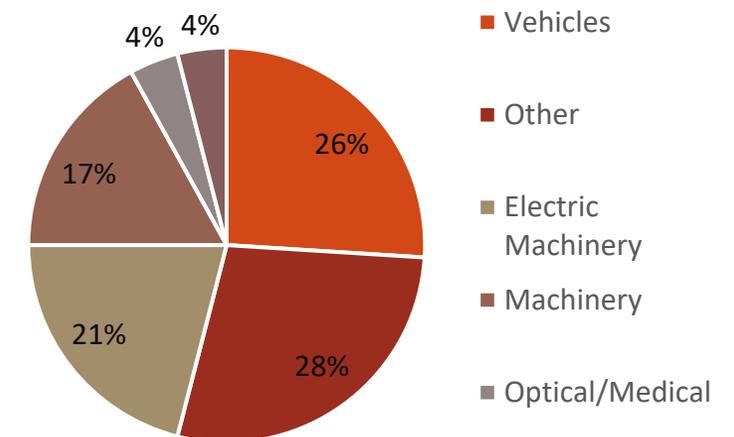
2017



Source: WTO (2017)

## Mexican manufacturing exports to US

2016 (% of total)



Source: USTR (2017)

Source: Prepared with data from U.S. Bureau Census, Foreign Trade Statistics; Trade Data Online, Industry Canada; Mexican Secretariat of Economy.

## ❖ Mexico-US Trade

❖ 80% of the 370 billion in goods and services exports go to United States. Mexican exports to the US are concentrated in manufacturing, specifically in vehicles and machinery which account for nearly two thirds of the manufacturing exports. Within NAFTA , Mexican manufacturing exports to US and Canada grew 8 times.

❖ Exports are equal to 25% of GDP of Mexico. Specifically, the automotive industry contributes at least 20% of manufacturing GDP which means a reduced access to US market would impact the Mexican economy.

# Mexico's Priorities for "Modernizing" NAFTA



# How to modernize NAFTA?

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The objectives set by the three countries stated that NAFTA can be updated and add essential disciplines for 21st century trade

Deepening NAFTA	Additions
Investment	E-Commerce
Financial Services	SMEs
Telecommunications	Competition
Intellectual Property	Regulatory Coherence
Environment Standards	Development
Labor Standards	Anti-Corruption
State Owned Enterprises	Customs and Trade Facilitation

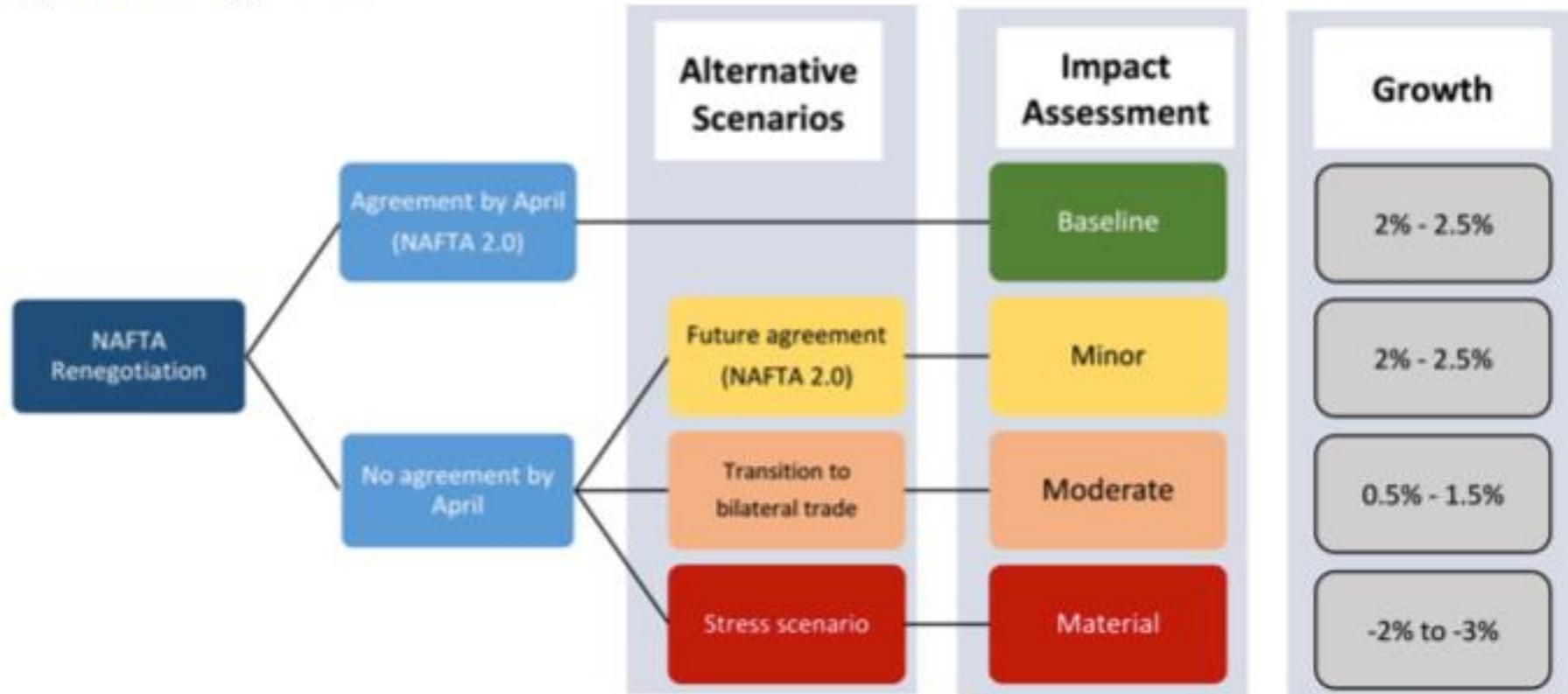
## Poison Pill Proposals for NAFTA and Mexico's Position

### Poison Pills for NAFTA:

- ❖ **Eliminating Trade Deficit** → Mexico believes that rebalancing trade should be by expanding it not restricting it.
- ❖ **Dispute Settlement** → Chapter 19. Mexico wants to maintain it. Mexico also agrees to modifications on Chapter XI and XX that could improve the Agreement.
- ❖ **Rules of Origin** → Mexico wants to avoid destroying regional supply chains, particularly in the automotive sector.
- ❖ **Government Procurement** → Doesn't want a reduced access. A dollar to dollar not a big issue.
- ❖ **Auto transport** → Maintain the commitments of NAFTA.
- ❖ **Restrictions to Agriculture** → reject managed trade.
- ❖ **Sunset Clause** → Mexico will not accept a clause that generates uncertainty.

# Potential Scenarios in the NAFTA Renegotiation

Our alternative scenarios consider the implications of no April agreement  
Scenario analysis of NAFTA renegotiations



Source: Moody's Investors Service

# Elements to Consider for NAFTA 2.0

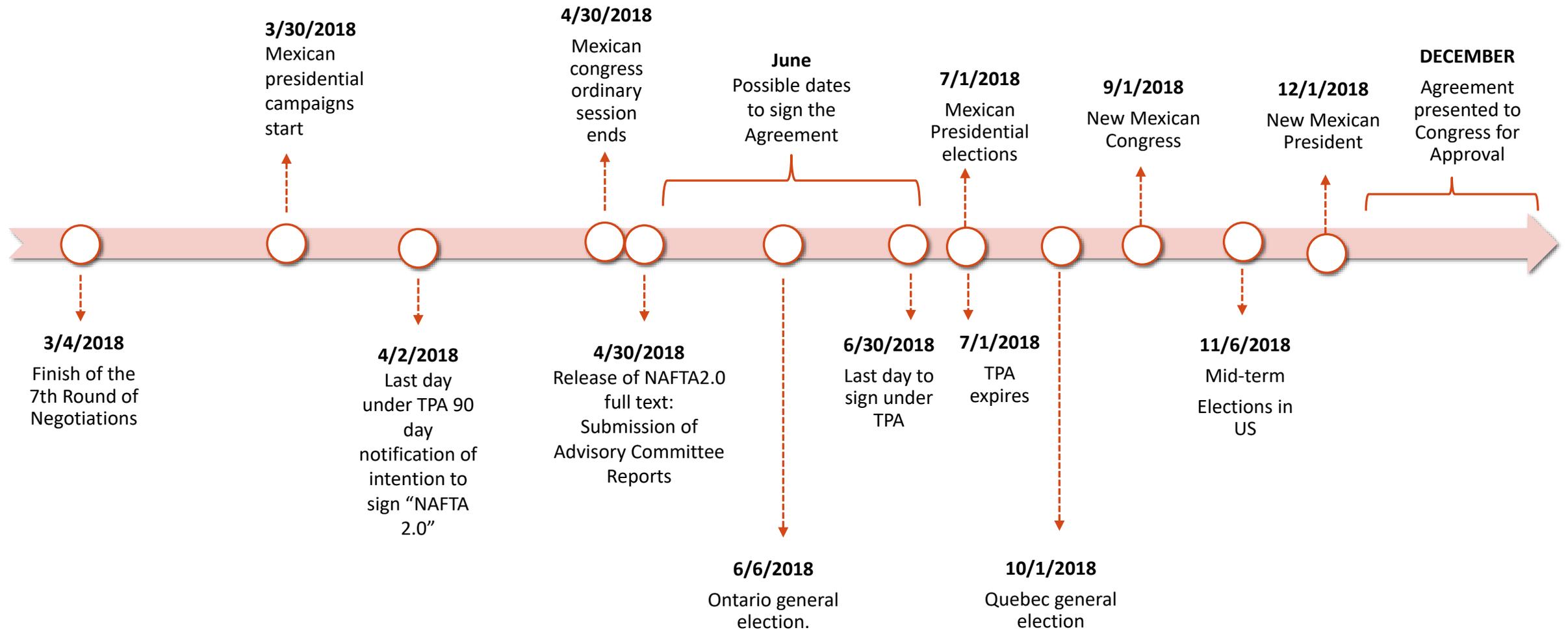
**Overview of NAFTA negotiation** → 7 rounds with 6 chapters and 4 Annexes from the 30 Chapters completed. Although, some Chapters are already with 1 or 2 obstacles to be finished.

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## Mexican Context

- ❖ **Mexican Private Sector** → They are eager to have a successful NAFTA and want to finish negotiations by the end of March 2018 to give certainty to trade and investment in Mexico. Moreover, there has been a constant lobbying to achieve a positive outcome.
- ❖ **Mexican Government** → Government has declared several times that they will not compromise negotiations for electoral reasons, There is pressure, but they are eager to continue working on negotiations. There is a clear possibility of achieving results before elections only if they finish before the end of March 2018.
- ❖ **Legislative Scenario** → After the release of the text and signing the treaty, Mexico has to send it to the Senate for approval. The Senate finishes activities March 30,2018. Although the current legislative scenario has majority from the party in power (PRI), internally there is pressure from other political parties to continue the negotiations for next year until a new Mexican president is elected.

# Relevant events for NAFTA Negotiations



# Potential Scenarios of US withdrawal from NAFTA

## Scenario of a Delayed NAFTA

- ❖ If Parties don't achieve a result for 2018, the negotiation might need to be suspended after election season.
- ❖ In the case of Mexico: presidential and Congress elections are in July 1st with new Congress by September 2018 and new President by December 2018.
- ❖ Countries are expected to continue the process and achieve an updated NAFTA by mid-2019.
- ❖ Mexican presidential candidates have manifested its interest in continuing negotiations.
- ❖ Engagement of Mexico, Canada, and the United States will reduce uncertainty.

## US Withdrawal with escalating bilateral tariffs

- ❖ A scenario where US impose tariffs much higher than WTO MFN rules, additionally to the non-tariff trade barriers might incentivize Mexico to respond to a tariff increase as well in sensitive sectors for US.
- ❖ Given that Mexican economy is not diversified, the economic impact in this scenario is highly negative with a fall in Mexican exports, and foreign direct investment.
- ❖ Moreover, the uncertainty regarding policymakers actions will damage business and consumer confidence.

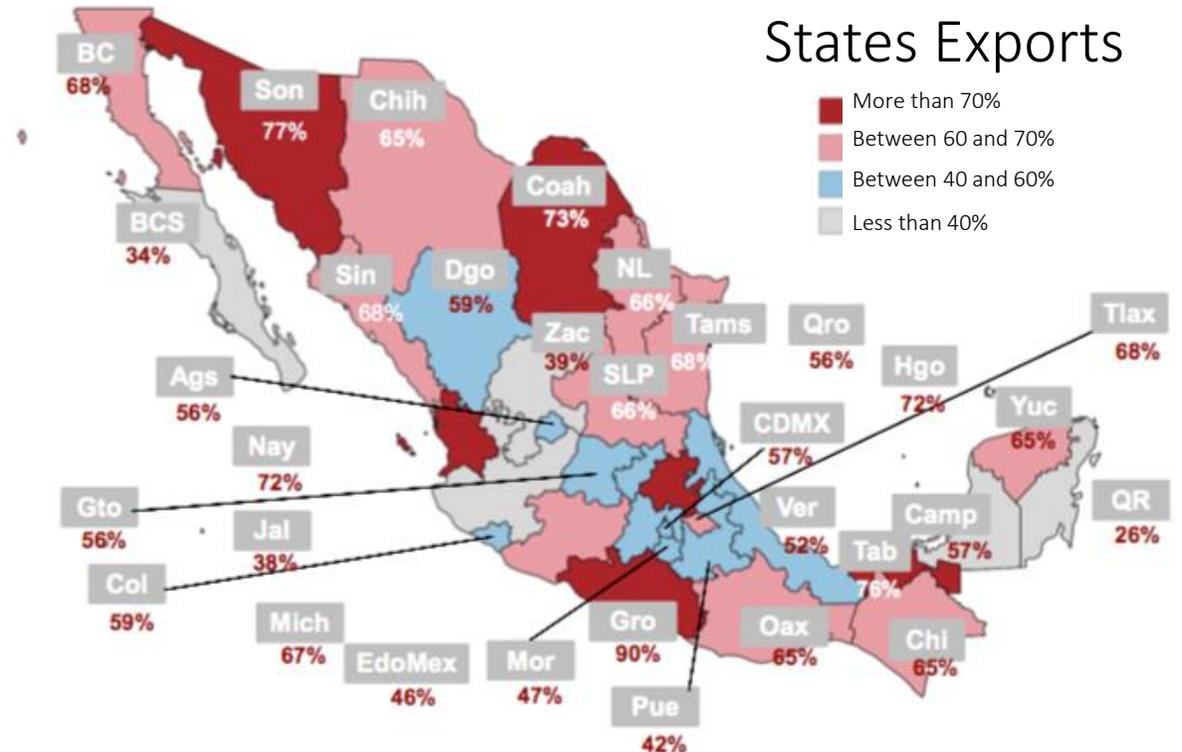
## US Withdrawal of NAFTA under WTO Rules

- ❖ US- Mexico trade relations will be regulated by the WTO rules. While Canada-Mexico trade relations are expected to continue using NAFTA.
- ❖ There will be negative trade and investment implications for Mexico especially in the manufacturing sector. Higher average tariff levels could decrease competitiveness of Mexican exports to the US.
- ❖ The end of NAFTA might cause the peso to depreciate given the reduced expected demand for the peso in trade transactions.

# Implications of a US withdrawal of NAFTA

❖ Mexico will face major challenges in their economy.

US Participation in Mexican States Exports



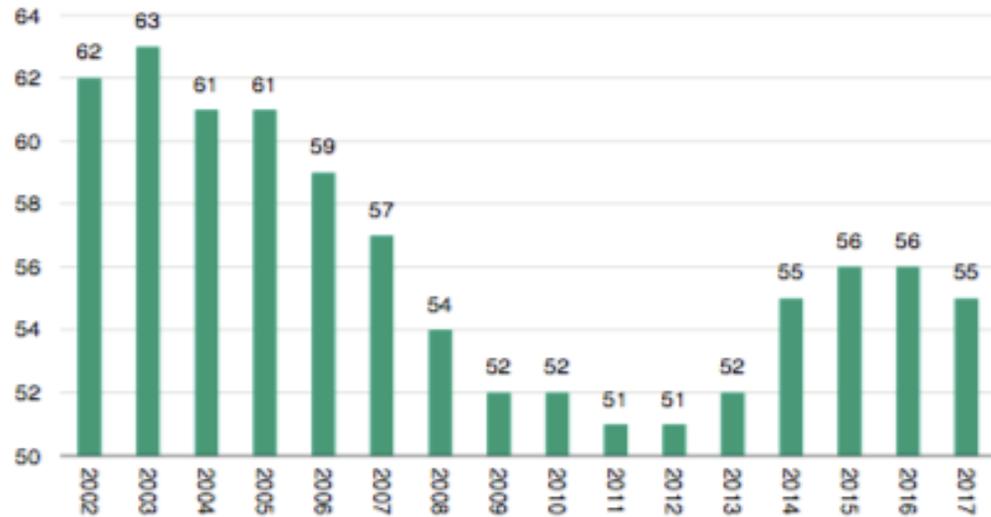
Source: Translation with data from IQOM Comercial, Instituto Nacional de Estadística y Geografía (INEGI) and Secretaría de Economía

❖ What will happen to the handful of Mexican States that depends on exports and FDI of US? The most vulnerable states include Chihuahua, Coahuila, Nuevo Leon, Tamaulipas, and Sonora, among others.

# Implications of a US withdrawal of NAFTA

	Trade	Investment	Intangible
Potential Actions and scenarios for US and Mexico trade relations	❖ MFN Tariffs of US would apply an average tariff of 3.5% while Mexico will apply an average tariff of 7.1% to imports from the US.	❖ Loss of investment and dispute settlement system provisions within the region.	❖ The uncertainty and the loss of a structural framework for Mexico and United States relations have sociopolitical, business and consumer confidence implications.
Industry implications	❖ The automotive, electrical machinery are the highest expected costs of tariffs in spite they don't have high US import tariffs. Apparel, seeds and fruits, tobacco, are sensitive to an increase of US tariff. In total there are around 50 industrial sensitive products.	❖ Investment in Mexico might suffer a reduction especially heavy manufacturing given the lack of provisions that generated certainty and preferential access to the North American Region.	❖ Government procurement, intellectual property and investment provisions will be lacking affecting major industries. ❖ Consumer and business confidence will fall and affect domestic activity.
Effect	❖ Mexican exports might be less competitive with non-tariff barriers, and administrative procedures. Moreover, the loss of preferential trade access would undermine a competitive position of Mexican exporters.	❖ A reduction and uncertainty in investment. Already in 2016, Mexican Central Bank estimated that foreign direct investment dropped 4.4 billion given the investor's perception of NAFTA uncertainty.	❖ Mayor economic implications, Mexico and United States relations transformed. Although, Mexico will continue to diversify into other markets.

### Share of Mexican exports to the US governed under NAFTA % of total



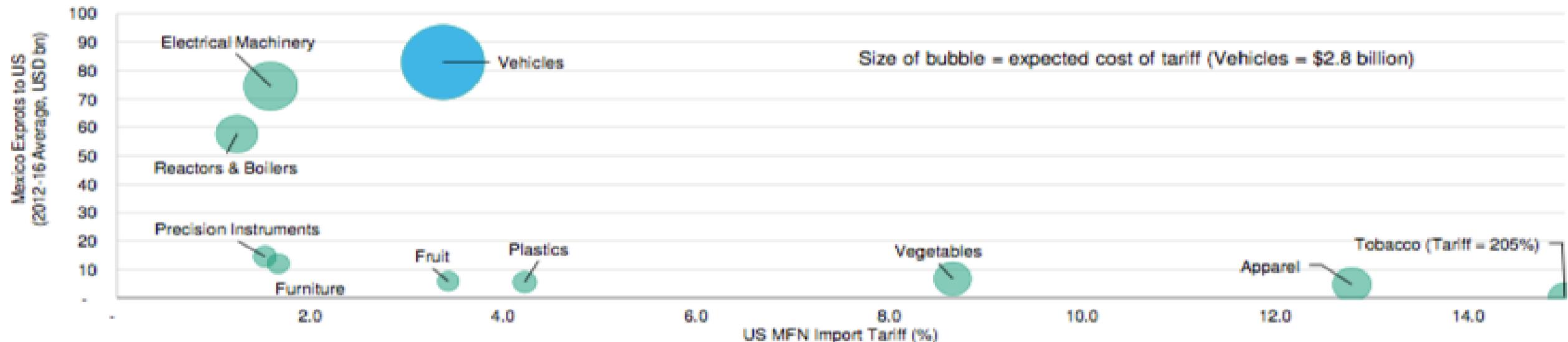
Source: World Trade Organization

- ❖ 80% of trade from Mexico goes to US. 55% is governed by NAFTA and 45% under WTO rules.

- ❖ Electrical machinery and vehicles are the ones with the highest expected costs due to high volumes of exports.

- ❖ However, the most sensitive industries for an increase in tariffs are tobacco (205%), apparel, (12.8%) and agricultural products such as vegetables, and fruit.

### Expected tariffs faced by Mexican exports to the US



# Mexican Alternatives to NAFTA

With NAFTA Mexico transition from one of the world's most protectionist economies to one of the most open to trade. Now, Mexican government maintains a vision of free trade, continuing the implementation of structural reforms, strengthening the Rule of Law, and creating certainty to national and foreign investors at a US NAFTA withdrawal.

Approaching Asia Pacific  
CPTPP

Strengthening the  
Pacific Alliance  
Beginning negotiations with  
their "associated members"  
Canada, Australia, Singapore  
and New Zealand



Update trade  
agreements  
European Union, and EFTA

Increase access with  
other partners  
Brazil and Argentina

# Conclusions

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- ❖ Given the proximity, the historical background and multiple initiatives related to security, migration, or trade such as NAFTA, North American region have created strong links that continue to be relevant in the 21<sup>st</sup> century not only economically, but even as a national security issue.
- ❖ The possibility of a positive outcome for NAFTA seems more than possible despite the political turmoil, and multiple declarations from Trump. An example of this are the approaching election campaigns, and the US protectionist trade policy actions such as the tariffs on imports of steel and aluminum which excluded Mexico and Canada that shows a positive indication of our close relations and puts even more pressure to finish negotiations successfully sooner than later.
- ❖ However, given that a possible scenario of a US withdrawal from NAFTA could occur, Mexico has maintained a trade diversification strategy to protect their foreign direct investments, and exports. Nonetheless, the negative impacts that a withdrawal envisage for the Mexican economy demonstrate that political willingness, checks and balances inside the three countries continue to have weight in today's negotiating process.
- ❖ NAFTA current negotiations as well as the objectives stated by Mexico, United States, and Canada seems to be leading successfully towards new provisions –particularly related to the TPP- that will modernize trade relations of the North American region for the future. The question resides, will NAFTA becomes the floor for next generation trade Agreements?