Regulating for Globalization

Trade, Labor and EU Law Perspectives

Whither NAFTA? (Part VI: The Analytics of the Mexican Handshake)

Jorge Miranda (Cassidy Levy Kent LLP) · Monday, September 10th, 2018

This the sixth post in a series of posts commenting on the NAFTA renegotiation process. For Part I click here, for Part II click here, for Part III click here, for Part IV click here, for Part V click here.

- The terms of the bilateral agreement reached by the United States and Mexico on August 27, 2018, as per public statements released thus far, are summarized in Part V of Whither NAFTA?
- Throughout the renegotiation process, Mexico kept on rejecting every proposal tabled by the United States. Being always on the defensive mode prevented Mexico from coming up with proposals of its own that would have further boosted exports from the United States (thus narrowing the bilateral U.S. trade deficit with Mexico, the purported fundamental objective of the NAFTA renegotiation from the U.S. perspective), without affecting the terms Mexico gained in NAFTA 1.0. In particular, Mexico could have offered to bring its applied tariff rate (nearly 7% on average) much closer to its WTO-bound tariff rate (36% on average).[1] Since all of the countries with which Mexico has signed a FTA would have been exempted from this tariff raise (perfectly in compliance with WTO rules), Mexico's imports would have been massively redirected towards FTA partners (the United States, mainly) and away from countries lacking a FTA with Mexico (China, for instance). Fast-track FTAs modelled after the CTPP could have been offered where needed to broaden the pool of FTA partners (for example, to bring Korea into that pool). Crucially, to the extent FTA partners supply imports that are substitutes of imports from countries lacking a FTA with Mexico, the price effects, and the adverse impact upon domestic consumers, of this upward adjustment in Mexico's applied tariff rate would have been negligible.
- Thus, as it lacked its own proposals, to arrive at a bilateral settlement with the United States Mexico largely ended up accepting the U.S. proposals that would do the least harm to Mexico's interests as *quid pro quo* for rejecting the U.S. proposals that would do the most harm to Mexico's interests. In other words, Mexico agreed to play with the deck of cards picked by the United States and within this context won a few hands and lost others.
- Fortunately, one part of the U.S. deck of cards that is evidently a win for everyone is the adoption of chapters on labor, the environment and digital trade, as well as rules on geographical designations. So is the strengthening of the chapters in the original NAFTA on IP, financial services and SPS measures. For the most part, these improvements in NAFTA 2.0 as compared to the original NAFTA were borrowed or else inspired by the TPP.
- As reported by press sources, the original "sunset clause" proposed would have terminated NAFTA 2.0 if five years after going into effect the parties did not come into an agreement

regarding its extension. According to the "sunset clause" that was reportedly adopted, NAFTA 2.0 would be terminated at the end of year 16, absent an extension. So the final version of the "sunset clause" was more flexible than the original version. In addition, if additional reviews can be launched subsequently to the six-year review, it might be possible to prolong the life of NAFTA 2.0 for longer than 16 years.

- The implementation of the new regional content rule in autos, which reportedly increases regional content from 62.5% to 75%, obviously will force at least certain car producers located in Mexico to re-organize their supply-chains to source a higher proportion of parts and materials from regional suppliers.[2] Importantly, the requirement that 40%-45% of auto content be made by workers earning at least US$ 16 dollars per hour is not likely to pull Mexican industrial wages up to this level. What it is likely to do instead is to establish a *floor* to the auto content originating in the United States and Canada (assuming Canada does join NAFTA 2.0), because it is only in the United States and Canada that North American industrial workers making parts and materials for automobiles earn at least US$ 16 dollars per hour. Should Canada in the end decline to join NAFTA 2.0, then this 40%-45% figure would translate into a floor for auto content originating in the United States. Reserving a certain proportion of regional content for a particular member country (or countries) would be a historical first in a FTA.
- This huge concession on the part of Mexico might have been in exchange for the United States undertaking to exempt Mexico from any future 232 measures on automobile imports. In fact, the Mexican press has reported that there is a "parallel letter" that commits the United States to do so. Whether such exemption is only in respect of a certain export volume is unclear at this point.
- In my opinion, scrapping Chapter Nineteen of the original NAFTA is a welcome development. I explain the reasons for this conclusion in a forthcoming Post.
- While limiting the protection available to foreign investors under the dispute settlement provisions of Chapter Eleven cannot be a good thing, safeguarding recourse to a full Chapter Eleven for oil & gas, energy and telecoms (as the press has reported) has the effect of preserving such protection for the sectors that really need it, on account of their heavy exposure to regulatory risk. In other words, while foreign investors in most sectors of the Mexican economy do not actually face much, if any, regulatory risk, investors in oil & gas, energy and telecoms do and, therefore, they are the ones that require protection against this risk. Such protection (reportedly) survives in NAFTA 2.0.
- To sum up, although Mexico and the United States reached a bilateral settlement in renegotiating NAFTA based upon the options delineated by the latter: (i) the provisions modernizing NAFTA (adding or strengthening chapters) are a win for both, (ii) Mexico managed to achieve substantial damage control in respect of the final terms of the "sunset clause" and the applicability of the dispute settlement provisions under Chapter Eleven, and (iii) the United States obtained a major victory in the area of rules of origin in autos.

[1] Data are from Mexico's 2017 WTO Tariff Profile.

[2] It is important to note that in NAFTA 2.0 the rules of origin controlling trade in textiles will also be substantially tightened.

*The opinions presented in this Post are mine alone and do not represent in any way official views of King & Spalding or its clients

To make sure you do not miss out on regular updates from the Kluwer Regulating for Globalization Blog, please subscribe here.

This entry was posted on Monday, September 10th, 2018 at 12:59 pm and is filed under Canada, Free Trade Agreement, Labor Law, Mexico, NAFTA, Trade Law, USA
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.