NAFTA’s Impact on Mexico

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Mexico’s Pre-NAFTA Unilateral Trade Liberalization

- First steps in opening closed economy focused on eliminating import substitution policies in mid-1980s
- In 1986, Mexico became member of General Agreement on Tariffs and Trade (GATT)
- Mexico’s trade-weighted average tariff fell from 25% in 1985 to about 19% in 1989.
After the mid 1980s, Mexico moved from closed to open economy

**Trade Openness: Exports + Imports / GDP**
*(Percentage)*

Note: Exports and imports of goods and services. Shaded area depicts Mexico’s entry into the GATT.
Source: World Bank national accounts data, and OECD National Accounts data files.
Mexico’s NAFTA Opportunity

- Lock in reforms of its market opening measures from mid-1980s
- Transform formerly statistic economy after devastating debt crisis of 1980s
- Increase investment confidence to attract foreign investment and spur economic growth
NAFTA Key Provisions

1. Removal of trade barriers
2. Rules of origin
3. Services trade
4. Foreign investment
5. Intellectual property rights protection (IPR) (1st FTA)
6. Government procurement
7. Dispute resolution
8. Labor and environmental provisions (side agreement) (1st FTA)
NAFTA Key Provisions

1. Removal of trade barriers and  2. Rules of origin

Tariff changes based on rules of origin:

- Most market opening measures from NAFTA resulted in removal of tariffs and quotas applied on imports from United States and Canada
- Average applied duty for all imports to the U.S. 2.07% in 1993.
- Average tariff on all imports from United States was 10% in 1993 (Canada’s was 0.37%).
NAFTA Key Provisions

1. Removal of trade barriers and 2. Rules of origin:

**Tariff changes based on rules of origin:**

- Significant changes in textiles, apparel, automotive, and agricultural industries
- Phased out all duties on textile and apparel goods within North America meeting specific NAFTA rules of origin over 10 year period
- Phased out Mexico’s restrictive auto decree
- Rules of origin requirement of 62.5% North American content for autos and 60% for vehicle parts
- U.S.-Mexico agricultural trade became duty-free when agreement went into effect
NAFTA Key Provisions

3. **Services trade.** Liberalized certain services sector, particularly financial services while others excluded like oil and gas drilling

4. **Foreign investment.** “Non-discriminatory treatment” for foreign investment in certain sectors

5. **IPR.** Enforceable commitments regarding protection of copyrights, patents, trademarks, and trade secrets

6. **Government procurement.** Opened up a significant portion in each country nondiscriminatory basis to suppliers for goods and services

7. **Dispute resolution.** Created an arbitration system for resolving disputes

8. **Labor and environmental provisions.** First agreement on labor and environmental cooperation
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After NAFTA exports grew rapidly, making United States by far Mexico’s leading trade partner.

![Mexico Exports Graph]

**Source:** SAT, SE, Banco de México, INEGI. Balanza Comercial de Mercancías de México. SNIEG.
Manufacturing exports after NAFTA increased substantially

Mexico Manufacturing Exports
(Billions US$)

Source: SAT, SE, Banco de México, INEGI. Balanza Comercial de Mercancías de México. SNIEG.
Automotive exports lead increase

**Mexico Automotive Exports**
(Billions US$)

Source: SAT, SE, Banco de México, INEGI. Balanza Comercial de Mercancías de México. SNIEG.
Nonautomotive exports also registered impressive increase

**Mexico Non-Automotive Exports**
*(Billions US$)*

Source: SAT, SE, Banco de México, INEGI. Balanza Comercial de Mercancías de México. SNIEG.
Export growth attributed to development of supply chains, especially in the auto industry

- Trade occurs in the context of production sharing
- Manufacturers in each country work together to produce goods
- Trade expansion has resulted in the creation of vertical supply relationships, especially along the U.S.-Mexico border
Export growth attributed to development of supply chains, especially in auto industry

- **Intermediate inputs produced in U.S. and exported to Mexico**
- **Finished product exported from Mexico to U.S.**
- **40% of content of Mexican exports are of U.S. origin**
Mexico’s export growth attributed to the development of supply chains, especially in the auto industry.
A U.S. consumer purchases a car for $50,000:
How is the value-added distributed?

Recording the transaction in gross terms.

Remaining value of the car sale covers distribution, R&D, and other value-added by car company.
Mexico’s export growth attributed to development of supply chains, especially in the auto industry

- Supply chains have been increasingly crossing national boundaries.
- Manufacturing work is performed wherever is most efficient.
- Autos manufactured in NAFTA region sold in U.S. have a domestic content of between 47% to 85%.
Foreign Direct Investment (FDI) increased rapidly after NAFTA

**Foreign Direct Investment in Mexico**
(Billions US$)

Source: Secretaría de Economía.
U.S. is largest source of FDI, integral part of the economic relationship, while Mexican FDI in the U.S. increased from $1.2b 1993 to $16.6b in 2015

U.S. and Canada Foreign Direct Investment in Mexico
(Billions US$)

FDI 1980
US $1.08
Canada $0.02

FDI 1993
US $3.50
Canada $0.07

FDI 2016
US $10.92
Canada $1.72

Source: Secretaría de Economía and Bureau of Economic Analysis.
Mexican economic growth after NAFTA is slower compared to the previous 20 years, but less volatile

**GDP per Capita**

(y-o-y %)

**1960-1993**
- Mexico 2.30%
- U.S. 2.41%
- Canada 2.18%

**1994-2016**
- Mexico 1.07%
- U.S. 1.51%
- Canada 1.52%

Note: Inflation adjusted.
Source: World Bank national accounts data, and OECD National Accounts data files.
Income disparity between Mexico and U.S. and Canada did not improve after NAFTA and continues.

**Ratio of GDP per Capita**

Note: GDP per Capita based on purchasing-power-parity (PPP).
Source: International Monetary Fund World Economic Outlook Database April 2017.
NAFTA increased synchronicity of Mexico-U.S. business cycle, particularly in manufacturing and automotive industries

Manufacturing Industrial Production
(y-o-y %)

Correlation: 0.11

Correlation: 0.77

Source: Instituto Nacional de Estadística y Geografía (National Institute of Statistics and Geography); Federal Reserve Board.
Income disparity between border Mexican states and southern Mexican states continued

Ratio of GDP per Capita
(#)

Note: GDP estimates from 1993 to 2005 different with National Accounts 2006 while GDP estimates from 2006 to 2015 with 2008 base year.
Source: Instituto Nacional de Estadística y Geografía (National Institute of Statistics and Geography) and Consejo Nacional de Población.
In the southern states, the agricultural sector plays an important role. After NAFTA, the agricultural sector registered strong downturn.

**Mexico Agriculture Value Added**  
(as a percentage (%) of GDP)

Source: World Bank national accounts data, and OECD National Accounts data files.
After NAFTA, labor productivity has improved most notably in manufacturing plants

Mexico Labor Productivity
(Index 2005Q1=100)

Note: Seasonally Adjusted. Personal that is employed in the establishment.
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In May 2017, the U.S. trade representative sent 30-day notification to Congress of administrations intent to begin talks with Canada and Mexico to renegotiate NAFTA

- The parties may agree on any modification of or an addition to the agreement

- When so agreed and approved in accordance with the applicable legal procedures of each party, a modification or addition constitutes an integral part of agreement (NAFTA Article 2202)
Issues facing Mexico

- Has stated it would consider modernizing NAFTA
- Government officials have alluded Mexico may seek to broaden NAFTA negotiations to include bilateral or trilateral cooperation on various issues, especially security and immigration
- May consider withdrawing from NAFTA, if negotiations are not favorable
- Priority for the government would be to improve agreement rather than to withdraw from it
Potential Topics for Prospect NAFTA renegotiations

1. Automotive sector

- New rules of origin to address modern developments in auto and auto parts manufacturing
- Encourage more production in North American auto manufacturing industry by raising rules-of-origin requirements
Potential Topics for Prospect NAFTA renegotiations

2. Services

- Remove barriers to electronic payment card services, electronic signature, mobile telecommunications, international roaming rates, and additional market access in areas such as audiovisual services

3. E-Commerce, Data Flows, and Data Localization

- Cross-border transfer of information by electronic means or force localization of data centers
Potential Topics for Prospect NAFTA renegotiations

4. IPR:

- Copyright in digital environment, additional patent protections for pharmaceuticals
- Criminal penalties for trade secret theft
- Provisions for customs agents to have ex officio authority to seize counterfeit and pirated goods
- Requirements for countries to provide criminal penalties for copyright and trademark infringement in digital environment
Potential Topics for Prospect NAFTA renegotiations

5. SOE

- Addressing potential commercial disadvantages to private sector firms from state-supported competitors receiving preferential treatment

6. Dispute settlement:

- NAFTA panels may be examined to function properly
Potential Topics for Prospect NAFTA renegotiations

7. Labor:

- Protecting collective bargaining and reforming its system for administration labor justice
- Update Mexico labor reform

8. Environment

- Adopt, enforce and not detract from their environmental laws to attract trade and investment
- Increase cooperation to address trans-national threats and police environmental crimes such endangered species trade and illegal fishing
Potential Topics for Prospect NAFTA renegotiations

9. Energy:
   - *Enhance bilateral cooperation on energy production and security*
   - *Update energy reform*

10. Customs and trade facilitation:
   - *Improve by lowering times in the movement of goods and services across countries*
Potential Topics for Prospect NAFTA renegotiations

11. Sanitary and Phytosanitary Standards (SPS)

- Improve scientific basis of SPS regulation, notifications to importers or exporters of shipments detained by SPS issues, or consultative mechanisms to seek quick resolution of such detentions
North American Supply Chains

- Many North American automotive assembly lines and part makers work together as one integrated production region from cities such as Toronto in Canada through Detroit and into numerous regions of Mexico.

- Labor intensive parts can be manufactured in Mexico, where production costs are lower, while more complex parts are made in the United States.
North American Supply Chains

- Tariffs or trade barriers have potential of disrupting these production chains

- Proponents want to bring back a share of global production to United States

- Opponents argue it could cause thousands of lost jobs in all three countries and benefit countries like Germany, Japan and China
Import penetration of Chinese manufactured products has surpassed Mexico

Note: Import penetration is the ratio between the value of imports divided by Gross Domestic Output minus exports plus imports.
Source: Bureau of Economic Analysis.
Free Trade Agreement (FTA) Diversification

- Mexico has numerous FTAs with other countries and may continue to seek to diversify trade through FTAs.
- Mexico willing to negotiate a new agreement with the Asia-Pacific region to be similar to TPP and include China in discussions.
NAFTA Withdrawal

- A country can withdraw from the agreement six months after it has provided written notice of withdrawal to the other parties.

- It also provides the agreement remains in force for other parties.

- Under this provision, existing NAFTA rates would continue for one year.
NAFTA Withdrawal

- During this time, governments can proclaim tariff rates existing prior to NAFTA
- Likely most-favored-nation (MFN) rate for Mexico
- MFN accorded to all members of WTO
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