# Scenarios and Sovereign Alternatives On NAFTA's Winding Road

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Whatever the results of the North American Free Trade Agreement (NAFTA) negotiations, including its possible cancelation, they will leave a profound mark on the present and future relations between Mexico and the United States and Canada. Probably the biggest impact will be for the fragile Mexican economy and its 2018 presidential elections, revealing the full extent of the political dimension of this complex process.

The possible outcomes are multiple, from a supposed "modernization" of the regional treaty to its elimination through a withdrawal of the United States, as President Donald Trump warned during his electoral campaign. One precedent for the second possibility is his swift decision to definitively abandon the Trans-Pacific Partnership. Under these circumstances, we can say that the NAFTA renegotiation is far from being only a technical or trade issue as the Mexican authorities are attempting to portray it.

Underlying this process are factors that could pose potentially serious conflicts between Mexico and the United States, such as the financing of the wall on our northern border, the threat of taxing Mexican remittances to our country, and the risk of mass deportations of young former beneficiaries of the Deferred Action for Childhood Arrivals (DACA) program. In this complex, changing renegotiation, I will examine the aspects I think are the most important.

## Trump's Neo-protectionism And NAFTA's "Free Trade" Rules

It is ironic that, despite NAFTA's institutional rules aimed at creating confidence, the protectionist measures Trump has

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announced are creating a climate of uncertainty. This has negative effects for the markets of goods, investments, and overall regional trade. Let's look at some indicators that illustrate the magnitude of the trade between Mexico and the United States that is at stake in the renegotiation talks.

By the end of 2016, transactions between the two countries came to US$500 billion, with Mexican exports to its northern neighbor coming to US$294 billion, or 13.4 percent of total U.S. imports. In this exchange, Mexico had a favorable balance of US$60 billion, making it the second supplier after China (which contributes with 21.1 percent of U.S. imports) of the world's largest economy. Canada, previously the United States' historic largest trade partner, has dropped to third place, with exports representing 12.7 percent of the U.S. total.[1]

That same year, foreign direct investment (FDI) in Mexico came to US$26 billion, 5.8 percent less than in 2015 (when it was US$28.38 billion), 40 percent of which came from the United States. Particularly noteworthy in 2015 were AT&T's acquisition of Unefon and Iusacell (for US$2.04 billion) and another U.S. company's purchase of Vitro for US$2.15 billion. Under Enrique Peña Nieto's administration, the accumulated FDI has come to US$134.96 billion, surpassing by 52.5 percent all the investment during the entire administration of National Action Party-member President Felipe Calderón, which came to US$88 billion.[2]

The authorities wield these figures as evidence of NAFTA's commercial and financial success. However, they also reveal the country's economic vulnerability. For example, 80 percent of Mexican exports go to the U.S. market, concentrated in a small number of goods, particularly cargo vehicles, cars, and auto parts, worth US$107 billion. This industry represents 36 percent of Mexico's total exports, indicating an excessive concentration and explains the interest of auto firms in renegotiating NAFTA. This trend contrasts with the drop in crude oil sales to US$7.58 billion, 39 percent lower than in 2015.

Trump's complaint about the U.S. trade deficit with Mexico is exaggerated. Some sources think that the negative US$63 billion balance in 2016 would drop to US$37.56 billion if the U.S.-made imports used in manufactured goods re-exported to our neighbor were deducted from the total. According to the U.S. Chamber of Commerce, this would bring down the U.S. deficit by 43 percent.[3] This is a manageable balance because it comes to 12 percent of the country's total, which in 2016 amounted to US$502 billion, of which US$386 billion corresponded to China; US$77 billion to Germany; and US$72 billion to Japan.[4]

Mexico is not the main cause of the trade deficit Trump is complaining about. However, he decided to try out his neo-protectionist policies with Mexico, identifying it as the "weakest rival." And, in effect, the economy's vulnerability and the discredit of the Peña Nieto administration are underlying factors for Trump's repeated threats about supposedly "unfair" trade practices that cost millions of jobs in the United States.

## The Importance of the Mexican Market For U.S. Investment and Products

One aspect not commonly mentioned about the renegotiation is the importance of the Mexican market for U.S. and Canadian exporters and investors. At the end of 2016, U.S. exports to Mexico came to US$211 billion (16 percent of the total), which are estimated to have created five million jobs there. On a regional level, the impact on trade is greater if we take into account that border transactions in the Laredo, Texas Customs District came to US$284 billion. Henry Cuellar, U.S. representative from Texas's 28th district, has said that protectionist measures will destabilize the market on both sides of the border.[5]

Mexico's status as a U.S. and Canadian partner implies enjoying important comparative advantages for foreign capital. In this vein, we should note that manufacturing has been the main target for foreign investment: the auto industry received 43 percent, reaffirming its importance in the NAFTA negotiations.[6] We should also remember that U.S. investors contributed 38.9 percent of all foreign capital invested, followed by Spain, with 10.7 percent, and Germany, with 9.0 percent. This investors' "club" is completed by Israel and Canada, contributing 7.5 percent and 6.3 percent, respectively. Clearly, though not marginal, Canadian investment is modest despite its being Mexico's third partner, with investments in banking, mining, and telecommunications.[7]

Although foreign direct investment in Mexico decreased by 5.8 percent in 2016, this market is very attractive for foreign capital, which enjoys its high profitability, low wages, and "flexible" environmental and labor regulations. In 2009, foreign investors made US$7.64 billion in profits. In short, an eventual cancelation of NAFTA is a complex decision that would have repercussions in all three economies.

### Nobel Laureates' Critiques and Trump's "Voodoo" Economics

The sharpest critiques of the Trump administration's fiscal and commercial policies have come out of academia in his own country. Not without humor, it has been said that Joseph Stiglitz, Paul Krugman, and Oliver Hurt have two things in common: the three economists have received the Nobel Prize and they have all questioned Trump's announced economic measures. Stiglitz foretold the failure of a trade policy based on the threat of levying high tariffs on products from Mexico and China.

At the Davos World Economic Forum, Stiglitz said that the president does not understand that the size of the trade deficit depends on the United States' macro-economy, not on its partners. He also warned that the proposed tax cuts will increase the country's fiscal deficit.[8] For his part, Krugman questioned the idea of levying a 20-percent tariff on Mexican imports. In a series of tweets, he called it a demonstration of the new administration's ignorance, dysfunctionality, and incompetence. He even called Trump "mentally ill." Nevertheless, recognizing that increased spending in infrastructure "could be good," he pointed out that combining it with lower taxes would cause budgetary problems.[9]

Oliver Hart was less harsh, commenting that he had not yet seen a coherent set of government policies and warning that the idea of dismantling trade agreements or levying tariffs is not the road the United States, or the world, should follow. However, he had no doubt about the president's will to help those who lost their jobs, although he said that there are better ways of doing that than applying protectionist measures. U.S. trade protectionism is nothing new; Trump simply has gone back to it from a furiously anti-Mexican, racist, persecutory perspective. In recent years, U.S. authorities have applied sanctions on Mexican citrus produce, avocado, and tuna exports, impeding the entry of freight shipments into the United States in violation of NAFTA norms.[10]

Former Secretary of the Treasury Larry Summers dubbed Trump economic team ideas and proposals "voodoo economics," while former Mexican President Ernesto Zedillo wrote an article in *The Washington Post* saying that if Trump "kills NAFTA," Mexico can take other economic roads toward progress.[11] This member of the Institutional Revolutionary Party recognized that the negotiations could fail and confirmed that in Mexican governmental and financial circles, people do not think that failure is impossible and that officials and business representatives have begun to accept it as a possibility.

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### Possible Scenarios and Alternatives Given the Uncertainty of a New NAFTA

Changes in the agreement's founding norms, and even its cancelation, would have repercussions in industrial, commercial, and trade activities in Mexico, the United States, and Canada. They would distort the international value chains in the auto, electronics, home appliances, and agribusiness export sectors. We should remember that big companies are sensitive to any modification in the rules of the game; this is due to the fact that they design their supply and production strategies based on stable institutional structures in local and international markets. Given this, the confidentiality of the negotiations and Trump's unpredictable policies are variables that reinforce uncertainty for economic and political actors, both inside and outside the North American region.

The renegotiation results may range all the way from accepting Donald Trump's trade demands to rejecting any intermediate, conciliatory agreement the negotiators might eventually arrive at. A scenario in which Trump decided to withdraw from the negotiations and declare the regional agreement "dead" is also not outside the realm of possibility. In this regard, we should remember his decision to withdraw from the dazzling Transpacific Partnership. With this same "personal style" of governing, Trump also withdrew from the Paris Accord, a multilateral commitment signed by more than 200 countries in 2015 to fight climate change.

The Mexican authorities' initial strategy of signing the regional agreement "at all costs" meant making strong concessions on e-commerce, increasing intellectual property rights

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in favor of multinational companies, and significantly changing the rules of origin by increasing the regional content requirements for manufactured exports, all of which, according to Trump, would encourage employment in the United States. One precedent in this regard is the renegotiation of the U.S.-Mexico sugar agreement last June, in which Mexican producers got the short end of the deal with the reduction of the refined sugar (higher value added and price) export quota in exchange for becoming a preferential supplier of raw sugar (of lower value).[12] It is very revealing that the American Sugar Alliance thanked President Trump for defending U.S. jobs, supporting sugar producers and taking Mexico to task for violating trade laws.[13]

NAFTA has been an emblematic instrument of the neoliberal model since the mid-1980s in our country. However, different studies prove that the open, deregulated economy has only developed an assembly-plant-export manufacturing sector based on low wages and a scant number of quality jobs.[14] This strategy has also led to greater concentration of income and wealth, increasing the number of people living in poverty from 53.3 million to 55.3 million in recent years.[15] Therefore, the aims of sustained growth and improved social well-being promised by the "free trade" strategy based on foreign investment and manufacturing exports to the North American region have not been achieved.

In a context of low production and job growth, accompanied by higher poverty rates, not ratifying NAFTA would lead to a potentially favorable scenario for examining macroeconomic policy alternatives for Mexico's sustained development. It would create political and social conditions that would stimulate the design of a new economic strategy to allow the reorganization of production, limit financial vulnerability, and put the brakes on the serious deterioration of society. Of course, financial, commercial, and technological globalization provides cold data about the reality that cannot go unrecognized. Nevertheless, nations have the potential to sovereignly design the way they insert themselves into the world economy and determine their objectives for development and well-being. And that could harmonize the potential of Mexico's domestic market by diversifying international trade in the context of a global economy. VM

## Notes

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