Economic Analysis

# Trade agreement with the United States: investment framework to be maintained

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On 27 August, Mexico and the US announced that they had reached an understanding allowing them to sign a trade agreement to replace the North American Free Trade Agreement (NAFTA). Although we are still awaiting the final text in order to offer our full assessment, on the basis of the announcement made by the negotiating teams, we can give a preliminary analysis. Whilst this is not an ideal trade agreement as it contains elements that can be seen as restrictive and protectionist – above all in the rules of origin that are applicable to the automotive sector – I nevertheless feel that it is a good one, bearing in mind the circumstances and certainly given the alternative. Had no agreement been reached, the US would very possibly have pulled out of NAFTA, as well as imposing 25% tariffs on Mexican automotive imports, which would have dealt a serious blow to the country's economy.

The conditions outlined in this new agreement should not prove to be restrictive in terms of trade as long as Mexico will be able to continue paying the WTO''s most-favoured-nation 2.5% tariff to export cars and vehicle parts to the US. This would not represent a loss of competitiveness – in fact, there are already many models being exported with this tariff. If the agreement comes into force, it need not significantly alter trade flows between Mexico and the United States.

However, NAFTA does not only involve trade flows. It has proved to be most positive as a way of attracting investment to Mexico. The figures speak for themselves. In 1993, the year before NAFTA was signed, the country received US$4.9 billion in direct foreign investment. Last year that figure was US$31.234 billion. From 1993 to 2017, direct foreign investment grew an average of 22% each year. Half the investment over this period has come from the US.

The agreement has allowed Mexico to send a message that the rules of the game as far as investors are concerned are perfectly clear and transparent and that they will not be changed halfway through. This has been especially important in a country which has structural weaknesses in matters related to the rule of law. Such messages could be sent as a result of the provisions set forth in Section 11 of NAFTA dealing with investment.

Among other things, this section establishes that member states may not treat investment from the other two trading partners less favourably than they treat domestic investment. It further states that the most-favoured-nation principle must continue to be applied, meaning that member states may not give less favourable treatment to their partners than they give to non-NAFTA members, investment flows need to be subject to international law, that restrictions may not be imposed on the nationality of public employees, plant location and operations centres, nor may the payment of dividends, royalties and capital gains be restricted and that expropriation is prohibited unless it is deemed to be in the public interest, in which case compensation shall be duly paid at market value.

In other words, NAFTA has meant that Mexico can provide foreign investors with a legal framework that its legal system is still not able to guarantee. It is therefore good news that Section 11 will be kept in the new agreement. This, together with the inclusion of a section that will deal with anti-corruption matters, means that when implemented, the new trade agreement between Mexico and the United States to which Canada will also hopefully be a signatory, will continue to represent a powerful instrument for investment in Mexico – investment which is a necessary condition for the country to ensure greater levels of growth.


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