

Global Economy

Mexico-US Trade Agreement: Uncertainty diminishes

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At the end of August Mexico and the United States announced a preliminary agreement intended to replace the North America Free Trade Agreement (NAFTA) signed in 1994.

Based on the information disclosed so far, and subject to seeing the actual text, I believe it is not a bad agreement considering the circumstances and the alternative. The circumstances in this occasion were very different from those prevailing when NAFTA was first negotiated. At that time, all three countries were committed to free trade. Now, one of the parties, the United States, has a different objective: to reduce its trade deficit with Mexico and Canada and to draw more investment in the automotive sector to its territory. The alternative was the break-up of NAFTA and the imposition of 25% import duties on automotive imports from Mexico.

The most significant changes in the agreement announced are centred on the automotive sector. And this is hardly surprising, given that the sector accounts for the entire trade deficit that the United States runs with Mexico. The agreement consists mainly in imposing three requirements for a vehicle to qualify for the 0% import duty: regional content of 75% as opposed to 62.5% previously; a minimum steel and aluminium content from the region; and that between 40% and 45% be produced by workers earning at least US\$16 per hour. The average wage of a Mexican worker in the automotive industry is US\$8 per hour, whereas his counterparts in Canada and the United States earn around US\$29 per hour. About half of the car models produced in Mexico do not comply with at least one of these requirements. However, what has been agreed should not be disruptive, since the vehicles that do not comply can be exported to the United States at the World Trade Organisation (WTO) “most favoured nation” import duty, which is 2.5%. In fact, at present around one third of the cars made in Mexico and exported to the United States are already subject to this import duty. What would be really disruptive would be for Trump to withdraw from the WTO as he has threatened. Furthermore, the agreement established an unspecified quota that Mexican auto exports would face, which would come into force only if the United States decided to impose a 25% tariff on imports from all countries. Although this is a protectionist measure and as such far from ideal, I think it is a good insurance policy for Mexico in case this risk materialises.

In short, the trade agreement announced is less favourable for both economies than NAFTA, but better than the alternative that was looming on the horizon.

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