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The U.S.–Mexico Trade Deal: Much Ado About Very Little

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INTRODUCTION

On Monday, August 27, 2018, President Donald Trump and Mexico's President Enrique Peña Nieto announced the resolution of several key issues that had blocked progress on the renegotiation of the North American Free Trade Agreement (NAFTA). The understanding announced this week includes concessions by both the U.S. and Mexico, in addition to items that were resolved in eight previous rounds of negotiations. Trump labeled the latest agreement as "maybe the largest trade deal ever."[1]

The announcement—choreographed with Trump at his desk and Peña on the speaker phone—gave the impression that the two countries had reached the final stage of a bilateral trade agreement. In interviews with the media, the White House and its economic advisors touted the agreement as the beginning of the end of the negotiations, and threatened to shut out Canada if it did not make its own concessions before the end of the week. Trump also asserted that the accord should not be called NAFTA but instead, a U.S.–Mexico Free Trade agreement—an apparent slight to Canada.

Optics aside, key questions arise from this news. What, specifically, are the details of this agreement? Do the agreed-to points represent a truly significant breakthrough in NAFTA renegotiations? Are the concessions enough to call the trade agreement both novel and "the largest ... ever"? What motivated Trump and Peña to reach an agreement, especially without Canada? How will Canada respond? What obstacles lie ahead? This issue brief addresses some of these important questions.

WHAT ARE THE DETAILS OF THE AGREEMENT?

It is difficult to discuss the details of the understanding, as no official document has been released. It is possible that the two governments and the negotiators do not want the media, trade experts, or critics to pick through the document in advance. But we do know that five crucial points that held back the U.S.-Mexico slice of the negotiations were resolved.

The first concession is related to rules about the origin of manufactured goods. Under the new deal, vehicles assembled in Mexico may enter the U.S. duty-free if 75% of the parts are made in North America; this is up from 62.5% of North American-made parts under NAFTA, but less than the 85% the U.S. originally pushed for. Although this item is intended to increase the number of U.S.-made products in the manufacturing chain, the production of car components could ultimately shift to Mexico. This is because the new agreement only requires the parts to be from North America—and not specifically the United States. If a car from Mexico is made from less than 75% of North American components, it will be subject to a 2.5% tariff when it enters the U.S.

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Mexico made an important concession by agreeing to have all trade disputes settled in U.S. courts. The U.S. made an important concession on agricultural imports from Mexico.

The agreement simply means that two NAFTA partners have dealt with some sticking points and the next steps can now be taken. Many other key issues remain unresolved.

Second, around 40% of all parts going into vehicles made in Mexico will have to come from countries where workers are paid at least $16 an hour. This effectively forces Mexico to raise wages for workers in its car manufacturing industry, where workers currently make around $20 a day or $2.50 an hour.[2] Trump has complained that low wages in Mexico have put American workers at great disadvantage and lowered U.S. manufacturing wages. The timing and extent of the wage increase in Mexico were not specified.

Third, a sunset clause provision proposed by the United States that mandates a full renegotiation of the agreement every five years was dropped. Instead, the agreement is valid for 16 years but must be reviewed every six years starting in 2024.

Fourth, Mexico made an important concession by agreeing to have all trade disputes settled in U.S. courts. Such disputes were previously settled under NAFTA Chapter 19.[3] In some business sectors—including, apparently, energy—unspecified ad hoc resolution mechanisms will settle trade disputes under the new deal.

Fifth, the U.S. made an important concession on agricultural issues by agreeing that tariffs on agricultural products from Mexico remain at the same level as under NAFTA— i.e., such products are free and clear of all tariffs and seasonal quotas.

DOES THE U.S.-MEXICO AGREEMENT REPRESENT SIGNIFICANT PROGRESS ON NAFTA AND FREE TRADE?

The answer is yes and no.

On one hand, the resolution of these issues advances the conversation between two NAFTA partners. It allows the U.S. and Mexico to move onto other pending issues and Canada to rejoin the negotiations. However, the resolution of these items does not amount to a new NAFTA or a new trade deal between Mexico and the United States—much less to the "largest trade deal ever." It simply means that two NAFTA partners have dealt with some sticking points and the next steps can now be taken. Many other key issues remain unresolved, including environmental standards—a major point of contention between the U.S. and Canada.

On the other hand, the overall impact of the deal is regressive rather than progressive in that it manages trade rather than unleashes its potential. North American trade is not further integrated into an economic platform capable of increased competitiveness with Asia and Europe. Instead, it reconceives trade among NAFTA partners as a zero-sum game whereby one country's loss is another country's gain. The deal is not good for consumers, as it may increase the price of automobiles for all. The new agreement, for example, could incentivize parts manufacturers to move to Mexico in higher numbers, as car parts can come from either country. Alternatively, parts manufacturers could choose to skip the cumbersome calculation of component percentages and simply pay the 2.5% import fee, passing it on to consumers. Manufacturers could also move production to countries not committed by treaty to higher wages, and pay the import fees mandated by the World Trade Organization.

In the end, the newly announced agreement is much more complicated than it appears to be, and it is difficult to predict how companies will respond to the new requirements. This much is clear: the agreement is neither a modernized nor more progressive version of NAFTA.

WHAT MOVED TRUMP TO REACH AN AGREEMENT?

Trump made key promises to his supporters during the presidential campaign and reiterated them once in office. His pledges included a building U.S. border wall, negotiating a denuclearized North Korea and a better Iran nuclear deal, launching an easy-to-win trade war with China, and forcing Europe to move on military spending. He has not been able to come through on any of these commitments. But Trump also promised to renegotiate NAFTA and do it quickly. A year into the negotiations, the parties were not yet close.

The looming November 2018 U.S midterm elections exacerbated his problems. Trump appeared ready to hit the campaign trail with none of his promises fulfilled, and he needed a win. Forcing a compromise on NAFTA by moving in Mexico's direction was apparently seen by the U.S. as a way to get its neighbor to the north to agree on the outstanding points between the U.S. and Canada—and to have an agreement in place before the political landscape becomes more complicated in the U.S. as newly elected members of Congress take office, and in Mexico, as a new administration takes office on December 1.

It is reasonable to conclude, therefore, that Trump had a political goal rather than a policy achievement in mind by meeting Mexico in the middle when it came to NAFTA.

WHAT MOVED PEÑA TO ACCEPT TRUMP'S CONDITIONS?

Mexico's president, Enrique Peña Nieto, is also working against the clock. New legislators will take their seats on September 1, and the country's new president will assume office on December 1. Peña is committed to saving NAFTA because he believes that doing so would be an important part of his legacy. In addition, he is under pressure from the country's elites to save the accord before the new administration, which won many votes from critics of NAFTA, takes office.

There also appears to be a tacit agreement between Peña and Mexico's incoming president, Andrés Manuel López Obrador, to wrap up negotiations as quickly as possible. López Obrador is not likely to have much room to maneuver when it comes to NAFTA. Any concessions he makes to Trump's demands will quickly erode his political support: it will be interpreted as a continuation of the status quo, which López Obrador explicitly ran against. He would prefer to have Peña bear the political cost of pushing through an agreement.

DID MEXICO LEAVE CANADA BEHIND?

It appears that Mexico has left Canada behind, but such is not the case. Although NAFTA is a trilateral agreement, some issues are bilateral by nature. Mexico and the U.S. had important topics to discuss without Canada, much as Canada and the U.S. have issues to discuss without Mexico. Once those bilateral issues are resolved, the third partner can rejoin the table. That is exactly what happened with the U.S.-Mexico agreement.

Still, Canada and Mexico have both been clear: any agreement, in the end, must be trilateral in nature. After the U.S. and Mexico resolved their major NAFTA-related issues, Chrystia Freeland, Canada's Minister of Foreign Affairs, rushed to Washington, D.C., to rejoin the negotiations. However, it is becoming clear that Trump's demands that Canada make quick concessions and that an agreement be ready by August 31 is unrealistic.

OBSTACLES AHEAD

Even if Trump's Aug. 31 deadline is met, Mexico will have a new congress on September 1, as noted above. The new members of congress are considerably more nationalistic—and more hostile to NAFTA—than those in the Peña administration. No one should expect the new congress to approve a deal without thoroughly discussing its ramifications for Mexico. A quick decision will not be rushed through. Similarly, members of the U.S. Congress have made it increasingly clear that they will not consider a two-country deal. Canada, some in Congress have argued, must be a part of any deal sent to Capitol Hill. In addition, the timing for a new deal is difficult, as many U.S. legislators will be on the campaign trail in the fall. In all, Congress does not appear amenable to taking up any major trade agreement discussions in the midst of a major political season.

The most likely outcome is that the August 31 deadline for Canada set by Trump will come and go, as others have, and the negotiations will continue. A new NAFTA, whether an improved or watered-down version, will have to wait for a better day.

The deal does not make North America more competitive than Asia or Europe. Instead, it reconceives trade among NAFTA partners as a zero-sum game whereby one country's loss is another country's gain.

ENDNOTES

1. Linda Qiu, "Trump Falsely Claims Preliminary Pact between U.S. and Mexico 'Maybe the Largest Trade Deal Ever,'" *The New York Times*, August 27, 2018, https://www.nytimes.com/2018/08/27/us/politics/fact-check-trump-nafta-mexico.html.

2. Mexico's wages in the manufacturing sector, in U.S. dollars, have remained steady for the last decade, at about US$2.5 an hour. That is significantly more than Mexico's minimum wage but considerably lower than U.S. manufacturing wages. See https://tradingeconomics.com/mexico/wages-in-manufacturing.

3. NAFTA Secretariat, Overview of the Dispute Settlement Provisions, https://www.nafta-sec-alena.org/Home/Dispute-Settlement/Overview-of-the-Dispute-Settlement-Provisions.

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