

## NAFTA, A Reality Check

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We have recently been bombarded with news and conflicting versions and positions on the North American Free Trade Agreement (“NAFTA”) renegotiation, to the point that it can be hard to focus on the facts and learn to ignore the noise that surrounds this sensitive topic.

We live interesting and confusing times. The U.S. executive branch talks about protectionism, which opposes to its traditional position in pro of globalization, while China talks about free trade. The debate between these two topics is not new, however, after years of experience it is demonstrated that free trade is a useful tool and protectionism is a dead-end street.

Much has been said and written on NAFTA, and we have seen conflicting information from different sources, data and numbers, that make it difficult to understand the impacts on NAFTA for its members, and more importantly, for the world economy.

In this article, we explain some of the most important facts about the relevance and impact of the relationship between the U.S. and Mexico regarding the NAFTA, in connection to the effects of competitiveness in the global marketplace, prices, economic growth, and creation of jobs, among others. We also try to explain and provide some examples to show how much really Mexico and the U.S. are interconnected, and that both countries are stronger and more competitive as a block. In addition, we provide an overview of the current status of the negotiation.

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### Misinformation vs. Facts

Speculation on this topic has disrupted business. However, although the relationship between the U.S. and Mexico has always been a deep and complex one, both countries share roots and ties in many aspects beyond trade with a large number of implications in the political, social, economical, family and security areas.

An important fact to consider (not a speculation) is that the three countries are very important clients for each other, and that the residents of the three countries benefit from the competitive prices and production chains of the other countries.

*Some examples:*

The relationship between the U.S. and Mexico goes far beyond trade. It includes cultural, historic, social, family, geographical, security, immigration, and other matters. The level of activity and interaction of their almost 2,000 miles of common border (without considering hundreds of flights and maritime transportation) represents to date:

- More than 1 million people and 370,000 vehicles crossing the border legally every day.
- Approximately USD\$1 million dollars per minute.

- That Mexico is the third largest trade partner of the U.S. and the second purchaser of U.S. exports.
- That the U.S. is the largest trade partner of Mexico.
- That trade with Canada and Mexico accounts for almost 14 million jobs in the U.S.
- That more than 1 Million U.S. citizens live in Mexico.

### *Myths:*

There is a general belief that NAFTA is the cause for many jobs lost. The truth, however, is that automatization, technology, IT and lower transportation costs are the real causes of 80% of manufacturing job losses; not free trade. More tariffs, duties and taxes will not make those jobs come back. It could actually cause the opposite effect, as there are millions of jobs that depend on NAFTA.

Real numbers show that if companies were to close their manufacturing operations in Mexico, it is quite unlikely, that they would be moving to the U.S., and the reason is the cost of production. For example, if the cost of manufacturing a product in Mexico is of USD\$10 Dollars, in the U.S. it can range between USD\$30 to USD\$40. Creating a supply chain in the U.S. that can be compared in prices to the ones offered by other countries would kill entities that operate on small margins. An example of this is Ford, whose cars are designed in the U.S., but are manufactured in México. The fact that many products are manufactured (in whole or in part) in Mexico is one of the main reasons why the U.S. and Canada can keep very competitive prices in the world market.

Finally, it appears that one of the main reasons why NAFTA is having bad publicity is the commercial deficit between the U.S. and Mexico. Nevertheless, if we consider that 40% of the content of Mexican exports comes from the U.S., the “deficit calculation” is not very accurate.

### *Competitiveness*

If companies were forced to relocate to a given country that does not offer the competitive advantages required, or that is not well suited to add value and efficiency to the production chain, their only option would be to increase prices and as a result, companies will no longer be competitive and will have to shut down.

The inertia of NAFTA trade can be compared to a train going 500 miles an hour, where any attempt to stop it would have significant adverse consequences for its passengers, who, in this case are (i) the end consumers of the three countries, and (ii) companies that benefit from the competitive advantages offered by a country. Digital economy, e-commerce and internet are unstoppable, and that is why globalization and trade are unstoppable.

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### **NAFTA Update**

We are not saying NAFTA should not be reviewed or updated. It can actually be a good opportunity for Mexico, Canada and the U.S. to modernize and bring new items to the table that were not considered during the first negotiations, back in the early 90's.

It is fair to say that NAFTA has implied and required many changes of business orientation, and many sectors have been benefited and affected in the three countries. On the other hand, it would be unfair to say that there have been “winners”

and “losers”. Instead of focusing on the collateral damages that NAFTA has brought, the negotiation should be recognized as a great opportunity to update the agreement in matters such as: (i) Labor and employment force, (ii) Energy (gas and oil) – when Mexico signed the NAFTA, there was a complete restriction on foreign investment in these sectors, (iii) Telecom, (iv) IT, (v) Intellectual Property, (vi) E-commerce, among others.

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### Importance of Mexico as a Business Partner

It is also important to outline the [relevance of Mexico as a trade partner](#):

- The geographical location of Mexico for North America and Latin America is unique. We share 3000 miles of border.
  - The Mexican public sector offers great incentives for foreign investment. As an example, just in the automotive sector, we can see manufacturing plants from Toyota, Daimler, BMW, VW, Nissan, and with them, all the supply chains.
  - Mexico is an important market for different sectors (e.g. automotive, IT, manufacturing, home devices, tourism).
  - Mexico is the top 2 client for products of at least 18 U.S. states.
  - The workforce in Mexico is highly qualified. This is the reason why many companies prefer manufacturing in Mexico than in other countries (which, although they might be cheaper, their quality is not as good).
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### Current status of the Renegotiation

The Administration of the [U.S. President gave Congress official notice on May 18th](#) regarding its intention to carry out with the renegotiation of NAFTA, with the purpose of supporting economic growth and better paying jobs. As of such notice, the President gives the Congress 90 days before opening trade negotiations. During such 90-day period, the Congress shall discuss and make the corresponding consultations to the private and public sectors about their concern and opinions. In this regard, the White House recently announced that it will publish the specific goals of the negotiation by July 17th, and informed the Congress that it [plans to start with the negotiations by August 16th, 2017](#).

As for Mexico, the private sector and the Federal Government have been working very closely, and in fact the Federal Government has been asking the main chambers of commerce and industry to provide their input to make sure that their interests are duly represented in the imminent negotiations of NAFTA. The position of Mexico seems to be very clear, consistent and aligned in the same direction (i.e. win-win basis).

In the worst-case scenario, if NAFTA was terminated, the rules of the World Trade Organization (“WTO”) would be applicable, with import tariffs of 3.5%.

As long as all parties are reasonable in their demands, and work in favor of the NAFTA block, the negotiations can be positive for the region. As we said, U.S. is a very important client for Mexico, but Mexico is also a very important client for the U.S.

Nobody wins if free trade is blocked. The results of the negotiation cannot be predicted, but, a trade war will not benefit anybody. North America is stronger as a block. The world competes in regions, and North America will be more competitive if it remains as a region. A very competitive one.

Based on the above facts your company can be in a better position to understand and anticipate the potential outcome of the negotiations.

<http://www.acc.com/legalresources/quickcounsel/nafta-a-reality-check.cfm>