



Saving US-Mexico relations from the NAFTA renegotiation

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President Trump's North American Free Trade Agreement (NAFTA) renegotiation has just finished round five. The talks have been contentious so far, but the parties are still projecting a conclusion in the first quarter of 2018. NAFTA has been great for U.S.-Mexico economic relations, and all participants in the negotiation need to make sure the benefits are not lost.

To understand the value of NAFTA for the two countries, it's worth recalling the state of U.S.-Mexico economic relations before NAFTA. Back in 1990, when the NAFTA negotiations started, the United States already had a free trade agreement with Canada, and Canada and Mexico were not particularly close. The focus of NAFTA, then, was on the United States and Mexico, beginning as informal bilateral talks between those two countries, which Canada then asked to join. Thus, to an extent it is hard to recall today, NAFTA was mainly about improving the contentious economic and political relationship the United States and Mexico had for most of their history.

And whatever you might think of this or that NAFTA provision, NAFTA has been good for that relationship.

Given recent political rhetoric, some people might find that assertion surprising. But a quick review of the rocky history of these two neighboring countries, marked by war, expropriation and mistrust, shows how far we have come. Today's disagreements seem challenging, but they pale in comparison to what previous generations dealt with. Current problems are technical ones that can be handled through negotiation and drafting of trade agreements — not unbridgeable, fundamental differences.

First, a fundamental and distinct aspect of NAFTA is that it involves significant liberalization (almost all tariffs have been eliminated) between neighboring large developed countries and a developing country. No trade agreement had gone quite so far in this regard before. It is for this reason that independent presidential candidate Ross Perot warned in 1992 of a “giant sucking sound” from U.S. factories moving to Mexico to take advantage of cheap labor.

Perot's concern was far too simplistic a take on NAFTA's impact. It is true that some factories have moved. But the broader impact was the promotion of an integrated North American

production network, through which companies could trade inputs across borders and make production more efficient, and therefore be more competitive with the rest of the world.

Despite this, concerns about competition with cheap Mexican labor have not gone away. NAFTA was the first trade agreement to include legal obligations — through a side agreement — on labor rights, but critics on the left were unsatisfied and pushed for stronger ones. Today's trade agreements include labor obligations in the main text that are as enforceable as the trade obligations. It is likely that a renegotiated NAFTA will have provisions similar to those of the Trans-Pacific Partnership. Everyone agrees that higher incomes and other labor protections in Mexico are the desired outcome. The question is just how to get there.

On the other side of the political spectrum, what U.S. businesses want to see in Mexico is a stable environment for investment. Though the U.S. is the leading source of foreign investment in Mexico, with \$92.8 billion invested in 2015, the situation has not always been so positive. Mexico remained highly protectionist until the late 1980s and did not open up substantially until after NAFTA. The infamous oil sector expropriation of 1938, while in the distant past, makes foreign companies nervous, and U.S. business groups wanted some guarantees that they would not be badly treated if they invested in Mexico.

Their mechanism for achieving this was a set of NAFTA provisions on investment that includes substantive legal protections, such as a minimum standard of treatment, and a procedure by which foreign investors can sue host governments in an international tribunal (rather than domestic courts). This approach to investment protection in trade agreements has grown increasingly controversial in recent years. Given the change in attitude by the Mexican government toward foreign investment, as well as the prospect of good domestic law protections as an alternative, one can imagine that this part of NAFTA is not as important as it was in the early 1990s.

Looming over all this is the U.S. trade deficit with Mexico. Economists are very clear that bilateral trade deficits are nothing to fear, but the Trump administration is worked up about them nonetheless. Somehow the NAFTA renegotiation may need to include a provision that at least has the appearance of addressing trade deficits, in order to satisfy Trump and a couple of his advisers.

It would be a shame if a misguided obsession with trade statistics undermines an agreement that has been a great boon for U.S.- Mexico relations. Things have never been better. That may be hard to see right now in the face of virulent political rhetoric, but history makes clear that the United States benefits from a friendly neighbor on its long southern border. A NAFTA renegotiation failure could be a major setback that undermines the great progress that has been made.

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