Mexico's Post-NAFTA Scenario: What Are We Really Talking About?

by Carlos A. Chavez,
Veronica Cantu and
Jaime A. Treviño

Five negotiation rounds between the Governments and trade representatives of the U.S.A., Canada and Mexico have been held and the uncertainty surrounding the future of the North American Trade Agreement, also known as NAFTA, keeps mounting with each passing round, negatively affecting the business environment within the three countries.

Considered by many trade experts as one of the most successful trade agreements in the world and with 23 years under its belt, NAFTA has shaped the trade relationship between its three signatories and it is particularly entrenched in the way of doing business in Mexico. The U.S. is Mexico's leading export market and its largest trading partner. All of this has been possible, primarily, due to NAFTA.

In light of these facts, most scenarios for a Mexican economy and business environment without NAFTA seem to be, prima facie, close to catastrophic. Over the past year, companies and individuals on the three countries have speculated on how day-to-day trade deals between these countries will work if NAFTA is effectively terminated or if the U.S. withdraws from it, as its current administration has repeatedly threatened. Living under a new globalized atmosphere, investors are facing questions regarding the tariff rates that may be applied to their goods and services, also wondering how disputes will be settled onward, what will happen with incentives programs backed by NAFTA and, specifically regarding Mexico, what will happen to its economy, which seems to be highly dependent on NAFTA.

It is undisputable that the termination of NAFTA would bring big changes for the Mexican and regional economy, as well as for consumers in the three countries; however, a thorough analysis should be carried out to understand what may lay ahead from a legal standpoint in such scenario.

Below we review some of the most significant consequences that would arise, from a Mexican legal perspective, upon the overall termination of NAFTA. A withdrawal only by the U.S.A., pursuant to article 2205 of NAFTA, will not mean the end of the agreement *per se*, as it will remain in force for Canada and Mexico. Likewise, as this analysis is presented from the Mexican legal standpoint, we will not review the possible scenario of a so-called "Zombie NAFTA", where deadlocks between the U.S. Administration and the U.S. Congress could keep certain parts of the agreement in force.

I. Tariffs.

Under NAFTA, most goods traded within the member countries are tariff-free. Without the agreement, tariffs would inevitably rise, thus eliminating the possibility of exporting to the other countries without paying tariffs. Now, in the absence of a free trade agreement and considering that all three countries are members of the World Trade Organization or WTO, the WTO rules would be applicable to trade between the countries under the "most-favored-nation" principle.

Under the aforementioned principle, our sources reflect that the average tariffs to be applied to goods entering Mexico would be of around 7.1%, whereas the average tariffs that goods would face when entering the U.S. would be of around 3.5%. About a quarter of U.S. exports to Mexico would be subject to tariffs of above 5%, while only 15% of exports from Mexico to the U.S. would be subject to tariffs above 5%. As an example, tariffs on automobiles to be exported from Mexico to the U.S. would be of 2.5%. On the other hand, tariffs on agricultural exports to Mexico would face an average tariff of 15.2%, and industrial goods would face a 7.1% tariff. Although not a tariff, it is important to mention that NAFTA's rules of origin would also disappear in this scenario.

Employing WTO tariffs would unequivocally affect Mexican exports, but we do not believe that it would be as catastrophic as it is being perceived. It is true that certain industries and regions in Mexico would sustain a larger damage should NAFTA disappear, but overall, U.S. exports -and not Mexican exports- would face a tougher battle under this scenario.

II. Dispute Settlement.

NAFTA contains three dispute settlement mechanisms: Chapter 11, Chapter 19 and Chapter 20; all of which would no longer be remedies for U.S. or Mexican companies if NAFTA is terminated. Chapter 11 deals with investor-state disputes and assures equal treatment among investors of the three countries in accordance with the principle of international reciprocity and due process before an impartial arbitration tribunal. Chapter 19, the dispute settlement mechanism that has been attacked more profusely by the U.S. Administration, provides ad-hoc panels which may review determinations in antidumping and countervailing duty cases, replacing the judicial review of local courts. Finally, Chapter 20 provides a dispute settlement mechanism applicable to all disputes regarding the interpretation or application of NAFTA.

Without NAFTA, disputes between the three countries or investors of the countries and the countries shall be resolved before different tribunals and under other rules. First of all, Chapter 20 disputes would cease to be an item should the agreement be terminated. Chapter 11 of NAFTA, an investor-state dispute settlement mechanism before an arbitration panel, currently does not have any parallel in international treaties signed by both Mexico and the U.S., and therefore, disputes by investors against the Mexican or the U.S. government would need to be conducted through the respective local courts and under local laws. The only option by these investors would be to request their own governments to challenge the other government's decision before the WTO under the WTO rules.

One of the main objectives of the U.S. administration by suggesting the elimination of Chapter 19 of NAFTA may be to attract antidumping and countervailing duty cases back to U.S. courts. This, however, would also mean that any case of such nature in Mexico would be handled by Mexican courts and U.S. exporters would need to rely on their decisions. As with the Chapter 11, the only recourse for exporters to

challenge these local resolutions would be to have their own government file a dispute under the WTO rules, a relatively slow judicial process.

III. Other Treaties.

Despite the importance of NAFTA for the Mexican economy and its development in the past two decades, it is important to note that Mexico has signed 11 additional free trade agreements with 44 other countries, including one with the European Union and the Trans-Pacific Partnership or TPP, a multicountry trade deal that provides Mexico with tariff-free access to several markets, and that includes dispute settlement mechanisms that are akin to the ones currently developed in NAFTA.

The existence of these multiple trade deals could lead multinational companies to reconsider their complex supply chains, built through decades of NAFTA, but not necessarily to drop entirely their Mexican operations, as they could take advantage of these other free trade agreements currently in place between Mexico and other economies.

As explained above, without NAFTA, the WTO would turn into the major source of applicable rules to trade between Mexico and the U.S., along with other treaties that would be applicable for specific cases of investment protection, such as the The Paris Convention for the Protection of Industrial Property, signed by both Mexico and the U.S.

IV. IMMEX.

Uncertainty also looms regarding the future of IMMEX and other incentives programs put in place by the Mexican government, some of them even before NAFTA was fully implemented. IMMEX stands for Maquiladora, Manufacturing and Export Services Industry and it is a program that was created to encourage foreign investment in the manufacturing industry. Under the incentives program laid out by Mexico, an IMMEX-approved Mexican company can temporarily import into Mexico, duty free, goods that undergo a manufacturing, transforming, and/or repairing of the industrial process, for their subsequent export.

In these days, more than 6,200 companies operate under the IMMEX regime in Mexico, taking advantage of this program and the incentives that are available under the rules and specifications of the IMMEX program. Although IMMEX is typically related to NAFTA, the program is not dependent on NAFTA at all, while NAFTA has definitively increased the investment flow through the IMMEX program as a result of the implementation of NAFTA. The IMMEX rules are solely and unilaterally implemented by the Mexican government, and while they do make references to NAFTA in certain aspects, they also rely on any other free trade agreement which Mexico may be part of. In essence, rules of origin and the existence of free trade agreements are considered to reduce the applicable import/export custom duties.

Due to the foregoing, the IMMEX program may need to be amended upon a termination of NAFTA, but its core rules will continue to be applied and enforced by the numerous IMMEX companies in Mexico, albeit with a different status quo and business environment.

V. Conclusion.

Terminating NAFTA would never be considered a positive outcome of the ongoing negotiation rounds for the revamping of the decades-old very influential free trade agreement. Nevertheless, the business

environment should not take a hard hit adapting to a reality without said agreement, considering that alternative mechanisms, international treaties and a comprehensive regulations are all present and ready to shape new trade partnerships for Mexico.

Please send any comments or questions to info@jata.mx. The authors are members of the legal team of JATA – J.A. Treviño Abogados. JATA is a Mexican law firm with offices in Monterrey, Mexico and Houston, Texas.

December 18, 2017.

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