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Regulatory and Institu-
tional Convergence in
the North American
Region**

Alejandro Ibarra-Yunez

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NAFTA as a Vehicle for Regulatory and Institutional Convergence in the North American Region

Alejandro Ibarra-Yunez
Professor of Economics and Public Policy
EGADE, ITESM - Monterrey

Of the three NAFTA countries, Mexico has faced the greatest challenge in upgrading its institutions and regulatory framework to move towards a system of market-based regulations. The transition is well underway but not yet complete. Issues abound. With some national policies, under NAFTA and with the WTO there are a number of outstanding issues, including tax surprises, panel disputes, compliance problems, corruption and new competition from Asia. Asian competition in particular is adding to pressure from NAFTA to accelerate a politically divided Mexico into completing its reform program.

Introduction

NAFTA at 10 years has deepened many dimensions of North American relations: from trade and investment in the North American region, to business expansion, institutional inter-linkages between Mexico, the US, and Canada, and even cross culturization among the three North American partners. As a trade agreement, it is wide, with few sectoral exceptions to liberalization. The trade deal is also deep in the sense that it encompasses much more than tariffication and tariff reduction and reaches out towards convergence in institutions and "rules of the game". Analysis of the economic effects of NAFTA shows its impact on export and import growth, regional development, impacts on labor markets, productivity improvement, and even macroeconomic coordination (Lederman, Maloney, and Serven 2003).

Much less has been said about the dynamics of regulatory and institutional convergence. Since Mexico has been the less developed of the three trading partners, it has had a relatively greater challenge to upgrade institutions and its regulatory framework, from a control-and-command economy, to market-based regulations. A continuing problem both for Mexico and its international partners, is the acceptance of these dynamics and improved compliance at level of the broad North American market, (Coglianese and Lazer (2001)). The present analysis explores Mexico's institutional changes and regulatory framework in light of NAFTA at 10.

NAFTA's framework goes beyond the Most Favoured Nation/National Treatment (MFN/ NT) multilateral criteria and rules of origin, to include Chapter 10 on government procurement, Chapter 11 on investment, Chapter 14 on banking and finance, and Chapter 19 on disputes and antidumping measures. In general, dispute panel rulings have been performing well, and procedures adhere to international practices. For example, antidumping measures did not increase among the three partners after NAFTA was signed; indeed, the total amount of cases initiated by Mexico actually declined during the past 10 years. The increased proportion of cases against the US arose from stronger intraregional trade and investment activity rather than targeted direction.

More recently, the trade codes have begun to extend their influence beyond the state to state framework of NAFTA into the realm of domestic affairs. For example Mexico has upgraded and installed regulations with regional and even global standards in competition policy, consumer rights, property rights, bankruptcy laws, maquiladoras, or the environment. NAFTA has moved the Mexican economy towards institutional upgrading. Unfortunately, in too many cases, new regulatory models are unavailable. Some of the regulations mentioned above need revision regarding (a) Compliance; and (b) the timing of application.

After 9/11 and mainly after recessionary pressures in the US and Mexico --much less in Canada-- protectionist measures and unilateral government decisions put at risk the question of an integrated North America market facilitated by a cohesive set of rules. Moreover, the Mexican legal setting, even if beyond the scope of NAFTA, needs to become more convergent with those of its NAFTA partners to solidify positions of the three countries with respect to global competition. This needs political will at the same time that it needs to be approached technically, not politically. Many problems of compliance and timing are conditioned by both interest groups in the private sector, and partisan positioning in the government sphere. Each has a voice in the reviewing and upgrading regulation, but the rule of law must prevail.

Some Problem Areas

WTO and NAFTA dispute settlement procedures have enabled the three countries (and others) to resolve problems arising from failure of trading partners to implement their international obligations, and to resolve disputes over application and interpretations of NAFTA and overall trade, investment, the environment, and other provisions. Filing of cases is needed to secure adherence to international economic rules. Much can be improved on some:

At the WTO, some cases stand out:

- a) Patent rights, following WTO's TRIPS agreement (an example: cumbersome government procedures for testing products, and its impact on the length of Intellectual Property Rights (IPR) protection).
- b) Subsidies and support programs that violate WTO provisions, both in agriculture and also in other manufacturing and service sectors.
- c) Unilateral tax surcharges and customs procedures at borders.
- d) Customs valuation procedures that violate agreed-upon methodologies and exacerbate problems with procedures for imports subject to barriers (The US has a committee of customs valuation to ensure its procedures are WTO compliant, but Mexico does not)
- e) Government procurement activities have not been entirely compliant with WTO agreements, restricting information and ultimately imports of goods and services by the government sector from NAFTA partners.

At NAFTA level, there are some outstanding cases of problem areas:

- a) Implicit expropriations, mainly arising from legal interpretation at different levels of governments.
- b) Customs valuation procedures and measures taken against smuggling and illegal branding of products, mainly from Asia.
- c) The agreement on trucking, the high fructose case, the US dolphin safe case that followed less than clear procedures, and the steel tri-protectionist case, to mention only the most visible ones.

In this connection, the Trade Policy Review Mechanism has not been implemented as a tri-country team, with attendant promotion of convergent competences (Del Duca 2003).

Much of the regulatory framework and its need for review however, seem to be domestic. The US trade laws, mainly parts of Section 301 on government practices; the special 301 on Intellectual Property Rights (IPR); Title VII on government procurement; parts of the Section 301 on US trade expansion, and recently section 1377 on telecom services, have all been unilateral and pander to interest groups rather than respect agreed-upon trade principles.

In the case of Mexico, regulations and their institutional setting have been implemented at various levels. But problems remain: For example in Mexico's new competition policy, sector-specific regulations on energy, petroleum, banking, or telecommunications, await definitions of the special regulatory agencies' autonomy and independence from other spheres of government. According to Noll (1985), even if the issue of regulatory upgrading is a multifaceted one, there are insufficient bridges between laws, delegated authorities, knowledge of the real economic effects of regulatory actions, and the administration and compliance of regulations. Regulations related to the NAFTA application are now in line with international practices and procedures. However, other domestic regulations need a dramatic shift towards predictability and towards a clear direction in favor of economic efficiency.

Pending and Pressing Issues

Companies in Mexico and subsidiaries in, as well as Mexican multinationals argue that the cost of doing business has increased, mainly since 2001. Main problems emanate from policy surprises in:

- a) Fiscal and tax charges, both at the VAT and exceptions, as well as the now contested special tax on production and services (IEPS) applied in Mexico to producers of soft drinks. Other fiscal surprises have negatively affected maquiladoras, such as the wage credit substitution tax. Other surprises arise from the application of intricate measurement of rules of origin (mainly applied to special sectors such as automotive vehicles and parts, and the textile sector. (as described in Chapter 3 of NAFTA)
- b) Application for dispute settlement and procedures from the three countries and problems of enforcing compliance with panel rulings.
- c) Judicial intervention on illegal business practices, such as environmental aspects of zoning/location
- d) Corruption and excessive red tape.

Other pressing matters relate to the apparent abandonment by the US of the international trade and investment policies in favor of its national security concerns, where these should call for international cooperation -- and this at the same time that the North American regional market increasingly deepens and reaches out to improve business, labor, consumers, resources, infrastructure, and rule making.

What is Ahead for Mexico?

Firms may seek to influence trade policies both for competitive or for non-competitive reasons. Competitive firms will lobby for liberal trade policies and would push for market-driven regulations. Non competitive firms would seek non efficiency-based strategies, advocating not only protectionist government measures but also regulatory environments that unrelated to economic efficiency. In order for regulatory change to take place in Mexico, as well as in other countries, leadership at governmental and NAFTA spheres is needed. Additionally, discussion of the issues in academic fora, and proposals based on research would greatly improve the understanding of this key aspect of North America as a tri-county region, threaded by sound institutions and North American-wide "rules of the game".

Mexican governments as well as companies and chambers of commerce and industry are beginning to address regulatory changes and strengthening institutions and legal settings, albeit mainly in reaction to the more competitive economic times. China's increased participation in world trade and emergence as a major recipient of foreign direct investment flows, reforms in India that liberalize labour, success stories of regulatory reform in Chile, New Zealand, or Ireland in recent years, and the current conflict and partisanship in current Mexican politics form the setting for institutional and regulatory reforms. Clearly Mexico's reform agenda not only relates to deepening NAFTA, but also to achieving economic efficiency and improved competitiveness. Urgency seems to attach itself to specific issues: it does not yet impose a strategic time frame for upgraded market- or compliance- driven regulations. In the current climate, leadership might not come from the North in NAFTA partners, and may not be evidenced by domestic governmental authorities in Mexico. Nor has leadership been sufficiently focused by interested firms or chambers, for whom addressing the issues even from the academic side would at least shed some light on this key aspect of the North American region—and which would resemble the willingness of business and industry to accept regulatory convergence in other increasingly integrated markets such as Europe.

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