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MEXICO WATER REPORT

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Bid Concerns for Foreign Companies

When the International economic crisis hit Mexico in late 2008, Conagua (Mexican Water Commission) established that its funding of public sector water projects would continue forward without delays. And, while one can argue that many projects did continue forward, especially in 2009, projects in 2010 were dramatically affected by budget, political/electoral, and typical Mexican bid bureaucracy. It appears now that many projects delayed in 2010 will likely come back on line in 2011. However, Wisconsin's Trade Office in Mexico warns that for foreign companies, it sees only serious concerns and larger problems and deceptions affecting their participation, or ability to participate, in Mexican public sector projects now and in the foreseeable future.

This article will explain the blurring that has taken place between National and International bids in general and especially with new and stricter national content regulations, as well as how ineffective NAFTA has been in protecting US and Canadian companies from this new Mexican protectionism. It will also discuss how and why foreign companies and companies trying to provide non-Mexican made product should be concerned about remaining viable in the Mexican public water sector.

Evolution of National Content Regulations in Mexican Government Procurement
In November of 1994, six months after NAFTA went into affect, Mexico established a rule that 50% of the contracts of federal, state, and municipal governments should be with small or medium Mexican companies, an interesting, progressive measure that for the most part was not enforced or enforceable. Ironically, although the NAFTA chapter on government procurement was supposed to create opportunities for US and Canadian companies and protect at least them from protectionist procurement measures in Mexico, said rule served as a precursor for much more protectionist measures in this area that would come from the Mexican federal government in November of 2000 and even more strongly in October of 2010.

In November of 2000, Mexico published its first Rules for the Determination and Accreditation of the Amount of National Content for Federal Government Procurement. In these rules, the Mexican government established that all federal government procurement goods purchases needed to have at least 50% national content. While procurement laws established that public works contracts could only be bid on by Mexican based companies, said contracts did not have any national content requirements. While said regulations allowed Mexican federal dependencies to establish national content minimums, this was something that was rarely done.

While these new national content requirements for the purchase of goods (but not on public works) now existed, said regulation (a) was not implemented with a heavy hand at the federal level, (b) state and municipal procurement officials virtually ignored these stipulations, and (c) federal officials looked the other way at these state and municipal transgressions. As a result, despite the creation of these 2000 Rules foreign companies could find a viable way to do business in the Mexican procurement system.

In October of 2010, the 2000 Rules were modified to make it even more difficult for foreign companies to participate in the great majority of government bids at the federal, state, and municipal levels. And more importantly, the implementation of these rules appears to be real and consistent this time, unlike in the case of past procurement and national content laws and regulations. Prior to the October 2010 National Content rules changes, the opportunities for foreign companies could be understood to be generally viable and even somewhat ample. If a foreign company had a Mexican subsidiary or sold its products through a Mexican intermediary, then they could participate freely in all bids, including national bids. However, the new 2010 regulation and its heightened implementation dramatically affected this viability. With the extension of national content to public works and the more strict enforcement of the national content regulations, foreign companies are effectively excluded from being able to participate in national bids even via a Mexican intermediary because said bids now require 55% national content, and they will require at least 65% national content in less than 18 months (in July 2012). And, the 2010 regulations are being interpreted so that even international bids are subject to national content requirements when Mexican products and technology can meet bid requirements.

Analysis of the Changes Resulting from the October 2010 Regulations

The most important change for the water sector brought about by the October 2010 National Content rule changes was related to the establishment that all municipalities and states that used any federal funding (80-90% of these cases or more) would have to abide by these new regulations as well. This change at the municipal level is something new and particularly damaging for foreign companies in the water sector since more than 95% of Mexican bids in this sector are municipally procured, and since municipal and state government bodies are exempt from NAFTA protection. It is interesting to note that while the Mexican federal government insists on the exclusion of municipal and state procurement from NAFTA protection, arguing that said entities are not truly federal and therefore exempt, it nonetheless conveniently uses municipal dependence on federal funding to insist that said entities have to comply with these federal regulations. This makes these entities de facto federal bodies from a national regulatory perspective but evidently and conveniently not from a NAFTA perspective. Is this a legitimate legal loop hole or a classic example of having your cake and being able to eat it – we see it as the later.

Another negative has emerged from this heightened enforcement and percentage increases in national content rules. Foreign companies and/or their Mexican intermediaries or partners, are being forced to decide between being excluded from the Mexican government procurement system altogether or lying and stating that their products meet national content minimums and bribing local officials to look the other way, hoping that federal oversight will not catch their digression.

Wisconsin's Trade Office in Mexico is already aware of a few cases of this type of behavior by foreign companies. This is not only inappropriate and illegal in Mexico, it also goes against US export practice laws that the US federal government promotes and enforces, thus providing US companies with another barrier to remaining viable in its second most important export market, a market where NAFTA was supposed to mean the elimination of old trade barriers and not the creation of new ones. We fear that too many local Mexican water procurement officials will become more aggressive in the future at using this national content rule as a tool for corruption, being able to function even more effectively and efficiently with it as gate keepers approving or eliminating bids at the beginning of the process using this legal“ruler” more adeptly than previous more onerous and questionable instruments.

It is important to mention that foreign manufacturers and Mexican intermediaries who sell foreign products into the Mexican public water sector are now beginning to see the implementation of these changes, that is, a commitment by the Mexican federal government to enforce these regulations and subsequently a new adherence by municipal and state governments to these regulations. Some companies who sell components to Mexican integrators, where a large part of a public work is labor or construction, seem to be less affected so far by these regulations. However, in 18 months when the percentage of minimum national content is 65%, this could and probably will change. And, it is important to clarify that these percentages are MINIMUM requirements and that foreign companies and Mexican distributors of their products are saying that they are now routinely running into bids where the percentages are above 65% and has high as 100%. For a company trying to sell product via a Mexican distributor to the Mexican government in a bid only for that product, virtually any national content requirement, as is the case in Mexico, will serve as an effective way to exclude these products from the market.

Analysis of NAFTA Government Procurement Provisions

Above we mention that NAFTA Chapter 10 Government Procurement does not seem to offer US and Canadian companies adequate protection from Mexican protectionist government procurement policies. When one reads the key articles in this Chapter, it is hard to imagine how US and Canadian companies are not protected from these types of actions.

Article 1003 – National Treatment and Non-Discrimination

1. With respect to measures covered by this Chapter, each Party shall accord to goods of another Party, to the suppliers of such goods and to service suppliers of another Party, treatment no less favorable than the most favorable treatment that the Party accords to (a) its own goods and suppliers; and (b) goods and suppliers of another Party.

2. With respect to measures covered by this Chapter, no Party may treat a locally established supplier less favorably than another locally established supplier on the basis of degree of foreign affiliation or ownership, or discriminate against a locally established supplier on the basis that the goods or services offered by that supplier for the particular procurement are goods or services of another Party.

Even US federal government officials responsible for NAFTA issues confirm that said articles do not protect US and Canadian companies from unjust Mexico government procurement procedures, specifically prohibiting US companies to bid directly without Mexican intermediaries and prohibiting Mexican government entities from using restrictive national content regulations to exclude US companies from the sector.

Likewise, Article 1024 (Further Negotiations), referenced extensively above in Article 1001, which discusses the initiation of negotiations for improvements in Chapter coverage to include local/state entities under Chapter 10 provisions, has NEVER taken place even though said article mandated that negotiations were supposed to start between the three parties no later than 1998 - 12 years of no activity on the issue.

In the case of international bids, it is now illegal, not to mention completely impractical as the system exists today, for a foreign company to bid on any international bids without a Mexican corporation, partner or intermediary as the formal bidder. As a result, any foreign company hoping to employ a rep or agent for this purpose can no longer do so. If NAFTA was supposed to help in this area, it absolutely has had no effect except to deceive US companies into believing that somehow they were better protected from these types of issues and problems after 1994 than before 1994.

Another problem lies with the Mexican government procurement system. Said system is structured so that effectively three types of bids are permitted: (a) national bids in which only Mexican-based companies can participate, (b) international bids where companies from countries with free trade agreements (like NAFTA) with Mexico can participate, and (c) open international bids where companies from any foreign country can participate. However, foreign companies cannot participate in any of these bids without a Mexican entity, despite what NAFTA seems to establish. One might argue that foreign companies should be content to be able to participate in the international bids and agree to set up Mexican corporations to participate in national bids or simply allow Mexican companies to have these national bids that one might assume are of lower value and probably fewer in number than the international bids. However, Wisconsin's Trade Office in Mexico analyzed all public sector water bids between July 2009 and June 2010, and found that during that year period, only 2.28% of all such bids were international in nature. In speaking with Mexican water government officials involved in procurement bids, it appears that this is a trend that will continue and by no means an exception.

These Chapter 10 articles have been ignored or Mexican officials have found ways to change their meaning and circumvent their enforcement so that Chapter 10 is completely ineffective and out of step with if not contradictory to the spirit and purposes behind the inclusion of a government procurement chapter in NAFTA. As a result, one has to ask, does Chapter 10 have any merit or help protect US and Canadian companies in any way from Mexican government protectionism in government procurement – we have to conclude that it does not.

U.S. and Canadian Procurement Laws vs. Mexican Procurement Laws

The above information in this article demonstrates that Mexican government procurement laws and regulations are clearly protectionist in general and even towards US and Canadian products, something clearly not in the general spirit of NAFTA nor the spirit or evidently the reading of Chapter 10. An easy but incorrect assumption might be made that the US and Canadian government procurement laws and regulations are probably just as protectionist as those in Mexico. While Wisconsin's Trade Office in Mexico has not studied this issue exhaustively, from conversations with US federal government officials and from some investigation of some applicable regulations, it seems that the US does not treat NAFTA partners, nor for that matter countries with which it does not have free trade agreements, in the same negative way that Mexico does. The US does offer protection for some metal/steel producers in government procurement bids, but said protection is clearly temporary in nature. These US measures neither apply to all products that are procured by the federal government nor are written into the law as something intended to be permanent, as is the case with the Mexican National Content Regulations published in October of 2010.

It is important to mention that all of Canada´s provinces and almost 2/3 of US states have ratified the GATT Agreement on Government Procurement, which establishes that these entities cannot discriminate against foreign products the way that the Mexican federal government is currently doing. And, to our knowledge, not a single Mexican state has made any effort to look into the ratification of this GATT Agreement. One has to ask why this is so and why the Canadian provinces and 2/3 of the US states should adhere to these more stringent, non-protectionist GATT policies if their NAFTA partner counterparts have expressed no interest or willingness to pursue similar actions.

Conclusion

Many U.S. and Canadian manufacturers who were expecting government procurement opportunities to come from NAFTA and the supposedly more liberal, open Mexican economy have to be feeling deceived. One can easily argue that Mexican laws and NAFTA have not only not created procurement opportunities, they have restricted if not eliminated most opportunities that existed before NAFTA. This claim is serious because It comes with three very negative implications: (1) NAFTA is almost useless and even detrimental for government procurement opportunities in Mexico, (2) in the area of government procurement there exists a serious lack of commitment by Mexico to trade relations with its most important trade partners, and (3) Mexico's government procurement policies demonstrate serious contradictions in the loud and proud stance of the Mexican federal government that if a country signs a free trade agreement with Mexico, its market will be opened to the products of the companies from these nations.

Shouldn´t Mexico exclude countries that have signed free trade agreements with Mexico, especially the U.S. and Canada, from these blatantly protectionist measures? And, if it does not see the reasoning and prudence of doing so, shouldn´t the U.S. and Canadian federal governments be more vocal in public and more active in bilateral and trilateral negotiations with Mexican officials about these concerns. In the next edition of the Quarterly, we are going to discuss options for how U.S. and Canadian water-focused companies and their respective associations can work together with their respective governments to get these measures modified if not repealed. If any foreign companies or

Mexican intermediaries would like to interface with Wisconsin's Trade Office in Mexico to discuss these issues and future lobbying efforts, please do not hesitate to contact us.