

Mexico | The collapse of NAFTA will increase the risks to world trade

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This week sees the start of the sixth round of renegotiations of the North American Free Trade Agreement of NAFTA in Canada. According to members of the Mexican negotiating team, previous rounds have seen significant progress in a number of areas. However, there are still major obstacles, the result of the United States placing certain demands on the table that Mexico and Canada have termed unacceptable. Three of these requests need to be highlighted: (i) a requirement that for a car to be considered to have been made in North America -and therefore benefit from zero tariffs - at least half of all parts have to be sourced from the US, (ii) the introduction of a clause requiring the agreement to be reviewed every five years. If one of the parties declares it not to be beneficial to its interests, the treaty may be revoked and (iii) removal of the dispute settlement mechanism included in the original agreement. The first of these is particularly protectionist in its demands. No such requirement exists in any free trade agreement anywhere in the world.

This round of discussions will provide a context that allows us to be more optimistic with regard to the chances of a successful renegotiation. Trump recently told the Wall Street Journal that he was seeking a negotiation that was favourable to the United States. If this failed, he would then pull out of the agreement. This was nothing new. What was different this time is that he said that he preferred the first of these two options. He also said that he knew that Mexico would be holding presidential elections this year, a factor which might complicate the negotiations, and that as a result, he was prepared to be patient and wait for a satisfactory agreement. Furthermore, the United States Agriculture Secretary recently said that Trump was fully aware of the advantages NAFTA had brought to the country's farming and fisheries sectors. Meanwhile, a number of Republican senators and congressmen have made strongly-worded declarations in favour of maintaining the agreement.

In Mexico, the exchange rate has fluctuated in response to expectations as to what might happen with NAFTA. In recent days, the peso fell when Canadian civil servants claimed that a US abandonment of the treaty was imminent and then rose after the aforementioned WSJ interview with Trump. In fact, the main driver affecting the peso-dollar exchange rate over the past year and a half has been Trump. Initially it fluctuated on the likelihood of his winning the 2016 presidential election, with subsequent swings stemming from uncertainty as to his position with regard to NAFTA.

Of course, a successful renegotiation that satisfies all parties is the best possible scenario. I feel that a break-up of NAFTA would prove to be a negative outcome, although not for the reasons that are most commonly cited. Without NAFTA, Mexico will still be able to trade with Canada and the United States under WTO rules. This would not prove overly disruptive to trade relations between Mexico and the United States, as the increase in tariffs would not be too high (I believe that Mexico's strategy in such a scenario would be to keep zero tariffs on US and Canadian imports, benefitting consumers and producers that use imported inputs).

It seems to me that the underlying problem is the Trump administration's obsession in reducing the US trade deficit with the rest of the world. This deficit is the result of macroeconomic imbalances and not wording of trade agreements. If the Trump administration decides to pull out of NAFTA, eventually it will realise that this

will not result in a reduction of the US deficit with Mexico and Canada. The American reaction could be to go against WTO rules and seek to reduce its deficit with China. All of this might take place within a context of falling trade and even trade wars on a global scale. The last time that this happened, the result was the first world war. Trump's aversion to trade deficits is very dangerous. The collapse of NAFTA could have extremely serious consequences for international trade and therefore global growth and well-being.

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