KPMG eurasia group

NAFTA Insights

August 2017 – Edition 1

Welcome to the first edition of the NAFTA Insights newsletter. These regular briefings are designed to help you keep abreast of the latest developments and business implications related to NAFTA negotiations. By combining Eurasia Group's business-relevant political analysis with assessments of the 'now what' for business from the professionals of KPMG's member firms, our aim is to enable you to be on the front foot as the process unfolds. This edition covers a sweep of the process and likely outcomes as the opening round kicks off in Washington, and we will adjust the frequency and substance of future editions to match the progress of negotiations.

The US, Canada, and Mexico are staking out their opening positions. Canada and Mexico both want to see the agreement preserved, given its importance to their economies. The Trump Administration, with its many criticisms of NAFTA, will ultimately need to balance those criticisms, perhaps changing and modernizing NAFTA without fundamentally altering the agreement in ways that would negatively affect US consumers, companies, or workers – and do so in ways that Canada and Mexico can accept.

So what is likely to happen?

According to the Eurasia Group's calculus, the most likely outcome of the renegotiation — a 65 percent probability — is a quick, relatively painless agreement by the first quarter of next year to update and modernize NAFTA. Eurasia believes all sides have such an interest, and a quick agreement could give the Trump Administration a concrete achievement to present ahead of the 2018 midterm elections.

An alternative scenario — a 35 percent probability, according to Eurasia Group — is a renegotiation that slips later into 2018 because of more complicated and perhaps controversial issues, which would create additional obstacles for a successful conclusion to the political process.

So when will we know more?

Though there is no formal deadline in Mexico, Mexican presidential elections and the expiration of trade promotion authority (TPA) in the US give the talks a functional deadline of July 2018. If the process extends into next summer, the presidential race would make it harder for the Mexican government to accept changes. Likewise, there is a risk that negotiations would have to be reopened if less market-friendly leader Andres Manuel Lopez Obrador wins the presidency. If a more market-friendly candidate wins the presidential race, the talks could be concluded more quickly.

In the US in general, trade agreements in election years have historically been more challenging to advance – a challenge that increases as the election year advances.

So who wants what?

The US administration has both general and specific goals. In general, the Trump Administration (which is not fully in place) is looking to strike a balance, making changes that would more directly benefit US workers, while not hurting US businesses.

Regarding specific goals, the administration on 17 July released its negotiating objectives, as required by TPA. Many of these goals were unsurprising and will be relatively uncontroversial, such as adding a chapter on digital trade and increasing protections for intellectual property. But others, including reducing the US trade deficit with Mexico, eliminating the Chapter 19 dispute settlement mechanism, and language prohibiting currency manipulation, are likely to be more contentious. Overall, the US objectives are consistent with the Eurasia Group view that renegotiation will be relatively painless, provided USTR Robert Lighthizer and his team are willing to compromise on the most controversial portions of their agenda.

For both Canada and Mexico, the ultimate goal will be preservation of NAFTA. The accord has been a boon for both countries, particularly for Mexico, where it has catalyzed years of growth. Both countries have matters they would like to see resolved in the talks, such as disputes over dairy and softwood lumber for Canada and the continued opening of the energy sector for Mexico. That said, NAFTA's survival as the bedrock of an integrated North American market will be their primary goal.

So what should you look out for?

The negotiations themselves will take place behind closed doors, but details will leak out. The most important aspects of the talks to follow are:

- Chapter 19 dispute settlement mechanisms: The Trump administration wants to eliminate them, but both the Mexican and Canadian governments want to preserve them.
- Rules of origin: Strengthening the rules is something the US thinks would help to make its manufacturing sector more competitive, though doing so could be very disruptive for existing value chains and is therefore a sensitive issue in the negotiations.
- Trade deficit reduction targets: Mexican negotiators could not accept overly ambitious and onerous targets.
- Labor standards: The Mexican government is willing in principle to make changes to its labor laws and to raise the minimum wage to satisfy US demands, but its room for maneuver will be limited after approving a labor reform at the beginning of President Enrique Pena Nieto's term.

If these issues have not been settled by the end of this year that would be a negative sign for the talks. Similarly, silence from the negotiators and the leaders of the US, Canada and Mexico would be a positive sign. If the negotiations themselves can be kept largely out of the public eye, until agreements are reached, they are much more likely to succeed.

As always, please reach out to us and the team for any questions, queries or opportunities: GO-FM Geopolitics.

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