NAFTA Insights

February 2018 – Edition 6

Since the last NAFTA Insights, talks have improved but Mexican elections still pose a significant risk. With Eurasia Group providing the latest developments from Round 6 of the NAFTA renegotiations, this edition considers potential action steps for businesses in anticipation of the upcoming changes to cross-border trade in the NAFTA territory.

So what's the latest on negotiations?

The sixth round of the NAFTA renegotiation concluded on 29 January in Montreal with some advances but relatively limited progress on the key remaining contentious issues. However, while highlighting the difficulties that remain in the negotiations, the closing ministerial statements signaled that enough progress had been made to continue the negotiations, with a new round of talks now scheduled for 26 February through 6 March in Mexico City.

The negotiating teams were able to close the anti-corruption chapter and some sectoral annexes, the first chapter successfully completed since the fourth round in October. Regarding the anti-corruption chapter, bribery and illicit earnings will be considered as punishable actions, preventive and punitive measures will be outlined to avoid such behaviors and payments will be provided to accelerate procedures. Cooperation between countries and the enforcement of the integrity of government officials also will be supported.

It also looks like the digital trade, telecommunications, the food safety plan and animal health chapters could be closed in the upcoming round in Mexico. The president of the Business Coordinating Council (CCE), Juan Pablo Castañon, suggested that around 6 to 10 chapters could be closed on the next round which would represent up to 40 percent of the deal. Eurasia Group points to the fact that negotiators have agreed to continue the talks as a signal that all sides still want a deal. This also further reaffirms Eurasia Group's view that Trump will not send the withdrawal letter at this point. But USTR Robert Lighthizer remained critical of various proposals including the binding dispute settlement mechanism and Canada's counteroffer to the US auto content proposal, while lamenting that the pace of the talks was still very slow.

The slow pace has made Eurasia Group revise their call – they now think it is unlikely that a deal will be reached by the end of the first quarter. Instead, Eurasia Group suggests that it is becoming more likely that the negotiations will be extended past the March deadline, an outcome that President Trump alluded to being open to in an interview with the Wall Street Journal on 11 January. Furthermore, recent comments by Economy Minister Ildefonso Guajardo at Davos signal that Mexico is willing to continue talks throughout the electoral cycle - bringing Eurasia Group to conclude that even with an extended deadline, a deal is still likely this year, now by July.

But the extension also reinforces Eurasia Group's view that the Mexican election in the summer represents a significant risk for NAFTA, as a deal will be harder to negotiate during presidential campaigns which are expected to ramp up in April. If a deal is not done by July, the Peña Nieto administration would still have until December to negotiate the deal, before the next president takes office (on 1 December). But Eurasia Group thinks that this could be difficult if leftist candidate Andres Manuel Lopez Obrador wins. As a result, investment in the region could take a hit.

What else should you keep an eye on?

Looking beyond NAFTA to the broader geopolitical environment, Eurasia Group suggests that we're in a period of "geopolitical recession", where international politics is facing a growing power vacuum due to rising trends that reject globalism. With countries largely looking inward, the rules of engagement are being re-written.

In 2017, we saw this play out in very significant ways. To pick but a few; closely contested elections highlighted the rise of populism and far right public sentiment across the developed world. Strongman stances became – or at least were seen in popular opinion as – government policies in the East and West alike. And most importantly, game theory became media fodder as trade agreements covering some of the world's biggest markets came up for negotiation.

Looking forward, 2018 seems set to continue the political drama of this year - from nuclear war to trade wars, keystone elections to keyboard crime. Global corporations clearly recognize these risks - nearly 80 percent of respondents to WEF's recent annual Global Risk Perception Survey[1] said they expect an increase in risks associated with war involving major powers, and an overwhelming 93 percent expect political or economic confrontations between major powers to worsen.

Why is this important? This isn't intended to fear-monger – it merely highlights that NAFTA negotiations can't be considered in isolation, and there are broader trends and moves at play that could impact the end state of the agreement.

Thriving in this environment may require going beyond how your business traditionally has dealt with political risk. The impact of politics on a sector or business can manifest in unprecedented and seemingly disconnected ways, and it requires a whole-of-company view to navigate this landscape.

[1] WEF's Global Risks Report 2018, available here.

What should you do?

Here's one suggestion for how you plan for the world in 2018: don't get caught up in the 'black swans' – by definition they are unpredictable and unexpected. Prioritize scenario planning over horizon scanning; in this topsy-turvy world, it is much better to focus your time and energy on the known unknowns than trying to complete a full set of possible risks.

We've spoken about scenario planning and preparing for changes to NAFTA within a broader context (like US Tax Reform). The revised Trans Pacific Partnership Agreement (TPP) without the U.S. (now called the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)), signed on 23 January 2018, may also create a new level of opportunity for companies with a presence in Canada and Mexico. Importers in these countries should incorporate the impact of CPTPP in their scenario planning.

But in light of the geopolitical environment, why not think even more holistically? Consider stress-testing your 3-year business plan to the following scenarios (individually or collectively):

- 2x increase in operating expenditure of transacting across borders (financial hedges, professional fees, regulatory compliance, travel cost and the like).
- 72-hr outage of information backbone (website, online gateways, encrypted messaging services and similar). Here's a tidbit for you: if a major cloud provider went down in an attack, the damages would be somewhere in the range of a Sandy event to a Katrina event (an estimated US$50-US$120 billion).
- Zero cross-border travel for one week (no plane, train or road journeys across international borders).
- Double transport time (and/or cost) of transporting goods (sea, air, road, rail).

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

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Key links

- KPMG's site for Brexit and geopolitics
- Eurasia Group's site for geopolitics

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