

The Risks of Ending NAFTA

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The growing complexity of the NAFTA negotiations has led to a series of discussions and statements regarding the potential scenarios that a critical situation in the negotiations themselves, or in a unilateral decision by President Trump to abandon the treaty, could precipitate. The Mexican government has been constructing a narrative aimed at preventing a sudden collapse of confidence and expectations, involving in that process the main business leaders. The objective is very clear and reasonable; however, it is fundamental to understand what is involved because the national mood has been radically altered in recent weeks as a result of both the attempts to minimize the relevance of NAFTA, while adopting catastrophic positions.

What's relevant is to recognize what NAFTA is and why it is important. In a word, the NAFTA is transcendent because it constitutes an anchor of stability, a source of certainty that enjoys international support and recognition. This certainty is key both for internal confidence and for attracting foreign investment.

- NAFTA was conceived as a mechanism through which the Mexican government obtained a kind of certificate from the US government as a guarantor that the rules of the game would be preserved, that the open trading regime would be maintained, and that the commitments made in the text of the NAFTA would be strictly adhered to.
- At the outset, the objective of those negotiations was not trade, but a guarantee for investment. This guarantee would serve both to generate confidence in the preservation of the open trading regime and in the protection of foreign investments. What turned out to be NAFTA incorporates these two elements in its text as well as in the political commitments that accompanied it.
- In the extreme speculation that Mexicans have fallen in through the past few weeks, there is no discussion about how to preserve NAFTA, but who should get out first: the Americans if they see that Canada and/or Mexico are not willing to accept their demands (many of them clearly unacceptable) or Mexico as a symbol of congruence and manhood. The reality is that if the US government withdraws from NAFTA (a scenario that I still think is unlikely) for Mexico, it is crucial to sustain the relationship with Canada, which,

although less relevant in both economic and political terms, at least obliges Mexico to preserve the legal regime of protection for investment, not a mean feat. It would also compel Mexico to preserve the trading framework inherent in NAFTA, which entails a fundamental internal discipline, thus reducing the potential for incorporating endless distortions in economic decisions.

- On the other hand, it is imperative to understand the political role of NAFTA within Mexico: its objective was to dramatically limit the latitude of future governments for making changes to the basic framework of economic policy (the open trading regime) in the event that a president with a different economic philosophy came to government. That is, the NAFTA was conceived as a profoundly political instrument for internal purposes, in recognition of the enormous *de facto* powers of the presidency, something very different from the checks and balances that characterize the US. It is thanks to NAFTA that the economic policy was not altered in the midst of the massive crisis of 1995 and could serve the same purpose should Lopez Obrador win the presidential election next year.
- In other words, NAFTA constitutes a limit (smaller now than before due to the Trump effect, but a limit nonetheless) to a radical change in domestic economic policy, something of enormous relevance for the country's political stability.
- In this context, should the NAFTA with the US end, it is clear that, as has been argued repeatedly lately by government and business leaders, most of our exports would continue to have access to the US market, but now under WTO rules, where Mexico and the United States are granted most-favored-nation treatment, the essence of international trade where all participating nations enjoy the same rights and obligations.
- However, the end of NAFTA (at least with the US) would indeed jeopardize the general economic policy, since it would open the door to the imposition of new import tariffs (those committed by Mexico within the WTO framework are much higher than those of the USA), as well as other changes in fields as diverse as the handling of the banks, the tax and fiscal policy. That is to say, in the absence of NAFTA, the government would feel completely free to favor companies and discriminate against others, grant protections, incentives and subsidies to their favorites and, in a word, abandon the regime of economic equity that, although it certainly has not fixed all the problems of the country, constitutes the backbone of the economic activity.
- It is important to remember that the country's economy shrank by 9% in 2009 because, as exports declined due to the US crisis, domestic demand collapsed, thus provoking a snow ball effect that brought about the sudden contraction of all economic activity. That event demonstrated that the NAFTA is the only engine of growth of the Mexican economy. Modifying the economic framework that is inherent to NAFTA would imply putting the engine of the Mexican economy at risk. This is not a minor matter. It is equally important to remember that Lopez Obrador's approach to economic policy consists precisely in reversing the economic framework towards that which prevailed in the 1970's.

In short, the risk of NAFTA's termination would not be appreciated, at least not at the outset, in foreign trade, particularly in exports, but in the ability to attract investment from abroad and in the preservation of domestic confidence. NAFTA is the only source of certainty in the Mexican economic world; disregarding its importance or minimizing it could have dramatic consequences, none of which are in the interest of either Mexico or the United States.