Intelligence MEMOS

As NAFTA renegotiations proceed, the C.D. Howe Institute Intelligence Memos will be looking at what to expect and provide analysis on the latest developments. This post is part of that series.

From: Dan Ciuriak

To: Concerned Canadians

Date: November 27, 2017

Re: **What if the United States Walks Away From NAFTA?**

The renegotiation of the North American Free Trade Agreement (NAFTA) opens up the possibility of the trade agreement lapsing. Canada's trade with the United States is remarkably balanced, when taking into account trade in goods, trade in services, investment income earnings and royalty payments for intellectual property. Nonetheless, not only has NAFTA been re-opened but Canada has become a target of both protectionist rhetoric and actions – including the application of anti-dumping duties and countervailing measures against alleged subsidies.

The United States is also demanding the scrapping of an important discipline on such actions, the NAFTA Chapter 19 binational review panels that Canada obtained as a key concession in the original free trade talks with the Reagan Administration. This, along with other demands that have been characterized as poison pills, raises the possibility of a breakdown in talks.

In a forthcoming paper, we evaluate what would happen if trade between Canada, the United States and Mexico reverted to the rules under the World Trade Organization. We also consider the impact if NAFTA lapses but the Canada-US free trade agreement (CUSFTA) remains in place; and scenarios under which free trade would continue between Canada and Mexico. The key findings are as follows:

- NAFTA lapsing hurts all three NAFTA parties in terms of foregone household income, jobs and growth. Real GDP in the NAFTA region would be 0.225% smaller without NAFTA than with it, trade would fall by over US$120 billion, economic welfare would be close to $60 billion lower, wages would fall with productivity declines, and job totals across the NAFTA parties would be reduced by about 220,000.
- Walking away from NAFTA does not resolve US concerns about bilateral trade deficits; the United States suffers about as large a drop in its bilateral exports to NAFTA partners as it reduces imports from them.
- The US suffers relatively small negative effects compared to the size of its economy but these are concentrated in the automotive sector and the farm belt. In turn, this suggests protracted talks, consistent with how the internal US debate over NAFTA appears to be shaping up.

Key impacts on Canada are as follows:

- Taking into account the redirection of Canadian exports to third parties, total exports would decline by about US$20 billion or 2.8 percent.
- Canada experiences a decline in household income of $15 billion and a loss of real GDP of 0.55 percent. This negative impacts would be abated only moderately (about $3 billion less income decline and 0.08 less of a decline in real GDP) if Canada and Mexico continue under NAFTA or retain free trade under the Comprehensive Progressive Agreement for Trans-Pacific Partnership (CPTPP).
- Job losses could be in the 25-50 thousand range due to long-term worker exit from the labour force, even after full employment in the post-NAFTA economy has been re-established. Temporary unemployment during a possibly long adjustment period could add very significantly to these losses. Retaining free trade with Mexico would reduce these losses by 4-8 thousand.
- Industrial products in the chemicals, rubber and plastics complex and automotive sectors experience large declines in bilateral exports to NAFTA partners; these losses are partly compensated by re-orientation towards third markets and to the domestic market, in part filling gaps resulting from declining bilateral imports. Total sales of these sectors fall by $3-4 billion.

Canada's economy could remain essentially unharmed if NAFTA is terminated but the CUSFTA is preserved and could even make marginal gains in trade, real GDP and economic welfare if Canada's bilateral relations with Mexico remain liberalized. Mexico, however, would not be able to escape significant negative impacts, with particularly large adjustment challenges for its industrial sector, compensated somewhat by its agricultural sector reclaiming domestic market share.

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