Predicting life after NAFTA: 'It would not be a disaster'

By Greg Keenan
November 27, 2017 – *The Globe and Mail*

Consumers would take a hit, the Canadian dollar would fall and economic growth in Canada would be curtailed if NAFTA were terminated, but policy makers and businesses would adjust quickly, the Bank of Montreal concludes in a new study.

The adjustments in interest rate policy, currency markets and business activity would ease the damage caused by the end of the three-country trade deal and a reversion to tariffs established under the World Trade Organization regime, the bank's study says.

"Reverting to WTO-level tariffs would leave Canada unequivocally worse off than under NAFTA, but it would not be a disaster, at least not for the aggregate economy," the report released on Monday notes.

The study done by a team of BMO economists, titled The Day After NAFTA, is the latest in a series by analysts, banks and think tanks amid a deadlock in negotiations on a new Canada-U.S.-Mexico pact.

That deadlock after five rounds of talks comes amid key U.S. demands that Canada and Mexico have rejected outright as not being worthy of counterproposals. Among those are the elimination of a dispute settlement mechanism; onerous rules of origin for automobiles and other manufactured goods; an automatic review of the agreement every five years; and the end of supply management in Canada's farm sector.

The study assumes Canada would reject those terms in any bilateral discussion with the United States that might happen if the North American free-trade agreement ends.

The risks to Canada from the deal being terminated are manageable, BMO chief economist Doug Porter said in an interview.

The Canadian economy has endured severe trauma in recent decades, including the massive appreciation of the Canadian dollar in the mid-2000s, the financial crisis of 2008-09 and the collapse of the technology bubble, Mr. Porter noted.

"I would actually view the termination of NAFTA as not being in quite the same league as some of those traumatic events," he said.

Nonetheless, the Canadian dollar would likely sink about 5 per cent to the 74-cent (U.S.) range, real GDP would be about 1 per cent lower than it otherwise would have been and certain sectors of the economy and regions of the country would sustain more damage than others, the bank concludes.

But the Bank of Canada would likely respond by holding the line on interest rates in 2018, perhaps even cutting them once.

British Columbia has the least exposure based on exports to the United States as a percentage of GDP, but Alberta's $50-billion (Canadian) in crude oil exports would likely escape any tariffs, leaving it less vulnerable than some other provinces.

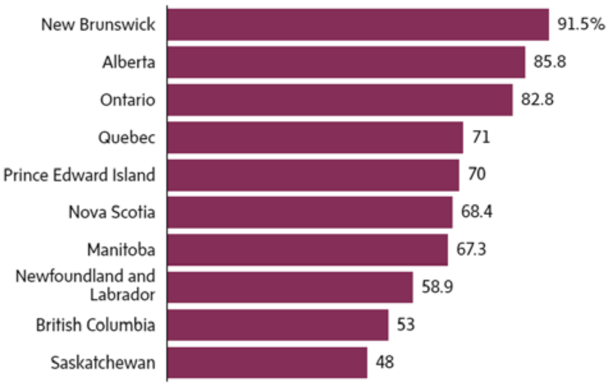
Ontario would be the province most in danger, given that 83 per cent of that province's exports went to markets in the United States last year.

The danger to Ontario comes in part from the impact termination would have on the transportation equipment industry, which includes the auto sector and is ranked by the study as one of the most vulnerable given the integrated nature of the industry in North America.

Prices would rise about 1 per cent in Canada over all and by more than that figure for some goods and services, Mr. Porter noted.

U.S. exports as a percentage of total exports

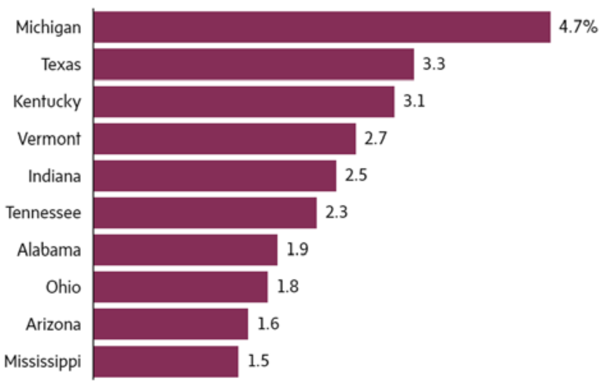
In 2016, by export value



THE GLOBE AND MAIL, SOURCE: BMO NESBITT BURNS

Ten most vulnerable states

Vulnerable exports (by value) as a percentage of state GDP in 2016



THE GLOBE AND MAIL, SOURCE: BMO NESBITT BURNS; NOTE: VULNERABLE EXPORTS INCLUDE TEXTILES, CLOTHING & LEATHER; TRANSPORTATION EQUIPMENT; COMPUTERS & ELECTRONICS; AGRICULTURE; ELECTRICAL EQUIPMENT & APPLIANCES

“Often forgotten is the biggest beneficiary of free trade is the average person, the consumer, and I suspect that were NAFTA to be terminated, ultimately the biggest loser from that would be the North American consumer,” he said.

Autos and textiles, clothing and leather are two sectors of the economy that have the highest WTO tariffs that Canada imposes so prices for those goods could be affected.

With the imposition of WTO tariffs, the levy on vehicles imported from the United States would be 6.1 per cent, while the average tariff on textiles, leather and clothing would be even higher at 8 per cent.

The study said the U.S. economy would endure a smaller impact than Canada, but Michigan, Texas and the belt of auto-producing states in the south – including Alabama, Tennessee and Kentucky – would face greater risks than many other states.

But the implications go beyond economics, David Jacobson, vice-chairman of BMO and the U.S. ambassador to Canada from 2009 to 2013, said in the interview.

“If the United States backs out of a trade agreement for the first time in our history, I think it can’t help but cast a shadow over all those other things that are so important to people on both sides of the border,” Mr. Jacobson said.