Intelligence MEMOS

From: Dan Ciuriak

To: Canadians Concerned about US Trade Policy

Date: February 20, 2020

Re: **THE NEW NAFTA: BETTER THAN NO NAFTA BUT CURB YOUR ENTHUSIASM**

As Parliament takes up the study of the new NAFTA, we provide some quantitative evidence concerning the economic and trade implications of what is on the table.

The Canada-United States-Mexico Agreement (CUSMA), originally agreed in November 2018, and amended in Mexico City last December, represents a significant step back from the three-decade partnership in North America launched with the 1989 Canada-United States Free Trade Agreement (CUSFTA) and further developed with the addition of Mexico in the NAFTA.

The CUSMA signals this clearly: the words "North America", and "free trade" have vanished. Unusually for a modern trade agreement, it has little traditional market access liberalization. Moreover, its modernizing elements, based largely on the Trans-Pacific Partnership (TPP) text, contribute little to reducing trade costs or border frictions.

At the same time, the CUSMA introduces more restrictive rules of origin and increases uncertainty about future market access by leaving unchecked protectionist measures dusted off by the Trump administration, including the Section 232 tariff measures that have been used against Canadian steel and aluminum exports and threatened against Canadian exports of automotive products.

While side agreements provide some assurance against the further use of these measures on these products, there is no such guarantee for other products. And the introduction of a sunset clause coupled with rhetorical signals of the intent to use this to revise the deal in favour of the United States, send a warning signal to business: curb your enthusiasm about investing in Canada to make hay in the US market. The new institutional environment works to effectively raise non-tariff barriers to the US market.

The protectionist focus of the agreement comes with a net cost to all three parties. These costs are, however, more severe for Canada and Mexico since North American trade makes a proportionately much larger contribution to our economies. We estimate that the Agreement will lower Canada's real gross domestic production (GDP) by -0.4 percent and Mexico's by -0.8 percent on an ongoing basis.

For the United States, the estimated impact is -0.1 percent. The only comparable published study of the agreement – by the United States International Trade Commission (USITC) – arrives at a similar estimate for the United States of -0.12 percent but does not provide estimates for Canada or Mexico.

One element of the USITC study warrants explicit comment: it introduces a large positive impact for reduction of uncertainty about future cross-border data flows and data localization requirements. These uncertainty effects flip the -0.12-percent impact into a 0.35-percent gain or even as much as a 1.21 percent gain. We decline to introduce such an effect into our evaluation for three major reasons which call into question the additional effect of the CUSMA in this area:

- Canada and Mexico have already signed onto similar provisions in the CPTPP and the USMCA changes matters comparatively little.
- The future regulatory regime for data flows in areas ranging from privacy, to competition policy, to taxation, to protection of democratic processes is being actively pursued worldwide; outcomes are highly uncertain and there is little empirical evidence on what restrictions will ultimately be deemed as legitimate as opposed to barriers to digital trade that would be prevented by CUSMA disciplines.
- The United States has articulated an extraordinarily expansive scope for national security, in particular for the emerging Internet of Things (IoT) area, which suggests all three parties will have considerable latitude to develop regulations on data flow to ensure national security in the backbone services sectors (communications, transportation, power, and finance) at least.

As regards last December's amendments, these have little impact at the macroeconomic level since the revisions were limited to making discrete interventions in areas that could not be meaningfully quantified. Only the change concerning biologic drugs had measurable commercial consequences and in this respect the change was aligned with Canada's interests.

The bottom line for Canada is that the CUSMA as amended is a step down from the NAFTA, but a marginally better outcome than if the United States were to withdraw entirely. For certain industries – especially the highly integrated automotive sector, the cost of NAFTA lapsing would be much higher than the outcome under CUSMA.

Summary of Main Results

	USMCA		NAFTA Lapsing	
	Real GDP (*% change*)	Welfare (*USD millions at 2019 prices*)	Real GDP (*% change*)	Welfare (*USD millions at 2019 prices*)
Canada	-0.40	-10.39	-0.49	-13.9
Mexico	-0.79	-14.78	-1.09	-23.0
United States	-0.10	-17.82	-0.10	-22.4

Sources: CUSMA Updated (C.D. Howe Institute Working Paper, forthcoming); and Dan Ciuriak, Lucy Ciuriak, Ali Dadkhah, and Jingliang Xiao. 2017. "The NAFTA Renegotiation: What if the US Walks Away?" C.D. Howe Institute Working Paper., Toronto: C.D. Howe Institute. November.

Dan Ciuriak is Fellow-in-Residence with the C.D. Howe Institute, Senior Fellow with the Centre for International Governance Innovation, and Director and Principal, Ciuriak Consulting Inc.

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