From NAFTA to USMCA and the Evolution of US Trade Policy

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The Trump administration has pursued a sharply different – and for its trade partners unsettling – trade policy from that followed by the United States in the postwar period. While much attention has been focussed on the oftentimes contradictory, oftentimes theoretically unfounded, and oftentimes undiplomatically aggressive manner in which that policy has been implemented, I will argue that the policy contains a coherent if not necessarily desirable or achievable vision for the US economy, and that the USMCA is consistent with and advances this policy. Further, I will review how this policy is implemented in the USMCA. Finally, I will comment on the implications of the agreement for the future of the North American economies – as distinct from the North American economy.

The Method in the Madness of the Trump Administration’s Trade Policy

The broad aims of the Trump administration’s trade policy have been reasonably clearly stated and repeatedly reaffirmed. First, the administration has set out the aim of re-industrializing the US economy. The rationale given for this is national security. To achieve its objectives in this regard, the Trump administration is willing to accept short-term welfare losses for this departure from the optimization of economic production on conventional comparative advantage and efficiency terms. The existing measure that might best exemplify this type of policy is the Jones Act, which requires that US coastal shipping be conducted on ships built in the United States and manned by US sailors, with the underlying objective of ensuring that the United States has a marine reserve to support its navy in times of war. The Trump administration’s industrial policy generalizes this aim and in effect can be considered akin to “the Jones Act on land” (Crowley and Ciuriak 2018).

Second, it is seeking to re-balance American trade by taking back concessions it had made in underwriting the rules-based system; concessions that it now considers to have been disadvantageous for the US, or even abused by its trading partners.
Third, it is seeking to reclaim sovereignty by rolling back the constraints on its exercise of unilateral action created by binding dispute-settlement provisions in trade agreements, as well as what it considers the over-reach of the judicial function of the World Trade Organization (WTO). The administration views it as having infringed on US sovereignty in ways that the United States had not intended when the WTO Agreement was negotiated.

Fourth, it is intent on countering China, whose rapid technological advance has, inter alia, enabled it to take a leading position in the development of the 5G communications networks that underpin the Internet of Things (IoT). This is considered a national security threat as the international rollout of China’s IoT strategy through the Digital Silk Road challenges the US’s traditional hegemonic position.

Fifth, the United States is intent on advancing its intellectual property (IP) and digital economy interests through expanded protection for IP, and by locking in the current open digital regime for the platform economy in which its firms hold a dominant position in the global economy outside of China.

As a gloss on this characterization, a not unreasonable case for recapturing manufacturing activity can be based on recapturing the knowledge externalities generated in solving the engineering problems that “making things” throws up. By ceding many manufacturing activities to East Asia and elsewhere, the US also ceded the learning experience. The essence of this argument was captured by USTR Lighthizer’s response to a question in Congress: he stated that the problem with Canadian aluminum was not that it was Canadian but that it was aluminum. This crystallizes the point; the rest can be backed out by applying conventional economic analysis of “learning by doing” effects.

Moreover, changing America’s comparative advantage towards manufacturing would likely shift it away from services, and particularly from the financialization of its economy. Such a rebalancing away from financialization would likely have positive domestic welfare benefits through the redistribution of income towards lower income groups as Thomas Palley (2013) has argued, offsetting to some extent the efficiency losses from tariffs.

Unfortunately, the Trump administration has not developed a well-reasoned economic case supported by evidence and the tactics it has chosen more than offset any credible positive effects the US economy could realize from such a policy. These tactics include: welfare-damaging unilateral tariffs and the weaponization of uncertainty (Crowley and Ciuriak 2018); the disruption of the global trading system; the alienation of its allies through the weaponization of inter-dependence; and the open attempt to destabilize the European Union. Then there is the impetus it has given to its chief rival, China, to accelerate its technological modernization by confronting it with existential threats. Further, the use of threats by the Trump administration potentially reduces the seigniorage benefits the United States obtains from the US dollar’s role as the vehicle currency for international transactions by accelerating moves to create an alternative to the US-dollar-based SWIFT international payments system.

**How the USMCA Advances the Trump Administration’s Trade Policy**

The USMCA advances these trade policy objectives in numerous ways, oftentimes through a broadside of measures.

First, as regards re-industrialization, it imposes more restrictive rules of origin – in particular, in the auto sector but also targeting steel and aluminum, chemicals and other industrial inputs – in order to force companies to repatriate to North America the sourcing of production inputs from overseas, which
means largely repatriating such sourcing to the United States itself.

Second, as regards re-balancing, it extracts commercial concessions without any reciprocation. From Canada, the takeback is in dairy including a roll-back of Canadian exports to third parties with the intention that Canada’s export market share be ceded to US exporters.¹ From Mexico, the takeback is in autos, through the introduction of new labour-value content requirements in the rules of origin; Mexico will not be able to meet these requirements and that will therefore lead to the imposition of tariffs on some US imports of autos from Mexico.

Third, to prepare the takeback of concessions from third parties, it imposes managed trade conditions on the auto sector through side letters to the agreement. In the event that the United States imposes Section 232 tariffs on automobiles worldwide, these side letters would impose ceilings on US imports of autos from Canada and Mexico on a tariff-free basis, ensuring that the takeback benefits accrue to the US auto sector.

Fourth, it undermines certainty about future market access to the US economy through changes to the institutional structure. These changes include:

- the introduction of a sunset clause;
- the removal of the investor-state dispute settlement mechanism as it applies to Canada;
- the removal of binational panels with respect to anti-dumping and countervailing duty cases with respect to Mexico;
- the introduction of an “escape clause” for services commitments that allows the parties to revert to their commitments under the WTO General Agreement on Trade in Services (GATS), notwithstanding the commitments in the text, save for a specified set of sectors;² and
- the exclusion of government procurement, leaving unchecked in the US case the application of the Buy America program.

Even more important than what the USMCA does is what it does not do. In particular, it does not sideline the future application of Section 232 tariffs to Canada and to Mexico. By the same token, any carve-outs that Canada and Mexico can expect from the United States in future applications of Section 232 must be understood to be narrow and separately negotiated as per the side letter on automobile trade with explicit or implicit quotas applying, with no special status to be expected due to the USMCA. Given US Tariff Rate Quota (TRQ) design, this could mean restricted market access at less than the nominal value of the quota. This sends a strong signal to investors not to invest in Canada or Mexico on the hope of making substantial gains in US sales.

Fifth, related to this, it tightens border administration to prevent circumvention of US

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¹ For example, Canada agreed to cap its exports of skim milk powder and milk protein concentrates, which had increased in volume from around 17,000 metric tons (MT) to about 73,000 MT. Under the agreement, the aggregate export cap will be 55,000 MT in the first year, falling to 35,000 MT in the second year and thereafter. Exports that exceed this threshold will face an export surcharge of C$0.54 per kilogram, which is about a 30% export tax (see CRS 2019).

² In Annex II – Investment and Services Non-Conforming Measures, the Parties reserve the right to return to their level of commitments under the GATS except for the services listed in Annex II-A, in respect of which the Parties make improvements on the GATS. For the United States, these cover professional services such as foreign legal consulting, R&D services, express delivery and others.
tariffs based on imports into Canada or Mexico from third parties of production inputs intended for the US market. This border tightening offsets other measures in the USMCA that aim to facilitate North American trade and creates new incentives to relocate production intended for the US market into the United States.

Sixth, with regard to China, it introduces a novel feature for trade agreements, namely the section 32.10 measures that threaten loss of access to the US market, if Canada or Mexico were to negotiate a free trade agreement with a non-market economy, which is clearly to be read as China. While this adds nothing substantive to the ability of the United States to withdraw from the USMCA, the political signal is new and different.

Seventh, it extends protection for biologic drugs beyond what it achieved in the Trans-Pacific Partnership (TPP); and it extends copyright terms in Canada. Both of these promise net rent capture for the United States. As well, the USCMA incorporates and marginally tightens the digital economy measures of the TPP, which create a presumption in favour of the free flow of data across borders and the ban on data localization, measures that the EU has refrained from including in its modern free trade agreements pending a better understanding of how the digital economy is evolving. These provisions seek to lock in the current open regime for data flows that have permitted the US Internet giants to grow their market capitalization and potentially limit the scope for industrial policy. I have argued elsewhere that such a policy approach will likely be needed for Canada to capture some of the implicit rents in the emerging data-driven economy, which is prone to market failure on numerous grounds (see Ciuriak 2018).

This is a systematic, lawyerly, iron-clad, and frankly brutal implementation of the Trump administration’s policy as outlined above.

**Implications of the USMCA for the Trading System**

What’s in a name? The absence of “North America” in the title, together with the absence of the term “free trade,” emphasize that we have moved from an agreement aimed at North American integration under conditions where Canada, the United States and Mexico produced things together, to a hub-and-spoke relationship between client states and a regional hegemon. The nature of the negotiation, which involved two bilateral agreements, underscored this. We have moved from “three amigos” to two agreements under one uninspiring chapeau.

The fact that a trade deal with the United States does not sideline the use of Section 232 for Canada and Mexico means that Canada and Mexico remain exposed to future applications of this measure of unilateral US industrial policy. This is a remarkable concession by Canada, which (i) walked away from the negotiation of the original Canada-US FTA when the United States refused to include a measure to discipline the use of its trade remedy tools – anti-dumping (AD) and countervailing duties (CVD) – against Canadian exports; and (ii) made retention of the NAFTA Chapter 19 measures a red line issue in the USMCA negotiation (Ciuriak 2018). Arguably, the threat to Canadian exports posed by Section 232 is greater than that posed by AD/CVD measures since the latter are subject to multilateral rules, whereas the United States has argued that Section 232 judgements as to what constitutes a national...
security threat are not open to second guessing by WTO panels.³

The way forward for global trade is highly uncertain. It is unclear whether the USMCA can be ratified, given the conditions that must be put in place for all three parties to accept a final set of terms. Mexico must implement its USMCA-committed labour measures, with sufficiently credible enforcement to satisfy the Democratic party conditions for support. The removal of Section 232 steel and aluminum tariffs and retaliation and their replacement with negotiated trade restraints has removed one significant stumbling block, but ratification uncertainty may extend for some time.⁴

Should the agreement actually be put in place, the hub-and-spoke model does not multilateralize readily; accordingly, it offers the rest of the trading community no generalizable framework to work towards. Indeed, the tighter rules of origin drive narrow regionalization rather than promoting global integration and are incompatible with the optimization of global production, while tending to make North America a region of branch-plant economies.

The drive to isolate China is not something that is possible for the other major economies to entertain; China is integrated far too much into the global system of production. The exclusion clause concerning FTAs with non-market economies deployed in the USMCA is too weak to make a material difference and indeed it will likely undermine the ability of the United States to negotiate its own trade agreements in the future by raising the risk factor for its partners.

The EU, which appears likely to be next in the cross-hairs of the Trump administration’s rebalancing agenda, faces deep problems in signing an agreement with the United States given the gulf between Europe and the United States on agriculture as well as on digital governance. The USMCA model would simply add poison pills to that already seemingly insuperable negotiation problem. The EU is already tacking to stay the course in trade with China by labelling it a partner in some dimensions and a strategic competitor in a narrower range.

For the rest of the world, and especially for the smaller economies, the predictability of trade rules under the WTO system and the access to a binding dispute settlement process to which the larger economies are subject, is a major asset. They will not wish to abandon the WTO. The US undermining of the WTO is thus more likely to isolate the United States than anything.

³ Use of Section 232 may eventually be narrowed pursuant to both the WTO decisions and pushback from Congress. On 5 April 2019, the WTO published the panel decision on Russia’s invocation of Article XXI of the General Agreement on Tariffs and Trade (GATT) to justify its measures to block trade between Ukraine, Kazakhstan, and the Kyrgyz Republic that transited through Russia. The panel ruled in favour of Russia on grounds that there was an actual “emergency in international relations.” However, it rejected Russia’s argument (supported only by the United States amongst other Members) that the article is non-justiciable. Moreover, by stating that in the absence of such an emergency “Ukraine would have a prima facie case”, the panel indirectly limited the WTO-consistency of measures taken under that Article in the absence of a clear and present emergency. See WTO (2019). There is also concern amongst some Republican Congress members about the extent to which the President’s use of the Section 232 tariffs usurps Congressional authority over trade policy. However, with the WTO no longer in a position to reach a final decision through the Appellate Body for disputes involving the United States (not to mention China or the EU), and given the lack of any substantive pushback from Congress on the President to date, the risks of Section 232 tariffs for Canada and Mexico seem quite real.

⁴ This is an update to the version of this address delivered in Mexico City, which pre-dated the settlement on Section 232 steel and aluminum tariffs between the USMCA parties.
Finally, the agreement does not actually balance US trade as preliminary simulations of the agreement show (Burfisher et al. 2019). Accordingly, there is much pain for literally no real or perceived economic or political gain and indeed for some loss.

To summarize, this is a welfare damaging agreement that may not survive ratification and perhaps should not survive.

POSTSCRIPT

Since this address was delivered, more research has been published showing that the USMCA has a negative impact on the United States and by extension likely on Canada and Mexico as well (USITC 2019).

The Trump administration has continued to wield the threat of tariffs as a tool of national security and in the name of economic “emergencies,” arguing that these extraordinary powers, which are not disciplined by the USMCA or by Congress, supersede any trade agreement. By the same token, they undermine the value of any trade agreement. With ratification in the US Congress not assured, North America may be spared the harms from the USMCA, with NAFTA remaining the default. At the moment, that would be the best outcome for all.
REFERENCES


