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NAFTA 2.0: What Comes Next For the USMCA and American Trade Policy

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Background

The U.S., Mexico, and Canada have reached an agreement on a renamed North American Free Trade Agreement (NAFTA) deal. Overall, the U.S.-Mexico-Canada Agreement (USMCA) has been largely greeted as a deal that contains some beneficial modernization for some sectors of the economy, but in other areas is a step backwards from NAFTA. Many observers breathed a sigh of relief after the Trump administration dodged the worst-case scenario for Americans, outright termination of NAFTA with nothing to replace it.

NAFTA provides a tremendous example of how Americans benefit from reciprocal zero-tariff trade agreements. Consider the U.S. manufacturing sector. Since NAFTA took effect in 1994, U.S. manufacturing output per worker has increased by 91 percent, even after adjusting for inflation. Overall manufacturing output and average hourly earnings for manufacturing workers have both seen big increases since NAFTA was negotiated. Continued progress in manufacturing, the digital economy, agriculture, and other sectors of the economy would have been jeopardized by NAFTA termination. The new agreement, even if not as good as NAFTA in some respects, should at least remove that threat from the table for the time being.

Next Steps

The Trump Administration should:

1. Sign the new deal and submit it to Congress
2. Commit to keeping the existing NAFTA deal in place until the new pact is implemented. The biggest benefit of USMCA is the removal of uncertainty about the continuation of free trade in North America.
3. Lift tariffs on steel and aluminum imports from Canada and Mexico and insist that both countries lift their retaliatory tariffs. Maintaining tariffs is contrary to President Trump's stated goal of reciprocal zero-tariff trade.

Overview

USMCA is very similar to NAFTA in many ways and, most importantly, preserves its core intent of making North America a free trade zone -- specifically, "to support mutually beneficial trade leading to freer, fairer markets, and to robust economic growth in the region."

In terms of improvements, the new NAFTA liberalizes trade with regard to dairy, digital goods, and a few other products. But it moves in a protectionist direction in many areas such as automobiles, trucking, and labor policy. Further, it could hinder our ability to fix serious trade problems with China. It also preserves the current steel and aluminum tariffs -- and the retaliatory measures that Canada and Mexico have implemented in response.

NTU's Take: The new deal modernizes portions of NAFTA, but moves in a protectionist direction in some areas. Overall, it's slightly worse than the existing NAFTA, but far superior to withdrawal. It is essential to preserve economic stability and certainty with two of our most important trading partners and allies.

Key Provisions Of the USMCA

Dairy

While dairy currently makes up a very small percentage of trade between the U.S. and Canada (less than 0.1 percent of total trade), the provisions in NAFTA 2.0 should allow that figure to grow somewhat by moving away from existing protectionist policies. As part of the deal, Canada will abolish its Class 7 policy that effectively blocked imports of certain categories of milk used for making cheese and yogurt. Additionally, NAFTA 2.0 allows the U.S. to export more dairy products to Canada by lifting their cap on imports from 1 percent to 3.6 percent of their total market. This represents a small improvement over the 3.25 percent cap that was negotiated by the U.S. under the Trans Pacific Partnership agreement.

NTU's Take: While dairy was a hotly debated political issue during NAFTA renegotiations, the U.S. currently has a dairy trade surplus of about $650 million with Canada. The new deal liberalizes trade primarily by taking important steps to open up Canada's protected markets. This is a win for the U.S. dairy industry, although the benefits don't come close to offsetting the cost inflicted on dairy producers by U.S. tariffs and retaliation on other fronts of the administration's trade war.

De Minimis

De minimis exemptions allow lower-cost goods to cross borders free of taxes, duties, and bureaucratic delays. Higher de minimis thresholds mean lower taxes and less red tape on goods -- particularly retail items. The U.S. rightly made increasing Canadian and Mexican de minimis thresholds a top negotiating objective, but achieved only minimal success.

Under the USMCA, Canada will raise its de minimis threshold from $20 to $40 (CAD) with regard to taxes and from $20 to $150 (CAD) with regard to duties. This is a very small step in the right direction, as it will allow U.S. retailers to have slightly more access to Canadian consumers. But U.S. negotiators failed to secure a major victory here. The higher duty exemption will only translate to a few dollars on each transaction. The tax threshold is far more significant, as many Canadian provinces have high sales tax rates that often reach 15 percent when combined with the national rate. Raising the threshold by a mere $20 (CAD) provides very little benefit to American businesses. By contrast, the U.S. has an $800 (USD) threshold which gives Canadian businesses far greater access to the American market.

Also under the new deal, Mexico has agreed to raise its de minimis threshold from $50 to $100. Again, this is a step in the right direction, albeit a small one. U.S. negotiators should have insisted that both nations raise their thresholds to $800 to give reciprocal access to their markets.

NTU's Take: The U.S. made very small gains on de minimis thresholds -- particularly with regard to Canada. While the deal moves in a positive direction, these provisions represent a major missed opportunity to expand free trade and a failure to achieve reciprocity.

Sunset Clause

USMCA will terminate after 16 years unless all parties decide to extend the term of the agreement.

NTU's Take: If the agreement is as good as the administrations says it is, there is no reason for it to terminate in 16 years. As the Cato Institute's Simon Lester observed, "this provision is completely unnecessary. You can always review a trade agreement, as shown by the review of the existing agreement that led to this new U.S.-Mexico-Canada/NAFTA text, so there is no need for such a review provision."

Auto Rules of Origin, Wage Requirements, and Quotas

The agreement mandates that cars contain at least 75 percent North American content to qualify for zero-tariff treatment, an increase from 62.5 percent under NAFTA. In addition, 40 to 45 percent of the content of a car must be made by workers earning at least $16 an hour to be considered "North American." USMCA further imposes quotas on the volume of autos and parts Americans can import from Canada and Mexico without potentially being subject to prohibitive tariffs.

NTU's Take: Trump adviser Peter Navarro said "I believe everybody...would be more than happy to have higher wages and a secure job so that they can pay a few hundred bucks more for a car." But making cars more expensive does not magically increase wages or creates jobs. As President Reagan observed, local content requirements are a "cruel hoax." They increase car prices, leaving Americans with less money to spend on other products, and encourage auto manufacturers to produce in lower-cost countries. For an administration that claims to care about cutting regulation, the new wage mandate is a costly increase in red tape that will encourage auto production to move overseas. Auto quotas, even if mostly symbolic, have no place in a trade agreement.

Steel and Aluminum Tariffs

In March, the U.S. announced a 25 percent tariff on steel imports and a 10 percent tariff on aluminum imports citing national security concerns pursuant to Section 232 of the Trade Expansion Act of 1962. While several countries, including Canada and Mexico, were initially exempted, the tariffs took effect for most countries in June. Canada and Mexico promptly responded with retaliatory tariffs on $12.6 billion and $3 billion of U.S. imports, respectively.

NAFTA 2.0 does not deal directly with the 232 steel and aluminum tariffs, but a side letter establishes a 60-day window to negotiate an agreement. Given the absence of national security concerns and the completion of the NAFTA renegotiation process, there is no reason to retain the tariffs.

As Commerce Secretary Wilbur Ross testified to the Senate Finance Committee in June: "Our objective is to have a revitalized NAFTA, a NAFTA that helps America and, as part of that, the 232s would logically go away, both as it relates to Canada and as to Mexico."

NTU's Take: Many in the administration have claimed the steel and aluminum tariffs were being used as leverage to update NAFTA. Now that negotiations are complete, the tariffs should be suspended. The U.S. should insist that Canada and Mexico suspend their retaliatory tariffs as well.

Digital Trade

Much like the Trans-Pacific Partnership agreement, NAFTA 2.0 ensures that digital trade will not be hindered by protectionist policies. It bans duties and discriminatory policies on digital goods, such as music, video games, movies, and software. It also prohibits the forced localization of servers or other computing facilities.

NTU's Take: NAFTA clearly needed to be updated to reflect the modern, digital economy. The new agreement accomplishes this important goal to the great benefit of consumers and content producers.

Dispute Resolution and U.S. Investor Rights

Trade agreements must have an enforcement mechanism to ensure countries play by the rules. Canada successfully fought to maintain the system used to dispute anti-dumping duties and duties imposed on subsidized goods. Protection against having property expropriated by foreign governments used to be covered by Investor-State Dispute Settlement (ISDS) rules. These protections are significantly weakened compared to NAFTA.

NTU's Take: Protection against government confiscation of expropriation of property is a right guaranteed by the U.S. Constitution. U.S. trade agreements should make it harder for foreign government to seize Americans' property, not easier.

China

If either the United States, Canada, or Mexico enters into a free trade agreement with a non-market economy like China, the other countries can terminate the NAFTA 2.0 agreement.

NTU's Take: The United States must address the numerous problems caused by China and its history of flaunting trade rules and ignoring intellectual property protections. The administration should support free trade agreements that encourage China to become more market-oriented and play by the rules. The new NAFTA deal makes it harder to do so by effectively giving Mexico and Canada veto power over a U.S.-China agreement.

Cross-Border Trucking

The agreement allows the United States to restrict cross-border trucking from Mexico (but not Canada.)

NTU's Take: Trucks and drivers that meet U.S. safety standards should be allowed to deliver goods from Mexico to U.S. customers. It is costly and unnecessary to require trucks to stop at the border, unload their cargo, reload it onto another truck, and then finally be transported to its final destination. A 2009 U.S. Department of Transportation study found that cross-border trucking restrictions added $400 million per year to the cost of imports from Mexico.

Environment

According to USTR, "The Environment chapter includes the most comprehensive set of enforceable environmental obligations of any previous United States agreement." Ironically, despite President Trump's skepticism about global agreements and his withdrawal from the Paris Climate Accord and the Trans Pacific Partnership (TPP), USMCA copies much of its language in support of global environmental cooperation from TPP.

NTU's Take: The economic growth resulting from free trade allows people to afford greener economic policies. Free trade promotes conservation by generating a more efficient use of resources. Like TPP, the USMCA contains provisions to discourage subsidies that lead to overfishing. But it also makes it a trade violation to change U.S. environmental laws in order to encourage trade or investment. If President Trump or Congress attempt to reduce over-regulation at the Environmental Protection Agency or elsewhere in order to make it easier to do business in the United States, these actions would violate the USMCA.

Labor

President Obama often touted the Trans Pacific Partnership (TPP) as the most progressive trade agreement in history. That's no longer the case. The USMCA copies and pastes some of TPP's labor provisions, and goes even farther in other areas. Here is a representative example pasted directly from TPP:

> "The Parties recognize that it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in each Party's labor laws. Accordingly, no Party shall waive or otherwise derogate from, or offer to waive or otherwise derogate from, its statutes or regulations … in a manner affecting trade or investment between the Parties…. No Party shall fail to effectively enforce its labor laws through a sustained or recurring course of action or inaction in a manner affecting trade or investment between the Parties after the date of entry into force of this Agreement."

USMCA includes an additional mandate that was not part of TPP or prior U.S. trade agreements:

> "The Parties recognize the goal of eliminating sex-based discrimination in employment and occupation, and support the goal of promoting equality of women in the workplace. Accordingly, each Party shall implement policies that protect workers against employment discrimination on the basis of sex, including with regard to pregnancy, sexual harassment, sexual orientation, gender identity, and caregiving responsibilities, provide job-protected leave for birth or adoption of a child and care of family members, and protect against wage discrimination."

NTU's Take: Trade agreements should not subject U.S. labor laws and regulations to foreign approval. Issues relating to gender identity, family leave, minimum wage mandates, and right-to-work-laws are domestic concerns that have no place in trade agreements. USMCA's wage and collective bargaining provisions are even stronger than those imposed on countries by the European Union.

Conclusion

Cato Institute scholar Scott Lincicome suggested the USMCA is "a missed opportunity to liberalize further." One of the disappointments is that as other countries around the world are adopting new trade agreements, cutting tariffs, and engaging in competitive liberalization, the United States is stuck dusting the cobwebs off agreements negotiated years ago while unilaterally hiking tariffs to the highest levels in recent history.

In sum, the USMCA is a mixed bag that deserves a close evaluation by Congress. In the meantime, the Administration should jump-start North American trade by removing steel and aluminum tariffs while pursuing new zero-tariff, zero-barrier, zero-subsidy trade agreements to create jobs and prosperity across the United States.

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