USMCA: A Further Step in North American Integration?

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At the outset of the renegotiation of the North American Free Trade Agreement (NAFTA) in 2017, the Trump administration declared its intention to roll back several NAFTA provisions.[1] The Congressional bill that President Donald Trump signed in late January 2020, and that came into effect July 1, 2020 as the United States Mexico and Canada Agreement (USMCA), kept intact the essentially barrier-free trade and investment bloc created under NAFTA. Over the past 25 years, most tariffs and non-tariff barriers to merchandise trade and investment among Canada, the USA and Mexico have been eliminated. Investment within the region has increased significantly and trade tripled, often through the medium of supply chains that criss-cross the three national borders, particularly in the manufacturing and agri-food sectors. Canada, the US, and Mexico have consequently become each other's largest source of foreign direct investment and most important trading partners in most economic sectors.[2]

Given this considerable economic integration, what should we expect from USMCA? Is it a step forward in North America economic integration—for example, by catalyzing the harmonization of regulatory and other non-tariff measures that continue to constitute barriers to trade? Or, is USMCA likely to be `NAFTA business as usual'? That is, a trading relationship that on the whole works well and in which trading disputes are dealt with through formal dispute mechanisms, rather than via the exercise of asymmetrical market power and brinkmanship that has characterized the Trump administration.

In answer to the first question, some new-to-USMCA provisions create the opportunity for greater economic integration. In the auto sector, requirements for an increased amount (75%) of North American content, as well as for 40%-45% of auto content to be made by workers earning at least $16.00 per hour, are expected to encourage further production of autos and auto parts within the region.[3] New provisions with respect to textiles and apparel are also expected to encourage greater North American production and intra-regional trade. In addition, USMCA opens the Canadian dairy product market to a modest increase in US dairy imports. Elsewhere in the agriculture and food sectors, where regional supply chains are well established, commitments by governments to cooperate to reduce remaining regulatory and technical barriers to trade (such as different sanitary and phytosanitary standards) are expected to facilitate further cross-border trade. So too are USMCA chapters aimed at reducing the `red tape' of cross-border transactions, including via electronic transactions.[4] Moreover, new chapters obliging NAFTA partners to uphold labour standards and to deal with specific environmental challenges could expedite cross-border transactions by levelling the playing field for workers and businesses in the three countries.

However, experts expect these and other liberalizing USMCA chapters to have only modest effects in deepening economic ties.[5] One reason is that the economies of the three countries are already deeply integrated with goods, capital, services and people largely moving freely across their borders. A second reason is that provisions aimed at reducing remaining regulatory and technical non-tariff barriers to trade are cooperative commitments, not obligations; their outcomes will be contingent upon the incentives and voluntary efforts of governments and firms.[6] While multinational businesses usually have an economic interest in cross-national regulatory and standard harmonization, we should not expect all regulatory differences to disappear. They often reflect the different values and priorities of the domestic electorates to which governments respond.

In terms of formal procedures for resolving disputes that arise over perceptions of unfair trade practices such as dumping or subsidies, it is reasonable to expect 'business as usual' under USMCA. USMCA retains NAFTA's Chapter 19 dispute settlement mechanism whereby binational panels are used to resolve anti-dumping and countervailing duty complaints.[7] Chapter 19 panels do not always determine the outcomes of trade complaints; the latter are often terminated by parties reaching a negotiated settlement.[8] However, Chapter 19 constitutes a rules-based way to resolve trade disputes, and, as such, is perceived in Canada and Mexico as a curb on unilateral (American) protectionist trade actions.

'Business as usual' under USMCA does not mean the absence of trade disputes. In fact, new-to-USMCA chapters are likely to result in their increase. For example, its environmental chapter commits the three NAFTA partners to uphold their own environmental laws and specific multilateral environmental agreements to which they are party, and its labour chapter requires them to uphold specified labour rights. Since both chapters are subject to USMCA's dispute settlement mechanism, they are likely to be closely scrutinized for perceived violations, thereby adding to the caseload of unfair trade complaints. Nor does USMCA eliminate the right of the US President to impose tariffs on Canadian or Mexican imports on national security grounds: an action President Trump took scarcely a month after USMCA came into effect.[9]

Finally, there are additional reasons to anticipate a 'business as usual' scenario for North American integration. USMCA received cross-party support in all three trading partners. Its bipartisan support in the US is sharp contrast to NAFTA[10]—and which had been a renegotiation target for American presidents before Donald Trump. As well, and consistent with its bipartisan US Congressional support, USMCA appears to have `rebalanced' NAFTA by securing a number of US priorities.[11] These wins, alongside the further economic integration of the NAFTA countries, should bode well for USMCA when it comes up for review and renewal in 2026.

[1] Congressional Research Service, *NAFTA and the United States-Mexico-Canada Agreement*, March 2, 2020. https://crsreports.congress.gov. R4981, p.2.

[2] See testimony of Steve Verheul (Canada's chief trade negotiator) to the House of Commons Standing Committee on International Trade, February 5, 2020, 43rd Parliament, No. 003, 1st Session, as well as the report of the U.S. Congressional Research Service, *NAFTA and the United States-Mexico-Canada Agreement*, March 2, 2020. R4981.

[3] Steve Verheul, House of Commons Standing Committee on International Trade, February 5, 2020, 43rd Parliament, No. 003, 1st Session.

[4] Chrystia Freeland, House of Commons Debates, January 30, 2020, 43rd Parliament, 1st session, vol. 49, no. 011.)

[5] Congressional Research Service, *NAFTA and the United States-Mexico-Canada Agreement*, March 2, 2020. R4981, p. 41; Congressional Research Service, *U.S.-Mexico Economic Relations: Trends, Issues, and Implications*, RL32934, June 25, 2020, p. 25.

[6] See testimony of Aaron Fowler, Chief Agricultural Negotiator, Government of Canada, to the House of Commons Standing Committee on International Trade, February 5, 2020.

[7] Retaining Chapter 19 was a 'red line' for Canada and important to Mexico as well. The Trump administration, in its open negotiating position, had stated its intent to eliminate Chapter 19.

[8] US has launched five Chapter 19 trade actions against imports of Canadian softwood lumber, all of which have been resolved to date through fixed-erm agreements whereby Canada limits its softwood lumber exports to the US. The Congressional Research Service, *NAFTA and the United States-Mexico-Canada Agreement*, March 2, 2020, pp. 36-27 reports that the US was the importing country for three-fifths of the Chapter 19 complaints, two-thirds of which were terminated before a panel determination was made.

[9] In early August 2020, President Trump indicated he would re-impose tariffs on incoming Canadian aluminum and steel. Section 232 of the 1962 Trade Expansion Act allows tariffs to be imposed when imports constitute a threat to the national security of the US. In May 2018, he used this same tactic to pressure Canada to make concessions during the ongoing NAFTA renegotiation. Under USMCA, there are annual exemptions from Section 232 tariffs for light trucks, passenger vehicles and auto parts.

[10] Congressional Research Service, *Major Votes on Free Trade Agreements & Trade Promotion Authority*, July 22, 2020, Table 2, p. 5, reports that NAFTA received 234 Yes to 200 No votes in the House of Representatives and 61 Yes to 38 No votes in the Senate. USMCA received 385 Yes to 4 No votes in the House and 89 Yes to 10 No votes in the Senate.

[11] Besides new rules of origin and content with respect to the auto sector, they include worker rights protection in Mexico, a new chapter on digital commerce, and new rules to protect intellectual property rights.