NAFTA 2.0: The Best Trade Agreement Ever Negotiated (Except for All of the Others)

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The text of the new "United States-Mexico-Canada Agreement" was released last Sunday night, a few hours after I had spoken at an event in Birmingham, England, about the virtues of "The Ideal US-UK Free Trade Agreement." To borrow from the late Sen. Lloyd Bentsen: I know the ideal free trade agreement; USCMA, you're no ideal free trade agreement.

The ideal free trade agreement is one that accomplishes maximum market barrier reduction, enables maximum market integration, forecloses governments' access to discriminatory protectionism, and obligates the parties to refrain from backsliding.

As explained in the paper:

The ideal free trade agreement provides for the elimination of tariffs as quickly as possible on as many goods as possible and to the lowest levels possible. It should limit the use of so-called trade remedy or trade defense measures. It should open all government procurement markets to goods and services providers from the other party. It should open all sectors of the economy to investment from businesses and individuals in the other party. It should open all services markets without exception to competition from providers of the other party. It should ensure that the rules that determine whether products and services are originating (meaning that they come from one or more of the agreement's parties) are not so restrictive that they limit the scope for supply chain innovations…

…[T]he ideal FTA must also include rules governing e-commerce. Digital trade—data flows that are essential components in the provision of goods and services in the 21st century—must remain untaxed and protected from misuse and abuse. Rules that prohibit governments from imposing localization requirements or any particular data architectures that reduce the efficacy of digital services should be included, and obligations should be imposed on entities to ensure data privacy, consistent with the requirement that data flow as smoothly as possible.

When border barriers come down, the potentially protectionist aspects of regulation and regulatory regimes become more evident. Certainly, when businesses have to comply with two sets of regulations to sell in two different markets, it limits their capacity to realize economies of scale and reduces their capacity to pass on cost savings in the form of lower prices or reinvestment.

If those regulations are comparable when it comes to achieving the same social outcomes — consumer safety, product reliability, worker safety, environmental friendliness—there may be

scope to require businesses to comply with only one set. A regulatory cooperation mechanism to promote mutual recognition would be a useful innovation as a means to reducing business costs (provided no deep cultural aversion or science-based reason exists for considering one regulation better than the other and worth the greater cost).

Finally, the rules of the ideal FTA must be enforceable. What's the point of a trade agreement if its terms are just suggestions? To make sure governments keep their promises, trade agreements should have a binding and enforceable dispute settlement mechanism to ensure that the agreement is followed.

Rating USMCA by the Standards of an Ideal Agreement

Here's how the USMCA stacks up to the ideal free trade agreement, which:

- **Would provide for the elimination of tariffs as quickly as possible on as many goods as possible and to the lowest levels possible.**

In USMCA, most goods trade will *continue to be* tariff-free (the NAFTA status quo) under the new agreement, and barriers to certain agricultural products will be reduced, as well. Moreover, the value thresholds for importing goods without having to pay any duties have been raised in Mexico and Canada, which will benefit small businesses, disproportionately, as they tend to conduct a larger share of transactions online.

(*Conclusion: Criterion is almost met*).

- **Would limit the use of so-called trade remedy or trade defense measures.**

Trade remedy laws give domestic industries recourse to trade restrictions when they can demonstrate injury caused by "dumped," subsidized, or substantially increasing imports. These laws are prone to misuse and abuse and become loopholes through which the benefits of trade barrier reduction achieved in the agreement can be quickly rescinded.

In USMCA, no restrictions on the use of antidumping, countervailing duty, or safeguard measures are made. Rather, the long arm of the Safeguard law extends further under the revised deal by making it more difficult for Canadian and Mexican exporters to be excused from prospective safeguard tariffs. Moreover, the failure of the United States agreeing to blanket exemptions for Canada and Mexico from prospective tariffs on imported automobiles under Section 232 of the Trade Expansion Act of 1962 and the failure of the United States to remove the existing Section 232 tariffs on Canadian and Mexican aluminum and steel—thereby enshrining the view of Canada and Mexico as threats to US national security—is in extremely poor taste, violates the spirit of a trade agreement, and reflects an absence of understanding of the meaning of being a good trade partner.

(*Conclusion: Criterion worse than unmet.*)

- **Would open all government procurement markets to goods and services providers from the other party**.

"Buy American" and "Buy Local" requirements, in general, restrict access to bidding on and performing government procurement projects to US firms using US goods and providing US services. However, pursuant to terms of the Trade Agreements Act of 1979, free trade agreement partners, as well as signatories to the World Trade Organization's Agreement on Government

Procurement (GPA), are granted waivers from these "Buy" provisions so their firms can compete for US procurement work tendered by a defined list of agencies.

In the USMCA, no new access to US procurement markets is granted to Canadian bidders relative to the original NAFTA. In fact, the chapter makes no mention of Canada, presumably because Canada is a signatory to the GPA, which provides for slightly greater access to US procurement projects, anyway. The chapter does include provisions for Mexico but doesn't appear to afford new access to Mexican bidders, either, so relative to the terms of access in effect today, the USCMA provides no discernible change.

That's a huge missed opportunity because large portions of the estimated $1.7 trillion annual US federal and state government procurement markets remain off-limits to competition. This, of course, drives up the cost of every government project and ensures that taxpayers get the smallest bang for their buck. Given talk that President Trump is interested in advancing a major infrastructure bill—maybe in the neighborhood of $1 trillion—in the next Congress, this is a problem that should concern us all.

(*Conclusion: Criterion unmet.*)

- **Would open all sectors of the economy to investment from businesses and individuals in the other party**.

The US market is generally pretty open to foreign investment already, but investment restrictions continue to exist in certain industries, including financial services, commercial air services, communications, and mining. It doesn't appear that USMCA provides any significant new access for foreign investors in the United States.

(*Conclusion: Criterion unmet.*)

- **Would open all services markets without exception to competition from providers of the other party**.

The USMCA fails pretty miserably in this area. The chapter on cross-border trade in services reaffirms bans on foreign competition in maritime shipping, dredging, commercial air services, and trucking services. The absence of foreign competition in shipping raises transportation costs, which are among the most significant supply chain costs reflected in the prices Americans pay for goods purchased on Amazon and at brick and mortar establishments.

Commercial air travel is a significant cost of doing business for companies across all industries, and it accounts for an important share of consumer spending. Rules based on dubious national security arguments that preclude foreign carriers from flying routes between US cities reduce supply, lower quality, lessen accountability, and raise the cost of airfare.

Instead of opening domestic trucking services to foreign competition, the USMCA makes available, for the first time ever in the services sector, access to a "safeguard" mechanism (which could result in new restrictions) for US companies deemed to be "harmed" or threatened with harm by competition in the long-haul, cross-border trucking sector.

US demand for dredging services is on the rise for a variety of reasons, including the need to deepen US ports. A large majority of the 44 Atlantic and Gulf Coast ports are too shallow to accommodate the larger, higher capacity, more cost-efficient, post-Panamax container ships that

necessitated widening of the Panama Canal. If President Trump gets his infrastructure funding, there is likely to be a huge increase in demand for dredging services. This market should be opened fully, but USMCA ignores this looming matter, taxpayer be damned.

(*Conclusion: Criterion unmet.*)

- **Would ensure that the rules that determine whether products and services are originating (meaning that they come from one or more of the agreement's parties) are not so restrictive that they limit the scope for supply chain innovations**.

The so-called rules of origin in USMCA, especially concerning automobile production and assembly (but apparel and other products, too), have been among the most discussed provisions in the agreement. Rules of origin are the content and value-added terms that must be met for a product to be conferred as originating in the region (North America), entitling them to the preferential terms of access.

For both autos and apparel, the regional content threshold (minimum value of components from and labor performed in the three countries) was effectively increased in the USMCA. The reduced capacity for incorporating inputs from countries outside of North America is likely to make regional producers less competitive relative to producers in countries where there are fewer restrictions on sourcing. The changes will lead to higher regional production costs, which will encourage automakers, garment markets, and other producers to forego the more costly compliance with the qualification rules in favor of using non-qualifying inputs or producing outside the region altogether and paying the non-preferential tariff rates upon entry into the United States.

(*Conclusion: Criterion unmet.*)

- **Would include rules that prohibit digital trade—data flows that are essential components in the provision of goods and services in the 21st century—from being taxed and unprotected from misuse and abuse**.

The USMCA sets out reasonable rules in its Digital Trade chapter. (*Conclusion: Criterion met.*)

- **Would prohibit governments from imposing localization requirements or any particular data architectures that reduce the efficacy of digital services.**

The USMCA sets out reasonable rules in its Digital Trade chapter. (*Conclusion: Criterion met.*)

- **Would require businesses to comply with only one of the Party's regulations if the regulations are comparable in their objectives and outcomes—consumer safety, product reliability, worker safety, environmental friendliness—in order to reduce the costs of complying with two sets of regulations to sell in two different markets, and a regulatory cooperation mechanism to promote mutual recognition of regulatory compliance**.

There is growing receptivity to adopting mutual recognition and other forms of regulatory coherence that would ensure the same safety/social outcomes while reducing regulatory compliance costs. But such provisions are not in the USMCA and remain rare in practice. However, the USMCA does include a chapter called "Good Regulatory Practices," which creates mechanisms and protocols for establishing broader compatibility, transparency, and

predictability to regulation and regulatory processes. It is not novel but builds on a similar version established in the Trans-Pacific Partnership and operating under a separate US-Canada Regulatory Cooperation Commission.

(*Conclusion: Criterion almost met.*)

- **Would include an enforceable dispute settlement mechanism to ensure that the agreement is followed**.

Although the agreement includes a chapter called "Dispute Settlement," problems that afflict dispute settlement under the original NAFTA seem to remain unresolved by the language in USMCA. While there are pretty straightforward rules for how disputes should be settled and what parameters Parties should consider if and when needing to threaten or resort to retaliation, the text remains unclear as to the protocol for naming and seating panelists to adjudicate the issues.

Disagreements over these matters essentially made state-to-state dispute settlement inutile under NAFTA, leaving the terms of the agreement almost voluntary. The fact that this problem remains isn't too surprising given USTR Robert Lighthizer's distaste for binding dispute settlement—a position that contributes to the WTO Appellate Body crisis that imperils that institution presently.

(*Conclusion: Criterion unmet.*)

By the 10 standards identified as essential to an ideal free trade agreement, USMCA falls way short. Four criteria are "met" or "almost met." Six criteria are "unmet" or "worse than unmet." Realistically, "ideal" is probably too exacting a standard for our politically constrained trade negotiators. But then again, an agreement pursued with trade deficit reduction and supply chain repatriation as its main objectives was never going to be an exemplar of trade liberalization.

Grading on a Scale

What would be a more reasonable benchmark for assessing the USMCA? The terms of the TPP (which was President Obama's renegotiation of NAFTA from which President Trump withdrew the United States)? The existing NAFTA? US withdrawal from NAFTA without a replacement?

Relative to the TPP, the USMCA is a disaster. Yes, there's a little more liberalization in USMCA's Digital Trade chapter, better access for US dairy farmers and wine exporters to Canadian markets, a higher threshold for the value of exports not subject to customs duties in Canada and Mexico, and other marginal improvements (such as rules for "Good Regulatory Practices" and the retirement of traditional investor-state provisions). But there are considerably more provisions that are protectionist relative to the terms of TPP.

The far stricter rules of origin—especially concerning automobiles and clothing—give regional firms fewer options to compete with producers from outside the region and virtually guarantee higher prices for North American consumers. The USMCA includes unnecessarily stronger patent, copyright, and data protection provisions, which are—by definition—protectionism. It includes the first-ever trade agreement chapter with rules aimed at disciplining currency manipulation, which has a subjective definition, eludes any consensus about how to measure, and has potential to cloak garden variety protectionism in a veneer of legitimacy.

NAFTA 2.0 is certainly better in some regards. But even if its provisions could be demonstrated to be, on net, more liberalizing than the TPP's (to be sure, they cannot!), there is still the major shortcoming that TPP offered liberalization with nearly 300 million more people in nine more countries accounting for a combined GDP of $7.5 trillion. Canada and Mexico account for an aggregate $2.8 trillion. So, yeah.

Relative to the existing NAFTA, there are also pros and cons to the USMCA. Though there is greater liberalization in goods trade, it is marginally to imperceptibly so. Taking into consideration the negative changes, especially to the rules of origin, it's not obvious that USMCA is liberalized much from NAFTA. But it's possible—even probable—that some of the less directly liberalizing, technical, and procedural provisions, such as those governing "Digital Trade," "Customs and Trade Facilitation," "State-Owned Enterprises," and others, utilized in ways not completely apparent now, could lead to lower trade costs.

The only certainty is that the USMCA is better than a US withdrawal from NAFTA without a replacement agreement. That bullet appears to have been dodged. Beyond that, the best that can be said of the USMCA is that the negotiations—especially the animating theatrics, insults, and tantrums that came with the talks—are finished, and the dark clouds of uncertainty hanging over the region should begin to dissipate…only to be replaced by darker clouds over the descent of US relations with China and the WTO.

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