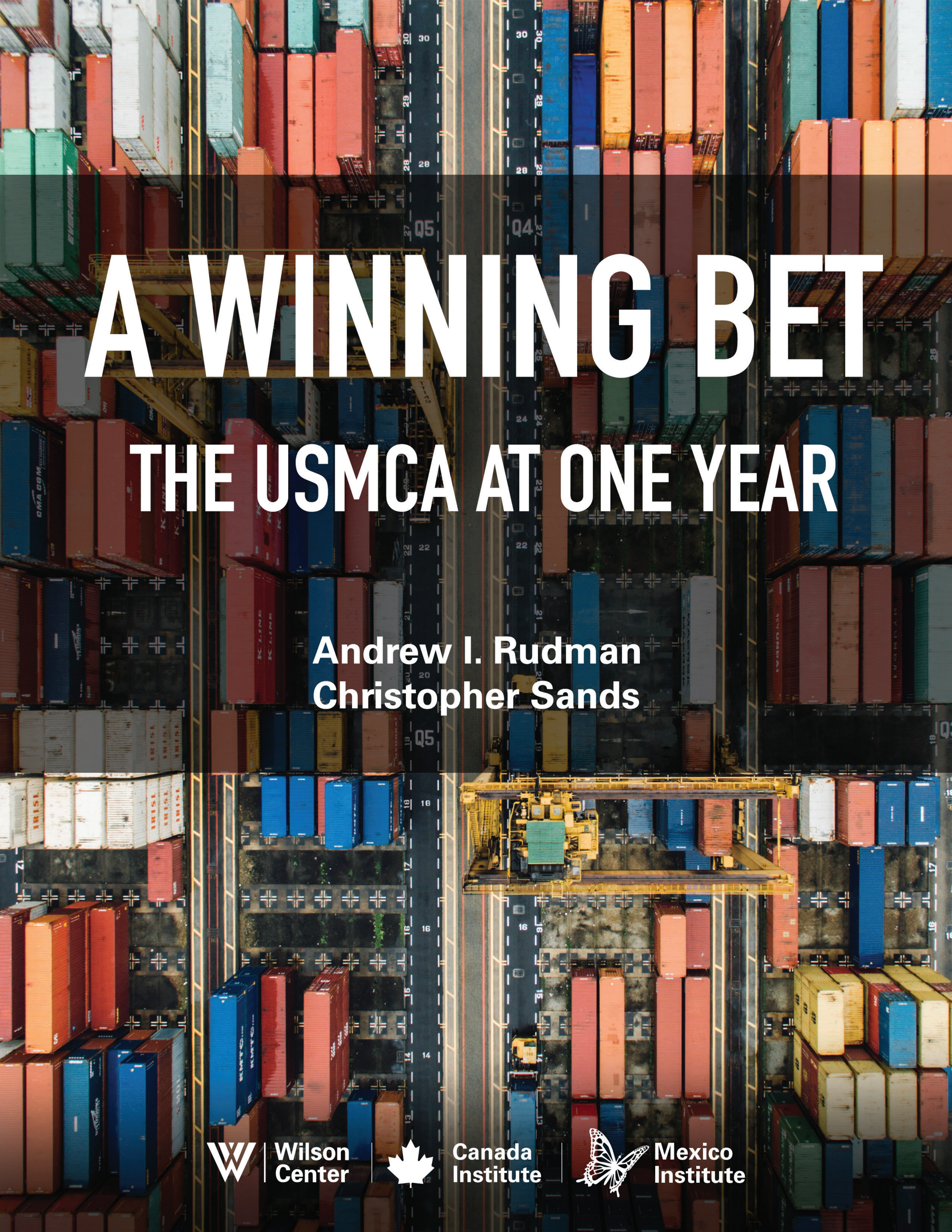

A WINNING BET

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Wilson Center | Canada Institute | Mexico Institute

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The USMCA at One – A Winning Bet

Andrew I. Rudman and Christopher Sands[1]

Introduction

The United States Mexico Canada Agreement (USMCA) entered into force on July 1, 2020 replacing the North American Free Trade Agreement (NAFTA) that had governed trade and guided cooperation among the three federal governments for 25 years. The USMCA's first year was extraordinary from many perspectives: the USMCA was implemented as the COVID-19 pandemic led governments in North America to impose heavy limits on business activity and to restrict border access to essential traffic.

The USMCA's 34 chapters, 12 annexes, and 16 side letters were put into effect by officials who could not meet face to face; relying instead on phone calls, video chats and email. Although the English language USMCA text is more than 1300 pages, to implement the agreement officials in dozens of agencies and bureaus need to incorporate the agreement's provisions into rules and regulations so that a customs officer can act on them and businesses can determine how their operations can or must change.

To review progress on implementation and enforcement of USMCA commitments, the agreement calls for the three trade ministers to meet annually as the "USMCA Trade Commission." In keeping with the social distancing protocols of the USMCA's first year, when the USMCA Trade Commission met for the first time on May 17-18, 2021 US Trade Representative Katherine Tai, Mexican Secretary of the Economy Tatiana Clouthier Carrillo, and Canadian Minister for Small Business, Export Promotion, and International Trade Mary Ng met virtually rather than in person.

Fortunately, on the first anniversary of the USMCA, the COVID-19 pandemic appears to be easing in North America and trade is rebounding. Border restrictions remain in place, but all three federal governments are considering how to lift them safely. Heading into its second year the USMCA has the potential to contribute significantly to the recovery of the North American economies if implementation continues, trade disputes do not deplete goodwill, and leaders seize opportunities to cooperate beyond the USMCA in promoting economic growth and infrastructure renewal. There is still much work to do to make the USMCA a success, but the agreement is already looking like a winning bet for the United States, Mexico, and Canada.

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A Winning Bet

When former U.S. President Donald Trump called NAFTA the worst trade deal in history and threatened to pull the United States out of the agreement unless Mexico and Canada agreed to make major changes to it, the outlook for North American trade looked dire. Mexican President Enrique Peña Nieto agreed to talks on NAFTA changes despite the Trump administration's insistence that Mexico fund the construction of a border wall to reduce unauthorized migration – a key Trump campaign promise. Despite willingness to participate in the renegotiation of NAFTA, Mexico firmly resisted pressure from the U.S., especially on reconfiguration of the auto industry.

Canadian Prime Minister Justin Trudeau also agreed to talk, but soon was grappling with U.S. tariffs on Canadian steel and aluminum under Section 232 of the U.S. Trade Expansion Act of 1962 – a section that allowed for tariffs in the interest of "national security." This offended many Canadians who were rightfully proud of having been a staunch U.S. ally since 1814. Though the history of US-Mexican relations has not been equally harmonious, (e.g., the 1846-48 Mexican-American War), Mexicans too were offended by the Section 232 tariffs given the deep integration of the auto industry to the benefit of all three NAFTA partners.

The Trump critique of NAFTA gave voice to latent concerns about the agreement and globalization among many Americans. President Trump and his U.S. Trade Representative Robert Lighthizer gambled that they could replace NAFTA with an agreement that would improve terms for U.S. workers and win support from the U.S. Congress despite the partisan polarization in Washington and across the country.

Trump and Lighthizer won that bet. As Table 1 shows, the USMCA was ratified by bigger bipartisan majorities in the U.S. House and Senate than either NAFTA or the 1988 Canada – United States Free Trade Agreement negotiated by the Reagan administration. Running against Trump in 2020, candidate Joseph Biden admitted that the USMCA was a better deal for Americans than NAFTA, which he voted for in the Senate, had been. And as the winner of the 2020 election, President Biden has stayed the course on USMCA implementation.

Table 1: US Congressional Trade Votes

Agreement (year)	US House Votes (Y/N)	US Senate Votes (Y/N)
Canada-US FTA (1988)	366 / 40	83 / 9
NAFTA (1993)	234 / 200	61 / 38
USMCA (2020)	385 / 41	89 / 10

Source: Congressional Record

In Mexico and Canada, initial skepticism about NAFTA in the 1990s gave way to popular support for the agreement. Few Mexicans or Canadians advocated NAFTA withdrawal or renegotiation because they believed that NAFTA had been beneficial. Indeed, for Mexico and Canada, the loss of preferential access to the U.S. market would have been devastating. It was natural, therefore, for Mexican and Canadian negotiators to enter talks with the United States on NAFTA renegotiation defensively.

Mexican President Enrique Peña Nieto's six-year term in office was set to end in 2018, and his successor would be chosen in an election in July while NAFTA renegotiation was underway. Elected in 2012, Peña Nieto supported NAFTA and good relations with the United States. The leading candidate to replace him, Andrés Manuel Lopez Obrador (AMLO), was a longstanding NAFTA critic. With low domestic approval ratings for his performance in office, Peña Nieto gambled that his team of trade negotiators, led by Secretary of the Economy Idelfonso Guajardo, could either conclude and ratify the deal before he left office or negotiate terms that his successor would endorse. As the 2018 elections neared, and victory seemed likely, AMLO signaled that he too preferred to have the agreement finalized prior to taking office so that he could focus on the issues he prioritized during the campaign (known as the Fourth Transformation).

It turned out that Peña Nieto and Mexico won that bet, too. His team coordinated closely with AMLO's trade advisor, Ambassador Jesus Seade Helu, adding him to the negotiating team in the crucial months between the July 1, 2018 election when Lopez Obrador won the presidency and December 1, 2018 when AMLO took office. Signing the agreement on November 30, 2018, Peña Nieto's final day in office, served the interests of both the incoming and outgoing presidents. Despite AMLO's long-standing skepticism of free trade (moderated during the campaign) and his contentious relationship with the private sector, AMLO's government continues to implement the new USMCA, including undertaking efforts to comply with the new labor obligations aimed at strengthening worker protections in Mexico (which are in line with labor reforms AMLO had long championed).

When Canadian Justin Trudeau led his party to victory in 2015, he was optimistic about relations with the United States and U.S. President Barack Obama who he admired. The 2016 U.S. election changed the dynamics, since Trump was unpopular in Canada, but Trudeau had support from opposition parties and voters for a policy of engagement with the new president. Trudeau wagered that engagement was the best way to defend Canada's interests, even as the new U.S. president belittled Trudeau on social media, calling him "very dishonest and weak" following the Group of 7 summit at which Trudeau hosted Trump and other leaders in Charlevoix, Quebec in 2018.

On October 21, 2019 voters in Canada did not know how Americans would vote on November 3, 2020. Nevertheless, they re-elected Trudeau albeit at the head of a minority government. Trudeau, too, had won his bet and secured continued Canadian access to the U.S. and Mexican markets by engaging with the Trump administration even when Trump himself made that difficult.

President Biden and U.S. Trade Representative Katherine Tai have continued the implementation of the USMCA but have also signaled that the United States will focus on economic recovery rather than new trade deals while also committing to a worker-centric trade policy in the future. The Trump administration used the trade negotiating authority given to the Obama administration by Congress in the *Bipartisan Congressional Trade*

Priorities and Accountability Act of 2015 (more commonly known as Trade Promotion Authority or TPA) to negotiate the USMCA.[2] That legislation provided for a single extension of that authority to June 30, 2021, which the Trump administration requested and received. The Biden administration's decision not to start new trade negotiations allowed that authority to expire. To negotiate any new trade deals, the administration will need Congress to pass new TPA legislation; an unlikely proposition until 2023 at the earliest.

This means that as the global economy recovers from the COVID-19 pandemic, Mexico and Canada have access to the U.S. market on good terms and risk no immediate diminution of that access to new agreements/partners. The USMCA continues to have broad, bipartisan support in the U.S. Congress and the Biden White House and so those terms are stable, despite a protectionist mood among U.S. voters and politicians evident in broad support for "buy American" provisions in legislation. For Mexicans and Canadians, the USMCA puts their economies in an enviable position as U.S. vaccination progress, and U.S. donations of vaccines to Mexico and Canada, hold out the prospect of economic recovery ahead of other major economies.

For all three North American governments, the USMCA was a winning bet.

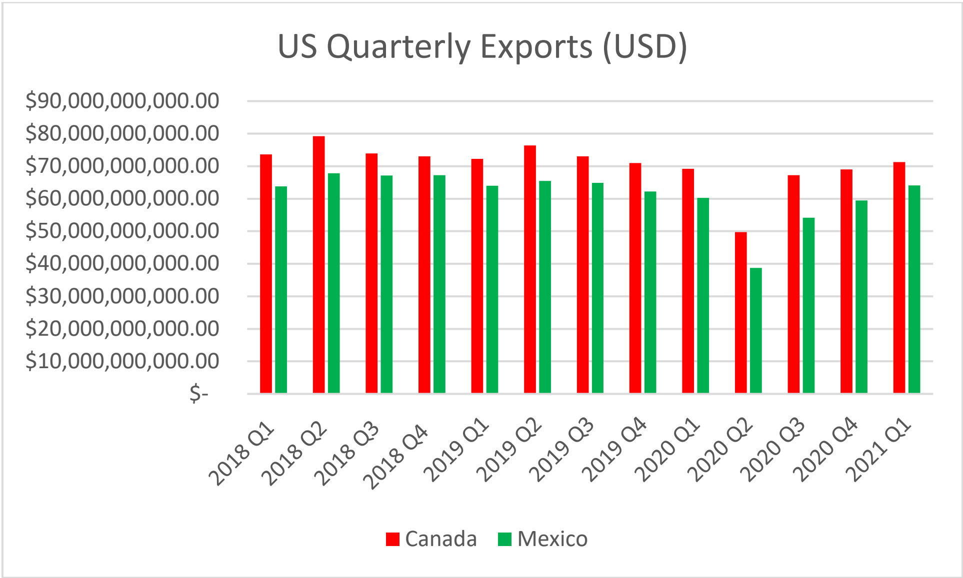
Year One Implementation and Performance

Trade in the first year of USMCA took place under pandemic restrictions of business activities and gatherings that varied in all three countries. In addition, border restrictions imposed by the three governments affected many service sector businesses but were carefully designed to allow "essential" cross-border transit insulating manufacturing and agricultural supply chains to operate with minimal disruption. Energy trade, whether conveyed via existing pipelines or power lines, was largely unaffected. New energy infrastructure faced permitting challenges, but these are related to ongoing climate concerns and other domestic political issues rather than any provisions of the new USMCA.

Table 2 shows the value of U.S. goods exports by quarter to Canada and to Mexico. The second quarter of 2020 shows a sharp drop in U.S. exports to both partners, and it is noteworthy that in prior years the second quarter tended to be the strongest quarter for exports. The decline in exports is likely explained by the adoption of business and social activity restrictions in all three countries in March of 2020. However, U.S. exports recover significantly in the third quarter of 2020 (July – August) just as the USMCA took effect.

[2] See Christopher Sands. *Table Stakes: Congress will be sitting across from Canada at the NAFTA 2.0 Negotiations.* (Toronto: C.D. Howe Institute) July 2017.

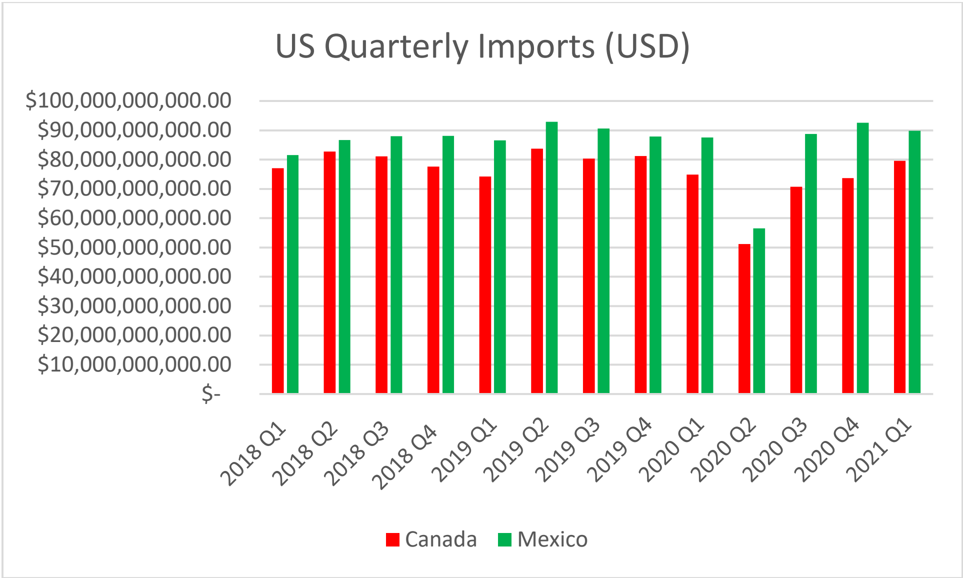
Table 2: US Exports to Canada and Mexico 2018-2021



Source: U.S. International Trade Commission Dataweb (http://datweb.usitc.gov)

Table 3 shows the value of U.S. goods imports from Canada and Mexico by quarter. Again, the second quarter of 2020 shows a marked decline in imports by value, but nearly full recovery in the third quarter as the USMCA takes effect.

Table 3: US Imports from Canada and Mexico 2018-2021



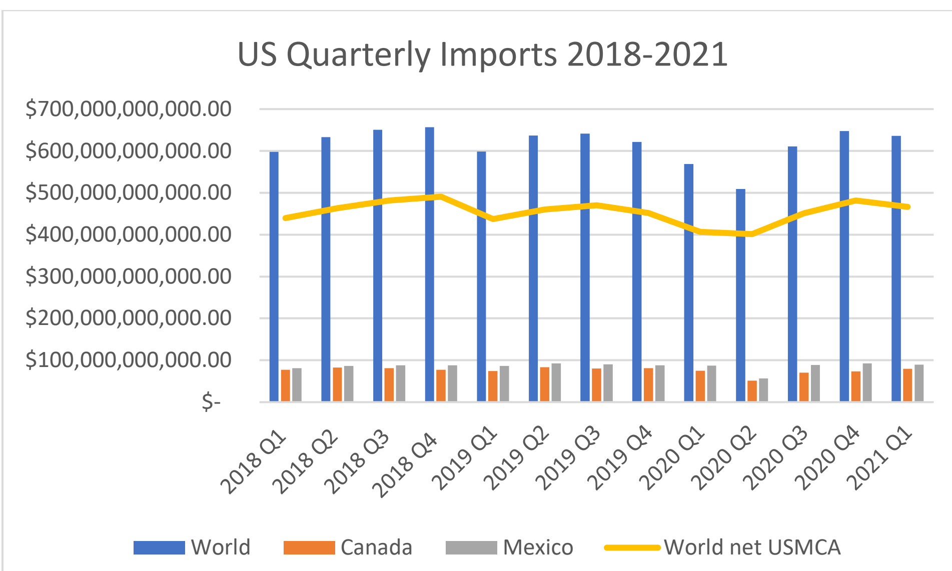
Source: U.S. International Trade Commission Dataweb (http://datweb.usitc.gov)

In Tables 4 and 5, the value of U.S. goods exports (Table 4) and imports (Table 5) are shown alongside world totals, with a yellow line highlighting the change in each quarter for the world without the values for USMCA partners Canada and Mexico.

Table 4: US Exports to World and USMCA Partners 2018-2021

Source: U.S. International Trade Commission Dataweb (http://datweb.usitc.gov)

Table 5: US Imports from World and USMCA Partners 2018-2021



Source: U.S. International Trade Commission Dataweb (http://datweb.usitc.gov)

These data include only three quarters of USMCA performance during which the pandemic and pandemic response measures are also factors. With these caveats, it is noteworthy that trade quickly recovered to pre-pandemic levels.

One possible explanation for this is the quality and flexibility of supply chain relationships that structure a substantial amount of international trade. Once firms figured out new USMCA requirements, they could adapt quickly, and "normal" trade patterns resumed.

To the extent that the USMCA as implemented creates a stable and supportive policy environment for supply chains, the agreement will moderate the negative impact of externalities such as the pandemic on trade. This trade resilience is another "win" for the United States, Mexico, and Canada from the bet they placed on the USMCA.

Next Steps for USMCA Implementation

The USMCA established 25 trilateral committees made up of public service professionals. In year one of the USMCA, these committees, listed in Table 6, were responsible for developing regulations required to fulfill the terms of the new agreement, coordinating enforcement and compliance with the new agreement's provisions, and picking up discussions on sensitive issues where the negotiators left details still to be finalized.

Most of the U.S. officials participating in most of the committees established by the USMCA have continued in these roles as the Trump administration ended and the Biden administration began. Some changes to committee membership are inevitable due to retirements and the desire of a new administration to put a different focus on a particular policy area.

Table 6: Committees Created by the USMCA

USMCA Chapter/Section	Committee
USMCA 02 17	Committee on Trade in Goods
USMCA 03 7	Committee on Agriculture Trade
USMCA 03 8	Consultative Committees on Agriculture
USMCA 04	Committee on Import Licensing
USMCA 05 16	Committee on Rules of Origin and Origin Procedures
USMCA 05 18	Subcommittee on Origin Verification
USMCA 06 8	Committee on Textiles and Apparel Trade Matters
USMCA 07 24	Committee on Trade Facilitation
USMCA 07 28	Subcommittee on Customs Enforcement
USMCA 09 17	Committee on Sanitary and Phytosanitary Measures
USMCA 10	Special Committees for Disputes, Extraordinary Challenge Committees
USMCA 11 11	Committee on Technical Barriers to Trade
USMCA 13 21	Committee on Government Procurement
USMCA 15 Annex B	Committee on Transportation Services
USMCA 17 9	Committee on Financial Services
USMCA 18 27	Committee on Telecommunications
USMCA 20 12	Committee on State-Owned Enterprises and Designated Monopolies
USMCA 20 14	Committee on Intellectual Property Rights
USMCA 24 26	Committee on Environment
USMCA 25 4	Committee on Small and Medium Sized Enterprise Issues
USMCA 26 1	Committee on North American Competitiveness
USMCA 28 18	Committee on Good Regulatory Practices
USMCA 31	North American Free Trade Commission
USMCA 31	Advisory Committee on Private Commercial Disputes
USMCA 33 6	Committee on Macroeconomic Issues

The USMCA committees are the most recent model to address one of the most challenging features of North American integration arrangements: institutions. The European Union and its predecessors were created by governments that delegated sovereign powers to European bodies and agencies. The common understanding of the European model is that national elites had lost legitimacy because of their actions in two World Wars leading to popular support for technocrats in European institutions whose performance would garner legitimacy for the single market and the EU itself.

NAFTA and the Canada – United States Free Trade Agreement that preceded it were designed to operate differently. Each government retained full sovereignty, and the work of managing economic integration was dependent on voluntary government cooperation. The NAFTA established 12 Working Groups made up of public servants from the three countries. The acrimonious political debate over NAFTA ratification in the U.S. Congress led U.S. participants in the NAFTA working groups to take a cautious and risk-averse approach to talks with Mexican and Canadian counterparts and only the North American Energy Working Group continued to meet regularly after 1998. It is worth noting that while the groups ceased to meet, dialogue about the deficiencies and challenges impeding further expansion of North American trade continued among representatives of all three governments. Resolution, however, would have required political capital to make difficult compromises that all three governments lacked.

President George W. Bush attempted to revive talks on government-to-government cooperation in 2005 through the creation of the Security and Prosperity Partnership for North America (SPP).[3] The SPP included 20 working groups, ten addressing economic issues and ten addressing security and border cooperation in the wake of the September 11 attacks that prompted the United States to invest in greater inspection and security at U.S. borders. Political support for the SPP Working Groups was provided by the three heads of government who met annually at a North American Leaders Summit (NALS) from 2005 - 2009. At the second NALS held in Cancún in 2006, the business communities of the three countries formed a private sector North American Competitiveness Council whose members met with the leaders to share ideas on how to improve the regional business environment. As SPP Working Groups generated proposals and sought input form leaders, a cabinet-level committee was formed that included the U.S. secretaries of State, Commerce, and Homeland Security and their Canadian and Mexican counterparts. This nine-member ministerial committee pressed working groups for progress and reported to the leaders on significant accomplishments and obstacles of the working groups.

President Obama revised the institutional mechanisms for cooperation yet again. After attempting a simplified, ten item agenda of issues agreed to by the leaders at the NALS held in 2009 in Guadalajara and assigned to cabinet members for follow-up, Obama acceded to Canadian requests for a bilateral dialogue on issues that did not concern Mexico. Similarly, in 2013, Presidents Obama and Peña Nieto established the cabinet-level High-Level Economic Dialogue (HLED) to address bilateral economic and security issues. This created a new model of "dual-bilateralism" for North American cooperation in which the role of leaders' summits was unclear and NALS meetings became irregular before stopping altogether during the Trump administration. The HLED, led by then-Vice President Biden, has been re-established and will meet for the first time under Presidents Biden and López Obrador in September 2021.

It is too soon to tell whether the return to committees of civil servants in the USMCA will work. Reviving annual leaders' meetings would be a positive step as they tend to serve as "action forcing events" that break bureaucratic log jams in and across all three countries. Unlike the period following the contentious U.S. debate over NAFTA, the current USMCA committees begin working after the agreement won bipartisan support in Washington and retains considerable political support in Mexico and Canada – far more encouraging to

[3] Greg Anderson and Christopher Sands. *Negotiating North America: The Security and Prosperity Partnership.* (Washington: Hudson Institute) 2007.

officials and more conducive to policy concessions by all sides – that will make the USMCA work for all North Americans.

An agenda for Year Two

Much has been achieved in the first year of USMCA, especially considering the pandemic. North American trade remains strong, and the region is well positioned to capitalize on a global recovery. Yet there remain several areas requiring further work by governments and stakeholders in USMCA's second year to enhance the agreement. A non-exhaustive list of these areas includes:

Supply chains: The COVID-19 pandemic exacerbated an already ongoing movement of global supply chains away from China to lower cost producers in Asia and, to some extent, Mexico. Post-pandemic, resilience and "near-shoring" are on the minds of manufacturers and logistics providers world-wide. USMCA provides a ready platform to support both concepts; doing so will strengthen North American economic security and competitiveness.

Critical minerals: A related issue concerns critical minerals on which innovative industry is increasingly dependent. As the auto industry moves toward electronic vehicles, for instance, access, movement, and disposal of critical minerals will drive or impede North American competitiveness and its response to climate change. As our economies adapt, governments should coordinate closely with each other and with private sector and civil society stakeholders to ensure that USMCA's provisions facilitate rather than impede the energy transition.

Rules of origin: The automotive rules of origin contained in the USMCA are some of the most complex of any free trade agreement. Currently, the USMCA parties and the automotive industry have different interpretations of the intent of these rules, especially as they relate to the calculation for regional content of intermediate inputs. Prompt clarification of these rules and clear guidance on implementation by customs agencies is essential to ensuring that the rules of origin achieve their intended outcome.

Data analytics: The USMCA commits the federal governments to make more data available to private firms, with appropriate protections for personally identifying information. Today, trade data published by the three governments counts the value of trade at the port of entry. Yet electronic bills of lading include specifics that could make trade data more precise, including the delivery address. This precision could inform communities in the interior of all three countries on their international trade connections, and guide policymakers in making smarter investments in infrastructure and even workforce training.

Ending border restrictions: The border restrictions implemented in response to the pandemic allowed most trade to proceed with only modest disruptions. However, conflicting definitions of terms such as "essential" created important manufacturing disruptions for individual firms across all sectors of the economy. While more acute between the U.S. and Mexico, the lack of common definitions should be addressed regionally in advance of a future pandemic or supply shock. In the same vein, establishing clear guidelines for when and how border restrictions will be relaxed or removed would be preferable to the current practice of deciding on a monthly basis whether to retain restrictions for an additional month.

Public health cooperation: Past pandemics, such as the 2009 H1N1 flu, have prompted North American governments to establish new mechanisms and to pledge greater coordination. The COVID-19 pandemic revealed significant deficiencies in the ability of North American governments to respond collectively to public health crises that disregard physical borders. Moving forward, governments should explore agreement to refrain from the application of export controls on critical health supplies (ventilators, PPE, vaccines, etc.), to facilitate approval of medicines and vaccines to treat or prevent future pandemic illnesses, and to establish protocols to allow medical professionals to practice in all three countries under emergencies.

Labor mobility and workforce upskilling: The list of professions covered under the NAFTA was not updated in the USMCA due to domestic political considerations and thus does not recognize or reflect the reality of the 21st century economy. Further, the lack of common credentialing requirements inhibits the movement of skilled workers across borders even when doing so would address a critical shortage. In addition, the new digital economy requires a workforce with new skillsets. Each of these labor-related challenges can be addressed and improved under the USMCA platform to further enhance North American competitiveness.

Enforcement: Now that the pandemic is subsiding, greater attention will be paid to enforcement of USMCA's terms and provisions. The private sectors in all three countries will apply pressure on their own governments and those of the other parties to ensure that new laws and regulations adopted anywhere in the region strictly comply with the terms of the agreement. Investors will be especially sensitive to any indication that certain provisions are less important (and this enforced less vigorously) than others. If governments appear to be picking and choosing which sectors or industries to support, it will send signals that will undermine investor confidence – a principal attribute of North American trade since NAFTA's earliest days.

Energy: The proposed reforms to Mexico's 2013 energy reform, now largely held in abeyance while legal challenges work their way through Mexico's legal system, raise important questions about Mexico's compliance with its USMCA commitments. Given the significance of these reforms for AMLO's Fourth Transformation and his pursuit of energy self-sufficiency, Mexico will aggressively defend its right to modify the way in which the energy sector is managed despite U.S. and Canadian assertions to the contrary. Also important will be how the three countries address climate change including greater use of fuel oil for electricity generation in Mexico that will increase greenhouse emissions and create challenges for investors with global emissions reduction targets.

Trade-essential Infrastructure: On both the U.S.' northern and southern borders, infrastructure has failed to keep pace with the growth of trade. Border infrastructure is not covered in USMCA nor was it covered in NAFTA, but it is essential for the continued growth of North American trade and the very success of NAFTA/USMCA has continued to build pressure for the three countries to build more modern border facilities and processes. The three governments (often working bilaterally) must move to simplify mechanisms to allow for creation of new infrastructure through innovative models including public-private partnerships and direct gifting to the federal governments of privately funded infrastructure. In addition to "brick and mortar" infrastructure like roads and bridges, simplified procedures to facilitate commerce such as the single window and common documentation will allow products and services to move more seamlessly between and around North America.

Conclusion

As important as what happened in the implementation process for the USMCA in its first year is what *did not* happen. The new Biden administration in the United States remained committed to the agreement negotiated by its predecessor, just as Mexico's Lopez Obrador administration had done a year earlier. In Canada, the Trudeau government held a plurality of seats in the House of Commons rather than a majority, but opposition parties supported implementation of the USMCA despite ongoing disagreements with the United States over softwood lumber trade and oil pipelines.

Even as governments scrambled to vaccinate their citizens and employed fiscal stimulus to spur economic recovery, the USMCA was seen as a positive factor by all three governments. This augers well for year two and beyond.