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What to Expect from USMCA (or NAFTA 1.01)

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After more than a year of talks, the US, Canada, and Mexico struck a new trade deal to replace NAFTA, known as the United States-Mexico-Canada Agreement, or USMCA. The agreement is still waiting for approval in Congress. After the Democrats took control of the House in the midterms last week, that approval is now in question.

Regarded as "the most important trade deal we've ever made" by President Trump, the USMCA is the replacement of the old NAFTA deal, which he described as "the worst trade deal maybe ever signed anywhere" (Brinkley, Oct 8, 2018). Since NAFTA was signed more than 25 years ago, there are some updates to the agreement that are arguably needed. The way countries trade with each other has transformed significantly since then. New components of trade, including digital commerce, should be addressed in the regional trade deals.

However, most of the old agreement remains intact. The new NAFTA doesn't change the old tariff structure or the zero tariffs policy on most manufacturing and agricultural goods. There are large sections of the old NAFTA which were not touched. The most significant changes, including digital trade, were previously negotiated as part of the Trans-Pacific Partnership, from which the current administration withdrew in 2016 (Pethokoukis, Oct 17, 2018).

This article reviews the changes in USMCA and evaluates its impacts on the various parties associated with the trade agreement.

Overview of changes

The first change in the country of origin rules: automobiles must have 75 percent of their components manufactured in Mexico, the US, or Canada to qualify for zero tariffs (USTR, Oct 1, 2018). It used to be 62.5 percent under NAFTA. The increased portion means that fewer cars or car components will come from suppliers elsewhere in the world. Consequently, it would impact car parts made in countries like

Germany, Japan, and China. Shifting supply lines can take decades and, along with increased costs based on lack of infrastructure, consumers end up paying more (Pethokoukis and Barfield, Oct 17, 2018).

The second change is on labor provision or minimum wage. Forty to forty-five percent of automobile parts have to be made by workers whose pay averages at least $16 an hour by 2023 (USTR, Oct 1, 2018). Mexico has also agreed to pass laws giving workers the right to union representation, extend labor protections to migrant workers, and protect women from discrimination. The countries can also sanction one another for labor violations. These rules demonstrate a key U.S. ambition to benefit American workers through rebalancing the manufacturing sector (Wingrove et al., Oct. 2, 2018).

The minimum wage will not bind in Canada and U.S., but it is about three times the current typical manufacturing wage in Mexico (Long, Oct. 1, 2018). Considering that the change doesn't happen until 2023 and with possible inflation involved in the process, the effect on Mexico's workers may not be as significant as it seems. More automation may be the substitute for workers as a result. This is a novel effort to set a minimum wage in a specific sector through a trade agreement. Usually, minimum wages require a domestic process and, in the US, often at the state level. It is unclear what precedent having minimum wages imposed by a trade agreement sets for future labor or trade law (Pethokoukis and Barfield, Oct 17, 2018).

The third big issue is the dairy market. To get an agreement, Canada agreed to open a small portion (3.59 percent) of its dairy market to farmers in the United States (Wingrove et al., Oct. 2, 2018). This concession follows similar concessions to the EU (Comprehensive Economic and Trade Agreement or CETA) and pacific country trade partners under the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), the successor to the Trans-Pacific Partnership trade agreement, which cumulatively means that Canada has opened up about 10 percent of its dairy market (CBC News, Oct 04, 2018). Also, as part of the deal, Canada will give up its unique pricing system of Class 7 milk that sets unusually low domestic prices of ultra-filtered milk (an ingredient used to increase protein content in cheese and yogurt) (Skerritt et al., Oct. 2, 2018). By allowing for low prices of this ingredient, the Canadian policy effectively subsidized Canadian dairy processors and made the imports of ultra-filtered milk uncompetitive (Wingrove et al., Oct. 2, 2018). Canada's concessions will boost the amount of milk, cheese, and cream that the U.S. can export without paying the tariff. As a result, Trudeau agreed to compensate the Canadian dairy farmers to soften the blow (CBC News, Oct 04, 2018). Considering the 500 billion dollars of annual trade flows going between these two countries, the dairy market is relatively small: in 2017, Canada imported around 368 million dollars of dairy products from the U.S. while exporting 112 million dollars (Skerritt et al., Oct. 2, 2018). President Trump, however, had insisted on changes to U.S. access to Canada's dairy market as a symbolic gesture on behalf of American farmers.

A significant new section in the new NAFTA is the digital trade section. When WTO and NAFTA were negotiated in the early 1990s, the internet was relatively new and far less critical. The digital trade section covers trade rules in the digital economy, including prohibiting duties on music and e-books, and protections for internet companies, so they're not liable for content their users produce (Kirby, Oct 3, 2018). The deal also extends the terms of copyright to 70 years beyond the life of the author (up from 50). It also extends the protection period of pharmaceutical drugs from generic competition.

Key Democratic Demands

The current consensus is the USMCA will not be passed easily (Alemany, Nov. 15, 2018). Generally speaking, news reports indicate that Democrats are in favor of the changed labor requirements (Byrd H. Nov. 13, 2018), but remained concerned about the ability to enforce the deal. House Minority Leader Nancy Pelosi released a statement on USMCA saying without enforcement, the deal could just be rebranding NAFTA (Alemany, Nov. 15, 2018). Second, labor activists have demanded a change in the clause regarding minimum hourly wages for Mexican autoworkers since the current deal does not include an adjustment for inflation. They fear the that the $16 wage may not be enough to curb the movement of jobs flowing out of the U.S. (Wasson and Mayeda, Nov. 14, 2018).

There are also concerns about the steel and aluminum tariffs, which remain in place for Canada and Mexico despite the new agreement (Byrd H. Nov. 13, 2018). Some of the newly elected Democrats in the House Representatives came from the Midwest, for example, "where the pain from the president's tariffs is being felt the most" and they would be expected to push for the removal of the tariff in the USMCA debates (Alemany, Nov. 15, 2018).

Summary

In summary, there are significant updates to NAFTA in the automobile and dairy industry, but other changes are relatively minor. There is also little evidence that it will significantly alter trade balances among the three countries (Martin Feldstein, April 25, 2017). Although U.S. Trade Representative Lighthizer remains "very confident" in ultimately getting the votes needed to pass the USMCA, it appears unlikely to happen in a lame duck session; passage will be up to the new Congress where the concerns on the steel and aluminum tariff adds uncertainty.

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