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THE NEW USMCA – WHAT IT MEANS AND HOW WE GOT HERE

In the beginning …

On January 1st, 1993, the North American Free Trade Agreement – otherwise known as NAFTA – came into effect. That agreement, involving Canada, the U.S. and Mexico established the framework for trade within the three countries. Not all trade was free trade – that is, with no tariffs, duties, quotas, etc. – but much more was free of such barriers than was the case before. And, beyond the goods and services that were free to move across the borders, the limits/tariffs on other things were clarified and set out.

All in all, it significantly improved the trade relationship among the three countries and trade among them has grown.

The Challenge of Economic Adjustment

At the time of signing, though, a challenge was set forth. Producers of various goods and services were challenged to adjust to new competition from the other partners in NAFTA. Whenever trading relationships change, some producers will face greater challenges than others to adjust to new competition. If those companies do not adjust effectively in terms of how they produce, the quality of what they produce, the price they charge, the costs they face, etc. they may find they are doing worse than before. Some may even fail.

At the same time, other companies may flourish and grow as a result of new opportunities.

So economic adjustment is a key factor when trade relationships change. When industries or companies struggle to adjust, and possibly fail, governments are likely to hear loud and clear from them that the new trading relationship is a problem.

The Challenge of Changing Technology

Along with changes in trading relationships comes the challenge of adjusting to changes in technology. Everyone is aware that the world is changing, and changing fast. Goods and services that are being produced and exchanged are in a period of rapid and profound change. Once again, if companies cannot, or will not, adjust to such change they will struggle – and may fail.

The Challenge of Economic Adjustment was the Root Cause for the Desire to Change NAFTA

Why this focus on economic adjustment and the challenges posed by new trade relationships and changing technology? Because, in many ways, that is what set the stage for the new trade agreement for the U.S., Canada and Mexico.

The Rust Belt Created an Opportunity for Donald Trump

Since January 1, 1994, all three economies have grown and prospered, with some glitches such as the financial crisis that hit in 2008. But in the United States some regions and certain industries struggled with the challenge of economic adjustment. This was particularly true of the ”rust belt” states in the U.S., such as Pennsylvania, Ohio, West Virginia, Indiana, southern Michigan, northern Illinois and parts of Iowa and Wisconsin. These states had manufacturing bases that struggled with global competition and competition from their North American trading partners.

Some of these states had relatively high wages compared with those paid to workers in Mexico. As a result, some auto production plants closed in the U.S. and relocated to Mexico where assembly was much cheaper. A city that lost a big auto plant faced significant increases in unemployment along with a sharp drop in the value of real estate. Another example: industries such as coal were declining significantly because of changes in energy use and environmental concerns.

As these stresses on communities built, there were few if any effective policies to assist those facing hard times. Many workers and families were paying the price for companies that were not adjusting well.

Donald Trump Appealed to Those Paying the Price for a Failure to Adjust

This set the stage for a Presidential victory by Donald Trump as he appealed particularly to the many in these states who were struggling and who believed existing leadership was not helping to improve their lives. Trump hit that nerve and he won Pennsylvania, Ohio, West Virginia, Indiana, Michigan, Iowa and Wisconsin.

NAFTA Was an Ideal Target

It should have surprised no one when Donald Trump set his sights on NAFTA – he made it loud and clear during the campaign that he would “tear up NAFTA” and that he thought it was the “worst trade deal in history.” The stage was set for someone like Trump to appeal to those disenchanted states and Americans. And there had to be things to blame for what they were experiencing. NAFTA was a prime target.

Many in the U.S. Supported, and Benefitted from, NAFTA

But it is important to note that many other parts of the U.S. benefitted significantly from NAFTA. Companies and industries adjusted well to the change and acted to take advantage of new opportunities that opened up. So bad feelings toward NAFTA were by no means consistent across the U.S. Most businesses and business organizations supported NAFTA and recognized that all countries benefitted from having a framework that clearly governed trade among the three nations. If you took a poll asking business people and leaders in the U.S. if the U.S. should tear up the NAFTA agreement the over-whelming result would have been 'no'.

But the NAFTA Target was Set In Donald Trump's Sights

But Donald Trump was elected on the basis of some very clear promises made to his base – and one of those was to tear up or somehow change NAFTA to improve the outcomes for American businesses and American workers. Trump has focused on keeping those promises – and he has utilized what one could politely refer to as a unique approach, a very aggressive and confrontational one. And that is what he set out to do with the U.S. trade deals.

Step One – Walk Away from the TPP

First, he walked away from the Trans Pacific Partnership, or TPP. Many of those who had been negotiating on behalf of the U.S. were not happy about this because the TPP was designed to correct some of the trade issues that were of concern to the U.S. But President Trump set out to be true to his word and the first thing to do – since signing of the TPP by participating nations was imminent - was to abandon it. Canada and 10 other countries proceeded to sign the deal without the U.S.

Step Two – Set the Stage for Negotiations with Tariffs on Steel and Aluminum

Second came NAFTA. To set the stage for harsh negotiations, President Trump announced the imposition of tariffs on imported steel and aluminum – products that Canada exports to the U.S. in large quantities. This was an effort to protect and bolster U.S. steel and aluminum manufacturers. A 25% tariff on steel and a 10% tariff on aluminum pushed up prices of foreign competitive products and made U.S. producers more competitive in their domestic market.

The Tariffs Also Imposed a Cost on Americans

At the same time, though, as the U.S. steel and aluminum producers and workers benefitted, many U.S. consumers paid a price. Why? Because those industries and products using aluminum and steel now had to pay higher prices and these were then built into higher prices charged for goods and services using those resources.

"Let's Play Hardball"

Regardless, the impact and message to countries like Canada were clear – President Trump was out to play hardball and could take measures that most, if not all, past Presidents would never have considered. Dealing with the Trump administration, it was very clear, was going to be different than dealing with any previous administration.

NAFTA Needed to Be Changed

In this environment, efforts were launched to review and revise NAFTA. Such efforts began around early 2017. Most people will acknowledge that NAFTA was in need of revision. As was noted, the world had changed a great deal since 1993. It had moved fully into the digital era with rapidly changing technology, new production methods, new products and services, robotics and so on. NAFTA did not address some aspects of trade that needed to be reviewed and so there was need for change.

But the Atmosphere for Negotiations was Different

But the atmosphere for the discussions and negotiations had been set – and they were unlike any such negotiations in the past. Donald Trump, in a loud and boisterous way, was intent upon coming out the winner.

Canada's Dairy industry Became a Prime Target

To help set the stage for that, one area of clear focus for the Trump administration was Canada's dairy, egg and poultry industry. This industry had historically been well protected from foreign competition through a set of tariffs, fixed prices and production quotas. U.S. dairy farmers cried foul (pun intended) and complained about access to Canada's dairy industry – an industry primarily concentrated in Ontario and Quebec.

TPP Had Set a Precedent

Interestingly, the TPP opened up Canada's dairy industry to the 10 countries involved in that agreement – 3.25% of the market was opened up to competition. This likely sent a clear message to the Trump administration that concessions were possible. After all, if the dairy industry was opened up to competition under the TPP, why not the same in a new North American agreement?

Trump was Disgruntled with Canada

So the negotiations ensued. Word came from President Trump that the Canadians were being tough negotiators; that he wasn't happy with the way Canada was negotiating; that he didn't like our chief negotiator, Foreign Affairs Minister Chrystia Freeland. He got into conflict with Prime Minister Justin Trudeau.

Mexico First

As a result, the U.S. turned first to Mexico for a deal on the assumption that they could do better in bilateral talks and get a deal more quickly. The President of Mexico, who was supportive of a new deal, was due to leave office soon and the U.S. wanted to get a deal done before he was gone. And they succeeded.

Trump Moved Beyond Disgruntled

Attention then turned to Canada and complaints from the President about Canada escalated. He threatened to pull out of NAFTA. With the U.S. being Canada's largest trading partner by far, this sent some shock waves throughout Canada. In the past, no one would likely have suspected a U.S. President of following through on such a threat. But things were different now, and the consequences of a collapse in the trade agreement with the U.S. could be devastating for Canada, especially for certain industries such as automotive. The pressure on Canadian negotiators to strike a deal was extraordinary. Yet, at the same time, Canada had to avoid making too many, or too significant, concessions that would hurt Canadian producers and workers.

A deadline was set for striking a deal and that deadline was fast looming. Concern over the consequences for Canada of failing to striking a deal was significant and real.

A Deal is Struck!

Then, at the last minute, a deal was struck. Both sides claimed it to be a good one – and the President, as was to be expected, claimed victory for the U.S. since, among other things, U.S. dairy farmers would gain some access to Canada's dairy, egg and poultry market.

Both Countries Claim Victory

In the end, a good part of the victory for both countries was that a deal was done at all as the consequences of the alternative were ominous for producers and consumers on both sides of the border. Both leaders have sung the praises of the new agreement and there has been widespread support from various sectors and industry and labour leaders in both countries.

President Trump also benefits from a deal with a new name and new branding. He can claim that he ended NAFTA and created the new USMCA – the United States, Mexico and Canada Agreement.

The Changes Made Sense and Were Needed

Most analysts will say (a) that NAFTA needed revision, (b) the new agreement is basically a revised NAFTA with many elements similar but with changes that needed to be made, and (c) that it reflects much of what is in the TPP agreement.

The Outcome: What Canada Conceded

So a deal is done, both countries are relieved, both leaders are happy and President Trump is back to saying nice things about Canada. Canada did make some concessions – most significantly giving up some additional access to the dairy market, a lengthening of the time period in which patents in the pharmaceutical industry will be protected, and an increase in the number of years (50 to 75) for copyright protection. Those in Canada's dairy industry in Ontario and Quebec will not be happy and there will be pressure on the federal government to provide some compensation for lost income. The extension of patents will mean that there will be a longer period before generic drugs can be used and this could push up the price of medications for Canadians. However, there may be a new national pharmacare program that would help relieve this burden.

Another aspect of the agreement, and one that could result in some controversy, is a clause that says that if any partner is looking to pursue a trade agreement with a non-market country – such as China – they have to let the other partners know. If Canada were to open negotiations with China, the other partners would have a six-month period in which they could withdraw from USMCA. Does this infringe on Canadian sovereignty? The government has said that it does not. The realities remain to be clarified.

The Outcome: What Canada Secured

At the same time, Canada secured a couple of very important things. First, the auto industry benefits from the new deal, especially in comparison to what might have happened had there been no deal and new tariffs were imposed by the U.S. on auto imports from Canada. This was a major gain for Canada.

In addition, something most Canadians might not know about is that NAFTA had Chapter 19, which outlined how disputes between the trading partners would be resolved. It stated that disputes would be resolved by a decision from an independent panel. The fear was that this would disappear and that disputes would be resolved in the courts. Canada did not look forward to taking the U.S. to court in the U.S. to try to resolve trade disputes. Under the new agreement, an independent dispute resolution mechanism is maintained.

Online Shopping

Many Canadians will also likely be happy to hear that, when they buy online, imports under $150 will not be subject to duty (the limit used to be $20) and items under $40 will not have sales tax added. Canadian retailers, however, are likely to be unhappy. Not only will this likely mean that Canadians buy more from the U.S. online, but also the limit on what Americans can order from Canada without duty has been reduced from $800 to $100. This could reduce U.S. purchases from Canada, although the favourable exchange rate will still influence U.S. buying.

Ratification is Still Required

The USMCA has to be ratified by the legislatures in all three countries. That is likely to happen since the consequences of no agreement and the unpredictable and unstable trading environment and conditions that could ensue are painful to imagine.

Most are Happy with the Deal

So we have a new agreement that is likely to come into place. Government leaders seem happy. Most business and labour leaders seem happy – especially when they think about the alternative. Donald Trump can boast of victory. Canada can be happy with what has been secured and can try to take steps to make dairy farmers happier than they are now.

But What Does This Hold for the Future?

A key question surrounds how we got here, though. The process was acrimonious and unlike any that Canada and the U.S. have experienced in the past. Will this be seen as a success in the U.S. and set the stage for the U.S. continuing to believe that a belligerent approach in the best approach? That will be debated. But there is no doubt that the agreement came with a cost – the damage to the historic relationship that has typified Canada/U.S. relations and the amicable context in which the two countries have worked out things in the past. Is this typical of the way things will be in the future? That is to be seen. We have a new agreement, but we may also have a new relationship.

Gary Rabbior, President
Canadian Foundation for Economic Education

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