

# PubPol 201

## Module 3: International Trade Policy

### Class 6

### NAFTA and Its Renegotiation as USMCA

# Class 6 Outline

## NAFTA and Its Renegotiation as USMCA

- What is NAFTA?
- What happened under NAFTA?
- Issues in renegotiation
- USMCA

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# NAFTA – What is it?

## NAFTA

“The single worst trade deal ever approved in this country” Donald Trump 2016

## USMCA

“A wonderful new trade deal” & “the most important trade deal we’ve ever made, by far” Donald Trump 2018



# NAFTA – What is it?

- A Free Trade Agreement (FTA) including US, Canada, and Mexico
  - Expanded a previous US-Canada FTA
  - Negotiated under President George H. W. Bush
  - Enacted 1993 under President Bill Clinton
  - Went into effect Jan 1, 1994

# NAFTA – What is it?

- FTA provisions:
  - Zero tariffs on imports from each other
  - Doesn't change tariffs on outside countries
  - Rules of origin
    - Goods cross borders tariff-free only if they “originate” in the NAFTA countries
    - “Originate” defined in terms of how much of a good was produced here
    - Example: Autos required 62.5% North American content

# NAFTA – What is it?

- Other provisions
  - Some liberalization in services
  - Foreign investment
    - ISDS in Chapter 11
      - Gives foreign investors right to dispute policies that reduce profits
      - Decided by 3-person panel, who may make states pay
  - Intellectual property rights
  - Opening of government procurement
    - Governments must let NAFTA suppliers bid

# NAFTA – What is it?

- Also Side Agreements on
  - Labor
  - Environment

# Clicker Question

Under which US president was the NAFTA enacted into US law?

- a) Ronald Reagan
- b) George H. W. Bush
- ✓ c) Bill Clinton
- d) George W. Bush
- e) Obama

# Clicker Question

The AFL-CIO, in “NAFTA at 20,” was critical of several aspects of NAFTA. Which of the following did it NOT criticize?

- a) ISDS
- ✓ b) Rules of origin
- c) The side agreement on labor standards
- d) The side agreement on environment
- e) None of the above (they criticized all of them)

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# NAFTA - What happened?

- What happened?
  - Not much, at first, in 1994
  - Mexico kept peso pegged to the dollar
  - Resisted devaluing peso in run-up to presidential election
  - Assassinations in 1994 included
    - Mar 23: PRI presidential candidate Colosio

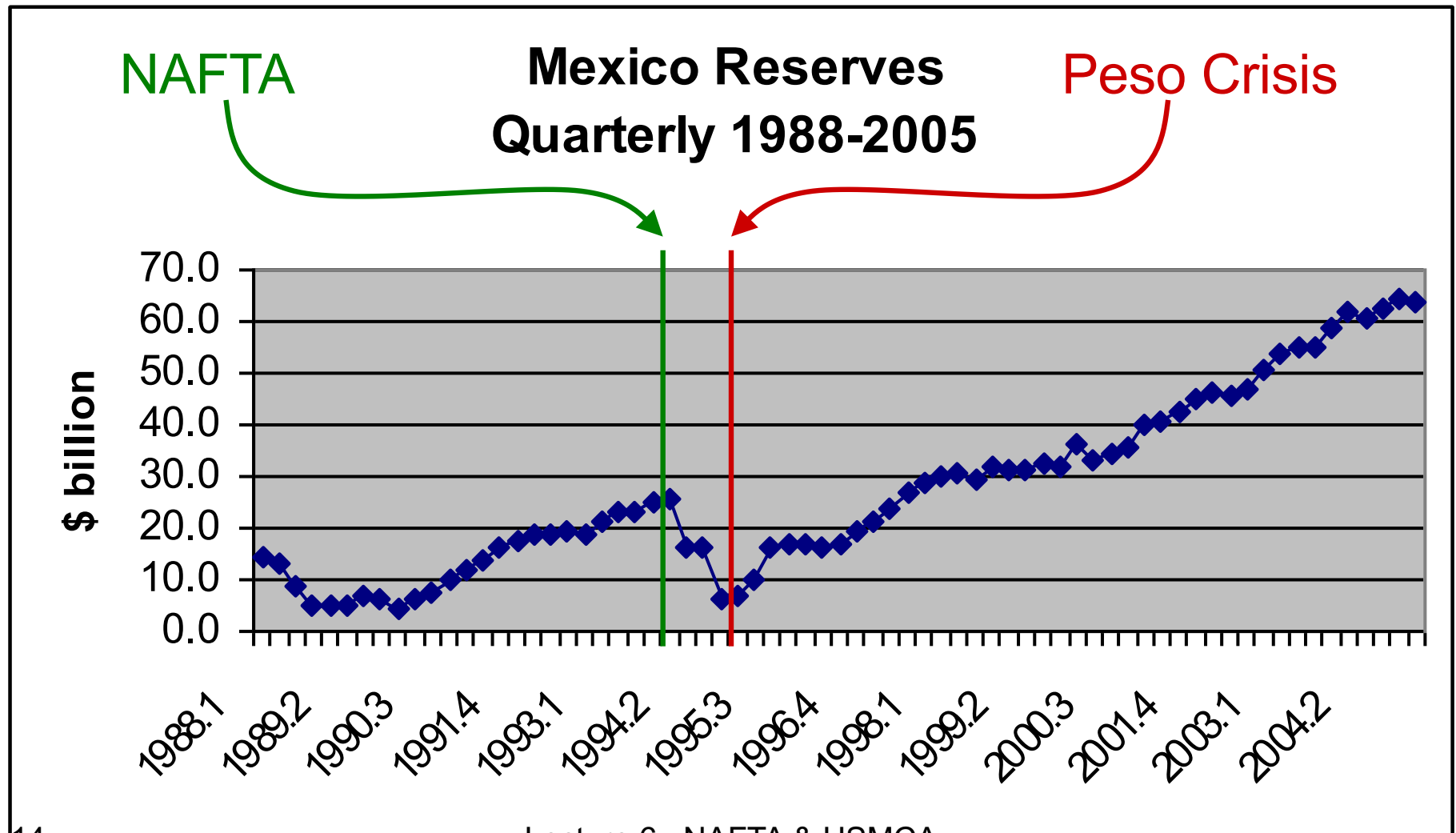


# NAFTA - What happened?

- Peso Crisis (aka “Tequila Crisis”)
  - December 20, 1994 (after the election)
    - Crisis hit the foreign exchange market
    - Mexico devalued the peso
  - Devaluation had devastating effects on the Mexican economy
    - Mexico had borrowed in dollars to pay for assets in pesos
    - Devaluation meant that debt was suddenly higher than assets for many

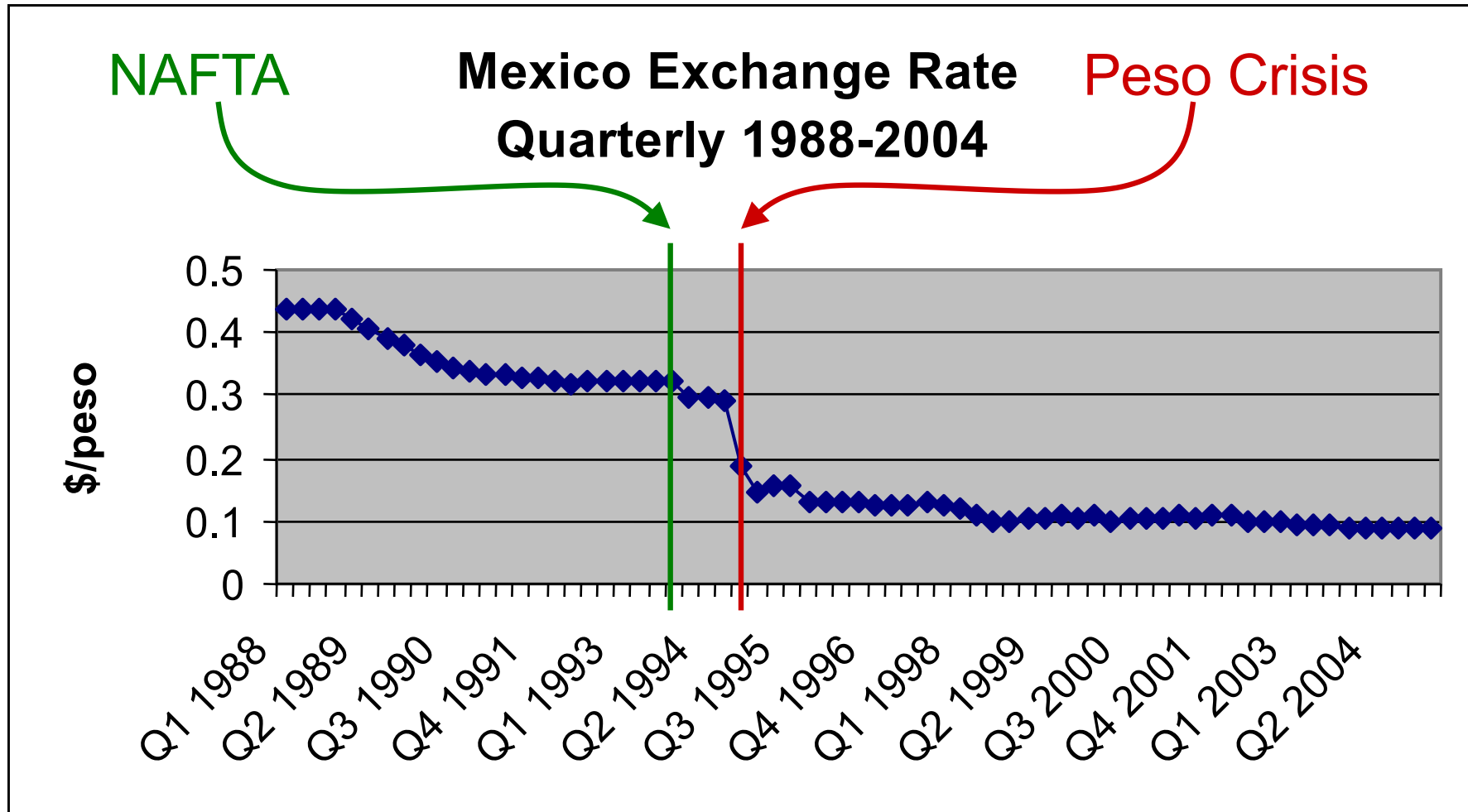
# What Happened: Mexico

## Reserves Fell at Once



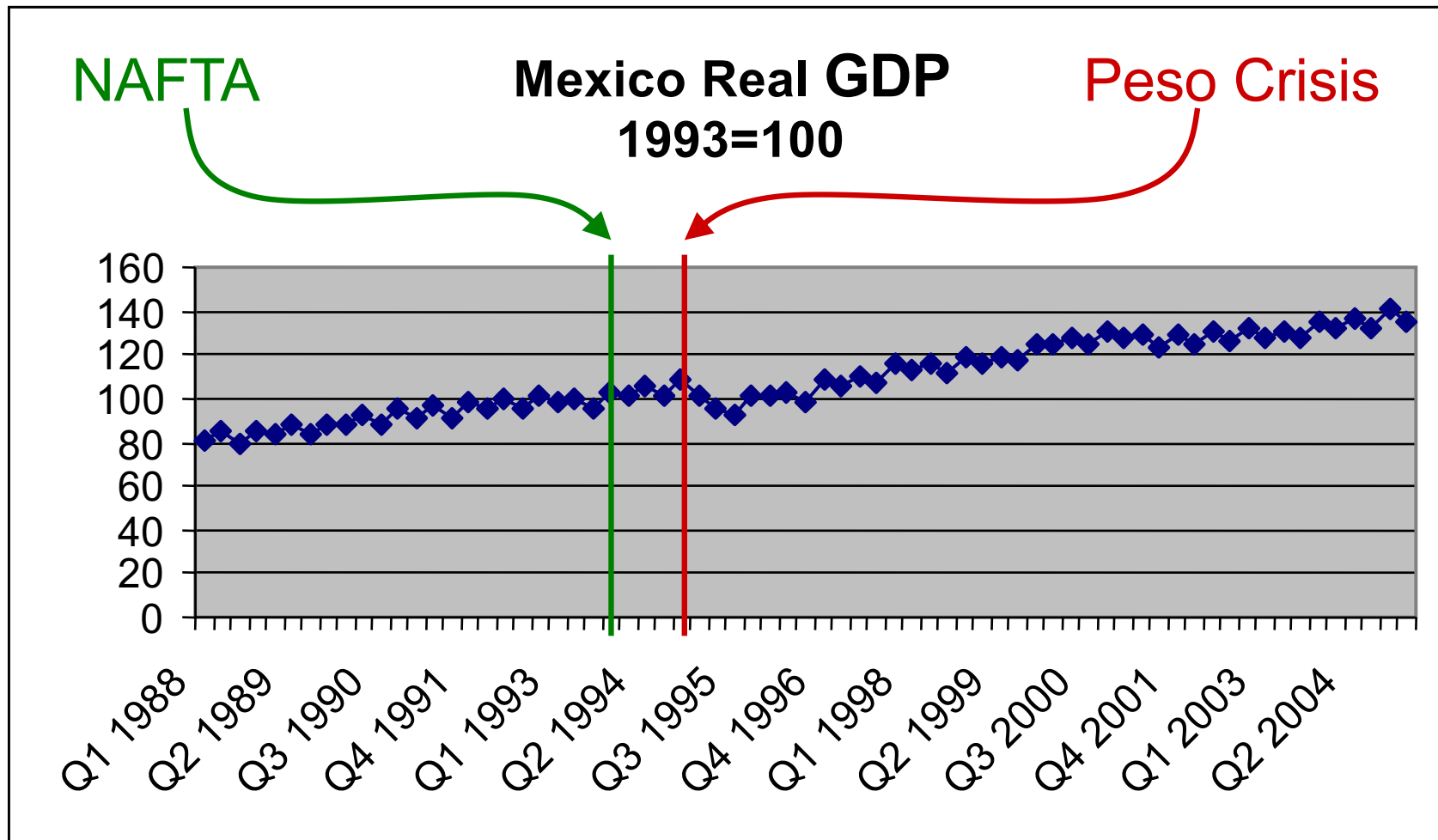
# What Happened: Mexico

## Peso Dropped One Year After



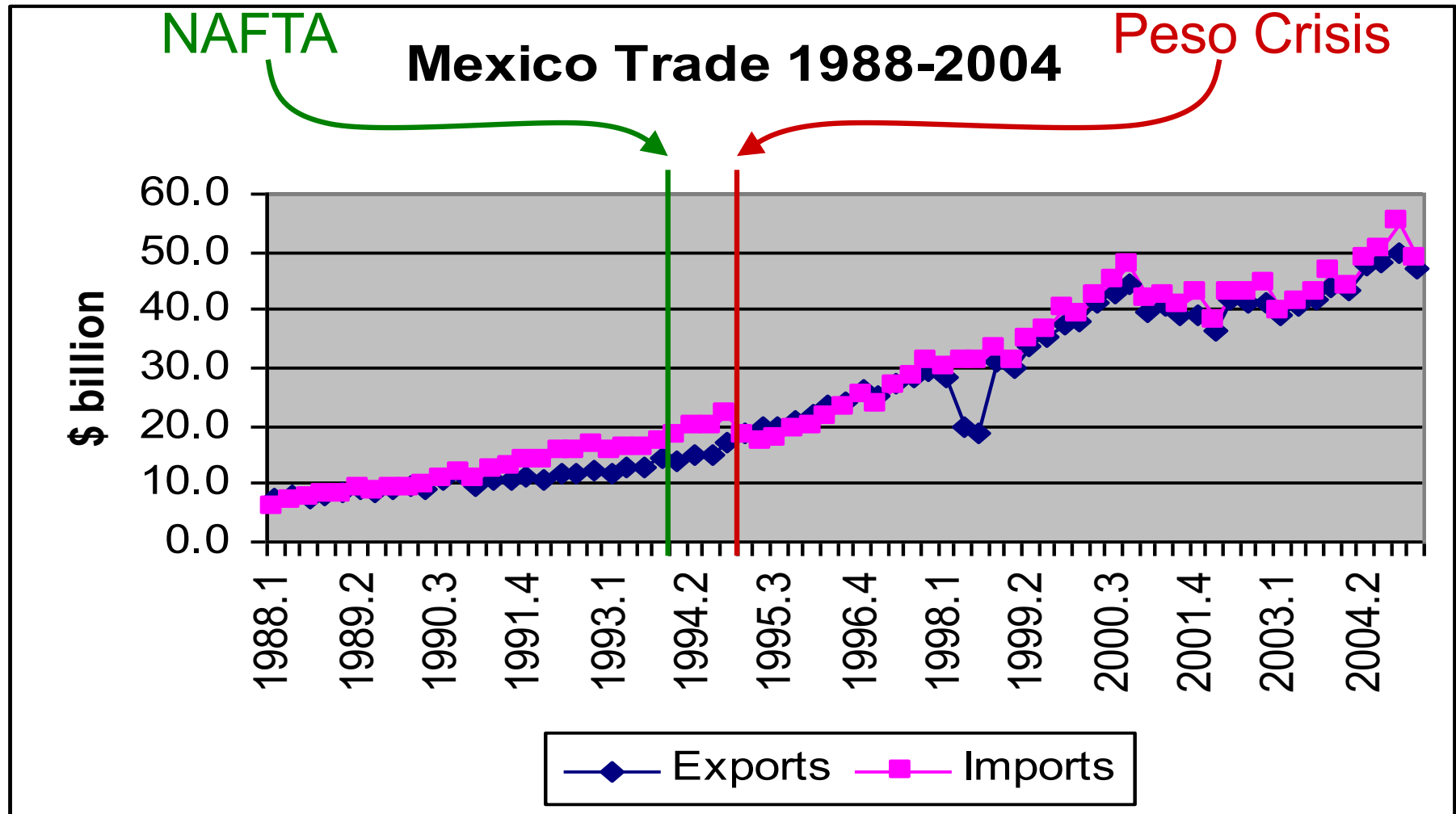
# What Happened: Mexico

## GDP Fell after Peso Crisis



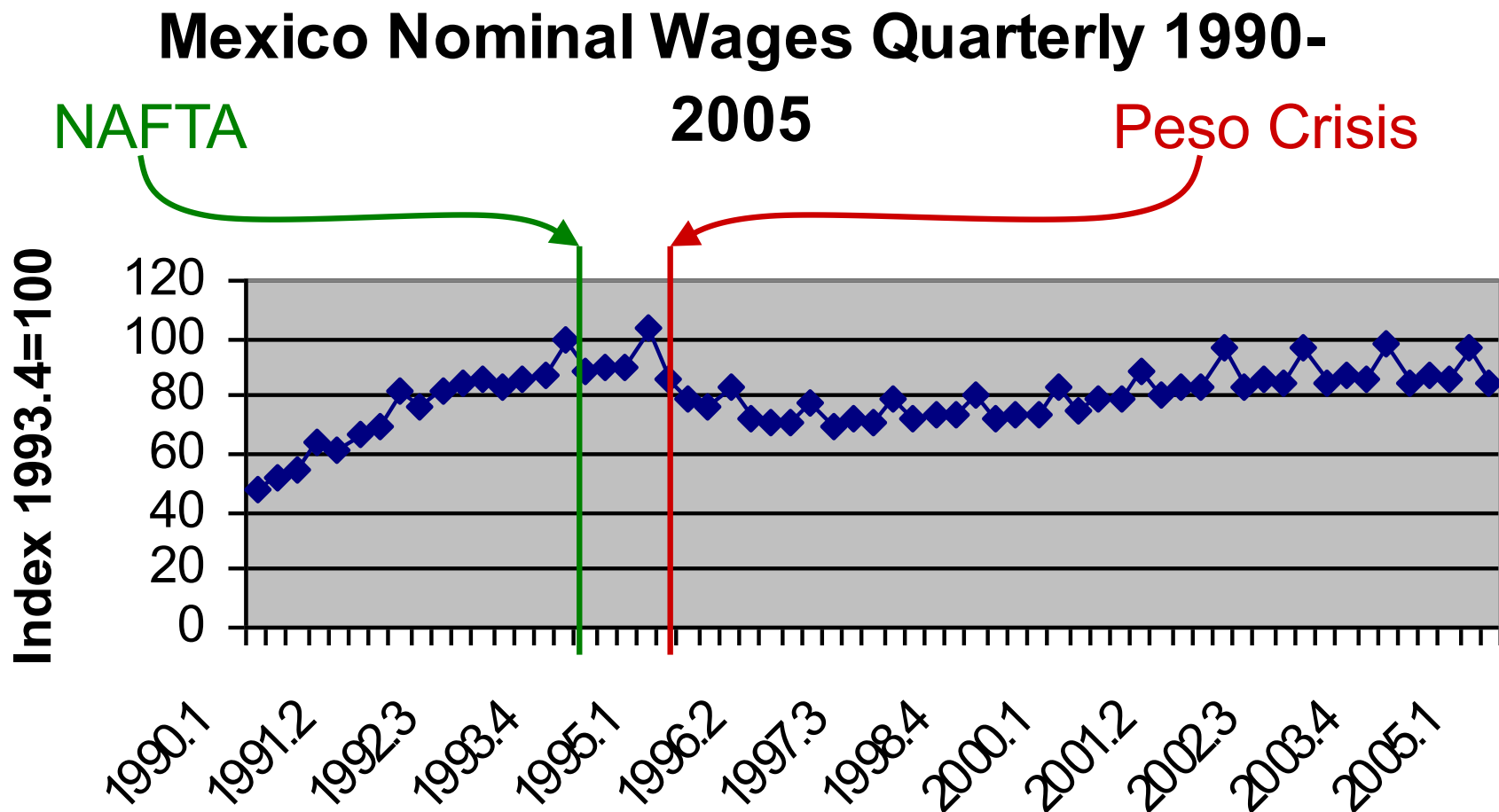
# What Happened: Mexico

Imports Fell after Crisis; Exports Rose



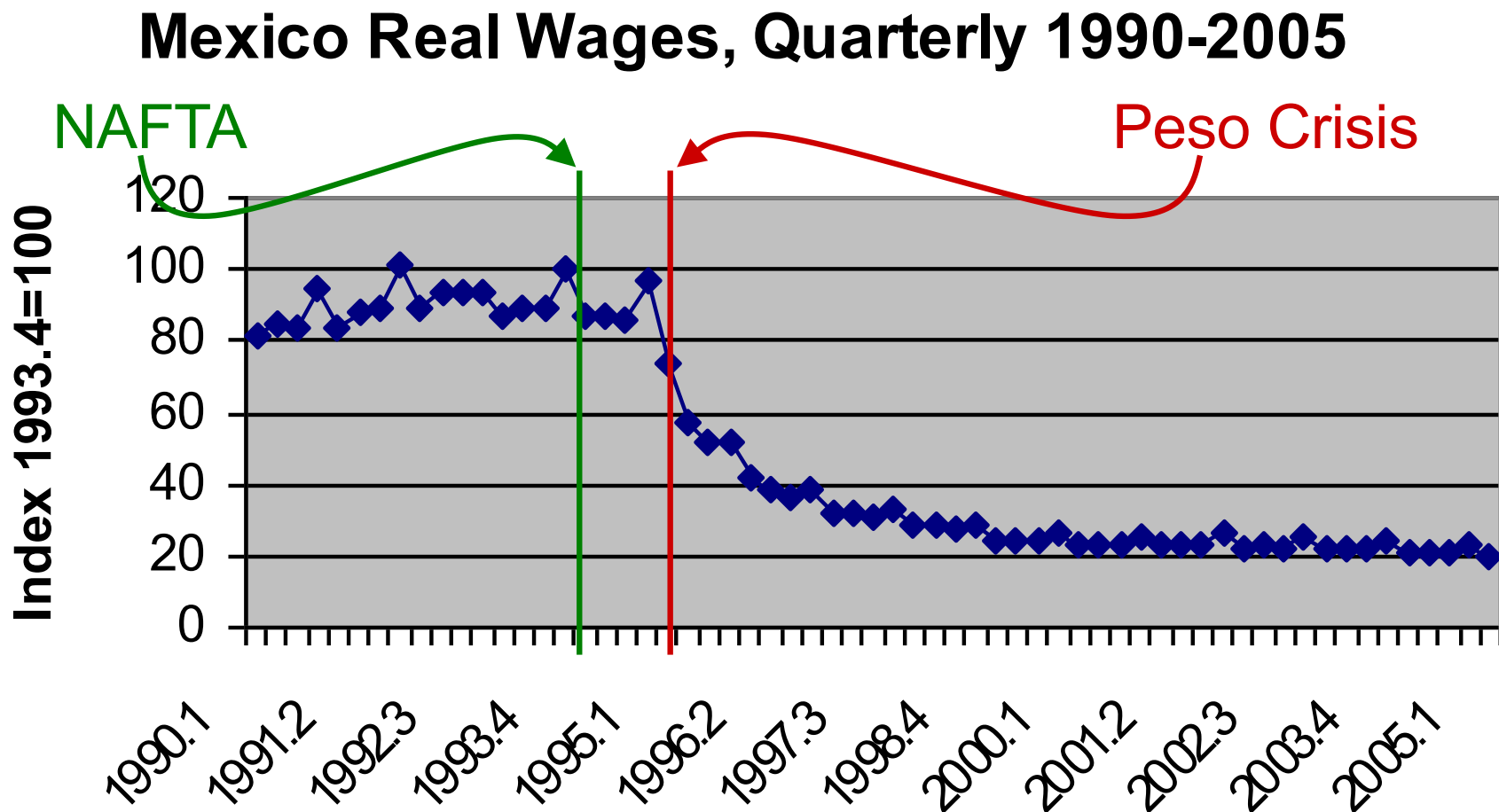
# What Happened: Mexico

## Wages Fell



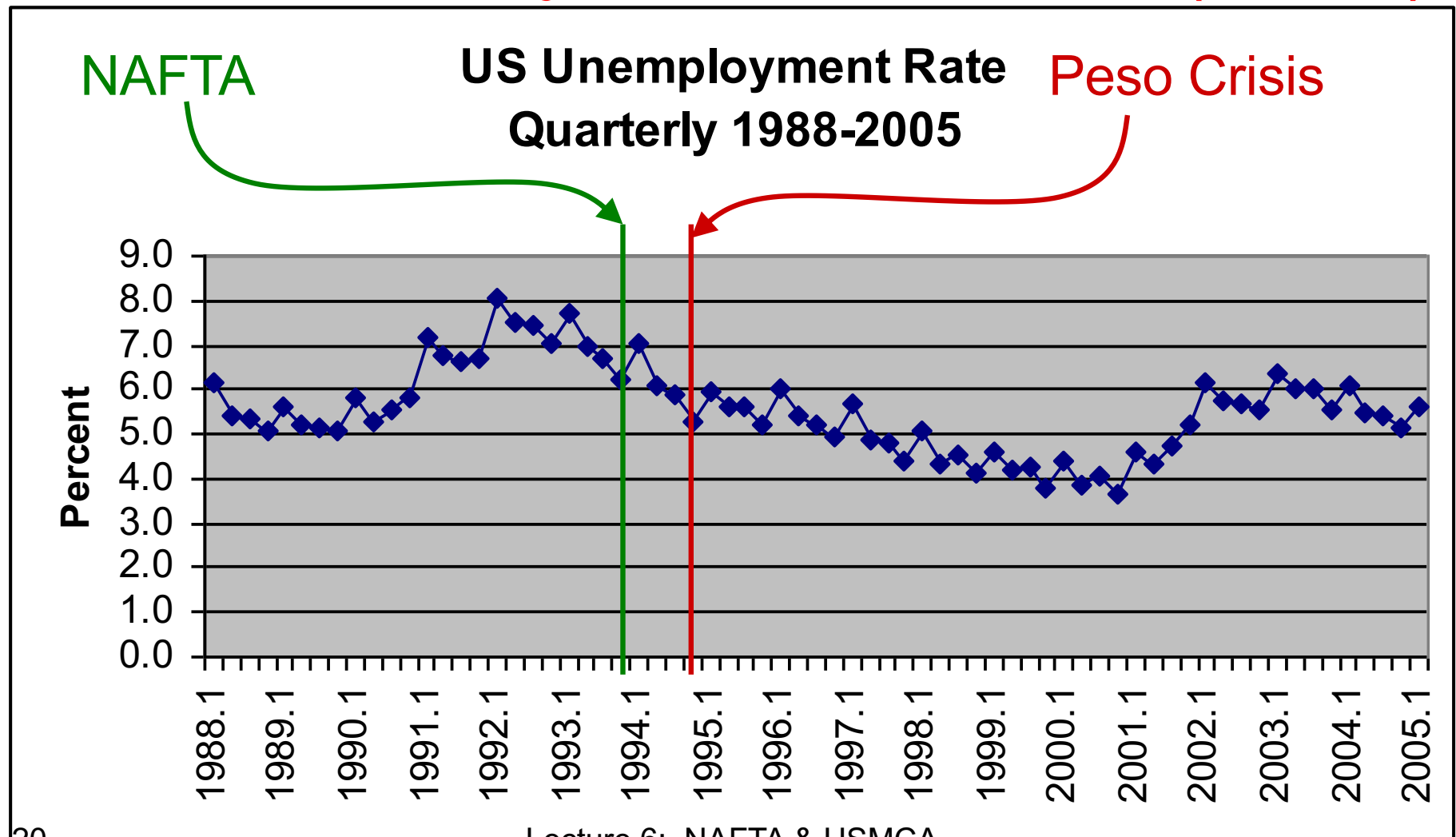
# What Happened: Mexico

Real Wages Plummeted!



# What Happened: U.S.

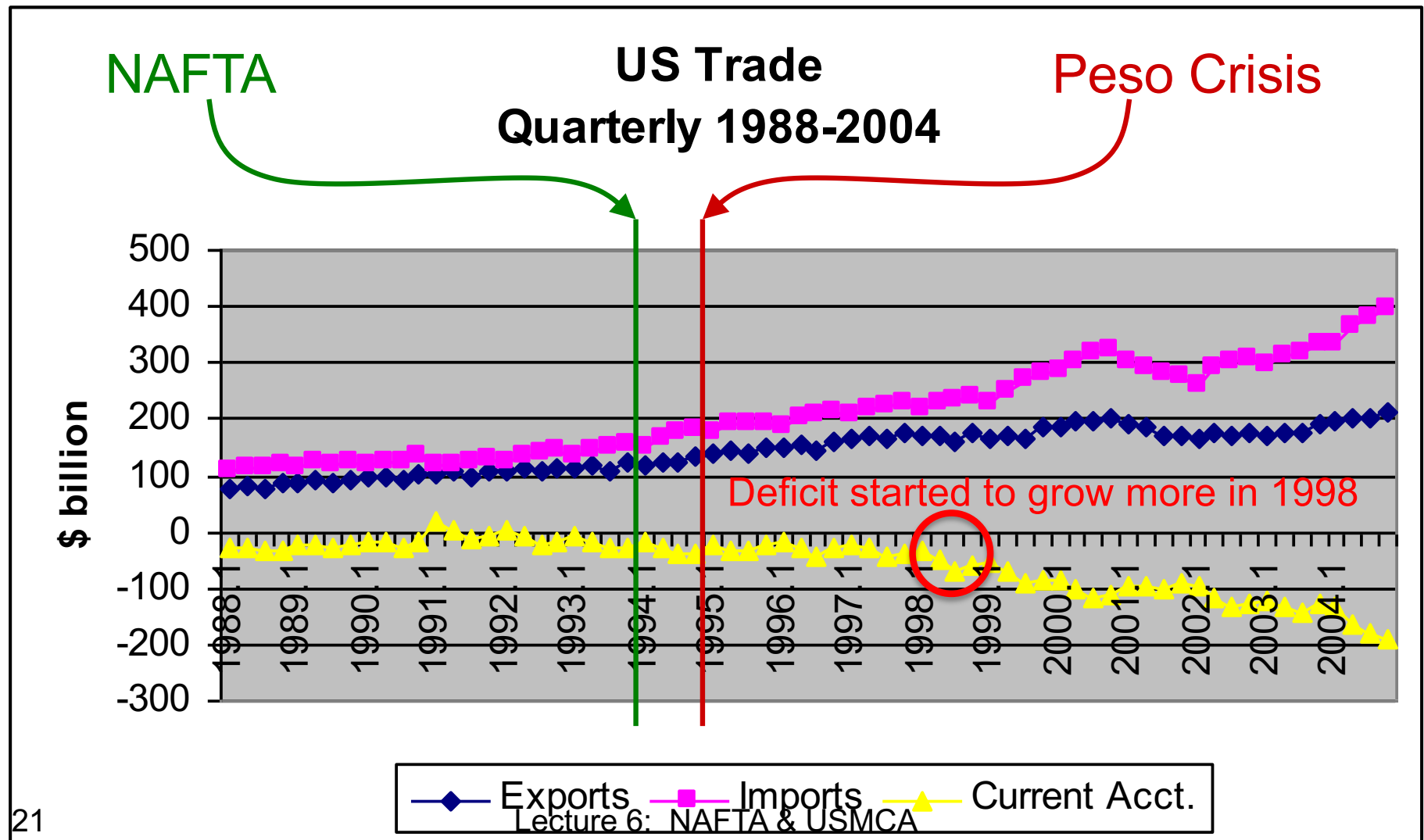
Unemployment: No effect (or fell)





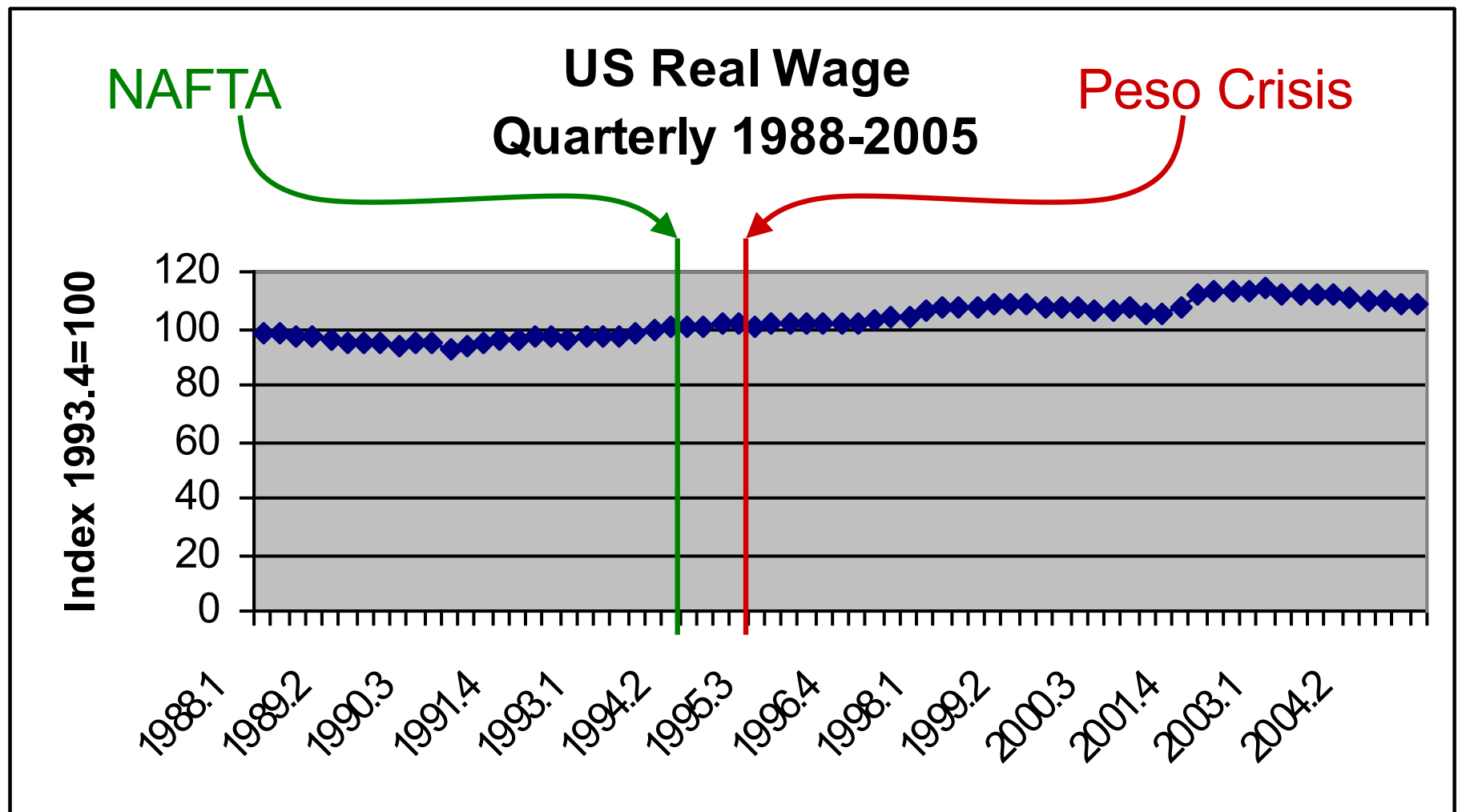
# What Happened: U.S.

## Trade: Continued growth



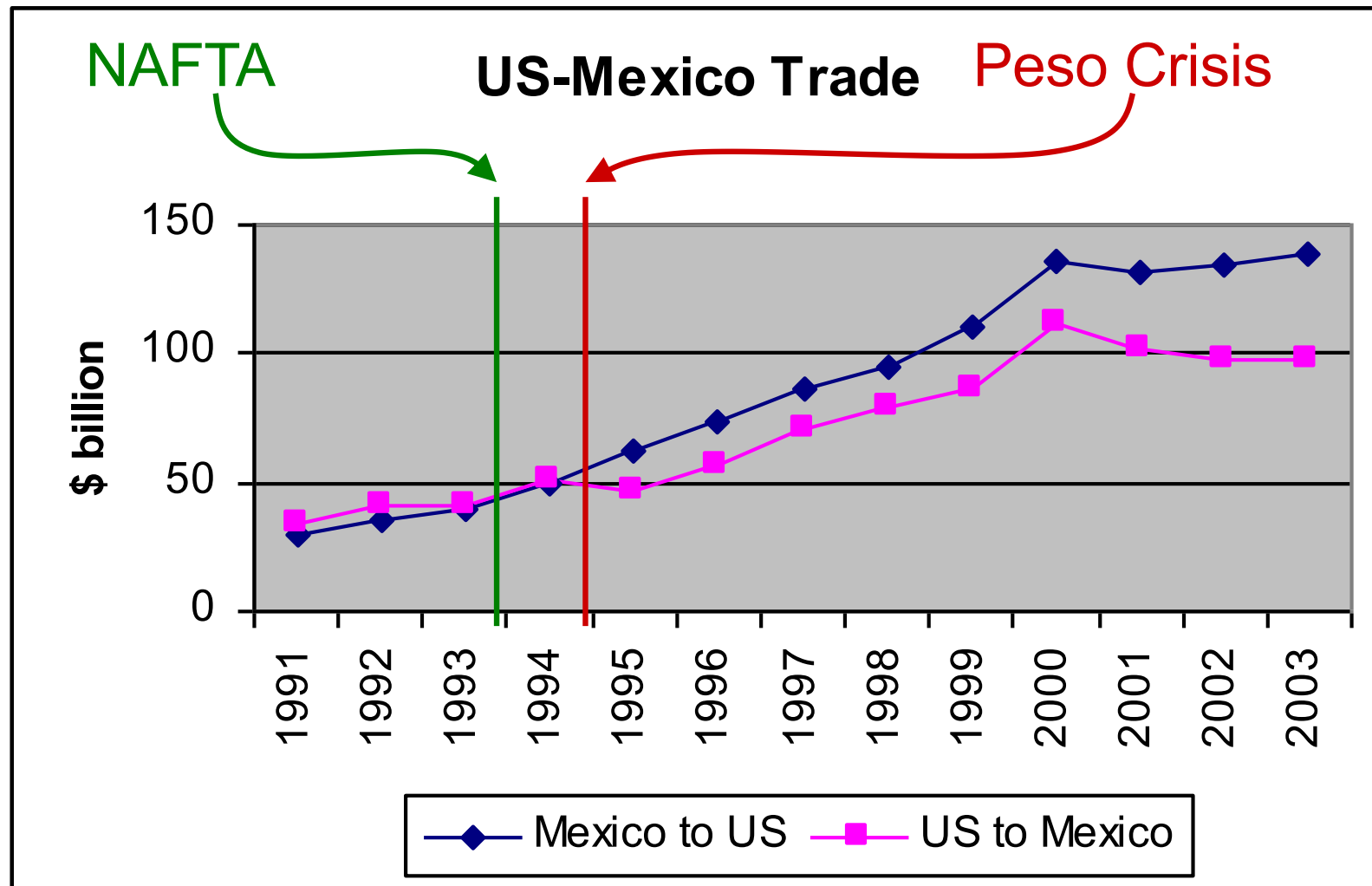
# What Happened: U.S.

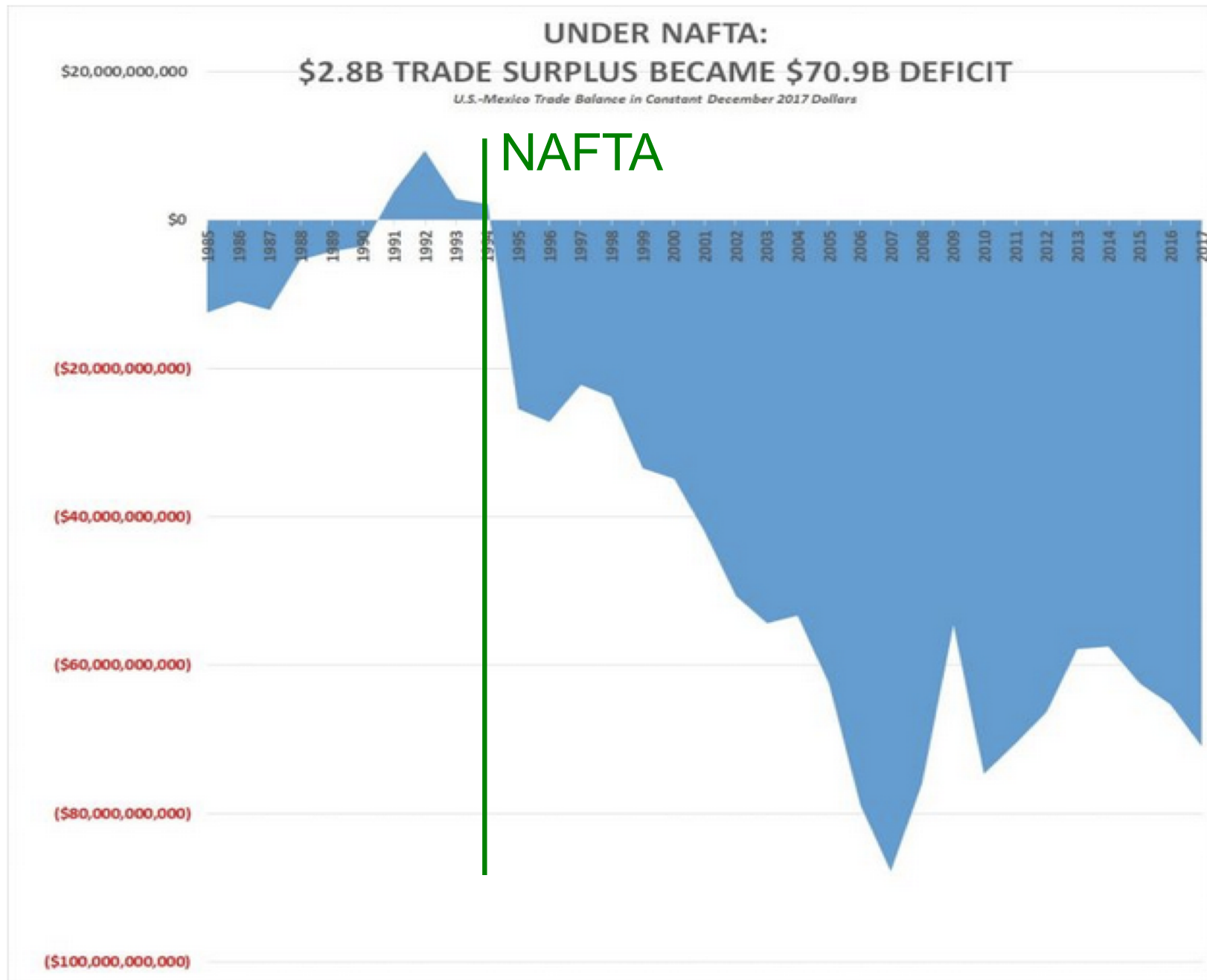
Real Wage: No Change



# What Happened: Bilateral Trade

Grew: But more To US than From

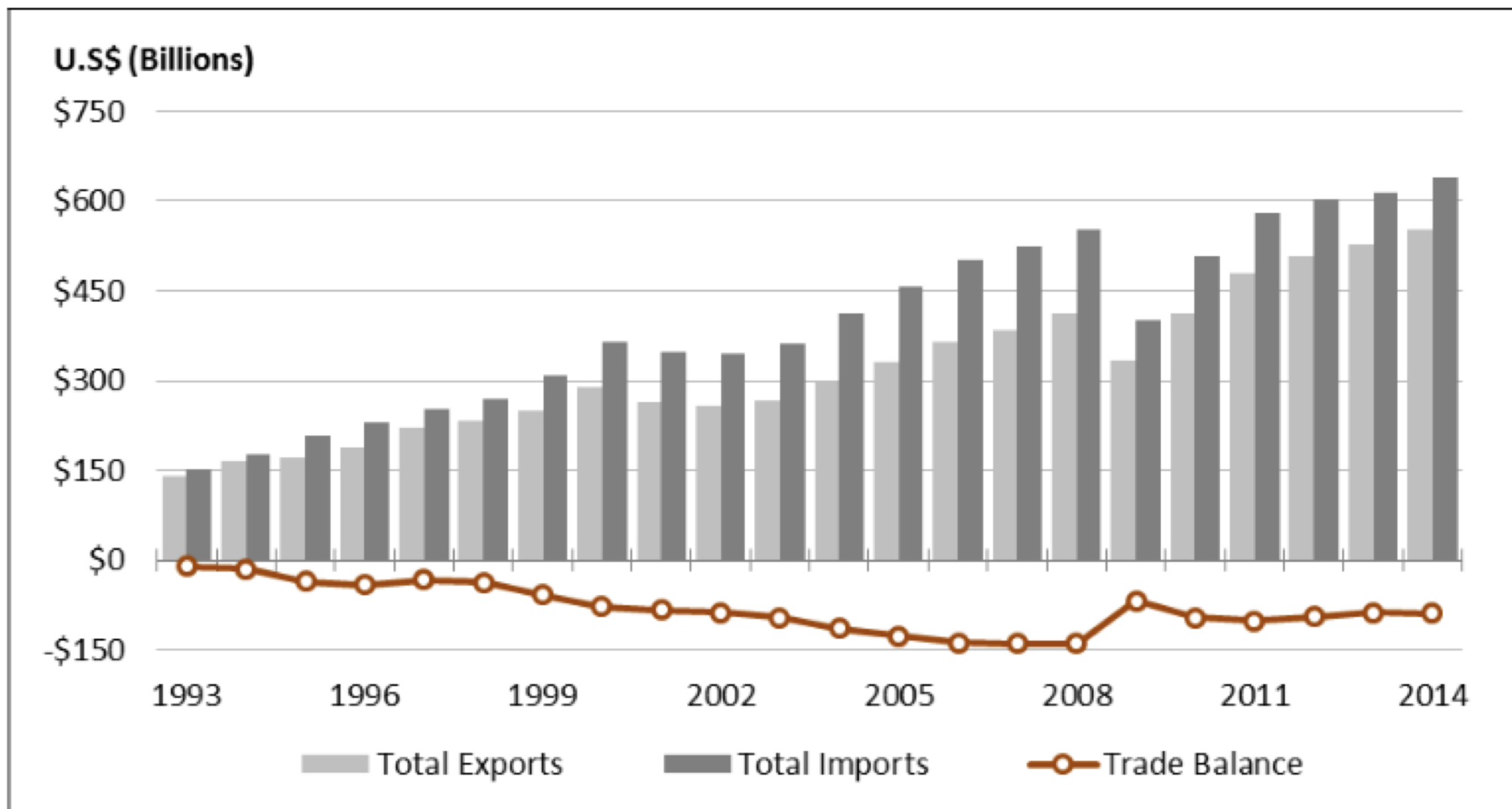




LECTURE 9: NAFTA AND COMMERCE

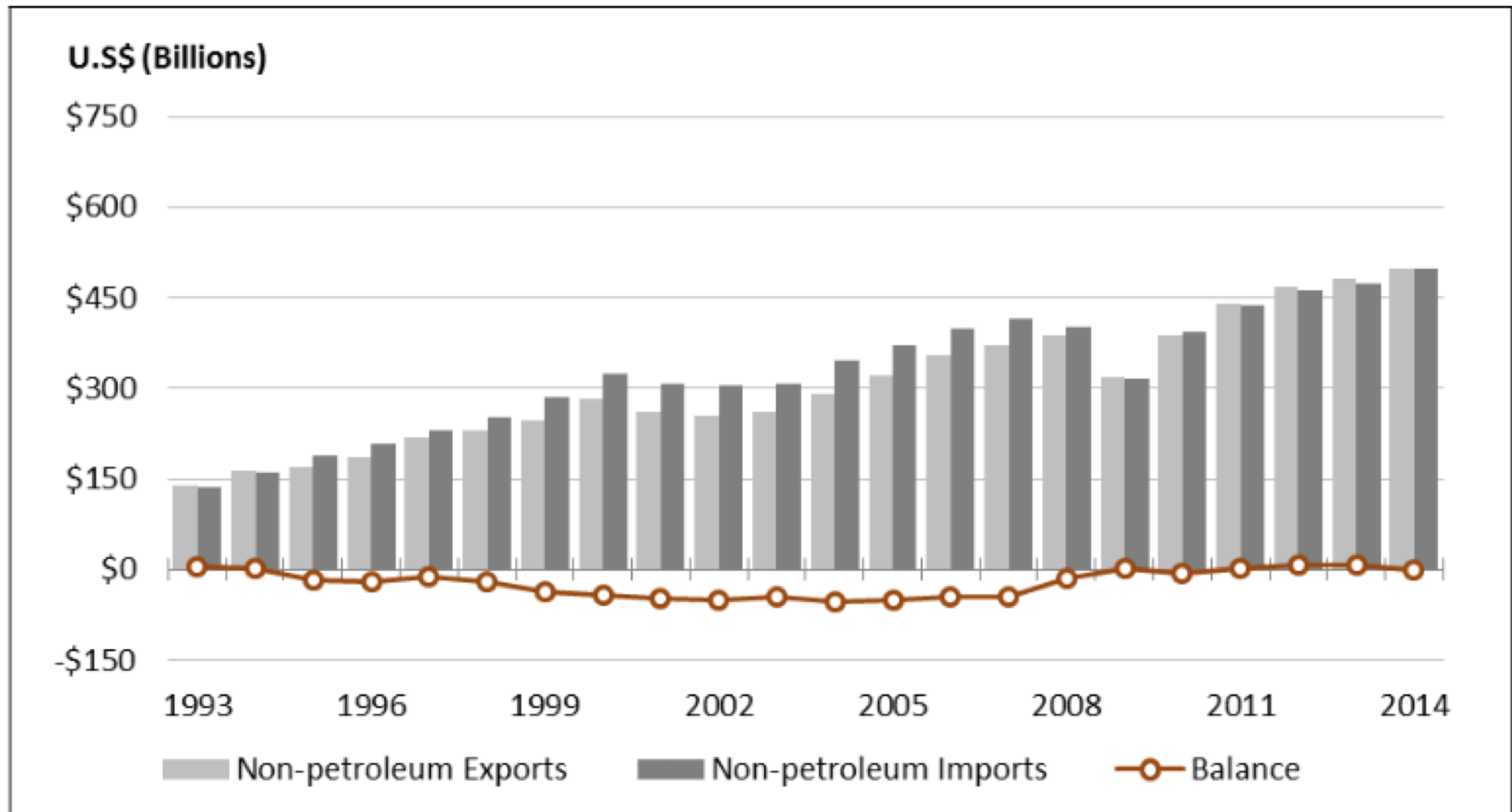
**Figure 1. U.S. Merchandise Trade with NAFTA Partners: 1993-2014**

(billions of nominal U.S. dollars)



**Figure 2. Non-Petroleum Trade with NAFTA Partners: 1993-2014**

(billions of nominal U.S. dollars)



# Clicker Question

How much higher was the US unemployment rate after the NAFTA than before, in percentage points?

- a) 10
- b) 5
- c) 2
- d) 1
- ✓ e) -1

# Clicker Question

Why did the US bilateral trade deficit with Mexico rise after NAFTA?

- a) The US reduced tariffs more than Mexico
- b) Mexico limited imports of US goods
- ✓ c) Mexican exports became cheaper in US \$
- d) Mexico had a comparative advantage



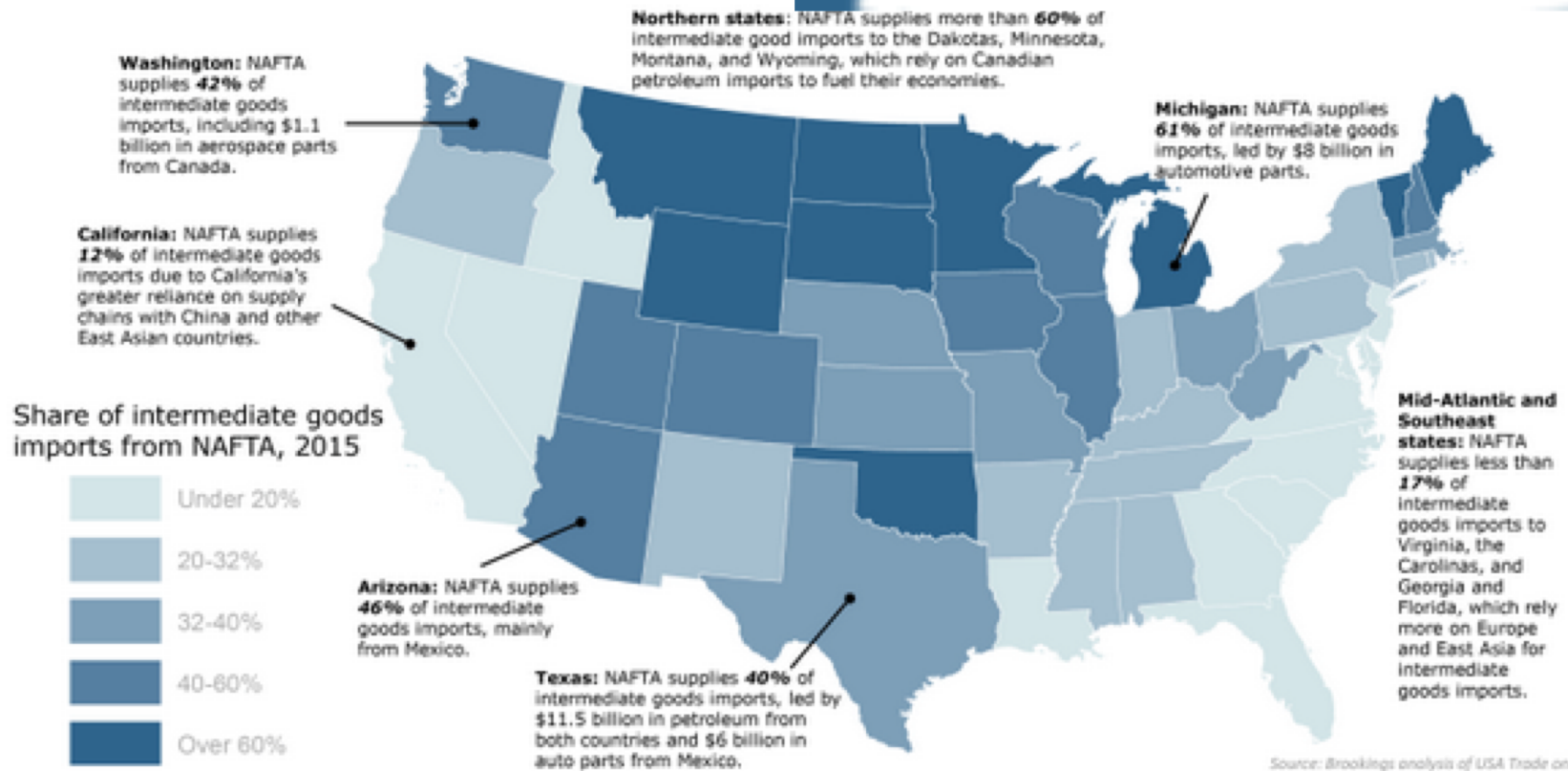
# Supply Chains

- Much of the growth of trade within NAFTA has been supply chains
  - Final goods are produced in one country with inputs from another
  - Inputs are in turn produced with inputs from yet another
  - And so forth
- Supply chains in much of manufacturing now cross the two borders many times

# Michigan: NAFTA supplies 61% of intermediate goods imports, led by \$8 billion in automotive parts.

## North American Production Platform

Half of U.S. imports from Canada and Mexico are intermediate goods that Union or China. From energy to autos, trade policy debates must recognize



# NAFTA Analyses

- Posen (2014)
  - “For every 100 jobs US manufacturers created in Mexican manufacturing, they added nearly 250 jobs at their larger US home operations”
  - Unemployment in US was actually lower after NAFTA than before (until the 2008 financial crisis)
  - Critics say NAFTA cost 45,000 jobs a year.
    - That may be true
    - But this is only 0.1% of normal job turnover in the US, where 4m-6m workers leave or lose jobs per month)

# NAFTA Analyses

- Hakobyan and McLaren (2016)
  - They look for effects on local labor markets, where
    - industries
    - and/or communities
      - were vulnerable to large tariff cuts against Mexico
  - They find
    - Substantial variation across localities

TABLE 3.—MOST AND LEAST VULNERABLE CONSPUMAS, EXCLUDING AGRICULTURE

State	Counties/Cities	$loc\tau_{1990}^c$ (%)
<b><i>A: Top Ten Most Vulnerable Conspumas</i></b>		
Georgia	Catoosa, Dade, Walker	4.74
North Carolina	Alamance, Randolph	4.41
South Carolina	Oconee, Pickens	4.24
South Carolina	Including Cherokee, Chester, Chesterfield, Clarendon	3.67
South Carolina	Anderson	3.62
North Carolina	Cabarrus, Rowan	3.54
North Carolina	Alexander, Burke, Caldwell	3.51
South Carolina	Including Abbeville, Edgefield, Fairfield	3.47
North Carolina	Cleveland, McDowell, Polk, Rutherford	3.46
Indiana	Gary	3.32
<b><i>B: Top Ten Least Vulnerable Conspumas</i></b>		
D.C.	Washington	0.09
Washington	Kitsap	0.19
Virginia	Arlington	0.21
Maryland	Calvert, Charles, St. Mary's County	0.23
Montana	including Flathead, Lincoln, Missoula, Ravalli	0.27
Maryland	including College Park, Hyattsville, Prince George's	0.28
Virginia	Alexandria	0.29
Montana	Including Big Horn, Blaine, Carter, Chouteau	0.30
South Dakota	Including Aurora, Beadle, Bennett, Brule, Buffalo	0.30
Iowa	Calhoun, Hamilton, Humboldt, Pocahontas, Webster	0.30

# NAFTA Analyses

- Hakobyan and McLaren (2016)
  - “...even workers in a nontraded industry—waiting on tables in a diner, for example—saw a sharp reduction in wages if they were in a vulnerable location that lost its protection quickly.”

# NAFTA Analyses

- Disruption of some industries and localities
  - Some was expected
  - May have been larger than expected
  - Has not been dealt with adequately by TAA
  - Nonetheless was still small
  - But provides easy ammunition for critics

# Clicker Question

In what region of the US are the states that were most vulnerable to NAFTA

- a) Northeast
- ✓ b) Southeast
- c) Midwest
- d) South
- e) Northwest



# Clicker Question

If you could have voted for or against NAFTA in 1993, how would you have voted; and if you could vote now on the US leaving NAFTA, how would you vote?

- a) 1993 yes; 2017 yes
- b) 1993 no; 2017 yes
- c) 1993 yes; 2017 no
- d) 1993 no; 2017 no

My answer, but  
yours may differ.

# Discussion Question

- Do you know anybody who was hurt by NAFTA?
- Do you know anybody who was helped by NAFTA?

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## NAFTA and Its Renegotiation as USMCA

- What is NAFTA?
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- **Issues in renegotiation**
- USMCA

# Issues in the Renegotiation

- Issues (US)
  - Trade imbalances
  - Reciprocal duty-free market access
  - Rules of origin
  - Regulations
  - Services
  - Digital trade
  - ISDS
  - State-owned enterprises
  - Labor standards
  - Chapter 19
  - Procurement
  - Currency manipulation

# Issues in the Renegotiation

- Too many to discuss them all
- The following are just some of the more important and/or interesting

# Issues in the Renegotiation

- Trade imbalances
  - The US top priority is to “Improve the U.S. trade balance and reduce the trade deficit with the NAFTA countries.”
  - That is not something that can itself be written into the NAFTA agreement
  - So the question will be which changes in the agreement might do this
  - One possibility is a “trigger mechanism” that raises tariffs if goal of reducing deficit is not met

# Issues in the Renegotiation

- Reciprocal duty-free market access
  - The stated intent of the US is to “maintain” this “while taking into account U.S. import sensitivities”
  - Top objectives of both Mexico and Canada are to avoid any increases in US tariffs
  - Perhaps some of the few positive barriers that continue under NAFTA will be removed.

# Issues in the Renegotiation

- Rules of origin
  - The TPP would have reduced the requirement for North American (N-A) content in autos from 62.5% to below 50%.
  - The new NAFTA will increases this requirement for autos and other products
  - The question is: how much, and how disruptive will it be
  - If too high, some producers will revert to sourcing from outside NAFTA
  - Lighthizer wanted “higher NAFTA content and substantial American content”. That would be unprecedented in an FTA



# Issues in the Renegotiation

- ISDS = Investor-State Dispute Settlement (Chapter 11 of NAFTA)
  - “While the U.S. has so far never lost an ISDS case, both Canada and Mexico have lost several, requiring payments to investors of over \$100 million.” (From Gertz, Mar 2017)
  - Big corporations wanted this retained
  - Others wanted it weakened or removed

# Issues in the Renegotiation

- Chapter 19
  - This now allows NAFTA countries an appeal against AD & CVD actions
  - Canada insists on keeping it
  - US wants it removed
  - You can see why from the data below

# Issues in the Renegotiation

- Currency manipulation
  - This seems an odd thing to include in NAFTA, since nobody has accused either Mexico or Canada of doing it
  - Intent is probably to have it (for the first time in an FTA) as a template for later FTAs with, say, Japan or China

# Issues in the Renegotiation

- Dairy & poultry
  - Canada wants to keep its “supply management system for dairy and poultry”
    - Supply management allows farmers to act collectively to manage supply and price
  - Canada has a 270% tariff on dairy imports (with a small quota tariff-free)
  - This was exempted from liberalization in NAFTA

# Clicker Question

Which of the following was not one of the objectives of the US in renegotiating NAFTA?

- a) Improve labor standards in Mexico
- b) Increase North American content in imports from Mexico
- c) Stop currency manipulation
- d) Increase duty-free exports to Canada
- ✓ e) Limit immigration from Mexico

# Clicker Question

Which country wanted to eliminate Chapter 19 of NAFTA (for disputes on things like anti-dumping)?

- a) Canada
- b) Mexico
- ✓ c) US
- d) All of the above
- e) None of the above

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# USMCA

- Outcome of the Renegotiation
  - May 18, 2017: Renegotiation began
  - Aug 27, 2018: Agreement reached between US and Mexico
  - Sep 30, 2018: Agreement reached with Canada to join USMCA



# USMCA

- Features of USMCA
  - Auto rules of origin
    - Required North American content raised from 62.5% to 75%
    - 40-45% content must be from labor paid \$16/hr or more (but does not rise with inflation)

# USMCA

- Features of USMCA
  - New rules (similar to TPP) on
    - Intellectual property
    - Environment
    - Labor
    - Financial services
    - Digital trade

# USMCA

- Features of USMCA
  - Sunset clause? Not exactly
    - Revisit deal after 6 years
      - If happy, extend for 10 more
      - If not, new negotiations

# USMCA

- Features of USMCA
  - Canadian dairy
    - Canada will increase permitted imports of dairy from US, to 3.6% of its market
    - Canada to cease selling some dairy ingredients abroad at low prices and will tax exports over over some threshold

# USMCA

- Features of USMCA
  - Currencies
    - Commitment to “refrain from competitive devaluations and targeting exchange rates”

# USMCA

- Features of USMCA
  - Trade with China
    - Countries must inform US 3 months before beginning trade negotiations with any “non-market economy” (i.e., China)
    - If agreement with such economy is reached, US can terminate USMCA with six months notice.

# USMCA

- Features of USMCA
  - Chapter 19
    - Keeps this dispute settlement system for trade remedies such as anti-dumping
    - Does not apply them to “national-security-based” tariffs

# USMCA

- Features of USMCA
  - Chapter 11 (ISDS)
    - Removes this for disputes between US and Canada
    - Keeps it for disputes with Mexico



# USMCA

- “Side letter” of USMCA
  - Promise to shield Canada & Mexico from future “national-security-based” tariffs (i.e., cars) (not enforceable)

# USMCA

- NOT a Feature of USMCA
  - Removal of US recent tariffs on steel and aluminum from Canada and Mexico

# USMCA

- Prospects for approval
  - Must be approved by all three legislatures
    - Canada: Dairy will resist, but approval assured
    - Mexico: Incoming President wants it done
    - US: Contentious, but best hope is approval in lame-duck session

# USMCA

- Importance of USMCA
  - Trump: “It’s not NAFTA redone, it’s a brand-new deal”
  - NYT: “a consequential set of revisions”
  - Economist: “a modest revision”, “inferior to the agreement it replaces”
  - Bown: deal to “result in less trade, not more”

# Clicker Question

Once the USMCA is fully in place, how much of a car imported to the US from Mexico with zero tariff can be made in China?

- a) None
- b) 10%
- ✓ c) 25%
- d) 37.5%
- e) 50%

The required North-American content will rise to 75% (from 62.5%)

# Clicker Question

What country's past currency manipulation was the reason for including this as a feature of USMCA?

- a) Canada
- ✓ b) China
- c) Mexico
- d) US
- e) All of the above except US

# Clicker Question

Which of the following is not an issue included in the USMCA?

- a) Intellectual property
- b) Environment
- c) Labor
- ✓ d) Aircraft
- e) Digital trade

# Discussion Question

- Who would you say “won” and “lost” from the NAFTA renegotiation?