Class 6 Outline

NAFTA and Its Renegotiation as USMCA
• What is NAFTA?
• What happened under NAFTA?
• Issues in renegotiation
• USMCA

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
• 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 require 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

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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

Mexico Reserves Quarterly 1988-2005

NAFTA

Mexico Reserves

Peso Crisis


$ billion
What Happened: Mexico
Peso Dropped One Year After

Mexico Real GDP, Quarterly 1990-2005
Index 1993.4=100

Unemployment: No effect (or fell)

What Happened: U.S.
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

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)

Source: Congressional Research Service
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

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

- 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

Source: Hakobyan and McLaren (2016)
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."

Discussion Question

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

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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

Table 3—Most and Least Vulnerable Counties, Excluding Agriculture

<table>
<thead>
<tr>
<th>State</th>
<th>Counties/Cities</th>
<th>$\text{inv}_{\text{US}}$ (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Georgia</td>
<td>Camden, Cobb, Walker</td>
<td>4.74</td>
</tr>
<tr>
<td>North Carolina</td>
<td>Alamance, Johnston</td>
<td>4.41</td>
</tr>
<tr>
<td>South Carolina</td>
<td>Orange, Pickens</td>
<td>4.24</td>
</tr>
<tr>
<td>South Carolina</td>
<td>Including Chester, Chesterfield, Cheraw</td>
<td>3.67</td>
</tr>
<tr>
<td>South Carolina</td>
<td>Spartanburg, Spartan</td>
<td>3.62</td>
</tr>
<tr>
<td>North Carolina</td>
<td>Shelby, Rutherford</td>
<td>3.54</td>
</tr>
<tr>
<td>North Carolina</td>
<td>Alexander, Bladen, Calhoun</td>
<td>3.51</td>
</tr>
<tr>
<td>South Carolina</td>
<td>Alamance, Edgewood,c, Fairfield</td>
<td>3.47</td>
</tr>
<tr>
<td>North Carolina</td>
<td>Cleveland, McDowell, Folk, Rutherford</td>
<td>3.46</td>
</tr>
<tr>
<td>Indiana</td>
<td>Gary</td>
<td>3.32</td>
</tr>
</tbody>
</table>

Source: Hakobyan and McLaren (2016)
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 almost certainly increase this requirement for autos and other products
  - The question will be: how much, and how disruptive will it be
  - If too high, some producers will revert to sourcing from outside NAFTA
  - Lighthizer wants “higher NAFTA content and substantial American content”. That would be unprecedented in an FTA

Issues in the Renegotiation

- Digital trade
  - Digital trade (& e-commerce) did not exist in 1993, and was not covered
  - All parties seem to agree that new rules should stop governments from placing restrictions on such trade
  - The TPP included this, and it may be copied here

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 want this retained
  - Others want it weakened or removed
Issues in the Renegotiation

- **ISDS**
  - USTR calls for
    - "rules that reduce or eliminate barriers to U.S. investment" (Is that pro-ISDS?)
    - "ensuring that NAFTA country investors in the United States are not accorded greater substantive rights than domestic investors" (Is that anti-ISDS)
    - (Perhaps he wants ISDS for US companies but not for foreign companies)

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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

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Issues in the Renegotiation

- **Procurement**
  - NAFTA currently required governments to open procurement to suppliers from all NAFTA countries
  - US wants to allow governments a preference for their own suppliers ("Buy American")
  - US might even ask for all three governments to give preference to US suppliers, not their own!
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

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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 $15/hr or more (but does not rise with inflation)

• 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

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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 and low prices and will tax exports over a certain threshold

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USMCA

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

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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.

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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

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USMCA

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

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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 assures
    • 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”

Discussion Question

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