Global Counsel

North American free trade – Trump edition

Blog post by Senior Director Stephen Adams, 4 October 2018

The Trump administration's revamped NAFTA (or USMCA, as we are being invited to call it) landed this week after a year or so of fraught negotiations with Mexico and Canada. If we discount the amendments to KORUS (The United States–Korea Free Trade Agreement) prompted by the US's steel and aluminium tariffs earlier this year, it is the Trump administration's first major trade agreement. It is certainly more than just a rebrand. The many small and large changes throughout the revised text group into and embed some now-familiar Trump policy themes, alongside some long-standing Washington aims.

One obvious one is the general desire to check outgoing US manufacturing FDI. This is the driver of important changes to the product-specific origin rules for automotive. These include a highly unorthodox new provision requiring that 40-45% of content by value must be made by workers earning at least $16 an hour, designed to keep USMCA manufacturing out of Mexico. Recognising that the US's low MFN tariff for cars (and thus limited preferential margin) may be more attractive than meeting these new requirements, the agreement takes the striking step of imposing an MFN+ tariff on cars from future Mexican car factories that do not meet these origin requirements.

This is also part of the rationale for the elimination of investor state dispute settlement provisions, which remain only for four energy and infrastructure sectors and not for fixed manufacturing investment. Even the sixteen-year sunset clause on the agreement can be seen as an attempt to add a layer of risk to regional supply chain development – although this effect would have been much more marked if the US had secured its desired five-year provision.

A second theme is the pursuit of Trump's Section 232 national security strategy on trade by other means. The revised origin rules for autos include new minimum thresholds for North American steel and aluminium, designed to strengthen the regional position of these US industries. The agreement also adds a highly unconventional provision that would allow something very like the administration's mooted 25% tariff on autos to kick in if either Canadian or Mexican car exports to the US pass a defined level in future.

What the deal does not do in this respect is unwind the current US 232 tariffs on Mexican or Canadian exports of steel and aluminium. It will be interesting to see if the US pursues a similar provision on cars with the EU – and similarly refuses to unwind its 232 steel or aluminium measures as part of a negotiation. Both would be a big problem for Brussels. The EU and others will also be thinking very carefully about the GATT compatibility of these provisions and the similar MFN+ measures on origin if they were ever to be activated.

A third theme is the elephant in the room that is China. USMCA contains an explicit provision reserving the right of the US to terminate the agreement if either Mexico or Canada enter an FTA with a non-market economy. Less directly and aggressively, many of the TPP provisions negotiated ultimately with an eye on buttressing US complaints about Beijing have found their way into the text, often in tougher forms than the US was able to secure with its TPP partners. These include more stringent provisions on state owned enterprises, tougher enforcement requirements on labour rights (although not TPP provisions against using labour standards as protection) and more expansive IP protection provisions. There are also the kind of provisions prohibiting currency manipulation that many in the US have been advocating since KORUS.

Assuming it can secure congressional approval (and this is hardly guaranteed, with the Democrats looking strong after November and in no mood to hand the administration anything) then USMCA's preservation of the core NAFTA framework is undeniably a good thing. So too is the upgrading of many parts of the agreement to meet or exceed the TPP benchmark. As its harshest political critic, Trump is in a position to endorse the fundamentals of North American trade liberalisation to an important constituency that has stopped listening to the US trade policy establishment. But it comes at the price of some attempts to direct and manage North American trade and investment and some apparent departures from WTO norms that should make US firms – and US trading partners – very uneasy.