NAFTA 2.0's 'poison pill' is a needed dose of trade medicine

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The pending United States-Mexico-Canada Agreement (USMCA), informally known as “NAFTA 2.0,” includes what Commerce Secretary Wilbur Ross characterized as a “poison pill.”

The provision requires parties to inform one another of their intention to enter into free-trade agreement negotiations with a nonmarket economy … with an eye toward China.

Secretary Ross’ characterization ruffles the feathers of some who say the provision limits USMCA trade partner choices. But it actually just reflects Washington’s desire to address persistent trade issues that namely pertain to China.

By creating an environment that allows our trade allies to take a stand on nonmarket economies, it can be seen as a needed course of treatment.

Trump trade team initiatives tend to draw cringes because of an apparent misunderstanding of why people trade in the first place, not to mention what drives trade deficits (hint: it’s not trade policy). The team’s desire to address nonmarket economy practices, however, is genuine.

It is the U.S. position that China has not yet transitioned to a market economy and therefore should not be granted market economy status. This position is shared by Japan and the European Union.

Owing to the country’s sheer size, whenever the Chinese government decides a particular sector is a priority, a massive amount of labor and capital are poured into that sector. Inevitably, a production surge floods the global economy.

We have seen the results of Chinese industrial policy and state subsidies play out across a number of sectors, such as steel, cement, flat glass, coal, chemicals, polysilicon, wind power and recently solar panels.

A growing recognition of the need to address non-market economy practices is taking shape in the ongoing talks regarding World Trade Organization (WTO) reform.

The recent joint statement by trade ministers of the United States, Japan and the EU confirms this shared objective, pushing for new rules on industrial subsidies, state-owned enterprises and the definition of a market economy.

The non-market economy clause in the USMCA makes sense and follows in the footsteps of earlier administrations. Under President George W. Bush, then-

Treasury Secretary Henry Paulson pursued an engagement strategy with the U.S.-China Strategic Economic Dialogue.

The Obama administration continued engagement while teaming up with others to confront one of the biggest trade problems: unfair competition among government-subsidized, state-owned enterprises.

The Trans-Pacific Partnership, he argued, would let America, not China, lead the way on global trade, put American workers first and let us set rules in these core areas.

To be fair, once China joined the WTO, steps were taken away from state-owned enterprises and toward privatization. The state enterprise share of gross industrial output declined from roughly half in 2001 to 26 percent by 2011.

But then, China appears to have stalled or even reversed course, and under Xi Jinping, pursued the centralization of the economic policy process and intense state intervention in industry.

From 2012 to 2016, data show a softening of private investment, and a potential resurgence in the state sector. The growing role of state-owned enterprises is concerning because they distort global allocative efficiency.

In theory, as Nobel Prize-winning economist Paul Krugman would tell us, the appropriate response to a foreign subsidy is a thank you note. In practice, thank you notes are rarely sent. The benefits of China’s affordable goods for consumers are widespread among people who often don’t know what’s behind the price tag.

The disruption to producers and workers who compete with Chinese firms is concentrated and visible. So, instead of sending a thank you note, we typically impose tariffs or antidumping and countervailing duties.

But our current trade remedies are not viable solutions. They do not change China’s non-market economy practices — they only serve to increase prices for American manufacturers and consumers. The non-market economy clause of the USMCA is a strong step in the right direction.

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