The net impact of Trump's new NAFTA is probably nothing

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Reuters/Kevin Lamarque

Uncertain terms.

What happens when America's deal-maker-in-chief takes on "the worst trade deal in the history of the world"? Not much, it turns out.

That's the conclusion drawn by an independent government agency in a new report (pdf) estimating the economic impact of the US-Mexico-Canada Agreement, as Donald Trump's renegotiated version of the 1997 North American Free Trade Agreement is officially known. Written by US International Trade Commission economists, the report was legally required before Congress votes on the deal. If approved, the law would boost the US economy by less than 0.4%, accounting for inflation. About $68 billion.

But it very plausibly could hurt the US economy more than it helps.

There are good reasons to think the report's prediction of a 0.4% GDP increase and a net increase of about 176,000 jobs overstates the likely impact of the USMCA. Those calculations—and the conclusion that the new trade deal will benefit the American economy—rest on one big assumption the report's authors made, Chad Bown, an expert on trade at the Peterson Institute for International Economics.

To understand what he means, it helps to break down the two main scenarios the report's authors modeled. Let's start with the most concrete of these—the estimated impact of the law if you don't make the iffy assumption Bown mentions.

The default scenario: not so sunny

The key question the ITC report strives to answer is: How would the changes that Trump's new deal makes to trade and investment barriers increase or decrease US output, employment, and wages?

The authors' base case—what we'll call the "default scenario"—models *known* barriers—tariffs, quotas, and labor regulations, for instance.

They find that the USMCA will cause the American economy to *shrink* a wee bit, say the authors—by about $23 billion. It will also drive down wages a tad and put nearly 54,000 people out of work. In other words, American companies, workers, and consumers as a whole will be slightly better off if the USMCA *doesn't* pass.

Most media coverage of the report didn't mention these findings at all—instead reporting only a slight boost in output, employment, and wages. (That's not surprising, exactly. The report is 375 pages long. The first mention of these more sobering results is on page 56.)

What is it about the USMCA that will cause this small hit to the American economy?

The biggest change is created by its new "rules of origin requirements" for the auto industry. If passed, the USMCA would force US automakers to buy more of their parts from domestic part makers. That would, on balance, help workers and firms in auto-parts manufacturing. But those gains wouldn't come from increased trade (which, all else equal, makes things cheaper). Instead, they'd be due to US consumers having to pay more for domestic-made autos. And that would reduce auto production, since higher prices would curb demand for American-made cars.

So in the authors' default scenario, the economy as a whole would be worse off. Here's the breakdown of those numbers, as reported on page 57 of the report**1**.

1

If you refer to the chart on page 57, the default scenario is presented under the "None" column, which reflects the economists' estimates of the USMCA's impact without assuming increased investment activity from "reducing policy uncertainty." The "Moderate" column reflects projections assuming that new USMCA provisions reduce trade costs incurred due to Nafta's lack of clarity by 25%. Finally, the "High" column—which we didn't include in the chart above—assumes a 50% reduction of such costs.

Impact under…	Default scenario	“Reducing policy uncertainty” scenario
US real GDP	-$23 billion	+$68 billion
US employment	-53,900 jobs	+175,700 jobs
US wages	-0.06%	+0.27%

What you’ve probably seen cited in press stories are data in the “reducing policy uncertainty” column. Those were the figures the authors highlighted in their executive summary. Why do they differ so much with the estimates for the default scenario? That brings us back to the big assumption that Peterson’s Bown mentioned.

The big assumption: “reducing policy uncertainty”

Under the default scenario, the authors modeled how the new deal would change barriers to trade and investment that are well known, well understood, and relatively easily quantified. To get the figures reported in the executive summary—the ones in the “reducing policy uncertainty” column in the table above—they focus on barriers that we don’t know much about at all.

To put it even more simply, they assume that there are barriers restricting trade and investment that we currently aren’t measuring very well—and that, by removing those barriers, the USMCA would likely be an overall benefit to the American economy.

Okay, so what are those assumed barriers? The main one is what the report calls “policy uncertainty,” explains Bown.

The authors’ chain of logic begins with the observation that there are areas of trade and investment that NAFTA doesn’t discuss. For instance, digital industries like e-commerce and data management. (Recall that NAFTA went into effect in 1994, back in the technological dark ages when Lycos and Infoseek ruled the web and Amazon just sold books.)

The authors assume that businesses in these sectors currently trade and invest *less* than they would if they knew their business was legally protected under NAFTA. The lack of a clear, certain policy discourages commerce.

For instance, imagine a US company that wants to build a server farm south of the border. It faces the risk that, after it builds its operation, Mexico could change its national laws and shut down the server farm. And since NAFTA doesn’t regulate that relatively young sector, the company could be stuck swallowing the losses.

The USMCA introduces new provisions that cover data management and other industries. These would reduce policy uncertainty, argue the report's authors. As a result, they reason, the trade pact would result in a mini-boom of new trade and investment. And it's this growth that will offset the hit to output and jobs from the USMCA's "rule of origin requirements," so that the the deal should wind up benefiting the economy after all.

Certain vs. uncertain "uncertainty"

Sort of like Donald Rumsfeld's famous construction about "known knowns" etc., the analysis of the USMCA's impact can be broken into types of "uncertainty" that we know exist—and those that we're less clear about. Call it certain vs. uncertain "uncertainty."

Is it plausible that the "uncertainty" created by NAFTA is currently so big that reducing it would turn a $23-billion contraction into a $68-billion gain?

Sure. But bear in mind, the report's finding that the USMCA will benefit the American economy as a whole is based on more uncertain "uncertainties."

Solid research demonstrates that "reducing policy uncertainty" does indeed stimulate trade, says Bown. That analysis focuses on goods affected by changes in tariff rates, though—and most of what the report's authors are talking about are services and non-tariff barriers (economist jargon for practices beside actual custom duties that stymie trade). Economists really don't know much about these dynamics, let alone how they might currently affect business activity in North America. They're uncertain about this "uncertainty," you might say.

What's sort of strange is that the report's authors then choose to ignore a far more certain source of "uncertainty": the USMCA's sunset clause, which would terminate the deal after 16 years if the signing parties don't agree to extend it **2**.

2

More precisely, the USMCA's provision holding that the pact will be reviewed every six years and terminate automatically in 16 years if no action is taken to extend it.

NAFTA doesn't have a sunset clause; its policies never expire. In other words, the USMCA's sunset clause imposes a very certain form of "uncertainty" on businesses. The authors quite reasonably cite the lack of historical precedent in their choice not to model sunset clause-related uncertainty. **3** Still, their choice to omit it in their modeling seems like an oversight, says Bown, given that their headline conclusions rest entirely on far more uncertain sources of "uncertainty."

The report says: "As these provisions are new to USMCA, there is little historical evidence suggesting their likely impact. In testimony to the Commission, interested parties have expressed mixed opinions on the provisions. Some have indicated that the provisions provide a beneficial means by which to address issues with the agreement that become apparent over time. Others have expressed concerns that these provisions introduce uncertainty that could discourage long-term investment."

In no “uncertain” terms?

It’s also worth scrutinizing the final link in the authors’ chain of logic: the assumption that the USMCA’s provisions truly would introduce more certainty to the areas on which NAFTA policy is hazy.

For example, the ITC report specifically cites the “free flow of data” as an area in which clearer regulation from the USMCA would be expected to boost trade and investment. But according to Simon Lester, trade policy expert at the Cato Institute, the “USMCA digital trade provisions do not create much certainty for North American data regulation and policy.” (See Lester’s blog for a pretty persuasive case study.)

We should note here that Lester and PIIE’s Bown both say that the ITC faced an unusually difficult task in modeling the USMCA’s possible impact. The assumptions made, both of them say, were reasonable and legitimate.

With the commission’s report published, Congress is now cleared to vote on Trump’s new deal (the law required the ITC to publish its analysis before Congress votes). To pass, the USMCA will need the support of at least two dozen House Democrats (paywall). Which means its outlook is—you guessed it—uncertain.