Understanding NAFTA and the USMCA

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The North American Free Trade Agreement was the overlying agreement for commerce between the United States, Canada and Mexico from 1994 to 2018. Backed by then-presidential candidate Ronald Reagan in the late ’70s and signed by President Bill Clinton in 1994, NAFTA became a standard for open trade around the globe and created one of the world’s largest free trade zones.

In October 2018, the treaty was set aside in favor of the newly minted United States-Mexico-Canada Agreement (USMCA), signed by President Donald Trump, Mexican President Enrique Peña Nieto and Canadian Prime Minister Justin Trudeau.

The new agreement has much in common with the terms of the original NAFTA, although there are new developments—particularly in vulnerable industries like textile manufacturing. But before we get to the new law of the land in North American trade, it is imperative to understand how we got here.

The History of NAFTA

Throughout its existence, NAFTA has been a controversial trade agreement. Ross Perot’s opposition to the agreement was his campaign’s primary platform in the 1992

U.S. presidential election, and he received the largest share of the vote a third-party candidate in the United States had ever garnered since World War I. Political ideology has played a large role in how politicians have viewed NAFTA over the years.

The accord began under President George H.W. Bush as a trade agreement between the United States and Canada that focused primarily on the agricultural relationship between the two allies. However, Mexico was seeking a way to reemerge after the recession-filled ’80s and was willing to lift its heavy tariffs on American automobile manufacturing to get a seat at the table.

Initial negotiations for NAFTA were often complicated and extended by political upheaval, especially in Canada, where the ruling Conservative government was wiped out by the Liberal Party for supporting the first draft of the treaty. New Canadian leaders wanted to add further provisions to the agreement just as the first President Bush’s term came to an end, having also lost an election to liberal Democratic candidate Bill Clinton.

The two left-leaning governments then created the North American Agreement on Labor Cooperation (NAALC) and the North American Agreement on Environmental Cooperation (NAAEC) and added them to the language of NAFTAto allay the fears that led to their elections. Specifically, progressive groups were afraid of a flood of cheap Mexican goods in markets that had worked for years to raise working conditions. There were concerns these goods would price out American workers and force businesses to lower wages and benefits.

However, with the new provisions attached, NAFTA was finally ratified by the United States Congress and signed by Clinton in 1994, promising more “good-paying American jobs” and a closer relationship with the country’s North American neighbors.

For many years prior to NAFTA, trade had been restricted between the United States and Mexico, with tariffs on as much as 50 percent of Mexican imported goods and similar measures for American exports. The lifting of those tariffs had a major effect on each economy in the agreement over the next two decades and is still being measured today.

Below are some of the key differences between the pre-NAFTA and the post-NAFTA world:

Before NAFTA:

- Mexican tariffs of 30 percent or higher on exported U.S. goods. Affected sectors included: engineering, construction, architecture, advertising, accounting, commercial education, consulting/management, healthcare and tourism

- Tariffs on nearly 50 percent of all Mexican goods imported to the United States
- High levels of intellectual property theft
- No dispute resolution process for independent companies participating in North American trade.
- High variation in standards between nations on the continent, specifically in developing Mexico
- Nontariff barriers, like lack of infrastructure, created a significant challenge for small-business owners seeking to expand into Mexico.
- Around 5 percent of products made in Mexico came from raw material provided by U.S. sources.
- Mexican automotive manufacturing a non-factor in U.S., Canadian markets
- Significant fluctuations in the exchange rate between member nations
- Regional trade of $290 billion in 1993
- $1.7 billion trade surplus with Mexico in 1993

Tariffs on textile production were particularly burdensome for North American manufacturers, as both Mexico and the United States had instated protectionist policies for the industry. NAFTA eliminated most of those tariffs and evened the playing field, though some suggest it was also the cause of major losses in textile manufacturing for the United States.

After NAFTA:

- Immediate elimination of 50 percent of existing tariffs, remaining tariffs were called off within a 15-year graduated schedule
- IP protection guaranteed in all three nations
- Creation of an impartial dispute resolution process, trilaterally decided
- Creation of unified standards (manufacturing, environmental, etc.) and procedures conforming to the highest level of standards between the three governments
- Streamlined border procedures and licensing requirements
- Creation of a North American trade corridor consisting of highways and railroads
- Around 40 percent of products made in Mexico come from U.S. sources
- Around 25 percent of all North American auto manufacturing takes place in Mexico
- American participation in the North American automotive market was reduced by about 10 percent, eliminating a large number of manufacturing jobs in the Midwest
- An increase in export-oriented industries in Mexico
- Doubled manufacturing productivity in Mexico
- Added power to control the currency exchange rate between member nations
- Total North American trade was valued at $1.1 trillion in 2016
- $54 billion trade deficit with Mexico

Effects of NAFTA

Most economists agree all three countries have benefitted from the elimination of tariffs and decreased protectionism. In Canada, the benefit has been exceptionally obvious, with long-term productivity up 15 percent in affected industries according to the National Bureau of Economic Research.

For all three nations, short-term job losses were seen in sectors that had been the most protected prior to NAFTA. However, Canada and Mexico have both experienced a net increase in employment since its passage. The results are less clear in the United States.

A 2012 poll of leading economists by the Initiative on Global Markets found that 95 percent of the economists surveyed felt NAFTA had a net positive effect on American citizens. Primarily, opposition to the bill comes from those who point to the loss of nearly 700,000 jobs in the manufacturing sector as a by-product of reduced protections.

However, a 2015 study by the Ball State University Center for Business and Economic Research found that 87 percent percent of the jobs lost in manufacturing could not be attributed to the treaty and were instead a result of increased automation and competition with China.

The USMCA

With the election of President Trump, NAFTA had served its final hour as the leading trade agreement in North America. One of Trump's primary campaign promises was the elimination of the deal that he called "historically bad."

However, President Barack Obama had also promised to update the trade agreement for a modern economy. The Obama administration crafted a 12-country trade agreement called the Trans-Pacific Partnership (TPP) designed to enlarge the free trade zone created by NAFTA and put pressure on the Chinese government to comply with fair trade practices.

Trump discarded the TPP as one of his first acts as president and instead put the pressure on the United States' previous trade allies to come up with an agreement that would benefit the U.S. in a more obvious way. This kicked off a review of all of the major trade agreements the U.S. has with other countries, including NAFTA.

After months of ongoing and tense renegotiations that stalled multiple times over sticking points for each nation involved, Mexico, and then Canada, agreed to the new terms of the USMCA agreement in October 2018.

Despite Trump's distaste for the previous negotiations, the USMCA might be best described as an amalgamation of NAFTA and the TPP, with some added consolations.

For instance, one provision of the USMCA increases the country of origin requirement from 62.5% to 75 percent for automobiles, meaning 75 percent of a vehicles content must be created within the borders of North America in order to avoid duties. Another would require 40 percent to 45 percent of auto content made in Mexico to be produced by employees making at least $16 an hour, which is designed to allay fears that high-paying jobs moving to a lower-paid Mexico.

Textiles in the USMCA

The USMCA also puts forth stronger country of origin requirements for textile production within the free trade zone, designed to bolster American textile manufacturing, including:

- Effective 12 months from the agreement being ratified, a good containing sewing thread or yarn used as sewing thread shall be considered originating only if such sewing thread is both formed and finished in the territory of one or more of the USMCA parties.
- Effective 18 months from the agreement being ratified, for a good containing a pocket or pockets, the pocket bag fabric must be formed and finished in the territory of one or more of the parties from yarn wholly formed in one or more of the USMCA parties.
- Effective 18 months from the agreement being ratified, goods containing fabrics shall be considered originating only if such fabrics are both formed from yarn and finished in the territory of one or more of the USMCA parties.
- Effective 30 months from the agreement entering into force, for blue denim fabric containing a pocket or pockets, the pocket bag fabric must be formed and finished within the USMCA territories.

We may be far out from economists coming to an agreement on the successes or failings of the USMCA, but with small policy changes having the potential to be magnified when spread out across a continent, it is critical for any business operating within the USMCA jurisdiction to understand how it will impact their markets.