The Future of North America’s Economic Relationship
From NAFTA to the New Canada-United States-Mexico Agreement and Beyond
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### Acronyms and Abbreviations

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<td>DMT</td>
<td><em>de minimis</em> threshold</td>
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A few months ago, it appeared as if the North American Free Trade Agreement (NAFTA) renegotiations were on ice as negotiators failed to make meaningful progress and Mexicans headed to the polls. Then, over just two months later, Mexico and the United States finalized a trade agreement that Canada subsequently joined. The Canada-United States-Mexico Agreement (CUSMA) was reached on September 30, 2018, and will replace NAFTA if successfully ratified by legislatures in all three countries.

In anticipation of the 2018 North America Forum hosted in Ottawa in October 2018, the Centre for International Governance Innovation (CIGI) undertook a trilateral project to anticipate and predict how North American trade and economic relations would unfold in the near term and further into the future.

Three authors, one from each of the North American countries, undertook short papers to explain the importance of the new CUSMA to their respective countries and how economic relations could be reshaped in the coming months and years. Featured authors include:

- Christine McDaniel, senior research fellow, Mercatus Center at George Mason University;
- Hugo Perezcano Díaz, deputy director, International Economic Law, CIGI; and
- Meredith Lilly, CIGI senior fellow, associate professor and Simon Reisman Chair in International Affairs, Carleton University.

The following pages include edited versions of each paper presented in a panel discussion at the North American Forum.
Introduction

This paper comprises the US component of a trilateral series led by trade experts for each North American country, with a view to advancing a discussion on the future of the North American economic relationship. The new agreement, CUSMA, is not drastically different from NAFTA although there are some changes with economic and broader trade policy implications. The outline below describes the current state of play in terms of CUSMA passing the US Congress and offers a summary of the economic and broader trade policy implications for Canada-United States-Mexico relations and beyond.

State of Play

On September 30, 2018, the United States, Mexico and Canada reached consensus on updating NAFTA, and on November 30, 2018, US President Donald Trump, Canadian Prime Minister Justin Trudeau and Mexican President Enrique Pena Nieto signed the agreement. Before the agreement takes effect, however, each country’s governments must ratify it.

The CUSMA would be the first major trade agreement of President Trump’s term, but US congressional approval is not certain. Republican members of Congress have expressed dissatisfaction with the sunset clause, restrictive rules of origin and the elimination of the investor dispute mechanism. Democrats have indicated a desire for even stronger labour and environmental protections.
The anti-trade rhetoric was common to both Hillary Clinton and Donald Trump’s 2016 presidential campaigns. To some extent, therefore, we should expect that each side will want to show follow-through on campaign promises for so-called fair trade deals. The CUSMA includes provisions on labour, wages, the environment, digital trade, as well as those specific to the auto and trucking sectors, all of which are likely to appeal to the Democratic base and would make it difficult for them to oppose the deal.

### The CUSMA

Some of the key differences in the CUSMA for the United States include the following:

- **The name of the agreement.** Over the years, the term NAFTA has begun to carry some baggage and become a catch-all term for the ills people commonly (yet undeservedly) relate to trade.

- **Automobiles.** The automobile chapter requires that 75 percent of vehicles be produced with North American content, and 40 to 45 percent of those vehicles be produced using North American labour paid at least US$16 per hour. These provisions reflect the US desire to prevent further US production moving to Mexico, as well as a desire to attract more production to the United States. In the end, the auto chapter was more focused on North America as opposed to only the United States, and the wage provision appears to have been a clever and efficient (less restrictive) way to address the US concern regarding further plant relocations to lower-wage Mexico. The regional wage provision directly addresses the US concern and avoids the blunt and overly restrictive requirements for US-specific content. Companies have three years to demonstrate compliance, and there appears flexibility in the text to allow supply chain managers to minimize the cost effects. Notwithstanding, in principle, increased restrictions on factor inputs (capital and labour) will harm the competitiveness of North American automakers.

- **Intellectual property.** The CUSMA establishes an updated legal and policy framework for intellectual property across the region. Overall, given the level of advanced economic development across the three countries, intellectual property rights laws of reasonable strength and enforcement across the region are, on average, a benefit for all producers and consumers, and the CUSMA reaffirms this stance.

It is not, however, necessarily the case that one country’s intellectual property rights, regulatory and pharmaceutical pricing regime is optimal for other countries. Data exclusivity periods for biologic drugs arguably fall into this category. In the Trans-Pacific Partnership Free Trade Agreement (TPP) negotiations, the United States advocated for 12 years of data exclusivity protection for biologics, which is a longer period than most countries have. Australia, Canada, New Zealand, Chile and others resisted, citing lack of economic evidence was in their interest. Further, it did not help the United States Trade Representative’s (USTR’s) case that the White House was not supporting the 12-year provision. In fact, the Obama administration repeatedly called for shorter exclusivity periods and even included the US$4.5 billion estimated cost savings in its budgets (US Government 2014, table S-9; 2015, table S-9; 2016, table S-90).

A longer waiting period will delay the introduction of generic biologics (called biosimilar drugs), increase profits for pharmaceutical companies and increase prices for consumers and insurers, including government programs. The economic case for longer data exclusivity periods is weak, and a white paper by the US Federal Trade Commission (2009) concluded that longer exclusivity periods were unnecessary to promote innovation. In the CUSMA case, however, it appears that the initial US-Mexico bilateral negotiations allowed the United States to coax Mexico into the longer waiting period, and once Canada rejoined the talks, Canada acquiesced.

Overall, this is an example of the dynamics of trade negotiations in different settings. In the TPP talks, several countries were able to push back on the United States in the name of good governance and evidence-driven economic policy regarding their national interests. In CUSMA talks, the United States appears to have had more influence given the smaller number of countries on the opposing side.

- **Agriculture.** No country is innocent of trade restrictions on agriculture, and the United States and Canada are no exceptions. The United States and Canada both agreed to concessions in agriculture that were not present in the TPP, and in that sense, this greater market access was a move towards greater agricultural trade liberalization for both.

Regional and global trade rules are generally tolerant of agricultural policies and programs aimed at price stability. Canada’s dairy and poultry regime, including the tariffs and supply management aspects, however, appeared to be a target of market access for the US administration. This market opening was a (small) win for US dairy producers, although as Meredith Lilly has noted in her companion piece in

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1 According to the Center for Automotive Research (2018) the average wage for auto assembly workers in Mexico is US$7.34 per hour and US$3.41 per hour for parts supplier workers, compared to US$29.08 per hour and US$19.84 per hour in the United States, respectively.

2 Australia was key in making the budget and economic case against longer data exclusivity protections for biologics. See Kehoe (2015).
this report, the accumulative market opening in the Canadian dairy market from a number of recent trade agreements may result in a substantial dairy regime change. The US concessions (albeit small) in sugar, sugar-containing products and peanuts was also a move towards greater liberalization.

→ De minimis threshold (DMT). Both Canada and Mexico increased their DMTs to tax and duty free cross border shipping. In international trade, the DMT is a valuation ceiling below which no duties (and sometimes no taxes) are charged, and clearance procedures and data requirements are minimal. Shipments valued above the threshold are subject to duties, taxes and time-consuming clearance procedures, which are costly and burdensome regulations that impose delays on consumers and businesses. These thresholds vary by country. Recently, the United States increased its threshold to US$800, but Canada’s, at CDN$20, is one of the lowest across members of the Organisation for Economic Co-operation and Development.

Setting aside what the optimal DMT is, the increase in the DMT in the CUSMA was a move in a trade-liberalizing direction, particularly for small- and medium-sized businesses and consumers across the region. A higher DMT can help to facilitate global e-commerce for consumers and businesses, particularly small and medium businesses, while an all-too-low DMT can be costly for governments (Lapitov, McDaniel and Schropp 2016).

The United States does not have a value-added tax (VAT) or federal excise tax (except on firearms, tobacco and alcohol) and, hence, the DMT only pertains to the duty and customs procedures. Countries with a VAT (such as Canada) will have to address this and find a solution that does not favour foreign retailers over domestic retailers.

Beyond CUSMA

Article 32.10 of the CUSMA requires notification of intent to enter into free trade negotiations with a non-market economy (for example, China). As Chrystia Freeland has noted, the right to withdraw “has always existed in NAFTA and it needs to exist” (CTV News 2018). So, in a sense, it is not technically a new provision. Moreover, there is a growing recognition of the need to address non-market economy practices, as many countries are putting forth their own thoughts on World Trade Organization (WTO) reform and discussing other plurilateral approaches. Article 32.10 helps create an environment that allows the United States, Canada and Mexico to take a stand on non-market economies, at least until a more widespread solution is found. When China joined the WTO in 2001, the general consensus and expectations were that China would gradually abandon its state control over its economy, phase out state-owned enterprises and instill changes that would encourage capital and labour to move towards the private sector. That development has not been realized.

Non-market economy practices, such as those practiced by China, are clearly the elephant in the room, and that was true long before President Trump took office. China’s state capitalism and heavy-handed government-controlled industrial policy can distort the prices producers and consumers face. Owing to the economy’s sheer size, whenever a particular sector is on a priority list by the Chinese government, an enormous amount of capital (below market prices) and low-cost labour pours into that sector. The resulting production surge can send ripple effects across the global economy.

In principle, economists know that the best response to low-cost, subsidized goods from abroad would be to send a thank-you letter (Sykes 2007, 106). In practice, we rarely see such thank-you notes sent. The benefits of China’s affordable goods for consumers are widespread among people who often do not know what is behind the price tag. Meanwhile, the disruption to producers and workers who compete with Chinese firms is concentrated and visible. Instead of sending a thank-you note, we typically impose tariffs or anti-dumping and countervailing duties. Yet tariffs are not viable solutions. They increase prices for American manufacturers and consumers, and do not necessarily change China’s non-market economy practices.

The United States has three options with which to manage the situation with China. The first option is to punish them with tariffs, investment restrictions and WTO challenges, and hope they change. This is already underway, with unilateral tariffs that aim to restrict Chinese firms’ access to the US market, investment restrictions that may target China’s much-needed access to US technology and complaints registered with the WTO. Yet, such a unilateral approach is unlikely to instigate a major change in China’s industrial policy.

A second option is to do nothing, which puts more of the risk on the private sector. While libertarians may prefer this approach, neither the US administration nor Congress appears to have the stomach for this option as evident in the recent Section 232 tariffs on steel and aluminum and the numerous and ongoing series of antidumping and countervailing duty cases. Even if the United States were to avoid trade restrictions, the “do nothing” approach may have the unintended consequence of China, again owing to its sheer size, influencing global trading rules in a way where the world ends up with more state-controlled industry. That is neither a world that existing WTO members envisioned when China joined the WTO nor is it a world we seek now.

A third option is to appeal to China’s incentives and strengthen global trade rules. This option does not necessarily involve any attempts to force change.
in China (which is arguably futile in any case), but instead simply changes the rules of the global trading regime in which China wishes to operate. Maintaining engagement in the global economy and access to the global market is clearly in China’s interest. China has benefited greatly from WTO membership and their future economic growth depends largely on continued access to the global market. With this option, in order to maintain such access to foreign markets, China would implement market-oriented reforms: a more open trade and investment regime, phasing out state-owned enterprises and government subsidies, stronger patent rights and legal-recourse mechanisms. These policy shifts — a shift in thinking, really — would help place China on a more sustainable path to economic growth. It would also dial down tendencies that lead to massive resources ploughing into unproductive uses, resulting in over-capacity and excess production flooding into international markets.

The United States, or at least this administration, has shown that it will not idly sit by and watch a large state-controlled economy steal the innovations and market share of US firms. Yet, it is unlikely China will undergo a massive shift in thinking because of tariffs alone.

The United States needs to work with its allies, such as Canada and Mexico, and play the long game. Many of the founding members of the WTO are as frustrated with China’s non-market economy practices as America is. In working with allies, a pact could be formed in which signatories commit to open trade and investment regimes, sufficiently strong intellectual property rights and enforcement and legal-recourse mechanisms. Signatories could commit to not engage in trade or investment with state-owned enterprises or those with close ties to state-owned enterprises. This would effectively provide a large disincentive to engage with Chinese state-owned enterprises and state-subsidized firms, which could promote the reallocation of resources away from China’s state-owned enterprises and back toward the private sector.

Whatever specific path Canada, the United States and Mexico choose moving forward, the past 12 months have demonstrated that, deep down, the three countries recognize that their interests are intertwined. They must use this foundation as a building block for the next phase of global trade reform for the better.


About the Author

Christine McDaniel is a senior research fellow at the Mercatus Center. Her research focuses on international trade, globalization and intellectual property rights. McDaniel previously worked at Sidley Austin, LLP, a global law firm, where she was a senior economist. She has held several positions in the US government, including deputy assistant secretary at the Treasury Department and senior trade economist in the White House Council of Economic Advisers, and has worked in the economic offices of the US Department of Commerce, USTR and US International Trade Commission. She holds a Ph.D. in Economics from the University of Colorado and received her B.A. in Economics and Japanese Studies from the University of Illinois at Urbana-Champaign.
Introduction

The United States under President Donald Trump is in no free trade mood. On July 24, 2018, he tweeted: “The European Union is coming to Washington tomorrow to negotiate a deal on Trade. I have an idea for them. Both the U.S. and the E.U. drop all Tariffs, Barriers and Subsidies! That would finally be called Free Market and Fair Trade! Hope they do it, we are ready - but they won’t!” (Trump 2018a).

A few of his supporters then went to great lengths to rebrand President Trump as a “radical” free trader (Thiessen 2018). He is not. He was right that the European Union would not agree to drop all tariffs, barriers and subsidies, and he did not mean for the United States to do so either. Not surprisingly, following the meeting with the European Union one day after his tweet, President Trump backtracked significantly. At the joint press conference with Jean Claude Juncker, the president of the European Commission, he explained that the United States and the European Union had agreed “to work together toward zero tariffs, zero non-tariff barriers and zero subsidies on non-auto industrial goods” (Naylor 2018). Thus, in addition to excluding automobiles from his “free market” equation, conspicuously absent from his prepared statement was the agricultural sector where both the United States and the European Union maintain high tariffs and some of the most trade-distorting non-tariff barriers and subsidies.

At around that time, Mexico and the United States engaged in bilateral talks leaving Canada on the sidelines of the NAFTA renegotiation. They reached a bilateral agreement on August 27, 2018. Canada and the United States then engaged in bilateral discussions and reached a deal on September 30, 2018, just before the expiration of a deadline that Mexico and the United
States had imposed so that the United States could submit an agreement to its Congress in time for Mexico’s outgoing-President, Enrique Peña Nieto, to sign it before he left office. After more than 14 months of ongoing negotiations to revise NAFTA, a new trilateral agreement to replace it, the unimaginatively named United States-Mexico-Canada Agreement, was signed by Presidents Peña Nieto and Trump and Canada’s Prime Minister Justin Trudeau on November 30, 2018.

It is certainly good news that the three parties were able reach an agreement that will continue to govern trade and investment flows in North America and that it will remain trilateral — largely. It is also good news that the new agreement, by and large, preserves a platform that existed prior to President Trump’s taking office, consisting of the text of the original NAFTA and that of the TPP that President Trump had rejected early into his presidency. Beyond that, the newCUSMA does not appear to have made any progress toward freer trade in the region. Indeed, it is a step — or many — back.

Despite President Trump’s big idea for a “radical” free trade and free market strategy, the United States did not propose “zero tariffs, zero non-tariff barriers and zero subsidies” to Mexico or Canada. Having completely phased out almost all tariffs under the original NAFTA by 2009, there was no discussion in the NAFTA negotiations about the United States removing the tariffs that President Trump recently imposed on imports of steel and aluminum products from Mexico and Canada. “[T]hey are two separate things as far as we [i.e. the United States] are concerned,” Ambassador Lighthizer clarified at the press conference on October 1, 2018 following the conclusion of the NAFTA negotiations (Global News 2018). President Trump added that he will not remove those tariffs unless Mexico and Canada agree “to something that would be different, like quotas” (ibid.). Moreover, the United States made clear, through side letters to the newCUSMA, that it may impose the same type of tariffs on imports of automobiles from both countries in the future. Understandably, Mexico and Canada will maintain the measures that they adopted in retaliation for the US steel and aluminum tariffs and protected their right to further retaliate immediately if the United States were to impose such tariffs on automobiles. However, both have already agreed to quotas for automobiles such as those that President Trump is seeking for aluminum and steel. President Trump also seems to have been quite happy with preserving Canada’s supply management system of high tariffs and import quotas: “And I fully understand…” he said at the October 1, 2018 press conference, “...and I tell them [i.e. Canadian officials] that, and I say, look, I understand you have limits...” (ibid.). Finally, there appears to have been no talk about “zero subsidies” either. Indeed, one of Canadian dairy producers’ main concerns about opening their market more to US imports is that there is an oversupply in the US market resulting from farm subsidies. In theCUSMA, the parties simply preserved their rights and obligations under the WTO Subsidies and Countervailing Duties Agreement.

So much for a free trade and free market strategy, although radical it is. We will see more tariffs and non-tariff barriers and probably the same amount of subsidization in trade agreements going forward. This is a change in paradigm, and one that we should be concerned about.

Is No Deal Now Out of the Question?

Everything now points to the new trade agreement remaining trilateral, but it is not yet a foregone conclusion. Since the beginning of the negotiations, the least likely scenario was a US withdrawal from NAFTA without alternative arrangements in place between the three parties — whether on a bilateral or a trilateral basis — and their falling back on the multilateral framework under the WTO. The fear of Mexico being left without a preferential trade agreement with the United States now seems to have dispelled, but it has not disappeared entirely. Indeed, at the press conference following the announcement that Canada and the United States had concluded negotiations, when President Trump was asked if he thought the US Congress would approve the new trilateral agreement he replied that he was “not at all confident” and said if it did not, he had other alternatives (ibid.). Earlier, he had warned in a tweet that “...Congress should not interfere w/ these negotiations or I will simply terminate NAFTA entirely & we will be far better off” (Trump 2018b).

President Trump’s tweet was in the context of the US Congress rejecting a bilateral deal with Mexico before Canada and the United States had concluded their bilateral negotiations. By now it is evident that Trump politics dominate the landscape in the United States, and Republicans in Congress will do absolutely nothing...
to oppose him. Anticipating that Democrats would win a majority in the House of Representatives, the warning seems to have been directed more to them, in case they obstruct approval of the agreement. But he may have warned Republicans as well, just in case.

### Trilateral It Is

In Mexico, Andrés Manuel López Obrador, Mexico’s president who took office on December 1, 2018, expressed his approval for the new agreement and consented to President Peña Nieto signing it before he left office. Shortly after winning the presidential election on July 1, 2018, López Obrador showed support for further progress in the NAFTA talks (which had been stalled pending the outcome of the elections and resumed bilaterally between the United States and Mexico on July 26, 2018). He also endorsed Mexico’s incumbent negotiators that would, forthwith, be accompanied by Jesús Seade, López Obrador’s designated lead trade negotiator. Even before Canada and the United States had reached a deal, López Obrador publicly stated that his government would not reopen the agreement (which, at that time, was between Mexico and the United States only) because he would not want to put Mexico’s economic future and financial stability at risk. “[F]or us, this matter is closed,” he stated on September 28, 2018 (El Universal 2018b).

López Obrador’s MORENA party has a majority in the Mexican Senate, and on the same date, Ricardo Monreal, the president of the Political Coordination Board (in effect the Senate majority leader), stated that the Mexican left would not oppose the agreement: “[W]e will approve it. Those who thought that today the left would be an obstacle to the trade negotiation are wrong” (El Universal 2018a). A few days later, after Canada and the United States reached an agreement, he anticipated that the new CUSMA will “pass unscathed” (ADN Político 2018).

In Canada, farmers have reacted strongly to the deal that grants the United States greater access to the dairy, poultry and egg markets, but the truth is that Canada managed, yet again, to preserve its supply management system, keeping those markets largely closed to competition from imports — with President Trump’s sympathy, as already noted. Further, the government intends to compensate farmers with subsidies. Canada also brought back from the dead NAFTA Chapter 19, the antidumping and countervailing duty dispute settlement mechanism, that Mexico had already agreed with the United States to eliminate. Canada also preserved its cultural exception. Those were three red lines that it had drawn, and it stood its ground. Canada, as did Mexico, negotiated in very difficult circumstances, faced with the credible threat that President Trump would withdraw the United States from NAFTA, the reality of US$12 billion of lost trade in steel and aluminum products and an ongoing risk of facing more damaging tariffs on exports of automobiles and auto parts to the United States. Thus, it appears that the Canadian Parliament, as well, should pass the new agreement.

In 2017, total trade in goods and services under NAFTA exceeded US$1.3 trillion (US Census Bureau 2018; Statistics Canada 2018). Businesses in North America are highly integrated and regional trade flows have proved too dynamic and too important for even the likes of Peter Navarro and President Trump to undo, whatever the political rhetoric may have been. It thus appears that the new agreement will be approved by each country’s legislatures.

### Mexico: A Brief Overview

Success is relative. It has many angles. As already noted, Mexico succeeded in preserving NAFTA and a trilateral deal. Given its — and Canada’s — economic dependence on trade with the United States, one might well argue that it was no small feat in the present circumstances.

While Mexico had recognized that NAFTA was in need of upgrading, it had always feared that reopening the text of the agreement would be like opening Pandora’s box, especially because it had maintained important sectors of its economy — namely, energy and telecommunications — closed to foreign investment and cross-border trade or largely shielded from foreign competition. However, in 2013-2014, Mexico undertook long-delayed and much needed energy and telecommunications reforms that provided for greater openness of those sectors. Mexico also believed that NAFTA had been significantly revamped through the TPP negotiations, without having had to reopen the agreement itself.

This time around, Mexico essentially reacted to US demands. It did not come to the table with any proposals of its own and it ended up making significant concessions. The new CUSMA is not about modernizing or upgrading NAFTA. While a deeper and more detailed

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4 MORENA has a majority in the House of Deputies (Mexico’s House of Representatives) as well, but for Mexico, the new CUSMA, like NAFTA, is an international treaty and the Senate has exclusive authority to approve it or not.

5 Even Peter Navarro seemed optimistic about the conclusion of a trilateral deal in an interview on Fox News on September 30, 2018, before the United States and Canada had reached an agreement: “The broad brush of the deal was that we want to restore North America as manufacturing powerhouse by reclaiming the supply chain. The deal in principle with Mexico will do that, if Canada comes in, that’s great. There is also a modernization component that brings in things like protection of digital, IP [intellectual property], pharma, things like that. That’s where things stand. Broad agreement on virtually all of that…” (Fox News 2018).
analysis is still needed, it appears that, except in one area — the so-called de minimis rule — which both Mexico and Canada vigorously resisted and gave little ground, none of the changes introduced in the agreement are trade progressive beyond what had already been achieved in the TPP. Indeed, the new deal is regressive relative to the existing NAFTA and TPP.

This is an overview of a few of the more salient issues of NAFTA negotiations with regard to Mexico.

→ **Automobiles.** The parties agreed to a stricter rule of origin which requires that cars, light trucks and certain auto parts have a regional value content of at least 75 percent and heavy trucks and parts at least 70 percent. In addition, at least 40 percent of the value (called labour value content [LVC]) in the agreement must come from individual plants or facilities located in North America where workers earn at least US$16 per hour (up to 10 percentage points of wages for research and development and information technology in the region may be counted in the LVC). In addition, at least 70 percent of the steel and aluminum used must also comply with the new agreement’s rules of origin.

These rules will require more manufacturing to be done in North America in high-salary areas, which will increase the cost of production and reduce competitiveness of the North American automobile industry as a whole. Mexico faces the additional challenge of becoming a high salary area. When the negotiations concluded, Mexico’s secretary of the economy stated that 70 percent of the industry already met the new threshold, but 30 percent did not, although the rules will be phased in gradually over a three-year period, and he was optimistic that it would have time to adjust.

Given the more stringent rules of origin and the significant regulatory burden that they will create, it could become more cost-effective not to comply with them and pay the applicable most-favoured nation (MFN) tariffs, which currently are at 2.5 percent (except for pick-up trucks, which are subject to 25 percent). However, President Trump has threatened to impose 25 percent import tariffs on automobiles and certain auto parts imported into the United States, including from Mexico and Canada, just like he did on steel and aluminum products, regardless of the new CUSMA. The result will be the increase in cost of vehicles produced in North America that will eventually translate into higher prices for consumers and the loss of competitiveness of the North American industry.

Perhaps the most troubling part of the new agreement are the “232 side letters” on automobiles where Mexico and Canada have recognized that the United States may impose new tariffs on imports of automobiles and auto parts for alleged national security reasons, and they have accepted limits on the number of vehicles that they can export to the United States. In other words, Mexico and Canada have already accepted quotas. Presumably, originating goods will continue to receive duty free treatment and non-originating goods would be subject to the 2.5 percent MFN tariff, but the letters are not at all clear on this point, and the United States has already asserted that it has a very broad discretion under section 232 of its Trade Expansion Act of 1962 (US Department of Commerce 2018). Mexico and Canada have preserved their right to resort to dispute settlement procedures under the current NAFTA, if it is still in effect (which suggests that the United States may be imposing such tariffs in the near future), or the CUSMA, but only with respect of whether the United States has complied with the quota. They have also preserved their right to challenge the measures under the WTO and the letters would give them a right to retaliate immediately (something they cannot legally do under the WTO).

However, the letters are troubling beyond trade in automotive goods because they reflect a change in paradigm. Since Breton Woods, the international community, under the leadership of the United States, had been moving progressively toward free trade by reducing tariff and non-tariff barriers as well as other obstacles to international trade; it has progressively built and strengthened a rules-based system. The United States is now pushing with all its might — literally — for managed trade with unilateralism as its working premise. It is not surprising that President Trump and Commissioner Lighthizer were able to agree quickly on the broad terms of the United States-European Union upcoming trade negotiations or that Canada succeeded in preserving its supply management system. Mexico and Canada did not get an exception from the US steel and aluminum tariffs. At the press conference following the conclusion of the NAFTA negotiations, President Trump said those tariffs would remain in effect until they could be replaced with something different, such as quotas, and Ambassador Lighthizer added that the parties have already engaged in discussions “with an effort to try to preserve the effect of our [i.e. the United States] program and still take care of their [i.e. Mexico’s and Canada’s] needs” (Global News 2018). It is not difficult to anticipate where the talks will lead.

→ **Dispute settlement.** NAFTA currently establishes three different dispute settlement mechanisms. The three were among the main issues of contention during the negotiations.

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NAFTA Chapter 20, state-state dispute settlement. The original US proposal — one that is close to Ambassador Lighthizer’s heart — was, in sum, to grant any party the ability to impede the progress of dispute settlement proceedings by allowing it to block the appointment of panellists, agreement over a meaningful mandate or any mandate altogether or the adoption of the panel’s decision on the dispute.

In 2000, the United States succeeded in dismantling the NAFTA dispute settlement mechanism and, for all practical purposes, obtained the result that it was seeking in the current negotiations through a formal amendment of the rules. As originally negotiated in 1992, NAFTA Chapter 20 required consensus to establish a roster of individuals that could serve as panellists so that, if a party failed to appoint any panellist, the appointment could be made by lot from among those in the roster. In the absence of a roster, a party could refuse to appoint panellists and effectively block the operation of the dispute settlement mechanism. That is precisely what the United States did in the case that Mexico brought against it over bilateral trade in sugar. No panel was ever established to hear that dispute and no dispute was ever submitted to dispute settlement under the Chapter again (Perezcano 2014), even though the parties did agree in late 2006 on a roster (which lapsed three years later).7

The parties appear to have fixed that problem in the CUSMA by providing that the roster shall remain in effect for a minimum of three years or until the parties agree to constitute a new roster (article 38.1(1)). However, the parties have yet to agree on an initial roster by consensus and there are other problems that may obstruct the operation of the dispute settlement mechanism, as they have in the past. For instance, NAFTA establishes a secretariat comprised of three national sections, one in each country. Under the Model Rules of Procedure, the section of the party complained against is responsible for administering the dispute and can be instructed to obstruct the proceedings. Indeed, the United States did so in the cross-border trucking contracts. When Mexico sought to have the panellist selected by lot from the roster, the United States instructed its section of the Secretariat to refrain from participating further in the process. The United States also sought to reject the panellist who it had originally appointed and who was also a member of that partial roster. Even with a roster in place, it took over 16 months of negotiations, and with Mexico threatening to instruct the Mexican section of the Secretariat to take over as the responsible section, for the United States to finally agree to appoint its panellists.8

Some commentators have suggested, based on “informed” sources, that “there is an understanding that, yes, the roster will be agreed and so the process will be unblocked” (Keynes and Bown 2018). The ability to block the establishment of a roster was the main culprit of the failure of NAFTA Chapter 20, but other provisions concerning appointments remain unchanged in the CUSMA. The parties still have to agree on the new model rules of procedure where they could improve the system. It remains to be seen, but there continues to be good reason for skepticism that the dispute settlement mechanism will work this time around.

NAFTA Chapter 11, investor-state dispute settlement (ISDS). The United States had proposed to allow each party to opt-out of the system and announced that it intended to do so itself. This is remarkable not only because US investors have been the greatest beneficiaries of ISDS, but especially because it is the first time (as far as the author knows) that the US government seeks to undermine protection for US interests abroad. ISDS between Mexico and the United States was significantly scaled back.9 For the vast majority of investments, ISDS is only available for alleged violations of national treatment, MFN and direct expropriation. For a few sectors only (oil and gas, supply of power generation services, telecommunications, transportation and infrastructure), investors will be able to bring claims for alleged breaches of any of the Chapter’s provisions, but the scope has been limited not only to such sectors, but also to investments under certain government contracts.

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7 The parties did agree to a partial roster not long after NAFTA came into force (which had lapsed by the time Mexico had requested the establishment of a panel on the sugar dispute).

8 Based on the author’s personal notes and records as someone who was directly involved in that process. See also (General Secretariat of the Organization of American States 2001).

9 Canada and the United States opted out of ISDS entirely as between themselves; Mexico and Canada will continue to have ISDS under the Comprehensive and Progressive Trans-Pacific Partnership Free Trade Agreement.
Since the original NAFTA was negotiated, Mexico viewed ISDS as one component in a system of checks and balances on its own government actions meant to preserve a stable economic framework based on open markets and free trade (Perezcano 2014). Strictly from a defensive perspective, one could argue that Mexico is better off without any ISDS altogether as it will face less exposure for government actions, but that does not favour its investment climate, especially with incoming President López Obrador and the new ruling class, who ideologically have always been critics of Mexico’s current economic model and believe in greater government intervention and control of economic activities.

While, during his campaign, López Obrador changed his political discourse around free trade — more as a populist response to President Trump’s rhetoric than out of conviction — and has, thus far, maintained a moderate and conciliatory tone, it is troubling that some of his most vociferous supporters who are now in Congress have begun to express their views of the economic policy that Mexico should turn to:

This has been a crushing victory for Andrés Manuel López Obrador and we now have a big challenge ahead because we can make all the constitutional amendments that we decide; the people have given us that tool. We can revert all the neoliberal reforms. Of course, we will have to reclaim the ports, airports, highways, railways, water, oil, telecommunications...everything, and put it at the service of our people.” (Zuckermann 2018)

More restricted access to ISDS alone will hardly be a deterrent for foreign investment in Mexico or encourage US investors to repatriate their investments, as Ambassador Lighthizer appears to have thought it could. However, it will increase the cost of investing in Mexico. Investors will be more cautious at first, and their decisions regarding investments in Mexico will largely depend on the policies that the new government implements and how they contribute to Mexico’s overall economic stability in the long run. Again, it remains to be seen.

— NAFTA Chapter 19, binational panel system for antidumping and countervailing duty determinations. Mexico gave up on NAFTA Chapter 19 early in the negotiations and turned it into a Canada-US bilateral issue. In the deal reached with the United States on August 27, 2018, Mexico agreed to eliminate the Chapter. Canada, however, stood its ground and, while no improvements were made — and the Chapter is in need of many — Canada was able to preserve it. In the wake of the current US protectionism, it would not be surprising to see increased use of trade remedies in the United States and, given the uncertainties surrounding the WTO dispute settlement mechanism, the new Section D of Chapter 10 of the CUSMA where NAFTA Chapter 19 was incorporated, may continue to be a valuable tool. Mexico will benefit from its restoration.

→ Energy. As already noted, in 2013-2014, Mexico carried out an important reform of its energy sector that opened the sector to much needed private investment. However, in the TPP negotiations, rather than embracing and cementing that greater openness, Mexico sought reservations that, in fact, provided for greater limitations than its legal framework contemplated.

López Obrador always opposed Mexico’s energy reform and opening the sector to private investment. He has already stated that no new contracts will be granted to private investors under the current framework. The energy chapter in the CUSMA is the only one where Mexico’s president sought to influence the outcome of the negotiations. Jesús Seade explained:

We began reviewing the texts and saw that the part concerning energy was perfectly and totally unacceptable to our movement, to the elected government, because it was all based on an approach that quoted and incorporated the energy reform. (Mares 2018)

We were not going to endorse the law to which the President Elect and the whole of MORENA opposed in due course a few years back. We did not raise amending the law in due course, not at all, but we rejected having an agreement based on an endorsement of that legislation... (Energía a Debate 2018)
Non-market Economies and Bilateral Agreements

On October 1, 2018, the possibility of ending with bilateral agreements appeared to have been avoided. However, the new article on non-market economies brings it back. The article is unprecedented in that it requires each party to inform the other parties of its intention to begin free trade agreement negotiations with a country that any one of them has designated as a “non-market economy” (i.e., China, first and foremost, although the article does not refer to it by name), at least three months before commencing negotiations. The article also requires the party that undertakes such negotiations to make the full text of the agreement available for the other parties to review no later than 30 days prior to the date of signature.

The significance of this provision has been downplayed by Mexican (and Canadian) negotiators who have stated that it adds nothing to the general withdrawal clause, which is currently in NAFTA and was carried over to the new CUSMA (Chávez 2018). But words matter and, considering the United States demanded its inclusion, it cannot be simply dismissed as redundant.

The article will be criticized as an invasion of sovereignty but, aside from that, the entry into force of a free trade agreement with a non-market economy gives the right to any other party to terminate the CUSMA and replace it with a bilateral agreement. Mexico and Canada have already gone through that process in the recent renegotiation of the NAFTA which, admittedly, was triggered by the threat of the United States walking away from the agreement under the existing withdrawal clause. Yet, as opposed to that clause, the new non-market economy clause specifically targets China and, perhaps, other non-market economies.

In practice, the clause would most certainly affect the incorporation of Chinese (i.e. non-originating) materials into a North American good, in order for it to qualify as originating for purposes of obtaining preferential tariff treatment when exported to another CUSMA party. It seems that the United States would then seek to impose new rules of origin in the bilateral agreement that would make it more difficult to incorporate Chinese goods. The immediate impact would be on compliance with the CUSMA rules of origin, which turned out to be, perhaps, the most difficult issue for Mexico in the recent negotiations. Even if the clause calls for replacement of the CUSMA with a bilateral agreement, activation vis-à-vis Mexico would bring Canada back to the table to weigh in against a free trade agreement with China that the United States opposes because of the high degree of integration of North American industries, the very reason why it was so important for the three parties to conclude one trilateral agreement rather than three sets of bilaterals.

The message that President Trump and his advisers (Peter Navarro and Ambassador Lighthizer) are sending to US trading partners is quite clear: the United States does not want anyone to negotiate with China. The message to China is quite clear as well: the United States is drawing its trading partners and building a front against China.

Conclusion

Mexico never wanted to reopen NAFTA for fear of facing demands for greater openness of its markets. That came at a cost of fostering a greater North American integration. While it would not have avoided the current US administration’s push for greater protectionism, a more integrated North America would have perhaps resisted better the current US administration’s demands. It was, after all, regional business integration and interdependence created by NAFTA that contained President Trump’s and his economic advisers’ most extreme impulses.

There is good reason to be skeptical that Mexico will be favourably inclined toward free trade and open market policies under the new government, despite López Obrador’s more moderate views thus far. It is likely that the current shift in paradigm — a shift toward managed trade — will suit his policies better. For that reason, it is certainly better for Mexico’s economy to have a trilateral trade agreement in place, even if it has been downgraded — and there is no question that NAFTA has been downgraded.

The United States opened Pandora’s box, and Mexico took a good look at what lay inside. True enough, it could have been worse. That it was not, and the fact that the bulk of NAFTA rules that have governed North American trade and investment flows over the past two decades will largely remain unchanged, is no reason to remain complacent.

11 See, for instance, the author’s comments on looking beyond NAFTA, upgrading it and improving regional integration in the context of the agreement’s 20-year anniversary (Perezcano 2014).
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About the Author

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Hugo’s expertise is in international law, economic law, international trade law and negotiations and international investment law. He has taught in those fields throughout his career and is a graduate of Mexico’s Autonomous Institute of Technology.
Introduction

This paper comprises the Canadian component of a trilateral series led by trade experts for each North American country, with a view to advancing a discussion on the future of the North American economic relationship. Outlined below are some of the likely impacts of the new trilateral trade agreement for Canada and analysis of the future consequences for North American economic relations.

The Canada-United States-Mexico Agreement

In August 2018, the United States and Mexico concluded a bilateral trade deal that Canada was pressured to join, largely on US terms. A month later, and on the eve of the October 1 deadline imposed by the United States and Mexico, Canada finalized the details of its participation in the deal. The need for Canada to join the trilateral agreement was made urgent by President Donald Trump’s threats to impose punitive auto tariffs on its northern neighbour if Canada failed to concede to US demands. Ultimately, Canada acquiesced, signing on to a new trilateral CUSMA that was similar to NAFTA, with several important shifts. These have been well documented elsewhere, however, the key differences for Canada include the following (USTR 2018a):

- A redesigned rules of origin chapter for automobiles, requiring 75 percent of vehicles to be produced with North American content. Further, between 40 and 45 percent of those vehicles must be produced using high-wage labour valued at US$16 per hour or higher. The clear goal of the US administration is to increase US-based vehicle manufacturing by reducing Mexico’s low-cost labour advantage as well as other foreign content from outside the North
American region. Canadian labour has celebrated this outcome; however, many economists agree that stricter and more onerous rules of origin will raise the price of North American produced vehicles and reduce the overall attractiveness of production in the region (Freund 2017).

- New labour, environment, digital, intellectual property and services chapters largely replicated from the original 12-country TPP. Through provisions outlined in these chapters, Canada will be required to make various adjustments to its domestic laws, including increasing copyright and data exclusivity protections for biologic drugs from eight to 10 years. Both will increase costs to consumers and governments and are not changes that Canada would have made in the absence of a trade agreement (see the companion piece by Christine McDaniel in this report for a detailed discussion on biologics).

- Increased de minimis levels for tax free cross-border shipping of CAD$40 and duty-free shipping of CAD$150. This is a positive change for consumers, although Canadian retailers are now calling on the Canadian government to align domestic tax policies so they will not be disadvantaged.

- American access, equivalent to 3.6 percent, to Canada’s dairy market with quotas for milk, butter, cream, cheese, skim milk powder and other products. Canada will also provide increased US access to its poultry and egg markets. In addition, Canada has agreed to dismantle milk Class 7, which had priced certain dairy ingredients at a level too low to make US exports to Canada attractive. While President Trump often publicly criticized Canada’s dairy tariffs as a source of US outrage over Canada’s supply management system, it was this latter issue pertaining to Class 7 that negatively impacted farmers in Wisconsin that caught his early indignation.

Implementation of the Class 7 measure requires cooperation from the provinces, and Quebec’s new premier has already rejected the plan. Unlike Ontario, which gained stability for its auto sector through CUSMA, Quebec gained nothing for the dairy concessions and is expected to challenge the federal government on the file in the months ahead. In addition, while Canada’s dairy concessions in CUSMA appear to be minor, the cumulative effects of the commitments, with additional ones made to TPP and European trade partners, could lead to severe disruption in the sector. The government will need to carefully design compensation for the Canadian farmers and processors who will be negatively impacted by all of these changes. Meanwhile, since the overall supply management system is expected to be maintained, Canadian consumers are unlikely to pay less for milk at the grocery store.

- Canada will also reduce agri-food barriers to US exports, offering national treatment to grain grading procedures and ensuring US wine is carried on store shelves in all Canadian provinces. These are both positive changes and ensure that Canada implements its trade agreements in good faith.

- In a surprise provision, CUSMA partners have agreed to provide three months’ notice of the commencement of free trade negotiations with a non-market economy. Upon completion of any such negotiations, CUSMA partners must be given the opportunity to review the text, and other partners may terminate the CUSMA agreement with six months’ notice. This extraordinary provision, which targets China, is without precedent in other free trade agreements and is a clear reflection of the US administration’s desire to deter trading partners from expanding economic relations with China.

- NAFTA’s Chapter 11 on ISDS has been dropped from the new agreement with potentially major implications for both investor protections and foreign direct investment climates in all three countries. The companion piece by Hugo Perezcano Díaz on Mexico in this report addresses these issues well.

Is CUSMA Worth It for Canada?

Those who believe that Trump was bluffing about imposing punitive 25 percent auto tariffs via section 232 national security measures are also likely to think that Canada should have held out for a better deal. However, even if it had been a bilateral US-Mexico deal only, the new auto rules of origin can succeed in reshoring American manufacturing jobs and investment only if Trump also raises the 2.5 percent US tariff on cars under current WTO rules. Indeed, there is mounting evidence to suggest that Trump will soon introduce worldwide auto tariffs — with exemptions for trade allies — in order to realize his America First manufacturing plan. For example, the United States has increased its capacity to export vehicles to South Korea while maintaining 25 percent tariffs on Korean truck imports into the United States until 2041 via the new United States-Korea Free Trade Agreement deal (USTR 2018b). The United States has also formally launched bilateral trade negotiations with each of Japan, the European Union and the United Kingdom that are likely to include voluntary export restrictions on automobiles in exchange for US exemptions from auto tariffs. Now that CUSMA has concluded, the groundwork for Trump’s great tariff wall has largely been laid, with traditional vehicle-exporting trading partners protected on one side, and China on the other.

Given the importance of Canada’s auto sector to the Ontario economy, combined with the ongoing chill on investment arising from the uncertainty surrounding NAFTA renegotiations, it was necessary for Canada
to reach an agreement with the Americans. Yet, notwithstanding the inclusion of modernization chapters from TPP that are generally positive for all three countries, the new CUSMA is not a better agreement for Canada and is, in many respects, worse than the original NAFTA. For example, two major priorities for Canadian business in the negotiations were to roll-back “Buy America” provisions on government procurement that have disadvantaged both Canada and Mexico and to modernize the list of professionals who can enter the United States visa-free via the NAFTA TN visa (Global Affairs Canada 2017). In the new CUSMA, the status quo prevails in both areas and Canada has little to show for its numerous concessions. Under any other circumstances, the CUSMA would be viewed as an unacceptable loss for Canada. But with a rule-breaking US president bent on reshaping international trade rules to advance its next cold war with China (Ward 2018), Canadian negotiators had little choice but to sign on.

What’s Next for CUSMA and Trilateral Relations?

At the national level, the Canada-US relationship has been much damaged by the optics of the negotiations. While Canadians will continue to travel to the United States for work and pleasure (Taylor-Vaisey 2017), they deeply dislike the US president and feel wounded by his insults to their country. Much work is required to restore the relationship, and it is hoped that finalizing the CUSMA can change the channel toward more positive interactions between both leaders and their teams.

On a practical level, the heavy work of pushing CUSMA through the US Congress rests with the Trump administration. Some on the Canadian side may even prefer CUSMA to fail in favour of the original NAFTA. However, Trump can be expected to threaten US withdrawal from NAFTA altogether if Congress fails to approve the new CUSMA legislation; thus, Canadians must remain cautious about what they wish for in the coming months.

Many Canadians also expected steel and aluminum tariffs to be lifted immediately upon reaching the CUSMA agreement. This was an unrealistic expectation. Historical evidence suggests that once the United States introduces protectionist measures, it can take years to unwind them. The most extreme example in recent times was Country of Origin Labelling (COOL) on US meat products that had long-term negative effects on Canadian and Mexican pork and beef sectors. Implemented in 2008 at the end of the Bush administration, COOL was broadened under Obama’s presidency and persisted through two WTO challenges and appeals. Only when Canada and Mexico were poised to roll-out US$1 billion in retaliatory measures in 2015 that targeted congressional interests did the United States finally rescind its COOL legislation (Bown and Brewster 2016). Buy America provisions in Obama’s economic stimulus legislation following the global financial crisis offers another example of how US protectionism had protracted consequences for Canada. Although the circumstances of the 2018 steel and aluminum tariff dispute are considerably different, resolving this situation will be difficult. The US administration is pushing Canada to accept quotas as a condition of lifting the tariffs, as it did with South Korea. If Canada is unwilling to accept managed trade in this area, its best chance for relief is for American business and agriculture interests to continue to make their case to the president to remove the tariffs (Murphy 2018) while awaiting the findings of the WTO challenge against the United States.

With respect to short-term Canada-Mexico relations, those closely involved in the talks know that Mexico did not throw Canada under the proverbial bus when Mexico finalized a pact alone with the Americans. In fact, Mexico kept Canada informed throughout the process, and Mexico’s negotiators remained helpful to the Canadian side until a final trilateral agreement was reached. However, these facts are not widely reported and do not reflect the general feeling among Canadians. Canada and Mexico must work to rebuild the public impression of mutual trust and goodwill. While there is no reason to believe good relations cannot be restored quickly, new President Andrés Manuel López Obrador is likely to devote most of his attention to domestic matters in his first months of office. Promoting trade ties with Canada will be a low priority, and Mexico’s relationship with the United States will necessarily dominate the new government’s attention on foreign policy and trade matters.

What about North American Relations in the Long-term?

Both Mexico and Canada’s overreliance on a single market positioned them weakly in CUSMA negotiations. Trump knew this and used US leverage to extract numerous concessions from both countries, offering nothing in return. In the aftermath, the need for Canada to diversify its export markets appears more urgent than ever. However, this recognition is hardly new and is much more difficult to achieve than simply inserting “diversification” into the new trade minister’s title. By virtue of a much smaller internal market, and despite laudable efforts by the previous Canadian government to diversify exports via new trade pacts with Europe, the TPP and Korea among others, Canadian exporters cannot replace the US market overnight — if ever. The gravity model of international trade has proven to be robust and is likely to keep Canadian exports in America’s orbit long into the future (Smith et al. 2018).
The new CUSMA complicates Canada’s diversification plans in several ways. On automobiles, the stricter rules for regional content will likely force North American vehicle manufacturers to further concentrate their supply chains inwards at the expense of other trade diversification goals and competitiveness for North American products (Lilly 2017).

The other diversification challenge comes with the CUSMA non-market economy clause outlined above and its implications for Canadian attempts to diversify to China. It is obvious that the US-China dispute is ramping up, making Canada’s attempts to diversify its markets via closer relations with China highly risky. The United States is increasingly asking traditional partners to pick sides; the importance of the US market to Canadian interests makes it very difficult to find the country that lies across the Pacific a more attractive choice in such a zero-sum game.

Canadians must also realize that American skepticism toward China is pervasive, bi-partisan and long standing. For example, President Obama had grown increasingly leery of the country over the course of his presidency, with the 12-country TPP serving as a deliberate geopolitical challenge to China’s rise. Many of the provisions targeting China in the new CUSMA were transferred from the original TPP (for example, currency manipulation, state-owned enterprises, data localization rules). In this way, the CUSMA can be viewed as a template for future negotiations with American trade partners that will outlast the Trump administration.

Despite the US position on China, there are many ways that Canada can seek to diversify its export markets without deliberately provoking the Americans. Numerous Asian countries are growing rapidly, and Canadian efforts to make gains with them will be non-controversial. Most obviously, the now 11-country Comprehensive and Progressive TPP will soon be implemented, offering Canadian exporters preferential access to exciting, high-growth markets in Southeast Asia.

In addition, there are several sectors in which Canada can advance its trade relations within North America. Donald Trump and US Commerce Secretary Wilbur Ross do not seem to care very much about nurturing growth in future sectors of the economy, so total has been their focus on resuscitating the manufacturing jobs of the twentieth century. Their neglect of the digital and service economies creates opportunities for Canada to further entrench its leadership in sectors such as artificial intelligence. Major digital giants such as Amazon, Microsoft, Alphabet-owned companies Sidewalk Labs and Google are establishing new centres in Ontario. It is an opportune time for Canada to seize this momentum to reach new global leadership in the sector.

Furthermore, with the highest educational attainment rankings in North America, Canadians will be more prepared for the jobs of the future economy that require advanced skills and education than either the United States or Mexico (Organisation for Economic Co-operation and Development 2016). To this end, the international education sector offers another area for Canada to lead in services trade, offering world-class post-secondary education to students from the world’s emerging economies.

New opportunities in regional energy integration also emerge as Mexico reflects its recent liberalization efforts in the new CUSMA and the United States adopts friendlier footing toward Canadian oil and gas infrastructure projects. In fact, the greatest challenge to increasing Canadian energy exports lies not with its NAFTA partners but within Canada’s own borders. From an uncompetitive business climate to regulatory paralysis and interprovincial infighting over approvals for new infrastructure projects, Canada is failing to attract foreign investment in the energy sector. To this end, investor confidence in Canada will not be increased with the removal of NAFTA Chapter 11 ISDS in the new CUSMA (Mexico kept these protections in place for the energy sector). It is vital for Canada to address its own domestic challenges to realize its comparative advantage; the new liquefied natural gas terminal announced for British Columbia may finally be a positive sign of shifting winds.

And What about Canada-Mexico Relations?

Much of this note has focused on the Canada-US relationship, with little mention of Mexico. This largely reflects the reality of the trading relationship between the two smaller countries: the US giant that lies between them has always dominated. Canada and Mexico have failed to grow the bilateral relationship significantly, and the vision of a truly trilateral and integrated North American economy has simply not been realized, save the automotive supply chain.

As Mexico continues to climb the ladder of global economic rankings, Canada must make greater efforts to nurture this bilateral relationship. Mexico is the only North American economy projected to grow rapidly in the coming decades as emerging markets take the place of the previous Western giants of the twentieth century. Mexico is poised to become a top 10 economy in the coming decades, while Canada is expected to slide gradually downward (PwC 2017). With job growth and expanding opportunities for an emerging middle class, Mexico is also increasingly becoming an immigration destination. Major economic reforms undertaken by Mexico over the past decade can be credited for much of its success and there is no guarantee that rapid growth will continue under President López.
Obrador. Still, NAFTA has helped lay the ground work for Mexico’s success, and it is in Canada’s interest to continue to cement those gains in its future relations with the country.

Conclusion: A More Cautious North American Relationship

As mentioned previously, the Canada-US relationship has been badly damaged by the past two years of animosity over NAFTA. It will take time to restore relations, which may be permanently changed. However, much of the bad blood is on the Canadian side, so determined are its citizens to view actions by the Trump administration as personal. Canadians would do well to take lessons from Mexicans who have managed to advance relations with the Trump administration more successfully, despite being treated far worse in his rhetoric.

If Trump succeeds in his strategy to reset US trade relations with the world, Canada could benefit from the positive spillovers of being a US neighbour, a phenomenon that has benefited Canada for more than a century already. Still, the president is playing a dangerous game that could equally backfire on the United States and catch its neighbours in the crossfire. The new CUSMA further tethers Canada to its American neighbour, for better and for worse. Canada should seek to assert its economic independence whenever and wherever possible, taking advantage of growth opportunities in emerging markets and new sectors of the economy. At the same time, Canadians must recognize that trade diversification goals are lofty, and gravity keeps them grounded. Canada’s North American cousins will always be its key trading partners and, just like family, Canada must keep nurturing those relationships even when it seems most challenging.

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