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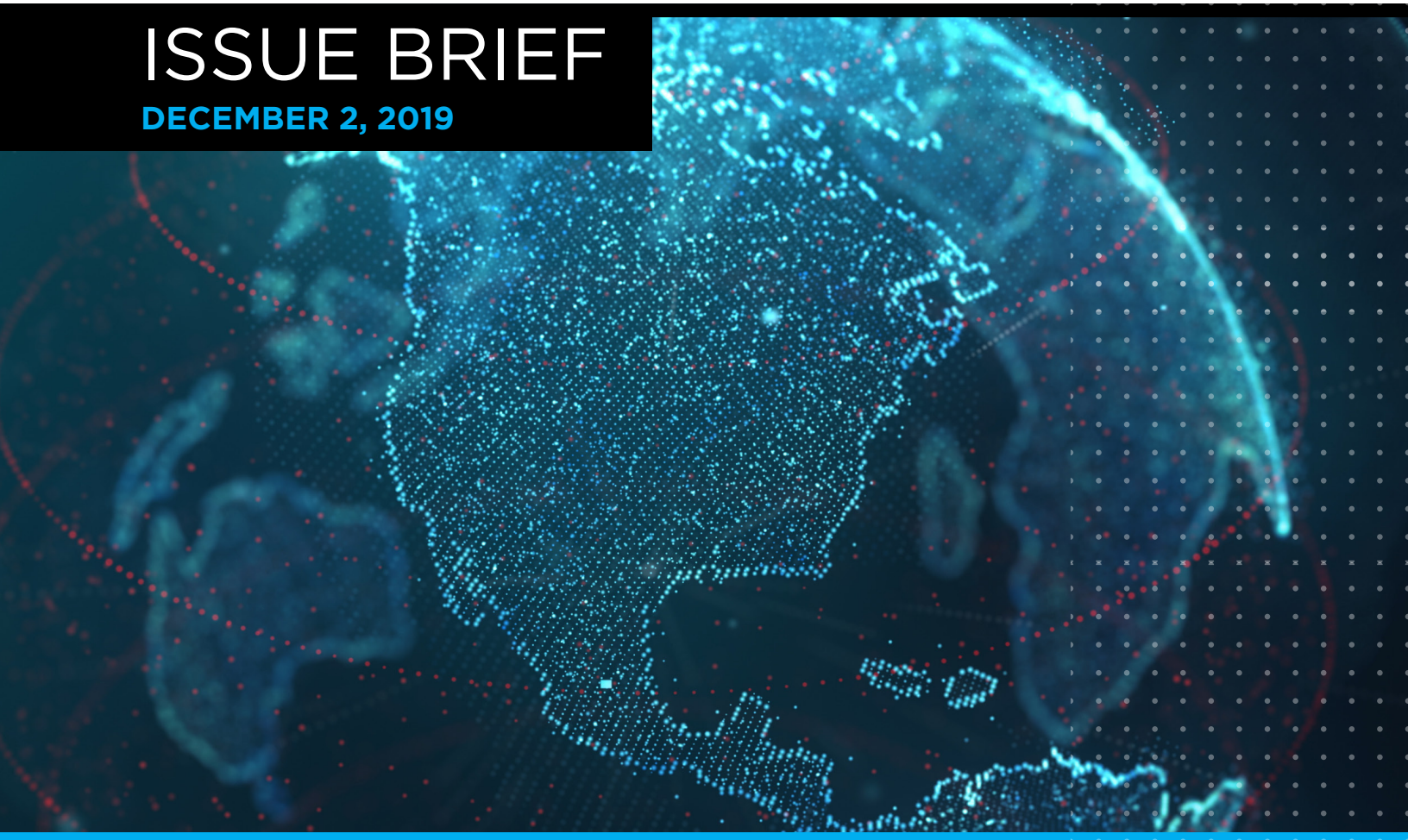

# The U.S. Ratification of USMCA

## Reading the Tea Leaves

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# The U.S. Ratification of USMCA: Reading the Tea Leaves

As we fast approach the end of 2019, the contentious North American Free Trade Agreement (NAFTA)/ United States-Mexico-Canada Agreement (USMCA) debate in Washington continues with no end in sight. The Negotiations which began in 2017 and were finalized in November 2018, gave birth to an updated trade agreement between the three countries. However, despite intensive efforts, only Mexico has ratified the agreement (it did so in June 2019). Canada went through their legislative process, but with a new Parliament following the October 2019 elections they will have to reintroduce the bill once the 43rd Parliament begins its session.

The situation in the U.S., on the other hand, is getting more complicated as we approach the 2020 Presidential election. Despite a push from the Trump Administration for a speedy approval this past summer, various concerns raised by the Democrats have kept the agreement in limbo. At an event held by the American Council for Capital Formation (ACCF) in June 2019, the chairman of the House Ways and Means Trade Subcommittee, Earl Blumenauer, was firm when asked a question on the possibility of a vote before the August recess, stating it was "Not going to happen"[1] And it didn't. Thanksgiving, another unofficial deadline for a 2019 approval, has also passed without action.

There is no question about the importance of the North American trade pact to the economies of the three parties, as outlined by a recent ACCF report.[2] Unfortunately, the pact's economic merits have not been enough to motivate a speedy ratification by the U.S. This short report looks at the issues raised by the Democrats as a stumbling block for ratification and other concerns about the future of USMCA emerging due to the uncertainty created by Chinese trade war.

## THE USMCA AND THE DEMOCRATIC PARTY: MAJOR CONCERNS

There are four areas of concerns that were raised by Democrats that led to the formation of the House Democrats' Trade Working Groups. Nine members[3] of the party are tasked with coming up with possible solutions to these concerns. The four issues are:

- ***Drug Pricing:*** The renegotiated trade agreement includes language that would give 10 years of data exclusivity for biologic drugs, a new class of medicines developed from living organic molecules and a growing part of the pharmaceutical industry. While

1 Politico, "Blumenauer: USMCA review could lead to trade 'reset'," June 20, 2019. http://accf.org/2019/06/20/blumenauer-usmca-review-could-lead-to-trade-reset/

2 Pinar Cebi Wilber, "NAFTA/USMCA: Past, Present And Future," May 2019, the American Council for Capital Formation. http://accf.org/2019/05/07/nafta-usmca-past-present-and-future/

3 These members led by House Ways and Means Chairman Richard Neal are Earl Blumenauer (D-Ore), Jan Schakowsky (D-Ill), Jimmy Gomez (D-CA), Suzanne Bonamici (D-Ore), John Larson (D-Conn), Terri Sewell (D-Ala) and Rosa DeLauro (D-Conn).

Mexico has no set length for this exclusivity, Canada has 8 years and the U.S. law has 12 years.[4] The proponents of this provision (mainly drug industry) quickly embraced the shorter 10-year period as they see it as an improvement especially in Mexican markets. Opponents of the provisions claim that, if locked in, the required length of time would not only keep the drug prices high in the U.S., it would also export these high prices to Canada and Mexico. In a political environment where high prescription drug prices are becoming a big issue in the U.S., and in the next election cycle, the members of the working group have already indicated that it would be hard to ratify the agreement unless these provisions are removed from the agreement. U.S. Trade Representative Robert Lighthizer and the Democrats have been working on possible modifications that would lower the protection term, but no resolution has yet been announced.[5] The recent rumors indicate that the White House is considering scaling back the protection.[6]

- ***Labor Provisions:*** The USMCA includes updated labor provisions that are in line with more recent free trade agreements that strengthens labor rights following not only domestic laws, but also adhering to core labor rights introduced by the International Labor Organization. The specific language in the agreement commits parties to:

  - *"not waive or otherwise derogate from labor statues or regulations to promote trade and investment*

  - *not fail to effectively enforce labor laws through a "sustained [consistent or ongoing] or recurring [periodically or repeatedly] course of action or inaction" in a manner affecting trade or investment between parties;*

  - *promote compliance with labor laws through appropriate government action, such as appointing and training inspectors or monitoring compliance and investigating suspected violations."*[7]

The labor provision discussions target Mexico's track record on worker rights. Mexico, the only country that ratified the agreement up to this point, has been doing significant work on labor reforms. On May 1, 2019, the country enacted a labor reform bill that enhances workers' rights by giving them the legal right to bargain collectively and creating an independent labor court to resolve disputes between union workers and employers. There are other modifications in the law such as prohibitions on discriminatory practices, promotion of gender equality, and increased maternity protection.[8]

Organized labor in the U.S. is skeptical that the Mexican government can implement changes that are required in the proposed agreement despite Mexico's legislative efforts and has been pushing the Democrats to wait on ratification of the agreement until the enacted reforms show actual results. In fact, growing American skepticism has led to various proposals, such as adding a labor inspection system within USMCA and an associated potential punitive action, like denial of tariff benefits for violators. Mexican government officials have rejected some of these ideas such as facility inspections by Americans.[9]

4 Baker McKenzie, "USMCA: Provisions and Potential Impact to the Healthcare Industry," November 28, 2018. https://www.bakermckenzie.com/en/insight/publications/2018/11/provisions-and-potential-impact-to-the-healthcare

5 Doug Palmer, "PhRMA urges Trump not to deal away prized USMCA provision," October 18, 2019. https://www.politico.com/news/2019/10/18/phrma-usmca-trump-050299

6 Nathaniel Weixel, "Trump Targets Drug Protections to Save Trade Deal," December 3, 2019. https://thehill.com/policy/finance/472913-trump-targets-drug-protections-to-save-trade-deal

7 Congressional Research Service, "USMCA: Labor Provisions," September 12, 2019, pg.1, https://crsreports.congress.gov/product/pdf/IF/IF11308

8 Oscar de la Vega, De La Vega & Martínez Rojas, "MEXICO - An Overview of the Recent Labor Law Reform in Mexico," May 6, 2019, American Bar Association, https://www.americanbar.org/groups/labor_law/publications/ilelc_newsletters/issue-may-2019/an-overview-of-the-recent-labor-law-reform-in-mexico/

9 Inside U.S. Trade's World Trade Online, "Mexican official: Government 'totally' opposed to facility inspections as part of USMCA labor solution," September 9, 2019. https://insidetrade.com/daily-news/mexican-official-government-'totally-opposed-facility-inspections-part-usmca-labor

With the backdrop of all these labor discussions, Mexican President Andres Manuel Lopez Obrador has communicated with House Democrats multiple times to reiterate his pledge to fully implement labor reforms to boost wages and the bargaining power of workers in his country. More recently, in a letter to Speaker Pelosi, President Obrador restated that "he has allocated more funds in next year's budget to implement changes in Mexican labor laws."[10]

The Mexican President's increased pressure on U.S. lawmakers to ratify the USMCA is not surprising: the uncertainty created by this limbo is having a negative impact on Mexico's investment levels, keeping their export-oriented economy stagnant. Delays in ratification could impact the Mexican budget further and make it hard to follow through on the labor provisions despite its promises, another reason for speedy ratification by the U.S.

- ***Environmental Provisions:*** The original NAFTA text does not include rules on environmental protection. The Clinton Administration addressed these concerns at the time with side letters that have been seen as ineffective by many. Like the strengthened labor provisions, the proposed USMCA includes stronger environmental rules in the body of the agreement. Specifically:[11]
    - *It requires countries to enforce their environmental rules and not weaken them to increase trade.*
    - *It protects the marine environment by preventing illegal fishing, prohibiting certain fish subsidies, and reducing marine litter.*
    - *It enhances cooperation to improve air quality.*
    - *It ensures market access for environmental technologies, goods, and services.*
    - *It improves the enforcement of illegal trafficking in wildlife, fish, and timber.*

"Delays in ratification could impact the Mexican budget further and make it hard to follow through on the labor provisions despite its promises, another reason for speedy ratification by the U.S."

Despite the improvements in USMCA, environmental groups claim that the agreement does "not meet baseline environmental criteria" and that "it glaringly fails to address or even mention climate change."[12] In fact, in a letter addressed to President Trump, more than 100 House Democrats asked that the agreement "meaningfully address climate change" by incorporating binding environmental standards as well as a commitment from the U.S. to remain in the Paris climate agreement.[13] [14]

10 Juan Montes, "Mexico's President Urges Quick U.S. Ratification of Trade Deal," November 29, 2019, The Wall Street Journal. https://www.wsj.com/articles/mexicos-president-urges-quick-u-s-ratification-of-trade-deal-11575039846

11 Ed Gerwin, "Getting to "Yes" on the USMCA: Maintaining and Modernizing North America's Economic Platform," July 2019, Progressive Policy Institute, pg 9. https://www.progressivepolicy.org/wp-content/uploads/2019/07/PPI_Getting-to-Yes-on-the-USMCA-V6-1.pdf

12 Amanda Maxwell, "Paris Agreement Guarantee Must Be Part of USMCA," November 4, 2019, NRDC. https://www.nrdc.org/experts/amanda-maxwell/paris-agreement-guarantee-must-be-part-usmca

13 Megan Cassella, "Democrats press Trump to commit to Paris climate deal as part of USMCA," September 17, 2019, Politico. https://www.politico.com/story/2019/09/17/democrats-trump-paris-climate-deal-usmca-1739745

14 President Trump officially pulled out of Paris Climate Accord in November 4, 2019. https://thehill.com/policy/energy-environment/468591-trump-pulls-out-of-paris-climate-accords

A recent research paper echoes these requests stating that the USMCA could go further by addressing the trade related aspects of climate change such as removing fossil fuel subsidies and encouraging the diffusion of climate friendly technologies.[15]

- ***Enforcement:*** The majority of the Democratic concerns regarding the USMCA are centered on the enforcement of the agreement. NAFTA's main dispute settlement mechanism was set by Chapter 20, but some have argued that the rules are flawed and unworkable, making them ineffective. The enforcement process starts with consultation of disputing parties, eventually leading to a five-person panel that provides recommendations to resolve the matter. Despite the set process, over NAFTA's 25 year history, there were only three panel decisions until 2001 and nothing subsequently.[16] The dispute settlement mechanism has multiple flaws such as Chapter 20 not requiring the parties to comply with the panel's ruling or the lack of requirement for the panelists to meet deadlines, creating a potentially lengthy process.[17] But the major problem appears to be "the ability of parties to block the establishment of a panel by refusing to appoint panelists or maintain a roster of qualified panelists from which appointments can be made."[18]

In the USMCA, Chapter 20 is replaced by Chapter 31, but with only minimal changes.[19] Experts question the effectiveness of the enforcement mechanism given its past history and the inherent flaws in its predecessor, Chapter 20.

There have been a number of suggestions on how to improve the enforcement in USMCA. The easier route, suggested by Jennifer Hillman, is to replace Chapter 31 with the Trans Pacific Partnership's dispute settlement provisions.[20] [21] There are also other flexible approaches such as joint U.S.-Mexican investigations and audits, enhanced funding for U.S. enforcement agencies, and significant technical assistance for the work required by Mexico to implement its promised reforms.[22]

## WHERE DO DEMOCRATS AND THE ADMINISTRATION STAND?

As negotiations between House Democrats and U.S. Trade Representative Robert Lighthizer proceed, conflicting news has arisen from both sides. Since the beginning of the process, Ambassador Lighthizer has been seen to be amenable to Democratic demands and was praised multiple times by the Democratic leadership for his cooperation.[23] The message from House Speaker Nancy Pelosi also underlines the positive tone of the negotiations as late as November 25: House Democrats have come within range of reaching a deal they can support but "now, we need to see our progress in writing from the Trade Representative for final review."[24]

15 Laurens, Noémie, Dove, Zachary, Morin, Jean-Frédéric and Jinnah, Sikina, "NAFTA 2.0: The Greenest Trade Agreement Ever?" 2019, World Trade Review. 18. https://www.researchgate.net/publication/334593290_NAFTA_20_The_Greenest_Trade_Agreement_Ever

16 Jennifer Hillman, "Democrats Are Right to Insist on Better Enforcement Provisions in the USMCA," October 7 2019, Council on Foreign Relations. https://www.cfr.org/blog/democrats-are-right-insist-better-enforcement-provisions-usmca

17 Jennifer Hillman, "A Serious Enforcement Mechanism Will Require Major Changes to USMCA's Dispute Settlement Provisions," September 30, 2019, International Economic Law and Policy Blog. https://ielp.worldtradelaw.net/2019/09/usmca-a-serious-enforcement-mechanism-will-require-serious-changes-to-usmcas-dispute-settlement-prov.html

18 Ibid

19 Ibid

20 Jennifer Hillman, "Democrats Are Right to Insist on Better Enforcement Provisions in the USMCA," October 7 2019, Council on Foreign Relations. https://www.cfr.org/blog/democrats-are-right-insist-better-enforcement-provisions-usmca

21 For a brief summary of dispute settlement chapter in Trans Pacific Partnership, see USTR's report: https://ustr.gov/sites/default/files/TPP-Chapter-Summary-Dispute-Settlement.pdf

22 Ed Gerwin, "Getting to "Yes" on the USMCA: Maintaining and Modernizing North America's Economic Platform," July 2019, Progressive Policy Institute, pg 9. https://www.progressivepolicy.org/wp-content/uploads/2019/07/PPI_Getting-to-Yes-on-the-USMCA-V6-1.pdf

23 Sabrina Rodriguez, "Among Trump's Cabinet, trade chief emerges as Democrat favorite" July 18, 2019, Politico. https://www.politico.com/story/2019/07/18/robert-lighthizer-democrat-favorite-1597043

24 Jacob Pramuk, "House Democrats are 'within range' of reaching a USMCA trade deal, Pelosi says," November 25, 2019, CNBC, https://www.cnbc.com/2019/11/25/nancy-pelosi-says-us-mexico-canada-trade-deal-is-within-range.html.

Unfortunately, President Trump does not seem to carry the same hopeful tone. His latest statement claims that USMCA is "dead in the water" blaming inaction by the Democrats.[25] This could also be seen as the President forcing the Democrat's hand.

In terms of timeline, missing the Thanksgiving deadline to strike a deal greatly endangered the chances for a vote on USMCA in December 2019, which has a limited number of working days. In fact, some statements point to an early 2020 vote, despite the upcoming Presidential election cycle. However, all three leading Democratic Presidential candidates (Joe Biden, Elizabeth Warren, and Bernie Sanders) have voiced their opinions against USMCA as written. It will be up to Democratic leadership and tweaks that will be provided by USTR to change the opinions among the Presidential hopefuls. There is also a slim chance that the other two Countries would refuse to accept the changes proposed by the U.S. without reopening negotiations.

There are also other political and economic factors that could force a 2020 vote on USMCA, despite it being a Presidential election year:

- ***U.S. Economy: Trade Uncertainty:*** U.S. economic growth has been hovering around 2 percent in 2019 (the latest estimate for the third quarter is 2.1 percent).[26] After the initial positive shock from the 2017 Tax Reform, which pushed the economic growth as high as 3.5 percent in the last quarter of 2017 and in second quarter of 2018, the economy seems to be on a lower growth trajectory. Some experts claim this as a failure of tax reform, but others are rightfully attributing it to the negative impact of trade wars on both the U.S. and global economies.

The fate of the USMCA isn't the only trade front where uncertainty persists. Since its inception, the current Administration has not only introduced increased tariffs on products such as steel, aluminum, washing machines and others, it has also started a trade war with one of its main trading partners, China. Escalating tariffs between the two countries have covered a large amount of traded products, triggering retaliation by China. In fact, Chinese tariffs for U.S. products have reached 21 percent, while China has reduced tariffs to 6.7 percent for the rest of the world.[27]

The economic war between the two powerhouses has disrupted supply chains, reduced investment, and started a roller coaster ride in financial markets. According to IMF estimates, global economic growth has been at its slowest pace since the 2009 recession, mainly due to the U.S. China trade war. The economic spat decreased global output by $700 billion, or 0.8 percent, the size of Switzerland's GDP.[28] Forecasters also predict further slowdown if the trade wars continue.

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25 Paul Connor, "USMCA 'dead in the water,' Trump says, blaming Democrats," November 24, 219, Fox Business. https://finance.yahoo.com/news/usmca-apos-dead-water-apos-125213736.html

26 Bureau of Economic Analysis, Gross Domestic Product, Third Quarter 2019 (Second Estimate); Corporate Profits, Third Quarter 2019 (Preliminary Estimate), November 27, 2019. https://www.bea.gov/news/2019/gross-domestic-product-third-quarter-2019-second-estimate-corporate-profits-third-quarter

27 Chad Bown, "US-China Trade War: The Guns of August," September 20, 2019, Peterson Institute for International Economics. https://www.piie.com/blogs/trade-and-investment-policy-watch/us-china-trade-war-guns-august

28 Paul Kiernan, "Officials View Trade Uncertainty as Biggest Global Economic Risk," October 19, 2019, the Wall Street Journal, https://www.wsj.com/articles/officials-view-trade-uncertainty-as-biggest-global-economic-risk-11571497200

In the U.S., the manufacturing sector has begun to feel the pressure of the trade wars. According to the latest numbers from the Institute for Supply Management's (ISM) survey of the country's manufacturing firms, (the Purchasing Managers' Index, or PMI), manufacturing activity has contracted for three consecutive months and August was the lowest point for the sector since June 2009.[29]

U.S. farmers have also been on the frontlines of the trade war. Chinese retaliation has mainly targeted U.S. agricultural products. The Administration tried to ease the financial pain with two rounds of financial aid for impacted farmers. The first round of aid was $12 billion and second round was $16 billion. However, despite the trade aid and slightly higher prices, farm finances deteriorated across the agricultural states during the summer and early fall according to Federal Reserve Bank of Kansas City.[30] A recent report by the Boston Consulting Group highlights another problem with prolonged trade wars: "The growing risk now is that much of the market share abroad that U.S. agribusiness is losing to foreign competitors will be hard, in not impossible, to win back – even if current trade conflicts are resolved to the U.S. government's satisfaction. Growers in Australia, Brazil, New Zealand, Russia, and other nations are rushing to replace US suppliers of soy, beef, wheat, and other foodstuffs affected by retaliatory tariffs from the US's trading partners."[31]

As President Trump embarks on his reelection campaign, subpar economic growth and a deteriorating manufacturing sector, which was the centerpiece of his first presidential bid, could spell trouble for his reelection chances. The mounting economic pressure on his key constituency, farmers, could also backfire despite the financial aid. Under these economic pressures, both China and the U.S. have been negotiating a trade truce in phases. The so-called Phase One deal is still in motion. Even though the Administration describes the phase one deal as "substantial," addressing U.S. concerns on intellectual property and financial services access and includes sizeable Chinese purchase of American agricultural products, experts believe the first phase will mainly be cosmetic, leaving important issues to future phases. In addition, Chinese insistence on rolling back existing tariffs as part of the deal and the U.S. resistance to the idea could further delay the agreement.

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Under a no China trade deal scenario, USMCA ratification could become more important as a symbolic win for the Trump Administration's trade agenda to ease some of the economic tensions in the country. At the same time, with acceptable changes, Democratic candidates can also get behind ratification and show that they can work across the party lines to reach some of the goals that are in line with their agenda.

29 October 2019 Manufacturing ISM® Report On Business, Institute for Supply Management, November 2019. https://www.instituteforsupplymanagement.org/ISMReport/MfgROB.cfm?SSO=1

30 Nathan Kauffman and Ty Kreitman, "Farm Finances Continue to Weaken Amid Ongoing Uncertainty," November 14, 2019, Kansas City Fed. https://www.kansascityfed.org/en/research/indicatorsdata/agcreditsurvey/articles/2019/11-14-2019/farm-finances-continue-to-weaken-amid-ongoing-uncertainty

31 Decker Walker, Michael McAdoo, Matt Westerlund, Iacob Koch-Weser, Lauren McGraw, and Marc Gilbert, "How Prolonged Trade Wars Could Hurt US Agribusiness for Good," Boston Consulting Group, October 2019. http://image-src.bcg.com/Images/BCG-How-Prolonged-Trade-Wars-Could-Hurt-US-Agribusiness-for-Good-Oct-2019_tcm9-231558.pdf

- ***Trade Wars already Impacting Elections:*** A new analysis by Emily Blanchard, Chad P. Bown, and David Chor highlights the impact of President Trump's trade agenda in flipping 40 previously Republican seats during the 2018 midterm elections.[32] The authors estimate that the trade war could be responsible for five House seats out of the 40 lost by the Republicans in November 2018. The study also underlines the success of strategic retaliatory tariffs imposed by China: Republican candidates lost more votes in counties where employment was concentrated in products affected by retaliatory tariffs, especially in "swing counties." With the upcoming Presidential election, both Democrats and Republicans could use a much-needed jolt to the U.S. economy and a "major win", such as ratification of the USMCA.

- ***Failure to Ratify USMCA could spell trouble for Other Trade Negotiations:*** Other bilateral trade deals have also been proceeding between the U.S. and other countries, such as Japan and India. In fact, on September 25, 2019, the U.S. and Japan announced that they had finalized a limited deal that could be the lead for a more comprehensive deal in the future. This "mini" deal mainly consists of tariff cuts on agricultural and industrial goods and commitments on digital trade. The U.S. Congress is not expected to play a role in the ratification of the Japanese deal as the President could use delegated tariff proclamation authorities in Trade Promotion.[33] The U.S. is also expected to embark on formal trade talks with the EU as well as the U.K. after Brexit. With the potential for upcoming trade negotiations, failure to ratify USMCA weakens the bargaining power of the U.S. President. A finalized USMCA agreement could demonstrate the U.S. priorities as other negotiations proceed.

## A FINAL NOTE

There is no doubt a modernized North American Trade Pact will have a positive impact on the economies of three countries, as well as help Mexico to reform its labor markets through enhanced cooperation. The delays in U.S. ratification creates more uncertainty for intertwined supply chains and negatively impacts the competitiveness of North America vis-à-vis other regions in the world. Due to the limited number of working days remaining in 2019, the hope is that ratification could take place in early 2020 despite the upcoming U.S. Presidential election. Some claim that Democrats could shelve ratification in order to deny a win to President Trump in an election year. However, these claims are shortsighted: Through the modifications that are being negotiated between Democratic leadership and Ambassador Lighthizer, the resulting agreement could be perceived as a win for Democrats as well. Speedy approval in early 2020 would not only create a political win-win for both parties, it could also set precedent for future modernized trade agreements as the original NAFTA did 25 years ago.

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32 Emily Blanchard, Chad Bown and David Chor, "Did Trump's Trade War Impact the 2018 Election?" 2019, Centre for Economic Policy Research Discussion Paper. https://www.piie.com/blogs/trade-and-investment-policy-watch/trumps-trade-war-cost-republicans-congressional-seats-2018

33 Congressional Research Service, "U.S. Japan Trade Agreement Negotiations," October 3, 2019. https://fas.org/sgp/crs/row/IF11120.pdf

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