The Political Economy of NAFTA/USMCA

Gustavo A. Flores-Macías and Mariano Sánchez-Talanquer

Subject: International Political Economy, Political Economy, Political Institutions
Online Publication Date: Aug 2019 DOI: 10.1093/acrefore/9780190228637.013.1662

Summary and Keywords

When the North American Free Trade Agreement (NAFTA) came into force on January 1st, 1994, it created the largest free trade area in the world, and the one with the largest gaps in development between member countries. It has since served as a framework for trilateral commercial exchange and investment between Canada, Mexico, and the United States. NAFTA's consequences have been mixed. On the positive side, the total value of trade in the region reached $1.1 trillion in 2016, more than three times the amount in 1994, and total foreign direct investment among member countries also grew significantly. However, the distribution of benefits has been very uneven, with exposure to international competition reducing economic opportunity and increasing insecurity for certain sectors in all three countries.

Twenty-four years later, the three countries renegotiated the terms of NAFTA and renamed it the United States–Mexico–Canada Agreement (USMCA). The negotiation responded in part to the need to modernize the agreement, but mostly to President Donald Trump's concerns about NAFTA's effect on the U.S. economy and the fairness of its terms. Although the revised agreement incorporated rules that modernize certain aspects of the institutional framework, some new provisions also make trade and investment relations in North America more uncertain.

Keywords: North American Free Trade Agreement (NAFTA), United States–Mexico–Canada Agreement (USMCA), free trade, trade agreements, North America, Canada, Mexico, United States, Latin American politics

Introduction

When the North American Free Trade Agreement (NAFTA) came into force on January 1st, 1994, it created the largest free trade area in the world, and the one with the largest gaps in development between member countries. It has since served as a framework for trilateral commercial exchange and investment between Canada, Mexico, and the United States. In 2016, the total value of trade in the region reached $1.1 trillion (see Figure 1), more than three times the amount in 1994 (McBride & Aly Sergie, 2018). Total foreign direct investment among member countries also grew exponentially.

Twenty-four years later, the three countries renegotiated the terms of NAFTA and renamed it the United States–Mexico–Canada Agreement (USMCA). The negotiation responded in part to the need to modernize the agreement, but mostly to President Donald Trump's concerns about NAFTA's effect on the U.S. economy and the fairness of its terms. At the time of writing in early 2019, the new USMCA still requires congressional approval in the three countries, to take place through an up-or-down vote most likely in 2019 or 2020.

The objective of this article is to present an overview of the political economy of NAFTA/USMCA. It first presents an overview of the context in which NAFTA was signed and its main objectives. Next, it discusses different views on the agreement, including the expected benefits and opposition at the time it was signed. Third, it examines NAFTA's performance since 1994, with an emphasis on winners and losers across the region. The fourth section discusses the politics behind the re-negotiation of the agreement and the emergence of USMCA, as well the improvements and setbacks associated with it. The final section concludes.

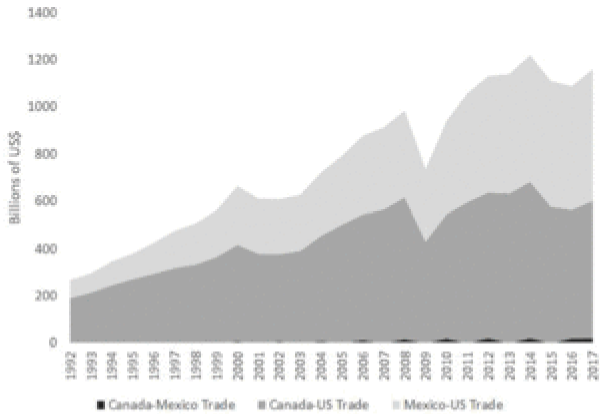

Figure 1. Value of total NAFTA trade flows.

Source: Sonneland (2018).

The Origins of NAFTA

The 1980s saw major acceleration of efforts to increase world trade. The precursor to the World Trade Organization (WTO), the General Agreement for Trade and Tariffs (GATT), experienced its most ambitious round of trade negotiations during the Uruguay round beginning in 1986. With 123 countries taking part in the negotiations, important advancements were made regarding cross-national commercial exchanges in industries such as agriculture and textiles, in addition to trade in services, respect for intellectual property, and flows of capital across borders.

This major trade impetus took place in part as a reaction to the exhaustion of the state-led developmental model in several parts of the world, which pushed governments to restructure their economies and seek alternative strategies to spur economic growth. In the United States and the United Kingdom, for example, President Ronald Reagan and Prime

Minister Margaret Thatcher put into practice many of the free-market ideas that had come out of neoclassical economics. In other parts of the world, as in Latin America, replacing state intervention in the economy with the invisible hand of the free market became a way to address the debt crisis that erupted in 1982 following Mexico's default.[1]

In the United States, President Ronald Reagan was elected in 1980 after Jimmy Carter's first and only term as president. He spoke in favor of a North American trade zone as early as his 1979 presidential campaign, in which he promised to leverage the power of market forces for development by cutting taxes and trade barriers. Four years after Reagan's election, Brian Mulroney became prime minister of Canada, after the Progressive Conservative Party won a significant majority in parliament. Riding the conservative wave in the Anglo-Saxon countries, his government came as a reaction to the nationalist governments of the Liberal Party during the 1970s, especially under Prime Minister Pierre Trudeau.

Reagan and Mulroney were ideologically compatible and receptive to the idea of experimenting with a free trade zone in North America. President Reagan played a major role in overcoming protectionist impulses in the United States, denouncing protectionism as a "cheap form of nationalism" (Reagan, 1998).[2] Although Canadians were wary of any partnership with the United States, Prime Minister Mulroney saw an opportunity in Canadians' changing attitudes toward free trade (Golob, 2003; Pastor, 2001, p. 64). In 1986, the United States and Canada engaged in negotiations for a bilateral trade agreement, which was signed the following year and came into force in 1989. The agreement, which included provisions about the reduction of tariff and non-tariff barriers to trade, was also among the first to include trade in services. It would later serve as the foundation for NAFTA negotiations (Mayer, 1998).

As the United States–Canada Trade Agreement was being negotiated, and in the aftermath of Mexico's 1986 accession to the GATT, Carlos Salinas de Gortari became Mexico's president in 1988, in a highly contested election, amid widespread allegations of fraud, and with the economy experiencing triple-digit inflation.[3] Salinas had earned a Ph.D. from the Harvard Kennedy School of Government in the United States, where he became exposed to the pro-market ideas that guided many of his administration's policies. For Mexico, the 1980s had been a "lost decade" of economic decline and hard stabilization policies following the 1982 crisis. In this context, Salinas decidedly deepened a pro-market turn initiated by his predecessor. This adherence to market reform represented a drastic shift away from the nationalist stance that had characterized Mexican governments for most of the 20th century.[4] A significant break in Mexico's foreign policy also took place, as Salinas's administration saw an unambiguous partnership with the United States as the way to further Mexico's interests. The country's proximity to the United States was reinterpreted as a major advantage that opened unique opportunities for modernization. For these to materialize, a free trade agreement was understood as the way to attract much-needed foreign investment and spur rapid growth by transforming Mexico into an exporting powerhouse oriented toward the U.S. market. In Salinas's words, free trade would allow Mexico to "export goods, not people" to the United States (McBride & Aly Sergie, 2018).

In 1990, Ronald Reagan's successor, U.S. president George H. W. Bush, and Mexican president Carlos Salinas de Gortari agreed to start negotiations toward a comprehensive free trade agreement between the two countries. Canada joined the deliberations the following year, and on December 17, 1992, President Bush, President Salinas de Gortari, and Prime Minister Mulroney signed the text of NAFTA. In addition to the calculations of political elites, pro-trade private interests played an important role in the approval of the agreement. Empirical studies show that U.S. industries with large economies of scale in production, which stood to gain from access to a regional market, as well as those which could move production of intermediate goods abroad to reduce costs, were more likely to lobby in favor of the agreement (Chase, 2003).

The signed agreement had clear aims: eliminating tariff and non-tariff barriers to trade and facilitating the movement of goods and services across member states' borders. It also sought to promote fair competition and improve investment conditions by protecting property rights. Three main principles guided the agreement: most-favored nation treatment (if a prerogative is granted to one party, all parties are entitled as well), national treatment (no discrimination between domestic and other parties' goods for taxation and other purposes), and transparency. Additionally, NAFTA codified agreements on a number of industries, including agriculture, automobiles, intellectual property, textiles, visa categories for labor mobility, and environmental regulations (Ford, 2008).

Two other agreements were adopted alongside NAFTA: the North American Agreement on Labor Cooperation (NAALC) and the North American Agreement on Environmental Cooperation (NAAEC). Both emerged out of concern in the United States and Canada over weak enforcement of labor rights and environmental standards in Mexico, which jeopardized NAFTA's approval in these countries' legislatures. Under the NAALC, complaints regarding protection for children, minimum employment standards, and prevention of occupational injuries and illnesses could in principle become grounds for potential trade-suspension sanctions. The agreement allowed for any civil society group to take a complaint to the Department of Labor in another country, but it had a fairly narrow scope and did not include provisions regarding several other areas recognized by the International Labor Organization (Aspinwall, 2017). The NAAEC, in contrast, did not allow for civil society groups of one country to bring complaints before the authorities of another. Rather, it created the trilateral Commission of Environmental Cooperation, whose staff can conduct investigations into the alleged violations and publish reports about them. It does depend, however, on member state approval for its activities (Aspinwall, 2017).

The elimination of trade barriers in certain sectors, such as beans, corn, and sugar, was staged over time to shield domestic industries from sudden disruptions and allow them to progressively adjust to the new rules. By 2008, however—coinciding with the global financial crisis—all of NAFTA's final provisions came into force. A decade later, a forceful political challenge to the principles of multilateralism and free trade embedded in NAFTA brought the agreement to the brink of collapse.

Political Opposition

Although many hailed the free trade initiative as visionary, there was considerable opposition in the three countries from its inception. If the United States–Canada Free Trade Agreement had generated anxiety in the United States and Canada, suspicion was even greater about the consequences of incorporating Mexico because of major differences in levels of development, size of the economy, and wages, not to mention language and culture. When NAFTA negotiations began in 1990, the size of the U.S. economy was 20 times that of Mexico and 10 times that of Canada. Per capita income in the United States was 8 times that of Mexico (Pastor, 2001, p. 63).

In the two advanced, industrialized democracies, there was generalized apprehension about the loss of jobs in manufacturing and agriculture, especially because Mexican wages amounted to about a sixth of those in the United States (Ford, 2008). Undocumented labor migration from Mexico generated further unease. To assuage this concern, supporters saw NAFTA as contributing to reduce labor migration flows by lifting living standards in Mexico. The logic was that by boosting economic activity and job-creation in their country, Mexicans would find it more attractive to stay home than to migrate north (Flores-Macías, 2008).

Not surprisingly, the topic of NAFTA was central to the 1992 presidential campaigns in the United States, which preceded Congressional approval of the agreement. During one of the debates, independent presidential candidate Ross Perot famously warned that the United States should prepare for the “giant sucking sound” of jobs moving across the border to Mexico. Although Democratic candidate Bill Clinton won the election and Perot came in third, the phrase and his challenge to the United States’ longstanding two-party system captured well existing concerns for broad sectors in the United States.

By signing NAFTA on his way out of the office, President Bush prevented the administration of incoming President Clinton, who had endorsed NAFTA but whose constituencies favored tougher labor and environmental provisions, from modifying the agreement. Although they ultimately failed, labor organizations such as the American Federation of Labor–Congress of Industrial Organizations (AFL-CIO), as well as environmental and human rights groups, lobbied hard to defeat the agreement in Congress (Lustig, 1991), which highlighted the need for the side agreements for NAFTA’s eventual approval.

Historical animosities also played a role in generating opposition. Canadians had been wary of their relationship with the United States throughout the 20th century: at least two prime ministers paid dearly for their efforts to reach free trade agreements with the United States (Pastor, 2001, p. 64).[5] For Mexicans, the relation was fraught with mistrust. Not only did the United States annex half of Mexico’s territory during the Mexican–American war, but the United States had also occupied Mexico several times as recently as the early 20th century. Moreover, the adoption of free-market policies by the then-dominant Institutional Revolutionary Party (PRI) had already led to a major split in the party and the formation of the leftist Party of the Democratic Revolution (PRD). Spearheaded by Cuauhtémoc Cárdenas—the son of 1930s President Lázaro Cárdenas, a symbol of the economic nationalism of the Mexican Revolution—Mexico's political left vigorously opposed the terms of NAFTA as a sacrifice of national interests at the altar of international capital. During the NAFTA negotiations, Cárdenas himself cited the perils of institutionalizing Mexico's role in the North American region as that of supplier of cheap labor for foreign corporations (Cárdenas, 1991).

Although NAFTA was ratified by the three countries' legislatures and entered into force on January 1st, 1994, it has remained controversial since.[6] On that same day, as the three governments celebrated the agreement, an indigenous guerrilla organization, the Zapatista Army for National Liberation (EZLN), launched an uprising in the state of Chiapas in southeastern Mexico, listing the new trade agreement among its grievances. In the United States, opposition has also taken the form of protests by the anti-globalization movement, including violent demonstrations at the WTO ministerial conference in Seattle in 1999. Over the next two decades, NAFTA remained a contentious topic in all three countries, emerging intermittently in electoral politics and facing resistance from a variety of social movements, from Mexican peasant organizations to unionized U.S. workers.[7]

Performance Over 24 Years: Average Gains, Uneven Results

Most analysts agree that, on average, NAFTA has brought economic benefits to the three countries, although these have been more modest for the United States and Canada than for Mexico (Caliendo & Parro, 2015). The stock of foreign direct investment (FDI) in Mexico grew sixfold during this period, from $15 billion to more than $100 billion, while FDI from Mexico to the United States grew by more than 1,200% (Villarreal & Fergusson, 2017, p. 20). Although some of the liberalizing measures Mexico adopted in the 1980s and 1990s contributed to these trends, NAFTA helped guarantee their continuity and boost investor trust (Villarreal & Fergusson, 2017, p. 21). In certain industries, such as automobile production, the ability to move goods smoothly across borders enabled substantial efficiency gains in supply chains. For the average consumer across the three countries, the adoption of NAFTA brought greater access to quality products at lower prices.

An accurate evaluation of the effects of NAFTA, however, must consider not only its overall trade and investment gains, but also the agreement's distributional consequences. In this sense, NAFTA's record has been decidedly mixed. Because of the many factors that explain economic performance, it has been difficult to establish a counterfactual trajectory for growth, employment, and industrial development in the absence of NAFTA. Against the backdrop of steady commercial and investment growth, the sudden opening to foreign competition disrupted entire industries and brought negative consequences for jobs and wages.

Supporters of the agreement point to estimates that place the number of jobs created by NAFTA at 14 million, and 200,000 export-related jobs created every year (which pay 15–20% more than the jobs that were lost) (McBride & Aly Sergie, 2018). The U.S. Department of Commerce estimates that exports to Canada and Mexico supported 2.8 million jobs in 2015, one out of every four export-supported jobs in the country (Rasmussen & Xu, 2016).

However, exposure to international competition reduced economic opportunity and increased insecurity for certain constituencies in all three countries. The lack of effective compensatory mechanisms to mitigate the losses bred discontent among social groups affected by international competition and multinational corporations' increasing market share in various sectors. Furthermore, job losses resulting from China's 2001 WTO membership and the increasing automation of manufacturing technology have been attributed to NAFTA, which has further contributed to negative perceptions of the agreement (Starr, 2010, p. 841; Wise, 2010). As a result, NAFTA remained a contentious issue in domestic politics, supported by majoritarian pro-trade political coalitions in each country but sowing resentment among social constituencies that came to see the agreement as a demonstration of the disproportionate influence of technocratic, globalizing elites and their allies in international capital over policy.

According to a report by the Congressional Research Service, NAFTA's net impact on the U.S. economy has been relatively small, at best about 5% of total GDP (Villarreal & Fergusson, 2017, p. 15), which is the share that trade with Canada and Mexico represented in 1994. Since the United States and Canada already had a trade agreement in place without NAFTA, the gains from adding Mexico are estimated at 1.4%, or a little less than a third of total gains. A 2016 U.S. International Trade Commission report concluded that NAFTA resulted in "a substantial increase in trade volumes for all three countries; a small increase in U.S. welfare; and little to no change in U.S. aggregate employment" (United States International Trade Commission, 2016, p. 255, cited in Villarreal & Fergusson, 2017, p. 16).

The report also pointed to some studies showing that trade with Mexico depressed wages in some industries while lifting them in others, and to other studies suggesting that NAFTA had "essentially no effect on real wages in the United States of either skilled or unskilled workers" (USITC, 2016, p. 259, cited in Villarreal & Fergusson, 2017, p. 16). Other analyses find evidence that NAFTA had a substantial negative effect on U.S. wages in industries and localities that were vulnerable to Mexican imports, with the losses exceeding average welfare gains (Hakobyan & McLaren, 2016).

Although NAFTA's overall impact on the U.S. economy may be relatively small, it has been very consequential for certain industries. For example, the U.S. agricultural sector has been one of the main beneficiaries of NAFTA, as farmers and ranchers relied heavily on the agreement to increase exports of grains, oilseeds, pork, and other foodstuffs. The

American Soybean Association (2018) reports that $43 billion in agricultural products are exported to Canada and Mexico every year.

Another major beneficiary was the U.S. automobile industry. Greater integration of supply chains across North American countries made it more competitive internationally, which in turn resulted in important welfare gains (Hufbauer & Schott, 2005). The intra-industry efficiencies in the automobile sector have been facilitated by relatively low labor costs in Mexico, which led auto companies to relocate production at the expense of manufacturing jobs in the United States. It may be the case, however, that many of those jobs would have been lost anyway due either to reduced international competitiveness of firms facing relatively high labor costs or automation.

For Canada, the expectation that trade integration with the United States and Mexico would significantly improve productivity has not materialized (Villarreal & Fergusson, 2017, p. 22). Although Canada's agricultural industry has benefited from the agreement, the gap between Canada's labor productivity and that of the United States has remained roughly constant.[8] Additionally, the automobile industry has suffered. Since 2009, in the aftermath of the global recession, no new auto assembly plants have been built. Instead, production lines have been transferred to Mexico and the United States, and the country's share of North America's vehicle output has been declining (Villarreal & Fergusson, 2017, p. 23).

For Mexico, NAFTA became one of the pillars of major structural change in the economy and state–society relations. Until the early 1980s, Mexico's inward-oriented development model had created strong corporatist relations between the state, protected sectors of industry, and organized labor. The unraveling of state-led development under the debt crisis and the adoption of liberalizing reforms, however, turned the country into one of the most open economies in the world.[9] This outward reorganization of the Mexican economy increased the share of international trade in GDP from about 30% before NAFTA to 78% in 2017.[10]

Despite this economic openness, the vast majority of Mexican exports go to the United States. Between 2013 and 2017, annual exports to the United States averaged 80% of the total value of exports.[11] The result of this dual pattern—increased weight of exports in the economy with continued concentration in the U.S. market—has been a strong dependence on the performance of the U.S. economy to produce growth, as well as continued access to its market to prevent economic turmoil.

In so far as NAFTA firmly hitched Mexico to the American economy, the agreement produced the economic effect intended by its advocates. On the down side, however, high trade dependence has made the country highly vulnerable to economic fluctuations in the United States and to the inherent volatility of international markets. The failure to adopt complementary policies to integrate markets domestically prevented the country from taking full advantage of the agreement, kept economic gains highly concentrated regionally, and ultimately made the growth rate highly dependent on the U.S. (Hernandez-Trillo, 2018). Further, the expectation that the size and dynamism of the U.S. market would pull

Mexico down the road of modernity and produce convergence with its more developed counterparts has not materialized (Easterly, Fiess, & Lederman, 2003).

Figure 2 shows that the economies of the United States, Canada, and Mexico have followed similar trajectories since the adoption of NAFTA, a testament to the agreement's actual capacity to serve as a platform to tie together the three countries' economic fortunes. Yet, Mexico's real economic growth has consistently trailed that of the United States or Canada, with both lower growth rates overall *and* deeper contractions during crises due to higher vulnerability to decreases in external demand.

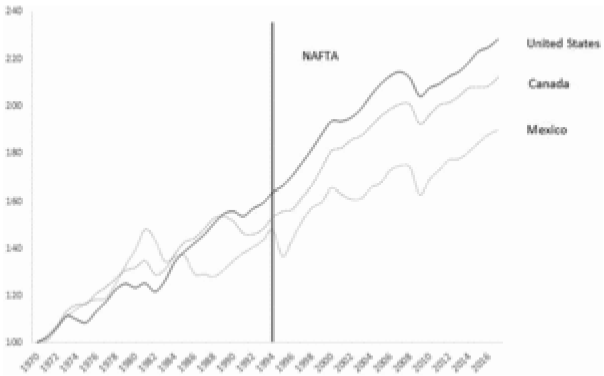

Figure 2. Cumulative real GDP per capita growth at PPP, 1970 = 100.

Source: OECD Statistics, GDP per head of population.

Further, average national growth rates mask steep inequalities across regions and industries, which have deepened in the post-liberalization period (Aguilar-Retureta, 2016; Chiquiar, 2005). States more proximate to the United States and with higher initial human and physical capital captured most of the gains from economic integration, as they were better positioned to attract foreign investment and reorient production toward the U.S. market. Poorer and more distant states in Mexico's south, however, lagged behind.

Similarly, certain industries were suddenly decimated. A study estimates that between 1994 and 2002, Mexico lost 1.3 million jobs in the agricultural sector (Polaski, 2003), which employed a fifth of the working-age population at the time. Although confounders such as the 1994 Peso Crisis make isolating the net effect of NAFTA difficult, the liberalization of trade represented a shock for small, poorer farmers in the Mexican countryside who were unable to compete with large, subsidized American agribusiness. Likewise, small and medium-sized firms in formerly protected industries struggled to survive. Loss of the jobs they provided fueled migration and the growth of Mexico's informal sector, which has steadily comprised some 59% of the workforce since 2005, when a consistent time-series data started to be recorded (Secretaría del Trabajo y Previsión Social, 2018, p. 17).

Regardless of whether NAFTA was responsible or not, many of the expectations placed on it were not met.[12] Overall, the net effect on labor has been less positive than was promised when the agreement was signed. The main manifestation is the lack of improvement in Mexicans' purchasing power, save for certain high-skilled workers in specific sectors. Despite moderate increases in productivity, by 2015 the real value of the minimum wage was approximately 20% lower than in 1990 (Provencio, 2017, p. 121). As for average wages, they were only 1.7% higher in 2017 than in 2000.[13] According to authorities' own measure of income poverty, 52.4% of the Mexican population lacked sufficient income to cover the cost of basic services and a basket of foodstuffs when the agreement came into force in 1994. By 2016, the same indicator had increased to 52.9%, a clear sign of the failure to lift living standards for a majority despite NAFTA (Consejo Nacional de Evaluación de la Política de Desarrollo Social, 2017).

At the same time, the quality of employment deteriorated: the share of salaried workers with labor contracts decreased from 55% in 1992 to 47% in 2014.[14] Trade union density, at about 25% in the early 1990s, is also markedly low at 12.5% at the time of writing, and only 10% of the workforce has their wages and employment benefits negotiated through collective bargaining arrangements.[15] NAFTA also did little to bridge a substantial wage gap between skilled and unskilled labor (Esquivel & Rodríguez-López, 2003).

Overall, then, labor conditions in Mexico tended to worsen, and real wages did not trend toward convergence with those of the United States and Canada. This outcome ran counter to the expectation that higher wages would reduce undocumented labor migration. In fact, the latter increased following the agreement in spite of tougher border control measures (Audley, Papademetriou, Polaski, & Vaughan, 2003). Whereas an estimated 170,000 Mexicans entered the United States undocumented during the 1980s, that number rose to 500,000 per year between 1993 and 2008 (Flores-Macías, 2008, p. 435).[16]

This picture is at least partially consistent with analyses of trade agreements as mechanisms that may produce some mutual benefits and net efficiency gains, as emphasized by conventional economic theory, but at the cost of upward redistribution, disproportionate economic gains for multinational corporations, and heavy losses for those affected—for example, labor or environmental interests. As noted by Rodrik (2018) and others, modern trade agreements go well beyond tariff elimination to span a broad set of policy domains, including investment, domestic regulatory standards, finance, labor, and intellectual property, among other areas. The political economy of trade agreements is therefore not simply about conflicts between special protectionist interests, on the one hand, and exporters or average consumers, on the other. Rather, large, international, and politically connected firms stand to gain the most from such complex and encompassing cross-border rules, practices, and protections. Their disproportionate ability to influence the fine print may help explain the unequal distributional effects of trade agreements like NAFTA, which can be larger than the average gains from trade themselves (Rodrik, 2018).

Yet, beyond its strictly economic objectives, NAFTA also pursued important political and foreign policy goals for elites on both sides of the Mexico–United States border. Liberalizing reformers hoped that Mexico's transformation into an export-based economy predominantly oriented toward the U.S. market would impose strict constraints on future policy-makers, unambiguously align Mexico with U.S. interests, and strengthen a relation historically fraught with mistrust. Unless politicians were willing to risk major economic downturn and disruption, NAFTA and the ensuing economic ties would serve as commitment devices for sustained pro-market positions, policy moderation, and a collaborative attitude toward the United States on the Mexican side. While strict economic cost–benefit analysis naturally tends to dominate the evaluation of free trade agreements, such geopolitical considerations can be an important force behind their adoption, design, and maintenance.

In this respect, NAFTA has arguably produced in Mexico the effect intended by its designers. The intensity of economic exchange has cemented United States–Mexico ties and likely moderated anti-Americanism both among elites and at the mass level, in a country that had historically maintained reservations about its northern neighbor. According to the World Value Survey, only 19% of Mexicans expressed trust in Americans in 1993, before NAFTA entered into force.[17] While time-series data using the same question wording are not available, by 2008 57.3% of Mexicans had a positive or very positive opinion about the United States.[18] The country's cultural proximity to the rest of Latin America notwithstanding, 47.7% agreed in 2014 with the statement that they were citizens of North America.[19]

NAFTA's Renegotiation and the Way Forward

Although social constituencies opposed to NAFTA remained on the political sidelines in the two decades following the adoption of the agreement, accumulated resentment among specific sectors over the social and economic disruptions brought about by globalization, socio-demographic change, and its institutional manifestations—such as NAFTA—retained its potential as a source of political mobilization. Against this background, the slow and uneven recovery from the 2008 global financial crisis laid the ground for a turn of the political tide. By reviving old grievances, aggravating insecurities, and deepening the sense of loss of economic and social status among previously ascendant sectors of American society, the financial crisis triggered a nationalist-protectionist backlash against the liberal consensus of the previous decades (Inglehart & Norris, 2016; Posner, 2017). By the 2016 U.S. presidential campaign, NAFTA had come under fire.

During the campaign, then Republican candidate Donald Trump characterized the agreement as "the worst deal ever" signed by the United States (Severns, 2016). Running on the promise of "making America great again," he made the revision of "unfair" trade deals and the securing of the country's southern border centerpieces of his protectionist message. In concrete terms, this meant terminating NAFTA, cracking down on immigration from the global south and culturally distinct nations, and building a physical wall along the border with Mexico, then the United States' third-largest commercial partner. Rather than aggressive steps, these were characterized as necessary remedies to the complacency of American political elites over the past decades, which had allegedly allowed foreign countries to take advantage of the working middle class and sunk the "real" America into crisis. Trump's nostalgic appeals to a bygone era of American dominance and prosperity struck a deep chord in broad areas of the country, such as the rust belt, allowing him to ride the wave of resentment all the way to the Oval Office.

Shortly after assuming power in 2016, President Trump moved to turn protectionism into practice. To support his assault on NAFTA, he often pointed to the trade balance between the United States and Mexico, which went from a surplus of $1.7 billion in 1993 to a deficit of $63.2 billion in 2016 (Villarreal & Fergusson, 2017, p. 15). In addition to strictly economic considerations, which were a central factor, NAFTA served as an outlet for the general anti-Mexico rhetoric that characterized Donald Trump's campaign and ignited his base.

On May 2017, President Trump notified Congress of his administration's intention to renegotiate the free trade agreement with Canada and Mexico, invoking the 2015 Trade Promotion Authority. This "fast track" procedure authorizes the president to negotiate international trade agreements and submit them to Congress for an up-or-down vote without the possibility of amendments.

Mexican authorities originally warned that if the United States insisted on renegotiating NAFTA, they would seek to broaden the scope of negotiations to include migration, narcotics, and security. For its part, Canada stated that it would rather withdraw from NAFTA than agree to unfavorable terms (Villarreal & Fergusson, 2017). In the end, however, the revised agreement reflected mostly changes proposed by the United States.

After more than a year of negotiations, in September 2018 the United States, Mexico, and Canada agreed to new terms for a revamped NAFTA. The executives of the three countries signed the agreement on November 30, 2018, after which the legislative bodies of each country will have the last word on its approval.[20]

The deal, rebranded as the United States–Mexico–Canada Agreement (USMCA) for political communication purposes—mainly, to allow President Trump to tout the end of NAFTA—maintained the core of the original agreement, which for some served as confirmation that the United States' threat of withdrawal was overblown. Yet, the revised agreement also incorporated new rules and provisions that, although they modernize certain aspects of the institutional framework, collectively make cooperative economic and political relations in North America more uncertain and contingent. The changes can be grouped into three categories: modernization, U.S. demands, and de-institutionalization.

Modernization

The first category corresponds to a series of modernizing changes to address previously neglected topics and update aspects of the agreement. Two important examples are digital trade and intellectual property provisions. On the first, the agreement took steps to eliminate barriers to the importation and exportation of digital products, facilitate the transfer of customer data across borders, and limit governments' ability to force tech startups to disclose proprietary information. Provisions were also included to enhance consumer confidence and privacy in digital trade and strengthen governments' ability to respond to cyber-security threats.

With respect to intellectual property, the new agreement introduced more stringent protections for patents and trademarks—an area in which the United States has a competitive advantage. In principle, these provisions should promote innovation by allowing parties to appropriate higher gains for technological innovation. U.S. pharmaceutical companies, for instance, stand to gain from a lengthened marketing exclusivity period of ten years when they develop new biological drugs. The new USMCA also includes provisions regarding agriculture biotechnology that facilitate the sharing of biotech information and market access for agricultural biotech products across the three countries.

Further, the new USMCA introduces new regulations to prevent certain trade practices considered to be illegitimate, such as deliberate currency manipulation and differential treatment in the purchase and sale of goods and services by state-owned enterprises and designated monopolies. Perhaps most importantly from a political economy standpoint, such new provisions evince a tougher U.S. approach against non-market practices that, from the perspective of the Trump administration, build unfairness into the international trade system.

At the bottom of these regulations appears to lie an attempt by the United States to introduce into the North American deal mechanisms to constrain and counterbalance China's increasing influence in the international system. New provisions that pose high barriers for Mexico or Canada to enter into free trade agreements with "non-market" countries aim in the same direction. In short, although the U.S. government's rhetoric throughout the negotiation process may have concentrated on the purportedly unequal gains from the existing deal among member countries, it is possible to infer that one of its underlying objectives was to safeguard the agreement with its closest trade partners in ways that increases its payoffs but also its leverage vis-à-vis China. At least to some extent, the United States appears to have negotiated in North America with an eye toward its larger rivalry with the world's rising power.

U.S. Demands

The second category concerns changes that the Trump administration demanded to rebalance what it considered an intrinsically unfair relation between the United States and its partners in the agreement. Among the main changes in this group are more demanding regulations for the automobile industry, rules that increase access for U.S. farmers to the Canadian dairy market, and new labor provisions aimed at protecting U.S. workers from "social dumping," given Mexico's comparatively lower wages and weak enforcement of labor laws.

Under the new agreement, the automobile industry will have three—for some autos, up to five—years to comply with stricter rules of origin to avoid tariff duties. Seventy-five percent of automobile content must now be sourced in North America, up from 62.5% in the original deal, and 70% of the steel and aluminum used by a producer must also originate in the region. In addition to higher regional value content requirements, the agreement introduces new labor value content provisions intended to shift part of auto and truck production back to the United States, and potentially Canada. To qualify for duty-free treatment, 40% of the total value of all vehicle inputs must be produced by workers making at least US$16 per hour, a provision that, for practical purposes, implies production outside of Mexico. Mexico may attempt to partially offset this new requirement by investing in research and development to increase its share of high-paying, non-assembling jobs in the sector, but the rule is clearly designed to satisfy U.S. demands.

Specifically, the requirement aims at fulfilling Donald Trump's campaign promise of reigniting American manufacturing and reversing the job losses suffered by the working class as a result of globalization. Given the special historical place of the automobile industry in American culture and in the rise of the United States as the world's economic superpower, the revival of automobile production on U.S. soil symbolizes the idea of restoring American greatness, so central in Donald Trump's path to the presidency. From this perspective, the imposition of favorable labor provisions in the automobile industry may appear as a success of Trump's tougher, more protectionist approach to trade policy.

In practice, however, demanding labor value content provisions may increase labor costs for companies. Should they transfer these costs to consumer prices, demand for vehicles produced in North America could decrease, and with it the number of jobs in the automobile industry. Alternatively, facing the prospect of reduced global competitiveness due to higher production costs, auto makers in the region may attempt to offset the effect of stricter labor provisions by expanding automation in assembly lines. This potential response also imposes limits on the flat-out return of automobile-industry jobs to the United States.

In all, the new rules of origin for the auto sector—the most dynamic under NAFTA—represent slightly modified versions of American demands, but it is unclear whether they will bring about the intended effects.[21] For Mexico, the prospect of reduced investment from auto companies in its territory poses an important challenge. Although provisions that protect the country from sudden losses and the potential adoption by the United States of new tariffs in the sector were negotiated in parallel to the main agreement, there is little in the new regulations that furthers Mexico's interests. Drawn into the negotiations by a protectionist U.S. administration, however, Mexico appears to have accepted less-than-ideal terms for the sake of maintaining the agreement and preventing further disruption.

If tougher rules of origin for the auto industry were among the central concessions the United States extracted from Mexico, increased access to the dairy market proved a hard sticking point until the very end of negotiations with Canada. In the end, the United States managed to secure greater market opportunities for its ranchers and farmers, as Canada agreed to drop a milk pricing system that posed barriers to U.S. producers. Under the new scheme, the United States will enjoy higher export quotas for its dairy products and the possibility of multiplying its presence in the Canadian market with products like milk protein concentrate, skim milk powder, and infant formula that are relatively easy to store and transport. In exchange, the United States dropped its demand to eliminate the international dispute-settlement mechanisms for countervailing and anti-dumping tariffs, which were built into NAFTA's chapter 19 and Canada wanted to keep to avoid litigation in U.S. courts.

Finally, U.S. demands included imposing stricter labor regulations on Mexico. Echoing a longstanding demand of sectors of American labor, Trump claimed during his campaign that trade agreements like NAFTA were to blame for deindustrialization and the hard times experienced by American workers. Railing against company executives who moved production to Mexico and other countries to take advantage of low wages and lax enforcement of labor rights, he promised to retaliate against firms that embraced this strategy. In this specific domain, his denunciations resonated with sectors of the Mexican left, who were critical of the strategy of suppressing wages for the sake of competitiveness. Shortly after leftist candidate Andrés Manuel López Obrador won the Mexican presidential election by a landslide on July 1st, 2018, his team joined the outgoing administration of Enrique Peña Nieto at the negotiation table and expressed its willingness to put the labor issue high on the agenda.

The new agreement includes stronger labor provisions to, in principle, create a more level playing field for workers across the three countries. As per the labor chapter in the new USMCA, Mexico must strengthen its labor laws to protect rights to unionization and collective bargaining, replace existing tripartite conciliation and arbitration boards with independent bodies and courts to adjudicate labor disputes, and effectively comply with other International Labor Organization principles that though formally recognized, are nevertheless weakly and selectively enforced.

A positive side-consequence of President Trump's antagonism toward NAFTA might therefore lie in stronger protection of labor rights for Mexican workers, along with a more vigorous Mexican domestic market due to higher wages. A key variable in the success of such new provisions, however, will be the strength of mechanisms to monitor implementation and enforcement, or else labor protections could continue to be a dead letter. The rise of the left to power in Mexico, however, might jointly work with U.S. pressure to change the trajectory of the Mexican labor market.

Yet, while stronger labor regulations in international trade agreements like NAFTA might have been long overdue, they open new challenges for the North American region as a whole and Mexico in particular, if they are to remain competitive at a global scale—and hence sustain necessary levels of job creation. Should the new agreement indeed help to produce a relatively more balanced distribution of the gains from trade between capital and labor, Mexico will need to implement effective strategies to attract foreign investors—previously pulled by low labor costs and complacent labor authorities—by other means.

Deinstitutionalization

The third and possibly most meaningful category in the transition from NAFTA to USMCA consists of new provisions that, overall, make trade and investment relations in North America more uncertain. Beyond any new sectoral regulations or content details, these changes are perhaps the distinctive features of the new agreement. At the core, they signal the entry into a new era in the politics of international economic relations—with its own ways and challenges—at the United States' behest.

Contributing to increased uncertainty are changes to dispute-settlement mechanisms that used to be part of NAFTA. In particular, expert international panels that examined the merits of investors' claims against host governments will be eliminated, with the exception of those in the energy, infrastructure, and telecommunications industries. The existence of such panels provided investors with guarantees and contributed to making NAFTA about investment as much as trade. Wary of potential regulatory changes in politically sensitive sectors like oil, corporations in these industries appear to have managed to maintain these protective mechanisms into USMCA.

In other industries, however, without this procedure foreign investors will have to rely on other means when controversies with governments emerge. On the up side, governments may now have more leverage over corporations tempted to resort to friendly international panels to eschew obligations in domains like taxation and the environment. Yet, the panels' elimination also increases risks of selective enforcement within countries, cronyism, long judicial disputes, and even corruption, as firms and governments confront each other in domestic courts.

In addition, the USMCA includes new review and termination provisions that undermine the very predictability and long-term outlook that trade agreements are meant to provide. Entering into the negotiations, the Trump administration demanded the adoption of an automatic sunset clause that would end of the agreement after five years, unless the parties explicitly agreed to renew it. Although such extreme demand was relaxed, the new USMCA contains a termination provision after 16 years, plus a review mechanism every six—at which parties may decide to extend the agreement for another 16 years.

These new temporal clauses erode NAFTA's character as a quasi-permanent institutional basis for cooperative economic relations between the three countries. All actors, from businesspeople and workers to politicians, now know that governments will again face each other at the negotiation table in six years, which means there is considerably less certainty about the rules of the game in the non-distant future. Independent of reforms during the now obligatory review process, the agreement itself might live for long, or it might not. From an economic standpoint, such unpredictability changes optimal behavior for decision-makers, be it exporting firms or potential investors. They may withhold investments that otherwise would have materialized, reorient their decisions toward short-term gain, or seek backdoor paths to obtain guarantees from political actors with the capacity to shape the rules. Politically, the institutions underpinning cross-national economic exchange will now be more subject to short-term political calculation by whoever holds the levers of power in each country, each time the agreement is up for review.

In short, while the new time clauses open the possibility of periodically updating and amending the agreement, their main implication lies in the shortening of time horizons and the intensification of uncertainty, with predictable effects on trade, investment, and rent-seeking behavior (Carballo, Handley, & Limão, 2018). Slowdowns in economic activity in both Canada and Mexico, as well as declines in foreign direct investment, can already be traced to the uncertainty surrounding the re-negotiation of NAFTA (Sands, 2018). It is harder to move forward when one may step into quicksand.

While in many respects USMCA represents old wine in a new bottle, the new temporal clauses built into the agreement arguably change the essence of the agreement itself and, in turn, of the relations between the three North American countries. More than a solid foundation for sustained cooperation or an institutional framework that solves credible commitment problems in order to materialize long-term mutual gains, the new agreement resembles a *modus vivendi*, a temporal, purely practical compromise between parties that must now take greater precautions against each other, should someone suddenly change their mind. While cross-border economic exchange can continue, greater distrust permeates relations in this more precarious equilibrium, while each party, uncertain about the moves of the others tomorrow, selfishly extracts the greatest possible gains today.

Conclusion

While trade volumes and foreign direct investment flows surged under NAFTA and the agreement generally benefitted consumers by providing cheaper, more varied goods, the benefits and losses were distributed differently depending on the industry. Whereas capital-intensive industries performed fairly well, workers in labor-intensive industries bore the bulk of the costs.

Although the North American region had grown accustomed to the framework set forth by NAFTA, President Trump made good on his campaign promise to renegotiate the agreement to extract better terms for the United States. This pledge found a receptive audience among broad sectors of disenchanted workers increasingly concerned about the decline of manufacturing jobs in the United States. In this sense, the more favorable terms that President Trump extracted from Canada and Mexico represent an important political victory.

However, although the new agreement preserved much of the foundation of NAFTA and even modernized certain aspects, the changes spawned by the USMCA may well have the unintended effect of making the North American region less competitive because of higher costs. This would jeopardize an even greater number of manufacturing jobs, and contribute to making employment more precarious in all three countries, not just the United States.

In all, the key to assessing NAFTA's transformation might lie not in any specific economic provision or any radical change to its substantive content, but in the weakening of political ties and the erosion of trust between longstanding allies brought in its wake. The seemingly trivial brand-name change from NAFTA to USMCA evinces a deeper problem of deinstitutionalization (Flores-Macías & Sánchez-Talanquer, 2018). As cracks continue to appear in the liberal globalizing consensus of the post-Cold War period, cooperation is now more contingent, and the international system itself more dangerous and unpredictable.

References

Aguilar-Retureta, José. (2016). **Regional income distribution in Mexico: New long-term evidence, 1895–2010**. *Economic History of Developing Regions*, *31*(2–3), 225–252.

American Soybean Association. (2018, October 1). **New NAFTA announced: American soybean growers pleased administration has reached deal with Canada and Mexico** [Online press release].

Aspinwall, Mark. (2017, August 10). Learning from the experience of NAFTA labor and environmental governance. *Forbes Insights*.

Audley, John, Papademetriou, Demetrios, Polaski, Sandra, & Vaughan, Scott. (2003). *La promesa y la realidad del TLCAN: Lecciones de México para el hemisferio*. Washington, DC: Carnegie Endowment for International Peace.

Caliendo, Lorenzo, & Parro, Fernando. (2015). Estimates of the trade and welfare effects of NAFTA. *The Review of Economic Studies*, *82*(1), 1–44.

Carballo, Jerónimo, Handley, Kyle, & Limao, Nuno. (2018, March 16). **Trade cold wars and the value of agreements during crises**. *VOX CEPR Policy Portal*.

Cárdenas, Cuauhtémoc. (1991, June). TLC: Una propuesta alternativa. *Nexos*.

Chase, Kerry. (2003). **Economic interests and regional trading agreements: The case of NAFTA**. *International Organization*, *57*(1), 137–174.

Chiquiar, Daniel. (2005). **Why Mexico's regional income convergence broke down**. *Journal of Development Economics*, *77*(1), 257–275.

Consejo Nacional de Evaluación de la Política de Desarrollo Social (CONEVAL). (2017). ***Evolución de las dimensiones de la pobreza 1990–2016***. Mexico: CONEVAL.

Easterly, William, Fiess, Norbert, & Lederman, Daniel. (2003). NAFTA and convergence in North America: High expectations, big events, little time. *Economía*, *4*(1), 1–40.

Esquivel, Gerardo, & Rodríguez-López, José Antonio. (2003). **Technology, trade, and wage inequality in Mexico before and after NAFTA**. *Journal of Development Economics*, *72*(2), 543–565.

Flores-Macías, Gustavo. (2008). NAFTA's unfulfilled immigration expectations. *Peace Review*, *20*(4), 435–441.

Flores-Macías, Gustavo, & Sánchez-Talanquer, Mariano. (2018). *NAFTA's overhaul: From stability to uncertainty*. Washington, DC: Foreign Policy Research Institute.

Ford, Andréa. (2008, December 30). A brief history of NAFTA. *Time Magazine Online*.

Golob, Stephanie. (2003). Beyond the policy frontier: Canada, Mexico, and the ideological origins of NAFTA. *World Politics*, *55*(3), 361–398.

Hakobyan, Shushanik, & McLaren, John. (2016). Looking for local labor market effects of NAFTA. *Review of Economics and Statistics*, *98*(4), 728–741.

Hernandez-Trillo, Fausto. (2018). Mexico, NAFTA, and beyond. *The International Trade Journal*, *32*(1), 5–20.

Hufbauer, Gary, & Schott, Jeffrey. (2005). *NAFTA revisited: Achievements and challenges*. Washington, DC: Institute for International Economics.

Inglehart, Ronald, & Norris, Pippa. (2016). *Trump, Brexit, and the rise of populism: Economic have-nots and cultural backlash* (HKS Faculty Research Working Paper Series RWP16- 026). Cambridge, MA: Harvard Kennedy School.

Lustig, Nora. (1991, November 1). TLC: A punto de ser socios. *Revista Nexos*.

Mayer, Frederick. (1998). *Interpreting NAFTA*. New York, NY: Columbia University Press.

McBride, James, & Aly Sergie, Mohammed. (2018, October 4). NAFTA's economic impact. *CFR Backgrounder*.

Morley, Samuel, Machado, Roberto & Pettinato, Stefano. 1999. Indexes of Structural Reform in Latin America, *Serie Reformas Económicas* 12, UNECLAC.

Office of the United States Trade Representative. (2018). **United States–Mexico–Canada trade fact sheet: Rebalancing trade to support manufacturing** [Online fact sheet]. Washington, DC: Office of the United States Trade Representative.

Passel, Jeffrey, Cohn, D'Vera, & González-Barrera, Ana. (2012). *Net migration from Mexico falls to zero—and perhaps less*. Washington, DC: Pew Research Center.

Pastor, Robert. (2001). *Toward a North American community*. Washington, DC: Peterson Institute for International Economics.

Polaski, Sandra. (2003). Jobs, wages and household income. In J. A. Audley (Ed.), *NAFTA's promise and reality: Lessons from Mexico for the hemisphere* (pp.11–38). Washington, DC: Carnegie Endowment for International Peace.

Posner, Eric. (2017). Liberal internationalism and the populism backlash. *Arizona State Law Journal*, *49*, 795–820.

Provencio, Enrique. (2017). Contexto económico y social de una joven democracia. In R. Becerra (Ed.), *Informe sobre la democracia mexicana en una época de expectativas rotas* (pp. 119–126). Mexico: Siglo Veintiuno Editores.

Rasmussen, Chris, & Xu, Susan. (2016). ***Jobs supported by export destination 2015***. Washington, DC: Office of Trade and Economic Analysis, International Trade Administration, Department of Commerce.

Reagan, Ronald. (1998). **Radio address to the nation on the Canadian elections and free trade, November 26, 1988**. Retrieved from *The American Presidency Project*. Santa Barbara: University of California.

Rodrik, Dani. (2018). What do trade agreements really do? *Journal of Economic Perspectives*, *23*(2), 73–90.

Sands, Christopher. (2018). **The risks of missing the May deadline for NAFTA 2.0** [Online commentary]. Washington, DC: Center for Strategic and International Studies.

Secretaría del Trabajo y Previsión Social (STPS). (2018, September). *Información laboral*. Mexico: STPS.

Severns, Maggie. (2016, September 26). Trump pins NAFTA, "worst deal ever," on Clinton. *Politico*.

Sonneland, Holly. (2018). **NAFTA by the Numbers in 2017** [Blog post]. Americas Society / Council of the Americas.

Starr, Pamela. (2010). The two politics of NAFTA in Mexico. *Law and Business Review of the Americas*, *16*(4), 839–853.

United States International Trade Commission. (2016, June). *Economic impact of trade agreements implemented under trade authorities procedures* (Publication No. 4614). Washington, DC: United States International Trade Commission.

Villarreal, M. Angeles, & Fergusson, Ian. (2017). *The North American Free Trade Agreement* (Report No. R42965). Washington, DC: Congressional Research Service.

Wise, Carol. (2010). The North American Free Trade Agreement: A requiem. *CESifo Forum*, *11*(4), 3–8.

Notes:

(1.) The adoption of trade liberalization policies in Latin American countries was uneven. Whereas some countries, such as Mexico, began adopting pro-trade reforms during the

1980s, others, such as Argentina, began in the 1990s. For an overview see Morley et al. (1999).

(2.) Reagan's policies were not always pro free trade, however. For example, he negotiated voluntary quotas on the exports of Japanese cars to the United States.

(3.) At the time, Mexico was a competitive authoritarian regime.

(4.) While José López Portillo (1976–1982) was the last president from the Institutional Revolutionary Party (PRI) from the nationalist tradition, Miguel de la Madrid (1982–1988) was the first to adopt a series of pro-market measures, including Mexico's accession to the GATT.

(5.) In 1911, Sir Wilfrid Laurier, and 1948, Prime Minister William Lyon McKenzie King.

(6.) The vote in the three countries' legislatures was as follows: U.S. House of Representatives (234–200); U.S. Senate (61–38); Mexico Senate (56–2); Canada Parliament (140–124).

(7.) NAFTA had become so politically toxic that the expansion of free trade into the rest of Latin America had to take place under a new Free Trade Area of the Americas (FTAA), rather than through NAFTA's accession clause (Art. 2204).

(8.) Canada's labor productivity has remained at 72% of that of the United States (McBride & Aly Sergie, 2018).

(9.) Over the past decades, Mexico has signed free trade agreements that cover relations with 46 countries, only second to Chile in Latin America.

(10.) World Bank National Accounts Data.

(11.) This figure marks a slight decrease from the 88.7% peak observed in 2000, yet on the aggregate, the volume of trade has grown exponentially with little diversification of foreign economic ties.

(12.) At times these expectations were inflated with the goal of getting NAFTA approved by reticent legislatures.

(13.) At purchasing power parity, OECD Statistics, Average annual wages.

(14.) Socio-Economic Database for Latin America and the Caribbean (CEDLAS and the World Bank), Employment statistics

(15.) International Labor Organization.

(16.) This flow peaked in 2000 at an estimated 780,000 Mexican migrants (Passel, Cohn, & González-Barrera, 2012).

(17.) Word Value Survey.

(18.) Latinobarometer.

(19.) Word Value Survey.

(20.) At the time of writing (March 2019) the legislatures had yet to vote on the agreement.

(21.) For an overview of changes to rules of origin see Office of the United States Trade Representative (2018).

Gustavo A. Flores-Macías

Department of Government, Cornell University

Mariano Sánchez-Talanquer

Department of Politics, Centro de Investigación y Docencia Económicas