T. ROWE PRICE INSIGHTS

ON THE U.S. ELECTION



North American Trade Pact: More Certainty, Muted Impact



Agreement offers political points for both parties.

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ince the beginning of his 2016 presidential campaign, President Donald Trump has vowed to abandon trade agreements he believes hurt the U.S. economy. By replacing the North American Free Trade Agreement (NAFTA) with the U.S.-Mexico-Canada Agreement (USMCA), the president can state that he fulfilled his commitment to eliminate, in his words, "the worst trade deal of all time"—another step in his "Promises Made, Promises Kept" campaign.

But the new agreement—while perhaps having an only limited economic impact—offers talking points for those across the political spectrum.

In Trade, Much Like Politics, Timing Is Everything

Given the proximity of 2020 elections, U.S. politicians from both parties felt pressure to tout USMCA as an opportunity to help their constituents.

The president, beyond the headline fulfilling a key campaign promise, can say he's cut a better deal for American companies, agriculture, and workers. His chief trade negotiator, Robert Lighthizer, claims that bipartisan support for the USMCA shows "you can have a permanent trade policy if you get the balance right."



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Democrats especially were eager to get on board with the agreement. In 2018, they took control of the House by winning some swing districts that are suburban and more politically moderate. Passing the USMCA allows the party to demonstrate that it engaged in bipartisan negotiations and action during a legislative session defined by impeachment.

By touting that they achieved more stringent labor provisions within the USMCA, Democrats also can argue that they pushed through changes that will improve economic prospects for working Americans. Notably, the AFL-CIO, the nation's largest union federation, reluctantly signed off on the pact. Democrats also forestalled extended patent protections for biologic drugs, which will enable less-expensive, generic competition in the marketplace.

Though the USMCA provides more trade certainty, the new accord between the United States and its two largest trading partners only incrementally alters the status quo.

The USMCA's Incremental Impact

Both Republicans and Democrats can claim victories in the new North American trade deal.

DAIRY

Canadian quotas on U.S. dairy eased.

AUTOS

Raises "Rules of Origin" requirement to 75% from 62.5%. Adds minimum wage requirement (>40% of a car's value (>45% for light trucks) must be made in North American factories paying an average of at least USD 16/hr wage).



Summary of Changes

CURRENCY

"Loyalty clause" requires that countries maintain market-determined exchange rates and refrain from competitive devaluations of their currencies.

BIOLOGICS

House Democrats removed provisions that would have protected biologics for at least 10 years and locked in the process of "patent evergreening," thus ensuring any U.S. drug pricing affordability legislation would not contradict the USMCA.



SUNSET CLAUSE

Institutes a 16-year term for the USMCA, with a review and extension period at year six. NAFTA had no sunset clause, but it did include a six-month withdrawal notice.

Source: T. Rowe Price.

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As of mid-January, the USMCA had been approved by both houses of the U.S. Congress and by the Mexican government. Canada's passage of the accord will be required for full ratification.

Modest Changes

Though the USMCA provides more trade certainty, the new accord between the United States and its two largest trading partners only incrementally alters the status quo. An International Monetary Fund (IMF) analysis found that the USMCA's impact on the U.S. gross domestic product would be negligible in its current form, though the IMF said it would result in some material gain on specific industries, "mostly driven by improved market access."

Among the changes: 75% of automotive parts will have to be manufactured in the U.S. to qualify for duty-free treatment, up from 62.5% in NAFTA; 40% of cars' values (45% for light trucks) must be assembled by workers earning a

minimum USD 16-an-hour wage. (While this change will result in higher costs for U.S. manufacturers, T. Rowe Price auto analyst Joel Grant expects the U.S. auto industry to adjust.)

Moreover, the deal also will remove the Trump administration's tariffs on steel and aluminum imported from Canadian and Mexican firms. The Canadian dairy market, long closed to U.S. farmers, also will be more accessible. And the pact gives U.S. technology companies the freedom to transfer and store data across North American borders.

Pact Could Boost Confidence

While the USMCA makes modest changes to NAFTA, we believe it could be a significant contribution toward greater stability in North American trade by giving U.S. businesses more confidence to invest—even if that benefit comes from the reversal of uncertainty created by the Trump administration's initial threat to withdraw from NAFTA.

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