Assessing the Impact of USMCA Renegotiation

Key Policy and Economic Challenges

Federal Reserve Bank of Dallas

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The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.

Shifting trade priorities — from greater efficiency to more resilience

- For decades, global trade prioritized **efficiency and openness** under multilateral rules.
  - Today, governments—including the U.S.—are increasingly using **sanctions, industrial policy, and security goals** to steer trade.
- Trade is clustering into **trusted regional blocs—friendshoring** and **nearshoring** bring greater security but not always efficiency.

- Key challenge: balancing **resilience & competitiveness** in a fragmented world.
  - The **USMCA review** reflects this shift—from **global outsourcing** to **regional strategic resilience**.

USMCA — towards rules-based conditionality

Core provisions at a glance

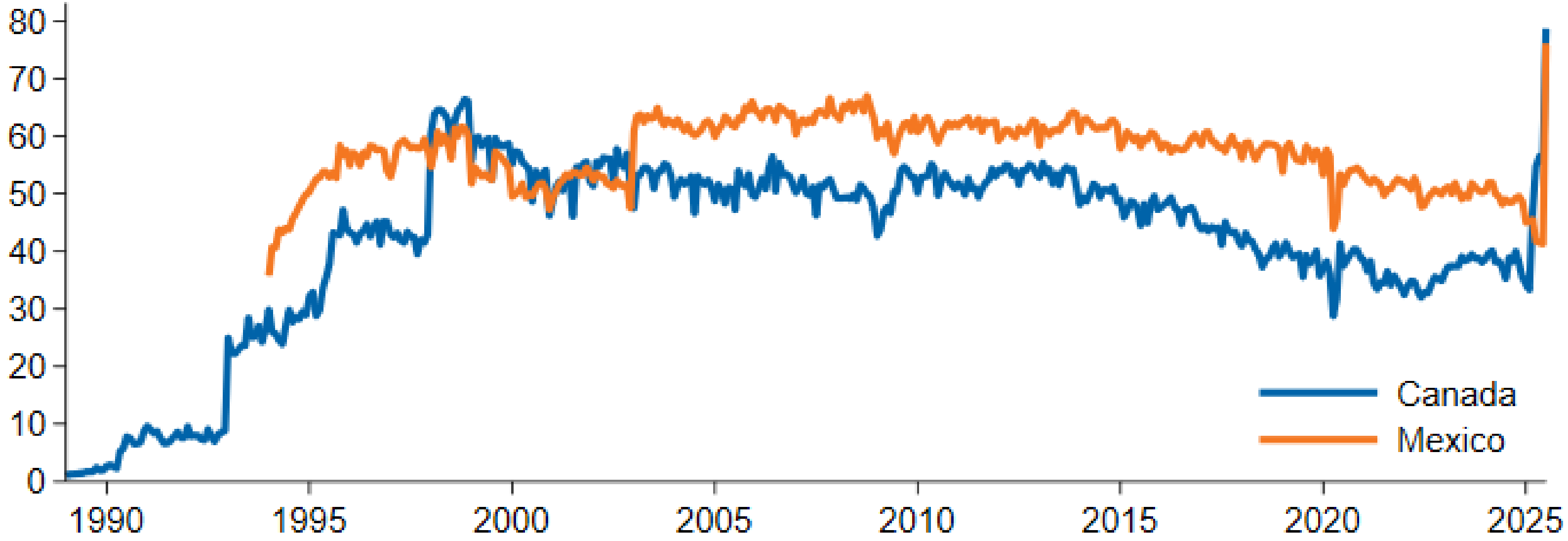
- **Market access & rules of origin (ROO)**: Stricter local content and wage rules deepen North American supply-chain integration.
- **Labor & environment**: Enforceable standards promote fair competition and sustainability across North America.
- **Digital trade**: Guarantees cross-border data flows and digital market access.
- **Investment**: Narrows investor–state arbitration to key sectors with domestic legal recourse.
- **Governance & review**: Adds a 16-year sunset and six-year reviews to keep the pact adaptable.

USMCA review — amid rising tariffs, trade fragmentation

- The **USMCA review** comes amid a new **tariff wave**, more **widespread** in country and industry coverage than the 2018-19 tariffs.
- Tariffs on non-USMCA goods **redirected trade toward compliant channels**.
    - Bowdle and Kamal (2025): auto compliance already **80-90%**; sharp increase in **crude oil and intermediates.**
        - **Hidden costs:** stricter origin, labor, and content rules add **1.4–2.5% ad valorem** in administrative costs—**$39–$71 billion** yearly.
    - Cebreros and Morán (2025): when **proof-of-origin costs** (inefficient sourcing) **exceed tariff savings**, firms skip preferential access.
- **Most North American trade now flows under USMCA terms**, softening the tariff shock for **Canada and Mexico** while deepening regional integration.

USMCA compliance rates at historically high levels

Share of imports for immediate use entered duty-free under free trade agreements, percent



NOTES: Imports for immmediate use, or for consumption, reflect the total nominal value of merchandise that has physically cleared through Customs either entering consumption channels immediately or entering after withdrawal for consumption from bonded warehouses or Foreign Trade Zones under Customs and Border Protection custody.
SOURCES: U.S. Census Bureau, accessed via the U.S. International Trade Commission's DataWeb at https://dataweb.usitc.gov; authors' calculations.

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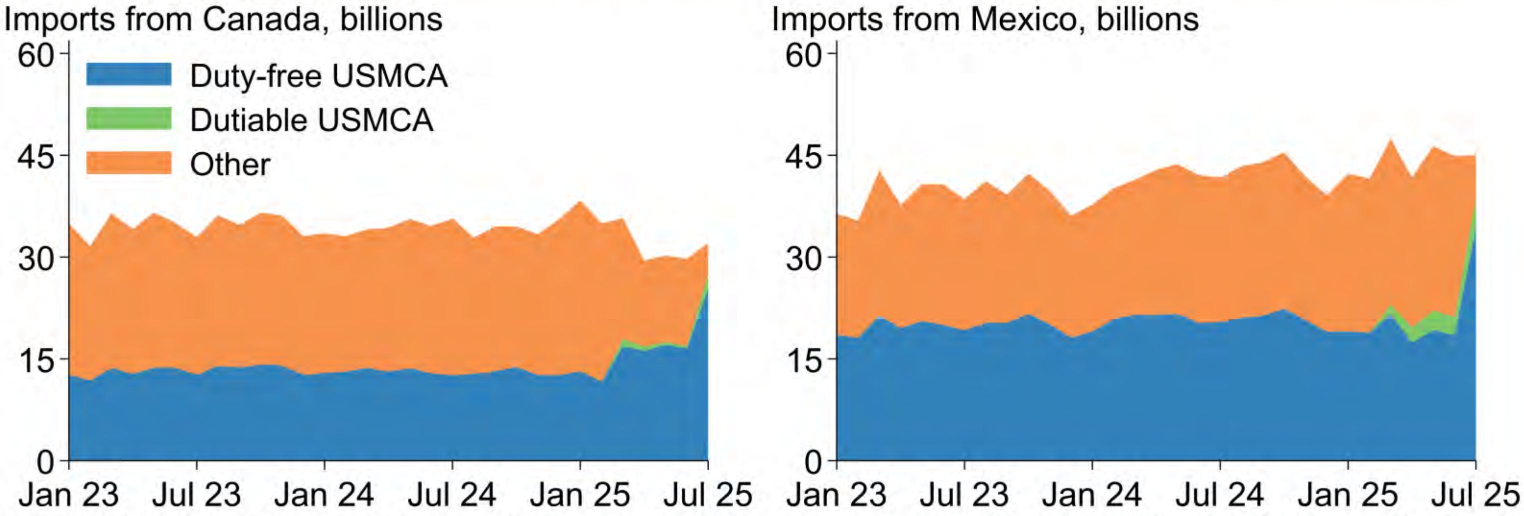
Courtesy of Ron Mau.

Rising USMCA compliance signals trade realignment, not imports decline



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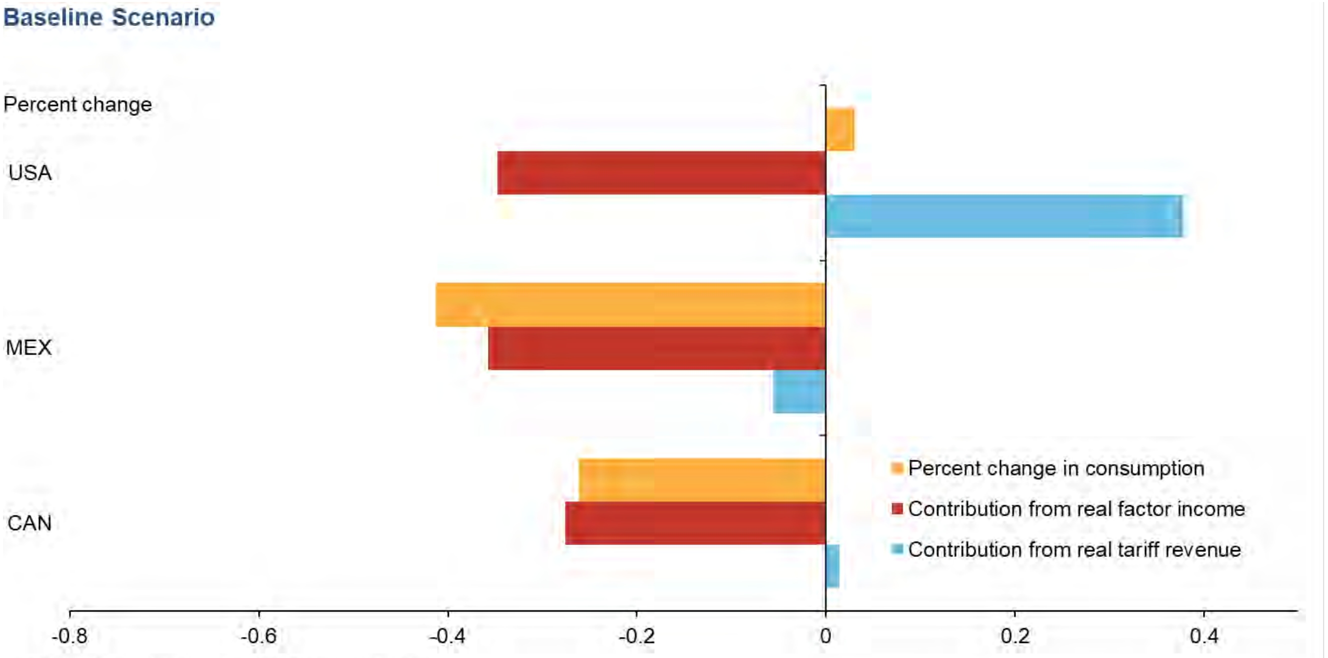
Tariff escalation and its economic consequences (as of September 2025)



NOTE: U.S. tariff schedule from September 2025.
SOURCES: Ana Maria Santacreu, Michael Sposi and Jing Zhang (2025): What Determines State Heterogeneity in Response to US Tariff Changes?
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Trade-offs: higher tariffs vs. tighter rules of origin

Higher tariffs on non-USMCA goods:

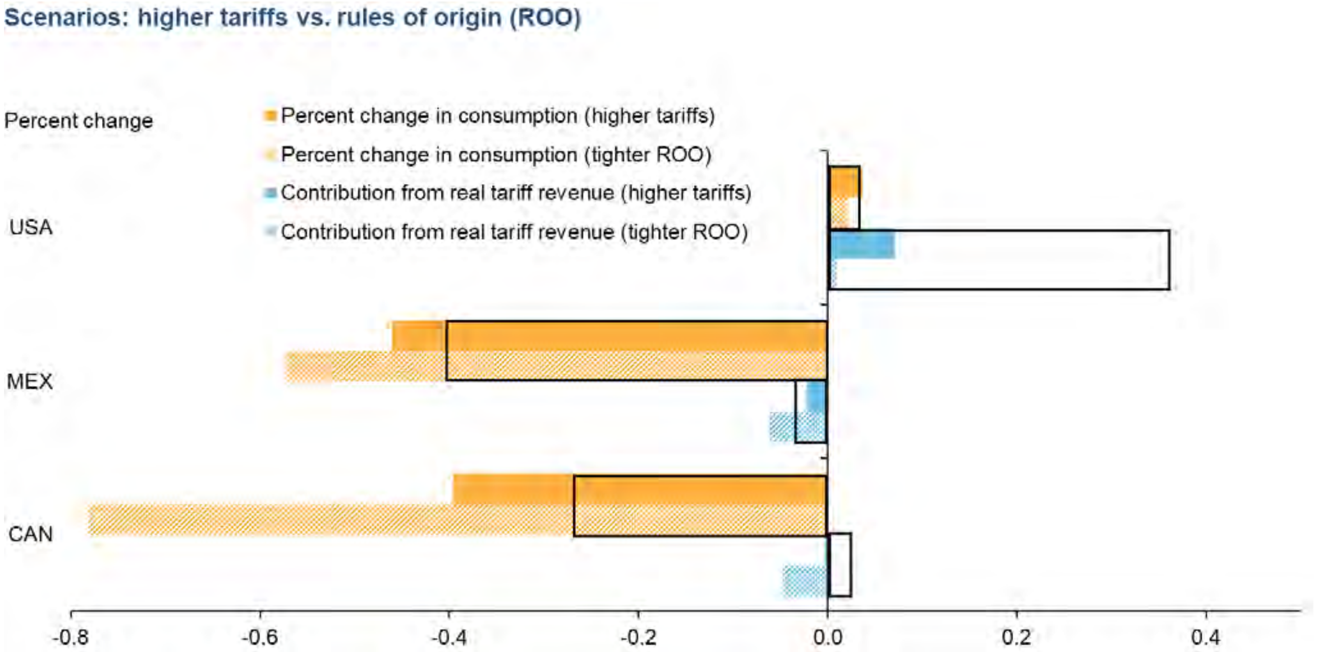
- U.S. raises tariffs within USMCA on non-compliant goods.
  - Mining / Metals / Computers & Electronics → max(25%, Sep 2025 rate)
  - All other sectors → max(5%, Sep 2025 rate)

Stricter ROO:

1. USMCA raises non-tariff barriers for imports to Canada and Mexico from outside North America by **25 pp.**
2. Tightening ROOs raises compliance costs, shifts incentives toward less efficient sourcing within North America.
   a. tariff-jumping FDI – an option?

Model outcome: Income losses for Canada and Mexico worsen with tighter ROO; U.S. impact minimal.

Trade-offs: higher targeted U.S. tariffs vs. tighter rules of origin



NOTE: Solid bars represent the higher tariffs scenario and dashed bars represent the stricter rules of origin scenario. Black unfilled lines represent the baseline based on the estimated effects from the tariffs in place as of September 2025.

SOURCES: Ana Maria Santacreu, Michael Sposi and Jing Zhang (2025): What Determines State Heterogeneity in Response to US Tariff Changes?

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Coordinated tariff policy: the North American trade bloc option

Full coordination:

- Mexico and Canada align tariffs with the U.S. on all non-USMCA partners.
- Yields **small U.S. terms-of-trade gains** → **lowers output losses for Canada and Mexico** (with higher tariff revenues).

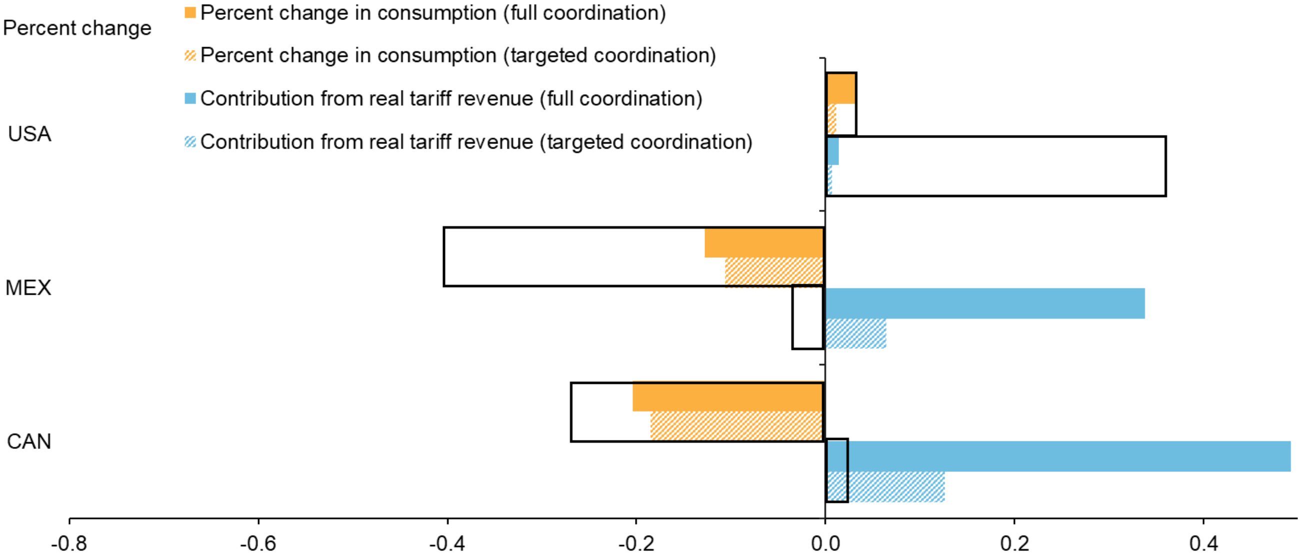
Targeted coordination (vs. China):

- Mexico and Canada mirror U.S. tariffs on China only.
  → Status quo: shared external Sep 2025 tariff schedule.
  → Escalation cases: max(50%, Sep 2025 rate) & max(100%, Sep 2025 rate).

Model outcome: U.S. effects remain limited under coordination (full or targeted), but turn into losses if there is an escalation. **Sectoral winners emerge in Mexico and Canada** (autos, semiconductors) as Chinese goods are displaced.

Coordinated tariff policy: the North American trade bloc option

Scenarios: full coordination vs. targeted coordination



NOTE: Solid bars represent the full coordination scenario and dashed bars represent the targeted coordination scenario. Black unfilled lines represent the baseline based on the estimated effects from the tariffs in place as of September 2025.
SOURCES: Ana Maria Santacreu, Michael Sposi and Jing Zhang (2025): What Determines State Heterogeneity in Response to US Tariff Changes?

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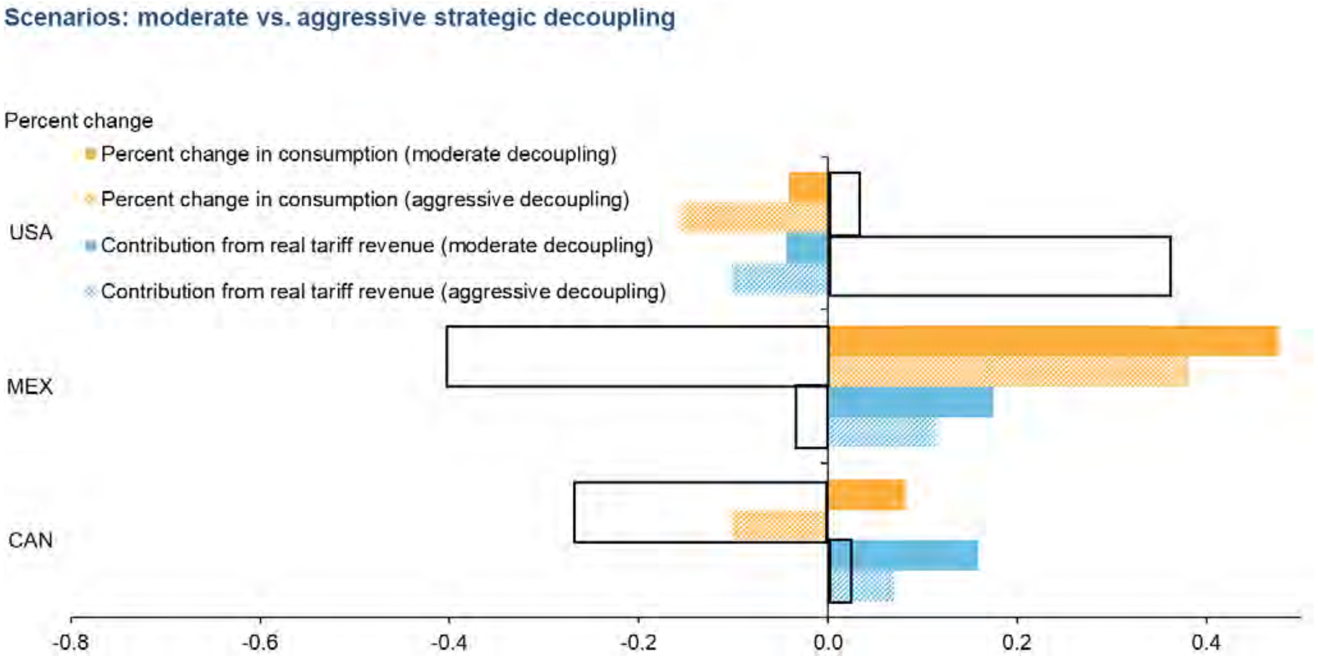
Coordinated tariff policy: the decoupling option



NOTE: Solid bars represent the moderate strategic decoupling scenario and dashed bars represent the aggressive decoupling scenario. Black unfilled lines represent the baseline based on the estimated effects from the tariffs in place as of September 2025.
SOURCES: Ana Maria Santacreu, Michael Sposi and Jing Zhang (2025): What Determines State Heterogeneity in Response to US Tariff Changes?
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USMCA renewal — some takeaways from scenario analysis

Evolving architecture: NAFTA's tariff liberalization → USMCA's rules-based conditionality (labor, local content) → toward more regionalization (USMCA 2.0)?

- **Tariffs vs. ROO:** higher U.S. tariffs or tighter sourcing rules worsen welfare, especially for Mexico and Canada.
- **Fragmentation:** regional blocs replace global integration — **restrictions on FDI** can deepen fragmentation, **erode North America's competitiveness**.

Coordination limits: even coordinated policies remain **largely zero-sum—or worse**—as country-level gains often translate into **regional losses**.

Institutional gaps: coordination scenarios **stops short of a customs union**, with **no shared mechanism to rebalance tariffs or share revenues**.

Analytical constraint: results hinge on the **terms-of-trade channel**, shaped by **fiscal policy and potential retaliation**.

- Big picture: The challenge is **balancing security, resilience, and competitiveness** in the next phase of North American integration.

Global Institute

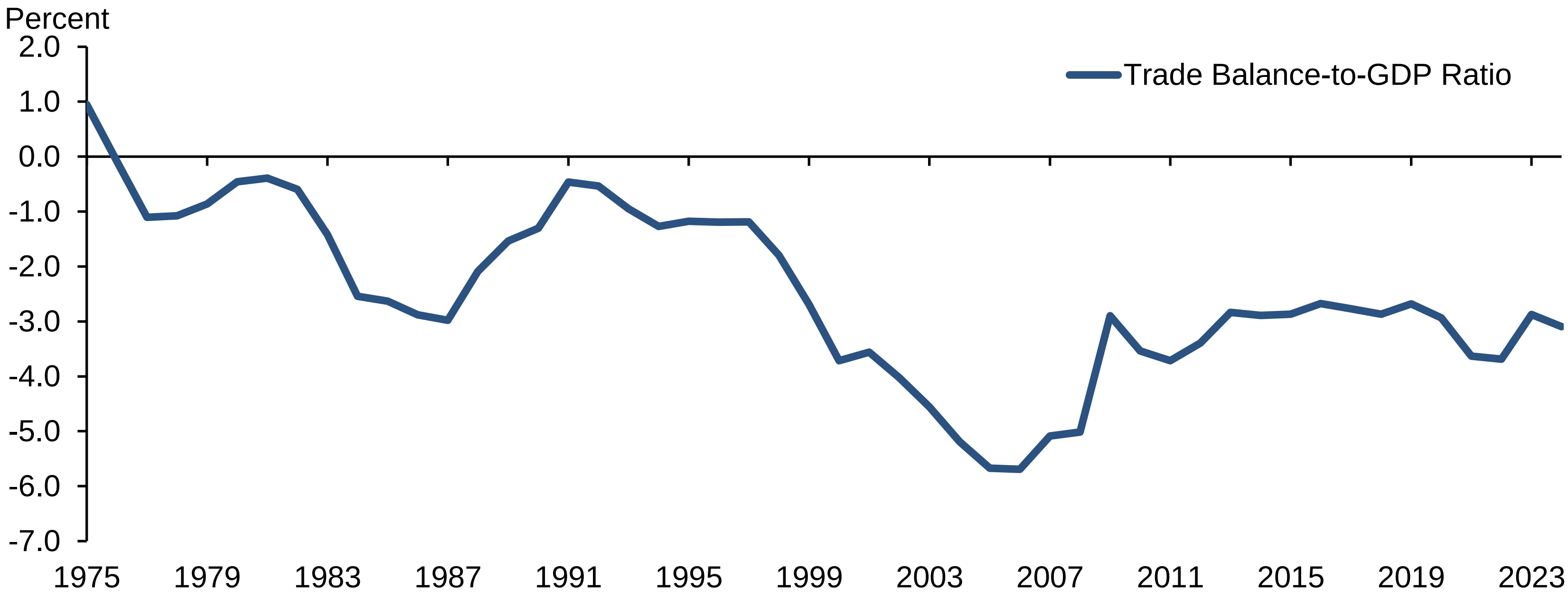
https://dallasfed.org/global

Overview of USMCA

Policy Area	Key Provisions	Objectives	Economic Impact
Market Access & Rules of Origin	• 75% regional value content for autos • 40–45% labor value content (≥ $16/hour) • Updated quotas for dairy, poultry, agriculture	Tightens regional supply chains; encourages production relocation within North America	Incentivizes **nearshoring** of intermediate goods, EV components
Labor & Environment	• Enforceable labor standards & collective-bargaining rights • Rapid-response labor mechanism • Environmental chapter with monitoring	Raises production costs but enhances social compliance and legitimacy	Shifts comparative advantage toward **formal manufacturing hubs** (Mexico’s northern states)
Digital Trade	• Ban on customs duties for digital products • Data-flow protection and no localization mandates • Source-code and algorithm safeguards	Reduces frictions in digital services; supports cross-border innovation ecosystems	Expands **service trade integration** (fintech, logistics, cloud services)
Investment	• Narrowed ISDS (U.S.–Mexico only for key sectors) • State-to-state dispute focus • Transparency, domestic court priority	Lowers investor arbitration risk exposure but adds compliance layers	Encourages **FDI aligned with strategic sectors** (energy, infrastructure)
Governance & Review	• 16-year sunset clause • 6-year review cycles • Institutional committees on competitiveness and SMEs	Embeds policy flexibility; promotes iterative alignment	Increases **policy certainty** while enabling periodic recalibration

45 years of persistent U.S. trade deficits

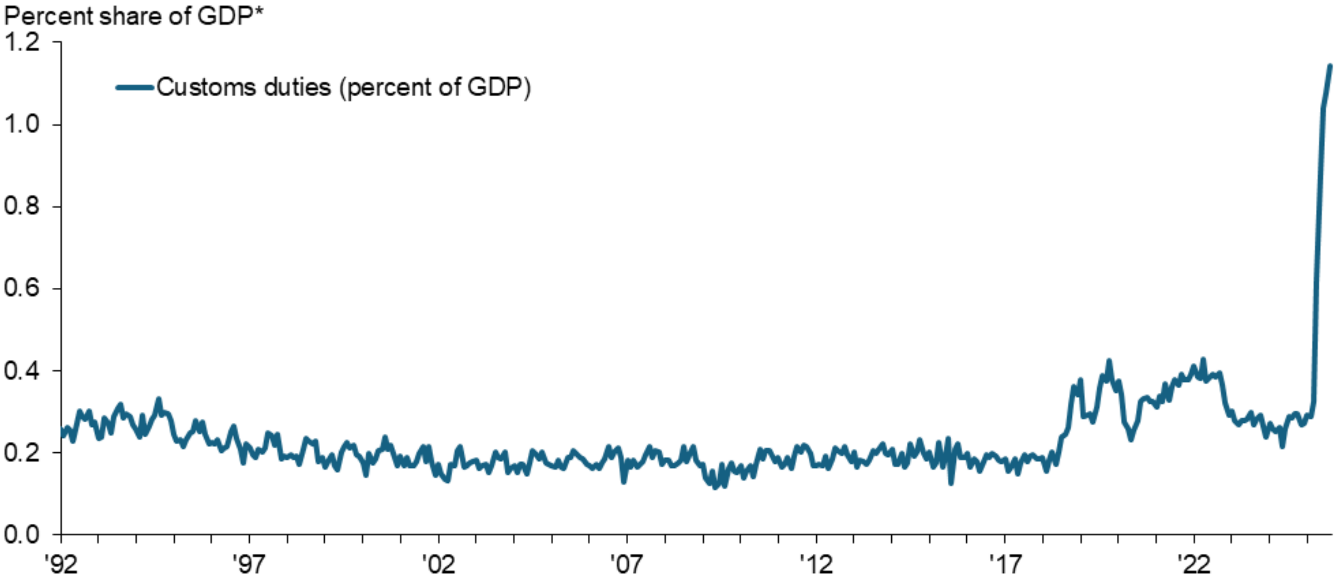
U.S. Trade Balance-to-GDP Ratio since 1975



Source: Bureau of Economic Analysis

Customs revenue surges toward 1% of GDP: a marked jump in 2025 collections

Customs duties rise in recent years as a source of government revenue



NOTE: Reported data show tariff revenue as a share of GDP based on a monthly GDP estimate. The ratio should be interpreted as the annualized share of GDP that would accrue if the monthly rate of tariff collection were sustained over the full year.

SOURCES: U.S. Treasury/Haver Analytics, S&P Global/Haver Analytics, authors' calculations.

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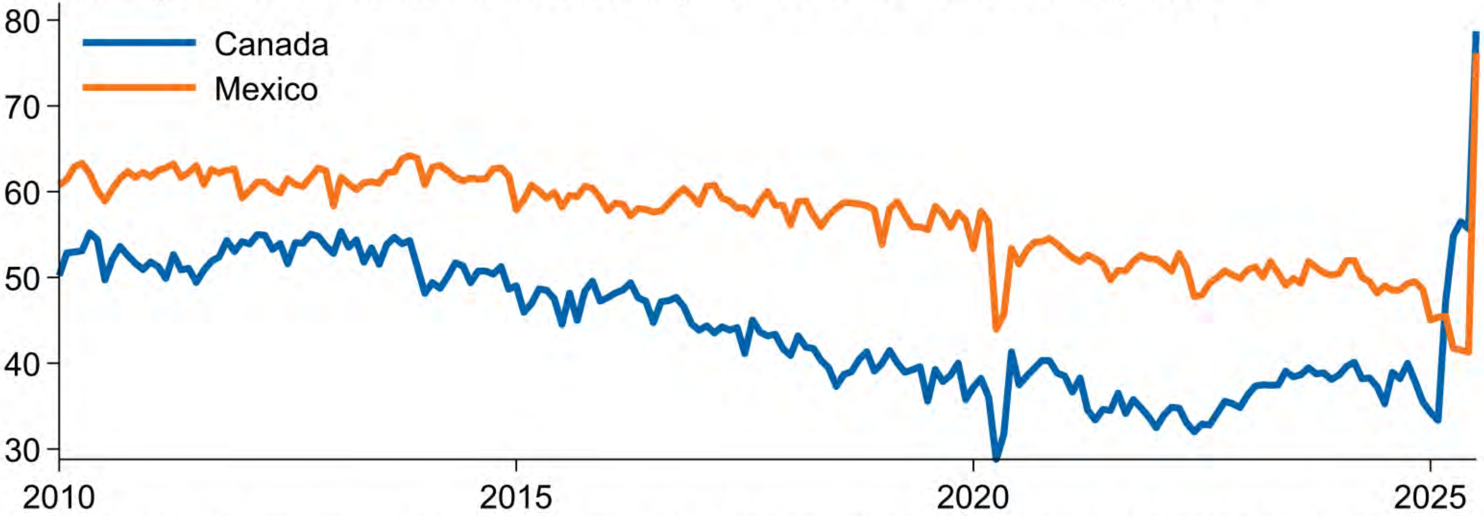
USMCA compliance rates rose sharply in 2025

Share of imports for immediate use entered duty-free under NAFTA/USMCA, percent



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Courtesy of Ron Mau.

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Some useful references

1. *What determines state heterogeneity in response to U.S. tariff changes?*, Ana Maria Santacreu, Michael Sposi and Jing Zhang, 2025
2. *A history of U.S. tariffs: quantifying strategic trade-offs in tariff policy design*, Enrique Martínez García and Michael Sposi, 2025
3. *U.S. tariff outcomes dependent on trading partner responses*, Enrique Martínez García and Michael Sposi, 2025
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7. *An anatomy of U.S. establishments' trade linkages in global value chains*, Aaron Flaaen, Fariha Kamal, Eunhee Lee and Kei-Mu Yi, 2024

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