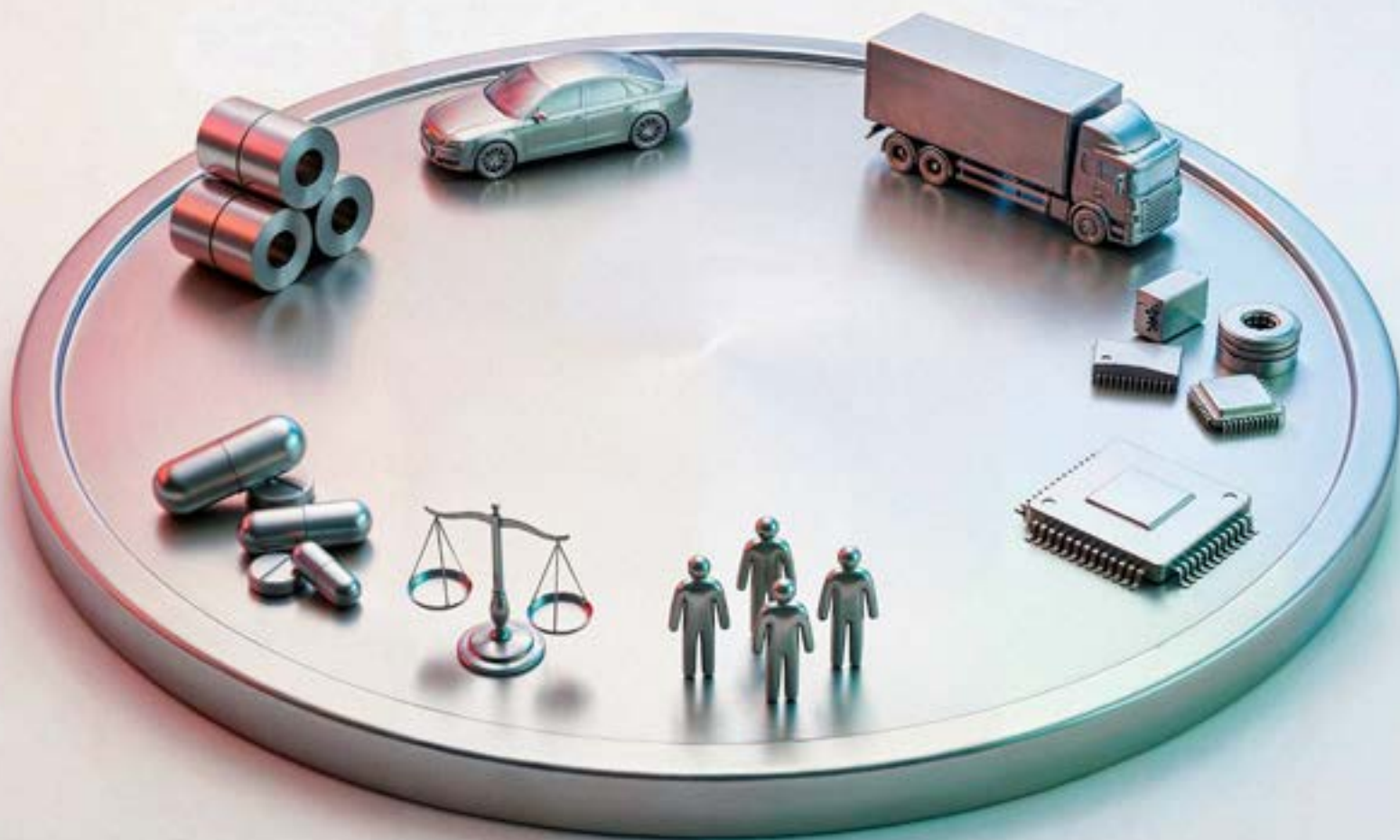


USMCA

FORWARD 2026

NAVIGATING THE JOINT REVIEW FOR A MORE SECURE AND COMPETITIVE NORTH AMERICA



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1. Joshua P. Meltzer served as editor of this report before transitioning to his new role at Amazon Web Services.

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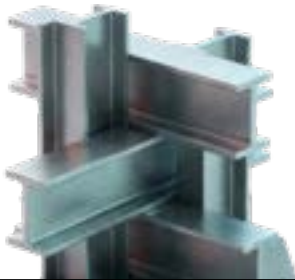
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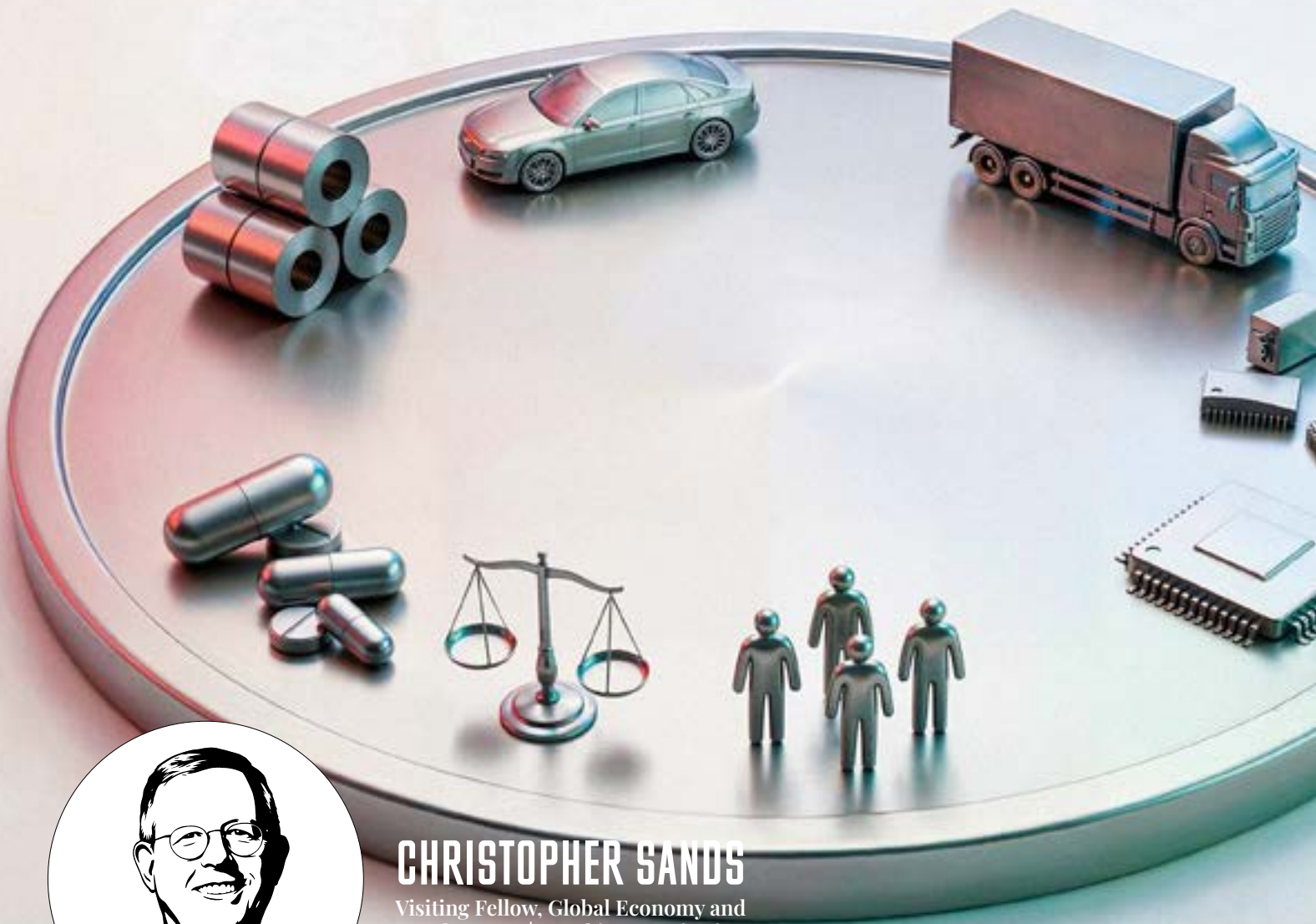
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UNITED STATES MEXICO CANADA AGREEMENT 2026: REVIEW AND DÉJÀ VU



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Eight years ago, in the second year of U.S. President Donald Trump's first term in office, North America was in a state of flux. The terms of the North American Free Trade Agreement (NAFTA) that had governed regional trade for a quarter century were being renegotiated. Whether the result would be a new NAFTA, or the end of NAFTA, was uncertain. The private sector paused investment until the outcome was clearer, and risk could be estimated.

Today, the Brookings Institution presents its 2026 USMCA Forward report, and a similar state of flux recurs. It is unclear whether the outcome of the first-ever joint review of the United States–Mexico–Canada Agreement (USMCA) will produce a renewal, revision, or termination of the agreement that was one of the most significant achievements of the first Trump administration.

Setting aside the uncertainty that hangs over this first-ever review of USMCA, it is worth acknowledging that the review itself is a positive development. NAFTA, like the Canada–United States Free Trade Agreement that preceded it, had no provisions for updates or adjustments. The conventional wisdom in Washington was that reopening NAFTA would precipitate its collapse. Yet because it had no mechanism for formal updates—and U.S. administrations under presidents of both parties agreed that it could not be reopened—NAFTA could not adapt to e-commerce, digital trade, or artificial intelligence and their impact on design and intellectual property protections. The USMCA corrects this shortcoming with the six-year review process.

As this is written, the review is proceeding and, as a new process, its dynamics are to some extent unpredictable. What is known is that the joint review leads to a decision that must be made by each of the USMCA member governments:

1. Whether to renew the USMCA for sixteen more years (with another joint review after six years);
2. Whether to withdraw from the USMCA (following a minimum of six months' notice to the other members); or
3. Whether to continue the USMCA without renewing it (in which case the agreement remains in force for ten more years and expires in 2036).

Each country must make its decision, but if one country chooses option 2 or 3, this will affect the others. If one country chooses option 3, continuation without renewal, then joint reviews like the current one will be conducted every year until all three agree to renew the agreement or it expires in 2036.

Following a Federal Register notice seeking input prior to the review, and stakeholder consultations and public hearings organized by the Office of the United States Trade Representative (USTR), U.S. Trade Representative Jamieson Greer briefed the Members of the House Ways and Means Committee on December 16 and the Members of the Senate Finance Committee on December 17 and posted his prepared testimony online.

Ambassador Greer told both committees that he was not prepared to recommend renewal of the USMCA to the president without changes. This signals that, for now, the United States is leaning in the direction of option 3, unless they obtain concessions during the joint review negotiations.

The prospect of nonrenewal of the USMCA makes the collection of analyses and viewpoints included in this edition of USMCA Forward pertinent for policymakers, the private sector, and concerned citizens in all three countries. For the continuation of the USMCA beyond 2036 depends largely on the United States—and possibly Canada and Mexico—being persuaded that, with certain changes, the agreement is worthy of renewal.

The contributors to USMCA Forward 2026 provide ten chapters offering expert analysis of what is working and where improvements are needed for the USMCA to achieve its potential. And, as in past editions, there are eleven viewpoints and essays written by government officials, private sector leaders, and civil society experts on the front lines of USMCA implementation that offer insights into how the agreement can be changed to win and sustain political support in Canada, Mexico, and the United States.

The chapter-length contributions begin with an assessment of the impact of the USMCA on trade and investment flows, the clearest performance indicators for any trade agreement. The co-authors of this chapter find growth in trade and investment and, in the past year, an increasing share of total trade that meets the USMCA rules of origin qualifying for tariff-free market access.

This good news is tempered by two chapters that address strains in U.S. relations with Mexico and Canada, respectively. In both cases, the threat of U.S. tariffs that drove businesses to shift toward greater USMCA compliance undermined the trust and confidence of stakeholders in Mexico and Canada in their relations with the United States. Our contributors see potential for the United States to improve its relationships with its two largest export markets, but they also offer candor about the damage done.

The remaining chapters delve into important sectors for USMCA trade and some key mechanisms of the agreement. Chapters on the automotive industry, steel, agriculture, and pharmaceuticals reveal the inner workings of the USMCA rules as well as the context of the various U.S. tariffs introduced under: Section 232 of the 1962 Trade Expansion Act; Sections 122, 201, 301, and 338 of the 1974 Trade Act; and the International Economic Emergency Powers Act (IEEPA) of 1977 (prior to the U.S. Supreme Court ruling against the use of IEEPA for

the issuance of tariffs). These chapters show sectors that are struggling to adapt to changing trade rules and persistent uncertainty.

Three additional chapters examine evidence on the performance of one of the USMCA's innovations, the Rapid Response Labor Mechanism in Mexico; the record of compliance with dispute settlement processes; and how labor is faring in each country—a critical concern of the Trump administration with regard to skilled labor in manufacturing. These chapters offer nuance and suggestions for improving how these USMCA provisions could evolve.

The eleven viewpoints include contributions from senior trade officials from Canada and Mexico. Ambassador Greer's congressional testimony provides an indication of the U.S. perspective that can usefully be compared with the Canadian and Mexican essays.

The remaining viewpoints come from leading trade associations and business groups, including the American Federation of Labor and Congress of Industrial Organizations. The consistent thread of optimism running through each contribution is striking. It is not optimism for the USMCA alone, but for the North American economy as a dynamic, competitive, and innovative regional production platform that draws synergies and fosters specialization through linkages connecting the U.S., Mexican, and Canadian markets.

For us, this optimism is a reason for hope that the ongoing USMCA review will lead to strengthened trade rules and sustained support for North American trade, investment, innovation, and competitiveness. The review process provides the opportunity for a serious assessment of the USMCA by all three countries. This edition of USMCA Forward is a timely contribution to the review process.



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DOMINIC LEBLANC
Minister of
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North America's economic partnership has been one of the most successful and deeply integrated in the world. Canada, the United States, and Mexico are bound not only by geography and history, but also by extensive trade and investment flows, seamless cross-border supply chains, shared values, and people-to-people ties.

For nearly a quarter century, the North American Free Trade Agreement (NAFTA) delivered prosperity for workers and businesses in the three countries. Since then, we have been able to build on the successful foundation laid by NAFTA by bringing into force the Canada-United States-Mexico Free

Trade Agreement—known as CUSMA in Canada, USMCA in the United States, and T-MEC in Mexico—on July 1, 2020. This modernized trade pact adapted and improved the rules of trade in light of substantial changes to technology and global trade patterns since the coming into force of the original agreement. It has been instrumental in strengthening our global competitiveness, fostering innovation, and ensuring continued shared prosperity.

The success of workers and businesses in all three countries depends on a predictable framework that leverages our respective strengths and maximizes gains from trade to the benefit of all citizens. Canada believes that this trilateral partnership is a strategic asset for the North American continent.

Today, our three countries face a rapidly evolving

HOW CAN THE USMCA SUPPORT A MORE COMPETITIVE NORTH AMERICA?

global landscape marked by geopolitical and economic uncertainty, technological disruption, and intensifying competition for strategic resources, investments, and talent. In this context, it is more important than ever that we work together to sharpen North America's competitive edge and prime it for the challenges of the 21st century. The USMCA provides a powerful platform to do just that.

Strengthening supply chain resilience and economic security

The success of the North American economy has been built on the integrated supply chains that span our continent, supporting millions of jobs and contributing to our shared prosperity. The smooth and efficient flow of goods and services across our borders is essential to maintaining the resilience of these integrated supply chains, which, in turn, are critical to economic

security. That is especially true for strategic resources and infrastructure—such as energy, critical minerals, and metals—that will become increasingly important as countries around the world seek to deploy new technologies, including robotics, quantum, and artificial intelligence at scale.

In this context, Canada is also concerned by the impacts of non-market policies and practices on our economic security. These policies and practices can hollow out strategic sectors of the North American economy, aggravate imbalances, and distort global markets. This is not good for North American businesses nor for its people.

These dynamics underscore the need for trusted partners to work together and take action to secure the critical sectors and resources necessary to maintain the competitiveness of our own markets. The USMCA provides

us with an ideal platform to protect and advance the most competitive and secure economic region in the world.

Enhancing investment climate and innovation with security and fairness in mind

The USMCA has strengthened North America's position as a unified economic bloc and a leading destination for investment. It provides greater certainty and predictability for investors and fosters cross-border collaboration in cutting-edge sectors by providing the degree of openness they need. This deep integration makes North America highly attractive for foreign direct investment, particularly in high-value sectors such as artificial intelligence, advanced manufacturing, semiconductors, and biotechnology.

World-leading intellectual property rules and robust regulatory cooperation under the USMCA encourage North American firms to invest in innovation and adopt new technologies and practices. In light of the intense competition to gain an edge in the aforementioned high-value sectors, transparency about foreign direct investment has never been more important—and through the USMCA, we can work together to protect our technological advantage and collective economic security.

The USMCA review: A strategic opportunity

The 2026 USMCA review offers a strategic opportunity to reaffirm the agreement's success. We believe that the fundamentals of the USMCA are still fit for purpose, and Canada will approach this process constructively, with a focus on ensuring the agreement is responsive to global uncertainty, enhances regional economic security and still reflects the aspirations of our citizens and businesses.

Throughout the review, Canada will be guided by four core principles: openness, reciprocity, stability, and predictability, which are key

to the ongoing success of the North American partnership.

We believe the review should reinforce the importance of integrated supply chains and a predictable regulatory environment. It should also explore ways to deepen cooperation in areas that are critical to our long-term competitiveness.

A vision for the future

North American competitiveness is not only about economic growth—it is about economic and national security, resilience, and leadership in addressing global challenges together. By leveraging our strengths, Canada, the United States,

and Mexico will continue to attract investment, create well-paid jobs, and lead the industries of the future.

To do that effectively, we should provide a high level of openness to each other's markets and promote stability in our economic relationships.

The USMCA is more than a trade agreement—it is a framework for strategic collaboration and shared prosperity. As we look ahead to the 2026 review and beyond, Canada remains committed to working with its North American partners to build the most competitive, secure, resilient, and prosperous economic region in the world.



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ROBERTO VELASCO ÁLVAREZ
Undersecretary for North
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Affairs | Government
of Mexico

In 2026, the United States–Mexico–Canada Agreement (USMCA) will undergo its first mandated joint review. This process will take place at a moment when, like Mexico itself, the international economic system is experiencing a profound transformation. The emerging paradigm is being shaped by geopolitical competition, a stronger role for industrial policy, and strategic concerns about the security and resilience of supply chains. For her part, President Claudia Sheinbaum is advancing a development program centered on welfare, social justice, and closing gaps while safeguarding macroeconomic stability and promoting investment.¹

Within this context of profound transformation, this article sets out three core messages to reflect on the joint review of the USMCA. First, it underscores the strategic importance of the USMCA in the current global environment. Second, it highlights the strategic implications of the review and how the agreement can support the priorities of our governments. Third, it outlines Mexico’s diplomatic approach going into the 2026 joint review, which consists of creating the right conditions for a beneficial outcome.

To begin with, in this evolving landscape, the USMCA is much more than a trade agreement; it is an anchor institution and a vehicle for advancing the interests of Mexico, the U.S., and Canada. It is an opportunity to turn economic integration into shared prosperity by easing cost pressures and supporting job creation across the region.

THE USMCA AND THE ROAD TO SHARED PROSPERITY IN AN ERA OF TRANSFORMATION

The three countries are co-producers within a deeply interconnected manufacturing base in which no country produces alone. Moreover, by promoting reliable access to inputs and goods, the agreement strengthens the strategic security of the region.

Second, to better understand what is at stake, it is helpful to examine the scale and depth of the region’s trade and investment ties. Mexico is not only the U.S.’ top trading partner but, alongside Canada, one of its two most important export markets. From January to November 2025, Mexico accounted for 15.4% of total U.S. exports. Of Mexico’s exports to the U.S., 87% complied with the USMCA as of November, ensuring that products meet the rules of origin specified in the agreement.² On investment, from 2020 to the second quarter of 2025, Mexico received \$106.2 billion in foreign direct investment

(FDI) from the U.S. and Canada, accounting for 51% of total FDI received in the period. The U.S. is Mexico’s top investor and is followed by Spain, Canada, Japan, Germany, the United Kingdom, the Netherlands, South Korea, and Australia.³

Importantly, the USMCA provides flexibility to pursue the objectives of each government. Increasing national production is not a zero-sum proposition given the region’s deep integration. President Sheinbaum’s Plan México seeks to raise Mexican value added within regional value chains. That means that Plan México will increase demand for U.S. and Canadian products and support high-paying jobs across all three countries. Mexico’s labor policy also contributes to this outcome. The minimum wage has increased by 154% since 2018 and has directly contributed to lifting 6.6 million people



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out of poverty, which also increases their purchasing power for imported goods.⁴

Third, Mexico's diplomatic approach ahead of the 2026 joint review has focused on managing its relationships with the U.S. and Canada effectively by keeping issues on separate tracks and addressing each on their own merits, while reinforcing our domestic economy. The goal is to create space for the USMCA to be strengthened and to continue serving as an effective instrument for our countries.

President Sheinbaum has led an active diplomatic effort with both the U.S. and Canada.

With the U.S., ensuring coordination and dialogue at the highest level on key issues, such as security, human mobility, and water has been a priority. On security, Mexico is fully committed to addressing this complex challenge. Early results are encouraging: The domestic security strategy has contributed to a 40% reduction in homicides and the dismantling of nearly 1,900 illicit drug laboratories.⁵ In addition to national efforts, following Secretary Marco Rubio's visit, Mexico and the U.S. announced a renewed security understanding that includes coordinated measures to combat illicit finance, drug and arms trafficking, and generators

of violence.⁶ Cooperation between our two countries has also contributed to reducing irregular migration flows significantly.⁷ On water management, both governments have strengthened their binational coordination under the 1944 Water Treaty and have worked to address sanitation challenges at the border.⁸

As it pertains to Canada, President Sheinbaum welcomed Prime Minister Mark Carney to Mexico City in September 2025 and announced the Canada–Mexico Action Plan 2025–2028.⁹ This whole-of-government approach initiative is designed to

deepen cooperation across shared priorities, including prosperity, mobility, security, and sustainability. This plan complements the USMCA, which remains one of the strongest pillars of the bilateral relationship.

In parallel, Mexico has implemented measures to transform its economy, consistent with President Sheinbaum's vision of "development with well-being, guided by the core principle of shared prosperity: for the good of all, the poor come first."¹⁰ For example, the increase in tariffs on more than 1,400 products imported from non-FTA partners is intended to raise the share of

domestic value added.¹¹ Other measures include significant labor market improvements, not only increases in the minimum wage mentioned above or the 2019 reform that strengthened union freedoms, but also a reform for digital platforms that entered into force last year and benefited 1.3 million workers, as well as the reduction of the statutory workweek from 48 to 40 hours.¹² Notably, Ambassador Jamieson Greer has echoed some of these actions and underscored the important role that Mexico plays in strengthening U.S. supply chain resilience in recent remarks.¹³

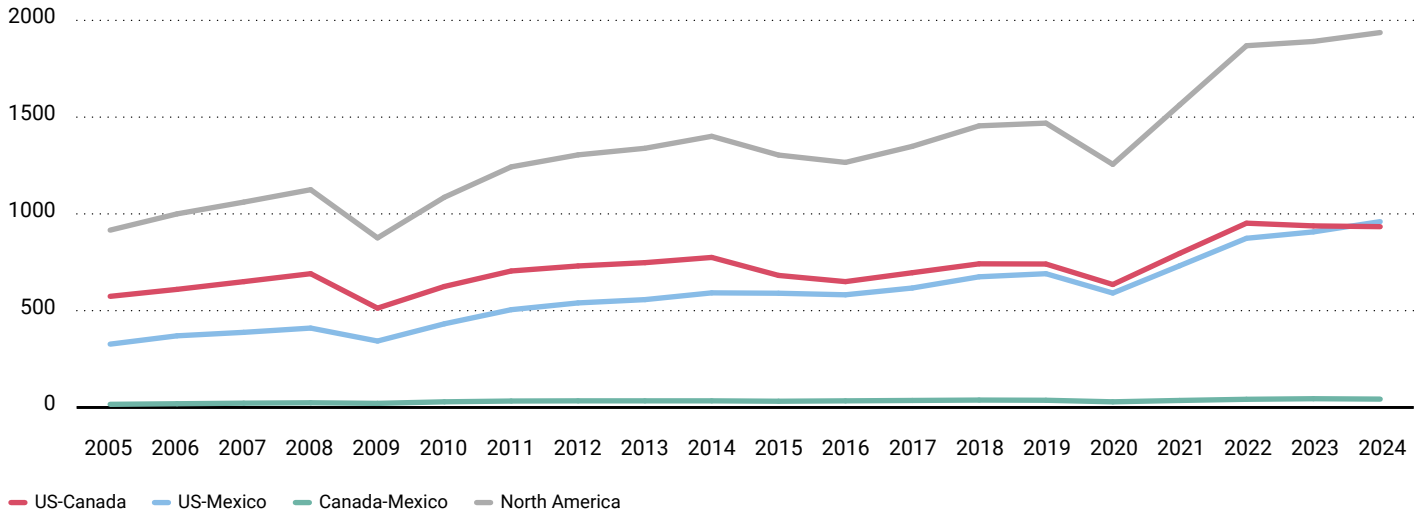
Finally, the principles that Mexico and the U.S. have agreed to guide their relationship can also serve as a useful compass for the review process itself: respect for sovereignty and territorial integrity, shared but differentiated responsibility, mutual respect and trust, and cooperation without subordination. Anchored in these values, the USMCA represents an opportunity to strengthen a partnership that is rooted in far more than commerce alone. Our countries are bound by history, deep people-to-people ties, strong cultural links, and a shared commitment to advancing prosperity and resilience. Together, these factors provide a lasting foundation for deeper economic integration.

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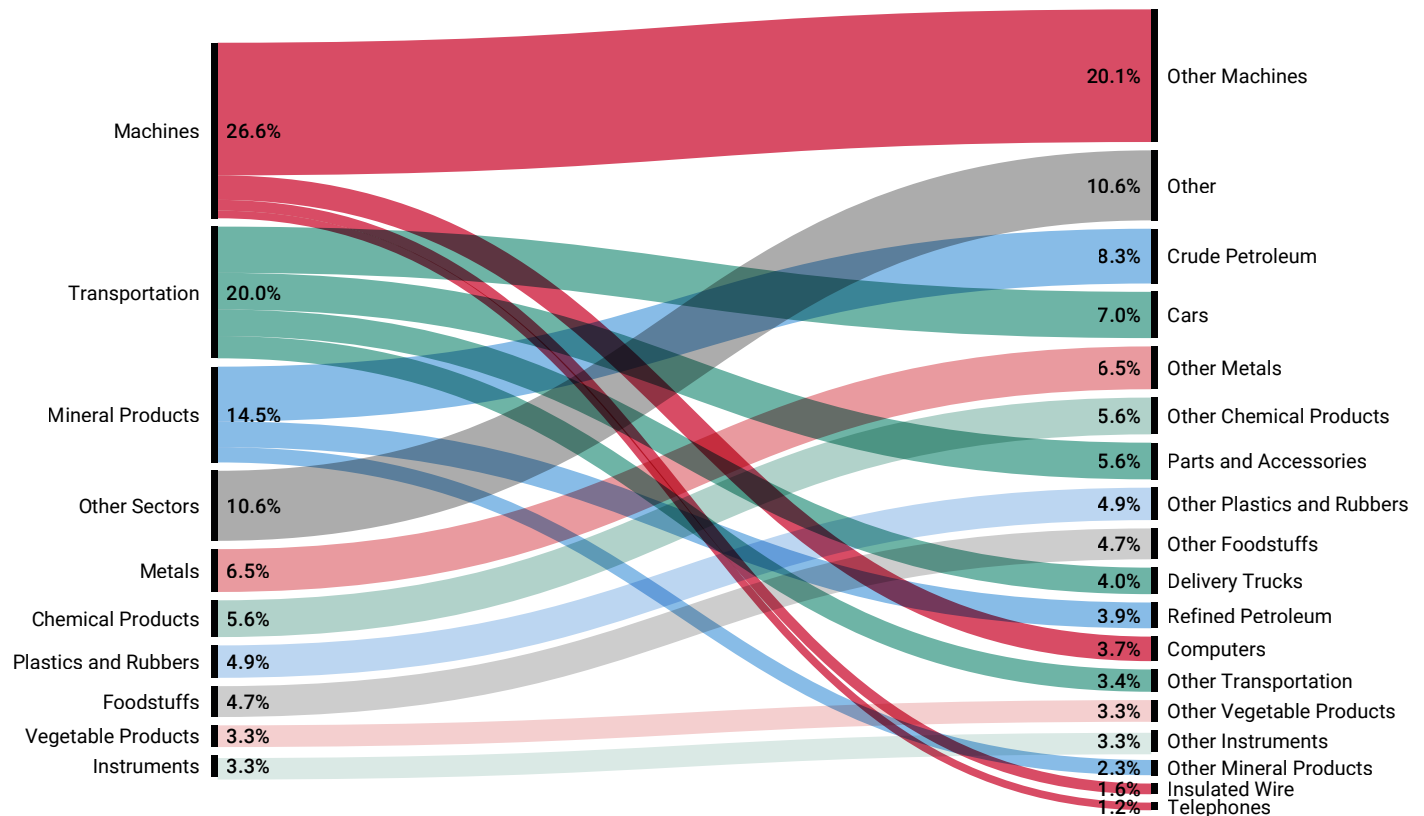
North American Trade at a Glance

USMCA TRADE REACHES A NEW HIGH TOTAL GOODS AND SERVICES BILATERAL TRADE, 2005-2024 (USD BILLIONS)



Source: U.S. Bureau of Economic Analysis, UN Comtrade, and Statistics Canada.

MANUFACTURING UNDERPINS USMCA TRADE USMCA INTRAREGIONAL GOODS TRADE, 2024

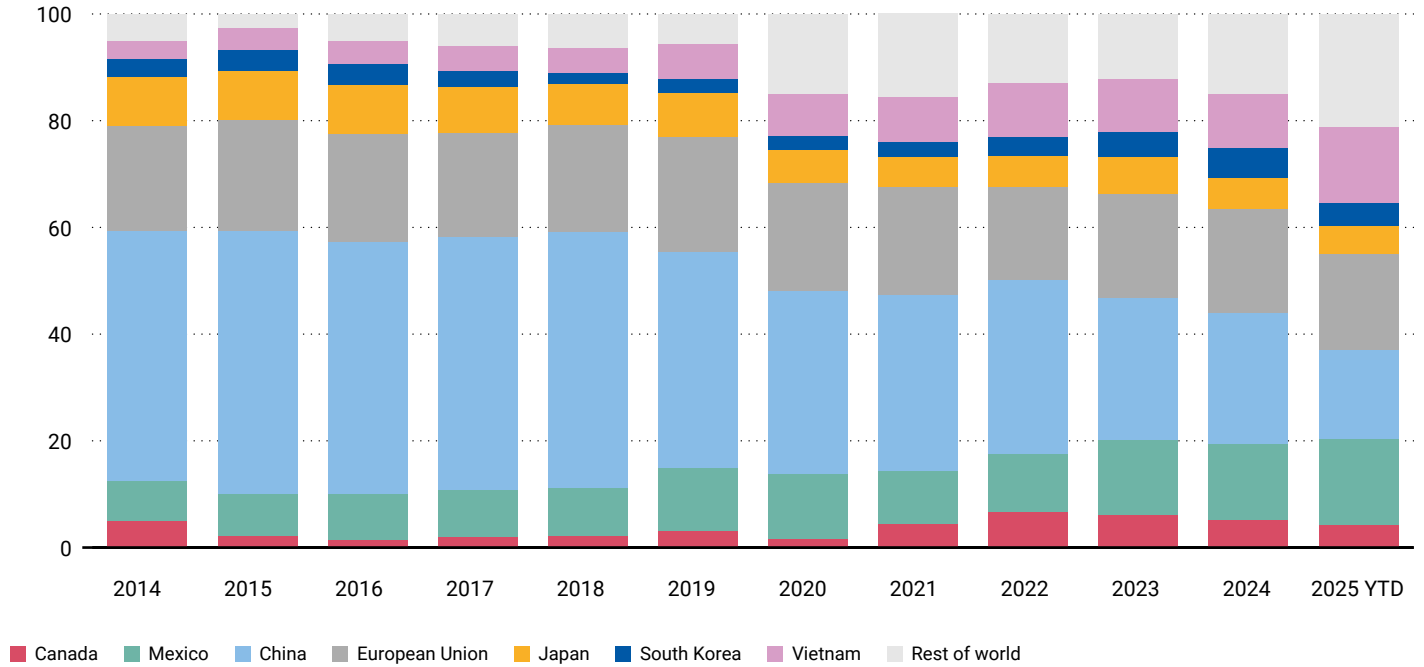


Source: BACI International Trade Database.

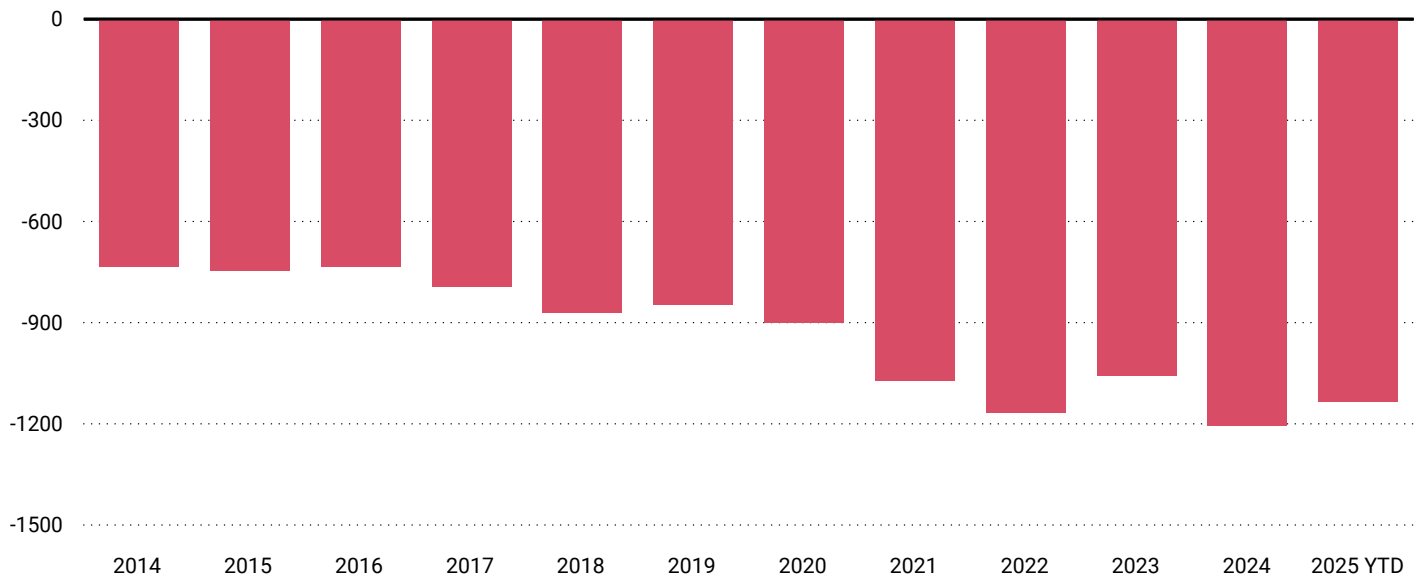
US MOVES AWAY FROM CHINA BUT GOODS DEFICIT GROWS

US GOODS DEFICIT BY PARTNER COUNTRY (%)

US goods deficit by partner country (%)



Total US goods deficit (USD billions)



Note: YTD: January - November.
Source: USITC Dataweb, Census Bureau.

TOP US JOB GAINS FROM TRADE WITH CANADA AND MEXICO ARE IN ADVANCED MANUFACTURING AND ENERGY

TOP 7 US STATES FOR JOB GROWTH SUPPORTED BY USMCA (2017 – 2023)

State	Jobs supported by USMCA (2017)	Jobs supported by USMCA (2023)	Net jobs gained (2017-2023)	Percent change (2017-2023)	Key sectors (jobs)
Oregon	26,877	41,180	14,303	53	Autos (12,491) Rubber (1,074) Misc. Base Metal Articles (603)
New Mexico	12,521	16,233	3,712	30	Machinery, Boilers, Nuclear Reactors (2,099) Electrical Machinery and Equipment (1,609) Mineral Fuels, Oils (203)
New Hampshire	8,870	10,188	1,318	15	Aircraft and Spacecraft (1,313) Machinery, Boilers, Nuclear Reactors (260) Optical, Photo, Medical Instruments (201)
Utah	19,176	20,457	1,281	7	Machinery, Boilers, Nuclear Reactors (729) Mineral Fuels, Oils (341) Electrical Machinery and Equipment (268)
Kentucky	44,944	45,947	1,003	2	Machinery, Boilers, Nuclear Reactors (2084) Mineral Fuels, Oils (369) Aircraft and Spacecraft (306)
Iowa	31,499	32,434	935	3	Oil Seeds and Fruits (1,536) Food Industry Residues (270) Mineral Fuels, Oils (241)
Minnesota	46,179	46,695	516	1	Cereals (1,385) Mineral Fuels, Oils (622) Autos (385)

Source: Brookings USMCA Tracker; Trade Partnership Worldwide LLC.

TOP CANADIAN JOB GAINS ACROSS PROVINCES FROM TRADE WITH THE US AND MEXICO ARE IN ENERGY AND ADVANCED MANUFACTURING

TOP 7 CANADIAN PROVINCES FOR JOB GROWTH SUPPORTED BY USMCA (2017 – 2023)

State	Jobs supported by USMCA (2017)	Jobs supported by USMCA (2023)	Net jobs gained (2017-2023)	Percent change (2017-2023)	Key sectors (jobs)
Alberta	250,425	563,965	313,540	125	Mineral Fuels, Oils (278,736) Machinery, Boilers (7,337) Meat (3,483)
Ontario	463,118	713,815	250,697	54	Autos (45,349) Machinery, Boilers (36,490) Precious Metals/Stones (26,931)
Quebec	243,226	366,775	123,549	51	Machinery, Boilers (19,689) Aircraft, Spacecraft (13,417) Precious Metals/Stones (10,307)
British Columbia	113,119	166,681	53,562	47	Mineral Fuels, Oils (27,149) Machinery, Boilers (5,017) Precious Metals/Stones (2,685)
Saskatchewan	45,018	69,804	24,786	55	Mineral Fuels, Oils (11,689) Fats & Oils (3,931) Machinery, Boilers (2,758)
Manitoba	40,016	60,247	20,231	51	Machinery, Boilers (4,138) Pharmaceuticals (2,374) Fats & Oils (1,887)
Newfoundland and Labrador	12,163	21,784	9,621	79	Mineral Fuels, Oils (7,319) Nickel (420) Fish & Crustaceans (384)

Source: Brookings USMCA Tracker; Trade Partnership Worldwide LLC.

TOP MEXICAN JOB GAINS BY STATE FROM TRADE WITH THE US AND CANADA ARE IN ADVANCED MANUFACTURING

TOP 7 MEXICAN STATES FOR JOB GROWTH SUPPORTED BY USMCA (2017 – 2023)

State	Jobs supported by USMCA (2017)	Jobs supported by USMCA (2023)	Net jobs gained (2017-2023)	Percent change (2017-2023)	Key sectors (jobs)
Nuevo León	343,737	664,152	320,415	93	Autos (80,946) Machinery, Boilers (65,364) Electrical Machinery (53,640)
Baja California	400,951	707,783	306,832	77	Autos (73,402) Apparel (Knitted) (38,631) Electrical Machinery (35,259)
Ciudad de México	503,480	800,675	297,195	59	Autos (145,397) Mineral Fuels, Oils (76,663) Railway Locomotives (20,202)
Chihuahua	481,972	720,447	238,475	49	Machinery, Boilers (56,972) Autos (53,103) Electrical Machinery (46,453)
Estado de México	287,448	516,874	229,426	80	Autos (121,787) Machinery, Boilers (19,248) Electrical Machinery (11,596)
Jalisco	382,990	597,535	214,545	56	Edible Fruit & Nuts (57,183) Autos (53,942) Beverages, Spirits (17,253)
Guanajuato	219,531	383,727	164,196	75	Autos (46,221) Edible Vegetables (23,516) Electrical Machinery (16,299)

Source: Brookings USMCA Tracker; Trade Partnership Worldwide LLC.

USMCA HAS STRENGTHENED ECONOMIC INTEGRATION IN NORTH AMERICA



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Introduction

Developments over the past year have made the USMCA more central to the international trade and manufacturing of the three North American economies, reinforcing the stakes for the 2026 USMCA review.

The USMCA compliance of Mexican and Canadian exports to the U.S. rose substantially in 2025—from less than one-half to almost 80% of trade value—as higher U.S. tariff rates for non-USMCA goods incentivized greater use of the trade agreement.⁵ Mexico continues to grow its lead as the top source of imports into the U.S., with Canada ranking second. And in 2025, Mexico closed in on Canada as the United States' top export market.

As U.S. direct imports from China continue to fall, this has increased attention on trade diversion of these Chinese exports and transshipment through third countries to the U.S. Such diversion or transshipment were not apparent in Mexico and Canada in 2025 trade data, however, with both countries also raising tariffs on select goods from China—and China's export growth was directed to other regions.

Uncertainty around the future of the USMCA contributed to subdued investment in Canada⁶ and Mexico,⁷ with manufacturing employment also weak on both sides of the U.S.-Mexico border in 2025. An enduring theme, however, is the continued growth and diversification of Mexican manufacturing. Analysis of the latest value-added trade data underscores the strong integration of North American manufacturing. This growth and integration increasingly apply to industries beyond the auto sector, such as computers and electronics, and medical devices. As mandated wage increases in Mexico have made some labor-intensive manufacturing less competitive, growth in higher value-added manufacturing areas point to one way in which USMCA may evolve.

Mexico solidifies role as principal US trading partner

Mexico became the top U.S. trading partner at the beginning of 2023, with total bilateral trade totaling \$873 billion in 2025. Canada is the U.S.' second-largest trading partner, with \$719 billion worth of trade during the same period. Both countries have surpassed China, which fell to third place, recording \$419 billion of trade with the U.S.⁸ In 2025, Mexico-U.S. trade represented 15.6% of all the goods exported and imported by the U.S.; the Canada-U.S. share followed at 12.8%, and with the China-U.S. share slumping to 7.5% (*Chart 1*).

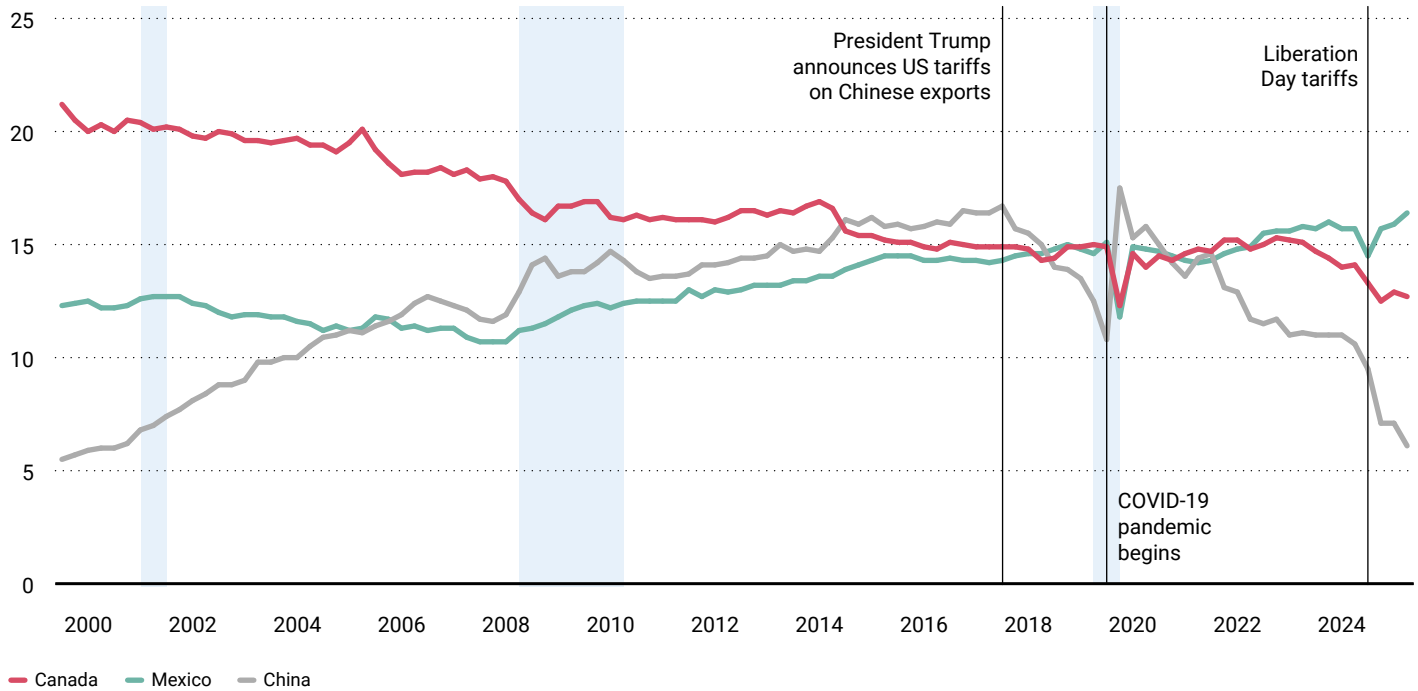
While Mexico has been the United States' largest source of imports since 2023, in 2025 Mexico was very close behind Canada as the United States' top export market. Together, Mexico and Canada absorb roughly one-third of U.S. goods exports—reinforcing the importance of North American markets and the USMCA for U.S. exporters.

Mexico's emergence as the U.S.' top trading partner followed, increasing U.S. trade tensions with China during the first Trump administration, prior to which China had moved past Canada to claim the top trading spot in 2014. The shift in U.S. trade back towards North America and away from China was reinforced by pandemic global supply chain disruptions that incentivized companies to build resiliency by moving operations closer to home.

Manufacturing drives rise in US-Mexico trade

Mexico's gains in U.S. import share have been driven by manufacturing as Mexico's expanding manufacturing base has offered an alternative to producing in China.⁹ Sourcing or producing goods in a nearby country is sometimes referred to as “nearshoring.”

FIGURE 1. MEXICO BECOMES TOP US TRADING PARTNER AT START OF 2023
SHARE OF TOTAL TRADE (%)



Notes: Data are quarterly, seasonally adjusted and run through November 2025. Shaded area refers to recession dates from NBER. Total trade is the sum of exports and imports. Liberation Day tariffs are a broad package of tariffs announced on April 2, 2025.

Source: Census Bureau.

While data on nearshoring-based new foreign investment is thin and evidence is mainly anecdotal,¹⁰ there has been a reinvestment of earnings by already established enterprises leading to an expansion of existing operations. The increased U.S. protectionism and related industrial policy are consistent with less global trade, more regional trade, nearshoring, and reshoring (the return of production to the home country).

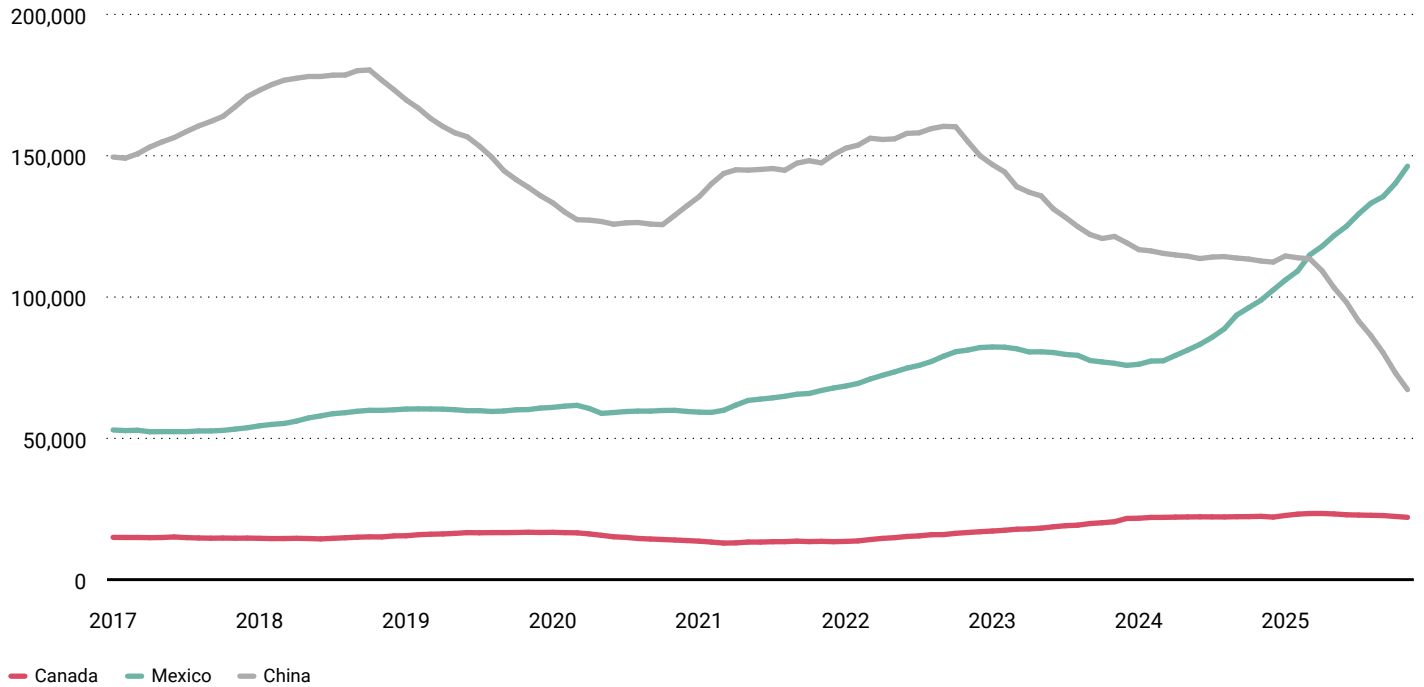
Total trade of manufactured goods between Mexico and the U.S. reached \$791 billion in 2025. Canada and China were second and third, with \$524.0 billion and \$387 billion, respectively, in manufacturing trade, with the U.S. bilateral manufacturing trade between Mexico and the U.S. accounting for 16.6% of all U.S. manufacturing trade; the Canada–U.S. share followed at 11.0%, and then the China–U.S. share at 8.1%.¹¹

Growing US-Mexico trade in computing equipment and electronics

While the motor vehicles sector continues to dominate U.S.–Mexico trade, accounting for 40% of U.S. goods imports from Mexico, more notable is the rapid rise in U.S. imports of Advanced Technology Products (ATPs) from Mexico, as measured by the U.S. Census Bureau (*Chart 2*).¹²

Mexico eclipsed China as the United States’ principal source of ATPs in 2025. With these advanced technology sectors including many of the most sensitive products in focus for U.S. economic and national security, this data points to the role and potential for further integration and complementarity of the North American manufacturing sector as U.S. “de-risking” from China proceeds.

FIGURE 2. US IMPORTS OF ADVANCED TECHNOLOGY PRODUCTS FROM MEXICO RISE RAPIDLY
DOLLARS (BILLIONS), 12-MONTH ROLLING SUM

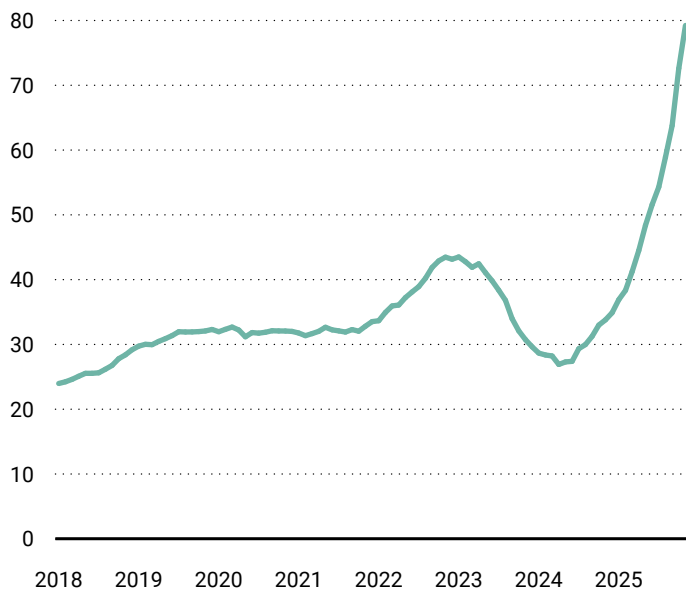


Notes: Data are through November 2025. The Census Bureau classifies as advanced technology products goods whose technology is in a recognized high technology field (e.g., information and communications, electronics, aerospace), and are leading edge in that field.

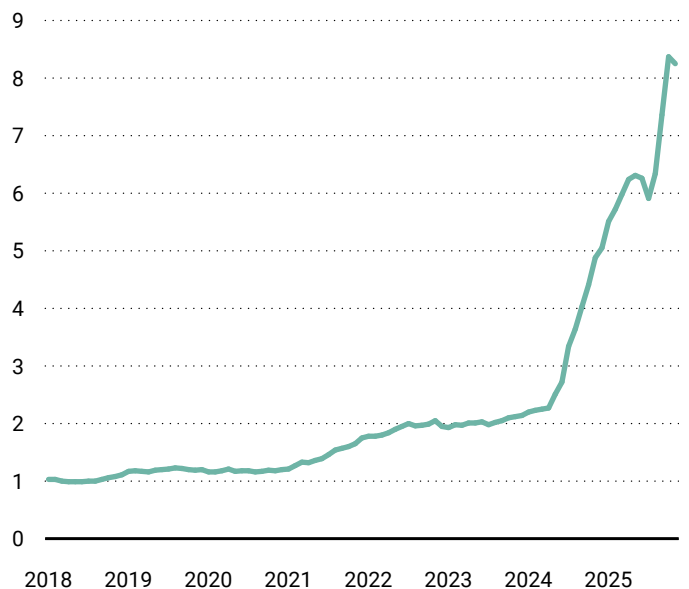
Source: Census Bureau.

FIGURE 3. MEXICO'S EXPORTS OF DATA CENTER EQUIPMENT ARE BOOMING
DOLLARS (BILLIONS), 12-MONTH ROLLING SUM

A. Mexico exports of data processing equipment



B. Mexico exports of server boards and parts



Notes: Data are a nominal, not seasonally adjusted and through November 2025.

Source: Banco de Mexico; Instituto Nacional de Estadística y Geografía (INEGI) (National Institute of Statistics and Geography).

Mexico’s manufacturing trade with the U.S., including ATPs, is part of global value chains in which intermediate goods are produced and traded between multiple countries before reaching the final U.S. consumer.

This trend has been particularly apparent in data servers and related equipment at the heart of the U.S. artificial intelligence (AI) data center buildout. Mexico’s overall exports of automatic data processing machines (HS code 8471), particularly data servers, motherboards and components for data centers, have more than doubled over the past year, exceeding \$79 billion in the 12 months ended in November 2025 (*Chart 3A*). Mexico’s exports of server boards and other parts for data servers (HS code 8473) are growing even faster (*Chart 3B*).

Mexico has also seen steady, if less rapid, growth in medical device exports, rising from \$9.0 billion in 2017, to \$20.6 billion over the 12 months ended in November 2025. U.S. imports of advanced technology products from Canada rose more modestly, reaching \$22.1 billion over the 12 months ended in November 2025. Aerospace products accounted for almost two-thirds of these imports, at \$13.7 billion.¹³

Mexico’s integration into global value chains

Mexico’s manufacturing trade with the U.S.,¹⁴ including ATPs, is part of global value chains in which intermediate goods are produced

and traded between multiple countries before reaching the final U.S. consumer.¹⁵

Measuring value added is the best way to estimate each country’s contribution to exported goods, since it accounts for inputs or previous production stages occurring outside its borders¹⁶. Estimating Mexico’s export value added allows assessment of the economic integration in North America and the degree of specialization in the region, as well as the extent to which goods from outside North America contribute to the region’s trade.

USMCA country partners’ value added in Mexican manufacturing exports to the U.S. increased modestly from 72.6% in 2017 to 73.7% in 2024, meaning that almost 74 cents of each dollar of manufactured goods exported to the U.S. from Mexico comes from North America (*Table 1*). The numbers reflect the strong intra-industry trade linkages in manufactured goods between the U.S. and Mexico, which are stronger than those with other countries. Mexican value added represents the majority share and has increased over this period, showing the movement of manufacturing activity towards Mexico due to the U.S.-China tariffs and post-pandemic supply chain shift. Also, the tariffs and supply chain changes have increased the participation of Chinese value

TABLE 1. MANUFACTURING VALUE ADDED IN EXPORTS FROM MEXICO TO THE US BY SOURCE (%)

Country	2017	2018	2019	2020	2021	2022	2023	2024
Mexico	48.9	52.6	56.2	56.2	57.0	57.7	58.8	54.5
Canada	1.1	1.1	1.1	1.2	1.0	1.0	0.9	1.0
China	6.5	7.2	7.3	7.2	9.0	8.1	6.9	8.3
USA	22.6	20.4	19.7	19.1	16.3	16.4	17.2	18.2
Other Asian Countries	6.8	5.9	5.6	6.1	6.2	5.1	5.0	6.6
Rest of World	14.1	12.8	10.0	10.3	10.7	11.8	11.2	11.5

Notes: Input-output tables from the Asian Development Bank. Other Asian Countries refers to India, Japan, Korea, Thailand, Taiwan and Vietnam. Borin and Mancini (2023) source based methodology.

Source: Authors’ calculations + Asian Development Bank.

TABLE 2. TRANSPORTATION EQUIPMENT VALUE ADDED IN EXPORTS FROM MEXICO TO THE US BY SOURCE (%)

Country	2017	2018	2019	2020	2021	2022	2023	2024
Mexico	50.8	53.5	56.6	57.3	59.8	60.5	62.5	57.2
Canada	1.1	1.3	1.3	1.3	1.1	1.1	1.0	1.0
China	4.8	5.3	5.9	5.8	7.2	6.5	5.4	7.1
USA	23.0	21.9	21.1	20.9	16.1	16.3	16.7	18.3
Other Asian Countries	6.4	5.4	5.2	5.2	5.4	4.5	4.3	5.6
Rest of World	13.8	12.5	10.0	9.6	10.3	11.1	10.2	10.8

Notes: Input-output tables from the Asian Development Bank. Other Asian Countries refers to India, Japan, Korea, Thailand, Taiwan and Vietnam. Borin and Mancini (2023) source based methodology.

Source: Authors' calculations + Asian Development Bank.

added at the cost of U.S. being further spurred by the rise of trade in computer and electronics.

The shift in U.S. trade policy and supply chain resilience led to a sharper increase in Mexican value added in the transportation sector, given the particularly deep manufacturing integration between the U.S., Mexico, and Canada, with almost 77 cents of each dollar exported from Mexico to the U.S. originating inside of North America (*Table 2*). The changes

in tariffs and supply chains also led to a decrease in U.S. value added and increase in Chinese value added.

The differences in value chain linkages can be seen in the value added heterogeneity across sectors, such as in Mexican exports of computer and electronics goods to the U.S. The share of U.S. value added is higher than that in other sectors, 22.9% in 2023, indicating greater use of U.S. inputs (*Table 3*).

TABLE 3. COMPUTER, ELECTRONIC, OPTICAL MANUFACTURING VALUE ADDED IN EXPORTS FROM MEXICO TO THE US BY SOURCE (%)

Country	2017	2018	2019	2020	2021	2022	2023	2024
Mexico	27.7	31.4	36.0	35.0	36.4	37.1	37.7	38.2
Canada	1.2	1.1	1.2	1.2	1.0	1.0	1.0	1.0
China	12.3	14.5	14.3	13.7	16.7	14.9	12.6	13.2
USA	29.0	23.8	23.7	22.9	20.1	20.6	22.9	21.9
Other Asian Countries	11.1	10.5	10.2	11.6	10.8	8.9	9.1	10.9
Rest of World	18.7	18.8	14.6	15.6	14.9	17.5	16.7	14.8

Notes: Input-output tables from the Asian Development Bank. Other Asian Countries refers to India, Japan, Korea, Thailand, Taiwan and Vietnam. Borin and Mancini (2023) source based methodology.

Source: Authors' calculations + Asian Development Bank.

Value added contribution from outside of North America—particularly East Asia—is higher than in other manufacturing sectors. However, Mexican value added has steadily increased, signaling an increase in manufacturing operations in Mexico in these sectors.

Data on intra-industry trade between the U.S. and Mexico also highlight the close integration of manufacturing production between the two countries. This is observed by the fact that Mexico and the U.S. are exporting and importing the same types of products. For example, the No. 1 U.S. export to Mexico, computer, and electronic products (21% share), is also the No. 2 U.S. import from Mexico (26% share). The No.2 U.S. export to Mexico, transportation equipment (13% share), is the No.1 U.S. import from Mexico (30% share) (*Table 4*).

Intra-industry trade or “production sharing” allows both countries to trade the same goods

at different stages of the production process, utilizing their comparative advantage, which is relatively capital-intensive production for the U.S. and labor-intensive for Mexico. Thus, the manufacturing process is efficient, allowing the region to consume at the lowest possible prices domestically while remaining competitive outside North America.

Some limited evidence of tariff circumvention, though little sign of new trade diversion in 2025

Some attention has focused on the growth of Mexico’s imports from China, including of intermediate goods, as a form of circumvention of the U.S. 2018–2019 tariffs on China. Circumvention is commonly viewed as arising when there is a change in the pattern of trade by businesses for the purpose of avoiding the payment of duties. A Brookings

**TABLE 4. TOP 10 US-MEXICO TRADED PRODUCTS
JANUARY- NOVEMBER 2025**

US Exports to Mexico		US Imports from Mexico	
Total (in billions)	\$309.80	Total (in billions)	\$492.50
Computer & Electronic Products (20.7%)	\$64.10	Transportation equipment (29.9%)	\$147.20
Transportation equipment (12.7%)	\$39.40	Computer & Electronic Products (26.4%)	\$129.90
Chemicals (8.7%)	\$26.90	Electrical Equipment & Components (9.0%)	\$44.30
Petroleum & Coal Products (8.5%)	\$26.20	Machinery, Except Electrical (6.4%)	\$31.30
Machinery, Except Electrical (6.9%)	\$21.40	Agricultural Products (3.3%)	\$16.30
Electrical Equipment & Components (6.7%)	\$20.80	Other Manufactured Commodities (3.1%)	\$15.10
Food & Kindred Products (5.0%)	\$15.40	Food & Kindred Products (2.7%)	\$13.40
Fabricated Metal Products (4.2%)	\$13.10	Fabricated Metal Products (2.5%)	\$12.30
Primary Metal Mfg (4.2%)	\$13.10	Beverages & Tobacco Products (2.1%)	\$10.50
Plastics & Rubber Products (4.0%)	\$12.30	Primary Metal Mfg (2.1%)	\$10.40

NOTES: Data are from January through November, 2025. Numbers in parentheses represent year-to-date shares through November 2025.

SOURCE: USATrade, Census Bureau.

Thus far, there is little sign in the aggregate trade data of Chinese exports being redirected to the rest of North America, either for “transshipment” to the U.S. or as end markets.

analysis found some circumvention occurring via Mexico, but at low level, and little evidence of circumvention through Canada.¹⁷ Increased China–Mexico trade has played a relatively modest role in Mexico’s export growth to the U.S., however, with the value-added data highlighting increased domestic content in Mexico’s exports.¹⁸

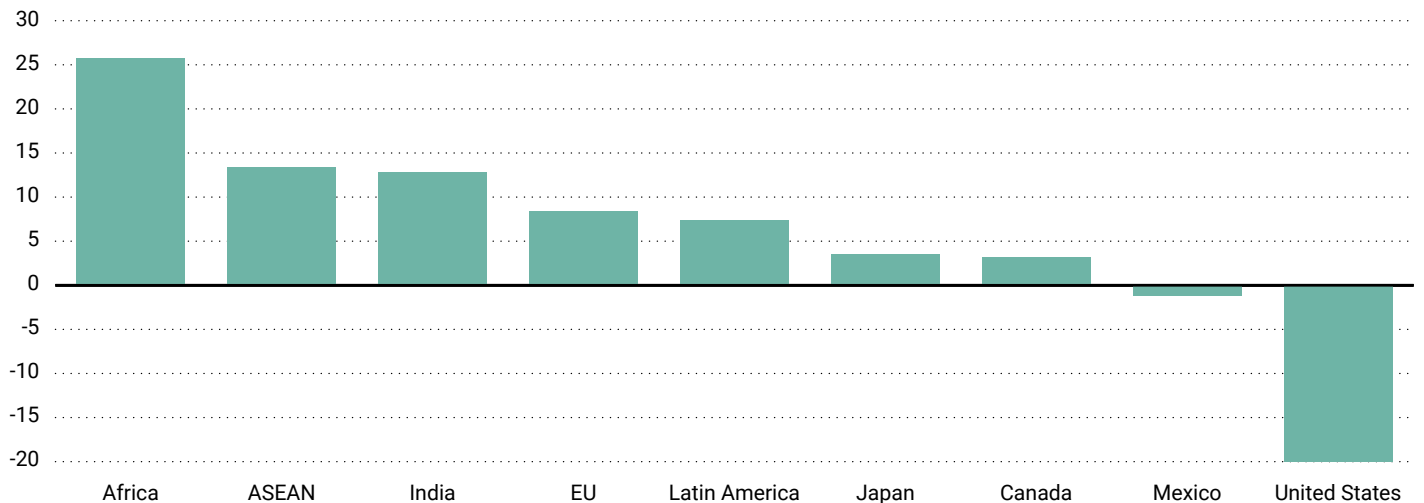
Another key issue is the redirection of Chinese exports to other markets following U.S. imposition of additional tariffs on China in 2025. With China’s overall exports continuing to grow rapidly, yet its exports to the U.S. declining a further 20% in 2025, a key question has been which countries will absorb this Chinese export surge.¹⁹ The U.S. government has also focused on potential transshipment of Chinese goods and content through third countries to the U.S.

China’s exports have shifted most notably to developing economies, continuing a recent trend—increasing 13.4% to the Association of Southeast Asian Nations (ASEAN) bloc and 25.8% to Africa. Among developed economies, the European Union has played the biggest role in absorbing China’s export surge, with China’s exports to the EU rising 8.4% in 2025 (*Chart 4*).

Thus far, there is little sign in the aggregate trade data of Chinese exports being redirected to the rest of North America, either for “transshipment” to the U.S. or as end markets. China’s exports to Mexico actually fell 1.2% in 2025 based on China customs data—after a steady rise over the past several years. China’s exports to Canada increased 3.2% in 2025, below China’s overall export growth of 5.5%.

Canada and Mexico have also imposed tariffs on China, which may be playing a role.²⁰ In 2024, Canada became the first economy to emulate U.S. tariffs on electric vehicles (EVs),²¹ steel, and aluminum from China²²—adding to these in 2025 to address trade diversion concerns and proposed additional tariffs that have not yet been implemented.²³ Mexico has steadily raised tariffs over the past two years on non-free trade agreement partners, including China, and approved significant additional tariffs in December 2025, taking effect at the start of 2026, ahead of the scheduled review of the USMCA.²⁴ Mexico’s latest measures increased tariffs by around 35% on the imports of auto parts, textiles, clothing, plastics, and steel, and 50% on autos, from non-free trade agreement partners,

FIGURE 4. PERCENT CHANGE IN CHINA EXPORTS TO KEY JURISDICTIONS, 2025 CHANGE, YEAR-OVER-YEAR



Source: People’s Republic of China, General Administration of Customs.

..the use of the USMCA has increased considerably as firms look to avoid U.S. tariffs imposed on goods from Mexico and Canada that do not meet the rules of origin of the trade agreement as most products traded under the USMCA remain tariff-free.

including China, India, South Korea, Thailand, and Indonesia.²⁵

USMCA trade rose following 2025 US trade policy shift

U.S. trade policy changed significantly in 2025. The average effective tariff rate for imports increased from 2.4% in 2024 to 16.9% in January 2026.²⁶ For Mexico and Canada, the average effective tariff rate increased to 12.8% and 8.1%, respectively. Goods from China are facing a much higher average effective tariff rate of 37%.²⁷

One key impact of these changes is that the use of the USMCA has increased considerably as firms look to avoid U.S. tariffs imposed on goods from Mexico and Canada that do not meet the rules of origin of the trade agreement as most products traded under the USMCA remain tariff-free. Tariffs on non-USMCA imports from Mexico are currently around 25%,²⁸ while Canada faces

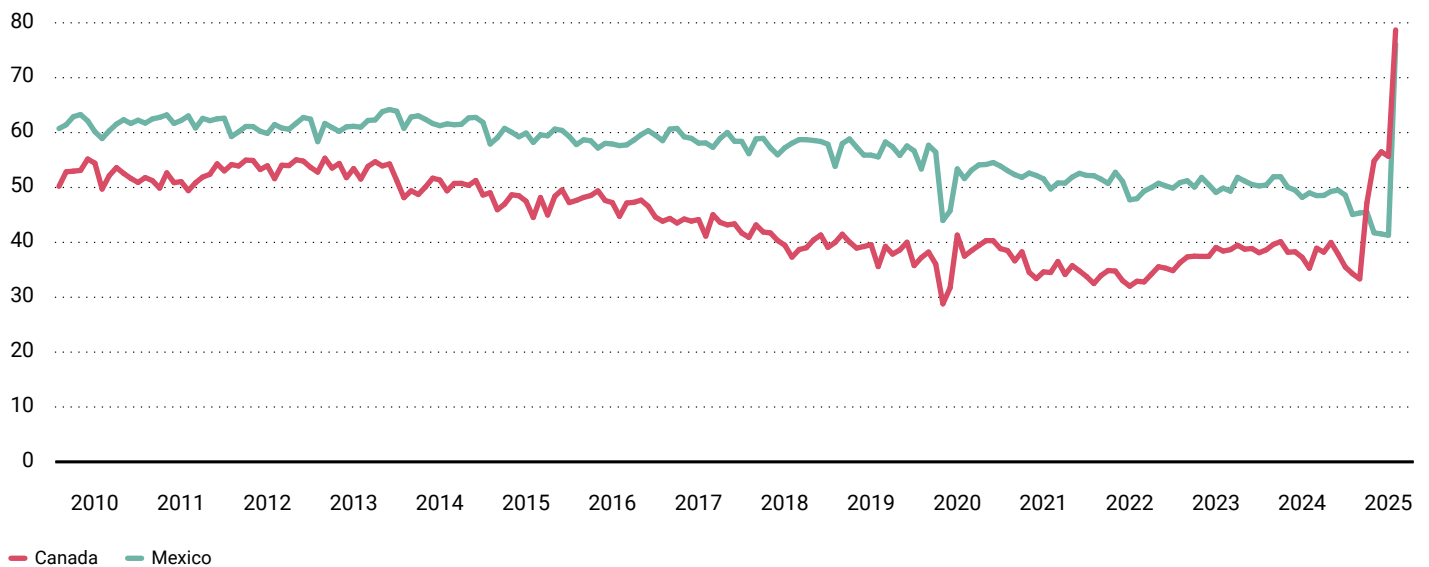
35% tariffs on non-USMCA goods.²⁹ A 25% tariff has been applied on passenger vehicles and light trucks from Canada and Mexico, while automotive parts qualifying for USMCA preferential treatment were granted a temporary exemption from the 25% tariff.³⁰ If a vehicle is USMCA compliant (meeting 75% regional value content, 70% steel/aluminum, etc.), the 25% tariff applies only to the value of the non-U.S. content.

USMCA compliance on all Mexican goods imported increased from 49.5% in December of 2024 to 76.1% in July of 2025 (*Chart 5*), while for all Canadian goods imported, compliance went from 35.5% to 78.7% during the same period.

In manufactured goods, compliance for Mexican-manufactured imported goods rose to 71.7% in July of 2025, and for Canadian goods to 48.9%. The increase in USMCA compliance can be observed across manufacturing industries except for transportation equipment, which has registered a decline due to the sector-specific U.S. tariffs on

FIGURE 5. USMCA COMPLIANCE INCREASED FOR ALL EXPORTS TO THE US FROM MEXICO AND CANADA

SHARE, NAFTA-USMCA DUTY-FREE / TOTAL IMPORTS



Note: Data are monthly through July 2025.

Source: U.S. International Trade Commission, Department of Commerce.

automobiles of 25% on non-U.S. content of USMCA compliant imports, and of 50% on the steel and aluminum content of imports.³¹

The automotive industry is facing a multitude of challenges from the tariffs and related supply chain concerns that have led to higher costs, fragmenting supply networks, and uncertainty. In addition, the transportation sector faces additional compliance costs to meet increasing complex trade regulations and reporting requirements. The transportation industry is Mexico’s leading industry representing 40% of total trade with the U.S.

Tariff uncertainty has restrained investment in Mexico, amid nascent pickup

Foreign direct investment (FDI) into Mexico has been relatively weak³² the past few years amid political uncertainty and questions surrounding the future of the USMCA.³³ FDI relative to Mexico’s GDP increased in 2025 after reaching a trough in 2024. However,

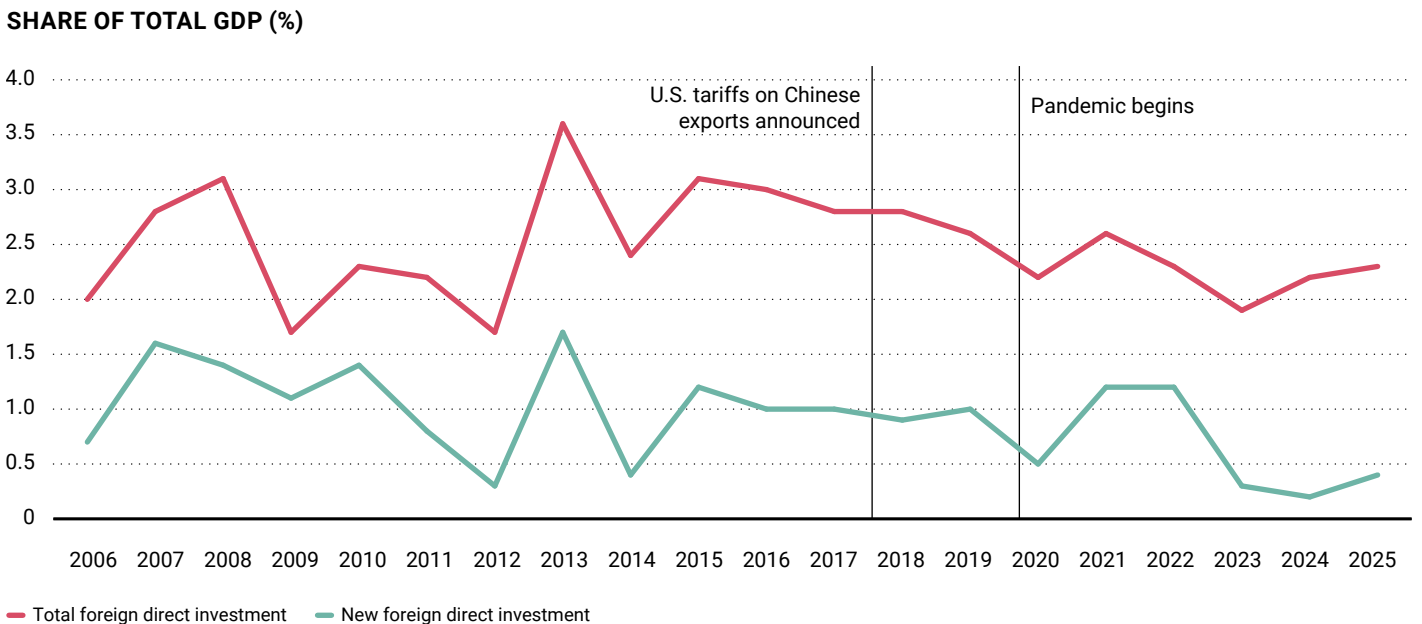
the 2025 pickup in FDI was mainly due to the reinvestment of profits as new FDI remains subdued (*Chart 6*).

Mexico experienced a moderate increase in new investment in 2021 to 2022, following the 2018 to 2019 U.S.–China trade war and USMCA taking effect in 2020. Since then, most activity has involved reinvested profits (brownfield investment), with relatively little new (greenfield) investment—the building of new production facilities (*Chart 7*).

Overall FDI reached \$40.9 billion over the first three quarters of 2025, a 14.5% increase from the full-year 2024 level. Significantly, Mexico has seen modest recovery in new investment to \$6.6 billion in the 2025 period—a tentative indication of renewed momentum for nearshoring, though still well below average 2015 to 2022 levels of \$13 billion.³⁴

The U.S. remains by far Mexico’s largest source of FDI, totaling over \$145 billion since 2017, more than 45% of total FDI during this period. Spain was the second largest investor over the period,

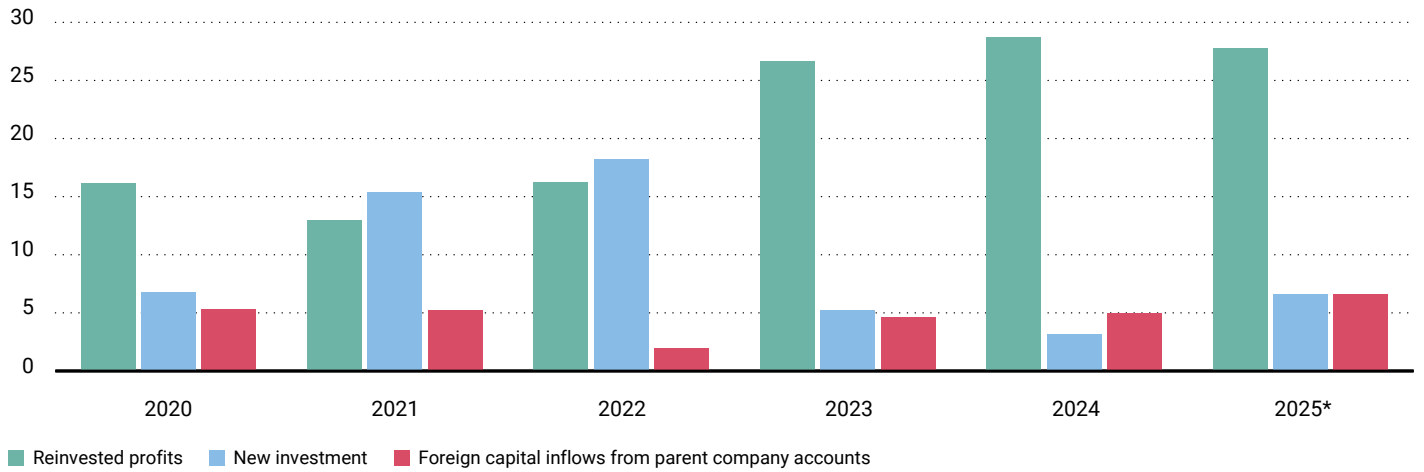
FIGURE 6. FDI RELATIVE TO GDP IN MEXICO INCREASES SINCE 2023



Note: Calculations use nominal figures. Data through third quarter 2025.
 Source: Secretaría de Economía (Secretariat of the Economy); adjustments by the Federal Reserve Bank of Dallas.

FIGURE 7. NEW INVESTMENT REBOUNDED MODESTLY IN 2025, THOUGH REINVESTED PROFITS CONTINUE TO DRIVE FDI

DOLLARS (BILLIONS)



*2025 through third quarter.

Source: Mexico Secretariat of the Economy; Banco de Mexico.

with \$36.5 billion in net FDI. Reinforcing the strong USMCA economic ties, Canada has been the third largest investor, at \$32 billion.

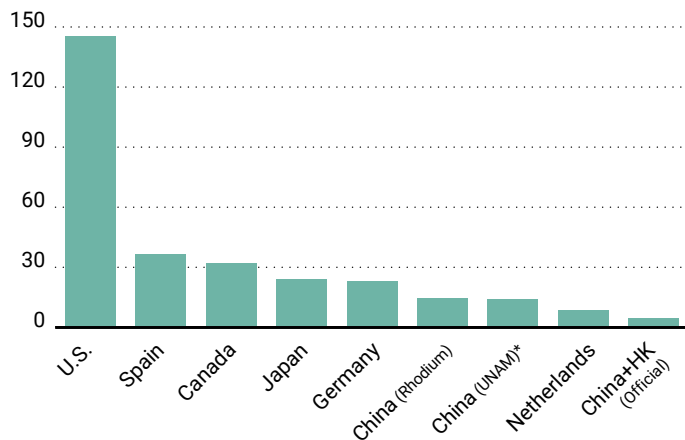
Investment from China—and how accurately it has been measured—has attracted significant attention.³⁵ China has been the fastest growing

source of investment into Mexico in recent years from a low level. Cumulatively, Mexico received \$2.9 billion in net FDI from China from 2017 to 2025, according to Mexican government statistics.³⁶ This amount rises to \$4.6 billion when including Hong Kong, a special administrative region of China.

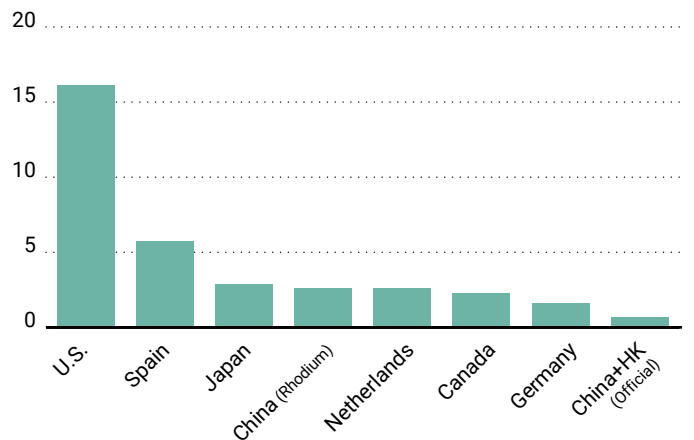
FIGURE 8. US AND ADVANCED ECONOMIES DOMINATE FDI IN MEXICO, WITH CHINA GROWING

DOLLARS (BILLIONS)

A. Cumulative FDI, 2017-25



B. FDI in 2025, Q1-Q3



Note: HK is Hong Kong. FDI is foreign direct investment.

Source: Mexico Secretariat of the Economy, National Autonomous University of Mexico (UNAM); Rhodium Group.

Alternate sources estimate Chinese FDI in Mexico to be considerably larger than official figures show—in part due to different methodologies.³⁷ However, even if relying on the higher alternate estimates, FDI from China into Mexico significantly trails that of the U.S. and also that of Canada, Spain, Japan, and Germany (*Chart 8*). Chinese FDI has been weighted heavily (almost two-thirds) towards new investment, which could partly explain the relatively high visibility and media attention on Chinese investment in Mexico.

The U.S. remained the largest source of FDI in 2025, at \$16.5 billion, 38% of this manufacturing and 32% in financial services. Spain was second at \$5.8 billion, mostly in financial services, with Japan third at \$2.9 billion, nearly all in manufacturing. Steady investment from China appears to have continued, with Rhodium estimating \$2.6

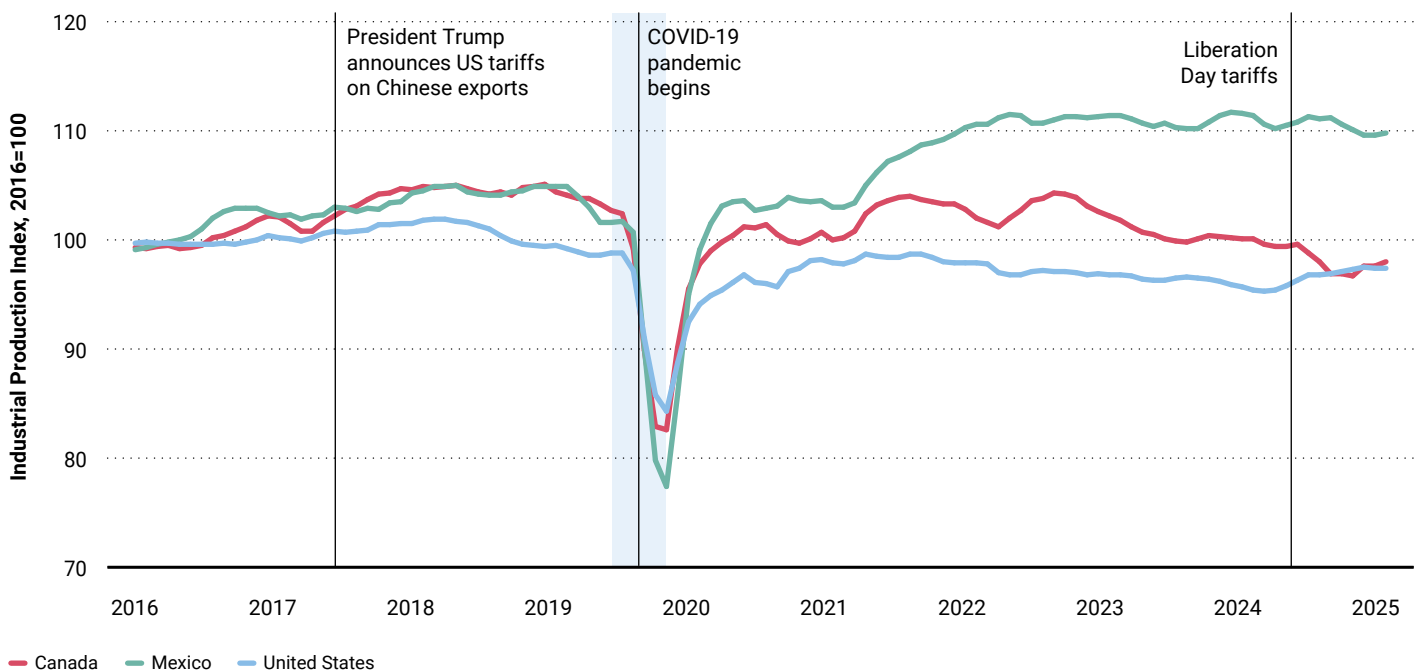
billion in completed transactions in 2025,³⁸ particularly in the auto parts sector, even as some Chinese investors are reportedly becoming more cautious about Mexico, given increased U.S. and Mexican government skepticism toward Chinese investments.³⁹

In the tariff environment Mexican manufacturing production rises but employment falls below 2018 levels

After the start of the U.S.-China trade dispute in 2018, manufacturing activity increased in all three USMCA countries, peaking in 2019 and subsequently slowing before the pandemic. All three recorded a post-pandemic rebound, but the U.S. and Canada never returned to pre-pandemic levels. Mexico’s manufacturing activity exceeded post-pandemic levels (*Chart 9*).

FIGURE 9. MANUFACTURING PRODUCTION IN US, CANADA BELOW PRE-CHINA TRADE DISPUTE LEVELS

INDUSTRIAL PRODUCTION, 2016 = 100



Note: Seasonally adjusted and three-month moving average. Shaded area refers to recession dates from NBER. Data through November 2025. Liberation Day tariffs are a broad package of tariffs announced on April 2, 2025.

Source: Bureau of Labor Statistics; Banco de Mexico; Instituto Nacional de Estadística y Geografía (INEGI) (National Institute of Statistics and Geography) and Statistics Canada.

Manufacturing production appears to have peaked in 2023 in both Mexico and Canada, subsequently stabilizing in Mexico while falling in Canada. The U.S.’ manufacturing activity reached its peak in 2022 and trended lower until 2024.

Employment has followed a somewhat different path. Mexican manufacturing employment is below 2018 levels and has been following a downward trend since 2022. Similarly, U.S. manufacturing employment trails 2018 numbers and has been losing jobs ever since 2022. In contrast, Canadian manufacturing employment was on an upward trajectory since the pandemic until 2023, stabilizing after that (*Chart 10*).

Outlook: Manufacturing employment in Mexico facing headwinds from tariff uncertainty and increased labor costs

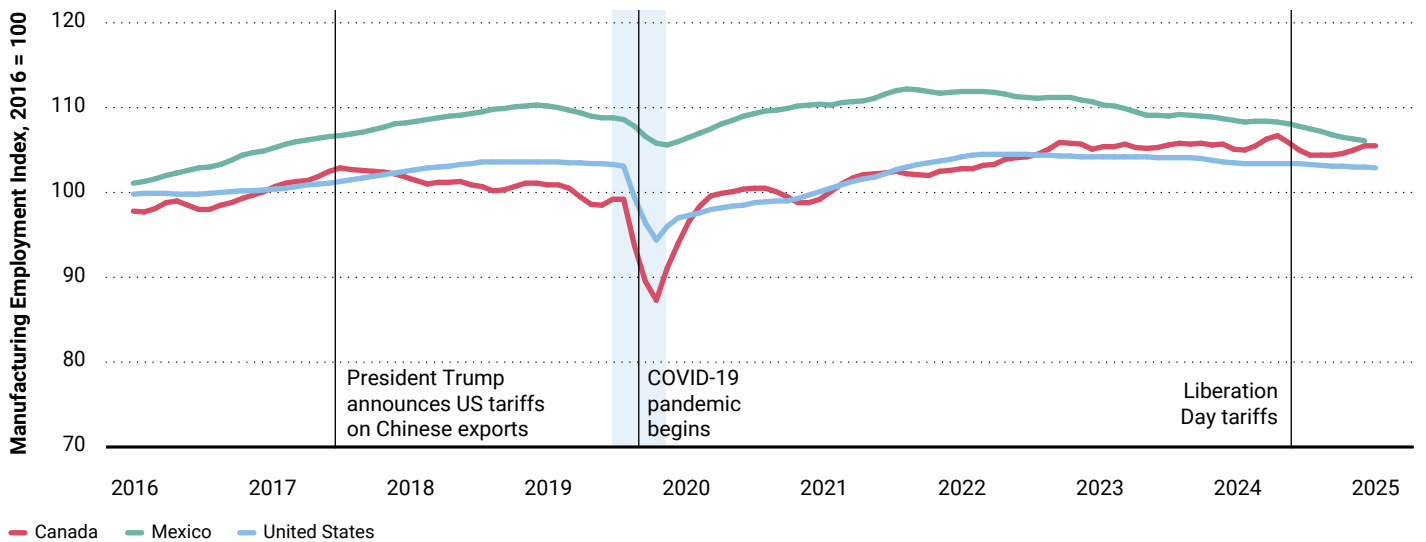
The manufacturing sector plays an essential role in Mexico’s economy. IMMEX facilities

(maquiladoras) are an important source of manufacturing activity and employment, particularly in northern Mexican border states. Three out of five IMMEX jobs are located in the border states of Baja California, Coahuila de Zaragoza, Chihuahua, Nuevo León, Sonora, and Tamaulipas. These facilities’ goods exports represent 60% of Mexico’s total manufacturing exports.⁴⁰

Firms that are part of the IMMEX (Programa de la Industria Manufacturera, Maquiladora y de Servicios de Exportación) program are mostly foreign-owned plants engaging in labor intensive assembly of intermediate and final goods for export.⁴¹ IMMEX firms import inputs temporarily duty-free from the U.S. or other countries. Tariffs are applied only to the value added by assembly on manufacturing products exported back to the U.S. IMMEX firms are highly integrated into global value chains.⁴²

The IMMEX sector reached its post-pandemic employment peak in June 2023 when it employed 3 million workers. However,

FIGURE 10. MANUFACTURING EMPLOYMENT IN MEXICO BELOW START OF US-CHINA TRADE DISPUTE LEVELS



Note: Seasonally adjusted and three-month moving average. Shaded area refers to recession dates from NBER. Data through November 2025. Liberation Day tariffs are a broad package of tariffs announced on April 2, 2025.

Sources: Bureau of Labor Statistics, Banco de Mexico, INEGI and Statistics Canada.

A pickup in U.S. manufacturing activity, accompanied by USMCA agreement continuity, would bolster employment growth, but the changing manufacturing dynamics from labor-intensive to more high-skilled production would probably not lead to a massive expansion in manufacturing jobs.

employment has since steadily declined, dropping to 2.8 million as of November 2023, while output did not similarly fall. These job losses are significant as IMMEX jobs represent a major source of employment in Mexico, accounting for more than 12.5% of formal employment as of November 2023.

Several factors are behind the substantial reduction in IMMEX jobs.

Due to the strong regional value chain linkages between the U.S. and Mexico, falling U.S. manufacturing activity has caused a decrease in demand for IMMEX manufactured goods.

Rising labor costs due to increases in Mexico’s federal minimum wage have outpaced labor productivity gains. The government increased the minimum wage by 129% in real terms during annual adjustments over the past six years.

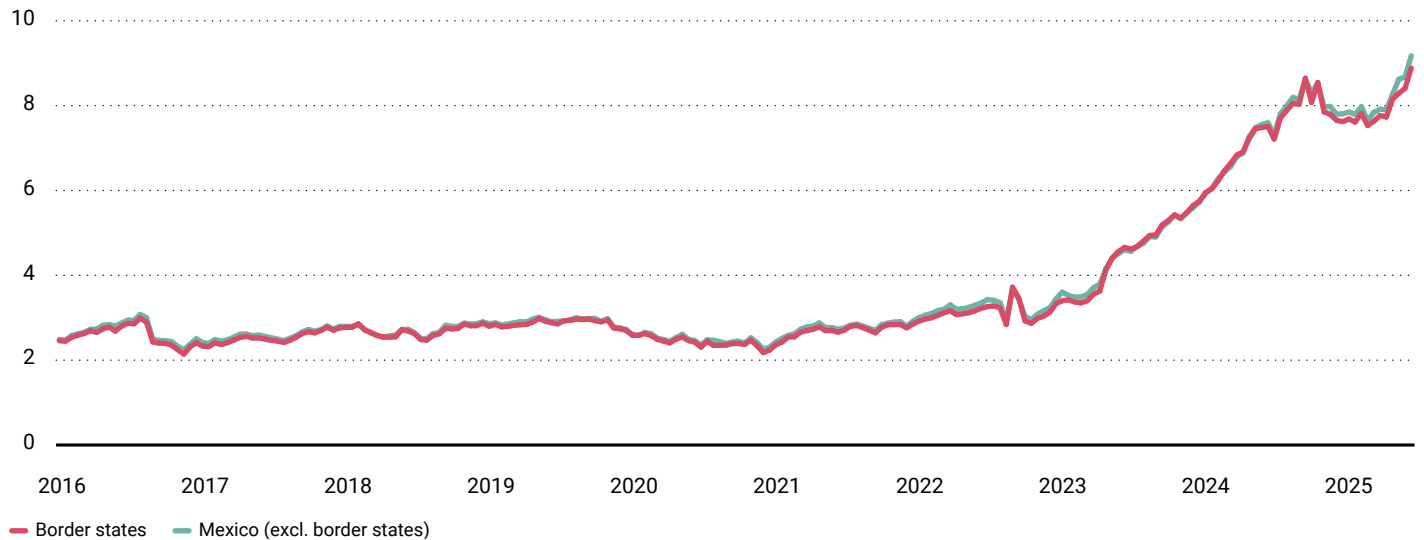
While the majority of workers in the formal sector, including IMMEX industries, earn more than the minimum wage, it serves as

a reference wage that drives other labor costs and can push up prices. As a result, the average daily salary in the formal sector increased 27.7% in real terms between 2018 and 2025, while IMMEX wages jumped in real terms by 198% from August 2020 to August 2025 (*Chart 11*).

The resulting structural shift toward more high-skill and capital-intensive industries employing fewer workers—industries such as server and medical equipment manufacturing—has affected the demand for maquila workers. Meanwhile, firms have also grown hesitant to expand operations in an environment of unpredictable trade policies and potentially changing tariff regimes between Mexico and the U.S.

A pickup in U.S. manufacturing activity, accompanied by USMCA agreement continuity, would bolster employment growth, but the changing manufacturing dynamics from labor-intensive to more high-skilled production would probably not lead to a massive expansion in manufacturing jobs.

FIGURE 11. MAQUILADORA (IMMEX) WAGES HAVE INCREASED THREEFOLD SINCE 2020
WAGES, REAL DOLLARS PER HOUR, SEASONALLY ADJUSTED



Note: Shown are wages in August 2025 dollars. Border states reflect data for Baja California, Sonora, Chihuahua, Coahuila de Zaragoza, Nuevo Leon, and Tamaulipas. Sources: Instituto Nacional de Estadística y Geografía (INEGI) (National Institute of Statistics and Geography); Federal Reserve Board; Bureau of Labor Statistics.

U.S. tariff changes in 2025 reinforced the growing importance of intra-North American trade and production linkages, and of the USMCA itself, with higher tariff rates on non-USMCA trade motivating a sharp increase in USMCA compliance.

Conclusion

U.S. tariff changes in 2025 reinforced the growing importance of intra-North American trade and production linkages, and of the USMCA itself, with higher tariff rates on non-USMCA trade motivating a sharp increase in USMCA compliance.

With potential strengthening of rules-of-origin requirements proposed by U.S. stakeholders for the USMCA review,⁴³ this goal is largely consistent with the Sheinbaum administration’s Plan México, focused on increasing national and regional content in Mexico’s manufacturing.⁴⁴ However, identifying achievable regional content requirements will be important to maintaining strong USMCA compliance, and research highlights sizeable compliance costs of stringent content requirements.⁴⁵

Evolving North American trade and investment ties with East Asia present both risks and opportunities. With U.S. imports from China

falling a further 20% in 2025, continuing a multiyear trend, this points to further potential for nearshoring, particularly for Mexico. Meanwhile growing investment in both Mexico⁴⁶ and Texas⁴⁷ from Taiwan, as well as from Japan and Korea, appear to be supporting growth in higher value manufacturing and further de-risking from China.

A structural shift appears underway in Mexico’s manufacturing towards more specialized high-skill jobs that complement the U.S. economy and points to a potential rebound in nearshoring investment and production if USMCA uncertainty is removed. Such capital-intensive manufacturing will require continued efforts towards developing Mexico’s skilled labor force, as well as trained labor on the U.S. side to take advantage of such reshoring opportunities. Growing nearshoring production in Mexico will also require addressing energy bottlenecks, with increased U.S. natural gas exports a key opportunity for both countries in the USMCA review.⁴⁸



CASE STUDY

JUAREZ'S MANUFACTURING TRANSITION

Ciudad Juarez is emblematic of both the challenges facing Mexico's manufacturing sector and the attendant opportunities. Juarez, on the Mexico-Texas border across the Rio Grande from El Paso, is the birthplace of the Mexican maquiladora manufacturing sector and remains a center in terms of employment.

It is also an area of transition, marked by significant job losses, increased automation, rising labor cost, and uncertainty surrounding trade and political environments. However, this is not the first time the city has experienced this kind of industry shock. Juarez went through a similar maquiladora transition in 2002 when the city lost about 60,000 maquiladora jobs after China joined the World Trade Organization. Low value-added and labor-intensive jobs went to Asia, such as the production of diodes, transistors, and simple capacitors, while relatively higher value-added production remained and evolved in the region such as the production of high-end flat screen TVs, metal mechanics, medical instruments, and supplies. In addition, automotive manufacturing consolidated.

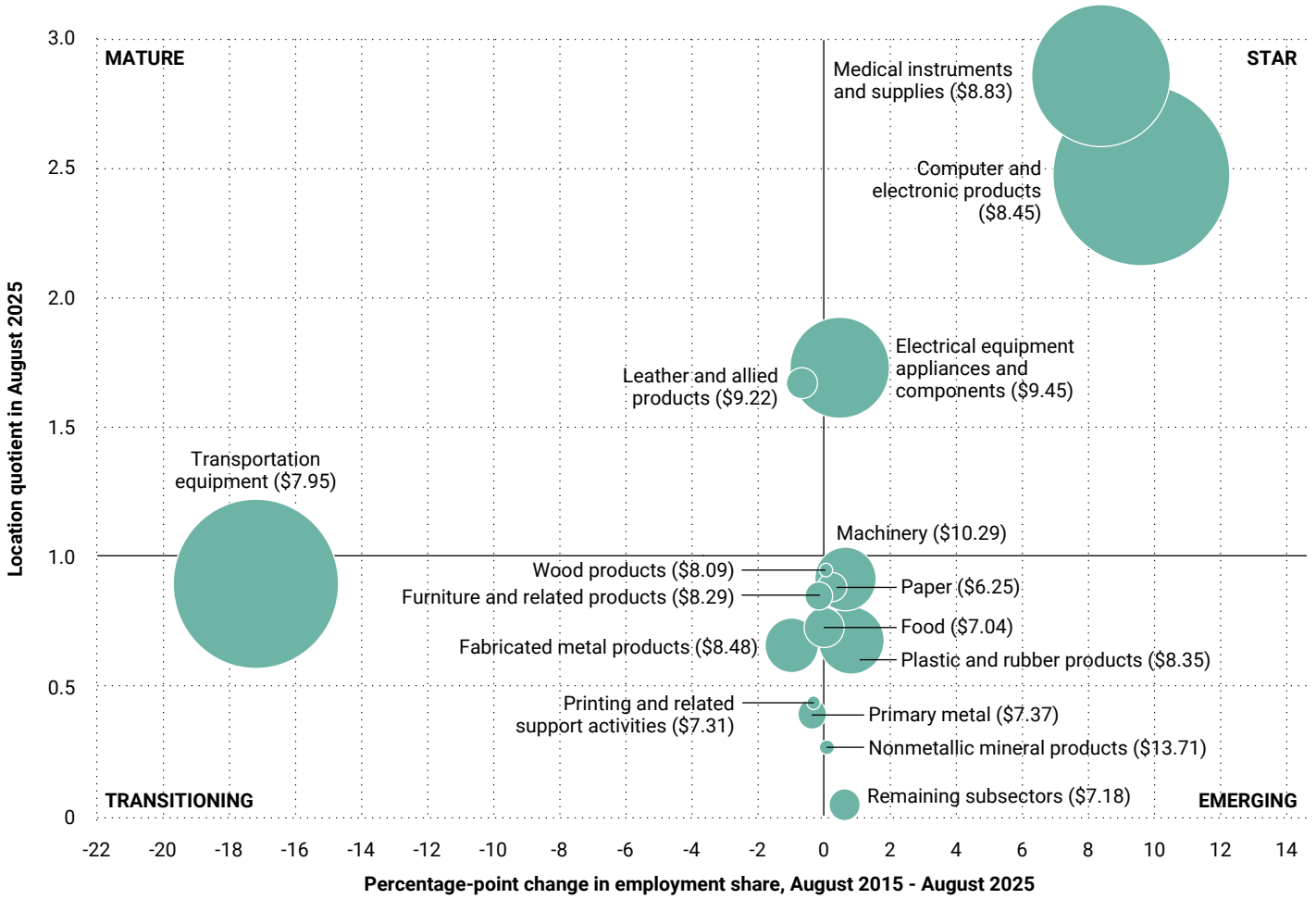
To explore Juarez's transition, we use cluster analysis.⁴⁹ An area typically has an economic base that consists of several dominant industry clusters. These clusters typically exceed the

national average in their share of employment, output, or earnings. Location quotients (LQs), which compare the relative concentration of industry clusters locally and nationally, are one way of assessing key drivers in an area's economy.

An LQ exceeding 1 indicates that a specific industry cluster is more dominant locally than nationally. LQ cluster growth is measured by the percentage point change in its share of local employment between 2015 and 2025.

Chart 12 plots industry cluster LQs and growth for Juarez maquiladora employment. Clusters in the top half of the chart, such as computer and electronic products, medical instruments and transportation equipment, are referred to as base clusters. They have a larger share of local employment relative to the nation and, thus, an LQ exceeding 1. A base cluster is usually vital to an area's economy and can be expanding relatively rapidly (star) or growing slowly or declining (mature). Those in the bottom half are less dominant locally than nationally and hence have an LQ below 1. "Emerging" clusters, such as machinery are relatively fast growing, while those growing slowly or declining are termed "transitioning." Average hourly compensation is shown in parenthesis.

FIGURE 12. JUAREZ MANUFACTURING TRANSITIONING AWAY FROM TRANSPORTATION EQUIPMENT MANUFACTURING



Note: Bubble size represents cluster employment. Number in parenthesis reflect the average wage in 2024. *Also includes other miscellaneous products.
 Source: Instituto Nacional de Estadística y Geografía (National Institute of Statistics and Geography); adjustments by Dallas Fed.

Juarez is transitioning away from low value-added transportation equipment manufacturing such as basic lighting components, wiper motors, wiring harnesses and connectors, and simple plastic interior and exterior panels. These products are often highly sensitive to price competition and tariffs, and their manufacturing is sometimes considered destined for a cost-cutting relocation.⁵⁰

Despite these challenges, the city remains a manufacturing hub, with continued investment in more advanced facilities, in some cases for nearshoring production. The local economy is evolving towards higher value-added electronics manufacturing, including

semiconductors, integrated circuits, Central Processing Units (CPUs), and networking equipment despite higher costs/wages. In addition, Juarez continues solidifying its medical instruments manufacturing base.

Geographically, clusters of firms are concentrated based on the technologies they employ, the markets they serve, the goods they produce, and the labor skills they require.

Going forward, the Juarez region should adapt quickly to the new requirements of its emerging manufacturing base, implying less labor intensive and greater skills manufacturing processes.



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- 3 Luis Torres, Senior Business Economist at the Federal Reserve Bank of Dallas
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KRISTEN SILVERBERG

President and COO | Business Roundtable (BRT)

Introduction

One of the most consequential economic achievements of President Donald Trump's first term, the United States–Mexico–Canada Agreement (USMCA), modernized North American trade and secured enforceable commitments from Canada and Mexico to support American workers and strengthen U.S. manufacturing. The agreement established robust intellectual property protections, cutting-edge digital trade rules, expanded market access in key sectors, and strengthened rules of origin to ensure that the benefits of preferential trade accrue to North American producers. Extending USMCA this year and restoring duty-free treatment for all qualifying goods—while aligning

with Mexico and Canada on policies to strengthen economic security—will be essential to preserving supply chain resilience, sustaining U.S. economic growth, and strengthening America's competitive position against China in critical industries.

Benefits of the trilateral agreement

The USMCA has delivered measurable benefits for the U.S. economy. Trade with Canada and Mexico now supports more than 13 million American jobs across manufacturing, agriculture, and services.¹ Since USMCA entered into force, Canada and Mexico have invested hundreds of billions of dollars in the United States, reinforcing integrated North American supply chains and driving regional trade to nearly \$2 trillion in goods and services annually.² Together, Canada and Mexico purchase more U.S. manufactured goods than the next dozen

STRENGTHENING US COMPETITIVENESS THROUGH A RENEWED USMCA

U.S. trading partners combined and represent the top export markets for U.S. agricultural products.^{3,4}

Maintaining USMCA as a trilateral agreement is essential to preserving the United States' economic advantage in North America because key sectors of the U.S. economy depend on deeply integrated supply chains. In 2024, more than half of U.S. manufacturing trade with Canada and Mexico occurred between related parties, reflecting deeply integrated production systems, particularly in sectors such as automotive manufacturing, where components cross borders multiple times before final assembly.⁵ Consistent with this integration, the U.S. International Trade Commission estimates that the United States received roughly 80% of vehicle manufacturing investment in the USMCA region between 2019 and 2023.⁶

Strategic importance

During President Trump's second term, USMCA has taken on increased strategic importance. As global trade has become more fragmented, the agreement has provided a stable economic foundation for North American firms and workers, while strengthening supply chain resilience and reducing reliance on China and other non-market economies.

The upcoming review of the agreement presents an opportunity for the administration to deepen cooperation on shared challenges and to align more closely in response to the policies and practices of non-market economies, including China, that undermine fair competition and market-based investment.

The parties should use existing USMCA mechanisms, including the Competitiveness Committee, and work closely with the private sector

to improve alignment on export controls, investment screening, critical minerals supply chains, trusted technologies, and excess capacity. For example, the partners could strengthen information-sharing and coordination on foreign investment review to ensure that subsidized or state-directed investments do not exploit duty-free access to the North American market. Greater alignment would reinforce trust in integrated North American supply chains and strengthen the long-term competitiveness of the USMCA region.

USMCA-compliant trade should be duty-free

To fully realize the benefits of USMCA and sustain the competitiveness of North American supply chains, the United States must preserve the duty-free treatment that lies at the core of the

agreement. Predictable, tariff-free access is not a discretionary benefit; it is the fundamental incentive that underpins investment decisions, sourcing strategies, and the integration of regional supply chains. Absent confidence that qualifying goods will move duty-free across borders, companies are less likely to invest in North America. Goods that comply with USMCA's rules of origin should be exempt from tariffs not expressly authorized by the agreement, including those imposed pursuant to Section 232 of the Trade Expansion Act of 1962 and the International Emergency Economic Powers Act (IEEPA). Applying such measures to USMCA-compliant trade undermines the agreement's negotiated balance, erodes its credibility, and weakens the very supply chains USMCA was designed to strengthen.

Restoring and maintaining duty-free treatment for all USMCA-compliant goods would reinforce sourcing and investment within North America, reward adherence to high-standard trade rules, and support the agreement's built-in mechanisms for ongoing cooperation and improvement. Canada and Mexico have demonstrated a willingness to align with U.S. efforts to address non-market policies and practices of third countries, including through coordinated approaches on products subject to Section 232 measures, such as steel and aluminum. Preserving tariff-free treatment within USMCA is therefore not only economically sound, but strategically essential to building a cohesive North American response to global trade distortions.

Conclusion

Ultimately, USMCA remains a critical driver of success for the U.S. business community. The trilateral agreement enables American businesses to compete more effectively against non-market economies while securing supply chains for critical industries. To preserve these advantages, the United States should confirm its intent to extend USMCA this year and fully restore preferential trade among the parties.

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JOSÉ MEDINA MORA ICAZA¹
 President | Mexico's Business
 Coordinating Council (CCE)

The year 2026 will be a decisive one for North American families. We have an opportunity to take advantage of the USMCA review to enhance our joint resilience and boost our shared competitiveness for the benefit of our peoples.

Renewing the USMCA for another 16 years would send an unequivocal signal to the rest of the world that North America is united and ready to outcompete all other regions.

As important as the review is for Mexico, it is critical to ensure that the U.S. public and decisionmakers appreciate the importance of the agreement for U.S. competitiveness and economic security.

First, Mexico is the single most important market for US exports

- In 2025, Mexico bought \$337 billion of U.S. goods (15.5% of total U.S. exports).
- Mexico is the #1 market for 27 U.S. industries, including meat and livestock, dairy, grains, sugar, oil and gas, chemicals, plastics, textiles, and auto parts.
- Mexico is the #1 buyer of U.S. steel and aluminum products: Mexican demand strengthens the U.S. industrial base in these critical sectors.
- Mexico is also the first or second destination for exports from 26 U.S. states.²

Therefore, it is not surprising that U.S. trade with Canada and Mexico sustains over 13 million American jobs.³

2026, A DECISIVE YEAR FOR NORTH AMERICA

Second, Mexican exports also sustain jobs in the US

No U.S. trading partner incorporates more U.S. inputs and materials into their exports than Mexico.⁴ This occurs across several sectors in manufacturing, most prominently in the automotive industry.

- When a car manufactured in Mexico is exported to the U.S., it will likely substitute a car assembled in Europe or Asia. This generates jobs in the U.S. since assembled vehicles in Mexico have on average 35% of U.S. auto parts content, while cars assembled in Europe or Asia contain mainly European and Asian parts.⁵
- In 2025, U.S. auto part exports to Mexico were eight times higher than those to Japan or to Germany.⁶ This reflects the advantages of geographic proximity, which facilitates co-production. Intermediate

goods routinely cross borders multiple times for successive stages of transformation before becoming final products.

Furthermore, 59% of all Mexican exports to the U.S. are intermediate goods, which are used by American manufacturers in their industrial production.⁷ They all have important U.S. content, from natural gas to iron ore, coal, petrochemicals, and many others. Not long ago, many of these inputs came from Asia.

Every dollar Mexican manufacturers export to the U.S., sustains U.S. export jobs. This key fact must be accounted for when comparing the U.S. trade deficit with Mexico to U.S. trade imbalances with other countries.

Trading with Mexico is a crucial component for the U.S. to successfully compete with

non-market economies, while creating jobs in America.

Third, trade in North America is complementary, contributing decisively to the affordability of goods, on both sides of the border

A great example is North American agriculture: U.S. consumers benefit from affordable and high quality fresh fruits and vegetables year-round, while Mexican cattle and livestock producers rely on U.S. grains for their competitiveness.

This illustrates how successful the USMCA has been.

But there are more opportunities for North America to jointly address supply chain weaknesses to create a more resilient production ecosystem. A good example is the semiconductor industry.

- The U.S. is launching an unprecedented effort to manufacture circuits on silicon wafers. The amount of \$2.3 trillion is expected to be invested in the U.S. over an eight-year period (2024-2032 (SIA)). But over 80% of global Assembly, Testing, and Packaging (ATP) capacity is concentrated in Asia, creating a major vulnerability for North American semiconductors supply chains.⁸
- The ATP processes transform semiconductor

wafers into usable products, from phones to medical devices. The \$100 billion electronics assembly and manufacturing base in Mexico has promoted a growing and cost-effective ATP industry, focused on older generation chips.

- Mexico is ideally positioned to strengthen North American semiconductor resiliency by hosting ATP facilities for mature node chips—which require more labor and less capital.

As we embark upon the review, the Mexican private sector believes four guiding principles will result in a stronger USMCA:

1. Duty-free access for all goods that comply with the USMCA rules of origin, including goods subject to Section 232 duties.
2. Ensure that USMCA rules of origin promote regional integration, maximize North America's complementarities, and avoid discrimination among the three countries.
3. Leverage USMCA committees to promote ambitious regulatory convergence, particularly in industrial sectors critical for the competitiveness of the region.
4. Strengthen dispute settlement mechanisms to ensure timely enforcement of the obligations of the agreement.



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GOLDY HYDER¹

President and CEO | Business Council of Canada

Extending the United States-Mexico-Canada Agreement (USMCA) is critical to the economic growth, competitiveness, and security of North America. The lives and livelihoods of American, Mexican, and Canadian workers, farmers, entrepreneurs, and their families depend on the certain and continued operation of the USMCA—an agreement which has benefited all three countries.

The USMCA has shown itself to be an improvement over the North American Free Trade Agreement (NAFTA) it replaced. Despite generational geopolitical shifts and a global pandemic, continental trade and investment have increased steadily as the USMCA has allowed and

encouraged businesses to make historic regional investments to create a more powerful and productive economic bloc.²

When negotiating the USMCA, the leaders of all three countries chose to include a review process to ensure it would continue to serve the interests of their citizens. While the evidence clearly demonstrates it does, this deal and our North American economy can be even better. We must seize the opportunity to strengthen the resilience of our integrated economies, so they generate greater prosperity for decades to come.

To do so, the review should adhere to a pair of guiding principles. First, a renewed USMCA must promote increased commercial dealings and cross-border investment between all three countries. Second, as trade agreements are negotiated by

THE USMCA MUST STRENGTHEN COOPERATION BETWEEN THE PUBLIC AND PRIVATE SECTORS

governments but for workers and businesses, a renewed USMCA must guarantee far greater collaboration between government and business.

With respect to this second principle, there is an easy solution: The membership of certain committees established by the provisions of the USMCA, including both the Committee on Good Regulatory Practices as well as the North American Competitiveness Committee, should be expanded to include private sector representatives from the U.S., Canada, and Mexico.

As the review process itself has demonstrated, consulting directly with those who rely on the USMCA for their commercial dealings and investment decisions is essential to ensuring the agreement achieves both its full potential as well as the economic policy objectives of our three countries. This level of cooperation should be

continuous, not limited to once every six years.

Moreover, the mandates of the USMCA committees should be streamlined to ensure they are narrowly focused on shared priorities such as eliminating regulatory burdens and increasing our economic competitiveness. Too often, their roles and responsibilities duplicate the work of other committees, or they are directed to consider extraneous factors unrelated to their core purpose.

Deeper cooperation between the public and private sectors of all three USMCA countries through the more effective use of streamlined, specific purpose committees would give us greater agility to adapt to changing global market realities and the emergence of new technologies. It would provide real-time input to inform how we can best harmonize and align economic policy decisions.



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If this proposed model was accepted, a renewed USMCA should create two new committees. The first of these would be an Energy Dominance Committee with the mandate to develop a common vision for how to harness and leverage our continental resources. This should include shared approaches to approve projects to enhance energy and critical mineral supply chains.

This new committee would respond to the call from business leaders in all three countries to create a North American Energy Alliance—a joint effort to seize opportunities across our continent and expand our reach around the world to provide allies and other like-minded trading partners with access to secure supplies of reliable energy and strategically important critical minerals.

A second new USMCA committee should focus on North American economic security. Its mandate would be to collectively assess threats and coordinate how best to address them. It would help develop a common vision of North American economic security and consider collective measures to protect our continent from economic coercion, unfair practices, and weaponized trade.

The public and private sectors of all three countries view North American economic security as an urgent priority. Yet, within the existing text and context of the USMCA, security interests are framed more as a rationale for a country to exempt itself from its obligations rather than a reason for greater alignment and collective action. This puts North American economic security at risk.

A USMCA committee on North American Economic Security could also provide a mechanism for business and government to harmonize and align policies and practices to better protect cross-border critical economic infrastructure and other integrated networks, many of which are operated, owned, or controlled by the private sector—strengthening “Fortress North America’s” defenses.

The USMCA is more than a free trade deal; it is a comprehensive economic agreement through which our three countries have resolved to “establish a clear, transparent, and predictable legal and commercial framework for business planning.”³ Ensuring greater collaboration with business leaders will ensure continued economic growth in North America.

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CANDACE LAING

President and CEO | Canadian Chamber of Commerce

In the 2025 National Security Strategy (NSS), the Trump Administration signals a significant reorientation of America's international priorities.¹ Unlike prior administrations, the NSS narrows the scope of America's national interests and brings a renewed focus to the Western Hemisphere.

The "Trump Corollary," or the "Donroe Doctrine" as the president has called it, entails that the United States will "reassert and enforce the Monroe Doctrine to restore American pre-eminence in the Western Hemisphere."² While this raises important questions about the nature and limits of American interventions in the region, particularly given the Trump administration's actions in

Venezuela, it also presents an opportunity to advance a positive vision for the region with North America at its center.

North America's role in the US Western Hemisphere strategy

According to the NSS, the administration's two primary goals for the Western Hemisphere are to enlist regional champions that can help bolster the region's economic and national security and expand partnerships in the region to counter the influence of non-hemispheric competitors.³ The North American economic partnership, underpinned by the United States-Mexico-Canada Agreement (USMCA), plays a major role in achieving both goals.

As the major economic partners of the United States in the region, Canada and Mexico are the United States' natural primary partners for building the Western

THE USMCA CAN HELP MAKE NORTH AMERICA THE ECONOMIC CORE OF THE WESTERN HEMISPHERE

Hemisphere's economic and national security.

As I have previously argued, the three countries should establish a North American economic security agenda.⁴ The tenets of such an agenda—including prioritizing North American economic competitiveness, increasing trilateral coordination on China, and forming new bilateral economic security initiatives within North America—remain highly relevant today. By further deepening the North American economic and security partnership, the three countries can establish the core economic foundation for hemispheric stability and competitiveness.

The relevance of deeper North American cooperation extends beyond traditional areas to emerging strategic priorities for the Western Hemisphere, such as Arctic security. Although the Trump

administration has identified Greenland as a strategic priority in the Arctic for America's national security,⁵ it is important to recognize that Canada is the largest Arctic nation by coastline. As a core hemispheric partner of the United States, Canada is central to safeguarding the Arctic at a time of increasing geopolitical competition with non-hemispheric competitors, including China and Russia. While there remains much work to do in this respect, Canada is already expanding the Canadian Armed Forces' presence in the region and making billion-dollar North American Aerospace Defense Command (NORAD) infrastructure investments in strategic locations such as in Yellowknife, Inuvik, and Iqaluit, including installing Over-the-Horizon radar technology.⁶

Moreover, it is important to note that American hemispheric pre-eminence

cannot be achieved by relying solely on tariffs and other coercive methods. This is particularly true in the case of the Arctic, where the Trump administration has threatened tariffs against eight NATO allies who do not support a U.S. acquisition of Greenland.⁷ While such measures may yield short-term leverage, they risk undermining business confidence, disrupting deeply integrated supply chains,

and harming relationships with regional partners in the long term. A truly durable hemispheric strategy requires predictable, rules-based, and mutually beneficial economic cooperation among partners. North America can lead the way by advancing a model for regional prosperity and security that will encourage expansion of partnerships in the region.

Why the USMCA review matters for the Western Hemisphere

The Trump administration's renewed focus on the Western Hemisphere comes at a pivotal moment for the future of the North American trading relationship. As the July 1, 2026 USMCA review date approaches, the United States should leverage this process to translate its hemispheric ambitions into concrete

outcomes that strengthen North America and also benefit the wider region.

Since entering into force in 2020, the USMCA has succeeded in creating a trading infrastructure that businesses have relied on to deliver significant economic benefits across North America. This includes a dramatic increase in intra-North American trade and



investment, strengthened co-production across key sectors, enablement of millions of jobs, and greater resilience during periods of global disruption.

Given the USMCA's immense economic importance, all three countries should prioritize the renewal of the agreement for a new 16-year term with some improvements. In the Canadian Chamber's comments for the Office of the United States Trade Representative (USTR) consultation on the USMCA review,⁸ we outline seven key areas where such opportunities exist. Such measures will benefit the three countries but can also play a key role in underpinning an effective and durable hemispheric strategy.

For instance, the three countries can leverage the agreement to promote resilient and competitive regional supply chains that are critical for preserving North American economic security. The Competitiveness Chapter established a committee intended to promote economic integration and enhance the competitiveness of North American exports. The three countries can reorient this committee to establish a competitiveness strategy for North America that engages the broader hemisphere in strategic areas, such as critical minerals.

Additionally, greater cooperation on policies related to digital trade and emerging technologies have enormous potential. Although the USMCA includes rules governing digital trade via its Digital Trade Chapter, advancements in digital technologies, including recent rapid advancements in artificial intelligence, require that the three countries update their approach. By updating the agreement to take these advancements into account, the USMCA can serve as a template for broader hemispheric digital cooperation, enhancing the uptake regulatory frameworks and standards that are favourable to North American firms.

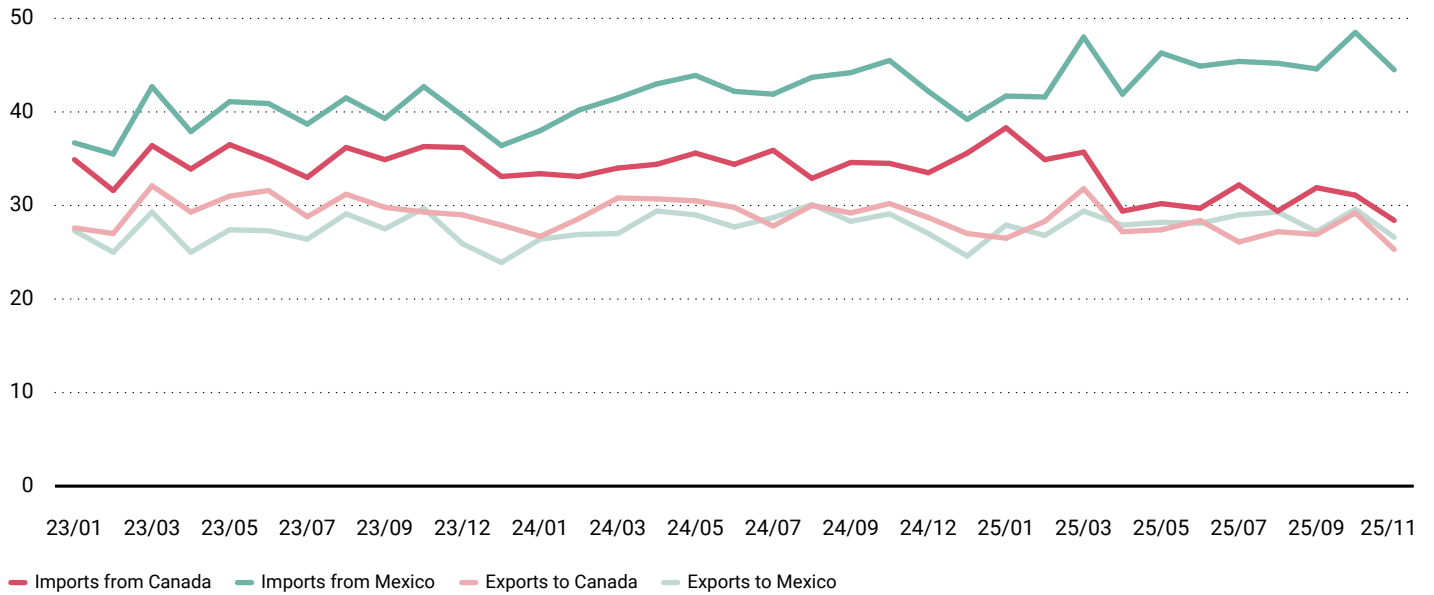
The USMCA could serve as a central economic pillar of America's effort to establish hemispheric leadership. By making a resilient North American partnership the foundation for engaging the broader hemisphere, the three countries have an opportunity to anchor the Western Hemisphere in integration and partnership rather than coercion. This approach would present a positive vision for hemispheric leadership, one that recognizes the importance of regional economic and national security but is fundamentally built on mutually beneficial economic cooperation.

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FOLLOWING US TARIFFS, TRADE WITH CANADA DECLINES WHILE US IMPORTS FROM MEXICO CONTINUES TO GROW

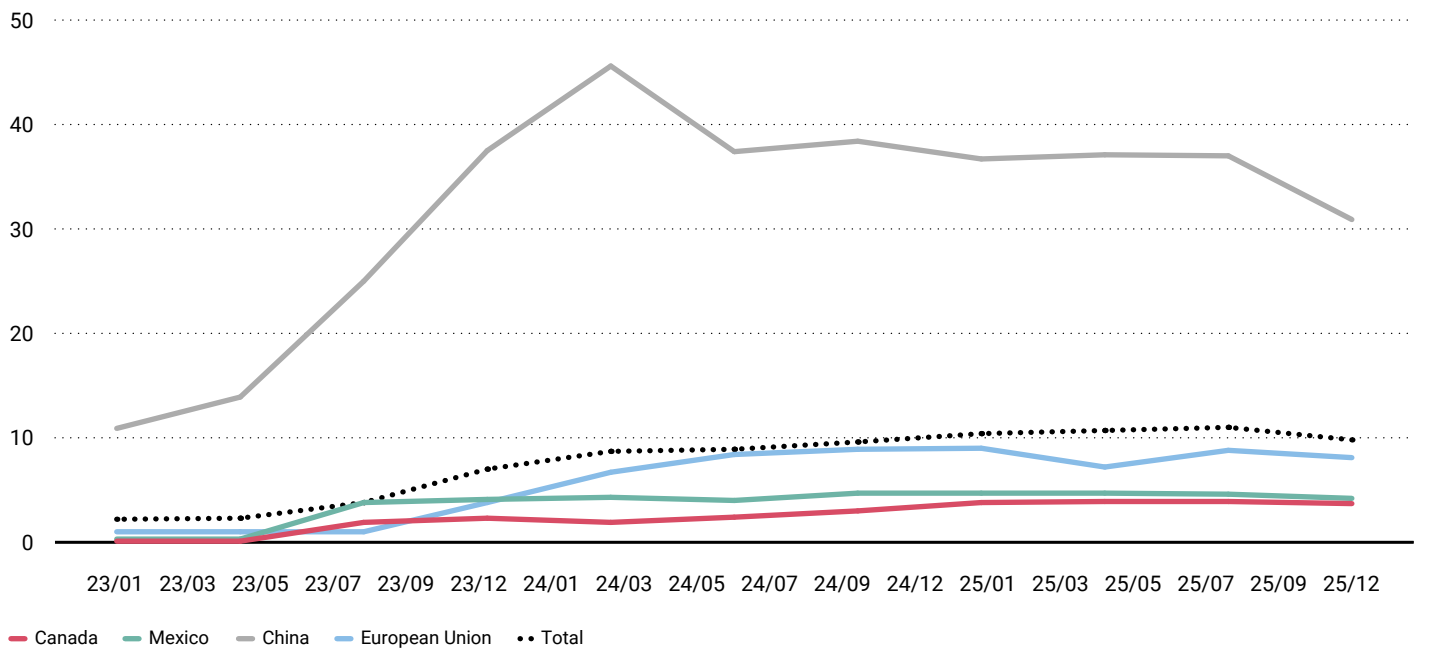
US TRADE WITH CANADA AND MEXICO IN BILLIONS USD



Source: USITC Dataweb.

DESPITE US TARIFFS, CANADA AND MEXICO MAINTAIN PREFERENTIAL ACCESS TO US MARKET

US AVERAGE EFFECTIVE TARIFF RATES, JANUARY - OCTOBER 2025 (%)




Note: Average effective tariff rates are calculated as duties collected as a share of total imports.
Source: USITC Dataweb.

IS CANADA ON A FORKED ROAD AWAY FROM NORTH AMERICA?



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The late University of Toronto historian Donald Creighton wrote in 1976 that Canada's international policies between 1939 and 1957 was a “forked road” choice between the high road of Canadian independence and the low road of closer relations with the United States. Creighton blamed Canadian Liberal Prime Ministers William Lyon Mackenzie King and Louis St. Laurent for squandering the opportunity of the postwar period to chart Canada's future independent of any outside power, be it London or Washington.¹

Creighton's metaphor addressed a formative moment in Canadian statecraft: The end of the Second World War, the onset of the Cold War, and the consolidation of North American industrial and security links. In his view, Canadian leaders could have pursued a more distinct course—more European, more Commonwealth, more autonomous—rather than accepting a logic of continentalism rooted in geography, investment, and American power. The “forked road” was therefore not only a question of trade and defense; it was also a question of political identity and sovereignty. Creighton's larger argument captures a durable Canadian dilemma: Whether national autonomy is best defended by building distance from the United States or by shaping and managing interdependence.

When Creighton's book appeared, Prime Minister Pierre Trudeau was already experimenting with industrial policy and economic nationalism to enhance Canadian autonomy from the United States. In 1969, the Nixon administration threatened to cancel the U.S.–Canada Automotive Products Sharing Agreement of 1965 (the Auto Pact).² In 1971, Nixon imposed a 10% “import surcharge” (in effect, a tariff) to address U.S. balance of payments problems and, in a break with the postwar norm, did not exempt Canada.³

Nixon's economic shocks gave Trudeau public support for policies intended to reduce Canadian reliance on the United States.

Trudeau launched a review of Canadian foreign policy that presented three options: accept a shaken status quo; pursue closer ties with the United States to reduce the likelihood of future unilateral U.S. actions; or adopt a Third Option that sought new partners to diversify Canada's trade and diplomacy. Trudeau advocated the Third Option, but it yielded few concrete results before he left office in 1984. Later that year, Canadians elected a Progressive Conservative government led by Brian Mulroney that made closer ties with the United States a governing priority. That shift culminated in the Canada–United States Free Trade Agreement (CUSFTA), which entered into force in 1989.⁴ Mulroney subsequently convinced the United States and Mexico to include Canada in their trade negotiations, producing the North American Free Trade Agreement (NAFTA).

The arc from the Third Option to CUSFTA and NAFTA can appear as a neat pendulum swing from economic nationalism to continentalism. In practice, it was more constrained. The Third Option did not fail because Canada lacked diplomatic ambition; it failed because the global economy of the late 1970s and early 1980s offered few practical substitutes for the U.S. market, and because the institutional and logistical infrastructure of Canadian trade was already oriented north–south. Mulroney's continental turn did not erase Canadian nationalism; it reframed it. Deep integration was defended as a means of sustaining Canadian prosperity and sovereignty through negotiated rules rather than ad hoc dependence on Washington.

In 2026, many Canadians aspire to that same balance of sovereign autonomy and North American integration. Yet during the 2025 election campaign Prime Minister Mark Carney declared that the old relationship between Canada and the United States is over, ended by the Trump administration's tariffs.⁵ Canada's current forked-road choice is whether to pursue a new, more conditional

Today, a renewed security and economic relationship with the United States is the desired “high road” ...

relationship with the United States or to revisit a modernized Third Option in search of additional partners. For Canada, however, that choice is inseparable from North American economic governance—above all the United States–Mexico–Canada Agreement (USMCA), now approaching its sixth-year review and therefore newly exposed to political leverage across all three capitals.

Canada’s predicament is often narrated as uniquely Canadian: A middle power next to a great power, with limited regional alternatives. But the policy challenge in 2026 is not as singular as Canadians sometimes assume. The United States remains the world’s largest economy and a central node in global finance, technology, and security. Yet domestic U.S. politics now routinely spill into trade and alliance management, creating uncertainty for partners. European leaders increasingly speak of “strategic autonomy” as insurance against future U.S. policy swings. Asian allies diversify supply chains and deepen regional trade ties even as they strengthen deterrence partnerships with Washington. In Latin America, governments pursue new export markets and investment sources while remaining attentive to U.S. migration and security preferences. Across these cases, the lesson is consistent: Diversification is possible, but it is rarely quick, cheap, or complete—and partial diversification can create new dependencies and domestic divisions.

Canada’s challenge is therefore not to decouple from the United States—or to treat Mexico as a peripheral consideration. It is to decide what kind of North American relationship can be made durable enough to support long-term investment and political confidence, while reducing vulnerability to coercive measures that can be imposed quickly and with limited recourse. The fork in the road is thus a choice among imperfect strategies, not a clean choice between idealized independence and reluctant dependence.

Today, a renewed security and economic relationship with the United States is the desired “high road,” and greater independence and self-reliance is the “low road” choice most Canadians would prefer not to tread. It is Creighton’s choice, inverted. In 2026, autonomy is increasingly defined not as distance from the United States but as resilience within interdependence: Stable, rules-based access to the U.S. market and security partnership, alongside credible alternatives that reduce vulnerability to sudden policy shocks. The USMCA is central to that resilience—not only as a trade agreement, but as an institutional framework through which Canada and Mexico seek predictability in their economic relationship with the United States.

Carney’s roadmap

Mark Carney came to electoral politics after a successful career as a civil servant and senior central banker in Canada and the United Kingdom. His professional formation was technocratic: Provide decisionmakers with realistic assessments of constraints and trade-offs, and discipline assumptions that rely on optimism rather than evidence. This experience has shaped Carney’s approach as prime minister. He has sought to respond to the United States with candor and strategic restraint, rather than rhetorical escalation.

It is not an exaggeration to note that without the re-election of U.S. President Donald Trump to a second term in 2024, Carney might not be prime minister today. After it became apparent that Trudeau’s relationship with Trump had worsened during the Biden administration and was beyond repair, Trudeau resigned as prime minister on January 6, 2025.⁶ The Liberal Party chose Carney as leader on March 9, 2025, whereupon Carney became Canada’s 24th prime minister. Two weeks later, Carney requested a federal general election for April 28.⁷

Carney sought a strong mandate to respond to U.S. threats and tariffs—two separate but related challenges. Trump mocked Trudeau as “Governor of the Great State of Canada” when Trudeau visited Mar-a-Lago on November 29, 2024.⁸ The remark evolved into a proposal to make Canada the U.S. fifty-first state and, when Canadians reacted negatively, Trump began talking of using “economic force” to compel annexation.⁹

Canadians accordingly understood Trump tariffs as a form of economic force. As the Brookings Institution has tracked, these included a 25% tariff on non-energy, non-USMCA compliant imports, and a 10% tariff on energy imports from Canada (March 4); 25% tariffs on steel and aluminum imports

(March 12); and a 25% tariff on automobile imports including automotive components not compliant with the USMCA rule of origin (April 3).¹⁰ For Canadian and Mexican policymakers alike, the details mattered: These actions underscored that even within the USMCA, preferential access could be narrowed by enforcement choices, rules-of-origin interpretation, and the use of statutory authorities outside the agreement’s normal trade-remedy channels.

The 2025 federal election was remarkable in two respects. First, it was a rare election in which the central question was Canada’s relationship with the United States. Second, all party leaders embraced a nationalist mood and pledged to defend Canadian interests.

TABLE 1. CURRENT PARTY STANDINGS

Province / Territory	Liberal	Conservative	NDP	Bloc Québécois	Green	Vacant	Total
Alberta	2	34	1	0	0	0	37
British Columbia	20	19	3	0	1	0	43
Manitoba	6	7	1	0	0	0	14
New Brunswick	6	4	0	0	0	0	10
Newfoundland & Labrador	4	3	0	0	0	0	7
Northwest Territories	1	0	0	0	0	0	1
Nova Scotia	11	0	0	0	0	0	11
Nunavut	0	0	1	0	0	0	1
Ontario	69	51	0	0	0	2	122
Prince Edward Island	4	0	0	0	0	0	4
Quebec	44	11	1	22	0	0	78
Saskatchewan	1	13	0	0	0	0	14
Yukon	1	0	0	0	0	0	1
Total Seats	169	142	7	22	1	2	

Source: House of Commons of Canada.

Carney won a plurality of seats in the House of Commons—more than any other party, but short of a majority.

Carney’s failure to win a clear majority was not unusual. Since 2004, Canada has elected only two majority governments.¹¹ The minority context was therefore a governing constraint. Carney needed a posture toward Washington that satisfied Canadians’ demand for firmness while remaining credible to markets and investors that require predictability.

Carney took office with a plan to improve relations with the United States by negotiating a new Security and Economic Agreement (SEA) that would involve new Canadian commitments addressing longstanding U.S. security concerns in exchange for relief from tariffs imposed on Canadian exports.¹² In effect, Carney sought a “reset” that would sit alongside the USMCA: Not a substitute for North American rules, but a political bargain intended to stabilize the environment as the USMCA moved toward its review. To demonstrate good faith, Carney committed unconditionally to meet NATO’s 2% of GDP defense target in the current fiscal year and announced new investments in border security.¹³ These moves broke the pattern of previous governments that delayed security investments while hoping for inducements from Washington.

Carney also intervened to suspend implementation of a Digital Services Tax (DST) scheduled for June 30, 2025, which applied retroactively and would have imposed immediate costs on U.S. firms.¹⁴ The DST was controversial because it departed from an OECD consensus intended to prevent damaging tax competition among advanced economies. Former Finance Minister Chrystia Freeland championed the tax over objections from Biden administration officials. Carney replaced Freeland following the election and, responding to complaints from the Trump administration, halted implementation of the DST.

After the DST dispute was resolved, Carney proposed SEA talks at the Group of 7 leaders’ summit in Kananaskis, Alberta in June, and Trump agreed to begin talks over the summer.¹⁵

From Carney’s perspective, the logic was straightforward: Address U.S. complaints that are politically salient in Washington—defense spending, border enforcement, fentanyl—and convert these into the basis for a durable economic understanding. But the bilateral environment in 2026 differs from earlier eras. During the Cold War, defense cooperation and economic integration were mutually reinforcing parts of a strategic project. In the Trump era, the political logic is closer to transactionalism: Partners are expected to deliver concessions, while economic “relief” is contingent and reversible, often framed as a discretionary favor rather than the product of negotiated reciprocity.

Potholes and road rage

In this context, it is not surprising that Carney’s effort to negotiate an SEA ultimately failed. The trade war the United States launched against Canada relied on tariffs applied under different statutory authorities—most controversially, the International Economic Emergency Powers Act of 1977 (IEEPA), which is subject to ongoing litigation, including review by the U.S. Supreme Court over whether the statute can be used to impose tariffs.¹⁶ IEEPA tariffs do not require the kind of injury investigation and remedy process that typically frames trade disputes and supports legal challenges.

Other tariffs, by contrast—including those imposed under Section 232 of the 1962 Trade Expansion Act—require notice of an investigation, a determination of injury (or threat), and the setting of a tariff level intended to correct rather than overcorrect the injury.¹⁷ These procedures take time and



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The USMCA is important to preserving a rules-based baseline when political conditions in Washington become unpredictable.

offer affected firms opportunities to comment and to seek review. Similar procedural safeguards exist for tariffs imposed under Sections 201 and 301 of the 1974 Trade Act.¹⁸ The sudden imposition of IEEPA tariffs, and the practical difficulty of challenging them in real time, has rattled firms and trade partners and made Trump tariff threats more grave than in his first term.

The bright spot has been the USMCA: The exemption of products that qualified under USMCA rules of origin limited damage to the Canadian economy and reinforced the value of the agreement for Canada and Mexico, despite the sacrifices each made to secure it during Trump’s first term.¹⁹ For Mexico, the same episode reinforces that USMCA preferences are most valuable when accompanied by predictable U.S. use of trade authorities—an issue that will sit at the center of the upcoming review. Both Canada and Mexico view the USMCA as more than market liberalization; the USMCA is important to preserving a rules-based baseline when political conditions in Washington become unpredictable.

Security tensions were similarly difficult to manage. Carney’s actions to meet Canadian security commitments were treated by Washington as overdue remedial measures rather than bargaining concessions. They did not alter U.S. thinking about resetting economic relationships to address perceived exploitation of the United States by trade partners that hollowed out manufacturing and undermined the workers and communities that manufacturing had supported. Bilateral talks continued but made little progress.

Tariff politics in the United States have also become structurally resilient. Even outside the Trump coalition, skepticism toward free trade has grown across both U.S. parties, shaped by deindustrialization narratives, strategic competition with China, and regional inequality. Tariffs function as a political symbol—evidence that Washington is “doing something” for workers—even when economists dispute their long-term efficacy. For Canadian and Mexican strategy, this implies that waiting out Trump may not be sufficient. A post-Trump administration

could reduce rhetoric and rebuild diplomatic process, but tariff tools may still be retained for leverage or domestic signaling, particularly as the USMCA review invites political posturing.

By late September, Carney sought a second meeting with Trump in Washington to re-energize talks. At an October 7 meeting in the Oval Office, Trump and Carney appeared to get along well. Trump characterized the relationship with Canada as a “natural conflict” over jobs and investment and said this “natural business conflict” was holding up progress. Carney responded,

“If I may, let us be clear about the relationship as it stands. We are the second largest trading partner of the United States, and we do a lot of trade going up across the border where we are cooperating. We are the largest foreign investor in the United States. Half a trillion dollars in the last five years and \$8 trillion in the next five years if we get the agreement we expect to get. Thirdly, there are areas where I would not say conflict, but we compete. They are areas where we compete, and it is and though its areas where we have to come to an agreement that works. But there are more areas where we are stronger together and that is what we are focused on, and we will get the right deal for America and for Canada.”²⁰

This exchange reflected Carney’s effort to replace Trump’s language of “conflict” with a framework of competition within a broader partnership. Following the meeting, the United States and Canada began sector-by-sector talks starting with energy, aluminum, and steel.²¹ That momentum proved short-lived after a viral video advertisement produced by the Ontario provincial government.²²

The video drew on a radio address by former U.S. President Ronald Reagan warning that tariffs can damage growth and prosperity more than they help workers. Trump’s name was not mentioned, but Trump was outraged by the

implied criticism from a president still revered by many Republicans and ordinary citizens.²³ Trump cancelled talks with Canada, and they remained suspended even after Ontario cancelled future airing of the video. Trump also announced he had no plans to meet Carney at the Asia Pacific Economic Cooperation summit in South Korea in November.²⁴

At APEC, however, Carney secured a meeting with Chinese President Xi Jinping.²⁵ In Beijing on January 16, Canada agreed to allow 49,000 Chinese-made electric vehicles to enter the Canadian market at a 6% tariff rate, and China lifted restrictions on Canadian agricultural products. The two countries also agreed to begin talks on Chinese purchases of Canadian energy.²⁶ In rapid succession, Canada announced the launch of talks on investment, technology, and trade with Qatar²⁷ and negotiations with India that could lead to Canadian oil, LNG, and uranium shipments by March.²⁸

Carney’s remarks at the World Economic Forum in Davos, Switzerland then drew renewed attention. As he had declared during the 2025 campaign, Carney argued in Davos that the U.S.-Canada relationship that evolved in the postwar period was over. He called on middle powers to work together in support of rule of law, human rights, and open trade, and urged countries to become more self-reliant on domestic markets for growth and on their own militaries for national security. Like the Ontario advertisement that angered Trump, Carney did not mention Trump by name.²⁹

Another forked road?

In his own speech in Davos, Trump lashed out at Carney by name, warning that Canada’s existence was dependent on the United States and that Carney should show more gratitude.³⁰ Trump later threatened a 100% tariff on Canadian exports if Canada negotiated a free trade agreement with China³¹—a signal

that USMCA Section 32.10 on engagement with nonmarket economies could become a flashpoint in the USMCA review. Canadian officials quickly reaffirmed that talks with China were intended to address trade irritants rather than foreshadow a free trade agreement.³² For Mexican readers, the episode is also instructive: The same review dynamics and the same leverage tools can be applied across North America, even when a specific dispute begins with one partner.

Carney's strategy seeks to avoid Creighton's metaphoric fork in the road by advancing Canadian autonomy and North American integration simultaneously. In October, Carney told an audience at the University of Ottawa that he wanted to see Canada's exports to countries other than the United States grow by an additional \$300 billion—a "U.S. plus" approach that Pierre Trudeau did not fully consider. And although Carney's proposed SEA failed, he remains committed to retaining the USMCA and preserving as much trade and investment with the United States as possible.³³

This is an ambitious strategy because it requires Canada to do several difficult things at once. First, it must preserve enough stability in North American trade and investment to keep integrated supply chains viable—particularly in autos, aerospace, machinery, and processed foods. That is a shared Canada–Mexico interest under the USMCA, and it is precisely why the review matters: Uncertainty can chill investment even before any formal changes are adopted. Second, Canada must develop new export pathways for energy and commodities, constrained by infrastructure, permitting, indigenous consultation, environmental politics, and capital costs. Third, it must manage the geopolitical implications of deeper engagement with non-U.S. partners, especially China, in a world where economic relations are increasingly securitized.

To accomplish this, Canada must export more of its energy and natural resource products,

including agrifood. Commodities are fungible: A bushel of wheat, a plank of softwood lumber, or a steel girder is largely the same whether produced in Canada or elsewhere. U.S. tariffs that price Canada out of the U.S. market can redirect Canadian supply toward buyers not applying comparable barriers.

That logic is persuasive but encounters practical limits. Access to buyers is mediated by logistics. Canada's trade infrastructure has historically been built to serve the U.S. market—pipelines south, rail and truck corridors south, integrated electricity grids, and business networks concentrated in border regions. Shifting volumes to Asia or Europe requires port capacity, shipping arrangements, and often additional processing. It also requires the political capacity to approve and build projects at a pace Canada has not consistently demonstrated.

For this reason, the Carney government has established a federal Major Projects Office to expedite permitting and construction of new infrastructure.³⁴ In effect, the office treats infrastructure as strategy: Canada's ability to diversify is less a diplomatic challenge than a state capacity challenge.

Unlike commodities, manufactured goods—from automobiles and parts to processed foods—are embedded in supply chains closely tied to the United States and, in many sectors, to Mexico as well. That is why Canada remains committed to the USMCA. For manufacturers, switching to new supply chain networks in Asia, Europe, or Latin America would require time and would be achieved at a high cost.

Avoiding a fork in the road that would lead Canada away from the United States and Mexico is the aim of what Carney called "principled pragmatism" in his World Economic Forum remarks, saying:

"[W]e aim to be both principled and pragmatic—principled in our commitment to

Unlike commodities, manufactured goods—from automobiles and parts to processed foods—are embedded in supply chains closely tied to the United States and, in many sectors, to Mexico as well. That is why Canada remains committed to the USMCA.

The United States benefits materially from North American integration: reliable energy supplies, critical mineral potential, trusted investment, and secure borders with both Canada and Mexico.

fundamental values, sovereignty, territorial integrity, the prohibition of the use of force, except when consistent with the UN Charter, and respect for human rights, and pragmatic and recognizing that progress is often incremental, that interests diverge, that not every partner will share all of our values. ... [D]iversification internationally is not just economic prudence; it's a material foundation for honest foreign policy, because countries earn the right to principled stands by reducing their vulnerability to retaliation.”³⁵

Carney's framing is designed to avoid a false binary. In the classic nationalist story, Canada must choose between economic prosperity tied to the United States and political autonomy. In Carney's view, autonomy is better defended by building options—diversifying enough to reduce vulnerability—while maintaining the economic base that funds defense, diplomacy, and domestic cohesion.

Yet a fork in the road remains, and it lies less in Canada's intentions than in the interaction between Canadian strategy and U.S. domestic politics. If Washington continues to treat tariffs as normal tools of alliance management, Canada will struggle to sustain the investor confidence required for large-scale industrial projects. If, however, Canada and Mexico can help create a more durable political constituency in the United States for stable North American trade—based on investment,

energy security, and manufacturing cooperation—then the “high road” remains open, and the USMCA review may become an occasion to reaffirm predictability rather than to intensify leverage.

For U.S. policymakers, the implication is straightforward. The United States benefits materially from North American integration: reliable energy supplies, critical mineral potential, trusted investment, and secure borders with both Canada and Mexico. If U.S. policy treats its USMCA partners primarily as trade adversaries, it encourages both governments—regardless of party—to invest politically and economically in diversification away from the United States. That diversification will be incremental, but over time it can erode the mutual advantages of North American integration.

Canada is not on a road away from North America so much as on a road toward a more conditional North America—one in which integration remains valuable but no longer fully secure. The policy task for Ottawa, Washington, and Mexico City is to determine whether North American integration will be governed principally by rules and mutual benefit, or by episodic coercion and political spectacle. That decision—more than any single tariff—will determine whether Canada's road continues through North America or bends away from it.

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To listen to popular Canadian opinion, one might believe that Canada is quickly decoupling from the U.S. economy. Consumer boycotts, tariff battles, and political rhetoric have created the impression of a widening breach. The two countries, often described as the world's best neighbors, seem to be stepping back from their traditional friendship, and considering a new kind of cross-border relationship that may include more fences than bridges. But even in this "America First" age, the bilateral rebalancing is a far cry from diplomatic decoupling.

In sectors tied to national security—from defense to energy and critical materials—the United States has a structural interest in keeping

Canada close. Proximity, reliability, and history make Canada a natural part of the American geoeconomic system, regardless of the temperature of trade politics. Even when rhetoric turns combative, Washington's deeper imperative remains the same: It needs a neighboring partner that can share risk, rather than a distant one it must replace.

And, perhaps counterintuitively, President Donald Trump's measures against Canada may make it a more reliable and valuable trade partner as we enter a new, more fractured, global environment where the U.S.' broader objective is to decouple from China.

The first wave of Trump tariffs, on relative terms, provided Canada favorable U.S. market access. In late 2025, the effective U.S. tariff rate for Canada was approximately 8%—better than 11% for

THE TRUMP PARADOX: HOW TRADE TENSIONS MAY STRENGTHEN CANADA'S POSITION IN AN INTEGRATED MARKET

Mexico, 17% for the rest of the world, and 20% for China, approximately.¹ This, alongside a weaker dollar, supported exports even as Ottawa pursued diversification. After an initial hit in spring 2025, Canada's trade surplus with the U.S. still reached its highest level in September since February 2025.²

Call it the Trump paradox.

One of the challenges of this paradox is that it is neither fixed nor predictable. Idiosyncratic measures against sectors—canola, potash, and filmmaking,^{3, 4, 5} to cite three targets—have compounded the challenges of investment and inventory planning.

Tariffs inflicted damage on key industries (like the automotive sector where Canada has had to shift from U.S. supply chains), while hardening resolve to build domestic capacity and greater strategic autonomy.

Even with this uncertainty, the fundamentals of both economies continue to be largely aligned, with capacity utilization in each economy running at long-term norms of just below 80%.^{6, 7}

A signal through the noise of the trade war is that Canada offers inherent strength that the U.S. will continue to draw on, even in the face of border taxes, trade frictions, and political agitation. As much as the Trump administration wants to build American self-reliance on energy, food, and manufactured products, it cannot be an economic island and meet the needs of its consumers, producers, and exporters.

Canada's ability to produce energy, minerals, and agri-food products, along with advanced manufactured goods and pharmaceuticals, will continue to elevate Canadian export potential. It will continue to be a trusted, democratic, and

security partner with rule of law and credible institutions.

That logic created deep economic integration back between Canada and the U.S. then, and it will hold now in new trade negotiations but on more political terms—shaped as much by industrial policy and security as by markets.

NAFTA was born partly from a political vision, but more so captured and codified what was already well advanced in the form of a continental market. Canada's Trade

Intensity Index with the U.S. doubled in NAFTA's first two decades, peaking at 7.4 in 2013 before easing to 6.1 in 2024 as commodity prices cooled and post-COVID, reshoring slowed supply-chain integration.⁸

The replacement of NAFTA with USMCA did not represent a clean break with the past so much as a recalibration of continental trade, placing greater weight on enforceable labor standards, tighter rules of origin, and the politics of supply chain security. In

2018, Prime Minister Justin Trudeau described a sense of relief, bordering on disbelief, that USMCA had not diverged further from NAFTA given the political temperature between him and the President.⁹

Looking ahead to the 2026 review, the politics of USMCA are likely to matter even more. Trump has repeatedly threatened to upend the agreement, not to sever North American trade but to increase U.S. leverage.¹⁰ He will try and bring Canada as close to U.S. terms as possible,

including greater access to Canada's dairy market, tougher rules of origin for conducting trade in strategic sectors such as defense, mining, advanced manufacturing, steel, and aluminium, and closer alignment of Canadian digital regulation affecting U.S. technology platforms. Canada will seek to protect market access and reduce dependency through its own industrial strategy.

Trump's extraordinary use of tariffs has braced Canadians for a more fundamental



remaking of continental free trade, on less favorable terms for Canada and Mexico.

This has put Canada on a more ambivalent, but strategic and resolute course. It is not unusual for Canadian governments of both major political parties over the decades to oscillate between closer alignment with Washington and periodic assertions of autonomy. But this time, it is different in at least one big way: Canada is now investing heavily in industrial strategy and other sovereign economic policies.

As a result, there are at least three major restructurings underway:

1. Expanding ports and export infrastructure to reach markets beyond the United States.¹¹
2. Building domestic defense, digital, and data capacity with a “Buy Canadian” approach to procurement and a willingness to increase collaboration with other European and Asian partners.¹²
3. Rebuilding domestic industrial capacity while reorienting manufacturing toward higher-value, globally competitive activity.¹³

These new directions reflect that Canada’s government is determined to set a resilient course for the economy, which is not dependent on a Truth Social post.

Taken together, and if executed, this strategy would not imply a retreat from the U.S. market so much as a change in how Canada relates to it. Trade with the United States would remain large and central, but less one-sided: Canada would export more from a broader base of domestic capacity, rely less on U.S. inputs, and approach the relationship from a position of greater bargaining strength. The result would likely be steadier, more diversified cross-border trade.

For two generations, free trade has been Canada’s defining economic condition. It has delivered prosperity, but also deep dependence on a single market—now under the threat of an administration that seeks hemispheric dominance, and even territorial expansion.

Canada now faces a harder, clearer choice than at any point since free trade began: How to remain economically integrated with its neighbor over the long term, while reducing its vulnerability to a partner that seems increasingly willing to weaponize that dependence in the short term.

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PERSPECTIVES ON THE US-MEXICO RELATIONSHIP, WHAT NEXT?



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Two hundred years and evolving

These days most analyses of the relationship between Mexico and the United States concentrate on short-term developments, particularly regarding the future of USMCA and the potential for unilateral law enforcement or even military action by the U.S. within Mexican territory targeting cartels. This focus is understandable, given that—as was the case eight years ago—the second Trump administration has disrupted bilateral relations and introduced significant uncertainty. Nonetheless, it is also important to consider the overall state of the relationship with a little more perspective as well as possible developments over the longer term.

The two centuries of diplomatic relations have been marked by geographic proximity, structural asymmetry, and a notable degree of interdependence. Through four different phases, the relationship has witnessed conflict and agreement as well as achievement and setbacks.¹ The initial phase extended from Mexico's recognition as an independent nation to World War II. Throughout this period, interactions were largely adversarial and shaped by the vulnerability of the Mexican state and the territorial ambitions of the United States. Significant events included armed conflict resulting in the loss of half of Mexico's territory,² U.S. intervention in the removal of President Francisco I. Madero³—the first democratically elected president, bombardment of the port of Veracruz,⁴ Francisco Villa's raid of Columbus, New Mexico,⁵ and the nationalization of oil companies by the Mexican government in 1938.⁶

World War II marked a significant turning point in the relationship opening a second phase. The exigencies of war created an increased demand in the United States for raw materials, labor, and security. In 1942, Mexico declared war on the Axis powers and contributed alongside the United States⁷—an effort not widely recognized by the American

public. Additionally, Mexico supported the war effort by supplying labor through the Bracero Program and providing goods from its industrial sector.⁸ In 1943, President Franklin D. Roosevelt visited President Ávila Camacho in Monterrey, Nuevo León, where the American president spoke—likely for the first time—of the interdependence between both nations and their resources.⁹

During the Cold War, Mexico and the United States enjoyed a new equilibrium. Mexico's Third World diplomatic activism and its flirting with Latin American governments from the political left were less important to the U.S. than a shared interest of keeping socialism out of Mexico. The so-called “war on drugs” declared by President Richard Nixon in 1971 naturally had an impact on the bilateral relationship that continues to this day. Indeed, the fight against drug trafficking remains one of the main sources of friction. It is during this second phase that the relationship begins to take shape with a tendency to discover interdependence and alignment of interests, and to manage if not solve differences.

NAFTA marked the commencement of a third phase and produced two notable impacts on the relationship. First, it enhanced economic integration through increased trade and investment flows, established regulatory frameworks, and fostered comprehensive production and supply chains. Second, it contributed to more robust cooperation across various domains, including security and law enforcement, migration, educational exchanges, border management, and infrastructure development. The ensuing 25 years following NAFTA can be characterized as shifting from the paradigm of “distant neighbors” to the construction of a “strategic partnership”—a term that became increasingly prevalent in official, business, and academic discourse on both sides of the border.

The Mexico–United States relationship has entered a fourth phase, beginning with the

Ties between Mexico and the United States are widely recognized as among the most complex, dynamic, and significant globally.

first presidency of Donald Trump, and the rise of Andrés Manuel López Obrador and Morena in Mexico. This period is broadly defined by a dynamic in which economic interdependence exists alongside significant political differences. Several factors contribute to the complexity of this stage: A shift in U.S. foreign and national security policy away from promoting a rules-based international order toward a “balance of power” arrangement; a reassertion of U.S. influence in the Western Hemisphere —described by some as a renewed Monroe Doctrine; the emergence of a new administration in Mexico under Morena, characterized by an economic nationalism does not necessarily support the development of a strategic partnership with the United States; evolving security concerns encompassing both non-state threats such as organized crime and fentanyl trafficking, as well as conventional risks within a changing geopolitical landscape; and finally a new context in the U.S. where illegal immigration is not only seen by Americans as a serious concern and challenge for the United States, but also as a threat to the social fabric of the country.

The future trajectory of the relationship under this new phase remains uncertain, although it has demonstrated considerable resilience and continued “along its tracks.” Furthermore, it is reasonable to anticipate that the elements discussed above will largely persist beyond a second Trump administration, given the structural changes occurring in both the U.S. political environment and the international order.

Significant stakes in the relationship

The resilience demonstrated by the bilateral relationship in recent years can be attributed, in part, to successive Mexican administrations—since 2017—advocating for Mexico’s significance to U.S. economic and security interests, rather than directly

confronting President Trump. Notably, various U.S. political stakeholders, including governors, legislators, business leaders, and academic figures, have played a significant role in this process. Moreover, the enduring strength of the relationship is also supported by its substantial scope and depth.

Ties between Mexico and the United States are widely recognized as among the most complex, dynamic, and significant globally. This characterization is substantiated by the long 3,169 kilometers border. The U.S.-Mexico border ranks as one of the most active, necessitating a wide array of formal and informal arrangements to address all sorts of challenges, including the management of over 50 ports of entry and international bridges. Each day, approximately one million individuals and 40,000 trucks cross this border.¹⁰ At least 12 metropolitan areas along the border can be considered binational, with their daily activities frequently extending across national boundaries. Additionally, the United States and Mexico jointly manage the Colorado and Rio Grande River basins under the terms of a 1944 treaty, resources vital to communities and businesses on both sides.¹¹

In 2025, Mexico became not only the top trading partner of the United States, above China and outpacing Canada, for the first time in 30 years, but also the most important destination of U.S. exports worldwide. Indeed, according to the U.S. Census Bureau, bilateral trade reached almost 840 billion dollars during 2024¹² and, through September 2025, remained at a healthy 653 billion despite the imposition of different tariffs beginning in February 2025.¹³ Geographical proximity, lower cost, and integrated supply chains explain this resilience.

Cross-border investment is also important. The United States is Mexico’s top foreign investor. According to the Bureau of Economic Analysis, in 2024 American direct investment (at historical cost basis) was estimated at

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\$160 billion, while Mexican investment in the U.S. was \$61 billion.¹⁴ The case for mutually beneficial investment flows is even stronger when normalizing these figures by the size of the economy and population. With our own preliminary estimates, U.S. direct investment in Mexico represented approximately 0.55% of its GDP or \$446 per capita, and 3.4% of Mexico’s GDP or \$471 per capita.¹⁵

In addition to trade and investment, there are significant flows of people for tourism and business purposes. More Americans visit Mexico each year than any other nationality (40 million in 2024)¹⁶ while Mexicans are the second-largest group of international visitors to the United States (20 million).¹⁷

It is estimated that approximately 37 million Hispanics of Mexican origin currently reside

in the United States, of which about 11 million were born in Mexico.¹⁸ At the same time, the U.S. Department of State estimates that roughly 1.6 million Americans live in Mexico.¹⁹

Taking a longer-term perspective

As previously noted, the year 2026 may represent a significant juncture in U.S.–Mexico relations. During the second Trump administration, illegal immigration from Mexico into the United States—a persistent issue—has declined to historically low levels, relieving some bilateral pressures.²⁰ Nonetheless, the future of the USMCA, currently undergoing statutory review, remains a key concern. While it is likely that the agreement will persist, two general scenarios are possible: Either its formal

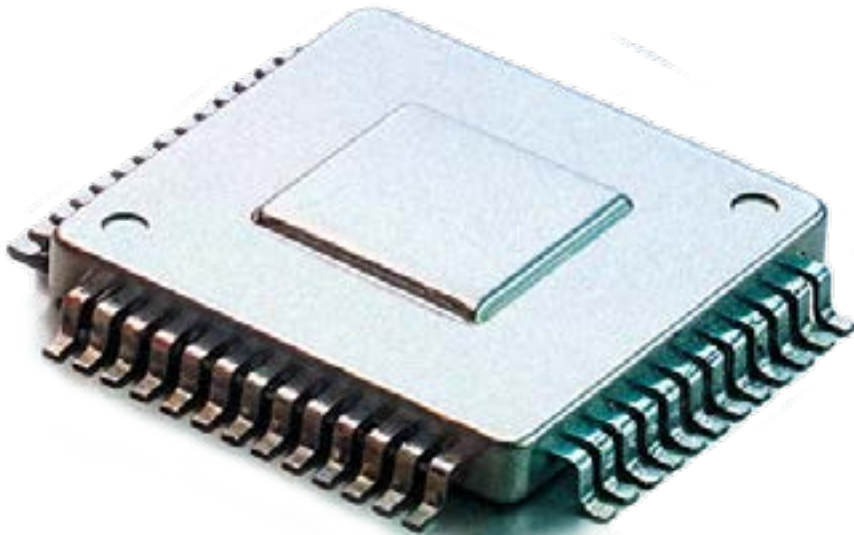


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extension occurs in July of this year with certain concessions and amendments to the United States, or the agreement continues without a formal extension beyond the July deadline—a status that is legally permissible—with the Trump administration maintaining strategic uncertainty on trade and other aspects of the relationship as leverage.

In terms of security, although the possibility of unilateral law enforcement or military measures by the Trump administration cannot be entirely ruled out, such a scenario still appears unlikely. The probability of this scenario in the near term will be predominantly determined by the effectiveness of ongoing security collaboration and the prevailing political climate within the United States.

When assessing the potential long-term trajectory of the relationship, three key questions appear particularly pertinent: 1) Whether Mexico and the United States can establish a more comprehensive and effective framework for security cooperation; 2) Whether both nations can achieve a stable and mutually beneficial trade relationship in the new world trade environment; and 3) How Mexico will navigate its position within the evolving geopolitical landscape.



A month after taking office, the Trump administration designated Mexican cartels as international terrorist organizations.²¹ Subsequently, it asserted that drug trafficking organizations “have an intolerable alliance with the government of Mexico.”²² On several occasions, President Trump has suggested that Mexico is effectively under the control of cartel groups.²³ Concurrently, Secretary of State Marco Rubio has repeatedly stated that bilateral security cooperation is at unprecedented levels.²⁴ This apparent contradiction indicates that security collaboration may be achieving certain objectives, while U.S. authorities might intentionally maintain ambiguity to strengthen their negotiating position and pursue increased cooperation.

On the Mexican side, inconsistencies are also observed. Mr. López Obrador and President Claudia Sheinbaum have criticized previous administrations’ approaches to security cooperation with the United States, contending that these policies compromised Mexican sovereignty and national interests. This criticism extended to the Merida Initiative, which was the primary mechanism for security collaboration from 2008 to 2021.²⁵ However, Morena administrations have continued cooperation and, in some cases, exceeded prior practices. Notably, there have been significant concessions to the U.S., such as the transfer of criminals not only through formal extradition processes but also via “expulsion” during 2025,²⁶ as well as authorization for U.S. aerial surveillance over Mexican territory to collect intelligence —apparently without Mexican direct participation.²⁷ Under a mantra of “cooperation yes, subordination no,” the Morena government seems to have established an ad hoc and mostly under-the-radar cooperation scheme.

These circumstances necessitate an examination of the potential progression of bilateral security and law enforcement cooperation in a way that is politically viable,

Bilateral cooperation regarding customs has a longstanding history, which intensified following the September 11, 2001 terrorist attacks as trade and security priorities became increasingly interlinked.

effective, and enduring for both governments. Providing a comprehensive response to this issue exceeds the scope of this essay; however, two collaborative approaches can be identified: the establishment of a joint binational customs agency or the creation of a formal security agreement.

Bilateral cooperation regarding customs has a longstanding history, which intensified following the September 11, 2001 terrorist attacks as trade and security priorities became increasingly interlinked. This partnership has yielded meaningful, though still limited, advancements in areas such as information sharing, pre-inspection processes, joint customs clearance procedures, and the planning and management of international crossings and bridges. Persistent and evolving security threats require more sophisticated and coordinated approaches. The integration of advanced technology presents significant opportunities to enhance the effectiveness of customs operations. Among the most critical issues on the bilateral security agenda are the illicit trafficking of synthetic drugs—including fentanyl and its precursors—and firearms, both of which pose substantial challenges for customs agencies at the shared border.

Overall, Mexico and the United States have engaged in generally equitable, though sometimes inconsistent, security cooperation over the past 25 years. This cooperative relationship has included training, the exchange of information and intelligence, financial aid to Mexico for equipment, professional development, institutional strengthening, coordinated law enforcement operations, and formal judicial assistance in particular cases. Concerns in Mexico about deeper collaboration center on issues of national sovereignty, while the United States has expressed dissatisfaction regarding the effectiveness of joint efforts. Both countries have proceeded with caution due to mutual distrust: The United States’ reservations are principally related to ongoing corruption

associated with organized crime, in some cases involving senior government officials,²⁸ whereas Mexico’s apprehension is largely rooted in the legacy of previous unilateral actions, and the reluctance of U.S. authorities to openly address and cooperate on matters occurring within their own borders after illicit substances have entered.

In recent years, some security experts have proposed the establishment of a dedicated security agreement.²⁹ This proposal has merit. It could offer significant advantages to both parties; The United States would benefit from increased certainty and stability of the cooperation, independent of political changes within Mexico, and Mexico would gain from a legally binding framework that clearly delineates the boundaries of collaboration. Although unilateral actions by the United States on Mexican territory remain a point of discussion.

With respect to trade and the USMCA, Mexico must understand that retaining preferential access to the U.S. market will require further strategic alignment with the United States. In the present context and for the foreseeable future, this alignment implies a fair level of cooperation and information exchange which can aid in vetting foreign investment in Mexico on goods and sectors that pose potential security risks (such as critical minerals, rare earths, strategic infrastructure, and communications), and mechanisms to avoid using Mexico for transshipments into the United States. The issue of circumvention can be addressed through the rules of origin clause of the USMCA under review. In return, the United States should unequivocally guarantee that Mexico will maintain preferential access with respect to other countries and especially its competitors.

Turning to geopolitics, while it is challenging to precisely characterize the fluid nature of international relations, forecasting the future global order—or potential disorder—proves

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even more complex. Nations such as Mexico, which possess notable economic significance and latent political influence, and whose military capacity is focused on homeland defense, often face difficulties in defining their international roles and navigating relations with the United States. One development that seems increasingly likely and holds relevance for Mexico is an intent by the United States to exert more influence throughout the Americas in the coming years. This prospect underscores the need for a thorough discussion within Mexico concerning two key issues.

Initially, there is the prospect that the current United States strategy regarding the hemisphere may develop into a “coalition of the willing” focused on trade and defense. While Morena administrations have supported further economic integration across the Americas, such integration appears unrealistic under existing geopolitical circumstances. It is also notable that Mexico declared its intention to withdraw from the Inter-American Treaty of Reciprocal Assistance (TIAR) in 2001—just days prior to the terrorist attacks on the United States—and completed its withdrawal formally in 2004.³⁰ This decision was originally motivated by the desire to adopt a multidimensional approach to hemispheric security and, at that time, may have seemed relatively insignificant. However, in retrospect, its implications could be more substantial.

Furthermore, Mexican officials may conduct an impartial assessment of the potential costs and advantages associated with engaging in dialogue with their American counterparts regarding Major Non-NATO Ally (MNNA) status. As outlined by the State Department, this designation offers certain privileges related to defense, trade, and security cooperation for foreign partners. While MNNA status does not include binding security commitments, it serves as a significant indicator of the close bilateral relationship between the United States and designated countries.

In summary, a consistent aim of Mexican foreign policy has been to maintain a prudent level of autonomy from the foreign policy direction of the United States. This approach is neither unexpected nor objectionable to Americans, as many nations have pursued similar objectives throughout history. Likewise, it would be advantageous for Mexico to carefully evaluate when such independence truly aligns with its national interests.

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In a new international trade landscape driven by U.S. tariff policy, Mexico has the opportunity to consolidate its position as a privileged trade partner. Seizing the moment to deepen North American economic integration could position the USMCA as the largest regional trade bloc. To achieve this goal, all three member countries will have to develop coordinated strategies to enhance cooperation across supply chains and promote shared growth.

According to World Bank data, in 2024 the USMCA was the world's second-largest trade agreement in terms of combined GDP, with a value of \$25.8 trillion, while the Regional Comprehensive Economic Partnership (RCEP)

currently holds the top position with an estimated \$28.5 trillion.¹ Although the USMCA has maintained a steady growth trajectory in recent years, the current international trade context highlights the need for renewed strategic efforts that would allow North America's trade agreement to become the world's largest bloc, bringing long-term benefits to the three countries.

In 2025, following the launch of the United States trade policy, Mexico and Canada consolidated their positions as the countries with the lowest effective U.S. tariff rates.² This privileged relationship has strengthened their competitive position relative to other U.S. trading partners and has opened the door to deeper supply chain cooperation and higher incentives for nearshoring. At the same time, U.S. trade restrictions on Chinese firms have increased the urgency of securing alternative suppliers capable

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of reliably meeting domestic demand. This strengthens Mexico and Canada's position as even stronger trade allies while potentially triggering a new investment cycle aimed at modernizing the region's manufacturing capacity.

Deeper commercial integration between partners would bring shared benefits to all three economies by enabling the development of more productive and competitive supply chains and generating economic spillovers that could lead to sustained regional growth. Existing investment patterns already illustrate this potential. In 2022, U.S. foreign direct investment (FDI) stock in Mexico and Canada totaled \$569 billion, a 9.5% increase from 2021. At the same time, Mexican and Canadian FDI in the United States reached \$623.1 billion in 2022, marking an 8% increase compared with the previous year.³ These figures suggest that further regional integration could

accelerate the pace of FDI growth not only from the United States, but also from Mexico and Canada.

There is another opportunity for strategic cooperation around certain key industries. The United States has made clear that strengthening domestic manufacturing capacity in strategic sectors is essential for national security. The Biden administration's review of supply chain vulnerabilities (covering pharmaceuticals, batteries, semiconductors, critical minerals, and other key industries) aligns with several ongoing President Donald Trump's Section 232 investigations, which grant the president authority to impose tariffs on imports deemed to threaten national security. This continuity suggests that the United States is likely to maintain a protectionist policy stance in these sectors in the coming years. This represents an important

strategic opening for Mexico and Canada. The USMCA can be used as a platform to support the development of these industries within North America to strengthen regional resilience and reinforce their position as long-term reliable allies. Given the distinctive advantages that each country brings to the economic relationship, the United States would benefit from expanding regional cooperation to reduce its dependence on Asian markets and foster stronger industrial capabilities within the North American region.

What does Mexico need to do to seize the opportunity to become the United States' substitute supplier for China? One of the key objectives of Plan México is to increase domestic value in global value chains by 15% by 2030, particularly in six strategic sectors: automotive, aerospace, electronics, semiconductors, pharmaceuticals, and chemicals.⁴ By hitting this target, Mexico would

strengthen its industrial base and enhance its competitiveness within North American supply chains. However, Mexico still faces the challenge of implementing the right strategies that would allow it to meet these objectives and ensure that public policy creates favorable investment conditions for these sectors while reinforcing Mexico's position in North America's value chains.

According to the Mexican Institute for Competitiveness (IMCO), meeting the goals of Plan México requires a strategy built on three pillars.⁵ First, the implementation of reforms regarding energy, administrative simplification, telecommunications, and other strategic areas must remain aligned with USMCA obligations. Second, Mexico must expand access to critical inputs such as steel, aluminum, glass, fibers, resins, and plastics. Third, in anticipation of the upcoming USMCA review, the Mexican government must set clear

priorities aimed at expanding regional trade by leveraging the strategic sectors identified in Plan México.

Mexico is entering a new era of tariffs that is likely to persist. Even in a scenario in which future U.S. administrations decide to scale back or eliminate the current tariff regime, the long-term consequences of today's trade policies will endure. This means that the ongoing restructuring of supply chains will shape the dynamics of global trade for years to

come. It will be essential to understand the outcome of the USMCA review and determine whether the agreement can be advanced toward becoming the world's leading trade bloc if this trade landscape is to be fully seized.

The global trading system is approaching a point of no return. Countries that adapt effectively to the emerging environment will be the ones that secure sustained growth in the decades to come. The question remains whether Mexico will be among them.

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The 2026 review of the United States–Mexico–Canada Agreement (USMCA) presents a critical opportunity to strengthen North America’s digital competitiveness, modernize Chapter 19 (Digital Trade), and reinforce regional cooperation on cybersecurity, artificial intelligence (AI), data governance, and small- and medium-sized enterprise (SME) inclusion.

North America is undergoing rapid technological transformation driven by AI, cloud services, automation, cybersecurity needs, and digital trade. While the digital economy has become a major engine of growth—exceeding \$1.5 trillion in cross-border digital trade—SMEs continue to face structural barriers

such as limited access to capital, digital skills gaps, and regulatory fragmentation.

Chapter 19 positioned the USMCA as a global benchmark for digital trade, guaranteeing free data flows, prohibiting data localization, and supporting non-discriminatory treatment of digital products. However, evolving technological challenges require updated commitments that safeguard competitiveness, resilience, and trusted innovation.

Strengthening regional cybersecurity cooperation

Cybersecurity is now central to economic and national security. Threats to critical infrastructure, regional supply chains, and cross-border data systems have grown significantly. As part of the review, the parties should modernize Article 19.15 by:

- **Harmonizing cybersecurity regulations** across the

STRENGTHENING NORTH AMERICA’S DIGITAL COMPETITIVENESS THROUGH CYBERSECURITY AND SME INCLUSION

three countries, aligned with NIST, ISO/IEC 27000, OECD principles, and global best practices.

- **Establishing a trilateral incident-reporting framework** with common thresholds, timelines, and response protocols.
- **Developing trusted, real-time information-sharing mechanisms** between governments and the private sector.
- **Protecting critical infrastructure**, including cloud services, telecommunications, customs systems, and industrial control systems, through joint simulation exercises and coordinated defenses.
- **Strengthening supply chain security** through regional certification programs for secure hardware and software.
- **Building a North American cybersecurity talent initiative** to close skills gaps, especially for SMEs.

These measures would enhance digital trust, reduce fragmentation, and protect the region’s shared economic infrastructure.

Ensuring technology neutrality and regulatory adaptability

To remain competitive in a rapidly evolving digital environment, the USMCA should also reaffirm technology-neutral, risk-based, and innovation-friendly regulation.

Policies should avoid prescriptive mandates that may become obsolete; align with international standards to reduce compliance costs; and encourage multi-stakeholder participation—including industry, academia, and civil society—in regulatory design.

A flexible, principles-based framework will allow businesses to adopt emerging technologies while ensuring fair competition and security.

Advancing AI governance and regional alignment

AI is transforming manufacturing, logistics, services, and trade. However, diverging national approaches risk creating barriers to cross-border digital activity. The review should aim to establish a trilateral AI governance framework focused on risk classification, transparency, accountability, and ethical deployment; promote interoperable data governance rules to support responsible AI development; and facilitate SME access to AI tools, capacity-building programs, and innovation sandboxes.

Coordinated governance will support innovation while maintaining public trust.

Promoting privacy interoperability and frictionless data flows

Data flows are essential for modern business models, but differing privacy frameworks increase uncertainty and disproportionately affect SMEs. The USMCA review should expand commitments to privacy interoperability, including certifications, model clauses, and mutual recognition agreements; encourage broader participation in the Global Cross-Border Privacy Rules (CBPR) Forum; and reinforce prohibitions on unjustified data localization.

Predictable and secure data flows will reduce compliance burdens and enhance regional competitiveness.

Supporting SME digital transformation and cross-border trade

SMEs represent more than 98% of enterprises in North America, yet many lack digital readiness.^{1,2,3} To close this gap, it will be essential to: 1) launch trilateral digital capacity-building programs including microcredentials, AI literacy, and cybersecurity training; 2) develop harmonized e-commerce and digital trade onboarding tools to simplify compliance; 3) enhance digital financial inclusion through aligned credit-assessment standards, open finance frameworks, and a trilateral fintech sandbox; and 4) promote corporate–SME linkages through regional procurement pipelines and supplier diversity initiatives.

These efforts would strengthen competitiveness and enable SMEs to participate in regional value chains.

Establishing a permanent trilateral digital economy forum

To ensure continuous adaptation and coordinated governance, the Mexican Association of the Information Technology Industry (AMITI) proposes creating a Permanent Digital Economy Forum under the USMCA Free

Trade Commission, consistent with Article 19.14. This mechanism would:

- Monitor the implementation and effectiveness of Chapter 19.
- Assess emerging risks and opportunities in areas such as AI, quantum computing, cybersecurity, and digital skills.
- Promote regulatory interoperability and avoid divergent national approaches.
- Facilitate annual multistakeholder dialogue among governments, industry, academia, and civil society.
- Develop shared guidelines and pilot initiatives, including mutual recognition of standards.
- Encourage procurement practices that promote open standards, interoperability, and digital sovereignty.

Such a forum would provide long-term continuity and ensure that North America remains a global leader in digital trade governance.

The 2026 USMCA review is a pivotal moment to reinforce North America's digital leadership. By modernizing Chapter 19, strengthening cybersecurity cooperation, advancing interoperable AI and privacy frameworks, and empowering SMEs, the region can build a secure, innovative, and inclusive digital economy.

AMITI reiterates its commitment to collaborating with policymakers in Mexico, the United States, and Canada to ensure that the USMCA continues to drive long-term competitiveness and shared prosperity across North America.

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CHALLENGES AND OPPORTUNITIES FOR THE NORTH AMERICAN AUTO INDUSTRY



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The year 2025 was a whirlwind for the North American auto industry. The year started with one of the most generous electric vehicle (EV) consumer subsidy schemes in history, targeted tariffs that ensured that the industry would not be overwhelmed by Chinese low-priced imports, and projections of the strongest annual growth all decade.² It ended with an elimination of the consumer subsidies for EVs, sweeping tariffs on all manner of products and countries, and ambiguous growth prospects.³ The upcoming renegotiation of the United States-Mexico-Canada Agreement (USMCA) offers a window for policymakers to think through how to best weather these storms and emerge stronger.

The auto industry has long been one of the most important industries in North America, and is the most traded regionally.⁴ It is a key driver of demand for foundational industries: Globally, the auto industry procures 12% of all steel (including 26% of U.S. steel), 13% of all semiconductors, and 75% of all lithium-ion batteries. By purchasing large quantities of these inputs, the auto industry drives economies of scale and learning-curve improvements that benefit a wide swath of other industries including data centers, aerospace, agricultural equipment, and appliances. EVs are particularly important drivers of innovation, not just in batteries but also in semiconductors, casting, and robotics.⁵

The path to USMCA: 1960-2020

From the 1965 U.S.-Canada Auto Pact, to the 1993 North American Free Trade Agreement (NAFTA), to the 2020 U.S.-Mexico Canada Agreement (USMCA), regional policymakers have sought to structure integration to improve efficiency and lower costs, promote economic development by encouraging the many industries that supply the industry, tackle competition from outside the bloc, create balance within the bloc, reduce wage gaps, and manage energy transitions. Achieving the

desired mix of openness and protection has not been a linear process, and threats have been commonplace. In the 1960s, Canada attempted to address a ballooning auto trade deficit with the U.S. by subsidizing its parts industry. When the U.S. threatened countervailing duties, the 1965 compromise allowed zero tariffs on products containing 50% U.S. or Canadian content, and the U.S. companies that dominated the market (through subsidiaries) committed to produce one car in Canada for every one sold there.⁶ Around the same time, Mexico considered measures like nationalization to get auto companies to tolerate licensing schemes and tariffs to require auto companies to use 60% Mexican content if they wanted to sell in that nation, and later to meet export targets.⁷ For its part, the U.S. successfully used tariff threats to get Japanese automakers to localize production, though the Reagan administration as part of this deal promised a veto of 90% local content requirements that had passed the U.S. House of Representatives, while its labor board issued rulings that facilitated these companies' use of non-union labor.⁸

NAFTA brought duty-free trade to the entire continent, along with continental "rules of origin" (ROOs). At its signing, President Bill Clinton predicted that Mexico's (NAFTA-required) wind-down of its industrial policies would lead to more U.S. autos being sold there and more U.S. jobs, while side deals on labor would ensure "there will be an even more rapid closing of the gap between our two wage rates" and noting the pact would enable better competition with European and Asian trading blocs.⁹ While NAFTA led to substantial regional integration over the next 25 years, some other promised benefits failed to materialize. Production in the U.S. and Canada did not expand, while Mexico's share of North American production expanded considerably.¹⁰ The Mexican auto workforce grew from 167,000 in 1994 to nearly 1.3 million by 2018,¹¹ but there was no convergence of Mexico's wage rates with those of the U.S. and Canada.¹² Moreover, the traditional Big

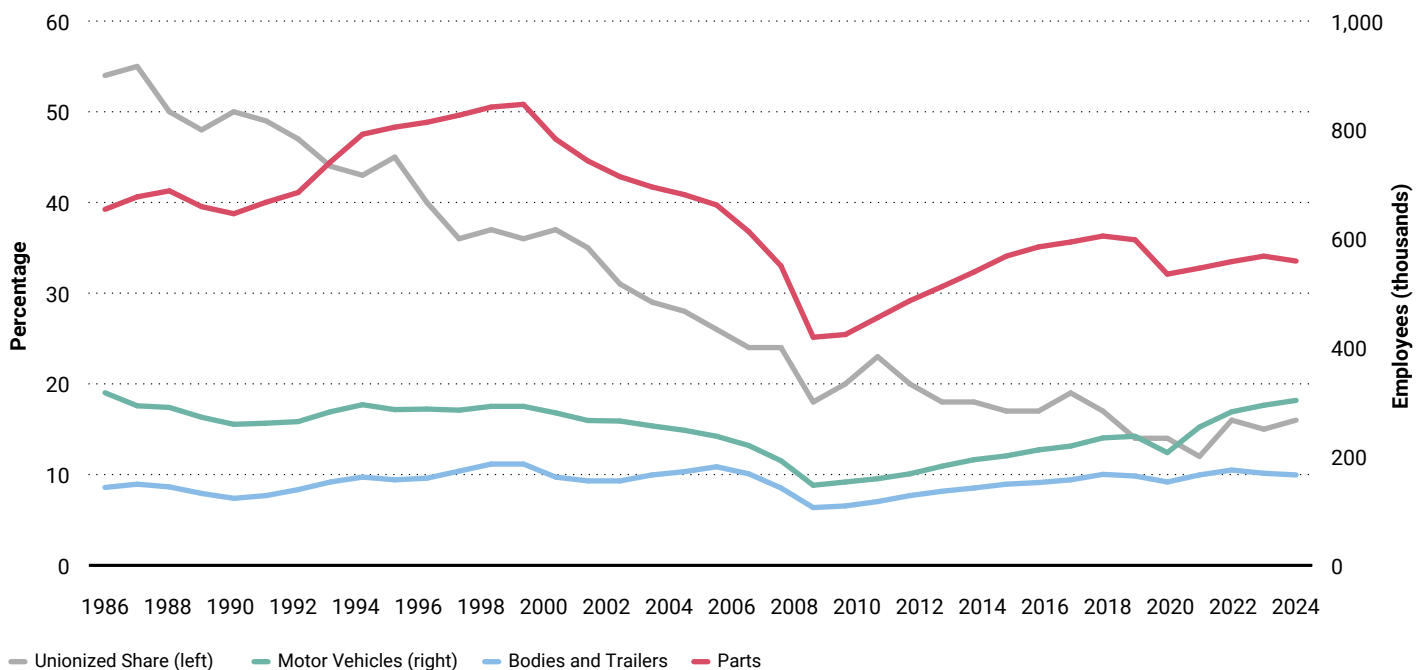
Three U.S. companies lost domestic, regional, and global market share; U.S. auto parts jobs contracted by between a third and a half from 2000 to 2018. Unionization rates plummeted as companies used threats of relocation to Mexico and elsewhere to quash union drives (see Figure 1).¹³ Though some of this job loss was due to uncompetitive products and processes,¹⁴ the situation created a fertile environment for Donald Trump to paint the Clinton record negatively, and to commit in his 2016 campaign to “renegotiate NAFTA. If I can’t make a great deal, we’re going to tear it up.”¹⁵

Starting in 2017, the Trump administration took several steps that affected auto industry trade. First, his Commerce Department found that auto imports impaired U.S. national and economic security under Section 232 of the Trade Expansion Act of 1962 and recommended tariffs of 25% to 35%, including on North American nations. Yet this report was not published nor acted upon at the time.¹⁶ Second, of relevance to the auto sector as a major input, the administration imposed global 25%

tariffs on imported steel and 10% on imported aluminum in July 2018 while negotiating side deals to dampen the impact on North American partners in May 2019.¹⁷ Third, NAFTA was re-negotiated over 2018–2019 to become the USMCA, which tightened ROOs still further—from NAFTA’s 62.5% regional content to a new 75% requirement. It also included requirements that 40% to 45% of a vehicle’s production value must be made by workers earning at least \$16 per hour, and 70% of a vehicle manufacturer’s steel and aluminum purchase value must originate in North America.¹⁸

These changes have had mixed results. According to the U.S. International Trade Commission, the new ROOs led firms to make sourcing changes that created a small number of jobs in the auto parts and steel industries, while only modestly increasing consumer prices.¹⁹ However, U.S. firms responded to the higher compliance costs by increasing imports from non-USMCA countries, and by opting to not comply with USMCA duty-free rules and instead pay the U.S.’ 2.5% most-favored nation

FIGURE 1. US MOTOR VEHICLE EMPLOYEES AND UNION MEMBERSHIP



Source: Employment Situation; Hirsch, Barry T., David A. Macpherson, and William E. Even (2025). Union Membership, Coverage, and Earnings from the CPS.

The USMCA experience made clear that new trade deals alone did not constitute an effective response to U.S. auto sector challenges.

tariff on passenger vehicles.²⁰ Rates of non-compliance for autos imported into the U.S. market quintupled (mostly driven by Mexican goods), while non-compliance for auto parts more than doubled for both Canadian and Mexican goods. The labor component of the ROOs did little to raise Mexican wages, as firms opted to meet this requirement through their U.S. and Canadian workers (The average hourly wage of automotive workers in Mexico in 2024 was \$5.66, compared to \$30.86 in the United States).²¹ In sum, the USMCA experience made clear that new trade deals alone did not constitute an effective response to U.S. auto sector challenges.

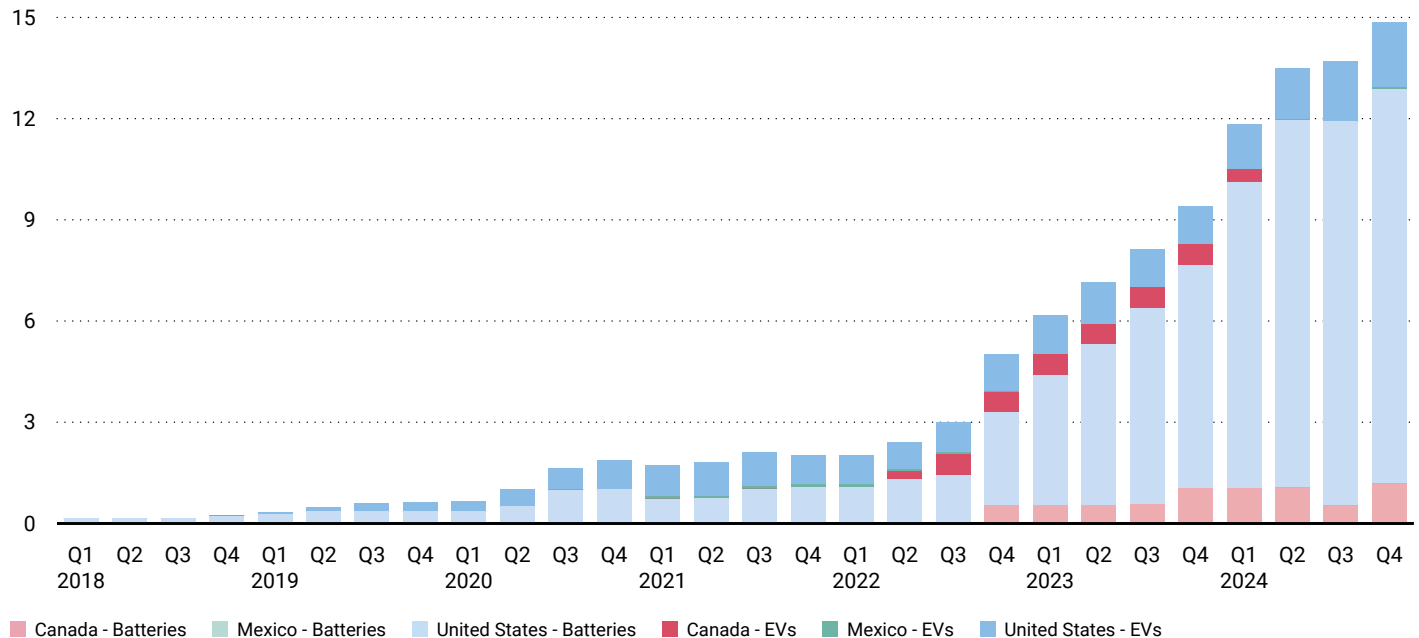
Rival visions: 2021-2025

In 2021, the incoming Biden administration built on the Trump administration’s approach on two fronts, focused on (re)building the social contract between the industry, workers, and the communities they serve. First, they

initiated a torrent of labor rights cases under USMCA, using the Rapid Response Labor Mechanism (RRM)—a novel mechanism that Trump had negotiated (under pressure from Democrats in Congress) but never utilized.²² Instead of a cumbersome inter-state arbitration process that could take a decade to complete, the RRM allows for relatively rapid expert investigations culminating potentially in the impoundment of goods made at specific facilities until labor abuses are remedied.²³ Biden initiated over 50 RRM actions—18 of which were in the automotive industry.²⁴ These cases led to benefits for about 20,000 workers in Mexico, including reinstatement of workers, payment of backpay, and more democratic union representation.²⁵

Second, Biden attempted to get auto companies to finally take on the challenge of international competition by transitioning to EVs. This was none too soon. While China was a negligible producer of EVs when NAFTA was signed and only a mid-range

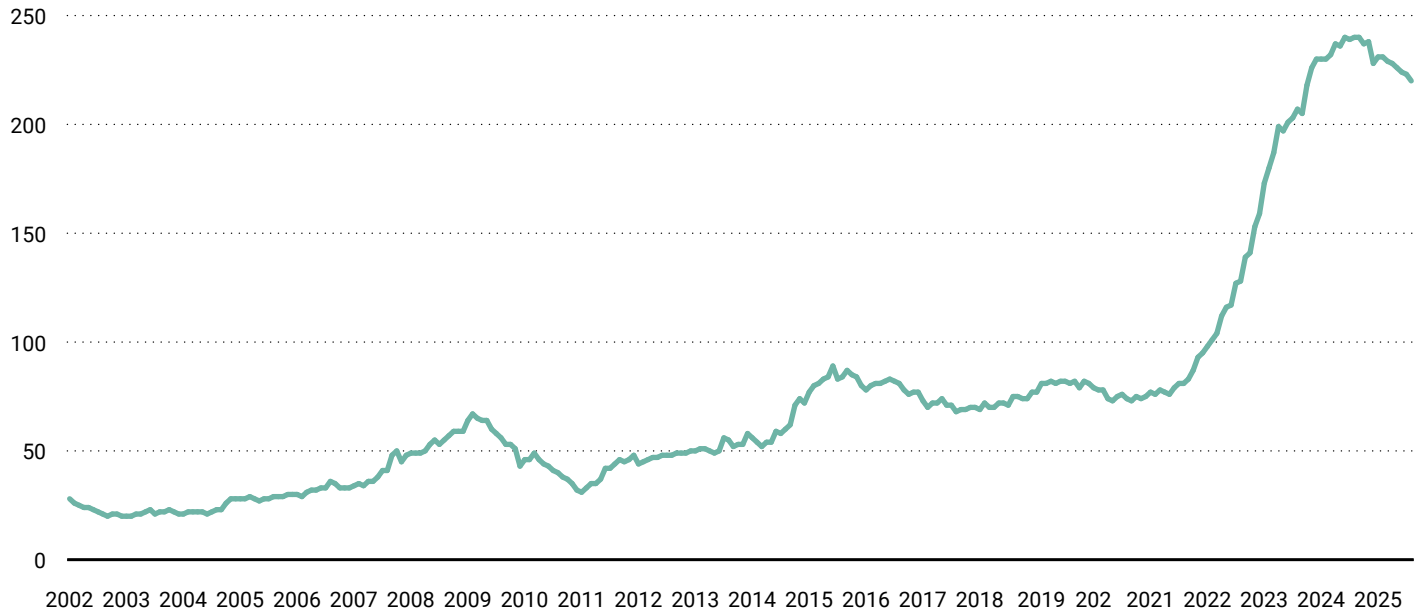
FIGURE 2. CLEAN INVESTMENT BY QUARTER
USD BILLIONS



Note: Data is limited for Canada and Mexico, so these numbers are a lower bound.

Source: Authors’ calculations + Clean Investment Monitor.

**FIGURE 3. TOTAL US CONSTRUCTION SPENDING: MANUFACTURING
USD BILLIONS**



Source: US Census Bureau, Construction Spending.

player when USMCA was negotiated, the country had rapidly expanded its production and exports. By the Biden years, low-cost producers like BYD were capable of supplying far more than Chinese domestic demand and over half of estimated global demand.²⁶ This new challenge compounded the preexisting one that EV production would lead to dislocation of 200,000 workers making gas vehicle propulsion system parts.²⁷ In response, the administration, through the Inflation Reduction Act (IRA) and Bipartisan Infrastructure Law (BIL), offered generous tax credits for EV producers and suppliers, consumer subsidies of up to \$7,500 for EV purchases,²⁸ and \$39.9 billion in grants and loans for the EV supply chain through the Department of Energy—73 % of which went to firms that had partnerships with labor unions (Canada²⁹ responded by investing \$52.5 billion in its EV supply chain and Mexico³⁰ is developing its own policies).³¹ Finally, in May 2024,³² the Biden administration imposed tariffs of 100% on Chinese EVs as a way to safeguard these substantial industrial policy

investments (In September 2024, Canada matched,³³ and Mexico³⁴ implemented a 50% tariff).³⁵ The combined impact of these policies were impressive. As Figure 2 shows, new investment in electric vehicles and batteries increased more than 500% in North America between the second quarter of 2022 and the end of 2024, while manufacturing factory construction in the U.S. (including these and other sectors supported by Biden’s industrial policies) increased by an unprecedented 130%³⁶ between January 2021 and June 2024 (see Figure 3).³⁷

The second Trump administration has introduced substantial new costs and uncertainty for the industry. First, in February 2025, the second Trump administration reinstated steel and aluminum tariffs that had been paused during the first Trump and Biden administrations, including on Canada and Mexico.³⁸ In March, Canada retaliated by imposing 25% tariffs on U.S. steel and aluminum.³⁹ These were later doubled. Second, in March, the administration picked

up the previously-shelved 2019 auto report and imposed 25% tariffs⁴⁰ on autos and auto parts under Section 232⁴¹—including those from Canada and Mexico.⁴² Canada retaliated in April with a 25% “surtax” on U.S. autos.⁴³ Third, in April, on so-called “Liberation Day,” the administration announced across-the-board tariffs of 10% with even higher rates for trade-surplus countries. They then negotiated “Agreements on Reciprocal Trade” (ARTs) with major trading partners like the U.K., EU, Japan, and Korea, which lowered the 25% auto tariff these countries faced to 10% to 15%. As the Big Three American automakers noted,⁴⁴ this is lower than what North American producers face on their imports from Canada and Mexico. Fourth, on July 4th, the One Big Beautiful Bill Act (OBBBA) repealed the EV consumer tax credit,⁴⁵ leading to a sharp drop⁴⁶ in the sale of EVs and several EV supplier⁴⁷ facilities shuttering.⁴⁸ This latter is especially ironic, given that the consumer subsidies included tough requirements⁴⁹ for local and regional- and ally- sourcing of inputs like critical minerals and batteries—promotion of which is supposedly an Administration priority.⁵⁰ Finally, through the OBBBA and other cuts, the budget for RRM and other USMCA enforcement (which has disproportionately aided autoworkers) was cut dramatically.⁵¹

Can USMCA 2.0 right the ship?

The USMCA renegotiation offers an opportunity to put the North American auto industry on a firmer footing, especially about addressing challenges from China, the energy transition, and ongoing labor inequities. Here are some changes we would suggest, both incremental and fundamental, all of which have at least some political support. We think it is important to include some more ambitious proposals due to the volatile times we find ourselves in. In such an era, policymakers will be well advised to think less in terms of constitution-style policy lock-

in (as in the original expiration-date-less NAFTA), and more in terms of using trade as a tool of industrial policy experimentation and learning over shorter (e.g., years- or decade-long) periods.⁵²

Coordinate policies to address China competition and promote the energy transition

Given the high degree of integration of the industry, it makes sense to have the countries’ external postures be more consistent. The parties should adopt similar tariffs on EVs, steel, and auto products from outside the bloc, especially China. The U.S. and Canada had been mirroring each other to some extent; Mexico should match these. The U.S. should reinstate its EV subsidies (as recommended in Brookings’s USMCA Forward 2025 edition); Canada and Mexico should proportionately match them.⁵³ A joint carbon import fee on goods from outside the bloc, an RRM-like mechanism to sanction polluters within the bloc (as called for by the Sierra Club⁵⁴ and other environmental groups),⁵⁵ and a joint critical minerals strategy (as called for by the Climate Leadership Council)⁵⁶ are further useful steps. Moreover, recognizing that China’s advantage is in part due to superior technology, it will also be useful to agree on common terms under which Chinese investment in North America is allowed, including provisions for technology transfer and use of Chinese software (to avoid potential surveillance). Although blocked by high tariffs and software bans⁵⁷ in the U.S. and Canada, Chinese automaker BYD is already the fourth largest automaker by sales in Mexico⁵⁸ and is rumored again to be considering building a plant there.⁵⁹ While allowing North Americans to buy \$20,000 or \$30,000 Chinese EVs would advance climate goals and save consumers money in the short-term, such a policy threatens regional security and high-standard production models, because

The USMCA renegotiation offers an opportunity to put the North American auto industry on a firmer footing, especially about addressing challenges from China, the energy transition, and ongoing labor inequities.

China’s success is due to high subsidies and low labor and environmental standards⁶⁰ as well as innovation.⁶¹ Chinese (and ideally other) investment should be allowed only if it includes requirements for neutrality towards union organizing, high environmental standards, and requirements for advanced technology transfer (mimicking Chinese policies toward U.S. multinationals, which traded market access in prior decades for technology transfer that was critical for their current development of superior technology).

Strengthen and modernize Rules of Origin (ROOs)

The ROO changes negotiated in the first Trump administration had less impact than desired, in part because of the low cost of non-compliance through paying the Most Favored Nation (MFN) tariff. Now, higher effective tariffs on imports from outside the bloc in all three countries should make the ROOs more effective. However, new distortions have been introduced by the ARTs, which disincentivize North American production. The ARTs should include similarly stringent local content, labor, and steel ROOs as the USMCA—and the USMCA 2.0 tariff rate should be lower than the ARTs’ rate in

recognition of the high degree of regional integration. The American Automotive Policy Council⁶² and the United Autoworkers Union⁶³ (UAW) have each advanced proposals to change ROO and related calculations to drive more regional procurement and investment.

Strengthen the Rapid Response Mechanism (RRM) and boost labor power

Finally, the renegotiation should acknowledge that much of the discontent with NAFTA and the USMCA is not about the total number of jobs in the industry, but job quality and persistent wage gaps within the bloc. Currently, the RRM applies only to Mexico. The parties should agree to make the mechanism trilateral, have all parties (including the U.S.) ratify all International Labor Organization conventions, and make other reforms recommended by the UAW,⁶⁴ which has some of the most experience with the mechanism. Given the high degree of integration of the three economies’ auto sectors, the parties should consider experimenting with trinational sectoral labor bargaining. The UAW’s experience putting investment commitments into its collective bargaining agreements shows the value of labor unions as industrial policy partners. Moreover, they would restore foreign aid to fund union-capacity building in Mexico. Many of these calls are echoed by other labor unions, progressive advocacy groups, Mexican labor unions, and manufacturers.⁶⁵

While the Trump administration is unlikely to take up all these reforms of their own initiative, the need for congressional support offers leverage to make the kinds of tough demands that have long characterized North American bargaining in the industry.



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INTRODUCTION TO STEEL, AN INDUSTRIAL MATERIAL



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Over the past three decades, the steel industry across Canada, Mexico, and the U.S. has evolved into a true regional market with high value production, processing, distribution, and consumption throughout the wider North American region. The USMCA and its NAFTA predecessor have been highly important in not only building this regional steel market, but also in sustaining the overall industry. The supply chain serving the construction and manufacturing industry is heavily dependent on free trade across the region. Section 232 tariffs on steel have inhibited this supply chain from operating efficiently. The removal of these tariffs, with appropriate safeguards, will better support the regional economic growth.

From the founding of U.S. Steel, the world's first billion-dollar corporation, to the pioneering use of the Electric Arc Furnace (EAF) by Nucor, steelmaking has a long and storied history in North America. Today, steel producers in Canada, Mexico, and the U.S. are among the cleanest and most efficient in the world.¹ Steelmakers here have continued to invest across the region into high value, low emission steelmaking, predicated on serving the North American market.

Steel, an industrial good and basic material, is a building block of modern society. While the process of steel manufacturing can sound simple, steel is an engineered product deliberately crafted to satisfy a specific end use for each heat of the furnace.

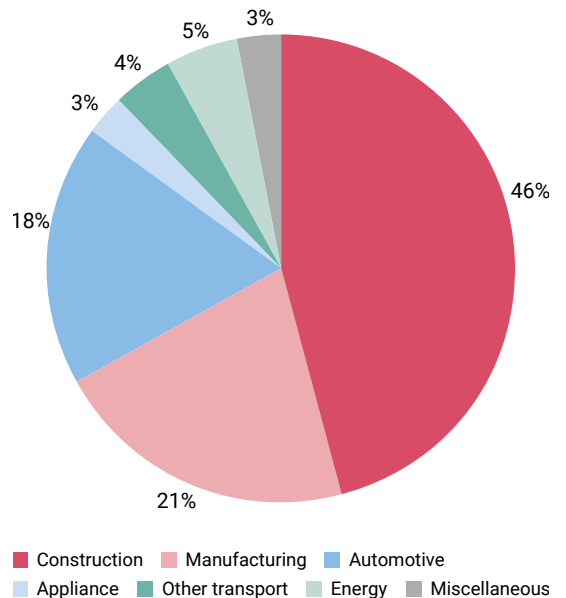
Barriers to entry in this market are initially related to the capital required to build a mill and generally two to five years to construct and start the mill, depending on the size and specific product produced. In the U.S. market, steel producers have enjoyed some of the highest prices across the world.² This is due to the U.S. and North America positioned as net importers of steel. In these markets, imports are required across key products to satisfy demand, and imports are often the marginal source of supply. Due to this, rather than steel

prices being set by the domestic cost curve, market prices are often determined by the cost of imported steel particularly in stronger periods of demand.

In 2024, Canada, Mexico, and the U.S. imported 49 million tons of finished and semi-finished carbon steel with 32.6% of these imports coming from within the region. Five countries accounted for the next 30% of imports. These countries in order of import market share are: Brazil (10.1%), South Korea (7.2%), Japan (6.0%), Vietnam (3.7%), and China (3.1%).³

Steel is used across a variety of industries, and as a result, changes in the price of steel can have broad economic effects. The following chart shows the diversity of end use demand. Though these segments can be consolidated into two primary categories: construction, and manufacturing when Appliance, Automotive, and Other transport are included in Manufacturing. When combined, these two categories reflect nearly 90% of steel consumption.⁴

**FIGURE 1. END USE
NA SECTOR SHARES OF DEMAND, 2025**



Source: CRU.

In North America, the U.S. steel market is the largest market in the region as well as the most protected market in terms of imports.

Construction is the largest source of direct end use steel demand. This category covers uses such as residential buildings, offices, hotels, data centers, and infrastructure, among others. Demand from each of these single categories can be cyclical from others based on underlying trends in each segment. For example, over the past two years, spending on office construction has trended lower while spending on data center construction has surged and is set to overtake spending on traditional offices.⁵

Manufacturing is the other major segment of steel demand as it includes the creation and assembly of products such as fabricated metal goods, machinery, and light weight vehicles. In construction, steel is used once per project, such as beams on a multi-story hotel or rebar for a highway project. Yet in manufacturing, steel is a consumable that scales alongside overall output. For example, the more vehicles built, the more steel consumed.

Cyclical market and volatile prices

The timeline between the initial order and when steel is placed into final use is measured in months, due to mill lead times as well as downstream processing and distribution. Due to this time frame, seasonal demand changes or sudden shifts in demand can wreak havoc with supply chain inventories as occasional production shortfalls or shifts in trade can suddenly tighten market supply leading to a domestic price surge. The opposite can also happen where demand forecasts are suddenly deemed too optimistic and orders further down the supply chain are cancelled. In this instance, inventories of steel products which were built up to support higher demand expectations are suddenly in a surplus. This surplus can quickly limit new orders placed at the mill, creating recessionary conditions until inventories are more in line with demand.

This often unpredictable behavior between supply and demand as well as the dependence on imports, which have even longer lead times, lead to high levels of price volatility. This dynamic plays out across North American markets as the region is historically interconnected due to the free trade agreements which have led to manufacturers expanding across borders.

Despite this volatility in prices, steel's role as a primary industrial input results in price inelasticity of demand particularly over short periods. For example, following the pandemic lockdowns benchmark, hot rolled (HR) coil steel surged by over 300%,⁶ yet steel demand remained largely unchanged. Yet over time, higher steel prices have led to some substitution such as lumber taking back share from steel studs, or asphalt shingles replacing steel roofing, as well as declines in demand as the higher prices negatively impacted various industries.

Current state: Intensified steel trade protection

In North America, the U.S. steel market is the largest market in the region as well as the most protected market in terms of imports.⁷ For decades, the U.S. mills have relied on antidumping (AD) and countervailing duties (CVD) as a tool to limit the financial disruption associated with dumped or subsidized imports from foreign steel makers. These cases are often filed during periods of low profitability in the market. This protection typically focuses on antidumping cases, which aim to address imports of steel sold at less than fair value, or where the foreign producers have a lower production cost due to government support. If a case is successful, despite requirements for a sunset review of the tariffs every five years, tariffs can remain in place for decades. Examples of this include an antidumping order placed on certain stainless steel wire rod from India in 1994,⁸ as well as carbon steel

plate from China in 1997 that both continue to remain in effect today.⁹

While AD/CVD cases are very specific and target individual countries and producers by product, there are other trade tools used by the U.S. to limit steel imports. The most recent examples are the Section 201 (S201) from the U.S. Trade Act of 1974 and Section 232 (S232) from the U.S. Trade Expansion Act of 1962. Each of these had been used in the past before they were used to protect the steel industry. For example, President Ronald Reagan utilized S201 to impose 45% tariffs on large motorcycles from Japan in the 1980s after a petition from Harley-Davidson.¹⁰ The first positive determination of S232 was in 1973 after an investigation found that oil imports threatened national security.¹¹ The remedy in this case was instituting an import license scheme, protection for refineries, and incentives for new refining capacity.

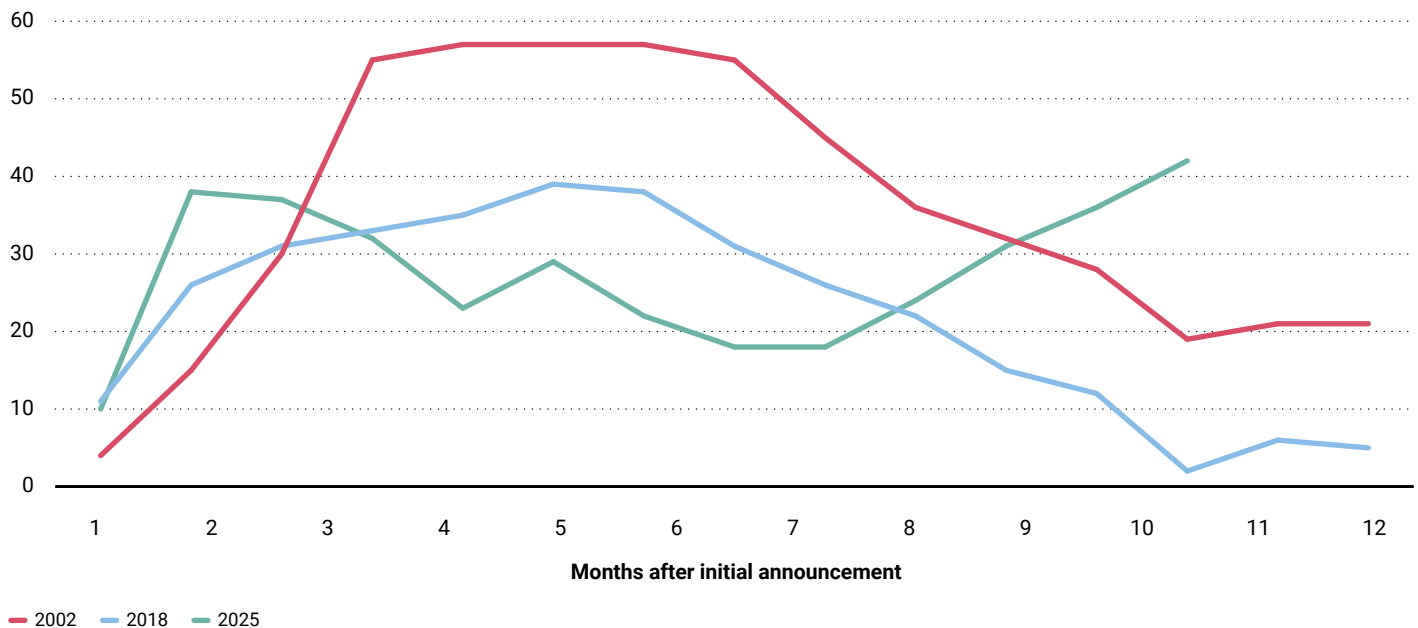
As a response to the bankruptcy of several U.S. steel producers, President George W. Bush turned to S201 to impose a three-year tariff of up to 30% on steel imports against most

countries in March 2002. Due to the North American Free Trade Agreement, Canada and Mexico were exempt from these tariffs.¹² These global tariffs were officially rescinded 20 months later in December 2003.¹³

In 2018, President Donald J. Trump turned to S232, which requires a finding that there is a threat to U.S. national security,¹⁴ to impose tariffs of 25% on imports of all steel. As part of the 232 investigation, national security was defined in terms of steel used in military products such as tanks and aircraft carriers as well as steel use in bridges, energy transmission, and more. The administration's goal was to support the U.S. steel industry in achieving a capacity utilization rate of 80% or higher, seen as the minimum rate required for the industry to operate sustainably and support national defense needs in the future.¹⁵

Canada and Mexico were granted temporary exemptions from these 232 steel tariffs for nearly three months, and in May of 2019, they were granted a full exemption in the negotiations leading up to the USMCA trade

FIGURE 2. US MIDWEST HR COIL PRICE, M/M CHANGE VS PRE-TARIFF



Source: CRU.

agreement.¹⁶ Following President Trump's first term, President Biden largely kept the S232 steel tariffs in place for most countries. The exception to this was tariff rate quotas put in place for the EU, Japan, and U.K. where a specified level of imports could come in without the S232 tariff.¹⁷ Yet, in February 2025, President Trump reinstated the S232 steel tariffs and eliminated all country-specific exclusions, including for Canada and Mexico.¹⁸ Further, in June 2025, the 25% S232 tariff was increased to 50% for all countries. In addition to this 50% tariff rate, the reinstated S232 tariffs allowed for other derivative products to be included rather than a process to request for exclusions.¹⁹ This has led the S232 tariffs to be applied further downstream to the steel content of imported products including bolts, bulldozers, and packaged products such as cans of shaving cream.²⁰

This imposition of steel tariffs on Canada and Mexico has had dramatic effects on the interconnected North American steel supply chain and end users. Perhaps the most visible example of this is the automotive supply chain. High quality steel is produced in all three countries. Some of this is sent to stamping facilities for use in parts of the automotive body such as the hood or doors. Other steel is processed and assembled across multiple vendors to produce small components that traverse the border multiple times and go into larger parts, such as a rear underbody assembly.²¹ Due to the interconnectedness and overall growth of the North American market since the North American Free Trade Agreement went into effect in January 1994, investment in the production and processing of steel as well as downstream manufacturing of goods have grown across Canada,



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Growth of manufacturing has been and will remain a key focus of North American political leadership as manufacturing supports domestic jobs on the shop floor, at suppliers, as well as in downstream processing, packaging, and service providers.

Mexico, and the U.S. One example for steel is ArcelorMittal's Calvert mill near Mobile, Alabama. With over 5 million tons of rolling capacity, this facility was built in 2010 to not only support the Southeastern U.S. market, but also automotive steel demand in Mexico.²²

These reinstated \$232 tariffs have led automotive manufacturers redirecting their network of suppliers to increase sourcing of U.S. produced steel. This shift in sourcing has led to higher compliance and sourcing costs, lower profits, and less diversity of supply.²³ A lack of supply diversity is often a key risk for manufacturers as an unexpected outage can quickly disrupt manufacturing output. Steel mills can experience sudden issues with the operation of their furnace or supply of key industrial inputs. In 2005, Hurricane Katrina caused extensive damage to an industrial gas complex which severely limited the supply of liquid hydrogen used in the production of galvanized steel.²⁴ In 2008, a steel mill in Dearborn, Michigan experienced an explosion at a blast furnace.²⁵ Both instances immediately created a shortage of material forcing steel buyers to slow operations until their supply of steel could be restored.

Recommendation: Limit disruptive steel imports from outside the North American market

Growth of manufacturing has been and will remain a key focus of North American political leadership as manufacturing supports domestic jobs on the shop floor, at suppliers, as well as in downstream processing, packaging, and service providers. For manufacturing output to be successful and grow domestically, businesses require an adequate supply of three things: competitively priced energy, labor, and materials. Without any one of these, manufacturing will be incentivized to offshore or outsource noncompetitive components.

Steel prices will also impact construction. At CRU, we estimate that over a variety of construction projects with varying steel intensities, steel represents approximately 15% of the total cost.²⁶ The more competitively priced steel is, the more overall projects can take place, leading to higher economic output. This is particularly apparent with government-funded infrastructure projects which are often used to support economic activity at the local or federal level. This can include the replacement of critical infrastructure such as bridges or the development of new highways, airport terminals, or electrical transmission and distribution systems. In this instance of publicly funded infrastructure spending, once a plan is approved and money allocated, the more that materials such as steel cost, the fewer projects get built.

Construction²⁷ and manufacturing²⁸ in North America are economic multipliers as spending and investment in these sectors generate significantly more economic activity than the initial amount spent. These two categories combined provide nearly \$3 per every \$1 invested through a combination of direct, indirect, and induced spending. Direct spending includes items such as materials, equipment, and labor to build and run the facility. Indirect spending represents money spent in the downstream supply chain to support the construction and operation of the site or facility. While induced spending is money spent from wages earned from the direct and indirect sectors.

Policymakers today can support economic growth via these industries through ensuring the upstream supply chain that includes steel is profitable for producers yet competitive enough to support the downstream users in construction and manufacturing. Due to the cyclical nature of steel demand, steel producers may not be profitable every quarter, but a profitable base of steel supply in Canada, Mexico, and the U.S. is required to support economic activity as well as national defense.

In the 2026 USMCA Joint Review, policymakers can support domestic steel production across the wider North American market. To do this, the U.S. should unwind the steel tariffs on Canada and Mexico and limit their scope. The current tariffs raise the domestic steel price, which has had negative impacts on investment and the competitiveness of domestic manufacturing, as well as overall construction output.²⁹ A balance must be found that supports not only domestic producers, but also steel consumers across the wider construction and manufacturing industries. Therefore, the S232 steel tariffs should be reformed to ensure a competitive supply of steel is available to North American users with some tariffs remaining on steel imports from hyper competitive markets such as those in and around China that are influenced by over production and government-led financial assistance.³⁰

While limiting imports from markets outside of North America, policymakers should return to a path towards minimal barriers of steel trade within the North American region. This recommendation could take shape in a variety

of ways from an initial quota of low to no S232 tariffs to going back to a full regional exclusion from S232. This type of policy would not restrict domestic producers from filing an AD/CVD trade case if there is dumping.

To do this, Canada, Mexico, and the U.S. would need to align trade policy on material inputs such as steel, among other key materials. If this long-term trade support is provided, it will incentivize new technologically advanced steel mill investment across the region. This alignment has already started to come about as both Canada and Mexico have brought about stricter trade restrictions in the past year. These protections include lower quotas on steel imports from non-free trade agreement countries and tariffs on steel-derivative products.

In time, it will lead to more competitive steel supply and costs that can then support construction and manufacturing segments as well as the jobs that go along with these industries.

Endnotes

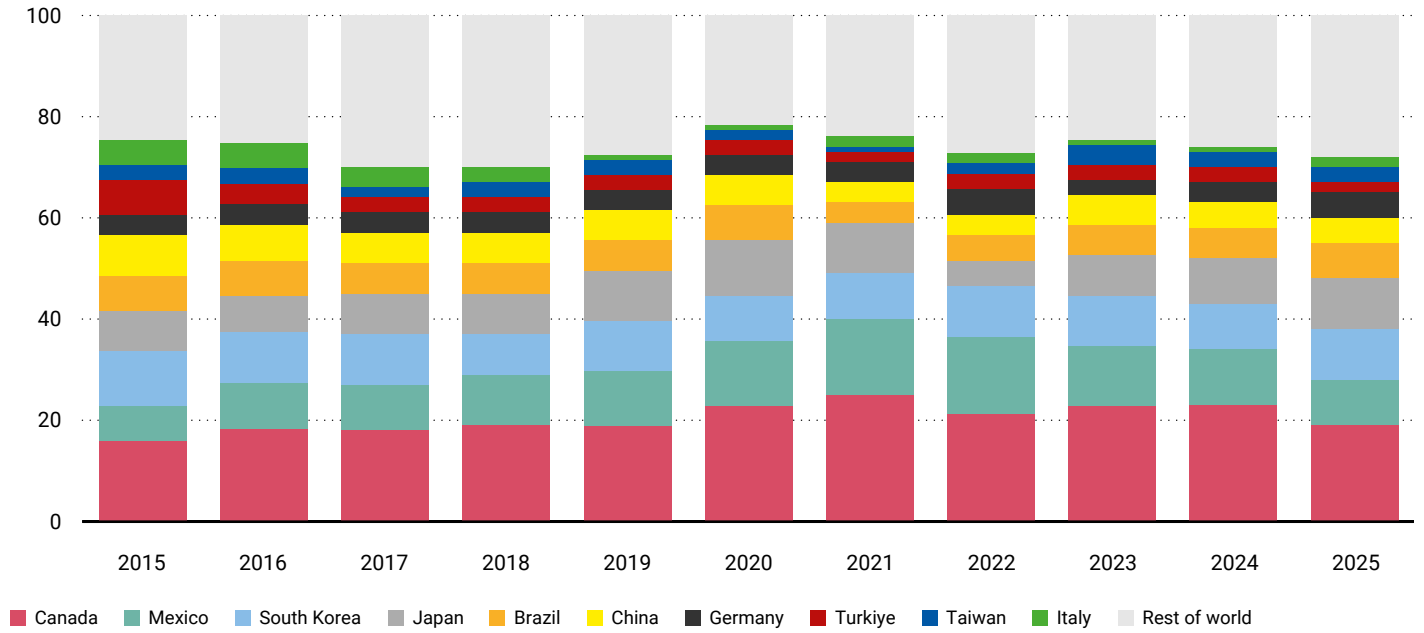
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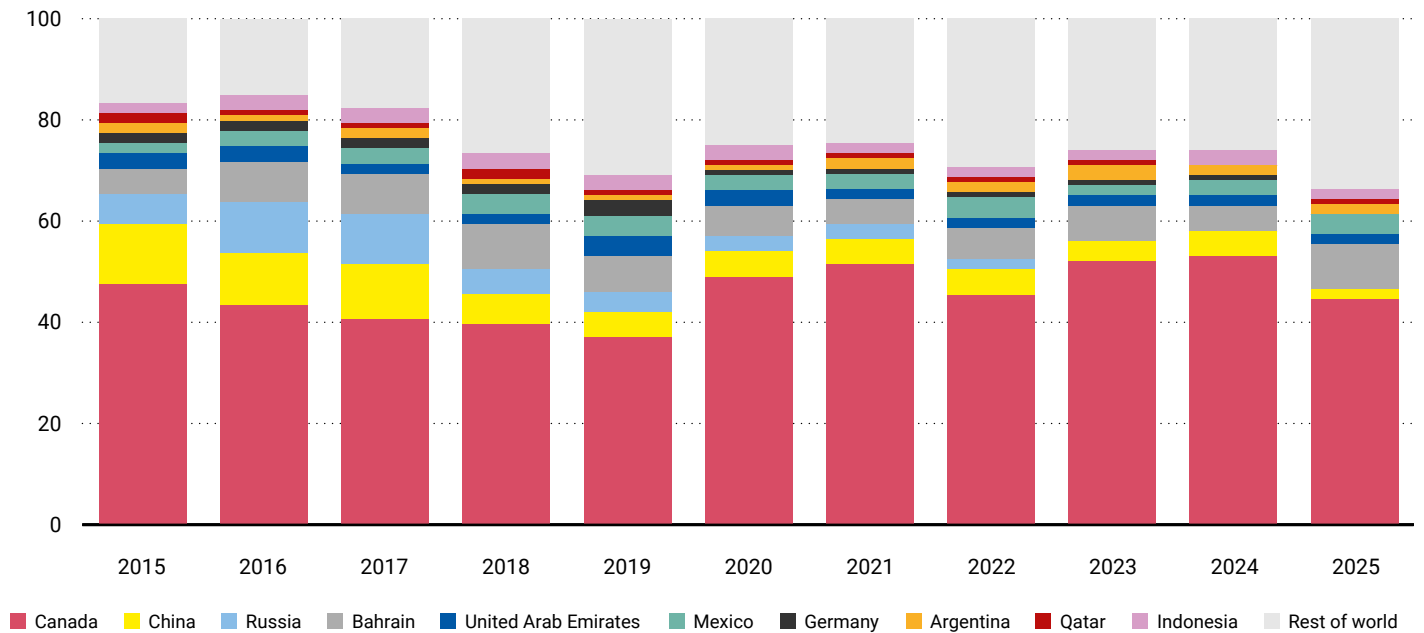
THE US NORTH AMERICAN NEIGHBORS ARE IMPORTANT SOURCES OF STEEL
SHARE OF US IMPORTS OF STEEL PRODUCTS BY COUNTRY (%)



Source: ITA US Steel Import Monitor.

CANADA REMAINS THE US KEY SUPPLIER OF ALUMINUM, THOUGH IMPORTS HAVE DECLINED FOLLOWING US TARIFFS

SHARE OF US IMPORTS OF ALUMINUM PRODUCTS BY COUNTRY (%)



Source: ITA US Aluminum Import Monitor.

REFINING USMCA TO STRENGTHEN INTEGRATION OF NORTH AMERICAN AGRICULTURAL SECTOR



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Opportunities for agriculture

North American agriculture's integration under NAFTA and now USMCA has created a continental market that buffers producers and consumers from global shocks, ensuring affordable food, stable value chains, and continued competitiveness. This integration is more important in an increasingly uncertain global trade environment, providing stability and resilience for producers and consumers across the continent. The upcoming USMCA review should be approached not as a reopening of settled ground, but as an opportunity to reinforce a framework that has already proven its worth in supporting stability, affordability, and competitiveness across North America's agricultural economy.

Integration and competitiveness in North American agriculture

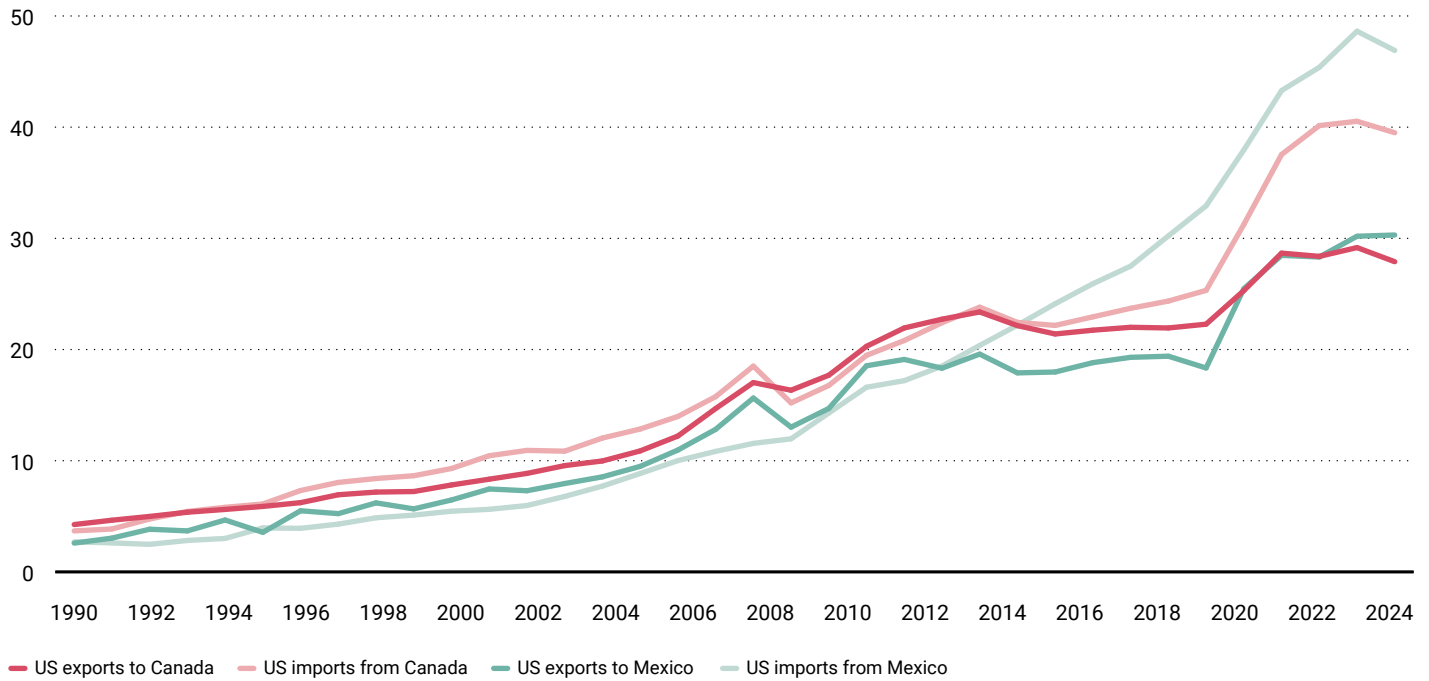
The United States, Canada, and Mexico together represent one of the most competitive and productive agricultural regions in the world. The United States and Canada are consistently among the top five global exporters of agricultural products over the past decade, accounting for 12% and 4.7% respectively of global agricultural exports in 2023,¹ Mexico accounting for 3.1% in 2023.²

Intra-North American trade anchors the agricultural economies of all three countries. Since the inception of NAFTA, U.S. agricultural exports to Canada and U.S. agricultural imports from Canada have grown fourfold and tenfold respectively.³ At the same time, U.S. agricultural exports to Mexico and U.S. agricultural imports from Mexico have grown over fivefold and close to fifteenfold respectively (see Figure 1).⁴ Canada and Mexico are the destination for about one-third of U.S. agricultural exports, while for Mexico, 90% of exports go to the United States and Canada, and for Canada, 63% of exports go to the United States and Mexico.⁵

The three North American neighbors are both competitors and complements in agri-food markets. Traditional sources of comparative advantage—climate, land endowments, and consumer tastes—explain much of the trade in final agricultural products. But modern drivers such as innovation and integrated value chains have deepened cross-border interdependence by distributing production stages across the continent, similar to manufacturing systems that locate each step for efficiency. Land-intensive crops such as grains and oilseeds suited for temperate climates move south, while labor-intensive fruit and vegetables production that thrives in warmer regions moves north. In 2024, 73.3% of U.S. agricultural exports to Mexico were grains, oilseeds, meat, and related products, and 73.1% of U.S. agricultural imports from Mexico consisted of fruit, vegetables, beverages, and distilled spirits (see Figures 2 and 3).⁶

Competition, by contrast, is most visible in U.S.-Canada trade, where two-way exchange occurs in similar, but differentiated products. U.S. imports from Canada fall largely into categories where the United States is a globally-competitive exporter: In 2024, 61% of U.S. imports from Canada were meat, grains, oilseeds, and related products.⁷ This overlap reflects firms competing within integrated markets for grains, oilseeds, and animal products, while also benefiting from cross-border value chain efficiencies. In a sector where even modest differences in weather conditions can dramatically affect output and product characteristics, this form of intra-industry trade enhances resilience by providing food manufacturers a wider range of reliable inputs and consumers greater product variety. Differences in crop types and production methods—such as U.S. soybeans and soybean oil alongside Canada's canola and canola oil—reflect specialization within a common market rather than duplication.

FIGURE 1. US AGRICULTURAL TRADE WITH CANADA AND MEXICO 1990-2025
USD BILLIONS



Source: USDA, Economic Research Service using data from U.S. Department of Commerce, Bureau of the Census, as compiled by USDA, Foreign Agricultural Service, Global Agricultural Trade System.

A further dimension of integration operates through cross-border value chains, in which raw materials or processed products from one country are inputs that support downstream industries in another. This dynamic is most clearly seen in cross-border livestock production: Canada exports feeder animals and hogs for slaughter, many of which are finished in U.S. operations concentrated in states such as Iowa and Minnesota.⁸ These facilities benefit from abundant feed supplies and slaughtering capacity, while processed pork products are exported throughout North America and globally. Mexico accounted for 37% of U.S. pork exports in 2022.⁹ The North American hog industry is thus a canonical example of a continental value chain, where multiple stages of production add value across borders.¹⁰

The North American agri-food system supports millions of jobs across agricultural production, food processing, manufacturing,

logistics, and services, while providing consumers with stable, affordable food supplies. Together, the agri-food sectors contribute nearly \$2 trillion to GDP and support more than 40 million jobs across the continent.^{11, 12, 13} These linkages make North American agriculture more than a collection of national industries—it is a single continental system that delivers stability, global competitiveness and shared prosperity.

Sectoral resilience in the face of global headwinds

As global trade uncertainty, climate shocks, and rising protectionism threaten to disrupt vital food and agricultural markets, North America’s deeply integrated agricultural market is a vital source of stability. Trade is increasingly shaped by political conflict, strategic competition, and a growing emphasis on self-sufficiency. Geopolitics, rather than

markets, now often determines access to key commodities and destinations.

Beijing’s recent curbs on agricultural imports from the United States and Canada reflect how geopolitics can shape trading relationships. Both countries have experienced politically motivated disruptions that reveal China’s leverage as a dominant buyer in global agricultural markets. In 2019, following a bilateral diplomatic dispute, China suspended import permits for two Canadian canola exporters, citing quality concerns.¹⁴ In 2024, China retaliated against Canada’s implementation of a 100% tariff on Chinese electric vehicles (EVs)¹⁵ with a 100% tariff on Canadian canola, followed by a 75.8% anti-dumping duty described as an “unmistakable act of economic coercion.”¹⁶

Similarly, the ongoing U.S.–China trade conflict has been damaging to the U.S. farm sector, most notably soybean exports. The loss of market share to Brazil has been compounded by China’s recent lack of soybean purchases from the United States,¹⁷ and diversion to

other markets is unlikely to offset the loss. These interventions matter because China remains a major agricultural export market for both U.S. and Canada, particularly for grains, oilseeds and meat. In 2022, China was the top destination for U.S. agricultural exports, valued at \$36.4 billion for the fiscal year (October 2021–September 2022), accounting for 18% of Chinese imports.¹⁸ Canada was China’s 8th largest supplier of agricultural products worth \$7.6 billion, or 3% of imports.¹⁹

These developments are occurring as the rules that have defined the global trading system weaken. Analysts describe a drift toward fragmented, preferential trade arrangements as the World Trade Organization’s influence wanes and multilateral governance erodes. Economist Richard Baldwin²⁰ characterizes this emerging order as “managed multilateral drift”: The World Trade Organization (WTO) endures with diminished authority, while regional and bilateral agreements take precedence. In this environment, regional frameworks such as the USMCA are

FIGURE 2. US AGRICULTURAL EXPORTS TO MEXICO 2024

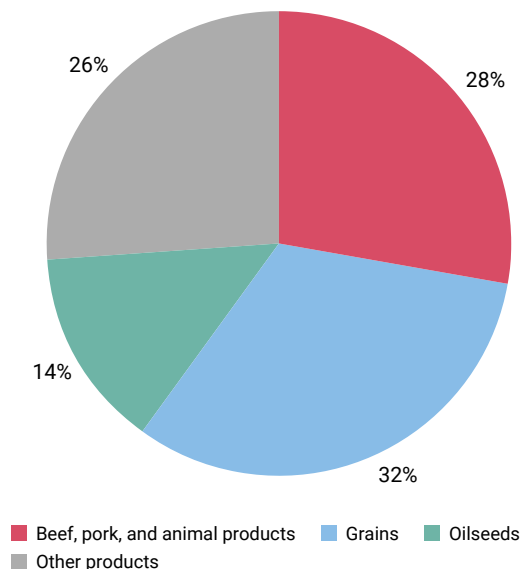
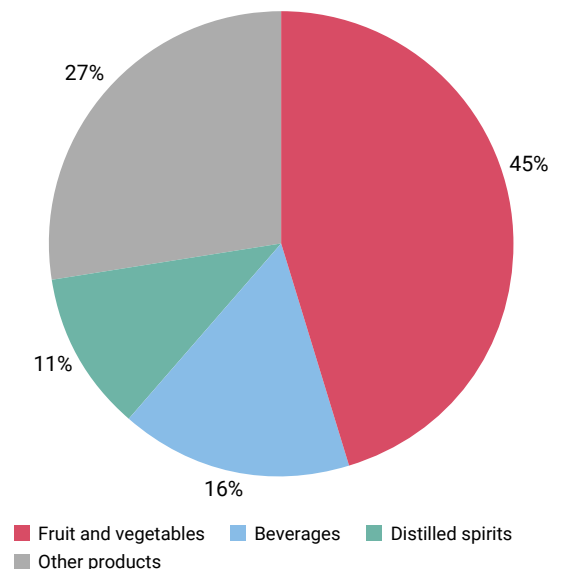


FIGURE 3. US AGRICULTURAL IMPORTS FROM MEXICO 2024



Source: USDA, Economic Research Service using data from U.S. Department of Commerce, Bureau of the Census, as compiled by USDA, Foreign Agricultural Service, Global Agricultural Trade System.

In this environment, regional frameworks such as the USMCA are becoming the practical anchors of stability, transparency, and rules-based trade for the agri-food sector.

... USMCA has transformed North American agricultural integration from an economic relationship into an institutional framework for competitiveness and resilience.

becoming the practical anchors of stability, transparency, and rules-based trade for the agri-food sector.

USMCA’s role and achievements

In a world of rising protectionism, the extent of the North American agri-food system’s integration should be reinforced, not relitigated. Under NAFTA, tariffs between the United States and Canada were fully eliminated by 1998, except for select exemptions for dairy, poultry, and egg products, sectors that Canada still governs through supply management. Tariff elimination between the United States and Mexico was completed by 2008, with no exclusions, while Canada-Mexico trade retained limited exemptions for dairy and poultry.

Progressive liberalization of agricultural trade in North America created opportunities and prosperity, though not without adjustment. For example, agriculture’s share of total Mexican employment has halved since 1994²¹ and the total number of corn-producing farms declined by 48% between 1991 and 2014.²² This was driven at least in part by the exposure to competition from producers north of the border.

The USMCA built directly on NAFTA’s achievements, preserving tariff-free trade for nearly all agricultural products while introducing targeted improvements to address remaining market-access challenges stemming from regulatory differences and administrative complexities. For U.S. producers, the agreement expanded opportunities in several sensitive Canadian sectors. A salient improvement was the establishment of tariff-rate quotas (TRQs) providing greater market opportunities for U.S. exports of dairy, poultry, and egg products.²³ The new TRQs created modest but symbolically important gains for these sectors, though concerns remain about how the TRQs are administered and the

effective level of U.S. access to the Canadian dairy market.²⁴

The agreement also enhanced transparency in sanitary and phytosanitary (SPS) measures and reaffirmed that food safety and plant and animal health regulations should be based on scientific evidence.²⁵ These provisions reduce uncertainty and compliance costs while safeguarding consumer safety — crucial for sectors such as livestock, grain, and horticulture, where technical standards often determine market access. By consolidating market access, enhancing regulatory coherence, and reestablishing credible dispute resolution, USMCA has transformed North American agricultural integration from an economic relationship into an institutional framework for competitiveness and resilience.

Managing frictions under USMCA

Disagreements are inevitable, particularly in sensitive sectors and as markets and technologies evolve. One of USMCA’s core institutional achievements has been the establishment of a credible dispute settlement mechanism that allows trade frictions to be managed through predictable processes rather than political escalation. This mechanism has functioned effectively in practice, reinforcing confidence in the agreement’s credibility — and North America’s agricultural resilience.

Since 2022, five disputes have been resolved through USMCA panel investigation—in comparison to only three investigations under NAFTA.²⁶ Of the five cases, three have involved important agricultural issues, including quota allocation under the Canadian dairy TRQ system and Mexico’s proposed ban on imports of genetically modified corn.²⁷ These disputes highlight that friction is not failure — it is evidence of a mature, integrated system operating under enforceable rules.

Longstanding trade frictions that predate USMCA underscore why a credible dispute settlement mechanism remains essential. A prominent example is recurring tension over U.S.-Mexico tomato trade. In 1996, the U.S. Department of Commerce and the Mexican tomato industry reached a suspension agreement halting an anti-dumping investigation and setting a minimum reference price for Mexican tomato imports. This arrangement helped ensure a stable and expanding year-round supply of tomatoes for U.S. buyers. The agreement was subsequently renegotiated in 2002, 2008, 2013, and 2019, but was terminated in April 2025,²⁸ leading to antidumping duties of 17.1% on all Mexican tomato imports.²⁹

The dispute's re-emergence after nearly three decades highlights a split among U.S. tomato growers: southeastern growers, especially in Florida, have consistently opposed the agreement, while western growers and importers—many of whom are deeply integrated with Mexican tomato suppliers and operating on both sides of the border—have supported it.³⁰ This long history, shaped by political considerations and U.S.-centric anti-dumping rules, reinforces the argument for an established, enforceable dispute settlement mechanism. By providing channels to resolve tensions transparently, USMCA sustains the trust and predictability that cross-border value chains require.



For agriculture, refining—not reopening—the agreement allows USMCA partners to reinforce the sector’s role as a driver of shared prosperity across the continent.

Future-proofing North American agri-food integration

Importantly, the upcoming USMCA review will unfold in a markedly different environment from when the agreement was negotiated. American consumers remain sensitive to food prices—in late 2025 the administration temporarily exempted a range of imported food products from tariffs imposed earlier in the year to ease cost pressures.³¹ This context underscores the political and economic value of maintaining a predictable, transparent trade regime within North America — ensuring consumers benefit from affordable food supplies even amid global volatility.

The review offers an opportunity to consolidate North America’s agricultural gains and prepare for new challenges. The objective should not be to renegotiate the fundamentals of market access, but to future-proof the framework—reducing transaction costs, improving regulatory coordination, and enhancing the resilience of agricultural value chains. To sustain these gains, the upcoming review should focus on three priorities:

- **Preserve tariff-free trade and avoid new border measures:** The most immediate priority is to preserve tariff-free trade across the continent. Any new border

measures—whether for political leverage or sectoral protection—would undermine the efficiencies and complementarities that define the integrated agri-food market.

- **Ensure clear and simple rules of origin:** Clear, simple rules of origin are essential so small and medium-sized enterprises can fully participate in cross-border value chains. Excessive administrative complexity risks discouraging smaller producers and processors, weakening the value chains that underpin competitiveness and employment.
- **Deepen Regulatory Cooperation and Standards Alignment:** Despite tariff-free trade, non-tariff barriers—such as divergent pesticide regulations, labeling requirements, and biotech approvals—continue to create friction. Deeper regulatory cooperation, building on USMCA’s science-based provisions, would reduce compliance costs while maintaining consumer safety and public confidence.³²

Strengthening these core provisions would ensure that North American agriculture remains competitive and resilient in an increasingly uncertain global environment. For agriculture, refining—not reopening—the agreement allows USMCA partners to reinforce the sector’s role as a driver of shared prosperity across the continent.

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LEVERAGING THE USMCA TO STRENGTHEN PHARMACEUTICAL MANUFACTURING AND SUPPLY CHAINS IN NORTH AMERICA



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Introduction

Pharmaceuticals occupy a unique position in the North American economy. They are simultaneously a high-value traded good, a strategic industry for innovation, and an essential component of public health security. Over the past several decades, the region has benefited from U.S. leadership in pharmaceutical research and development, as well as from integrated supply chains that draw on Canadian and Mexican capabilities in generics, regulatory oversight, and manufacturing. Yet, the COVID-19 pandemic underscored the fragility of global pharmaceutical supply chains and raised difficult questions about North America's reliance on foreign suppliers for active pharmaceutical ingredients (APIs) and finished drugs.^{1, 2}

The upcoming 2026 Joint Review of the United States–Mexico–Canada Agreement (USMCA) provides an opportunity to reexamine these dependencies and to propose cooperative reforms. While recent industrial policies in the United States have emphasized reshoring, including through executive orders on critical supply chains, regional coordination has lagged.³ Meanwhile, tariff proposals targeting pharmaceutical imports highlight the political salience of supply chain security but also raise concerns about higher consumer costs and potential disruptions to access.⁴

These debates are likely to intensify as the U.S. undertakes a forthcoming Section 232 national security review of the pharmaceutical sector.⁵ Although its findings have not yet been released, the review is widely expected to evaluate the feasibility of global, sector-wide tariffs on APIs and finished drugs as a tool for reducing foreign dependence. This development underscores the increasing role of national security framing in pharmaceutical supply chain policy and raises the stakes for coordinated regional strategies under USMCA.

In this context, strengthening the resilience, competitiveness, and equity of North America's pharmaceutical sector is not only an economic imperative but also a test of the credibility of USMCA as a framework for regional cooperation.

The state of pharmaceutical manufacturing in North America

North America's pharmaceutical sector combines world-leading innovation capacity with persistent structural gaps in manufacturing. The United States dominates global research and development (R&D), accounting for nearly half of worldwide pharmaceutical innovation spending, yet its domestic manufacturing base has steadily eroded since the 1990s as companies relocated API and generic drug production overseas. Today, most raw materials and chemical precursors for U.S.-consumed pharmaceuticals are imported, particularly from China and India, leaving the system vulnerable to global disruptions.⁶

In contrast, Canada and Mexico play more limited but strategically significant roles in the regional pharmaceutical landscape. Canada has a well-developed regulatory system and serves as a center to produce generic drugs and specialty pharmaceuticals, including vaccines and biologics. However, Canadian manufacturing operates on a relatively small scale and is insufficient to offset U.S. import dependencies. Mexico has emerged as a promising nearshoring hub. Its lower labor costs and geographic proximity to the U.S. market have attracted investment in generic medicines and medical devices, though the country has yet to fully develop advanced API capacity.⁷

Recent policy developments have emphasized the need for greater self-sufficiency in pharmaceutical production. In the United States, executive actions and legislative



... North America lacks a coherent trilateral framework for pharmaceutical security.

initiatives such as the Defense Production Act and supply chain reviews have highlighted pharmaceuticals as a sector critical to national security.⁸ These measures echo industrial policy approaches taken in other sectors, such as semiconductors, with the goal of reshoring essential production. Canada and Mexico have been more cautious, focusing on regulatory reforms and targeted investments rather than large-scale industrial policy interventions.⁹

Despite these initiatives, the region remains fragmented. Unlike the European Union, which has coordinated procurement and stockpiling strategies, North America lacks a coherent trilateral framework for pharmaceutical security. Instead, each country has pursued its own priorities, reflecting differences in political economy and health system design. This divergence risks undermining the resilience of the entire region. For instance, U.S. efforts to incentivize domestic manufacturing could inadvertently weaken opportunities for Canadian and Mexican producers unless harmonized with USMCA partners.

The state of pharmaceutical manufacturing in North America is thus characterized by innovation strength, persistent dependence on foreign suppliers, and uneven industrial strategies. Addressing these gaps will require not only national initiatives but also a regional strategy that leverages the complementary strengths of the three economies.

Supply chain dependencies and vulnerabilities

The pharmaceutical supply chain in North America is deeply intertwined with global production networks, particularly in Asia. Estimates suggest that 70% to 80% of APIs used in U.S. medicines originate abroad, with China and India serving as dominant suppliers.² While some advanced biologics and high-value drugs are imported from the

European Union, the dependence on Asian suppliers is most acute for generic drugs, and the APIs required to produce them. This heavy reliance creates vulnerabilities that extend beyond economics into the realm of national and regional security.

The COVID-19 pandemic served as a stress test, exposing weaknesses in the pharmaceutical supply chain. In 2020, India imposed export restrictions on several generic drugs and APIs to secure its domestic supply, while the European Union temporarily restricted exports of certain medical products.¹⁰ These measures highlighted how quickly national interests can override international supply agreements during crises. For North America, such restrictions translated into shortages of essential medicines, particularly sterile injectables and antibiotics, which were already prone to supply disruptions.

Geopolitical tensions further heighten these risks. As strategic competition between the United States and China intensifies, pharmaceuticals and medical products are increasingly seen through the lens of economic statecraft. Analysts have warned that Beijing could leverage its position in global API production in the event of escalating conflict or trade disputes.¹¹ Climate-related disruptions also threaten pharmaceutical supply chains, from droughts affecting chemical feedstocks to shipping bottlenecks in global chokepoints such as the Panama Canal and the Red Sea.¹²

These vulnerabilities are not limited to the United States. Canada and Mexico, while less dependent on Chinese APIs due to smaller markets, face similar exposure to global disruptions since both import significant volumes of finished drugs and raw materials. The trilateral dependence on non-North American suppliers suggests that without coordinated regional strategies, all three USMCA partners remain susceptible to external shocks. These shared vulnerabilities

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have also helped motivate recent U.S. inquiries, most notably the forthcoming Section 232 national security review of the pharmaceutical sector, which reflects growing bipartisan concern about the strategic risks associated with foreign API dependence.¹³

Innovation, prices, and access

North America plays a leading role in global pharmaceutical innovation, but this strength exists alongside persistent challenges of affordability and equitable access. The United States is the world's largest funder of pharmaceutical R&D, accounting for nearly half of global investment.¹⁴ American firms are particularly dominant in biologics, oncology therapies, and mRNA vaccine platforms. Canada and Mexico contribute more modestly to global innovation, but Canadian universities and firms have strong capabilities in vaccine research and biosimilars, while Mexico is increasingly active in clinical trials and contract manufacturing.¹⁵

Drug pricing highlights stark contrasts across the region. U.S. consumers pay substantially more for medicines compared with peers in Canada and Mexico. A 2021 RAND study found that U.S. prescription drug prices were more than 250% of those in 32 OECD countries, whereas Canadian and Mexican prices were closer to the OECD average.¹⁶ These disparities have contributed to cross-border purchasing, with Americans importing lower-cost medications from Canada and Mexico to mitigate out-of-pocket expenses.¹⁷

The USMCA itself reflects these tensions. The original agreement included provisions for extended data exclusivity on biologics, which would have strengthened intellectual property protections but risked raising drug costs. Under political pressure, these provisions were rolled back prior to ratification. This episode underscores the ongoing balancing act between rewarding innovation and ensuring affordability within a trilateral trade framework.



Effective policy must address both the innovation strengths of the region and the affordability constraints that shape public acceptance of pharmaceutical trade policy.

The affordability challenge also intersects with manufacturing security. Policies aimed at incentivizing reshoring, such as subsidies or tariffs, could raise production costs. Without coordinated strategies across the three countries, such measures may exacerbate price differentials and limit access, particularly for vulnerable populations. Effective policy must therefore address both the innovation strengths of the region and the affordability constraints that shape public acceptance of pharmaceutical trade policy.

Trade policy and the tariff debate

The debate over tariffs on pharmaceutical imports has grown more salient as U.S. policymakers grapple with vulnerabilities in global supply chains. During the first Trump administration, proposals surfaced to impose tariffs on imports of APIs and finished drugs, particularly from China. Advocates argued that tariffs could incentivize reshoring of production and reduce dependence on foreign suppliers. However, the effectiveness of tariffs as a policy tool for the pharmaceutical sector is highly contested.

The debate is further sharpened by the upcoming Section 232 national security review of pharmaceuticals, which is expected to consider global sectoral tariffs as a means of compelling reshoring.¹⁸ While the intent of such tariffs is to mitigate dependence on China and other suppliers, the review's potential recommendations highlight the tension between national security objectives and the economic and public health risks associated with broad-based trade restrictions.

First, the structure of the pharmaceutical supply chain limits the immediate impact of tariffs. The United States imports a substantial share of its APIs, and domestic manufacturing capacity is insufficient to replace these imports in the short term.¹⁹ Tariffs imposed without complementary subsidies or industrial policy

could therefore raise drug costs for consumers without meaningfully expanding domestic production.²⁰ Higher prices would exacerbate affordability challenges already evident in the U.S. market, with disproportionate effects on patients with chronic conditions who rely on generics and essential medicines.

Second, tariffs risk provoking retaliatory measures or disputes under World Trade Organization (WTO) rules. Pharmaceuticals have traditionally been subject to very low tariffs under multilateral agreements, including the WTO Pharmaceutical Agreement.²¹ Unilateral tariff action by the United States could trigger countermeasures from major suppliers such as China or India, potentially disrupting supply further.

Finally, tariffs carry implications for USMCA partners. Mexico and Canada could benefit from diverted production if firms shift operations into North America to avoid U.S. tariffs on Asian imports. Yet absent trilateral coordination, tariff policies could also generate new trade frictions within the region, particularly if supply chains fragment rather than integrate.

Overall, tariffs are a blunt instrument for strengthening pharmaceutical security. While they may have symbolic appeal as a signal of policy resolve, the economic risks and trade tensions they could generate underscore the need for more nuanced strategies that combine targeted incentives, regulatory cooperation, and trilateral frameworks.

Opportunities in the 2026 USMCA Joint Review

The 2026 Joint Review of USMCA represents a pivotal opportunity to strengthen regional cooperation on pharmaceutical security. While national strategies in the United States, Canada, and Mexico have highlighted vulnerabilities in drug supply chains, the lack

of a trilateral framework has limited progress. A coordinated approach could transform pharmaceuticals into a cornerstone of North American resilience.

One opportunity lies in creating a shared early-warning system for drug shortages. The European Union's Health Emergency Preparedness and Response Authority (HERA) provides a useful model, integrating supply monitoring, demand forecasting, and crisis coordination across member states.²² A North American equivalent could reduce duplication and allow the three countries to respond collectively to disruptions.

Another priority is investment in API and generic drug production capacity within North America. A trilateral investment fund or incentive program could support facilities in Mexico and Canada while leveraging U.S. demand, creating a more balanced distribution of production.¹⁹ This approach would not only reduce reliance on Asia but also foster economic development across the region.

Regulatory harmonization is also critical. Mutual recognition of good manufacturing practice (GMP) inspections, streamlined approval processes for generics, and closer alignment on intellectual property rules would lower transaction costs and accelerate market entry.²³ By reducing regulatory fragmentation, USMCA could enhance competitiveness and make regional production more attractive to firms.

Finally, the Joint Review provides a chance to institutionalize a North American supply chain security council, tasked with coordinating policy, monitoring vulnerabilities, and advising on crisis response. Such a body would anchor long-term cooperation and ensure that pharmaceutical resilience remains a sustained priority beyond moments of crisis.

The success of the Joint Review will be measured by whether the USMCA can

move from a trade framework to a platform for regional security. By addressing pharmaceutical supply chains directly, the three countries can demonstrate the agreement's relevance to both economic competitiveness and public health.

Policy recommendations

The analysis of pharmaceutical supply chains in North America highlights the need for a strategic, coordinated response that balances security, innovation, and affordability. The following recommendations are proposed for consideration during the 2026 USMCA Joint Review:

1. **Prioritize regional incentives over tariffs.** Instead of unilateral tariffs, the three countries should develop targeted incentives for production of APIs and essential generics. Such measures would reduce dependence on Asia while avoiding the consumer cost increases associated with tariffs.²⁴ This approach takes on added urgency in light of the forthcoming Section 232 national security review of pharmaceuticals, which may recommend global sector-wide tariffs; USMCA members should therefore proactively advance coordinated alternatives that strengthen resilience without elevating drug prices.²⁵
2. **Advance regulatory harmonization.** Mutual recognition of GMP inspections, streamlined generic drug approval, and closer intellectual property alignment could lower compliance burdens and accelerate regional integration.²⁶
3. **Establish a North American supply chain security council.** Modeled after the European Union's HERA, this body could coordinate monitoring, crisis response, and long-term resilience planning.²⁷
4. **Support Mexico's role as a nearshoring hub.** Mexico's cost advantages and geographic proximity position it as a critical partner for API and generic drug

By addressing pharmaceutical supply chains directly, the three countries can demonstrate the agreement's relevance to both economic competitiveness and public health.

A forward-looking strategy will be essential to safeguard innovation, affordability, and public trust in the North American partnership.

production. Coordinated investment could expand its role while creating regional redundancy.²⁸

5. Balance resilience with affordability.

Any policies aimed at strengthening supply chains must also account for drug pricing, particularly in the United States, to maintain public support and ensure equitable access.²⁹

Together, these recommendations offer a pragmatic roadmap for USMCA members to enhance security of supply while preserving North America’s leadership in pharmaceutical innovation.

Conclusion

Pharmaceuticals represent a vital intersection of trade, health, and security in North America. The United States leads the world in innovation, yet the region as a whole remains highly dependent on foreign suppliers for APIs and many essential medicines. The COVID-19 pandemic, coupled with growing

geopolitical tensions, revealed how fragile these supply chains are and how quickly disruptions can translate into shortages that threaten public health.²

The 2026 Joint Review of USMCA offers an opportunity to confront these vulnerabilities. By moving beyond national approaches toward a coordinated regional framework, the three countries can leverage their complementary strengths: U.S. research leadership, Canadian regulatory capacity, and Mexico’s manufacturing potential. Establishing mechanisms for shortage monitoring, regulatory alignment, and trilateral investment in critical medicines would signal that North America is prepared to address health security as a collective priority.³⁰

Pharmaceutical supply chains are thus more than an industrial concern. They are a test of USMCA’s ability to evolve into a platform for resilience and cooperation. A forward-looking strategy will be essential to safeguard innovation, affordability, and public trust in the North American partnership.

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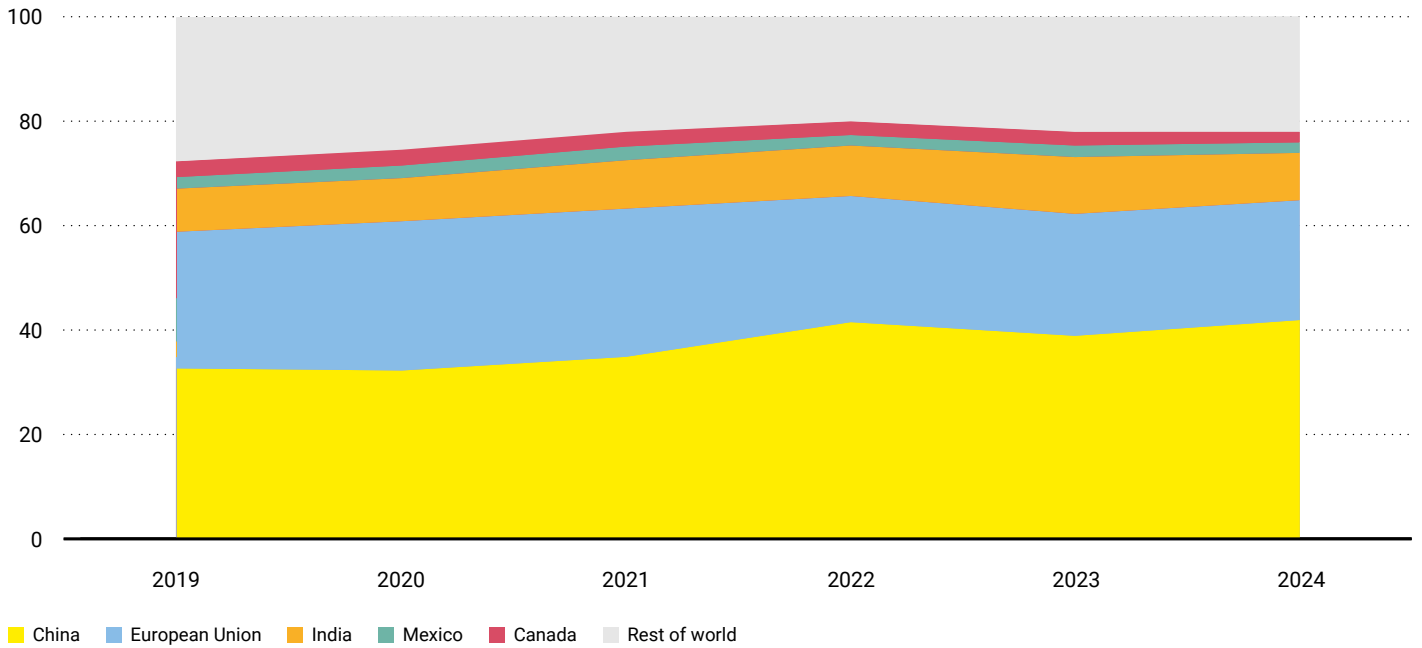
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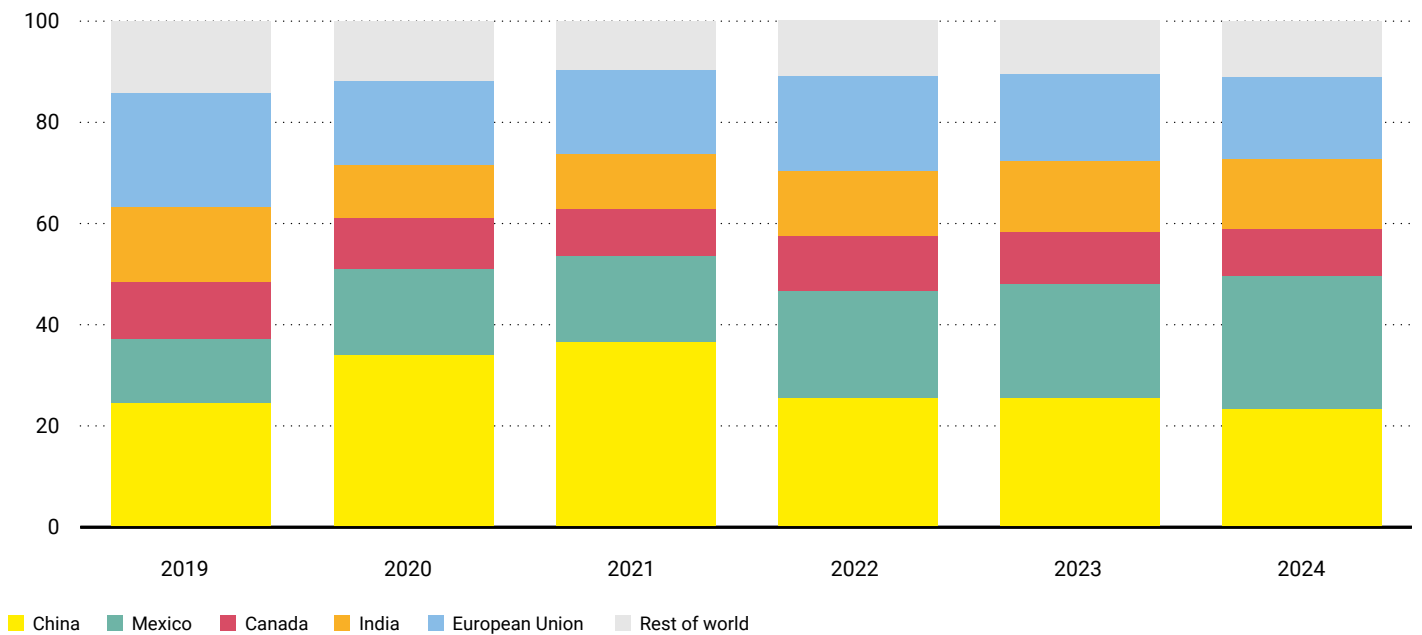
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CHINA TIGHTENS ITS HOLD ON PHARMACEUTICAL INPUTS
US IMPORTS OF PHARMACEUTICAL INPUTS, SHARE OF IMPORT VOLUME (%)



Source: Author's calculations, ITA Draft List of Critical Supply Chains, and USITC Dataweb.

MEXICO EMERGES AS LEAD SUPPLIER FOR FINAL PHARMACEUTICAL GOODS
US IMPORTS OF FINAL PHARMACEUTICAL GOODS, SHARE OF IMPORT VOLUME (%)



Source: Author's calculations, ITA Draft List of Critical Supply Chains, and USITC Dataweb.

WHEN DISPUTE SETTLEMENT FALTERS: RESTORING LEGAL CERTAINTY IN USMCA



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Law or leverage

“The question is, was it ever alive at all?” When U.S. Trade Representative Jamieson Greer was asked in December 2025 whether the rules-based international order had died, his answer cut to the heart of North American trade’s deepest challenge.¹ If rules are merely decorative—“white lies,” as Greer put it, “to paper over the actual power politics”—then USMCA’s dispute settlement architecture is an elaborate fiction. If rules shape behavior by creating enforceable expectations, then the 2026 Joint Review will determine whether North American integration has a future.

USMCA modernized continental trade governance in important ways: It restored state-to-state dispute settlement after NAFTA-era paralysis, introduced the Rapid Response Labor Mechanism (RRM), and updated rules for regional supply chains. Yet it also embedded a fateful structural choice: replacing durability with conditionality. As former White House Senior Advisor Jared Kushner acknowledged, the agreement was designed with the logic of a short-term commercial lease, preserving leverage for the stronger party.² That logic now defines the lived reality of North American trade. Review and withdrawal provisions, rather than functioning as neutral mechanisms of adaptation, have become instruments of recurring uncertainty.

USMCA’s credibility depends on whether dispute settlement functions as law or as a bargain. The 2026 review will set the tone not only for dispute resolution but for the agreement’s future. If review becomes a threat-based renegotiation, dispute settlement becomes ornamentation. If adjudication and compliance are insulated from leverage politics, USMCA can still deliver what trade agreements exist to provide: predictability.

From permanence to conditionality

For nearly three decades, NAFTA anchored investment decisions not because it was substantively flawless, but because it endured. Its indefinite duration insulated trade rules from electoral cycles and political theater. Withdrawal was possible by any Party but was extraordinary. Businesses could make long-term capital commitments confident that market access terms would persist.

USMCA replaced NAFTA’s open-ended duration with a time-limited structure that requires periodic renewal by all three parties. Article 34.6 permits withdrawal on six months’ written notice. Article 34.7 subjects the agreement to termination 16 years after entry into force unless all parties agree to extend it for another 16-year term.³ The July 2026 joint review marks the first test: If the parties do not agree to extend the agreement at that review, they must conduct annual joint reviews thereafter until they reach consensus to renew for a new 16-year period or allow the agreement to terminate on schedule in 2036.

These provisions were defended as modernization tools. As C.J. Mahoney has documented, NAFTA’s permanence made updating difficult; the only mechanism for forcing change was the threat of withdrawal: precisely the leverage that produced the NAFTA-to-USMCA transition.⁴ A predictable review cycle, the argument ran, would normalize adaptation rather than dramatize it. Both interpretations contain truth, and the tension between them illuminates the core challenge.

The question is not whether flexibility should exist, but how it is exercised. Review as scheduled assessment and targeted updates strengthen agreements by keeping them current. Review as leverage for unrelated concessions—full-blown renegotiation rather than calibrated modernization—undermines



the predictability that makes trade agreements valuable in the first place. Adaptation mechanisms are necessary; no agreement negotiated in 2018 can anticipate every development in digital trade, critical minerals, or supply chain security through 2036. The problem arises when review functions as implicit renegotiation.

Ambassador Greer's telling remarks at the Atlantic Council suggest the latter interpretation now predominates. He confirmed conducting only bilateral discussions: "I have not had a meeting this year where I sat with Canada and Mexico in a room, and we sat together and talked about USMCA." On the review clause itself, Greer was explicit: "Could it be exited? Yeah, it could be exited. Could it be revised? Yes. Could it be renegotiated? Yes. I mean, that is the purpose of that clause. And all of those things are on the table."⁵

The statement is legally accurate. These options do exist. But treating a review mechanism designed to facilitate updates as an instrument for fundamental renegotiation transforms scheduled maintenance into structural uncertainty. A mechanism designed for preservation becomes a permanent source of uncertainty, discounting legal commitments long before any formal notice is given.

The 2025 National Security Strategy reinforces this approach, framing trade explicitly as leverage: "The United States will prioritize commercial diplomacy... using tariffs and reciprocal trade agreements as powerful tools." Agreements with dependent partners, it states, "must be sole-source contracts for our companies."⁶ Read expansively, this language treats allied markets as captive rather than competitive—an approach that may secure short-term concessions while eroding the integrated continental economy that serves American interests over the long term.

[Dispute settlement] is the mechanism that converts political disagreement into juridical resolution, allowing law to substitute for power.

Dispute settlement performance

Dispute settlement is a trade agreement's shock absorber. It is the mechanism that converts political disagreement into juridical resolution, allowing law to substitute for power. USMCA's record reveals both meaningful progress and worrying fragility.

State-to-state panels

Chapter 31 was designed to restore impartial adjudication after NAFTA's late-stage paralysis. Panels have been constituted and have issued competent rulings on Canadian dairy quotas, automotive rules of origin, and Mexican energy policy.⁷ The problem is not adjudication but compliance.

Canada implemented the first dairy ruling only after months of delay. When revised measures still fell short, the United States established a second panel in January 2023. Mexico has oscillated between cooperation and defiance on energy regulation. The pattern is consistent: Machinery functions, but compliance remains contingent on domestic political considerations. Where implementation is partial, delayed, or strategically diluted, panel authority weakens. Compliance contingent on political convenience converts binding rulings into bargaining chips. Law renegotiated ex post cannot anchor expectations ex ante.

The Rapid Response Labor Mechanism

The RRM is USMCA's most innovative enforcement tool. Over thirty cases against Mexican facilities—primarily automotive, but also glass, leather, and ammunition—have produced corrective action, including worker reinstatement and independent union recognition.⁸ As Kathleen Claussen has documented, the facility-specific approach enables rapid, targeted enforcement that traditional dispute settlement cannot achieve.⁹ It demonstrates that accelerated compliance

is possible when institutional design aligns incentives properly.

Yet enforcement flows largely in one direction—United States toward Mexico—reflecting American priorities and the structural power imbalance within the agreement. Unless Canada and Mexico also deploy the RRM to protect their own labor interests, the mechanism risks appearing as selective discipline rather than systemic enforcement. Asymmetry undermines legitimacy, even when outcomes are normatively attractive.

Trade remedies

In antidumping and countervailing duty disputes, the USMCA performs the worst. Softwood lumber epitomizes the failure: decades of litigation, victories without enforcement, and panel decisions effectively ignored.¹⁰ Legal outcomes are circumvented through new administrative determinations or additional tariffs. Where dispute settlement exists in theory but not in consequence, firms rationally revert to political lobbying, unilateral retaliation, or domestic litigation outside the agreement. The cumulative effect on investor confidence is significant: When adjudication is treated as advice rather than obligation, capital factors in political risk premiums—precisely the dynamic the original free-trade vision sought to eliminate.

Across all mechanisms, a pattern emerges: Adjudication functions; compliance remains discretionary. In an agreement already shadowed by potential termination, that discretion is magnified.

The 2026 review as stress test

The Joint Review was designed as an institutional health check. It now risks becoming brinkmanship's focal point. If review signals renegotiation, parties will rationally

The principal danger is not that USMCA terminates in 2026, but that it functions as though it might, permanently discounting legal commitments.

withhold compliance today to strengthen their bargaining position tomorrow.

The asymmetry is structural. Canada and Mexico cannot credibly threaten withdrawal without catastrophic cost. The United States can. This shapes expectations throughout the agreement's life—no overt coercion required. The principal danger is not that USMCA terminates in 2026, but that it functions as though it might, permanently discounting legal commitments. In such an environment, dispute settlement becomes theater: Invoked when convenient, ignored when costly.

Ambassador Greer's remarks also signal possible bilateralization: "Our economic relationship with Canada is very, very different than our economic relationship with Mexico. The labor situations are different. The import-export profile is different. The rule of law is different. So, it makes sense to talk about things separately with Canada and Mexico."¹¹ Some bilateral discussions are legitimate. But wholesale bilateralization transforms a unified economic space with common rules into hub-and-spoke arrangements, with the United States negotiating separately with each partner on potentially different terms. For businesses operating integrated North American supply chains, this would introduce substantial complexity and uncertainty.

The overlay of unilateral trade measures compounds the problem. Section 232 tariffs on steel and aluminum, Section 301 actions, and emergency measures under IEEPA have been deployed against USMCA partners for matters that might otherwise be channeled through the agreement's dispute settlement provisions. These unilateral actions—more than any single negotiating episode—represent the most problematic erosion of USMCA's rule of law. When legal frameworks can be bypassed through executive action, they cease functioning as credible constraints.

Re-anchoring legal certainty

Restoring predictability does not require rewriting USMCA. It requires disciplining the use of existing provisions and strengthening compliance mechanisms.

- **Automatic compliance:** Model mechanisms on WTO negative consensus: panel reports binding unless all parties reject them, with automatic compliance reviews and fixed timelines to increase transparency about implementation.
- **Procedural insulation:** Pending disputes cannot fold into review bargaining. The firewall between adjudication and negotiation must hold if dispute settlement is to retain authority.
- **Enforcement symmetry:** The RRM and similar instruments must function as reciprocal tools available to all parties, not unilateral levers reflecting the priorities of the strongest economy.
- **Disciplined emergency measures:** Expedited consultations, defined security criteria, automatic sunsets, and compensation mechanisms can prevent emergency authorities from becoming routine leverage without eliminating genuine flexibility.
- **Review as maintenance:** Clarify that six-year reviews target updates, not wholesale renegotiation. Reverse the default: automatic extension unless all parties agree to terminate. This alone would allow businesses to plan beyond six-year horizons and restore the foundation for long-term investment that NAFTA once provided.

Conclusion: The fulcrum

USMCA's greatest achievement was not market access but the institutionalization of law over power. Its greatest risk is the quiet erosion of achievement through design choices that privilege leverage over certainty. This is key for dispute resolution.

Ambassador Greer’s question—“was [the rules-based order] ever alive at all?”—deserves a serious answer. If rules were merely decorative, states would not invest enormous diplomatic resources negotiating them, litigating under them, or demanding compliance with them. The United States itself has been the most frequent user of WTO dispute settlement, NAFTA Chapter 19 panels, and now USMCA mechanisms—behavior inconsistent with a view that rules do not matter. Rules matter because they create expectations, and expectations shape behavior.

The 2026 review will reveal whether North America remains committed to rules-based integration or accepts a future of perpetual recalibration. Dispute settlement is the fulcrum. If it holds, the agreement endures. If it falters, no amount of modernization elsewhere will compensate.

Law does not replace leverage; it channels it productively. Within established frameworks, partners know what to expect; economies align accordingly. When leverage operates unpredictably, partners hedge, supply chains fragment, and the integrated continental economy that benefits American consumers and producers begins to fracture.

The choice facing North America is not between rules and power. It is between productive leverage and destructive uncertainty—between a continental economy built on credible stable commitments and one perpetually discounted by the threat of their withdrawal. Destructive uncertainty that serves no one’s long-term interests.¹² That choice will be made, one way or another, in 2026.

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The significance of the USMCA to the economic vitality of the United States, Canada, and Mexico is aptly described elsewhere in this report. How important is enforcement of the USMCA rules through the dispute settlement mechanism? How should we assess the performance of the USMCA state-state dispute settlement mechanism (DSM) to date?

As a preliminary matter, it is important to understand the context for the dispute settlement chapter negotiations. A common objective for the three negotiating parties was to fix a significant procedural problem with the NAFTA DSM—the ease with which panel formation could be blocked.

However, for the United States, an important objective was to craft a DSM that avoided some of the problems and excesses that it saw in the World Trade Organization’s DSM.

With respect to panel formation, the USMCA’s DSM is a success, a significant improvement over NAFTA. Indications are that procedurally speaking, the USMCA DSM is working. Panels are being formed and reports are being issued without significant delay. This is in good part due to the work that went into ensuring that the parties finalized the rules of procedures, code of conduct, and rosters by the time of entry into force of the USMCA.¹ It is important to remember that all this work was done under the first Trump administration.

The United States did in fact obtain modifications to the DSM aimed at avoiding panel overreach, in particular the

THE USMCA DISPUTE SETTLEMENT MECHANISM HAS BEEN SUCCESSFUL

temptation for panelists to create rules beyond those negotiated by the parties. These are issues at the core of U.S. criticism of the WTO’s Appellate Body.² While the United States considers these modifications improvements to the DSM, others view them as dilutions of the DSM. One commentator has described them as “propos[als] to further weaken the role of authoritative panel adjudication.”³

It is useful to look at the objectives and the actual modifications. A key objective for the USMCA dispute settlement chapter negotiation was to: “Establish a dispute settlement mechanism that is effective, timely, and in which panel determinations are based on the provisions of the Agreement and the submissions of the parties and are provided in a reasoned manner.”⁴ This was amplified in the revised objectives to include: “Provide mechanisms

for ensuring that the Parties retain control of disputes and can address situations when a panel has clearly erred in its assessment of the facts or the obligations that apply.”⁵

What did these objectives translate into? They are simple instructions to panelists, but admittedly powerful reminders of the limits of what they are tasked to do. In Article 31.13 (Function of Panels), the following two instructions were added:

Paragraph 2: “The findings, determinations, and recommendations of the panel shall not add to or diminish the rights and obligations of the Parties under this Agreement”; and

Paragraph 6: “The panel shall base its report on the relevant provision of this Agreement, the submissions and arguments of the disputing Parties, and on any information or advice put

before it under Article 31.15 (Role of Experts).⁶

The first addition is straight from the WTO's Dispute Settlement Understanding. Hardly revolutionary, though a significant concept to reiterate for the USMCA DSM given what has developed in the WTO system. The second is a simple instruction to keep the focus on what the agreement actually provides, and what the disputing parties present as arguments.

Why was this so important to the United States and perceived as a watering down of dispute settlement by others? This is the divide between the United States and many others over state-

to-state dispute settlement mechanisms.

On the one hand, you have those who view state-to-state mechanism more like an international court. Panel reports must be "binding" and the mechanism needs to be clear that the losing responding party "must" comply with the findings of a panel. This approach, it is argued, provides the predictability and certainty that makes these mechanisms worthwhile.

However, the United States approaches dispute settlement very differently.⁷ The longstanding view of the United States is that, as a sovereign, you retain the

right to decide what to do in the case of a loss. From the U.S. perspective, rather than focusing on whether the system is "predictable", it is more important that the system be structured in such a way as to deliver an outcome that is credible and trustworthy. This is important because, when faced with the possibility of having to remove or modify a law, regulation, or policy to comply with a panel finding, a government must go through complex domestic legal and political dynamics. Reality dictates that parties will comply where compliance is politically achievable, not because the agreement says results are binding. The results of a credible dispute settlement process are a

more powerful incentive to eventual compliance than just because a dispute settlement chapter text says that you must comply. In addition, from the U.S. perspective, a DSM should assist the parties in resolving the issue but not dictate a particular outcome.

As we head into the USMCA review, it is important to remember that it was negotiated under the first Trump administration. At the conclusion of the USMCA negotiations, my colleagues and I in the USTR's office were pleased with the results.⁸

How has the USMCA DSM worked in practice? In the five years that the USMCA has been in force, panels have



completed four state-state disputes.⁹ This might seem a small number, yet under the 25 years of NAFTA only three disputes were finalized.¹⁰ In terms of process, indications are that the procedural improvements in the USMCA dispute settlement chapter are working. Panels have been formed fairly expeditiously, and reports have been issued within a reasonable time and are focused.

In terms of substantive results:

- The United States prevailed in the first dispute against Canada over the dairy tariff rate. Canada amended its regime, the United States filed a second dispute, and the panel found Canada had complied, though the report contained a dissenting opinion.¹¹
- Canada successfully sued the United States over the application of the solar safeguard on Canadian exports. The United States amended its measure consistent with the recommendation of the panel.¹²
- The United States successfully sued Mexico over its ban on genetically modified corn. Mexico removed the ban.¹³
- Canada and Mexico successfully sued the United States over its implementation of the autos rules of origin. Resolution is pending.¹⁴

What does this mean for the future?

Out of four completed disputes, two or three depending on where you sit, have been “resolved” and the relevant party complied. That is positive.

On Canada dairy, I have no doubt that the U.S. dairy industry believes it is being denied benefits. And, I would expect this will be raised in the upcoming USMCA review unsurprisingly given the history of this issue. It is a testament to the complexity of domestic dynamics and how they influence perceptions of panel findings.

On United States autos, that resolution is pending predictably. Autos rules of origin was a contentious issue during the USMCA negotiation and is potentially even more so now. Another issue that is likely to be dealt with in the upcoming USMCA review.

To view this as a failure of the DSM is to expect too much of the system. Parties need to accept that certain issues are not going to be completely resolved through dispute settlement. Dispute settlement is merely a tool, and it has its limits. Sometimes it will serve to simply demonstrate where the rules need improvement. Unless there are clear procedural deficiencies identified in the various proceedings to date, the best

way forward is to continue using the mechanism.

Make the system work to demonstrate what efficient, timely, and credible dispute resolution mechanisms can look like.

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ASSESSING THE USMCA RAPID RESPONSE LABOR MECHANISM IN MEXICO: 3 METRICS OF ANALYSIS



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The purpose of the USMCA’s Facility-Specific, Rapid Response Labor Mechanism (RRLM) for Mexico is to address facility-specific violations of internationally recognized labor rights and Mexican labor law as they relate to freedom of association and collective bargaining rights (USMCA Article 31-A.2).¹ The United States and Canada are not subject to its provisions. It requires that Mexico “adopt and maintain in its statutes and regulations” in accordance with the International Labour Organization (ILO) 1998 Declaration on Fundamental Principles and Rights at Work (USMCA Articles 23.1 and 23.3),² and mandates that Mexico establish and provide laws and institutions in accordance with its Constitution that ensure “the effective recognition of the right to collective bargaining” (USMCA Annex 23-A).³

There are mixed views about the effectiveness of the RRLM so far.⁴ This article assesses the effectiveness of the RRLM in three ways: 1) Compared to other labor provisions in trade agreements; 2) Compared to previous external efforts to influence constitutional and legislative efforts in Mexico to secure Freedom of Association (FoA) rights; and 3) Based on the scale of the impact on Mexican workers. The chapter concludes that the RRLM compares favorably to other labor provisions in trade agreements (e.g., NAFTA and CAFTA) and to prior attempts at influencing Mexican labor relations reforms. Yet, while there have been significant positive impacts on a subgroup of Mexican workers, reforms are necessary to expand that impact to reach and empower a larger group of workers.

Comparison between the RRLM and the CAFTA Labor Chapter

The most relevant comparison to the RRLM is the 2004 Dominican Republic–Central America–United States Free Trade Agreement (CAFTA) Labor Chapter, which preceded USMCA and significantly influenced those advocating for the RRLM. These CAFTA

labor commitments were a substantial improvement over NAFTA, under which commitments to workers’ rights were only included as a non-enforceable side agreement. However, under CAFTA significant hurdles to enforcing the labor chapter commitments has meant that only four claims of labor rights violations have proceeded to date under the agreement—in Guatemala, Costa Rica, the Dominican Republic, and Honduras.⁵ The Guatemala case highlights the limitations of the CAFTA labor chapter. In April 2008, the U.S. Department of Labor’s Office of Trade and Labor Affairs (OTLA) received a submission from the AFL–CIO and six Guatemalan worker organizations claiming that Guatemala had violated its obligations under the CAFTA–DR Labor Chapter to enforce workers’ rights. In June 2017, following a nine-year process that began with a petition by U.S. and Guatemalan labor unions in April 2008, an international arbitration panel found that Guatemala’s failure to enforce its labor laws effectively did not, as stipulated by CAFTA Article 16.2.A, adversely affect trade.⁶ Much to the disappointment of labor rights advocates, the panel’s decision was final with no appeal process.

The labor chapter and dispute settlement mechanism of the USMCA were designed to address these limitations. Under USMCA, all parties have agreed to comply with all ILO core labor standards, including the right to strike. The Dispute Settlement Chapter (31) includes the innovative United States–Mexico Facility-Specific Rapid Response Labor Mechanism (Annex 31-A, RRLM),⁷ which applies only to Mexico. The RRLM focuses on where there is denial of freedom of association and collective bargaining rights. The mechanism provides for a time-bound review process that could include, should violations not be resolved at prior stages, a review by a panel of labor experts at higher levels of dispute resolution.⁸

The purpose of the RRLM is to quickly remediate denial of these labor rights at covered facilities in Mexico. Any person, group,

Prior trade agreements sought to encourage improvements in labor relations regimes, including in Mexico, but none generated reforms as deep or institutionalized as those associated with the USMCA.

or government can submit a formal written request (“petition”) to the Interagency Labor Committee for Monitoring and Enforcement (Interagency Labor Committee, ILC), asking to invoke the RRLM with respect to a specific covered facility. The ILC is co-chaired by the U.S. Department of Labor (DOL) and the United States Trade Representative (USTR), who can also initiate investigations based on anonymous reports and a phone hotline, although this is not common. The ILC was created by the U.S. USMCA Implementation Act, which establishes an interagency body to monitor and enforce labor obligations under the agreement, including the RRLM and Mexican labor reforms.⁹ The ILC has an obligation to review the petition within 30 days of submission to determine whether a facility qualifies as a Covered Facility under the RRLM and whether there is “sufficient, credible evidence of a denial of rights (as defined) enabling the good-faith invocation of enforcement mechanisms.”¹⁰

If the respondent Party (i.e., Mexico) investigates the U.S. government’s denial of rights findings and determines that there is a denial of freedom of association and collective bargaining rights as defined by Mexican law, it has 45 days from the date of the request for review to seek to remedy the issue. Mexico investigates the denial allegation through its Labor Ministry (STPS). Article 31-A.4.6 encourages dialogue and negotiations, noting, “[T]he Parties shall consult in good faith for a period of 10 days and shall endeavor to agree upon a course of remediation that will remediate the Denial of Rights without interrupting trade” (emphasis added). If the Parties disagree on a remediation course, the complainant Party may request a review by a panel of experts. If the panel determines that there has been a denial of rights, the complainant Party may impose remedies, including suspending preferential tariffs or imposing penalties on goods manufactured at the covered facility. After repeated violations, a firm’s products or services could be denied

entry into the United States.¹¹ Once there is agreement that the denial of rights has been remedied, the complainant must immediately remove sanctions, (i.e., suspension of liquidation).

In summary, the RRLM—when combined with Mexican labor law reforms—offers an expedited, binding, cross-border mechanism that allows workers and their unions to address violations of freedom of association and collective bargaining rights at covered facilities. This significantly surpasses earlier labor provisions in trade agreements, including NAFTA and CAFTA. As we will see ahead, one result of the RRLM was 10 successful cases in which workers formed independent unions and subsequently bargained with employers to substantially improve wages.

Comparisons with prior external attempts to influence labor reform in Mexico

Prior trade agreements sought to encourage improvements in labor relations regimes, including in Mexico, but none generated reforms as deep or institutionalized as those associated with the USMCA. Under NAFTA and CAFTA-DR, labor provisions emphasized enforcement of existing domestic labor law rather than structural legal reform. Negotiations for the Transpacific Partnership (TPP) went further by calling for labor law reforms in countries such as Vietnam and Malaysia, but the TPP was ultimately abandoned by the United States. The labor-related demands advanced during the USMCA negotiations represented the most far-reaching effort to date to externally influence Mexican labor law. However, rather than openly resisting these pressures, President Enrique Peña Nieto (2012–2018) strategically internalized them by embedding labor reform within the domestically framed *justicia cotidiana* (“everyday justice”) agenda.¹²



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For close to a century, Mexico has provided a paradigmatic case of “state corporatism,” in which the state controlled and tightly regulated labor unions and employer associations.¹³ This system of state-led labor control resulted in decades of declining real wages, undemocratic unions that bargained contracts designed not to improve conditions of work but rather ensure labor peace, and the continuation of state and employer-controlled union.¹⁴ From the 1960s forward, independent¹⁵ unions emerged and maintained their presence in several notable cases (electrical workers, teachers, universities, Nissan, Volkswagen). Still, they were few and relatively weak compared to the national power of the traditional corporatist unions. These independent unionists and their allies long sought to reform the labor regime to allow for independent unions and effective and transparent collective bargaining to improve

terms and conditions of work,¹⁶ but with limited success. The system persisted into the 21st century, despite the national electoral defeat of the corporatist political party, the PRI, in 2000 because the unions that came out of this political legacy had their own institutional life and capacity to realign themselves according to changing political circumstances.¹⁷

The long process of the more substantive reforms of 2017 to 2019 began in 2009, when several international and national unions filed a complaint with the ILO regarding violations of freedom of association rights (Convention 87) based on long-standing critiques of the system by Mexican worker rights advocates and scholars. The complaint resulted in a series of reviews by the ILO’s Committee of Experts on the Application of Conventions and Recommendations.¹⁸ The U.S. government raised similar concerns and

placed considerable pressure on Mexico to reform its labor regime under the Obama administration during the 2015 to 2016 Transpacific Partnership trade negotiations. These pressures for reforms combined with growing domestic pressure for reform led Mexico to adopting a constitutional reform that “significantly strengthened the legal basis for democratic worker rights.”¹⁹

When Andrés Manuel López Obrador, of the progressive MORENA party, took power in 2018, he continued the process of labor reform begun under Peña Nieto who had anticipated the renegotiations of NAFTA and the importance of the workers’ rights issue.²⁰ In 2019, the government revised its Federal Labor Law, requiring workers to have a choice over trade union representation, including the right to vote on initial collective bargaining agreements (CBAs) and annual updates through universal, free, direct, and secret ballots. The reforms further established new institutions, notably a new labor court system and a federal decentralized agency, the Federal Center for Conciliation and Labor Registration, which operates independently of the executive branch to register trade unions and resolve employment conflicts.²¹

A key part of these reforms involved “legitimation votes,” a process where workers in unionized workplaces vote on whether to approve (legitimize) or reject (vote down) existing CBAs. Notably, this process was encouraged and reinforced by the USMCA, and many of the initial cases leveraging the RRLM were based on violations of the legitimation vote process by corporatist unions attempting to maintain their power. In this context, the General Motors (GM) facility in Silao was the second RRLM case. Workers at the 6,500-employee facility leveraged the RRLM to ensure a democratic vote on the union contract, which facilitated the formation of an independent union and subsequently successfully negotiated an 8.5% wage increase with the company.²²

The GM case is not unique. At this writing, 42 cases have gone through the RRLM process. By September 2024, unions had combined organizing and leveraging of state institutions, and used the RRLM in 19 auto sector cases, resulting in eight major collective bargaining agreements covering 21,348 workers.²³ During a period when the annual inflation rate was 5.5%, these CBAs raised combined wages by an average of 8.5%.²⁴ These legal reforms and independent union organizing represent a significant step forward in the century-long effort to reshape Mexico’s labor relations system, promote independent and democratic union organizing, and improve workers’ and their families’ lives through collective bargaining.

Limits of the RRLM

While many RRLM cases have been successful, some have not led to positive outcomes for workers. Despite significant organizing efforts, state leverage, and two RRLM petitions, workers at the VU Manufacturas facility were unable to negotiate a new CBA. The company, which was facing bankruptcy prior to the petition, decided to close the factory and not bargain with an independent union. Despite this setback, the United States Trade Representative (USTR) estimated that, by January 2025, 42,000 workers had benefited from the RRLM through backpay and reinstatement and free and fair union elections.²⁵ Yet, while significant, this only represents a small part of more than 5 million manufacturing workers in the country. By August 2025, 32 RRLM cases had been concluded. In 11 of these cases, workers gained a new union and/or a new or revised collective bargaining agreement.²⁶

Of course, not all workplaces need to go through the RRLM process to see positive effects. There is the potential for spillover effects, where managers address workers’ concerns out of fear that if they fail to do

These pressures for reforms combined with growing domestic pressure for reform led Mexico to adopting a constitutional reform that “significantly strengthened the legal basis for democratic worker rights.”

And the USMCA, by encouraging major labor reforms in Mexico and providing leverage to enforce laws, has worked in parallel with Mexican labor reforms in making an important breakthrough in a century-old system built on undemocratic unions and protection contracts.

so, a case could move forward. This helps explain the successful organizing drive by an independent union at the 3M factory in San Luis Potosi, which did not pursue a RRLM case.²⁷ However, such spillover effects are not significant enough to be reflected in the broader economy through wage increases for Mexican workers.²⁸ A growing critique of the RRLM is that it has not lowered the wage gap between American and Mexican workers nor prevented the loss of U.S. manufacturing jobs.²⁹

The notion of “bringing jobs back to the U.S.” was part of the political discourse in the U.S. in the debate surrounding approval. This goal does not appear in the text of the USMCA, although some hoped that rules-of-origin provisions might assist in achieving that objective. Reducing the U.S.-Mexico wage gap also does not appear in the USMCA goals for the RRLM, yet some hoped the RRLM, by aiming to strengthen collective bargaining wages, would increase wages overtime in Mexico. However, since “covered facilities” are limited to facilities producing for export or that competes with exports in a priority sector, a more appropriate analysis would be to compare wage gaps across these sectors.

A salient critique of the RRLM is that it fails to prioritize certain economic activity (e.g., favoring autos and auto parts) and excludes the agricultural sector (USMCA, Annex 31-A, Footnote 4).³⁰ There is also a concern that units in the Mexican government are deprioritizing labor reform enforcement by cutting the budgets of labor institutions.³¹ It is important to note that the Trump administration also has cut funding to organizations supporting the work of the RRLM, such as the Solidarity Center. The Mexican government, while remaining committed to the RRLM, is also increasingly pushing back on U.S. claims of labor rights violations by demanding more evidence and requesting the U.S. to use the RRLM as a tool of “last resort.”³²

Reforming the RRLM: Some preliminary reflections

The RRLM represents a significant advancement over labor provisions in previous trade agreements. Its facility-specific focus ensures attention on firms that violate workers’ rights. Its time-bound provisions address delays such as the 9-year CAFTA process in Guatemala. Additionally, its sanctioning capabilities tackle the weak, voluntary mechanisms on Freedom of Association in the NAFTA side agreement. And the USMCA, by encouraging major labor reforms in Mexico and providing leverage to enforce laws, has worked in parallel with Mexican labor reforms in making an important breakthrough in a century-old system built on undemocratic unions and protection contracts.

Yet, important limitations of the USMCA’s RRLM and Mexico’s labor reforms are becoming more evident. Undemocratic unions have manipulated the system and retain power in most unionized workplaces, enforcement funding for labor institutions declined in 2025, and the scope of workers covered by the agreement remains limited. For these reasons, and in the context of the mandatory 2026 USMCA review, there are a growing number of voices both in the U.S.³³ and Mexico³⁴ calling for substantial reforms in the USMCA such as increased transparency, expanded coverage including the agricultural sector, application of RRLM provisions to workers’ rights in the U.S. and Canada, stronger collective bargaining protections, improved labor regulations and sanctions in Mexico, and the creation of a wage floor. More broadly, in the context of the economic provisions of the USMCA, U.S. labor unions are demanding dramatic reforms to stop job loss in the U.S. manufacturing sector and reduce the U.S.-Mexico wage gap.³⁵

Expanding the scope of the RRLM to include the agricultural sector is important and appears to have significant support in Mexico and the U.S. This would be particularly important if combined with opening the RRLM process to workers in the U.S., because it would allow Mexican workers in the agriculture sector in the U.S. to have this added protection, especially in workplaces that lack union representation. Funding is also crucial and it would be important for both the Mexican and U.S. governments to

increase their support to the institutions and advocacy groups that support the RRLM process. What is most important is that any reforms are carefully consulted in the U.S. and in Mexico with workers and the democratic unions that represent them since they are the ones who are directly impacted by worker rights violations. Building cross-border labor solidarity is a delicate task that requires trust, patience, and a willingness to establish proposals that are favorable to all workers on both sides of the border.

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The upcoming 2026 U.S.-Mexico-Canada Agreement (USMCA) joint review presents a critical opportunity to evaluate whether the agreement is promoting workers' rights and fair competition in the North American marketplace.

Unlike its predecessor, the North American Free Trade Agreement (NAFTA), the USMCA contains a "sunset clause," which provides that the agreement will expire after 16 years unless the parties agree to extend it. Starting in July 2026, the parties will meet annually to review the performance of the deal, discuss possible improvements, and ultimately decide whether it merits a 16-year extension.

When the USMCA came into

force in 2020, workers were promised a different economic model from NAFTA: one based on respect for workers' rights and fair competition rather than a corporate-driven race to the bottom. In particular, the agreement required Mexico to implement reforms to eliminate its corrupt system of "protection contracts," where employers sign bogus collective bargaining agreements with illegitimate, undemocratic trade unions that do not represent workers' interests. For decades, the protection contract system—coupled with Mexico's weak labor justice institutions—have kept Mexican workers' wages artificially low, encouraging corporate offshoring and dragging down wages across North America.

Unfortunately, more than five years since the USMCA was passed, it is clear that the agreement is failing to deliver on its promise to address systemic labor exploitation in

UNFULFILLED PROMISES: WHY THE USMCA JOINT REVIEW MUST DELIVER FOR WORKERS

Mexico and end the corporate offshoring of good, union jobs. The U.S.-Mexico trade deficit has exploded, Mexico is failing to effectively enforce its new labor laws, and wages in its export manufacturing sector remain unconscionably low. Accordingly, the AFL-CIO opposes a 16-year extension of the agreement without major changes to address the challenges outlined below.

Trade deficits and offshoring

The USMCA was supposed to rebalance North American trade flows and narrow the United States' chronically large traded goods deficit with Mexico. Yet the opposite has happened: Since the USMCA came into force, the United States bilateral trade deficit with Mexico has exploded from \$101 billion in 2021 to \$171.5 billion in 2024.² This alarming data point tracks with announcements by major multinationals like Stellantis,³ John Deere,⁴ and Case New Holland⁵ to close U.S. plants

and offshore production to Mexico. Simply put, if a measure of its success is a reduction in trade deficits, the USMCA has failed.

Mexican labor reform and the wage gap

Another primary goal of the USMCA was to raise wages and working conditions in Mexico to reduce the incentive for corporations to offshore jobs from the United States (and Canada) to Mexico. Here, too, the agreement is failing to deliver the change workers were promised. Despite some increases in the minimum wage floor, the vast majority of workers in Mexico's export manufacturing sector have not seen meaningful wage gains under USMCA and still make roughly a tenth of what their American counterparts earn.⁶

While the Mexican government has largely fulfilled its obligation to establish new labor justice institutions, these entities are failing to

effectively defend Mexican workers' fundamental rights to organize trade unions and bargain collectively. For example, the newly created Federal Center for Conciliation and Labor Registration⁷ (CFCRL), the federal agency tasked with enforcing Mexican workers' new rights to democratic and independent trade union representation, does not have the legal authority to issue fines on employers who violate the law.⁸ On top of this, the

Mexican government has consistently underfunded the CFCRL and slashed the budget of the newly created labor courts, undermining the ability of these new entities to carry out their core enforcement functions.

Given the serious nature of these failures, the joint review must focus on creating a labor action plan with clear, timebound implementation benchmarks for the Mexican government to come into

full compliance with its obligations under the USMCA's labor chapter, including by agreeing to adequate minimum funding levels for the new labor justice institutions.

Rapid Response Labor Mechanism

The USMCA's rapid response labor mechanism (RRM) is a major innovation in trade enforcement that has proven effective at holding companies accountable for

respecting workers' rights at specific facilities in Mexico. Over 40 RRM cases have been initiated by the United States with many of these resulting in tangible wins for workers, including democratic union representation, wage increases, and new collective bargaining agreements.⁹

Despite this success, in some cases the RRM has struggled with delays and failed to address common forms of employer union busting, including "blacklisting" of



union supporters and failing to engage in good faith bargaining. The joint review should identify ways to strengthen the mechanism and broaden its impact, including by addressing barriers to accessibility and improving coordination with petitioners on developing meaningful remediation plans.

China

Since the USMCA came into effect, Chinese investment into Mexico has more than doubled, raising concerns the agreement is being used as a backdoor for unfairly traded goods to enter the North American market.¹⁰ Duty free access to the U.S. market has made Mexico an attractive location for Chinese companies looking to sidestep tariffs the U.S. has imposed to address pervasive state subsidies, dumping, intellectual property theft, and other unfair trade practices. During the joint review the parties must adopt strengthened border measures, including coordinated tariffs, stronger rules of origin, and enhanced investment screening, to address this economic and security threat to the development of strong and resilient North American supply chains.

Forced labor imports

The USMCA required all three parties to adopt and implement a ban on the import of goods made with

forced labor.¹¹ While all three countries have adopted some form of an import ban, the Canadian and Mexican governments have done little to enforce it in practice.¹² The joint review must yield commitments from all three parties to strengthen their respective import bans, including by developing formal channels for enforcement agencies to share information and coordinate on enforcement actions.

Conclusion

As we approach the 2026 joint review, we agree with United States Trade Representative Jamieson Greer that the “[USMCA’s] shortcomings are such that a rubber stamp of the agreement is not in the national interest.”¹³ The Trump administration must be ready to use the leverage created by the sunset clause and joint review process to insist on improvements to the agreement so that it delivers on its promise to promote dignity and fair competition for workers across North America.

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LABOR ENFORCEMENT IS CONCENTRATED IN THE AUTO INDUSTRY

USMCA RAPID RESPONSE MECHANISM CASES BY INDUSTRY (2020 – 2025)

Industry	Total cases	Cases resolved	Industry resolution rate (%)
Automotive	21	18	86
Manufacturing	11	6	55
Apparel	1	1	100
Services	2	1	50
Food processing	2	1	50
Mining	3	1	33
Telecommunications	1	0	0
Total	41	28	68%

Source: Brookings USMCA Tracker.



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WAGES AND PRODUCTIVITY IN MEXICO UNDER USMCA



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This chapter analyzes the extent to which Mexico has narrowed the wage gap with the United States and Canada. While some stakeholders in the U.S. and Canada contend that Mexico deliberately maintains low wages to secure a competitive advantage, evidence suggests that the decline in U.S. manufacturing employment stems primarily from the China Shock rather than from Mexican competition. In fact, due to the highly integrated North American supply chain, Mexican and U.S. labor are often complementary rather than direct competitors; paradoxically, Mexico itself has experienced negative effects from this shock. These external dynamics are further complicated by Mexico's persistent dual economy, in which a highly productive export sector coexists with a massive informal sector that suppresses national productivity. This structural dynamic began before NAFTA and has persisted under the USMCA. While the agreement has supported some economic growth, it alone is insufficient to address deeper, longstanding challenges such as widespread informality and chronically low productivity.

Mexican economy under USMCA

Mexico's total productivity¹ grew strongly during the first 20 years of the so-called Mexican Miracle (1950–1970), but it declined thereafter, averaging negative growth rates from the onset of the debt crisis in 1982 up to the present day.² In the early 1990s, Mexico reformed its economy in response to what is referred to as the lost decade of the 1980s, a period marked by economic stagnation and annual inflation rates exceeding 100%.

The country adopted an outward-oriented growth strategy that included greater international trade, financial liberalization, and a set of policies aimed at bringing inflation under control. As part of this strategy, Mexico signed the North American Free Trade Agreement (NAFTA) with the United States

and Canada. This contributed to a substantial increase in trade, which rose from 26% of GDP in 1993 to 80% in 2024, as shown in Figure 1.

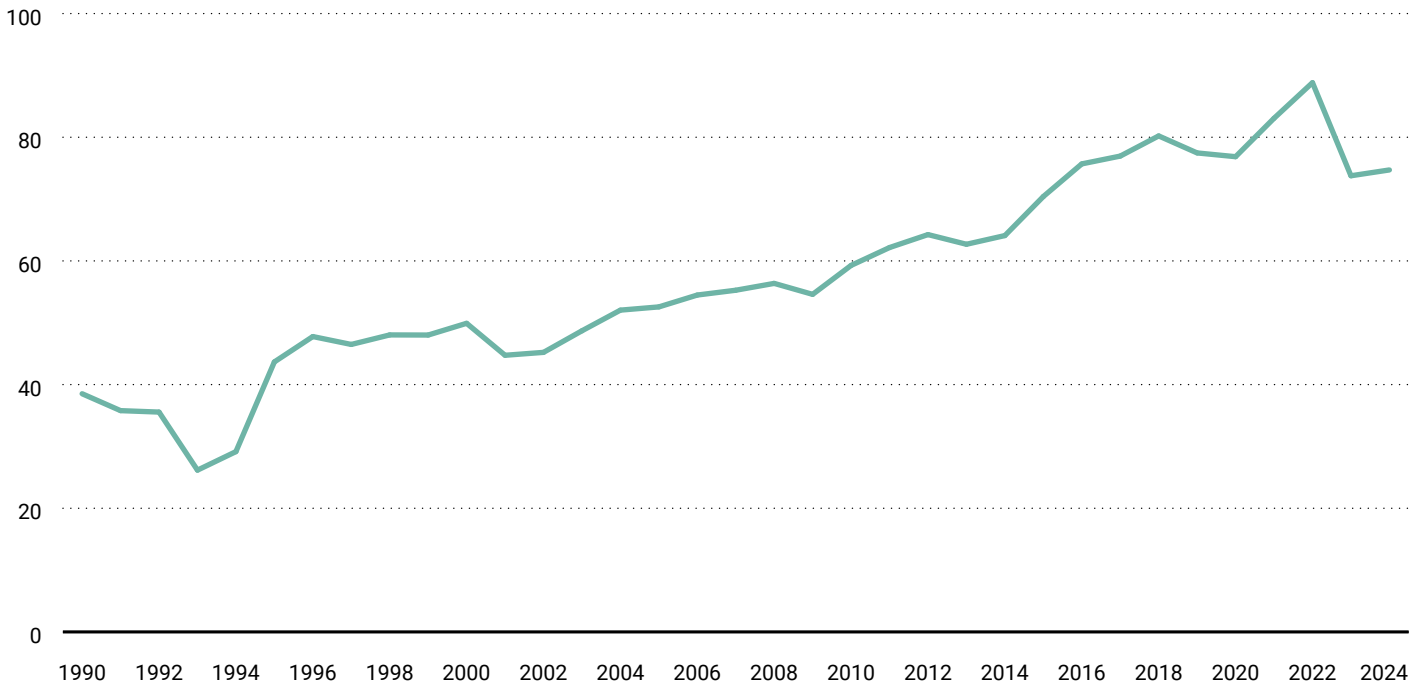
However, following the financial crisis of December 1994 (the so-called *Téquila* Crisis), Mexico was bailed out by the United States. Since then, the country has devoted considerable attention and effort to taking advantage of the benefits provided by the agreement. Over time, however, economic policy gradually lost sight of the fact that the agreement was only one component of a far more complex development strategy that required broader policy attention, as I explain in this chapter.

The prior import-substitution and state-led development strategy—which during its first 20 years (1950–1970) promoted the manufacturing sector—had initially achieved high rates of economic growth and high total factor productivity (TFP). Yet it left behind an important legacy. By abandoning the agricultural sector and channeling resources toward manufacturing, the country created significant distortions in relative prices, which in turn encouraged migration from rural areas to industrial cities. In addition, population policy was neglected during those two decades of rapid growth, resulting in birth rates far outpacing the capacity to create new jobs.

Thus, by 1970, when industrial growth slowed down sharply and therefore ceased generating sufficient employment—and with demographic pressures increasingly demanding new jobs—the conditions emerged for the expansion of what is now known as informality. This refers to workers who are not registered with fiscal and/or social-security authorities. They mainly include self-employed workers, street vendors, and salaried workers lacking legally required benefits.

Today, Mexico can be understood as a dual economy in which a modern, globally integrated formal sector coexists with a larger

FIGURE 1. TRADE (% OF GDP) - MEXICO



Source: World Bank World Development Indicators.

informal sector—measured in employment terms—that survives in the gray economy. Currently, about 55% of total employment is informal.³ The latter exhibits extremely low labor productivity, largely because its activities take place “in the shadows,” as Santiago Levy has shown.⁴ These activities, by their very nature, do not participate in international trade (they cannot, for example, issue formal invoices). Consequently, when national productivity levels are estimated, the aggregate result is negative.

It is important to emphasize that while the formal sector is significantly more productive than the informal one, the large size of the gray economy pulls the overall average downward, as shown in Table 1, which presents Total Factor Productivity (TFP) estimates for various years. Nonetheless, productivity in the formal sector is also negative. The table includes a pre-NAFTA estimate (1993), showing that even before NAFTA entered into force, the formal sector already exhibited negative TFP—and this trend has persisted to the present day.

TABLE 1. TOTAL FACTOR PRODUCTIVITY (MEAN FOR SECTORS)

Sample	1993	1998	2003	2008	2013	Avg 2014-2023
All Sectors	-2.55	-2.47	-2.48	-2.87	-2.83	-0.055
Formal Sector	-0.23	-0.42	-0.15	-0.37	-0.49	NA
Informal sector	-3.01	-2.87	-2.78	-3.15	-3.11	NA

Note: Methodologies of estimation for both sources differ.

Source: Author’s calculations + Joaquín Mayorga Garrido-Cortés, Resource Misallocation in Mexico (M.A. thesis, CIDE, 2017); INEGI (2014–2023).

In other words, based on these estimates, TFP did not increase under NAFTA and remained negative even after its renegotiation into the USMCA.

Gains from USMCA

This does not mean that NAFTA and USMCA did not bring benefits. Rather, the issue is that Mexico has relied too heavily on the agreement to address structural problems inherent to its dual economy. As noted earlier, the agreement is a valuable instrument, but it is not a panacea for Mexico’s economic challenges. To properly

assess its benefits, the only study that has jointly evaluated welfare and wage outcomes for all three member countries is Caliendo and Parro.⁵

Using unique datasets, these authors decomposed and quantified the distinct role played by intermediate goods and intersectoral linkages as amplifiers of the gains arising from tariff reductions, thereby overcoming key empirical challenges. Their model suggests two important results.

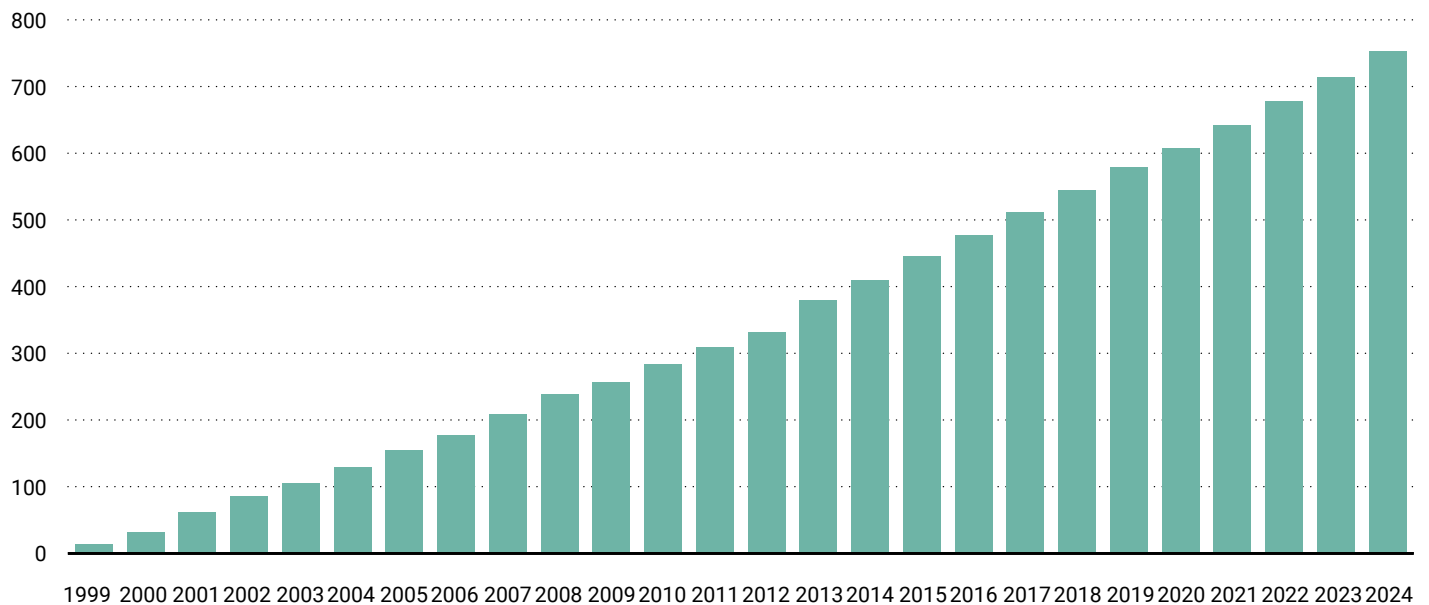
First, NAFTA’s tariff reductions had a significant impact on the member economies. NAFTA increased aggregate intra-bloc trade

TABLE 2. WELFARE EFFECTS FROM NAFTA’S TARIFF REDUCTIONS

	Total	Terms of Trade	Volume of Trade	Real Wages
México	1.31%	-0.41%	1.72%	1.72%
Canada	-0.06%	-0.11%	0.04%	0.32%
U.S.A.	0.08%	0.04%	0.04%	0.11%

Source: Caliendo and Parro (2017).

**FIGURE 2. ACCUMULATED FDI
USD MILLIONS**



Source: Author’s calculations + INEGI.

by 118% for Mexico, 11% for Canada, and 41% for the United States. Second, the effects on welfare (see Table 2) were unevenly distributed. While Mexico and the United States gained 1.31% and 0.08%, respectively, Canada experienced a small welfare loss of 0.06%. Real wages, however, increased slightly in all member countries, with Mexico experiencing the largest gains—a result consistent with Fentanes and Levy.⁶ The decomposition further shows that trade creation among North America members exceeded trade diversion away from the rest of the world.⁷

Mexico is, in fact, the country that benefited the most in terms of intra-bloc trade, welfare, and real wages. Nevertheless, the United States and Canada also gained, though to a lesser extent, as standard international trade theory would predict.

Still, some policymakers—particularly in the United States—perceive the agreement as having harmed their country in terms of wages and employment. However, as shown above, the findings of Caliendo and Parro⁸ indicate that this is not the case. Moreover, the current dynamics of trade among the three countries suggest that these results continue to hold under the USMCA.

Wages and productivity in the Mexican economy

It is important to pinpoint that USMCA also has other, often overlooked, objectives—one of the most important being the strengthening of property rights in Mexico.⁹ This contributed to a significant increase in foreign direct investment (FDI) following the signing of the original agreement, a trend that continued after the renegotiation under the USMCA, as shown in Figure 2. The increases in FDI were also driven by expanding export opportunities to the United States and by Mexico’s comparatively lower labor costs relative to its two trade partners. Figure 3 presents Mexico’s

minimum wage (adjusted for purchasing power) relative to those of the U.S. border states. As shown, real wages remained largely stable until 2018.

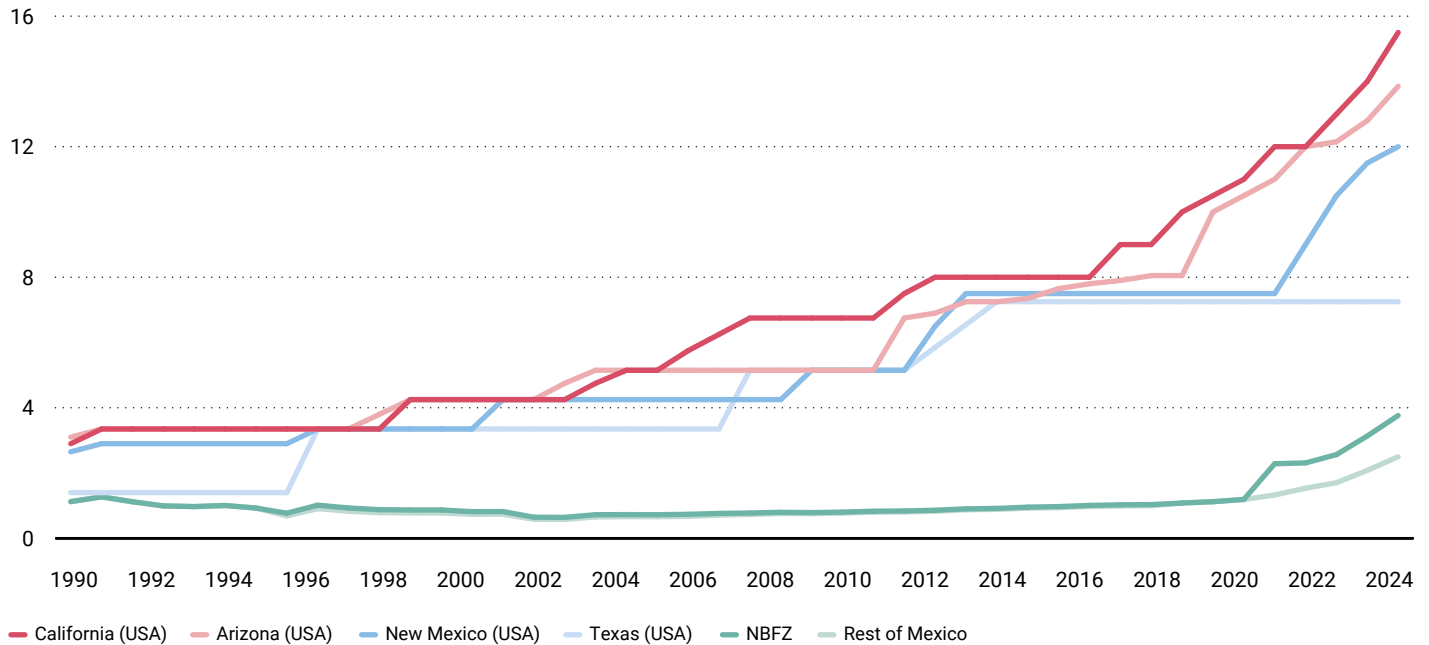
Thus, the perception in the United States that jobs were being lost to Mexico due to low Mexican wages was partly rooted in these two indicators: rising FDI and wage containment. Following the renegotiation of NAFTA into USMCA in 2020, a novel wage-content rule was included in USMCA that requires that 40% to 45% of a vehicle’s value be produced by workers earning at least \$16 per hour. This provision was specifically designed to discourage outsourcing to Mexico and to incentivize higher labor compensation. USMCA in effect mandated wage increases for workers involved in the production of export-oriented manufactures (NBFZ)—particularly in the automotive industry—with the goal of stemming the alleged outflow of jobs from the United States (Figure 3).

Official employment statistics,¹⁰ however, suggest that the outflow of jobs from the United States to Mexico has not been—nor is it currently—a persistent problem in the United States. Over this century, the U.S. unemployment rate has moved largely in line with the country’s own economic cycle and in response to external shocks such as the subprime crisis and the COVID-19 pandemic. Excluding these events, the average unemployment rate has been relatively stable at around 4.8%, slightly above what is considered the natural rate of unemployment—or the rate consistent with full employment—in the United States.

Moreover, the phenomenon known as the “China Shock” was the primary driver of concentrated manufacturing job displacement in the early 21st century in the U.S.,¹¹ however, Mexico also experienced its own China Shock. Mexico in many sectors competes with China. In addition, the highly integrated North American supply chain—particularly

Moreover, the phenomenon known as the “China Shock” was the primary driver of concentrated manufacturing job displacement in the early 21st century in the U.S. ...

FIGURE 3. MEXICAN MINIMUM WAGES COMPARED TO THE US SOUTHWESTERN STATES
US DOLLARS PER HOUR; MEXICAN WAGES ADJUSTED BY PPP



Source: Garduño Rivera-Reid, Neil, and Haoying Wang, "Mexico's minimum wage data trends, policies, and a research agenda," *Investigaciones Regionales Journal of Regional Research*.

in industries such as automotive and machinery—means that U.S. and Mexican workers are often complements rather than direct substitutes in the production process, with Mexican factories relying on U.S.-made parts and vice versa. As a result, the negative impact of China on U.S. manufacturing also adversely affected Mexico.

In addition, it has been argued that Mexican workers' rights were undermined by NAFTA. The USMCA responded to these concerns and incorporated stronger labor and environmental protections, enshrining workers' rights to unionize and collective bargaining, and instituting stricter enforcement mechanisms, such as the ability to block goods from entering if labor laws are violated.

These labor concerns were addressed by the Mexican administration that took office in 2018 (in the middle of the renegotiation of USMCA)¹² with the so-called New Labor Model¹³ that was designed in 2019 and implemented in 2022,

which aimed at moving toward an environment of greater union democracy, faster and more transparent labor justice, and a more dignified and equitable working environment for workers in Mexico. Of particular importance for the USMCA is the guarantee of union freedom, which was incorporated into its provisions.

This component—known in Mexico as “union freedom and democracy”—seeks to return control of unions and collective bargaining agreements to workers through: 1) personal, free, and secret ballots for electing union leadership and, crucially, for legitimizing collective bargaining agreements (CBAs); 2) elimination of the possibility that a worker be dismissed for not belonging to or for resigning from a union; 3) requirements that unions provide financial accountability to their members; and 4) a mandate that a majority of workers approve collective bargaining agreements through a vote for them to be valid, putting an end to the so-called “protection contracts.”

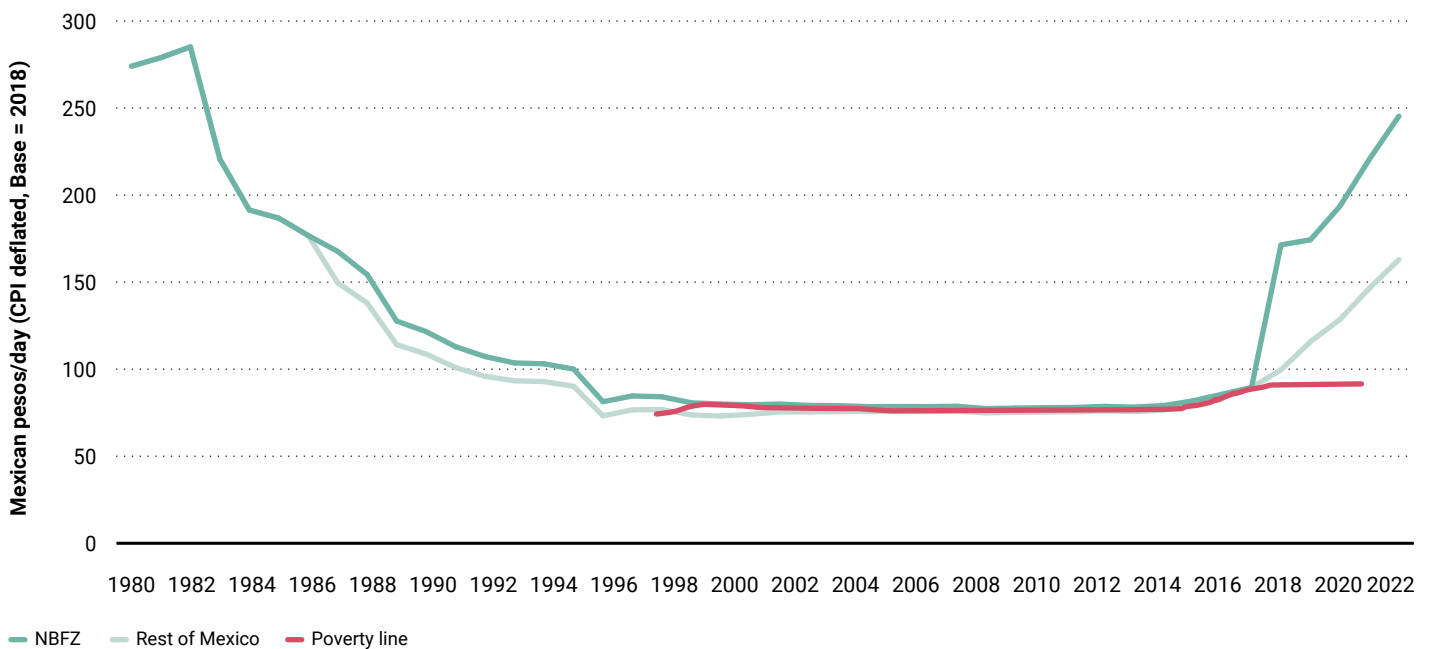
Compliance with these measures will depend heavily on how they evolve over time, particularly on how the new enforcement body operates. The 2025 Independent Mexico Labor Expert Board (IMLEB) Report¹⁴ concluded that Mexico is not in compliance with its labor obligations under the USMCA, citing a failure to adequately implement and enforce the necessary domestic labor reforms. The core findings leading to this conclusion focused on the continued suppression of independent unionism and the lack of protection for workers’ rights to freedom of association and collective bargaining.

It is true that in international rule-of-law indicators Mexico tends to score well in the drafting of laws but performs very poorly in their enforcement. For example, in the World Justice Project’s 2025 ranking, the country is placed 121st out of 143 countries.¹⁵ Similarly, in the World Bank’s 2024 Business Ready index¹⁶—which measures the legal ease of doing business—Mexico ranks well in legislative

drafting but very poorly in implementation. Although this indicator pertains to business regulations, labor-union aspects are included. The IMLEB argues that legal reforms alone are inadequate to produce a democratic transformation without a concerted effort to enforce the laws and protect workers from retaliation and violence by employers and incumbent, pro-employer unions.¹⁷

Perhaps the most important pillar of the labor-reform package was the decree to increase minimum wages (MW).¹⁸ While the rise in the MW was an internal demand—given that, in real terms, in 2018 it fell below the amount needed to purchase the basic consumption basket (used to define the extreme-poverty line, shown in Figure 4)—it can also be interpreted as a commitment undertaken during the renegotiation of the agreement to reduce the gap between wages in the U.S. and Mexico, especially in the export sector, located in the northern border (NBFZ).

FIGURE 4. REAL MINIMUM WAGES IN MEXICO SINCE 1980S (2018 PRICES)



Source: Author’s calculations + Garduño Rivera-Reid, Neil, and Haoying Wang, “Mexico’s minimum wage data trends, policies, and a research agenda,” *Investigaciones Regionales Journal of Regional Research*.



Mexico must address its structural productivity problems. The USMCA provides only marginal support in this regard.

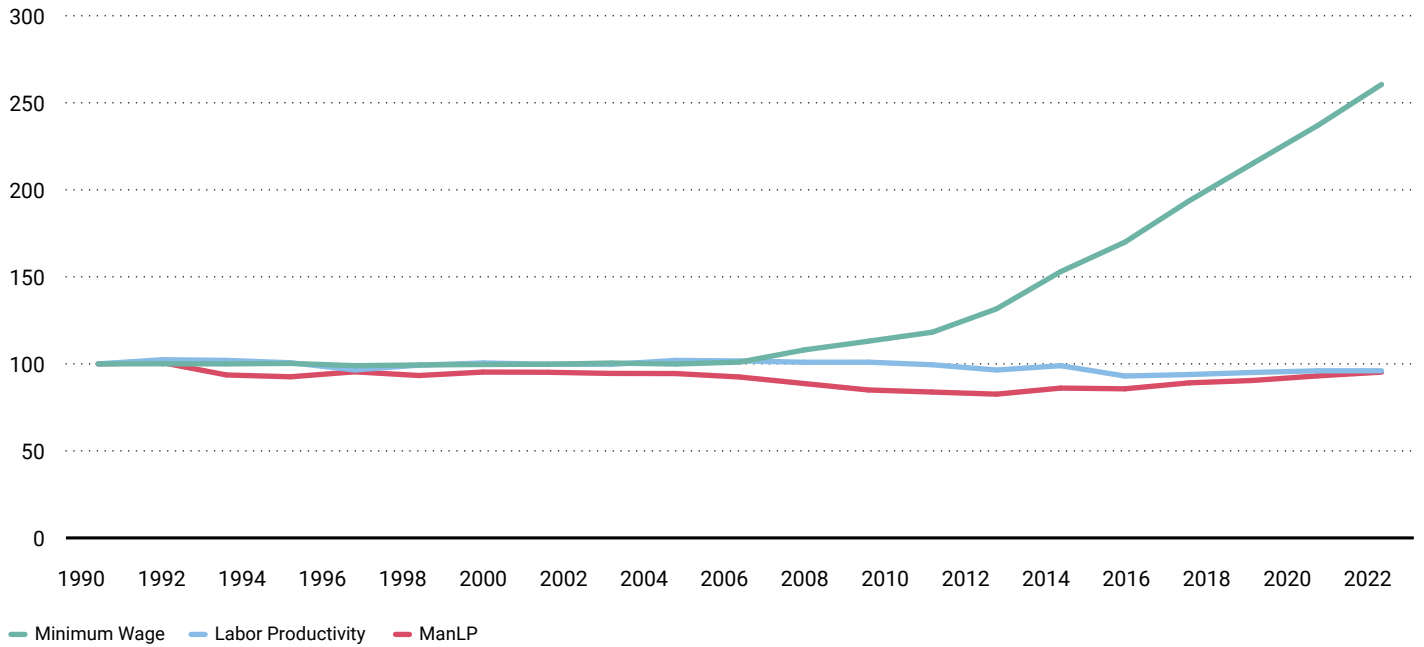
As noted, while the legislated increase in minimum wages was an internal demand—and by 2013 they were even below the country’s average labor productivity—the rise since 2017 has approached 200% (131% in real terms), far outpacing average labor productivity (in the general economy and the one considering only manufacturing, which is more related to USMCA) (see Figure 5).¹⁹ This has begun to raise competitiveness concerns in the business sector, particularly among small and medium-sized enterprises. In fact, one consequence of rising MW has been that formal employment has sharply slowed its rate of growth, increasing the number of informal workers as small and medium entrepreneurs try to circumvent these increases. Today 56% of work force is employed in the informal sector, an indicator 2 percentage points above the one prevailing at the end of 2024.²⁰ Finally, inflation in the services sector, which is labor-intensive, has begun to show resistance to declining.²¹

The abrupt increase in the minimum wage has reduced the gap between MW and wages in other sectors of the economy. Figure 6 presents the ratio of wages in different activities compared to the minimum wage. As can be seen, this gap has narrowed sharply. On the one hand, this helps reduce income inequality; on the other hand, it may indicate that the minimum wage will eventually exert upward pressure on overall wages, which could in turn place additional pressure on inflation rates. This development may further exacerbate the existing inconsistency between labor productivity and wage growth.

The lesson—and thus the central challenge—remains: Mexico must address its structural productivity problems. The USMCA provides only marginal support in this regard; it helps strengthen the export sector and stimulate some economic growth, but it cannot, on its own, resolve the structural issues that characterize the [dual] Mexican economy.²²

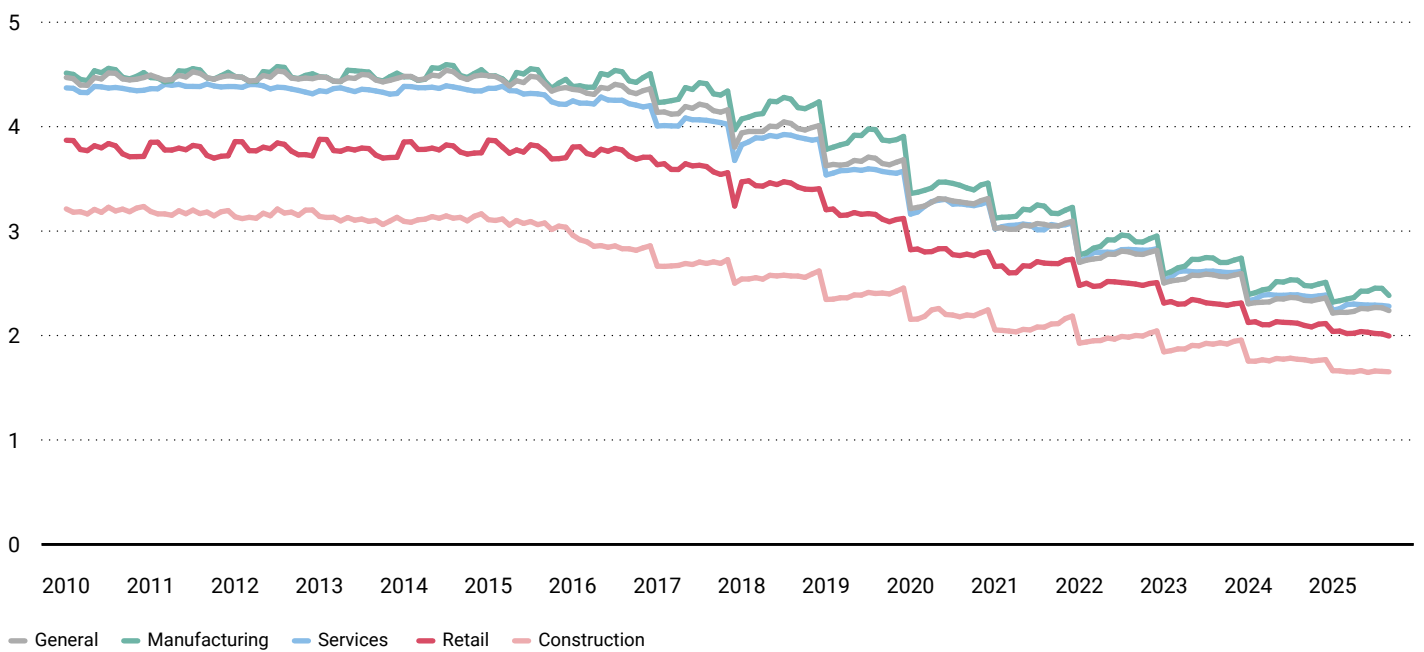
FIGURE 5. MINIMUM WAGES VS. LABOR PRODUCTIVITY

BASE = 100



Source: Author's calculations + INEGI.

FIGURE 6. SELECTED SALARIES/MINIMUM WAGE RATIO



Source: Author's calculations + IMSS.

Endnotes

- 1 Total Factor Productivity (TFP) measures how efficiently an economy uses its standard inputs—labor (workers' hours) and capital (machinery, buildings, infrastructure)—to produce goods and services (output). In simple terms, TFP is the portion of economic growth or output increase that *cannot* be explained simply by using more workers or more equipment. It tells you how much "more with less" an economy is producing.
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- 3 Instituto Nacional de Estadística y Geografía (INEGI), *Encuesta Nacional de Ocupación y Empleo (ENOE), Indicadores de Ocupación y Empleo*, Boletín de Indicador 732/25, December 24, 2025, https://www.inegi.org.mx/contenidos/saladeprensa/boletines/2025/iooe/IOE2025_12.pdf
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- 7 Caliendo and Parro, "Estimates of the Trade and Welfare Effects of NAFTA."
- 8 Caliendo and Parro, "Estimates of the Trade and Welfare Effects of NAFTA."
- 9 Fausto Hernández-Trillo, "Mexico, NAFTA, and Beyond," *The International Trade Journal* 32, no. 1 (January 2018): 5–20, <https://doi.org/10.1080/08853908.2017.1387622>
- 10 Federal Reserve Bank of St. Louis, "Unemployment Rate (UNRATE)," *FRED, Federal Reserve Economic Data*, <https://fred.stlouisfed.org/series/UNRATE>
- 11 As documented by David, David Dorn, and Gordon H. Hanson (2016) *The China Shock: Learning from Labor-Market Adjustment to Large Changes in Trade*. *Annu. Rev. Econ.* 2016. 8:205–40 and later updated by other institutions, such as the Economic Policy Institute.
- 12 The parties reached an agreement on October 1, 2018, which was signed at the G20 Summit the following month by U.S. President Donald Trump, Mexican President Enrique Peña Nieto, and Canadian Prime Minister Justin Trudeau. A revised version of USMCA was signed on December 10, 2019, ratified by all three countries—Canada last on March 13, 2020—and entered into force on July 1, 2020.
- 13 Secretaría del Trabajo y Previsión Social, *Hacia un nuevo modelo laboral: Reforma a la Ley Federal del Trabajo* (México: Dirección General de Concertación y Capacitación Laboral, 2019), https://reformalaboral.stps.gob.mx/sitio/rl/doc/HACIA_UN_NUEVO_MODELO_LABORAL.pdf
- 14 Independent Mexico Labor Expert Board, *Report to the Interagency Labor Committee and the U.S. Congress, October 6, 2025* (Washington, DC: AFL-CIO, October 6, 2025), https://aflcio.org/sites/default/files/2025-10/IMLEB_REPORT_2025_10_06.pdf
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- 16 World Bank, "Domestic credit to private sector (% of GDP) — Mexico (IC.BRE.BE.P1)," *World Bank Data*, <https://data.worldbank.org/indicator/IC.BRE.BE.P1?locations=MX>
- 17 AFL-CIO, *Independent Mexico Labor Expert Board Report*.
- 18 Minimum wages in Mexico are set by a committee composed of representatives from labor unions, employers, and the government.
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- 22 Fausto Hernandez-Trillo, "Mexico, NAFTA, and Beyond," *The International Trade Journal* 32, no. 1 (2018): 5–20, <https://doi.org/10.1080/08853908.2017.1387622>

