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The Current podcast**

“USMCA fails to renew—but it’s not over yet”

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Participants:

Kari Heerman
Director, Trade and Economic Statecraft
Senior Fellow, Economic Studies
The Brookings Institution

Christopher Sands
Visiting Fellow, Global Economy and Development
The Brookings Institution

Duncan Wood
Visiting Fellow for North America
The Wilson Center

Episode Summary:

On July 1, the U.S. government declined to renew the U.S.-Mexico-Canada Agreement (USMCA)—but that’s not the end for the region’s free trade agreement. Kari Heerman spoke with Christopher Sands and Duncan Wood about what went wrong, what went right, and what comes next for North American economic relations.

HEERMAN: On July 1st, the U.S. government declined to renew the USMCA agreement. A lot of people heard that headline and thought, "Okay, the USMCA is no longer in effect," but that's not in fact the case.

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HEERMAN: Hi, this is *The Brookings Current* from the Brookings Podcast Network. I'm Kari Heerman, a senior fellow in Economic Studies and director of trade and economic statecraft at Brookings. On July 1st, the Office of the U.S. Trade Representative announced that the U.S., quote, "Did not agree to renew the USMCA in its current form." The USMCA, or United States Mexico Canada Agreement, is a free trade agreement among the three countries that went into effect six years ago, negotiated during the first Trump administration to replace the North American Free Trade Agreement, or NAFTA. This renewal would have extended the pact as-is for another 16 years with another joint review in 2032.

Here to discuss with me what happened or failed to happen and what it means for economic relations in North America are two experts on the topic. Chris Sands is a visiting fellow in Global Economy and Development here at Brookings, where he leads the USMCA Initiative. And also Duncan Wood, visiting fellow for North America at the Wilson Center.

Welcome, Chris.

SANDS: Thank you, Kari.

HEERMAN: And welcome to you, Duncan.

WOOD: Thanks for having me.

[1:29]

HEERMAN: Chris, I'd like to start with the news itself. As I just said in the intro, on July 1st, the U.S. government declined to renew the USMCA agreement. A lot of people heard that headline and thought, "Okay, the USMCA is no longer in effect," but that's not in fact the case. You and our colleague Maricarmen Barron Esper wrote a piece on the Brookings website calling the review "a procedural success." So tell us, Chris, what did happen, what didn't happen, and what comes next?

[1:57]

SANDS: Well, thank you very much, and I understand a lot of our viewers will be puzzled because there was this build-up and then nothing. And I think people jump to the conclusion, "Well, does that mean USMCA is dead? Something must have happened for all of that pressure to build up."

But actually, what happened is very subtle. This is the first time we've had a review clause built into a trade agreement that allows us to potentially modernize the

agreement but also get the governments to re-endorse it. Some of some of the viewers remember NAFTA. And NAFTA was passed, and then most politicians in the United States anyway stopped wanting to talk about it. It was too controversial.

And so as a result, there was a feeling that it had no friends in Washington, and by the time we get to 2017 and newly elected President Donald Trump says he's going to get rid of NAFTA, and he means it, there's very few people pushing back except in the business community and elsewhere. So this was going to be the great innovation of the USMCA. And for trade nerds, we've been building up for a long time.

So on July 1st, the three governments had to put their cards on the table, and they could have done one of three things. One, they could withdraw from the agreement. It would end right away or in six months' time. Two, they could renew the agreement 16 more years, as you said in the intro. Or they could decide they're not yet ready to renew, but they're not withdrawing. And what that does is it lets the agreement continue for another 10 years to its original end of term when it has a sunset moment.

But for all practical purposes, July 2nd was just like July 1. Trade continued, negotiations continued, so there wasn't the big triumph that we might have hoped for, but there is actually some continuity. And the fact that the governments went through all the procedure, they did the examination, they talked to each other, shows that this process may not have reached a renewal conclusion, but it still was faithfully followed by all three governments. And so gives me hope that we'll be doing this next year and the year after, but we'll ha- we'll get better at it as we go along.

[3:56]

HEERMAN: Duncan, are you prepared to call this review a procedural success or any other kind of a success?

[4:02]

WOOD: I think the biggest success here is actually one that Chris alluded to in his three options. The first of those options is withdrawal, and withdrawal is an option at any point, at any time in the life of this agreement. All the the country or the government that wants to withdraw has to do is just to notify the other two parties that it will withdraw, and six months later it's out of the agreement. That hasn't happened.

So for all of the blustering that we've seen about this particular agreement, the United States has chosen not to withdraw. It's chosen to stay engaged. It's chosen to say, "Okay, we're not ready to renew right now, but, you know, the talks continue."

And that's borne out by the fact that the talks are ongoing. It's not like on January 1st things stopped. You've got ongoing negotiations with Mexico, with Canada. The talks may be more formal on the Mexican side, but they're happening on on both sides. And I think that's very, very important to understand and and to note here.

And the reason why that matters is that, as you suggested, there was all of this kind of hand-wringing beforehand, "Oh my God, what happens if we don't extend for

another 16 years?" And understandably so, because investors love security and and certainty, et cetera. But the fact is is that we've got another 10 years. We've got multiple opportunities to actually extend. And I'm, for one, personally very confident that that will happen eventually.

[5:21]

HEERMAN: So, the agreement didn't end, but this still feels like some kind of a pivotal and important moment, a transition to a new era of negotiating, working out our next version of the agreement. But we have had a North American agreement for the past 30 years. And so before we talk about where we're headed, let's talk a little bit about what we've built. Chris, the USMCA Initiative has done a tremendous amount of work documenting the effectiveness and the implementation of the USMCA in terms of trade, flows, jobs, investment.

When you look at that record that is collectively reflected by your your work, what do you think the governments are or should be trying to preserve, and what are they trying to change?

[6:02]

SANDS: Well, I think some of the big gains that we've had are in manufacturing, and we've been able to take advantage of the specialization that different countries can bring to the table to develop supply chains that are truly continental and serve all three markets. Together, the three countries are half a billion people, and some of the wealthiest half a billion people in the world, which is a huge potential market for all of us.

Some of the last couple of decades, there've been countries that have tried export-led growth as a way to turn their fortunes around. Well, within North America, by integrating supply chains, it's a much more mutual benefit. It's not just Mexico and Canada exporting to the United States, it's Mexico and Canada buying things from the United States. Per capita, Canada is number one. You know, I have to put the per capita in there to get Canada to be number one. But Canada and Mexico together are the biggest consumers of American exports in the world. They buy what we make.

And for an administration, I could say this for the Trump administration, I could say it for the Biden administration, that is interested in reviving U.S. exports and becoming that global powerhouse we had the potential to be, this is our home market, and we have been able to do that through a series of investments.

And I'll add to that. Not only have our supply chains built that way, but our infrastructure is built that way. Highways, railways, air transit links. We've made sure that we can move goods quickly and cleanly all across the continent. And that connects states like Missouri, Kansas, Arkansas to the heart of a beating economy, one that is really among the most competitive in the world.

One downside though, and that has been in the process of uncertainty about renewing the agreement, in Canada and Mexico, there's been a bit of a pall cast on new investment because nobody knows what the risk is. So if you're talking

multimillion-dollar investment in new plant and equipment, new machine tools, or even in a data center or silicon chip-making facility, you need to at least know that the rules will stay stable for you to make that investment and get the return on the investment.

And I think the uncertainty we've created in the process of negotiating the deal, while it does put pressure on Canada and Mexico, has the perverse effect of either stymying investment, which is a shame because that, we start falling backwards, or driving that investment into the United States at the expense of Canada and Mexico.

And that erodes the mutuality of the benefit of North America, which still, I think, has been a big win for the U.S. and a big win for our neighbors.

[8:29]

HEERMAN: So it sounds to me like from what Chris is saying that what is at stake is the current agreement, the current rules that exist, and that providing certainty that has helped create North America as a global powerhouse and could continue to be that way.

Do you get the sense, Duncan, that that is the objective that the U.S., Mexico, and Canada are trying to achieve? And if that's the case, if it's to sort of preserve the rules that that exist, what are we negotiating about? What what is on the table? What are the issues that each capital is focused on?

[9:01]

WOOD: So it's about preserving the rules, absolutely. It's also about preserving that economic reality that Chris so eloquently described. You know, the infrastructure, the energy flows, the the flows of goods and services. That is something that is existential for both Canada and Mexico, and upon which an enormous amount of prosperity here in the United States depends.

The rules are, of course, integral to that. But the rules themselves in that agreement, they're set, but there is some scope for changing things on the margins. As long as it doesn't require us to go to Congress to ratify an entirely new agreement, then we can change things, and that's what the review process is all about.

And I think that some of the issues that we're beginning to hear about, whether it's national content or regional content, whether it is, you know, the question of competition with China, I think those are the right kind of conversations to be having at this point in time.

What I'm not happy about is the conversation about deficits, because deficits, I think, are a red herring in many ways. That assumes that there is a zero-sum equation underway here in North America. And I see it very much as a positive-sum game. And part of that is because of the integration of manufacturing platforms. Part of it is because, you know, goods flow across borders several times before they end up at market.

But I think it's also that so much of the competitiveness of all three countries depends upon this integration of manufacturing and of services and of commodities.

And that's something which, as we face a world where China is, you know, really the the biggest challenger to the United States in terms of competitiveness and global market share, it's the only way that I see that the United States can really stay in the game.

[10:44]

HEERMAN: So for the United States, for Washington, though, deficits and balance are on the table. Very fundamentally, when you're looking at what are these countries negotiating at, they are looking for levers to improve what they see as an important element of our economic relationship, which is its balance.

But as you pointed out as well, there are these broader challenges that are global, that are less specific to this particular administration. What does our posture vis-à-vis China look like? How do we ensure security of supply for things like critical minerals? These broader issues. Are there specific things that countries are negotiating over specific tools in either of these buckets that are kind of the things that people should be watching for?

[11:24]

SANDS: I want to pick up on something that's really actually in in Duncan's wheelhouse very much because of his his past work, and that is just to draw a focus on energy. Now, why energy? Well, energy is the biggest item traded between the United States and Canada. It does go back and forth, but Canadian oil sands oil, LNG, and of course hydroelectricity, which comes down, give Canada a trade deficit with the United States. If it wasn't for energy, Canada would be in the balance.

Now, why is that important? If you look around the world, Europe is trying to find alternatives to Russian natural gas, which they've been buying for a long time. They're thinking about nuclear power plants. They're thinking about infrastructure, but they don't have it.

If you look at China, the crisis in Iran has led the Strait of Hormuz to be questionable, raised energy prices. So you see countries all over Asia resource-starved, unable to sort of square that equation, and they're really suffering.

North America, we don't have this problem. And yes, part of that has been Donald Trump's vision of sort of energy dominance. Let's produce as much as we can. But even so, Canada's supplies have helped to keep us robust and one of the lowest cost places to work.

Now behind that is another thing which relates to sort of basic commodities, and that's critical minerals. There's no doubt that critical minerals are a huge Chinese advantage. They've worked for decades to put themselves not only in the position of having access to minerals, but having processing capacity so that they can, that they can use that as a chokehold on the global economy.

There is a critical minerals resource base here in North America, but we have to get it out of the ground, and we have to get it processed, and build an entire critical minerals economy, something that Duncan's written a lot about and that I'm very

interested in because it was one of the things we thought if they had modernized USMCA, they might have been able to add something on critical minerals that ensured the development of this industry was truly continental and not just an American industry.

[13:15]

WOOD: And I think all of this comes together, whether you're talking about energy or basic commodities or critical minerals, it all comes together as part of that equation about how much regional content is gonna be in the final product and how much U.S. content is gonna be in there. So Chris talked about the fact that Canada exports so much energy to the United States. That predominantly goes to the northern states.

The United States exports an enormous amount of energy to Mexico. It exports natural gas in massive quantities. Mexico is the single largest consumer of U.S. natural gas. It exports refined petroleum products as well. This is fundamental to Mexico being able to produce manufactured goods, thereby taking on U.S. exports.

When you look at the amount of U.S. content that is in goods that are imported into the United States, you compare it between, sort of, China, for example. The figures that we have is that probably 4% of the value of Chinese imports is originated in the United States. With Canada, the figure, and it's a bit out of date, but it's 25%. For Mexico, it's 40%. That's extraordinary. So for every dollar that you import from Mexico into the United States, 40% of its original value started here.

Now, those numbers are outdated, as I say. There was a big shift in the second decade of this of this century, um where we began to see that a lot more Asian content was coming in replacing U.S. goods, and that's part of the conversation today. That's why we're having this conversation over regional and national content.

[14:45]

HEERMAN: Yeah, that's very interesting, and in a way a very sensible economist thinks about what content it is embedded in our imported goods. That is a hard one to to get through, and I think you did a great job and a great service for bringing it in into this conversation here.

One of the questions that I'm often asked about these negotiations from a number of different groups is should this continue to be a trilateral agreement? After all, we are negotiating many, many bilateral agreements around the world. Should it move to two bilateral agreements? Should the negotiations be happening separately with Mexico, separately with Canada, or should we be pooling things?

Can you break down this issue, this question that people are asking, and give us a little insight into it?

[15:25]

SANDS: Sure. I would say a couple of things. If you look at USMCA, it is a bit of a hybrid. It's a trilateral chapeau on what are a couple of bilateral agreements. And some provisions affect everyone, but there are annexes and side letters that are

really bilateral. For example, there's a chapter that talks about Mexicans' ownership of their hydrocarbons, and that is a big commitment, very important to the Mexicans to have their own chapter.

That means that we really don't need to have a debate between two agreements and one agreement. We've got a flexible agreement that allows us to have all that within.

But then when you talk about who else should be involved, I think you start getting to the challenge that Europe has and that the World Trade Organization, the WTO, has. Why? Because the more people who are around the table, the harder it is to come to consensus. And the beauty of USMCA, and before that NAFTA, is that you're talking about three partners that share quite a lot of common interest, and so it's easier to move forward. It's easier to modernize and to gain consensus. And that's been much harder for Europe.

And in the WTO, which is an important part of world trade, we are having trouble amending the appellate mechanism. That's something that the U.S. has been quite firm about, that it needs reform, that it's been distorted. We've talked about extending it, but in recent years we've had a lot of plurilateral agreements, ones just for the coalitions of the willing, and we haven't really been advancing liberalization.

So I think the Three Amigos, the Three Musketeers of North America, however we phrase it, are actually a kind of a smart number. It allows us to do a lot of great things together.

[16:59]

HEERMAN: One thing is for sure, we would phrase it slightly differently in each country, as we have with the USMCA and CUSMA and—

WOOD: —you can't agree on the name of anything, I know.

HEERMAN: Exactly. So that's where we are.

Duncan, it strikes me that Canada and Mexico do seem to be engaging in this process vis-à-vis the United States quite differently. They seem to be following different strategy. Can you give us some insight into this, where it's coming from, and what their different strategies look like?

[17:25]

WOOD: So, first of all, I would just point out the fact that these two bilateral negotiations the United States is having with, one with Mexico, one with Canada, that was entirely expected. That's how the original USMCA was negotiated. The United States came to a deal first with Mexico and then Canada kinda came on board. It's not surprising at all, and it's very much the mark of the negotiating tactics of this administration in the United States.

Secondly, why are they so different? Well, I would say that the Mexicans have made this decision that the USMCA is an existential issue for them, and that they're willing to give up a lot of things in order to make sure that the agreement continues. And that means issues on many different dimensions or axes of the relationship.

So one is security. Security, the Mexicans have been so cooperative with the United States, engaging in quite effective operations within Mexico on disrupting fentanyl production, for example, extraditing without due process in some cases crime bosses from Mexico, and generally being willing to say yes to the United States on many, many security related issues.

Secondly, on migration, Mexico continues to play a fundamentally important role in stopping Central American migration coming up and transversing through Mexico.

On third issue, Mexico has been very willing to change its overall trade stance with the rest of the world to try to exclude as many Chinese goods as possible. And that's, those have been specific requests.

Now, some people, and I would put myself in this camp, argue that Mexico believes that it's doing this in order to get the USMCA extension, and that hasn't worked. They're still in the game. The conversation still goes on. But I think there is a growing realization in Mexico that just because you give what the United States is asking for, it doesn't mean they're gonna give you something in exchange. There is no quid pro quo sometimes. And so that's a, I think, a little nagging doubt that's there in the minds of many people in Mexico.

Canada has gone the opposite direction, of course. I mean, Mark Carney has come out. He's become this sort of fêted figure around the world, you know, for his recognition that the international system is not what it used to be. And he's really highlighted the need for autonomy, independence. But that's a controversial issue because of course, as we all know, Canada's economy depends so heavily upon that integration with the United States. So there's only so far you can push it, but it's so far I would say it's not an unsuccessful negotiating tactic on the part of the Canadians

[19:56]

HEERMAN: Well, this has been a really interesting talk. I want to just finish with one last question, brief answer from both of you. For listeners who want to watch this review and keep up with it over the next year, what should they be paying attention to?

[20:08]

SANDS: Well, of course, the Brookings USMCA Initiative website. You should always check out our our publications. I also think that there's a lot of room to focus on specific sectors now as we start looking at the problems of the auto industry, problems of the energy sector, et cetera, problem for agriculture, which you wrote on for our last USMCA Forward 2026 piece.

We talk about the macroeconomy, but really this is a series of very specific needs for different sectors, and I think that's important because Congress is important. And Congress has taken a backseat on these negotiations, but they do have a lot of ability to influence trade policy.

And we have two years left of the current Trump administration. Who knows what comes beyond? But the idea that Congress is going to remain in the backdrop when so much is at stake strikes me as unlikely. And in the coming years, if you understand the sectors that drive the states and the provinces across North America, you will start understanding how the agenda is getting set.

[21:00]

HEERMAN: That's an excellent point, Chris. This doesn't show up as a massive part of the headline macroeconomy, but at the industry level, it can be existential. Duncan, what should, what should our listeners be following?

WOOD: I think it's the evolution of the negotiating tactics from both Canada and Mexico. I believe there's now a growing realization that what makes sense is now to push this beyond the Trump administration. In other words, delay as much as possible. We have the rules in place. It's not completely certain, so investors are a bit, you know, nervous about that. But let's keep it going, and then hopefully, fingers crossed, as the next administration comes in, there is a more open approach to the USMCA and that, in fact, you can get a better deal by waiting.

The other thing that I would say that people should look out for is that on Sunday in the World Cup final, Madonna is gonna be singing, United States. Justin Bieber is gonna be singing, Canada. Where's the Mexican singer? Shakira is not Mexican, okay? We need to have somebody singing in the halftime show at the World Cup final.

SANDS: Any nominations?

WOOD: I would say Maná. Maná has been appearing on uh on TV, on on Telemundo, talking about the football all the time, and I would say that he would be a prime candidate.

HEERMAN: Or we're gonna have to fight with Chris's assessment and invite Colombia into the into the agreement. Those are the only, the only choices we have I think.

WOOD: I will vote in favor.

[music]

HEERMAN: Okay. Thank you both for engaging in this terrific conversation. I love where it ended up. And thank you all for listening or watching. You can learn more about Brookings research on trade on our website, brookings.edu, and find out what Duncan is up to at wilsoncenter.org.

My name is Kari Heerman, and this is *The Brookings Current*.