

October 30, 2018

**PRE-HEARING BRIEF**

**U.S. INTERNATIONAL TRADE COMMISSION INVESTIGATION NO. TPA-105-003  
“UNITED STATES-MEXICO-CANADA AGREEMENT: LIKELY IMPACT ON THE  
U.S. ECONOMY AND ON SPECIFIC INDUSTRY SECTORS”**

Public Citizen welcomes the opportunity to provide written comment on the United States International Trade Commission (USITC) investigation of the likely economic impact of renegotiated North American Free Trade Agreement (NAFTA). Public Citizen is a national, nonprofit consumer organization with more than 400,000 members that champions citizen interests before Congress, the executive branch agencies and the courts. We have conducted extensive analysis of the economic impacts of existing and prospective U.S. trade and investment agreements and the methodologies employed to project such impacts, starting in 1991 during NAFTA negotiations.

Our comments focus on what methodologies the USITC should employ in this investigation to obtain the most accurate and useful data on prospective effects of a renegotiated NAFTA. The USITC’s past trade agreement assessments have proved to be widely off the mark. Often, the failure has not only been one of degree, but of direction.

Prior to the 1993 congressional consideration of NAFTA, the USITC provided rosy projections of the pact’s likely economic impacts that have proved to be dramatically wrong,<sup>1</sup> as data documenting nearly 25 years of NAFTA’s actual outcomes have shown. Rather than improving the U.S. trade balances with Mexico and Canada, as the USITC projected, the pact led to a massive new NAFTA trade deficit.<sup>2</sup> Rather than increasing U.S. and Mexican wage levels, as the USITC projected, U.S. wages are flat and Mexican wages are down in real terms.<sup>3</sup> Rather than creating U.S. jobs, as the USITC projected, the U.S. Labor Department has certified 959,547 U.S. jobs as lost to NAFTA,<sup>4</sup> with more U.S. jobs outsourced to Mexico weekly and the Trade Adjustment Assistance (TAA) data not even fully accounting for all 2017 NAFTA-related job losses.

Unfortunately, the inaccuracies in the USITC NAFTA projections were not a one-off fluke. This submission describes the poor track record of USITC’s projections with respect to other free trade agreements (FTAs) and Permanent Normal Trade Relations (PNTR) with China. We offer

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<sup>1</sup> United States International Trade Commission, “Potential Impact on the U.S. Economy and Selected Industries of the North American Free-Trade Agreement,” USITC Publication 2596, January 1993. Available at: <https://www.usitc.gov/publications/332/pub2596.pdf>.

<sup>2</sup> Public Citizen, “NAFTA’s Legacy: Lost Jobs, Lower Wages, Increased Inequality,” Feb. 2018. Available at: [http://www.citizen.org/sites/default/files/nafta\\_factsheet\\_deficit\\_jobs\\_wages\\_feb\\_2018\\_final.pdf](http://www.citizen.org/sites/default/files/nafta_factsheet_deficit_jobs_wages_feb_2018_final.pdf).

<sup>3</sup> Organisation for Economic Co-operation and Development, OECD.Stat, accessed Oct. 30, 2018. Available at: <https://stats.oecd.org/>.

<sup>4</sup> Public Citizen, Trade Adjustment Assistance Database, 2018, accessed Oct. 30, 2018. Available at: <http://www.citizen.org/taadatabase>. Note: This figure is only those jobs lost under NAFTA that qualify under the narrow requirements of the Trade Adjustment Assistance program, meaning it represents an undercount of the full damage.

specific methodological changes that could improve the accuracy of the USITC projections related to this investigation. These include:

- Avoiding unjustified modeling assumptions and enhancing transparency to reveal the impact of assumptions on the model. For instance, the assumption of full employment is highly problematic in view of recent research showing workers face lengthy gaps in employment when losing jobs to trade agreements and many face significantly lower wages when reemployed.<sup>5</sup>
- Not replicating past USITC methodologies that employ broad-brush assumptions about gains from elimination of domestic consumer and environmental protections, while ignoring economic and social costs, and computable general equilibrium (CGE) modeling of so-called “non-tariff barriers” that is ill-suited to assess the impact of non-tariff policy changes.
- Assessing the distributional impacts of various NAFTA 2.0 provisions, including those that provide more expansive patent and copyright monopoly protections. This is especially important when considering the intellectual property protections in NAFTA 2.0 that will increase protections currently in place in partner countries. Receipts from new licensing fees extracted from other countries, for example, can entail losses to U.S. workers by necessitating a rise in the trade deficit in areas like manufactured goods. This needs to be accounted for in the model, not simply the positive gains to U.S. pharmaceutical or content-providing companies.
- Modeling scenarios under which various NAFTA 2.0 non-tariff provisions, like labor standards, are enforced and are not enforced to reveal the implications of uncertain enforcement of the pact’s obligations.

### **Past USITC Projections of Trade Agreement Impacts Have Been Dramatically Wrong**

The need for the USITC to improve its methodology for the assessment of prospective NAFTA 2.0 economic impacts is spotlighted by the systematic disconnect between previous USITC projections and the actual outcomes of past U.S. trade agreements. The inaccuracy of past USITC trade-pact assessments is evident when reviewing the studies prepared on the three most economically impactful U.S. agreements: NAFTA, the U.S. bilateral agreement with China that set the terms of its World Trade Organization (WTO) entry and related PNTR vote and the U.S.-Korea Free Trade Agreement (KORUS). Unfortunately, many of the methodological problems that resulted in these past studies being wildly off-kilter were replicated in the most recent 2016 USITC trade-pact assessment on the economic impacts of the Trans-Pacific Partnership (TPP). As economist Dean Baker noted in his assessment of the USITC’s TPP study, the structure of the model employed made it “inevitable” that the USITC would project net economic gains from the TPP even as studies using different methodologies projected net losses.<sup>6</sup>

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<sup>5</sup> With respect to wages, *see* U.S. Bureau of Labor Statistics, “Displaced Workers Summary,” Table 7, U.S. Department of Labor, Aug. 28, 2018. Available at: <https://www.bls.gov/news.release/disp.t07.htm>.

<sup>6</sup> Dean Baker, “The International Trade Commission’s Assessment of the Trans-Pacific Partnership: Main Findings and Implications,” Center for Economic and Policy Research, Nov. 2016. Available at <http://cepr.net/publications/reports/international-trade-commission-assessment-of-the-tpp>. Baker writes that USITC’s finding of modest economic gains from the TPP was “inevitable given the structure of the model.”

The USITC's repeated methodological problems have resulted in assessments that often are the opposite of actual trade-pact outcomes. Consider the 1993 USITC study on the possible economic effects of Mexico joining the existing 1988 FTA between the United States and Canada. The 1993 NAFTA USITC report projected that the U.S.-Mexico trade balance in goods and services would improve and the U.S.-Canada trade balance would not be affected in a significant way.<sup>7</sup> Using a base year of 1993, the USITC projection for trade flows was that U.S. exports to Mexico would increase from 5.2 percent to 27.1 percent and U.S. imports of Mexican goods and services would increase at about half that rate from 3.4 percent to 15.4 percent. The actual outcome has been diametrically different: Imports from Mexico grew at nearly double the rate of U.S. goods exports to Mexico.<sup>8</sup> Before NAFTA, the United States had a trade surplus in goods of \$1.6 billion with Mexico in 1993 dollars. Applying even the USITC's low-end projection for exports and high-end projection for imports, the USITC predicted outcome for a fully implemented NAFTA would have been a U.S. trade deficit of \$2.3 billion. Just ten years later in 2003, however, the U.S. trade deficit in goods with Mexico already had grown to almost \$43 billion in inflation-adjusted terms. The difference was not made up by the U.S. services trade surplus with Mexico, which was only \$4 billion in 2003 (again in constant 1993 dollars).<sup>9</sup> The USITC projections for U.S.-Canada trade were also dramatically off. The United States had a trade deficit in goods with Canada of \$19 billion in 1993. By 2003, the U.S. goods trade deficit with Canada more than doubled to \$60 billion. In 2017, the U.S. goods trade deficit with Mexico and Canada was \$75 billion and \$39 billion, respectively (in constant 1993 dollars).<sup>10</sup> In 2017 dollars, the latest annual data show the goods trade deficit with Mexico and Canada was \$126 billion and \$65 billion, respectively.

In addition, the USITC NAFTA study endorsed external studies that predicted an increase in U.S. jobs as a result of NAFTA.<sup>11</sup> However, in making these rosy predictions, these studies and the USITC assessment neglected to factor in that NAFTA's investor protections reduced the risk

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<sup>7</sup> United States International Trade Commission (USITC), "Potential Impact on the U.S. Economy and Selected Industries of the North American Free-Trade Agreement," USITC Publication 2596, Jan. 1993. Available at: <https://www.usitc.gov/publications/332/pub2596.pdf>. NAFTA USITC study estimated minimal changes to U.S.-Canada trade flows given many of the tariff cuts and non-tariff provisions included in NAFTA were also included in the U.S.-Canada FTA already in effect.

<sup>8</sup> As services trade data is not broken down by trade partners for years prior to 1999, we focus on goods trade.

<sup>9</sup> U.S. Bureau of Economic Analysis, "U.S. Trade in Goods and Services by Selected Countries and Areas, 1999-present," Table 7 and Table 8, updated Sept. 5, 2018. Available at: <https://www.bea.gov/data/intl-trade-investment/international-trade-goods-and-services>.

<sup>10</sup> U.S. International Trade Commission, "Interactive Tariff and Trade DataWeb," accessed Sept. 12, 2018. Available at: <http://dataweb.usitc.gov/>. We subtract "imports for consumption" from "domestic exports" to calculate the NAFTA trade balance as this "narrow" trade balance better accounts for the direction of U.S. re-export flows. Public Citizen obtained data from Statistics Canada that revealed the country of origin of the foreign goods re-exported from the United States to Canada, which showed 73 percent of U.S. goods re-exported to Canada came from non-NAFTA countries. To the extent that most U.S. re-exports to NAFTA countries are of goods made in non-NAFTA countries (rather than re-export of goods imported from Mexico or Canada), the narrower measure of the NAFTA trade balance is likely closer to the true value than the broader measure. See Public Citizen, "Canada Trade Deficit: Trump Actually Was Right When He Thought He Was Wrong," Public Citizen Press Release, March 15, 2018. Available at: [https://www.citizen.org/sites/default/files/canada\\_trade\\_deficit\\_-\\_trump\\_actually\\_was\\_right\\_when\\_he\\_thought\\_he\\_was\\_wrong.pdf](https://www.citizen.org/sites/default/files/canada_trade_deficit_-_trump_actually_was_right_when_he_thought_he_was_wrong.pdf).

<sup>11</sup> United States International Trade Commission (USITC), "Potential Impact on the U.S. Economy and Selected Industries of the North American Free-Trade Agreement," USITC Publication 2596, Jan. 1993, at 2-3. Available at: <https://www.usitc.gov/publications/332/pub2596.pdf>. The studies cited in the main text of the USITC NAFTA assessment included Gary Clyde Hufbauer and Jeffrey J. Schott, "NAFTA: An Assessment," Institute for International Economics Draft Report, Jan. 1993. This study predicted a net increase of 171,000 U.S. jobs. The USITC NAFTA assessment also provided "contrary views," but they were relegated to a footnote (#11) on page 2-3.

for U.S. firms to relocate production to Mexico to take advantage of its lower wages and weaker environmental standards. The Economic Policy Institute has estimated that the increase in the NAFTA trade deficit equated to a *net* loss of one million U.S. jobs in the first ten years of the agreement.<sup>12</sup> EPI calculates that the ballooning trade deficit *with Mexico alone*, as U.S. firms relocated production to Mexico, destroyed about seven hundred thousand net U.S. jobs between NAFTA's implementation and 2010.<sup>13</sup> Nearly one million jobs have been certified as lost to NAFTA according to the U.S. Department of Labor's TAA program, which itself is a significant undercount of trade-related job loss.<sup>14</sup> Given the time lag between job losses and certification under TAA, this data does not even include all 2017 NAFTA-related job losses or all of those to date in 2018.

The projections in the USITC study conducted prior to Congress's 2000 vote on Permanent Normal Trade Relations for China and China's accession to the WTO were similarly unrelated to the actual outcomes.<sup>15</sup> Using 1998 as a base year, the USITC estimated that U.S. exports to China would increase by 10.1 percent, or \$15.7 billion, while imports from China into the United States would increase 6.9 percent, or \$76.1 billion. The USITC findings would have resulted in an increase in the U.S. bilateral trade deficit with China of \$60 billion in 1998 dollars. U.S. employment impacts were not given and the possibility of China's WTO accession having a negative effect on U.S. jobs in the aggregate was not discussed. Instead, in just the first five years after WTO accession in 2001, the U.S. trade deficit in goods with China increased to \$190 billion in 1998 dollars from \$57 billion in 1998 and \$77 billion in 2001. U.S. exports to China increased by 152 percent, but imports increased nearly as much (147 percent) from a much higher starting point. Since then, the trade deficit has only continued to expand and is on pace to set another record in 2018. EPI estimates that the trade deficit with China has resulted in 3.4 million eliminated or displaced jobs in the United States.<sup>16</sup>

The same disconnect occurred in the USITC assessment of likely KORUS outcomes. In its initial 2007 assessment,<sup>17</sup> the USITC estimated that the agreement would eventually reduce the U.S. trade deficit of goods with Korea by increasing U.S. goods exports from 30 to 33 percent. The USITC projected that U.S. goods imports from Korea would grow much more slowly: from 14 to 15 percent. The agreement resulted in U.S. exports to Korea declining 7.8 percent and imports from Korea increasing 13.1 percent by the end of its fifth year.<sup>18</sup> The 85 percent trade deficit

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<sup>12</sup> Robert E. Scott, Carlos Salas, and Bruce Campbell, "Revisiting NAFTA: Still Not Working for North America's Workers," Economic Policy Institute, Briefing Paper 173, Sept. 28, 2006. Available at: <http://s2.epi.org/files/page/-/old/briefingpapers/173/bp173.pdf>.

<sup>13</sup> Robert E. Scott, "Heading South: U.S.-Mexico trade and job displacement after NAFTA," Economic Policy Institute Briefing Paper 308, May 2011. Available at: [http://www.epi.org/publication/heading\\_south\\_u-smexico\\_trade\\_and\\_job\\_displacement\\_after\\_nafta1/](http://www.epi.org/publication/heading_south_u-smexico_trade_and_job_displacement_after_nafta1/).

<sup>14</sup> Public Citizen, Trade Adjustment Assistance Database, 2018, accessed Oct. 25, 2018. Available at: <http://www.citizen.org/taadatabase>.

<sup>15</sup> U.S. International Trade Commission, "Assessment of the Economic Effects on the United States of China's Accession to the WTO," USITC Publication 3229, Sept. 1999. Available at: <https://www.usitc.gov/publications/docs/pubs/332/PUB3229.PDF>.

<sup>16</sup> Rob Scott and Zane Mokhiber "The China Toll Deepens," Economic Policy Institute Report, Oct. 23, 2018. Available at: <https://www.epi.org/files/pdf/156645.pdf>.

<sup>17</sup> United States International Trade Commission, "U.S.-Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects," USITC Publication 3949, Sept. 2007. Available at: <https://www.usitc.gov/publications/pub3949.pdf>.

<sup>18</sup> United States International Trade Commission, "U.S.-Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects," USITC Publication 3949, Sept. 2007. Available at: <https://www.usitc.gov/publications/pub3949.pdf>. A five-year benchmark is used here: according to the USITC report, "93 percent of U.S. tariff lines and 92 percent of Korean tariff lines would have free rates of duty after 5 years."

increase with Korea under the pact – from \$14 billion in the 12 months before the pact went into effect on March 15, 2012 to \$26 billion in its fifth year (in constant dollars) – came in the context of the overall U.S. trade deficit with the world decreasing by 5 percent. The USITC Korea FTA report also projected outcomes by sector. As a recent Center for Economic and Policy Research study noted: “there was virtually no correlation between the predicted and actual change in exports and imports by industry following implementation of the KORUS.”<sup>19</sup>

For the upcoming NAFTA 2.0 investigation to accurately inform the American public and Members of Congress on the pact’s possible economic effects, the USITC cannot replicate its past methodologies.

### **Key Improvements in USITC Methodology Needed for NAFTA 2.0 Assessment**

In light of the past disconnect between USITC trade-pact economic impact projections and actual outcomes, Public Citizen recommends that the USITC alter the design of its assessment of NAFTA 2.0.

#### *Avoid Unjustified Assumptions and Improve Transparency*

Despite the poor track record of USITC models, the agency has continued to employ largely the same methodology. While the USITC has moved, for example, from a static to a dynamic model that simulates the economy year by year, in creating the equations to estimate trade flow outcomes, it has continued to rely on numerous assumptions that have been widely criticized as unjustifiable. This includes arbitrary decisions with respect to what economic factors are included and excluded and what included factors are assumed to remain constant. Such assumptions not only can contribute to gaps between projections and outcomes with respect to import and export levels, but also, given that the results of the trade flow simulations are then used as the basis of projecting broader outcomes (such as on U.S. economic growth), assumptions piled on assumptions can cause results that are incorrect, not only in degree, but in direction.

The USITC’s methodology for trade-pact assessments has continually incorporated several unrealistic assumptions. This includes simply ruling out the possibility of increasing trade deficits or less than full employment!

First, the model assumes full employment in the long term. This assumption pre-determines a key result: the model cannot show a trade agreement leading to higher unemployment because it simply assumes everyone will be fully employed. Second, it does not take into account adjustment costs, such as transitory unemployment in the short- and medium terms. The model simply assumes that those who lose their jobs to trade can easily shift to other jobs, with workers seamlessly moving into expanding economic sectors.<sup>20</sup> Yet, recent research shows that such

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<sup>19</sup> David Rosnick and Dean Baker, “Trade and Jobs: Can We Trust the Models,” Center for Economic and Policy Research, April 2016. Available at <https://ideas.repec.org/p/epo/papers/2016-05.html>

<sup>20</sup> David Rosnick and Dean Baker, “Trade and Jobs: Can We Trust the Models,” Center for Economic and Policy Research, April 2016, at 2. Available at <https://ideas.repec.org/p/epo/papers/2016-05.html>

transitions are often not easy and some of the job losers may leave the labor market and never come back.<sup>21</sup>

In addition, the USITC model assumes that trade agreements do not directly impact macroeconomic outcomes, such as growth-slowing sustained trade deficits, that can lead to lower aggregate demand and higher unemployment levels. Yet, in reality, trade agreements can lead to growing and sustained bilateral trade deficits which are not offset by decreases in bilateral trade deficits elsewhere, as has been the case with respect to Mexico under NAFTA, China since its WTO accession and Korea since the FTA. Despite decades of evidence showing that such assumptions are not justified, for the TPP study the USITC assumed a trade deficit fixed at a certain percentage of GDP, again dismissing the possible impact of the prospective trade pact on overall deficit levels.<sup>22</sup>

The fact that the USITC's model simply rules out the possibility of increasing trade deficits and job losses means that the model also is unlikely to pick up a trade agreement's full effect on inequality that persists long after the initial shock.

The USITC ITC model also assumes full implementation of an agreement's provisions, regardless of foreseeable circumstances, when this may not be a reliable assumption. With respect to NAFTA 2.0, this is especially relevant to the pact's labor provisions. The official Labor Advisory Committee (LAC) report noted that the text includes "modest but meaningful improvements" in the labor provisions<sup>23</sup> and an annex requiring reforms to Mexican labor law that the LAC characterizes as "new rules to eradicate wage-suppressing protection contracts." The LAC notes that, of the labor provisions, this annex has the potential to be the "most meaningful, but only if it is enforced." The LAC report emphasizes significant shortcomings in the NAFTA 2.0 text with respect to monitoring and enforcement related to labor terms and notes that, absent significant improvements, the terms in the text are not likely to actually result in improved wages or conditions for workers. The LAC report also notes that the text does not condition the pact's going into effect on Mexico's compliance with the new labor obligations. This is a critical factor, as labor obligations in past pacts included in an agreement's core text and subject to the same enforcement as other terms, such as in the U.S.-Peru FTA, have not been fully implemented. In other words, compliance with these standards in NAFTA 2.0 is not certain. Thus, if the USITC study will assume that the labor provisions could have a substantial effect on the U.S. economy, the model should include two scenarios: one assuming compliance with higher standards and one that does not.

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<sup>21</sup> See e.g. David H. Autor, David Dorn, Gordon H. Hanson, "The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade," National Bureau of Economic Research, NBER Working Paper No. 21906, Jan. 2016.

<sup>22</sup> United States "Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors," Investigation No. TPA-105-001, USITC Publication 4607, May 2016, at 93. Available at: <https://www.usitc.gov/publications/332/pub4607.pdf>. The possibility that savings rates could be endogenous to the structure of the economy influenced by trade rules is not considered. Nor is the role other countries' savings rates – undisciplined by currency provisions – play. And the trade deficit ratio to GDP is set at levels far lower than the historical trend since the 1990s.

<sup>23</sup> "Report on the Impacts of the Renegotiated North American Free Trade Agreement," Labor Advisory Committee on Trade Negotiations and Trade Policy, Sept. 27, 2018. Available at: <https://ustr.gov/sites/default/files/files/agreements/FTA/AdvisoryCommitteeReports/Labor%20Advisory%20Committee%20on%20Trade%20Negotiations%20and%20Trade%20Policy%20%28LAC%29.pdf>.

Finally, the USITC modeling must fairly assess the economic gains and losses from the agreement provisions in the aggregate and in terms of how these gains and losses are distributed. The NAFTA 2.0 study cannot assume away distributional impacts, as has been the case with past trade-pact assessments. This is of particular relevance to the intellectual property rules in NAFTA 2.0 that extend beyond both the WTO's Trade Related Aspects of Intellectual Property Rights (TRIPS) terms and the original NAFTA terms to lock in bad U.S. policies that keep prescription drug prices high and export those policies to Mexico and Canada. These new provisions would grant, for example, 10 years of marketing exclusivity for cutting-edge biologic medicines such as many new cancer treatments. NAFTA 2.0 obligations that would require longer monopoly protections for medicines in Mexico and Canada can redistribute income away from U.S. manufacturing and traded services sectors by extracting licensing fees that must be offset by a rise in the trade deficit, which costs jobs in certain U.S. sectors.<sup>24</sup> Increased payments to drug companies would raise the value of the dollar, making U.S. goods and services less competitive internationally. For TPP, the losses in output in these sectors could have been larger than the cumulative economic gains of 0.23 percent of GDP projected by the USITC, but this aspect was not included in USITC's model.<sup>25</sup>

Given that different assumptions included in a model can result in diametrically opposed outcomes, it is essential that the USITC's NAFTA 2.0 study provide greater transparency about the assumption going into the model. Consider the competing findings of the Peterson Institute for International Economics and economists at Tufts University with respect to the economic impacts of the TPP. The Peterson Institute used a CGE model with assumptions similar to those employed by the USITC in past studies and found the pact would result in a modest increase in gross domestic product but would not impact overall U.S. employment.<sup>26</sup> Using an economic model called the United Nations Global Policy Model that allows for the possibility of less than full employment and rising income inequality, Tufts University economists concluded that the TPP would reduce U.S. growth rates and lead to the loss of 448,000 American jobs.<sup>27</sup> The Tufts findings spotlight just how drastically the assumptions baked into a model affect the outcomes: The Tufts economists employed the results of Peterson Institute trade flow simulation. That is to say that they plugged the Peterson findings on import and export levels at full TPP implementation derived from one set of unrealistic assumptions into a model that applies more realistic assumptions about how trade flow changes affect growth and employment and got the opposite outcomes with respect to those measures that the Peterson CGE model produced.

Our recommendation is that the USITC "show its work" by explicitly describing the assumptions of its model. We also suggest that the USITC make available in its report the data underlying the analysis so that others can examine the assumptions and perform additional analysis. As Arvind

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<sup>24</sup> Dean Baker, "The International Trade Commission's Assessment of the Trans-Pacific Partnership: Main Findings and Implications," Center for Economic and Policy Research Report, Nov. 2016, at 26. Baker estimated that additional pharmaceutical spending by TPP partners would reach \$77.5 billion a year. The need for an offsetting change adopts the USITC assumption of no change in the overall trade deficit.

<sup>25</sup> United States "Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors," Investigation No. TPA-105-001, USITC Publication 4607, May 2016, at 38. Available at: <https://www.usitc.gov/publications/332/pub4607.pdf>.

<sup>26</sup> Peter A. Petri and Michael G. Plummer, "The Economic Effects of the Trans-Pacific Partnership: New Estimates," Peterson Institute for International Economics, January 2016

<sup>27</sup> Jeronim Capaldo and Alex Izurieta, "Trading Down: Unemployment, Inequality and Other Risks of the Trans-Pacific Partnership Agreement," Tufts University, January 2016.

Panagariya, the Columbia University trade economist whose previous stints with the World Bank, International Monetary Fund and World Trade Organization reflect his status as a supporter of past trade policies, has commented on the need for more transparency from CGE modelers:

*Unearthing the features of CGE models that drive them is often a time-consuming exercise. This is because their sheer size...makes it difficult to pinpoint the precise source of a particular result.... They often remain a black box....The challenge to CGE modelers is to offer similar stylized counterparts of their models, so that others can examine the assumptions underlying them.*<sup>28</sup>

We also recommend that the USITC show the range of uncertainty related to the impact of the agreement and what is driving that result. Wherever possible, ITC should provide a range of possible outcomes from a low estimate to high estimate for such measures as impact on GDP and employment, rather than specific point estimates as it did in the TPP study. (See e.g. Table ES.1 in the TPP study). It would also be beneficial to disaggregate the factors driving the results (See e.g. Figure 2.5 in the TPP study) beyond the three categories (traded goods provisions, trade services provisions and investment provisions) that are typically are provided.

#### *Avoid Broad-Brush Characterizations of Non-Tariff Measures*

The output of any model is greatly affected by the data put into it. Perhaps the most controversial issue in this regard is how “non-tariff barriers” are considered. With tariff levels between NAFTA countries already at zero but for a very small amount of trade subject to tariff-rate quotas, a large portion of any projected gains from NAFTA 2.0 will necessarily be premised on effects resulting from changes to non-tariff measures (NTM), namely countries’ domestic laws regulating food and product safety, service sectors and more. A large portion of the projected gains the USITC study on TPP reported were premised on the reduction in NTMs and included assumptions of broad cuts to NTMs applying to goods and services and that such cuts would generate economic benefits.<sup>29</sup>

First, trade agreements will not and should not result in the removal of all NTMs, given that what trade agreements may seek to characterize as “barriers” are also consumer and environmental protections that bar dangerous goods from entry into the U.S. market, service sector regulations that require foreign firms to meet domestic laws that safeguard public health, prevent fraud and protect the environment, and so forth. Consider what the annual U.S. Trade Estimate Report on Foreign Trade Barriers and many international agencies, such as the World Bank, deem to be NTMs. Using USTR’s annual National Trade Estimate as a guide, removal of all NTMs would require countries to abandon a vast swath of health, environmental, food and product safety, energy, financial and other public interest safeguards. The 2017 report, for example, cited

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<sup>28</sup> Arvind Panagariya and Rupa Duttagupta, “The ‘Gains’ from Preferential Trade Liberalization in the CGE Models: Where Do They Come From?” in Sajal Lahiri, *Regionalism and Globalization*, London and New York: Routledge, 2001. Available at: <http://www.columbia.edu/~ap2231/technical%20papers/cge-critique.pdf>.

<sup>29</sup> United States “Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors,” Investigation No. TPA-105-001, USITC Publication 4607, May 2016, at 799. Available at: <https://www.usitc.gov/publications/332/pub4607.pdf>. We assume all of the gains to services trade liberalization (34.2 percent of real income gains) and most of the gains to goods trade liberalization (totaling 55.4 percent of real income gains) arise from the removal of NTMs.

regulations to promote breastfeeding as barriers to trade in breastmilk substitutes like infant formula and previous reports have listed other common, popular consumer and environmental policies similarly.

To provide a realistic assessment of the likely impact of any agreement, USITC must base its analysis on the reality that neither Congress nor the U.S. public would permit the elimination of the vast majority of non-tariff measures that could be construed as “barriers.” Consider a 2009 study conducted for the European Commission by ECORYS Nederland BV on the Transatlantic Trade and Investment Partnership that concluded that it would be “realistic” to expect only 25 percent of NTMs to be eliminated or “converged” over time under a potential U.S.-EU deal.<sup>30</sup> And that was for two regions that had not been tied together in a regional trade agreement for 25 years the way that NAFTA countries have been integrated. For NAFTA countries, the share must be far less.

Given the reports of the U.S. trade advisory committees representing business interests were very supportive of the new NAFTA 2.0 Chapter 28 on “Good Regulatory Practices,” which, for example, obligates countries to publish an annual list of anticipated new regulations and initiate retrospective review of existing regulations,<sup>31</sup> the USITC may be tempted to overestimate the impact of these provisions and those in Chapter 12 Sectoral Annexes and other chapters on NTMs.

Second, whatever the assumption about the extent of NTM elimination, in most CGE studies, individual NTMs are not evaluated rigorously for their impact on trade or the potential benefits or costs of their elimination. This is a fundamental flaw the USITC must not replicate.

Past CGE modeling of NTMs is premised on guesstimating some level of across-the-board cuts in NTMs based on rough evaluation of an agreement, and then on simply assuming that such cuts would facilitate trade. Yet, even this latter assumption is problematic. A 2014 study on this question by three U.S. and European trade economists called “Trade Restrictiveness Indices in Presence of Externalities: An Application to Non-Tariff Measures” found that NTMs actually *facilitate* trade in two in five product lines affected by NTMs.<sup>32</sup>

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<sup>30</sup> Koen G. Berden, et al, “Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis,” ECORYS Nederland BV, Dec. 11, 2009. Available at: [http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc\\_145613.pdf](http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc_145613.pdf).

<sup>31</sup> Industry Trade Advisory Group (ITAC)-3 for the chemicals and pharmaceutical industry called the chapter a “significant win.” ITAC-14 (covering provisions relating to standards and technical trade barriers) called it a “new high-water mark for such commitments in trade agreements.”

“ITAC 3 Advisory Committee Report to the President, the Congress, and the United States Trade Representative on the Trade Agreement,” Industry Trade Advisory Committee Chemicals, Pharmaceuticals, Health/Science Products and Services (ITAC 3), Sept. 25, 2018. Available at:

<https://ustr.gov/sites/default/files/files/agreements/FTA/AdvisoryCommitteeReports/ITAC%203%20REPORT%20-%20Chemicals%2C%20Pharmaceuticals%2C%20Health%20Science%20Products%20and%20Services.pdf>. “Advisory Committee Report to the President, the Congress and the United States Trade Representative on The Trade Agreement with Mexico and potentially Canada,” Industry Trade Advisory Committee Standards and Technical Trade Barriers (ITAC 14), Sept. 27, 2018. Available at: <https://ustr.gov/sites/default/files/files/agreements/FTA/AdvisoryCommitteeReports/ITAC%2014%20REPORT%20-%20Standards%20and%20Technical%20Trade%20Barriers.pdf>

<sup>32</sup> John Christopher Beghin, Anne-Célia Disdier and Stéphan Marette, “Trade Restrictiveness Indices in Presence of Externalities: An Application to Non-Tariff Measures,” CESifo Working Paper No. 4968, Sept. 2014. Available at: <https://ideas.repec.org/p/ces/ceswps/4968.html>. The authors write: “Accounting for the trade-facilitating effect of NTMs

This study highlights why the USITC cannot presume that elimination of NTMs will expand trade. Further, the USITC must consider that elimination of some NTMs would likely impose significant economic *costs* on U.S. consumers, workers and the environment in addition to the non-economic toll that would result from a degradation of health, safety, environmental, and other public interest standards. Consider only one example: the elimination of food safety protections that could result in greater incidence of food-borne illness in the United States. This would not only increase the medical costs of affected consumers but would also reduce their productivity levels and number of days at work, resulting in a negative impact on aggregate economic output. In calculating the prospective economic impacts of NTM convergence or elimination under a NAFTA 2.0, the USITC must incorporate risk-adjusted estimates of such economic costs alongside any estimated economic gains based on the specific NTMs assumed to be eliminated so as to produce a projection of the *net* impact of the deal.

USITC should also incorporate into its analysis of NAFTA's net impact the large *social* costs associated with the degradation of NTMs created to ensure food safety, financial stability, climate security, internet freedom, access to medicines and other public interest goals. A 2008 study by economists at the United Nations Conference on Trade and Development (UNCTAD) noted:

*Focusing only on the protection effects of [NTMs] is likely to cause the social benefits they might provide to be disregarded. This is important from a policy point of view, since the optimal liberalization policy for [NTMs] will often not – unlike for tariffs – be their elimination but rather their rationalization to the social-utility maximizing level; in other words, the desirable policy prescription is to minimize their cost-benefit ratio.<sup>33</sup>*

USITC should seek to quantify social costs that would result from dismantling NTMs, whether through willingness-to-pay or other appropriate methods, adding the sums to the economic costs discussed above to tabulate a projected net impact of the NAFTA 2.0 deal.

Finally, an additional judgment call comes into play as to how to incorporate NTM cuts into the model. NTM cuts introduced into the model as “technical changes” yield a greater impact on trade flows than do NTM cuts introduced as “tariff equivalents,” or a drop in the price of imports.<sup>34</sup> Consider the USITC TPP assessment: How the USITC arrived at one percent across-the-board efficiency gains from the removal of NTMs on goods is not explained in the report, but rather is simply stated as a fact.

Given the very simplistic manner in which CGE modeling treats NTMs and the manifold assumptions required, USITC should seek alternatives to a CGE model in investigating the likely

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significantly reduces previous measures of countries' trade policy restrictiveness obtained while constraining these NTMs to be trade reducing.”

<sup>33</sup> Marco Fugazza and Jean-Christophe Maur, “Non-Tariff Barriers in Computable General Equilibrium Modeling,” U.N. Conference on Trade and Development, Policy Issues in International Trade and Commodities: Study Series No. 38, 2008. Available at: [http://unctad.org/en/Docs/itcdtab39\\_en.pdf](http://unctad.org/en/Docs/itcdtab39_en.pdf).

<sup>34</sup> See John Gilbert, “Non-Tariff Measures in CGE Models: A Review of Some Recent Results,” WTO/ESCAP 12<sup>th</sup> ARTNeT Capacity Building Workshop for Trade Research Presentation, Dec. 2016. Available at: <https://www.unescap.org/sites/default/files/5-4.A%20Review%20of%20Some%20Recent%20Results.pdf>.

economic effects of the NAFTA 2.0 deal as well as in its assessments of subsequent agreements. If USITC is to model the effect of removal of NTMs, it needs to assess whether specific NTMs have costs that outweigh the benefits, and conduct such calculations on the basis of individual assessments of specific NTMs. The full range of economic and social costs must be incorporated, not only costs to trade and investment. If that is outside of the scope of the proposed study, then USITC must err on the side of being conservative in both the number of NTMs that it assumes could be cut and in the positive economic impact that cutting those NTMs may have. USITC should straightforwardly convey the uncertainty accompanying the model by testing economic impacts of NTM removal under scenarios with different assumptions. In this case, USITC should report the entire range of results, including any changes in magnitude or direction of the projected economic effects.

### **Conclusion**

Public Citizen appreciates the opportunity to submit this pre-hearing comment as part of USITC's investigation regarding the likely economic impact of the renegotiated NAFTA. As past projections on the likely impacts of previous U.S. trade pacts have proven dramatically wrong, these comments have focused on what methodologies the USITC should employ to obtain the most accurate and useful data on the prospective effects of the renegotiated NAFTA. A thorough and nuanced investigation by the USITC will allow the public and Members of Congress to properly evaluate the potential effects of the deal. We welcome further engagement as USITC continues its investigation.