



MANUFACTURING POLICY INITIATIVE AT SPEA

INSIGHT INTO MANUFACTURING POLICY

USMCA through the Lens of Smart Manufacturing

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One way to interpret a trade agreement is through the lens of new, emerging products and services. Nations favor trade agreements that benefit their domestic economy while also frustrating the aims of their strategic competitors across the globe.

And so it is with the US-Mexico-Canada Trade Agreement (USMCA), which, if adopted, would replace the 1994 North American Free Trade Agreement (NAFTA). A careful reading of the new agreement reveals a distinct US approach to smart manufacturing—the integration of sensors, controls, and software platforms to optimize performance at the production unit, plant, and supply chain levels.

This digitalization within and across supply chains is widely perceived to be the future of manufacturing. It is heavily influenced by information governance—that is, norms of behavior for the collection, management, and disposition of information. These norms can be determined by markets and through laws and regulations. Critical components of information governance for smart manufacturing include technical standards, cybersecurity, privacy protection, digital trade flows, and the regulation of artificial intelligence (AI).

Nestled within the 1,800 pages of the USMCA are numerous provisions that will impact, directly and indirectly, the digital transformation of manufacturing. These provisions reflect (1) support for the market-driven approach favored by the US and (2) opposition to other approaches, particularly those favored by China and the EU.

Support for a Market-Driven Approach

The US approach to smart manufacturing can be described as market-driven with a reticence toward government-imposed mandates or restrictions. Such an approach is thought to favor entrepreneurship and technological innovation—a source of comparative advantage for the United States.

Several of the USMCA provisions would expand this US approach to Mexico and Canada. These provisions address international standards, digital trade, and good regulatory practices. Table 1 provides a succinct summary.

International standards are requisite for smart manufacturing. For example, interoperability of sensors and devices across supply chains requires common

language—standard protocols for communication. Such standards embody intellectual property and are often referenced by domestic regulation—thereby creating winners and losers. Standards have created non-tariff trade barriers (e.g., the standard for electrical prongs in the EU versus the USA).

With respect to international standards, the US prefers that the private sector lead in standards development for smart manufacturing and that standards be developed through a consensus process involving all stakeholders. USMCA Chapter 11 (Technical Barriers to Trade, or TBT), which builds on the World Trade Organization’s TBT agreement, includes commitments to ensure that domestic standards (1) are based on international standards (Article 4), (2) are developed to ensure mutual recognition by each Party (Article 4), and (3) are developed in a transparent manner with opportunities for input (Article 7).

Table 1. USMCA Reflects US Preferences for Smart Manufacturing

<i>Provision</i>	<i>US Preference</i>	<i>USMCA</i>
Technical Standards	Consensus-based and private-sector led	standards should be developed in a transparent manner with opportunities for input from stakeholders
Digital Trade	Free flow of information within and across borders	no duties on electronic data transmissions, no restrictions on cross-border information flows
Privacy and Cybersecurity	Any requirements should be risk-based	privacy and cybersecurity protections must be risk-based
Good Regulatory Practices	Regulations should be no more stringent than necessary	parties should remove unnecessary regulatory barriers to innovation
Data Localization	No requirements	prohibition on data localization requirements
Access to Source Code	No requirements	prohibition on requiring government access to source code or algorithms

With respect to digital trade (Chapter 19), the US favors the free flow of electronic information within and across borders. USMCA ensures no custom duties on electronic transmission of data (Article 3), prohibits restrictions on cross-border information flows for business purposes (Article 3.1), ensures that privacy protections (Article 8.3) are

risk-based (risk-based cybersecurity protections are covered under a different chapter), and promotes open and machine-readable government data (Article 18).

With respect to regulation, the US favors a light touch—regulations should be no more stringent than necessary (especially for new and emerging technologies) and based on the best available information. USMCA (Chapter 28) aims to remove unnecessary regulatory barriers to competition (Articles 4f and 14) and to ensure that regulation is based on the highest quality information available to regulators (Article 15.1).

Opposition to Approaches of China and the EU

The US approach to smart manufacturing differs from that of China and the EU. China’s approach can be described as government-managed, with a goal to create “national champions”—that is, world-class firms that can compete globally. This approach is paying off. For example, in just a few short years, China has become the world leader in electric vehicles (in accordance with Made in China 2025), and it may soon surpass the US in AI capabilities (which is the stated goal of China’s AI policy). The EU approach also features a more active role for government than that of the US. For example, the EU is more likely to regulate to ensure the privacy of personal information and promote cybersecurity.

Several of the USMCA provisions are significant not for the change it will have in North America, but for creating international norms to counter China’s historical and ongoing practices as well as some EU policies (e.g., the new EU-Japan agreement promotes the adoption of EU standards).

With respect to China, these provisions address currency manipulation, state-owned enterprises, data localization, government access to source code and algorithms, and non-market economies.

USMCA Chapter 33 commits each Party to utilize market-determined exchange rates (Article 2.1) and prohibits a Party from manipulating its international exchange rate in foreign exchange markets for competitive advantage (Article 4.2). In the recent past, China has been accused of currency manipulation.

Chapter 22 of USMCA addresses state-owned enterprises (SOEs). It expands the definition used in the Comprehensive and Progressive Trans-Pacific Partnership to include indirect ownership or control (Article 1). It would require SOEs to operate in accordance with commercial considerations and require non-discriminatory treatment of competitors (Article 4). Even though North American economies are not dominated by SOEs, these USMCA provisions—which emphasize transparency and prohibit certain practices—set a precedent for future trade agreements. The US has accused China of providing special treatment (illegal subsidies, etc.) for its SOEs, some of which are among the world’s largest companies.

Chapter 19 of USMCA would prohibit data localization requirements. Article 19.12 states that “No Party shall require a covered person to use or locate computing facilities in that

Party's territory as a condition for conducting business in that territory." This provision is counter to current Chinese law.

USMCA (Chapter 19, Article 16) would prohibit a Party from accessing source code from a firm or requiring a firm to reveal algorithms as a precondition to conduct business in a country: "No Party shall require the transfer of, or access to, a source code of software owned by a person of another Party, or to an algorithm expressed in that source code, as a condition for the import, distribution, sale or use of that software, or of products containing that software, in its territory." Such access is possible under China's cybersecurity law.

USMCA Chapter 32 requires consultation before a Party enters into discussion on a trade agreement with a non-market economy (Article 10). It also allows the other Parties to exit before such a trade agreement enters into force (Article 10.5): "Entry by a Party into a free trade agreement with a non-market country will allow the other Parties to terminate this Agreement on six months' notice and replace this Agreement with an agreement as between them (bilateral agreement)." Although these provisions do not set out substantive trade rules drawn from the US model, they do discourage Canada and Mexico from integrating with China (considered a non-market economy) through a free trade agreement.

Conclusion

The nation that can most successfully influence information governance will provide its domestic manufacturing sector with a first-mover advantage in smart manufacturing.

With the USMCA, the US government is propagating its preferred approach across North America, while at the same time limiting adoption of the approaches favored by China and the EU.

The battle to define international trade rules for 21st century manufacturing is not going to be decided overnight; we are just at the beginning of a conflict that will play out over decades. The evolution of global norms will be influenced by the competing policies of each country and region.

Peer Reviewers: Bradford Ward, Partner, King & Spalding; John Magnus, President, TradeWins LLC; and Lisa Schroeter, Global Director of Trade and Investment Policy, The Dow Chemical Company.

For further reading:

US Trade Representative. 2018. "Agreement between the United States of America, the United Mexican States, and Canada Text," November 30. <https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between>