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Canada's CUSMA Conundrum

by Lawrence L. Herman

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POLICY PERSPECTIVE

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Donald Trump's egregious threat to impose 25 percent tariffs on all Canadian and Mexican imports shows the world that his administration has no intention of complying with U.S. treaty obligations.

The threatened tariffs contravene U.S. obligations under the Canada-U.S.-Mexico Agreement (CUSMA) as well as the World Trade Organization (WTO) Agreement. It is a signal that shows Canada, Mexico and the world at large that his future government will not be bound by America's treaty obligations, be they multilateral or bilateral. In other words, there are no rules that the U.S. can be expected to follow in ongoing trade relations.

That approach was seen during Trump's first administration, when tariff surcharges were applied on imports of steel, aluminum, solar panels and other items, which a subsequent WTO panel found had contravened U.S. treaty commitments.

While some experts maintain that such tariff increases are beyond presidential powers and require congressional action, even if U.S. domestic laws that restrain their application, the threats themselves are hugely destabilizing.

End of the Special Relationship

Trump's threat destroys the notion that Canada and the U.S. have some kind of "special relationship," casting Canada in the same camp as Mexico as two equally blameworthy countries allowing entry into the U.S. of illegal aliens and a range of illicit drugs such as fentanyl. It belies the idea that Canada and the U.S. share some special historic legacy, as President John Kennedy said many years ago.[1]

Trump's tariff threat also undercuts the musings by Doug Ford and some provincial premiers that Canada and the U.S. can best solve their trade and other problems bilaterally, cutting Mexico out of the picture, harkening back to the days of the 1965 Auto Pact and the 1987 Free Trade Agreement (FTA).

That is not a realistic prospect. Resurrecting Canada-U.S. trade on a bilateral basis would mean terminating the CUSMA and forging a completely new Canada-U.S. trade agreement. This is not going to happen. Among other things, it would require the U.S. president to get Congressional approval trade promotion authority (TPA), which is simply not in the cards.

That said, one element to take from the 1986-1988 FTA negotiations would be for the Canadian government to appoint a special envoy, with necessary political credentials, negotiating skill and expertise, as negotiator vis-à-vis the Americans, both for the CUSMA review and in dealing with

[1] John Kennedy famously said in his speech to the Canadian Parliament on May 17, 1961: "Geography has made us neighbors. History has made us friends. Economics has made us partners. And necessity has made us allies. Those whom nature hath so joined together, let no man put asunder."

the Trump tariff threat. This would be a variation of the Mulroney government's decision to appoint Simon Reisman from outside the government who was given full authority to lead the FTA negotiations. There would, of course, have to be governmental accountability and oversight but the appointment would ensure that the best qualified person with the necessary gravitas, expertise and political credibility would lead the Canadian cause.

CUSMA Scenarios

When Trump entered office in 2017, he threatened to tear up the North American Free Trade Agreement (NAFTA). Leaving aside U.S. constitutional issues, and while it may seem far-fetched, Trump could threaten do this again with CUSMA, to maximize political leverage.[2]

The U.S. does have the clear right withdraw from the Agreement by giving six months' notice under Article 34.6. If it did that, even if Canada and Mexico stayed on board, CUSMA would effectively be terminated. While it's hard to envisage that happening because, as many have commented, it would be hugely disruptive to the U.S. economy itself, it has to be factored in as a possible, even if far-fetched, scenario.

What is more plausible would be an array of tough U.S. demands to change CUSMA to its liking in the review process that starts in 2026 under Article 34.7 of the Agreement. The article says that if the three governments don't agree to extend it, the Agreement will terminate in 2036. Until then, there will be with annual reviews of the Agreement's operation, a process was designed to give the U.S. side maximum leverage, as former U.S. Trade Representative Robert Lighthizer and Katherine Tai, his successor, have made clear.

While it's difficult to predict how the Article 34.7 review will unfold, the U.S. side will certainly use the process to apply maximum pressure on Canada, for example, by demanding concessions to end the U.S. trade imbalance with Canada (excluding hydrocarbons). It will almost certainly insist on its own interpretation of the 75 percent rule-of-origin requirement in the automotive sector. It will also target Canada's dairy import restrictions and the digital service tax. In all, the CUSMA review will be a difficult one for Canada.

Can CUSMA Be Kept in Play?

All is not all doom and gloom. Assuming Trump's bullying 25% tariff threat can be eliminated – a large assumption – there are possibilities that envisage CUSMA remaining in force even after tough bargaining during the 2026 review process, with agreements on modernizing and updating

[2] During the 2017 NAFTA renegotiations, the initial US position was that the new agreement (CUSMA/USMCA) should terminate definitively after six years. In the end, the Americans agreed to the 2036 termination date and the 2026 review process in Article 34.7.

the deal, efforts that might even lead to its eventual continuation beyond the 2036 termination date. Unlikely, perhaps, but still within the realm of possibility.

Very useful and creative ideas about CUSMA modernization were put forward in a recent paper by the Canada West Foundation, the Canadian Global Affairs Institute and Alberta-based business groups, supplemented by creative insights and recommendations from former senior federal officials such as Colin Robertson and John Weekes. These recommendations could also meet some of Trump's concerns over northern border security and drug enforcement matters, points that have been addressed – in part – by recent Canadian government announcements.

Keeping CUSMA in play would be in parallel to these areas of Canada-U.S. cooperation other than in trade and tariffs, ranging from border cooperation and customs pre-clearance, joint maritime enforcement, visa and immigration information sharing, transboundary waters and the work of the International Joint Commission (IJC), the Great Lakes Water Quality Agreement and a host of other areas. The list is long on bilateral matters – outside of CUSMA – that should continue to give promise, whatever happens to the Agreement over the course of events.

Bilateral Trade Outside of CUSMA

One central area in the trade field that should continue as a "win-win" for both countries is the Joint Action Plan on Critical Minerals, agreed to between Trudeau and Trump in June 2019 during Trump's first administration. It should appeal to Trump as a bilateral initiative he had authored as president. It is a strategic plan

> . . . aiming to advance bilateral interest in securing supply chains for the critical minerals needed for strategic manufacturing sectors, including communication technology, aerospace and defence, and clean technology . . . guiding cooperation between officials in areas such as industry engagement, innovation, defence supply chains, improving information sharing on mineral resources and potential, and cooperation in multilateral fora.

It is also an area where Canada has important advantages:

"Canada already supplies many of the minerals deemed critical by the United States: in 2020, bilateral mineral trade was valued at $95.6 billion, with 298 Canadian mining companies and a combined $40 billion in Canadian mining assets south of the border."[3]

The Action Plan is a substantive bilateral effort, outside of the three-way CUSMA arrangements that is compatible with the national security and re-shoring Make America Great Again objectives of the Trump administration. It carries forward the idea that Canada and the U.S. remain in a

[3] *Ibid*. Canada is also a member of the US-led Minerals Security Partnership, which encourages public and private sector coordination on critical minerals investments.

relationship whereby the two countries can mutually work out difficulties and move forward on common ground, even if not cast in the positive phrases used by President Kennedy decades ago.

Beyond critical minerals, there are numerous trade-related fields where Canada has strictly bilateral arrangements with the U.S. that do not detract from three-way CUSMA arrangements or do an end-run around Mexico. Included are the many elements in Canada-U.S. defence production sharing arrangements,[4] cooperation in the energy field,[5] and so on. These are initiatives to which trade war would do immeasurable harm.

Conclusions – Avoiding the Cutting Room Floor

The forgoing covers the threatened trade war, not dealing with the many binational understandings and initiatives in current Canada-U.S. relations in other sectors. The point has been to demonstrate that there are practical trade arrangements that can be carried on between the Canada and the U.S. jointly, while at the same time keeping the three-way CUSMA in play as the agreement undergoes the review process.

The conclusions from the above are that Canada should approach the difficult and challenging months ahead as follows:

- Canada should work with the Trump team, as the government has been doing, to address US border security and drug trafficking concerns to avoid Trump's unprecedented threat of a trade and tariff war;

- The government should support CUSMA, preparing proposals for modernizing and improving the Agreement as part of the 2026 review process. Some of these could follow through with agreements that might be concluded in the above tariff discussions;

- Without abandoning or undercutting Mexico or CUSMA, Canada should continue to work bilaterally with the US on areas outside of the Agreement, particularly in furthering the Joint Action Plan on Critical Minerals and recent initiatives involving energy supply chains;

- At the same time, the government should make it clear that if the U.S. enacts tariffs on Canadian imports, Canada will retaliate in kind and that cooperation in the above matters will come to an end;

[4] *Defence Production Sharing Agreement* (1 October 1956), still in effect. The agreement was established to achieve greater integration of both countries' military development and production capabilities while maintaining greater standardization of military equipment, wider dispersal of production facilities, and establishing a supply of supplemental sources.
[5] While announced under the Biden administration in 2023, the Energy Transition Task Force (ETTF) is a bilateral initiative on cooperation on clean energy supply chains, including: security in renewable energy and critical minerals, grid integration and resilience, nuclear energy, and other areas to advance collective energy security. It covers matters that should appeal to the Trump administration.

- The Trudeau government should appoint an outside individual with the necessary political credentials, skills and gravitas as special envoy to negotiate with the Trump administration on these matters.

It remains unclear whether a determined response by Canada, with the prospect of a full-scale economic war and all its negative consequences on both sides of the border, will lead to common sense prevailing in the White House. That said, it is incumbent on the Canadian government to present a clear and resolute position in dealing with this unprecedented threat from a former friend and ally.

About the Author

***Lawrence L. Herman**, Herman & Associates (Toronto) and Senior Fellow, C.D. Howe Institute, has practiced international trade and investment law and policy in government and in the private sector for over 50 years.*

Lawrence Herman was a member of Canada's mission to the UN and the GATT in the 1970s and in private law practice acted as counsel for Canada in the International Court of Justice and has advocated cases before the Canadian International Trade Tribunal (CITT), NAFTA panels and Canadian courts. Mr. Herman advises governments, State agencies and international organizations on trade, economic sanctions and investment issues.

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He has authored and edited two compendium volumes on international trade: Canadian Trade Law: Practice and Procedure *(Thomson Reuters 2007, 2016) and* Export Controls & Economic Sanctions *(Thomson Reuters 2010). Mr. Herman regularly publishes commentaries on international law and policy for think-tanks and for various news publications.*

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