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The Future of the USMCA

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6 August 2026

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Executive Summary

A Shift in North American Trade

- The USMCA review does not signal the end of North American integration but a shift toward using trade policy to advance U.S. industrial policy, economic security, and strategic competition under the America First agenda.
- Changing geopolitical and economic conditions including supply chain disruptions and China's growing technological and manufacturing leadership have transformed the USMCA from a traditional free trade agreement into a strategic tool for strengthening U.S. competitiveness and reshaping regional production.

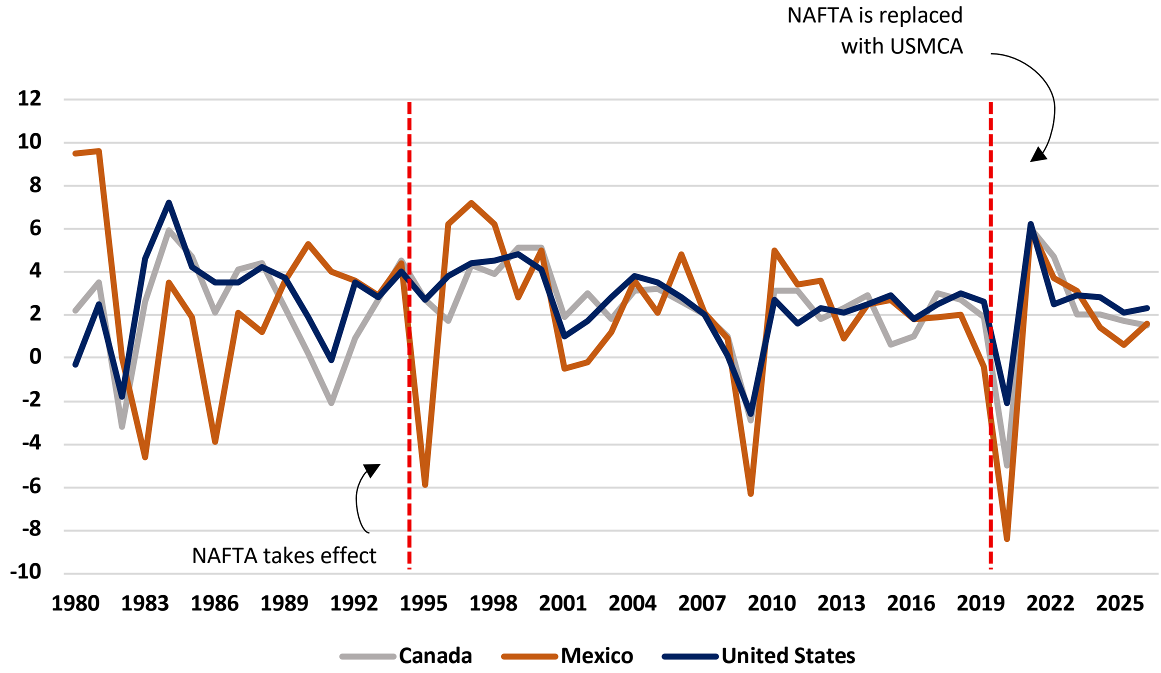
America First Reshapes the USMCA

- The Trump administration is repositioning the USMCA from a traditional free trade agreement toward a strategic instrument that supports industrial policy, economic security, and U.S. competitiveness.
- China has become the central driver of the review, with Washington seeking to reduce Chinese participation in critical industries and strengthen regional supply chains through stricter rules of origin and higher domestic content requirements.
- The proposed reforms aim to reorganize North American manufacturing around U.S. strategic priorities, with Mexico likely to remain an attractive production base while Canada faces greater pressure to compete for investment.
- The USMCA review is increasingly unfolding through parallel U.S. negotiations with Mexico and Canada, with tariffs serving as a bargaining tool to secure concessions on manufacturing, market access, and industrial investment.
- Although a complete USMCA collapse remains unlikely, prolonged uncertainty or U.S. withdrawal would disrupt North American trade, expose highly integrated industries and export-dependent states to higher tariffs and retaliation, and increase political pressure from businesses to preserve the agreement.

Can North America Build a Manufacturing Ecosystem?

- North America is experiencing a surge in industrial investment, but the success of these projects will depend on developing regional supplier networks and upstream manufacturing capabilities rather than expanding final assembly alone.
- Despite deeper regional integration, North America remains heavily dependent on imported intermediate goods from Asia, while certification barriers, concentrated production hubs, and technological gaps continue to limit supply chain resilience.
- Long-term competitiveness requires stronger backward linkages in component manufacturing, engineering, advanced materials, and research-intensive industries, as stricter rules of origin alone cannot create productive capabilities.
- For Mexico, the USMCA review presents both opportunities and constraints. Plan México seeks to use industrial policy to move beyond the traditional export-led model, but future U.S. demands and existing USMCA rules could limit its policy space while labour reforms may support more inclusive domestic growth.

Key Picture: Variation in GDP Growth of USMCA Members (Real GDP Growth Rate)



Source: IMF WEO April 2026

Introduction

The Trump administration's decision not to extend the United States-Mexico-Canada Agreement (USMCA) in its current form has been widely portrayed as creating uncertainty over the future of North American trade. While the agreement remains fully in force, Washington has triggered its built-in review mechanism rather than agreeing to a straightforward extension, initiating negotiations that could continue for several years before the agreement's scheduled sunset in 2036. Yet the review should not be interpreted as a rejection of North American integration. Instead, it reflects a broader shift in the purpose of US trade policy.

Rather than focusing primarily on tariff reduction and market liberalization, the next phase of the USMCA is increasingly centered on industrial policy, economic security, and strategic competition. The review is likely to become less about preserving the existing agreement than about reshaping it to support the Trump administration's America First agenda, strengthening US industrial competitiveness, reshoring manufacturing, reducing trade deficits, and limiting China's role in regional supply chains. In this sense, Washington increasingly views the USMCA not simply as a free trade agreement, but as a strategic instrument for advancing US economic and geopolitical objectives.

From NAFTA to USMCA and Beyond

Implemented in 2020, the USMCA replaced the North American Free Trade Agreement (NAFTA), which had governed regional trade since 1994. While preserving NAFTA's tariff-free framework, the agreement introduced stricter automotive rules of origin, stronger labour and environmental provisions, enhanced digital trade rules, and a unique six-year joint review mechanism with a sixteen-year sunset clause.

The revised agreement was widely viewed as a compromise between preserving the benefits of regional integration and addressing long-standing US concerns regarding manufacturing relocation and labour standards. It largely succeeded in maintaining deeply integrated North American production networks while providing businesses with greater regulatory certainty.

Yet the global economy has changed dramatically since the agreement entered into force. The COVID-19 pandemic exposed the vulnerabilities of highly fragmented global supply chains. Geopolitical tensions accelerated the securitization of trade policy, while China's continued dominance across electric vehicles, batteries, rare earth processing, semiconductors, and clean-energy technologies fundamentally reshaped policymakers' understanding of economic competitiveness. Consequently, the strategic questions confronting North America today extend far beyond the issues that shaped the original USMCA negotiations.

Why Washington Wants a New Agreement

The review is not simply about updating an existing trade agreement. It reflects the Trump administration's broader effort to align North American integration with its America First agenda and strengthen the United States' competitive position in an era of intensifying rivalry with China. Whereas earlier trade agreements emphasized reciprocal liberalization and economic efficiency, the current administration increasingly evaluates them according to whether they reinforce domestic manufacturing, reduce external dependencies, and advance US industrial leadership.

China has become the defining strategic variable in this transformation. During the original USMCA negotiations in 2018 and 2019, policy debates focused primarily on trade balances, labour standards, and manufacturing relocation. Today, Washington increasingly views North American integration through the lens of geopolitical competition with Beijing. This extends well beyond concerns that Chinese firms could use Mexico as an export platform to circumvent US tariffs. Increasingly, policymakers seek to limit Chinese participation in strategically important sectors—including electric vehicles, batteries, semiconductors, telecommunications equipment, and critical minerals—while reducing dependence on Chinese-controlled supply chains.

The automotive industry lies at the center of this strategy. Modern vehicle production depends on highly integrated cross-border supply chains, with components routinely crossing US, Canadian, and Mexican borders multiple times before final assembly. Although the USMCA strengthened regional content requirements relative to NAFTA, US officials argue that it has neither reversed the long-term relocation of manufacturing to Mexico nor sufficiently strengthened domestic industrial capabilities.

Washington is therefore seeking stricter rules of origin, reportedly including raising North American content requirements for automobiles from 75% to 82%, requiring that half of a vehicle's content be produced in the United States, and potentially extending similar rules to sectors such as electronics. These proposals are intended to reduce dependence on Chinese supply chains, expand regional sourcing of strategic components, and encourage greater investment in US-based production.

The proposed changes would affect USMCA members unevenly. Mexico could remain an attractive manufacturing hub because of its lower labour costs and established industrial base, while Canada risks losing investment as firms increasingly choose between locating production in the United States or Mexico.

These proposals represent more than traditional protectionism. Rather than discouraging trade, they seek to influence where production occurs, who participates in regional value chains, and where technological capabilities are concentrated. The objective is not simply to preserve North American manufacturing, but to reorganize it in ways that strengthen US industrial leadership while reducing strategic dependence on external suppliers.

Negotiations Gain Momentum

Formal negotiations have accelerated in recent weeks. The United States and Mexico have launched a new round of bilateral discussions focused on tightening automotive rules of origin, strengthening regional supply chains, and limiting Chinese participation in North American production networks. US Trade Representative Jamieson Greer has reiterated that reducing trade deficits and expanding domestic manufacturing remain central objectives of the administration's trade agenda.

Canada has adopted a different negotiating approach. Prime Minister Mark Carney has emphasized that Ottawa is seeking a comprehensive revision covering multiple sectors rather than a limited agreement focused primarily on the automotive industry. While describing discussions as constructive, Canadian officials have acknowledged that negotiations are likely to continue well into next year and have warned that Canada is prepared to respond should the United States impose additional tariffs.

Although the USMCA remains formally trilateral, negotiations are increasingly proceeding through parallel bilateral channels. By negotiating separately with Mexico and Canada before consolidating a revised agreement, Washington gains greater flexibility to tailor its demands to each partner. Recent US tariff announcements also illustrate that tariffs and USMCA negotiations are no longer separate policy instruments. Instead, tariff threats have become part of Washington's broader bargaining strategy, encouraging concessions on manufacturing, market access, and industrial investment.

The negotiations are inherently asymmetric. The United States accounts for roughly three-quarters of North America's GDP and remains by far the largest export market for both Canada and Mexico. This provides Washington with considerable leverage during the review process. President Trump has openly questioned the value of maintaining the agreement in its current form, and told Fox that "Mexico and Canada need us. We don't need them." While such remarks form part of the administration's negotiating strategy, they also signal that Washington increasingly views the review as an opportunity to reshape the agreement around US priorities rather than simply renew the existing framework.

Can North America Build a Manufacturing Ecosystem?

The USMCA review comes at a time of unprecedented industrial investment across North America. Since 2024, governments and private firms have announced tens of billions of dollars in semiconductor fabrication plants, battery facilities, electric vehicle production, and critical minerals processing. These investments are supported not only by the USMCA, but also by a broader industrial policy framework—including tax incentives, manufacturing subsidies, domestic procurement policies, and strategic investment programs—that increasingly complements trade liberalization with active industrial policy to strengthen regional manufacturing.

Despite this investment boom, North America's manufacturing model remains structurally dependent on imported intermediate goods. While regional integration has been highly successful in final assembly, many critical upstream inputs—including advanced semiconductors, electronic components, electric motors, converters, battery materials, and precision industrial equipment—continue to be sourced primarily from Asia. As a result, the region has regionalized assembly far more successfully than intermediate manufacturing, leaving strategic supply-chain vulnerabilities largely intact.

This dependence reflects several structural weaknesses. Regional suppliers often face costly and non-transferable certification requirements that discourage firms from switching to North American suppliers, even where production capacity exists. Production of key industrial components is also concentrated in a limited number of manufacturing hubs, creating geographic bottlenecks, while domestic technological capabilities in advanced electronics and semiconductor production remain insufficient to replace extra-regional suppliers in the near term. Consequently, stricter regional content requirements alone are unlikely to eliminate these dependencies.

These shortcomings have important implications for long-term competitiveness. While final assembly generates employment and exports, sustained productivity growth, technological upgrading, and industrial resilience depend on developing higher-value upstream activities—including component manufacturing, engineering, advanced materials, machinery production, and research-intensive industries. Without stronger backward linkages, industrial subsidies and stricter trade rules risk creating an economy that assembles products rather than one that manufactures them.

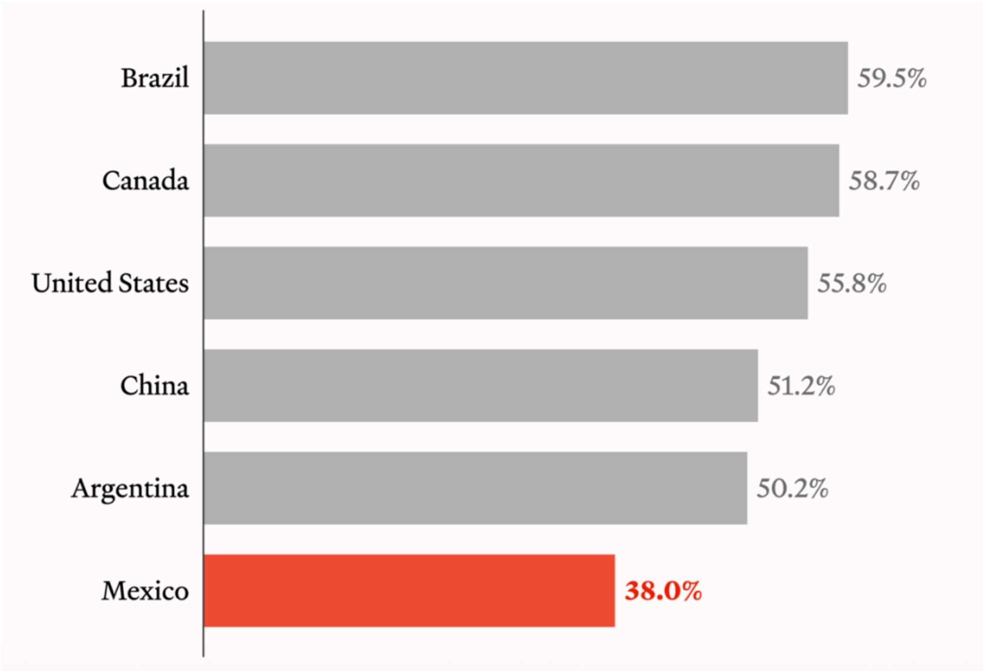
Plan México

The 2026 USMCA review presents both risks and opportunities for Mexico's development strategy under President Claudia Sheinbaum's Plan México. While North American integration has expanded trade over the past three decades, it has failed to resolve Mexico's persistent challenges of slow growth, poverty, and inequality. Plan México aims to move beyond the traditional export-led model by promoting public investment, industrial policy, state-owned enterprises, local content requirements, and strategic sectors such as semiconductors, electric vehicles, aerospace, pharmaceuticals, and energy.

However, Mexico's industrial ambitions are constrained by existing USMCA provisions governing public procurement, state-owned enterprises, investment protection, and energy. Although the agreement preserves some policy space through sectoral carve-outs, additional measures, including subsidies, stronger local content requirements, and strategic trade policies, could face legal challenges under the USMCA or WTO rules. Future US demands could further limit Mexico's industrial policy flexibility.

At the same time, US pressure for higher wages and stronger labour-rights enforcement offers an opportunity to strengthen Mexico's domestic economy. Higher wages would reduce poverty and inequality while boosting domestic demand and reducing reliance on exports to the United States. Ultimately, they view the USMCA review not only as a trade negotiation but also as an opportunity to advance a more inclusive and industrialized growth model.

Figure 1: Labour Income as Percent of GDP, 2025



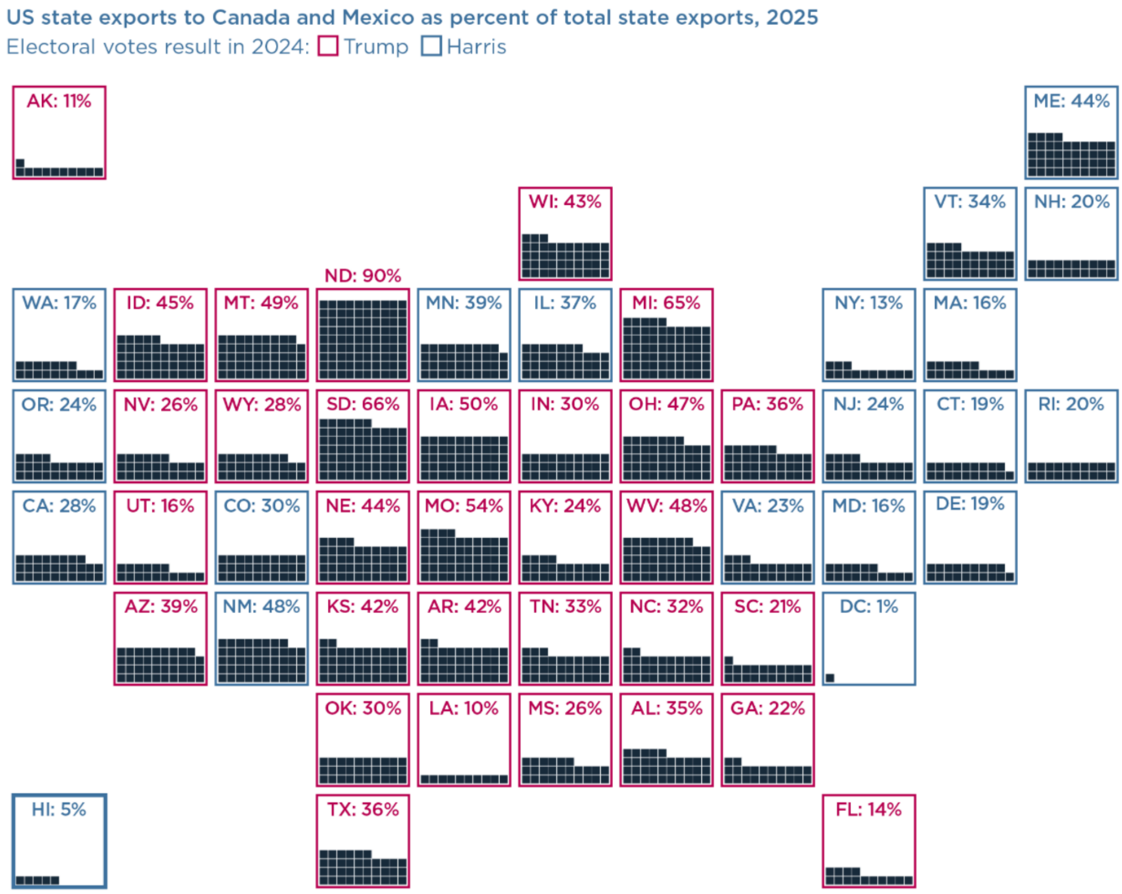
Source: ILO

Economic Risks of USMCA Termination

While a full termination of the USMCA remains unlikely, the ongoing review has increased uncertainty over the future of North American trade. Failure to reach an agreement would trigger annual reviews through 2036, undermining business certainty, while a formal US withdrawal would restore WTO most-favored-nation (MFN) tariffs. The Trump administration could then impose broader tariffs on Canadian and Mexican imports, likely prompting retaliatory measures against US exports.

The economic impact would be concentrated in highly export-dependent states and industries. States such as Texas, Michigan, Indiana, Kentucky, Arizona, North Dakota, and Iowa are particularly exposed due to their strong trade links with Canada and Mexico, while sectors including automobiles, auto parts, petroleum, semiconductors, computers, and aircraft rely heavily on North American markets. As a result, business opposition from affected industries and states could become a significant political constraint against a complete USMCA breakdown.

Figure 2: Trump-voting states are at highest risk for export losses if the USMCA ends



Source: PIIE