

Alert | International Trade



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From NAFTA to USMCA: The New North American Trilateral Free Trade Agreement

On Sept. 30, 2018, Canada reached an agreement to join the United States and Mexico in the creation of an agreement to modernize the North American Free Trade Agreement (NAFTA). This was the last day for the three countries to reach an agreement that could be signed by Mexican President Enrique Peña Nieto before leaving office on Dec. 1, 2018, and at the same time comply with the requirement under the 2015 Trade Promotion Authority law that requires the president of the United States to submit a trade deal to Congress 60 days before it can be signed.

The New Agreement

The **U.S.-Mexico-Canada Agreement** (USMCA) includes revisions to several provisions that are part of the soon-to-be obsolete NAFTA. Some of the most notable revisions include the following:

- **Sunset Provision:** One of the most remarkable aspects of the new agreement is the inclusion of a “sunset” provision. USMCA includes a provision that requires that the agreement be terminated 16 years after the date of its entry into force, unless each country confirms it wishes to continue the agreement for an additional 16-year term. The agreement also requires that the parties meet within six years of the agreement’s entry into force, and within six years of the beginning of every renewal period (if any), to conduct a “joint review” of the operation of the agreement, review any recommendations for action, and decide on any appropriate actions, including whether or not the agreement should be extended for an additional 16-year period. The original proposal advanced by the United States would have automatically terminated NAFTA after five years unless all three countries agreed to extend it.

- **Dairy:** Canada has agreed to eliminate its Class 7 dairy-pricing scheme and increase overall market access for U.S. dairy producers by granting them access to 3.59 percent of Canada's dairy market, which is slightly greater than the 3.25 percent market access Canada was willing to provide the United States in the Trans Pacific Partnership (TPP). This will allow an increased volume of U.S. dairy imports to enter Canada's borders. This was one of the major goals for the United States in a modernized agreement, and it proved to be one of the major points of contention that kept the United States and Canada from reaching common ground.
- **Automobile Rules of Origin:** USMCA requires that automobiles contain at least 75 percent value of North American parts, up from the current 62.5 percent NAFTA requirement, for them to continue to be free from import duties. If certain automobiles or light trucks do not comply with these new requirements, they will be subject to the most-favored nation tariff rates of 2.5 and 25 percent, respectively. Most of the new rules of origin contained in the new agreement have been designed to be rolled out in four phases over a three-year period. In addition, USMCA requires that 40 to 45 percent of vehicle value be built in regions paying at least US\$16 per hour. Auto manufacturers will have three years to comply with these new guidelines. However, the terms of the new agreement also provide a duty-free arrangement for up to ten percent of the previous year's total production of a manufacturer's automobiles that have been manufactured before USMCA's effective date. This arrangement will only be applicable to automobiles that comply with a number of conditions for a period of up to five years after the deal's implementation. The applicable conditions for this arrangement include (a) requiring a minimum of 62.5 percent of North American content, (b) requiring that a minimum of 70 percent of the automaker's total purchases of steel and aluminum in the previous twelve months be of North American origin, and (c) requiring the automaker to certify its compliance with the agreement's labor value content outlined in Article 4-B.7(1) and (2).
- **Investor-State Dispute Settlement:** USMCA eliminates NAFTA's Chapter 11 provisions on investor-state dispute settlement between the United States and Canada and limits them between the United States and Mexico. There are also no provisions covering Mexican investors in Canada or Canadian investors in Mexico, presumably because these parties may rely on similar rights provided under the Comprehensive Progressive Trans-Pacific Partnership (CPTTP), which provides for a reliable avenue to address investor-state disputes. For U.S. investors in Mexico and Mexican investors in the United States, there is still access to investor-state arbitration under USMCA Chapter 14, but their rights are limited to claims over national treatment, most-favored nation treatment, and direct expropriation. However, the agreement also provides for additional protections for investments that pertain to government contracts in the areas of oil and gas, power generation, telecommunication and transportation services, and ownership or management of infrastructure. USMCA also provides for stricter requirements to pursue local remedies for at least 30 months before pursuing an arbitral claim under the new agreement. Moreover, one of the annexes to USMCA contains a fork-in-the-road provision foreclosing recourse to arbitration under USMCA to U.S. and Mexican investors that bring claims of breaches to treaty obligations before local courts of the host state. It should also be noted that investments from any of the three countries established between Jan. 1, 1994, and the date of entry into force of USMCA will retain the option to bring claims under NAFTA Chapter 11 against any of the USMCA countries within three years of the new agreement's entry into force. Similarly, arbitration proceedings that are initiated before USMCA enters into force and continue after that date will be allowed to proceed and with no alteration to the claimant investor's protections.
- **Labor Provisions:** The inclusion of heightened labor standards under USMCA is mainly aimed at Mexico. An annex to the USMCA's labor chapter requires that Mexico adopt legislation in accordance with the country's constitution by Jan. 1, 2019. The text of the annex requires that the implemented Mexican legislation provide for the establishment of an independent entity for conciliation and union

collective bargaining agreement registration and “independent Labor Courts” for the adjudication of labor disputes. Mexico’s new legislation will also be required to outline independent verification requirements to ensure that compliance with the collective bargaining requirements set out in USMCA are being upheld. In addition, as part of the agreement, Mexico has committed to recognize workers’ right to collectively bargain, and the three USMCA countries have agreed to enforce rights recognized by the International Labor Organization (ILO). Most notably, the annex provides for the possibility of delaying the entry into force of USMCA until such legislation becomes effective. Another important provision of USMCA’s Chapter 23 on Labor is the requirement for the three countries to cooperate in the identification of goods produced by forced labor.

- **Currency Manipulation:** USMCA contains language aimed at deterring its members from manipulating their currencies. The effect of this provision remains to be seen, as all three USMCA countries operate under a free-floating exchange rate system. However, the currency language in USMCA is expected to become a model for inclusion in future U.S. trade agreements.

Other Relevant Points

Several important provisions from the original NAFTA have remained under the new agreement. For instance, the contents of NAFTA Chapter 19, which provides for the establishment of dispute settlement panels to address trade remedies decisions, is set to remain unchanged. This is a provision that was at the heart of the original bilateral trade agreement between the United States and Canada, which dates back to the 1990s, and that remained in NAFTA. This chapter provides for the right to challenge a member country’s anti-dumping and countervailing duty decisions before an expert panel composed of members from the two countries involved in the relevant dispute, instead of domestic courts. The inclusion of this provision was of great significance for Canada, as the United States had sought to eliminate it from a modernized deal and viewed it as an encroachment of U.S. sovereignty. Despite the inclusion of this provision, U.S. officials have reportedly stated that leaving the trade remedy dispute settlement system in place will not prevent the U.S. from enforcing its trade remedy laws.

Another provision that remains generally unchanged is government procurement. Under USMCA Chapter 13, government procurement market access between the United States and Canada is set to continue under the terms of the World Trade Organization’s (WTO) Government Procurement Agreement. Although NAFTA’s government procurement provisions were reportedly the focus of much discussion during the negotiations of the new agreement, the U.S.’s “Buy American” rules that prevent cross-border procurement remain unchanged under USMCA with regard to Canada. In terms of government procurement rules between Mexico and the United States, the two countries have agreed to accord parties of the other country treatment no less favorable than the treatment accorded to domestic goods, services, and suppliers.

The new agreement outlines criminal penalties for pirating movies online, prohibits duties on digital music, books, software, and video games that are distributed electronically, and provides for stronger intellectual property protections, including increased patent protection for certain biotechnology. USMCA also addresses a number of sectors of the digital economy by, for instance, providing for duty-free treatment of e-books, music, and other products that are purchased electronically.

The United States has also reached a series of side agreements with Mexico and Canada. The side deals between the United States and Mexico cover a number of products, including biological products, and auto safety standards, among others, while the side deals between the United States and Canada cover a number of products and guidelines for research and development expenditures.

Section 232 Tariffs

No agreement was reached as part of USMCA on U.S. Section 232 tariffs on imports of certain steel and aluminum products from Mexico and Canada. Although government officials from all three countries repeatedly stated that these tariffs would in no way affect the negotiation of a new trade agreement, many industry sectors were hopeful about the possibility of the elimination of the tariffs for Canadian and Mexican imports. As such, these tariffs remain in place pending further negotiations. On a similar topic, a side letter to the new agreement provides that imports of Canadian products that are affected by any new U.S. Section 232 tariffs will be exempted for at least 60 days after the imposition of a measure so that the parties may engage in negotiations. At the time of publication of this Alert, it is unclear whether the same 60-day exemption will apply for Mexican products.

In terms of any potential tariffs on automobile imports, official sources from all three countries have been quoted stating that current Mexican and Canadian production capacities would be excluded from any potential Section 232 tariffs on imports of autos and auto parts. Specifically, the United States has reportedly agreed to exclude annually 2.6 million auto imports each from Mexico and Canada from potential Section 232 tariffs. In addition, reportedly, the United States has agreed to exclude from potential Section 232 auto tariffs \$38 billion in annual Canadian auto parts imports and \$108 billion in annual Mexican auto parts imports.

Next Steps

The new agreement is expected to be signed at the end of November, just before the Dec. 1, 2018, presidential transition in Mexico, and come into force in 2020. Before USMCA comes into effect with respect to the United States, Congress must draft and pass implementing legislation that incorporates the provisions of the new agreement for the president to sign into public law. It is expected that Congress will take up the USMCA-implementing legislation in February or March, at the earliest. However, congressional approval of USMCA could take longer, particularly if the Democrats take control of the House of Representatives in the November midterm congressional elections. Mexico and Canada will also have to submit the text of the new agreement for approval under their respective ratification systems.

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