



MK&A Policy Brief – October 2018

An Overview of the Revised NAFTA Deal

On October 1st, the Office of the US Trade Representative released the text of a trilateral agreement-in-principal with Mexico and Canada – named the United States-Mexico-Canada Agreement (or USMCA). This paves the way for formal signing of the agreement by November 30th (signifying the last day of office of outgoing Mexican President Enrique Peña Nieto), in accordance with timelines as set out under US Trade Promotion Authority (TPA).

Given the various mark-up and congressional review requirements under the TPA, US implementation of the new agreement is not expected until well into 2019 at the earliest. There are a number of challenges facing the US Administration within that timeline. Text and an implementing bill must be introduced and considered by both chambers of Congress before the TPA expires in December 2018, or risk moving without the TPA (requiring a minimum of 60 votes in the Senate to pass).

The ratification process is further complicated by the US mid-term elections in November and potential makeover of the US House of Representatives and perhaps the Senate. The volatility and partisanship marking current-day US politics defy any predictions on congressional approval of the USMCA implementing legislation taking place some 9-12 months hence.

The NAFTA will remain in force until the USMCA is ratified and implemented, thereafter replacing (not superseding) the previous agreement.

Below is a brief assessment of the gains and concessions made by Canada to achieve literally 11th hour finalization of the new trilateral agreement.

I. Gains for Canada

Investment certainty. The conclusion of negotiations on a revised NAFTA – commenced at the behest of the US through USTR notice of intent to Congress on May 18, 2017 – offers a level of economic and business certainty with respect to the established rules of trade between Canada and the US and Mexico. Tariff-free movement of goods and services between the three countries is largely preserved.

Sunset clause. The USMCA provides for a performance review at six year intervals, at which time parties can unanimously agree to an extended term of 16 years, or a dissatisfied party could initiate a series of annual reviews for up to a decade before seeking withdrawal. This offers greater investment certainty than the original negotiating position of the US, which was for a five year, unilaterally-triggered sunset provision.

Dispute resolution. The USMCA preserves Chapter 19 of the NAFTA, which provides for objective panel review of anti-dumping and countervail duty (CVD) findings issued by domestic agencies. This is an important win for Canada given the US softwood lumber file. At the outset of negotiations the US sought to eliminate Chapter 19, preferring instead to resort to the domestic courts for appeal proceedings.

Moreover, the NAFTA Chapter 11 investor-state dispute settlement is to be eliminated between Canada and the US with respect to bilateral cross-border investments, after a three year grand-fathering period. Canada had lost \$219 million in awards and settlements to US investors as a result of investor challenges against usually provincial government policy decisions.¹

Government Procurement. The USMCA leaves the status quo intact with respect to access to each of the parties' government procurement processes. The US had originally tabled a proposal demanding strict reciprocity in access

¹ Canada is currently facing eight active investor-state claims – including Omnitrax's recent NAFTA claim related to its broken rail line to Churchill, Manitoba; and Lone Pine's challenge to Quebec's fracking moratorium – that combined seek more than \$475 million in damages.

to future US government contracts, which would have severely disadvantaged Canadian bids.

Perishable and seasonal goods. There is no reference in the USMCA to specialized procedures for trade remedy investigations involving seasonal and perishable goods, as was originally proposed by the US at the behest of Florida tomato growers. Although the US proposal originally targeted Mexican imports of fresh produce to the US, Canadian growers were concerned that the availability of special trade remedy powers could be applied more broadly.

Cultural Exemptions. Canada's broad cultural exemptions attained under the NAFTA are preserved under the USMCA.

Natural Resource Exemption. A side letter to the USMCA stipulates that Canadian freshwater resources are excluded from the agreement.

II. Canadian Concessions

Rules of Origin for Autos. Under the new rules of origin for automobile manufacture, tariff-free eligibility under the USMCA requires at least 75 percent of an auto's value originating from one of the three parties (up from 62.5 percent under the NAFTA). In addition, 40 percent of auto content and 45 percent of heavy truck content must attach to workers earning at least \$16/hour. And vehicle makers must certify that 70% of steel and aluminum purchases originate from one of the three parties.

The new regional and labour content requirements contemplate a four-year phase-in period, allowing North American auto makers time to adjust production strategies.

Furthermore, side letters to the USMCA basically exempt Canada and Mexico from the US threat of global auto tariffs under s. 232 of the Trade Expansion Act (which sets out the national security rationale for imposing tariffs in exceptional circumstances). While such exemptions do avoid needlessly disrupting the

North American auto supply chain, specific reference in the USMCA legitimizes a US tactic which almost universally is seen as trade non-compliant.

However, conceding to US demands with respect to autos was critical, given the hundreds of thousands of jobs at stake in an industry that is integral to the North American manufacturing. Any disruption of the highly integrated, sophisticated supply chain that had evolved under the NAFTA would have resulted in a major setback for all three economies.

Supply Management. Under the USMCA, the US acquired marginally more market access for dairy than negotiated under the Trans-Pacific Partnership (TPP) Agreement, amounting to about 3.6% of the Canadian dairy market as opposed to 3.25% under the TPP (see Table 1 for details). The big difference for the US, however, is that under the TPP the extra TRQ space was to be shared with the other 10 parties (essentially Australia and New Zealand) whereas the new USMCA TRQs will be filled by US product alone.

The USMCA also stipulates that Canadian milk pricing Classes 6 and 7 (dealing with dried milk components) will be eliminated within six months after the agreement comes into force, and that Canada will ensure that skim milk solids will henceforth be priced no lower than a level based on the US price for nonfat dry milk. Significant investments were made by Canadian processors over the last several years in reliance on access to domestic milk solids and protein; these plans will now need to be re-thought.²

Canada also agreed to cap future exports of skim milk powder, milk protein concentrates and infant formula in third markets or apply an export surcharge, thus limiting future Canadian competition against US dairy product worldwide.

Moreover, the new agreement provides the US more than double the current access to Canada's poultry market and almost triple the current access to Canada's egg market.

² The Dairy Processors Association of Canada (DPAC) commented that the concession of Class 7 will "stifle innovation, stunt market growth, and create additional losses for those dairy processors who have made significant capital investments recently to improve Canada's domestic processing capacity".

As with Canadian market access concessions made under the Canada-EU CETA, the federal government has promised to compensate supply-managed sectors for losses incurred as a result of the USMCA concessions. However, no details as to the nature and quantity of the compensation package have been released to date.

Patent Extensions. The USMCA provides for extended protections on intellectual property through lengthened patent periods and tightened copyright provisions. In relation to pharmaceuticals, extended patents from 8 to 10 years are expected to increase Canadian health care costs.

Increased De Minimis for Cross-Border Shipments. The USMCA raises Canada’s de minimis shipment value for imported goods (those goods entering tariff free) to C\$150. Canada’s previous de minimus level of C\$20 had been unchanged since 1985, and were not reflective of the current trend towards e-commerce transactions.

Wine Trade. A side letter to the USMCA stipulates the end of BC wine exclusivity on provincial grocery store shelves; the practice is likely to be phased out by November 2019. Other provincial alcohol monopolies and grandfathered marketing practices are maintained.

Future Trade Agreements with “Non-Market” Parties. Article 32 of the USMCA commits parties to provide three month notice of any FTA negotiations with a “non-market” country. Parties may terminate the USMCA as a consequence of another party entering into an FTA with a non-market country, reverting the USMCA to a bilateral agreement. This is an highly unusual provision, clearly

	CPTPP	USMCA	CETA
Cheese (MT)			
year 1	2,416	2,084	3,774
year 6	14,500	12,500	17,700
year 13	15,545	13,402	17,700
year 16	16,016	13,808	17,700
year 19	16,502	14,226	17,700
	highest access: CETA		
Milk (MT)			
year 1	8,333	8,333	-
year 6	50,000	50,000	-
year 13	53,607	53,607	-
year 16	55,231	55,231	-
year 19	56,905	56,905	-
	CPTPP = USMCA		
Cream (MT)			
year 1	500	1,750	-
year 6	580	10,500	-
year 13	713	11,257	-
year 16	734	11,599	-
year 19	734	11,950	-
	highest access: USMCA		
Eggs (mn dozens)			
year 1	2.8	10.0	-
year 6	16.7	16.1	-
year 13	17.9	31.4	-
year 16	18.4	31.4	-
year 19	19.0	31.4	-
	highest access: USMCA		
Chicken (MT)			
year 1	3,917	47,000	-
year 6	23,500	57,000	-
year 13	25,195	61,112	-
year 16	25,959	62,963	-
year 19	26,745	62,963	-
	highest access: USMCA		
MT = metric tons; italics represent ceiling			
Sources: Global Affairs Canada, USTR.			

aimed at complicating Canada and Mexico's stated intention to explore trade talks with China.

Steel and Aluminum Tariffs. The USMCA does not resolve US tariffs on Canadian and Mexican steel and aluminum imports, which remain in place although the US has indicated a willingness to continue talks on these. It is likely that a resolution will be found before implementation which converts the current tariffs to volume restrictions or quotas like those applied by the US against Argentina and Korea.

III. Canadian Ratification

The politics of Canadian ratification of the USMCA are less complicated than that of the US.

Nonetheless, with an October 21, 2019 election looming, the federal government will seek to ratify the USMCA before the House of Commons rises for summer break in late June 2019. Accordingly, implementing legislation is likely to be tabled mid-February 2019. Presumably USMCA implementation will be a priority on the government's legislative agenda, but the timing for achieving ratification and royal assent will nonetheless be tight.

Meanwhile the federal government is also trying to deliver on implementation and royal assent of the TPP, or Comprehensive and Progressive Trans-Pacific Partnership Agreement. The agreement was signed in March 2018. The federal government vowed to move expeditiously towards ratification, introducing implementing legislation in June. Second reading began mid-September. The CPTPP comes into force once six of the parties have achieved ratification; to date three parties have done so – Mexico, Japan and Singapore.

To defuse the politics around USMCA ratification, the federal government will want to prioritize negotiations with the US regarding removal of the steel and aluminum tariffs, and will want to introduce a compensation package for supply-supply-managed sectors in short order.