What you need to know about potential changes to US import/export rules

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North American Free Trade Agreement (NAFTA)

Canada, Mexico and the United States are partners in the world's largest trade agreement, the North American Free Trade Agreement (NAFTA). NAFTA came into effect in 1994 to remove the barriers to the flow of goods and services between Canada, Mexico, and the United States. However, as part of its "America First" agenda, the Trump administration has stated its intention to pursue fundamental changes to NAFTA to provide favourable terms for US businesses. The Trump administration recently sent the US Congress a draft list of priorities which covers a broad range of areas for negotiation. Among other things, the list of priorities includes reducing non-tariff barriers on US agricultural exports; pursuing "rules of origin" which promote US jobs and production; gaining greater access to Canada's heavily regulated telecommunications sector; protecting digital trade and commerce; strengthening enforcement of intellectual property; reinstating tariffs in cases where imports cause or threaten injury to domestic industries; and establishing rules that require government procurement to be conducted in a manner that is consistent with US policy.

The list also includes a recommendation to remove "Chapter Nineteen: Review and Dispute Settlement in Anti-dumping/Countervailing Duty Matters", which provides that anti-dumping and anti-subsidy disputes be settled by a special dispute panel, a provision which has helped Canada's soft lumber industry in the past.

Congress will now be revising this list. The Trump administration is required to provide Congress with 90 days' notice before it can commence negotiations. So formal discussions with Canada and Mexico can begin as early as this summer.

Although the Trump administration's focus has largely been on Mexico, on March 31, 2017, President Trump included Canada in a couple of executive orders. The first order will look at identifying forms of trade abuse and non-reciprocal practices that currently contribute to the US trade deficit. The second order will focus on improving the collection of anti-dumping and countervailing duties, which are levied against foreign governments who subsidize products, leading to pricing practices below cost. The Trump administration is hoping to quantify how much of its trade deficit is due to unfair practices and to find solutions for the imbalance.

What does this mean for Canada?

The United States and Canada have enjoyed a strong trade relationship with approximately US$600 billion of goods traded between the two countries on an annual basis. Though it is well known that the United States is Canada's largest export market, it is worth noting that Canada is the United States' second largest goods trading partner and was the United States' largest goods export market in 2015. The trading relationship, therefore, clearly benefits both parties.

In January, Stephen Schwarzman, head of President Trump's strategic and policy forum and one of President Trump's key economic advisors, met privately with Prime Minister Justin Trudeau and also spoke with the federal cabinet in Calgary (where the ministers met for a two-day retreat). Mr. Schwarzman stated that Canada should not be concerned, as the focus by the Trump administration is for countries that have large trade imbalances with the United States, which is not the case for Canada: "I think trade between the United States and Canada is really very much in balance and is a model for the way that trade relations should be … So I think Canada is very well-positioned for any discussions with the United States."

Backing up Mr. Schwarzman's claims are US government statistics[1] - the United States actually had a trade surplus with Canada of approximately US$12 billion in 2015 and US$13 billion for 2016 for goods and services (although the United States did have a deficit in the fourth quarter of 2016). In contrast, the United States had trade deficits in 2015 of US$49 billion and US$336 billion with Mexico and China, respectively.

So why should Canada be concerned? With respect to US/Canada trade, there has been a fairly clear distinction between deficit and surplus when it comes to goods and services. Historically, the United States has had a trade deficit with Canada on goods and a surplus on services. With respect to goods, the United States had a trade deficit of approximately US$11 billion in 2016 (US$15 billion in 2015) - the largest import was crude oil and gas and the largest export was machinery. The countries also have significant back and forth trade in vehicles and agricultural products. For trades of services (which include travel, transportation, intellectual property/software and information services), the United States had a trade surplus of approximately US$24 billion in 2016 (US$27 billion in 2015).

One of the main reasons for the overall swings in the trade balance between Canada and the United States is the price of oil. Canada has been the largest foreign supplier of mineral fuels to the United States, exporting US$70 billion to the United States in 2016. Thus, when oil prices rise, the United States is likely to have an overall trade deficit with Canada. Likewise, when oil prices drop, the United States is likely to have a trade surplus, which is what happened in 2015 and through the majority of 2016.

If there are changes in US policies which affect certain key sectors, they could have a significant impact on Canadian exporters and Canada's overall trade balance.

Border adjustment tax (BAT)

The Trump administration is also considering options that may affect trade policy outside of NAFTA. Included in the Republican blueprint is a plan to overhaul tax policy and encourage companies to do business in the United States. This includes substantially reducing US corporate tax rates and the potential implementation of a border adjustment tax (BAT).

The BAT proposes to tax imports into the United States at corporate tax rates, and exempt exports from the United States from corporate taxation.

[1] Office of the United States Trade Representative and the US Census Bureau

What does this mean for Canada?

If the blueprint is enacted, Canada, Mexico and other countries who export substantial volumes to the United States will be significantly impacted. A tax on Canadian exports to the United States would result in Canadian products being more expensive, which may lead to US businesses and consumers looking domestically or elsewhere for cheaper goods. As a result, Canadians exporters may find their trade with the United States decreasing over time. Further, Canadian businesses could receive increased competition from US exporters, who may have the ability to reduce prices as a result of the tax policy changes.

Proponents of the BAT believe that, over time, its impact will be neutral and that the BAT would cause the US dollar to increase, which would make US exports more expensive and foreign goods cheaper to import.

Critics, however, argue that this assumes the increase in the value of the US dollar will appreciate sufficiently to fully offset the BAT. There are also other factors that can affect currency besides the demand and supply of traded goods.

It should be noted that the BAT is likely to be in violation of the rules of the World Trade Organization (WTO), which provide that imports must generally be treated equally as domestically-produced goods and services. Because the BAT proposes to tax the entire value of imported goods, it does not appear to meet these rules. The Trump administration will, therefore, likely encounter significant challenges getting the proposals enacted.

Final thoughts

Canadian companies doing business with the United States face uncertainty regarding their US trading relationship. Companies exporting to the United States should ensure they are compliant with the current tax and trade laws, customs documentation and procedures, and overall export controls, and consider a full-scale review of their risk areas.

Although the full impact of the NAFTA and BAT proposals have yet to be determined, since no legislation has been released, it's never too early to start thinking about what these proposals can mean to you and your business. Please reach out to your Grant Thornton advisor to discuss this release in further detail.