The United States-Mexico-Canada Agreement

What's next?

October 2018

Now that Canada, the United States and Mexico have concluded negotiations around an updated free trade agreement, many Canadians may be wondering: what's next? Several industries may experience changes as a result of the new agreement and these changes have the potential to trickle down to individual consumers in various ways.

What is the USMCA?

The new United States-Mexico-Canada Agreement—or USMCA—provides an update to the previous North American Free Trade Agreement (NAFTA) signed in 1994. The USMCA builds on and modifies the free trade policies originally outlined in NAFTA and presents a revised agreement for a modern day trade environment.

Industries affected

Agriculture

One of the industries potentially most affected by the changes in the USMCA is Canada's dairy industry. While the highly debated supply management system used to price dairy products in Canada has been retained, some notable changes have been proposed:

- Class 6 and 7 milk—special domestic milk categories sold at very low prices—will be eliminated within the supply management system;
- Component pricing of certain products (milk protein concentrate, skim milk powder and infant formula) will now be based on a US reference price; and
- Approximately 3.6% of Canada's dairy market will now be opened up to US milk producers.

These changes are likely to increase competition in the industry, which may result in lower prices to consumers but potential losses to dairy farmers. To offset these losses, the federal government has indicated that it will provide compensation to dairy farmers. Although specifics are yet to be provided, the government has stated that such compensation will be in place by the time the USMCA takes effect.

In addition to the changes to Canada's dairy industry, certain other changes affecting Canada's agriculture sector have been proposed:

- US-grown wheat registered in Canada will now receive an official Canadian grade;
- Tariffs on whey powder and margarine will be eliminated; and
- Canada has agreed that British Columbia will eliminate rules allowing only BC-produced wine to be sold in grocery stores.

Manufacturing

Contentious issues within the negotiation process were the agreement's treatment of auto manufacturing, as well as the United States' use of Section 232 of the Trade Expansion Act of 1962, which contains largely tariff-cutting measures. Section 232, however, allows the US government to impose tariffs that would restrict imports on certain products on the basis of national security.

Automobiles

The USMCA will require that cars and trucks traded between the three nations meet the following requirements:

- 75% of the components used in production must be manufactured in a member country (up from 62.5% under NAFTA);
- 70% of total steel and aluminum used in production must be North American; and
- 40% to 45% of automobile content produced in a member country must be made by workers earning at least $16 per hour.

In what is likely good news for the Canadian auto industry, in the event that Section 232 tariffs are imposed on auto exports to the United States, Canada will still be able to export 2.6 million passenger vehicles per year without incurring tariffs. As this amount is higher than the amount currently being exported, it leaves room for export growth.

These requirements have the potential to benefit workers in the steel and aluminum industries but may increase the consumer cost of purchasing a vehicle.

Section 232 tariffs

With respect to Section 232, while the 25% tariffs currently being imposed on Canadian steel and aluminum exports to the United States have not been resolved, the United States has committed to providing a 60 day exemption from any future measures imposed under Section 232 to allow for negotiations between the two nations to take place in advance.

The Canadian government has indicated that it hopes to resolve the tariffs on steel and aluminum exports prior to the signing of the USMCA.

Energy

The major change with respect to the energy sector is the removal of NAFTA's "energy proportionality clause" which provided the United States with proportionate access to Canadian oil, natural gas, coal, electricity and refined petroleum products. The effect of this was that, in the case that Canada were to reduce its total production of such products, the United States would still be entitled to the same portion of total supply—thus reducing the amount available for Canadian consumption.

Intellectual property

The changes around intellectual property included in the USMCA now mirror those that were included in the Comprehensive and Progressive Trans-Pacific Partnership Agreement.

Relevant changes are:

- Copyright terms in Canada have been extended to 70 years past death (up from 50 years) for copyrighted works and 75 years past death for performances and sound recordings;
- Biologic drugs will now be protected from generic competition for ten years, instead of the previous eight (this extension does not affect chemical drugs);
- Internet service providers will be protected from liability with respect to the actions of their users; and
- Patent applicants must be compensated for unreasonable delays in the processing of patent applications.

The change in data protection for biologic drugs is notable as even two years of additional protection against generic competition has the potential to greatly increase health care costs for Canadian federal and provincial governments.

Digital trade

Although addressed in more recent trade agreements, digital trade had not been previously addressed in NAFTA. The USMCA closes this gap by including such rules throughout various chapters of the agreement, as well as a separate chapter thereon.

New rules in this area would prohibit:

- Customs duties on importing or exporting digital products transmitted electronically (although internal taxes, such as sales taxes, and other fees would be allowed);
- Rules that require a business located in a particular country to locate its servers and storage devices in that particular country;
- Rules that restrict the cross-border flow of information, provided it is conducted for business purposes; and
- Rules that would require a business to provide its source code (or algorithms) as a condition to import, distribute or sell its software in a member country.

Overall, the agreement compels the parties to avoid unnecessary regulatory burdens, to adopt and maintain laws to protect online consumers and personal information, and to participate in the development of digital trade.

Effect on individuals

Many of the trade changes mentioned have a first-hand effect on Canadian businesses, but those effects will eventually trickle down to Canadian consumers.

USMCA changes directly affecting individuals are as follows:

- The amount of goods an individual will be able to bring into Canada without paying duties ($150) and sales taxes ($40) has been increased;
- Duties won't be imposed on products purchased electronically, such as music and e-books;

- Updated labour provisions protecting workers against discrimination based on gender and providing the right to freedom of association and collective bargaining have been included; and
- A general exception giving governments the ability to provide preferential treatment to indigenous people and indigenous-owned business has been included.

Additional changes

Sunset clause

Another highly-contested item in the negotiations was the implementation of a sunset clause. While the United States originally proposed a five year expiration period for the agreement, the final agreed-upon term will see the USMCA lasting for a period of 16 years, with an opportunity to review and potentially extend the agreement taking place every six years. This sunset clause is a shift from the previous NAFTA agreement, which had no expiration date.

Future trade agreements

An additional clause has been added to the USMCA that has the potential to limit future trade agreements between Canada and certain countries. This clause states that if a member country enters into free trade negotiations with a non-market country, the other USMCA members must be notified in advance. Furthermore, members have the right to review the potential agreement and potentially exit the USMCA (with a six month notice period). This rule is widely seen as an attempt by the United States to limit both Mexico and Canada from entering into free trade discussions with China.

Dispute mechanisms

In what was seen as a win for Canada, the Chapter 19 dispute resolutions from the previous NAFTA have been retained. These resolutions allow for an impartial binational panel to review disputes surrounding anti-dumping and countervailing duties.

Historically, Chapter 19 has been used to protect Canada's softwood lumber industry against US import duties. NAFTA's Chapter 20, which provides a resolution mechanism for disputes between member nations with respect to the agreement itself, has also been preserved in the USMCA.

One change made with respect to dispute resolution was the removal of the Chapter 11 provisions from NAFTA. Chapter 11 allowed for investors to sue governments over policy changes that would harm future profits. It has now been eliminated for claims against Canada and the United States, and restricted in Mexico.

What's next?

Now that the issues have been agreed upon, the finalized USMCA agreement needs to be signed by leaders of the three member countries and passed by each country's legislative body prior to becoming effective. A 60 day review period will now take place, during which changes may occur—especially given the fact that this 60 day period spans the November congressional elections in the United States. After coming into effect, the majority of the provisions will not become active until 2020.

In the coming weeks, we will continue to monitor the progress on this new agreement as it evolves, and provide further insight on how these changes may affect different industries in Canada. Please contact us if you would like more information.