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ARTICLE

Reports On USMCA Offer Industry-Specific Guidance For Cos.

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On May 17, 2019, the U.S. Trade Representative announced that it would remove tariffs on steel and aluminum imports from Mexico and Canada.[1] These tariffs were imposed under a Section 232 investigation, and they created a major diplomatic hurdle to passing the U.S.-Mexico-Canada Trade Agreement. Now that the tariffs are removed, the USMCA may pass more easily through Congress. If ratified by Congress, it would replace the North American Free Trade Agreement that has been in force since 1994.

On April 18, 2019, the International Trade Commission released a report assessing the likely economic impact of the USMCA.[2] As required by Congress, the ITC report assesses the agreement's likely impact on gross domestic product, exports and imports, employment, and U.S. consumer interests.

The USTR has released an automotive industry report with similar findings.[3] Although key questions remain, these predictions shed light on the uncertainties surrounding the USMCA.

President Donald Trump signed the USMCA on Nov. 30, 2018, along with Mexican President Enrique Pena Nieto and Canadian Prime Minister Justin Trudeau. The three leaders signed the trade agreement at the G20 Summit in Buenos Aires, amid questions about how this new agreement would affect the U.S. economy as well as trade relationships with Canada and Mexico. Congress has not yet ratified the agreement, but the president and the USTR have expressed the goal of reaching a vote by late summer 2019.

The 379-page ITC report includes economic predictions for how the USMCA will affect eight key areas: agriculture, automobiles, intellectual property rights, e-commerce, labor, international data transfer, cross-border services, and investment. The ITC report estimates that the USMCA would raise U.S. real GDP by $68.2 billion (0.35%) and increase U.S. employment by 176,00 jobs (0.12%).

The ITC report estimates that U.S. exports to Canada and Mexico would increase by $19.1 billion (5.9%) and $14.2 billion (6.7%), while U.S. imports from Canada and Mexico would increase by $19.1 billion (4.8%) and $12.4 billion (3.8%). The ITC used an "economy-wide simulation via a computable general equilibrium model" to reach these estimates, predicting that the largest impact would come from 1) provisions that reduce policy uncertainty regarding cross-border data flows, and 2) changes to the automotive rules of origin.

However, certain provisions of the USMCA may lead to more acute impacts on companies in certain industry sectors who structure their operations in certain ways. By keeping a close eye on the provisions affecting their clients' industry sectors, companies can prepare for key changes that will affect them if the USMCA is ratified.

The analysis below includes key takeaways from the ITC report, focusing on industry sectors where the report predicts significant economic impact if the USMCA is ratified. Regulatory uncertainty often impedes future growth. Understanding how the USMCA will affect companies and their industries can help companies plan for the future and make important decisions about trade and investment.

Digital Trade

The USMCA is the first agreement of its kind to contain a chapter on digital trade. Chapter 19 includes crosscutting provisions designed to reduce uncertainty by allowing a free flow of information across the borders of Canada, Mexico, and the U.S.[4]

The most important provisions are Article 19.11, which prohibits discriminatory treatment of cross-border data transfers, and Article 19.12, which prohibits forced localization of computing facilities as a condition of doing business. Article 19.16 protects U.S. businesses from forced transfer of their proprietary source code and algorithms. Other notable provisions include Article 19.3, which bans import duties on digital products, and Article 19.4, which prohibits a member country from discriminating against digital products made in another member country.

Provisions that address cybersecurity and consumer fraud include Articles 19.7, 19.8 and 19.15, reflecting the countries' agreement to use risk-based approaches to address cybersecurity threats. Other chapters containing relevant provisions that would affect digital trade include Chapter 17 (Financial Services)[5] and Chapter 18 (Telecommunications),[6] which would allow U.S. telecom providers to access Mexican and Canadian networks.

For clients conducting business both in Europe and North America, these provisions deserve special attention because of their contrast with the EU General Data Protection Regulation, implemented in May 2018. While the GDPR requires limits on cross-border data transfers, the USMCA would prohibit limits between member countries. Thus, companies may need multiple sets of data transfer policies, depending on whether they are engaging with European countries or North American countries.

Digital privacy and cybersecurity remain ever-growing areas of concern that the USMCA seeks to address, but individual companies should still develop internal data protection policies to ensure that their own data and the data of their affiliates are not compromised.

E-Commerce

Chapter 7 (Customs Administration and Trade Facilitation) would affect tangible goods that consumers order online.[7] Article 7.8(f) would increase the de minimis thresholds that currently govern cross-border shipments of goods under certain price ranges, exempting express shipments that meet this threshold from customs duties, taxes, and formal entry procedures at customs checkpoints. For the U.S., the USMCA would raise this fixed amount to US$800, for Mexico it would be US$117 for customs duties and US$50 for taxes, and for Canada it would be C$150 for customs duties and C$40 for taxes.

As long as consumers are ordering goods from each country that cost less than these amounts, the goods are duty-free or tax-free when they cross borders between the member countries. The ITC report predicts that this change would especially benefit e-commerce, "increas[ing] the value of U.S. e-commerce exports by $332 million to Canada and by $91 million to Mexico."

Intellectual Property Rights

Chapter 20 of the USCMA outlines a baseline framework for the protection of intellectual property rights within North America.[8] The ITC report predicts that enforcement of the USMCA's intellectual property provisions would strengthen protections for "trade secrets, regulatory data protection, patents, trademarks, copyrights, and civil, criminal, and administrative enforcement."

- Biologics and pharmacy: Article 20.49 requires protection of biological data for at least 10 years, which marks an increase from the previous time frames under NAFTA (8 years in Canada and 5 years in Mexico). Article 20.48

requires 5 years of protection for new pharmaceuticals, and Article 20.45 requires 10 years of protection for agricultural chemicals.

- Trademarks: Articles 20.17-20.26 expand the scope of protectable trademarks, and introduces transparency provisions for geographical indications.
- Copyrights: Articles 20.57-20.69 expand copyright terms to the author's life plus 70 years, which is an increase from the 50 years that NAFTA required.
- Enforcement: Articles 20.79–20.89 expand enforcement obligations, including criminal remedies for cable and satellite signal theft and detention of infringing goods in-transit.

Of the many industries where intellectual property rights play a key role, scientific instruments and medical devices were the only two industry sectors where the ITC report predicted a significantly positive relationship between trade flow and the USMCA's strengthened intellectual property rights, because the USMCA would likely lower trade costs for those industries.

According to the ITC report, the USMCA's additional layer of intellectual property rights protection is not likely to shift other industries' trade patterns in a notable way. According to the ITC, this is because in other industries such as biopharmaceuticals, competition between originators and generics often reduces the impact of policy changes such as those in the USMCA. Also, in heavily regulated industries where the U.S., Canada and Mexico already have established trading patterns, the USMCA is unlikely to change these patterns.

Investor-State Dispute Settlement

Under NAFTA, investor-state arbitration is currently available to any parties that have invested in the territories of the U.S., Mexico or Canada. Chapter 14 of the USMCA would reduce the availability of investor-state arbitration so that in three years:

- Between the U.S. and Canada, this mechanism would no longer be available at all. Disputes would be handled by local courts instead.
- Between the U.S. and Mexico, Annex 14-E provides that only government contractors in five covered sectors may freely file direct investor arbitration claims going forward: 1) oil and natural gas, 2) power generation, 3) telecommunications, 4) transportation services, and 5) some infrastructure.[9]

Note that in Mexico, U.S. investors outside of these covered areas, including noncontractors, can still use international arbitration courts, but Annex 14-D requires that they must "first exhaust Mexican domestic remedies to resolve their disputes, or spend at least 30 months attempting to do so." Also, U.S. investors outside the five covered areas listed above may only raise arbitration claims about 1) direct expropriation, 2) national treatment, and 3) most-favored nation treatment when using ISDS.

Thus, the investor arbitration mechanism in Mexico will still be available to noncontractors, but the USCMA's specific rules limit its availability. The ITC predicts that these changes will reduce U.S. investment in Mexico outside of the five protected industry sectors.

Automotive Industry

Chapter 4 of the USMCA includes significant changes to the automotive rules of origin that NAFTA put in place, requiring more parts and vehicles to be produced within North America than before.[10] Rules of origin are a tool that NAFTA used to encourage certain percentages of cars, trucks, and their parts to be made in North American facilities. The USMCA tightens these rules in several notable ways:

- Origination: Appendix 4-B, Article 3.3 requires that for vehicles to be considered "originating" in North America, vehicles must meet regional value content requirements by having certain percentages of their parts produced in North America, in contrast to NAFTA which allowed certain content to be "deemed" originating even if produced outside North America.
- Regional value content for vehicles: Appendix 4-B, Articles 3.1-3.2 increase the regional value content requirement from 62.5% to 75% for passenger vehicles and light trucks, so that 75% of each automaker's fleet must be produced

in North America.

- Regional value content for parts: Appendix 4-B, Articles 3.2 and 3.4-3.5 increase the regional value content requirements for auto parts, ranging from 65-75% depending on whether parts are considered “complementary,” “principal,” or “core.”
- Labor value content: Appendix 4-B, Article 7 adds an unprecedented labor value content requirement such that 40% of passenger car value and 45% of light truck value must be made in North American facilities where workers make at least $16 per hour.

In its analysis of the estimated economic impact of the USMCA on the automotive sector, the USTR predicts that over a five-year period, the new agreement will result in $34 billion in new automotive manufacturing investments in the U.S., as part of a larger shift from manufacturing in countries outside North America toward more manufacturing in the U.S., Mexico, and Canada. This estimate includes $15.3 billion in investments that automakers have already publicly announced.

The USTR has worked closely with major automakers to develop these estimates. Six automakers have already increased their investments in the U.S. as a result of the USMCA by announcing new plants or expansions to existing plants: Fiat Chrysler Automotive, Ford, General Motors, Volkswagen, Toyota, and SK Innovation.

The USTR also predicts $23 billion in new annual purchases of U.S.-made automotive parts; and the creation of 76,000 jobs in the U.S. automotive sector. According to U.S. Trade Representative Robert Lighthizer, “[o]ne of President Trump’s major priorities in renegotiating and replacing NAFTA was to discourage the outsourcing of American automotive jobs and instead to encourage more investment and manufacturing jobs here in the United States.”

However, automakers may face significant fines and punishments if they do not comply with the USMCA’s new rules within a five-year transition period. The USTR is developing an enforcement mechanism that would “retroactively impose duties on the cars that otherwise would have paid the duties but for the transition,” if automakers fail to “qualify their entire North American fleet under the new auto rules of origin.”

While an International Monetary Fund working paper has predicted that some automakers will opt to pay these fines rather than comply with the new rules of origin, the ITC report indicates that the USTR has consulted with several major automakers who are planning to comply with the new rules and avoid fines.

Costs to consumers would also increase; the ITC report estimates that prices for small cars would increase by 1.61% and prices for trucks would increase by 0.37%, resulting in an overall consumption decline of 140,000 vehicles. Some vehicles may be too expensive to produce domestically, causing a decline in consumer choice.

Other Sectors

Regarding other industry sectors, the ITC report predicts that the USMCA will not have a significant economic impact on the energy products industry, the chemical and pharmaceutical industries, and the electronic products industry. If companies have concerns or questions about how specific USMCA rules would affect their industries if enacted, they should seek the guidance of counsel.

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[1] https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/may/united-states-announces-deal-canada-and.

[2] https://www.usitc.gov/publications/332/pub4889.pdf?source=govdelivery&utm_medium=email&utm_source=govdelivery.

[3] https://ustr.gov/sites/default/files/files/Press/Releases/USTR%20USMCA%20Autos%20White%20Paper.pdf.

[4] https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/19_Digital_Trade.pdf.

[5] https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/17_Financial_Services.pdf.

[6] https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/18_Telecommunications.pdf.

[7] https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/07_Customs_Administration_and_Trade_Facilitation.

[8] https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/20_Intellectual_Property_Rights.pdf.

[9] https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/14_Investment.pdf.

[10] https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/04_Rules_of_Origin.pdf.

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