

NAFTA Renegotiation and the Proposed United States-Mexico-Canada Agreement (USMCA)

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Summary

The 116th Congress faces policy issues related to the Trump Administration's renegotiation of the North American Free Trade Agreement (NAFTA) and the proposed United States-Mexico-Canada Agreement (USMCA). On May 18, 2017, the Trump Administration sent a 90-day notification to Congress of its intent to begin talks with Canada and Mexico to renegotiate and modernize NAFTA, as required by the 2015 Trade Promotion Authority (TPA). Talks officially began on August 16, 2017. Negotiations were concluded on September 30, 2018. The proposed USMCA was signed on November 30, 2018. The agreement must be approved by Congress and ratified by the governments of Mexico and Canada before it can enter into force.

The first NAFTA negotiations were launched in 1992 under President George H.W. Bush and continued under President William J. Clinton, who signed the implementing legislation on December 8, 1991 (P.L. 103-182). NAFTA entered into force on January 1, 1994. It is particularly significant because it was the most comprehensive free trade agreement (FTA) negotiated at the time, contained several groundbreaking provisions, and was the first of a new generation of U.S. FTAs later negotiated. Congress played a major role during its consideration and, after contentious and comprehensive debate, ultimately approved legislation to implement the agreement.

NAFTA established trade liberalization commitments and set new rules and disciplines for future FTAs on issues important to the United States, including intellectual property rights protection, services trade, dispute settlement procedures, investment, labor, and environment. NAFTA's market-opening provisions gradually eliminated nearly all tariff and most nontariff barriers on merchandise trade. At the time of NAFTA negotiations, average applied U.S. duties on imports from Mexico were 2.07%, while U.S. businesses faced average tariffs of 10%, in addition to nontariff and investment barriers, in Mexico. The U.S.-Canada FTA had been in effect since 1989.

The proposed USMCA, comprising 34 chapters and 12 side letters, retains most of NAFTA's market opening measures and most of its chapters, while making notable changes to auto rules of origin, dispute settlement provisions, government procurement, investment, and intellectual property rights (IPR) protection. It also modernizes provisions in services, labor, and the environment. New trade issues, such as digital trade, state-owned enterprises, anticorruption, and currency misalignment, are also addressed. Key issues for Congress in regard to the proposed USMCA include the constitutional authority of Congress over international trade, its role in revising, approving, or withdrawing from the agreement, U.S. negotiating objectives and the extent to which the proposed agreement makes progress in meeting them as required under TPA. Congress may also consider the agreement's impact on U.S. industries, the U.S. economy, and broader U.S. trade relations with Canada and Mexico.

The timing for congressional consideration of the proposed USMCA is unclear in part because of the TPA timeline and also because of issues of interest and concern voiced by Congress, including the level of enforceable labor provisions, auto rules of origin, and investor-state dispute settlement. Some policymakers have stated that the path forward to passage of the USMCA by Congress is uncertain partially because the three countries have yet to resolve disputes over U.S. steel and aluminum tariffs imposed by the Trump Administration. The United States, Canada, and Mexico are currently in a trade dispute over U.S. actions under Section 232 of the Trade Act of 1962 to impose tariffs on such imports due to national security concerns. In response to the U.S. action, Mexico and Canada initiated World Trade Organization dispute settlement proceedings and retaliated against certain U.S. exports. The conclusion of the proposed USMCA did not resolve the Section 232 tariff dispute. The U.S. business community, industry groups, and some

congressional leaders have publicly stated that the tariff issue must be resolved before the USMCA could enter into force.

Contents

Introduction 1
NAFTA Overview 3
Key NAFTA Provisions 5
Trade Trends 7
Trade in Oil and Gas 8
Trade in Value Added 9
Merchandise Trade in Selected Industries 10
U.S. Investment with Canada and Mexico 11
NAFTA Renegotiation Process and TPA 12
Trade Deficit Reduction 13
Proposed USMCA 14
Rules of Origin 14
Motor Vehicle Industry 15
Agriculture 17
Customs and Trade Facilitation 19
Energy 20
Government Procurement 21
Investment 22
Minimum Standard of Treatment (MST) 23
Performance Requirements 23
Denial of Benefits 23
Government Right to Regulate 24
Investor-State Dispute Settlement (ISDS) 24
Services 26
Express Delivery 26
Temporary Entry for Business Purposes 27
Financial Services 27
Telecommunications 28
Digital Trade 29
Intellectual Property Rights (IPR) 29
Patents 30
Copyrights 31
Trademarks 31
Trade Secrets 32
Geographical Indications (GIs) 32
IPR Enforcement 32
Cultural Exemption 33
State-Owned Enterprises (SOEs) 33
Labor 34
Environment 35
Dispute Settlement 36
Binational Review Panels for Trade Remedies 37
Currency Manipulation 38
Regulatory Practices 39
Trucking 39
Anticorruption 40

"Sunset" Provision in Review and Term Extension 40
Issues for Congress 40
Roles of Congress and the President in NAFTA Renegotiations 41
Economic and Other Considerations 42
Mexico's New President 43
Canada and Mexico's Participation in the CPTPP and other FTAs 44
Canada's FTAs 44
Mexico's FTAs 45
Potential Impact of U.S. Withdrawal from NAFTA 45
Tariffs 47
Outlook 48

Figures

Figure 1. U.S. Merchandise Trade with NAFTA Partners: 1993-2017 8
Figure 2. U.S. Services and Merchandise Trade Balance with NAFTA Partners 8
Figure 3. U.S. Merchandise and Oil and Gas Trade with NAFTA Partners 9
Figure 4. U.S. Total Trade and Value Added Balances with NAFTA Countries: 1995-2011 10
Figure 5. U.S. Trade with NAFTA Partners in Selected Industries 11
Figure 6. Foreign Direct Investment Positions Among NAFTA Partners 12
Figure 7. U.S. Imports from NAFTA Partners: 2017 43

Tables

Table 1. Selected Economic Indicators for Mexico, Canada, and the United States 4
Table 2. MFN Tariffs for NAFTA Countries 47

Contacts

Author Information 49

Introduction

The 116th Congress, in both its legislative and oversight capacities, faces numerous trade policy issues related to the North American Free Trade Agreement (NAFTA) renegotiations and the proposed United States-Mexico-Canada Agreement (USMCA).[1] On May 18, 2017, the Trump Administration sent a 90-day notification to Congress of its intent to begin talks with Canada and Mexico to renegotiate and modernize NAFTA, as required by the 2015 Trade Promotion Authority (TPA).[2] Talks officially began on August 16, 2017. On September 30, 2018, leaders from the United States, Canada, and Mexico announced the conclusion of the negotiations for a modernized NAFTA, which would now be called the USMCA. On November 30, 2018, the proposed USMCA was signed by President Donald J. Trump, then President Enrique Peña Nieto of Mexico, and Canadian Prime Minister Justin Trudeau. President Trump stated his intention to withdraw from or renegotiate NAFTA during his election campaign and has hinted at the possibility of NAFTA withdrawal since he entered into office.

Key issues for Congress in regard to the consideration of the proposed USMCA include the constitutional authority of Congress over international trade, its role in revising, approving, or withdrawing from the agreement, U.S. negotiating objectives and the extent to which the proposed agreement makes progress in meeting them as required under TPA. Congress may also consider the agreement's impact on U.S. industries, the U.S. economy, and broader U.S. trade relations with Canada and Mexico, two of the United States' largest trading partners.

The proposed USMCA, if approved by Congress, would revise some key provisions such as auto rules of origin, which, some argue roll back longstanding U.S. FTA provisions. On the other hand, it establish new updated provisions in areas such as digital trade and intellectual property rights. A key question for Congress may be whether the agreement strikes the right balance overall.

Joint Statement on Proposed USMCA

"Today, Canada and the United States reached an agreement, alongside Mexico, on a new, modernized trade agreement for the 21st Century: the United States-Mexico-Canada Agreement (USMCA). USMCA will give our workers, farmers, ranchers and businesses a high-standard trade agreement that will result in freer markets, fairer trade and robust economic growth in our region. It will strengthen the middle class, and create good, well-paying jobs and new opportunities for the nearly half billion people who call North America home.

"We look forward to further deepening our close economic ties when this new agreement enters into force.

"We would like to thank Mexican Economy Secretary Ildefonso Guajardo for his close collaboration over the past 13 months."

Joint Statement from United States Trade Representative Robert Lighthizer and Canadian Foreign Affairs Minister Chrystia Freeland, September 30, 2018.

Source: USTR, at https://ustr.gov/about-us/policy-offices/press-office/press-releases.

After numerous rounds of negotiations, on August 31, 2018, after the United States and Mexico announced a preliminary U.S.-Mexico agreement, President Trump notified Congress of his intention to "enter into a trade agreement with Mexico – and with Canada if it is willing."[3] On September 30, 2018, U.S. Trade Representative (USTR) Robert Lighthizer announced that the

[1] For more information, see CRS In Focus IF10047, *North American Free Trade Agreement (NAFTA)*, by M. Angeles Villarreal, and CRS In Focus IF10997, *Proposed U.S.-Mexico-Canada (USMCA) Trade Agreement*, by Ian F. Fergusson and M. Angeles Villarreal.

[2] See CRS In Focus IF10038, *Trade Promotion Authority (TPA)*, by Ian F. Fergusson.

[3] The White House, *President Donald J. Trump is Keeping His Promise to Renegotiate NAFTA*, Fact Sheet, Washington, DC, August 27, 2018.

three countries had reached an agreement on a USMCA trade deal that would revise, modernize, and replace NAFTA upon ratification.[4]

Canada, in its negotiating objectives, pledged to make NAFTA more "progressive" by strengthening labor and environmental provisions, adding a new chapter on indigenous rights, reforming the investor-state dispute settlement process, and protecting Canada's supply-management system for dairy and poultry, among other objectives.[5] Mexico's set of negotiating objectives prioritized free trade of goods and services, and included provisions to update NAFTA, such as working toward "inclusive and responsible" trade by incorporating cooperation mechanisms in areas related to labor standards, anticorruption, and the environment, as well as strengthening energy security by enhancing NAFTA's chapter on energy.[6]

While the USTR's NAFTA negotiating objectives included many goals consistent with TPA, USTR also sought, for the first time in U.S. trade negotiations, to reduce the U.S. trade deficit with NAFTA countries, among other specific objectives. U.S. objectives appeared to seek to "rebalance the benefits" of the agreement, echoing President Trump's statements that NAFTA has been a "disaster" and the "worst agreement ever negotiated."[7] Some U.S. negotiating positions could be seen to have the explicit or implicit goal of promoting U.S. economic sovereignty and/or rolling back previous liberalization commitments in specific areas, such as reviewing and potentially sunsetting the agreement every five years, questioning the validity of binational dispute settlement, enhancing government procurement restrictions, and increasing U.S. and North American content in the auto rules of origin.[8] Trump Administration officials also spoke of unraveling the North American and global supply chains as a way of attempting to divert trade and investment from Canada and Mexico to the United States.[9] Mexican and Canadian negotiators viewed such proposals as counterproductive to the spirit and mutual economic benefits of NAFTA and repeated their positions to modernize NAFTA with provisions such as those in the proposed Trans-Pacific Partnership (TPP). The differences between views on modernizing the agreement and U.S. proposals led to perceived tensions in the negotiations.

The proposed USMCA presents an opportunity to incorporate elements of more recent FTAs that have entered into force or were negotiated, such as the U.S.-Korea FTA (KORUS) and the proposed TPP. The U.S. and global economies have changed significantly since NAFTA entered into force 25 years ago, especially due to technology advances. The widespread use of the commercial internet, for example, has dramatically affected consumer habits, commercial activities such as e-commerce and supply chain management. Negotiators also sought updated provisions in other areas such as intellectual property rights (IPR), labor, and the environment. The increased role of state-led or supported firms in trade competition with private sector firms is also a new issue of debate and focus of new rules-setting.

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[4] The White House, *President Donald J. Trump Secures A Modern, Rebalanced Trade Agreement with Canada and Mexico*, Fact Sheet, Washington, DC, October 31, 2018.

[5] Alexander Panetta, "Canada's 10 NAFTA Demands: A List of What Canada Wants as Talks Start this Week," *The Canadian Press*, August 14, 2017.

[6] Mexico's Economic Secretariat (Secretaria de Economia), *Mexico's Negotiating Priorities for the Modernization of NAFTA* , Mexico City, Mexico, July 2017.

[7] CBS News, Trump Calls NAFTA a Disaster, September 25, 2016, https://www.cbsnews.com/news/trump-calls-nafta-a-disaster/; *Politico*, "The Real Game Trump is Playing on NAFTA," February 26, 2018, https://www.politico.com/magazine/story/2018/02/26/donald-trump-nafta-negotiations-217085.

[8] Simon Lester and Inu Manak, "The Rise of Populist Nationalism and the Renegotiation of NAFTA, *Journal of International Economic Law*, 2018, March 2018.

[9] James Pethokoukis, "Does Trump want to somehow get rid of global supply chains?, *AEI Ideas*, January 31, 2017, http://www.aei.org/publication/does-trump-want-to-somehow-get-rid-of-global-supply-chains/.

Many economists and business representatives generally look to maintain and strengthen the trade and investment relationship with Canada and Mexico under NAFTA or the proposed USMCA, and to further improve overall relations and economic integration within the region. However, labor groups and some consumer-advocacy groups argue that NAFTA resulted in outsourcing and lower wages that have had a negative effect on the U.S. economy. Some proponents and critics of NAFTA agree that NAFTA should be modernized, but have contrasting views on how to revise the agreement.

This report provides a brief overview of NAFTA and the role of Congress in the renegotiation process, and discusses key provisions in the proposed USMCA, as well as issues related to the negotiations. It also provides a discussion of policy implications for Congress going forward. It will not examine existing NAFTA provisions and economic relations in depth. For more information on these issues, please see CRS Report R42965, *The North American Free Trade Agreement (NAFTA)*, by M. Angeles Villarreal and Ian F. Fergusson.

NAFTA Overview

NAFTA negotiations were first launched under President George H. W. Bush. President William J. Clinton signed into law the NAFTA Implementation Act on December 8, 1993 (P.L. 103-182). NAFTA entered into force on January 1, 1994. It is significant because it was the first FTA among two wealthy countries and a lower-income country and because it established trade liberalization commitments that led the way in setting new rules for future trade agreements on issues important to the United States. These include provisions on intellectual property rights (IPR) protection, services trade, agriculture, dispute settlement procedures, investment, labor, and the environment. NAFTA addressed policy issues that were new to FTAs and was influential in concluding major multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO). The United States now has 14 FTAs with 20 countries.

NAFTA's market-opening provisions gradually eliminated nearly all tariff and most nontariff barriers on goods and services produced and traded within North America. At the start of NAFTA, average applied U.S. duties on imports from Mexico were 2.07% and over 50% of U.S. imports from Mexico entered duty free.[10] In contrast, the United States faced higher tariff, nontariff, and investment barriers in Mexico.[11] Trade among NAFTA partners has more than tripled since the agreement entered into force, forming integrated production chains among all three countries. Many trade policy experts and economists give credit to NAFTA for expanding trade and economic linkages among the parties, creating more efficient production processes, increasing the availability of lower-priced and greater choice of consumer goods, and improving living standards and working conditions.[12] Others blame NAFTA and subsequent U.S. FTAs for

[10] Executive Office of the President, *Study on the Operation and Effects of the North American Free Trade Agreement*, July 1997, pp. 6-7.

[11] Most of the market-opening measures resulting from NAFTA were between the United States and Mexico, and Canada and Mexico, because the United States and Canada had a free trade agreement at the time that had been in effect since 1989.

[12] For example, see Gary Clyde Hufbauer, Cathleen Cimino, and Tyler Moran, *NAFTA at 20: Misleading Charges and Positive Achievements*, Peterson Institute for International Economics, Number PB14-13, May 2014; and U.S. Chamber of Commerce, *NAFTA Triumphant: Assessing Two Decades of Gains in Trade, Growth, and Jobs*, October 2015.

disappointing employment trends, a decline in average U.S. wages, and for not having done enough to improve labor standards and environmental conditions abroad.[13]

Another important element of NAFTA is that it helped "lock in" trade and investment liberalization efforts taking place at the time, especially in Mexico. NAFTA was instrumental in developing closer U.S. relations with both Mexico and Canada and it may have accelerated ongoing trade and investment trends. At the time that NAFTA was implemented, the U.S.-Canada Free Trade Agreement (CUSFTA) was already in effect and U.S. tariffs on most Mexican goods were low, while Mexico had the highest level of trade barriers among the three countries. From the 1930s through part of the 1980s, Mexico maintained a strong protectionist trade policy in an effort to be independent of any foreign power and as a means to promote domestic-led industrialization.[14] In 1991, for example, U.S. businesses were very restricted in investing in Mexico. Under Mexico's restrictive *Law to Promote Mexican Investment and Regulate Foreign Investment,* about a third of Mexican economic activity was not open to majority foreign ownership.[15] Mexico's failed protectionist policies did not result in increased income levels or economic growth, and the income disparity with the United States remains large, even after NAFTA.

Table 1. Selected Economic Indicators for Mexico, Canada, and the United States

(1994 and 2017)

	Mexico		Canada		United States	
	1994	**2017**	**1994**	**2017**	**1994**	**2017**
Population (millions)	92	129	29	37	263	327
Nominal GDP (US$ billions)[a]	508	1,148	548	1,627	7,309	19,371
Nominal GDP, PPP Basis (US$ billions)[b]	790	2,372	654	1,671	7,309	19,371
Per Capita GDP (US$)	5,499	8,890	19,914	44,415	27,777	59,332
Per Capita GDP in $PPP	8,555	18,370	22,531	45,630	27,777	59,330
Exports of goods and services (% of GDP)	14%	37%	33%	31%	10%	12%
Imports of goods and services (% of GDP)	18%	39%	32%	34%	11%	15%

Source: Compiled by CRS based on data from Economist Intelligence unit (EIU) online database.

Notes: Some figures for 2017 are estimates.

a. Nominal GDP is calculated by EIU based on figures from World Bank and World Development Indicators.

b. PPP refers to purchasing power parity, which reflects the purchasing power of foreign currencies in U.S. dollars.

NAFTA coincided with Mexico's unilateral trade liberalization efforts. After NAFTA, the United States and Canada gained greater access to the Mexican market, which was the fastest-growing

[13] For example, see AFL-CIO, *NAFTA at 20*, March 2014; and Robert E. Scott, Carlos Salas, Bruce Campbell et al., *Revisiting NAFTA: Still Not Working for North America's Workers*, Economic Policy Institute, Briefing Paper #173, September 28, 2006.

[14] For more information on Mexico's trade policies, see CRS Report R40784, *Mexico's Free Trade Agreements*, by M. Angeles Villarreal.

[15] CRS Report R42965, *The North American Free Trade Agreement (NAFTA)*, by M. Angeles Villarreal and Ian F. Fergusson.

major export market for U.S. goods and services at the time.[16] NAFTA also opened up the U.S. market to increased imports from Mexico and Canada, creating one of the largest free trade areas in the world. Since NAFTA, the three countries have made efforts to cooperate on issues of mutual interest, including trade and investment, and also in other, broader aspects of the relationship, such as regulatory cooperation, industrial competitiveness, trade facilitation, border environmental cooperation, and security.

Key NAFTA Provisions

Some key NAFTA provisions include tariff and nontariff trade liberalization, rules of origin, commitments on services trade and foreign investment, IPR protection, government procurement rules, and dispute resolution. Labor and environmental provisions are included in separate NAFTA side agreements. NAFTA provisions and rules governing trade were groundbreaking in a number of areas, particularly in regard to enforceable rules and disciplines that were included in a trade agreement for the first time. There were almost no FTAs in place worldwide at the time, and NAFTA influenced subsequent agreements negotiated by the United States and other countries, especially at the multilateral level in light of the then-pending Uruguay Round of major multilateral trade liberalization negotiations.

The market-opening provisions of the agreement gradually eliminated nearly all tariffs and most nontariff barriers on goods produced and traded within North America, mostly over a period of 10 years after it entered into force. Some tariffs were eliminated immediately, while others were phased out in various schedules of 5 to 15 years. Most of the market-opening measures from NAFTA resulted in the removal of tariffs and quotas applied by Mexico on imports from the United States and Canada. The average applied U.S. duty[17] for all imports from Mexico was 2.07% in 1993.[18] Moreover, many Mexican products entered the United States duty-free under the U.S. Generalized System of Preferences (GSP). In 1993, over 50% of U.S. imports from Mexico entered the United States duty-free. In contrast, the United States faced considerably higher tariffs and substantial nontariff barriers on exports to Mexico. In 1993, Mexico's average applied tariff on all imports from the United States was 10% (Canada's average tariff on U.S. goods was 0.37%).[19] Non-tariff barriers also affected U.S.-Mexico trade, such as sanitary and phytosanitary (SPS) rules, Mexican import licensing requirements, and U.S. marketing orders.[20] The market opening that occurred after NAFTA is likely a factor in the significance of trade for Mexico's economy. In 1994, Mexico's exports and imports equaled 14% and 18%, respectively, of GDP, while in 2017, these percentages increased to 37% and 39%. For the United States, trade is less

[16] United States International Trade Commission (USITC), *Potential Impact on the U.S. Economy and Selected Industries of the North American Free-Trade Agreement*, USITC Publication 2596, January 1993.

[17] An average or simple average tariff is an average of a country's tariff rates. This can be calculated in several ways. Most common is the trade-weighted average tariff, which is the average of a country's tariffs, weighted by value of imports. This is calculated as the ratio of total tariff revenue to total value of imports.

[18] Executive Office of the President, *Study on the Operation and Effects of the North American Free Trade Agreement*, July 1997, pp. 6-7.

[19] Ibid. Canadian tariffs on U.S. goods at the time of NAFTA were low due to the U.S.-Canada Free Trade Agreement that had been in effect since January 1, 1989.

[20] Marketing orders and agreements are U.S. Department of Agriculture-sponsored agreements among domestic producers to help provide stable markets for dairy products, fruits, vegetables and specialty crops (see https://www.ams.usda.gov/rules-regulations/moa). Prior to NAFTA, the most significant Mexican exports that were limited by U.S. marketing orders included tomatoes, onions, avocados, grapefruit, oranges, olives, and table grapes.

significant for the economy, with the value of imports and exports equaling 15% and 12%, respectively, of GDP in 2017 (see **Table 1**).

NAFTA rules, disciplines and nontariff provisions include the following:

- **Agriculture.** NAFTA eliminated tariffs and tariff-rate quotas (TRQs) on most agricultural products. It maintains TRQs with high over-quota tariffs for U.S. exports of dairy, poultry, and egg products to Canada. NAFTA addressed sanitary and phytosanitary (SPS) measures and other types of agricultural non-tariff barriers. SPS regulations are often regarded by agricultural exporters as one of the greatest challenges in trade, often resulting in increased costs and product loss and disrupting integrated supply chains.[21]
- **Investment**. NAFTA removed significant investment barriers in Mexico, ensured basic protections for NAFTA investors, and provided a mechanism for the settlement of disputes between investors and a NAFTA country. NAFTA provided for national and "nondiscriminatory treatment" for foreign investment by NAFTA parties in certain sectors of other NAFTA countries. The agreement included country-specific liberalization commitments and exceptions to national treatment. Exemptions from NAFTA included the energy sector in Mexico, in which the Mexican government reserved the right to prohibit private investment or foreign participation.
- **Services Trade**. NAFTA services provisions established a set of basic rules and obligations in services trade among partner countries. The agreement granted services providers certain rights concerning nondiscriminatory treatment, cross-border sales and entry, investment, and access to information. However, there were certain exclusions and reservations by each country. These included maritime shipping (United States), film and publishing (Canada), and oil and gas drilling (Mexico).[22] NAFTA liberalized certain service sectors in Mexico, particularly financial services, which significantly opened its banking sector.[23]
- **Financial and Telecommunications Services**. Under NAFTA, Canada extended an exemption granted to the United States, under the CUSFTA, to Mexico in which Mexican banks would not be subject to Canadian investment restrictions. In turn, Mexico agreed to permit financial firms from another NAFTA country to establish financial institutions in Mexico, subject to certain market-share limits applied during a transition period ending by the year 2000. In telecommunications, NAFTA partners agreed to exclude provision of, but not the use of, basic telecommunications services. NAFTA granted a "bill of rights" for the providers and users of telecommunications services, including access to public telecommunications services; connection to private lines that reflect economic costs and available on a flat-rate pricing basis; and the right to choose, purchase, or lease terminal equipment best suited to their needs.[24] NAFTA did not require parties to authorize a person of another NAFTA country to provide or

[21] See CRS Report R44875, *The North American Free Trade Agreement (NAFTA) and U.S. Agriculture*, by Renée Johnson.

[22] United States General Accounting Office (GAO, now called Government Accountability Office), "North American Free Trade Agreement: Assessment of Major Issues, Volume 2," *Report to the Congress,* September 1993, pp. 35-36.

[23] Hufbauer and Schott, *NAFTA Revisited,* pp. 28.

[24] GAO, *Report to Congress,* September 1993, pp. 38-39.

operate telecommunications transport networks or services. Nor did it bar a party from maintaining a monopoly provider of public networks or services, such as Telmex, Mexico's dominant telecommunications company.[25]

- **Intellectual Property Rights (IPR) Protection**. NAFTA was the first U.S. FTA to include IPR protection provisions. It built upon the then-ongoing Uruguay Round negotiations that would create the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement in the WTO and on various existing international intellectual property treaties. The agreement set specific enforceable commitments by NAFTA parties regarding the protection of copyrights, patents, trademarks, and trade secrets, among other provisions.
- **Dispute Resolution**. NAFTA's provisions for preventing and settling disputes regarding enforcement of commitments under the agreement were built upon provisions in the CUSFTA. NAFTA created a system of arbitration for resolving disputes that included initial consultations, taking the issue to the NAFTA Trade Commission, or going through arbitral panel proceedings.[26] NAFTA included separate dispute settlement provisions for addressing disputes related to investment and over antidumping and countervailing duty determinations.
- **Government Procurement**. NAFTA opened up a significant portion of federal government procurement in each country on a nondiscriminatory basis to suppliers from other NAFTA countries for goods and services. It contains some limitations for procurement by state-owned enterprises.
- **Labor and Environment**. NAFTA marked the first time that labor and environmental provisions were associated with an FTA. For many, it represented an opportunity for establishing a new type of relationship among NAFTA partners.[27] Labor and environmental provisions were included in separate side agreements. They included language to promote cooperation on labor and environmental matters as well as provisions to address a party's failure to enforce its own labor and environmental laws. Perhaps most notable were the side agreements' dispute settlement processes that, as a last resort, may impose monetary assessments and sanctions to address a party's failure to enforce its laws.

Trade Trends

U.S. trade with NAFTA partners increased rapidly once the agreement took effect, increasing more rapidly than trade with most other countries. U.S. total merchandise imports from NAFTA partners increased from $151 billion in 1993 to $614 billion in 2017 (307%), while merchandise exports increased from $142 billion to $525 billion (270%) (see **Figure 1**). The United States had a trade deficit with Canada and Mexico of $89.6 billion in 2017, compared to a deficit of $9.1 billion in 1993. Services trade with NAFTA partners has also increased. The United States had a services trade surplus with Canada and Mexico of $31.4 billion in 2016 (see **Figure 2**).

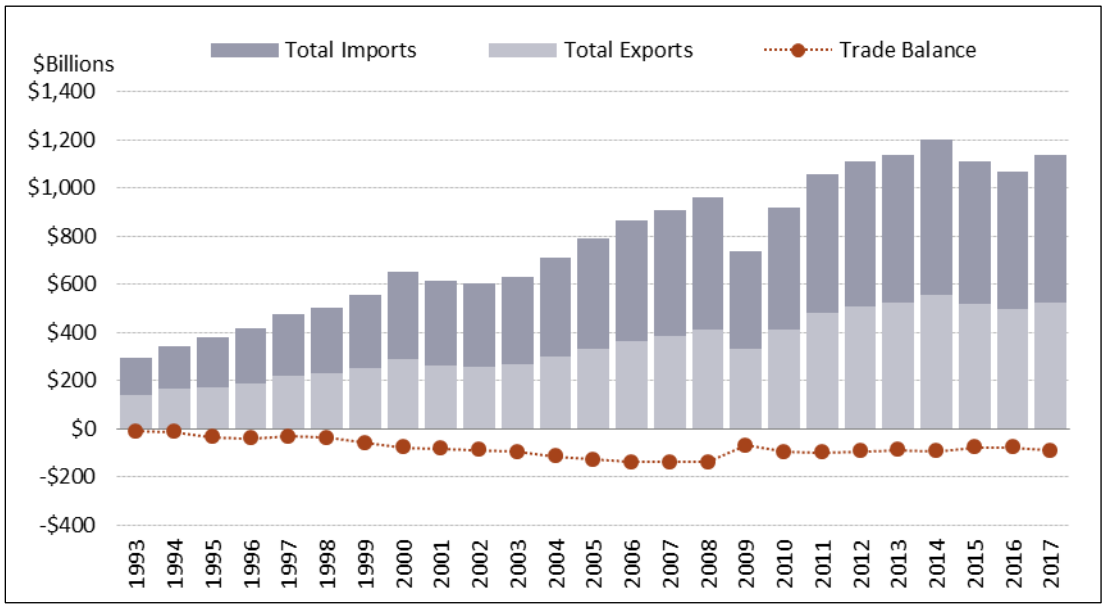
[25] Office of the united States Trade Representative (USTR), *Description of the Proposed North American Free Trade Agreement*, August 12, 1992, p. 29.

[26] If the parties are unable to resolve the issue through consultations, they may take the dispute to the NAFTA Trade Commission, which is composed of Ministers or cabinet-level officers designated by each country. A party may also request the establishment of an arbitral panel, which may make recommendations for the resolution of the dispute.

[27] Woodrow Wilson International Center for Scholars, *NAFTA at 10: Progress, Potential, and Precedents*, pp. 20-30.

Figure 1. U.S. Merchandise Trade with NAFTA Partners: 1993-2017

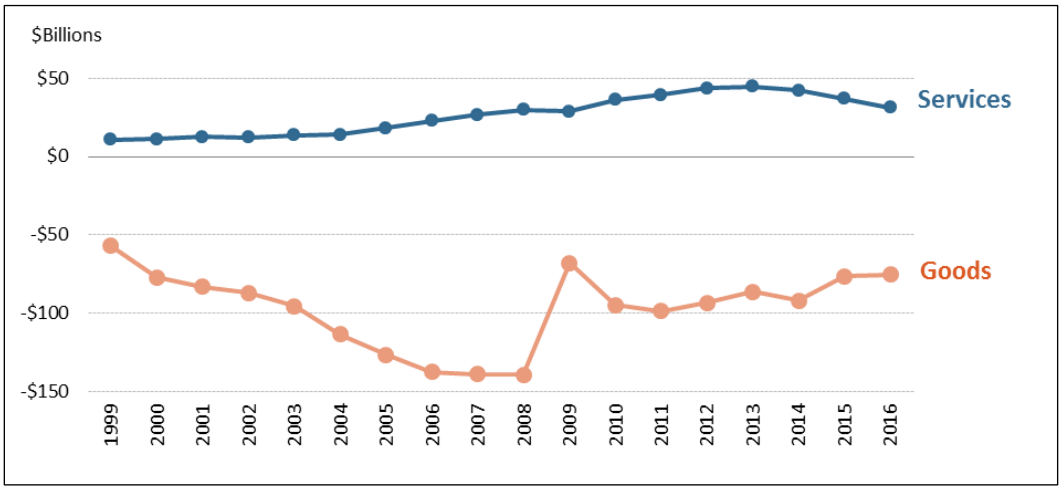
(billions of nominal dollars)



Source: Compiled by CRS using trade data from the U.S. International Trade Commission's Interactive Tariff and Trade Data Web, at http://dataweb.usitc.gov.

Figure 2. U.S. Services and Merchandise Trade Balance with NAFTA Partners

(billions of nominal dollars)



Source: Compiled by CRS using trade data from the U.S. Bureau of Economic Analysis at http://www.bea.gov and the U.S. International Trade Commission's (USITC's) Interactive Tariff and Trade Data Web, at http://dataweb.usitc.gov.

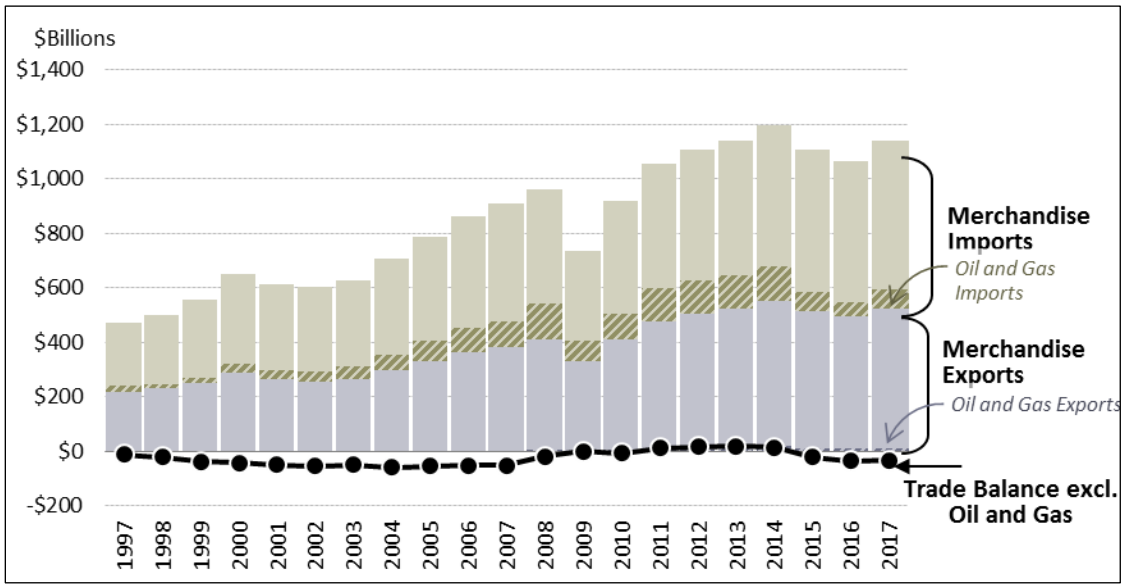
Trade in Oil and Gas

Trade in oil and gas is a significant component of trilateral trade, accounting for 7.2% of total U.S. merchandise trade with Canada and Mexico in 2017. As shown in **Figure 3**, U.S. oil and gas exports to Canada and Mexico increased from $0.9 billion in 1997 to $13.4 billion in 2017, while

imports increased from $22.3 billion to $69.0 billion. If oil and gas products are excluded from the trade balance, the deficit with NAFTA partners is lower than the overall trade deficit. In 2017, the total U.S. merchandise trade deficit with Canada and Mexico was $88.6 billion, while the merchandise deficit without oil and gas products was a significantly lower $33.0 billion.[28]

Figure 3. U.S. Merchandise and Oil and Gas Trade with NAFTA Partners

(1997-2017)



Source: Compiled by CRS using trade data from the U.S. International Trade Commission's Interactive Tariff and Trade Data Web, at http://dataweb.usitc.gov.

Notes: Oil and gas trade data are at the NAIC 3-digit level, code 211, which include activities related to exploration for crude petroleum and natural gas; drilling, completing, and equipping wells; operating separators, emulsion breakers, desilting equipment, and field gathering lines for crude petroleum and natural gas; and other activities.

Trade in Value Added

Conventional measures of international trade do not always reflect the flows of goods and services within global production chains. For example, some auto trade experts claim that auto parts and components may cross the borders of NAFTA countries as many as eight times before being installed in a final assembly plant in a NAFTA country.[29] Traditional trade statistics include the value of the parts every time they cross the border and count the value multiple times. The Organization for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO) developed a Trade in Value Added (TiVA) database, which presents indicators that provide insight into domestic and foreign value added content of gross exports by an exporting industry.[30] These statistics provide a more detailed picture of the location where

[28] For more information, see CRS Report R42965, *The North American Free Trade Agreement (NAFTA)*, by M. Angeles Villarreal and Ian F. Fergusson.

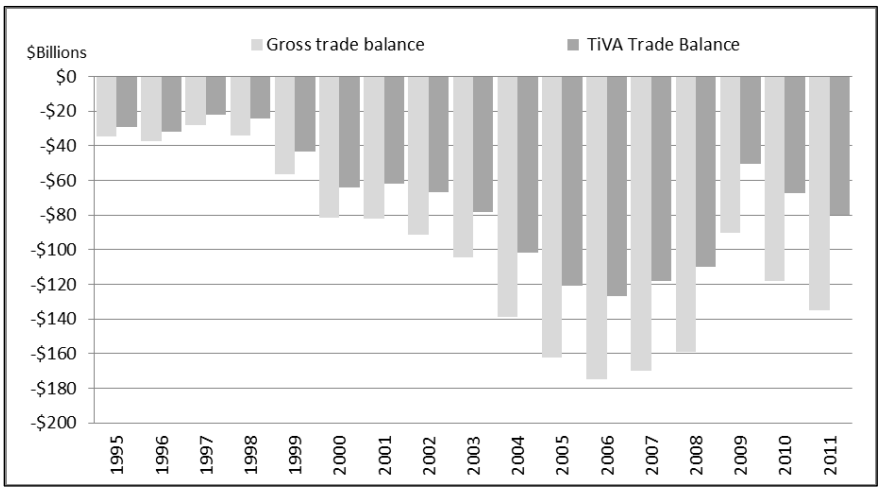
[29] Center for Automotive Research, *NAFTA Briefing: Trade Benefits to the Automotive Industry and Potential Consequences of Withdrawal from the Agreement*, January 2017.

[30] Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO), *Trade in Value Added*, available at http://www.oecd.org/sti/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm.

value is added during the various stages of production. U.S. trade with Canada and Mexico is diverse and complex since a final good sold in the market could have a combination of value added from all three countries, or from other trading partners. The most recent TiVA data available (2011) for trade in goods and services indicate that the conventional measurement puts the total U.S. trade deficit (including goods and services) with NAFTA countries at $135 billion, while the TiVA methodology puts the deficit at $79.8 billion (see **Figure 4**).

Figure 4. U.S. Total Trade and Value Added Balances with NAFTA Countries: 1995-2011

(billions of nominal dollars)



Source: Compiled by CRS using data from the Organization for Economic Co-operation and Development (OECD)/World Trade Organization (WTO) Trade in Value Added (TiVA) 2016 indicators.

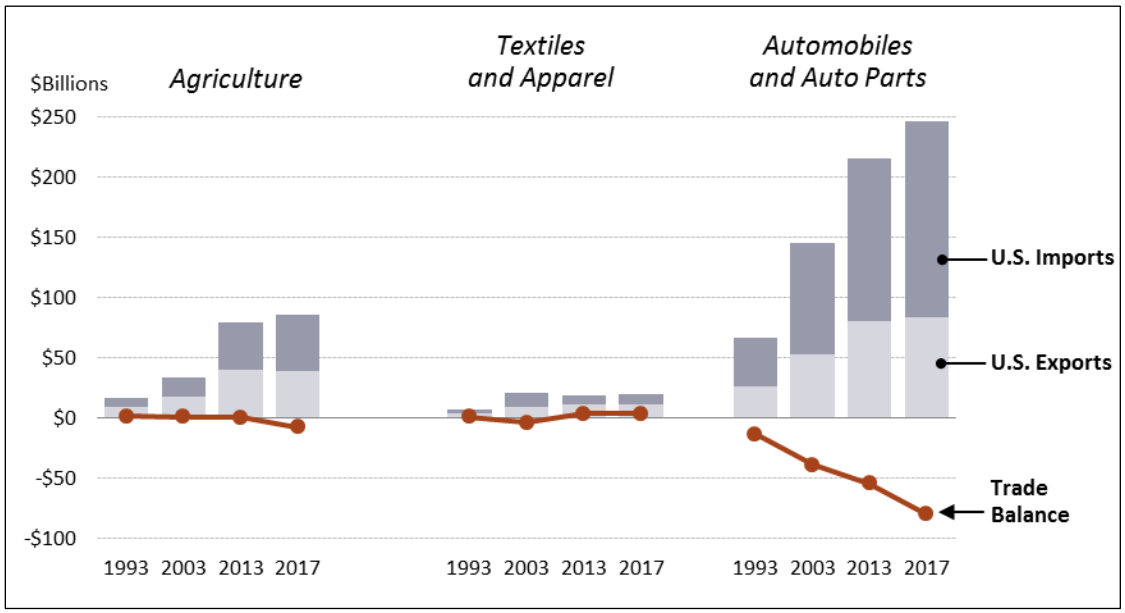
Notes: Data are the most recent available and include trade in goods and services. Totals in this figure may differ from USITC data cited in other sections of this report because of differences in methodology used by different sources.

Merchandise Trade in Selected Industries

NAFTA removed Mexico's protectionist policies in the auto sector and was instrumental in the integration of the motor vehicle industry in all three countries. The sector experienced some of the most significant changes in trade following the agreement. Motor vehicles and motor vehicle parts rank first among leading exports to and imports from NAFTA countries as shown in **Figure 5**. Agriculture trade also expanded after NAFTA, but to a lesser degree than the motor vehicle industry. The trade balance in agriculture also has a far lower trade deficit. Trade trends by sector indicate that NAFTA achieved many of the trade and economic benefits that proponents claimed it would bring, although there have been adjustment costs. It is difficult to isolate the effects of NAFTA to quantify the effects on trade in specific industries because other factors, such as economic growth and currency fluctuations, also affect trade.

Figure 5. U.S. Trade with NAFTA Partners in Selected Industries

(billions of nominal dollars)



Source: Compiled by CRS using data from the U.S. International Trade Commission, U.S. Department of Agriculture, International Trade Administration's Office of Textiles and Apparel.

U.S. Investment with Canada and Mexico

Foreign direct investment (FDI) has been an integral part of the economic relationship between the United States and NAFTA partners for many years. Two-way investment between Canada and the United States has increased markedly since NAFTA, both in terms of the stock and flow of investment. The United States is the largest single investor in Canada with a stock of FDI into Canada reaching $391.2 billion in 2017, up from a stock of $69.9 billion in 1993 (see **Figure 6**). U.S. investment represents about half of the total stock of FDI in Canada from global investors. The United States was the largest destination for Canadian FDI in 2017 with a stock of $453.1 billion, a significant increase from $40.4 billion in 1993. These trends highlight the changing view of FDI among Canadians, from one that could be considered fearful or hostile to FDI as vehicles of foreign control over the Canadian economy, to one that is more welcoming of new jobs and technologies that result from FDI.

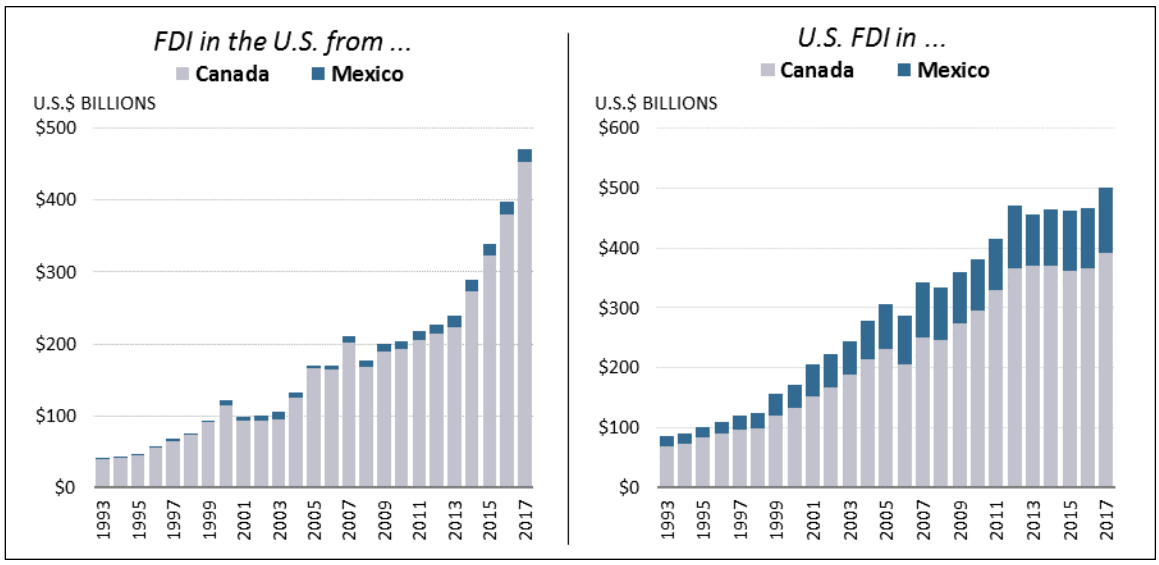
In Mexico, the United States is the largest source of FDI. The stock of U.S. FDI in Mexico increased from $15.2 billion in 1993 to $109.7 billion in 2017 (see **Figure 6**). Total FDI in Mexico dropped 19% in 2015, mainly due to a decline in investment in the services sector and automotive industry. Other countries in Latin America also experienced similar declines in FDI in 2015. Some economists contend that Mexico's recent economic reforms have added resilience to the Mexican economy and that greater economic growth and investment in Mexico would occur over time as a result.[31] Mexican FDI in the United States, while substantially lower than U.S.

[31] "Foreign Investment Dropped 19% Last Year, FDI was US$27 billion but Mexico Ranked No. 2 in Latin America, Behind Brazil," *Mexico Daily News*, June 8, 2017.

investment in Mexico, has also increased rapidly, from $1.2 billion in 1993 to $18.0 billion in 2017.[32]

Figure 6. Foreign Direct Investment Positions Among NAFTA Partners

(historical-cost basis)



Source: CRS based on data from U.S. Department of Commerce, Bureau of Economic Analysis.

NAFTA Renegotiation Process and TPA

Under Article II of the Constitution, the President has the authority, with the advice and consent of the Senate, to make treaties. Under Article I, Section 8, Congress has the authority to lay and collect duties, and to regulate foreign commerce. The President may seek expedited treatment of the implementing legislation of a renegotiated NAFTA under the Bipartisan Comprehensive Trade Promotion and Accountability Act of 2015 (TPA).[33] NAFTA provides, "The Parties may agree on any modification of or addition to this Agreement. When so agreed, and approved in accordance with the applicable legal procedures of each party, a modification or addition shall constitute an integral part of the agreement."[34]

Under TPA, the President must consult with Congress before giving the required 90-day notice of his intention to start negotiations.[35] The Trump Administration's consultations included meetings between U.S. Trade Representative Robert Lighthizer and members of the House Ways and Means Committee and Senate Finance Committee and with members of the House and Senate Advisory Groups on Negotiations.[36] The Office of the United States Trade Representative

[32] Foreign direct investment data in this section is derived from data from the Bureau of Economic Analysis online database at http://www.bea.gov.

[33] P.L. 114-26.

[34] North American Free Trade Agreement (NAFTA), Article 2202, https://www.nafta-sec-alena.org/Home/Legal-Texts/North-American-Free-Trade-Agreement.

[35] CRS In Focus IF10297, *TPP-Trade Promotion Authority (TPA) Timeline*, by Ian F. Fergusson.

[36] These groups were created by TPA to provide additional opportunities for consultation with the committees of jurisdiction, as well as other committees with jurisdiction over potential subject matter in the trade agreement.

(USTR) held public hearings and has received more than 12,000 public comments on NAFTA renegotiation.[37]

In order to use the expedited procedures of TPA, the President must notify and consult with Congress before initiating and during negotiations, and adhere to several reporting requirements following the conclusion of any negotiations resulting in an agreement. The President must conduct the negotiations based on the negotiating objectives set forth by Congress in the 2015 TPA authority. See box below for the dates on which these requirements were or are expected to be met.

TPA: Key TPA Dates and Deadlines for USMCA

- May 17, 2017: President sends to Congress required 90-day notification of intent to begin negotiations with Canada and Mexico.
- July 17, 2017: USTR published a summary of the Trump Administration's specific objectives with respect to the negotiations.
- August 16, 2017: Negotiations with Mexico and Canada began.
- August 30, 2018: Notification to Congress of intent to sign agreement with Mexico, and possibly Canada.
- September 30, 2018: United States and Canada conclude negotiations; USMCA draft text released. Advisory committee reports released.
- November 30, 2018: USMCA is signed.
- January 29, 2019: List of required changes to U.S. law delivered to Congress.
- At least 30 days prior to introduction of implementing legislation: Final agreement text, draft Statement of Administrative Action due.
- Around April 20, 2019: International Trade Commission (ITC) report due (extended due to government shutdown)

Trade Deficit Reduction

The Trump Administration, for the first time in the negotiating objectives of an FTA, indicated its aim to improve the U.S. trade balance and reduce the trade deficit with NAFTA countries in the renegotiation of NAFTA.[38] The trade balance with NAFTA partners has fluctuated since the agreement entered into force, increasing from $9.1 billion in 1993 to $89.6 billion in 2017. President Trump and some officials within his Administration believe that trade deficits are detrimental to the U.S. economy.[39] USTR Robert Lighthizer stated after the second round of negotiations that while he wanted to negotiate an agreement that is approved by Congress, he also wanted to bring down the trade deficit, as part of his mission, in order to help American workers

[37] Office of the United States Trade Representative, *Summary of Objectives for the NAFTA Renegotiation*, July 17, 2017, p. 2, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/july/ustr-releases-nafta-negotiating.

[38] Office of the United States Trade Representative (USTR), *Summary of Objectives for the NAFTA Renegotiation*, July 17, 2017, p. 4.

[39] Peter Navarro, a Trump Administration trade official states that trade deficits have a negative effect on GDP and believes that trade deficit reduction is one of four key factors needed to achieve GDP growth. In a *Wall Street Journal* commentary, he stated that trade deficits transfer wealth to other countries and contends that "tough, smart negotiations is [sic] a way to increase net exports—and boost the rate of economic growth." See Peter Navarro, "Why the White House Worries About Trade Deficits," *The Wall Street Journal*, March 5, 2017.

and farmers.[40] Other critics of NAFTA also argue that U.S. free trade agreements (FTAs) have contributed to rising trade deficits with some trade partners.[41]

Economists generally argue that it is not feasible to use trade agreement provisions as a tool to decrease the deficit because trade imbalances are determined by underlying macroeconomic fundamentals, such as a savings-investment imbalance in which the demand for capital in the U.S. economy outstrips the amount of gross savings supplied by households, firms, and the government sector.[42] According to some economists, a more constructive alternative would be to help strengthen Mexico's economy and boost Mexico's imports from the United States.[43] Others contend that FTAs are likely to affect the composition of trade among trade partners, but have little impact on the overall size of the trade deficit.[44] They argue that trade balances are incomplete measures of the comprehensive nature of economic relations between the United States and its trading partners, and maintain that trade imbalances are determined by macroeconomic fundamentals and not by trade policy.[45]

From this perspective, it is not clear how the Administration would expect to reduce the trade deficit through the proposed USMCA.

Proposed USMCA

The proposed USMCA, comprising 34 chapters and 12 side letters, retains most of NAFTA's chapters, making notable changes to market access provisions for autos and agriculture products, and to rules and disciplines, such as on investment, government procurement, and IPR. New issues, such as digital trade, state-owned enterprises, anticorruption, and currency misalignment, are also addressed. Because NAFTA is 25 years old, the proposed USMCA could be viewed as an opportunity to include obligations not currently covered in the original text, such as digital trade or more enforceable labor and environmental provisions. The following selective topics provide an overview of proposed USMCA provisions and a comparison to existing NAFTA provisions.

Rules of Origin

Rules of origin in NAFTA and other FTAs help ensure that the benefits of the FTA are granted only to goods produced by the parties that are signatories to the FTAs rather than to goods made wholly or in large part in other countries. If a U.S. import does not meet NAFTA rules-of-origin requirements, it will enter the United States under another import program or at U.S. MFN tariff rates. In 2017, 53% of U.S. imports from Canada and Mexico entered duty-free under NAFTA, while 47% entered under normal trade relations.[46] In the case of NAFTA, most goods that contain materials from non-NAFTA countries may also be considered as North American if the materials

[40] David Lawder, "U.S. Trade Rep Says in NAFTA Talks He Keeps Trump's Views in Mind," *Reuters News,* September 6, 2017.

[41] Public Citizen, *Job-Killing Trade Deficits Surge Under FTAs: U.S. Trade Deficits Grow 462% with FTA Countries, but Decline 7% with Non-FTA Countries*, March 2017.

[42] C. Fred Bergsten, *Trade Balances and the NAFTA Renegotiation*, Peterson Institute for International Economics, Policy Brief, June 2017.

[43] Ibid.

[44] For more information on the U.S. trade deficit, see CRS In Focus IF10619, *The U.S. Trade Deficit: An Overview*, by James K. Jackson.

[45] Ibid.

[46] CRS calculations based on imports for consumption data from the U.S. International Trade Commission.

are sufficiently transformed in the NAFTA region to go through a Harmonized Tariff Schedule (HTS) change in tariff classification (called a "tariff shift"). In many cases, goods must have a minimum level of North American content in addition to undergoing a tariff shift. Regional value content may be calculated using either the "transaction-value" or the "net-cost" method. The transaction-value method, which is simpler, is based on the price of the good, while the net-cost method is based on the total cost of the good less the costs of royalties, sales promotion, and packing and shipping. Producers generally have the option to choose which method they use, with some exceptions, such as the motor vehicle industry, which must use the net-cost method.[47]

The U.S. proposal on tightening rules of origin in the motor vehicle industry was viewed as one of the more contentious issues in the negotiations. Please see section below on the "Motor Vehicle Industry" for a discussion of the auto rules of origin.

NAFTA's rules of origin requirements state that if the transaction value method is used, not less than 60 per cent if the good must be of North American content for a good to receive NAFTA benefits. If the net cost method is used, not less than 50 percent if the value of the good must be of North American content. The proposed USMCA maintains these percentages for general imports. As noted below, certain industries such as the motor vehicle industry have specific rules of origin requirements.

Motor Vehicle Industry

NAFTA phased out U.S. tariffs on motor vehicle imports from Mexico and Mexican tariffs on U.S. and Canadian products as long as they met the rules of origin requirements of 62.5% North American content for autos, light trucks, engines and transmissions; and 60% for automotive parts. Some tariffs were eliminated immediately, while others were phased out in periods over 5 to 10 years. The agreement phased out Mexico's restrictive auto decrees, which for many years imposed high import tariffs and investment restrictions in Mexico's auto sector, and opened the Mexican motor vehicle sector to trade with and investment from the United States.[48]

NAFTA and the elimination of Mexican trade barriers liberalized North American motor vehicle trade and was instrumental in the integration of the North American motor vehicle industry.[49] North American motor vehicle manufacturing is now highly integrated, with major Asia- and Europe-based automakers constructing their own supply chains within the region.[50] The major recent growth in the North American market occurred largely in Mexico, which now accounts for about 20% of total continental vehicle production.[51] In general, recent investments in U.S. and Canadian assembly plants have involved modernization or expansion of existing facilities, while Mexico has seen new assembly plants.[52]

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[47] CRS Report RL34524, *International Trade: Rules of Origin*, by Vivian C. Jones.

[48] Beginning in the 1960s, Mexico had a restrictive import substitution policy in which the government sought to supply the entire Mexican market through domestically produced automotive goods. The series of auto decrees established import tariffs as high as 25%, had high restrictions on foreign auto production, prohibited imports of finished vehicles, imposed high domestic content requirements and had export requirements in which a certain amount of exports was required for every dollar of imports.

[49] CRS Report R44907, *NAFTA and Motor Vehicle Trade*, by Bill Canis, M. Angeles Villarreal, and Vivian C. Jones.

[50] Similarly integrated motor vehicle supply chains have evolved in Europe and Asia.

[51] In 1986, Mexican production of cars and light trucks accounted for 2.5% of total North American production. Ward's Datasheet, *North America Car & Truck Production, 1951-2016*.

[52] See CRS Report R44907, *NAFTA and Motor Vehicle Trade*, by Bill Canis, M. Angeles Villarreal, and Vivian C. Jones

The proposed USMCA would tighten auto rules of origin by including

- new motor vehicle rules of origin and procedures, including product-specific rules, and requiring 75% North American content;
- for the first time in a trade agreement, wage requirements stipulating 40%-45% of North American auto content be made by workers earning at least $16 per hour;
- a requirement that 70% of a vehicle's steel and aluminum must originate in North America; and
- a provision aiming to streamline the enforcement of manufacturers' rules of origin certification requirements.

In addition, side letters would exempt from potential Section 232 tariffs, which are being investigated by the Department of Commerce[53], the following items from Canada and Mexico:

- 2.6 million passenger vehicles each from Canada and Mexico on an annual basis;
- light trucks imported from Canada or Mexico; and
- auto part imports amounting to U.S. $32.4 billion from Canada and U.S. $108 billion from Mexico in declared customs value in any calendar year.

During the negotiations, vehicle and parts manufacturers generally supported retaining the current rules of origin under NAFTA, whereas labor groups sought to require a higher percentage of regional content, which they believe would reduce the share of parts produced in non-NAFTA countries. Some observers state that "it is unclear" whether the auto rules of origin in the proposed USMCA meet the requirements under the World Trade Organization's Article XXIV of the General Agreement on Tariffs and Trade.[54] Article XXIV states that duties and other commerce regulations between parties of a customs union "should not on the whole be higher or more restrictive" than the rate of the duties and regulations "applicable in the constituent territories prior to the formation of such union."[55]

Some economists and other experts believe that the higher North American content requirement in the proposed USMCA could have unintended consequences. They contend that trade in motor vehicles within North America may not be able to meet the new requirements and would be ineligible for USMCA benefits. Such experts say that it would be more cost efficient for manufacturers of motor vehicles and motor vehicle parts to pay the MFN tariff[56] of about 2.5%, rather than meet the cumbersome rules-of-origin requirements. They argue that a change in rules poses a significant risk to North American auto production, because it is likely that manufacturers would not have the supply to meet the new rules and would not be able to remain competitive in the market.[57] Auto manufacturers in Mexico are concerned that they may lose market share to

[53] See CRS In Focus IF10971, *Section 232 Auto Investigation*, coordinated by Rachel F. Fefer.

[54] See Jana Titievskaia and Marian Dietsch, *U.S.-Mexico-Canada Agreement (USMCA): Potential Impact on EU Companies*, European Parliament Research Service, At A Glance, December 2018; and Maria Curi, "EU think tank questions USMCA's compliance with WTO obligations," *World Trade Online*, January 16, 2019.

[55] See paragraph 5 of Article XXIV of the General Agreement on Tariffs and Trade, at https://www.wto.org/english/tratop_e/region_e/region_art24_e.htm

[56] Most-Favored Nation (MFN) Tariffs are what countries promise to impose on imports from other members of the World Trade Organization (WTO), unless the country is part of a preferential trade agreement such as a free trade agreement (FTA). In practice, MFN rates are the highest (most restrictive) that WTO members charge one another.

[57] Personal communication with motor vehicle representatives and government officials in Mexico City on September 25-29, 2017.

Asian manufacturers.[58] For example, because the rules of origin in the U.S.-South Korea FTA are much lower than those in the USMCA, it is possible that motor vehicle producers would shift production to South Korea, especially in light trucks.[59]

Even with these concerns, motor vehicle producers, in general, support the conclusion of the negotiations for the proposed USMCA and its ratification. Some automakers say that complying with the new rules of origin may be cumbersome, but probably manageable. Some also contend that production in the United States has the potential to increase under the agreement, although it is not clear whether this would translate into more U.S. jobs.[60] Auto industry representatives reacted favorably to the conclusion of the negotiations and generally agree with changes modernizing the agreement, such as updating border customs procedures (i.e., trade facilitation measures), digital trade provisions, and IPR protection.[61]

The United Auto Workers union (UAW) called for the renegotiation of NAFTA to provide more benefits to workers in all three signatory countries.[62] The UAW supports a strengthening of labor and environmental provisions, ensuring "fair" trade among all NAFTA parties through more enforceable provisions, and enhancing provisions on worker rights protection.[63] After the announcement of the proposed USMCA, the UAW issued a statement that it would need time to evaluate the details of the agreement before determining whether the "agreement will protect our UAW jobs and the living standards of all Americans."[64]

Agriculture[65]

NAFTA's agriculture provisions include tariff and quota elimination, sanitary and phytosanitary (SPS) measures, rules of origin, and grade and quality standards.[66] NAFTA set separate bilateral undertakings on cross-border trade in agriculture, one between Canada and Mexico, and the other between Mexico and the United States. As a general matter, CUSFTA provisions continued to apply on trade with Canada.[67] Under CUSFTA, Canada excluded dairy, poultry, and eggs for tariff elimination. In return, the United States excluded dairy, sugar, cotton, tobacco, peanuts, and peanut butter. Although NAFTA resulted in tariff elimination for most agricultural products and redefined import quotas for some commodities as tariff-rate quotas (TRQs),[68] some products are still subject to high above-quota tariffs, such as U.S. dairy and poultry exports to Canada. Canada

[58] Ibid.

[59] KORUS's rules of origin in motor vehicles range from 35-55%. See CRS Report RL34330, *The U.S.-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implementation*, coordinated by Brock R. Williams.

[60] Sarah Foster and Andrew Mayeda, "USMCA Will Add to Costs, Could Eliminate Jobs," *Bloomberg News*, November 15, 2018.

[61] Ben Miller, "Automakers React Positively to Announcement of US/Canada/Mexico Trade Deal," October 1, 2018.

[62] CRS Report R44907, *NAFTA and Motor Vehicle Trade*, by Bill Canis, M. Angeles Villarreal, and Vivian C. Jones.

[63] United Auto Workers (UAW), *Renegotiating NAFTA*, August 11, 2017.

[64] UAW, "UAW President Gary Jones Issues Statement on USMCA Announcement," October 1, 2018.

[65] For more information on USMCA outcomes, see CRS In Focus IF10996, *Agricultural Provisions of the U.S.-Mexico-Canada Agreement*, by Jenny Hopkinson.

[66] See CRS In Focus IF10682, *NAFTA Renegotiation: Issues for U.S. Agriculture*, by Renée Johnson, and CRS Report R44875, *The North American Free Trade Agreement (NAFTA) and U.S. Agriculture*, by Renée Johnson.

[67] Governments of Canada, the United Mexican States, and the United States of America, *Description of the Proposed North American Free Trade Agreement*, August 12, 1992, p. 12.

[68] Tariff-rate quotas (TRQs) allowed NAFTA partners to export specified quantities of a product to other NAFTA countries at a relatively low tariff, but subjected all imports of the product above a pre-determined threshold to a higher tariff.

maintains a supply-management system for these sectors that effectively limits U.S. market access. These products were also exempt from Canada-Mexico trade liberalization. NAFTA also addressed SPS measures and other types of nontariff barriers that may limit agricultural trade. SPS regulations continue to be regarded by agricultural exporters as challenging to trade and disruptive to integrated supply chains.[69]

In conjunction with agricultural reforms underway in Mexico at the time, NAFTA eliminated most nontariff barriers in agricultural trade with Mexico, including import licensing requirements, through their conversion either to TRQs[70] or to ordinary tariffs. Tariffs were phased out over 15 years with sensitive products such as sugar and corn receiving the longest phase-out periods. Approximately one-half of U.S.-Mexico agricultural trade became duty-free when the agreement went into effect. Prior to NAFTA, most tariffs in agricultural trade between the United States and Mexico, on average, were fairly low, though some U.S. exports to Mexico faced tariffs as high as 12%. However, approximately one-fourth of U.S. agricultural exports to Mexico (by value) were subjected to restrictive import licensing requirements.[71]

In the USMCA negotiations on agriculture, a principal U.S. demand was for additional market access to Canada's supply-management-restricted dairy, poultry, and egg markets. This system places a tariff-rate quota on imports of those products into Canada. While most of the in-quota tariff levied is 0%, out of quota tariffs (TRQ) can reach 313.5% for dairy products. Canada was not willing to abolish supply management, but did allow a yearly expansion of the TRQ for dairy products; an expansion of duty-free quota for poultry from 47,000 tons to 57,000 tons in year six, and a subsequent 1% annual increase for 10 years. The TRQ for eggs would increase to 10 million dozen annually. In return, the United States is providing more access to Canadian dairy, sugar, peanuts and cotton. U.S. tariffs for peanuts and cotton are to be phased-out over five years, and TRQs for dairy and sugar products are to be increased. The United States also negotiated changes to Canadian wheat grading system and providing national treatment for beer, wine, and spirits labeling and sales. A U.S. proposal to allow trade remedies to be used for seasonal produce was not adopted.

USMCA partners agreed to several other non-market access provision in the agriculture and sanitary and phytosanitary standards chapter. These include

- regulatory alignment among the parties;
- protection for proprietary formulas for pre-packaged foods and food additives (limited to furthering "legitimate objective[s]," which is not defined); and
- SPS rules based on "relevant scientific principles;" greater transparency in SPS rules.

Biotechnology provisions affecting agriculture include

- transparent and timely application and approval process for crops using biotechnology;
- procedures for import shipments containing a low-level presence of an unapproved crop produced with biotechnology; and
- establishment of a working group on agricultural biotechnology.

[69] CRS In Focus IF10682, *NAFTA Renegotiation: Issues for U.S. Agriculture*, by Renée Johnson.

[70] Tariff-rate quotas (TRQs) allowed NAFTA partners to export specified quantities of a product to other NAFTA countries at a relatively low tariff, but subjected all imports of the product above a pre-determined threshold to a higher tariff.

[71] Business Roundtable, *NAFTA: A Decade of Growth*, p. 35.

Customs and Trade Facilitation

Customs and trade facilitation relates to the efficient flow of legally traded goods in and out of the United States. Enforcement of U.S. trade laws and import security are other important components of customs operations at the border. NAFTA's chapter on customs procedures includes provisions on certificates of origin, administration and enforcement, and customs regulation and cooperation. More recent agreements have modernized provisions in regard to customs procedures and trade facilitation. The World Trade Organization (WTO) Trade Facilitation Agreement (TFA), the newest international trade agreement in the WTO, entered into force on February 22, 2017. Two-thirds of WTO members, including the United States, Canada, and Mexico, ratified the multilateral agreement.[72] Trade facilitation measures aim to simplify and streamline customs procedures to allow the easier flow of trade across borders and thereby reduce the costs of trade. There is no precise definition of trade facilitation, even in the WTO agreements. Trade facilitation can be defined narrowly as improving administrative procedures at the border or more broadly to also encompass behind-the-border measures and regulations. The TFA aims to address trade barriers, such as lack of customs procedural transparency and overly burdensome documentation requirements.[73]

In the proposed USMCA, parties affirmed their rights and obligations under the TFA of the WTO. USMCA provisions also include commitments to administer customs procedures in such ways as to facilitate trade or the transit of a good while supporting compliance with domestic laws and regulations. Parties commit to create a Trade Facilitation Committee to cooperate on trade facilitation and adopt additional measures if necessary. Other provisions include measures for online publication of information and resources related to trade facilitation, communications mechanisms, establishment of enquiry points to respond to enquiries by interested persons, rules for issuing written advance customs rulings, procedures for efficient release of goods in order to facilitate trade between the parties, expedited customs procedures for express shipments, automated risk analysis and management procedures, creation of a single-access window system to enable electronic submission through a single entry point for importation into the territory of another party, and transparency procedures. Given the magnitude and frequency of U.S. trade with NAFTA partners, more updated customs provisions in NAFTA could have a significant impact on companies engaged in trilateral trade.[74]

The USMCA would set *de minimis* customs threshold for duty free treatment at US$800 for the United States, C$150 (about US$117) for Canada, and US$117 for Mexico. Tax-free threshold would be set at C$40 (about US$31) for Canada and US$50 for Mexico. Proponents of the higher *de minimis* thresholds contend that these changes will facilitate North American trade by allowing low-value parcels to be shipped across international borders tax and tariff free and with simple customs forms.[75] Some Members and other stakeholders have raised concerns about a footnote that would allow the United States to decrease its threshold to a reciprocal *de minimis* amount in an amount no greater than the Canadian or Mexican threshold. They contend that lowering the current U.S. threshold could come at a cost to U.S. consumers and express carriers.[76]

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[72] CRS Report R44777, *WTO Trade Facilitation Agreement*, by Rachel F. Fefer and Vivian C. Jones.

[73] Ibid.

[74] The World Trade Organization's (WTO's) Trade Facilitation Agreement (TFA), if fully ratified, could also affect trade facilitation among NAFTA parties. Ninety-eight out of a necessary 109 countries have ratified the agreement.

[75] Gary Clyde Hufbauer and Euijin Jung, *Higher De Minimis Thresholds: A Win in the USMCA*, Peterson Institute for International Economics, October 15, 2018.

[76] Akin Gump, Struss Hauer & Feld LLP, *The New United States-Mexico-Canada Agreement (USMCA) Raises*

Energy

NAFTA includes explicit country-specific exceptions and reservations, including the energy sector in Mexico. In NAFTA's energy chapter, the three parties confirmed respect for their constitutions. This was of particular importance for Mexico and its 1917 Constitution, which established Mexican national ownership of all hydrocarbons resources. Under NAFTA, the Mexican government reserved to itself strategic activities, including investment and provisions in such activities, related to the exploration and exploitation of crude oil, natural gas, and basic petrochemicals. Mexico also reserved the right to provide electricity as a public service within the country. Despite these exclusions from NAFTA, energy remains a central component of U.S.-Mexico trade.[77]

The proposed USMCA does not have an energy chapter and moves some of NAFTA's energy provisions to other parts of the agreement. The USMCA adds a new chapter specifically recognizing Mexico's constitutional prohibitions on foreign investment or ownership of Mexico's energy sector. Other provisions in the USMCA, such as the investor-state dispute settlement (ISDS) provisions in regard to Mexico's energy sector, would help protect private U.S. energy projects in Mexico.

In 2013, the Mexican Congress approved the Peña Nieto Administration's constitutional reform proposals for the energy sector. The reforms restructured Mexico's state-owned oil company, PEMEX, as a "state productive company," which means that despite being owned by the state, it competes in the market like any private company.[78] It has operational autonomy, in addition to its own assets. These reforms opened Mexico's energy sector to production-sharing contracts with private and foreign investors while keeping the ownership of Mexico's hydrocarbons under state control.[79] Following the reforms, Mexico adopted new procurement rules to increase efficiency and effectiveness in the procurement process. In the NAFTA renegotiations, U.S. industry groups called for the United States to use NAFTA's so-called ratchet mechanism in regard to Mexico's energy reforms, which would prevent the reforms from being reversed and grant protection to U.S. investors.[80]

In regard to Canada, negotiators addressed a so-called "proportionality" provision contained in the energy chapters of both CUSFTA and NAFTA, which would be dropped under the proposed USMCA. This provision provides that Canadian restrictions on energy exports cannot reduce the proportion of exports delivered to the United States. The chapter also prohibits pricing discrimination between domestic consumption and exports to the United States. Some Canadians maintain that this provision restricts the ability of Canada to make energy policy decisions and may seek to change this provision.

Canada's and Mexico's De Minimis Thresholds, but the Reciprocal Treatment Provision Poses Risks to U.S. Express Carriers and Consumers, International Trade Alert, October 25, 2018.

[77] See CRS Report R43313, *Mexico's Oil and Gas Sector: Background, Reform Efforts, and Implications for the United States*, coordinated by Clare Ribando Seelke, and CRS Report R44747, *Cross-Border Energy Trade in North America: Present and Potential*, by Paul W. Parfomak et al.

[78] Organisation for Economic Co-operation and Development (OECD), *Fighting Bid Rigging in Public Procurement: A Review of the Procurement Rules and Practices of PEMEX in Mexico*, 2016, p. 11.

[79] Ibid., p. 9.

[80] U.S. Congress, House Committee on Ways and Means, Subcommittee on Trade, *Modernization of the North American Free Trade Agreement (NAFTA)*, 115th Cong., 1st sess., July 18, 2017 (Testimony of Dennis Arriola, Executive Vice President, Sempra Energy).

Government Procurement

The NAFTA government procurement chapter sets standards and parameters for government purchases of goods and services. Government procurement chapters typically extend national and nondiscriminatory treatment among parties and promote transparency in the tendering process. The schedule of commitments, set out in an annex to the chapter, provides opportunities for firms of each nation to bid on certain contracts for specified government agencies over a set monetary threshold on a reciprocal basis. The United States and Canada also have made certain government procurement opportunities available through similar obligations in the plurilateral WTO Government Procurement Agreement (GPA). Mexico is currently not a member of the GPA.

Supporters of expanded procurement opportunities in FTAs argue that the reciprocal nature of the government procurement provisions in FTAs allows U.S. firms access to major government procurement market opportunities overseas. In addition, supporters claim open government procurement markets at home allow government entities to accept bids from partner country suppliers, potentially making more efficient use of public funds.

Other stakeholders contend that public procurement should primarily benefit domestic industries. The Buy American Act of 1933, as amended, limits the ability of foreign companies to bid on government procurements of manufactured and construction products. Buy American provisions periodically are proposed for legislation such as infrastructure projects requiring government purchases of iron, steel, and manufactured products.[81] Such restrictions are waived for products from countries with which the United States has FTAs or to countries belonging to the GPA. The Trump Administration has made it a priority to support strong Buy American and Hire American policies in government procurement and has sought to minimize government procurement commitments with other parties.

The proposed USMCA government procurement chapter only applies to procurement between Mexico and the United States. It is the first U.S. FTA not to include procurement commitments for all parties. Procurement opportunities between the United States and Canada continue to be covered by the plurilateral WTO GPA. The proposed USMCA carries over much of the NAFTA government procurement chapter's coverage for U.S.-Mexico procurement. It covers largely the same entities and maintains the same thresholds as NAFTA, as adjusted annually for inflation. Core provisions

- promote transparency in the tendering process through online tender information and descriptions;
- provide online application and documentation processes without cost to the applicant;
- provide for publication of post-award explanations of procurement decisions;
- exclude government procurement from the financial services chapter;
- exclude textile and apparel procured by the Transportation Security Administration (TSA) under the "Kissell Amendment;"
- allow Mexico to set aside annual procurement contracts of $2.328 billion, annually adjusted for inflation, to Mexican suppliers;
- allow for coverage of build-operate-transfer (BOT) contracts (As Mexico has taken an exception to this provision, the United States will extend this coverage to Mexico when Mexico reciprocates.)

[81] U.S. manufactured products have been defined in regulation as containing at least 50% domestic content.

The exclusion of Canada is a break from previous government procurement chapters in U.S. FTAs. As noted above, procurement opportunities in each country for U.S. and Canadian firms will continue to be covered by the GPA, which was revised and updated in 2014. The national treatment and transparency provisions are common to both the GPA and the proposed USMCA, as are the provisions modernizing the agreement to provide for online tendering. The differences primarily are with the schedules and the thresholds. In some areas, the GPA provides a more open procurement market. For example, the GPA covers 75 U.S. government entities, including 35 U.S. states, whereas NAFTA covers 56 federal entities and does not cover state procurement. The GPA has a higher monetary threshold than NAFTA for procurement of goods and services ($180,000 v. $80,317), but a lower construction procurement threshold ($6.9 million v. $10.4 million).[82] In addition, while the proposed USMCA uses a negative list approach for services (all services included unless specifically excluded), Canada—though not the United States—maintains a positive list (only services specifically enumerated are covered) for services in the GPA. Government procurement between Canada and Mexico will continue to be covered by the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP or TPP-11).

Some industry groups have criticized the exclusion of Canada and financial services from the agreement. The Automotive and Capital Goods Advisory Committee (ITAC-2) maintained that excluding countries sets a bad precedent for future FTAs, that there was a "not inconceivable" chance that the United States could withdraw from the GPA, leaving no reciprocal access to the Canadian procurement market, and that other countries with FTAs with Canada, such as the EU and the TPP-11, would have greater access to the Canadian procurement market than that provided by the GPA.[83] The Services ITAC (ITAC-10) expressed concern that continued access to government procurement for financial services under USMCA has been called into doubt by the exclusion of that sector from the agreement. ITAC-10 noted that, under NAFTA coverage, U.S. insurance providers cover two-thirds of Mexican government employees.[84]

Investment

NAFTA removed significant investment barriers, ensured basic protections for NAFTA investors, and provided a mechanism for the settlement of disputes between investors and a NAFTA country. U.S. FTAs, including NAFTA and bilateral investment treaties (BITs) maintain core investor protections reflecting U.S. law, such as obligations for governments to provide investors with nondiscriminatory treatment, a minimum standard of treatment, and protections against uncompensated expropriation, among other provisions.[85] Since NAFTA, investment chapters in FTAs and the U.S. model BIT clarified certain provisions, including commitments to affirm more clearly a government's right to regulate for environmental, health, and other public policy objectives.

[82] "Procurement Thresholds for Implementation of the Trade Agreements Act of 1979," 82 *Fed. Reg.* 58248, December 11, 2017.

[83] "USMCA Agreement: Addendum to the Earlier (September 28, 2018) Report of the Industry Trade Advisory Committee on Automotive Equipment and Capital Goods, October 2018," https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/advisory-committee.

[84] "A Trade Agreement with Mexico and possibly Canada," Report of the Industry Trade Advisory Committee on Services, September 27, 2018, https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/advisory-committee.

[85] See CRS In Focus IF10052, *U.S. International Investment Agreements (IIAs)*, by Martin A. Weiss and Shayerah Ilias Akhtar.

The proposed USMCA provisions, in general, largely track those of NAFTA, with the exception of the elimination of some investor-state dispute settlement (ISDS) provisions in NAFTA's investment chapter (See "Investor-State Dispute Settlement (ISDS)"). During the negotiations of the proposed USMCA, the U.S. business community strongly opposed reported U.S. proposals to scale back or eliminate NAFTA ISDS provisions. The American Petroleum Institute (API), for example, stated that strong ISDS provisions protect U.S. business interests and that weakening or eliminating NAFTA's ISDS would "undermine U.S. energy security, investment protections and our global energy leadership."[86] On the other hand, U.S. labor and civil society groups welcomed the Administration's more skeptical approach to ISDS. The 2015 TPA called for "providing meaningful procedures for resolving investment disputes," which may affect congressional consideration of an agreement.[87]

The proposed USMCA clarifies language related to national treatment and most-favored-nation treatment. In determining whether an investment is afforded national treatment in the context of expropriation, a "like circumstances" analysis can be used. Under the article, "like circumstances" depends on the totality of the circumstances including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives."[88]

Minimum Standard of Treatment (MST)

The proposed USMCA, like NAFTA, requires parties to provide MST to investments in accordance with applicable customary international law, including fair and equitable treatment and full protection and security. It defines the applicable standard of treatment for a covered investment as the customary international law MST of aliens, and that "fair and equitable treatment" and "full protection and security" do not create additional substantive rights. However, the proposed USMCA clarifies that a party's action (or inaction) that may be inconsistent with investor expectations is not, on its own, a breach of MST, even if loss or damage to the investment follows.

Performance Requirements

The proposed USMCA would prohibit parties from imposing specific "performance requirements" in connection with an investment or related to the receipt of an advantage in connection with it. These include prohibitions on performance requirements such as to export a given level or percentage of goods, achieve a given level or percentage of domestic content, or transfer a particular technology. A new feature not in NAFTA includes prohibitions on performance requirements related to the purchase, use, or according of a preference to a technology of the party (or of a person of the party), and related to certain royalties and license contracts.

Denial of Benefits

The proposed USMCA's denial of benefits article, among other things, permits a party to deny the investment chapter's benefits to an investor that is an enterprise of another party (and to the investments of that investor) if that enterprise is owned or controlled by a person of a non-party

[86] American Petroleum Institute (API), *API Supports NAFTA Modernization that Retains Strong Protections for U.S. Investors*, February 20, 2017, http://www.api.org/news-policy-and-issues/news/2018/02/20/api-supports-nafta-modernization-that-protect-us-investors.

[87] P.L. 114-26, §102 (b)(4)(f).

[88] USMCA Article 14.5.4

or of the denying party or does not have "substantial business activities" in the territory of any party *other* than the party denying benefits. This article presumably is intended to address some stakeholder concerns that the chapter could be used to afford shell companies access to its protections.

Government Right to Regulate

Unlike NAFTA, the proposed USMCA contains a provision stating that, except in rare circumstances, nondiscriminatory regulatory action by a party to protect legitimate public welfare objectives (e.g., in public health, safety, and the environment) do not constitute indirect expropriation. Debate exists about what exactly are "rare circumstances." The proposed USMCA includes a statement that nothing in the Investment Chapter shall be construed to prevent a government from regulating in a manner sensitive to "health, environmental, and other regulatory objectives," as long as the action taken is otherwise consistent with the chapter. Previous U.S. FTAs, including NAFTA, limited the affirmation of a government's right to regulate to "environmental concerns."

Investor-State Dispute Settlement (ISDS)

ISDS has been a controversial aspect of the NAFTA investment chapter. It is a form of binding arbitration that allows private investors to pursue claims against sovereign nations for alleged violations of the investment provisions in trade agreements. It is included in NAFTA and nearly all other U.S. trade agreements that have been enacted since then, and is also a core provision in U.S. bilateral investment treaties (BITs). Generally, ISDS tribunals are composed of three lawyer-arbitrators: one chosen by the claimant investor, one by the respondent country, and one by mutual decision between the two parties. Most cases follow the rules of the World Bank's Centre for Settlement for Investor Dispute or the United Nations Commission on International Trade Law. Fifty-nine ISDS actions have been adjudicated under NAFTA, with the majority coming after 2004.[89]

Supporters argue that ISDS is important for protecting investors from discriminatory treatment and are modeled after U.S. law. They also argue that trade agreements do not prevent governments from regulating in the public interest, with clear exceptions for these actions, as well as for national security and for prudential reasons; ISDS remedies are limited to monetary penalties; and ISDS cannot force governments to change their laws or regulations. Critics counter that companies use ISDS to restrict governments' ability to regulate in the public interest (such as for environmental or health reasons), leading to "regulatory chilling" even if an ISDS outcome is not in a company's favor. The United States, to date, has never lost a claim brought against it under ISDS in a U.S. investment agreement.

[89] United Nations Conference on Trade and Development (UNCTAD).

ISDS provisions in the proposed USMCA would substantially revise longstanding provisions in NAFTA, other U.S. FTAs, and current BITs that were actively sought by past Administrations. Significantly, ISDS between Canada and the United States is ended under the new agreement. U.S. and Mexican investors would not be able to bring arbitration claims under USMCA against Canada, nor would Canadian investors bring such claims against the United States or Mexico. With respect to Mexico and the United States, the proposed USMCA would limit ISDS to claimants regarding government contracts in natural gas, power generation, infrastructure, transportation, and telecommunications sectors; or in other sectors provided the claimant exhausts national remedies first. Canada and Mexico are maintaining ISDS among themselves through CPTPP.

NAFTA Record on ISDS
As of February 2019

- 61 cases initiated under NAFTA Investment Chapter.
- U.S. Investors have won 10 cases against NAFTA partners (5 against Canada, 5 against Mexico).
- Foreign investors have won 0 cases against the United States.
- 26 (43%) decided in favor of state (on merits/no jurisdiction); 10 (16%) decided in favor of investor; 9 (15%) settled; 6 (9%) discontinued; 10 (15%) pending.
- 7 (11%) discontinued or breach found but no damages; pending 10 (16%).
- Individual cases initiated against: United States: 16 Canada: 26; Mexico: 19
- 10 decisions favorable to U.S. government as respondent; 0 decisions unfavorable; 4 settled; 1 discontinued; 1 pending.
- 8 decisions favorable to Canadian government as respondent; 5 unfavorable; 5 settled; 4 discontinued; 4 pending.
- 8 decisions favorable to Mexican government as respondent; 5 unfavorable; 0 settled; 2 discontinued; 4 pending.
- Nationality of investors in cases initiated against United States: Canada (15); Mexico (1).
- Respondent governments in cases initiated by U.S. investors: Canada (26); Mexico (17).

Source: United Nations Conference on Trade and Development (UNCTAD).

Under the proposed USMCA, ISDS is continued in three circumstances:

- Legacy claims from existing investments are eligible for arbitration under NAFTA ISDS provisions for three years from the date of NAFTA termination;
- Direct expropriation claims, including claims of violation of national treatment, would continue to be eligible for arbitration for United States and Mexican investors, provided that they exhaust domestic remedies first. Indirect expropriation, in which an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure, is no longer covered; and
- Government contracts in certain covered sectors (oil and gas, power generation, telecommunications, transportation, and infrastructure) would be eligible for arbitration under USMCA ISDS. This use of ISDS is designed to protect investors in heavily regulated industries whose investments may be affected by the presence of state-owned enterprises in the sector.

Services

The United States has a highly competitive services sector and has made services trade liberalization a priority in its negotiations of FTAs, including NAFTA and the proposed USMCA.[90] NAFTA covers core obligations in services trade in its own chapter, but because of the complexity of the issues, it also covers services trade in other related chapters, including financial services and telecommunications. NAFTA contained the first "negative list" services chapter in a U.S. trade agreement, and it is maintained in the proposed USMCA. With a negative list, all services are covered under the agreement unless specifically excluded from it, or unless NAFTA parties reserved a service to domestic providers at the time of the agreement. This approach generally is considered to be more comprehensive than the "positive list approach" used in the WTO General Agreement on Trade in Services (GATS), which requires each covered service to be identified. The negative list approach also implies that any new type of service that is developed after the agreement enters into force is automatically covered unless it is specifically excluded. Key provisions of the services chapter in NAFTA and the proposed USMCA include the following:

- nondiscriminatory treatment of services from partner-country providers in like circumstances, including national treatment and MFN treatment;
- no limitations on the number of service suppliers, the total value or volume of services provided, the number of persons employed, or the types of legal entities or joint ventures that a foreign service supplier may employ;
- prohibition on locality requirements that a service provider maintain a commercial presence in the country of the buyer;
- support of mutual recognition of professional qualifications for certification of service providers;
- transparency in the development and application of government regulations; and
- allowance for payments and transfers of capital flows "freely and without delay" that relate to the provision of services, with permissible restrictions in some cases for bankruptcy and criminal offences.

Express Delivery

NAFTA did not contain commitments on express delivery; however, the United States made market access of express delivery services a priority in its more recent FTA negotiations. The proposed USMCA addresses express delivery in a chapter annex.[91] The commitments on express delivery focus, in particular, on cases where a government-owned and operated postal system provides express delivery services competing with private sector providers. The proposed USMCA stipulates that the postal system cannot use revenue generated from its monopoly power in providing postal services to cross-subsidize an express delivery service. The proposed USMCA would also require independence between express delivery regulators and providers, prohibit the requirement of providing universal postal service as a prerequisite for express delivery, and prohibit fees on express delivery providers for the purpose of funding other such providers. In addition, the proposed USMCA specified a threshold level for the customs *de minimis*, a critical

[90] For more information, see CRS Report R43291, *U.S. Trade in Services: Trends and Policy Issues*, by Rachel F. Fefer, and CRS Report R44354, *Trade in Services Agreement (TiSA) Negotiations: Overview and Issues for Congress*, by Rachel F. Fefer.

[91] USMCA, Annex 15-A

commitment for express delivery providers and small businesses as shipments valued below the *de minimis* receive expedited customs treatment and pay no duties or taxes.

De Minimis Threshold

The *de minimis* threshold for assessing customs duties on imported goods was a new issue in the USMCA negotiations, one which affects several negotiating areas such as customs, services, and e-commerce. The controversy surrounds the threshold customs valuation assessed among the three NAFTA nations for goods entering the country (mailed, delivered by courier, transported by distributors, etc.) without charging duty or sales tax. The United States has sought increased thresholds from its trading partners. While the United States currently exempts duties for shipments under $800 (P.L. 114-125, §901), Canada's threshold is C$20 (recently about US$15-16) and Mexico's is $50. The proposed USMCA raised the customs threshold for duty free treatment to $117 (C$150) for Canada and Mexico. The tax-free threshold was set at $50 for Mexico and C$40 (about $31) for Canada. However, a footnote also allows the U.S. threshold to be lowered to achieve reciprocity, a controversial provision to some Members of Congress.

Temporary Entry for Business Purposes

In addition to cross-border trade in services, a person supplying the service may travel to and provide certain services in the location where the service is performed. NAFTA includes commitments on temporary entry for service professionals, such as accountants, architects, legal, and medical providers, and other business personnel, in order to facilitate such trade. As temporary entry has been a controversial issue in the context of previous trade agreements, the proposed USMCA chapter on temporary entry largely replicates NAFTA's provisions. The proposed USMCA does not place new restrictions on the number of entrants or expand the list of eligible professionals, as many businesses and other service providers had hoped.

Financial Services

Financial services, including insurance and insurance-related services, banking and related services, as well as auxiliary services of a financial nature, are addressed in a separate USMCA chapter as in previous U.S. FTAs. The financial services chapter adapts relevant provisions from the foreign investment chapter and the cross-border trade in services chapter. The prudential exception in NAFTA and the proposed USMCA provides that nothing in the FTA would prevent a party to the agreement from imposing measures to ensure the integrity and stability of the financial system. As with NAFTA and other FTAs, the proposed USMCA distinguishes between financial services traded across borders and those sold by a provider with a commercial presence in the home country of the buyer. In the case of providers with a foreign commercial presence, the USMCA applies the negative list approach with commitments applying generally except where noted; in the case of cross-border trade, the proposed language limits coverage to a positive list of specific banking and insurance services as defined by each country.[92]

Perhaps the provision in the proposed USMCA that has drawn the most attention is the prohibition on data localization requirements. Financial services firms rely on cross-border data flows to ensure data security, create efficiencies and cost savings through economies of scale, and utilize internet cloud services that are often provided by U.S. technology firms. Localization requirements imposed by countries could require companies to have in-country servers and data centers to store data. These types of regulations can create additional costs and may serve as a

[92] See USMCA Annex 17-A for a complete listing of insurance, banking, and other financial services covered by the cross-border trade in financial services disciplines.

deterrent for firms seeking to enter new markets or a disguised barrier to trade. Localization supporters, though, claim they increase local control, privacy protection, and data security.

While NAFTA allowed the transfer of data in and out of a party in the ordinary course of business, TPP was the first proposed U.S. FTA to prohibit data localization for e-commerce applications. However, it specifically carved out financial services, based on the apprehension of regulatory authorities that such data may not be available during time of crisis. The proposed USMCA strengthened the language to protect the free flow of data and removes the carve-out provided that a Party's financial regulatory authorities have "for regulatory and supervisory purposes, immediate, direct, complete, and ongoing access" to data located in another party's territory.[93] Canada has a one-year transition period to implement the data localization prohibition.

The proposed USMCA also includes commitments on electronic payment card services. It requires that each country in the agreement allow for the supply, by persons of other parties, of electronic payment services for payment card transactions, defined by each country, generally including credit and debit cards. The provisions on card services would, however, allow for certain preconditions of access, including requiring a representative or office within country.

Other new USMCA financial services provisions would

- exclude government procurement from financial services disciplines;
- modify investor-state dispute settlement (ISDS) through a bilateral annex on Mexico-United States Investment Disputes in Financial Services;
- allow a financial institution from one party with a presence in a second party to have access to the latter's payment and clearance system; and
- protect source code and algorithms and a prohibition on forced technology transfer in the digital trade section.

Telecommunications

The telecommunication chapter in NAFTA requires regulatory transparency; interconnection among providers; reasonable and nondiscriminatory access to network infrastructure and government-controlled resources like spectrum bandwidth for reasonable rates; and protection of the supplier's options for employing technology. The proposed USMCA telecommunications chapter adopts these provisions and would be the first U.S. FTA to cover mobile service providers. The chapter would promote cooperation on charges for international roaming services and allow regulation for mobile roaming service rates. Other provisions aim to ensure that suppliers can resell and unbundle services, and that suppliers can furnish value-added services. The telecommunications chapter does not cover television or radio broadcast or cable suppliers. It also promotes the independence of regulators. It does not contain the provision in NAFTA recognizing the importance of international standards for global compatibility and interoperability.

The chapter has the effect of binding Mexico to its 2013 Constitutional reforms in telecommunications, by guaranteeing the independence of the regulatory commission, nondiscriminatory repurchase rates, and interconnection obligations. The proposed USMCA chapter does not affect Canadian restrictions on foreign ownership of telecommunications common carriers.

[93] USMCA Article 17.18.

Digital Trade

NAFTA was negotiated and came into effect at the dawn of the consumer Internet age, and it did not contain provisions to address barriers and rules and disciplines on digital trade. Congress established principal negotiating objectives in TPA-2015 on digital trade in goods and services, as well as on cross-border data flows. The objectives include equal treatment of electronically delivered goods and services, as compared to physical products, protection of cross-border data flows, and prevention of data localization regulations, as well as prohibitions on duties on electronic transmissions.

The proposed USMCA digital trade chapter broadly covers all industries, but explicitly excludes government procurement or provisions on data held or processed by governments of the parties. It also does not include financial services, which has separate obligations in the financial services chapter. Overall, the chapter aims to promote digital trade and the free flow of information, and to ensure an open Internet. While the majority of the obligations related to digital trade are found in the digital trade chapter, there are relevant provisions in other chapters, including financial services, IPR, and telecommunications.

Key provisions of the proposed USMCA digital trade chapter

- ensure nondiscriminatory treatment of digital products;
- prohibit cross-border data flows restrictions and data localization requirements;
- prohibit requirements for source code or algorithm disclosure or transfer as a condition for market access, with exceptions;
- prohibit customs duties or other charges for electronically transmitted products;
- require parties to have online consumer protection and anti-spam laws, and a legal framework on privacy;
- promote cooperation on cybersecurity, and risk-based strategies and consensus-based standards over prescriptive regulation in combating cybersecurity risks and events;
- prohibit imposition of liability for harms against Internet services providers or users related to information stored, processed, transmitted, distributed, or made available by the service, with the exclusion of ISP liability for intellectual property rights (IPR) infringement; and
- promote publication of open government data in machine readable format for public usage.

Intellectual Property Rights (IPR)

NAFTA was the first FTA to contain an IPR chapter, which in turn was the model for the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement that came into effect a year later in 1995.[94] IPR chapters in trade agreements include provisions on patents, copyrights, trademarks, trade secrets, geographical indications (GIs), and enforcement. NAFTA predated the widespread use of the commercial Internet, and subsequent IPR chapters in U.S. FTAs contain obligations more extensive than those found in TRIPS and NAFTA. In general, they have followed the TPA negotiating objective that agreements should "reflect a standard of protection similar to that found in U.S. law." The President's NAFTA renegotiation objectives reflect TPA-

[94] See CRS In Focus IF10033, *Intellectual Property Rights (IPR) and International Trade*, by Shayerah Ilias Akhtar and Ian F. Fergusson.

2015 and the aims of U.S. negotiators in the TPP (although in some instances the negotiated TPP outcomes were less extensive). The United States achieved most of what it sought in the proposed USMCA and some results that went beyond TPP:

Patents

Patents protect new innovations, such as pharmaceutical products, chemical processes, business technologies, and computer software. These provisions largely track provisions in more recent U.S. FTAs, including TPP:

- **Patent and Regulatory term extension.** Provides an extension for "unreasonable" delays in the patent examination or regulatory approval processes. NAFTA allowed countries to provide such an extension but did not define unreasonable. The proposed USMCA defines unreasonable as five years after the filing of the application, or three years after a request for examination has been made.
- **Patent Linkage.** Mandates notification to the patent holder when a generic manufacturer seeks to rely on an originator's test data for marketing approval, and obligates the marketing authority to prevent a generic manufacturer from seeking market approval without the rights holder's consent. It provides flexibility on the notification system and the procedures (e.g., judicial or administrative proceedings, and remedies, such as preliminary injunctions) for a patent holder to assert his rights, as well as for a party to challenge the patent's validity. This provision was not in NAFTA, but has been in more recent U.S. FTAs.
- **Protection of test data.** Protects test data that patent holders submit for regulatory approval for pharmaceuticals on which generics may later rely. These provisions were not in NAFTA. USMCA provides test data protection for:
  - ***Chemical-based (small-molecule) drugs***: Five years of data exclusivity for new drugs, and three years for new formulations of existing drugs; and
  - ***Biologics***: Ten-year period of data exclusivity for biologic drugs. The United States sought 12 years of data exclusivity for biologics, the length of exclusivity in U.S. law. Canada now provides a total of eight years of

IPR Highlights in USMCA

Biologics. Requires a 10-year period of data exclusivity for biologics.

Digital enforcement. Extends IPR enforcement, including for copyrights, to the digital environment.

Trade secrets. Requires criminal procedures and penalties for trade secret theft, including cybertheft; also clarifies that SOEs are subject to trade secret protection requirements.

Internet Service Providers (ISPs). Requires "notice and takedown" to address ISP liability while allowing an alternative system to remain for Canada (e.g., "notice and notice").

Trademarks. Extends trademark protection to sounds and to "collective marks" and removes administrative requirements to enable easier protection and enforcement of trademarks.

Geographical indications (GIs). Requires administrative procedures for recognizing and opposing GIs, including guidelines for determining when a name is common. Also, for GIs that a Party protects through international agreements, includes requirements on transparency and opportunity to comment or oppose GI recognition.

biologics data exclusivity while Mexico provides a regulatory five-year period for both chemical and biologics.[95]

Copyrights

Copyrights provide creators of artistic and literary works with the exclusive right to authorize or prohibit others from reproducing, communicating, or distributing their works. Debate exists over balancing copyright protections while protecting the free flow of information, with digital trade raising new issues:

- **Extension of copyright terms.** Extends copyright terms from 50 years after death of the author, or 50 years from the publication (the WTO standard) to a 70-year period. Among the USMCA parties, only Canada maintains the 50-year term.
- **Technological Protection Measures.** Prohibits circumventing technological protection measures (TPMs), such as encryption, or altering or disabling rights management information (RMI).
- **Limitation and Exceptions.** Confines "limitations and exceptions to "certain special cases that do not conflict with the normal exploitation of the work….and do not unreasonably prejudice the legitimate interests of the rights holder." The proposed USMCA does not contain additional language that was in the TPP to "endeavor to achieve an appropriate balance" between users and rights holders in their copyright systems, including digitally, through exceptions for legitimate purposes (e.g., criticism, comment, news reporting, teaching, research). The "appropriate balance" language speaks to "fair use," exceptions in copyright law for media, research, and teaching. Rights-holder groups have criticized such provisions in the FTA context, while open Internet groups have sought to have the fair-use provision inserted into the proposed USMCA.
- **"Safe harbor."** Protects internet service providers (ISPs) against liability for digital copyright infringement, provided ISPs address intermediary copyright liability through "notice and takedown" or alternative systems (e.g., "notice and notice" in Canada). Rights-holder groups sought to limit what they considered "overly broad safe harbor provisions," while technology and business groups favored retention.

Trademarks

Trademarks protect distinctive commercial names, marks, and symbols. The proposed USMCA includes provisions on trademark protection and enforcement and provides for the following:

- ***Sound and Scent Marks.*** Extends trademark protection to sounds and requires "best efforts" to register scents. (Under NAFTA, a party could require that marks be "visually perceptible" in order to be registered.)
- ***Certification and Collective Marks.*** Provides trademark protections to "certification marks" (e.g., such as the Underwriters' Laboratory or Good Housekeeping Seal) and adds protection for "collective marks." Certification

[95] CRS Report R44489, *The Trans-Pacific Partnership (TPP): Key Provisions and Issues for Congress*, coordinated by Ian F. Fergusson and Brock R. Williams.

marks are usually given for "compliance with defined standards," while collective marks are usually defined as "signs which distinguish the geographical origin, material, mode of manufacture or other common characteristics of goods or services of different enterprises using the collective mark."[96]

- ***Well-known Trademarks.*** Extends specific protections for "well-known marks" to dissimilar goods and services, whether or not registered, so long as the use of the mark would indicate a connection between the goods or services and the owner of the well-known mark and the trademark owner's interests are likely to be damaged by the use.
- ***Domain Names.*** Requires each party to have a system for managing its country-code top level domains (ccTLDs) and to make available online public access to a database of contact information for domain-name registrants. The proposed USMCA requires parties to make available appropriate remedies when a person registers or holds, with "bad faith intent to profit," a domain name that is identical or confusingly similar to a trademark. This provision is intended to protect against what is often referred to as "cybersquatting."

Trade Secrets

Trade secrets are confidential business information (e.g., formula, customer list) that are commercially valuable. The proposed USMCA parties agreed to require criminal and civil procedures and penalties for trade secret theft, prohibition on impeding licensing of trade secrets, protections for trade secrets during the litigation process, and penalties for government officials who wrongfully disclose trade secrets, including through cyber theft and by state-owned enterprises (SOEs).

Geographical Indications (GIs)

GIs are geographical names that protect the quality and reputation of a distinctive product from a region (e.g., Ontario ice wine, Florida oranges). In FTA negotiations, the United States has sought to limit GI protections that can improperly constrain U.S. agricultural market access in other countries by protecting terms viewed as "common." This goal may be complicated by the recent Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union, which provides additional protections for GIs in Canada. The proposed USMCA

- protects GIs for food products that Canada and Mexico have already accepted as a consequence of trade agreements with the European Union;
- provides transparency and notification requirements, and objection procedures, for new GIs; and
- sets forth guidelines to determine whether a term is customary in the common language.

IPR Enforcement

Like previous U.S. FTAs, the proposed USMCA commits parties to provide civil, criminal, and other national enforcement for IPR violations, such as copyright enforcement in the digital

[96] For more information on these marks, see WIPO, "Certification Marks," http://www.wipo.int/sme/en/ip_business/collective_marks/certification_marks.htm; and WIPO, "Collective Marks," http://www.wipo.int/sme/en/ip_business/collective_marks/collective_marks.htm.

environment, criminal penalties for trade secret theft and camcording, and *ex-officio* authority to seize counterfeit trademark and pirated copyright goods at the border. The provisions of the chapter, in turn, are enforceable through the state-to-state dispute settlement chapter.

Cultural Exemption

Since the U.S.-Canada FTA, Canada has taken an exclusion on cultural industries from national treatment and MFN treatment. This exclusion reflects the Canadian government's attempts to promote a distinctly Canadian culture and the fear that, without its support, American culture would come to dominate Canada. Thus, the government imposes Canadian content ("Cancon") requirements on radio and television broadcasts, cable and satellite diffusion, the production of audio-visual material, film or video recording, and on various print media. The U.S. entertainment industry, in particular, has long sought to have this provision eliminated. In the end, Canada prevailed and the exclusion remains, although a provision was inserted allowing the United States and Mexico to take reciprocal action.

State-Owned Enterprises (SOEs)

NAFTA includes provisions on SOEs, but they are limited in scope.[97] They allow parties to maintain or establish SOEs, while requiring that any enterprise owned or controlled by a federal, provincial, or state government must act in a manner consistent with that country's NAFTA obligations when exercising regulatory, administrative, or other government authority, such as the granting of licenses. NAFTA committed parties to ensure that any SOEs accord nondiscriminatory treatment in the sale of goods or services to another party's investment in that territory.

The proposed USMCA includes a new chapter on SOEs, requiring SOEs to act in accordance with commercial considerations and to provide nondiscriminatory treatment to other USCMA country firms. The provisions update NAFTA by ensuring that SOEs compete on a commercial basis, and that the advantages SOEs receive from their governments, such as subsidies, do not have an adverse impact on U.S. workers and businesses. The renegotiations addressed potential commercial disadvantages to private sector firms from state-supported competitors receiving preferential treatment.[98]

U.S. government and business stakeholders raised concerns in the TPP negotiations over competition with companies linked to the state through ownership or influence. As a result, they supported new specific FTA disciplines, such as those in the proposed USMCA, to address such competition. Some legal analysts contend that the proposed USMCA limits the definition of expropriation so as to protect against "direct" expropriation only, and that it does not protect interests against indirect expropriation.[99] Indirect expropriation occurs when a state's regulatory actions could take effective control of—or interfere with—an investment.

[97] The definition of a State-Owned Enterprise in the agreement is an enterprise principally engaged in commercial activities and in which a party's government directly or indirectly owns more than 50% of capital share, controls more than 50% of voting rights, holds the power to control the enterprise through any other ownership interest including indirect or minority ownership, or holds the power to selects a majority of board members.

[98] USTR, *Updating the North American Free Trade Agreement (NAFTA),* available at https://ustr.gov/sites/default/files/TPP-Upgrading-the-North-American-Free-Trade-Agreement-NAFTA-Fact-Sheet.pdf.

[99] Julie Bedard, David Herlihy, and Timothy G. Nelson, *The United States-Mexico-Canada Agreement Significantly Curtails Foreign Investment Protection,* Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates, October 2, 2018.

Labor

NAFTA marked the first time that worker rights provisions were associated with an FTA by including labor provisions in a side agreement, the North American Agreement on Labor Cooperation (NAALC), which required all parties to enforce their own labor laws, as well as provisions to encourage greater cooperation. The side agreement includes a consultation mechanism for addressing labor disputes and a special labor dispute settlement procedure. The enforcement mechanism applies mainly to a party's failure to enforce its own labor laws. Under provisions of the 2002 TPA, seven subsequent FTAs included a similar provision within the main text of the agreement.

The rationale for including labor provisions in U.S. FTAs is to help ensure that countries not derogate from labor laws to attract trade and investment and that liberalized trade does not give a competitive advantage to developing countries due to a lack of adequate standards. Worker rights provisions in U.S. trade agreements have evolved significantly since NAFTA.[100] More recent agreements, including FTAs with Colombia, Panama, Peru, and South Korea, incorporated internationally recognized labor principles requiring parties to adopt and maintain in their statutes and regulations core labor principles of the International Labor Organization (ILO) (ILO Declaration). They also required countries to enforce their labor laws and not to waive or derogate from those laws to attract trade and investment. These provisions are enforceable under the same dispute settlement procedures that apply to other provisions of the FTA, and violations are subject to the same potential trade sanctions.

***ILO Declaration on Fundamental Principles and Rights at Work* (1998)**

- freedom of association;
- effective recognition of the right to collective bargaining;
- elimination of all forms of compulsory or forced labor;
- effective abolition of child labor; and
- elimination of discrimination in respect of employment and occupation.

In the NAFTA renegotiations, the United States sought to strengthen NAFTA provisions related to the protection of worker rights. The proposed USMCA revises these provisions and provides the same dispute mechanism as other parts of the agreement. USMCA's provisions on labor would require parties to not only enforce their own laws, but also to adopt and maintain specific laws related to the ILO Declaration. It would require parties to

- adopt and maintain in statutes and regulation, and practices, worker rights as stated in the ILO Declaration of Rights at Work, in addition to acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health;
- not waive or otherwise derogate from its statues or regulations;
- not fail to effectively enforce labor laws through a sustained or recurring course of action or inaction in a manner affecting trade or investment between parties;
- promote compliance with labor laws through appropriate government action such as appointing and training inspectors or monitoring compliance and investigating suspected violations.

[100] See CRS In Focus IF10046, *Worker Rights Provisions in Free Trade Agreements (FTAs)*, by Cathleen D. Cimino-Isaacs and M. Angeles Villarreal.

The provisions include language stating that each party retains the right to exercise reasonable enforcement discretion and to make *bona fide* decisions with regard to the allocation of enforcement resources provided that the exercise of that discretion is not inconsistent with the labor obligations. The agreement also states that nothing in the labor chapter shall be construed to empower a party's authorities to undertake labor law enforcement activities in the territory of another party.

Additionally, the USMCA would commit Mexico to

- enact specific legislative action to establish effective recognition of the right to collective bargaining;
- establish and maintain independent and impartial bodies to register union activities and collective bargaining agreements;
- establish independent Labor Courts for the adjudication of labor disputes; and
- enact other legislation to protect worker rights.[101]

Concerns over NAFTA labor provisions are often discussed in the context of Mexico's record on worker rights. While Mexico has enacted labor laws and undertaken constitutional reforms, the challenge has been to enforce those laws. Mexican labor reform is a priority for Mexico's new President Andrés Manuel López Obrador. In the proposed TPP, the United States signed separate labor consistency plans with Vietnam, Malaysia, and Brunei, which included commitments for specific legal reforms and other measures. Some stakeholders advocated for a similar plan for Mexico in conjunction with a revised NAFTA, although the United States was unable to negotiate one with Mexico in TPP. However, in the USMCA, Mexico agreed to develop and implement reforms to strengthen its labor laws to protect collective bargaining and to reform its system for administering labor justice.[102] Labor reform measures to increase protection of worker rights have been introduced in the Mexican Senate. Mexican Trade Undersecretary Maria Luz de la Mora stated that legislation enacting Mexican labor reforms is expected to be passed by the Mexican Senate before the end of the legislative session, in April 2019.[103]

Environment

NAFTA was the first U.S. FTA to include a side agreement related to the environment. As with the chapter on worker rights, environment provisions in U.S. FTAs have evolved significantly over time. The NAFTA side agreement—the North American Agreement on Environmental Cooperation (NAAEC)—requires all parties to enforce their own environmental laws, and contains an enforcement mechanism applicable to a party's failure to enforce these laws. NAAEC includes a consultation mechanism for addressing disputes with a special dispute settlement procedure. Seven subsequent FTAs, negotiated under the 2002 TPA, included a similar environmental chapter within the main text of the agreement, including a country's obligations to enforce their own laws.[104]

[101] The agreement states that it is the "expectation" of the parties that Mexico shall adopt such legislation before January 1, 2019 and that entry into force of the USMCA may be delated until such legislation becomes effective.

[102] "Mexican Senate Labor Proponent Says Reforms Could be Passed Soon," *World Trade Online*, January 16, 2019.

[103] "Mexican Official: Labor Reform Legislation Slated to Pass by the end of April," *World Trade Online*, February 19, 2019.

[104] For more information, see CRS In Focus IF10166, *Environmental Provisions in Free Trade Agreements (FTAs)*, by Richard K. Lattanzio and Ian F. Fergusson.

More recent U.S. FTAs added an affirmative obligation for FTA partner countries to adhere to multilateral environmental agreements (MEAs) and allowed for environmental disputes under the FTAs to access the main dispute settlement provisions of the agreement. These obligations generally were reflected in the TPA-2015 negotiating objectives. The proposed USMCA environment chapter obligates each party to

- not to fail to effectively enforce its environmental laws through a sustained or recurring course of action or inaction to attract trade and investment;
- not to waive or derogate from such laws in a manner that weakens or reduces the protections afforded in those law to encourage trade or investment; and
- ensure that its environmental laws and policies provide for and encourage high levels of protection; and
- strive to improve its levels of environmental protection.

The agreement also would

- require parties to adopt and maintain statutes and regulations consistent with multilateral environmental agreements to which each is a party;
- recognize the sovereign right of each party to establish its own levels of domestic environmental protection, its own regulatory priorities, and to adopt or modify its priorities accordingly;
- acknowledge a party's right to exercise discretion with regard to enforcement resources;
- provide for the resolution of disputes; and
- provide for a mechanism on implementation of the agreement.

The proposed USMCA directly or implicitly addresses obligations under major Multilateral Environmental Agreements (MEAs). It also includes obligations and encouragements to protect the ozone layer, protect the marine environment from ship pollution, encourage conservation and sustainable use of biodiversity, and encourage sustainable fisheries management.

Dispute Settlement

NAFTA and other U.S. FTAs, as well as the WTO, provide for the resolution of disputes arising under the agreement. These provisions are in addition to procedures with regard to investor-state dispute resolution (see "Investor-State Dispute Settlement"). The proposed USMCA dispute settlement provisions are designed to resolve disputes in a cooperative manner. A party first seeks redress of a grievance through a request for consultation with the other party. These steps include

- initial consultations between the parties;
- good offices, conciliation, or mediation; and (if no resolution);
- establishment of a dispute settlement panel.

Panels are composed of five members, of whom each side appoints two. A chair is appointed by mutual consent of the parties. Failing that, the disputing party selected by lot makes the decision. After the panel renders its decision, the unsuccessful party is expected to remedy the measure or practice under dispute. If it does not, the aggrieved party may seek compensation, suspension of benefits, or fines. In cases in which a dispute is common to both WTO and FTA rules, a party can choose the forum in which to bring the dispute (i.e., at the WTO or before a NAFTA panel), but cannot bring the dispute to multiple fora.

Three state-to-state dispute resolution panels under NAFTA were completed between 1994 and 2001 A fourth case (Restrictions on Sugar from Mexico) was never considered because the United States was able to block a panel chair—and, consequently, a panel—from forming. This action exposed an issue in the panel selection process, which has not been used since.

Under the panel selection process, the parties shall select and maintain a roster of 30 panelists, chosen by consensus for a three-year term with the possibility of reappointment. The issue arises when the roster is not constituted or maintained. If a roster has lapsed, as may have been the case in the sugar dispute, a party can challenge any proposed panelist and potentially block any panel from being established.[105] As noted above, a party seeking redress of an issue common to the USMCA and WTO can use either venue. However, the proposed USMCA contains several provisions that are not in the WTO agreements at all, or are treated less extensively. In this case, a functioning USMCA dispute settlement system could be the only arbiter of such disputes. This issue was not resolved in the USMCA. In addition, some chapters or sections are not subject to dispute settlement including

- The Good Regulatory Practices chapter;
- The Competition Policy chapter;
- The Competitiveness chapter;
- The Small and Medium-Sized Enterprise chapter;
- The Transparency and Procedural Fairness for Pharmaceutical Products and Medical Devices section of the Publications and Administration chapters;
- The Macroeconomic Policies and Exchange Rate Matters Chapter other than transparency and reporting obligations that have not been resolved through consultations.

Binational Review Panels for Trade Remedies

Unlike other U.S. FTAs, NAFTA (and the proposed USMCA) contains a binational dispute settlement mechanism (NAFTA Chapter 19, USMCA Chapter 10). It provides disciplines for settling disputes arising from a NAFTA party's statutory amendment of its antidumping (AD) or countervailing duty (CVD) laws, or from a NAFTA party's AD or CVD final determination[106] on the goods of an exporting NAFTA party. The dispute settlement system in NAFTA Chapter 19 originated during the Canada-United States Free Trade Agreement (CUSFTA) negotiations that culminated in 1988, and it was retained under NAFTA. It was a priority negotiating issue for the Canadian government.

The binational panel mechanism provides for a review of NAFTA parties' final administrative determinations in AD/CVD investigations in lieu of judicial review in domestic courts. In cases in which an aggrieved NAFTA country maintains that a NAFTA partner did not preserve "fair and predictable disciplines on unfair trade practices," or asserts that a NAFTA partner's amendment to

[105] See Simon Lester et al, "Access to Trade Justice: Fixing NAFTA's Flawed Dispute Settlement Process," *World Trade Review*, published online March 16, 2018, for a more detailed description of this issue.

[106] In Canada, AD/CVD investigations on imports are conducted by the Canada Border Services Agency (CBSA, which makes dumping and subsidy determinations) and the Canadian International Trade Tribunal (CITT, which determines injury to Canadian industries). In Mexico, both injury (i.e., to Mexican industries) and dumping/subsidy determinations are made by the Secretaría de Economía, Unidad de Practicas Comerciales Internacionales. U.S. injury determinations are made by the International Trade Commission (ITC), and the International Trade Administration of the Department of Commerce investigates and determines the existence and amount of dumping/subsidies.

its AD or CVD law is inconsistent with the WTO Antidumping or Subsidies Agreements,[107] the aggrieved NAFTA partner may request a judgment from a binational panel rather than through the legal system of the defending party.[108]

Chapter 19 Panels Involving the United States

As of February 2019, Chapter 19 panels have reviewed 155 cases. The United States and its industries have been a party to 91% of all Chapter 19 panel reviews (141 panels), as either the importing or exporting country. In 77% of these panels (109 panels), the United States was the importing country and investigating authority. In these 109 cases, panels reviewed 55 U.S. decisions regarding U.S. imports from Canada and 54 U.S. decisions regarding U.S. imports from Mexico. Panels issued a ruling in one-third of these cases. Nearly two-thirds of the cases were terminated by one or both of the parties before the panel made a determination.

As the exporting country, U.S. industries requested 40 panel reviews of another party's investigatory decisions. These panels included 20 reviews of Canadian decisions and 20 of Mexican decisions. Nearly two-thirds (26) of these panels completed their review and issued a ruling. The remaining one-third (14) were terminated by one or both of the involved parties before the panel ruled.

Source: Evaluated and compiled by CRS using information from the NAFTA Secretariat, available at https://www.nafta-sec-alena.org/Home/Dispute-Settlement.

The Trump Administration sought to eliminate the Chapter 19 dispute settlement mechanism during the USMCA negotiations.[109] By contrast, Canada and Mexico expressed support for retaining the mechanism, with Canada drawing a "red line" firmly opposing its elimination.[110] At the end of the negotiations, the three countries decided to retain the system. NAFTA Chapter 19 is effectively replicated in the Trade Remedies Chapter of the USMCA.

Currency Manipulation

NAFTA does not have provisions related to currency manipulation. For the first time in a U.S. trade agreement, the proposed USMCA includes obligations to guard against currency manipulation. The parties agreed to "achieve and maintain a market-determined exchange rate regime," and to "refrain from competitive devaluation, including through intervention in the foreign exchange market." However, only transparency and reporting requirements are subject to dispute settlement procedures.

The June 2015 TPA included, for the first time, a principal trade negotiating objective addressing currency manipulation. While neither Canada nor Mexico have been accused of currency manipulation in the past, the inclusion of a currency manipulation chapter could serve as a precedent for including such provisions in future FTAs. Over the past decade, some Members of Congress and policy experts have been concerned that foreign countries may use exchange rate policies to gain an unfair trade advantage against the United States, or are "manipulating" their currencies. Specifically, the concern is that other countries may purposefully undervalue their currencies to boost exports, making it harder for other countries to compete in global markets.

[107] The WTO Antidumping Agreement's official title is the *Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade*; and the Subsidies Agreement's title is the *Agreement on Subsidies and Countervailing Measures*. NAFTA pre-dated the entry-into-force of the agreement establishing the WTO by one year. At the time of the NAFTA negotiations, the multilateral General Agreements on Tariffs and Trade (GATT) was in force. The GATT was incorporated with revisions into the WTO agreements.

[108] CRS In Focus IF10645, *Dispute Settlement in U.S. Trade Agreements*, by Ian F. Fergusson.

[109] USTR, *Summary of Objectives for the NAFTA Renegotiation,* p. 14.

[110] "Trudeau: Chapter 19, cultural exemptions are NAFTA red lines for Canada," *Inside U.S. Trade,* September 4, 2018.

They argue that U.S. companies and jobs have been adversely affected by the exchange rate policies adopted by China, Japan, and other countries "manipulating" their currencies.[111] Some economists are skeptical about currency manipulation and whether it is a significant problem. They raise questions about whether government policies have long-term effects on exchange rates, whether it is possible to differentiate between "manipulation" and legitimate central bank activities, and the net effect of alleged currency manipulation on the U.S. economy.[112]

Regulatory Practices

Nontariff barriers, including discriminatory and unpredictable regulatory processes, can be an impediment to market access for U.S. goods and services exports. NAFTA includes broad provisions on regulatory practices in several chapters, including the Customs Procedures, Financial Services, and Energy chapters, but does not have a specific chapter on regulatory practices. NAFTA may have influenced the United States, Canada, and Mexico to increase cooperation on economic and security issues through various endeavors such as the North American Leaders' Summits, the North American Trusted Traveler Program, the U.S.-Canada Beyond the Border Action Plan, and the U.S.-Mexico High Level Regulatory Cooperation Council.[113]

The proposed USMCA has a new, separate chapter on regulatory practices in which the parties agreed upon commitments to promote regulatory quality through greater transparency, objective analysis, accountability, and predictability to facilitate international trade, investment, and economic growth. The chapter states that the application of good regulatory practices can support the development of compatible regulatory approaches among the parties, and reduce or eliminate unnecessarily burdensome, duplicative, or divergent regulatory requirements. Such commitments could complement ongoing efforts and include increased transparency in the development and implementation of proposed regulations, opportunities for public comment in the development of regulations, and/or the use of impact assessments and other methods to ensure regulations are evidence-based and current.[114]

Trucking

The implementation of NAFTA trucking provisions was a major trade issue between the United States and Mexico for many years because the United States delayed its trucking commitments under NAFTA. NAFTA provided Mexican commercial trucks full access to four U.S.-border states by 1995 and full access throughout the United States by 2000. The two countries cooperated to resolve the issue over time and engaged in numerous talks regarding safety and operational issues. By 2015, the trucking issue had been resolved.

Under NAFTA, Mexican commercial trucks have authority under the agreement to operate in the United States, but they cannot operate between two points within the country. This means that they can haul cross-border loads but cannot haul loads that originate and end in the United States. The proposed USMCA would cap the number of Mexican-domiciled carriers that can receive

[111] See CRS In Focus IF10049, *Debates over Currency Manipulation*, by Rebecca M. Nelson, and CRS Report R44717, *International Trade and Finance: Overview and Issues for the 115th Congress*, coordinated by Mary A. Irace and Rebecca M. Nelson.

[112] Ibid.

[113] See section on North American Cooperation in CRS Report 96-397, *Canada-U.S. Relations*, by Ian F. Fergusson and Peter J. Meyer.

[114] USTR, *Summary of Objectives for the NAFTA Renegotiation*, July 17, 2017, p. 7.

U.S. operating authority and would continue the prohibition on Mexican-based carriers hauling freight between two points within the United States. Mexican carriers that already have authority under NAFTA to operate in the United States would continue to be allowed to operate in the United States.

Anticorruption

The United States has been influential in including commitments to combat corruption in international trade into its FTAs by incorporating chapters on transparency and anticorruption into the agreements. Although it has been part of U.S. policy for many years, the use of these types of provisions has evolved over time with anticorruption commitments becoming progressively stronger.[115] NAFTA does not include a separate chapter related to transparency or anticorruption, but it does include several provisions that were considered groundbreaking at the time, including binding rules and disciplines on and removal of barriers to foreign investment. It was not until the proposed TPP that anticorruption provisions were specifically included as a U.S. FTA chapter. Earlier agreements such as the U.S.-Chile FTA included anticorruption provisions related to government procurement, but none in the transparency chapter. The Dominican Republic-Central America FTA (CAFTA-DR) was negotiated several years later and contains anticorruption provisions in the transparency chapters that apply to the whole agreement.

In the NAFTA renegotiations, both the United States and Mexico included anticorruption provisions in their negotiating objectives. The proposed USMCA has a new chapter on anti-corruption, similar to that of the proposed TPP, in which the parties affirm their resolve to prevent and combat bribery and corruption in international trade and investment. The scope of the chapter is limited to measures to prevent and combat bribery and corruption in regard to any matter covered by the agreement.

"Sunset" Provision in Review and Term Extension

In the Final Provisions chapter of the proposed USMCA, parties commit to a review of the agreement on the sixth anniversary of the agreement's entry into force. If all parties agree to continue the agreement after six years, it shall remain in force for another 16 years. If a party does not confirm its wish to extend the term of the agreement for another 16-year period, parties shall conduct a joint review of the agreement every year. The agreement only specifies that a "party" would review the agreement; it does not state whether it would be the President or Congress that reviews the agreement. This may be of interest to Congress as it considers the USMCA implementing legislation and what its role would be in reviewing the USMCA. Some industry observers contend that the sunset provision may have a detrimental effect on investor confidence and affect long-term investments. Others believe that the provision will not have an effect as parties can choose to review an agreement at any time.

Issues for Congress

There are a number of significant issues for Congress in the consideration of the proposed USMCA. Key issues Congress may examine include modernized provisions of the agreement, the role of the Congress and the President in the NAFTA renegotiation and approval process, whether the agreement meets TPA objectives, the possible economic impact, especially in the auto

[115] Transparency International, "Anti-Corruption and Transparency Provisions in Trade Agreements," *Anti-Corruption Helpdesk,* 2017.

industry, and how the agreement may impact U.S. relations with Canada and Mexico, two of the United States' largest trading partners. Some lawmakers believe that the renegotiations resulted in a positive outcome that would enhance relations with NAFTA partners through a modernized agreement. Other lawmakers have expressed concerns about specific aspects of the agreement, including labor, with a goal of revision. What follows are a few selected areas of potential congressional interest.

Roles of Congress and the President in NAFTA Renegotiations

A possible issue for Congress relates to the roles of Congress and the President in the modernization of the agreement or possible withdrawal. Implementing legislation for the USMCA agreement may be considered under Trade Promotion Authority (TPA). Under TPA, if the President "makes progress in meeting" TPA's principal trade negotiating objectives and meets various consultative, notifications, and reporting requirements before, during, and after the conclusion of negotiations, Congress shall provide expedited procedures for automatic introduction of the implementing bill submitted by the President, a timetable for guaranteed committee consideration and discharge, floor consideration, prohibition of amendments, and limitation on debate. The process from introduction must be completed within 90 days, but it has often been completed much more quickly. As TPA was in effect when the USMCA was signed on November 30, 2018, it is eligible for TPA consideration. There is no deadline for presidential submission or congressional consideration of implementing legislation.

TPA's requirement that the President fulfill consultation, notification and reporting obligations helps preserve the congressional role in trade agreements by giving Congress the opportunity to influence the agreement before it is finalized. Congress may be interested in the extent to which the President advances U.S. negotiating objectives in TPA as approved by Congress in 2015, given several notable breaks in USMCA with the contents of previous U.S. FTAs. Should Congress determine that the President has failed to meet these and other requirements, it may decide that the implementing bill is not eligible for consideration under TPA rules. It would implement this decision by adopting a joint "procedural disapproval" resolution in both houses of Congress or a Consultation and Compliance Resolution in either house. In addition, expedited procedures under TPA are considered rules of Congress and can be changed at any time. Given that, either House can deny expedited treatment to implementing legislation. In the House, the Speaker may direct the Rules Committee to enact a rule stripping expedited treatment from the implementing legislation. In the Senate, changing a rule would require unanimous consent, or a supermajority to waive it.[116]

President Trump has indicated that he would consider withdrawing from NAFTA as a means of pressuring Congress to support timely action on implementing legislation. It is not clear, though, whether the President has the legal authority for withdrawing from an agreement without the consent of Congress. If President Trump attempts to withdraw from the agreement, it is possible that Congress would attempt to challenge or delay the effort. The question of who has the authority to terminate NAFTA, a congressional-executive agreement, has been debated by lawmakers, legal experts, and others.[117]

[116] For more information on these procedures, see CRS Report R43491, *Trade Promotion Authority (TPA): Frequently Asked Questions*, by Ian F. Fergusson and Christopher M. Davis; and CRS Report R44584, *Implementing Bills for Trade Agreements: Statutory Procedures under Trade Promotion Authority*, by Richard S. Beth

[117] For more information, see CRS Report R44630, *U.S. Withdrawal from Free Trade Agreements: Frequently Asked Legal Questions*, by Brandon J. Murrill.

Economic and Other Considerations

Congress may examine the economic effects of a USMCA and the broader strategic implications of possible withdrawal from NAFTA absent action on legislation to implement the USCMA. President Trump has repeatedly threatened to withdraw from NAFTA. Some analysts maintain that these statements are not to be taken lightly because the potential cost of such actions could be very significant for the U.S. economy.[118] The United States shares strong economic ties with Mexico and Canada. Any disruption to the economic relationship could have adverse effects on investment, employment, productivity, and North American competitiveness. In addition, Mexico and Canada could consider imposing retaliatory tariffs on U.S. exports if the United States were to withdraw, while at the same time maintaining existing and pursuing new FTAs without the United States.

The full effects of the proposed USMCA on North American trade relations are not be expected to be significant because nearly all U.S. trade with Canada and Mexico that meets rules of origin requirements is now conducted duty and barrier free under NAFTA. The proposed USMCA would maintain NAFTA's tariff and non-tariff barrier eliminations. If the USMCA is approved by Congress and it enters into force, many economists and other observers believe that it is not expected to have a measurable effect on U.S. trade and investment with other NAFTA parties, jobs, wages, or overall economic growth, and that it would probably not have a measurable effect on the U.S. trade deficit.[119] The U.S. International Trade Commission (ITC) is conducting an investigation into the likely economic impacts of the proposed USMCA, a required element of the Trade Promotion Authority (TPA) process.[120] TPA 2015 states that the ITC must issue its report within 105 days of the President's signing of a trade deal. The ITC report, due by March 15, 2019, has been delayed because of the partial government shutdown, which lasted 35 days. It is now expected to be released by April 20, 2019.

One exception to this overall economic evaluation may be the motor vehicle industry, which may experience more significant effects than other industries because of the changes in rules of origin in the USMCA and because of the high percentage of motor vehicle goods that enter duty-free under NAFTA. The highest share of U.S. trade with Mexico is in the motor vehicle industry and it is also the industry with the highest percentage of duty-free treatment under NAFTA because of high North American content. In 2017, leading U.S. merchandise imports from NAFTA partners were motor vehicles ($102.1 billion or 17% of total imports from Canada and Mexico), oil and gas ($68.8 billion or 11% of imports), and motor vehicle parts ($58.7 billion or 10% of imports). About 98.6% of U.S. motor vehicle imports and about 77.5% of motor vehicle parts imports from Canada and Mexico entered the United States duty-free under NAFTA.[121] In comparison, only 12.6% of oil and gas imports and 49.3% of total U.S. imports from Canada and Mexico in 2017 received duty-free benefits under NAFTA as shown in **Figure 7**.

[118] Fred Bergsten, *Mexico and the NAFTA Renegotiations*, Wilson Center, Webcast, Washington, DC, August 15, 2017.

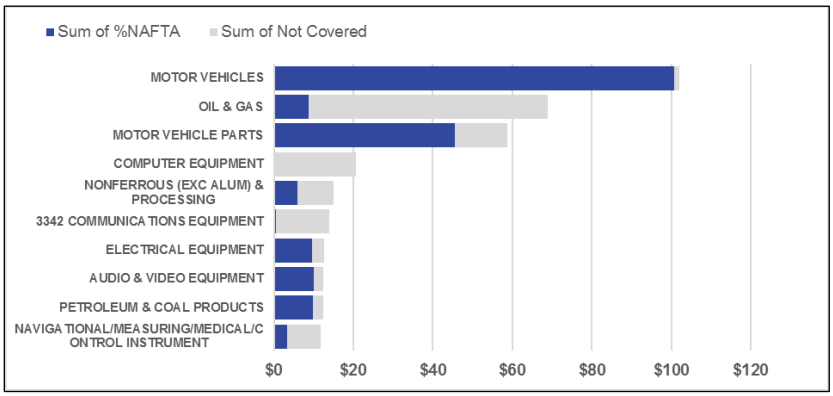
[119] John Brinkley, "USMCA is not the Magnificent Trade Deal Trump Says It Is," *Forbes.com*, October 8, 2018.

[120] CRS In Focus IF10038, *Trade Promotion Authority (TPA)*, by Ian F. Fergusson.

[121] CRS calculations based on trade data from the U.S. International Trade Commission.

Figure 7. U.S. Imports from NAFTA Partners: 2017

(billions of dollars)



Source: Compiled by CRS using data from the U.S. International Trade Commission (USITC) trade dataweb.

Some analysts believe that the updated auto rules of origin requirements contained in the USMCA could raise compliance and production costs and could lead to higher prices, which could possibly negatively affect U.S. vehicle sales. The net impact, however, may be more limited depending on the capacity of U.S. automakers and parts manufacturers to shift suppliers and production locations and the ability to absorb higher costs, according to some observers.[122] Some observers contend that manufacturers with a stronger presence in Mexico, such as General Motors and Fiat Chrysler Automobiles, may be more impacted.[123]

Other observers and stakeholders are continuing to review the provisions in the new agreement and what effect, if any, these changes would have on U.S. economic relations with Canada and Mexico. To some analysts, provisions in areas such as customs regulation, digital trade, sanitary and phytosanitary measures, and enforcement on labor and the environment are considered an improvement over similar provisions in NAFTA. Other proposed changes in the agreement, such as largely heightened IPR protections and generally less extensive investment provisions, have both supporters and detractors. For example, there is some concern that the ISDS provisions in the USMCA effectively may only apply to certain U.S. contracts in Mexico's energy sector and possibly leave out other sectors such as services. Under USMCA, investors in many sectors would be limited to filing ISDS claims for breaches of national treatment, most-favored nation treatment, or expropriation, but not indirect expropriation.

Mexico's New President

On July 1, 2018, Mexico held presidential and legislative elections in which Andrés Manuel López Obrador and his leftist MORENA party won by wide margins. President López Obrador entered into office on December 1, 2018. He won the presidency with 53.2% of the vote, more than 30 percentage points ahead of his nearest rival. MORENA's coalition also won majorities in both chambers of Mexico's Congress.[124]

[122] Nick Lichtenberg, "USMCA 'Manageable' Changes Auto Compliance, Production Costs: Moody's," *Bloomberg First Word*, October 10, 2018.

[123] Ibid.

[124] CRS In Focus IF10867, *Mexico's 2018 Elections: Results and Potential Implications*, by Clare Ribando Seelke and Edward Y. Gracia.

Although President López Obrador voiced skepticism about NAFTA in the past, he has stated on several occasions that he supports the agreement, arguing that it should be improved to benefit Mexico rather than being terminated. Mexico's chief NAFTA negotiator under López Obrador's Administration, Jesús Seade, stated that the proposed USMCA is a "satisfactory result" for Mexico and that it will create an incentive for increased investment linkages and deeper economic integration.[125]

Canada and Mexico's Participation in the CPTPP and other FTAs

An issue for congressional consideration is Mexico and Canada's ongoing trade initiatives and how they may affect the United States. In addition to numerous FTAs with other countries, Canada and Mexico are signatories to the TPP, now known as CPTPP or TPP-11. Following the withdrawal of the Trump Administration from the then-proposed TPP in January 2017, the 11 parties agreed on a final deal for the CPTPP on January 23, 2018; it was signed on March 8, 2018. Canada and Mexico have ratified the agreement. With six of the 11 countries having ratified it, the CPTPP came into effect on December 30, 2018. It provides Canada and Mexico preferential market access in numerous industries to several lucrative Asian markets, especially Japan, and may affect current trade and investment trends with the United States.[126]

According to a June 2017 study, Canada and Mexico could have potential gains from CPTPP, mainly because they would have increased access to other markets, especially Japan, without having to compete with U.S. exports.[127] The study projects that Canada's exports to CPTPP countries, without the United States, would increase by 4.7% by 2035 and that Mexico's would increase by 3.1%. The study states that Canada's agricultural exports, particularly beef, would benefit from access to the Japanese market.[128]

Canada's FTAs

In addition to NAFTA, and the CPTPP, Canada has also negotiated other FTAs. Canada's Comprehensive Economic and Trade Agreement (CETA) with the European Union provisionally came into force on September 21, 2017. This agreement provides preferential market access for goods and certain services (including agriculture) among other provisions such as those on geographical indications (GIs)—geographical names that protect the quality and reputation of a distinctive product originating in a certain region. For instance, Canada agreed to recognize GIs on certain cheeses generally viewed as common food names in the United States, some of which survived as recognized GIs under the USMCA. Canada likely will begin talks with the United Kingdom for an FTA, if the terms of Brexit allow it to negotiate FTAs with other countries. Canada also has a free trade agreement in force with South Korea and has conducted exploratory discussions on launching FTA negotiations with China. In addition, Canada has FTAs with several countries in Central and South America, and is an observer to the Pacific Alliance.[129]

[125] Ashish Kumar Sen, *Why it Will Be Hard to Kill NAFTA if Congress Does Not Approve Trump's Trade Deal with Mexico and Canada*, Atlantic Council, December 14, 2018.

[126] CRS In Focus IF10000, *TPP: Overview and Current Status*, by Brock R. Williams and Ian F. Fergusson.

[127] Carlo Dade, Dan Ciuriak, Ali Dadkhah et al., *The Art of the Trade Deal: Quantifying the Benefits of a TPP Without the United States*, Canada West Foundation, June 2017.

[128] Ibid., pp. 24 and 04.

[129] CRS Report R43748, *The Pacific Alliance: A Trade Integration Initiative in Latin America*, by M. Angeles Villarreal.

Mexico's FTAs

Some observers contend that Mexico's trade policy is the most open in the world.[130] It has a total of 11 free trade agreements involving 46 countries, including it the 11-member CPTPP. These also include agreements with most countries in the Western Hemisphere, as well as agreements with Israel, Japan, and the EU. Mexico and the EU renegotiated a new FTA that is expected to open up the Mexican market to more EU exporters and investors. The two parties announced an agreement in principle on April 21, 2018. The new agreement, which must be ratified by both parties before entering into force, includes commitments to cooperate on issues such as climate change, human rights, combating poverty, or researching new medicines.[131] Mexico is also a party to the Pacific Alliance, a regional trade integration initiative formed by Chile, Colombia, Mexico, and Peru. The trade bloc's main purpose is for members to forge stronger economic ties and integration with the Asia-Pacific region. In addition to reducing trade barriers, the Alliance has sought to integrate in areas including financial markets and the free movement of people.[132] In 2018, the Pacific Alliance admitted Singapore, Australia, New Zealand, and Canada as associate members as a first step to deepening the relationship.[133]

Potential Impact of U.S. Withdrawal from NAFTA

President Trump stated to reporters on December 1, 2018, that he intended to notify Canada and Mexico of his intention to withdraw from NAFTA in six months.[134] Article 2205 of NAFTA states that a party may withdraw from the agreement six months after it provides written notice of withdrawal to the other parties. If a party withdraws, the agreement shall remain in force for the remaining parties. Private sector groups are urging the President to remain within NAFTA until the proposed USMCA enters into force. They claim that withdrawing from NAFTA would have "devastating" negative consequences.[135] Congress may consider the ramifications of withdrawing from NAFTA and how it may affect the U.S. economy and foreign relations with Mexico. It may monitor and consider the congressional role in a possible withdrawal.[136]

Numerous think tanks and economists have written about the possible economic consequences of U.S. withdrawal from NAFTA. For example

- An analysis by the Peterson Institute for International Economics (PIIE) finds that a withdrawal from NAFTA would cost the United States 187,000 jobs that rely on exports to Mexico and Canada. These job losses would occur over a period of one to three years. By comparison, according to the study, between 2013 and 2015, 7.4 million U.S. workers were displaced or lost their jobs

[130] CRS Report R40784, *Mexico's Free Trade Agreements*, by M. Angeles Villarreal.

[131] Organization of American States, Foreign Trade Information System (SICE), *Mexico-European Union, Eighth Round of Negotiations to Modernize FTA*, available at http://www.sice.oas.org/TPD/MEX_EU/MEX_EU_e.asp.

[132] CRS Report R43748, *The Pacific Alliance: A Trade Integration Initiative in Latin America*, by M. Angeles Villarreal.

[133] Harry Pearl, "Australia, New Zealand Launch Trade negotiations with Pacific Alliance," *Reuters*, June 30, 2017.

[134] Andrew Restuccia, Doug Palmer, and Adam Behsudi, "Trump Says He will Withdraw from NAFTA, Pressuring Congress to Approve New Trade Deal," *Politico*, December 2, 2018.

[135] Letter from Nathan Nascimento, Executive Vice President, Freedom Partners Chamber of Commerce, Tim Phillips, President, Americans for Prosperity, and Daniel Garcia, President, The Libre Initiative, to President Donald Trump, President of the United States, October 3, 2018.

[136] See CRS Report R44630, *U.S. Withdrawal from Free Trade Agreements: Frequently Asked Legal Questions*, by Brandon J. Murrill.

involuntarily due to companies shutting down or moving elsewhere globally. The study notes that the most affected states would be Arkansas, Kentucky, Mississippi, and Indiana. The most affected sectors would be autos, agriculture, and non-auto manufacturing.[137]

- A 2017 study by ImpactEcon, an economic analysis consulting company, estimates that if NAFTA were to terminate, real GDP, trade, investment, and employment in all three NAFTA countries would decline.[138] The study estimates U.S. job losses of between 256,000 and 1.2 million in three to five years, with about 95,000 forced to relocate to other sectors. Canadian and Mexican employment of low skilled workers would decline by 125,000 and 951,000, respectively.[139] The authors of the study estimate a decline in U.S. GDP of 0.64% (over $100 billion).
- The Coalition of Services Industries (CSI) argues that NAFTA continues to be a remarkable success for U.S. services providers, creating a vast market for U.S. services providers, such as telecommunications and financial services. CSI estimates that if NAFTA is terminated, the United States risks losing $88 billion in annual U.S. services exports to Canada and Mexico, which support 587,000 high-paying U.S. jobs.[140]

Some trade policy experts contend that NAFTA has been a bad deal for U.S. workers and cost the United States nearly 700,000 jobs as of 2010.[141] They contend that renegotiating NAFTA offers new opportunities to update the agreement with a new labor template and updated provisions to raise labor standards and help protect U.S. workers. The Economic Policy Institute (EPI) recommends that the United States seek stronger labor standards and enforcement in the NAFTA renegotiations. USMCA's modernized labor provisions may reflect some of the EPI recommended changes of including ILO conventions concerning the freedom of association, collective bargaining, discrimination, forced labor, child labor, and workplace safety and health.[142]

Canada and Mexico likely would maintain NAFTA between themselves if the United States were to withdraw. U.S.-Canada trade could be governed either by CUSFTA, which entered into force in 1989 (suspended since the advent of NAFTA), or by the baseline commitments common to both countries as members of the World Trade Organization. If CUSFTA remains in effect, the United States and Canada would continue to exchange goods duty free and would continue to adhere to many provisions of the agreement common to both CUSFTA and NAFTA. Some commitments not included in the CUSFTA, such as intellectual property rights, would continue as

[137] Sherman Robinson et al., *Withdrawing from NAFTA Would Hit 187,000 U.S. Exporting Jobs, Mostly in Heartland*, Peterson Institute for International Economics, November 16, 2017.

[138] Terrie Walmsley and Peter Minor, *Reversing NAFTA: A Supply Chain Perspective*, ImpactEcon, Working Paper, March 2017, pp. 26-27.

[139] Ibid.

[140] Testimony of Christine Bliss, President of Coalition for Services Industries (CSI), House Ways and Means Committee Subcommittee on Trade, July 18, 2017.

[141] Robert E. Scott, Josh Bivens, and Samantha Sanders, *Renegotiating NAFTA: What should the priorities be?*, Economic Policy Institute, December 7, 2017.

[142] Ibid.

baseline obligations in the WTO.[143] However, it is unclear whether CUSFTA would remain in effect, as its continuance would require the assent of both parties.[144]

Tariffs

In the unlikely event of a U.S. withdrawal from NAFTA, the United States would presumably would return WTO most-favored-nation tariffs, the rate it applies to all countries with which the United State does not have an FTA. The United States and Canada maintain relatively low simple average MFN rates, at 3.5% and 4.1%, respectively. Mexico has a higher 7.0% simple average rate. However, all countries have higher "peak" tariffs on labor intensive goods, such as apparel and footwear, and some agriculture products.

Table 2. MFN Tariffs for NAFTA Countries

(By percentage, trade weighted reflects 2015 trade)

Tariff Type	United States	Canada	Mexico
Simple Average Bound	3.4	6.5	36.2
Agriculture	4.8	15.4	45.0
Non-Agriculture	3.2	5.2	34.8
Simple Average MFN Applied	3.5	4.1	7.0
Agriculture	5.2	15.6	14.6
Non-Agriculture	3.2	2.2	5.7
Trade-Weighted Av. MFN	2.4	3.1	4.5
Agriculture	3.8	12.4	20.1
Non-Agriculture	2.3	2.3	3.5

Source: World Trade Organization, Tariff Profiles 2017.

Of the three NAFTA parties, the United States has the lowest MFN tariffs in most categories. Applied tariffs are higher in Mexico than the United States or Canada, although Canada has double-digit applied agricultural tariffs. The United States and Canada have relatively similar bound and applied tariffs at the WTO. Mexico's bound tariff rates are very high and far exceed U.S. bound rates. Without NAFTA, there is a risk that tariffs on U.S. exports to Mexico could reach up to 36.2% (see **Table 2**).[145] In agriculture, U.S. farmers would face double-digit applied and trade-weighted rates in both Mexico and Canada. Mexico and Canada likely would maintain duty-free treatment between themselves through maintenance of a bilateral NAFTA, or through commitments made in conjunction with the CPTPP (TPP-11)

If the United States withdrew from NAFTA, certain commitments would be affected, such as the following:

[143] Similarly, while NAFTA commitments on government procurement would lapse if the agreement terminated, procurement commitments would continue under the WTO Government Procurement Agreement.

[144] "What If the United States Walks Away from NAFTA," by Dan Cuiriak, *C.D. Howe Institute Intelligence Memo,* November 27, 2017.

[145] Mary Amiti and Caroline Freund, *U.S. Exporters Could Face High Tariffs without NAFTA*, Peterson Institute for International Economics, Trade and Investment Policy Watch, April 18, 2017.

- **Services Access.** The three NAFTA countries committed themselves to allowing market access and nondiscriminatory treatment in certain service sectors. If the United States withdrew from NAFTA, it would still be obligated to adhere to the commitments it made for the WTO's General Agreement on Trade in Services. While these commitments were made contemporaneously with NAFTA, given that the NAFTA schedule operated under a negative list basis—all sectors included unless specifically excluded—and GATS on a positive list—specific sectors are listed for inclusion—NAFTA is likely more extensive.
- **Government Procurement.** As noted previously in this report, the NAFTA government procurement chapter sets standards and parameters for government purchases of goods and services. The schedule annexes set forth opportunities for firms of each party to bid on certain contracts for specified government agencies. The WTO Government Procurement Agreement (GPA) also imposes disciplines and obligations on government procurement. Unlike most other WTO agreements, membership in the GPA is optional. Canada and the United States would still have reciprocal obligations as members of the GPA. In fact, since the GPA was renegotiated in 2014, commitments between the two are greater than under NAFTA. However, Mexico is not a member of the GPA, and U.S. withdrawal from NAFTA would allow Mexico to adopt any domestic content or buy local provisions. (Since U.S. firms are more competitive in obtaining Mexican contracts than Mexican firms in the United States, this may adversely affect some U.S. domestic firms.)
- **Investment.** Unlike many chapters in NAFTA which have analogous counterparts in the WTO Agreements, the investment chapter in the WTO does not provide the level of protection for investors as does NAFTA, subsequent U.S. trade agreements, or bilateral investment treaties. If the United States withdrew from NAFTA, U.S. investors would lose protections in Canada and Mexico. Countries would have more leeway to block individual investments. U.S. investors would not have recourse to the investor-state dispute settlement (ISDS) mechanism, but would need to deal with claims of expropriation through domestic courts, or recourse to government-to-government consultation. Canada and Mexico likely would maintain investor protection between them through the prospective CPTPP or through maintenance of NAFTA provisions.

Outlook

The timeline for congressional consideration of the proposed USMCA remains unclear in part because of the TPA timeline and also because of issues voiced by Congress related to various provisions of the agreement and other ongoing trade issues with Canada and Mexico. The agreement would have to be approved by Congress and ratified by Mexico and Canada before entering into force. On August 31, 2018, pursuant to TPA, President Trump provided Congress a 90-day notification of his intent to sign an FTA with Canada and Mexico. On January 29, 2019, as required by TPA 60 days after an agreement is signed, U.S. Trade Representative Robert Lighthizer submitted to Congress changes to existing U.S. laws that will be needed to bring the United States into compliance with the proposed USMCA. A report by the ITC on the possible economic impact of TPA is not expected to be completed until April 20, 2019 due to the 35-day

government shut down. The report has been cited by some Members of Congress as key to their decisions on whether to support the agreement.[146]

Some policymakers have stated that the path forward to passage of the USMCA by Congress is uncertain partially because the three countries have yet to resolve disputes over U.S. steel and aluminum tariffs. The United States, Canada, and Mexico are currently in a trade dispute over U.S. actions to impose tariffs on such imports due to national security concerns as discussed earlier in the report, The conclusion of the proposed USMCA did not resolve the Section 232 tariff dispute. The U.S. business community, industry groups, some congressional leaders, and Mexican government officials have publicly stated that the tariff issues must be resolved before the USMCA could enter into force.[147]

Questions surrounding passage of Mexico's proposed labor reforms could be a key issue for Congress as lawmakers consider the proposed USMCA. Under Annex 23-A of USMCA's labor chapter, Mexico has commitments to adopt and maintain measures necessary for the effective recognition of the right to bargain collectively, including the establishment of an independent Labor Court for the adjudication of labor disputes. The reforms were expected to be passed into law before January 1, 2019 in order to avoid a delay of the USMCA's entry into force. Mexico has not yet passed the reforms. Mexican officials have stated that passing labor reforms are a priority for President López Obrador and the Mexican Congress and that the legislation could be passed as early as February 2019. Other issues are also surfacing as major areas of debate among Members and between the Executive Branch and Congress, as discussed above.

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[146] "ITC Says Release of USMCA Study to be Delayed Due to Shutdown," *World Trade Online*, January 29, 2019.

[147] See Hoagland, "Ways and means Democrats Question USMCA Timing, Point to 232 Issues," *World Trade Online*, January 23, 2019; Isabelle Hoaglana, "Brady: Congress Not Willing to Consider USMCA until Steel, Aluminum Issues Resolved," *World Trade Online*, January 29, 2019; and Letter from Group of 46 industries to The Honorable Wilbur Ross and The Honorable Robert Lighthizer, January 23, 2019.

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