

MEMORANDUM

October 30, 2018

To: The Honorable Henry Cuellar
Attention: Zackary Linick

From: Congressional Research Service

Subject: **The Proposed USMCA and U.S. Trade Relations with Mexico**

This memorandum responds to your request for background information on the proposed U.S.-Mexico-Canada Agreement (USMCA) in comparison to the North American Free Trade Agreement (NAFTA) and implications for U.S.-Mexico trade relations. The memorandum provides a summary of selected USMCA provisions that may affect U.S.-Mexico trade relations in the context of NAFTA. The information provided in this memorandum may be used in other CRS products.

Overview of the USMCA

Market Access

A significant aspect of NAFTA relates to market access for goods and services. The agreement eliminated tariffs over 10 years (15 years for a few sensitive products) and most nontariff barriers on North American goods, as long as they meet specific rules of origin. Trade barriers on sugar and corn received the longest phase-out periods.

The proposed USMCA would maintain NAFTA market access provisions.¹ It would maintain duty-free treatment on cross-border trade for goods meeting rules of origin requirements. It would add new provisions for transparency in import licensing and export licensing procedures. Selected more specific provisions are addressed below.

Motor Vehicles and Rules of Origin

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 proposed USMCA would tighten auto rules of origin by including:

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

- 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 Commerce², 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.

Agriculture

The headline issue in the USMCA agriculture negotiations was dairy trade with Canada. The agreement expand TRQs that increase each year for U.S. exports of dairy, poultry, and eggs, but it does not dismantle Canada's supply-management system for those products. Canada also removed its "Class 7" pricing for ultra-high filtration (UHF) milk. In return, the United States expanded import quota levels for Canadian dairy and sugar products. The agreement has several provisions of general applicability and that concern Mexico. It:

- Requires that sanitary and phytosanitary (SPS) measures must be based on "relevant scientific principles," and sets forth procedures for resolving SPS disputes;
- Protects proprietary formulas for prepackaged foods and food additives that limit the information parties can ask for from food company exporters;
- Establishes transparency and notification requirements for any new geographical indications (GIs) that a country wants to recognize and establishes a process for determining whether a food name is common or should be protected. USMCA protects GIs for food products that Canada and Mexico have already agreed to in trade negotiations with the European Union (EU) and:
 - Allows U.S. producers to continue to use 33 terms for cheese in Mexico,
 - Requires that Tequila and Mezcal may only be produced in Mexico, along with a side letter protecting Charanda, Sotol, and Bacanora spirits; and
- specifies protections, transparency requirements and coordination on agricultural biotechnology, an issue that is not addressed in NAFTA.

The agreement does not include changes to trade remedy laws to address seasonal produce as requested by southeastern U.S. produce growers and opposed by Mexico. It also does not address non-tariff barriers to market access for U.S. fresh potatoes in Canada and Mexico. Finally, the agreement does not address a resolution for retaliatory tariffs on U.S. agricultural exports to those countries.³

² See CRS In Focus IF10971, *Section 232 Auto Investigation*, coordinated by Rachel F. Fefer.

³ Adapted from CRS In Focus IF10996, *Agricultural Provisions of the U.S.-Mexico-Canada Agreement*, by Jenny Hopkinson

Dispute Settlement

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.⁴ These dispute settlement provisions in Chapter 20 were innovative at the time NAFTA was negotiated. They have rarely been used, in part because the provisions of NAFTA substantially overlap with those of the World Trade Organization (WTO), which came into force a year after NAFTA. WTO dispute settlement has been used extensively—over 500 cases brought involving WTO members including the United States, Canada, and Mexico—due to perceived advantages such as an appellate mechanism and a growing body of precedent.

Alone among current U.S. FTAs, NAFTA also contains a binational dispute settlement mechanism in Chapter 19 that provides disciplines for settling disputes arising from a NAFTA party's statutory amendment of its antidumping (AD) or countervailing duty (CVD) laws, or as a result of a NAFTA party's AD or CVD final determination⁵ on the goods of an exporting NAFTA party. Chapter 19 provides for binational panel review of final determinations in AD/CVD investigations conducted by NAFTA parties *in lieu of* judicial review in domestic courts. In cases in which a NAFTA partner did not preserve "fair and predictable disciplines on unfair trade practices," or asserts that a NAFTA partner's amendment to its AD or CVD law is inconsistent with the WTO Antidumping or Subsidies Agreements,⁶ the aggrieved NAFTA partner may request a judgment from a binational panel rather than through the legal system of the defending party.⁷ The Trump Administration stated in its summary of objectives for NAFTA renegotiation that it would seek to eliminate the Chapter 19 dispute settlement mechanism.⁸

The proposed USMCA would maintain the NAFTA state-to-state mechanism (NAFTA Chapter 20) for most disputes arising under the agreement. It would also retain the binational dispute settlement mechanism (NAFTA Chapter 19) to review trade remedy disputes. However, USMCA would eliminate some investor-state dispute settlement (ISDS) provisions in NAFTA's investment chapter (NAFTA Chapter 11). The USMCA would eliminate ISDS with respect to Canada entirely⁹, and limit ISDS between the United States and Mexico to claimants regarding government contracts in the oil, natural gas, power generation, infrastructure, transportation, and telecommunications sectors; or in other sectors provided the claimant exhausts national remedies first.

Unlike many chapters in NAFTA which have analogous counterparts in the WTO Agreements, NAFTA's investment chapter commitments are largely outside the scope of WTO agreements. The WTO Trade-Related Agreement on Investment Measures (TRIMS) is narrowly focused on goods trade, does not

⁴ If the parties are unable to resolve the issue through consultations, they may take the dispute to the NAFTA Trade Commission, which is comprised 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.

⁵ In Canada, AD/CVD investigations on imports are conducted by the Canada Border Services Agency (CBSA, makes dumping and subsidy determinations) and the Canadian International Trade Tribunal (CITT, 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.

⁶ 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.

⁷ CRS In Focus IF10645, *Dispute Settlement in U.S. Trade Agreements*, by Ian F. Fergusson.

⁸ USTR, *Summary of Objectives for the NAFTA Renegotiation*, p. 14.

⁹ Mexico and Canada are maintaining ISDS among themselves through the Comprehensive and Progressive Trans-Pacific Partnership (TPP-11).

address ISDS, nor does it provide NAFTA's level of investor protection, also found in subsequent U.S. free trade agreements, or bilateral investment treaties. Therefore, if the USMCA, which includes less extensive investment protections than NAFTA, enters into force, U.S. investors would lose some investment protections in Mexico (as well as Canada), such as the ability to bring to arbitration claims for indirect expropriation, as well as ability to effectively use ISDS for certain investments. Mexico and Canada are maintaining ISDS among themselves through the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP or TPP-11).¹⁰

Intellectual Property Rights (IPR)

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.

USMCA would retain NAFTA's core protections for copyrights, patents, including exclusivity periods for test data, trade secrets, trademarks, and geographical indications, as well as specific enforcement requirements. USMCA would add new IPR protections:

- 10 years of data protection for biologics;
- Copyright protection term, in general, extended from 50 to 70 years after the author's death;
- Prohibitions on circumvention of technological protection measures;
- Criminal and civil penalties protections for trade secret theft, including by state-owned enterprises and cyber-theft; and
- Copyright safe-harbor provisions on internet service providers' liability.

Energy

In NAFTA's energy chapter, the three parties confirmed respect for their constitutions, particularly of 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.¹¹

Although the USMCA would remove NAFTA's energy chapter, which recognizes Mexico's constitutional prohibitions on foreign investment or ownership of Mexico's energy sector, it would add a new chapter with provisions that recognize the Mexican constitution and the Mexican government's direct ownership of hydrocarbons. Other provisions in the USMCA would, in effect, "lock in" the current legal framework for private energy projects in Mexico, which is an expansion from NAFTA, by granting equal opportunities for U.S. companies to participate in energy and electricity contracts in Mexico.

¹⁰ The CPTPP enters into effect 60 days after ratification by at least 50% of the signatories (six of the eleven participating countries). As of October 27, 2018, five countries, including Mexico and Canada, had ratified the agreement.

¹¹ 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.

Labor and the Environment

NAFTA marked the first time that provisions on worker rights and the environment were associated with an FTA. It includes these provisions in side agreements that require all parties to enforce their own labor and environmental laws, as well as provisions to encourage greater cooperation. The side agreements include consultation mechanisms for addressing disputes and special labor and environmental dispute settlement procedures. The enforcement mechanism applies mainly to a party's failure to enforce its own labor and environmental laws in a manner affecting trade and investment. Seven subsequent FTAs included similar provisions within the main text of the agreement. The proposed USMCA revises labor and environmental provisions and provides the same dispute mechanism as other parts of the agreement.

USMCA's provisions on labor and the environment would require parties to not only enforce their own laws, but also to adopt and maintain specific laws, similar to labor and environment provisions in more recent U.S. FTAs. It would require parties to:

- Adopt and maintain in statutes and regulation the International Labor Organization (ILO) Declaration of Rights at Work,
- Enforce their own labor and environmental laws, and not to waive or derogate from these laws in a manner involving trade or investment,
- Prohibit the most harmful fisheries subsidies¹², and
- Adhere to provisions related to illegal trafficking, marine species, air quality, marine litter, and sustainable forestry.

In addition, it would commit Mexico to specific legislative actions to establish effective recognition of the right to collective bargaining.

Government Procurement

NAFTA Chapter 10 on government procurement sets standards and parameters for government purchases of goods and services. 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.

The proposed USMCA government procurement chapter would only apply to U.S.-Mexico procurement. U.S. procurement relations with Canada, however, would presumably remain covered by the more recent and comprehensive WTO GPA as long as both countries remain parties. However, the monetary threshold for the GPA is higher at \$180,000 as compared to NAFTA's \$25,000, thus reducing the number of contracts U.S. and Canadian firms would be guaranteed eligible to bid on in each government's respective procurement markets.

E-Commerce, Data Flows, and Data Localization

NAFTA was implemented in the early days of the Internet, and does not contain digital provisions. The USMCA includes new digital trade provisions similar to those in the proposed Trans-Pacific Partnership (TPP), including prohibiting customs duties on electronically-transmitted products, and limits on source

¹² Research studies show that certain types of government fishing fleet subsidies contribute to a critical global problem of having too many vessels on the world's oceans chasing too few fish. See Elizabeth Wilson, *Fishing Subsidies Are Speeding the Decline of Ocean Health*, Pew Charitable Trusts, July 19, 2018, <https://www.pewtrusts.org/en/research-and-analysis/articles/2018/07/19/fishing-subsidies-are-speeding-the-decline-of-ocean-health>.

code disclosure requirements. USMCA contains broader provisions on cross-border data flows and restrictions on data localization requirements than TPP. Many of the digital trade commitments will facilitate trade in services as well.

Financial Services

Under the financial services chapter, the parties agreed to cross-border data flows and prohibitions on data localization, an issue that was not resolved in the TPP. Parties must also grant financial institutions of a USMCA partner established in its territory access to payment and clearing systems operated by public entities. Parties must also provide national treatment to new financial products and services, i.e., a party must allow the provision of new financial products and services by a partner country's firms if it allows its own firms to market those products and services. However, USMCA excludes from its obligations measures adopted or maintained by a party related to government procurement of financial services or subsidies or grants provided by the party regarding the cross-border trade in financial services.

New Provisions

Additional provisions in USMCA that are not in NAFTA include:

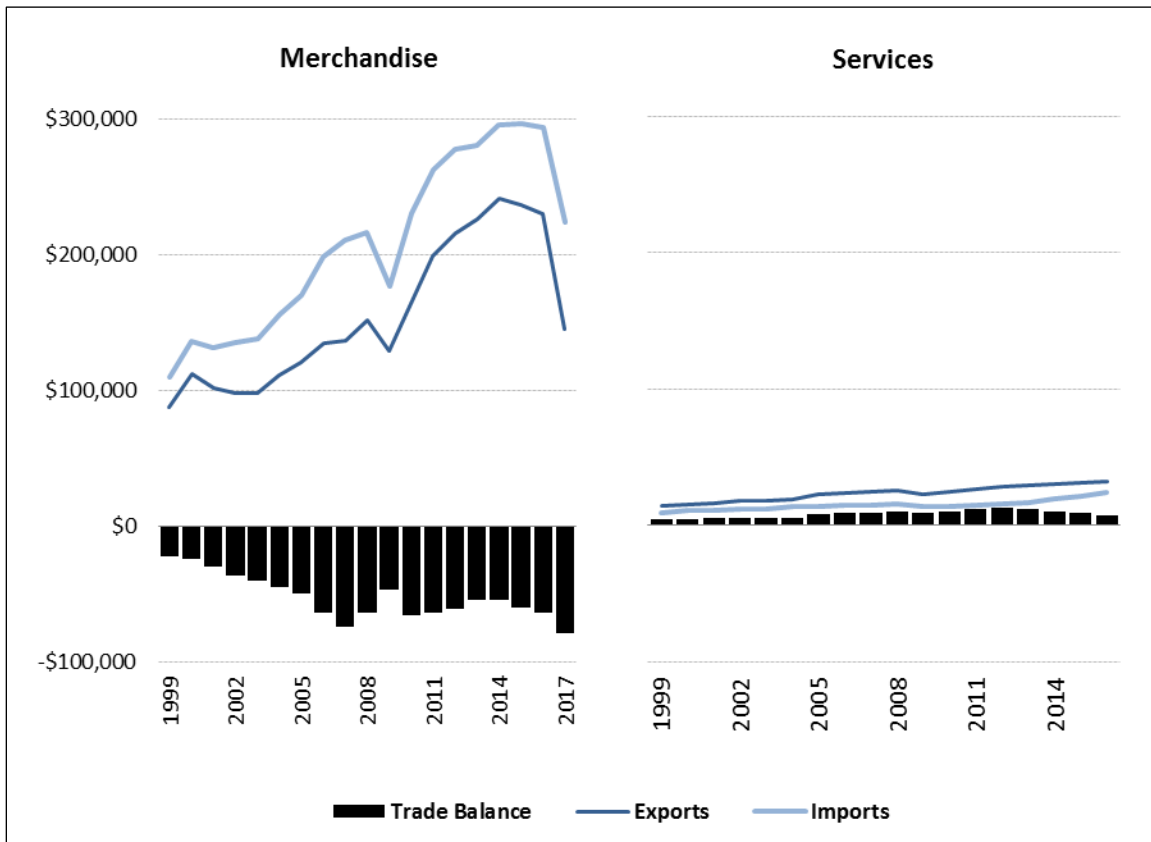
- Binding obligations on currency misalignment. The parties agreed to “achieve and maintain a market-determined exchange rate regime,” and to “refrain from competitive devaluation, including through intervention in the foreign exchange market.” However, only transparency and reporting requirements are subject to dispute settlement procedures.
- A sunset clause requiring a joint review and agreement on renewal six years after entering into force; in lieu of mutual agreement at the time, USMCA would expire 16 years later.
- A new chapter on State-Owned Enterprises (SOE), require SOE's to act in accordance with commercial considerations and require SOEs to provide non-discriminatory treatment to other USMCA country firms.
- *De Minimis* customs threshold for duty free treatment set a \$117 (C\$150) for Canada and Mexico. Tax-free threshold set at \$50 for Mexico and C\$40 (about \$31) for Canada.
- Possibility for a party to withdraw from the agreement if another party enters into an FTA with a country it deems to be a non-market economy (e.g., China).
- 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.

U.S.-Mexico Trade Relations

The United States is, by far, Mexico's leading partner in merchandise trade, while Mexico is the United States' third-largest trade partner after China and Canada. Mexico ranks second among U.S. export markets after Canada, and is the third-leading supplier of U.S. imports. U.S. merchandise trade with Mexico increased rapidly since NAFTA entered into force in January 1994. U.S. exports to Mexico has increased from \$41.6 billion in 1993 (the year prior to NAFTA's entry into force) to a peak of \$241.0 billion in 2014 (479% increase), before a steady decline to \$144.6 billion in 2017. The value of U.S. exports to Mexico declined 37.1% between 2016 and 2017. U.S. imports from Mexico increased from \$39.9 billion in 1993 to a peak of \$296.4 billion in 2015, and then decreased to \$223.4 billion in 2017. Imports from Mexico decreased by 24.0% in 2017 (see **Figure 1**). In 2017, the trade deficit with Mexico was \$78.8 billion.

In services, the value of trade between the United States and Mexico is much lower, though it is also increasing rapidly (see **Figure 1**). U.S. services exports to Mexico totaled \$32.0 billion in 2016, up from \$14.2 billion in 1999, while imports were valued at \$24.6 billion in 2016, up from \$9.7 billion in 1999. The United States had a services trade surplus from Mexico of \$7.5 billion in 2016.¹³

Figure 1. U.S. Trade with Mexico: 1999-2017
(U.S. \$ in billions)



Source: Compiled by CRS using the United States International Trade Commission (USITC) Interactive Tariff and Trade DataWeb at <http://dataweb.usitc.gov>.

The full effects of the proposed USMCA on U.S.-Mexico trade relations would not be expected to be significant because nearly all U.S. trade with Mexico is now conducted duty and barrier free. A 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.-Mexico trade and investment, jobs, wages, or overall economic growth, and that it would probably not have a measurable effect on the U.S. trade deficit with Mexico.¹⁴ The U.S. International Trade Commission (ITC) is conducting an investigation into the likely economic impacts of a USMCA, a required element of the Trade Promotion Authority (TPA) process.¹⁵ TPA 2015 states that

¹³ U.S. Bureau of Economic Analysis interactive statistics, available at <http://www.bea.gov>.

¹⁴ John Brinkley, "USMCA is not the Magnificent Trade Deal Trump Says It Is," *Forbes.com*, October 8, 2018.

¹⁵ CRS In Focus IF10038, *Trade Promotion Authority (TPA)*, by Ian F. Fergusson.

the ITC must issue its report within 105 days of the President's signing of a trade deal. If President Trump signs the USMCA at the end of November, the ITC report would be due by mid-March 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 Mexico were motor vehicles (\$57.4 billion or 26% of imports) and motor vehicle parts (\$45.5 billion or 20% of imports). About 99.4% of U.S. motor vehicle imports and about 75.6% of motor vehicle parts imports from Mexico entered the United States duty-free under NAFTA.¹⁶ In comparison, only 55.6% of total U.S. imports from Mexico in 2017 received duty-free benefits under NAFTA.

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.¹⁷ Some observers contend that manufacturers with a stronger presence in Mexico, such as General Motors and Fiat Chrysler Automobiles, may be more impacted.¹⁸

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 would be limited to filing ISDS claims for breaches of national treatment, most-favored nation treatment, or expropriation, but not indirect expropriation.

A preliminary U.S.-Mexico agreement in the NAFTA negotiations was announced August 30, 2018. After further negotiations with Canada, the three countries announced a slightly revised version of the U.S.-Mexico agreement on September 30, the USCMA, which under TPA could be signed on November 30, 2018. TPA contains certain notification and reporting requirements that likely will push consideration of implementing legislation into the next Congress.¹⁹

¹⁶ CRS calculations based on trade data from the U.S. International Trade Commission.

¹⁷ Nick Lichtenberg, "USMCA 'Manageable' Changes Auto Compliance, Production Costs: Moody's," *Bloomberg First Word*, October 10, 2018.

¹⁸ *Ibid.*

¹⁹ See CRS In Focus IF10038, *Trade Promotion Authority (TPA)*, by Ian F. Fergusson