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YOU SAY USMCA OR T-MEC AND I SAY CUSMA: THE NEW NAFTA – LET'S CALL THE WHOLE THING ON

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SUMMARY

When U.S. President Donald Trump declared that the North American Free Trade Agreement (NAFTA) was the worst trade agreement ever, and threatened to rip it up, it seemed that the very foundations of the North American economy were about to be shaken up. Nor did it help matters that Trump pulled out of the Trans-Pacific Partnership (TPP), withdrew from the World Trade Organization (WTO) and topped all that off by using aggressive trade tactics against major U.S. trade partners like Canada, Mexico and China.

Fortunately, nothing of the sort happened, and the final, revised agreement, recently ratified by Canada, will make incremental rather than earth-shattering changes to free trade flows between Canada, the U.S., and Mexico. Its biggest contribution to the economy is that it puts an end to the uncertainty around the investment climate caused by Trump's actions.

The new NAFTA – referred to in Canada as the Canada-United States-Mexico Agreement (CUSMA) – turned out not to be a game-changer. The old NAFTA, which came into force in 1994, needed updating and its successor improves upon it incrementally. Its economic impact is likely to be a modest one, but its benefits for Western Canada are especially worth noting.

The year 2019 saw the four Prairie Provinces and B.C. carry out nearly C$230 billion in trade with the U.S. and Mexico, with slightly more than C$8 billion of that arising from trade with Mexico alone. In terms of GDP, CUSMA's influence is also expected to be small; however, the certainty it lends to the North American investment climate will have a salutary effect.

After China, Canada is the second largest trading partner with the U.S. In 2018, that relationship amounted to $618.6 billion in total goods trade, with trade in services between the two countries that same year totalling close to $99.9 billion. With oil and gas the largest export to the U.S. and Mexico, the provisions in CUSMA around those resources are beneficial for oil-producing Alberta.

Changes to rules of origin regarding diluent in pipelines are expected to save the Canadian industry $60 million annually in duties and fees, while the elimination of a previous rule requiring a certain level of energy exports to the U.S. means that Canada's sovereignty over its energy resources is reaffirmed.

One of the most important aspects of CUSMA is its guarantee of Canada's tariff-free access to the U.S. and Mexico. Without a trade deal, federal government estimates are that Canada's oil and gas exports would risk dropping by US$38.2 million in a few years.

CUSMA contains nothing drastic. Even one of the provisions that generated the greatest wariness – allowing U.S. imports into Canada's supply-managed dairy system, – comes with a 10-year incremental phase-in and is accompanied by compensation.

On April 3, Canada completed ratification and indicated its readiness to bring the agreement into force. Canada must now wait for the U.S. to do likewise. With all the benefits that CUSMA offers to the many sectors of Canadian industry, it is hoped that the agreement will come into force soon.

INTRODUCTION

Canada recently ratified the Canada-United-Mexico Agreement (CUSMA) and indicated its readiness to the U.S. and Mexico to implement the agreement. CUSMA[1] will replace NAFTA, which came into force in 1994. Canada and the United States are two of the most integrated economies in the world and this integrated North American economy was greatly enhanced by the Canada-U.S. Free Trade Agreement (CUSFTA) brought into force in 1989 and the subsequent NAFTA. CUSFTA and NAFTA were both game changers in regional trade agreements and both set a high standard for such agreements for decades. This briefing note analyzes and assesses the new CUSMA agreement that the three countries recently approved.

The U.S. is by far the largest trading partner of each of the western provinces (Manitoba, Saskatchewan, Alberta and British Columbia). Mexico is among the top five trading partners for each province. In 2019, Western Canada conducted almost C$230 billion in trade with the U.S. and Mexico. Just over C$8 billion of this trade is conducted with Mexico. We find that the agreement is overall a net benefit to Canada, and to Western Canada especially, because it reduces policy uncertainty for the North American economy.

The agreement is expected to have a small impact on the Canadian economy in terms of GDP. However, such an assessment ignores the agreement's biggest potential impact, which is to reduce the uncertainty created by the renegotiation process. This uncertainty hurt the investment climate in Canada and it will be resolved by ratifying the agreement.

OVERVIEW

CUSMA was initially agreed to and signed on Dec. 20, 2018. However, before it could be ratified in the new Democrat-controlled U.S. Congress, it went through another round of negotiations and was revised at the insistence of the Democrats, led by Nancy Pelosi, Speaker of the House of Representatives. The revision has been completed and on Dec. 10, 2019, Canadian Deputy Prime Minister Chrystia Freeland, United States Trade Representative Robert Lighthizer, and Mexican undersecretary for North America Jesús Seade signed a revised version of the agreement. Mexico ratified the original agreement and has subsequently ratified the revised CUSMA. The U.S. House of Representatives and Senate voted in favour of the agreement and, on Jan. 29, 2020, U.S. President Donald Trump signed it. The Liberal minority government touted the agreement, urging Parliament to sign. Since they lack a majority government, the Liberals required at least one other party to support CUSMA in order for it to pass. On March 13th, implementing legislation for CUSMA (Bill C-4) was passed by the Canadian House of Commons and Senate and given Royal Assent. Bill C-4 integrated CUSMA into Canadian law and set out amendments required to Canadian legislation before the agreement could be ratified. On April 3, Canadian media reported that Canada completed ratification and indicated its readiness to bring the agreement into force. Canada and Mexico must now wait for the U.S. to provide

1 The agreement is known as the Canada-United Sates-Mexico Agreement (CUSMA) in English Canada, the Accord Canada–États-Unis–Mexique (ACEUM) in French Canada, the United States-Mexico-Canada Agreement (USMCA) in the U.S., and Tratado entre México, Estados Unidos y Canadá (T-MEC) in Mexico.

its ratification notice before the agreement can be implemented. It is unclear when this will occur, due to the crisis caused by COVID-19. Also, US politicians and companies have placed pressure on the U.S. Trade Representative to delay the deal. Further, changes to rules of origin require new regulations that have yet to be completed.

During the 2016 U.S. presidential campaign, Donald Trump famously called NAFTA the worst trade agreement ever signed. As president, he wasted no time creating uncertainty in the world trading system by:

- pulling out of the Trans-Pacific Partnership (TPP);[2]
- threatening to terminate NAFTA;
- undermining the rules-based multilateral trading system by threatening to withdraw from the World Trade Organization (WTO) and blocking appointments to the appellate body; and
- by arguing that trade wars are easy to win and making aggressive use of seldom used trade actions, such as sections 301 and 232, on China and key allies, including Canada and Mexico.[3]

NORTH AMERICAN TRADE

Canada is the second largest goods trading partner on a two-way basis with the U.S. (having recently been surpassed by China) with $618.6 billion in total goods trade in 2018 (USTR n.d.). Canada is the largest goods export market for the U.S. and the second largest supplier of import goods to the U.S. market. Moreover, two-way trade in services between Canada and the U.S. totalled approximately $99.9 billion in 2018 (USTR n.d.).

Figure 1a displays Canada's top five exports to the U.S. and Mexico in 2019. Figure 1b displays Western Canada's top export industries to the U.S. and Mexico in 2019. By far, the largest industry is oil and gas manufacturing, accounting for 85 per cent of Western Canada's goods exports. Other notable western industries include sawmills and petroleum refining, which account for four and five per cent of Western Canada's exports to North America, respectively. Unsurprisingly, the overwhelming majority of exports from the lumber industry originate in B.C., while Alberta is the largest exporter of petroleum. The western Canadian region falls behind only Central Canada (Quebec and Ontario) in terms of value of trade with the U.S. and Mexico. On the national level, oil and gas extraction is the largest export industry to the U.S. and Mexico and the West leads Canada in the export of oil and gas.

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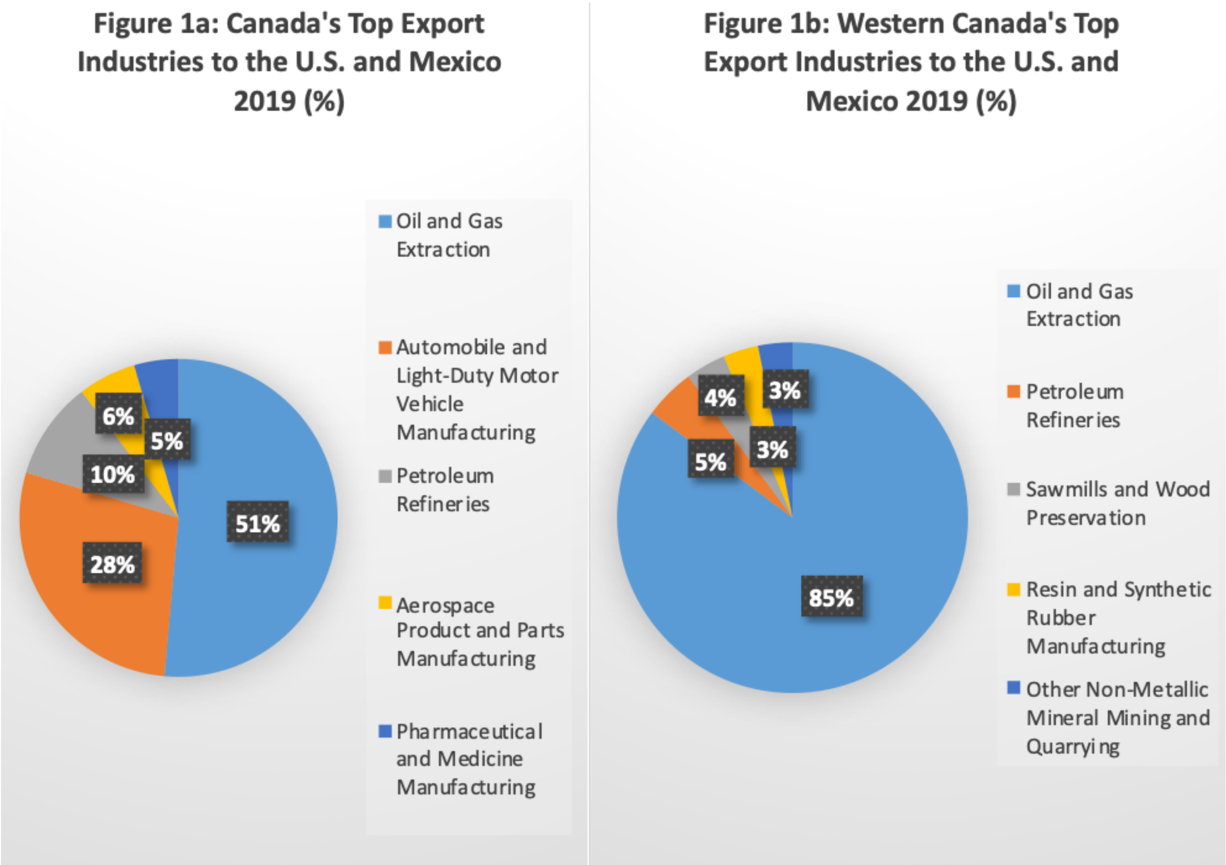
2 Note that the TPP had bipartisan support and was a key piece of former president George W. Bush's trade policy. It was finalized and signed by former president Barack Obama. Note also that after the U.S. pulled out of the TPP, the other 11 countries signed what became known as the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) on March 8, 2018 in Santiago, Chile.

3 Section 232 of the *Trade Expansion Act* of 1962 gives the president broad authority to restrict imports in the interest of national security and this provision was used to impose tariffs on steel and aluminum products. Section 301 of the *Trade Act* of 1974 gives the president broad authority to impose tariffs on countries that make unjustified, unreasonable or discriminatory trade actions. It was used on imports from China.

FIGURE 1: WHAT DOES CANADA TRADE WITH THE U.S. AND MEXICO?



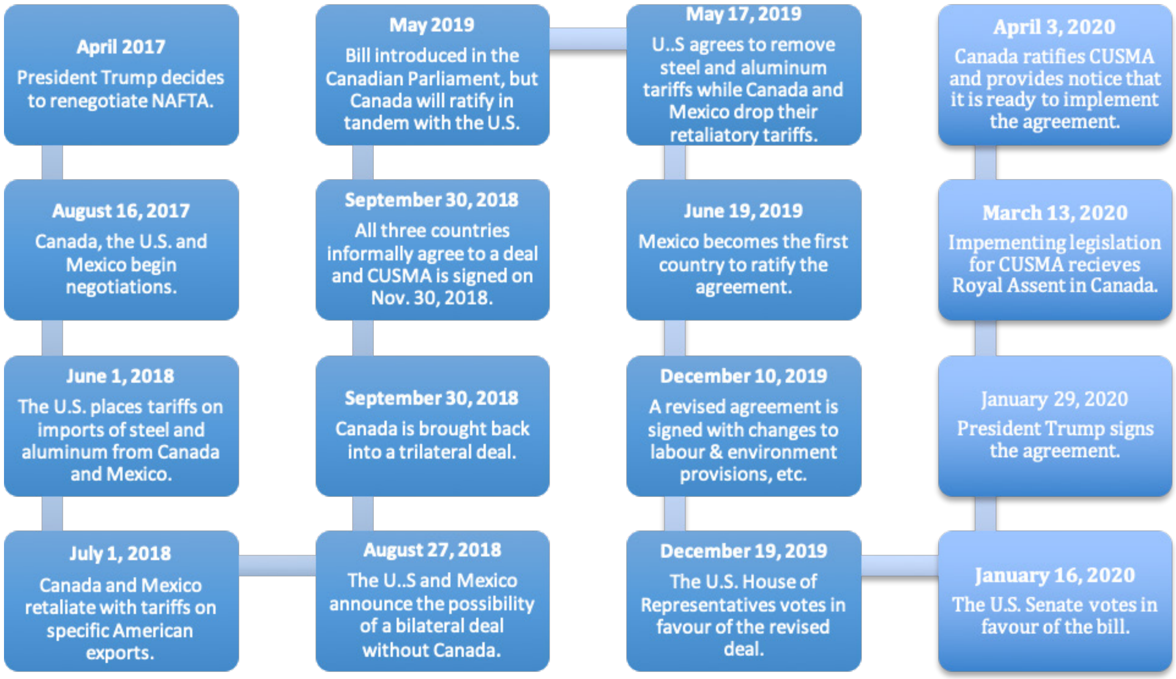
Source: Statistics Canada Trade Data Online

The U.S. is by far the largest trading partner for each of the western provinces and Mexico is among the top five trading partners for each province. Alberta exports the majority of Western Canada's oil and gas to the U.S. and Mexico, making it the largest provincial exporter. Petroleum-related products are Alberta's most significant exports to the North American continent, amounting to just over 70 per cent of Alberta's exports to both countries.

CUSFTA, NAFTA AND CUSMA

The Trump administration placed considerable pressure on Canada and Mexico to achieve a deal. This included imposing 25-per-cent tariffs on steel and 10-per-cent tariffs on aluminum imports from the two countries on June 1, 2018. Both countries retaliated with tariffs on imports from the U.S. Although the U.S. had agreed to remove these tariffs upon completion of an agreement, the tariffs remained in place after the three countries signed a new agreement on Nov. 20, 2018 at the G20 summit in Buenos Aires. Mid-term elections disrupted the ratification process in the U.S. The Democrats then took control of Congress and required changes to the agreement before moving it forward to a vote. The Democrats' changes included strengthening the labour and environmental provisions, while Republican lawmakers pushed for elimination of the steel and aluminum tariffs as had been agreed to. Table 1 provides an overview of the timeline of key events in the negotiations.

TABLE 1: A TIMELINE OF CUSMA NEGOTIATIONS



The three countries went back to the bargaining table and on Dec. 10, 2019, Freeland, Lighthizer and Seade signed a revised version of the agreement.

It was very clear that although the three North American countries had worked together to improve and update NAFTA over the years, it was time to overhaul the agreement. Although NAFTA was a cutting-edge agreement in 1994, there was considerable room for updating, improving and expanding the agreement's provisions to make it more effective for Canada and its North American partners. The world economy had changed considerably and the nature of regional trade agreements had been transformed in recent years. Meanwhile, Canada and Mexico have been active in the new generation of trade agreements. Canada has successfully negotiated, signed and ratified the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) and the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). Both of these agreements are considered cutting-edge in their approach and scope. The new-generation trade agreements substantially update and improve upon the first-generation regional trade agreements such as CUSFTA and NAFTA.

Overall, the revised NAFTA is more of a managed trade agreement than a free trade agreement like its predecessor. It has some major changes for automakers with revisions to the rules of origin changes that require 75 per cent of the components of cars or trucks be manufactured in North America to qualify for zero tariffs (a major change up from 62.5 per cent in NAFTA). The agreement also requires that about 45 per cent of automobile components must be made by workers earning at least US$16 an hour by 2023. The deal includes new labour and environmental standards, intellectual property protections and some digital trade provisions. As always, there will be some Canadian winners and losers from the agreement and many of the provisions are difficult to quantify. A key positive result for Canada was the preservation of an independent mechanism to resolve trade disputes between the countries (NAFTA's Chapter 19). Moreover, many will applaud the removal of the contentious provision in NAFTA granting investors the ability to sue governments over changes to policies that potentially damaged their businesses (Chapter 11). This has been eliminated in Canada and the U.S. and its use has been restricted in Mexico except in a few sectors. Another important outcome for Canada and Mexico is the elimination of the high tariffs on steel and aluminum imposed by the U.S. Although this had been promised in negotiations, the tariffs were not initially removed when the agreement was signed, but the tariff removal became a condition of support for the agreement in Congress.

CUSMA, TRADE AGREEMENTS AND UNCERTAINTY

Given the context for the NAFTA renegotiations and the American disdain for trade rules, the steel and aluminum tariffs and the renegotiation of NAFTA created tremendous policy uncertainty in North America. After the three parties revised the initial deal in December 2019, Bank of Canada Governor Stephen Poloz emphasized the importance of CUSMA's completion. He noted that uncertainty in the realm of trade policy was partially responsible for lower than expected investment into Canada. This concern over the impact of uncertainty is substantiated by a growing body of economic literature that models and measures the impact that uncertainty surrounding trade agreements has on economic activity. For example, scholars at VoxEU.org created the World Trade Uncertainty Index, which attempts to measure the link between trade policy and trade uncertainty (Ahir et al. 2019). The volatility of the North American trading relationship in recent years has contributed to a spike in trade uncertainty which has led to a decline in economic output. By eliminating uncertainty surrounding tariffs, CUSMA's ratification should help investment into Canada and help to curb negative trends in economic output.

Overall, the agreement is more about managed trade; for example, by increasing North American content in automobile production. The provisions in the text are difficult to quantify but attempts to do so have found fairly moderate impacts of the agreement on the Canadian economy overall. For example, an economic impact assessment of the agreement conducted by scholars at the C.D. Howe institute found small negative impacts such as: "Canada's real GDP stands to shrink by -0.4 percent and economic welfare to fall by over US $10 billion" (Ciuriak et al. 2019). However, that study ignored the impact of signing the agreement on resolving uncertainty and improving the investment climate in Canada. Reports released by both Global Affairs Canada and the U.S. International Trade Commission (ITC 2019) also find that the agreement will have minimal impact on GDP. In spite of this, the report concludes that CUSMA is a better option than the absence of a trade deal entirely. This is, in part, because the deal reduces uncertainty in various sectors. However, this report does not attempt to quantify the benefits of reduced policy uncertainty (Global Affairs Canada 2020).

The ITC's report on the agreement did attempt to quantify the effects of policy uncertainty reduction. It found that the agreement's most significant effects will be in its ability to reduce policy uncertainty in an array of sectors (ITC 2019). Positive effects are expected on U.S. GDP, output, employment and wages.

CUSMA AND THE WEST

CUSMA has important implications for western Canadian trade with the North American continent. By "Western Canada" we mean Manitoba, Saskatchewan, Alberta and British Columbia. The U.S. is by far the largest trading partner for each province and Mexico is among the top five trading partners for each province as well.

As with the original NAFTA, there is strong support for the agreement in Western Canada. According to Abacus Data, just under 64 per cent of Western Canadians, on average, believe that the deal is a "good step" for Canada (Anderson and Coletto 2018). This makes Western Canada more supportive of the deal than the Canadian average of 59 per cent. Western Canadians view the deal as favourably as they did the original CUSFTA and NAFTA.

CUSMA lacks a specific chapter dealing with energy matters. Rather, there are energy-related aspects spread throughout the agreement. While the legal underpinnings of North American trade in this industry will remain largely unchanged, there are notable changes, including the following:

- Changes to rules of origin concerning diluent in pipelines transporting crude oil. The amount of non-originating diluent is increased, which, according to Global Affairs Canada, will save Canadian industry $60 million/year in duties and fees.
- The "energy proportionately clause" has been removed from the agreement. Under NAFTA, Canada was required to maintain a certain level of energy exports to the U.S. based on recent export levels. Although no parties invoked the clause, Global Affairs notes that the elimination of this provision "reaffirms Canada's sovereignty over its energy resources."

Further, Canada will maintain tariff free access to the U.S. and Mexican markets. In the absence of an agreement with the U.S. and Mexico, Canada would have faced most-favoured-nation tariffs of 5.25 cents/bbl – 10.5 cents/bbl on petroleum products. In an economic impact assessment, GAC finds that, in the absence of a trade deal, Canadian exports of oil and gas would shrink by US$38.2 million by 2025 (Global Affairs Canada 2020).

The new NAFTA agreement does have some provisions in agriculture and agri-food with implications for the Canadian agri-food sector. The most significant provisions are increased access for U.S. producers into the Canadian supply-managed markets of dairy, eggs and poultry. The access will be implemented over a 10-year period and, even after 10 years, Canadian products will continue to dominate the market. Moreover, the government of Canada has agreed to offer compensation to affected producers and processors to facilitate the transition to increased competition. Consumers will benefit and producers will have time to adjust with compensation to offset the costs of adjustment.

More important for western producers, NAFTA's beneficial terms with respect to trade in grains have been maintained. The U.S. is a major market for Canadian grain producers. It is also Canada's largest export market in wheat and second for Canadian barley exports. The revised NAFTA maintains Canada's access to the U.S. and Mexican economies and this is significant for Canadian producers. CUSMA reduces the tariff on Canadian margarine exports to the U.S. from eight per cent under NAFTA to zero under the revised agreement. There was also some increased market access for beet producers to export refined sugar to the U.S. under changes to the tariff-quota system that expands the quota for exports of refined sugar – this is good news for Alberta beet producers.

Some provisions in USMCA have implications for agricultural biotechnology, designed to promote trade in this area in ways which protect consumers. The provisions take a collaborative approach with working groups established to share information and manage policies related to agricultural biotechnology to improve information and streamline the authorization process for agricultural biotechnology products. An alcohol annex emphasizes national treatment with protection and recognition of national products such as Canadian whisky, Tennessee and Kentucky bourbons and Mexican tequila and mescal. Labelling rules have also been modernized.

Overall, like the rest of the agreement, the changes affecting agri-food are incremental and not transformative. The focus of changes with respect to agriculture emphasize co-operation and incrementally increased market access and integration between the three countries. The agri-food industry in North America is integrated and the biggest impact of the revised agreement will be reducing the uncertainty over market access for agri-food producers and consumers in North America. The evidence is that uncertainty has particularly strong effects on supply chains that are an integral aspect in the agri-food industry.

CONCLUSIONS

As this briefing note highlights, the major result from the renegotiated NAFTA is resolving the uncertainty surrounding the contentious and politicized negotiation process. The result is an updated and improved NAFTA and this is important and a positive result. However, many of the improvements had been covered in the TPP negotiations and the final reworked NAFTA agreement improves and updates NAFTA incrementally. This new agreement doesn't have the transformative or game-changing nature of the previous iterations of North American agreements. There are some important updates and improvements and the agreement does resolve the uncertainty created by the negotiating process. The agreement's economic impact is expected to be modest, but getting a deal done was crucial.

TABLE 2: THE EVOLUTION OF NORTH AMERICAN INTEGRATION: HIGHLIGHTS OF AGREEMENTS

CUSFTA	NAFTA	CUSMA	CUSMA Revised
January 1, 1989 - CUSFTA went into effect between the U.S. and Canada.	**January 1, 1994 - NAFTA went into effect between the U.S., Canada and Mexico.**	**November 30, 2018 – The three NAFTA countries signed CUSMA.**	**December 10, 2019 – Revised CUSMA was signed.**
Key provisions	**Key provisions**	**Key provisions**	**Key provisions**
• Elimination of tariffs. • Reduction of many non-tariff barriers. • Included trade in services. • Investment provisions. • Government procurement. • Dispute settlement mechanisms. • Easing of cross-border entry of businesspersons. • Autos: required 50% of a car's parts be made in North America to qualify it for duty-free trade. • Included an energy chapter. • No termination date but includes a six-month withdrawal clause. • Was suspended and superseded by NAFTA and would come back into effect if NAFTA were terminated.	• NAFTA's architecture and language closely follows CUSFTA. • Has improvements over CUSFTA in areas of services, investment and intellectual property rights. • Autos: required 62.5% of a car's parts be made in North America to qualify it for duty-free trade. • Similar to CUSFTA: Government procurement; dispute settlement; cross border movement of businesspersons. • Chapter 11 – investor–state dispute settlement mechanism (ISDS) extend rights beyond CUSFTA for investors in dispute settlement. • Key exclusions include Canadian supply management including dairy and poultry, Mexico's energy sector and some transportation services. • Two side agreements on labour and the environment.	• Will be reviewed every six years and could expire in 2036, or be extended to 2052. • 30% of vehicle production must be done by workers earning an average production wage of at least $16 per hour. • Zero tariffs if 75% of their vehicles' components are manufactured in the U.S., Canada or Mexico, up from 62.5% under NAFTA. • 70% of the steel and aluminum used in vehicles will have to come from the U.S., Canada or Mexico. • Canada will ease restrictions on its dairy market and allow American farmers to export about $560 million worth of dairy products. That is about 3.5% of Canada's total $16-billion dairy industry. • Trade disputes will continue to be decided by a panel of representatives from all three nations. • Intellectual property rules stiffened.	• Labour chapter provisions have been added to allow parties more ability to pursue violations of labour standards through the labour dispute mechanism. • The environment chapter increases the parties' obligations toward environmental protection, including requirements to follow various multilateral environmental agreements. • Both the alterations to the labour and environmental chapters place the burden of proof upon the defending party in the dispute. • Canada is not required to alter its intellectual property policies in the pharmaceutical sector. • Strengthened state-to state-dispute settlement. • Removal of investor-state dispute settlement (ISDS) mechanism.

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