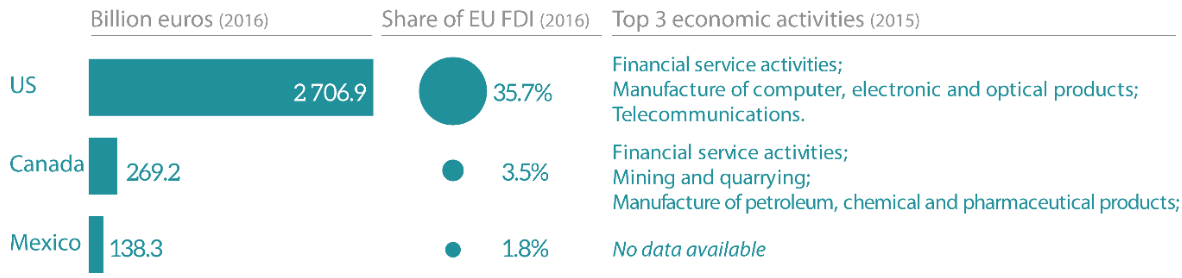
United States-Mexico-Canada Agreement (USMCA): Potential impact on EU companies

The USMCA is a new trade agreement due to replace the North American Free Trade Agreement (NAFTA). The United States, Mexico and Canada signed the agreement on 30 November 2018. While the text of the agreement may still change, if approved, certain USMCA provisions on rules of origin, geographical indications and voluntary export restraints could have implications for EU companies trading with or present in North America, in particular carmakers, food and drink exporters, and dairy producers. The USMCA could also set precedents for future US trade policy, in departing from key principles in international trade and origin determination.

Background

The North American Free Trade Agreement (NAFTA) entered into force under US President Bill Clinton in 1994, already accompanied by criticism. From a European perspective, NAFTA created opportunities to expand trade and investment, in particular for the car industry. During his presidential campaign, President Trump referred to NAFTA as the 'worst deal ever'. While it is difficult to isolate the economic effects of NAFTA, experts consider that it contributed to a tripling of trade between the partners but also to undesirable employment effects such as declining US wages. As soon as he entered office, President Trump notified the signatory parties that he wanted to renegotiate NAFTA.

EU 28 outward investment in the US, Canada and Mexico



Data source: IMF data.

On 30 November 2018, the parties signed a revised NAFTA, renamed the United States-Canada-Mexico Agreement (USMCA), on the margins of the G20 Summit in Buenos Aires. The negotiators were able to build on drafts from the Trans-Pacific Partnership (TPP) negotiations and conclude the agreement relatively swiftly. The agreement will enter into force only once legislators in all three countries have ratified it. Securing Congressional approval in the US is expected to be a major hurdle.

Ratification following the US mid-term elections

Upon signature of the agreement, President Trump threatened to give notice to terminate NAFTA, allegedly to push Congress to approve the USMCA swiftly. For procedural reasons, the vote in Congress on the USMCA will take place after Democrats regain a majority in the House of Representatives in January 2019. Under the fast-track procedure of the Trade Promotion Authority, Congress cannot amend the text of the USMCA but has to take a simple yes/no vote on the agreement. The committees responsible in both houses could however perform mock mark-ups of the draft legislation, to indicate changes they see necessary. Democrat concerns focus on the enforcement mechanisms around labour and environmental rules.

Potential impact on EU companies

The level of trade liberalisation provided by the USMCA differs little from that of NAFTA in terms of tariffs. However, impacts on EU companies disaggregated by sector would be more significant. Notwithstanding the risks emanating from continued regulatory uncertainty regarding effects on EU companies with

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PE 630.341– December 2018

integrated supply chains in North America, specific USMCA provisions on rules of origin, geographic indications and voluntary export restraints may affect EU carmakers, food and drink exporters and dairy producers in particular.

Car manufacturers

First, the USMCA increases the requirements for North American content in cars from 62.5 % (under NAFTA) to 75 %. While car manufacturers were in favour of keeping these rules of origin the same, trade unions called for higher local content requirements to bring jobs 'back' to the US. Second, the USMCA includes provisions to increase the share of North American steel and aluminium content in cars to 70 %. Third, the agreement would also introduce a requirement of 40 % to 45 % of a car to be made by workers earning at least US$16 an hour. The aim of these provisions is to encourage companies, including European carmakers, to shift production from low-wage Mexico into the US. If the agreement passes, EU carmakers can opt to alter supply chains to comply with the stricter rules of origin, or revert to paying the World Trade Organization (WTO) most-favoured-nation tariff. This is worth 2.5 % of the value of the imported passenger car in the US, but is much higher in Mexico and Canada – a relevant factor as a significant proportion of cars produced by EU companies in the US are subsequently exported to these two countries. The USMCA side letters also limit trade in cars from Canada and Mexico to 2.6 million units per country. In December 2018, executives of German car manufacturers met with the US administration to discuss further investment in the US in the wider context of the US Section 232 auto investigation.

Food and drink exporters

Recognition and protection of geographical indications (GIs) are central demands for the EU in its trade agreements (including the EU-Canada Comprehensive Economic and Trade Agreement (CETA) and the future EU-Mexico Global Agreement). The USMCA includes a section on GIs that outlines procedures for GI protection, a defence of generic names, and grounds for the opposition or cancellation of GIs. Additionally, in a side letter on cheeses, the US administration and Mexico agreed on full reciprocal market access for 33 cheese names. At the same time, the USMCA contains an exception for GIs protected under international agreements. This would mean that EU GIs under CETA or EU-Mexico Agreement would remain protected.

Dairy producers

The EU, as the world's largest dairy exporter (of skimmed milk powder in particular), has an interest in keeping competition on the world market fair. Dairy industry representatives in the EU, the US, Mexico and other countries have raised concerns about the highly protected Canadian dairy market. The supply management system in place led Canadian exports of skimmed milk powder to rise from 14 000 metric tonnes in 2015 to 72 000 metric tonnes in 2017. The USMCA addresses these issues in part, by narrowly opening about 3.6 % (up from 1 %) of the Canadian dairy market to tariff-free imports of US companies. New Zealand and Australia are asking for similar concessions. This might increase competition for EU companies that gained dairy access under CETA. At the same time, under the USMCA, Canada is required to apply charges to exports of skimmed milk powder, infant formula and milk-protein concentrates exceeding certain thresholds. EU companies could benefit from these provisions if they lower unfair competition in the global dairy market.

Trade policy implications

The USMCA is selectively restrictive, with provisions that risk being at odds with WTO rules, for instance the voluntary export restraints prohibited under the Safeguards Agreement. With the new rules of origin for cars, it is unclear whether the USMCA liberalises 'substantially all trade', as required by Article XXIV of the General Agreement on Tariffs and Trade. Similarly, the regional sourcing provision for steel and aluminium appears to be a local content requirement, which is difficult to justify with fundamental WTO obligations of national and most-favoured-nation treatment. The USMCA also features a notification requirement for parties starting trade negotiations with a non-market economy. Commentators have raised concerns as to whether this provision, informally dubbed the 'China clause', could infringe on parties' sovereignty in the realm of trade. Canada and Mexico did not secure a general exemption from US steel and aluminium tariffs, leaving little prospect of such an exemption for the EU. Notably for the EU debate over investment dispute settlement, the USMCA scales back investor-state arbitration for Canada.