SMARTRADE℠

Thompson Hine

Always Innovating

Navigating a New North America

Trade, Supply Chain & Energy Issues in a Post-Pandemic and USMCA World

May 12, 2021

USMCA’s Challenges and Opportunities

Sergio Gómez Lora

Inteligencia Comercial

May 2021

A. **Mexico Political and Policy Overview**

B. **Challenges for North American Competitiveness**

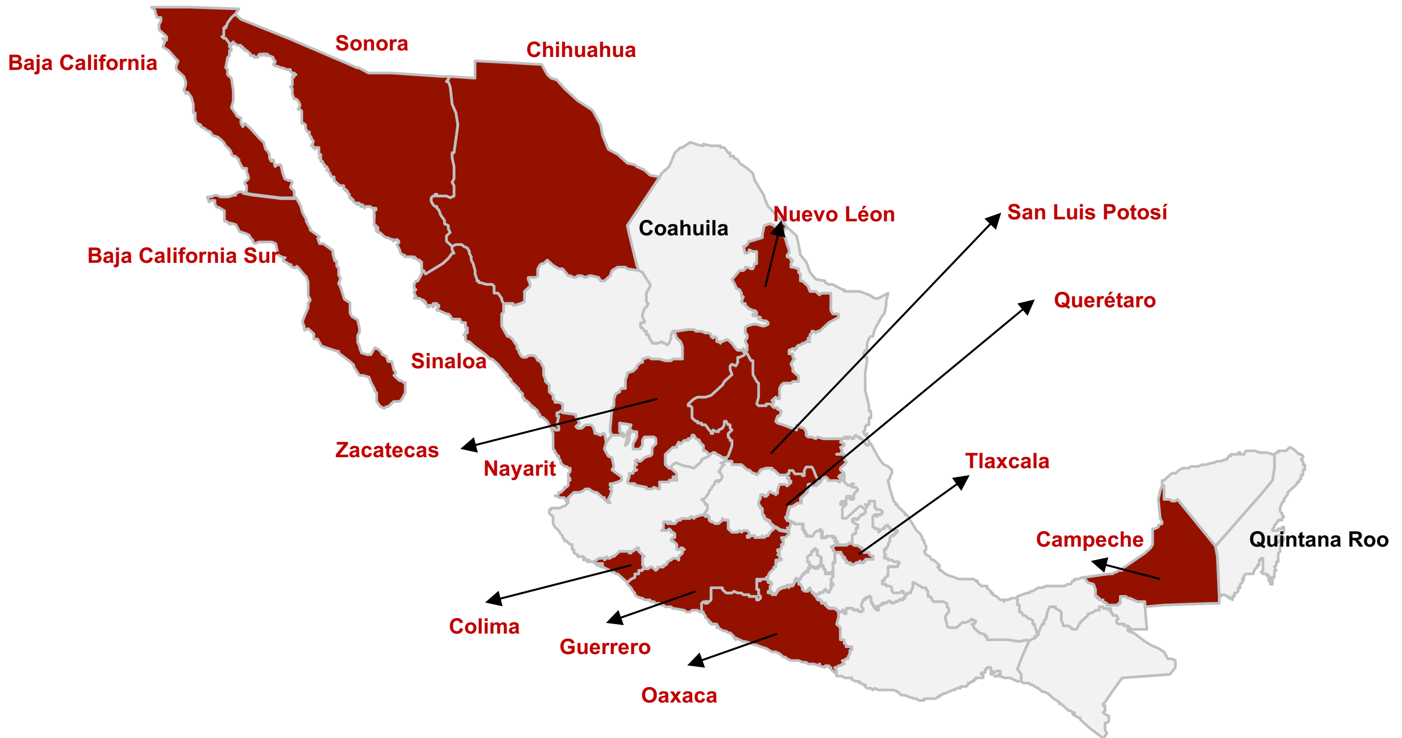
C. **Opportunities for North America**

D. **Final Comments**

Mid-term Elections in Mexico
June 6, 2021

15 Governorships

30 Local Congresses
Ex. Coahuila and Quintana Roo



- Morena has majority in 19 Local Congresses
- After a Constitutional amendment is passed in the Federal Chamber of Deputies, 18 Local Congresses are required for approval

CÁMARA DE DIPUTADOS

500 Federal Representatives

Chamber of Deputies
2018 -2021
Traditional alliances

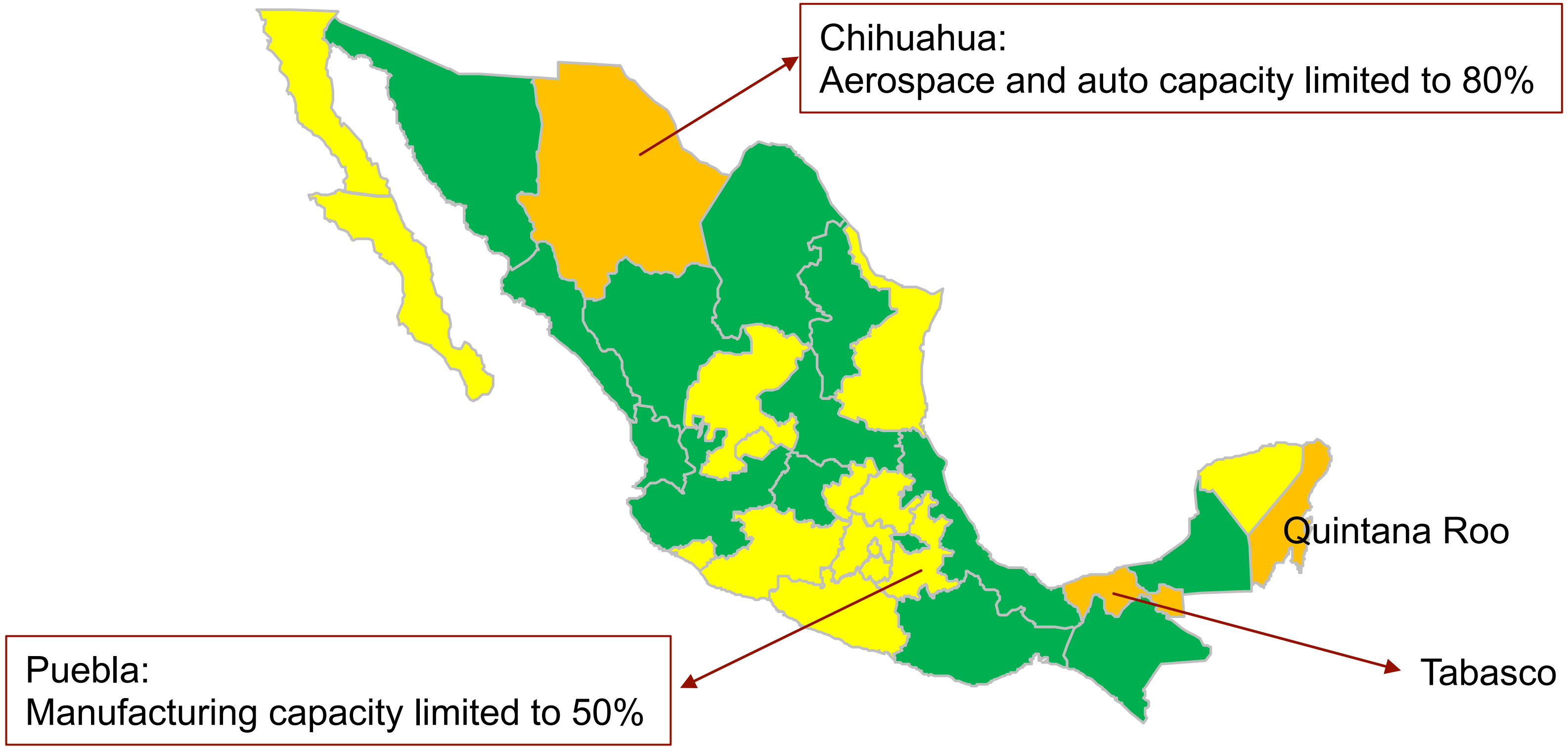
morena		PT		encuentro social		
191	+	61	+	55	=	307
PAN		PRD		MOVIMIENTO CIUDADANO		
82	+	21	+	27	=	130
PRI		VERDE		nueva alianza		
45	+	16	+	2	=	63
						500

251 votes are required to approve laws and **334** for Constitutional amendments

Source: Grupo Estrategia Política

Pandemic Risk Map in Mexico

May 10 to 23, 2021



Maximum Health Alert: 0 states
Economic activities: Only essential
Schools: Closed
Public spaces: Closed

High: 3 states
Economic activities: Essential and non-essential at reduced level
Schools: Closed
Public spaces: Open-air allowed with limited capacity

Medium: 15 states
Economic activities: All activities
Schools: Closed
Public spaces: Open-air allowed, indoor activities with limited capacity

Low: 14 states
Full economic activity
Resumption of school, social, and leisure activities

Source: Grupo Estrategia Política

Mexico Amends Outsourcing Law
April 24, 2021

- Outsourcing will only be allowed for specific tasks that are not part of the **“Corporate Purpose”** of the hiring business
- Companies operating in Mexico that want to provide any services to third parties need to:
  - Run an assessment on current corporate structure, bylaws, job descriptions, and services agreements, and
  - Register with the STPS as a specialized supplier to make sure they will be able to:
    - render specialized services to clients,
    - allow the hiring business to deduct the cost of the specialized services received from taxes.
- If violation of the new terms of the law, both the contractor and the hiring business would be subject to fines US$8,962 - US$224,050
- Transition period: September 2021

A. Mexico Political and Policy Overview

B. Challenges for North American Competitiveness

C. Opportunities for North America

D. Final Comments

USMCA is Off to a Rocky Start

Mexico

ENERGY	FOOD LABELING	GOV'T PROCUREMENT	DIGITAL SERVICES	BIOTECH
(strengthening PEMEX and CFE vs private corporations)	(NOM-051 & ban sales to minors)	(Pharmaceuticals and medical equipment)	(new requirements for audiovisual and cinematography)	(GMO, Glyphosate herbicides)

United States

AUTO RULE OF ORIGIN	BUY AMERICAN	TRUCKING SAFEGUARD

Recent Reforms to Mexico's Energy Sector

Reform to Mexican Electricity Law	Reform Hydrocarbons Law	Eliminate Asymmetrical Treatment to PEMEX
Entered into force March 10, 2021	Entered into force May 5, 2021	Approved by Congress Pending publication
March 24, 2021.- A Federal Judge suspended its application due to legal actions (amparos). Mexican courts will determine whether it violates Mexican Constitution	May 10, 2021.- A Federal Judge temporarily suspended the application of three articles of the Law* The judge will issue a definitive ruling on May 14.	

*Article 57 - empowers the Government to carry out the "temporary occupation, intervention, or suspension" of any permit granted under the Hydrocarbons Law.
Transitory articles 4 and 6.- allow authorities to revoke permits that, as of May 5, did not meet the hydrocarbon storage requirements ordered by the Ministry of Energy (SENER), and in general, those that do not meet any other requirement.

Labor Risk for Businesses in USMCA

May 10, 2021 - AFL-CIO, SEIU, and SNITIS filed the first labor case against Tridonex* (auto parts) under the Rapid Respond Labor Mechanism (RRLM)

- U.S. government has 30 days to determine if the case has merit.
- A solution will have to be agreed within the next 55 days to avoid panel
- If a solution is not agreed, the panel could impose fines or tariffs to Tridonex

House Ways and Means Committee Chairman Richard E. Neal (D-MA)

"Today marks a decisive step toward fulfilling the promise of the USMCA and ensuring that workers' rights are meaningfully upheld across North America. We led House Democrats' efforts to secure significant improvements to the agreement and develop new and aggressive enforcement mechanisms to support workers…"

Committee on Finance Chairman
Ron, Wyden (D – OR)

"Today's petition, on behalf of workers in Mexico is a critical test of the Brown-Wyden rapid response mechanism and the ability of the USMCA to deliver the labor reforms Mexico promised."

*Based in Matamoros, Mexico with a subsidiary in Philadelphia (Cardone) owned by a Canadian group.

Labor Risk for Businesses in USMCA

May 12, 2021 – USTR asked Mexico to review whether there has been a denial of labor rights at the General Motors plant in Silao, Guanajuato.

- This second complaint under the RRLM is the first case initiated by the US authorities.
- May 11, Ministry of Labor and Social Welfare declared the vote invalid and ordered the union to hold another vote within 30 calendar days.
- Mexican authorities will have 45 days to agree on a solution with the US. If not, USTR could request a panel.

USTR Katherine Tai

"…the U.S. had a "number of concerns" with Mexico's USMCA implementation performance: USTR is not afraid to use the enforcement tools provided in USMCA"

Important Meetings for USMCA in the following days….

May 12	Senate Finance Hearing on 2021 Trade Agenda
May 13	Ways and Means Committee Hearing on 2021 Trade Policy Agenda
May 17 - 18	First meeting of the USMCA Free Trade Commission Trade ministers will conduct an exhaustive review of the issues related to the implementation of the Agreement.

A. Mexico Political and Policy Overview

B. Challenges for North American Competitiveness

C. Opportunities for North America

D. Final Comments

Strengthen Regional Integration and Buy North America

Disruption	Opportunity

COVID-19

U.S. - China Trade War

- Companies are hedging the risks in having industrial operations in remote geographic areas: “China plus one” strategy.

- Mexico is well positioned to benefit of this restructuring of supply chains

Critical Supply Chains Review

- Executive Order, February 24, 2021, to secure U.S. supply chains
- Two stages :
  1. **100-day review** across federal agencies to address vulnerabilities in four key sectors (June 4, 2021):

Semiconductors DOC	**Large capacity batteries, electric vehicles** DOE	**Critical minerals and other rare materials** DOD	**Active Pharmaceutical Ingredients (APIs)** DOH

  2. **One-year review** of a broader set of six U.S. supply chains (February 23, 2022):

Defense DOD	**Public health and biological preparedness** DOH	**Information and communications technology (ICT)** DOC and DHS	**Agri commodities & food production** USDA
Transportation DOT			
Energy sector DOE			

Semiconductor Value Chain

Investment Opportunity in Mexico

1. Research

15 to 20% of total industry R&D

Geographic specialization:

U.S., China and Europe

2. Design

R&D	CAPEX	VALUE ADD
53%	13%	50%

U.S., China, and Europe

5. Electronic Design Automation (EDA) & Core IP

R&D	CAPEX	VALUE ADD
3%	<1%	4%

South Korea, Japan and Taiwan

Manufacturing

3. Front End

Wafer fabrication

R&D	CAPEX	VALUE ADD
13%	64%	24%

China, Taiwan

4. Back End

Assembly, packaging & testing

R&D	**CAPEX**	**VALUE ADD**
3%	**13%**	**6%**

East Asia: Malaysia, Vietnam, and the Philippines

6. Equipment & Tools

R&D	CAPEX	VALUE ADD
9%	3%	11%

U.S., Japan, and Europe

7. Materials

R&D	CAPEX	VALUE ADD
1%	6%	5%

U.S., Japan, and South Korea

Electronic Devices

R&D $92B

CAPEX $108B

VALUE ADD $290B

% of industry total, 2019

Source: Semiconductor Industry Association (SIA)

Lithium- Ion Battery for Electric Vehicles Value Chain

Investment Opportunity in Mexico

Raw Materials

- Lithium
- Graphite
- Nickel
- Cobalt
- Manganese
- Aluminum

1 Cell manufacturing

1. Cathode (lithium/graphite)
2. Anode (nickel/cobalt/manganese) separated by an electrolyte.
3. Minerals are used in powdered form and the electrolyte is in the form of foils.

75% of total cost

2 Module Manufacturing

Modules are made by:

- attaching multiple cells in a case with terminals
- electronics to provide safe charging and discharging of the cells

11% of total cost

3 Pack Assembly

- Usually very close to a vehicle's final assembly plant
- Battery packs consist of battery modules, electrical connections, and cooling equipment.
- Manufacturers can assemble them by hand or by using automated equipment.

14% of total cost

Source: Conde, Terence, Ibusuki. 2017. Battery global value chain and its technological challenges for electric vehicle mobility. University of Sao Paulo, Brazil.

Active Pharmaceutical Ingredients (APIs) Value Chain

Investment Opportunity in Mexico

1 KSM, Intermediates and API Laboratories

Geographic specialization:

China and India

2 KSM, Intermediates and API Pilot Plant

U.S., China, and India

3 KSM, Intermediates and API Industrial production

U.S, China, and India

4 Transportation

5 Pharmaceutical plant

China, U.S., Europe

6 Medical services and patients

Worldwide

Source: CANIFARMA and AMIIF

A. Mexico Political and Policy Overview

B. Challenges for North American Competitiveness

C. Opportunities for North America

D. Final Comments

Important Challenges Ahead for North America

- USMCA must be duly implemented and respected to fully realize its potential
- Labor risk deserves special attention
- The reshoring of supply chains brings additional opportunities for new investments in North America
- IQOM could help to:
  - Monitor strategic changes in Mexico
  - Engage federal and local governments to review/analyze investment conditions in Mexico
  - Identify opportunities to strengthen North American supply chains
  - Mitigate labor risk

Due Diligence/Risk Mitigation

- **IQOM** is **partnering with corporations** in Mexico to **help them mitigate** USMCA supply chain risk related to labor

Objectives

- Reduce Company's risk of non-compliance and protect supply chain
- Prepare Company for possible labor investigation

Methodology

- **1.1** Awareness building for HR Management
- **1.2** Compliance Diagnostic
- **2** Risk Analysis and Awareness Building among Suppliers
- **3** US Stakeholder monitoring

IQOM's methodology is divided in two phases:

	Diagnostic (4-8 weeks*)	Recommendations (2 weeks*)
Activities	**1.1 Training and awareness building** - Training sessions for HR management and union **1.2 Assessment of strategy to comply with labor obligations** - Interviews and surveys, review of documents to prove compliance	**Recommendations to close gaps and implement systematic processes to demonstrate compliance**
	2. Risk analysis and supplier training - Training, surveys and evaluation of contracts	**Recommendations to protect the supply chain**
	3. ID stakeholders in Mexico, Canada and the U.S. - Identification of companies, unions, and government stakeholders	**Monitoring and lobbying strategy**
Deliverables	• **Training sessions** • **Supplier risk matrix** • **Risk map**	• **Strategy to close compliance gaps / monitor supplier compliance** • **Review of supplier contracts** • **Lobbying strategy**

* Timing will be case specific

Inteligencia Comercial

Sergio Gómez Lora
CEO

sgl@iqom.com.mx

(202) 800 - 8850

600 13th St. Suite 700 Washington D.C. NW

International Trade

New Year, New NAFTA – Evaluating USMCA's Impact on Current Operations and Due Diligence Procedures

By Dan Ujczo

The "new NAFTA," now known as the United States-Canada-Mexico Agreement (USMCA), entered into force this past summer in a manner similar to a pandemic-impacted wedding—the three countries got formally "hitched" but the large celebration and rollout were reserved for a later day. Specifically, USMCA launched on July 1, 2020, but the respective government agencies exercised "restrained enforcement" for the first six months of implementation. However, as of January 1, 2021, USMCA is the enforceable law of the land and companies, as well as their advisers, must account for potential competitiveness, compliance and due diligence impacts going forward.

USMCA Is Not NAFTA

The threshold consideration is assessing whether an entity's current operations qualify for preferential (e.g., duty-free) treatment under USMCA. Qualifying under NAFTA does not automatically lead to qualification under USMCA. Even where this process is relatively straightforward, USMCA imposes stricter certification and record-keeping requirements, requiring companies to "show their work," overhaul supplier contracts and re-align data management/record-keeping systems. Traceability and transparency within global supply chains are the hallmarks of USMCA. Companies should rest assured that in the event they elect to bypass a USMCA analysis, it will not be long before a customer, supplier or government agency comes knocking to request documents verifying USMCA certification and compliance.

USMCA also includes unprecedented labor protections and enforcement mechanisms that will require robust diligence by those companies having operations in Mexico and/or that rely on Mexico-sourced goods in their supply chains. The labor reforms in Mexico, enforced by USMCA, will be the most dominant issue in North American trade for the next three to five years and, potentially, beyond. The COVID-19 pandemic has muted the issues over the past year; however, U.S. and international labor unions repeatedly have stated that they intend to use the USMCA enforcement mechanism in early 2021. U.S. companies operating in Mexico will be the target. Accordingly, all U.S. companies operating in Mexico need to closely evaluate and internally audit their labor-management/HR relationships "in country" to ensure compliance.

The North American "Renovation"

The positive news is that companies can readily achieve USMCA compliance. Contrary to then-President Trump's assertion that he would "rip up" the NAFTA, the USMCA includes approximately 60% of the same or similar terms found in the NAFTA and other trade agreements. Yet, the USMCA is more than a "rebrand." The approximately 40% that contains changes greatly impacts the foundation of North American and global supply chains in areas such as manufacturing, agriculture and textiles. The best way to evaluate USMCA is to envision the new agreement as a three-stage "renovation": (1) there are fresh coats of paint on more than half of the NAFTA that provide some new advantages to companies; (2) there are upgrades to the fixtures and appliances such as new provisions regarding digital trade, e-commerce, intellectual property, regulatory cooperation, competitiveness, small and medium-sized enterprises and customs facilitation (e.g., the "border"); and (3) some walls have been knocked down to establish new structures in areas such as automotive, textiles, labor and the environment. But as Tom Hanks learned in "The Money Pit," any large-scale renovation takes more than "two weeks." Companies that devote the human and time resources toward USMCA compliance will benefit from the improvements. Those that do not will be left with lost customers, compliance costs and potential labilities arising from customs, labor and environmental penalties.

USMCA "Wins" – Raw Material Imports

Before turning to the challenges, it is important to emphasize that USMCA provides competitive advantages to companies that utilize its provisions. The agreement enhances key sectors such as food processing, chemicals, polymers, coatings, electronics, and other areas where companies import raw materials or unfinished goods into North America for further production. For example, under NAFTA, North American companies were required to "trace every molecule" in the formulation process to determine if a paint, polymer, plastic or rubber product was "made in North America." Under USMCA, there are several straightforward tests that can be summarized as "if you mix it in North America, it is from North America." These streamlined processes and rules apply across a number of sectors including food production and electronics. Exploring these provisions will result in reducing compliance costs for companies and fostering greater continental competitiveness.

USMCA Challenges – Semi-Finished/Finished Imports

USMCA includes, however, significant changes that seek to prevent the duty-free entry of semi-finished and finished products into the North American supply chain. As much as USMCA concerns North American trade, its main targets are goods sourced from non-market economies (NMEs) such as the People's Republic of China. For example, the headline-capturing automotive rules of origin (ROO) raise thresholds for North American-made passenger vehicles and light trucks from NAFTA's 62.5% to USMCA's 75%. These auto ROO cascade throughout the supply chain, raising regional value content thresholds for auto parts as well as imposing 70% steel and aluminum content requirements. The auto ROO also require that at least 40% of the vehicle be produced with labor making at least $16 per hour. This labor value content (LVC) requirement restricts parts sourced from low-cost NMEs and Mexico (although some non-U.S. original equipment manufacturers (OEMs) have raised wages in Mexico to account for the LVC) in order to promote sourcing from the United States and Canada. Setting aside the political rhetoric, there is no expectation that companies will pull up stakes on existing manufacturing facilities and return to the United States. Rather, the objective is to stop the overseas and southward movement of existing supply chains as well as ensure that next-generation technologies emerge from the United States, Canada and, to some degree, Mexico. The companies most impacted by USMCA are those that have semi-finished goods from Asia in their supply chains and/or are operating in emerging areas such as electric batteries, autonomous/intelligent technologies, 5G and other telecommunications. These companies will need to closely examine their existing supply chains to determine USMCA compliance.

USMCA Certification – From a Noun to a Verb

The USMCA attempts to strike a balance by providing companies flexibility regarding the "certificate" needed to demonstrate USMCA compliance while imposing strict substantive requirements for the "certification" process. This is a sea change, as for nearly three decades, companies seeking NAFTA treatment submitted a prescribed certificate of origin (COO) that ostensibly demonstrated the criteria for claiming duty-free treatment. Companies would secure COO from their suppliers, add their information, and issue a new certificate up the chain. Over time, many companies became less rigorous in their analysis and the certificates of origin became perfunctory and, in many cases, resulted in faulty stacks of COO. Form prevailed over substance.

The USMCA fundamentally alters this certification process. The new agreement changes the passive "certificate" to the more active "certification" of origin. This is more than semantics. USMCA eliminates a prescribed form, thereby giving companies more flexibility on how to demonstrate USMCA compliance. However, companies must "show their work" and keep on file the analysis performed by in-house purchasing and finance teams, legal counsel and customs brokers demonstrating USMCA compliance. This requires companies to not accept at face value a supplier's or distributor's assertion that a good is USMCA-qualified. The company needs to "trust but verify."

Looming Labor Issues

Beyond customs compliance, the most transformative change emerging from USMCA is labor-management relations in Mexico, creating potential liabilities for U.S. companies managing their Mexico-based facilities and/or relying on products from Mexico.

Prior to USMCA, Mexico independently made constitutional reforms in areas of labor and workers' rights, yet the implementation remained stalled. The 2018 election of Mexico's President Andrés Manuel López Obrador, coupled with calls from the U.S. Congress, catalyzed the labor implementation process. Mexico thereafter commenced a review of more than 600,000 existing collective bargaining agreements, sought to adjudicate more than one million pending labor claims brought by workers, and began the formation of the regulatory and judicial infrastructure to enforce these reforms. USMCA's Labor Chapter includes many of these labor reforms and adds "teeth" in the form of a Facility-Specific Rapid Response Labor Enforcement Mechanism.

This dispute resolution mechanism is unlike anything found in the NAFTA or any other trade agreement. Any worker, union or nongovernmental organization can assert claims against any plant operating in Mexico and the governments are obliged to investigate and resolve the issue under strict timelines. The investigation may include facility audits and inspections, as well as arbitration by a standing roster of labor-minded panelists that have been selected by the countries. Penalties can include enforcement under domestic laws, imposing duties or stopping imports from that facility, and, if there are repeated offenses, stopping all cross-border shipments from the company writ large (not just from that facility/plant).

Ensuring Compliance

The honeymoon is over and now is the time to ensure compliance with USMCA. Key steps include:

- Examine the company's current use of NAFTA/USMCA commencing with an examination of existing COO/USMCA certifications issued by the company and its suppliers. A starting point may be requesting such documents from the purchasing/shipping team as well as from third-party providers such as customs brokers.
- Ensure that the company has properly classified the goods under the Harmonized Tariff Schedule of the United States and properly assessed the valuation of the goods. In many cases, the company performed this initial classification/valuation exercise years ago during NAFTA, but has not made updates during product improvements and/or consideration under USMCA. This is analysis that will require purchasing and the finance team to ensure alignment between procurement, pricing and tax strategies.
- Perform the rules of origin analysis under USMCA to determine if duty-free preferences apply, and maintain strict record-keeping procedures documenting this analysis.
- Develop a USMCA certification of origin document (many templates are available; however, do not skip the step of performing the actual analysis).
- Update purchasing documents, invoices, standard terms and conditions and shipping documents to account for USMCA changes.
- Determine areas where USMCA may provide benefits/challenges to the company and adjust processes/sourcing as needed.
- Scrutinize labor-management issues in Mexico. "Scorecards" are available and are being distributed by OEMs to suppliers. While scorecards can be useful guides, ensure that the company's internal assessments are performed by counsel, with accompanying legal and privilege protections.
- Utilize the USMCA review to update customs compliance programs. The first step in a customs verification/audit is to review the company's customs compliance manual, organizational chart and import/export records, including procedures for internal reviews/audits/spot-checks. Does your company have these policies in place?
- Incorporate USMCA issues into due diligence checklists.

After performing hundreds of USMCA reviews, experiences teaches that no company has moved from NAFTA to USMCA without making changes. Every company needs to tweak, many need to transition, and some need to transform supply chains and processes. There are lurking liabilities in faulty NAFTA COOs, failure to perform the analyses and record keeping needed under USMCA, and labor-management issues in Mexico.

Please contact Dan Ujczo with any questions.

The George W. Bush Institute – SMU Economic Growth Initiative

at

The George W. Bush Institute

NORTH AMERICAN COMPETITIVENESS IN THE WORLD:

GEORGE W. BUSH INSTITUTE RECOMMENDATIONS FOR THE U.S.-MEXICO-CANADA AGREEMENT COMPETITIVENESS COMMITTEE

Matthew Rooney
Managing Director, George W. Bush Institute - SMU Economic Growth Initiative

Andrea Durkin
Advisor, George W. Bush Institute - SMU Economic Growth Initiative

February 2021

George W. Bush
Institute

About the George W. Bush Institute:

Housed within the George W. Bush Presidential Center, the George W. Bush Institute is an action-oriented, nonpartisan, policy organization with the mission of developing leaders, advancing policy, and taking action to solve today's most pressing challenges. Through three Impact Centers — Domestic Excellence, Global Leadership, and an Engagement Agenda — the Bush Institute delivers measurable results that save and improve lives. To learn more, visit www.BushCenter.org.

George W. Bush Institute – SMU Economic Growth Initiative:

The Bush Institute – SMU Economic Growth Initiative combines the public policy expertise of the George W. Bush Institute and the academic expertise of SMU. The joint initiative draws from economic policy-making experience at the highest levels and from cutting edge academic research to identify ideas for promoting innovation, entrepreneurship, and faster, more inclusive growth through global competitiveness and sound immigration policy.

Executive Summary

North America is the most competitive region in the world – demonstrably more so than any other economic area. The economies of Mexico, Canada, and the United States are complementary, and our industries have leaned into the advantages of integrated service sectors, supply networks, and manufacturing platforms.

The U.S.-Mexico-Canada Agreement, which came into effect in July 2020, offers a modern framework for deeper economic integration over the coming decade and introduces an important new perspective – how the North American partners compete together in the world.

The George W. Bush Institute – SMU Economic Growth Initiative convened a broad and diverse group of North American experts to discuss how the new North American Competitiveness Committee created in USMCA's Chapter 26 can prioritize its agenda and work with stakeholders to ensure our workers and producers benefit fully from the agreement while strengthening the region's competitiveness.

Specifically, we recommend the Competitiveness Committee pursue initiatives in three priority areas:

- **Prepare workers for a competitive future through a community-driven approach,** including raising skill levels and creating portable credentials, learning from community-level approaches to competitive adjustment, maximizing opportunities for digital trade, supporting culturally and economically bi-national border communities, and revisiting targeted visa improvements.
- **Deploy technologies to move digital and physical products and services more efficiently,** including creating a trilateral working group to undertake holistic infrastructure planning, gathering more and better real-time data to inform infrastructure investment decisions, exploring innovative financing options for border infrastructure, and routinely benchmarking North America's border infrastructure against the rest of the world.
- **Confront the China challenge,** including sharing information and coordinating key policies vis-à-vis China such as intellectual property rights prosecutions, use of export controls, and foreign direct investment reviews, mitigating risks to the regional supply of critical minerals, deepening regulatory cooperation to shore up North America's energy advantage, and undertaking work to map North American supply networks of "essential" goods and services with a view to developing greater resilience and effective emergency coordination.

Introduction

North America is the most competitive region in the world – demonstrably more so than any other economic area. The economies of Mexico, Canada, and the United States are complementary, and our industries have leaned into the advantages of integrated service sectors, supply networks, and manufacturing platforms.

Our unique partnership has enabled the region to weather slowdowns in the global economy even as major emerging markets and Europe experienced serious challenges. However, as the George W. Bush Institute – SMU Economic Growth Initiative recommended in November 2016, if we are to maintain our global lead, we need a strategic plan outlining how we will work together from the highest levels of political leadership to the community level. We must redouble efforts to remove barriers to deeper integration. We must strengthen the resilience of our workforce and our economies as we rebound from the devastating effects of the pandemic while competition with a rising China intensifies.

USMCA offers a modern framework for deeper economic integration over the coming decade. But as American economist Donald Boudreaux rightly points out, countries don't trade; people trade. After the ink dried on July 1, 2020, the real work to promote the agreement's benefits to North American workers and producers – who are the backbone of the region's strength and competitiveness – began.

With this in mind, once the U.S.-Mexico-Canada Agreement came into effect, the Bush Institute – SMU Economic Growth Initiative reconvened a broad and diverse group of North American experts to discuss how the agreement can further promote North American competitiveness. This group informed the recommendations found in this paper.

A Competitiveness Committee can help us keep our edge

USMCA Article 26.1.1:

"Recognizing their unique economic and commercial ties, close proximity, and extensive trade flows across their borders, the Parties affirm their shared interest in strengthening regional economic growth, prosperity, and competitiveness."

While the North America Free Trade Agreement was fundamentally a market-access agreement among the three countries, USMCA introduces a critical perspective – how the North American partners compete together in the world. In this set of recommendations, we focus on the new North American Competitiveness Committee created in USMCA's Chapter 26 and an initial agenda the three countries, working with all interested stakeholders, should set for themselves.

Generally, we believe the committee should not limit itself to the four corners of USMCA. It should deliberate and provide guidance on initiatives enhancing the region's competitiveness in ways that enable our workers and producers to fully benefit from the agreement.

Establish the baseline and then measure progress

USMCA Article 26.1.2:

"With a view to promoting further economic integration among the Parties and enhancing the competitiveness of North American exports, the Parties hereby establish a North American Competitiveness Committee (Competitiveness Committee), composed of government representatives of each Party."

The Bush Institute – SMU Economic Growth Initiative maintains a unique Global Competitiveness Scorecard. Originally, it was developed to objectively measure and debunk anti-NAFTA rhetoric that held our three governments back politically from updating the agreement to reflect contemporary economic circumstances.

The Scorecard assesses rule of law, regulatory efficiency, open markets, and protections for innovation, as well as the delivery of quality education and health services to support a productive workforce. Using a holistic set of metrics, we combined these indicators to compare competitiveness among both countries and regions. This allows for a robust evaluation of the successes of first NAFTA and now USMCA because it relies on more than just the trade figures.

Further analyzing growth in GDP, GDP per capita, GDP per employed person, and employment figures for North America as a region, also allows us to better understand the economic outcomes and benefits of the "North American style" of regional integration. The bottom line is that Canada, Mexico, and the United States together outperform the world's other major regions, including the European Union, APEC in Asia, and the Pacific Alliance in Latin America, not just in terms of competitiveness, but also growth and job creation.

The Scorecard results and the ability to break down the components of competitiveness can be used in conjunction with other indices and real-time data to provide a benchmark for discussions about the contribution of the USMCA going forward.

More importantly, the Scorecard can help inform the deliberations of the USMCA Competitiveness Committee, its engagement with stakeholders, and the development of a roadmap to accelerate post-pandemic recovery and enable long-term economic growth throughout the region. For example, our analysis shows that the region's score in the Business Environment category has declined somewhat over the last decade, driven largely by the relatively slower pace of information and communication technology (ICT) adoption in Mexico, increased regulatory burdens of starting a business in the United States, and rising time and costs associated with permitting and enforcing contracts in Canada. North America's Health and Education score has seen the steepest decline in the Scorecard's indices. Diminished trust in Mexico's institutions is showing up in weaker Legal Systems scores. North America's Trade Environment score is driven by trade freedom and market efficiency. Here too, we see a decline in scores that accompanied increased security procedures at customs and border checkpoints after 9/11.

As a final example, Mexico's liberalization of foreign investment in its energy and telecommunications sectors drove up the region's score on Investment Environment, but a rollback in regulatory reforms will diminish these gains.

In sum, the Scorecard can illuminate the foundations of North American competitiveness as well as areas that require improvement. It provides an important opportunity to emphasize how the region is stronger together in the global economy than any other region working toward integration. And, when it comes time to review progress under the agreement as its "sunset" provisions kick in a short six years from now, the numbers will help tell the positive story.

In 2005, President George W. Bush convened the first North American Leaders' Summit bringing together the Prime Minister of Canada and Presidents of the United States and Mexico. The summits enabled the leaders to strengthen the prosperity and security of their countries within the framework of NAFTA. These Summits should resume to provide leadership-level impetus to plans developed by the USMCA Competitiveness Committee.

An agenda for the USMCA Competitiveness Committee and its stakeholders

The Bush Institute – SMU Economic Growth Initiative recommends the Competitiveness Committee organize its work around three priority themes:

1. **Preparing workers for a competitive future through a community-driven approach**
2. **Deploying technologies to move digital and physical products and services more efficiently**
3. **Confronting the China challenge**

Theme One: A Community-Driven Approach to Deriving the Full Competitive Benefits of the USMCA

USMCA Article 26.1.5(c)

"The Competitiveness Committee shall provide advice and recommendations, as appropriate, to the [USMCA Free Trade] Commission on ways to further enhance the competitiveness of the North American economy, including recommendations aimed at enhancing the participation of small businesses (SMEs), and enterprises owned by under-represented groups including women, indigenous peoples, youth, and minorities."

NAFTA's critics were concerned with the negative effect on cities, sectors, and workers that could not adjust to changed conditions of competitiveness. Many communities found opportunity in deeper trade and investment relationships with North American partners, but others bore the brunt of employment losses or divestment, particularly in manufacturing. Our colleagues in Canada and Mexico cited similar challenges for communities within some states and provinces that did not experience gains from NAFTA.

Focus on raising skill levels and portable credentials, not just mobility

The largest metro economies generate the bulk of each nation's exports and attract the vast majority of jobs from foreign direct investment. The largest U.S. metropolitan areas accounted for 58% of goods traded between the United States and Canada/Mexico in 2010, according to a Brookings Institution analysis. Twenty-five U.S.-Canada metro pairs, led by New York and Toronto, and 15 U.S.-Mexico metro pairs, led by Los Angeles and Mexico City, each traded more than $1 billion in goods that year. The study has been not repeated, but it would be reasonable to assume a continued or upward trajectory in trade among major North American metro pairs.

While NAFTA and other trade agreements produce overall national economic gains, they may leave many workers in import-sensitive sectors and communities poorly positioned to relocate to industries and cities where jobs are created by new trade and investment patterns. Geographic mobility, or a relocation of labor to where supply is needed, has been declining in general, yet that trend does not fully explain why all three countries are experiencing worsening disparities in productivity and income across subnational regions.

Many studies support the view that technological change, not trade, has been the most powerful driver of productivity differences and growing income inequality among workers, with unskilled workers particularly affected by automation. Significantly, a 2019 International Monetary Fund analysis found that while both technology and trade can cause unemployment and lower labor force participation, regions hit by trade shocks tend to bounce back within a couple of years, while the effects of automation are long-lasting. The same study concluded that countries more open to trade had lower regional inequality.

North American trade has generated job opportunities in regionally integrated advanced manufacturing and logistics, where technical skills are in high demand. As companies expand and deepen their North American supply chain investments, they are generating demand for skilled workers in all three countries, but consistently cite a shortfall of job candidates with sufficient skills to meet their labor needs. Therefore, the trade community should not rely on outdated economic arguments that mobility will produce a positive "general equilibrium" outcome. Rather, a key ingredient to achieving positive effects from USMCA is more support for skills improvements to meet the competitive labor demands of a changing North American market.

The Bush Institute – SMU Economic Growth Initiative has argued that low-cost, flexible certificate and technical training programs are an effective way to enhance the skills of North American workers and that regional collaboration has many advantages. The USMCA Competitiveness Committee can promote dialogue on how to bring certification standards and training practices into better alignment with regional labor market needs. It can also enable us to deploy and scale the use of productivity-enhancing technologies and processes on which workers in all three countries need to be trained and proficient.

Learn from community-level approaches that worked

It is also important to ask why some regions and cities adjust to import competition and thrive while others may fail to find their footing. How did Greenville–Spartanburg, South Carolina, go from relying on a waning textile industry to attracting hundreds of world-class companies – from automakers to high-tech manufacturers – and experiencing a resurgence in manufacturing jobs through international trade and investment? How are finance and business hubs thriving from delivering complex cross-border services? What policies are supporting their success?

The USMCA Competitiveness Committee could host discussions with community leaders and businesses across North America to share insights about localized pro-trade and investment strategies that have benefited successful cities, particularly mid-sized cities experiencing growth. Discussions should drill down into ways traditionally underrepresented groups and small businesses can take advantage of access to North American markets and acquire jobs in integrated industries.

Open the door wide to digital trade

Millions of workers transferred processes and their own jobs to online and virtual communications and technology platforms during COVID-19. In many professions and industries, employees and firms began moving away from some of the largest cities in the United States and Canada. They went to other cities that score high for education levels, quality of life, and openness – as well as for economic freedom and affordability. This geographic dispersion will have lasting effects.

We believe the trend toward trade in digital products and services, along with the increased viability of working remotely, offers an opportunity to spread the benefits of increased North American trade among workers in smaller cities and communities throughout the entire region. Many studies suggest that, in addition to improving human capital, policies that boost market connectivity – physical and digital – can help alleviate geographic sources of economic disparities. In Mexico, where populations may remain concentrated in large cities, internet penetration remains around 63%, lower than in the roughly 88% in the United States and 90% in Canada.

This underscores the importance of ensuring our countries are physically and digitally equipped to take advantage of the regulatory harmonization and liberalization in digital trade offered by USMCA's new digital provisions. As part of a worker- and community-driven approach, the Competitiveness Committee should undertake to review what the United States, Canada and Mexico can do together to not only implement new digital provisions in USMCA, but to maximize opportunities for digital trade.

Support culturally and economically binational border communities

Adjacent communities like the Cali Baja "megaregion" encompassing San Diego and Imperial counties in California and the state of Baja California in Mexico are tightly integrated with high volumes of two-way intra-industry trade. Cali Baja has become a global hub for high-tech research and development and advanced manufacturing, attracting, for example, the world's largest medical device cluster. Other top industries include highly specialized manufacturing of high-value audio and video equipment, aerospace products and parts, plastics, semiconductors, and motor vehicle parts. North American and global firms take advantage of binational coproduction, which supports high-paying jobs and contributes to economies on both sides of the border.

Services are also highly traded in Cali Baja to support advanced manufacturing in the region. Computer system design services, scientific research and development, data processing and hosting, and other professional services now comprise more than half the value of trade within the region. By focusing on improving trade and investment efficiencies in binational communities and regions such as Cali Baja, the Competitiveness Committee can support their growth, promote the development of symbiotic and skilled workforces, and help ensure their resiliency in the face of global competitors such as China.

There are many groups and coalitions that have collaborated for decades on issues that matter to border states and communities. One notable example is the Pacific North West Economic Region Foundation involving the U.S. states of Alaska, Idaho, Oregon, Montana and Washington and the Canadian provinces and territories of British Columbia, Alberta, Saskatchewan, Yukon, and the Northwest Territories. These groups live the North American economy every day and should be engaged by the Competitiveness Committee not only on USMCA implementation but also on issues that can be addressed outside the agreement to brings its potential benefits to fruition.

More immediately, we also encourage the Competitiveness Committee to shine a light on the need to safely resume normal pedestrian and private vehicle border crossings that were shut down to nonessential traffic last March due to COVID-19. Border communities rely on daily visitors who patronize their stores, restaurants and tourist attractions. Getting safely back to normal is key to the post-pandemic economic recovery of these important border communities.

Revisit targeted visa improvements

Beyond pedestrian and private vehicle crossings, our expert group recommends the Competitiveness Committee develop a process for expanding and harmonizing U.S., Mexican, and Canadian trusted traveler programs. In particular, the group agreed on the need for skilled technicians to have greater certainty in their ability to move back and forth across North American borders to support advanced manufacturing after-sales services such as equipment repairs. This would enable workers to keep their jobs where they are domiciled while supporting integrated North American manufacturing.

Theme Two: Jointly prioritize border infrastructure investments and speed up the use of interoperable modern technology to clear goods across North American borders

USMCA Article 26.1.5(d)

"The Competitiveness Committee shall identify priority projects and policies to develop a modern physical and digital trade- and investment-related infrastructure and improve the movement of goods and provision of services within the free trade area."

North American trade is projected to increase under USMCA. In addition, COVID-19 has accelerated the rise in consumer purchases through e-commerce platforms. The Competitiveness Committee should drive the effort to coordinate the intelligence needed to prioritize border infrastructure investments and improvements.

Smart borders are needed now more than ever

The World Bank reports that the time and cost of border procedures, documentary compliance, and domestic transport within the overall process of exporting or importing a shipment of goods has increased substantially in all three countries over the past 10 years. As a result, North America's average percentile rank on the World Bank "trading across borders" indicator has fallen to 60% percent from 75% over the past decade.

This decline signals the need for the three countries to invest more in digitization and coordinated prescreening programs at the borders. As the effects of the COVID-19 pandemic linger, these needs grow more acute and urgent.

According to initial estimates prepared for the Bush Institute, targeted investments in border infrastructure would increase U.S. GDP by 1 percentage point within five years—an addition of $220 billion—while reducing the U.S. federal budget deficit by 1.16% of GDP after five years, a savings of nearly $250 billion.

Make infrastructure planning more holistic

There are many government entities, jurisdictions, and private stakeholders involved in planning, approving, funding, building, and operating well-functioning border crossings.

The Competitiveness Committee should create a permanent trilateral working group comprised of federal, state, local and indigenous representatives along with private sector and academic experts. This group should generate an end-to-end border perspective: They should enable the prioritization of border infrastructure projects according to market conditions and needs while ensuring that critical internal infrastructure components such as interstate highways and bridges are ready to feed into large cross-border projects upon completion.

North American experts cited the expansion of the San Ysidro border crossing and modernization of Otay Mesa East in the San Diego-Tijuana corridor as good examples of improved coordination between the U.S. and Mexican governments. However, experts also said that the many processes for approvals, land acquisition and other decisions remain opaque. The private sector would like to see a trinational infrastructure working group develop some basic blueprints for how each government makes project decisions at the national and subnational levels.

Gather and use more and better real-time data

As the world becomes more data-driven, gaps in the collection and use of real-time border crossing data have become more apparent. Additional and shared data would improve the governments' ability to model, analyze and forecast the volumes and routes of cargo and passenger traffic throughout North America, which in turn could inform investment and staffing decisions at border crossings while reducing costs. For example, real-time data about rising levels of fresh produce exports from Mexico would provide a basis for the U.S. Department of Agriculture to assign more entomologists to ports where inspections are forecast to increase.

A trilateral working group should analyze which technologies should be deployed to expand throughput, measure and reduce wait times, and wirelessly move information into risk assessment systems, while offering a rich source of information on which to base decisions about physical infrastructure investments. The expert group specifically cited use of nonintrusive border inspection equipment such as radio-frequency identification (RFID), transponders and X-ray technologies as priorities. It also recommended boosting internet broadband at ports to facilitate greater mobility by border and inspection agents while also enabling the transmission of data to officers in off-site locations to support faster approvals.

Explore innovative financing

Within a trilateral working group, experts in project financing could also explore alternative models to fund major border infrastructure investments. They could include sources such as pension funds and the expansion of the Donations Acceptance Program to enable private participation in large-scale border and port improvement projects. The expanded use of digital technology could provide accuracy and transparency to the collection and dissemination of any fee- or toll-based revenue, opening the door to more public-private partnerships. The group could also engage in discussions with the U.S. International Development Finance Corporation and the existing North American Development Bank to expand multi-government backing of new projects while leveraging both public and private sources of financing.

Benchmark against global competitors

The Competitiveness Committee could leverage the new trilateral body of experts to regularly analyze and benchmark North American border infrastructure and trade corridors against the rest of the world.

Theme Three: Show a united front in protecting North American workers and businesses against anti-competitive practices by China

USMCA Article 26.1.5(e)

"The Competitiveness Committee shall discuss collective action to combat market-distorting practices by non-Parties that are affecting the North American region."

The adverse effects of China's aggressive drive to global economic dominance are well understood and represent a concern shared by all three North American partners.

Notwithstanding the primacy of individual bilateral diplomacy and political engagement with China, North America – by virtue of how it competes in the global economy as a region – has an economic relationship with China. Through USMCA, and in the context of preserving and protecting North American competitiveness, the three governments should develop an agenda for policy coordination in critical areas to prevent and mitigate anti-competitive practices by China.

Share information and work to coordinate key policies vis-à-vis China

The Competitiveness Committee should prioritize ways to combat China's illegal acquisition of advanced technologies and intellectual property. The governments should develop mechanisms to share information that would strengthen the prosecution by departments/ministries of justice of intellectual property theft by Chinese firms. They should also seek to increase coordination in their use of export controls on sensitive or dual-use technologies as well as specific restrictions on exports and financial engagement with Chinese companies that have been sanctioned or blacklisted. The governments should also initiate regular discussions and information sharing regarding the conduct of foreign direct investment reviews.

Additionally, given our renewed trilateral attention to labor matters and our commitment in USMCA Article 23.6 to "establish cooperation for the identification and movement of goods produced by forced labor," our governments should immediately work together to prevent the entry into North American markets of goods made with forced labor in China.

There is also shared interest in addressing the persistent industrial subsidization of Chinese producers that threatens to undermine the long-term viability of some of our most important North American industries. Having agreed on commitments in the USMCA regarding the conduct of state-owned enterprises and subsidization, the three governments should work to widen multilateral support for their inclusion in other free trade agreements and in the World Trade Organization.

Mitigate risks to the supply of critical minerals

A high priority for North American governments is ensuring reliable supplies of critical mineral commodities that are essential to high-tech industrial products and defense applications. Despite holding reserves, the United States and Canada do not currently mine significant amounts of critical minerals. Mexico has a robust mining industry that attracts investment from American and Canadian firms, but it is not a significant producer of the 35 minerals designated as critical by the U.S. Department of Interior.

The United States is import-dependent for 31 of 35 critical minerals and relies entirely on imports to satisfy demand for 14 critical minerals. Canada is the largest supplier of seven critical minerals and a major supplier of another seven. Concerningly, China has achieved dominance in global trade of critical minerals. In recent years, China has demonstrated its willingness to withhold access to rare earth supplies for political leverage. In some cases, China's substantial investment and unfair subsidization of mining and exports of critical minerals has driven prices to unprofitable levels for North American mining operations. North American governments are now reviewing regulations that have stifled investments in mining with the aim of stimulating sources of finance to resume mining operations and rebuild a workforce that can support the renewal of a mining sector.

Nonetheless, North American manufacturing is worryingly vulnerable to disruptions in supply from China. To reduce the region's reliance on China, the three North American governments could combine efforts to improve the mapping of critical minerals across North America, discuss ways to streamline regulatory approvals for mining permits, accelerate research and development in alternatives, stockpile in a coordinated manner, and support innovation in extraction and recycling techniques. Just as hydraulic fracturing has reduced North American reliance on foreign oil and gas, collaboration and technological advancement can accelerate independence in the critical minerals industry.

The United States and Canada have developed an extensive intergovernmental network to explore and advance these initiatives, but the USMCA Competitiveness Committee should advocate to include Mexico, which is a key player in regional coproduction of both high-tech and clean-tech products that rely on critical minerals. Combining the competitive advantages of all three governments would accelerate the region's move toward greater self-sufficiency and reduce the need to purchase critical minerals from China.

USMCA Article 26.1.4

"The Competitiveness Committee shall discuss and develop cooperative activities in support of a strong economic environment that enhances a predictable and transparent regulatory environment."

Deepen our energy advantage

The productivity of Canada's oil sands, the U.S. shale boom, and historic Mexican energy reforms have ushered in an era of unprecedented abundance in the North American energy sector. This is a key competitive advantage in the region's trading relationship with China. The United States, Canada, and Mexico trade large amounts of energy in the form of oil and refined products, gas, and electricity, but we can expand energy trade and investment further.

Mexico's reforms in the energy sector have been pivotal to unlocking regional opportunity. But recent changes in the regulatory process for foreign investors – including obtaining permits and how long they will last – threaten to roll back achievements that have strengthened the competitiveness of Mexico's energy sector. In the United States, permitting processes were streamlined by executive orders that may also prove short-lived.

The Competitiveness Committee has an opportunity to shore up regulatory reforms that facilitate North American trade and investment in traditional energy products while also launching discussions around a regional strategy for achieving a sustainable mix of North American energy sources including water, solar and wind-generated energy.

Develop greater resilience to supply chain risks

Although each government has a responsibility in emergencies to first protect its own citizens, the level of supply chain integration in the region should be seen as an asset: It will facilitate each government's ability to secure essential goods, whether through new production, the diversion of supplies toward emergency purposes, or by maintaining open channels of existing supply.

The Competitiveness Committee should initiate a process to map regional supply chains related to disaster relief and to define "essential" goods, services and businesses as a way to prioritize trade facilitation in emergency circumstances. The committee should incorporate lessons learned within the private sector from the bottlenecks created during COVID-19 when each government acted independently. Best practices could then be incorporated into the North American Plan for Pandemic and Animal Influenza, which has provided a collaborative framework for North American pandemic preparedness since 2009. Our network of experts has experience we would like to lend to the effort to create an "essential goods and services" checklist.

If the Biden Administration uses the Defense Production Act in the name of reducing dependence on China for critical goods and services, the governments should discuss appropriate defense production sharing agreements and expanded North American exemptions from "buy American" requirements. In this sense, North American integration should be viewed as an asset to strengthen resilience and decrease dependence on influence-seeking foreign actors. Working together helps assure that all three countries in the region maintain access to high quality, safe, and reliable supplies while avoiding unnecessary costs to North American producers and consumers in times of heightened need.

Focus on a Strong Vision for North American Competitiveness

We urge the USMCA partner governments to seize the opportunity created by the Competitiveness Committee to develop a strong vision for North American competitiveness that places our region at the center of the global economy. Its work plan should be focused, with measurable goals, but broad and ambitious in potential impact. The kinds of initiatives we recommend would necessarily require a coordinated interagency effort, involvement of subnational government experts, and robust engagement with private sector and civil society stakeholders. But a holistic and inclusive approach that avoids adding bureaucracy to any new North American constructs will pay significant dividends. We stand ready to be part of this North American conversation and offer the support of our network to implement our recommendations and to help develop and operationalize additional recommendations that might flow from the Competitiveness Committee's work.

Acknowledgments

The George W. Bush Institute – SMU Economic Growth Initiative thanks the North America Working Group for its support and participation in numerous discussions over the course of the last several months. Its expertise and advice were invaluable as the Bush Institute – SMU Economic Growth Initiative developed these policy recommendations.

William Anderson
Chris Bachmann
Sandra Barreda
Kimberly Breier
Lucia Bustamante
Carlo Dade
Theresa Flores
Gustavo de la Fuente
Noe Garcia
Antonio Garza
Allison Gifford
Maryscott Greenwood
Gerónimo Gutiérrez Fernández
Brian Kingston
Pia Lara
Marta Leardi-Anderson
Ana López Mestre
Cecilia De La Macorra
Gary Mar
Tiffany Melvin
Eric Miller
Israel Morales
Oscar Ocampo
Lorna Romero
Shafak Sajid
Roberto Salinas León
Colleen Sklar
Manuel Suárez-Mier
Francisco de la Torre Galindo
Laurie Trautman
Daniel Ujczo
Andrea van Vugt
Adriana Vega
Earl Anthony Wayne
David Wilkins
Duncan Wood
Kenia Zamarripa

George W. Bush Institute – SMU Economic Growth Initiative Team

Andrea Durkin
Monica Kladakis
Matthew Rooney
Nick Saliba
Kristin Kent Spanos
Jenny Villatoro

GEORGE W. BUSH
INSTITUTE

BUSHCENTER.ORG

2943 SMU BOULEVARD | DALLAS, TEXAS 75205

Updated January 14, 2021

U.S.-Mexico-Canada (USMCA) Trade Agreement

Overview

On November 30, 2018, President Trump and the leaders of Canada and Mexico signed the United States-Mexico-Canada Agreement (USMCA). USMCA revises and modernizes the North American Free Trade Agreement (NAFTA), in place since 1994. USMCA replaced NAFTA as of July 1, 2020. Pursuant to trade promotion authority (TPA), the Administration provided the required consultations and notifications to Congress.

TPA and Other Key Dates for USMCA

- August 30, 2018: Notification to Congress of intent to sign agreement with Mexico.
- September 30, 2018: USMCA draft text released. Advisory committee reports released.
- November 30, 2018: Agreement is signed.
- January 29, 2019: List of required changes to U.S. law delivered to Congress.
- April 18, 2019: International Trade Commission (ITC) report released (extended due to government shutdown).
- May 30, 2019: Draft Statement of Administration Action (SAA) and text of the agreement submitted to Congress.
- December 10, 2019: Protocol of amendment agreed to by United States, Mexico, and Canada.
- December 13 and 16, 2019: Implementing legislation introduced in House and Senate (H.R. 5040 and S. 3052).
- December 17, 2019: USMCA implementing legislation approved in the House by a vote of 385-41.
- January 16, 2020: USMCA implementing legislation approved in the Senate by a vote of 89-10.
- January 29, 2020: President Trump signed legislation P.L. 116-113.

On December 10, 2019, the United States, Canada, and Mexico agreed to a protocol of amendment to the original USMCA text. The revisions include modifications to key elements of the original text regarding dispute settlement, labor and environmental provisions, intellectual property rights (IPR) protection, and steel and aluminum requirements in the motor vehicle industry rules of origin. The revised agreement provides for a facility-specific rapid response labor mechanism to address worker rights provisions.

Key Provisions

USMCA, composed of 34 chapters and 12 side letters, retains most of NAFTA's chapters, making notable changes to market access provisions for autos and agriculture products, to rules such as investment, government procurement, and intellectual property rights (IPR), and to provisions regarding labor and the environment. New issues, such as digital trade, state-owned enterprises, and currency misalignment are also addressed.

Market Access

Motor Vehicles. While NAFTA phased out tariffs on automotive imports among the three countries, subject to rules-of-origin (ROO) requirements of 62.5% content for autos, light trucks, engines, and transmissions, and 60% for all other vehicles and automotive parts, USMCA tightens ROO by including the following.

- New motor vehicle ROO and procedures, including product-specific rules and requiring 75% North American content.
- Wage requirements stipulating that 40%-45% of 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 (changes to USMCA require that steel be melted and poured in North America).
- Streamlining of ROO certification enforcement.

To provide manufacturers time to adjust, the date of entry into force of motor vehicle ROO was delayed until January 2021.

Table 1. Select USMCA Changes to NAFTA

Sector	USMCA	NAFTA
Autos	(Starting in Jan. 2021) 75% ROO; 70% steel and aluminum requirement; steel must be melted and poured in region; wage requirement.	62.5% ROO; no wage requirement; no steel and aluminum requirement.
IPR protection	Biologics: No commitments (10 years in original text). Copyright: 70 years.	Biologics: No commitments Copyright: 50 years.
Government Procurement	U.S.-MEX only; CAN to use WTO GPA.	Trilateral commitments.
Digital Trade	Cross-border data flows; restricts data localization.	No commitments.
Investor-State Dispute Settlement (ISDS)	Not applicable to U.S.-CAN disputes; U.S.-MEX disputes restricted.	Trilateral commitments.
State-owned enterprises	SOEs to adhere to market forces.	No commitments.

Source: CRS from USMCA Agreement.

Dairy. USMCA increases U.S. dairy access to Canada's dairy market, but it does not dismantle Canada's supply-management system. 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.

Dispute Settlement

USMCA maintains the NAFTA state-to-state mechanism for most disputes arising under the agreement. It also retains the binational dispute settlement mechanism to review trade remedy disputes. However, USMCA: eliminates investor-state dispute settlement (ISDS) for Canada after the termination of NAFTA; maintains ISDS only between the United States and Mexico for claimants regarding government contracts in the oil, natural gas, power generation, infrastructure, and telecommunications sectors; and maintains U.S.-Mexico ISDS in other sectors provided the claimant exhausts national remedies first. USMCA removes procedures allowing a party to block the formation of a dispute settlement panel.

Intellectual Property Rights (IPR)

NAFTA was the first free trade agreement (FTA) to include an IPR chapter. USMCA retains 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. The revised USMCA removes provisions on biologic data protection, among other changes. USMCA provisions include:

- copyright term extended to 70 years;
- 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 ISP liability.

Energy

Although USMCA removes NAFTA's energy chapter, it adds a new chapter with provisions recognizing Mexico's constitution and the Mexican government's direct ownership of hydrocarbons. Existing foreign investors in the energy sector likely remain protected by similar provisions as those in NAFTA. Mexico appears to be legally bound by its 2013 constitutional energy reforms in the energy sector.

Labor and Environment

USMCA revises NAFTA and incorporate provisions to provide the same dispute mechanism as other parts of the agreement. USMCA requires parties to:

- Adopt, maintain, enforce, and not derogate from statutes and regulation regarding the International Labor Organization (ILO) Declaration of Rights at Work.
- Adopt, maintain, enforce, and not derogate from environmental laws, including seven multilateral environment agreements.

USMCA has new provisions affecting labor and environmental disputes that shift the burden of proof to the responding party that a complaint affects trade and investment unless otherwise demonstrated. USMCA also includes a rapid response mechanism for worker rights complaints at covered facilities, Mexican labor reform monitoring, creation of a new interagency committee on labor with reporting requirements to Congress, and enhanced anti-worker violence and forced labor provisions.

Government Procurement (GP)

NAFTA set standards and parameters for government purchases of goods and services and opportunities for firms of each nation to bid on certain contracts for specified government agencies above a set monetary threshold on a reciprocal basis. The USMCA provisions only apply to U.S.-Mexico procurement, while Canada remains covered by the more recent and comprehensive World Trade Organization Government Procurement Agreement (GPA). However, the monetary threshold for the GPA is higher at $180,000 as compared to NAFTA's $25,000.

E-Commerce, Data Flows, and Data Localization

The USMCA has new digital trade provisions, including prohibiting customs duties on electronically transmitted products and limits on source code disclosure requirements. USMCA contains broad provisions on cross-border data flows and restrictions on data localization requirements. NAFTA did not contain digital trade provisions.

New USMCA Provisions

- Binding obligations on currency misalignment.
- A sunset clause requiring a joint review and agreement on renewal at year 6; in lieu of mutual agreement at the time, USMCA would expire 16 years later.
- A new chapter on State-Owned Enterprises (SOE).
- *De minimis* customs threshold for duty free treatment set at $117 for Canada and Mexico. Tax-free threshold set at $50 for Mexico and C$40 for Canada.
- Allowing a party to withdraw from the agreement if another party enters into an FTA with a country it deems to be a nonmarket economy (e.g., China).

Issues for Congress

Some issues for Congress include:

- The extent to which USMCA met TPA's negotiating objectives and implications for possible TPA renewal by Congress.
- Oversight of the effective implementation of the new and revised USMCA commitments.
- Whether new provisions on labor and environmental enforcement meet congressional concerns.
- How USMCA revisions will affect the future of U.S. trade policy given its reduced commitments in some areas and expanded commitments in others.

M. Angeles Villarreal, Specialist in International Trade and Finance

Ian F. Fergusson, Specialist in International Trade and Finance

IF10997

Disclaimer