NAFTA Re-Branded USMCA: A First Look at Its Potential Impact on the U.S. Auto Industry

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On October 1st the United States reached a deal with Canada and announced the newly minted United States–Mexico–Canada Agreement or "USMCA". The U.S auto industry, including the UAW and analysts had a mixed initial reaction to the White House announcement of the deal, which it says will make it easier for automakers and suppliers to expand domestic plants by making it more expensive to produce outside the U.S. The newly announced pact is over 100 pages long, and all parties agree needs significant further review to understand how all the details will impact the various sectors.

The three countries reached the agreement after more than a year of negotiations, which began after President Donald Trump promised to renegotiate the nearly 25-year-old agreement. However, congressional approval remains uncertain, especially if Democrats take control of the House in the November midterm elections. The president appeared to foreshadow to such problem, saying he is "not at all confident" he would get enough votes even though he said the deal should "pass easily."

The most significant changes to the trade agreement are:

- **Country of origin rules**: Autos will have tariff-free access to the US market as long as 75 percent of their components are made in North America — compared to 62.5 percent now. Vehicle parts will be further classified into subclasses; core components, main components, and complement parts requiring 75%, 70% and 65% RVC respectively. The rules will be phased in, starting at 66% on January 1, 2020, or the date the agreement comes into force and increasing to 75% in 2023. USMCA increases the value of non-originating goods that may be used under the *de minimis* provision from 7% to 10%. The agreement further specifies that 70% of the steel and aluminum used must originate in North America for a vehicle to be classified as a North American originating vehicle. Autos

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that do not meet the modernized NAFTA rules of origin will pay a 2.5 percent tariff (MFN rate). Autos non-conforming to new rules of origin rules made at new plants could be hit by Section 232 tariffs on auto imports if so imposed

- **Labor provisions or Labor Value Content:** The new deal will require that a significant percentage of the car (40%) be produced by workers making at least $16 per hour, a threshold meant to raise wages in Mexico and undercut the country's competitive cost advantage.
- **Investor-State Disputes**: The deal eliminates expert trilateral panels for resolving government-investor disputes in most industries, except for those covering energy and telecommunication. It also preserves panels for bilateral disputes regarding dumping and countervailing duties, it defers to domestic courts as the main mechanism for solving controversies.
- **Sunset**: NAFTA had an indefinite lifespan, the USMCA will expire in 16 years. The three countries will conduct a joint review six years after the deal enters into force, with an option to extend the deal beyond the 16-year term.
- **Tariffs**: Mexico and Canada both entered into additional side letters that include protections should the US adopt Section 232 tariffs on vehicles and vehicle parts. The side agreement between the two countries would allow the United States to pursue national security tariffs on annual Mexican car and SUV imports of over 2.6 million vehicles, plus another 300,000 for "noncompliant vehicles from Mexico" a number that significantly exceeds last year's total imports. The side deal would allow any future national security levies on auto parts imports from Mexico above a value of $108 billion per year on the same grounds, and $33 billion from Canada. Mexico would reserve the right to challenge the U.S. use of "national security" tariffs at the World Trade Organization. The agreed cap of motor vehicles and parts exports into the U.S. is essentially a quota, similar to what was required in the 232 steel and aluminum case for countries to be excluded and which were agreed to by Korea, Brazil, and other countries. However, steel and aluminum tariffs will remain, as well as respective retaliations. The three countries are currently in negotiations to remove the steel and aluminum tariffs.
- **Certificate of Origin:** A formal Certificate of Origin is no longer be required under the USMCA.
- **Access to the Canadian dairy market**: The US got Canada to open up its dairy market to US farmers.
- **Intellectual property and digital trade:** The deal extends the terms of copyright to 70 years beyond the life of the author (up from 50). It also extends the period that a pharmaceutical drug can be protected from generic competition. The USMCA strengthens intellectual property regimes by establishing 10-year biologics pharmaceuticals patents, 15-year industrial designs patents, 10-year agricultural chemicals patents.
- **Non-Market Economies**: Chapter 32 of the new deal addresses the ability of members to enter into a free-trade agreement with a country that has a "non-market economy." While there are many countries considered "non-market economies," the most notable member of the list is China. It is basically a poison pill meant to stop Canada and Mexico from entering a deal with China. The text stipulates that three months before the US, Canada, or Mexico begin trade negotiations with a non-market economy, the other two countries must be notified. Additionally, any formal text of a deal

with a non-market economy must be provided to the other members at least 30 days before signed.

- **Energy (Mexico):** The Energy Chapter recognizes the sovereign right to regulate and modify the Mexican legal framework, including the Constitution. It reaffirms Mexico´s property rights on hydrocarbons in Mexico´s subsoil. Mexico is reserving the right to adopt or maintain measures in sectors, sub-sectors or activities that are not reserved in the Annexes of Specific Provision on Cross-Border Trade in Services, Investment, and State-Owned Enterprises as long as these measures are consistent with the Mexico agreement that is least restrictive and that is already ratified upon the entry into force

It should not be ruled out that the text of the agreement could continue to be modified. The heading of the text contains a legend that reads: "*Subject to Legal Review for Accuracy, Clarity, and Consistency, Subject to Language Authentication*".

In conclusion, the deal succeeds in revitalizing many of the agreements that were reached in the now-defunct Trans-Pacific Partnership (TPP). It updates some parts of NAFTA and it succeeds in keeping a trilateral deal. However, it is unclear whether this version of the trade agreement will muster the necessary support to get Congress to approve it.

Since the start of NAFTA renegotiations and tariff implementations (Section 232 and 301), we have been helping clients navigate the implications of new trade regulations in their business. We can assist you in developing strategies to assess and mitigate risk arising from regulation changes. See Client Alerts on these topics on the following links: September 18, September 7, August 31, August 9, August 2, July 11, July 9, June 15, and April 4.

Butzel will be providing further Client Alerts and other updates as we analyze the complete new USMCA specifically tailored to the auto industry and its global supply chain. We will be focusing on the consequences that new rules origin and labor value content requirements will have on the integrated supply chain, as well as on the interaction of the new pact with both the enacted and proposed Sections 232 and 301 tariffs.

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