North American Free Trade Agreement

What it Means for Investors in Canada

[1] *The Market*

Coming into effect on January 1, 1994, NAFTA created a single, North American market of 360 million consumers and a combined GDP in excess of $8.5 trillion.

Canadian goods, services and capital now have barrier-free access to the affluent U.S. market as well as to Mexico. It is expected that in the near future NAFTA will be expanded to include other nations.

[2] *Elimination of Tariff and Non-Tariff Barriers*

Canada-U.S. products continue to trade under the schedule negotiated in the Canada-U.S. Free Trade Agreement. Most Canadian exports enter the U.S. free of duty. The remaining tariffs on Canadian exports to the U.S. will be eliminated no later than January 1, 1998. With NAFTA, tariffs on most Canadian exports to Mexico will be phased out by January 1, 2003.

Mexico has provided immediate duty-free access for many of Canada's key export interests including agricultural and fish products, many metals and minerals, most telecommunications equipment, many types of machinery, and certain wood and paper items. Mexican tariffs in sectors such as furniture, pharmaceuticals, and some wood and finished metal products will be phased out by January 1, 2003.

Most of Mexico's non-tariff barriers such as import licences will also be eliminated by January 1, 2003.

[3] *National Treatment*

NAFTA provides for national treatment, most favoured nation treatment, and the prohibition of trade distorting performance requirements.

Canada, the U.S., and Mexico must treat each other's goods, services, and investors as they treat their own. Once goods, services or investments from one country enter the other, they cannot be discriminated against on the basis of origin.

International investors with investments in Canada are covered by NAFTA if they use Canada as a "home base" to make investments in the U.S. or Mexico.

[4] *Secure Market Access*

NAFTA ensures secure access for Canadian-based exporters to both the U.S. and Mexico. Clearer North American content rules, including those for autos, reduce the risk of unilateral interpretations by customs officials (see illustration on next page).

[5] *Improved Dispute Settlement Mechanisms*

Exporters and business investors can be reassured that their interests will be effectively defended in a more transparent and enforceable dispute settlement system.

Disputes arising from the application of duties can be referred to bi-national panels.

Disagreements between investors and NAFTA governments may be settled through international arbitration. Under the Canada-U.S. Free Trade Agreement, a system of bi-national panels was established to review countervailing and anti-dumping decisions and to make binding determinations on whether or not they were in accordance with domestic legislation. NAFTA enhances the FTA rules and has extended them to Mexico. The bi-national dispute settlement system has been strengthened and any uncertainty over its permanency removed.

NAFTA Tariff Elimination Schedule

Tariffs Eliminated January 1, 1994	Tariffs Phasing out by 1998	Tariffs Phasing out by 2003
Locomotive and Rail Cars	Hydraulic Turbines	Other Railway Cars and Coaches
Construction Equipment	Air Conditioners	Boats and Drilling Platforms
Telecommunications Equipment	Many Resins	Bicycles
Fertilizers	Most Copper Wire	Most Flat-Rolled Stainless Steel
Health and Medical Equipment	Laundry Soaps	Furniture
Many Chemicals and Plastics	Wood and Paper	Pharmaceuticals

Note: Examples only. For details, consult NAFTA Tariff Schedule of Canada.

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An essential element of the decision by the Government of Canada to proceed with NAFTA was the creation of working groups on subsidies and dumping, that will address long-standing Canadian concerns about disputes arising from countervailing and anti-dumping duties. The working groups are to complete their work by the end of December 1995, to seek solutions that reduce the possibility of disputes from the operation of trade remedy laws.

[6] *Government Procurement*

All three countries have agreed to provide substantially increased access to government procurement opportunities not only in goods, but also in services, including construction services.

For example, Canadian companies can bid for service and drilling contracts with the Mexican state-owned company Petroleos Mexicanos (PEMEX).

[7] *Facilitation of Business Travel*

Business travel has been expedited through the introduction of simplified procedures. Eligible business people in over 60 professions can be granted temporary entry without any prior approval procedures.

[8] *Intellectual Property Protection*

NAFTA includes comprehensive coverage of intellectual property rights encompassing standards and rules of enforcement. The patents, trademarks, copyrights and trade secrets of Canadian-based companies and individuals are protected.

The agreement provides a higher level of protection for intellectual property rights than any other bilateral or multilateral agreement.

[9] *Investment*

Under the agreement, all investors from NAFTA countries are to be treated equally. The NAFTA coverage extends to investments made by any company incorporated in a NAFTA country, regardless of its country of origin. This helps to ensure that foreign investors continue to view Canada as an attractive place to invest by offering them a more secure footing in the North American marketplace.

Mexico is reducing investment restrictions on dozens of sectors, including autos, mining, agriculture, fishing, transportation and most manufacturing.

Investor state arbitration has also been included so that disputes between investors of a NAFTA country and a NAFTA government may, at the investor's request, be settled through international arbitration. This gives Canadian investors in the United States and Mexico added confidence and security.

Under NAFTA, 100% foreign investment is allowed in most Mexican industries.

There are major disciplines on the use of trade distorting investment restrictions, ensuring that Canada and the other NAFTA countries remain preferred sites for domestic and foreign investment.

Review thresholds regarding investments in individual Mexican companies have been raised, from a maximum threshold of US$25 million in the first year of the agreement to US$150 million after nine years.

As agreed in NAFTA, Mexican and U.S. firms benefit from increased review thresholds under the *Investment Canada Act*. These have since been extended to all WTO (World Trade Organization) members, for investments in both goods and services. Subject to certain exceptions (cultural industries, financial and transportation services, and uranium), under NAFTA, the threshold for 1995 is $160 million (assets of business being acquired) for direct acquisitions. Indirect acquisitions by American and Mexican

Formulas for Determining North American Content Levels

In those cases where North American content is an issue, exporters or producers can choose between two formulas:

Transaction Value Method
(not less than 60%)

$$RVC = \frac{TV - VNM}{TV} \times 100$$

RVC = regional value content (%)
TV = transaction value adjusted to F.O.B. bases
VNM = value of non-originating materials used by producer in the production of a good

Net Cost Method
(not less than 50%)

$$RVC = \frac{NC - VNM}{NC} \times 100$$

NC = net cost of a good

investors are not reviewable under the *Investment Canada Act.*

[10] *NAFTA vs EU*

The European Union has eliminated internal trade barriers but has established a common external tariff and is moving towards common internal regulations covering goods, services, capital and people.

NAFTA members maintain existing import regimes with their other trading partners. There is no comprehensive harmonization of internal regulations or policies, economic, social, cultural or otherwise.

SECTOR-SPECIFIC PROVISIONS

[11] *The Auto Sector*

The Canada-U.S. Auto Pact continues.

The Mexican auto market – the fastest growing in North America – is being opened to Canadian automotive exports. With NAFTA, Canadian manufacturers get immediate access to Mexico for medium and heavy-duty trucks and buses. By 2003, Canada will have open access to the entire Mexican automotive market.

With NAFTA, Mexican tariffs on vehicles and light trucks have been cut in half. In 1998, duties on three-quarters of parts exports to Mexico will be eliminated. Mexican "trade balancing" and "local content requirements" will be phased-out by January 1, 2003.

NAFTA carefully spells out North American content rules for vehicles and auto parts. The North American content requirement for light vehicles including cars and light trucks, to qualify for duty-free treatment, has been raised to 62.5% in two stages over eight years. New plants will have to reach the new content level by January 1, 1998. Major plant refits will have two years.

A clearer, easier to achieve formula for calculating North American content has been agreed to.

NAFTA includes an extension of the duty draw-back until 1996. A new duty refund system thereafter reduces future input costs for Canadian manufacturers.

[12] *Financial Services*

The Canada-U.S. Free Trade Agreement marked the first time financial services were included in a trade agreement. The U.S. agreed to have the principles of national treatment, market access and most-favoured nation apply to financial services.

Under NAFTA, Mexico will provide substantial access to its market after a transition period. Canadian banks, trust companies, securities brokers and insurance companies will be able to open subsidiaries, invest in, and acquire ownership of financial institutions in Mexico. Canadian financial institutions will be able to service their clients throughout the NAFTA region.

[13] *Other Service Sectors*

NAFTA provides coverage of cross-border services including transportation services, specialty air services (e.g. aerial mapping and surveying), and professional services.

In transportation services, the trucking industry has greater freedom for Canadian transporters to carry cargo from Canada to the U.S. and onward to Mexico.

Canada and Mexico agreed to maintain their relatively open international maritime shipping market.

Mexico agreed to open its market to business and professional services, including management, engineering, advanced data processing, accounting and legal services.

Canadian-based companies are able to bid for major procurement contracts of the U.S. and Mexican governments and state-owned corporations. In the U.S., the services market is approximately $30 billion a year. In Mexico, the state-owned petroleum and electricity corporations contract for more than $8 billion a year in goods and services.

[14] *Textiles and Apparel*

NAFTA contains new, tighter rules of origin requiring greater sourcing in North America. For apparel, the new rules require that yarns and fabrics in a garment be made in North America to qualify under the Agreement. For yarns, the fibres must originate in North America. These new rules are offset by increased "tariff rate quotas" which provide preferential access for Canadian-made garments to the U.S. market.

With NAFTA, Canadian and Mexican tariffs on apparel will be eliminated by January 1, 2003. For textiles, the phase-out will be over by January 1, 2001.

[15] *Energy and Petro-Chemicals*

NAFTA limits Mexico's use of restrictive trade practices in the energy sector. It contains disciplines that prohibit Mexico from applying discriminatory border restrictions and export taxes.

The elimination of Mexican investment restrictions on secondary petrochemicals, coupled with the immediate elimination of trade restrictions on most petro-chemicals, offers important opportunities for Canadian-based companies. Canadian manufacturers of industrial equipment for the energy industry have access to freer Mexican markets. The agreement also contains clearer disciplines on energy regulators to avoid discriminatory actions and to minimize disruption of contractual arrangements.

[16] *Agriculture*

The Canada-U.S. Free Trade Agreement continues to govern agricultural trade between Canada and the United States. Within NAFTA, Canada and Mexico have a separate agreement. Mexico's market is being opened through the immediate elimination of import licences and the phase-out of tariffs.

[17] *Telecommunications*

Canada is a recognized world leader in telecommunications. NAFTA encourages the development of competitive telecommunications networks, providing a market for Canadian developers of such enhanced services as electronic messaging, advanced data networks and electronic mail.

Mexico is in the process of modernizing its services so that they are compatible with Canadian and U.S. networks. By the year 2000, Mexico's demand for imported telecommunications products is expected to grow by 42%. Under NAFTA, Mexico eliminated its tariffs on all communications equipment in 1994, with the exception of tariffs on central switching apparatus and telephone sets. These will be phased out by January 1, 1998.

[18] *Transportation*

NAFTA has streamlined transportation between the three countries. By January 1, 1999, trucks and buses can criss-cross the North American continent with virtually no border restrictions.

Under NAFTA, for instance, a Canadian driver can haul a load from Calgary to Mexico City, with a stop in Texas to pick up more goods. On the way home, the same driver can deliver Mexican goods to both Canadian and U.S. destinations.

Canadian and Mexican firms have access to each other's international maritime shipping markets.

NAFTA provisions on cross-border trade and services do not include passenger and cargo services for the airline industry. They do, however, provide for specialized air services such as aerial mapping and surveying, as previously noted.

Note: All figures are quoted in Canadian dollars unless indicated otherwise.