How the New NAFTA Affects Cannabis Stocks

Description

At the end of 2018, Canada, the United States, and Mexico agreed on new terms to replace the North American Free Trade Agreement (NAFTA). The new treaty, the Canada-United States-Mexico Agreement (CUSMA), establishes updated legal language surrounding trade tariffs, environmental and labour regulations, and intellectual property protections. Now that cannabis is considered a legitimate export for medicinal use, international trade faces the complex task of applying current laws to a product which was once prohibited.

It was only just last year that **Canopy Growth** (TSX:WEED)(NYSE:CGC) completed the first legal export of medical cannabis to the United States. As the world waits for the United States and Canada to follow Mexico in ratifying the new trade agreement, this is what cannabis investors should know about how the deal affects the marijuana industry.

Intellectual property rights

Article 20.36 in CUSMA gives Canada, Mexico, and the United States the right to consider particular inventions unpatentable. These inventions include those products which protect human, animal, or plant life and health. Enforcement agencies may arguably regard medicinal cannabis as a necessary therapeutic product applicable under paragraph three of Article 20.36.

The pharmaceutical industry and the price of patentable drugs are at the forefront of the intellectual property rights discussion. Patents remain a primary barrier to competition — driving up prices on life-saving medications like insulin and antiretrovirals used in the treatment of HIV.

The language used in CUSMA gives the governments of Canada, the U.S., and Mexico authority to disregard international pharmaceutical patents, including those about medicinal cannabis. How the legal language is interpreted and enforced in practice is ambiguous.

Zero tariffs on THC

CUSMA tariff schedules explicitly list tetrahydrocannabinol (THC) as a zero-duty eligible product, meaning THC products are exempt from import taxes. Currently, Canada imposes a tariff of 6.5% on THC imports; the United States and Mexico do not impose tariffs on THC imports.

Investors in cannabis should not be concerned about the removal of tariffs on THC imports into Canada. Canadian cannabis producers have a definite first-mover advantage in the global arena. If anything, lower levies on THC imports will enable the industry to reduce production costs and increase profit margins.

Supply-chain impacts

Canada suffers from a cannabis supply shortage and faces high costs to cultivate marijuana. The cost to grow cannabis is 15 times as expensive in Canada than in Colombia — a country which legalized the sale of medicinal marijuana in 2016. Due to the climate, Canadian producers must grow marijuana in pricey, energy-intensive greenhouses.

Zero-duties on THC imports from the United States and Mexico will increase the geographical scope available for Canadian producers to cultivate cannabis. Always one step ahead of the competition, Canopy Growth announced on April 18, 2019, a deal to acquire **Acreage Holdings**, a New York-based marijuana parent corporation in the United States. The agreement will allow Canopy to expand its cultivation operations to U.S. states such as California, Maine, Oregon, and Iowa.

Foolish takeaway

If Donald Trump, the current U.S. president, can hash out his differences with a divided Congress to ratify CUSMA, the treaty will only aid Canada's budding cannabis industry in building a more responsive supply chain.

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