

Intelligence MEMOS



From: Jon Johnson
To: Canadian trade negotiators
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Re: The Auto Industry's CUSMA Challenge

In the negotiations for a new NAFTA, the US side targeted the North American auto industry for major change. It argued that NAFTA rules of origin, which set the requirements for duty-free treatment, permitted too much non-North American content in automobiles. As well, Donald Trump himself was fixated on the significant US trade deficit with Mexico, which largely comes from automotive goods.

For Canada's auto industry, there is much at stake. In 2017, it sent close to \$62 billion in automotive goods to the US, and that market is overwhelmingly the destination for vehicles produced in Canada. It is vital, therefore, that rules of origin be transparent and administratively workable.

The rules under the Canada-United States-Mexico-Agreement (CUSMA) are considerably more stringent than under NAFTA. In my new C.D. Howe Institute [Commentary](#), I analyze the new rules, identify ambiguities and areas of uncertainty, and make suggestions for clarifications through the adoption of the Uniform Regulations – for which CUSMA fortunately provides – that will provide greater certainty to both businesses and administrators in how to apply the rules.

Adapting to the CUSMA rules will require major adjustments in supply chains. This is particularly the case with the substantially higher Regional Value Content (RVC) thresholds required for most automotive goods, which are moving from 60 to 75 percent in the most common categories. While some relief is possible through limited alternative staging alternatives, the transitions to the higher RVC thresholds under CUSMA is only three years for passenger vehicles and light trucks, as compared with eight years under NAFTA.

Further, the CUSMA rules of origin are needlessly complex. There are multiple categories of parts for different categories of vehicles with varying RVC requirements that depend on the end use of the part. Complexity increases compliance costs, which are burdensome for all producers, but particularly for smaller producers less able to afford investment in expensive compliance systems.

While the CUSMA rules mostly eliminate NAFTA tracing requirements, the CUSMA text inexplicably retains a form of tracing for several narrow categories of vehicles. As well, the CUSMA rules of origin regime contains two requirements that are unprecedented in such regimes; namely, a steel and aluminum purchase requirement (70 percent) and a labour value content requirement.

These are performance requirements that are consistent with a managed trade regime (where rules are designed to achieve certain economic outcomes) and not with a free trade regime (which seeks to remove barriers to trade so that economic results are dictated by market forces.) If CUSMA is approved and comes into effect, the North American automotive industry will have to live with the agreement's rules of origin for a long time.

Once a trade agreement comes into effect, it is very difficult to change. This is particularly the case in the United States, with its complex rules for approving trade agreements and its separation of powers. CUSMA has not yet come into effect, however, and there is still time for extensive clarification through the CUSMA Uniform Regulations.

North American automotive producers should review carefully the CUSMA rules of origin and urge their respective governments to negotiate and implement Uniform Regulations that clarify ambiguities, establish procedures to reduce compliance costs and facilitate the routine application of rules of origin to the greatest extent possible.

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