

Intelligence MEMOS



From: Jon Johnson
To: Steve Verheul, Assistant Deputy Minister, Trade Policy and Negotiations, Global Affairs Canada
Date: April 19, 2021
Re: **CANADA AND MEXICO SHOULD NOT NEED TO DEFEND ROLLUP IN A CUSMA FIGHT WITH THE US**

There are reports that US Customs and Border Protection, responsible for US administration of the CUSMA rules of origin (ROOs), maintain that if a part incorporated into an automotive good contains any foreign content, the amount of foreign content must be subtracted from the North American regional-value content calculation.

This interpretation is inconsistent with a way to manage origin calculations called “roll-up,” that has been explicitly incorporated into the CUSMA ROOs. This perpetuation of a decades-old anti-Japanese regime will only increase cost and complexity for the auto industry.

The ROOs in the Canada-US Free Trade Agreement, NAFTA and the CUSMA set out regional value content (RVC) requirements for certain goods, including vehicles and many key automotive components such as engines and transmissions.

The original Canada-US Free Trade Agreement RVC requirement was based on the direct cost of processing a good, while the NAFTA and CUSMA RVC requirements provide for a transaction value method (based on the good’s selling price) and a net cost method (based on good’s total cost less certain deductions). The net cost method was mandatory for most automotive goods under NAFTA and this continues under CUSMA.

Under the Canada-US Free Trade Agreement and the NAFTA RVC requirements, and currently under the CUSMA RVC requirements, only the value of non-originating materials (VNM) incorporated into a good counts against the producer. However, what about a non-originating sub-material incorporated into a material that otherwise satisfies the specific rule of origin that applies to it? When “roll-up” applies, the value of any non-originating sub-materials is “rolled up” into the value of the originating material and does not count against the producer.

Roll-up makes real practical sense. Producers are not required to determine the value of sub-materials provided by suppliers with whom they have no direct connection.

Roll-up applied to all goods subject to an RVC requirement under the Canada-US Free Trade Agreement and to all non-automotive goods subject to a NAFTA RVC requirement. CUSMA returns to the application of roll-up for RVC requirements for automotive goods, with a few minor exceptions, as well as for all non-automotive goods subject to an RVC requirement.

The NAFTA departure from roll-up for automotive goods occurred because the Big Three (GM, Ford and Chrysler) considered roll-up open to abuse by the Japanese transplants (Toyota and Honda) and insisted that the NAFTA automotive ROOs require producers trace the value of sub-materials. Under the NAFTA tracing rule for light duty vehicles, such as passenger cars, VNM (the value counting against the producer) equals the value of materials imported from non-NAFTA countries under tariff provisions specified on a tracing list. The producer had to trace the value of the imported material even though the importer was several steps up the value chain with no direct relationship with the producer.

The North American automotive producers lived with this cumbersome regime for the 25 years of NAFTA’s existence. However, the Trump Administration wanted to end it because the tracing list was considered insufficiently comprehensive

Other than retaining tracing for a few minor categories of vehicles, the CUSMA automotive ROOs eliminate tracing and, instead, substantially increase value content thresholds. For example the threshold for a car powered with a gasoline engine increases from 62.5 percent under NAFTA to 75 percent with the fully phased-in CUSMA rate starting July 1, 2023.

However, one consequence of the elimination of tracing is renewal of roll-up for automotive goods. Section 14(1) of the trilaterally agreed CUSMA Uniform Regulations, entitled *Roll-Up of Originating Materials*, expressly sanctions roll-up by making it crystal clear that VNM does not include “the value of non-originating materials used to produce originating materials that are subsequently used in the production of the good.”

Consider a gasoline engine for a passenger car. Suppose that the piston heads in the engine are imported from Japan but the engine qualifies as “originating” under its ROO.

Under the Canada-US Free Trade Agreement, the value of the imported piston heads were “rolled up” into value of the originating engine and did not count against the vehicle producer under its RVC requirement.

Under NAFTA, even if the engine qualified as “originating”, the car producer had to trace the value of the imported piston heads and include their value in its VNM.

Under CUSMA, roll-up applies as Section 14(1) explicitly provides and the producer does not have to include the value of the piston heads in its VNM.

But Canada, the US and Mexico have adopted CUSMA Uniform Regulations regarding the interpretation of ROOs by border agencies, precisely to avoid disputes on these matters having to be settled by an international panel.

The CUSMA Uniform Regulations are clear on the question of roll-up, and Canada and Mexico should not have to resort to the CUSMA dispute settlement procedures to resolve this question.

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