

Intelligence MEMOS



From: Jon Johnson
To: Global Affairs Canada and the Canadian Auto Industry
Date: October 24, 2018
Re: **CLARITY STILL NEEDED ON USMCA AUTO RULES OF ORIGIN**

The automotive rules of origin in the new trade deal with the US and Mexico involve multiple classes of vehicles and parts and differing regional value content (RVC) thresholds for each. These thresholds must be met in order to qualify for duty-free trade.

For example, the RVC threshold for a spark-ignition reciprocating piston engine classified under subheading 8407.34 for a passenger vehicle or light truck will be increased in phases to 75 percent by January 1, 2023 (assuming the USMCA enters into force by January 1, 2020). However, the threshold for the same engine for a heavy truck will be increased in phases to 70 percent by January 1, 2027.

For the Canadian auto industry, the most important motor vehicle classification in the USMCA rules is the “passenger vehicle” (a vehicle under subheadings 8703.21 through 8703.90 with some exceptions). A “passenger vehicle” must satisfy four different requirements to qualify as “originating” and be eligible for USMCA duty-free treatment.

First the vehicle must satisfy an RVC requirement that will be increased in phases to 75 percent by January 1, 2023.

Second the engine, transmission, body and chassis, axle, suspension system, steering system and (for electric cars or hybrids) the advanced battery must all qualify as originating.

Third the producer of the vehicle must have purchased at least 70 percent of its steel and aluminum in North America during the previous year.

And finally, the vehicle producer must satisfy a labour value requirement of 40 percent by January 1, 2023, when the regime is fully phased in.

The USMCA rules for “passenger vehicles” have dispensed with the NAFTA requirement that most parts and components be traced back to the point of entry into North America from a non-NAFTA country. Oddly, however, the NAFTA concept of tracing has been retained for a few vehicles, including passenger vehicles with compression ignition engines (typically diesel engines) and for certain vehicles for transporting between 10 and 15 persons. NAFTA heavy duty vehicle tracing has been dropped for heavy trucks but, again oddly, has been retained for trucks for off-road use, specialty vehicles and a few other vehicles.

Fortunately the USMCA rules of origin carry forward the NAFTA concept of Uniform Regulations. This concept entails that regulations implementing the rules of origin in each USMCA country should be identical except for allowing minor differences in tariff nomenclature. The NAFTA Uniform Regulations enabled the NAFTA parties to clarify many uncertainties in the NAFTA text, and the USMCA Uniform Regulations must do the same.

In particular, the USMCA labour value requirement with which producers of “passenger vehicles” must comply desperately needs clarification. Of the required labour value content of 40 percent, at least 25 percentage points must consist of “high wage material and manufacturing expenditures,” no more than 10 percentage points may consist of “technology expenditures” and no more than five percentage points may consist of “assembly expenditures.” These concepts are badly defined in the USMCA text. The Uniform Regulations must transform the labour value requirement into a coherent regime so that each producer of a “passenger vehicle” knows exactly what information needs to be gathered, what calculations must be made and what reporting must be completed.

The USMCA automotive rules of origin will be applied to the tens of millions of dollars of automotive goods that will cross USMCA borders each day. Global Affairs Canada and the Canadian auto industry must work closely with their US and Mexican counterparts to ensure that the USMCA Uniform Regulations accomplish the objective of ensuring that the USMCA rules of origin can be administered in a routine manner without controversy.

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