

Intelligence MEMOS



From: Jon Johnson
To: The Honourable Ministers of International Trade, and Foreign Affairs
Date: June 29, 2017
Re: **NAFTA RULES OF ORIGIN NEED A DOSE OF UNIFORM REGULATION**

Antidumping, countervailing actions, steel investigations, supply management regimes; these all make for great sound bites. In contrast, the technicalities of rules of origin that determine which goods may benefit from duty relief within a free trade area, can seem mind-numbing. However, the rules of origin lie at the heart of the NAFTA trading relationship and must be applied on a daily basis in thousands of transactions by producers in each NAFTA country. Above all, the rules must be predictable in their application and uncontentious.

The three NAFTA Parties adopted an innovative approach – harmonizing their domestic regulations implementing the NAFTA rules of origin. The reason for doing this was directly related to the experience under the Canada-US Free Trade Agreement (CUFTA). Shortly after the CUFTA came into effect, Canada issued regulations implementing the CUFTA rules of origin. The US did not immediately issue regulations but, rather, adopted customs orders covering individual situations. Several of these orders led to direct confrontations with Canada. One confrontation involving the treatment of non-mortgage interest was only settled (in Canada's favour) by invoking a CUFTA Chapter Eighteen panel. The US administration ultimately issued its own regulations, which bore little relationship to their Canadian counterparts.

Given the magnitude and importance of the NAFTA trading relationship, the NAFTA Parties did not wish to repeat this chaotic experience. Accordingly the NAFTA text required the NAFTA Parties to establish Uniform Regulations regarding the interpretation, application and administration of the rules of origin. In the course of negotiating the Uniform Regulations, the NAFTA Parties addressed and resolved ambiguities and filled many gaps in the NAFTA text.

One example involves the WTO Customs Valuation Code that is applied in regional content requirements to address inter-company pricing issues. All three countries are party to it, but it addresses cross border situations only and does not cover domestic transfer pricing situations. Domestic transfer pricing is relevant to application of regional value content requirements in NAFTA, such as when producers purchase from suppliers to whom they may be related or whom they have assisted. In the Uniform Regulations, the NAFTA Parties rewrote the Customs Valuation Code so that its principles could be applied to domestic transactions.

The CUFTA rules of origin were a major point of contention under the CUFTA and made headlines. With the Uniform Regulations, the NAFTA rules of origin became routine and uncontentious, as they should be.

The parties renegotiating NAFTA will have differing positions as to the origin requirements that should apply to a number of goods. However once these differences are resolved, the implementation of new NAFTA rules of origin must be free from dispute and completely predictable, without which the complexity and unpredictability will make it difficult for smaller businesses, in particular, to benefit from the agreement. The Parties to the renegotiated NAFTA can only achieve this result by amending the existing Uniform Regulations to accommodate the revised rules and continuing their practice under the renegotiated NAFTA of harmonizing their laws implementing the rules of origin.

Jon Johnson was a former advisor to the Canadian Government during NAFTA negotiations and is a Senior Fellow at the C.D. Howe Institute.