

TECHNICAL ADDENDUM TO “BUMPER TO BUMPER: WILL THE CUSMA RULES OF ORIGIN MAKE AMERICA’S AUTO INDUSTRY GREAT AGAIN?”

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The purpose of this Technical Addendum is to provide additional technical detail respecting selected topics described in the Commentary.

The CUSMA Rules of Origin are set out in CUSMA Chapter 4. The Product Specific Rules of Origin for all goods are set out in Annex 4-B to CUSMA Chapter 4, organized in accordance with Harmonized System (HS) Chapters, Headings and Subheadings.¹

There is also an Appendix to Annex 4-B entitled “Provisions Related to the Product Specific Rules of Origin for Automotive Goods” (hereinafter referred to as the “Auto Appendix”). The Product-Specific Rules of Origin for goods classified under HS headings 8701 through to 8708 (various types of motor vehicles and parts for motor vehicles) are set out in Auto Appendix, Article 2.

CATEGORIES OF MOTOR VEHICLES AND PARTS

As described in the *Commentary*, there are two principal categories of motor vehicles, and their parts, that receive special treatment in the Auto Appendix. The first is passenger vehicles and light trucks and the second is heavy trucks.

The definitions of “passenger vehicle,” “light truck” and “heavy truck” in Auto Appendix, Article 1 are as follows:

passenger vehicle means a vehicle of subheading 8703.21 through 8703.90 (vehicles

for transporting people), except for: (a) a vehicle with a compression-ignition engine classified in subheading 8703.31 through 8703.33,² or a vehicle of 8703.90 with both a compression-ignition engine and an electric motor for propulsion; (b) a three or four-wheeled motorcycle; (c) an all-terrain vehicle; or (d) a motorhome or entertainer coach.

light truck means a vehicle of subheading 8704.21 or 8704.31 (trucks with gross vehicle weight not exceeding 5 tonnes), except for a vehicle that is solely or principally designed for off-road use.

heavy truck means a vehicle of subheading 8701.20 (road tractors for semi-trailers), 8704.22, 8704.23, 8704.32, 8704.90 (various trucks with a gross vehicle weight exceeding 5 tonnes), or 8706 (chassis fitted with an engine), except for a vehicle that is solely or principally designed for off-road use.

REGIONAL VALUE CONTENT (RVC) CALCULATIONS FOR PARTS OF PASSENGER VEHICLES AND LIGHT TRUCKS

As described in the *Commentary*, there are three categories of parts used in passenger vehicles and light trucks for which the Auto Appendix sets out specific requirements respecting RVC thresholds: core parts, principal parts and complementary parts.

1 The first two digits in an HS code signify the HS chapter. The first four digits signify the HS heading and the first six digits signify the HS subheading.

2 Subheadings 8703.31 through 8703.33 cover vehicles for transporting people (i.e., cars) with compression ignition engines (diesel or semi-diesel) with varying cylinder capacities. The effect is to exclude from the CUSMA definition of “passenger vehicle” cars with diesel engines.

1 Core Parts for Passenger Vehicles and Light Trucks listed in Table A.1.

These include:

various sizes of spark ignition engines; parts of spark ignition engines; compression ignition engines; lithium ion batteries; chassis with engines for various vehicles; bodies for various vehicles; gear boxes; drive axles; suspension systems; and steering wheels, columns and boxes for motor vehicles and chassis frames.³

The rules of origin for the gear-boxes, the drive axles, the suspension systems and the steering wheels, columns and boxes on this list⁴ provide that only the net cost method may be used. However, change in tariff classification only options are available for these goods. The RVC requirements are mandatory with the engines on this list, but the rules permit use of either the net cost method or the transaction value method.

Auto Appendix, Article 3(2) provides that when these goods are for use in a passenger vehicle or a light truck:

- (a) The RVC requirement using the net cost method will be increased to 66 percent (starting from the later of January 1, 2020 or the date of entry into force of CUSMA) and then the next year to 69 percent and then the following year to 72 percent, and finally to 75 percent (from the later of January 1, 2023 or three years after the date of entry into force of CUSMA.)
- (b) The RVC requirement using the transaction value method will be increased to 76 percent (starting from the later of January 1, 2020 or the date of

entry into force of CUSMA) and then the next year to 79 percent and then the following year to 82 percent, and finally to 85 percent (from the later of January 1, 2023 or three years after the date of entry into force of CUSMA.)

If a lithium battery is the primary source of power for a passenger vehicle or light truck, the RVC requirement using the net cost method is 75 percent and using the transaction value method is 85 percent, with no phase-in period to these thresholds.⁵

2 Principal Parts for Passenger Vehicles and Light Trucks listed in Table B.

Table B sets out a list of automotive parts for motor vehicles, including:

various tires and inner tubes; glass products including rear view mirrors; various pumps, compressors and fans; ball bearings and various roller bearings and related products; housed bearings and bearing housings, flywheels and pulleys; various electric motors; electromagnetic couplings; clutches and brakes; starting equipment; bumpers; seat belts, brakes; road wheels, mufflers and exhaust pipes; clutches; and car seats and parts.⁶

The rules of origin for many of these parts set out in Annex 4-B provide for a change in tariff classification only with no RVC requirement. The remaining rules in Annex 4-B set out an RVC requirement with a choice between the net cost method and the transaction value method.⁷ The rules of origin in Auto Appendix, Article 2 for

3 For the complete list, see Table A.1 to the Auto Appendix. The RVC requirements are set out in Auto Appendix, Articles 3(2) and 3(3).
 4 Set out in Auto Appendix, Article 2.
 5 See Auto Appendix, Article 3(3) as well as the rules of origin for lithium batteries classified under HS subheading 8507.60 set out in Annex 4-B. For other uses, the RVC requirement using the net cost method is 50 percent and using the transaction value method is 60 percent.
 6 For the complete list, see Table B to the Auto Appendix.
 7 Each of these rules provides the alternative of satisfying a more demanding change in tariff classification without an RVC requirement.

parts in Table B classified under HS heading 8708 impose an RVC requirement using the net cost method without a transaction value option.⁸

When parts in Table B are for use in a passenger vehicle or a light truck, Auto Appendix, Article 3(4) that provides that the RVC thresholds will be increased as follows:⁹

- (a) The RVC using the net cost method will be increased to 62.5 percent (starting from the later of January 1, 2020, or the date of entry into force of CUSMA) and then the next year to 65 percent and then the following year to 67.5 percent, and finally to 70 percent (from the later of January 1, 2023, or three years after the date of entry into force of CUSMA).
- (b) The RVC using the transaction value method (if the rule includes a transaction value method) will be increased to 72.5 percent (starting from the later of January 1, 2020, or the date of entry into force of CUSMA) and then the next year to 75 percent and then the following year to 77.5 percent, and finally to 80 percent (from the later of January 1, 2023, or three years after the date of entry into force of CUSMA).

3 Complementary Parts for Passenger Vehicles and Light Trucks listed in Table C

Table C sets out a list of automotive parts for motor vehicles, including:

various tubes, pipes and hoses; locks; catalytic converters; various valves; taps cocks; various electric motors; various batteries (except lithium batteries; distributors and ignition coils; signaling equipment; sound recording equipment; various lamp units, insulated wiring sets, certain measuring equipment; and thermostats.¹⁰

The rules of origin for distributor and ignition coils, sound recording equipment and the lamp units provide for a change in tariff classification only with no RVC requirement. The remaining rules (all of which are in Annex 4-B) provide for an RVC requirement with a choice between the net cost the transaction value method.¹¹

When parts in Table C are for use in a passenger vehicle or a light truck, Auto Appendix, Article 3(5) that provides that the RVC thresholds will be increased as follows:

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- 8 Each of these rules provides the alternative of satisfying a more demanding change in tariff classification without an RVC requirement.
 - 9 The intent of the trailing language in Auto Appendix, Article 3(4), which says that notwithstanding any RVC requirement in this paragraph the part is originating if it meets the applicable change in tariff classification in Annex 4-B, appears to be that the increases in RVC thresholds only apply to rules that contain an RVC requirement respecting parts in Table B, and not to rules that provide for a change in tariff classification only. In other words, it is not intended to impose an RVC requirement where none would otherwise exist. There is similar trailing language in Auto Appendix, Article 3(5) respecting Complementary Parts for Passenger Vehicles and Light Trucks in Table C. However, there is no similar language in Auto Appendix, Article 3(2) respecting Core Parts in Table A.1 for Passenger Vehicles and Light Trucks. Nor is there similar language in Articles 4(2) and 4(3) respecting parts listed in Tables D and E for heavy trucks, even though the product specific rules for many of these parts provide for a change in tariff classification alone. The CUSMA Uniform Regulations should make clear that the clarification to Auto Appendix, Articles 3(4) and 3(5) respecting meeting applicable changes in tariff classification also applies to Core Parts for passenger vehicles and light trucks in Appendix Article 3(2) and to the rules for heavy trucks in Auto Appendix, Articles 4(2) and 4(3).
 - 10 For the complete list, see Table C to the Auto Appendix.
 - 11 Each of these rules provides the alternative of satisfying a change in tariff classification without an RVC requirement. The RVC requirements for taps cocks under HS subheading 8481.80 and for certain auto regulating instruments under HS subheading 9032.89 are 35 percent using the net cost method and 45 percent using the transaction value method.

- (a) The RVC using the net cost method will be increased to 62 percent (starting from the later of January 1, 2020, or the date of entry into force of CUSMA) and then the next year to 63 percent and then the following year to 64 percent, and finally to 65 percent (from the later of January 1, 2023, or three years after the date of entry into force of CUSMA).
- (b) The RVC using the transaction value method (if the rule includes a transaction value method) will be increased to 72 percent (starting from the later of January 1, 2020 or the date of entry into force of CUSMA) and then the next year to 73 percent and then the following year to 74 percent, and finally to 75 percent (from the later of January 1, 2023 or three years after the date of entry into force of CUSMA.)

RVC CALCULATIONS FOR PARTS OF HEAVY TRUCKS

As described in the Commentary, there are two categories of parts used in heavy trucks for which the Auto Appendix sets out specific requirements respecting RVC thresholds: principal parts and complementary parts.

1 Principal Parts for Heavy Trucks listed in Table D

Table D sets out a list of parts for heavy trucks including:

various sizes of spark ignition engines; parts of spark ignition engines; compression ignition engines; parts of compression ignition engines; various pumps; bearings; transmission shafts; flywheels; electric motors, starter motor; chassis fitted with engines; bodies; bumpers and parts; brakes and parts; gear boxes, drive axles, road wheels; shock absorbers; radiators; mufflers and exhaust pipes; clutches and parts, steering wheels,

airbags and parts; and car seats.¹²

The engines are subject to a mandatory RVC requirement with a choice between the net cost method and the transaction value method. A chassis with an engine for a heavy truck (HS subheading 8706.00) is subject to a mandatory RVC requirement using the net cost method. The rules for gears, ball or roller screws and gear boxes, flywheels and pulleys, and starter motors and generators require a change in tariff classification only. The rules for all the parts classified under HS headings 8707 and 8708 provide for a choice between a change in tariff classification only and a less stringent change in tariff classification coupled with an RVC requirement using the net cost method. The rules for all the other parts provide for a choice between a change in tariff classification only and a less stringent change in tariff classification coupled with an RVC requirement using either the net cost method or the transaction value method.

When parts listed in Table D are for use in a heavy truck, Auto Appendix, Article 4(2) provides that the RVC will be increased as follows:

- (a) The RVC using the net cost method will be increased to 60 percent (starting from the later of January 1, 2020, or the date of entry into force of CUSMA), then to 64 percent (from the later of January 1, 2024, or the date of entry into force of CUSMA) and finally to 70 percent (from the later of January 1, 2027, or seven years after the date of entry into force of CUSMA).
- (b) The RVC using the transaction value method (if the rule includes a transaction value method) will be increased to 70 percent (from the later of January 1, 2020, or the date of entry into force of CUSMA) to 74 percent (from the later of January 1, 2024, or the date of entry into force of CUSMA) and finally to 80 percent (from the later of January 1, 2027, or seven years after the

12 For a complete list, see Table D to the Auto Appendix.

date of entry into force of CUSMA.)

All these parts except for a few specifically designed for heavy trucks also appear on Table A.1, Table B and Table C of the Auto Appendix, which apply to passenger vehicles and light trucks. The rules of origin correspond to those that apply to the parts listed in Table A.1, Table B and Table C. However, for each of these parts the required RVC will differ, depending on whether the part in question is being produced for use in a passenger vehicle or light truck, or in a heavy truck.¹³

2 Complementary Parts for Heavy Trucks listed in Table E

Table E of the Auto Appendix sets out a list or parts for heavy trucks including:

various pumps; electronic brake systems including ABS and ESC systems; ball bearings and other bearings; clutches and shaft couplings and other couplings, lithium ion batteries; ignition starters and generators.

The rules of origin for electronic brake systems including ABS and ESC systems provide for a change in tariff classification only with no RVC requirement. The rules for all the other parts provide for a choice between a change in tariff classification only and a less stringent change in tariff classification coupled with an RVC requirement using either the net cost method or the transaction value method.¹⁴

When parts listed in Table E are for use in a heavy truck, Auto Appendix, Article 4(3) provides that the RVC will be increased as follows:

- (a) The RVC using the net cost method will be set at

50 percent (starting from the later of January 1, 2020 or the date of entry into force of CUSMA) and then increased to 54 percent (from the later of January 1, 2024, or the date of entry into force of CUSMA) and finally to 60 percent (from the later of January 1, 2027, or seven years after the date of entry into force of CUSMA).

- (b) The RVC using the transaction value method (if the rule includes a transaction value method) will be set at 60 percent (starting from the later of January 1, 2020, or the date of entry into force of CUSMA) and then to 64 percent (from the later of January 1, 2024, or the date of entry into force of CUSMA) and finally to 70 percent (from the later of January 1, 2027, or seven years after the date of entry into force of CUSMA).

There is some overlap between the parts for heavy-duty trucks in Table E and some of the parts for passenger vehicles and light trucks listed in Table B.

RETENTION OF TRACING FOR VEHICLES IN AUTO APPENDIX SECTION 10

As described in the *Commentary*, Auto Appendix Article 10 sets out two relatively narrow categories of vehicles and parts to which special rules apply for RVC calculations that closely follows the wording of the heavy-duty vehicle- tracing language in NAFTA Article 403(2).

Vehicles and Parts in Auto Appendix, Article 10(1)

The vehicles included in the category listed in Auto Appendix, Article 10(1)(a) are:

- 1 A motor vehicle for the transport of 15 or fewer

13 The CUSMA Uniform Regulations could usefully provide clarity as to which RVC requirement applies to producers who are producing parts for use in both a passenger vehicle and light truck, and for use in a heavy truck.

14 Including the lithium ion batteries under HS subheading 8507.60. While the RVC requirements for these batteries for use in a passenger vehicle or a light truck are 85 percent using the transaction value method and 75 percent using the net cost method, the RVC requirements for use in a heavy truck are 50 percent using the net cost method and an RVC requirement of 60 percent using the transaction value method.

persons of subheading 8702.10 or 8702.90. HS heading 8702 includes motor vehicles for the transport of ten or more persons, including the driver. This category includes these vehicles with only diesel or semi-diesel engines or only spark-ignition engines, but does not include vehicles powered by electric motors, either alone together with an engine.¹⁵

- 2 A motor vehicle with a compression-ignition engine as the primary motor of propulsion,¹⁶ a three or four-wheeled motorcycle, a motorhome or entertainer coach, or a vehicle solely or principally for off-road use of subheading 8703.21 through 8703.90. These vehicles are expressly carved out of the definition of “passenger vehicle.”
- 3 A vehicle of subheading 8704.21 or 8704.31 that is solely or principally for off-road use. These HS subheadings cover trucks with semidiesel or diesel engines or spark ignition internal combustion engines with a gross vehicle weight not exceeding 5 tonnes. These subheadings are included in the definition of “light truck” but that definition excludes such vehicles solely or

principally for off-road use.

The parts listed in Auto Appendix, Article 10(1)(b) are:

Goods of headings 84.07 (spark-ignition reciprocating or rotary internal combustion piston engines) or 84.08 (compression-ignition internal combustion piston engines (diesel or semi-diesel engines), or subheading 8708.40 (gear boxes for motor vehicles) for use in the motor vehicles described above.

Article 10(1) provides that the RVC requirement for each of these vehicles and parts is 62.5 percent using the net cost method.¹⁷

Vehicles and Parts in Auto Appendix, Article 10(2)

The vehicles listed in Auto Appendix, Article 10(2) (a) are:

- 1 A motor vehicle of heading 8701 (tractors) except for road tractors for semi-trailers under

15 Subheading 8702.10 covers vehicles with only compression-ignition internal combustion piston engine (diesel or semi-diesel). Subheading 8702.90 covers vehicles not elsewhere covered by heading 8702. Export figures for these vehicles are not readily available because Statistics Canada only goes down to the 6-digit subheading level and the distinction between 15 or fewer passengers and 16 or more passengers is made at the 8-digit level. The other subheadings included under heading 8702 (HS subheadings 8702.20, 8702.30 and 8702.40) cover vehicles powered by electric motors, either alone or with compression ignition engines or spark ignition internal combustion reciprocating piston engine engines. The rules of origin for these vehicles are not covered by Auto Appendix, Article 10 or any other special rule in the Auto Appendix, and, oddly, there is no specific rule of origin in Auto Appendix, Article 2 for vehicles classified under these tariff provisions. This should be rectified in the Uniform Regulations. Exports to the US from Canada in 2017 under subheadings 8702.20, 8702.30 and 8702.40 only amounted to \$4,391,753.

16 These include the diesel and semi-diesel vehicles classified under HS subheadings 8703.31, 8703.32 and 8703.33 specifically excluded from the definition of “passenger vehicles.” These categories of vehicles are significant because, as noted in the *Commentary*, exports from Canada to the US in 2017 of vehicles under these subheadings amounted to \$0.9 billion.

17 The rules of origin in Annex 4-B for engines that are not for use in a passenger vehicle or light truck, or in a heavy truck, provide the option of using the transaction value method. Presumably this option is not available for engines falling within Auto Appendix, Article 10(1)(b) because the chapeau of that article specifies the net cost method. The rule of origin for gear boxes of subheading 8708.40 that are not for use in a passenger vehicle or light truck, or in a heavy truck provide the option of satisfying the rule through a change in tariff classification alone. Is this option still available for a gear-box covered by Auto Appendix, Article 10.1(b)? The Uniform Regulations must clarify how these provisions are to be applied. These same considerations apply to the engines and gear boxes falling within Auto Appendix, Article 10(2) (b) described below.

- subheading 8701.20 (which are included in the definition of “heavy trucks”).
- 2 A motor vehicle for the transport of 16 or more persons of subheading 8702.10 or 8702.90.
 - 3 A motor vehicle of subheading 8704.10 (dumpers for off-highway use), a motor vehicle of subheading 8704.21 through 8704.90 (trucks of various gross vehicle weights) that is solely or principally for off-road use.
 - 4 A motor vehicle of heading 87.05 (specialty vehicles including mobile drilling derricks, concrete mixers and fire fighting vehicles).
 - 5 A good of heading 87.06 (chassis fitted with an engine) not for use in a passenger vehicle, light truck, or heavy truck.

The parts included in this category listed in Auto Appendix, Article 10(2)(b) are:

A good of heading 84.07 (spark-ignition reciprocating or rotary internal combustion piston engines) or 84.08 (diesel or semi diesel engines), or subheading 8708.40 (gear box), that is for use in a motor vehicle Auto Appendix, Article 10(2)(a).

The parts included in this category listed in Auto Appendix, Article 10(2)(c) are:

A good in Table F of the Auto Appendix that is subject to a regional value content requirement and that is for use in a motor vehicle in paragraphs 1(a) or 2(a), except for:

- (a) A good in Auto Appendix, Article 10(2)(b),

namely the engines under heading 8407 and 8408 and the gear boxes under subheading 8708.40 that are already included under Auto Appendix, Article 10(2)(b); and

- (b) A good of subheading 8482.10 through 8482.80, 8483.20, or 8483.30 (various bearings).¹⁸

Auto Appendix, Article 10(2) provides that the RVC requirement for all the vehicles and parts in Auto Appendix, Article 10(2) is 60 percent using the net cost method.¹⁹

Special Rules in Auto Appendix, Article 10(3) for Calculating VNM for Vehicles and Parts in Auto Appendix, Articles 10(1) and 10(2)

Auto Appendix, Article 10(3) sets out special rules for calculating the value of non-originating materials (VNM) when applying the RVC requirement using the net cost method for:

- 1 A vehicle provided for in Auto Appendix, Article 10(1)(a) or 10(2)(a) described above;
- 2 A good listed in Table F of the Auto Appendix for use in a vehicle provided for in Auto Appendix, Article 10(1)(a)20; and
- 3 A component listed in Table G of the Auto Appendix for use in a vehicle provided for in Auto Appendix, Article 10(2)(a)

Table F sets out virtually the same parts as are listed in the NAFTA light duty vehicle tracing list in

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- 18 The effect of this exclusion is that the 60 percent rule of origin that would otherwise apply does not apply to bearings of subheadings 8482.10 through 8482.80, 8483.20 or 8483.30 used in vehicles described in the Auto Appendix, Articles 10(1)(a) or 10(2)(a). Instead, the rules of origin applicable to bearings used in these vehicles are the rules set out in Annex 4-B that prescribe changes in tariff classification alone or more lenient changes in tariff classification coupled with RVC requirements with a choice between the transaction value method with an RVC of at least 60 percent or the net cost method with an RVC of at least 50 percent.
 - 19 The rules of origin for many of the goods listed in Table F provide for the use of the transaction value method. For these goods that are covered by Auto Appendix, Article 10(2)(b), the only RVC application available is 60 percent using the net cost method.
 - 20 While Article 10(3) links the vehicles in Article 10(1)(a) to goods in Table F for VNM calculations, Article 10(2)(c) which sets RVC thresholds, links the goods in Table F to different vehicles that are listed in Article 10(2)(a). There seems to be no rationale for this. Is it a mistake?

NAFTA Annex 403.1, and Table G sets out exactly the same components and materials that appear in the NAFTA heavy-duty tracing list in NAFTA Annex 403.2

Respecting each material used by the producer listed in Table F or Table G, the producer can choose between including in VMN the value of any such material that is not originating, or the value of non-originating in materials used in the production of such material.²¹ This language almost exactly tracks the wording of NAFTA Article 403(2), which establishes the NAFTA heavy-duty vehicle tracing regime. As is apparent from the text of both the Canadian and US versions of the NAFTA Uniform Regulations, “the value of non-originating in materials used in the production of such material” applies whether or not “such material” is originating.²²

Applying VNM Rule in Auto Appendix, Article 10(3) to a Vehicle in Auto Appendix, Article 10(2)

In addition to Article 10(3) tracking the language of the heavy-duty tracing regime in NAFTA 403(2), Table G of the Auto Appendix, as just noted, sets out the same components and materials as are listed in the NAFTA heavy-duty vehicle

tracing list set out in NAFTA Annex 403.2. This suggests that the VNM provisions of Article 10(3) are to be applied to vehicles and parts in Auto Appendix, Article 10(2) in the same manner as NAFTA heavy-duty tracing.

As a hypothetical example, suppose that the producer of tractor of heading 8701 referred to in Auto Appendix, Article 10(2)(a) acquires an engine that is originating under the rule of origin that applies to it, but the engine contains a cast head imported from outside CUSMA territories. Based on an example set out in the NAFTA Uniform Regulations, the value of the cast head will be included in the producer’s VNM, even though the engine into which it has been incorporated is originating.²³

Suppose however that the same producer acquires brakes that qualify as originating but the brakes contain materials that have been imported. Brakes are not included in Table G, so the value of the non-originating materials contained in the brakes is not added to the producer’s VNM. Suppose, however, that the brakes are non-originating but contain materials that qualify as originating. The producer must add the entire value of the brakes to its VNM and will receive no credit for the originating materials.

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- 21 The text of CUSMA published by the USTR on September 30, 2018 provided for a tracing regime for the vehicles and engines identified in Auto Appendix, Article 10(1) that was clearly based on the NAFTA light duty vehicle tracing regime. The final texts of CUSMA published by the USTR on November 30, 2018 and on May 30, 2019 dropped the idea of light duty vehicle tracing.
- 22 The alternative interpretation is “the value of non-originating in materials used in the production of such material” applies only if “such material” is non-originating. This interpretation would provide a more lenient rule by permitting the producer to restrict the value of VNM to only the value of the non-originating sub-materials and limiting the effect of roll-down. It is unlikely that the CUSMA drafters intended this result, particularly given the provisions of the NAFTA Uniform Regulations, which were agreed to by all three NAFTA countries, and which provide guidance to what the NAFTA drafters thought the NAFTA text meant.
- 23 This example is based on Example 1 following Section 10 of the each of the Canadian and US versions of the NAFTA Uniform Regulations.

Applying VNM Rule in Auto Appendix, Article 10(3) to a Vehicle in Auto Appendix, Article 10(1)

While Article 10(3) tracks the language of the heavy-duty tracing regime in NAFTA 403(2), Table F with which Auto Appendix, Article 10(3) is coupled for vehicles and parts in Auto Appendix, Article 10(1) corresponds to the light duty vehicle tracing list in NAFTA Annex 403.1. In short, CUSMA drafters have coupled the NAFTA heavy-duty vehicle tracing language with the NAFTA light duty vehicle tracing list. This creates considerable uncertainty as to how these provisions are to be applied.

As a hypothetical example, suppose that a producer of a car with a diesel engine acquires brakes that are originating but that contain materials that are non-originating. Table F includes “Brakes and servo-brakes; parts thereof.” Following the language of Auto Appendix, Article 10(3), the producer must include the value of the non-originating materials in its VNM, even though the brakes are originating. However, suppose that the brakes are non-originating but that the producer can obtain information as to the value of non-originating materials contained in the brakes. The producer would be required to include in VNM only the value of those non-originating materials. Note that this result is the opposite of what would occur if the vehicle in question were the tractor of heading 8701 referred to above.

Averaging

Auto Appendix, Article 10(4) sets out averaging options for producers of the vehicles and parts covered by Articles 10(1) and 8(2) that are identical to the averaging options set out in NAFTA Article 403(3) for all vehicles and Article 403(4) for parts on the NAFTA light duty vehicle tracing list (which corresponds to Auto Appendix, Table F) and the NAFTA heavy-duty tracing list (which

corresponds to Auto Appendix, Table G).

NAFTA New Building and Refit Provisions

For vehicles described in Auto Appendix, Articles 10(1) and 10(2), Auto Appendix, Article 10(6) carries forward the provisions in NAFTA Article 403(6) providing for a less strict RVC requirement for a vehicle produced in a plant consisting of a new building with substantially all new machinery (RVC of 50 percent for five years following production of first prototype) and a plant which has undergone a refit (RVC of 50 percent for two years following production of first prototype).

These NAFTA provisions could usefully have been carried forward for passenger vehicles and light trucks, and for heavy trucks.

Need for Clarification through Uniform Regulations

Tracing regimes are complicated by the fact that a producer does not have direct access to the values that it is supposed to account for when making its calculations. This is because the relevant transaction establishing the value of the material required to be traced may be several steps up the producer’s supply chain involving different parties. As Section 9 (NAFTA light duty vehicles) and Section 10 (NAFTA heavy-duty vehicles) of the NAFTA Uniform Regulations demonstrate, the exercise of establishing alternative values when the required values are not available to the producer, and making tracing regimes capable of being applied on a routine basis, is very complex.

The retention of these tracing regimes (NAFTA heavy-duty vehicle tracing for vehicles and parts under Auto Appendix, Article 10(2) and some sort of NAFTA heavy and light duty tracing amalgam for vehicles and parts under Auto Appendix, Article 10(1)) makes no sense. However, if CUSMA is approved and comes into effect, and if the parties wish to retain these regimes, CUSMA Uniform

Regulations must spell out for producers and customs administrators exactly how these rules are to be applied. Alternatively, as mentioned in the Commentary, the CUSMA parties could agree through the Uniform Regulations to substitute a more sensible regime for these classes of vehicles and parts.

USTR, USITC AND IMF ASSESSMENT OF CUSMA AUTOMOTIVE RULES OF ORIGIN

Reports from the Office of the US Trade Representative (USTR) and the US International Trade Commission (USITC), together with an International Monetary Fund (IMF) Working Paper, assess the likely impact of the CUSMA Automotive Rules of Origin on the US automotive industry. As noted in the Commentary, the conclusions are strikingly different.

The USTR report²⁴ predicts new automotive investments in the US of \$34 billion,²⁵ new annual auto parts purchases in the US of \$23 billion²⁶ and the creation of 76,000 new automotive jobs.²⁷ The USTR maintains that automakers in North America intend to comply with new rules rather

than forego tariff preferences.²⁸ The USTR also considers that the new rules will not significantly affect consumer vehicle prices.²⁹

The USITC report³⁰ assesses the likely impact of CUSMA on the US economy as required under the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 and includes coverage of the automotive sector. The USITC predicts an increase in US automotive parts production offset by a small decline in US vehicle production for a net increase of 28,000 full time equivalent employees,³¹ which differs significantly from the USTR figure of 76,000 jobs. Like the USTR, the USITC expects that most automakers will try to comply with the new rules rather than not complying and paying duties.³² However, the USITC report predicts that complying with these rules will increase the cost of many models.³³ The USITC report also qualifies the 28,000 figure as a “high end” estimate.³⁴ The USITC predicts higher costs for US produced vehicles with resulting lower demand and a decline in finished vehicle production and exports to Canada and Mexico.³⁵ Higher costs will also likely adversely affect exports of vehicles to non-CUSMA countries.³⁶ However,

24 *Estimated Impact of the United States–Mexico–Canada Agreement (USMCA) on the U.S. Automotive Sector* dated April 18, 2019 and cited in the Commentary.

25 USTR Report page 2 and pages 3–4.

26 USTR Report page 2 and pages 4–5.

27 USTR Report page 2 and page 5.

28 USTR Report page 2.

29 USTR Report page 2.

30 *U.S.–Mexico–Canada Trade Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors*, April 19, 2019, Publication Number: 4889, Investigation Number: TPA 105-003. This report, which is cited in the Commentary, was prepared by the USITC at the request of USTR Robert Lighthizer as required by with section 105(c) of the *Bipartisan Congressional Trade Priorities and Accountability Act of 2015*.

31 USITC Report pages 18 and 69.

32 USITC Report page 63.

33 USITC Report page 86.

34 USITC Report page 69, footnote 82.

35 USITC Report page 86.

36 USITC Report page 86, footnote 147. See as well USITC Report page 339 item 3.

the report predicts that production of core parts (engines, transmissions, body, axle, suspension and steering systems and advanced batteries) in the US would increase by reason of reshoring (i.e. returning production to US territory).³⁷

Like the USTR, the USITC expects that automakers will largely try to comply with the new rules of origin rather than not complying and paying duties.³⁸ However, the USITC report states that because of the complexity of CUSMA automotive rules of origin, it is difficult to predict how automakers will react to them.³⁹

The IMF Working Paper⁴⁰ is significantly more pessimistic. The paper states that while most US and Canadian production can meet the new requirements, less than 70 percent of Mexican vehicle production can meet the new requirements⁴¹ and because of the higher RVC requirements and the LVC requirement, the preferred strategy will be to pay the MFN tariffs.⁴² The paper predicts a welfare loss to the US from both the RVC and the LVC requirements because prices of its imports from Canada and Mexico will increase.⁴³ The RVC and LVC requirements will lead to a decline in intra-CUSMA trade and will lead to an increase in consumer prices and a decrease in consumer

demand in all three countries.⁴⁴

In its conclusions, the IMF Working Paper states that the tighter auto rules of origin and the LVC requirement will not achieve their desired outcomes. Production of vehicles and parts in North America will decline, sourcing of vehicles and parts from outside the region will increase, and consumer prices will rise.⁴⁵

The difference in predicted outcomes is partly explained by the provenance of each document. The USTR magnifies what it sees as a positive impact of the deal it negotiated, by incorporating investment plans that auto makers were required to submit to be granted a maximum transition period in order to be able to comply with the new rules. Here, the industry itself had an incentive to provide optimistic investment plans, and to minimize the impact on consumer prices and the industry's international competitiveness. Furthermore, the report incorporates planned auto investments that may, or may not, be attributed to CUSMA.⁴⁶ While claiming to be conservative in assuming that each new assembly job will support two jobs in the parts industry, and emphasizing the incentive under CUSMA to develop new auto technologies within the US, it disregards the wider economic impact of

37 USITC Report page 86.

38 USITC Report page 63.

39 USITC Report page 339.

40 *NAFTA to USMCA: What is Gained?* Working Paper No. 19/73, by Mary E. Burfisher, Frederic Lambert, and Troy Matheson, Publication Date: March 26, 2019, ISBN/ISSN:9781498303286/1018-5941. The IMF Working Paper, which is cited in the Commentary, is subject to the caveat that the views expressed are those of the authors and not necessarily those of the IMF, its Executive Board or IMF management. The IMF Working paper is referred to on pages 62-63 of the USITC Report as the “BLM Study” under the heading “Review of Related Literature”. The USITC points out modelling and other differences that it maintains explain differences in the conclusions reached in the BLM Study and the USITC Report.

41 IMF Working Paper page 7.

42 IMF Working Paper page 8.

43 IMF Working Paper page 12.

44 IMF Working Paper page 21.

45 IMF Working Paper page 23.

46 On page 3, the USTR Report does recognize that these investment decisions may only be partially influenced by the need to comply with the new automotive rules of origin.

jobs being diverted to auto production from other sectors. Overall, the report is designed to put the rosier possible picture on CUSMA.

The USITC report more realistically assumes that some producers will pay the tariffs rather than comply with complex rules of origin, and accordingly that prices will increase and auto sales decline as a result. But it remains optimistic that the reshoring of parts jobs could offset the resulting decline in assembly jobs. By contrast, the IMF Working Paper, while not pronouncing

on jobs, emphasizes the inefficiencies and lost competitiveness for the North American auto sector overall, but suggests that other provisions facilitating trade and, especially, dropping tariffs on steel and aluminum (which the US has now done) could help offset these losses.