

Auto sector gears up for potential changes to NAFTA's rules of origin



An employee works in the auto parts production line in the Bosch factory in San Luis Potosi, Mexico, on January 11, 2017.

PEDRO PARDO/AFP/GETTY IMAGES

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The new U.S. administration could insist that any vehicle built in North America contain a certain percentage of U.S. content as a way of increasing manufacturing jobs in the United States, auto-industry officials and trade experts say.

As Donald Trump's government gets set to take office on Friday, renegotiation of the North American free-trade agreement is at the top of its agenda, and restructuring how the trade deal applies to the auto sector is expected to be a critical part of the talks.

As The Globe and Mail reported earlier this week, the rules of origin under NAFTA are a key focus for the United States. Those rules, which are particularly prominent and in the automotive sections of the agreement, stipulate that 62.5 per cent of a vehicle contain North American content in order to qualify for duty-free access to each of the countries.

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That content could come from all three countries or any single country, although in practice all vehicles have a mix of parts originating in the United States, Canada and Mexico.

Setting a minimum threshold for U.S. content in vehicles – suggestions are that the United States could demand 25 per cent or 33 per cent – and raising the overall North American content requirement to 75 per cent, would likely lead to more auto-parts plants locating in the United States, meeting Mr. Trump's goal of increasing U.S. manufacturing jobs.

"A new NAFTA requirement to mandate that a specific amount of local content come from the U.S. may satisfy some American concern regarding investment flight to Mexico," said one industry source. "That might be palatable to Canada and Mexico if it also came packaged with an increase in overall NAFTA regional value content level across the continent."

Trade lawyers cautioned that it is too early to know if the rules of origin in the auto sector will be the focus of U.S. negotiators.

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"I had always assumed that the Americans would want to negotiate more U.S. origin content as a starting point for their negotiations in automobiles and other manufacturing goods," said veteran trade lawyer Lawrence Herman.

"They probably have in mind insisting that for duty-free treatment into the U.S., there has to be a higher level of U.S. origin content. That could be, and I say could be, one of their positions, but we don't know until we see the details."

Simply raising the overall regional value content requirement to 75 per cent from 62.5 per cent wouldn't meet Mr. Trump's goal of increasing U.S. jobs because auto makers could purchase more parts and components from Canada and Mexico to meet the new target.

Mr. Trump has already singled out several auto makers with threats that if they export vehicles to the U.S. market from Mexico, they could face high tariffs.

"Much of this is about Trump wanting to prevent vehicles from being manufactured in Mexico, causing a loss of U.S. jobs," said trade lawyer Cyndee Todgham Cherniak.

Canadian officials and auto-industry executives should ally themselves with governors of auto-producing states in the Great Lakes area, she said, so the new administration gets the message that there is already high U.S. content in Canadian-produced vehicles.

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Riyaz Dattu, a specialist in international trade at law firm Osler Hoskin & Harcourt LLP, said changes to the rules of origin would upend global supply chains for manufacturers in the auto sector and in the oil patch that have evolved over more than 20 years of free trade.

"It may wreak havoc on supply chains, because supply chains are currently based on the existing rules of origin, and the current rules may allow for third-country products to be embedded into the manufactured goods that are sold to the United States," he said. "While the target might be Mexico, if these rules are going to be part of NAFTA, we will get sideswiped."

Rules of origin apply to other sectors as well as automotive.

Steel, for example, that is shipped duty free between the three countries must originate in one of the NAFTA countries. Steel that is imported can also be shipped duty free if it is significantly altered so that its tariff code changes, such as steel coil being galvanized or processed into steel tubing, said Joseph Galimberti, president of the Canadian Steel Producers Association.

With files from reporter Jeff Lewis in the Calgary Bureau.

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