

Canadian Rules of Origin and a Comparison of the Rules of Origin in TPP Countries and the TPP Rules of Origin

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This paper is a background document for Moroz (2016) that provides greater detail on various issues concerning rules of origin that are raised in that paper, such as how Canada has addressed various challenges in negotiating regional trade agreements (RTAs) with different partners and the comparison of the rules of origin in the 32 RTAs involving at least two of the TPP parties and the rules found in the TPP.

The first section of this paper describes the three main techniques for expressing under rules of origin how much production must occur, and which inputs must be made, in the territory of a RTA in order for a good to be considered “originating” and hence eligible for tariff preferences under a RTA. Section 2 discusses the various approaches Canada has used to address the challenges of negotiating rules of origin with different countries given its heavy dependence on the U.S., both as major supplier and as major market for many sectors. The third section provides a general description of the rules of origin found in the 32 RTAs involving TPP countries. Section 4 describes the TPP rules of origin and compares them with the rules of origin found in the 32 RTAs involving TPP signatories.

1. Rules of Origin

Rules of origin are used to define how much production must be done, and which inputs must be sourced, in the territory of a RTA before a good can be considered “originating” and hence eligible for the tariff preferences under that RTA. Most RTAs, including the TPP and Canada’s other RTAs, use three main methods to express whether there has been sufficient production and input sourcing for a good to be considered “originating”.

The first is the change in tariff classification method, or tariff-shift rule, which is based on the World Customs Organization’s Harmonized Commodity, Description and Coding System (HS). Such rules define the required production and input sourcing in terms of the difference between the tariff classification of the inputs imported from outside the RTA territory (i.e., non-originating inputs) and the tariff classification of a good produced in the territory using these imported inputs. Tariff shift rules can specify which imported non-originating inputs may not be used by disallowing a change from the tariff classification of that non-originating imported input and the tariff classification of the final good. A rule of origin that disallows the use of more imported inputs in the production of an originating good is more restrictive than a rule of origin with fewer disallowed inputs.

The second method is the regional value-content method which can be expressed either as stand-alone test (i.e., there is no required change in tariff classification) or as an alternative to a tariff-shift rule (which may be combined with a

tariff-shift rule of origin that is more liberal than original tariff-shift rule). This type of rule specifies the regional content (i.e., value of originating inputs plus value of production within the RTA territory) that must be added to non-originating inputs in order for the final good to be considered an originating good. Most regional value-content tests stipulate either the minimum level of regional content as percentage of the value of the final good or the maximum value of non-originating inputs as percentage of the value of the final good, although the specific definition of the value of the inputs or the final good can vary between RTAs.

The third method is a specific processing requirement that stipulates which production processes must occur in the RTA territory in order for a good to be considered to an originating good. Such rules can be a stand-alone rule of origin, an alternative to either a tariff-shift or regional value-content rule, or combined with a tariff-shift or regional value-content rule.

As a general matter, if a rule of origin for a final good stipulates that certain inputs must be originating, then these inputs themselves must either be wholly obtained within the RTA territory or, if they contain non-originating inputs, have undergone sufficient production and input sourcing within the RTA territory in order to meet their own rules of origin before they are treated as originating content in that final good.

2. Challenges for Canada on Rules of Origin

Canada's most important RTA is the North American Free Trade Agreement (NAFTA) that was implemented in 1994. Since then, Canada has implemented an additional 10 RTAs, concluded three more negotiations, including the Comprehensive Economic and Trade Agreement (CETA) with the European Union (EU) as well as the TPP, and is currently negotiating a further seven RTAs.² In addition to expanding its international market access, a key motive for Canada pursuing many of these RTAs, including joining the TPP negotiations, has been to maintain its competitive position in key markets for agricultural and other products vis-a-vis its main global competitors as they too have been negotiating their own RTAs. In negotiating its RTAs, Canada has employed a number of approaches in negotiating the rules of origin to safeguard and advance its interests.

One of the main challenges Canada faced in the NAFTA negotiations was the U.S. demands for relatively restrictive rules of origin across a wide range of products. In most cases, including automotive products, Canada was able to negotiate rules that accommodated its interests. However, the U.S. insistence for the restrictive yarn-forward rule of origin for textiles and apparel placed Canada in a dilemma. The yarn-forward rule requires that not only must the apparel or final textile item be cut, sewn and finished in the NAFTA territory, but that both the yarn used to make the fabric and the fabric made from that yarn must also originate within the NAFTA territory. Prior to the NAFTA, many of Canada's textiles and apparel producers were sourcing yarn or fabric from either low-cost Asian sources or high-quality European suppliers. Canada was able to negotiate tailor-made rules of origin for a few specific products that met the

requirements of Canadian producers. But Canada's main technique to address this concern was to negotiate a derogation from the rules of origin. This derogation allows a limited quantity of fabric or apparel to benefit each year from NAFTA tariff preferences by meeting a less stringent processing requirement. For example, exports of apparel that are cut, sewn and finished in Canada from offshore yarn or fabric are eligible, up to the specified annual quantities, for duty-free treatment when exported to the U.S.³

Setting aside textiles and apparel, the NAFTA, and its predecessor, the Canada-U.S. Free Trade Agreement (FTA), have played an important part in shaping the structure and competitiveness of many Canadian industries by encouraging their integration into the North American economy and its supply chains. Many Canadian industries now rely heavily on the U.S., both as their source of key inputs and as the major market for their outputs. While a large part of the Canadian automotive sector — its largest manufacturing sector — had already been heavily integrated with the U.S. automotive sector due to the 1965 Canada-U.S. Automotive Products Agreement (i.e., the Auto Pact), the NAFTA provided duty-free access to the U.S. and Mexican markets for the Japanese-owned automotive companies in Canada which did not have the duty-free access to the U.S. market that was afforded to other vehicle assemblers under Auto Pact. They gained duty-free access under the NAFTA, which allowed them to become an active part of the integrated North American automotive economy.

This heavy dependence of many Canadian industries on the U.S. has shaped significantly Canada's approach to rules of origin in its RTAs that were negotiated after the implementation of the NAFTA. One common feature of most of Canada's post-NAFTA agreements is that the rules of origin for many products are more liberal than the rules found in the NAFTA. Either the regional value content thresholds are lower, or the required changes in tariff classification or processing requirements are less onerous. For example, many of these agreements include a regional value-content requirement of 20 percent for passenger cars under the net cost method (see below), in contrast to 62.5 percent threshold under this method found for cars in the NAFTA. This has allowed Canadian vehicle assemblers to continue to source automotive inputs from the U.S. while having the opportunity to take advantage of the preferences offered under these other RTAs.

For various other products, Canada has included in a number of its post-NAFTA RTAs (and the TPP) a modified regional-value content test — the "focused-value method". This method focuses on a designated list of inputs, usually the dedicated parts or components of a good, and ignores all the other inputs, whether originating or non-originating, when calculating the regional value-content level. Under this method, the regional value-content level can be calculated in two ways: a) subtracting the value of the non-originating inputs on the designated input list from the value of the good and dividing by the value of the good (which is the calculation used in the TPP and the CETA); or b) dividing the value of the non-originating inputs on the designated input list by the value of the good (which is the calculation used in the Canada-Peru FTA). Allowing a significant percentage of these key parts or components to be non-originating, and ignoring whether all the other inputs are originating or not, provides

significant flexibility for Canadian producers to maintain their existing suppliers. It also reduces compliance costs since the producer needs only to track the sourcing of the designated inputs.

Seeking more liberal rules of origin and derogations has allowed Canada to mitigate many of its concerns in many industries. However, Canada's automotive industry, which is heavily integrated into the North American automotive sector, poses a special challenge. Not only is the vast portion of Canadian-made vehicles and parts exported to the U.S. under the NAFTA, but many of the parts used in the assembly of vehicles in Canada come from the U.S. Consequently, even a lower regional value threshold can pose challenges in complying with the rules in RTAs with other countries.

To address this, Canada's RTAs with Peru, Colombia, Panama and South Korea also stipulate that an automotive part made in the U.S. can count as originating content under these RTAs if the production and sourcing for that part in the U.S. would have met the rule of origin under these agreements had the U.S. been a member of these RTAs. This provision allows Canadian automotive producers to maintain their U.S. sourcing under these agreements, even though these RTAs stipulate a higher regional value-content threshold for such products than that found in some of Canada's other post-NAFTA RTAs. Canada's RTAs with Colombia, Honduras and Peru include a similar provision that allows specified yarns and fabrics made in Mexico or the U.S. to be treated as originating materials in the production of textiles and apparel (again, provided the production and sourcing for those yarns or textiles in the U.S. would have met the rule of origin under these agreements had the U.S. been a member of these RTAs).

In most of the above RTAs, Canada's negotiating partner was also a small open economy that generally favours, like Canada, more liberal rules of origin. Canada, however, faced a major challenge when it entered negotiations on the CETA with the EU in 2009. As a large economy, with many input suppliers, the EU sought, unsurprisingly, relatively more restrictive rules of origin. The CETA negotiations raised the potential of forcing Canadian producers to choose between maintaining their existing preferential access to, and sourcing of inputs from, its NAFTA partners, or shifting their sourcing to the EU to take advantage of the new tariff preferences offered in the large EU market.

In addition to seeking rules of origin that met its needs, Canada negotiated derogations from the normal rule of origin for a number of products, including various textiles and apparel goods, refined sugar and certain high-sugar-containing products and chocolate preparations, certain seafood products, various processed food products (e.g., pasta, bakery products, cranberry and blueberry juice), dog and cat food, and passenger cars.⁴ If the CETA is implemented, these Canadian products will be eligible for EU tariff preferences, up to the specified annual quantities, by meeting a less onerous rule of origin. For motor vehicles, the two parties also agreed that, in the event that the EU and the U.S. implement an RTA (and subject both to a higher regional value-content threshold and to Canada's and the EU's agreement on the applicable conditions), U.S. parts would be treated as originating materials when used in the

production of motor vehicles for purposes of the CETA. Canada also achieved an alternative rule of origin for buses carrying 10 or more people based on the focused-value method for calculating the regional value content level.

In pursuing the above RTAs, Canada has adapted its approaches on rules of origin to meet the specific circumstances at hand in order to maximize the opportunities and minimize the disruptions for its producers. As evident from the various techniques described above, Canada's key policy goal has been to allow its firms to maintain both their preferential access to the U.S. market and input sourcing from the U.S. under the NAFTA, while also being able to take advantage of the new opportunities provided by other RTAs.

3. Rules of Origin in Regional Trade Agreements Involving TPP Parties

The TPP signatory countries are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam and the U.S. These 12 countries are participants in 32 separate RTAs currently in force that involve at least two TPP signatories, although many of these agreements are bilateral free trade agreements (FTAs) directly between various TPP parties (see Appendix for the full list of these RTAs).

This section provides a general description of the rules of origin found in these 32 RTAs, while the following section takes a deeper look at the TPP rules of origin and compares the relative restrictiveness of these rules with the rules found in these 32 RTAs by product categories. As in any comparison involving a broad range of agreements, exceptions to the general comparisons can be found in each RTA. In addition, while many of the RTAs discussed below cover more than 95 percent of tariff lines, some agreements exclude a number of broad sectors (e.g., motor vehicles and their parts in the case of Chile's RTAs with Malaysia and Vietnam). For the purposes of this paper, the term "motor vehicles" covers only passenger cars, buses and trucks, and excludes motorcycles.

As a general matter, the RTAs involving various configurations of TPP countries, and the TPP itself, use mainly the tariff-shift and regional value-content approaches for expressing the rules of origin. Processing requirement rules tend to be found mainly in certain food processing sectors (e.g., animal and vegetable oils), petroleum goods, chemical and plastic products and, to a lesser extent, apparel. In some cases, a rule of origin may stipulate that a processing requirement must be met in addition to fulfilling a change in tariff classification rule or achieving a regional value-content threshold.

The rules of origin in the RTA's involving the Western Hemisphere TPP countries (i.e., RTAs between themselves or with Asian TPP members) stipulate a tariff-shift rule for almost all products covered by these agreements; the usual exception being motor vehicles where the rule of origin is frequently based on a mandatory regional value-content test. For a few agricultural products and for many non-agricultural goods, these agreements also provide an alternative rule of origin whereby if the required change in

tariff classification does not occur, the product can still qualify as an originating good if it meets a less stringent tariff-shift rule and a regional value-content test.

The RTAs between the Asian TPP signatories set out tariff shift rules for the large majority of goods covered by these agreements. However, for many goods across all sectors, these agreements, along with the Peru-Singapore FTA, also provide an alternative regional value-content test, either combined with a less restrictive tariff-shift rule or with no requirement for a change in tariff classification. One notable exception is the Australia-Japan FTA which does not include an alternative regional value-content test for agricultural products.

For purposes of the discussion below, the comparisons of the regional value-content thresholds in the various RTAs involving the TPP parties are based largely on the build-down formula used in the TPP. This method is found in the U.S.'s post-NAFTA RTAs and is closely comparable to both the transaction value method used in the NAFTA and Canada's, Chile's, Mexico's and Peru's RTAs, and the value of the good method used in the RTAs involving solely Asian TPP partners.⁵ All of these methods focus on the price paid or payable for the good, although there may be some minor variations across these RTAs in the adjustments that may be made either to the price of the good or to the prices of non-originating inputs when making the calculation.⁶ Under these approaches, the regional content percentage is calculated by subtracting the value of non-originating materials (i.e., inputs) from the price of the good, and then dividing by the price of the good.

Most of the RTAs involving the Western Hemispheric TPP signatories provide producers with the choice of using an alternate approach for calculating the regional value-content of most goods that are subject to a value-content test. One of these alternatives is the net cost method. Net cost is calculated by subtracting from the total cost of producing the good the following costs: sales promotion, marketing and after-sales service costs, royalties, shipping and packing costs, and certain interest costs. The percentage content is calculated by subtracting the value of non-originating materials from the net cost of the good, and dividing by the net cost. By excluding the above costs, as well as profits, from the originating content of the good, the net cost method is more stringent than the above price-based methods at any given threshold level. The net cost approach is the alternative method in the NAFTA, the Canada-Chile FTA and the Chile-Mexico FTA. It can also be found for selected goods in the other RTAs involving Canada, Chile, Mexico or the U.S. For a few goods, such as automotive products in the NAFTA or the U.S. RTAs with Australia and Peru, only the net cost method may be used to calculate the regional value-content level.

The RTAs negotiated by the U.S. after the NAFTA offer a different alternative, referred to as the build-up method. This method calculates the content level by dividing the value of *originating* inputs by the value of the good. In a few cases, only the build-up method can be used to determine the regional value-content percentage; for example, automotive engines in the Chile-U.S. FTA. The build-up method is also found in some of the other RTAs between TPP parties (e.g., the Chile-Japan FTA).

The Canada-Peru FTA uses, as the alternative to the tariff-shift rule for a wide range of products, the focused-value method for almost all goods facing a regional value-content test. A good qualifies as originating if the value of the non-originating materials on the designated input list, divided by the transaction value of the good, does not exceed the prescribed threshold. This method is not directly comparable to the other methods discussed in this paper. As noted below, the one notable exception in the Canada-Peru FTA to using the focused-value method is motor vehicles. Producers of motor vehicles face a mandatory regional value-content test that requires the value of all non-originating materials be taken into account when determining if the prescribed threshold has exceeded.

The Chile-Peru FTA also focuses on the value of the non-originating inputs when calculating the regional value-content of a good; however, in this agreement, all of the non-originating inputs must be taken into account when making the calculation.⁷ Under this FTA, if the production of a good does not meet the specified processing requirements or conditions set out in the rules of origin chapter, a good can still qualify for tariff preferences if the value of all non-originating materials, divided by the value of the good, does not exceed 50 percent. While a rough comparison of this approach can be made with the build-up method in that the two resemble a reverse mirror image, it is very difficult to compare this method with the other methods above that focus on measuring the originating content level.

The RTAs solely between the Asian TPP members, and the Chile-Peru FTA, do not offer an alternative method for calculating the regional value-content percentage for products facing a regional value-content test. Producers under these agreements can only use the value of the good method.

4. TPP Rules of Origin and Comparison with the Rules of Origin of the Other Regional Trade Agreements Involving TPP Parties

Similar to the existing RTAs involving TPP signatories, the two main types of rules of origin employed in the TPP are tariff-shift rules and regional value-content tests. Production processing rules are found mainly in certain food processing sectors (e.g., animal and vegetable oils), petroleum goods, chemical and plastic products, where they are either a mandatory requirement or an alternative rule to a tariff shift rule.

The TPP stipulates a tariff-shift rule of origin for almost all products covered by the agreement, with the main exception being motor vehicles where the rule is a mandatory regional value-content test. For the wide range of other goods, producers are offered a choice between alternative rules of origin, usually between a more stringent tariff-shift rule and a regional value-content test with or without a more liberal tariff-shift rule.

For most goods facing a regional value-content test in the TPP, whether with or without an accompanying tariff-shift rule, producers have the option of using the build-down or the build-up method. For certain automotive parts (e.g., engines), the net cost method is offered as a third option. However, only the net cost and build-down methods

are permitted for motor vehicles. The TPP also includes a modified focused-value method that is provided as a third alternative for a range of products (e.g., transmission shafts and housed ball bearings). In contrast to the focused-value approach used in the Canada-Peru FTA, the TPP focused-value approach calculates the regional value-content by subtracting the value of the non-originating inputs on the designated materials list from the value of the good and dividing by the value of the good.

Given the differences inherent with each of these methods in the TPP, the thresholds for both the net cost and build-up methods are set 10 percentage points lower than the threshold for the build-down method for each product facing a regional value-content test (e.g., 40 percent for the former two tests versus 50 percent for the build-down method). The threshold for the focused-value approach is higher than that for the build-down method, in most cases by 10 percentage points. These adjustments to the thresholds under each method are intended to make them roughly equivalent.

The next four sub-sections discuss and compare the TPP rules of origin and the rules found in the 32 RTAs involving TPP signatories on sectoral basis, starting with agriculture.

4.1 Rules of Origin for Agricultural Products

There are a significant number of similarities in the rules of origin for many agricultural products (HS Chapters 1 to 24, including fishery products) in the RTAs involving TPP countries. These rules, however, also reflect specific import sensitivities or export interests for selected products. For example, the rules for most processed or prepared meat, fish, fruit and vegetable products in Japan's individual RTAs with other TPP members require that the animals, fish, fruits and vegetables used as inputs in the production of these products be born and raised, harvested or grown in the territories of these countries.⁸ Peru's agreements with Mexico and Singapore, as well as the one with Japan, also include similarly restrictive rules of origin for these products, as well as requiring that rice, potato and corn flour and starches be made from rice, potatoes and corn grown in their territories.

While not nearly as extensive as those found in these Japanese and Peruvian RTAs, most of the RTAs involving the TPP countries include similar restrictive tariff-shift rules for selected agricultural products. The U.S. RTAs require that orange juice be made from oranges grown in the respective RTA territories. These agreements also stipulate that refined sugar be made from raw sugar cane or beet grown in the RTA territories. In addition, these U.S. RTAs either require that only originating sugar be used or limit the amount of non-originating sugar that can be used, in the production of a large range of sugar-containing confectionaries. Some U.S. RTAs, such as the one with Peru, place similar restrictions on materials used in the production of selected fish and fruit preparations. The Canadian and U.S. FTAs include restrictions on the use of non-originating milk for dairy products and preparations containing more than 10 percent by dry weight in milk solids. Less restrictive tariff-shift rules for almost all

agricultural products, including those mentioned above, are found in the RTAs involving Malaysia and Vietnam with other Asian TPP members, other than with Japan.

An important difference in the agricultural rules of origin in the RTAs involving the Western Hemispheric TPP signatories and Japan's RTAs on the one hand and the remaining RTAs between the Asian TPP countries on the other hand, is that the former group of RTAs either provides an alternative regional value-content test only for a small number of goods or does not offer such an alternative test for any agricultural products. In contrast, the latter group of RTAs (i.e., solely between Asian TPP parties) provides flexibility in the form of an alternative regional value-content test for a wide range of agricultural prepared or processed products, usually with a 40 percent threshold. For example, while both groups of countries require refined sugar and most high-sugar containing products to be made from originating raw sugar, the latter group provides the alternative of a 40 percent regional value-content test. The RTAs involving Australia, Brunei, New Zealand, Malaysia and Vietnam also include, as a second alternative rule, processing requirement rules for some agricultural goods (e.g., cooking vegetables, refining of animal and vegetable oils).

4.2 TPP Rules of Origin for Agricultural Products

For most agricultural products (HS Chapters 1 to 24, which includes fishery products), the TPP rules of origin are as restrictive, or more restrictive, than those found in most of the RTAs between TPP signatories, including the NAFTA. It appears that the TPP negotiators chose to resolve difficulties by accommodating the agricultural sensitivities of individual participants by opting for more restrictive rules of origin.

The TPP rules for many processed fish, meat, fruit and vegetable products are more restrictive than the rules found in many of the RTAs involving the TPP parties as they either do not allow or limit the use of fish, cattle, fruit or vegetables harvested, slaughtered or grown outside the TPP territory. As noted below, some flexibility is provided for meat products.

The rules for these goods have been fine-tuned to allow for the use of non-originating inputs in certain cases. For example, fillets, meal and food preparations of tuna, salmon, sardines and sprats must be made from fish caught in the territories of the TPP parties in order to qualify for TPP tariff preferences. On the other hand, such products produced from other species, such as herring, trout, cod and haddock, can be made from fish imported from outside the TPP zone.

A wide range of fruits and vegetables, including peaches, strawberries, mangoes, guavas, citrus fruits, potatoes, olives, onions, asparagus, mushrooms and peas, must also be grown in the TPP region for many of their preparations to qualify for TPP tariff preferences. Some flexibility is provided for a small number of selected products. For example, single fruit jams made from peaches, strawberries, mangoes or guavas can use non-originating fruits as long as the value of those fruits does not exceed 50 percent of the value of the product.

The TPP rules for most processed beef, pork and chicken meat preparations require that they be made from animals slaughtered in a TPP country, although some flexibility is provided as producers of these goods have recourse to an alternative regional value-content test of 45 percent under the build-down method if non-originating meat is used in their production.

Rice and potato flour and starches must be made from rice and potatoes grown in TPP countries. There also are limitations on using non-originating potato flour in the production of certain other products (e.g., the weight or value of non-originating rice flour cannot exceed a certain threshold of the weight or value of the good).

The TPP also incorporates the more restrictive rules of origin for sugar and sugar-containing products, as well as dairy and dairy-containing products, that are found in the RTAs involving TPP signatories (see previous sub-section).

The TPP offers, as an alternative rule to the stipulated tariff-shift rule, a regional value-content test to fewer products than the RTAs solely between the Asian TPP parties, except those involving Japan. On the other hand, more agricultural goods are eligible for such an alternative rule than in the case of most of the RTAs involving the Western Hemispheric RTA signatories. The products eligible for an alternative regional value-content test (usually with a 40 percent threshold under the build-down approach) include, in addition to processed meat preparations, certain refined vegetable oils (e.g., palm, sesame and castor oils), crushed pepper, fruit and nut mixtures, juice mixtures, mayonnaise, salad dressing and non-alcoholic beer and wine.

As compared to the NAFTA, the TPP represents a tightening of the rules of origin for a significant range of agricultural products. For example, while the NAFTA did not allow the use of non-originating citrus fruits in the production of single fruit juices, the TPP expands the restriction on using non-originating fruits and vegetable to a wide range of products. Similarly, the NAFTA rules for meat preparations allowed the use of non-NAFTA fresh, chilled or frozen meat. However, it is not expected that these more restrictive TPP rules of origin will have much impact on Canadian producers as many of the newly restricted inputs are readily available in Canada or from the U.S. In addition, Canadian firms will have access to these inputs from other TPP members, many of which are also important agricultural producers.

4.3 Non-Agricultural Products

Turning to non-agricultural products (HS Chapters 25 to 97), one important difference between RTAs of TPP parties is that the tariff-shift rules are more restrictive for a significant number of non-agricultural products in the RTAs involving the Western Hemispheric TPP countries than those rules in the RTAs solely between the Asian TPP signatories. In other words, the tariff-shift rules in the former group of RTAs require more of the inputs to originate in their RTA territories, although in many of these cases, the producer has recourse to an alternative regional value-content test with a less strict tariff-shift rule. This distinction has, however, lessened over time for Canada, Mexico and the U.S. as the three have moved towards more liberal tariff-shift rules for various

non-agricultural goods since the NAFTA. The notable exception is the rules of origin for textiles and apparel.

As second important distinction between the RTAs involving the Western Hemispheric TPP members on the one hand and the RTAs solely between the Asian TPP countries on the other hand is that the latter group of RTAs includes a regional value-content test as the alternative to the tariff-shift rule, usually with a 40 percent threshold under the value of the good approach, for most products across all non-agricultural sectors. The RTAs involving the Western Hemispheric countries provide an alternative regional value-content test (almost always combined with a tariff-shift rule) for fewer non-agricultural goods, mainly concentrated in the industrial and consumer manufactured goods sectors (i.e., HS Chapters 84-96). The NAFTA, the Canada-Chile FTA and Mexico's RTAs with Chile and Peru also provide an alternative regional value-content test for many chemical, plastic and rubber products.⁹ However, Canada and the U.S. have largely discarded the regional value-content test for many chemical, plastic and rubber products in most of their RTAs subsequent to the NAFTA, replacing it with more liberal tariff-shift rules or an alternative processing requirement rule (e.g., chemical reaction, purification and isomer isolation rules for chemicals). However, the RTAs involving Canada, Chile, Mexico, Peru and the U.S. do not provide an alternative regional value-content test for textiles and apparel, except in the case of the Chile-Mexico FTA.

The third important difference between the RTAs amongst the TPP parties is that the threshold percentage varies significantly for the products facing a regional value-content test, whether as a standalone test or as an alternative to a tariff-shift rule.

The NAFTA and the Japan-Singapore FTA specify the highest thresholds of the RTAs involving TPP parties. The latter stipulates a threshold of 60 percent under the value of the good approach for almost all products facing a regional value-content test. The NAFTA has a 60 percent threshold for almost all products facing a regional value-content test under the transaction method, with the alternative of 50 percent under the net cost method. The two notable exceptions under the NAFTA are footwear and automotive goods where only the net cost method may be used. Footwear faces a 55 percent threshold level under this method. The threshold is 62.5 percent for passenger cars and their engines and gear-boxes, and 60 percent for other motor vehicles, their engines and gear-boxes, and for most other automotive parts. In addition, the NAFTA stipulates a list of automotive parts for which their value, if they are non-originating, must be "traced" through the automotive production chain up to the final motor vehicle when calculating the regional value-content percentage.

The U.S. agreements with Australia, Chile, Peru and Singapore contain a 45 percent value-content requirement under the build-down method for almost all products facing a regional content value test, with an alternative of 35 percent under the build-up method. The first notable exception is footwear where certain footwear (e.g., waterproof and sports footwear) face higher thresholds. The threshold is 55 percent under the build-down method in the Australia-U.S. FTA, with an even more stringent threshold of 55 percent under the build-up method in the U.S. RTAs with Chile, Peru and Singapore

with no alternative test under the build-down method. While the U.S. FTAs with Australia, Chile and Singapore stipulate thresholds of 35 percent under the build-up method and 45 percent under the build-down method for other footwear, the Peru-U.S. FTA sets the threshold for other footwear at 20 percent threshold under the build-up method. The second notable product exception is automotive goods, for which various methods and thresholds are used. The Australia-U.S. FTA and Peru-U.S. FTA only allow producers to use the net cost method for motor vehicles and engines, with a threshold of 50 percent and 35 percent respectively. While the former agreement also maintains a 50 percent net cost requirement for other automotive parts, the Peru-U.S. FTA provides producers with the choice of 45 percent under the build-down method or 35 percent under the build-up method for these parts. The U.S. RTA with Chile stipulates a 30 percent threshold under the build-up method for engines, but allows producers to use either the build-down method at 50 percent or the build-up method at 30 percent for vehicles and other automotive parts. The automotive rule of origin in the Singapore-U.S. FTA is a 30 percent regional value-content test under the build-up method.

The threshold level for almost all products facing a regional value-content test in the various RTAs between Australia, Brunei, Japan, Malaysia, New Zealand, Singapore and Vietnam (including the ASEAN Free Trade Area and its agreements with Australia, Japan and New Zealand) is 40 percent under the value of the good method, whether this test is a stand-alone test, is combined with a tariff-shift rule or is an alternative to a more restrictive tariff-shift rule. The two notable exceptions are the 60 percent threshold for passenger cars and motorcycles and the 50 percent level for other motor vehicles in the Japan-Malaysia FTA, and, as noted earlier, the general 60 percent threshold in the Japan-Singapore FTA.

Mexico's FTAs with Chile, Japan and Peru stipulate a 50 percent content level under the transaction value method for most products facing a regional value-content test, with the alternative of 40 percent under the net cost method in the agreement with Chile. The first notable exception to this general approach is footwear at 55 percent under the transaction method in the Japan-Mexico FTA. The second notable exception is motor vehicles where the content level is 32 percent and 35 percent in its RTAs with Chile and Peru, respectively (with the alternative of 26 percent under the net cost method in the agreement with Chile), but 65 percent for both motor vehicles and their parts in Mexico's FTA with Japan.

Chile's RTA with Japan sets out a content level of 45 percent under the build-down method and 30 percent under the build-up method for all goods facing a regional value-content test, including motor vehicles. Its FTAs with Australia, Malaysia and Vietnam stipulate a 40 percent threshold under the value of goods method. Motor vehicles are excluded from the coverage of the Chile-Malaysia and Chile-Vietnam FTAs. As noted above, the Chile-Peru FTA uses a different formula for determining the content level which focuses on the value of non-originating materials as opposed to the originating regional content, by stipulating that the value of non-originating materials

cannot exceed 50 percent of the value of the good where this rule is applied under this agreement.

The regional value-content threshold for most goods facing this test in the Japan-Peru Free FTA is either 40 percent or 50 percent under the value of the good approach, with various chemicals and many types of machinery and electrical equipment facing the latter level. The threshold for motor vehicles and most automotive parts, however, is 45 percent (but 50 percent for engines and their parts). In contrast, the content level in the Peru-Singapore FTA ranges from 30 per cent for rubber products to 35 percent for some goods (e.g., certain chemicals, most scientific equipment), 40 percent for electrical equipment, automotive goods and ships, and 45 percent for plastic goods and most non-electrical machinery and equipment, with a few products required to achieve 50 percent (e.g., most footwear).

The content threshold in the Canada-Chile FTA is 35 percent under the transaction value method for many manufactured products, with an alternative of 25 percent under the net cost method. However, it ranges from 40 percent for rubber products under the transaction value method (or 30 percent under the net cost method) to 50 percent for zinc articles (40 percent under the net cost method), 60 percent for various chemical, plastic and steel and certain other metal goods (with the alternative of 50 percent if the net cost method is used), and up to 65 percent for certain chemical products such as cleaning products and explosives (with a 50 percent threshold under the net cost alternative). Only the net cost method can be used to calculate the regional value-content percentage for motor vehicles, automotive parts and footwear, with the thresholds set at 20 percent, 30 percent and 55 percent, respectively.¹⁰

As noted above, the Canada-Peru FTA uses the focused-value method for almost all products facing a regional value-content test, which is not directly comparable to the other methods used in the other RTAs or the TPP. For most goods facing a regional value-content test based on this method in this RTA, the allowable value of non-originating materials on the designated list of inputs is 65 percent of the transaction value of the good. The allowable percentage of such non-originating inputs is lower for some products, such as 50 percent for footwear, 40 percent for ships and 35 percent for certain cutlery sets. The one exception to using the focused-value approach in the Canada-Peru FTA is motor vehicles. Producers must take into account the value of all non-originating materials used in the production of motor vehicles when calculating the regional value-content of their products. The value of all non-originating inputs cannot exceed 55 percent of the transaction value of the vehicle or 65 percent of the net cost of the vehicle, but under both options, U.S.-made parts are eligible to be counted as originating inputs.

4.4 TPP Rules of Origin for Non-Agricultural Goods

This sub-section compares the rules of origin for non-agricultural goods in the 32 RTAs involving TPP parties and the TPP on a sector basis.

The TPP rules of origin for most mineral fuel, chemical, plastic and rubber products provide producers with the alternative of meeting either a tariff-shift rule or a processing requirement rule (e.g., chemical reaction). For certain products, mainly plastic products, there is a further alternative provided in the form of a regional value-content test with a threshold for most such products of 45 percent under the build-down method or 35 percent under the build-up method. As such, the TPP rules for these products are more liberal than those found in the NAFTA, the Canada-Chile FTA and Japan's agreements with Mexico and Peru. These agreements, mainly negotiated more than 10 years ago, only include a processing requirement rule for a few products. Instead, these RTAs rely heavily on relatively more restrictive tariff-shift rules, with alternative regional-value-content tests with higher content thresholds than those found in the TPP.

On the other hand, the TPP rules of origin for mineral fuels, chemical, plastic and rubber products are somewhat more restrictive than those found in the RTAs between the Asian TPP signatories and some of their agreements with West Hemispheric countries (e.g., the Chile-Malaysia FTA). Most of these products in these RTAs face an alternative regional value-content test of 40 percent of the value of the good as compared to 45 percent under the comparable build-down method in the TPP. But the TPP does offer the alternative of meeting a processing requirement rule for many of these products. The rules of origin for these products in the remaining RTAs between TPP parties, including the ones involving the U.S., the Chile-Japan FTA and the Mexico-Peru FTA, are largely similar to those in the TPP, although the Mexico-Peru FTA stipulates a 50 percent content level under the value of the good method for those goods given the alternative option of meeting a regional value-content test. The focused-value method used in the Canada-Peru FTA is not directly comparable to those in the TPP and other RTAs.

The tariff-shift rules of origin for almost all wood, pulp and paper products are largely comparable between the TPP and the existing RTAs between TPP partners. The one notable difference across the various RTAs is that most of the agreements between the Asian TPP members also include an alternative stand-alone 40 percent regional value-content test which is not included in the TPP. The TPP tariff-shift rules for these products, however, are not unduly onerous.

As regards base metal products (e.g., iron and steel, aluminum, copper), the tariff shift rules are roughly similar in most of the existing RTAs between TPP countries. Most of the RTAs between Asian TPP signatories also include the alternative of a 40 percent regional value-content test for most of these products. In contrast, most of the RTAs involving the Western Hemispheric TPP signatories offer a regional value-content test for relatively few products. In earlier agreements, such as the NAFTA and the Canada-Chile FTA, the threshold is set at 60 percent under the transaction value method and 50 percent under the net cost method, while the thresholds are lower in the agreements subsequently negotiated with other parties by countries (e.g., 45 percent under the build-down method and 35 percent under the build-up method, respectively, in the Australia-U.S. and Peru-U.S. FTAs).

The TPP largely incorporates the relatively liberal tariff-shift rules found in all most all of the RTAs between TPP parties for most base metal products. It also provides an alternative regional value-content test for a wide range of these products, with the thresholds ranging from 40 percent to 50 percent under the build-down method and 30 percent to 40 percent under the build-up method. A number of products also have a third option under the focused-value method, usually with a threshold that is 10 percentage points higher than the threshold under the build-down method for the good in question.

Turning to footwear, a major export interest for Vietnam, the TPP stipulates a regional value-content requirement of 55 percent under the build-down method and 45 percent under the build-up method, and introduces a new restriction in the change in tariff classification not found in the NAFTA and the other RTAs involving the TPP signatories, namely that non-originating partially-assembled or “hanging” uppers may not be used. These TPP thresholds are significantly higher than the thresholds found in the RTAs solely between the Asian TPP members. The picture is mixed in the comparison of the TPP footwear rules of origin with the rules for these products in the RTAs involving the TPP Western Hemispheric countries. The TPP regional value-content test is less stringent than the test found in the NAFTA, the Canada-Chile FTA, the Canada-Peru FTA and, for certain footwear (e.g., waterproof footwear), the U.S. agreements with Australia, Chile, Peru and Singapore. On the other hand, the TPP regional value-content test is more demanding than the test for other footwear in the U.S. agreements with these four TPP countries, as well as the test for footwear found in Peru’s agreements with Mexico and Singapore. The Japan-Mexico FTA stipulates a 55 percent regional value-content percentage under the value of the good approach, which matches, for all intents and purposes, the same as the 55 percent threshold set in the TPP under the build-down method. The TPP footwear rules of origin, however, could potentially be more restrictive than the rules found in any of the RTAs involving TPP parties because of the prohibition on using non-originating “hanging” uppers. To the extent that TPP footwear producers import “hanging” uppers from outside the TPP region, they face a more onerous rule of origin.

In the case of textiles and apparel, the TPP has retained the restrictive tariff-shift yarn-forward rule of origin found in the NAFTA and most of the other RTAs involving the U.S. and other Western Hemispheric TPP members.¹¹ These rules are much stricter than their counterpart rules found in the RTAs solely between the Asian TPP signatories. For example, a number of these Asian agreements allow non-originating greige fabrics to be cut, printed and finished when they are used in the production of originating apparel or other final textile articles. The RTAs between Australia, Malaysia, New Zealand and Vietnam also allow producers to use non-originating yarn or fabric in the production of apparel and other final textile articles provided that the cutting and sewing or knitting-to-shape, and finishing of the apparel occurs in the territories of these RTAs and that the regional value-content percentage is not less than 40 percent.

The TPP does not include the type of derogations found in the NAFTA that allow limited quantities of textiles and apparel to qualify for tariff preferences under a more liberal rule of origin, with one exception.¹² Vietnam can use non-originating cotton fabric

to produce parts eligible for preferences into the U.S., but the annual allowable volume is both capped and linked to Vietnam's purchase of U.S.-originating cotton fabrics. The main tool providing flexibility for all TPP members is a "short supply list" that identifies yarns and fabrics that are considered not to be commercially available within the TPP region. In many cases, the use of such non-originating yarns and fabrics is restricted to the production of certain products.¹³

In the TPP, producers of motor vehicles and most automotive components must meet a regional value-content test in order for their goods to be eligible for tariff preferences. The TPP, however, offers a number of alternative approaches for this test, each with their own thresholds. The value-content requirement for motor vehicles is 55 percent under the build-down method and 45 percent under the net cost method. The thresholds for gasoline engines exceeding 250cc and diesel engines, as well as gear-boxes, brakes and certain other parts, are 45 percent under both the build-up and net cost methods, and 55 percent under the build-down method. The threshold for smaller gasoline engines is 35 percent under the first two methods and 45 percent under the build-down method. Certain other parts, such engine parts, radiators, mufflers and their respective parts, also face the same thresholds under these three methods. Other parts, including airbags, door assemblies and drive axles with differential, are required to meet a 40 percent requirement under either build-up or net cost methods, or 50 percent under the build-down method. The content level for vehicle seats is 30 percent under the build-up method and 40 percent under the build-down method.

The TPP, however, provides automotive producers with flexibility in meeting the rules of origin for certain goods. In the case of motor vehicles, certain designated parts can also qualify as originating inputs when used in the production of a vehicle if, rather than satisfying their applicable rule of origin, they undergo one or more of the specified qualifying operations. The designated parts are safety glass, bodies (including cabs), bumpers, door assemblies and certain other body stampings, and drive axles with differential. The eligible qualifying operations are complex assembly, complex welding, die or other casting, extrusion, forging, laminating, metal forming, machining, moulding and stamping and pressing. Similar flexibility is also provided for inputs used in the production of eligible major components, such as gasoline engines exceeding 250cc, diesel engines, brakes, gear-boxes, suspension systems and steering columns.¹⁴ Inputs used in the production of these eligible components qualify as originating inputs if they undergo one or more of the above qualifying operations. However, the value of these inputs that can be counted as originating under this provision is capped at either five percent of the originating content of the eligible component for some of these goods or 10 percent for others. If the eligible major component meets its rule of origin, including as a result of applying this provision, then the full value of that eligible component is treated as originating content for purposes of the regional value-content calculation for a motor vehicle.

As noted above, the automotive rules of origin vary significantly across the RTAs between TPP members, both in the formula used to calculate the regional value-content and the threshold that must be achieved. A direct comparison between the automotive

rules across these RTAs, however, is not straightforward for the reasons indicated below, which include the fact that the NAFTA includes a special tracing mechanism for automotive goods.

As a general observation, the TPP rules of origin for vehicles and many automotive parts, such as engines and gear-boxes and their parts, are more restrictive, albeit in varying degrees, than the rules found in many of the RTAs between TPP members, even after taking into account the alternative processing requirement rules offered by the TPP for various automotive inputs. But many of these RTAs either involve countries that are not significant automotive producers or, in the case of Canada's and Mexico's RTAs with Chile and Peru, stipulate low regional value-content thresholds for automotive goods to accommodate their industries' reliance on U.S.-made parts.

On the other hand, the TPP automotive rules of origin are more liberal, again in varying degrees, than the rules found in the Australia-U.S. FTA, the Japan-Mexico FTA, the NAFTA and, for passenger cars, the Japan-Malaysia FTA. Each of these agreements involve major automotive producers and stipulate higher thresholds under their regional value-content tests for many automotive goods than the thresholds found in the TPP under the comparable methods employed in those RTAs.

There is, however, a debate over whether the TPP is less restrictive than the NAFTA (see U.S. House of Representatives, Ways and Means Committee (2016), Inside U.S. Trade (2016) and Inside U.S. Trade (2015). The NAFTA threshold of 62.5 percent or 60 percent for automotive goods under the net cost method is clearly stricter than the 45 percent, 40 percent and 35 percent levels found under this method in the TPP. However, any direct comparison between thresholds is complicated by the fact that the NAFTA requires the value of non-originating parts on the designated NAFTA list to be traced throughout the production process when calculating the regional value of automotive goods. Parts not on the designated list are deemed to be originating, regardless of where they are obtained. While the NAFTA tracing list includes most of the components and parts that go into motor vehicles, the increased use of electronics and the introduction of new components such as rear-view cameras into vehicles means that number of parts and inputs now used in vehicles are not on this list. This has the effect of reducing the gap between the NAFTA and TPP thresholds for motor vehicles by lowering the effective NAFTA threshold. This "tracing" effect, however, is smaller in the case of those major components that have not been affected by the introduction of new electronics or parts.

In addition, the TPP automotive rules treat the full value of an automotive part as originating content if the production and sourcing of that part satisfies its TPP rule of origin, even if some of the inputs used to make that part are non-originating. Consequently, if that part is used in the production of another automotive component or a vehicle itself, then 100 percent of its value, including its non-originating content, is counted as originating content when calculating the regional value-content level of that

component or vehicle. This is the so-called “roll-up effect” waters down the TPP threshold level.¹⁵

Without detailed (and likely confidential) company information on costs and sourcing of inputs, it is not possible to reach a definitive quantitative conclusion on which rule of origin is more restrictive. Nevertheless, given that the tracing and roll-up effects work to offset each other to some degree, it remains highly likely that the NAFTA automotive rule is significantly more restrictive due to the significantly lower TPP thresholds and, albeit to a lesser extent, the TPP’s alternative processing requirement rules for certain automotive inputs.¹⁶ The difference between the automotive rules of origin in the two agreements is much more pronounced for automotive components and parts since the TPP threshold levels are much lower for many parts.

The TPP rules of origin for the remaining manufactured products¹⁷, including industrial machinery, household appliances, industrial and consumer electronic products, toys, scientific equipment, musical instruments and transportation equipment other than automotive, mostly involve a tariff-shift rule that requires the dedicated parts used in the production of the good to be originating, with an alternative regional value-content test when non-originating dedicated parts are used. For many of these goods, the TPP threshold is 40 percent under the build-down method and 30 percent under the build-down method. Other goods face a threshold of 45 percent and 35 percent, respectively, under these methods, with a few facing higher thresholds under the two methods. In addition, producers of most of these products have the option of using the focused-value method, with varying thresholds.

The tariff-shift rules in the TPP are similar to, if not more liberal for various products than, the rules found in most of the RTAs involving TPP signatories for most of these remaining manufactured goods. The main differences between the TPP and the other RTAs involving TPP signatories are found in thresholds for the regional value-content tests. The RTAs between the Asian TPP countries, and the Chile-Vietnam FTA, set out a threshold of 40 percent under the value of the good approach for most of these products, which is closely comparable to the 40 percent threshold under the TPP’s build-down method.

The U.S. RTAs with Australia, Chile, Peru and Singapore, and the Chile-Japan FTA, stipulate a threshold of 45 percent under the build-down method and 35 percent under the build-up method for most of these goods. The thresholds in the Chile-Malaysia and Peru-Singapore FTAs are a mix of 40 percent and 45 percent for these goods under the value of the good approach, although the Peru-Singapore FTA also stipulates a 50 percent threshold for some of these goods and only 35 percent for some others. The Japan-Peru FTA and Mexico’s RTAs other than NAFTA stipulate a higher threshold of 50 percent for most of these goods under the transaction value method, which is very similar to the build-down method. The TPP thresholds for these remaining manufactured goods are significantly less than the 60 percent threshold under the transaction value method required under the NAFTA. On the other hand, the TPP thresholds are somewhat higher than the threshold of 35 percent under the transaction

value method found for most of these products in the Canada-Chile FTA. They may also be slightly higher than the thresholds found in the Canada-Peru FTA, but a direct comparison is difficult between the method used in that agreement and the methods used in the TPP.

Overall, the TPP rules of origin for most non-agricultural goods are more liberal than the rules in the NAFTA, and are either comparable or more liberal than the rules found in most of the other RTAs involving the Western Hemispheric TPP parties. As discussed above, the one notable exception is textiles and apparel, where the restrictive yarn-forward rule of origin found in the NAFTA and the other RTAs involving the Western Hemispheric TPP countries has been incorporated into the TPP.

On the other hand, the TPP rules for most wood products, base metal products and manufactured industrial and consumer goods are largely similar to the rules in the RTAs solely between the Asian TPP signatories and a few of their agreements with West Hemispheric countries (e.g., the Chile-Malaysia FTA). The one notable exception is the Japan-Singapore FTA for those goods facing a regional value-content test as the TPP sets a significantly lower threshold under this test. On the other hand, the TPP rules of origin for footwear and particularly textiles and apparel are significantly more restrictive than the rules for such goods found in these Asian RTAs. The TPP rules for various mineral, chemical, plastic, rubber and automotive products are somewhat more restrictive than the rules found in these RTAs, except in the case of passenger cars in the Japan-Malaysia FTA and the goods facing a regional value-content test in the Japan Singapore FTA.

5. Final Remarks

This paper is a background document for a number of the issues discussed in Moroz (2016). That paper looks at the role of rules of origin in RTAs with a focus on three critical aspects: restrictiveness, cumulation, and compliance costs. It then examines the TPP rules of origin from two perspectives: the broader implications of the TPP's weaving together the different rules in the 32 RTAs involving TPP parties into a single, common set of rules with full cumulation; and the implications for Canada. As noted in this document, the TPP rules of origin are more restrictive for many agricultural products, but more liberal for many non-agricultural products, than the rules found in many of the 32 RTAs involving at least two TPP signatories. As discussed in Moroz (2016), one consequence is that TPP rules of origin, by establishing a common set of rules of origin with full cumulation for the 12 TPP signatories, could have an impact on the level of trade diversion in inputs between the TPP parties and between these countries and the rest of the world. Moroz (2016) also examines the challenges of negotiating rules of origin in a world of regional and global supply chains by looking at the TPP outcome on the rules in two sectors: textiles and apparel, and automotive goods. It also discusses the implications for the Canadian automotive sector of the more liberal automotive rules in the TPP, as compared the rules for such goods to the NAFTA. The paper concludes with some observations on navigating rules of origin in the future.

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Appendix: Regional Trade Agreements in Force between TPP Signatories

In addition to individual regional trade agreements (RTAs) in force directly between TPP countries, the list below includes RTAs where at least two TPP countries are members.

1. ASEAN Free Trade Area (Brunei Darussalam, Malaysia, Singapore and Vietnam are members)
2. ASEAN-Australia-New Zealand
3. ASEAN-Japan
4. Australia-Chile
5. Australia-New Zealand
6. Brunei Darussalam-Japan
7. Canada-Chile
8. Canada-Peru
9. Chile-Japan
10. Chile-Malaysia
11. Chile-Mexico
12. Chile-Vietnam
13. Japan-Australia
14. Japan-Malaysia
15. Japan-Mexico
16. Japan-Peru
17. Japan-Singapore
18. Japan-Vietnam
19. Malaysia-Australia
20. New Zealand-Malaysia
21. New Zealand-Singapore
22. North American Free Trade Area (NAFTA - Canada, Mexico and the U.S.)
23. Peru-Chile
24. Peru-Mexico
25. Peru-Singapore
26. Singapore-Australia
27. South Pacific Regional Trade and Economic Co-operation Agreement (Australia and New Zealand are members)
28. Trans-Pacific Strategic Economic Partnership (Brunei Darussalam, Chile, New Zealand and Singapore)
29. U.S.-Australia
30. U.S.-Chile
31. U.S.-Peru
32. U.S.-Singapore

Source: World Trade Organization, Regional Trade Agreements -
https://www.wto.org/english/tratop_e/region_e/region_e.htm, accessed on May 21, 2016.

Endnotes

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² For the full list of Canadian RTAs which are in force, concluded or under negotiation, see Canada's Free Trade Agreements, Global Affairs website - <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fta-ale.aspx?lang=eng>

³ These NAFTA fabric and apparel derogations are commonly known as Tariff Preference Levels (TPLs). The NAFTA provides TPLs for broad categories of textiles and apparel, along with certain narrow categories such as men's suits, with differing annual quantities. Canada has included similar derogations for textiles and apparel in many of its subsequent RTAs.

⁴ A number of the EU's RTAs provide similar derogations for various products exported to the EU by the other party under these agreements. In the case of CETA, the EU also obtained a derogation for various textile and apparel exports to Canada.

⁵ In some of these RTAs, the value of the good method is referred to as "qualifying value of the good" approach.

⁶ Many of these RTAs require that the price paid or payable be determined in accordance with the WTO Customs Valuation Agreement.

⁷ In the Japan-Singapore FTA, the usual value of good approach is used for most goods facing a regional value-content requirement; however, there is one exception: for goods of HS Chapter 22 (Alcoholic Products) facing a regional value-content test, the calculation involves dividing the value of non-originating materials by the value of the good.

⁸ In the case of Japan's FTAs with Malaysia and Vietnam, fish caught and fruits and vegetables grown in the territories of the other ASEAN countries are treated as originating materials under these RTAs.

⁹ The NAFTA parties and Canada and Chile are examining potential amendments to their respective RTAs that would involve adding, or replacing some of the existing rules of origin with, processing requirement rules for chemical and plastic products.

¹⁰ In 2013, Canada published a request for public comments on a series of proposed amendments to the rules of origin in the Canada-Chile FTA. These proposals included offering producers of automotive goods and footwear the option of satisfying an alternative regional value-content test based on the transaction value method (albeit with a higher threshold than under the net cost method). The proposed amendments also included the proposal to lower the threshold under the net cost method for footwear to 40 percent. As of August 2016, these proposals have not been implemented.

¹¹ The notable exception is the Chile-Mexico FTA which has a relatively liberal change in tariff classification rule combined with alternative regional value-content test of 50 percent under the transaction value method or 40 percent under the net cost method.

¹² In addition to the NAFTA, the Canada-Chile FTA and the Chile-U.S. FTA also provide derogations for textiles and apparel products. Presumably producers in these countries will still be able to use the derogations for textiles and apparel provided under those RTAs.

¹³ Examples of where the use of short-supply inputs is restricted under the TPP to certain products include: a) "Knit fleece fabric classified in subheading 6001.22, of 67- 73 percent acrylic and 27-33 percent viscose, weighing 200-280 g/m² used in the production of sweaters, pullovers, sweatshirts and waistcoats and similar articles"; and b) "Fabrics of man-made fibres of Chapters 54 and 55 used to make the outer surface of insulated food or beverage bags classified in subheading 4202.92."

¹⁴ See Appendix 1 to Annex 3-D of the TPP. The full list of major components eligible under this TPP provision is: gasoline engines exceeding 250cc, diesel engines, chassis fitted with engines, bumpers and parts thereof, safety seat belts, brakes and servo-brakes and parts thereof, gear-boxes and parts thereof, drive-axles with differential and parts thereof, suspension systems and parts thereof, steering wheels, columns and boxes and parts thereof, and those parts classified under HS subheading 8708.29, which includes certain body stampings and door assemblies.

¹⁵ The U.S. objective for pursuing tracing for automotive goods in the NAFTA negotiations was to eliminate the roll-up effect for such goods.

¹⁶ For a fuller discussion and comparison of the NAFTA and TPP automotive rules of origin, see U.S. House of Representatives, Committee on Ways & Means, Minority Staff Report (2016). This Report states that “[i]ndustry advisors, however, indicate that USTR had informed them that the equivalent was perhaps as low as the mid-fifties, and more specifically it appears that USTR has indicated the number may be 53 percent.” (According to media reports, the Detroit-3 took the view that a 50 percent content threshold under the TPP was comparable to the 62.5 percent threshold under the NAFTA with tracing; see Inside U.S. Trade (2015)).

¹⁷ Manufactured goods classified in HS Chapters 84-86 and 88-96, excluding automotive parts included in those chapters such as motor vehicle engines classified in Chapter 84.