



United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-251023

December 22, 1992



148282

The Honorable Louise M. Slaughter
House of Representatives

Dear Ms. Slaughter:

This letter provides updated information relevant to the issues discussed in our report to you, International Trade: Implementation of the U.S.-Canada Free Trade Agreement (GAO/GGD-93-21, Oct. 27, 1992). Of particular importance is the fact that negotiations on the North American Free Trade Agreement (NAFTA) have been concluded, and the President signed the agreement on December 17, 1992. This agreement, upon passage of implementing legislation by Congress, would become effective on January 1, 1994, and would address some of the problems raised in our report.

For example, NAFTA responds to certain concerns about the origin and preference requirements in the U.S.-Canada Free Trade Agreement (FTA). The rule of origin provisions that determine eligibility for FTA preferences are among the most complex parts of FTA. Generally, eligibility is established when the manufacture or assembly of a product results in the "substantial transformation" of the parts and materials used in the production process. The FTA's test for the substantial transformation of most items is whether a change in tariff classification takes place. FTA preference is established for such items when their manufacture or assembly in the United States or Canada results in a tariff classification different from the parts and material that went into them.

However, for other products, FTA confers preference only if they meet a U.S.-Canada "value content" test. As noted in our report, the "value content" requirement of FTA was considered particularly burdensome for some businesses because of the extensive record-keeping requirements. It was also difficult for Customs auditors to verify. Under NAFTA, this value content requirement

GAO/GGD-93-10R U.S.-Canada Trade

~~556137~~
056137/148282

and the associated burdensome record-keeping will be eliminated for certain products and replaced with the more general rule of origin based on a change in tariff classification. In order to implement this change for some affected products, such as photocopying apparatus, new tariff categories were created to identify the major subsystems of articles requiring assembly of many parts. These new categories clarify the distinction between activities that result in substantial transformation and those that do not.

Other provisions of NAFTA address additional concerns of North American industry. For example, some products whose origin had to be established with a change of tariff classification did not qualify for FTA benefits even though they were made almost entirely of U.S. and Canadian parts and materials. Some of the foreign parts --however minimal in value--had the same tariff classification as the finished product in which they were used. Consequently, their assembly did not result in the change in tariff classification required to establish substantial transformation and confer U.S. or Canadian origin. Under NAFTA, a de minimis rule will prevent such goods from losing eligibility for NAFTA preference solely because they contain minimal amounts of "nonoriginating" material. A good will be considered to be North American if the value of non-NAFTA parts and materials comprises no more than 7 percent of the price or total cost of the good.

NAFTA will also change the current FTA provisions establishing origin for vehicles and automotive parts. Vehicles and automobile parts will require a greater percentage of North American content in order to qualify for NAFTA preference. The North American content requirement will rise from the current 50 percent to 62.5 percent for passenger automobiles and light trucks, as well as engines and transmissions for such vehicles, and to 60 percent for other vehicles and automotive parts.

These changes will not take effect until NAFTA comes into force, which is presently proposed to be on January 1,

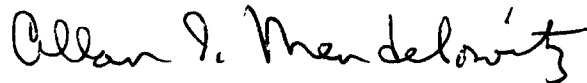
B-251023

1994. If the agreement is not approved by all three countries, the United States and Canada would have to pursue resolutions of these problems in the bilateral FTA.

In any event, it is important that Customs proceed with its stated plans to assist industry in resolving trade problems. As noted in our report, Customs told us that its ombudsman and its Project North Star Commercial have met and plan to establish liaison with Commerce's Office of Canada. Such an integration of government activities could eventually provide an authoritative source of assistance and information to U.S. exporters and importers. These collaborative efforts are critical to helping U.S. businesses resolve problems that inhibit their ability to derive full benefit from FTA. Furthermore, should NAFTA be approved and implemented, such efforts will become all the more important. Our work on issues related to U.S.-Mexico trade suggests that coordination problems also exist on that border.

We believe this information should be considered in tandem with the information contained in the report. If you have any questions, please call me on (202) 275-4812.

Sincerely yours,



Allan I. Mendelowitz, Director
International Trade and Finance Issues

