

Chapter 14: NAFTA Rules of Origin: Adaptation in North America and Emulation Abroad

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In his presentation, “NAFTA Rules of Origin: Adaptation in North America and Emulation Abroad,” Jeremy T. Harris, an economist at the Inter-American Development Bank, noted that NAFTA has introduced a new model for designing, negotiating, and implementing rules of origin. Harris said that in so doing, NAFTA has set up a model of success for ensuing free trade agreements (FTAs). In his joint research with Antoni Esteveordal, manager of the Integration and Trade Sector at the Inter-American Development Bank, Harris has addressed the question of how the rules of origin in NAFTA have become more flexible and how this flexibility has affected the trade flows between the United States, Canada, and Mexico. According to Harris, his and Esteveordal’s research also indicates that NAFTA set the default “template” for the product-specific rules of origin (PSROs) of subsequent FTAs of NAFTA partners, and also heavily influenced other FTAs globally.

To outline the results of his and Esteveordal’s findings, Harris first described the evolution of NAFTA’s rules of origin. Next, he introduced the five liberalizations of PSROs in NAFTA, and showed their impacts on the trade flows between the United States, Canada, and Mexico. Finally, he compared the PSROs found in NAFTA with those found in other FTAs via an examination of four different dimensions of these rules.

Evolution and Liberalization of Product-Specific Rules of Origin in NAFTA

In the first part of his presentation, Harris explained the reasons for using PSROs in NAFTA, as well as the reasons why default positions of PSROs in NAFTA tend to be restrictive. According to Harris, countries with a diverse export supply (i.e., large countries) would favor regimes with rules that vary across products. Therefore, when negotiating FTAs, negotiators from such countries usually use PSROs. Meanwhile, supporting evidence comes from the results of a simple regression comparing the combined gross domestic product (GDP) and the size of the economies covered by an FTA with the level of restrictiveness of the FTA’s rules of origin. The results showed that FTAs with higher combined GDPs have more restrictive PSROs, which reflects the greater availability of material inputs within the partner

²⁷ The views in this article are solely the opinions of the authors and should not be interpreted as reflecting the views of the Inter-American Development Bank.

countries. A second factor, according to Harris, is uncertainty about eventual FTA effects; this may have led to conservative default positions and, therefore, to more restrictive PSROs than strictly necessary. These two factors probably explain why the default positions of PSROs in NAFTA have been restrictive. However, as Harris pointed out, NAFTA does include mechanisms for modifying the rules of origin.

Next, Harris introduced two ways to modify PSROs in NAFTA. The first is “technical rectifications”—updates of existing rules so they will accord with new versions of the international Harmonized System. According to Harris, in principle this leaves the effects of the rules unchanged. The second approach is liberalization of PSROs, which changes the rules to allow greater use of non-originating materials.

Harris then briefly described the five PSRO liberalizations NAFTA has made. Not all were suitable for further analysis. Since the first liberalization only covered the chemical sector and the 2009 one overlapped with the financial crisis, which could result in outside factors swamping any visible effects of the liberalization, Harris only analyzed and demonstrated the effects of the three other liberalizations on trade flows of NAFTA partner countries. The three liberalizations occurred in 2003, 2005, and 2006, and liberalized 76, 112, and 120 subheadings, respectively. Harris then showed the figures for the intra-NAFTA bilateral trade flows—between Canada and Mexico, Canada and the United States, and Mexico and the United States—in 2004, 2006 and 2007, respectively. He found that all bilateral trade flows in these three years experienced more growth in some liberalized products than in comparable products without PSRO changes. He also noted that changes that resulted in greater access to U.S. or Canadian markets were twice as common as changes that resulted in greater access to the Mexican market. Finally, the growth rates of some liberalized products were high enough to argue that trade in those products was not economical without the liberalization of PSROs. Hence, Harris concluded that overall the NAFTA mechanism for liberalizing PSROs does work well and should be used more frequently in other FTAs.

Global Influence of the NAFTA Rules of Origin

In the second part of his presentation, Harris discussed the global influence of the NAFTA PSROs. Harris stated that looking at a sample of FTAs signed after NAFTA took effect had shown him that NAFTA PSROs have served as a template for subsequent negotiations. To further illustrate this, Harris introduced a database that he and his colleagues developed. The database, which overall has 433,409 specific rules, includes information on 85 FTAs, coded at the six-digit level. Each PSRO was compared with those in other FTAs using the following four dimensions: (1) “level of classification change,” which is the level (chapter, heading, subheading, or item) at which a PSRO imposes a tariff shift on a given item; (2) specific products excepted from the level of classification change; (3) value requirements, varying by percentage required and method of calculation; and (4) uniquely identified processing requirements.

By comparing NAFTA PSROs and the PSROs in other FTAs, Harris found that pre-NAFTA agreements, including that of the European Union (EU), follow a model of PSRO completely different from the PSROs in NAFTA. By contrast, Harris found that 36 post-NAFTA FTAs apply the NAFTA criteria for at least 50 percent of their products when only the level of classification change (dimension 1) was taken into account. When dimensions 2 and 3 are also taken into account, the number of post-NAFTA FTAs that apply the NAFTA criteria falls a bit, but there is still a remarkable similarity.

According to Harris, when looking only at Mexico's FTAs with three Central American countries, almost 80 percent of the PSROs are exactly the same as NAFTA's. Mexico's agreement with Japan, signed 11 years after NAFTA, has over 55 percent similarity with NAFTA. Looking at the PSROs found in U.S. FTAs with other countries also shows a high similarity to PSROs in NAFTA, except in U.S. FTAs with partners in the Middle East. Harris noted that the latter FTAs followed the model of the U.S.–Israel FTA, which has very simple, across-the-board rules overall. The exception is the area of textiles and apparel, where the U.S. essentially used the NAFTA model.

Harris also touched on post-NAFTA FTAs outside the Western Hemisphere, which echoed NAFTA PSROs as well. He stated that eight of these FTAs—four of which are wholly within Asia—match NAFTA PSROs' "level of classification change" dimension more than half of the time. Finally, Harris introduced the results of comparisons on a sectoral level, which showed that similarities between PSROs in different FTAs do not correlate with the sophistication of the products they cover. There are high levels of similarity in animal and vegetable oils and in footwear, as well as a fairly high level of similarity in transport equipment. On the other hand, precious metals and stones, minerals, and some other products have a low level of similarity.

Conclusions

In closing, Harris stated that NAFTA's institutional mechanisms for adapting PSROs to evolving market structures have had a small but significant positive effect on regional trade. Such mechanisms exist in most FTAs, and should be used aggressively to encourage regional trade. He also noted that NAFTA set the default "template" for PSROs of subsequent FTAs of NAFTA partners, and also heavily influenced FTAs globally. Hence, NAFTA has provided a common global language for the rules of origin.

Harris anticipated that the ongoing mega-regional negotiations (the Trans-Pacific Partnership, the Transatlantic Trade and Investment Partnership) would likely update the NAFTA template for the next two decades, and he noted that systemic effects of these negotiations with respect to PSROs should be

considered. The final point he made is that multilateral discipline on the rules of origin could be very helpful.

References

Harris, Jeremy T. 2014. "NAFTA Rules of Origin: Adaptation in North America and Emulation Abroad." Presentation for the conference "NAFTA at 20: Effects on the North American Market."
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