

CHAIRMAN



UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, D.C. 20436

September 14, 2001

The Honorable Robert B. Zoellick
United States Trade Representative
600 17th Street, NW
Washington, DC 20508

Dear Mr. Ambassador:

Thank you for your letter of July 31, 2001, requesting the Commission's advice on the probable effect of certain proposed modifications to the rules of origin contained in the North American Free Trade Agreement (NAFTA). Your request also stated that you required this information at the earliest possible date, but not later than September 14, 2001. Section 103 of the NAFTA Implementation Act requires the President to obtain advice from the Commission regarding any proposed modifications to the rules of origin contained in the NAFTA.

The Commission advice for each proposed modification is presented in attachment 1. Attachment 2 contains a list of the proposed modifications.

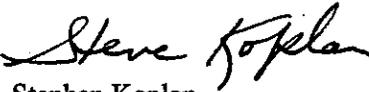
The Commission assessed each proposed modification to determine the probable effect on U.S. trade under the NAFTA and on domestic industries. In making its assessment, the Commission first compared the rules incorporating the proposed modifications with the current rules to ascertain any changes in the application of the NAFTA rules of origin. If such changes were identified, the Commission then made qualitative and quantitative determinations of the probable effect of the modifications (the methodology used by the Commission in making these assessments is explained in attachment 3).

The Commission's examination of the six proposed modifications determined that these changes are expected to have an economic effect, but these effects are limited to negligible or minor effects on total U.S. trade and on the U.S. industry producing the affected products.

In making its assessment, the Commission also considered comments from the public on the effect of the proposed modifications. Attachment 4 contains the *Federal Register* notice requesting comments and a list of organizations that were contacted directly. Seven written submissions regarding the proposed modifications were received from the public (see attachment 5 for a summary of these submissions).

As requested, a public version of the report will be made available by placing the Commission's response on the ITC Internet site. As with any advice and analysis of this type, it must be noted the advice presented in this letter should not be construed as indicating how the Commission would find in an investigation conducted under other statutory authority covering the same or similar subject matter.

Sincerely,


Stephen Koplan

Attachments: as stated

Attachment 1
USITC Probable Effects Advice on Proposed
Modifications to the NAFTA Rules of Origin

Item #	Proposed modification title	
	Probable effects on: ¹	Nature of modification and effects explanation
1	Alcoholic Beverages	
	<p>U.S. total trade: Imports: Minor increase Exports: Minor increase</p> <p>U.S. production: Minor</p>	<p><i>Modification:</i> Proposed rule affects goods classified in subheadings 2208.30 through 2208.70 only, and liberalizes origin determination by allowing these goods to have up to 10 percent by volume of alcoholic ingredients regardless of origin of such ingredients.</p> <p><i>Effects:</i> There likely will be little increase to U.S. NAFTA trade resulting from this modification. It will affect only U.S. imports of goods in subheading 2208.40 (other items are NTR duty-free), and U.S. exports to Mexico (Canada NTR duty rates are zero for all items). U.S. total imports of subheading 2208.40 goods (rum and tafia) are not likely to increase because rum and tafia producers typically do not mix alcoholic ingredients when producing these products. U.S. total exports are not likely to change more than a minor amount because Mexico is a small market for U.S. alcoholic beverages. The effect on U.S. production is likely to be minor because the effects on total trade are small.</p>
2	Petroleum/Topped Crude	
	<p>U.S. total trade: Imports: Minor increase Exports: Minor increase</p> <p>U.S. production: Minor</p>	<p><i>Modification:</i> Proposed rule allows origin for goods created as a result of enumerated processes, regardless of classification of inputs. Therefore, origin determination is liberalized. Enumerated processes applicable only to certain goods in heading 2710 and all goods in subheadings 2712-2715.</p> <p><i>Effects:</i> There will likely be little increase to U.S. NAFTA trade resulting from this modification. It will affect only U.S. imports of certain goods in heading 2710 (2711-2715 goods are NTR duty-free). U.S. exports are not likely to change more than a minor amount because Canada and Mexico account for only 10-15 percent of total U.S. exports. The effect on U.S. production is likely to be minor because the expected changes in trade are a small share of U.S. production.</p>
3	Esters of Glycerol	
	<p>U.S. total trade: Imports: Negligible Exports: Negligible</p> <p>U.S. production: Negligible</p>	<p><i>Modification:</i> Five rules (2905.11-2905.45, 2905.49.aa, 2905.49, 2905.50, and 2906.11-2907.30)² are collapsed into one rule (2905.11-2907.30). However, proposed rule changes origin criteria for goods classified in tariff item 2905.49.aa only. It liberalizes by removing restriction on certain inputs, and restricts by not allowing other inputs.</p> <p><i>Effects:</i> There will likely be no change to NAFTA trade and virtually no economic effect resulting from this modification. Production and trade of the chemicals classified in tariff item 2905.49.aa are insignificant; these chemicals are typically used in small quantities for laboratory purposes only. Industry sources indicate that there is no commercial U.S. production of these chemicals, and other than a single import from Belgium in 2000, no trade has ever been recorded.</p>

Note.—Item # refers to items in the list of proposed modifications included in Attachment 2. NTR indicates normal trade relations (formerly most-favored nation). For the purposes of the NAFTA rules of origin, the term "heading" refers to 4-digit Harmonized System (HS) categories, "subheading" refers to 6-digit categories, and "tariff item" refers to 8-digit categories. See footnotes at end of table.

Attachment 1–Continued
USITC Probable Effects Advice on Proposed
Modifications to the NAFTA Rules of Origin

Item #	Proposed modification title	
	Probable effects on: ¹	Nature of modification and effects explanation
4	Pearl Jewelry	
	U.S. total trade: Imports: Minor increase Exports: Minor increase U.S. production: Minor	<i>Modification:</i> Proposed rule liberalizes origin determination by removing restriction on certain pearl inputs for heading 7113-7118. However, only certain goods classified in 7113 and 7116 are affected as other goods do not contain pearls. <i>Effects:</i> There likely will be little increase to U.S. NAFTA trade resulting from this modification. The amount of U.S. imports from Canada and Mexico that do not receive NAFTA preferential rates is small. Based on industry contacts, the amount of U.S. exports to these countries that do not currently receive NAFTA preferential rates is also small. Because there will be little effect on NAFTA trade, the effect on U.S. production is likely to be minor.
5	Headphones with Microphones	
	U.S. total trade: Imports: Minor increase Exports: Minor increase U.S. production: Minor	<i>Modification:</i> Proposed rule would liberalize origin determination by broadening allowable inputs in heading 8518 to include inputs from subheadings 8518.10 and 8518.29, unlike existing rule which allows inputs from 8518.90 only. <i>Effects:</i> There likely will be an increase of U.S. NAFTA trade resulting from this modification, but effects on total imports will be small because NAFTA imports are a small share of total U.S. imports. The effect on total exports also will likely be minimal because U.S. NAFTA exports are a small share of total U.S. exports (most current U.S. exports are goods that have been imported into distribution centers in the United States and re-exported, according to industry sources). The effect on U.S. production is likely to be minor because the effects on total trade are small.
6	Chassis Fitted with Engines	
	U.S. total trade: Imports: Minor increase Exports: Minor increase U.S. production: Minor	<i>Modification:</i> Proposed rule would liberalize origin determination by allowing certain inputs from chapter 87, unlike existing rule which requires all inputs to be outside this chapter. <i>Effects:</i> There will likely be little increase to U.S. NAFTA trade resulting from this modification. Current U.S. imports from Canada and Mexico that do not qualify for NAFTA preferential rates are small. Although U.S. exports are substantial to NAFTA partners, most of these exports already qualify for NAFTA preferential tariff rates, according to industry contacts. Because there will be little effect on NAFTA trade, the effect on U.S. production is likely to be minor.
¹ See attachment 3 for a description of the methodology used in determining the probable effect of the modification, and for the definition of the code words used to describe the effect. ² 2905.49.aa is equivalent to U.S. tariff item 2905.49.20, Canadian tariff item 2905.49.10, and Mexican tariff item 2905.49.02.		

Attachment 2
Proposed Modifications to the NAFTA Rules of Origin

	Proposed modification title
Item #	Existing and proposed rule(s)
1	<p>Alcoholic Beverages</p> <p>Existing rule: 2203-2209: A change to headings 2203 through 2209 from any other heading outside that group, except from tariff items 2106.90.ee.¹</p> <p>Proposed rules:</p> <p>22.03-22.07: A change to heading 22.03 through 22.07 from any heading outside that group, except from tariff item 2106.90.ee or heading 22.08 through 22.09.</p> <p>2208.20: A change to subheading 2208.20 from any other heading, except from tariff item 2106.90.ee or heading 22.03 through 22.07 or 22.09.</p> <p>2208.30-2208.70: No required change in tariff classification to subheading 2208.30 through 2208.70, provided that the non-originating alcoholic ingredients constitute no more than 10 percent of the alcoholic content of the good by volume.</p> <p>2208.90: A change to subheading 2208.90 from any other heading, except from tariff item 2106.90.ee or heading 22.03 through 22.07 or 22.09.</p> <p>22.09: A change to heading 22.09 from any other heading, except from tariff item 2106.90.ee or heading 22.03 through 22.08.</p>
2	<p>Petroleum/Topped Crude</p> <p>Existing rule: 2710-2715: A change to headings 2710 through 2715 from any heading outside that group.</p> <p>Proposed rules:</p> <p>27.10: A change to heading 27.10 from any other heading, except from heading 27.11 through 27.15; or</p> <p style="padding-left: 40px;">Production of any good of heading 27.10 as the result of atmospheric distillation, vacuum distillation, hydroprocessing (hydrocracking), catalytic reforming, alkylation, catalytic cracking, thermal cracking or coking.</p> <p>27.11-27.15: A change to heading 27.11 through 27.15 from any heading outside that group.</p>

Attachment 2–Continued
Proposed Modifications to the NAFTA Rules of Origin

Item #	Proposed modification title
Item #	Existing and proposed rule(s)
3	<p>Esters of glycerol</p> <p>Existing rules:</p> <p>2905.11-2905.45: A change to subheading 2905.11 through 2905.45 from any other subheading, including another subheading within that group.</p> <p>2905.49.aa: A change to tariff item 2905.49.aa² from any other tariff item, except from heading 29.01 through 29.03; or</p> <p style="padding-left: 40px;">A change to tariff item 2905.49.aa from heading 29.01 through 29.03, whether or not there is also a change from any other tariff item, provided there is a regional value content of not less than:</p> <p style="padding-left: 80px;">(a) 60 percent where the transaction value method is used, or</p> <p style="padding-left: 80px;">(b) 50 percent where the net cost method is used.</p> <p>2905.49: A change to subheading from any other subheading.</p> <p>2905.50: A change to subheading 2905.50 from any other subheading.</p> <p>2906.11-2907.30: A change to subheading 2906.11 through 2907.30 from any other subheading, including another subheading within that group.</p> <p>Proposed rule:</p> <p>2905.11-2907.30: A change to subheading 2905.11 through 2907.30 from any other subheading, including another subheading within that group.</p>
4	<p>Pearl Jewelry</p> <p>Existing rule:</p> <p>71.13-71.18: A change to headings 71.13 through 71.18 from any heading outside that group, except from tariff items 7101.10.aa or 7101.22.aa.³</p> <p>Proposed rule:</p> <p>71.13-71.18: A change to headings 71.13 through 71.18 from any heading outside that group.</p>
5	<p>Headphones with Microphones</p> <p>Existing rule:</p> <p>A.) 8518.30.aa: A change to tariff item 8518.30.aa from any other tariff item.⁴</p> <p>B.) 8518.30: A change to subheading 8518.30 from any other heading; or</p> <p>A change to subheading 8518.30 from subheading 8518.90, whether or not there is also a change from any other heading, provided there is a regional value content of not less than:</p> <p style="padding-left: 40px;">(1) 60 percent where the transaction value method is used, or</p> <p style="padding-left: 40px;">(2) 50 percent where the net cost method is used.</p> <p>Note: The modification involves #B only; other rule listed for reference</p>

Attachment 2–Continued
Proposed Modifications to the NAFTA Rules of Origin

Item #	Proposed modification title
Item #	Existing and proposed rule(s)
5	<p>Headphones with Microphones–Continued</p> <p>Proposed rule: 8518.30: A change to subheading 8518.30 from any other heading; or</p> <p style="padding-left: 40px;">A change to subheading 8518.30 from subheading 8518.10, 8518.29 or 8518.90, whether or not there is also a change from any other heading, provided there is a regional value content of not less than:</p> <p style="padding-left: 80px;">(a) 60 percent where the transaction value method is used, or (b) 50 percent where the net cost method is used.</p>
6	<p>Chassis Fitted with Engines</p> <p>Existing rules: 87.06: 8706.00.aa: A change to tariff items 8706.00.aa⁵ from any other chapter, provided there is a regional value content of not less than 50 percent under the net cost method.</p> <p style="padding-left: 40px;">8706.00.bb: A change to tariff items 8706.00.bb⁵ from any other chapter, provided there is a regional value content of not less than 50 percent under the net cost method.</p> <p>Proposed rules: 87.06: 8706.00.aa: A change to tariff item 8706.00.aa from any other heading, except from subheading 8708.50 or 8708.60, provided there is a regional value content of not less than 50 percent under the net cost method.</p> <p style="padding-left: 40px;">8706.00.bb: A change to tariff item 8706.00.bb from any other heading, except from subheading 8708.50 or 8708.60, provided there is a regional value content of not less than 50 percent under the net cost method.</p>
<p>¹ 2106.90.ee is equivalent to U.S. tariff items 2106.90.12, 2106.90.15 and 2106.90.18, Canadian tariff item 2106.90.96, and Mexican tariff items 2106.90.10 and 2106.90.11.</p> <p>² 2905.49.aa is equivalent to U.S. tariff item 2905.49.20, Canadian tariff item 2905.49.10, and Mexican tariff item 2905.49.02.</p> <p>³ 7101.10.aa is equivalent to U.S. tariff item 7101.10.30, Canadian tariff item 7101.10.10, and Mexican tariff item 7101.10.01. 7101.22.aa is equivalent to U.S. tariff item 7101.22.30, Canadian tariff item 7101.22.10, and Mexican tariff item 7101.22.01.</p> <p>⁴ 8518.30.aa is equivalent to U.S. tariff item 8518.30.10, Canadian tariff item 8518.30.10, and Mexican tariff item 8518.30.03.</p> <p>⁵ 8706.00.aa is equivalent to U.S. tariff items 8706.00.03 and 8706.00.15; Canadian tariff item 8706.00.20, and Mexican tariff item 8706.00.02. 8706.00.bb is equivalent to U.S. tariff items 8706.00.05, 8706.00.25, and 8706.00.50; Canadian tariff items 8706.00.10 and 8706.00.90, and Mexican tariff item 8706.00.99.</p>	

Attachment 3 Probable Effect Methodology

The Commission's probable effect analysis was based on an impact assessment of whether a proposed rule modification would likely increase or decrease preferential trade flows of U.S. exports and imports in the NAFTA markets as compared with the current NAFTA rules of origin, and the resulting effect on total U.S. imports, exports, and production. The methodology consisted of two steps—first, a comparison of the rules containing the proposed modification with the current rule to ascertain if any substantive change in the application of the NAFTA rules of origin would occur for any of the products covered by the rule, and second, if such a change was identified, a determination of the economic effects of the rule modification.

For those modifications determined to have no substantive change in the application of the rules of origin, there will be no probable effect on U.S. trade. **For such cases, the effect on U.S. trade and industry was determined to be "None."** In certain other cases, a substantive change in the coverage of individual rules of origin was identified, but further analysis was not warranted because of the production patterns or inputs of the affected products in the NAFTA countries, or because production and trade of the affected products were negligible. **In these cases, the effect on U.S. trade and production was determined to be "Negligible."**

For the rule modifications with a substantive change that was greater than negligible, each was analyzed to determine if the modification would liberalize or restrict NAFTA eligibility as compared with the current rules. If a proposed modification liberalized NAFTA eligibility for the affected products (i.e., making it easier for NAFTA-origin status to be granted), the amount of NAFTA trade would be expected to increase. Conversely, if any proposed modification restricted NAFTA eligibility, the amount of NAFTA trade would be expected to decrease.

Further analysis was conducted using a partial equilibrium model to estimate the change in the NAFTA trade value for the affected products covered by the modification. This model used three variables for the affected products to estimate the change in trade value: (1) the difference in the NAFTA and non-NAFTA tariff rates; (2) an elasticity factor based on the elasticities of supply and demand; and (3) the value of preferential or non-preferential trade in the NAFTA markets.¹

Tariff rates for the year 2000 were used for each NAFTA country for variable 1. Preferential imports are eligible for the NAFTA tariff rate in each NAFTA market, which is free in most cases.² The non-NAFTA rate was assumed to be the U.S. normal trade relations (NTR) rate (formerly most-favored-nation (MFN) rate) or the MFN rate for Canada and Mexico.³

¹Preferential trade includes U.S. imports from Canada and Mexico and U.S. exports to Canada and Mexico that enter under the provisions of the NAFTA. Conversely, non-preferential trade is U.S. imports from Canada and Mexico and U.S. exports to Canada and Mexico that do not enter under the provisions of the NAFTA. U.S. import data show the amount of imports from Canada and Mexico that qualify for NAFTA preferential rates. However, U.S. export data do not have this detail, and the amount of exports receiving NAFTA preferential tariff rates was estimated by conversations with industry contacts.

²Certain Mexican NAFTA tariff rates are in the process of elimination by staged reductions, as are some U.S. and Canadian rates on Mexican goods.

³Although the non-NAFTA rate could conceivably be, in the U.S. case, the column 2 rate (which is usually much higher than the NTR rate), virtually all U.S. imports qualify for the NTR rate based on GATT membership or statute.

The values used for variables 2 and 3 were designed to estimate upper bound effects of the proposed modification in a base case analysis using present trade levels with NAFTA partners.⁴ If this analysis resulted in minor effects on the U.S. production for the affected products (i.e., a change in production of 6 percent or less), the analysis was concluded. If greater than minor effects resulted from this analysis, then the values used in base case variables 2 and 3 were examined to validate that they properly reflected industry conditions.

The effects on U.S. industry were determined by relating the expected change in NAFTA exports or imports to the amount of total U.S. imports, exports, and production by using the economic model.⁵ Increased imports would have a negative effect on the U.S. industry by lowering sales (and, therefore, U.S. production), the size of the effect dependent not only on the expected increase in imports but also the degree of substitutability between domestic and imported products. Increased exports benefit the U.S. industry by allowing it to increase sales (and, therefore, U.S. production).

In summary, the following code words and definitions were used to indicate the probable effect on the level of total U.S. trade and production (see attachment 1 for the advice for each proposed rule modification):

- None:** No effect
- Negligible:** Insignificant effect (further analysis using the economic model is not warranted).
- Minor:** Import or export changes of less than 6 percent and production change (increase or decrease) of less than 6 percent based on economic model.
- Significant:** Import or export changes of 6 percent to 15 percent and production change (increase or decrease) of 6 percent to 15 percent based on economic model.
- Substantial:** Import or export changes of more than 15 percent and production change (increase or decrease) of more than 15 percent based on economic model.

⁴For variable 3 under a liberalization situation, the base case assumed that all non-preferential trade would enter under NAFTA preferential tariff rates. In a restriction situation, the base case assumed that no trade would enter under NAFTA preferential tariff rates.

⁵Production effects are limited to the U.S. industry producing directly competitive products with the products affected by the rules of origin modification.

Attachment 4
***Federal Register* Notice and Organizations Contacted**

The Commission solicited comments on the proposed modifications by issuing a public notice which was published in the *Federal Register* (see following pages). The organizations listed below were contacted directly and informed of the opportunity to submit written comments. The Commission also received numerous requests from interested parties for technical information regarding the proposed modifications.

Organizations contacted

American Chemical Council

American Petroleum Institute

Distilled Spirits Council of the United States (DISCUS)

Exxon/Mobil Corp.

Ford Motor Co.

General Motors

Soap & Detergent Association (part of the Glycerine Producers Association)

Independent Petroleum Association of America

Jewelers of America

Manufacturing Jewelers & Suppliers of America, Inc.

National Petroleum Refiners Association

Plantronics Inc.

Shell Oil Co.

UNITED STATES INTERNATIONAL TRADE COMMISSION

PROBABLE EFFECT OF CERTAIN
MODIFICATIONS TO THE NORTH AMERICAN FREE TRADE AGREEMENT
RULES OF ORIGIN

AGENCY: United States International Trade Commission

ACTION: Request for written submissions

EFFECTIVE DATE: August 2, 2001

SUMMARY: The Commission received a request from the United States Trade Representative (USTR) on August 1, 2001, to provide advice on the probable effect on U.S. trade under the North American Free Trade Agreement (NAFTA) and on domestic industries on certain modifications to the rules of origin in NAFTA Annex 401.

FOR FURTHER INFORMATION: Information may be obtained from David Lundy, Office of Industries (202-205-3439, or lundy@usitc.gov); and on legal aspects, from William Gearhart, Office of the General Counsel (202-205-3091). The media should contact Margaret O'Laughlin, Office of Public Affairs (202-205-1819). Hearing impaired individuals are advised that information on this matter can be obtained by contacting the TDD terminal (202-205-1810). General information concerning the Commission may also be obtained by accessing its Internet server <http://www.usitc.gov>. The public record for this investigation may be viewed on the Commission's electronic docket (EDIS-ON-LINE) at <http://dockets.usitc.gov/eol/public>.

BACKGROUND: According to the USTR's letter, U.S. negotiators have recently reached agreement in principle with representatives of the governments of Canada and Mexico on proposed modifications to Annex 401 of the NAFTA. Chapter 4 and Annexes 401 and 403 of the NAFTA contain the rules of origin for application of the tariff provisions of the NAFTA to trade in goods. Section 202(q) of the North American Free Trade Agreement Implementation Act (the Act) authorizes the President, subject to the consultation and layover requirements of section 103 of the Act, to proclaim such modifications to the rules as may from time to time be agreed to by the NAFTA countries. One of the requirements set out in section 103 of the Act is that the President obtain advice from the United States International Trade Commission.

The USTR requested that the Commission provide advice on the probable effect on U.S. trade under NAFTA and domestic industries as a result of five groups of proposed modifications to Annex 401. A list of the proposed modifications is available from the Office of the Secretary to the Commission or by accessing the electronic version of this notice at the Commission's Internet site <http://www.usitc.gov>. The current U.S. rules of origin can be found in general note 12 of the 2001 U.S. Harmonized Tariff Schedule (see "General Notes" link at <http://dataweb.usitc.gov/scripts/tariff/toc.html>).

As requested, the Commission will forward its confidential advice to the USTR by September 14, 2001.

WRITTEN SUBMISSIONS: No public hearing is being scheduled in connection with preparing this advice. However, interested parties are invited to submit written statements (original and 14 copies) concerning any economic effects of the modifications. Commercial or financial information that a submitter desires the Commission to treat as confidential must be submitted on separate sheets of paper, each clearly marked "Confidential Business Information" at the top. All submissions requesting confidential treatment

must conform with the requirements of section ° 201.6 of the Commission's Rules of Practice and Procedure (19 C.F.R. 201.6). All written submissions, except for confidential business information, will be made available in the Office of the Secretary to the Commission for inspection by interested parties. To be ensured of consideration by the Commission, written statements relating to the Commission's report should be submitted to the Commission at the earliest practical date and must be received no later than the close of business on August 30, 2001. All submissions should be addressed to the Secretary, United States International Trade Commission, 500 E Street SW, Washington, DC 20436.

Persons with mobility impairments who will need special assistance in gaining access to the Commission should contact the Office of the Secretary at 202-205-2000.

By order of the Commission.

Donna R. Koehnke

Secretary

Issued: August 2, 2001

Attachment 5

Positions of Interested Parties

The Commission received written comments regarding the proposed modifications from seven parties. These comments are summarized below.

American Petroleum Institute (Petroleum/Topped Crude)

The American Petroleum Institute (API), which represents 400 companies involved in the oil and gas industry, supports the proposed change to Chapter 4 of Annexes 401 and 403 of the NAFTA rules of origin. According to API, the proposed change will significantly simplify the process of determining NAFTA eligibility for products that are clearly manufactured within the NAFTA region. API believes that domestic refiners will benefit from these changes, and the rule will increase trade among NAFTA parties.

The proposed rule change recognizes that substantial processing within the NAFTA region should be sufficient to confer NAFTA origin. Each of the processes named in the rule change is complex, capital intensive, and produces new articles of commerce that differ from the starting feedstock. According to API, using this same criteria, two other processes could be included in the list of those that confer origin, that of hydrodesulfurization and isomerization. API encourages that these two processes be considered by NAFTA parties for future changes.

Chevron USA, Inc. (Petroleum/Topped Crude)

Chevron, a major U.S. refiner and marketer of petroleum products, supports the proposed change to Chapter 4 of Annexes 401 and 403 of the NAFTA rules of origin. Chevron indicates that the current NAFTA Annex 401 rule of origin is commercially unrealistic, in that it allows de minimis quantities of non-NAFTA refined or partially refined feedstocks to disqualify NAFTA-originating status for refinery products that are produced in the NAFTA territory. To prevent complete loss of NAFTA-originating status, NAFTA territory refiners and manufacturers implement complex inventory management methods.

According to Chevron, this complex, costly, and time-consuming accounting procedures will be eliminated by the NAFTA rule of origin changes. The proposed rule of origin is commercially realistic, acknowledges the economic realities of refinery operations, and is more administrable by both manufacturers and Customs. Under the new rule, even where non-NAFTA feedstocks are introduced they will undergo substantial processing which results in the creation of new and different articles of commerce. The origin-conferring operations discussed in the rule are substantial operations which will not, and cannot, be performed without substantial economic justification. Furthermore, the origin-conferring operations require substantial capital investments in NAFTA country refining facilities, ensuring that "pass-through" operations are not established for the purpose of securing NAFTA benefits for non-NAFTA goods. According to Chevron, the adoption of this rule will allow U.S. producers of refined petroleum products to take full advantage of the benefits of NAFTA.

Crompton Corp. (Petroleum/Topped Crude)

Crompton Corp.,¹ supports and recommends adoption of the proposal to amend the NAFTA Annex 401 Preference Rule of Origin for refined petroleum products and topped crudes. According to Crompton, the current rule is highly restrictive as it allows even *de minimis* quantities of non-NAFTA refined or partly refined feedstocks to disqualify refined petroleum products from NAFTA “originating” status. According to Crompton, in order to qualify for NAFTA-originating status for refined petroleum products produced in the NAFTA territory, domestic producers are required to implement and administer complex inventory management methods, which are cumbersome, time-consuming, and costly.

The proposed new rule is considered by Crompton to be more commercially realistic and administrable and takes into account the economic realities of refinery operations. The proposed new rule provides definitions for the various refinery operations, such as atmospheric distillation, vacuum distillation, catalytic hydroprocessing, catalytic cracking, reforming, alkylation, thermal cracking, coking, and so forth. According to Crompton, the new rule will confer upon NAFTA territory refiners the competitive advantage that the NAFTA intended; the refining operations covered by the rule are all substantial operations that will not be performed without substantial economic justification. The origin-conferring operations, according to Crompton, require substantial capital investments in NAFTA country refining facilities, ensuring that “pass through” operations are not established for the purpose of securing NAFTA benefits for non-NAFTA goods.

ExxonMobil Refining and Supply Company (Petroleum/Topped Crude)

ExxonMobil Refining and Supply Co., supports and recommends adoption of the proposal to amend the NAFTA Annex 401 Preference Rule of Origin for refined petroleum products and topped crudes. ExxonMobil stated that the proposed changes will simplify the process of determining NAFTA eligibility for products that are manufactured within the NAFTA region. The proposed changes relating to petroleum and topped crude will benefit domestic refiners because it simplifies the NAFTA origin rule and it will result in increased trade among NAFTA partners.

In addition, ExxonMobil proposes the inclusion of hydrosulfurization and isomerization on the list of processes that confer origin. These processes are the same nature as those already included in the proposed rule.

Freightliner LLC (Chassis Fitted with Engines)

Freightliner, the largest heavy-duty truck manufacturer in North America, supports the modification to the NAFTA rule of origin for HTS heading 8706. According to Freightliner, the current rule creates a costly and time consuming administrative burden on U.S. chassis manufacturers by requiring a change from outside chapter 87 for any non-NAFTA certified components. As a large portion of chassis components are classified in heading 8708, the current rule requires U.S. chassis manufacturers to obtain

¹Crompton Corp., formed by the merger of Crompton & Knowles and Witco, produces specialty chemicals and equipment used in products from tires to textiles and paper to auto parts. It makes rubber chemicals and polymers, seed-treatment and crop-protection chemicals, additives for plastic and petroleum products, organosilicones used in fiberglass, and petroleum additives.

NAFTA Certificates of Origin for virtually all components, even those of low value, in order to meet the 7 percent de minimis exception. This creates a corresponding burden on U.S. suppliers of those components, as they must provide documentation to chassis manufacturers.

According to Freightliner, the proposed modification will continue to provide adequate protection of North American manufacturers, with the benefit of alleviating the administrative burden of complying with the rules of origin. As the proposed modification retains the regional value content and requires that drive axles (8708.50) and non-driving axles (8708.60) be of certified North American content, this ensures that chassis manufacturers continue to source the majority of their components from North American suppliers, as well as affords a special level of protection to North American axle manufacturers.

Plantronics, Inc. (Headphones with Microphones)

Plantronics, Inc. commends the proposed modification to the NAFTA rules of origin for HS subheading 8518.30 (headphones and microphones). Their submission states that the proposed modification will generate cost savings that will benefit both their company and their customers (most of whom are located in the United States). Under current NAFTA rules of origin, most headsets manufactured by Plantronics in Mexico are not eligible for NAFTA preferential tariff rates.

Plantronics is the only headset company with major manufacturing facilities in North America. Its main manufacturing plant is in Tijuana, Mexico with some assembly operations done in Santa Cruz, California. Plantronics has 508 employees in the United States, 1,494 in Mexico, and 173 in other countries. The company faces considerable competition from domestic and foreign companies that source their product from the Far East. All of Plantronics headsets manufactured in Mexico are imported into the United States, including those destined for other foreign markets, to take advantage of major U.S. airports. As such, import duties are paid by the company, unless it is an in-bond shipment. When they are exported to a foreign destination customs duties on these imports are claimed back via a process called duty drawback. The duty drawback procedure is onerous and requires the company to pay the customs duty and then reclaim the duty months later after detailed documents are filed. These documents must then be maintained for several years in order to support the claim.

Headsets are classified under HS subheading 8518.30 and incorporate speakers and microphones classified under HS subheadings 8518.10 and HS 8518.29, respectively. The speakers and microphones used by Plantronics are imported from Asia and account for between 8 and 23 percent of the total cost of the finished product, thereby exceeding the cost share required by NAFTA for de minimis status. The proposed NAFTA rules of origin modification would allow many of the Plantronics headsets to qualify for duty free-status under NAFTA because they already meet the regional content test of 50 percent.

The effective duty rate for headsets manufactured in Mexico and imported into the United States is lower than the 4.9 percent statutory rate because Plantronics headsets have a high percentage of U.S. content which is not included in imported value and some headsets are already NAFTA-qualified. Plantronics estimates that the proposed modification would save their company \$723,333 annually in custom's duties assuming that 85 percent of their Mexican manufactured headsets receive duty-free status under NAFTA.

Vitol SA, Inc. (Petroleum/Topped Crude)

Vitol SA, Inc. supports the proposed modifications of the NAFTA Annex 401 Preference Rule of Origin for refined petroleum products and topped crudes. According to Vitol, the current NAFTA rule does not reflect the realities of the feedstocks used in the refining process. The current rule recognizes only the refining of virgin crude oil beginning with atmospheric distillation to produced gasoline, and the other refined products classified in HTS 2710; yet, refineries use many other materials that are substantially transformed in complex refining operations subsequent to distillation, such as topped crude and naphtha. The proposed rule corrects the problems in the current rule.

Vitol stated that the proposed rule will bring economic benefits to direct and downstream U.S. consumers of refined petroleum products. The new rule will also benefit trade within the NAFTA region and create more jobs.