NAFTA

AND

THE URBAN TRANSIT AND RAIL SECTOR

ACCESS NORTH AMERICA
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Canada

NAFTA AND THE URBAN TRANSIT AND RAIL SECTOR

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NAFTA AND THE CANADIAN URBAN TRANSIT AND RAIL SECTOR

The North American Free Trade Agreement (NAFTA) came into effect January 1, 1994. The overall objective of this Agreement is to promote employment and economic growth by expanding trade and investment opportunities in the North American free trade area and by enhancing the competitiveness of Canadian, Mexican and U.S. companies in global markets.

NAFTA provides Canadian manufacturers of urban transit and rail equipment with continued preferential access to U.S. markets and new preferential access to Mexico. Mexico is undertaking major initiatives to modernize its transportation infrastructure, which will include some privatization of previously state-run operations. These initiatives may present new opportunities for aggressive Canadian manufacturers.

To make the most of these opportunities, you should first understand how the Agreement affects you and your business operations. Second, you should assess your strategic business plans and determine whether and how your production and marketing practices might need to be altered as a result of NAFTA.

This booklet highlights key aspects of the Agreement for the Canadian urban transit and rail sector including manufacturers of urban buses, intercity coaches, transit rail cars and related systems, freight cars and locomotives. It provides product-specific information on tariff rates, tariff phase-outs and rules of origin, and it describes other provisions of the Agreement relevant to manufacturers and distributors of this equipment. It also provides an overview of the North American urban transit and rail equipment market and highlights potential new market opportunities in Mexico.

Tariffs for Urban Transit and Rail Equipment

Under NAFTA, tariffs on urban transit and rail products being traded between Canada, Mexico and the United States will be eliminated under the various tariff reduction phase-out categories established under the Agreement. Some tariffs were eliminated immediately on implementation of the Agreement on January 1, 1994, while other tariffs will be reduced over five or ten years being completely eliminated by January 1, 1998 or by January 1, 2003.

Canada-United States Tariffs

Trade between the United States and Canada will continue to be governed by the tariff phase-outs negotiated under the provisions of the Canada-United States Free Trade Agreement (FTA). These phase-out schedules are unaffected by NAFTA. Under the FTA, tariffs for all urban transit and rail products have already been reduced by at least 60 percent and all tariffs will be eliminated by January 1, 1998.

Schedule of Phase-Outs

Annex A contains a product-specific listing of the Mexican and Canadian tariff elimination schedules for most urban transit and rail products. The applicable tariff phase-out stages for other products and inputs are listed in the country-specific NAFTA tariff schedules.

A review of the Canadian and Mexican tariff phase-outs for your products will assist you in assessing the potential impact of NAFTA on your company.

Mexican Phase-Outs

Mexican import tariffs on urban transit and rail products ranged between 10 and 20 percent prior to NAFTA. Over half of these were eliminated immediately on implementation of the Agreement on January 1, 1994. Included was the removal of tariffs on such items as:

- diesel engines;
- rail locomotives and self-propelled railway cars and their parts;
- most railway freight cars and their parts;
- signalling equipment and parts;
- most axles and wheels and their parts; and
- coupling devices and parts.

The majority of remaining Mexican import tariffs will be eliminated in 10 annual reductions ending January 1, 2003.

This includes the tariffs on railway passenger and special purpose coaches, some self-discharging rail cars, air brakes and their parts, iron or steel rails and cross-ties, cargo containers, and buses with a capacity for more than nine persons.

Canadian Phase-Outs

As of January 1, 1994, Canada eliminated tariffs on qualifying Mexican products such as rail or tramway construction iron or steel materials; locomotives; some axles, wheels and parts; and most railway rolling stock parts.

Canada negotiated five-year tariff phase-outs on a few items such as some AC generators; locomotive parts; and some axles and wheels. A 10-year tariff elimination staging will be applied to passenger and special purpose rail coaches, air brakes, cargo containers and buses. The 10-year tariff phase-outs negotiated under NAFTA on some bogies may be superseded by the tariff eliminations that are part of Canada's commitments to the recently concluded Uruguay Round negotiations of the General Agreement on Tariffs and Trade (GATT).

Treatment of Jointly Produced Goods

NAFTA protects Canadian urban transit and rail companies from inappropriate reductions in Canadian tariffs applied to goods jointly produced in the United States and Mexico. Such goods will generally face higher rates of duty when entering Canada than goods that are wholly produced in Mexico. The applicable base tariff rates for jointly produced goods are shown in brackets in Annex A.

Accelerated Duty Elimination

As with the FTA, there is an acceleration clause in NAFTA. Tariffs for urban transit and rail products may be phased out faster than originally negotiated if the three countries agree to such action. If only two countries agree, acceleration takes place only between those two.

Rules of Origin for Urban Transit and Rail Equipment

NAFTA provides preferential tariff treatment for all "originating" North American goods traded between Canada, the United States and Mexico. Rules of origin are used to determine whether a product qualifies as a good originating in North America. These rules ensure that NAFTA benefits are only available for goods substantively produced or transformed in North America.

Any goods produced in any or all of the three NAFTA countries, with components and materials that themselves are wholly sourced or manufactured in any of the three countries, qualify as originating goods entitled to preferential tariff treatment.

Goods using non-North American inputs must meet the requirements set out in the NAFTA rules of origin to be considered as "originating."

The NAFTA rules of origin for urban transit and rail equipment set out the following requirements:

- Each non-North American input must undergo sufficient transformation during production in one or more of the NAFTA countries to result in a specified change of tariff classification.
- When certain parts of non-North American origin are used in the production of a good, the manufacturer may be required to meet a value content test.

The specific rule of origin for each product sets out the required tariff classification change and indicates when a value-content test is required. The product-specific rules of origin applicable to most urban transit and rail equipment are found in Annex B.

How NAFTA Rules Differ from the FTA Rules

The NAFTA rules of origin build on the rules that were developed for the FTA. Canadian exporters will find the NAFTA rules clearer, more predictable and more flexible. The format for these rules is more detailed and user-friendly.

NAFTA introduces a few changes in the product-specific rules of origin for urban transit and railway equipment. The changes only pertain to certain parts for transit and railway equipment.

In addition, NAFTA has introduced new provisions of general application that may assist some Canadian exporters. Notable changes include:

- **Easier, more flexible methods to calculate regional value content.** Regional value content for most goods may now be calculated by means of either a "net-cost" method or a new "transaction-value" method. In addition to providing producers with greater flexibility, this corrects the ambiguities experienced with the regional value content formula under the FTA. Producers who choose to use the "transaction-value" method will be able to avoid the need to maintain the cost-accounting systems required under the FTA and the "net-cost" method. The methods of calculating regional value content are described in Annex C.
- **The introduction of a *de minimis* rule.** Under NAFTA, a good is determined to originate in North America if the value of non-North American materials that fail to meet the specific rule of origin is no more than 7 percent of the transaction value or total cost of the good. This provision will be of particular interest to exporters whose products incorporate limited amounts of non-North American inputs. It can enable goods that otherwise might not qualify to qualify, or it can eliminate the imposition of the value content requirement for such goods.

Producers of goods subject to a regional value content requirement should carefully examine the new NAFTA methods of calculation. This is particularly important for firms that either barely met or that failed to meet the FTA requirements.

How to Use the Rules of Origin

If you export to the United States or Mexico, you should verify that your products qualify for NAFTA tariff preference. The following steps should assist your review.

- **Step 1.** If your good is manufactured in Canada using inputs wholly sourced or manufactured in North America it qualifies as "originating" and is entitled to preferential tariff treatment when exported to the United States or Mexico.

  Exporters should be careful when determining whether their inputs are North American. Inputs purchased from North American suppliers are not necessarily North American, as they may have been produced or imported from non-North American sources.

- **Step 2.** If your good uses non-North American inputs, you must identify the tariff classification for the good and for any non-North American inputs. Should you have difficulties determining the tariff classification, contact the appropriate customs agencies identified in this booklet.

- **Step 3.** Look up the specific rule of origin for your product in Annex B or in the NAFTA text. As the rules will make mention of tariff chapters, headings, subheadings and items, some understanding of the classification system is necessary. A tariff item has eight digits. The first two digits identify its chapter, the first four digits the heading and the first six digits the subheading of the good.

- **Step 4.** In most cases, a rule will indicate what changes in tariff classification must occur between each of the non-North American inputs and the finished good. It will read something like "a change to heading (XXXX) from any other heading, except heading (YYYY)." The first number refers to the good, the second number to excluded inputs. As long as all non-North American inputs come from permitted headings or subheadings, the good qualifies.

- **Step 5.** Usually, if the rule precludes the use of certain non-North American inputs, there will be an alternative rule permitting such changes if a value content test is met. It will read something like "a change to heading (XXXX) from heading (YYYY) provided there is a regional value content of not less than..." In these cases a producer must calculate the regional value content in accordance with one of the two methods specified in NAFTA. Annex C describes the two methods of calculating regional value content. Producers should note that the rules of origin for certain urban transit equipment (e.g. buses) classified in Chapter 87, provide for only the "net-cost" method of calculating regional value content.

An Example

A Canadian producer of self-propelled railway coaches uses imported diesel engines from Germany and coach shells from France.

Since some non-North American inputs are used, these railway coaches do not automatically qualify as "originating." The product-specific rule must be used.

The producer determines that self-propelled railway coaches are classified under tariff heading 8603. The non-North American parts fall under headings 8408 and 8607, respectively.

The rule of origin for heading 8603 (i.e. railway coaches) requires "a change to heading 8601 through 8606 from any other heading, except from heading 8607." In this example, the railway coaches in question would not qualify under this part of the rule because the coach shells are classified under heading 8607.

The second part of the rule of origin for railway coaches permits "a change to heading 8601 through 8606 from heading 8607 ... provided there is a regional value-content of not less than 60 percent where the transaction-value method is used, or 50 percent where the net-cost method is used." In this example, if the value of the North American content exceeds either of these figures, the railway coaches would qualify.

Additional Information

More detailed information on the NAFTA rules of origin is contained in the following publications:

Guide to Rules of Origin and Customs Procedures for Canadian Exporters to the U.S. Market, available through InfoEx at 1-800-267-8376;

Trilateral Customs Guide to NAFTA, and *NAFTA Rules of Origin — A Step by Step Guide*, available from Revenue Canada, Customs Infoline (613) 941-0965 Fax: (613) 941-8138.

While all firms exporting to the United States or Mexico should obtain copies of these publications, they will be particularly useful for firms whose products are subject to a value content requirement.

NAFTA CUSTOMS MATTERS

Classification and Origin Determination

The tariff classification and origin status of your products should be determined before you start exporting.

- Advisory classifications and origin determinations may be obtained from your customs broker or from one of the three customs agencies listed at the end of this publication.
- Written, binding rulings on classification, origin status and marking requirements may now be obtained in advance from Canadian, U.S. and Mexican customs headquarters.

Rulings must be obtained from the country into which you are shipping your goods. Contacts for these are listed at the end of this publication.

Customs Administration

From experience gained in the Canada-United States Free Trade Agreement, governments learned the importance of precisely describing and agreeing upon various customs administration procedures.

NAFTA contains a number of provisions that address some of the difficulties experienced by governments, importers and exporters. These include the following:

- uniform regulations to ensure consistent interpretation, application and administration of the rules of origin, and other customs administration matters;
- common record keeping requirements, a uniform Certificate of Origin, and standardized certification requirements;
- broader rights of appeal of determinations of origin and advance rulings to allow appeals by both the exporter and importer within the NAFTA area; and
- the creation and regular meetings of trilateral working groups to address future modification of the rules of origin, marking obligations and uniform customs regulations, and to review controversial customs issues.

Country of Origin Marking Requirements

The United States and Mexico both require that imports be marked to indicate to the purchaser the country of origin. Goods incorrectly marked can be held at the border. To provide greater clarity and certainty to exporters, NAFTA provides for uniform standards on how goods are to be marked.

Method of Marking

The country of origin of a good must be marked legibly and conspicuously and must be placed where it can be easily seen during normal handling.

Marking must be sufficiently permanent to remain in place unless deliberately removed. Acceptable marking methods include stampings, mouldings, stickers, labels, tags and paint.

Imports do not have to be marked with their country of origin when:

- the cost of marking would discourage importation;
- marking would materially impair the function of the good;
- marking would substantially detract from its appearance;
- the good is a crude substance; or
- the importer will substantively transform the good.

Country of Origin

NAFTA provides for very precise and detailed rules on how the country of origin of a good is to be determined. However, almost all goods manufactured in Canada that qualify for NAFTA tariff preference can be marked as originating in Canada.

Firms that only do minor processing, simple assembly or blending of imported inputs or those whose goods do not meet the NAFTA rule of origin should carefully check the marking rules of the country into which they are exporting. Their product may be able to be marked as a product of Canada, but in some cases it must be marked as a product of the country from which the inputs originate.

If there is doubt as to how to correctly mark a product, exporters can request an advance ruling from the importing country. A listing of the customs agencies is included in the contacts section of this publication.

What Else You Should Know

While the following provisions of the Agreement may not be specific to the urban transit and rail industry, they nonetheless affect the overall North American trading environment and are of interest to companies participating in it.

Temporary Entry for Business Purposes

Canadian manufacturers of urban transit and rail equipment will be able to use NAFTA temporary entry provisions to facilitate travel necessary to promote the sales of goods in the United States and Mexico. Such "business visitors" require proof that they are citizens of one of the NAFTA countries, and a letter from their employer indicating the nature of their visit, their principal place of employment and the actual place of accrual of profits.

Sales representatives may bring commercial samples, advertising materials and equipment necessary to carry out the business activity without having to pay duty on those goods.

After-sales service providers are also classified as business visitors under NAFTA. Therefore, Canadian firms can now provide service and training as part of a warranty or a service contract. Such service providers may obtain duty-free, temporary entry status for the equipment necessary to do the job.

Temporary entry is also available for other business travellers such as traders and investors, intra-company transferees and professionals.

If you expect to use any of the temporary entry provisions, you should check with the relevant immigration or customs authorities for information on any documentation requirements.

Duty Drawback

Duty drawback is the refund of customs duties levied on materials and components imported from other countries when they are incorporated into goods that are subsequently exported.

For Canada-United States trade, the FTA prescribed that all duty drawback programs were to be eliminated by January 1, 1994. NAFTA extends this deadline by two years. These programs can now be used until January 1, 1996. For trade with Mexico, existing drawback programs can be used until January 1, 2001.

After these dates, each country will still be able to adopt a partial duty-refund procedure for those goods that do not benefit from the preferential NAFTA tariff. This will avoid the payment of duties in two countries. The amount of duties waived or refunded under such programs cannot exceed the duties charged for the imported inputs or the duties charged on the finished good, whichever is less.

Safeguard Mechanism

As under the FTA, NAFTA establishes rules and procedures under which a country may take special "safeguard" actions to provide temporary relief to industries adversely affected by surges in volumes of imports.

If increased imports injure or threaten to seriously injure Canadian industry, Canada can suspend further tariff concessions or even "snap-back" the tariff to the pre-NAFTA rates of duty.

To maintain liberalized trade and avoid abuse, any country choosing to take a safeguard action must pay compensation, usually in the form of reduced duties for other goods being imported. The cost of taking safeguard actions can be considerable, and this remedy must be pursued with caution.

Dispute Settlement

NAFTA strengthens the dispute settlement mechanism negotiated under the FTA. There are three steps in the NAFTA provisions:

- **A consultative process.** When a country believes that its NAFTA access rights have been impaired, it can ask for consultations with the allegedly offending country. The other NAFTA country can also participate if it wishes.
- **An arbitration process.** If agreement is not reached through consultations, a meeting of the NAFTA Trade Commission may be called to discuss how the disagreement may be settled amicably. The commission is composed of cabinet level representatives designated by each country.
- **A "panel process."** If agreement cannot be reached through arbitration by the NAFTA Trade Commission, a NAFTA panel can be convened. The panel process would determine whether any trade action taken by a NAFTA country is consistent with the NAFTA provisions. Dispute resolution must occur within strict time limits and countries must comply with panel recommendations or offer acceptable compensation.

Procurement

Under NAFTA there are greater opportunities for Canadian firms to sell to the Mexican and U.S. governments. Whereas FTA procurement disciplines applied only to goods purchased by some government departments, NAFTA expands the scope of obligations to include services and construction, lowers the thresholds for competitive bidding, expands coverage to include more U.S. departments and agencies, and includes Mexican government purchases.

Unfortunately, Canada was unable to negotiate an extension of procurement obligations to include indirect procurements funded by the U.S. federal government in the area of transportation-related construction and urban mass transit. In addition, NAFTA does not place obligations on state and local governments nor does it eliminate the legislated preferences that the United States extends to its small and minority businesses.

NAFTA, however, does contain a specific provision that calls for renewed trilateral procurement negotiations within five years of the coming into force of the Agreement. It specifies that the Parties are to seek to expand the coverage of the existing procurement chapter to include other government enterprises and procurement that would otherwise be subject to legislated or administrative exceptions. This could include the "Buy America" provisions affecting the urban transit and rail equipment sector.

Standards

NAFTA includes provisions to help prevent standards from becoming trade barriers. NAFTA promotes the use of compatible standards, technical regulations and conformity-assessment procedures. In time, this provision will reduce the burden of compliance with different standards for different countries.

To reduce exporters' costs, NAFTA encourages mutual acceptance of test results and certification procedures. Approved facilities will eventually be able to certify that a product meets the standards of all three countries. The Canadian Standards Association is now able to certify that certain products meet the more than 360 U.S. health and safety standards. Underwriters' Laboratories of Illinois has been granted approval to certify that products comply with Canadian standards.

NAFTA requires that the three countries seek to ensure that provincial, state and local governments, as well as non-government standard-setting bodies, comply with the provisions described. This clause was negotiated to help Canadian manufacturers who presently face a myriad of U.S. state regulations.

Notwithstanding these improvements, Canadian firms exporting to Mexico or the United States must still ensure that products meet the safety regulations, labelling requirements and other technical standards of the country into which they are being exported.

Intellectual Property Rights

Canadian producers rely on patent and trademark protection to safeguard innovative products, special manufacturing processes and internationally known names. NAFTA provides extensive protection for patents, trademarks and trade secrets. It is the first trade agreement to offer protection for trade secrets, which can include formulas, customer lists and production processes.

The Agreement also contains extensive provisions on intellectual property enforcement, including civil and administrative procedures, provisional remedies, criminal penalties and border enforcement mechanisms.

Further information may be obtained on intellectual property matters by calling the Intellectual Property Directorate, Industry Canada at (819) 997-1936.

Other NAFTA Provisions

The Agreement contains provisions on a variety of other issues including investment, the environment, competition policy, cultural industries and cross-border trade.

To obtain additional information on these and other provisions of NAFTA, consult the publications listed at the end of this booklet.

The Canadian Industry in a North American Context

Canadian Market

Canadian firms manufacture a full range of rolling stock, including urban buses, intercity coaches, intercity and transit rail cars and related systems, freight cars, and locomotives. Virtually all urban transit and rail systems and vehicles sold in the Canadian market are assembled in Canada, though most major components are imported, mainly from the United States. Canadian suppliers also manufacture components for this industry. They supply a wide variety of related products and services in addition to rolling stock.

The number of people employed in the manufacture of transit vehicles and related parts and supplies is roughly 10,000. This excludes after-market components and products, which cannot always be identified by sector, and consulting services, which are also substantial contributors to sales and employment.

Canada-United States Trade

Over 70 percent of Canadian production is exported, mainly to the United States. Under the Canada-United States Free Trade Agreement (FTA), tariffs have been eliminated on most urban transit and rail equipment, the exception being freight cars, on which tariffs will continue to be phased down until their eventual removal in 1998.

NAFTA confirms existing Canadian access to the United States market. Non-tariff measures such as "Buy America" requirements continue to affect this sector by restricting market access and discouraging investment or expansion in Canada.

Opportunities for freight rail equipment in the U.S. market will improve with full implementation of FTA tariff cuts. Canadian firms are expected to continue to play a major role in both the new freight car and locomotive rebuild markets. Freight car production should see some upturn as railways renew ageing equipment and acquire specialized new designs, such as those for intermodal use.

Canada-Mexico Trade

In contrast to the substantial Canada-United States trade flows in this sector, Canada-Mexico trade to date has been minimal. Limited sales of locomotive and freight cars, including some used equipment, have been made to Mexican railways. Canada-based multinational Bombardier has recently purchased the Mexican rail car manufacturer Concarril, and has secured major refurbishing and new transit system contracts from this Mexican base. AMF Technotransport has been successful in securing contracts to remanufacture traction motors for the Mexican railroads.

Mexican bus manufacturer Dina has recently announced its intention to purchase Motor Coach Industries (MCI), a manufacturer of intercity coaches with plants in both Canada and the United States. No immediate impact is anticipated on existing MCI plants in Winnipeg and North Dakota, which manufacture for the U.S. and Canadian markets, but the transfer of Canadian and U.S. technology to Dina's Mexican facilities appears possible.

United States-Mexico Trade

In the freight rail sector, the proximity of Mexico has led to strong exports from the United States of rail equipment and systems expertise. Major railroads in the United States have formed linkages with the Mexican railroads and are participating in refurbishing the Mexican system to prepare for the anticipated opportunities expected to result from NAFTA.

There has been no significant penetration of the U.S. transit equipment market by Mexico-based manufacturers. In addition to facing U.S. non-tariff barriers, Mexico has produced products that have not found favour with U.S. transit systems.

Competitive Implications

Little immediate impact is anticipated for Canadian urban transit and rail equipment manufacturers as a result of NAFTA. Despite the apparent labour cost advantage enjoyed by Mexican producers, lower productivity and a lack of up-to-date product technology are expected to curtail Mexican opportunities to penetrate the U.S. and Canadian markets. There is no Mexican manufacturer of railway locomotives.

New Mexican Market Opportunities

As Canada-Mexico trade in this sector has to date been limited, the lack of knowledge of potential opportunities for Canadian firms in the Mexican market needs early attention. In an effort to maximize opportunities created by the implementation of NAFTA, Industry Canada and Foreign Affairs and International Trade Canada are cooperating:

1) to distribute written material in Spanish that describes Canadian urban transit and rail sector capabilities;
2) to carry out market surveys and disseminate the results, describing opportunities in Mexico for Canadian transportation products and services, and the types of commercial arrangements most likely to be successful in exploiting these opportunities; and
3) to support initiatives to educate prospective Canadian exporters.

Mexico is undertaking major initiatives to modernize its transportation infrastructure; this will include privatization of some of the elements of the previously state-run operation. For example, long-term concessions being awarded for the operation of locomotive and railcar maintenance facilities may present opportunities for Canadian companies.

You may obtain information on planned trade fairs or missions and on the Mexican market by contacting InfoEx or the Industry Canada contacts listed at the end of this publication.

TAKING ADVANTAGE OF NAFTA OPPORTUNITIES

Individual companies need to look at the facts to clearly determine how North American trade liberalization will affect their business. Prudent company directors will formulate a business plan to ensure that the business continues to grow while the opportunities provided by NAFTA are taken advantage of.

In assessing the impacts of the Agreement for your business, you should ask yourself the following questions:

- What effect will NAFTA tariff reductions have on my business?
- How might the changes to the rules of origin affect my products?
- Do the extended duty drawback provisions, and the improved standards, safeguards and investment provisions affect my business?
- How will NAFTA affect my customers, suppliers, and competitors?

You will want to assess how to adapt your business to the new environment under NAFTA. Some questions to be considered include:

- Which U.S. and Mexican markets have the best growth potential for my products?
- What are the best transportation, distribution and servicing arrangements for the new markets?
- Which of my products will face tougher competition domestically?
- Do I need to change my product line to take advantage of the NAFTA opportunities?
- Can new technologies or production processes reduce my costs?
- Can I take better advantage of NAFTA tariff preferences by using more North American inputs?
- What effect will expanding my market have on my cash flow, profit and loss account, and balance sheet?
- Are my human resource needs going to change?

Answering these questions will provide a good start on the type of information that you need to develop and implement a strategic plan of action in response to NAFTA's competitive environment. A full strategic plan is necessary for companies to compete successfully in today's open market system. If you need assistance in developing a strategic plan call your regional Industry Canada office or the sector contact listed at the end of this publication.

CONTACTS

For further information concerning the subject matter contained in this publication contact Industry Canada at:

Urban Transit and Rail Directorate
Tel.: (613) 954-3427
Fax: (613) 952-8088, or

NAFTA Information Desk
International Business Branch
Tel.: (613) 952-5010
Fax: (613) 952-0540

For information on NAFTA-related customs matters, advanced rulings on classification, and tariff rates contact:

Revenue Canada — Customs, NAFTA Infoline:
(613) 941-0965 Fax: (613) 941-8138

Mexico Customs Service, NAFTA Hotline:
(011-525) 211-3545 Fax: (011-525) 224-3000

U.S. Customs Service, NAFTA Hotline:
(202) 927-0066 Fax: (202) 927-0097

For information on NAFTA-related export development programs and activities contact:

InfoEx
Foreign Affairs and International Trade Canada
Tel.: 1-800-267-8376 (Ottawa area: (613) 944-4000 or 993-6435)
Fax: (613) 996-9709

To obtain product-specific reports on North American trade data contact:

Market Intelligence and Technology Opportunities Service
Industry Canada
Tel.: (613) 954-4970 Fax: (613) 954-2340

To obtain information on how to access government procurement opportunities in Canada, the United States and Mexico contact:

Open Bidding Info Line
Public Works, Government Services Canada
Tel.: (819) 956-3440

Open Bidding Registration
Tel.: 1-800-361-4637 (Ottawa area: (613) 737-3374)

OTHER PUBLICATIONS

The other sector-specific NAFTA publications in this series include:

- Apparel
- Chemicals
- Construction Materials
- Electrical Equipment
- Electronic Components
- Environmental Equipment and Services
- Fish and Fish Products
- Furniture
- Health Care Products
- Industrial Equipment
- Major Appliances
- Paper Products
- Plastics
- Primary Metals
- Professional and Business Services
- Resource Equipment
- Sporting and Recreational Equipment
- Telecommunications Equipment
- Textiles
- Wood and Wood Products

To order any of the above or additional copies of this publication contact:

NAFTA Information Desk
Industry Canada
Tel.: (613) 952-5010
Fax: (613) 952-0540

The following publications provide additional information on the Agreement and guidance on exporting within the NAFTA trade area:

- *NAFTA: What's it all about?*
- *North American Free Trade Agreement*
- *Documents and Regulations for Exporting to Mexico*
- *Guide to Rules of Origin and Customs Procedures for Canadian Exporters to the U.S. Market*
- *Mexico: A Guide for Canadian Exporters*
- *Government Procurement in Mexico*

These are available from:

InfoEx
Foreign Affairs and International Trade Canada
Tel.: 1-800-267-8376 (Ottawa area: (613) 993-6435)
Fax: (613) 996-9709

For additional information on importing products to Canada and on other customs issues, the following publications are available:

- *Importing Goods Into Canada*
- *Trilateral Customs Guide to NAFTA*
- *NAFTA Rules of Origin — A Step by Step Guide*

These may be obtained from the regional offices of Revenue Canada — Customs or by contacting:

Revenue Canada — Customs
Tel.: (613) 941-0965 Fax: (613) 941-8138

The following publication provides reports on 36 manufacturing sectors and describes the new benefits and opportunities in Mexico and Canada for U.S. industries:

- *NAFTA Opportunities for U.S. Industries* (PB#94-100849)

The above publication or the individual sector reports may be ordered through:

U.S. Department of Commerce
Tel.: (703) 487-4650

Annex A

Canada-Mexico NAFTA Tariff Phase-Outs

This annex lists the tariff phase-out stages for most urban transit and rail equipment by tariff classification number. It contains a brief description of the products in each tariff subheading as well as the specific phase-out category and base rate of duty for each tariff item.

The information contained in this annex is to be used as a guide only. In the event of any discrepancy in information between this schedule and the official country-specific tariff schedule, the latter will prevail.

Tariff classifications are identical for all countries up to the "subheading level," as indicated by the first six digits of the classification of a good. At the eight digit or "tariff item" level, however, classifications often differ between Canada, Mexico and the United States. Consequently, it may be necessary to refer to each country's tariff schedule to find the product descriptions at the more detailed tariff item level.

The following provides a key to the various phase-out categories and other abbreviations used:

A – tariff elimination occurred on implementation of the Agreement on January 1, 1994;

B – tariff to be eliminated in five equal annual stages beginning January 1, 1994 and ending January 1, 1998;

C – tariff to be eliminated in 10 equal annual stages beginning January 1, 1994 and ending January 1, 2003;

D – the tariff is already zero or free;

( ) – the bracketed tariff rate is to be applied when calculating the duty on goods that are "jointly produced" by Mexico and the United States, and are imported into Canada;

nes – not elsewhere specified in the tariff schedule.

Urban Transit and Rail Equipment Canada-Mexico Tariff Phase-Out Schedule

SUB-HEADING	DESCRIPTION	CANADA ITEM	CANADA RATE (%)	CANADA PHASING	MEXICO ITEM	MEXICO RATE (%)	MEXICO PHASING
7302.10	Rails, iron or steel	7302.10.10 7302.10.20 7302.10.90	Free 6.8 7.8	D C C	7302.10.01 7302.10.02	10 Free	C D
7302.20	Sleepers (cross-ties), iron or steel	7302.20.00	6.5 (10.2)	C	7302.20.01	10	C
7302.30	Switch blades, crossing frogs, point rods and other crossing pieces, iron or steel	7302.30.00	10.2	C	7302.30.01 7302.30.99	10 10	C C
7302.40	Fish plates and sole plates, iron or steel	7302.40.10 7302.40.90	Free $7.12/tonne	D C	7302.40.01 7302.40.99	15 10	C C
7302.90	Rail or tramway construction material of iron or steel, nes	7302.90.00	10.2	A	7302.90.01 7302.90.99	15 10	C C
8408.90	Engines, diesel, nes	8408.90.10 8408.90.90	Free Free	D A	8408.90.01 8408.90.99	15 10	A A
8501.64	AC generators, of an output exceeding 750 kVA	8501.64.10 8501.64.90	2.5 10	B B	8501.64.01 8501.64.99	20 10	C C
8530.10	Electrical signalling, safety or traffic control equipment for railways or tramways	8530.10.00	Free	D	8530.10.01	10	A
8530.90	Parts of electrical signalling, safety or traffic control equipment	8530.90.10 8530.90.20	Free 6.5	D A	8530.90.01	10	A
8601.10	Rail locomotives powered from an external source of electricity	8601.10.00	10	A	8601.10.01	10	A
8601.20	Rail locomotives powered by electric batteries	8601.20.00	10	A	8601.20.01	10	A
8602.10	Rail locomotives, diesel-electric	8602.10.00	10	A	8602.10.01	10	A
8602.90	Rail locomotives, nes, and locomotive tenders	8602.90.00	10	A	8602.90.01 8602.90.99	10 10	A A
8603.10	Self-propelled railway cars powered from an external source of electricity	8603.10.00	Free	A	8603.10.01	10	A
8603.90	Self-propelled railway cars, nes	8603.90.00	Free	A	8603.90.99	10	A
8604.00	Railway maintenance-of-way service vehicles	8604.00.10 8604.00.90	Free 2.5 (4.6)	D A	8604.00.01 8604.00.02 8604.00.03 8604.00.99	10 10 10 10	A C C A
8605.00	Railway passenger and special purpose coaches, not self-propelled	8605.00.00	11.5	C	8605.00.01 8605.00.02 8605.00.03 8605.00.99	10 10 15 10	C C C C
8606.10	Railway tank cars, not self-propelled	8606.10.00	11.5	A	8606.10.01 8606.10.99	10 10	A A
8606.20	Railway cars, insulated or refrigerated, other than tank cars	8606.20.00	11.5	A	8606.20.01	10	A

SUB-HEADING	DESCRIPTION	CANADA ITEM	CANADA RATE (%)	CANADA PHASING	MEXICO ITEM	MEXICO RATE (%)	MEXICO PHASING
8606.30	Railway cars, self-discharging, other than tank or refrigerated type	8606.30.00	11.5 (17.5)	C	8606.30.01 8606.30.99	10 10	C C
8606.91	Railway cars, closed and covered	8606.91.00	11.5	A	8606.91.01	10	A
8606.92	Railway cars, open, with non-removable sides of a height exceeding 60 cm	8606.92.00	11.5	A	8606.92.01	10	A
8606.99	Railway cars, nes	8606.99.00	11.5	A	8606.99.01 8606.99.99	10 10	A A
8607.11	Driving bogies and bissel-bogies	8607.11.10 8607.11.20	6.5 Free	C A	8607.11.01 8607.11.99	15 10	C A
8607.12	Bogies and bissel-bogies, nes	8607.12.10 8607.12.20 8607.12.90	6.5 Free 11.5	C A C	8607.12.01 8607.12.99	15 10	C A
8607.19	Axles, wheels and parts	8607.19.11 8607.19.12 8607.19.13 8607.19.20 8607.19.91 8607.19.92 8607.19.93	7.5 7.5 7.5 Free 6.5 Free 11.5	B B B A A A A	8607.19.01 8607.19.02 8607.19.03 8607.19.04 8607.19.05 8607.19.06 8607.19.07	Free 10 10 10 10 10 10	D A A B A A A
8607.21	Air brakes and parts for railway rolling stock	8607.21.00	10.5	C	8607.21.01 8607.21.02 8607.21.99	10 10 10	C C C
8607.29	Brakes, nes, and parts thereof for railway rolling stock	8607.29.00	10.5	A	8607.29.01 8607.29.99	10 10	A A
8607.30	Coupling devices and parts, for railway rolling stock	8607.30.00	7.5	A	8607.30.01 8607.30.99	10 10	A A
8607.91	Locomotive parts, nes	8607.91.00	6.5	B	8607.91.01 8607.91.02 8607.91.03 8607.91.04 8607.91.99	10 10 10 10 10	A C A A A
8607.99	Railway rolling stock parts, nes	8607.99.11 8607.99.12 8607.99.19 8607.99.20	Free 2.5 8.5 11.5	D A A A	8607.99.01 8607.99.02 8607.99.03 8607.99.04 8607.99.99	10 10 10 10 10	A A A A A
8608.00	Signalling devices for railways, waterways and airports and parts thereof	8608.00.11 8608.00.19 8608.00.90	6.5 Free 10.2	A D A	8608.00.01 8608.00.02 8608.00.03 8608.00.04 8608.00.99	10 10 10 15 15	A A A C C
8609.00	Cargo containers designed to be carried by one or more modes of transport	8609.00.10 8609.00.20 8609.00.90	6.5 (10.2) 9 (13.6) 6 (9.2)	C C C	8609.00.01	20	C
8702.10	Diesel powered buses with a seating capacity of > nine persons	8702.10.10 8702.10.90	6 6	C C	8702.10.01 8702.10.02	20 20	C C
8702.90	Buses with a seating capacity of more than nine persons, nes	8702.90.10 8702.90.90	6 6	C C	8702.90.01 8702.90.02 8702.90.03 8702.90.04	20 20 20 20	C C C C

Note: You are reminded that this schedule is to be used as a guide only.

ANNEX B

Rules of Origin for Urban Transit and Rail

Chapter 73	**Articles of Iron or Steel**
73.01-73.03	A change to heading 73.01 through 73.03 from any other chapter.
Chapter 84	**Nuclear Reactors, Boilers, Machinery and Mechanical Appliances; Parts Thereof**
84.07-84.08	A change to heading 84.07 through 84.08 from any other heading, including another heading within that group, provided there is a regional value content of not less than: (a) 60 percent where the transaction-value method is used, or (b) 50 percent where the net-cost method is used.
Chapter 85	**Electrical Machinery and Equipment and Parts Thereof; Sound Recorders and Reproducers, Television Image and Sound Recorders and Reproducers, and Parts and Accessories of Such Articles**
85.01	A change to heading 85.01 from any other heading, except from Canadian tariff item 8503.00.11 through 8503.00.19, U.S. tariff item 8503.00.40A, 8503.00.60A or 8503.00.60C or Mexican tariff item 8503.00.01 or 8503.00.05; or A change to heading 85.01 from Canadian tariff item 8503.00.11 through 8503.00.19, U.S. tariff item 8503.00.40A, 8503.00.60A or 8503.00.60C or Mexican tariff item 8503.00.01 or 8503.00.05, whether or not there is also a change from any other heading, provided there is a regional value content of not less than: (a) 60 percent where the transaction-value method is used, or (b) 50 percent where the net-cost method is used.
8530.10-8530.80	A change to subheading 8530.10 through 8530.80 from any other heading; or A change to subheading 8530.10 through 8530.80 from subheading 8530.90, whether or not there is also a change from any other heading, provided there is a regional value content of not less than: (a) 60 percent where the transaction-value method is used, or (b) 50 percent where the net-cost method is used.
8530.90	A change to subheading 8530.90 from any other heading.

Chapter 86	**Railway or Tramway Locomotives, Rolling-Stock and Parts Thereof; Railway or Tramway Track Fixtures and Fittings and Parts Thereof; Mechanical (Including Electro-Mechanical) Traffic Signalling Equipment of all Kinds**
86.01-86.06	A change to heading 86.01 through 86.06 from any other heading, including another heading within that group, except from heading 86.07; or A change to heading 86.01 through 86.06 from heading 86.07, whether or not there is also a change from any other heading, provided there is a regional value content of not less than: (a) 60 percent where the transaction-value method is used, or (b) 50 percent where the net-cost method is used.
8607.11-8607.12	A change to subheading 8607.11 through 8607.12 from any other heading.
8607.19	
8607.19.aa	A change to Canadian tariff item 8607.19.11, U.S. tariff item 8607.19.10A or Mexican tariff item 8607.19.02 or 8607.19.06 from any other heading; or A change to Canadian tariff item 8607.19.11, U.S. tariff item 8607.19.10A or Mexican tariff item 8607.19.02 or 8607.19.06 from Canadian tariff item 8607.19.13, U.S. tariff item 8607.19.10B or Mexican tariff item 8607.19.07, whether or not there is also a change from any other heading, provided there is a regional value content of not less than: (a) 60 percent where the transaction-value method is used, or (b) 50 percent where the net-cost method is used.
8607.19.cc	A change to Canadian tariff item 8607.19.12, U.S. tariff item 8607.19.20A or Mexican tariff item 8607.19.03 from any other heading; or A change to Canadian tariff item 8607.19.12, U.S. tariff item 8607.19.20A or Mexican tariff item 8607.19.03 from Canadian tariff item 8607.19.13, U.S. tariff item 8607.19.20B or Mexican tariff item 8607.19.07, whether or not there is also a change from any other heading, provided there is a regional value content of not less than: (a) 60 percent where the transaction-value method is used, or (b) 50 percent where the net-cost method is used.
8607.19	A change to subheading 8607.19 from any other heading.
8607.21-8607.99	A change to subheading 8607.21 through 8607.99 from any other heading.
86.08-86.09	A change to heading 86.08 through 86.09 from any other heading, including another heading within that group.

Chapter 87	**Vehicles Other Than Railway or Tramway Rolling-Stock, and Parts and Accessories Thereof**
87.02	
8702.10.aa	A change to Canadian tariff item 8702.10.10, U.S. tariff item 8702.10.00A or Mexican tariff item 8702.10.03 from any other heading, provided there is a regional value content of not less than 50 percent under the transaction-value method.
8702.10.bb	A change to Canadian tariff item 8702.10.90, U.S. tariff item 8702.10.00B or Mexican tariff item 8702.10.01 or 8702.10.02 from any other heading, provided there is a regional value content of not less than 50 percent under the transaction-value method.
8702.90.aa	A change to Canadian tariff item 8702.90.10, U.S. tariff item 8702.90.00A or Mexican tariff item 8702.90.04 from any other heading, provided there is a regional value content of not less than 50 percent under the transaction-value method.
8702.90.bb	A change to Canadian tariff item 8702.90.90, U.S. tariff item 8702.90.00B or Mexican tariff item 8702.90.01, 8702.90.02 or 8702.90.03 from any other heading, provided there is a regional value content of not less than 50 percent under the transaction-value method.

ANNEX C

Calculating Regional Value Content

The rules of origin specify that certain goods must meet a regional value content requirement.

NAFTA provides two alternative methods that exporters can use to calculate the regional value content of their goods:

- the transaction-value method; and
- the net-cost method.

In most cases, exporters can choose either method.

If exporters select the transaction-value method and they are advised by Customs that the transaction value of the good (or the value of any material used to produce the good) is unacceptable or needs to be adjusted, they can choose to use the net-cost method.

However, if they select the net-cost method initially and the results are unfavourable, they cannot switch to the transaction-value method.

Transaction-Value Method

Under the transaction-value method, exporters have to subtract the value of any non-originating material (i.e. non-North American) used to produce the good from the actual price paid or payable for the good. In most cases, the value of non-originating material is the total amount it costs producers to purchase the material and get it to the production site.

Then, exporters have to divide the difference by the price, and convert the result to a percentage to get the regional value content or the RVC.

The formula is as follows:

$$\frac{\text{Transaction value} - \text{Value of non-originating materials}}{\text{Transaction value}} \times 100 = \text{RVC}$$

In most cases, if exporters use the transaction-value method, the specific rule of origin will require that the RVC for an originating good must be at least 60 percent.

Exporters cannot use the transaction-value method in the following circumstances:

- the good has no transaction value (e.g. barter);
- the transaction value of the good is not acceptable under the Customs Valuation Code (refer to brochure entitled *Value For Duty*, available at any Customs regional office); and
- the majority of the producer's sales are to related parties.

Exporters who are not sure whether they can use the transaction-value method should call a Revenue Canada — Customs regional office.

Net-Cost Method

Under the net-cost method, exporters have to subtract the value of non-originating materials used to produce the finished good from the net cost of the good. In most cases, the value of a non-originating material is the total amount it costs producers to purchase the material and get it to the production site.

Then, exporters have to divide the difference by the net cost, and convert the result to a percentage to get the RVC.

The net-cost formula is as follows:

$$\frac{\text{Net cost} - \text{Value of non-originating materials}}{\text{Net cost}} \times 100 = \text{RVC}$$

In most cases, if exporters use the net-cost method, the specific rule of origin will require that the RVC for an originating good must be at least 50 percent.

To determine the net cost of a good, begin with all the costs of producing the good, and then subtract any costs that are specifically excluded. Specifically excluded costs are costs for:

- sales promotion and marketing;
- after-sales service;
- royalties;
- shipping and packing; and
- non-allowable interest.

DATE DUE - DATE DE RETOUR

ISTC 1551 (2/90)