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USMCA: Motor Vehicle Provisions and Issues

Background

The proposed United States-Mexico-Canada Agreement (USMCA), if approved by Congress, would revise and replace the North American Free Trade Agreement (NAFTA), which has been in force since January 1, 1994. NAFTA eliminated trade and investment barriers between the United States and two of its largest trading partners, Canada and Mexico. It was the most comprehensive free trade agreement (FTA) negotiated at the time and contained groundbreaking provisions in areas such as market access, rules of origin (ROO), intellectual property rights, services, investment, dispute settlement, and worker rights. The North American motor vehicle industry is highly integrated, partially as a result of NAFTA and is a major source of trade and investment among the NAFTA partners. The changes in the proposed USMCA provisions have implications for the motor vehicle industry in all three countries, as well as for future U.S. trade policy.

NAFTA and Mexico's Motor Vehicle Industry

NAFTA helped "lock in" Mexican liberalization efforts of the late 1980s and expanded the Mexican market for U.S. motor vehicles and investment. Mexico's restrictive auto decrees of 1962, 1972, 1977, 1984, and 1989 reserved the Mexican market for domestically produced parts and vehicles through restrictive requirements on domestic content, trade balance, production quotas, price controls, and export levels, in addition to restrictions on foreign investment and high tariffs. Mexico began liberalizing restrictive trade and investment rules in 1989. In 1991, there were only 83 cars per 1,000 people in Mexico, compared to 289 in 2015.

NAFTA and Motor Vehicles

NAFTA phased out tariffs on motor vehicles and parts, and other trade barriers, such as Mexico's auto decree, over a 10-year period. NAFTA, the U.S.-Canada FTA of 1988, and the elimination of Mexican trade barriers were instrumental in the integration of the North American motor vehicle industry. The integration of the North American motor vehicle industry expanded under NAFTA with major Asian and European automakers constructing their own supply chains within the region. The major growth occurred largely in Mexico, which now accounts for about 20% of total continental vehicle production. The highest share of U.S. trade with Mexico is in the motor vehicle industry; it is also the industry that makes the most use of NAFTA duty-free treatment (see **Figure 1**).

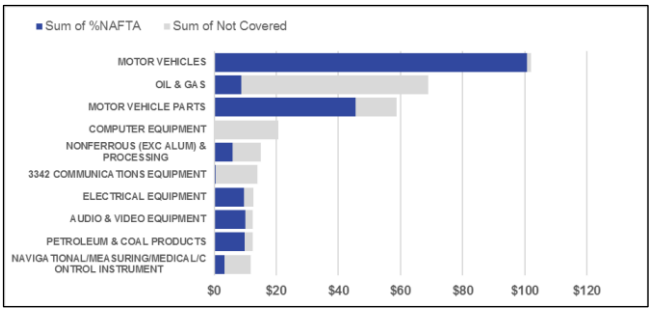
USMCA Key Changes

The proposed USMCA would maintain NAFTA's tariff and non-tariff market-opening provisions. Key changes from NAFTA would include:

- New motor vehicle ROO and procedures.
- Increase in North American content requirement from NAFTA's 60%-62.5% to 75%.
- 70% of a vehicle's steel and aluminum must originate in North America, and the steel must be domestically melted and poured. (NAFTA does not have similar provisions.)
- Wage requirements stipulating that 40%-45% of North American auto content be made by workers earning at least $16 per hour, averaged by class, model or plant, with credits for R&D and production in high-wage regions. (NAFTA does not have a wage provision.)
- Additional side letters that would exempt from potential Section 232 tariffs: 2.6 million passenger vehicles each from Canada and Mexico annually; light trucks from Canada or Mexico; auto parts imports amounting to $32.4 billion from Canada and $108 billion from Mexico in declared customs value in any calendar year.

Figure 1. U.S. Imports from Canada and Mexico: NAFTA and Other Programs, 2017

($ in billions, % of imports covered by NAFTA)



Source: Compiled by CRS with USITC data.

Trade Agreements and Rules of Origin

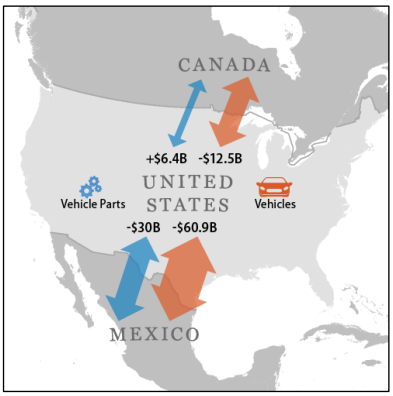
ROO are used to determine the country of origin of imported products. Preferential ROO are applied in FTAs to ensure only eligible products receive preferential tariff benefits if the good is made wholly or in large part within the region. If the good is not wholly obtained in the region, a tariff-shift method and/or regional value content (RVC) method is applied to determine origin. Goods may qualify if the materials are sufficiently transformed within the region to go through a Harmonized Tariff Schedule (HTS) change in tariff classification (also known as a "tariff shift"). In many cases, goods must meet a minimum level of RVC, in addition to undergoing a tariff shift. RVC may be calculated using the "transaction-value" or the "net-cost" method. A good would meet RVC requirements if regional transaction-value is at least 60% or regional net cost is at least 50%. However, like NAFTA, USMCA has a separate set of ROO for motor vehicles and parts in which RVC must use the net-cost method. If preferential ROO requirements are not met, the good will be imported under most-favored nation

(MFN) tariff rates. For example, U.S. MFN rates are 2.5% for passenger vehicles and 25% for trucks.

U.S. Motor Vehicle Industry

Globally, motor vehicle manufacturing has largely been reorganized around regional rather than purely domestic supply chains. North America is the world's third largest motor vehicle manufacturer, after China and the European Union, producing 17.4 million passenger and commercial vehicles in 2018; of these: 11.3 million were assembled in the United States, 4.1 million in Mexico and 2 million in Canada. Since NAFTA, the three countries developed an integrated supply chain with hundreds of suppliers providing thousands of parts for vehicles, some of which cross the border multiple times as they are assembled into larger products. For example, some vehicle seats utilize components from four different U.S. states and four Mexican locations, with final assembly in the U.S. Midwest. Parts manufacturers operate in all three countries to be close to vehicle assembly plants.

Figure 2. U.S. Motor Vehicle and Parts Trade Balance
(2018, $ in billions)



Source: CRS based on data from U.S. Department of Commerce.

The United States exports more than two million motor vehicles a year to markets around the world—with Canada and Mexico being the two largest markets. In 2018, as shown in **Figure 2,** the U.S., motor vehicle trade balance with Canada was -$12.5 billion (down from -$20 billion in 2017), and with Mexico, -$60.9 billion (up from -$45 billion in 2017). In motor vehicle parts, the United States had a trade deficit of $30 billion with Mexico in 2018. Only in motor vehicle parts trade with Canada did the United States record a surplus ($6.4 billion) in 2018. Although not accounted for in trade statistics, vehicle parts exported from the United States to Mexico and Canada often come back to the United States in finished motor vehicles.

Auto parts and final assembly account for a large share of U.S. manufacturing employment: more than 830,000 jobs in 2018, with 597,000 in parts manufacturing and 234,000 in vehicle assembly. According to the Center for Automotive Research (CAR), average production wages at General Motors (GM) range from $16.67 per hour for temporary workers to $32.32 for permanent employees who assemble vehicles, for a weighted average of about $26 per hour. At Toyota the hourly production worker wage is reportedly about $21.29. Hourly production wages in Canada are similar to those at the Detroit 3 (GM, Ford, and Fiat Chrysler). In Mexico, average hourly wages for workers in auto assembly were $7.34 in 2017.

Possible USMCA Effects

The U.S. Trade Representative asserts that USMCA will increase: assembly and parts jobs, capital investments in U.S. automotive plants, and domestic parts production, including those used in autonomous and electric vehicles. Several studies have estimated the possible impact of USMCA automotive provisions, with some substantive differences in their conclusions.

The U.S. International Trade Commission (USITC) modeling suggests that USMCA ROO are unlikely to result in major changes in the North American auto supply chain. It forecasts increases in:

- U.S. employment in the production of core parts such as engines and transmissions;
- demand for North American made steel and aluminum;
- imported parts from outside North America; and
- production costs in the United States and Mexico, resulting in higher prices for automobiles.

As a result of more expensive vehicles, the USITC model predicts that some 140,000 fewer vehicles would be sold, mostly smaller passenger cars.

CAR forecasts that USMCA would provide "a degree of stability" to automotive production in North America, with a likely increase in production of core parts. It notes that most U.S.- and Canadian-made vehicles already meet most of the new rules. At 68%, most of Mexico's production follows the rules. CAR foresees a "slight increase" in U.S. consumer prices of North American vehicles.

An International Monetary Fund (IMF) report contends that the new automotive ROO would "not achieve their desired outcomes": the rules would lead to a decline in North American vehicle and parts production, shifting production outside the region, and, in turn, higher vehicle prices.

Outlook for Congress

The proposed USMCA provisions affecting the motor vehicle industry, such as the increased North American content requirements and its implications for U.S. trade policy, are a central issue of congressional debate over ratification of the agreement. Some policymakers contend that tightening the ROO scales back provisions in NAFTA and actually restricts trade, which could complicate future U.S. trade negotiating efforts to open other markets. Other policymakers welcome provisions such as the wage requirement, stating that it would benefit U.S. workers. See also CRS Report R44981, *NAFTA Renegotiation and the Proposed United States-Mexico-Canada Agreement (USMCA)*, by M. Angeles Villarreal and Ian F. Fergusson.

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