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USMCA: Motor Vehicle Provisions and Issues

Background

The United States-Mexico-Canada Agreement (USMCA), ratified by Congress on January 16, 2020, and signed into law on January 29, 2020 (P.L. 116-113), replaced the North American Free Trade Agreement (NAFTA) on July 1, 2020. NAFTA reduced and 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. NAFTA was instrumental in reshaping the North American motor vehicle industry, which has become highly integrated and a major source of trade and investment among the three trading partners.

NAFTA and Mexico's Motor Vehicle Industry

Mexico's protectionist 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. NAFTA "locked in" Mexico's unilateral liberalization efforts of the late 1980s of its restrictive barriers and expanded the Mexican market for U.S. products.

NAFTA and Motor Vehicles

NAFTA phased out tariffs on motor vehicles and parts over a 10-year period. NAFTA, the U.S.-Canada FTA of 1988, and the elimination of Mexican trade barriers were instrumental in the initial integration of the North American motor vehicle industry. Production of vehicles and parts expanded significantly as major U.S., Asian, and European automakers developed supply chains in the region. Major growth occurred largely in Mexico, which now accounts for 23% of total continental vehicle production and a significant portion of duty-free trade in auto parts. Motor vehicles and parts account for the highest share of U.S. imports from Canada and Mexico that claim NAFTA/USMCA duty-free benefits. As shown in **Figure 1**, 97% of U.S. imports in motor vehicles from Canada and Mexico and 70% of U.S. imports in motor vehicle parts entered duty-free under NAFTA/USMCA in 2020.

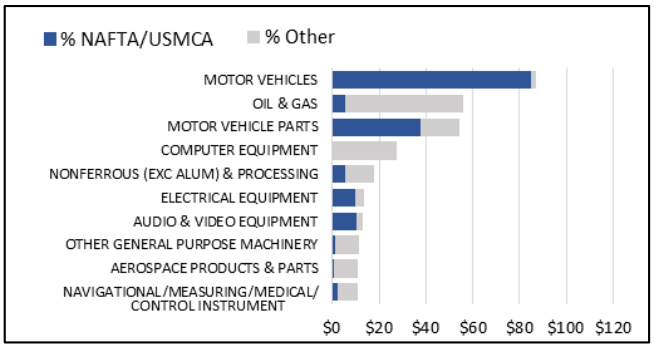
USMCA Key Changes

The USMCA maintains NAFTA's tariff and nontariff market-opening provisions. Key changes include:

- New motor vehicle ROO and procedures with an increase in the North American content requirement from NAFTA's 60%-62.5% to USMCA's 70%-75%.
- Requirements that 70% of the aluminum used in vehicles subject to tariff-free access be produced in North America and that 70% of steel be domestically melted and poured.
- New 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 research and development and production in high-wage regions. (NAFTA did not have a wage provision.)

Figure 1. Comparison of U.S. Imports from Canada and Mexico: NAFTA/USMCA and Other, 2020

($ in billions, percentage imported under NAFTA/USMCA)



Source: Compiled by CRS with USITC data.

Trade Agreements and Rules of Origin

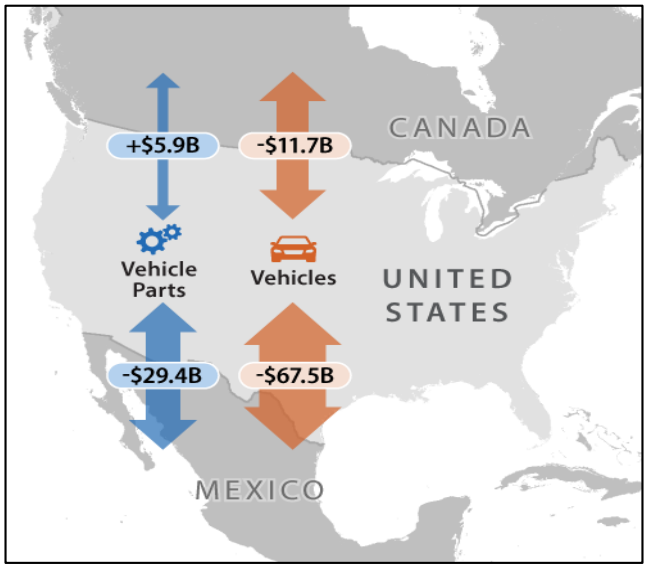
ROO are used to determine the country of origin of imported products. Preferential ROO are applied in FTAs to ensure that a good receives preferential tariff benefits only if it is made wholly or in large part within the region. If the good is not wholly obtained in the region, a tariff-shift method 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. 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. Importers may choose to import under MFN rates if the cost of complying with ROO requirements are higher, which could potentially increase inputs from Asia or other countries outside the region.

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 16.8 million passenger and commercial vehicles in 2019; of these 10.9 million were assembled in the United States, 3.9 million in Mexico, and 1.9 million in Canada. Across the region, hundreds of suppliers provide thousands of parts for vehicles, some of which cross the border seven or eight times as they are assembled into larger products, according to industry representatives. 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
(2019, $ in billions)



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

The United States exports more than 2 million motor vehicles a year to markets around the world—with Canada and Mexico being the two largest markets. In 2019, as shown in **Figure 2**, the U.S. motor vehicle trade deficit with Canada was -$11.7 billion (down from -$20 billion in 2017), and with Mexico, -$67.5 billion (up from -$45 billion in 2017). In motor vehicle parts, the United States had a trade deficit of $29 billion with Mexico in 2019. Only in motor vehicle parts trade with Canada did the United States record a surplus ($5.9 billion) in 2019. 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 incorporated into finished motor vehicles.

Auto parts and final assembly account for a large share of U.S. manufacturing employment: more than 900,000 jobs in 2021, with 712,000 in parts manufacturing and 188,000 in vehicle assembly. Average production wages at General Motors range from $16 per hour for temporary workers to $32 for permanent employees who assemble vehicles, for a weighted average of about $21 per hour. At Toyota, the hourly production worker wage is reportedly about $20. Hourly production wages in Canada are similar to those at the Detroit 3 (GM, Ford, and Stellantis' Chrysler unit). In Mexico, average hourly wages for workers in auto assembly are much lower. It is challenging to compare Mexican wages with U.S. wages because of differences in how Mexican plants compensate their employees.

Possible USMCA Effects

The Trump Administration asserted that USMCA would increase assembly and parts jobs, capital investments in U.S. automotive plants, and domestic parts production, including those used in autonomous and electric vehicles. Other studies have forecast different outcomes.

U.S. International Trade Commission (USITC) modeling suggested that USMCA ROO are unlikely to result in major changes in the North American auto supply chain. It forecast a slight decrease in the sale of smaller passenger cars and increases in U.S. employment in the production of 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. The nonprofit Center for Automotive Research (CAR) forecast that USMCA would likely increase production of core parts, noting that most North American-made vehicles already meet most of the new rules. CAR predicted a "slight increase" in U.S. vehicle prices. An International Monetary Fund (IMF) report contended that the new ROO would "not achieve their desired outcomes" and would lead to a decline in North American vehicle and parts production, shifting production outside the region and resulting in higher vehicle prices.

Since USMCA was negotiated, the pace of passenger vehicle electrification has increased, with implications for the North American supply chain. Production of many parts used in a conventional vehicle powertrain may decline and be replaced with fewer parts used in electric vehicles. The large, heavy batteries that power those vehicles are likely to be produced close to the final assembly plants. These technological and manufacturing changes are likely to result in the shrinkage of the current vehicle parts trade, increasing the value added of the assembly plants.

Issues for Congress

USMCA implementation is an ongoing area of interest for Congress. A major issue is whether non-originating material in core auto parts (e.g., engines and advanced batteries) deemed originating (100% North American content) should be included in the calculation of the RVC in larger parts or motor vehicles. In August 2021, the Mexican and Canadian governments, which argue that total value of core parts deemed originating should be counted, formally requested consultations with the United States, which asserts that non-originating parts should not be included in the larger RVC calculation. The larger implications of the stricter RVC requirements and the wage requirement on U.S. domestic production and motor vehicle supply chains is unclear. On labor issues, USTR has twice asked Mexico to review whether workers at an auto parts plant were denied labor rights addressed in USMCA. USTR and the Labor Department later announced successful remediation under USMCA's dispute resolution procedures.

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