Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

April 21, 2022

USMCA: Motor Vehicle Rules of Origin

The United States-Mexico-Canada Agreement (USMCA), approved by Congress on January 16, 2020 (P.L. 116-113), entered into force on July 1, 2020. It replaced the 1994 North American Free Trade Agreement (NAFTA). Congress has an oversight role in its implementation and U.S. North American trade relations. A major issue concerns the new rules of origin for the motor vehicle industry, which were relatively contentious in the USMCA negotiations and debate surrounding its passage.

Rules of origin (ROO) are the criteria used to determine the national origin of a product. Most free trade agreements have ROO provisions to determine which goods traded between member countries are eligible for preferential treatment. They generally seek to ensure that the benefits of the agreement are granted to goods primarily produced by a member country (and therefore subject to the entirety of its commitments) rather than to goods made wholly, or in large part, in other countries. Under USMCA, most goods that contain materials from non-USMCA countries may be considered as North American (i.e., eligible for preferential treatment) if the materials are sufficiently transformed in the region and the transformation results in a change in tariff classification (called a "tariff shift"). USMCA's general rule is that the regional value content (RVC) is not less than 60% if the "transaction-value" method is used, or not less than 50% if the "net-cost" method is used. Producers generally have the option to choose which method they use, with some exceptions, such as the motor vehicle industry, which must use the net-cost method. USMCA also has some product-specific rules for different industries, which in some cases include additional requirements, such as for textiles and apparel and motor vehicles and motor vehicle parts.

Motor Vehicle ROO

NAFTA phased out U.S. tariffs on motor vehicle imports from Mexico and Mexican tariffs on U.S. and Canadian products as long as they met the ROO requirements. USMCA maintains these tariff eliminations, but tightens the ROO, as shown in **Table 1**. It also has a new provision to streamline certification requirements and other provisions.

Possible Effects

During the negotiations, motor vehicle and parts manufacturers generally supported retaining NAFTA ROO. Labor groups, however, sought to require a higher percentage of regional content, which they believed would reduce the share of parts produced outside the United States.

Some economists contend that the higher RVC content requirement may have unintended consequences. For example, they state that it would be more cost efficient for motor vehicle and parts manufacturers to pay the 2.5% U.S. MFN tariff rather than meet the extensive ROO requirements. They argue that the new rules pose a risk to North American auto production, because they may raise production costs, resulting in higher vehicle prices, reduced demand for motor vehicles, fewer auto exports, and incentivize more automation in motor vehicle production, thereby reducing demand for workers.

Table 1. NAFTA and USMCA Motor Vehicle ROOs

NAFTA	USMCA
62.5% RVC	75% RVC for passenger vehicles, light trucks, certain parts
No labor value content rule (LVC) (no wage requirement)	LVC stating that 40%-45% of qualifying vehicles be produced by workers earning at least $16 per hour
No steel and aluminum requirement	70% of a motor vehicle manufacturer's steel and aluminum purchases must originate in North America

Source: CRS based on text of USMCA and NAFTA agreements.

The Congressional Budget Office (CBO) estimated that USMCA's stricter ROOs for motor vehicles and new wage requirements will result in a decline in duty-free imports of motor vehicles and parts into the United States. A portion of that decline would be replaced by domestic production, while a portion would be replaced by imports subject to duties. CBO estimates that U.S. importers of motor vehicle and parts not meeting the higher ROO requirements will pay approximately $3 billion in duties over the next decade. A 2019 USMCA study by the U.S. International Trade Commission stated that the ROO changes would have the most significant effects on the U.S. economy and the motor vehicle industry and could lead to price increases or vehicle consumption decrease in the United States.

Auto manufacturers in Mexico are concerned that they may lose U.S. market share to auto imports from Asia. Even with these concerns, some motor vehicle producers support USMCA and say that complying with the new rules of origin may be challenging, but probably manageable.

Entry into Force and Implementation

USMCA entered into force on July 1, 2020. To help importers adjust to the new rules under USMCA, U.S. Customs and Border Protection (CBP) established the USMCA Center to coordinate implementation of the trade agreement. CBP staff at the center organized outreach events, developed information resources, and provided technical guidance to public and private sector stakeholders.

USMCA provides a three-year transition period for the new ROO. It also allows vehicle producers to request an alternative staging regime that would permit producers a longer transition period (five years) to implement the new rules of origin. The U.S. Trade Representative (USTR) accepted petitions with a draft alternative staging plan from April 21, 2020 to July 1, 2020. The plan may include investment or purchase commitments in the United States and North America to the U.S. Trade Representative (USTR). Companies with approved requests include Ford, Honda, Hyundai, Tesla, Toyota, and Volkswagen.

USMCA Dispute Resolution

USMCA dispute resolutions provisions are intended to resolve disputes through consultation. The party or parties alleging that another party is violating USMCA may request consultations, defined as confidential discussions that include good offices, conciliation, or mediation, and if no resolution is achieved, establishment of a dispute settlement panel. After a panel renders a decision, it prepares a report. If the findings determine that the responding party has violated USMCA commitments, the parties must seek to resolve the dispute within 45 days. If a resolution is not reached, then the aggrieved party or parties may suspend certain agreement benefits until the parties agree on a resolution.

Motor Vehicle ROO Dispute

A major issue regarding USMCA's motor vehicle ROO is whether non-originating material in core motor vehicle parts (e.g., engine heads and battery cells) deemed originating (100% North American content) should be included in the calculation of the regional value content (RVC) in larger core parts (see below) or motor vehicles. USTR's interpretation of the so-called "roll up provision" is that the value of non-originating materials in core auto parts should not be included in the larger RVC calculation in determining country of origin. In August 2021, the Mexican and Canadian governments, which argue that the total value of core parts deemed originating (North American inputs plus foreign inputs) should be counted, formally requested consultations with the United States.

Core Parts and Components for Determining Origin

Engine: Heads, blocks, crankshafts, crankcases, pistons, rods, head subassembly.

Transmission: Transmission cases, torque converters and housings, gears and gear blanks, clutches, valve body assembly.

Body and Chassis: Major body panels, secondary panels, structural panels, frames.

Axle: Axle shafts, axle housings, axle hubs, carriers, differentials.

Suspension System: Shock absorbers, struts, control arms, sway bars, knuckles, coil springs, leaf springs.

Steering System: Steering columns, steering gears/racks, control units.

Advanced Batteries: Cells, modules/arrays, assembled packs.

Source: Table A.2 in Annex 4-B, Chapter 4 of the USMCA.

The Mexican government argued that the United States is not recognizing flexibilities, such as the roll up provision that it contends were negotiated to help North American motor vehicle producers meet the RVC requirements. The Canadian government stated that because consultations regarding the interpretation of the ROO failed to produce a resolution, Mexico and Canada moved to the next step of the dispute resolution provisions of the agreement. On January 6, 2022, Mexico requested a panel to resolve the dispute, stating that the United States adopted an "incorrect interpretation" of the ROO. On January 13, Canada announced that it was joining the dispute as a complaining party, stating that it shared Mexico's view. A panel reportedly is expected to reach a decision regarding the proper interpretation around September 2022.

Issues for Congress

USMCA contains key changes in motor vehicle ROO from NAFTA and other previous U.S. FTAs, as well as congressional reporting requirements. USTR, in consultation with the Interagency Committee on Trade in Automotive Goods, established by the USMCA Implementation Act, is required to submit a biennial report to Congress on motor vehicle trade under the agreement (19 U.S.C. §4532(g)(1)). The report is to include, among other things, a summary of how producers demonstrate compliance with the ROO, use of the alternative staging regime, and whether the ROO are effective. The first report is expected to be submitted to the House Ways and Means and Senate Finance Committees no later than July 1, 2022.

Another potential issue for Congress is the revision to the electric vehicle tax credit included in the House-passed Build Back Better legislation (H.R. 5376). It would provide up to $12,500 in tax credits for the purchase of electric vehicles, including $4,500 if a vehicle is assembled at U.S. plants with unionized labor and an additional $500 if it has at least 50% U.S. content and battery cells. Canada and Mexico have stated that the credits are discriminatory and have threatened to file dispute settlement complaints if they are approved.

As USMCA implementation moves forward, Congress may examine issues and consider oversight related to:

- What is the impact of USMCA's motor vehicle ROO on domestic producers and what are the implications of the current dispute over ROO interpretations?
- Are the ROO improving the competitiveness of the U.S. motor vehicle industry?
- How have the new ROO impacted small and medium motor vehicle producers/suppliers?
- How could the proposed electric vehicle tax credits be formulated to meet USMCA commitments?
- Have there been implementation and/or compliance issues with the LVC requirements? If so, what?

Liana Wong, Analyst in International Trade and Finance
M. Angeles Villarreal, Specialist in International Trade and Finance

IF12082

Disclaimer