USITC Releases First Biennial Report on Economic Impact and Operation of USMCA Automotive Rules of Origin

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On June 30, 2023, the U.S. International Trade Commission (ITC) released its first report on the economic impact of the United States-Mexico-Canada (USMCA) automotive rules of origin. Rules of origin (ROOs) are used to determine the national origin of a product and whether it qualifies for preferential treatment pursuant to a trade agreement between (or among) member countries. The ITC's report addresses the impact of the USMCA's automotive ROOs on the U.S. economy, particularly the U.S. automotive industry and other pertinent industries, as well as the impact of the rules on U.S. competitiveness, and whether the rules remain relevant in light of recent technological advances in the United States.

The key findings of the report are as follows: (1) notwithstanding some noticeable impact of the USMCA on the U.S. economy and U.S. competitiveness, it is too early to understand the full extent of the effect of the agreement; (2) the automotive ROOs appear to have increased costs as well as the U.S. share of USMCA production; (3) there is a sharp increase in investment in electric vehicles (EVs) and the industry shift to EV production will likely require changes to, or the continued monitoring of, the USMCA automotive ROOs to ensure they remain relevant; and (4) additional technological changes may also impact the relevancy of the USMCA automotive ROOs.

Background

The USMCA entered into force on July 1, 2020, and replaced the North American Free Trade Agreement (NAFTA). Over the past three years, the agreement has presented some opportunities and challenges for the United States and its main trading partners. Some of the biggest challenges pertain to the treatment of automotive goods under the agreement.

Under the USMCA, an originating good is one that meets the rules of origin set forth in General Note 11 of the Harmonized Tariff Schedule of the United States (HTSUS) and all other requirements of the agreement. An additional set of rules applies to automotive goods (specifically, passenger motor vehicles, light and heavy trucks, and certain automotive parts). Specifically, automotive goods must meet four additional ROOs: (1) regional value content (RVC) requirements; (2) North American steel and aluminum procurement requirements; (3) labor value content requirements; and (4) core parts requirements.

Pursuant to section 202A(g)(2) of the USMCA Implementation Act, the ITC is required to provide five biennial reports to the President, the House Committee on Ways and Means, and the Senate

Committee on Finance, regarding (1) the economic impact of the automotive ROOs; (2) the operation of the automotive ROOs and their effects on the competitiveness of the United States; (3) whether the automotive ROOs are relevant in light of technological changes in the United States; and (4) any other matters the ITC considers relevant to the economic impact of the rules.

This is the first of five biennial reports on the economic impact of the USMCA automotive ROOs. The next report, due in 2025, has the same reporting requirements but will present updated data and information about the industries through December 31, 2024. Each subsequent report will report on the same topics and two new years of data and information.

ITC Findings

Economic Impact of the USMCA Automotive ROOs and Their Effects on U.S. Competitiveness

While the full impact of the USMCA will not be apparent until the agreement is fully implemented, in 2027 or later, the ITC has found that the economy-wide effects of the ROOs were marginal in the first two and a half years after the USMCA entered into force. According to the report, vehicle manufacturers and suppliers explain that the ROOs have increased costs at multiple stages of the supply chain, but that they have also increased the U.S. share of USMCA vehicle and parts production. The COVID-19 pandemic and global supply chain disruptions had a major impact on U.S. automotive production and trade. Consequently, there is no clear picture of the effect of the USMCA's entry into force on U.S. competitiveness.

One potential indication of increased U.S. competitiveness is that the United States' share of USMCA light vehicle production, as well as light vehicle and parts exports as a share of global exports, increased slightly after the agreement's entry into force. U.S. light vehicle production as a share of USMCA production increased from 64.8 percent in 2018 to 68.1 percent in 2022. U.S. light vehicle exports as a share of global light vehicle exports increased from 6.6 percent in 2018 to 7.7 percent in 2022. U.S. automotive parts exports as a share of global parts exports also increased from 8.1 percent of global exports in 2018 to 8.4 percent in 2022.

Employment and investment data also indicate some changes in competitiveness. Investments in Canada and the United States have reportedly increased sharply, with most of the new investments going into EVs and EV batteries. The surge in investment in EVs is thought be in response to an increase in consumer demand, therefore, the extent to which these changes can be attributed to the ROOs remains unclear.

Technological Changes Impacting the Relevance of the USMCA Automotive ROOs

Because the agreement is in its early years of implementation, the overall impact of any technological changes is limited. According to the report, two recent technological changes in the U.S. automotive industry have created divergences in the tariff treatment of similar goods in the USMCA automotive ROOs. The first change pertains to the growth in production of electric and hybrid pickup trucks. Currently, the USMCA automotive ROOs do not categorize EV and hybrid pickup trucks as light trucks. Unlike other trucks, EV and hybrid pickup trucks are classified under HTSUS subheading 8704.90, which covers all trucks not classified elsewhere in heading 8704. Vehicles under 8704.90 are categorized as "heavy trucks" under the USMCA automotive ROOs. This difference in classification means that a different set of product-specific ROOs applies to EV and hybrid trucks. Until recently, sales of EV and hybrid trucks were really low or nonexistent. However, the increasing demand for EV and hybrid trucks means that the disparate treatment of these

vehicles will have important practical implications. The report addresses several other instances of classification divergence that do not result in different tariff treatment for similar goods to demonstrate where Harmonized System (HS) classifications have changed since the USMCA entered into force.

The second technological change involves a new production process for aluminum vehicle bodies. Currently, the USMCA automotive ROOs do not allow for cast aluminum bodies to qualify as originating via the same product-specific ROOs as stamped aluminum bodies. The difference in treatment between stamped and cast aluminum body parts is due to the tariff shift rules for aluminum components. Under the USMCA, non-originating aluminum may be considered originating if the aluminum is subjected to a manufacturing process in a USMCA country that results in certain tariff shifts. For example, an aluminum product, such as an ingot, may be deemed originating if it is subjected to a manufacturing process such that it transforms into another intermediary aluminum product (classified under a different HS heading from the original product). However, the process of casting aluminum products, unlike the stamping process, does not produce an intermediary aluminum product. This allows for stamped body parts to qualify as originating more easily than cast body parts.

In addition to tariff classifications, the report addresses input from various stakeholders on proposed changes to the automotive ROOs. According to the report, some stakeholders believe that the industry-wide shift to EVs and hybrid vehicles merits changes to, or the continued monitoring of, the USMCA automotive ROOs to ensure that they remain relevant. Some stakeholders have proposed additions to the ROOs parts lists that they believe would better account for the increasing share of EVs in the U.S. market. The International Union, United Automobile, and Aerospace and Agricultural Implement Workers of America (UAW) have proposed adding EV components and EV battery components to the core parts list of the USMCA automotive ROOs. The list proposed by the UAW includes automotive-grade semiconductors, electric motors and electric drivetrains, non-lithium-ion batteries, charge ports and charging stations, various battery components (cathodes, anodes, separators, casings), and various critical minerals (cobalt, nickel, manganese, graphite, silicone). Other stakeholders stated that EV technologies are already addressed by the ROOs and that because the technology is still evolving and industry investments and changes are ongoing, any proposed changes are premature.

Finally, the report addresses additional ongoing technological changes in the U.S. automotive industry that may impact the relevancy of the USMCA automotive ROOs. One such change is with respect to the increasing value of nontraditional automotive inputs relative to the value of the final vehicle and how this might impact the RVC calculations for the larger vehicle components being produced with a growing share of nontraditional parts. The value of nontraditional automotive inputs (i.e., semiconductors and sensors) is rising both in an absolute sense as well as relative to traditional automotive inputs. Some in the automotive industry believe the rising value of nontraditional automotive inputs merits changes to the ROOs because electronic components typically originate from Asia. One industry proposal addressing this issue involves adding certain electronic components, such as automotive-grade semiconductors and sensors, to the USMCA automotive core parts list to incentivize USMCA-originating electronic supply chains. Core parts must satisfy the higher 75 percent originating content requirement to qualify for preferential treatment.

Another technological change relates to the lack of recycling-specific automotive ROOs. According to the report, the “current treatment of recycled battery materials under the USMCA automotive ROOs may pose challenges to emerging supply chains because of a lack of recycling-specific provisions in the ROOs.” Currently, for example, the determination of whether a battery made using recycled

materials qualifies as originating under the USMCA relies on the same ROOs applied to the original battery, i.e., whether the recycled cells were created within the USMCA region.

Tags: ITC, Rules of Origin, USMCA