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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. The new rules of origin for the motor vehicle industry 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 (FTA) 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 producers 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 would 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 estimated 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 upon full entry into force. 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. 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 has been 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 RVC calculation of larger core parts (see below) or motor vehicles. USTR’s interpretation of the so-called “roll up provision” was 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. In January 2022, Mexico, later joined by Canada, requested a panel to resolve the dispute, stating that the United States adopted an “incorrect interpretation” of the ROO. On January 11, 2023, the panel ruled in favor of Mexico and Canada’s interpretation of the ROO.

Issues for Congress

USMCA contains key changes in motor vehicle ROO from NAFTA and 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 first report was submitted to the House Ways and Means and Senate Finance Committees on July 1, 2022. It stated that there was evidence of producers making “significant investments” in North America in order to meet the ROO, but industry is still adapting to the more complex rules. USTR will continue to assess the effectiveness of the rules. The U.S. International Trade Commission is investigating the economic impact of the ROO on the United States and expects to deliver the report to the President and relevant congressional committees by June 30, 2023.

Another related issue for Congress is the revised electric vehicle (EV) tax credit in P.L. 117-169 (commonly referred to as the Inflation Reduction Act of 2022). It provides \$3,750 if the EV is assembled in North America, and another \$3,750 if the battery meets specific sourcing requirements, for a total of \$7,500 in tax credit. The North America final assembly requirement differs from a previously proposed bill that would have required U.S. assembly, which Canada and Mexico raised concerns over. The battery sourcing requirements may further change the North American motor vehicle supply chain if producers choose to comply in order for their EVs to be eligible for the tax credit. Other U.S. trading partners, including the European Union, Japan, and South Korea, have stated that the requirements violate World Trade Organization rules.

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 January 2022 panel decision on the ROO dispute?
- What are the effects of the new ROO on the U.S. motor vehicle industry?
- How have the new ROO impacted small and medium motor vehicle producers/suppliers?
- How are North American vehicle manufacturers responding to the new ROOs?
- Have there been implementation and/or compliance issues with the LVC requirements? If so, what?

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