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TPP Issue Analysis: Trade in the Automotive Manufacturing Supply Chain

The U.S. government has estimated that nearly a million Americans work in automotive manufacturing.¹ But even this is a relatively narrow measure of the industry's importance to the U.S. economy. As President Obama has said:

This industry is like no other – it's an emblem of the American spirit; a once and future symbol of America's success. It's what helped build the middle class and sustained it throughout the 20th century. It's a source of deep pride for the generations of American workers whose hard work and imagination led to some

¹ U.S. Bureau of Labor Statistics, "Automotive Industry: Employment, Earnings, Hours" (data extracted on December 30, 2015) <http://www.bls.gov/iag/tgs/iagauto.htm>.

of the finest cars the world has ever known. It's a pillar of our economy that has held up the dreams of millions of our people.²

The automotive industry also plays a critical role in U.S. trade. It is the largest source of U.S. exports.³ And auto manufacturing has played and continues to play a critical role in many of the most industrialized economies of the world, such as in Germany and Japan, and has a major impact on many other sectors of the economy. Auto trade has also historically been a chief source of friction among the United States and some of its trading partners that have much more closed home markets.

TPP is one of the most important trade agreements ever for the global automotive industry. The 12 TPP parties are both major *consumers* of automotive products, representing nearly 40 percent of world GDP,⁴ and major *producers* of automotive products, covering four of the world's top 10 automotive producers: the United States (second after China); Japan (third); Mexico (seventh); and Canada (tenth).⁵

TPP raises the following two critical questions, and the upcoming forum will help to answer them:

1. **Market Access. Will TPP help to ensure more reciprocal trade in autos by opening historically closed markets, such as Japan's, to U.S. exporters? Or will the United States be required to open its market even further to imports before other countries open their markets to us?**

As a preliminary matter, it is unclear whether the TPP will succeed where past agreements failed in opening the Japanese market; however, the tariff phaseouts for imports of cars and trucks into the United States appear to be sufficiently long to provide a period for Japan to demonstrate it has opened its market before the United States is required to further open its market to more imports from Japan

2. **Rules of Origin. What impact will the rules of origin in TPP have on U.S. jobs and manufacturing in the United States, particularly given the differences between the TPP rules and the NAFTA rules?**

As a preliminary matter, it appears that the rules of origin in TPP are weaker than the NAFTA rules. The weaker rules of origin can be expected to be harmful for U.S. production of auto parts, particularly more basic parts, and possibly finished vehicles as well. But the magnitude of the harm is difficult to assess. The analysis of the U.S. International Trade Commission may be helpful to ascertain whether and to what extent the weaker rules of origin will impact U.S. businesses and workers.

² Remarks by the President on the American Automotive Industry (March 30, 2009)

<https://www.whitehouse.gov/the-press-office/remarks-president-american-automotive-industry-33009>.

³ See http://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf, Exhibit 7, taking automotive products (including vehicles, parts, and engines) as a breakout of the larger category of capital goods.

⁴ See <http://data.worldbank.org/data-catalog/GDP-ranking-table>.

⁵ See <http://www.oica.net/category/production-statistics/2014-statistics/>.

Each of these issues is discussed further below.

I. **“Market Access”: Addressing Tariff and Non-Tariff Barriers with TPP Countries**

A. **Overview of the TPP Auto Markets**

By far the most important automotive “market access” issue in TPP concerns Japan, the largest TPP economy (after the United States) and one with which we do not already have a trade agreement. From the perspective of U.S. automotive *exports*, the Japanese market is the third largest in the world – and is more than three times as large as the markets for Brunei, Malaysia, New Zealand, and Vietnam *combined* (i.e., the four other TPP countries with which the United States does not already have a trade agreement).⁶ From an *import* perspective, imports from Japan already constitute nearly 40 percent of the total U.S. auto market. (And imports from these four other TPP parties are virtually non-existent.)

With respect to the six TPP parties that already have trade agreements with the United States⁷, the United States has already eliminated auto tariffs on a reciprocal basis. That is not to say, however, that there are not major automotive-related trade issues with these countries. To the contrary, as global automotive manufacturers invest tens of billions of dollars annually in Mexico⁸ (with some help in the form of subsidies from the federal and state governments in Mexico⁹), Mexico is quickly becoming an automotive export powerhouse, with nearly three-

⁶ It is important to note that TPP will help to open these other markets to U.S. exporters. For example, Malaysia will eliminate its 30% duty on U.S. motor vehicles over the course of up to 13 years, and Vietnam will eliminate its tariffs of up to 70% on vehicles and 27% on parts over the course of up to 12 and 11 years respectively. While the tariffs being eliminated are significant, the time horizon over which those tariffs will be reduced and eventually eliminated are long, something the industry trade advisory committee for autos considered “disappointing.” See *Advisory Committee Report to the President, the Congress, and the United States Trade Representative on the Trans Pacific Partnership Trade Agreement*, Industry Trade Advisory Committee on Automotive Equipment and Capital Goods (ITAC 2) (December 2, 2015) at pp. 5-6 (“The Malaysia and Vietnam motor vehicle markets offer important export opportunities for U.S. motor vehicle and automotive parts manufacturers. Although the tariff phase-down commitments are comprehensive, disappointingly the most important vehicle categories will not be completed until 13 years after the agreement is implemented. With regards to auto parts tariffs, Malaysia will open its auto parts market to imports rapidly, but Vietnam will not open its auto parts market for between 3-11 years. In comparison most all U.S. auto parts tariffs are immediate duty free.”).

⁷ Canada and Mexico under NAFTA; Australia, Chile, Peru, and Singapore under bilateral trade agreements.

⁸ See “Automakers ramp up Mexican production,” Detroit News (April 15, 2015) <http://www.detroitnews.com/story/business/autos/foreign/2015/04/15/automakers-ramp-mexican-production/25812473/>.

⁹ See “Workers May Be Losers in Mexico’s Car Boom,” Washington Post (June 17, 2015) (“Mexican states, in their competition to attract auto investment, make the deals even sweeter. Companies have been given land, tax breaks and infrastructure by local governments. At the Mazda plant in Guanajuato, the state government agreed to pay half of the employee salaries for six months.”) http://www.washingtonpost.com/world/the-america/workers-may-be-losers-in-mexico-car-boom/2015/06/17/03da0a96-ee7f-11e4-8050-839e9234b303_story.html?hpid=z8; “Mexican Subsidies for BMW under Fire,” Deutsche Welle (February 1, 2015) (“For its new plant, the German carmaker is to get a total of 3,500 pesos (196 million euros, \$236 million) in tax breaks, concessions and other support payments out of San Luis Potosi’s budget. In return, BMW commits to creating up to 1,500 jobs there by 2024 and invest \$1 billion over the next 15 years. But according to La Jornada, the auto maker can cancel the deal at any stage without having to make punitive payments.”) <http://www.dw.com/en/mexican-subsidies-for-bmw-under-fire/a-18167227>; and “Incentives for Manufacturing in Mexico,” <http://www.mexicogov.org/incentives.php>.

quarters of those exports flowing to the U.S. market.¹⁰ General Motors predicts Mexico could become the second largest global exporter by 2020.¹¹ And Mexico, which has long failed to meet internationally recognized standards for worker rights, pays its auto workers only 14 to 25 percent what U.S. auto workers make.¹² The subject of worker rights in Mexico, however, will be addressed in a separate forum.

B. History of the One-way Flow in U.S.-Japan Auto Trade

Japan has long been the most closed auto market among industrialized nations, with imports from all countries constituting just six percent of the Japanese market.¹³ Although Japan currently imposes no tariffs on imports, it has effectively shut out foreign imports through a range of non-tariff barriers that include unique, Japan-specific safety and environmental regulations, high auto-related taxes, zoning laws and other obstacles to establishing dealerships, service and repair center for foreign cars.¹⁴ This type of closed or “sanctuary” market typically allows a country to charge high prices in the home market, which are then used to subsidize low price sales in markets overseas.

In 2014, Japan supplied nearly 20 percent of the vehicles imported into the U.S. market by value, even with U.S. import tariffs of 2.5 percent for passenger vehicles and 25 percent for trucks.¹⁵ Japan has also managed to export to the United States ten times more auto parts by value than the United States has been able to export to Japan, with an average U.S. tariff of 2.5 percent in place for auto parts.¹⁶

¹⁰ “Mexico Sets Auto Production Record, Aims for More,” Wall Street Journal (January 8, 2015) <http://www.wsj.com/articles/mexico-sets-auto-production-record-aims-for-more-1420749573>.

¹¹ “The Mexican Automotive Industry: Leading the World,” Galicia, Armando Cortés, Negocios ProMéxico (April 2015) at p. 50, <https://www.promexico.gob.mx/documentos/revista-negocios/pdf/abr-2015.pdf>.

¹² See “Workers May Be Losers in Mexico’s Car Boom,” Washington Post (June 17, 2015) https://www.washingtonpost.com/world/the_americas/workers-may-be-losers-in-mexicos-car-boom/2015/06/17/03da0a96-ee7f-11e4-8050-839e9234b303_story.html?hpid=z8.

¹³ See “These 5 Facts Explain the Obstacles to the Trans-Pacific Partnership,” Time Magazine (August 7, 2015) <http://time.com/3980075/these-5-facts-explain-the-obstacles-to-the-trans-pacific-partnership/>; and Submission of the American Automotive Policy Council in Response to the Office of the United States Trade Representative’s Request for Comments on Negotiating Objectives with Respect to Japan’s Participation in the Proposed Trans-Pacific Partnership Trade Agreement (June 2013) at 4. <http://americanautocouncil.org/sites/default/files/AAPC%20Submission-USTR%20TPP%20Japan%20FINAL%20June%209%20SUBMITTED.pdf>.

¹⁴ Submission of the American Automotive Policy Council in Response to the Office of the United States Trade Representative’s Request for Comments on Negotiating Objectives with Respect to Japan’s Participation in the Proposed Trans-Pacific Partnership Trade Agreement (June 2013) <http://americanautocouncil.org/sites/default/files/AAPC%20Submission-USTR%20TPP%20Japan%20FINAL%20June%209%20SUBMITTED.pdf>.

¹⁵ See <http://www.census.gov/foreign-trade/statistics/product/enduse/imports/index.html#J>.

¹⁶ In 2014, the United States imported \$14.5 billion in auto parts from Japan while it exported only \$1.4 billion to Japan.

http://www.trade.gov/mas/manufacturing/OAAI/build/groups/public/@tg_oaai/documents/webcontent/tg_oaai_004_047.pdf.

As a result, for more than thirty years, the United States has run massive trade deficits with Japan. In 2014, the U.S. trade deficit with Japan of \$67 billion was the third largest (after China and Germany), and the automotive deficit of \$49 billion (including vehicles and parts) represented 70 percent of that overall deficit.¹⁷

The extreme imbalance in the U.S.-Japan trade in automobiles has long been a source of friction in the bilateral trade relationship. And the many attempts that the United States has made over the years to open Japan's auto market have all failed. In the 1970s and 1980s, Japan made significant inroads exporting its cars to the relatively open U.S. auto market. At the same time, Japan provided substantial shelter to its automakers at home by keeping its market closed through high tariffs and non-tariff barriers. The resulting one-way trade pattern that developed sparked four forceful attempts by the United States to pursue reciprocal access to Japan's market in the years between 1985 and 1995.

These efforts culminated in the conclusion of the U.S.-Japan Auto Agreement in 1995. In announcing the agreement, then-President Clinton remarked that "[t]rade must be a two-way street" and that the agreement would "move cars and parts both ways between the United States and Japan" because Japan would take steps to, among other things, increase the number of dealers in Japan selling non-Japanese cars and loosen certain regulations to permit more U.S. auto parts to be sold in Japan.¹⁸

U.S. automakers responded with enthusiasm, making large investments in the United States and in Japan aimed at substantially increasing sales and operations in Japan. After initial improvements in penetrating Japan's auto market, U.S. automakers saw sales of their autos in Japan slow and falter as the yen weakened against the dollar. In a letter to USTR in June 1998, the President of the American Automobile Manufacturers Association pointed out that the massive 45 percent depreciation of the yen following a series of direct interventions by the Bank of Japan had effectively negated any market opportunities achieved by the 1995 agreement. This last major attempt to crack open Japan's automotive market also ended in failure and frustration.

C. The U.S. TPP Auto Market Access Negotiations: Goals and Outcomes

For the United States, the challenge in negotiating the terms for automotive market access in the TPP has been to secure effective opportunities for U.S. industry to overcome Japan's non-tariff barriers and penetrate the markets that have been hitherto impermeable and leveraging, to the maximum extent possible, the reduction and eventual elimination of U.S. import tariffs on motor vehicles and parts in order to open Japan's auto market.

When Japan joined the TPP negotiations in 2013, many expressed serious concerns including the American Automotive Policy Council (AAPC), which opposed Japan's participation in the TPP. Almost universally, those who have witnessed the repeated attempts and repeated failures of the United States to make meaningful inroads into Japan's auto market

¹⁷ See U.S. Dept. of Commerce, Bureau of Census, U.S. International Trade Commission (ITC) database, HTS Definition by USDOC/ITA/OAA.

¹⁸ President William J. Clinton, Remarks on the Japan-United States Trade Agreement (June 28, 1995) <http://www.gpo.gov/fdsys/pkg/WCPD-1995-07-03/pdf/WCPD-1995-07-03-Pg1147.pdf>.

have focused on the need for a renewed and even more assertive approach in the TPP negotiations. The approach required that U.S. negotiators seek to achieve specific outcomes in at least the following three separate areas in order to ensure the best chances of reversing the one-way pattern of auto trade between the United States and Japan: (1) phasing out of U.S. auto tariffs; (2) disciplines on non-tariff barriers, including disciplines on currency manipulation; and (3) a special dispute settlement mechanism for U.S.-Japan autos trade.¹⁹

The results from the automotive market access negotiations between the United States and Japan in these three areas are described and assessed below.

1. Tariff Phase-Outs (Cars, Trucks, Auto Parts)

Some²⁰ proposed phasing out U.S. tariffs for motor vehicles and auto parts as soon as, but not before, Japan established a consistent record of openness to imports, in line with the import penetration level of other industrialized nations. Alternatively, it was proposed that the United States not reduce its tariffs on auto products until 25 years, and not eliminate U.S. tariffs until 30 years, after the TPP agreement has entered into force. The purpose of this alternative was, in part, to provide sufficient time for Japan to demonstrate that it is open to auto imports before the United States was required to further open its market to Japanese imports.

The outcome of the negotiations is mixed.

With respect to **passenger vehicles**, the U.S.-Japan bilateral automotive market access outcome in the TPP provides that the U.S. tariff of 2.5 percent on passenger vehicles will be eliminated over the course of 25 years with reduction to 2.25 percent, beginning in year 15; to 1.25 percent in year 20; to 0.5 percent in year 22; and finally to zero in year 25.²¹ This outcome falls short of a goal of not reducing tariffs until year 25 (tariffs begin phasing out in year 15), reducing tariffs over the course of five years (tariffs will be reduced for 10 years, between year 15 and 25), and not eliminating the tariff until year 30 (the tariff will be eliminated in year 25).

With respect to **trucks**, TPP provides that the U.S. tariff of 25 percent on trucks will not be eliminated for Japan until year 30 of the agreement, with no reduction in the interim. This means that the U.S. truck tariff will remain at 25 percent until it is eliminated in the 30th year that

¹⁹ See U.S.-Japan Automotive Trade: Proposal to Level the Playing Field (<http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/Levin%20--%20Japan-TPP%20Proposal.pdf>) and Submission of the American Automotive Policy Council in Response to the Office of the United States Trade Representative's Request for Comments on Negotiating Objectives with Respect to Japan's Participation in the Proposed Trans-Pacific Partnership Trade Agreement (June 2013) (<http://americanautocouncil.org/sites/default/files/AAPC%20Submission-USTR%20TPP%20Japan%20FINAL%20June%202013%20SUBMITTED.pdf>).

²⁰ See U.S.-Japan Automotive Trade: Proposal to Level the Playing Field (<http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/Levin%20--%20Japan-TPP%20Proposal.pdf>).

²¹ See U.S. Tariff Elimination Schedule for products falling under heading 87.03 (<https://ustr.gov/sites/default/files/TPP-Final-Text-US-Tariff-Elimination-Schedule.pdf>) and the General Notes to the Tariff Schedule of the United States, Section 4(aa) (<https://ustr.gov/sites/default/files/TPP-Final-Text-US-General-Notes-to-Tariff-Schedule.pdf>).

the TPP is in effect. This outcome exceeds the goal of maintaining the tariff until year 25 and reducing it by increments until elimination in year 30.

With respect to **auto parts**, the TPP provides that U.S. tariffs on 80 percent of auto parts originating from Japan will be eliminated on entry into force of the TPP. Tariffs on particularly sensitive products (for the steel and auto industries) will be reduced on different schedules, with the most sensitive products being subject to annual reductions until elimination in the 15th year of the agreement. This outcome falls short of a goal of maintaining U.S. tariffs for 25 years before phasing out and being eliminated in year 30; even the longest phase-outs, for a very select group of products, will last only 15 years.

2. Non-Tariff Barriers

The challenge set out for U.S. negotiators for removing Japan's significant non-tariff barriers reflect the long and disappointing history of U.S. attempts to access Japan's automotive market. These were to: secure Japan's commitment to eliminate all existing non-tariff barriers in the auto sector, including trade in auto parts; establish effective mechanisms to avoid Japan adopting new non-tariff barriers and to immediately address new concerns with existing measures; and, of monumental importance to U.S. automakers, to impose disciplines on currency manipulation.

With respect to the **elimination of existing non-tariff barriers**, the U.S.-Japan bilateral agreement on automotive trade in the TPP provides:

- (1) for various disciplines on Japan's adoption of technical regulations related to motor vehicles including, e.g., ensuring regulations are not adopted to create unnecessary obstacles to trade, not preventing or delaying the marketing of motor vehicles because it incorporates new technology or features;
- (2) that Japan will recognize that U.S. vehicles comply with Japanese safety standards when those vehicles comply with U.S. standards that are recognized by Japan's authorities as "no less stringent" than the Japanese standards (Japan's authorities have also confirmed recognition of seven U.S. safety standards as being equivalent to Japanese standards); and
- (3) that Japan will permit the importation and use of replacement parts needed to repair or service parts for U.S. autos and not require those parts to undergo an additional safety inspection.²²

In terms of **establishing mechanisms to avoid adopting new non-tariff barriers and to address new concerns with existing measures**, the U.S.-Japan bilateral deal requires:

- (1) notice-and-comment procedures for regulations mandating a substantial change in design or technology;

²² See Appendix between Japan and the United States on Motor Vehicle Trade, U.S. Tariff Schedule Appendix D and Appendix D to the Schedule of Japan.

- (2) advisory groups to relevant government regulatory agencies be established and operated in a transparent manner (including publication and notice, opening meetings to the public, allowing interested parties to appear or submit information to such groups, making available meeting minutes); and
- (3) Japan to supply the United States on request with additional information regarding the regulations or standards, including other regulatory approaches being considered and any impact analysis.²³

With respect to **currency disciplines**, which some have described as the most serious non-tariff barrier U.S. exporters have faced over the years in the Japanese market, the TPP does not itself address currency manipulation. Instead, that issue is addressed in the Joint Declaration of the Macroeconomic Policy Authorities of Trans-Pacific Partnership Countries. Currency manipulation was the subject of an earlier TPP forum.²⁴

The U.S.-Japan automotive agreement in the TPP provides for a number of disciplines and procedural mechanisms for addressing existing and potential non-tariff barriers to the Japanese auto market. The increase in transparency and process enhancements are positive developments and the additional disciplines are enforceable through dispute settlement. However, it is difficult to say whether the provisions in this agreement will make a significant difference in U.S. industry's ability to access Japan's market. While these new provisions may prove to be helpful, some experts and stakeholders remain skeptical that these rules and procedures alone (without meaningful disciplines on currency manipulation) will result in significant new access to Japan's auto market, given the U.S. industry experience with the competitive damage that results from other countries' interventions to actively weaken their currencies against the U.S. dollar in order to stimulate their exports (and auto exports in particular).²⁵

²³ Id.

²⁴ That forum took place on January 7, 2016. See <http://democrats.waysandmeans.house.gov/press-release/advisory-wm-democrats-host-%E2%80%98trading-views%E2%80%99-tpp-hearing-currency-manipulation>.

²⁵ See *Advisory Committee Report to the President, the Congress, and the United States Trade Representative on the Trans Pacific Partnership Trade Agreement*, ITAC 2 (December 2, 2015) at pp. 7-8 (“ITAC 2 Automotive Equipment members note that commitments made by Japan to the United States in the Appendix D and the automotive-related side letters, aimed in large part at addressing the non-tariff barriers U.S. motor vehicle exports face in Japan, marginally improves U.S. automakers access to the Japanese domestic automotive market. . . . However, given the scope of what is covered and the decades long experience in previous agreements with Japan that have taken similar approaches, the view of ITAC 2 Automotive Equipment members is that these commitments will not lead to a substantially larger U.S. presence in the Japanese motor vehicle market.”)

3. Special Dispute Settlement Mechanism

The goals for the U.S.-Japan automotive negotiations in TPP also called for the establishment of a dispute settlement mechanism that: (1) is applicable specifically to United States-Japan automotive trade; and (2) permits the United States, where Japan has been found to have acted inconsistently with its obligations under the TPP agreement, to (a) suspend benefits accruing to Japan by delaying the reduction of U.S. tariffs, if U.S. tariffs have not yet been reduced, and (b) to re-impose tariffs to pre-reduction levels, if U.S. tariffs have started being or have already been reduced.

TPP establishes a special and additional dispute settlement mechanism for resolving any disputes between the United States and Japan that arise under any of the obligations in the TPP Agreement relating to motor vehicles.²⁶ This mechanism is also expedited, designed to run approximately 30 percent faster than the TPP-wide mechanism. It becomes available on January 1 of the second year following entry into force of the TPP Agreement and lapses five years after U.S. tariffs on motor vehicles (including both passenger cars and trucks) have been eliminated, taking into account any delays in reduction and implementation that result from dispute settlement actions taken pursuant to this mechanism.

The U.S.-Japan autos-specific dispute settlement mechanism also provides for special remedies not available under the TPP-wide mechanism. If Japan is found to be in breach of its TPP obligations with respect to trade in vehicles (either passenger cars or trucks), the United States will be authorized to do the following: (a) when the U.S. tariffs on passenger cars or trucks has already started being or been reduced, re-impose tariffs on vehicles (passenger cars and/or trucks) that have already been reduced or re-impose tariffs on other imports from Japan that have already been reduced, or (b) when the U.S. tariffs on motor vehicles have not yet been reduced, delay implementation of the tariff reduction or elimination schedule for vehicles (passenger cars or trucks) in accordance with a formula that takes into account the duration of Japan's maintenance of its breach, the level of trade damage caused by the breach, and the value of the imports from Japan to the United States for passenger cars and trucks.

It is worth noting that this expedited mechanism with special remedies is available to both the United States and Japan, with modifications to the remedies available to Japan that reflect the fact that Japan maintains no tariffs on motor vehicles and the difference in scale between the value of imports from Japan to the United States and imports from the United States to Japan.

II. “Rules of Origin” and Their Impact on U.S. Auto Parts Producers

A. What Are “Rules of Origin”?

A critical component to understanding the potential effects of TPP on automotive production – and jobs – in the North American region is understanding the circumstances under which a particular good *qualifies* for the preferential tariff treatment provided for under the agreement. Tariff preferences will generally only be available for goods that “originate” in the TPP

²⁶ Appendix between Japan and the United States on Motor Vehicle Trade, Art. 7.

region – that is, goods that contain enough regional content, or are sufficiently processed in the region, to merit preferential treatment. “Rules of origin” are used to determine whether a particular good qualifies.

Rules of origin are considered a highly technical aspect of trade law. But they are as important as the tariffs themselves. If the rules required *no* particular amount of processing in the region, then goods from non-parties to the agreement would enjoy the same benefits as goods from countries that *are* parties to the agreement. That in turn means that the tariff preferences would essentially be available to every trading partner, not the parties to the particular agreement in question. Yet non-parties do not commit to any obligations themselves, be it reciprocal tariff benefits, or any of the other provisions of the chapter on labor, the environment, or state owned enterprises. Therefore, there must be *some* disciplines on which goods are eligible for the preferential treatment, in order to ensure that the benefits to the agreement flow primarily to the parties that have signed onto the agreement’s obligations.

On the other hand, if the rules are too constraining – for example, requiring 100% content in the region – then they are effectively unusable given that complex supply chains mean that virtually every manufactured product contains *some* foreign content. Producers would ignore the rules of origin when making sourcing decisions and the TPP Agreement with its tariff preferences would become irrelevant.

Optimal rules of origin strike the balance between incentivizing production in the region, without being so strict that the rules – and preferences -- are ignored.

Thus, the question of what the “market access” provisions will actually deliver in terms of increased production in the United States, and the TPP region more generally, depends in part on the rules of origin used to determine which goods qualify for benefits.

The bottom line is that a strong rule of origin will ensure maximum production within the trade agreement region, provided the rule is not so strong that auto producers find it unusable. A weak rule of origin creates outsized incentives to source from outside the TPP region.

With that overview, we turn to the automotive industry in particular.

B. The NAFTA Rules of Origin and the Integrated North American Market

The United States and Canada began integrating their automotive markets in 1965, with the Canada-United States Automotive Products Agreement.²⁷ In 1989, the parties went further by concluding a bilateral trade agreement. In 1994, with NAFTA, they added Mexico to their bilateral agreement, creating a regional area with interdependent automotive supply chains, although the markets themselves and the regulatory environments in each country still have some major differences, such as those concerning labor standards as mentioned above. Indeed, in 1998, the Center for Strategic and International Studies wrote that “[t]he auto industry is at the

²⁷ Congressional Research Service, The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Automotive Rules of Origin, note 15.

heart of NAFTA If any single sector can provide a measure of NAFTA’s performance, it is the auto industry.”²⁸

NAFTA sets out a regional value content requirement of 62.5% for vehicles and most parts, with a 60% requirement for most of the remaining parts.²⁹ These rules are based on the “net cost” methodology with several important corollary rules, such as “tracing” and “deemed originating,” as described in the attached annex.

Given that all three NAFTA parties are also TPP parties, some have argued that the TPP rule of origin should be at least as strong³⁰ or stronger³¹ than the NAFTA rule. The NAFTA rule has clearly achieved its purpose. Automotive trade has grown dramatically under the NAFTA rule. And the TPP Agreement will include nine more parties, including Japan, a major auto and auto parts producer.

C. The TPP Rules of Origin

1. Passenger Cars and Trucks

a. The “Net Cost” Option

The TPP rule of origin for automobiles and trucks is 45% under the “net cost” method – 17.5 percentage points below the NAFTA net cost requirement of 62.5%. This difference suggests that more content can come from non-TPP countries like China, Germany, and Thailand – and therefore less content can come from U.S. auto parts producers and others in the trade agreement region.

This 17.5 percentage point gap, however, may be less than, or more than, it seems, based on differences between methods of calculating the RVC under TPP and NAFTA. As explained further in the attached Technical Annex, the TPP rules do not include the NAFTA “tracing” or “deemed originating” rules for calculating the RVC. But, because these two rules have opposite or offsetting effects, it is unclear *in the abstract* exactly how the TPP 45% rule compares to the NAFTA 62.5% rule. We do not have access to the business proprietary information needed to know *in fact* how the two rules compare.³²

Industry advisors, however, indicate that USTR had informed them that the equivalent was perhaps as low as the mid-fifties,³³ and more specifically it appears that USTR has indicated

²⁸ Sidney Weintraub and Christopher Sands, The North American Auto Industry since NAFTA: Introduction, CSIS 1998, p. 1.

²⁹ Some parts have an RVC of 50%.

³⁰ See, e.g., Amendment to Senate Amendment to H.R. 1314, offered by Mr. Levin (“Right Track for the Trans-Pacific Partnership Act of 2015”), section 102(a)(7).

³¹ See, e.g., Joint Statement of United Steelworkers, United Auto Workers and International Association of Machinists, http://www.goiam.org/images/articles/imap/latest-icemail/2013/Sep-Dec/10_31_2013_TPP_Updated.pdf

³² In his Path Forward on the Trans Pacific Partnership issued in January 2015, Ranking Member Levin proposed that “[b]efore the rules of origin are finalized, the Administration should prepare a report to Congress based on empirical evidence that explains the rule of origin for automotive products, textile and apparel products, and other products where the rule of origin is key.”

<http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/A%20Path%20Forward%20to%20an%20Effective%20TPP%20Agreement%201.pdf>

³³ ITAC-12 report, p. 14.

the number may be 53%. Thus, the TPP rule (45% net cost) is weaker than the NAFTA rule (no lower than 53% net cost, when adjusted for more of an apples-to-apples comparison).

Moreover, it appears that a special appendix would lower this number even further. The United States and Japan negotiated an appendix that is applicable to all parties. Table A of that appendix provides a list of parts, including safety glass, bodies, body stampings, bumpers, and drive axles.³⁴ If one of a list of operations is performed on those parts, they are deemed originating, and their value counts as originating content for purposes of calculating the RVC for the finished vehicle. The list of operations includes complex assembly, machining, stamping, and laminating.

Thus, today under NAFTA, to get duty-free treatment a car or truck imported into the United States must have at least 53% of its value originate within Canada, Mexico, and/or the United States. But, the day TPP enters into force, that same car can enter the United States duty free with just 45% content, either from just those three countries, or from other TPP countries as well. And that figure – 45% -- does not count the additional flexibilities provided in a special appendix.³⁵ This means, for example, that for the first time under TPP a car from Canada or Mexico can enter the United States duty-free with (1) unlimited auto part content from the TPP countries not covered by NAFTA, such as Japan; and (2) at least eight percent more auto part content from the rest of the world, such as China, Germany, or Thailand. This would enable parts that are currently produced in the NAFTA region to be sourced from these other countries and still get duty-free treatment when the final product is circulated in Canada or Mexico.

There are other differences between NAFTA and TPP, apart from the rules of origin, that would appear to create other new incentives to source auto inputs from outside the trade agreement region. Specifically, NAFTA restricts “duty drawback” whereas TPP’s silence on that issue suggests it is permitted. Under duty drawback, the import duties paid on an input can be refunded when that input is incorporated into an exported product. Thus, for example, under NAFTA, if an automaker in Mexico pays the Mexican government a 10% duty on an imported bumper from China, the Mexican government may not refund that duty when the car is exported to the United States. But under TPP, it appears that the Mexican government may refund those duties. That creates an additional incentive to source the bumper from China instead of from the United States or other TPP countries.

Finally, it is important to recognize that the rule of origin in TPP would not have any obvious impact on auto parts sourcing with respect to U.S. imports of Japanese motor vehicles until the tariff on cars and trucks is reduced (in year 15 for cars and year 30 for trucks). This is because rules of origin only matter if the exporter is claiming a tariff preference under the trade agreement, and there is no tariff preference for imports of Japanese vehicles during the first 15 years for cars and 30 years for trucks.

³⁴ See Table A to Appendix 1 to Annex 3-D.

³⁵ The NAFTA and the TPP Agreement will co-exist. TPP will not replace NAFTA. Thus, a Mexican or Canadian auto exporter could continue to rely upon the NAFTA rules when it exports cars to the United States. However, as explained above, the weaker TPP rule of origin makes it less likely that they would do so.

b. The “Build Down” Option

Whereas NAFTA only provided one option for establishing origin and a right to preferential (duty-free) treatment finished automobiles, TPP provides an alternative. This additional methodology is based on the price paid or payable for a good (its “transaction value”) instead of its “net cost.” More than one methodology is based on transaction value, but for purposes of this discussion the important one is “build down.” For technical reasons, the “build down” methodology makes it is easier to meet a particular RVC threshold, and as a result, the RVC for “build down” is higher than it is for “net cost.” Specifically, under TPP, an auto is eligible for preferential tariff treatment if 55% of its value originates within the TPP countries under build down. (Build down is described in the attached Annex.)

Because this rule was not included in NAFTA, it provides exporters with additional flexibility: they can choose *either* to rely upon the 45% net cost method *or* the 55% “build down method.” They do not need to satisfy both requirements.

It is difficult in the abstract to compare this 55% build down method to NAFTA’s 62.5% net cost method, and we lack the business proprietary information to determine how they compare in ‘real world’ scenarios. However, “build down” includes more costs than does “net cost.” As a result, if one were to convert a build down number into a net cost equivalent, the net cost equivalent would be a lower number than the build down number. (In fact, under existing trade agreements, it appears that the negotiators concluded that equivalent content would be achieved by a net cost rule that is 20 percentage points lower than a build down rule.) In other words, a car under NAFTA that has 55% TPP content under a build down methodology likely has something less than 55% under a net cost methodology – perhaps as little as 35% under a net cost methodology.

Thus, as with the net cost method, it appears that the “build down” method of calculating the rule of origin in TPP is weaker than the rule of origin in NAFTA – and, in any event, an exporter gets to choose whichever of the two methods it likes best. This appears to mean that some auto parts that are currently produced in the United States for incorporation into automobiles that are made in Canada or Mexico could be produced in third countries such as China, Germany, or Thailand under TPP.

2. Auto Parts

a. The “Net Cost” Option

In TPP, the RVC on major parts ranges from 35% to 45% using net cost. There is no tracing list. “Deemed originating” will be discussed below. The RVC for automotive parts in NAFTA was higher: 60% or 62.5%, depending on the part (with some parts having an RVC of 50%).

As the attached chart indicates, the TPP rules more closely track the weaker net cost rules in KORUS (generally, 35%) than the stronger rules in NAFTA (mostly, 60% or 62.5%). As noted above, the justification for the lower RVC for KORUS was the need for U.S. producers to use parts from Mexico and Canada, which counted as non-originating under that agreement. Yet Mexico and Canada are parties to TPP, along with nine other countries besides the United States. Therefore, in the context of past agreements, the TPP RVCs seem exceptionally low.

There are two additional concerns. First, the special appendix described above also has provisions relating to parts, not just finished vehicles. As with finished vehicles, Table C of the appendix provides for even more flexibility to use non-originating materials and to have them count as originating under the agreement. The appendix sets out a list of operations, such as “complex assembly,” and a list of parts, such as engines, chassis, bumpers, brakes, drive axles, steering wheels, and suspension systems, and provides that, as long as one of the listed operations occurs in a TPP party, that part becomes originating. For these parts, there is a cap to how much the non-originating materials subject to one of the listed operations can contribute to the RVC, ranging from 5 to 10%.³⁶

By way of example, under the appendix, certain engines, and chassis fitted with engines, can be subjected to “complex assembly” in a TPP party and be considered originating, limited to a cap of 10%. The net cost RVC for these products is 45%; however, when the additional 10% flexibilities in the appendix are considered, the RVC effectively drops to 35%. Put differently, the RVC for a 12-party agreement that includes all three NAFTA parties is the same as the RVC for a 2-party agreement that only had one of the three. Recalling that the justification for the low KORUS RVC was the absence of Mexico and Canada, it is not clear on what basis the RVC for TPP can be explained.

In a sense, TPP has retained something similar to the NAFTA concept of “deemed originating” for these components, without its counterpart, the tracing list. That is, the aspect of NAFTA that facilitated non-originating materials was retained, in a much narrower form, but the aspect of NAFTA that restricted the ability of non-originating materials to become originating was *not* retained.

b. The “Build Down” Option

Whereas NAFTA only provided one option for establishing origin and a right to preferential (duty-free) treatment, TPP provides an alternative. This additional method is based on the price paid or payable for a good (its “transaction value”) instead of its “net cost.” Specifically, under TPP, an auto part can get preferential tariff treatment if between 45% and 55% of its value originates within the TPP countries under this method, depending on the part. (This methodology is described in the attached Annex.)

Because this rule was not included in NAFTA, it provides exporters with additional flexibility: they can choose *either* to rely upon the 35% to 45% net cost method *or* the 45% to 55% “build down method” (depending on the part). They do not need to satisfy both requirements.

It is difficult in the abstract to compare this 55% build down method to NAFTA’s 62.5% net cost method, and we lack the business proprietary information to determine how they compare in ‘real world’ scenarios. However, “build down” includes more costs than does “net cost.” As a result, if one were to convert a build down number into a net cost equivalent, the net cost equivalent would be a lower number than the build down number. (In fact, under existing trade agreements, it appears that the negotiators concluded that equivalent content would be achieved by a net cost rule that is 20 percentage points lower than a build down rule.) In other

³⁶ See Appendix 1 to Annex 3-D, Table C.

words, a car under NAFTA that has 55% TPP content under a build down methodology likely has something less than 55% under a net cost methodology – perhaps as little as 35% under a net cost methodology.

Thus, as with the net cost method, it appears that the “build down” method of calculating the rule of origin in TPP is weaker than the rule of origin in NAFTA – and, in any event, an exporter gets to choose whichever of the two methods it likes best. This appears to mean that some inputs (e.g., steel) that are currently produced in the United States for incorporation into auto parts that are made in Canada or Mexico could be produced in third countries such as China, Germany, or Thailand under TPP.

D. Putting the Pieces Together

As the analysis unfolds, it becomes clear that the risk of job loss in the NAFTA region, including the United States, becomes more acute further upstream due to the cascading effect of the rules throughout the production chain. Compare the incentives under the two agreements. Under NAFTA, the rule for the finished vehicle is 62.5%. Moving back through the production line, engines and their parts are also subject to a 62.5% rule. Moreover, under NAFTA’s special ‘tracing list’ rule, parts of engines sourced from outside NAFTA will always count as non-originating. The incentive, therefore, is to source originating engine parts in the NAFTA region to make it possible to meet the 62.5% rule of origin for engines, and the incentive is to source the engine in the NAFTA region as well, in order to meet the 62.5% content requirement for the finished vehicle.

By contrast, TPP has a lower overall content requirement for vehicles – 45%. That alone creates an incentive to source more parts outside the TPP region. Moreover, engine parts, for example, are not on a tracing list. The effective RVC of the engine is 35%, once the appendix is taken into account; as a result, 65% of the parts of an engine can come from outside the TPP region and still meet the RVC for the engine, meaning that the engine itself will be considered originating in the TPP region, and its full value will count toward the 45% RVC for the finished vehicle. The same analysis applies for bodies, chassis (fitted with engines) and, essentially, the other major components of a vehicle.

Moreover, it appears these TPP rules are even weaker than the KORUS rules, even though, as explained before, comparisons to KORUS are flawed because Canada and Mexico are not part of that agreement. For example, the build down RVC in KORUS is 55% for engines and chassis; but in TPP, once the special appendix is considered, the RVC is effectively only 45%.

These rules may have a particularly negative effect on raw materials producers, the producers at the beginning of the supply chain. This includes steel.

E. Industry Views

Two of the advisory groups weighed in with particularity on the automotive rules of origin. The automotive equipment manufacturers stated:

Most ITAC Automotive Equipment members view that the TPP’s RVC . . . for motor vehicles strikes the right balance between the ability of TPP-based

manufacturers that have made significant investments in the TPP region to enjoy the preferential tariff benefits of the TPP and preventing those that have not from enjoying the same benefits. That said, ITAC 2 Automotive Equipment members acknowledge the real concerns raised by some that the automotive rule of origin RVC is not sufficiently strong, particularly for automotive parts.³⁷

In addition, they “do not strongly object” to the special appendix because it is optional.³⁸ Again, however, this appendix, which reportedly was negotiated for the benefit of producers in Japan, confers an advantage on those who *do* use it, because it further lowers the amount of regional content that must be included in a vehicle or part in order to be eligible for preferential treatment under the agreement.³⁹ Finally, it is worth noting that, before the negotiations in Atlanta, the Motor Equipment Manufacturers Association wrote to USTR urging that the auto parts rules of origin “should reflect any final deal on finished motor vehicles.”⁴⁰ As explained above, the rules for auto parts in the final deal are weaker than the rules for finished vehicles.

The steel advisors confirmed their concerns about the automotive rules of origin. They wrote:

the automotive market is enormously important to the health of the domestic steel industry [representing] 26% of all 2014 domestic shipments [We are] very concerned that [the TPP automotive] rules [of origin] are likely to lead to greater use of non-U.S. and non-TPP steel in vehicles and automotive goods, which is a negative result for both U.S. steel companies and U.S. manufacturing in general. The TPP should not confer an advantage to producers whose primary supply chain is located outside the TPP region. [We believe] that the lower TPP RVC standard will diminish the benefits currently accruing to NAFTA steel producers, their integrated supply chains, and the NAFTA economy.⁴¹

The TPP RVC is apparently sufficiently low that North American steel producers jointly protested them in advance of the closing of the deal. In September, they issued a statement expressing concern about the “substantially lower” TPP rules of origin and urging their respective governments to insist on a stronger rule.⁴²

The increase in risk up the supply chain may explain why U.S. automotive equipment producers are split in terms of rendering an opinion on the adequacy of the TPP rules of origin.⁴³ Some parts producers will benefit from the flexibility of being able to use less expensive components from outside the TPP region, while still being part of the vehicle assembler’s supply

³⁷ ITAC 2 report, p. 7.

³⁸ ITAC 2 report, p. 7.

³⁹ One argument is that the rules of origin will not matter for Japan because of the lengthy U.S. phaseout of the tariff. However, that argument ignores the fact that U.S. producers will purportedly be competing with Japanese producers *in other TPP markets*. Thus, if Japanese producers are able to use more components from non-TPP countries, and U.S. producers are not, U.S. producers will be at a disadvantage.

⁴⁰ <http://www.mema.org/Document-Vault/MEMA-Industry-News/MEMA-TPP-ltr-2015.pdf>

⁴¹ ITAC-12 Report, December 3, 2015, p. 14.

⁴² http://www.steel.org/~media/Files/AISI/Public%20Policy/Letters/Joint_Letter_TPP-RVC_Sept_21_2015_signed.pdf?la=en

chain. Take the engine example above. The engine producer under TPP will have the flexibility to source parts from outside the TPP region, while still meeting the 45% (net cost) RVC. That is not possible under NAFTA because of the higher RVC and the tracing list restrictions that preclude non-originating engine parts from becoming originating. By contrast, the engine *parts* suppliers, and their suppliers, have increasing exposure, precisely because the engine producer has the additional flexibility to source from outside the region. Thus, the more remote the parts supplier is from the finished vehicle, the more risk that the supplier loses the advantage he currently enjoys under NAFTA.

e. Countervailing Arguments

There are arguments suggesting that the weaker TPP rules will not have a drastic effect on North American automotive production. For example, an argument has been floated that rules of origin do not necessarily drive sourcing decisions, and thus their relevance is overstated. For example, these arguments cite the 2.5% U.S. tariff on autos as being so low as not to be a serious driver of sourcing. There are several counterarguments. First, 2.5% is in some cases considered the difference between profit and loss on an automobile. Second, if the tariffs were irrelevant, then their elimination through NAFTA would presumably have not had much effect on North American automotive integration. Third, and perhaps most importantly, the tariff on trucks is 25%. Even if it were true that the 2.5% tariff were not significant enough to drive sourcing patterns, that argument would not seem to be viable with a tariff of 25%.

Another argument has to do with “just in time” production. That is, to some degree, parts producers will naturally be located in close proximity to the assemblers. This is the conventional wisdom for parts such as seats, one of the last products to be included in the vehicle, where assemblers cannot afford to have the seats subject to transportation or border delays. The argument for bodies is similar, but the argument is amplified by the fragility of the component, which makes it more challenging to transport.⁴⁴

On the other hand, while the concept of “just in time” production currently drives proximate production of late-stage components, there is no reason producers must adhere to this approach. If the financial incentives to source from a distance outweigh the benefits of just-in-time delivery, then it stands to reason that the latter will give way to the former. For example, in 2014 Japan exported \$347 million worth of certain engines⁴⁵ to the United States, a 37.5% increase over the previous year. Even body stampings are imported, with \$70 million coming from Taiwan – the leading exporter, above Mexico and Canada -- in 2014.⁴⁶ Therefore, it seems precarious to rest the fate of jobs in the automotive sector on current strategies that may ultimately be rendered obsolete.

The possibility of increased exports from North America to other TPP parties is also an issue to be considered. However, the Administration has not identified any actual expected increase in exports. USTR has cited “export opportunities” in Japan⁴⁷ but does not appear to

⁴⁴ Thomas Klier & James Rubenstein, Who Really Made Your Car? W.E. Upjohn Institute for Employment Research, 2008, pp. 83 and 88.

⁴⁵ HTSUS 8407.34.48 (“Spark-ignition reciprocating or rotary internal combustion piston engines . . . of a kind used in motor vehicles . . . of a cylinder capacity exceeding 2,000 cc [not used or rebuilt].”)

⁴⁶ HTSUS 8708.29.25 (“Body stampings [not for tractors suitable for agricultural use]”)

⁴⁷ <https://ustr.gov/tpp/#promoting-manufacturing>

have translated those changes into an estimated increase in actual exports there. The challenges in accessing that market have been described at length, and thus the prospects of increased exports are not necessarily promising. Other new markets are Malaysia and Vietnam. However, as explained in Part I above, these markets are fairly small.

Another argument in favor of weaker rules of origin in TPP is that, by giving downstream automakers more flexibility to choose their suppliers, the weaker rules will make U.S. automakers more competitive in the global market. On the other hand, we know that U.S. automakers can already meet the NAFTA rule of origin, whereas some have suggested that Asian automakers and auto parts makers have supply chains that are more integrated with non-TPP parties.

As noted above, there was a proposal that the Administration prepare an analysis of the rules of origin prior to closing the deal, so that many of these questions could be answered, and the basis for the ultimate set of rules would be known. In the absence of such an analysis, there is an increased concern of the potential impact of this to allow producers to outsource beyond TPP countries and maintain the non-TPP supply chain with countries such as China and Thailand. That comes at the expense of devising incentives to source within the TPP region, where the parties take on obligations that are meant to ensure that competition enjoys a level playing field – for example, by requiring parties to comply with core ILO labor standards. It seems that the desire to maintain supply chains with countries not obligated through TPP to abide by those standards trumped the desire to maintain supply chains with countries that are.

As noted above, the need to preserve jobs in the automotive supply chain was one of the bases for the Administration's assistance to the industry in 2009. What is not clear is how the TPP rules of origin fit in with the argument that the automobile industry is a core component of the American economy. It is vital that there be total clarity as to the impact of TPP on this industry under ROOs that are weaker than those under NAFTA – that is, weaker than those under the status quo.

Technical Annex on Rules of Origin Methodologies

There are different methodologies used to calculate regional value content (RVC), with the main variable being the cost or value used as the basis for making the calculation.

- *Net cost.* The method used by North American producers is “net cost.” Net cost is “total cost [incurred in the region] minus sales promotion, marketing and aftersales service costs, royalties, shipping and packing costs, and nonallowable interest costs”¹ With limited exceptions, net cost is the sole RVC method available under NAFTA.
- *Build down.* Producers outside of North America tend to use other methods, which are based on the price paid or payable for the good (“transaction value”), rather than its “net cost.” Transaction value includes some of the costs that are *not* included in net cost, such as profit and royalties. Those costs can be more challenging to value, and some have argued that, accordingly, they can influence whether a good is originating. Take profit, for example: “the question as to how high the profit margin can be has to be asked, i.e., an exporter cannot artificially increase the profit margin in order to qualify for preferential treatment.”²

Because of the differences between the net cost and transaction value methodologies, the RVCs for a particular good are adjusted to reflect those differences. In NAFTA, net cost is the default methodology for automotive goods, with the transaction value method available for some goods, and expressly *excluded* from being used for automotive goods. In the FTAs since NAFTA, the option of using methodologies based on transaction value is more widely available, but the gap between net cost and transaction value – typically expressed in the specific methodology called “build down” -- is 20 percentage points. Thus, for KORUS, the net cost RVC is 35% for cars, but the build down RVC is 55%. (As the name implies, “build down” starts with the transaction value and deducts the value of non-originating content to derive the RVC.³)

Under NAFTA, for those non-automotive goods where transaction value/build down was permitted, the gap was 10 percentage points, rather than 20.

There are two wrinkles to these rules that affect the actual amount of NAFTA content in the vehicles or parts. The first is the tracing list, and the second is “deemed originating.”

The tracing list. As the name implies, the tracing list sets out a list of parts. The parts on this list retain their origin, no matter how much further work is done on them. For example, engine parts are on the list. If an engine part comes from China, that engine part will never count toward the 62.5% threshold. That may seem like a perfectly normal outcome, but it isn’t under typical rule of origin principles.

¹ NAFTA Article 415.

² Anne van de Heetkamp and Ruud Rusveld, *Origin Management: Rules of Origin in Free Trade Agreements*, Springer-Verlag, 2011, p. 86

³ TPP Article 3.5. Build up is the reverse, where the calculation is based on adding up the value of originating materials to reach the required threshold, rather than beginning with the value and deducting non-originating materials.

Normally, if a part from outside a free trade area is sufficiently processed to become a different article of commerce, that part counts as if it were made in the free trade area. That is, it goes from being non-originating to originating. Under typical trade rules, if the engine parts from China are sufficiently processed in the free trade region to become originating – as a hypothetical, by being assembled into an engine -- the entire value of the engine counts as having been made in the region, including the non-originating parts. That is, the engine parts are “rolled up” into the engine, which is itself “originating” in the NAFTA region. The reasoning is simple: producers would otherwise have to trace every part, down to the raw materials, and that is simply too burdensome given modern supply chains.

The tracing list is a departure from this normal rule. For the goods on the tracing list, non-originating parts can *never* be counted as originating, no matter how much processing occurs. This creates an incentive to source the parts on the tracing list in the region, because only production actually occurring in the region can count towards the originating content of the final product – the engine, and in turn the vehicle.

Deemed originating. The flip side of the tracing list is that anything *not* on the list is considered to have originated in the region, no matter where it was actually made.

Part	HS Code	U.S. Duty	NAFTA RVC	Tracing List?	KORUS RVC	TPP RVC	TPP Appendix*
Bodies	8707.10 8707.90	2.5% to 4%	60 (NC)	Y	35 (NC) 35 (BU) 55 (BD)	35 (NC) 35 (BU) 45 (BD)	Complex assembly.**
Engines	8407.33 8407.34	2.5%	62.5 (NC)	Y	35 (NC) 35 (BU) 55 (BD)	45 (NC) 45 (BU) 55 (BD) (effectively 35/35/45 with the Appendix)	Complex assembly; cap of 10%
Chassis (fitted with engine)	8706.00	2.5% to 4%	60 (NC)	Y	35 (NC) 35 (BU) 55 (BD)	45 (NC) 45 (BU) 55 (BD) (effectively 35/35/45 with the Appendix)	Complex assembly; cap of 10%
Safety glass	7007.11 7007.21	5.5%	None: Change from any heading other than 7003 through 7009	Y	None: Change from any heading other than 7003 through 7009	None: Change from any other heading	For 7007.11 and 21: Heat-treating; laminating**
Bumpers	8708.10	2.5%	60 (NC)	Y (but not parts of bumpers)	35 (NC) 35 (BU) 55 (BD)	45 (NC) 45 (BU) 55 (BD)	For bumpers excluding bumper parts: ¹ Complex assembly; cap of 10%
Body stampings and door assemblies	8708.29	2.5%	60 (NC)	Y	35 (NC) 35 (BU) 55 (BD)	40 (NC) 40 (BU) 50 (BD)	For body stampings and door assemblies, excluding parts: Stamping, including

¹ This means that the finished bumper, as long as it is subject to operations listed in the Appendix, can be counted up to 10% as content for a subsequent component. However, bumper parts cannot be subject to complex assembly and counted 10% toward the RVC for the finished bumper. Rather, the bumper parts must independently meet the RVC for bumpers, which is 45% under net cost and 55% under

							pressing**
Drive axles	8708.50	2.5%	60 (NC)	Y	35 (NC) 35 (BU) 55 (BD)	40 (NC) 40 (BU) 50 (BD) (effectively 35/35/45 with the Appendix)	Complex assembly for drive axles and parts;** For parts of drive axles, a cap of 5%
Safety seat belts	8708.21	2.5%	60 (NC)	Y	35 (NC) 35 (BU) 55 (BD)	45 (NC) 45 (BU) 55 (BD) (effectively 35/35/45 with the Appendix)	Complex assembly; Cap of 10%
Other parts of bodies	8708.29	2.5%	60 (NC)	Some parts	35 (NC) 35 (BU) 55 (BD)	40 (NC) 40 (BU) 50 (BD) (effectively 35/35/45 with the Appendix)	Cap of 5%
Brakes	8708.30	2.5%	50 (NC)	N	35 (NC) 35 (BU) 55 (BD)	45 (NC) 45 (BU) 55 (BD) (effectively 35/35/45 with the Appendix)	Complex assembly; cap of 10%
Gear boxes and parts	8708.40	2.5%	60 (NC)	Y	35 (NC) 35 (BU) 55 (BD)	45 (NC) 45 (BU) 55 (BD) (effectively 35/35/45 with the Appendix)	Complex assembly; cap of 10%
Suspension systems	8708.80	2.5%	60 (NC)	Y (shock absorbers)	35 (NC) 35 (BU) 55 (BD)	45 (NC) 45 (BU) 55 (BD) (effectively 35/35/45)	Complex assembly; cap of 10%

						with the Appendix)	
Steering wheels	8708.94	2.5%	60 (NC)	Y	35 (NC) 35 (BU) 55 (BD)	45 (NC) 45 (BU) 55 (BD) (effectively 35/35/45 with the Appendix)	Complex assembly; cap of 10%
Safety airbags	8708.95	2.5%	50 (NC)	N	35 (NC) 35 (BU) 55 (BD)	40 (NC) 40 (BU) 50 (BD) (effectively 35/35/45 with the Appendix)	Complex assembly; 5%
Other parts	8708.99	Either free or 2.5%, depending on the part	60 (NC)	Some parts	35 (NC) 35 (BU) 55 (BD)	40 (NC) 40 (BU) 50 (BD) (effectively 35/35/45 with the Appendix)	Cap of 5%

*The Appendix lists a number of operations that render the good originating, no matter where the materials were sourced. This column identifies one of the operations that might apply given the part in question.

**Parts benefiting from this special rule may not be traded as finished goods across TPP borders, but rather must be incorporated into a finished vehicle that is itself traded.