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EPI comments to the Office of the United States Trade Representative on the US-Mexico-Canada Agreement with respect to automotive goods

Public Comments • By Adam S. Hersh • January 22, 2024

Submitted online on January 17, 2023 via https://www.federalregister.gov/documents/2023/11/22/2023-25765/request-for-comments-and-notice-of-public-hearing-concerning-the-operation-of-the-united

Mr. Justin Hoffmann
Deputy Assistant U.S. Trade Representative
for Market Access and Industrial
Competitiveness
Office of the USTR
600 17th Street NW
Washington, DC 20508

Dear Mr. Hoffman and members of the Interagency Committee on Trade in Automotive Goods:

Thank you for the opportunity to submit comment on the operation of the US-Mexico-Canada Agreement with respect to automotive goods. My name is Adam S. Hersh and I am Senior Economist at the Economic Policy Institute (EPI), a Washington, DC, 501(c)3 nonprofit organization created in 1986 to include the needs of low- and middle-income workers in economic policy discussions. This comment represents my own opinions and does not necessarily reflect those of EPI or its board.

Synopsis

The challenge for the U.S. and North American automotive industries remains the same today under USMCA as it did under NAFTA and before: surging automotive imports from low-wage, low-standard producers made possible by a regulatory environment favoring corporations and capital owners over workers and communities, wherever that may be in the global economy.

Today, this central problem is evolving, even since the formulation of USMCA: **intensifying import competition for parts, finished vehicles, and, increasingly, automotive IT services (operational software and personal user data) from Chinese and other foreign firms receiving unparalleled state subsidies**.

In particular, Chinese-owned and Chinese-affiliated firms have been repositioning their global footprint to launder the origins of their production chains through countries with more favorable tariff treatment in U.S. markets in response to U.S. trade enforcement measures like the 2018 Sections 232 and 301 tariffs and an ever-growing rap sheet of antidumping and countervailing duty actions. This includes Mexico, with a platform into North American automotive (and other manufactures) supply chains, as well as across South and Southeast Asia, from where U.S. automotive imports are also now surging. We have seen the same pattern before in other critical manufacturing industries like steel and aluminum, and other industries with subsidy-driven chronic global surplus capacity.[1]

Despite its advances over NAFTA, USMCA is ill-fit to address this challenge to the U.S. and North American automotive industries and to enable them to sustain good jobs given the right policy environment. To be sure, USTR must ensure the robust implementation of USMCA's terms *and* that U.S. trade policy is working in lock-step with other organs of the administration – including with macroeconomic policies impacting the competitive value of the U.S. dollar – to achieve U.S. industrial policy goals in transportation equipment and manufacturing more broadly.

Background

NAFTA was a raw deal for working people in the United States, Canada, and Mexico alike. Drafted with little transparency or concern for non-commercial interests – and without the participation of relevant stakeholders – what resulted was not a "free" trade agreement, but a "managed" trade agreement, where trade was managed in the interests of the most influential business lobby groups. NAFTA rewrote the rules for the North American economy, driving Mexican farmers from their land and homes *en masse* into low-wage, low-standard urban manufacturing life with subsidized U.S. and Canadian agricultural exports and a Wall Street-led Mexican peso crisis in 1995.[2]

The opportunity to offshore production to Mexico at depressed wages and employment exposed industries and those receiving displaced workers. Initial inflows of investment into Mexican maquiladoras lost favor to Chinese export manufacturing platforms, where wages and standards were lower, once China entered a glide path to WTO membership. But the culmination of these effects on U.S. workers, families, and communities over the decades since NAFTA helped fuel the waves of opioid addiction, suicide, and other deaths of despair now pervasive across the country, as well as a sharp lurch to the right in nationalist political sentiment in the communities most impacted by trade shocks.[3]

USMCA made some incremental, albeit significant, improvements over the NAFTA, including by strengthening the regional automotive industry and enforcing stronger labor rights broadly across the North American economies. This includes Mexico's commitment to sustain and monitor the implementation of reforms and the Rapid Response Mechanism, which aims to snuff out labor violations when they arise. But most importantly, USMCA introduced stronger automotive rules of origin (ROOs) that set high regional value content thresholds (RVC), first-ever minimum labor value content rules (LVC), and regional content requirements for steel and aluminum automotive inputs – industries critical to U.S. national and economic security. These gains were painstakingly negotiated to improve upon the original USMCA draft first signed by President Trump in 2018 – and more painstaking work is needed to implement the terms robustly. Still, the USMCA falls far short of what would be needed to make our closest and most important trading relationships truly worker-centered.[4]

Surging imports imperil U.S. automotive industries

Following trends in other industries, including steel and aluminum products, production chains oriented around Chinese-owned and -affiliated firms are penetrating North American automotive supply chains with rapidly expanding manufacturing platforms in Mexico and a range of foreign countries whose auto parts exports to the U.S. are surging

– like Thailand, India, Vietnam, Malaysia, Indonesia, and the Philippines (see **Table 1**). Combined parts imports from these countries amount to 46% of total U.S. parts imports. It must also be noted that the U.S. State Department repeatedly reports systematic violations of labor and human rights in these countries, including forced and child labor, and that most have not ratified core ILO conventions on forced labor or freedom of association and the right to organize.

The changing pattern of U.S. automotive imports does not reflect trade diversion away from Chinese imports following the 2018 Secs. 232 and 301 tariffs so much as a recalibration of Chinese production chains to evade these and other U.S. trade enforcement measures. China's ballooning outward direct investment positions since 2018 indicate a rapidly expanding overseas footprint for production chains centered around Chinese-owned and -affiliated firms; its FDI position increased by 126% in Mexico, 40% in Thailand, 246% in India, 119% in Vietnam, 97% in Malaysia, 73% in Indonesia, and 12% in the Philippines. In sum, Chinese direct investment in these countries grew by 79% or more than $42 billion in just four years (Table 1).

At the same time, producers of manufacturing machinery and equipment from China to these emerging automotive production hubs also expanded rapidly since 2017: 134% to Mexico, 92% to Thailand, 79% to India, 149% to Vietnam, 159% to Malaysia, 119% to the Philippines, and exponentially to Indonesia (Table 1). Publicly available data does not allow direct and systematic monitoring of foreign automotive industry direct investments, but a spate of media reports on Chinese outward investment in automotive industries corroborate the available international macroeconomic data.[5]

Problems with USMCA rules of origin

Although some reports suggest that most North American vehicles are expected to meet RVC thresholds, even under USMCA ROOs, substantial non-North American content will creep into North American supply chains and qualify for duty-free entry to U.S. markets.[6] The "rolling up" methodology used to calculate regional content shares allow the share of non-North American-originating content to increase exponentially as components are added and transformed through the production chain and to be counted as 100% USMCA-originating. The more complicated an intermediate auto part is – i.e., the more underlying, lower-tier components are required to make an intermediate part – the more foreign content can masquerade as "Made in North America." Even under USMCA RVC calculations, substantial extra-North American content will enter at 0% duty.

The leakage problem undercuts U.S. and North American workers by pitting them against non-USMCA producers without a commitment to the same worker, environmental, and consumer safety standards and without extending reciprocal market access to similar U.S.-based producers. What's more, the subterranean content can qualify for U.S. taxpayer subsidies under the 2022 Inflation Reduction Act (IRA) policies – through Section 30D consumer tax credits for content that rolls up into USMCA-conforming content, or through Section 45W commercial tax credits for non-conforming cars through the "lease loophole." A bigger issue, though, for U.S. automotive industries is that a 2.5% price wedge between USMCA-conforming and non-conforming passenger vehicles and parts is simply not big

Table 1

Auto part imports are surging where Chinese manufacturing is expanding

U.S. Import Partner	Share of US Parts Imports, 2023	Real Growth in Parts imports, 2017–2023	Chinese Real Manufacturing Machinery Exports (% Change 2017–2022)	Chinese FDI position (Change 2018–2022 $millions)	Chinese FDI position (% Change 2018–2022)
Mexico	38%	20%	134%	940	126%
Canada	10%	11%	82%	3624	19%
China	9%	-17%			
Japan	8%	-17%	34%	10082	88%
South Korea	7%	57%	43%	546	9%
Germany	6%	5%	78%	6563	55%
Thailand	3%	45%	92%	5487	40%
India	2%	75%	79%	5313	246%
Vietnam	1%	60%	149%	9875	97%
Malaysia	1%	222%	159%	9785	97%
Indonesia	1%	4%	62161%	10394	73%
Philippines	1%	33%	119%	505	12%

Source: EPI analysis of USITC Dataweb, UN COMTRADE, and IMF Consolidated Direct Investment Survey, and Bureau of Labor Statistics data. Chinese machinery exports include HTS codes 84-85. U.S. parts imports comprise 80 6-digit HTS codes, available https://www.trade.gov/automotive-parts-tariff-codes.

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enough to entice foreign producers benefitting from government support at home to go along with the USMCA rules, or to deter their rapid expansion into Mexican manufacturing platforms in an expanding range of parts, technology components, and finished vehicles.

In contrast, it is clear that import duties and other U.S. trade enforcement measures remain important tools in bolstering U.S. automotive industries amid surging unfair foreign competition. In contrast to rapidly declining U.S. production of passenger cars and SUVs and content covered by 2.5% most-favored nation (MFN) tariffs projected by market analysts like S&P Global Mobility, U.S. production of light duty trucks covered by a 25% MFN tariffs are expected to nearly double over the next decade (and hit President Biden's zero-emission vehicle target in the U.S. *before* passenger cars). These trade policy measures must work to complement other facets of U.S. industrial policies targeting investments and high quality jobs in electric vehicles and the green transition made possible by the 2021 Infrastructure Investment and Jobs Act (IIJA) and the IRA.

What's more, USMCA was negotiated before the U.S. government adopted bold policies to expand electric vehicle (EV) production and utilization. As a result, EV powertrain components received inadequate treatment in the scheduling of core and super-core parts for determining RVC calculations. USTR should address this oversight in the upcoming scheduled review with USMCA partners to ensure that investments in EV technologies and manufacturing capacity made possible by the IIJA and IRA receive the full complementary support of U.S. trade policy.

Recommendations

There is much work to be done to fully implement and maintain, let alone expand upon, automotive trade measures in USMCA. But USMCA will not make or break the U.S. automotive industry or determine whether it can continue supporting the good quality jobs and a domestic manufacturing base that will be needed to tackle our unfolding global climate crisis. Realizing this promise requires U.S. policymaking to operate on all levels towards this common goal. This means that we need policies that create a level playing field for trade against low-standard, government-subsidized competitors alongside policies to invest in the technology and workforce that will keep U.S. producers at the cutting edge, and macroeconomic policies that ensure stable, growing demand for producers.

We cannot meet a challenge that we do not fully understand. That is why I urge the administration to take immediate steps, in partnership with Mexican and Canadian partners and relevant representative stakeholder organizations, to conduct a study of the extent of penetration of subsidized content in North American automotive supply chains. This study should take a census of relevant firms and their beneficial owners, map their positions within automotive supply chains and modes of government support, and identify systems for ongoing monitoring and reporting.

I am encouraged by Treasury Secretary Yellen's recent MOU to open discussions with Mexico on bringing CFIUS-like reviews to Mexico's inward direct investment regime.[7] Given increasing IT content in vehicles and connectivity to personal user data, such a comprehensive approach to North American supply chains is warranted. But there is much terrain to navigate before such an idea could become operational. In the meantime, the administration should take unilateral actions to evaluate select investments in conjunction with USMCA RCV and LCV content certifications.

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