Intelligence MEMOS

From: Jon Johnson and Daniel Schwanen

To: North American Automakers

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Re: **Effect of the USMCA Automotive ROOs – Conflicting Views**

Reports from the Office of the US Trade Representative (USTR) and the US International Trade Commission (USITC), together with an International Monetary Fund (IMF) Working Paper, assess the likely impact of USMCA's automotive rules of origin (ROOs) on the US automotive industry.

The conclusions are strikingly different.

The USTR report, dated April 18, predicts new automotive investments in the US of $34 billion, new annual auto parts purchases in the US of $23 billion and the creation of 76,000 new automotive jobs. The USTR maintains that automakers in North America intend to comply with new rules rather than forgo tariff preferences. The USTR also considers that the new ROOs will not significantly affect consumer vehicle prices.

The USITC report, released on April 19, assesses the likely impact of the USMCA on the US economy as required under US trade law, and includes coverage of the automotive sector. It predicts an increase in US automotive parts production offset by a small decline in US vehicle production for a net increase of 28,000 full-time equivalent employees. Like the USTR, the USITC expects that most automakers will try to comply with the new ROOs rather than not complying and paying duties. However, the USITC report predicts that complying with these rules will increase the cost of many models, resulting in lower demand and a decline in finished vehicle production and exports to non-USMCA countries. However, production of core parts (engines, transmissions, body, axle, suspension and steering systems and advanced batteries) in the US would increase by reason of reshoring (i.e., returning production to US territory).

The IMF Working Paper is significantly more pessimistic. It states that less than 70 percent of Mexican vehicle production is capable of meeting the new requirements and because of the higher content (RVC) requirements and the labour value content (LVC) requirement, the preferred strategy will be to pay Most Favoured Nation (MFN) tariffs. The paper predicts a welfare loss to the US from both the RVC and the LVC requirements because prices of its imports from Canada and Mexico will increase. The RVC and LVC requirements will lead to a decline in intra-USMCA trade and will lead to an increase in consumer prices and a decrease in consumer demand in all three countries. The paper maintains that all three USMCA countries would have a significant welfare gain if the US Section 232 tariffs on steel and aluminum, and the reciprocal taxes imposed by Canada and Mexico, were eliminated.

The difference in predicted outcomes is partly explained by the provenance of each document. The USTR magnifies what it sees as a positive impact of the deal it negotiated, by incorporating investment plans that automakers were required to submit to be granted a maximum transition period for complying with the new ROOs. Here, the industry itself had an incentive to provide optimistic investment plans, and to minimize the impact on consumer prices and the industry's international competitiveness. Furthermore, the report incorporates planned auto investments that may, or may not, be attributed to the USMCA. While claiming to be conservative in assuming that each new assembly job will support two jobs in the parts industry, and emphasizing the incentive under the USMCA to develop new auto technologies within the US, it disregards the wider economic impact of jobs being diverted to auto production from other sectors. Overall, the report is designed to put the rosiest possible picture on the USMCA.

The USITC report, in contrast, more realistically assumes that some producers will pay the tariffs rather than comply with complex rules of origin, and relatedly that prices will increase and auto sales decline as a result. But it remains optimistic that the reshoring of parts jobs could offset the resulting decline in assembly jobs. The IMF report, in contrast, while not pronouncing on jobs, emphasizes the inefficiencies and lost competitiveness for the North American auto sector overall, but suggests that other provisions facilitating trade and, especially, dropping tariffs on steel and aluminium would help offset these losses.

The main takeaway is that how the agreement is implemented (if and when it is ratified), and which way the ultimate political decision on steel and aluminum trade falls, will have a considerable impact on its ultimate outcome. More to come on these issues in coming weeks.

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