

The Impact of NAFTA Renegotiation on the Automotive Industry

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Changes to North American Free Trade Agreement (NAFTA) have been anticipated since the moment of President Trump's election. When U.S. Trade Representative Robert Lighthizer notified Congress on May 18th of the Administration's intent to renegotiate NAFTA, he triggered the 90-day consultation period before formal negotiations can begin. While no formal renegotiation plans have been announced by the United States, Canadian, or Mexican governments, speculation has begun to swirl regarding changes to key NAFTA provisions, in particular the rules of origin requirements upon which North American automakers depend.

NAFTA and its Rules of Origin Requirements

Prior to the agreement, NAFTA countries levied tariffs on automobiles and automobile parts. For example, the United States levied tariffs of 2.5 percent on automobiles, 25 percent on light-duty trucks, and a trade-weighted average of 3.1 percent on automotive parts from Mexico.¹ Mexico levied tariffs of 20 percent on automobiles and light trucks and 10 percent-20 percent on auto parts from the United States and Canada.²

NAFTA eliminated barriers to trade, either upon NAFTA's effective date or during a phase-out over five to ten years, provided that the vehicles and parts meet the rules of origin requirements. Under NAFTA, a certain percentage of the materials within a good must be made within a NAFTA country to qualify. The required North American content for automobiles, light trucks, engines, and transmissions began at 50 percent and increased to 62.5 percent over an eight year period from 1994 to 2002.³ The required North American content for other vehicles and automotive parts began at 50 percent and increased to 60 percent over the same period.⁴ In calculating this percentage, NAFTA requires that manufacturers and producers track the regional value content of major automotive components and subassemblies.⁵

Consider, for example, a car assembled in Mexico with an engine manufactured in Japan. The manufacturer must calculate the percentage value of the engine in relation to the entire vehicle to determine whether the vehicle meets the 62.5 percent North American content. Just because the car was assembled in Mexico does not make the car 100 percent North American made.

NAFTA has a number of specific rules for calculating the regional value of automobiles and automobile parts. These rules require that manufacturers calculate the regional content by including the value of some input materials within an automotive part. This is a valuation method called tracing. NAFTA has two sets of tracing rules, one for light-duty and one for heavy-duty goods. The lists of parts subject to tracing in each category can be found in the Appendix to 19 C.F.R. § 181.⁶ If the non-originating materials are not on these tracing lists, however, they are treated as originating.

Potential Changes to NAFTA and Its Impact on the Automobile Industry

NAFTA's tariff elimination changed how the automobile industry in North America manufactured its products, and, as a result of NAFTA, automotive trade has expanded exponentially among the three NAFTA countries. This all stands to change during upcoming negotiations, where the rules of origin provisions are certain to be an important topic. In fact, Mexico's Foreign Relations Secretary Luis Videgaray recently said "One part that must inevitably be reviewed is the chapter on rules of origin."⁷

While the exact form of these changes is not yet certain, there is some speculation that the Trump Administration will try to tighten the rules of origin requirements for automobiles and auto parts in order to reduce the United States' trade deficit with Mexico.⁸ The regional content rules could be increased to as much as 70 percent or 80 percent, depending on the vehicle or part.⁹ Others in the field have suggested that the United States could try to negotiate a U.S. content requirement to benefit manufacturers within U.S. borders.¹⁰ Both government leaders and North American automakers are wary of changing these rules drastically. At an event in Mexico City, Mexican Economy Minister Ildefonso Guajardo cautioned that Mexico, the United States, and Canada could "shoot ourselves in the foot" if the countries make changes that will drive investment elsewhere.¹¹

Another potential issue to be addressed is the way in which regional content is calculated. The lists that determine whether a good is subject to tracing are likely to be expanded. Many parts used in automobiles today, especially electronic components that were not in existence or widely available when these lists were contemplated, are excluded from the tracing requirement. Many of these expensive, electronic components come from non-NAFTA countries, but because they are not included in the tracing lists, they are considered originating. These components help the completed part or automobile achieve the requisite originating content threshold. In renegotiation, these lists will likely be greatly expanded and, as a result, it will be much more difficult for manufacturers to meet the originating content requirements that allow their goods to pass through NAFTA countries duty free.

As August 16, the end of the 90-day consultation period with Congress, draws closer and negotiation plans solidify, details regarding each country's objectives and strategy will become more certain. The International Trade Commission will be holding a hearing on NAFTA beginning on June 27, where those potentially affected by changes to the agreement will have an opportunity to testify.

¹ See M. ANGELES VILLAREAL AND IAN F. FERGUSON, CONGRESSIONAL RESEARCH SERVICE, NAFTA AT 20: OVERVIEW AND TRADE EFFECTS 6 (2014).

² See *id.*

³ See [UNITED STATES CUSTOMS AND BORDER PROTECTION, AUTOMOTIVE PRODUCTS](#), (2014).

⁴ See *id.*

⁵ See *id.*

⁶ 19 C.F.R. § 181 Appendix, Schedule IV, Schedule V.

⁷ Adriana Gomez Licon, [Mexico to review rules of origin to help NAFTA renegotiation](#), WASHINGTON TIMES (May 30, 2017).

⁸ Eric Kulisch, [Automakers urged to prepare for NAFTA changes: A U.S. content requirement may be on negotiating table](#), AUTOMOTIVE NEWS (June 5, 2017).

⁹ *Id.*

¹⁰ *Id.*

¹¹ Frank Jack Daniel and Sharay Angulo, [Mexico warns on NAFTA sourcing: 'Don't shoot ourselves in the foot'](#), REUTERS (May 23, 2017).