

U.S. House of Representative – Committee on Ways and Means

Trans-Pacific Partnership Roundtable on Auto Manufacturing Supply Chain

Convened by Democratic Members

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Congressman Levin, Senator Brown, honorable members of the Ways and Means Committee, and honorable members of the U.S. Congress, thank you for the opportunity to share my views on the impact of the Trans-Pacific Partnership (TPP) for the auto manufacturing supply chain. I will focus my remarks on the issue of the TPP rules of origin for these sectors.

Rules of origin are a highly technical component of trade agreement. As production is disaggregated across borders, rules of origin take on added importance. A complex product, such as a car or smartphone, is now produced with components manufactured in multiple countries. The rules of origin chapter of a free trade agreement set the guidelines for determining the national origin of the product. This, in turn, affects whether that product qualifies for preferential tariff treatment.

Regarding the TPP rules of origin for autos and auto parts, I wish to highlight five points for your attention:

First, rules of origin continue to matter greatly for trade in auto and auto parts. While some cars are now assembled at the point of sale with local-made parts, this is not true across-the-board, and the practice varies by market. Even in advanced economies with auto plants, such as Australia, the U.S. and Japan continue to export large volumes of already-assembled autos and complex parts. Rules of origin therefore influence exporters' decisions on the sourcing of upstream components.

Second, the TPP rules of origin differ from those of past U.S. trade agreements. In particular, it is worth focusing on how they differ from those of the North America Free Trade Agreement (NAFTA). This is important, because Canada and Mexico are top export markets for U.S. autos, and the North American supply chain is highly vertically integrated.¹

¹ Canada remains the top export market, with the U.S. exporting over a half million more new passenger vehicles and light trucks to Canada than it does to China (the fastest-growing and second largest export market for U.S. vehicles). Mexico is the third largest export market, as measured by units, and fifth largest, as measured by value. See International Trade Administration, Trends in U.S. Vehicle Exports (August 2015), at pp. 11-12.

NAFTA rules of origin dictate that in order for vehicles and many parts to qualify for NAFTA preferences, it must have a regional value content of 62.5% as measured by through a net cost method. Certain exceptions exist, with heavy duty trucks and some parts subject to a lower 60% threshold. By contrast, TPP rules of origin allow cars and motor vehicles to qualify for TPP preferences if the regional value content is 45%, as measured through a net cost method. The TPP also allows for calculation using an alternative methodology relying upon value rather than cost (*i.e.*, the “build down” method) that NAFTA does not.² For some parts, the threshold is as low as 35% under the net cost method.³

Because the rules are not exactly analogous, it is not possible to engage in an exact apples-to-apples comparison. Nevertheless, most analysts, including myself, believe that the TPP rules-of-origin stipulate a lower threshold than NAFTA.

Third, the lower TPP thresholds are a result of a compromise between Japan and other TPP countries. Japanese auto manufacturers now source a growing proportion of their components from non-TPP countries, especially China. (See Figure 1 highlighting Japanese imports of select auto parts.) Japanese companies sought lower thresholds in order to ensure that such cars will nevertheless qualify for TPP tariff preferences.⁴

Fourth, for American producers of transport vehicles and parts, the impact of the lower thresholds will vary, depending on a firm’s place in the production chain and the nature of foreign competition. Allow me to highlight a few examples:

For producers of finished automobiles in the U.S. that are at the end of the supply chain, some may welcome the TPP rules of origin. They might seek to substitute a portion of U.S. and NAFTA-made inputs for those made in China and other non-TPP countries, but have not done so because of the importance of the North American market and the NAFTA rules of origin. The lower TPP thresholds will allow them to make some of these changes. Imports of auto parts from China into the U.S. have grown in recent years, but only for select markets (see Figure 2). There is the risk that the TPP rules of origin for autos and auto parts will facilitate, rather than hinder, this continued growth. Nevertheless, some downstream end-producers will welcome the additional sourcing flexibility afforded by the TPP.

² The threshold is set at 55% under the build-down method for all cars and motor vehicles under the tariff headings 87.02 to 87.05.

³ Examples include motor vehicle bodies, road wheels, radiators, mufflers, exhaust pipes, and clutches. The threshold for these tariff lines is set at 45% under the build-down method. In addition, the TPP also permits the use of a build-up method for these and several other tariff lines. For these examples, the threshold is also set at 35% under the build-up method.

⁴ Higher thresholds force more manufacturers to have to make a choice between: (a) continuing their current practice of sourcing parts from non-TPP countries, with the risk of not qualifying for TPP preferences if the percentage is too high, or (b) switching their sourcing away from China and other non-TPP countries toward auto parts made in TPP countries in order to qualify for the TPP preferences. Lower thresholds decrease the number of Japanese manufacturers that are forced into making this choice, allowing them to keep their existing supply chains intact while enjoying TPP preferences.

Other U.S. downstream producers, however, may not welcome the lower thresholds. These are manufacturers that do not seek to change their supply chains as set originally under NAFTA rules of origin. Instead, they would prefer that TPP rules of origin with higher thresholds that will force their Japanese competitors to shift away from parts made in China and other lower-cost, non-TPP markets.

For upstream U.S. producers of components and other inputs into vehicles, the impact of the TPP rules of origin also varies. Producers of cost-sensitive and relatively non-complex inputs, such as steel or tires, will likely be hurt, as the lower TPP thresholds allow NAFTA producers (which include Japanese, European, and Korean firms) to substitute away from U.S. and NAFTA-made inputs to lower-cost, non-TPP alternatives, while still maintaining the benefits of trade preferences. On the other hand, producers of certain auto parts and components will be largely unaffected. These include those who are products (a) are relatively complex, (b) do not face significant competition from China or Southeast Asia, and/or (c) for which proximity matters more than cost. The TPP rules of origin still require that a significant percentage of the content be from TPP countries, and it is unlikely that these inputs will be substituted out.

In short, the net impact of the TPP rules of origin is complicated for the American automotive and auto parts sector. I urge you to consider carefully the supply chain position and competitive interests of the producers in your district, especially for auto parts and other inputs, if applicable.

Lastly, as noted, the TPP rules of origin are the product of a carefully-crafted compromise between negotiators. USTR officials have warned against upsetting this balance. Nevertheless, should you wish to do so, one possibility to consider is to request that the thresholds rise over a phase-in period, as they did in NAFTA.⁵ This would help guard against substitution of U.S.-made parts and inputs toward non-TPP sources and facilitate that the creation of pan-TPP supply chains. However, such a change might require the rollback of concessions obtained for American exporters in other parts of the agreement.

While the rules-of-origin chapter and its Annex are highly technical, for some American producers of auto parts and inputs, it is arguably as important as the related tariff concessions. I encourage the committee to consider its implications carefully as it deliberates on the overall merits of the TPP.

Thank you.

⁵ NAFTA rules of origin were phased in over an 8-year transition period. They increased from a regional value content of 50% under the net cost method initially to a mid-point level after 4 years, and then to the final threshold of 62.5% (for autos and light vehicles listed in Annex 403.1) or 60% (for other heavy-duty trucks listed in Annex 403.2) after 8 years.

Figure 1. Japanese Imports of Select Auto Parts

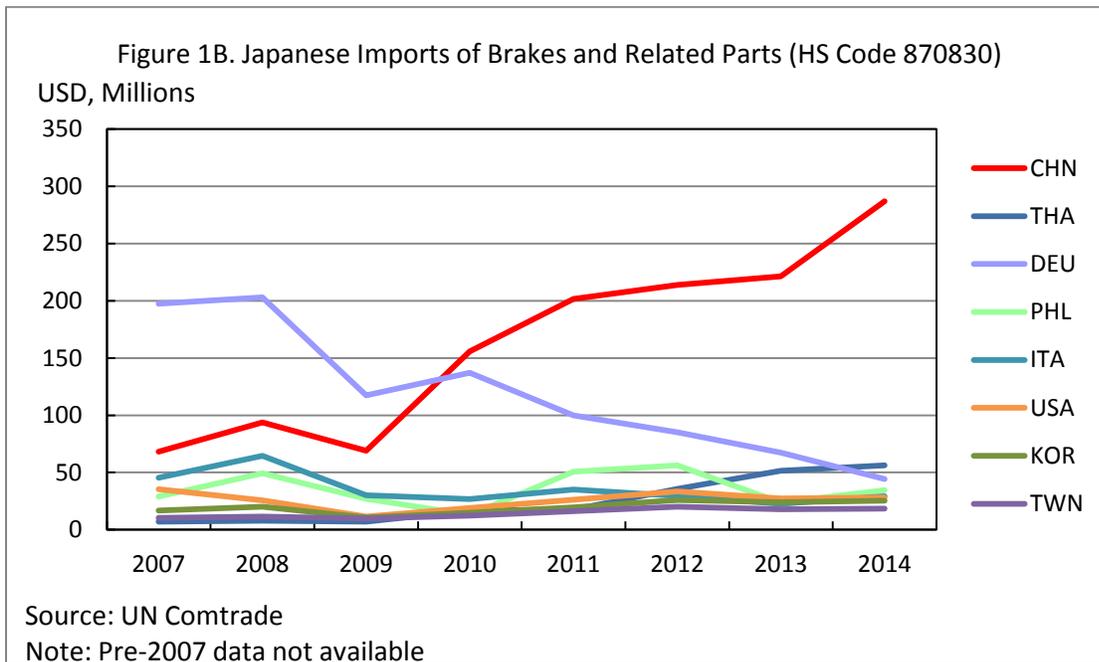
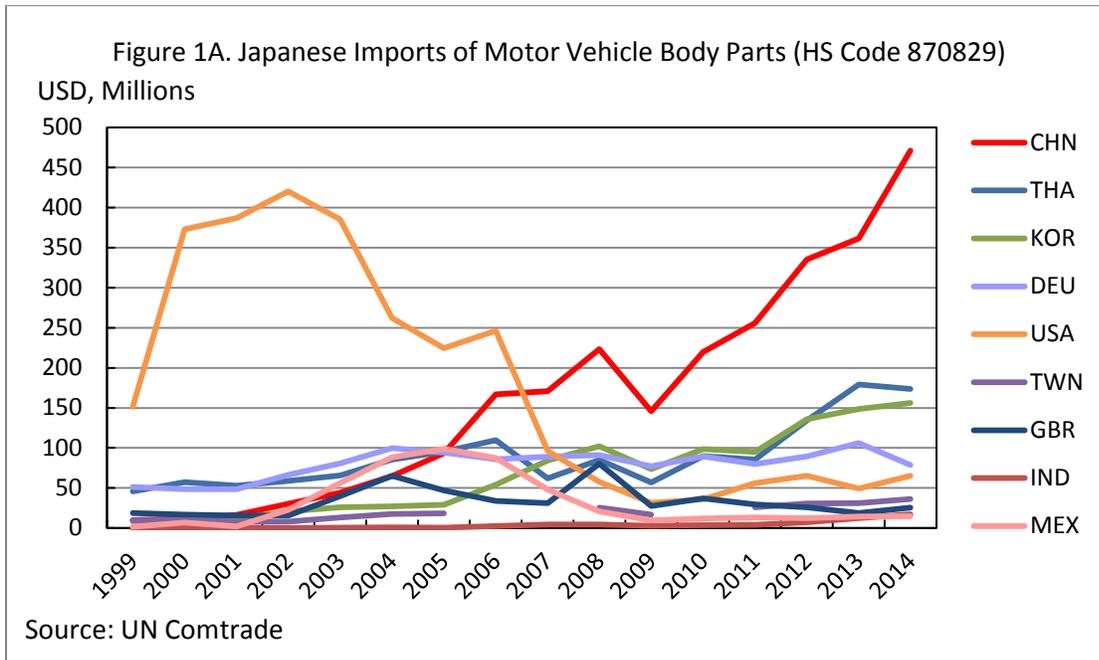
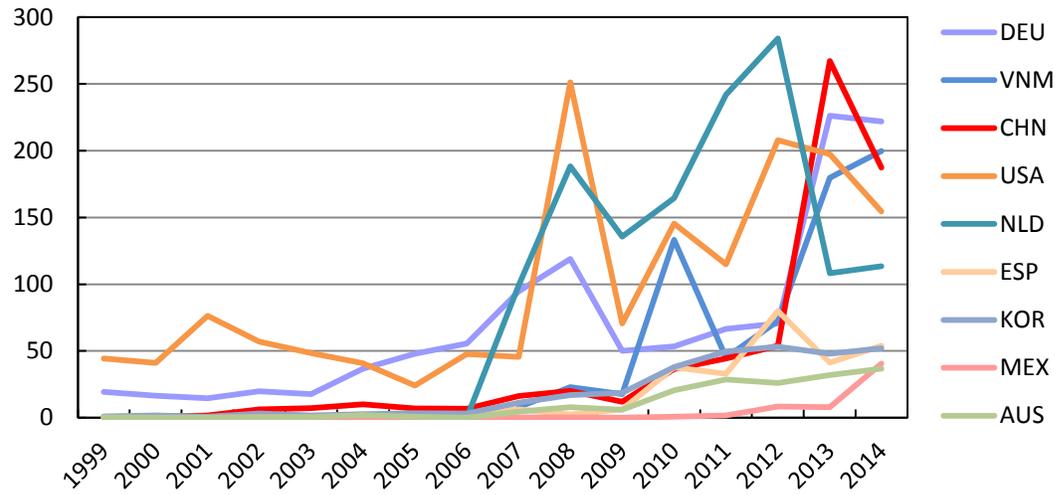


Figure 1C. Japanese Imports of Motor Vehicle Transmissions (HS Code 870840)

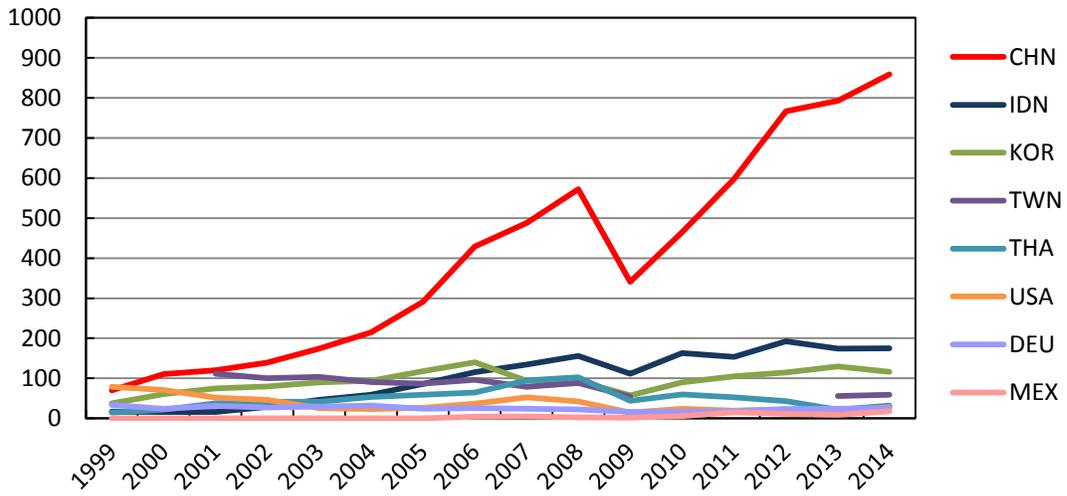
USD, Millions



Source: UN Comtrade

Figure 1D. Japanese Imports of Wheels and Related Parts (HS Code 870870)

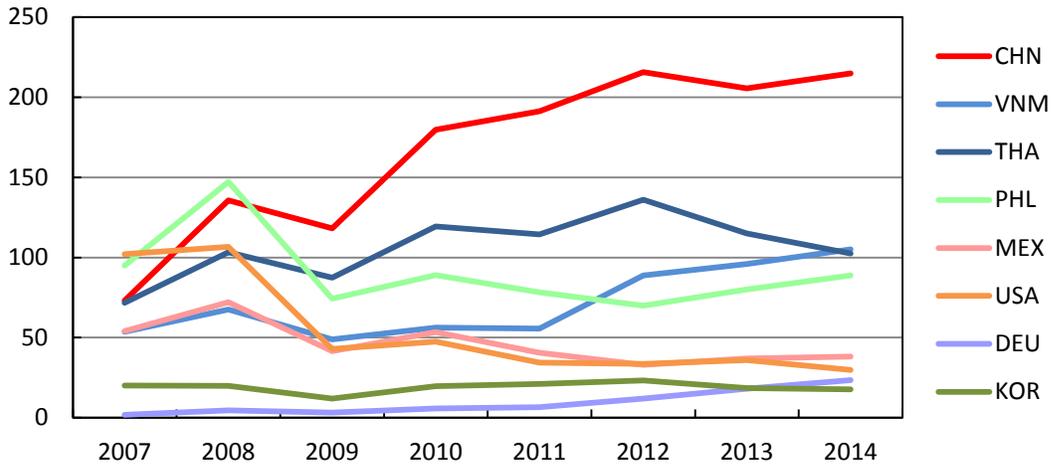
USD, Millions



Source: UN Comtrade

Figure 1E. Japanese Imports of Airbags and Related Parts (HS Code 870895)

USD, Millions

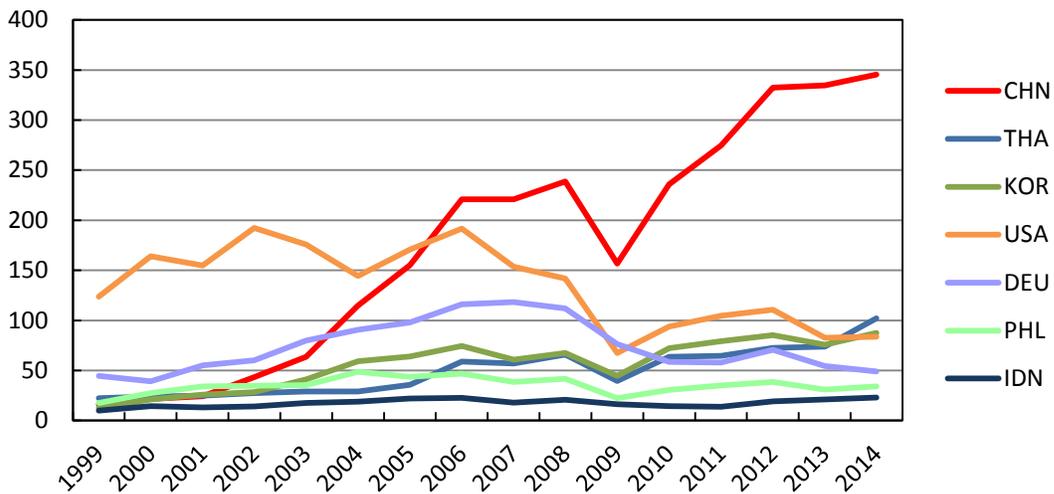


Source: UN Comtrade

Note: Pre-2007 data not available

Figure 1F. Japanese Imports of Misc. Motor Vehicle Parts (HS Code 870899)

USD, Millions



Source: UN Comtrade

Figure 2. U.S. Imports of Select Auto Parts

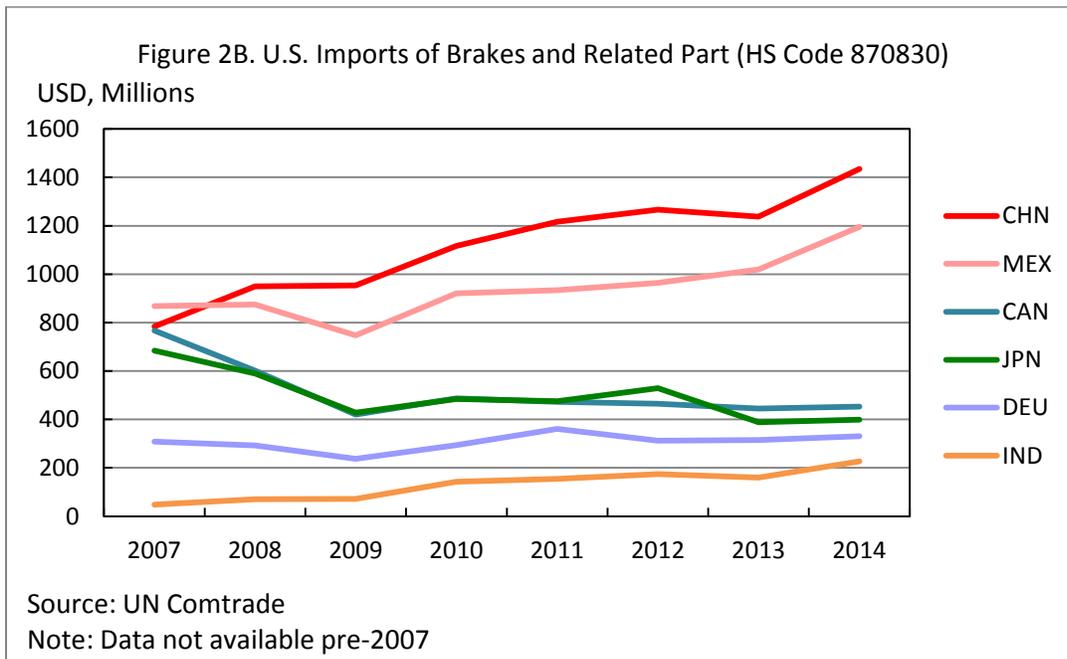
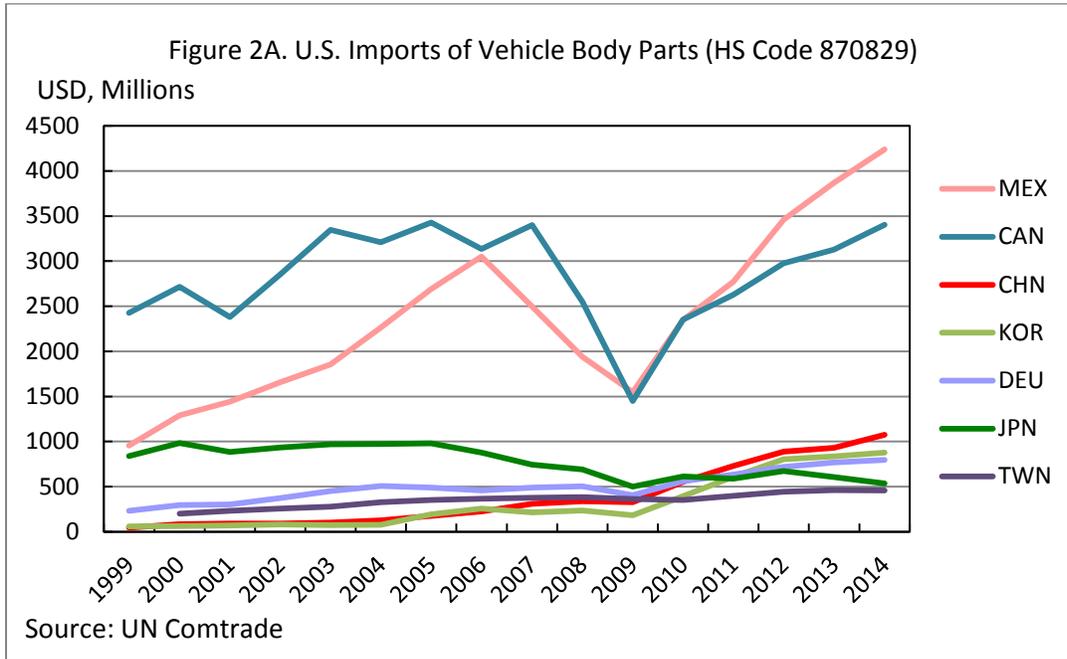
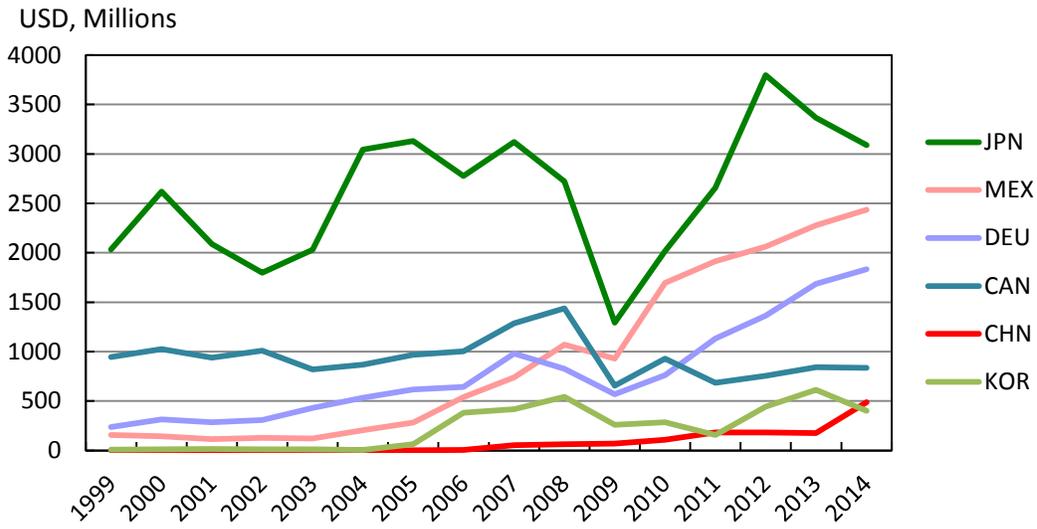
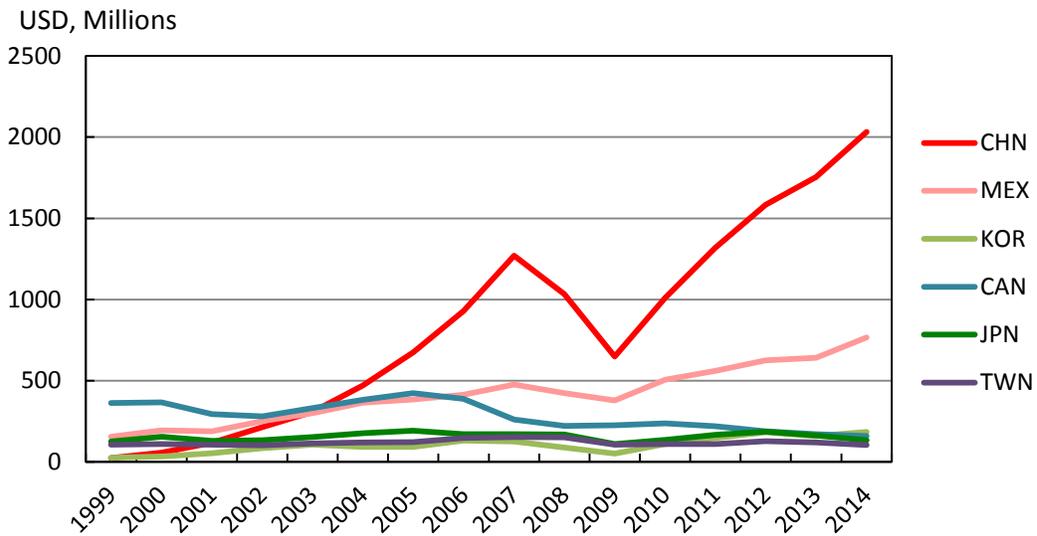


Figure 2C. U.S. Imports of Motor Vehicle Transmissions (HS Code 870840)



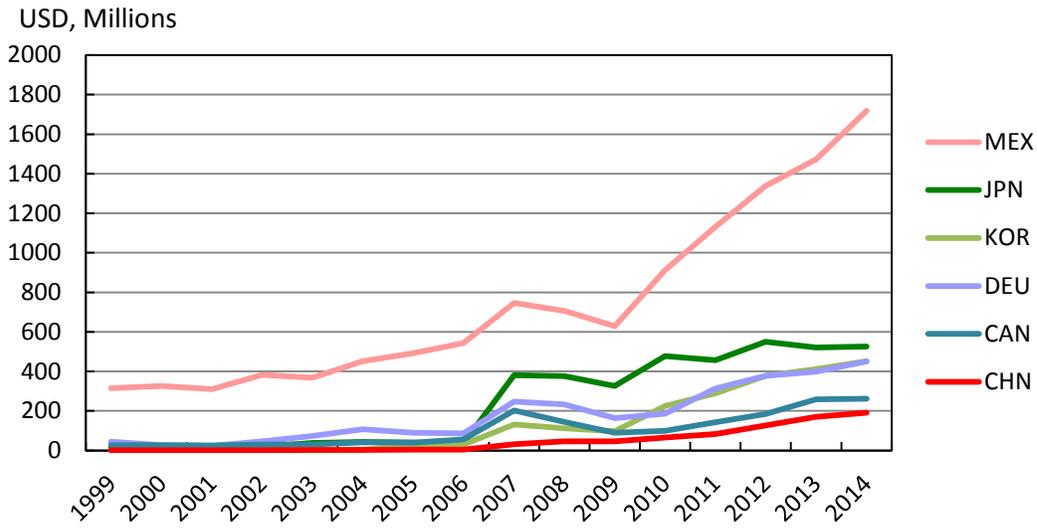
Source: UN Comtrade

Figure 2D. U.S. Imports of Road Wheels (HS Code 870870)



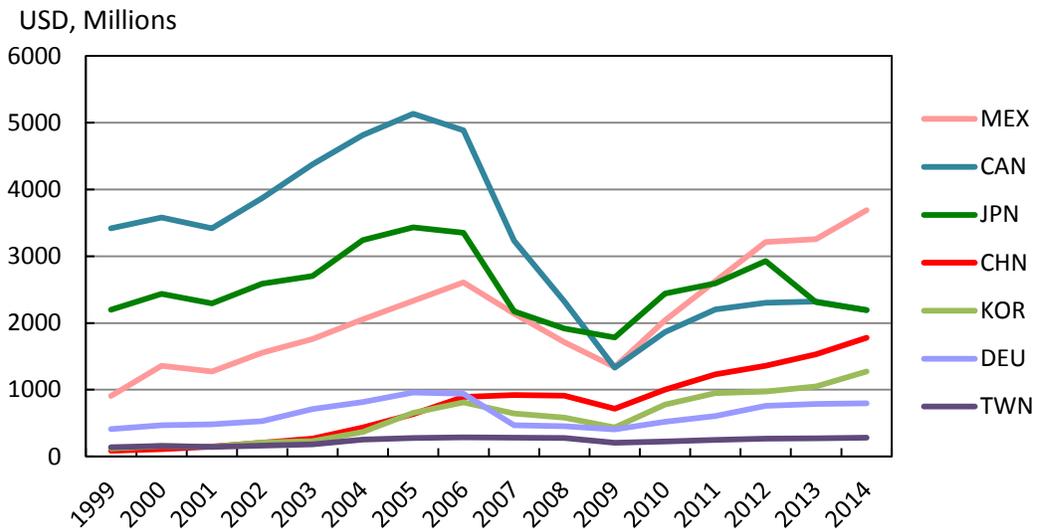
Source: UN Comtrade

Figure 2E. U.S. Imports of Steering Wheels (HS Code 870894)



Source: UN Comtrade

Figure 2F. U.S. Imports of Misc. Motor Vehicle Parts (HS Code 870899)



Source: UN Comtrade