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THE AUTOMOTIVE RULES OF ORIGIN CONTROVERSY THAT STALLED TRANS- PACIFIC PARTNERSHIP NEGOTIATIONS

*Elise LeGros**

AUTOMOTIVE rules of origin have been some of the most contentious issues in the Trans-Pacific Partnership (TPP) deliberations between the twelve TPP countries—Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. Automotive rules of origin determine the percentage of cars or car parts (such as engines or transmissions) that have to originate in a treaty-region to receive preferential tariff treatment.¹ The North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico² also has automotive rules of origin that have allowed car and car parts markets to flourish in the NAFTA region.³ With that in mind, the United States, Canada, and Mexico (as parties to the TPP) had a keen interest during TPP negotiations to ensure that the TPP automotive rules of origin—which, if ratified by Congress, will supersede NAFTA’s automotive rules of origin⁴—remain favorable to NAFTA countries.

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1. *NAFTA Countries, Japan to Return to Auto Talks*, BLOOMBERG BNA INT’L TRADE DAILY (Sept. 18, 2015), http://news.bna.com/tltn/TDLNWB/split_display.adp?fedfid=75998889&vname=itdbulallissues&wsn=499854000&searchid=26251054&doctypeid=1&type=date&mode=doc&split=0&scm=TDLNWB&pg=0.
2. See generally North American Free Trade Agreement art. 403, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993).
3. See Carter Dougherty, *Mexico Throws a Wrench into Trade Talks*, BLOOMBERG BNA INT’L TRADE REPORTER (Sept. 3, 2015), http://news.bna.com/itln/ITLNWB/split_display.adp?fedfid=75398829&vname=itrnotallissues&wsn=486494000&searchid=26251062&doctypeid=1&type=date&mode=doc&split=0&scm=ITLNWB&pg=0.
4. See Trans-Pacific Partnership, art. 1.2, Nov. 5, 2015, available at <https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text> (“Recognizing the Parties’ intention for this Agreement to coexist with their existing international agreements,” and that “[i]f a Party believes the provision of this Agreement is inconsistent with a provision of another agreement . . . the Parties to the other agreement shall consult with a view to reach a mutually satisfactory solution.”); see also Julien Chaisse, *The Shifting Tectonics of International Investment Law – Structure and Dynamics of Rules and Arbitration on Foreign Investment in the Asia-Pacific Region*, 47 GEO. WASH. INT’L L. REV. 563, 618 (2015).

I. NAFTA'S AUTOMOTIVE RULES OF ORIGIN

NAFTA's automotive rules of origin require 62.5 percent of a car and certain car parts⁵ (including engines) to "originate" from the NAFTA region.⁶ The 62.5 percent regional value-content requirement (RVC) takes into account the net cost of the car or car part and value of materials used in production of the car or car part that did not originate in the NAFTA region.⁷ For instance, if a car seat manufacturer uses a motor produced in a non-NAFTA country to make a car seat and then sells that seat to a car manufacturer in a NAFTA country, the car manufacturer in the NAFTA region must include the value of the non-originating motor when calculating the car's RVC.⁸ NAFTA employs tracing to calculate the RVC for cars; certain materials are included on a tracing list and if a car part is on the list, then it must be treated as a non-originating part.⁹

Canada and Mexico's auto markets have flourished under NAFTA's rules of origin.¹⁰ Duty-free access to the U.S. market and access to cheap domestic labor led to expanded auto production in Mexico.¹¹ NAFTA's automotive rules of origin "shifted a significant portion of low-value-added manufacturing to Mexico, while allowing Canada to retain significant levels of high-value-added production . . ."¹² Today, Canada and Mexico are the first and second largest exporters of vehicles to the United States.¹³ So both countries had a keen interest in any TPP provision that might affect the NAFTA rules of origin.

II. TPP AUTOMOTIVE RULES OF ORIGIN

Mexico and Canada's disagreements over automotive rules of origin stalled the more general negotiations taking place between all TPP countries at a meeting in Maui, Hawaii in July 2015 (the Maui meeting).¹⁴

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5. This percentage refers to cars that transport fifteen people or less. There are separate provisions for larger cars (that carry sixteen or more people) and the car parts for larger cars. This article focuses on the rules of origin for smaller cars. See North American Free Trade Agreement, *supra* note 2, art. 403, § 1, at 351.
 6. *Id.* art. 403, § 5(a), at 351.
 7. *Id.* art. 402, §§ 3, 5, at 349–50.
 8. Lawrence M. Friedman, *NAFTA Rules of Origin*, BARNES/RICHARDSON GLOBAL TRADE LAW (Jan. 1, 2003), <http://www.barnesrichardson.com/?t=40&an=7124&format=xml&p=3734>.
 9. North American Free Trade Agreement, *supra* note 2, art. 403, § 1, at 351.
 10. Peter Menyasz, *Little Room for Canada to Negotiate on Autos*, BLOOMBERG BNA INT'L TRADE DAILY (Aug. 21, 2015), http://news.bna.com/itln/ITLNWB/split_display.adp?fedfid=74857761&vname=itrnotallissues&wsn=486537500&searchid=26251083&doctypeid=1&type=date&mode=doc&split=0&scm=ITLNWB&pg=0.
 11. Dougherty, *supra* note 3. One study showed that Mexican automotive workers' wages ranged from one-eighth to one-fifth of U.S. auto workers' wages. Len Bracken & Emily Pickrell, *U.S., Mexico, Canada in Talks on Autos*, BLOOMBERG BNA INT'L TRADE REPORT (Aug. 20, 2015), http://news.bna.com/itln/ITLNWB/split_display.adp?fedfid=74857759&vname=itrnotallissues&wsn=486513500&searchid=26251075&doctypeid=1&type=date&mode=doc&split=0&scm=ITLNWB&pg=0.
 12. Menyasz, *supra* note 10.
 13. Dougherty, *supra* note 3.
 14. *Id.*

Prior to TPP negotiations, the United States and Japan had entered into bilateral negotiations regarding automotive rules of origin.¹⁵ Matt Blunt, head of the American Automotive Policy Council, noted that automobile provisions in the TPP are extremely important due to the magnitude of auto trade between the United States and Japan.¹⁶ According to one source, at the end of 2014, Japanese manufacturers made 3.82 million cars in the United States and about seventy-four percent of Japanese-branded vehicles that were sold in the United States were built in Canada, the United States, or Mexico.¹⁷

At the Maui meeting, the United States revealed the results of its bilateral-negotiations with Japan to the other TPP parties for the first time. One source reported that the United States and Japan suggested the RVC should be forty-five percent for finished cars and thirty percent for car parts.¹⁸ The United States was purportedly supposed to share these numbers with Canada and Mexico before the Maui meeting but did not, and thus Canada and Mexico felt blindsided by the lack of transparency.¹⁹ According to another source, when the TPP automotive rule of origin was suggested to be well below NAFTA's 62.5 percent rule of origin, "Mexico and Canada resented not being consulted in advance and felt as though the U.S. was dictating the terms to them . . ."²⁰ A director from an Ottawa-based public and government relations consulting firm said that the "demands by the [United States] and Japan on auto content caught everyone by surprise . . ."²¹

Many argued that NAFTA's 62.5 percent mark should have been the starting point of TPP negotiations.²² Those concerned expressed worry about Japan's ability to substitute auto parts made in Texas or Mexico for parts made in Thailand and other non-TPP countries.²³ Moreover, the

15. Len Bracken, *Canada, Mexico, Japan in TPP Auto Talks*, BLOOMBERG BNA INT'L TRADE DAILY (Aug. 5, 2015), http://news.bna.com/tDln/TDLNWB/split_display.adp?fedfid=73747108&vname=itdbulallissues&wsn=500384000&searchid=26251091&doctypeid=1&type=date&mode=doc&split=0&scm=TDLNWB&pg=0.

16. Mark Clothier & Carter Dougherty, *U.S. Automakers Leery as Pacific Trade Deal Talks Resume*, BLOOMBERG BNA INT'L TRADE DAILY (Jul. 27, 2015), http://news.bna.com/tDln/TDLNWB/split_display.adp?fedfid=73342658&vname=itdbulallissues&wsn=500622000&searchid=26251095&doctypeid=1&type=date&mode=doc&split=0&scm=TDLNWB&pg=0.

17. *Id.*

18. Rossella Brevetti, *TPP Auto Talks Among Japan, NAFTA Countries End Without Agreement*, BLOOMBERG BNA INT'L TRADE DAILY (Sept. 14, 2015), http://news.bna.com/tDln/TDLNWB/split_display.adp?fedfid=75712178&vname=itdbulallissues&wsn=499884000&searchid=26251130&doctypeid=1&type=date&mode=doc&split=0&scm=TDLNWB&pg=0.

19. Bracken, *supra* note 15.

20. *Id.*

21. Menyasz, *supra* note 10.

22. See Rossella Brevetti, *Senators Urge USTR to Fight for TPP Auto Rules*, BLOOMBERG BNA INT'L TRADE DAILY (Sept 11, 2015), http://news.bna.com/tDln/TDLNWB/split_display.adp?fedfid=75475050&vname=itdbulallissues&wsn=499898500&searchid=26251132&doctypeid=1&type=date&mode=doc&split=0&scm=TDLNWB&pg=0.

23. Dougherty, *supra* note 3.

President of the United Automobile Workers union warned in an email that “[a] low standard w[ould] lead to even more outsourcing to poor countries and fewer jobs in the United States.”²⁴

On August 20, 2015, steel industry associations in the United States, Canada, and Mexico wrote a joint letter to stop trade officials stressing that the TPP should maintain strong rules of origin “to sustain the benefits currently accruing to NAFTA steel producers, their integrated supply chains[,] and the NAFTA economy.”²⁵ The industry associations further urged that the TPP “‘must not confer an advantage to producers whose primary supply chain is located outside the TPP region.’”²⁶ On September 8, 2015, associations representing auto parts makers in NAFTA countries sent a letter to U.S. Trade Representative Michal Froman, Canada’s International Trade Minister Ed Fast, and Mexico’s Economy Minister Ildefonso Guajardo Villareal.²⁷ The letter advocated a fifty percent RVC for finished cars and car parts.²⁸

Three U.S. Senators—Sherrod Brown (D-Ohio), Rob Portman (R-Ohio), and Debbie Stabenow (D-Mich.)—also urged U.S. Trade Representative Michael Froman to use NAFTA’s 62.5 percent rule as a starting point.²⁹ In a letter to Froman, the three senators stated that “[u]ndermining the NAFTA rules of origin would displace the U.S. auto supply chain and result in the loss of jobs throughout the country.”³⁰ Matthew McAlvanah, spokesman of the Office of the U.S. Trade Representative, said that the final agreement must strike “the right balance between the needs of domestic auto producers, who have made clear that they rely on international supply chains to be able to produce in the United States, and our desire to promote U.S. sourcing and American jobs.”³¹

Meetings continued between the NAFTA countries and Japan throughout the months of August and September.³² By October 5, 2015, the dispute was resolved and all twelve TPP countries announced that they had reached a final agreement.³³ On October 7, 2015, reports surfaced that the minimum RVC under the TPP would be forty-five percent for fin-

24. *Id.*

25. Alex Lawson, *NAFTA Country Steel Groups Unite on TPP Auto Rules*, LAW360 (Sep. 22, 2015, 3:53 PM), <http://www.law360.com/articles/705660/nafta-country-steel-groups-unite-on-tpp-auto-rules>.

26. *Id.*

27. Rossella Brevetti, *Auto Parts Makers in NAFTA Countries Call for Strong TPP Content Rules*, BLOOMBERG BNA INT’L TRADE DAILY (Sept. 9, 2015), http://news.bna.com/tDln/TDLNWB/split_display.adp?fedfid=75399259&vname=itdbulallissues&wsn=499913500&searchid=26251136&doctypeid=1&type=date&mode=doc&split=0&scm=TDLNWB&pg=0.

28. *Id.*

29. Brevetti, *supra* note 22.

30. *Id.*

31. Dougherty, *supra* note 3.

32. *NAFTA Countries, Japan to Return to Auto Talks*, *supra* note 1.

33. Jackie Calmes, *Trans-Pacific Partnership is Reached, but Faces Scrutiny in Congress*, N.Y. TIMES (Oct. 5, 2015) http://www.nytimes.com/2015/10/06/business/trans-pacific-partnership-trade-deal-is-reached.html?_r=0.

ished cars and forty percent for car parts.³⁴

The final text of the TPP, released to the public on November 5, 2015,³⁵ appears to be relatively consistent with the reports. Under the TPP, vehicles made with some materials that do not come from a TPP country can still qualify as “originating”—and therefore get preferential duty treatment—if the RVC is at least forty-five percent or fifty-five percent, depending on which method of RVC calculation is used.³⁶ Certain car parts used in the production of the vehicle, such as bumpers, may be considered originating if they meet an individual, part-specific rule of origin or undergo certain manufacturing processes within the TPP region.³⁷ Certain car parts also may be considered originating if they have between thirty-five and fifty-five percent RVC, depending on which rule of origin applies and the RVC method of calculation used.³⁸ Finally, and unlike NAFTA, the TPP does not utilize “tracing” to calculate RVC.³⁹

III. CONCLUSION

Automotive rules of origin proved more controversial than expected and stalled TPP negotiations for roughly two months.⁴⁰ But ultimately, the parties were able to agree on a compromise.⁴¹ Industry leaders and trade officials from the United States, Mexico, and Canada expressed ap-

34. Emily Pickrell, *Mexican Groups OK with Regional Content Level*, BLOOMBERG BNA INT'L TRADE REPORTER (Oct. 7, 2015), http://news.bna.com/tldn/TDLNWB/split_display.adp?fedfid=76969752&vname=itdbulallissues&wsn=499738000&searchid=26251140&doctypeid=1&type=date&mode=doc&split=0&scm=TDLNWB&pg=0.

35. Jackie Calmes, *Trans-Pacific Partnership Text Released, Waiving Green Flag for Debate*, N.Y. TIMES (Nov. 5, 2015). The TPP automotive rules of origin are highly technical and will likely be subject to extensive analysis through the ratification process. *Id.*; see also *Trans-Pacific Partnership*, *supra* note 4. The author has summarized only those provisions that are pertinent to the conflict between the NAFTA and the TPP reported in this article.

36. *Trans-Pacific Partnership*, *supra* note 4, Annex 3-D, ch. 87; Reid Whitten, *The Trans Pacific Partnership and the Auto Industry: Will Six Thousand Pages Pave the Way for Increased Exports?*, SHEPPARD MULLIN GLOBAL TRADE LAW BLOG (NOV. 12, 2015), <http://www.globaltradelawblog.com/2015/11/12/the-trans-pacific-partnership-and-the-auto-industry-will-six-thousand-pages-pave-the-way-for-increased-exports/>.

37. *Trans-Pacific Partnership*, *supra* note 4, art. 3.6 & Annex 3-D, app. 1, § 1(a)–(b); *What will the Trans-Pacific Partnership mean to the Automotive Industry?*, PWC (Dec. 7, 2015), <http://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-trans-pacific-partnership-and-the-automotive-industry.pdf>.

38. *Trans-Pacific Partnership*, *supra* note 4, art. 3.5 & Annex 3-D, ch. 87; *What will the Trans-Pacific Partnership mean to the Automotive Industry?*, *supra* note 37.

39. *What will the Trans-Pacific Partnership mean to the Automotive Industry?*, *supra* note 37.

40. Adam Behsudi, *Auto rules complicate TPP endgame — USTR considers environmental dispute with Peru — Vietnamese official: Trade talks to resume to next month*, POLITICO (August 19, 2015, 10:00 AM), <http://www.politico.com/tipsheets/morning-trade/2015/08/auto-rules-complicate-tpp-endgame-ustr-considers-environmental-dispute-with-peru-vietnamese-official-trade-talks-to-resume-to-next-month-019669>.

41. Pickrell, *supra* note 34.

proval of the new rules.⁴² The president of the Mexican Automotive Industry Association, Eduardo Solis, said in a press conference that the final agreement was “fairly positive” and that it would “open up privileged areas of competition for Mexico.”⁴³ A Canadian trade official also stated that Canada was “pleased with the outcome” of the rules of origin negotiations.⁴⁴ According to the Office of the United States Trade Representative, the TPP’s rules of origin “ensure that TPP benefits will go to the United States and the TPP region and expand the auto industry’s potential export opportunities. These rules of origin are more accurate, more easily verifiable, and more enforceable than those of NAFTA”⁴⁵

But there also remains much controversy and disapproval of the automotive rules of origin. On December 3, 2015, the United Auto Workers’ executive board unanimously voted to oppose the TPP.⁴⁶ The Board claims that the TPP puts overseas profits before working families in the United States, and that the rules of origin standard “is unacceptable as over half of the value of a car or truck could be built by countries that are not in the agreement and still receive benefits.”⁴⁷ Further, there is strong opposition to the agreement in Canada.⁴⁸ Yet the president of the Canadian Automotive Parts Manufacturers Association recently stated in an interview that he thinks Canada must accept the TPP, and that the Association “put a lot of pressure while the negotiations were on, and that was the time to do it. But now it’s closed.”⁴⁹

42. William Mauldin, *U.S. Reaches Trans-Pacific Partnership Trade Deal With 11 Pacific Nations*, WALL ST. J. (Oct. 5, 2015, 5:12 PM), <http://www.wsj.com/articles/u-s-reaches-trade-deal-with-11-pacific-nations-1444046867>.

43. Pickrell, *supra* note 34.

44. Rossella Brevetti, *TPP Contains U.S.-Japan Auto Trade Provisions*, BLOOMBERG BNA INT’L TRADE DAILY (Oct. 5, 2015), http://news.bna.com/tldn/TDLNWB/split_display.adp?fedfid=76798608&vname=itdbulallissues&wsn=499760500&searchid=26251143&doctypeid=1&type=date&mode=doc&split=0&scm=TDLNWB&pg=0.

45. *The Trans-Pacific Partnership*, OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, <https://ustr.gov/sites/default/files/TPP-Getting-the-Best-Deal-for-the-US-Auto-Industry-Fact-Sheet.pdf> (last visited November 8, 2015).

46. *United Auto Workers Leadership Statement of Opposition to the TPP—Statement from UAW President Williams*, UNITED AUTO WORKERS (Dec. 3, 2015), <http://uaw.org/united-auto-workers-leadership-statement-of-opposition-to-the-tpp-statement-from-uaw-president-williams/>.

47. *Id.*

48. See, e.g., Peter Menyas, *Canada Not Close to Decision on TPP Approval*, BLOOMBERG LAW (Dec. 16, 2015), <https://www.bloomberglaw.com/search/results/df85f03c9e3af514e81884d31b7c20ab/document/XCRQGM6S000000?search32=C9P6UQR5E9FN6PB1E9HMGNRKCLP6QFBKE1O2O0BLEHNJMEREDTFMIRBGBTO6GSJ1EDIN6F9H7CTMCQBOBTH6URRCBTONAPBIF4UJ2>. A key contributor to Canadian discord with the TPP is Canada’s newly liberalized political climate; Canada entered into the TPP under its conservative former prime minister, Steven Harper. *Id.*

49. Allison Lampert & Leah Schnurr, *Canada auto parts makers back TPP, urge further gov’t support*, REUTERS (Dec. 1, 2015, 5:02 PM), <http://www.reuters.com/article/trade-tpp-canada-autos-idUSL1N13Q23B20151201>.

The TPP parties' governments must still ratify the TPP for it to take effect. If one of the NAFTA countries—Canada, for instance—chooses not to ratify the TPP, then Canadian-made vehicles would get duty-free access to the U.S. market only if they met NAFTA's 62.5 percent RVC requirement.⁵⁰ By contrast, if Mexico does ratify the agreement, Mexican-made vehicles would need to meet just a forty-five percent threshold under the TPP, and could source the remaining fifty-five percent from lower-cost sources.⁵¹

As of December 26, 2015, no NAFTA party government had ratified the TPP. Thus, it remains to be seen whether the automotive rules of origin in the TPP will ultimately replace those in NAFTA.

50. Lawrence L. Herman, *NAFTA is not TPP*, FIN. POST (Oct. 8, 2015, 10:37 AM), <http://business.financialpost.com/fp-comment/nafta-is-not-tpp>.

51. *Id.*

