

# Issue Brief

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## Biden Trade Regulators Lose, American Car Buyers and Manufacturers Win

Biden administration efforts to restrict automobile trade were recently rejected by a U.S.-Mexico-Canada Agreement (USMCA) trade panel. [Media reports](#) described the ruling as a [loss](#) for the United States.<sup>1</sup> It would be more accurate to call it a loss for Biden administration trade regulators and a win for the rest of us. The position advocated by the Biden administration would have increased car prices, disrupted supply chains, and undermined the ability of U.S. negotiators to do their jobs in the future.

### Background: Auto Rules of Origin

Free trade agreements include rules to define which products qualify for tariff-free treatment. These are often based on what percentage of a product originates within the region.

For example, in the North American free trade zone, if a vehicle with one percent regional content counted as North American, then cars could be imported from Europe or Asia into the United States, modified with the addition of a fancy license plate holder, and cross the border to Canada or Mexico tariff-free.

At the other extreme, if a car was required to have 100 percent North American content to receive tariff-free status, a vehicle assembled

<sup>1</sup> Begin, Riley, "Mexico, Canada prevail in trade dispute with US over duty-free auto imports." The Detroit News, January 11, 2023. Retrieved from: <https://www.detroitnews.com/story/business/autos/2023/01/12/mexico-canada-prevail-in-trade-dispute-with-us-over-auto-imports/69800537007/>.

## Key Facts:



The thriving North American automobile industry is one of NAFTA's biggest success stories.



New, stricter rules of origin increase the cost of labor and parts needed to make cars in North America, discouraging U.S. production and increasing prices for car buyers.



As carmakers struggle to rebound from the COVID pandemic, the last thing they need is for the federal government to interfere with supply chains, violate U.S. trade commitments, and increase the cost of assembling vehicles in the United States.

in the United States with 99 percent regional content but containing a screw from Korea or a hose from Germany would be subject to tariffs when exported to Canada or Mexico.

The 1988 U.S.-Canada Free Trade Agreement required [50 percent](#) regional content for automobiles.<sup>2</sup> In 1994, NAFTA turned up the dial to 62.5 percent, the [highest](#) regional value content requirement of any U.S. trade agreement.<sup>3</sup> NAFTA's replacement, USMCA, turned the dial to [75 percent](#) and added more requirements.<sup>4</sup> For example, 70 percent of the steel and aluminum in a new car must originate in a USMCA member country. For the first time in any U.S. trade agreement, USMCA includes a minimum wage requirement that 40 percent to 45 percent of qualifying vehicles be produced by workers earning at least \$16 per hour.

## Excessively High or Complex Regional Value Requirements Are Costly

The Biden administration [says](#) that increasing the regional value content for cars and trucks will increase investment in new automobile factories.<sup>5</sup> This view ignores the fact that the new, stricter rules of origin increase the cost of labor and parts needed to make cars in North America, discouraging North American production and increasing prices for car buyers.

The U.S. International Trade Commission [calculated](#) that higher costs resulting from USMCA would slash U.S. automotive production for North America by 102,900 vehicles and increase motor vehicle imports from outside North America.<sup>6</sup> The International Monetary Fund calculated that the stricter rules would [reduce U.S. production](#) of parts and vehicles.<sup>7</sup> The Peterson Institute for International Economics concluded the rules would [encourage](#) manufacturers to replace workers with machines.<sup>8</sup>

The stricter new USMCA rules were primarily designed to benefit the 0.25 percent of U.S. workers who belong to the [United Auto Workers](#) union at the expense of the other [99.75 percent of the U.S. labor force](#), and to secure support for USMCA from left-leaning Democrats in Congress.<sup>9</sup> Republicans typically oppose costly pro-union content and minimum wage regulations like those included in USMCA. President Ronald Reagan described domestic content proposals as a "[cruel hoax](#)" that would increase car prices and cost jobs in other sectors of the economy.<sup>10</sup> However, former U.S. Trade Representative Robert Lighthizer [deviated](#) from this position and pushed for much more restrictive and complex North American content rules when negotiating USMCA.<sup>11</sup>

## The Case Against the U.S. Government

There are many ways of calculating a vehicle's regional value content. Canada and Mexico believe USMCA regional value calculations require the use of "roll-up" methodology. Under this methodology, if a core part like an engine contains at least 75 percent North American content, then under USMCA rules it

<sup>2</sup> "United States-Canada Free Trade Agreement – 1988." U.S. Senate Committee on Finance Hearing, April 15 and 21, 1988. Retrieved from: <https://www.finance.senate.gov/imo/media/doc/hr9100-10073.pdf>.

<sup>3</sup> "NAFTA and Motor Vehicle Trade." Congressional Research Service, Updated July 28, 2017. Retrieved from: <https://crsreports.congress.gov/product/pdf/R/R44907>.

<sup>4</sup> "USMCA: Motor Vehicle Rules of Origin." Congressional Research Service, April 21, 2022. Retrieved from: <https://crsreports.congress.gov/product/pdf/IF/IF12082/1>.

<sup>5</sup> "Opening Statement of the United States of America." United States – Automotive Rules of Origin (USA-MEX-CDA-2022-31-01), August 2, 2022. Retrieved from: <https://ustr.gov/sites/default/files/enforcement/FTA/USMCA%2031/US.Autos.ROO.OS.8.2.22.pdf>.

<sup>6</sup> "U.S.-Mexico-Canada Trade Agreement: Likely Impact on the U.S. Economy and Specific Industry Sectors." U.S. International Trade Commission, April 2019. Retrieved from: <https://www.usitc.gov/publications/332/pub4889.pdf>.

<sup>7</sup> Burfisher, Mary E., Lambert, Frederic, and Matheson, Troy D. "NAFTA to USMCA: What is Gained?" International Monetary Fund, March 26, 2019. Retrieved from: <https://www.imf.org/en/Publications/WP/Issues/2019/03/26/NAFTA-to-USMCA-What-is-Gained-46680>.

<sup>8</sup> Lovely, Mary E. and Schott, Jeffrey J. "The USMCA: New, Modestly Improved, but Still Costly." Peterson Institute for International Economics, December 17, 2019. Retrieved from: <https://www.piie.com/blogs/trade-and-investment-policy-watch/usmca-new-modestly-improved-still-costly>.

<sup>9</sup> Author's calculation from UAW and U.S. Bureau of Labor Statistics Data at <https://uaw.org/about/> and <https://www.bls.gov/news.release/empsit.t01.htm>.

<sup>10</sup> President Ronald Reagan "Remarks and a Question-and-Answer Session During a United States Chamber of Commerce Teleconference" May 10, 1983. Retrieved from: <https://www.presidency.ucsb.edu/documents/remarks-and-question-and-answer-session-during-united-states-chamber-commerce>.

<sup>11</sup> Ambassador Robert Lighthizer. "Opening Statement of USTR Robert Lighthizer at the First Round of NAFTA Renegotiations." August 16, 2017. Retrieved from: <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/august/opening-statement-ustr-rob-ert-0>.

counts as a North American component. In the total vehicle content calculation, 100 percent of the engine would count as North American. If an engine contained less than 75 percent North American content, it would count as [zero](#) in the total vehicle regional value calculation. After USMCA took effect, U.S. officials changed the methodology, counting the actual value of core parts instead of rounding them off.<sup>12</sup>

Canada and Mexico argued this violated the methodology required under USMCA. Under USMCA dispute resolution rules, the disputed U.S. methodology was assumed to be permitted unless Canada and Mexico proved their case.

Mexico referred to USMCA text to back its claim. It also cited [USTR officials](#), who wrote: “Moreover, the value of these [vehicle] parts can be rolled up in either of these calculation[s] so if the RVC [regional value content] of the parts, either individually or as a super-core, reaches 75%, then the entire value (100%) of the net cost is considered originating when meeting the RVC for the vehicle.”<sup>13</sup>

Canada similarly referenced [USTR statements](#) in its submission to the USMCA panel: “On September 10, 2018, an executive from Volkswagen USA asked USTR: ‘If we get our final Core Parts average to 75%, can we include them as “100% originating” on the vehicle’s RVC calculation? Or do we have to take each RVC obtained for each core part in the vehicle’s calculation?’” USTR replied: ‘Yes, you may include them all as 100% originating.’”<sup>14</sup>

## The Biden Administration’s Response

In addition to citing USMCA text, the Biden administration responded to the USMCA charge by [asking](#) why Canada and Mexico challenged the United States. The administration then answered its own question: “It seems the answer is simply because multinational auto companies that have assembly operations in Mexico and Canada do not want to invest in, and produce, more North American content.”<sup>15</sup>

Aside from being entirely irrelevant to the question of how USMCA rules should be interpreted, that charge is insulting and ludicrous. A less-politicized analysis from the U.S. International Trade Commission found that the stricter rules of origin contained in USMCA will [reduce U.S. production](#) of small cars, mid-to full-sized cars, multi-passenger vehicles, and pickup trucks.<sup>16</sup> Deviating from the “roll-up” methodology exacerbates this cost.

Another irrelevant assertion from the Biden administration was that: “... the lack of content manufactured in North America that is actually present in vehicles receiving preferential treatment, was one of the fundamental issues that led to the possible breakdown of NAFTA.”<sup>17</sup> It is more accurate to say that the thriving North American automobile industry is one of NAFTA’s biggest success stories.

## Figure 1: U.S. Motor Vehicle Output and Prices

<sup>12</sup> Kulisch, Eric. “NAFTA’s touchiest issue: rules of origin.” Automotive News Canada, August 14, 2017. Retrieved from: <https://canada.autonews.com/article/20170814/CANADA01/308149989/nafta-s-touchiest-issue-rules-of-origin>.

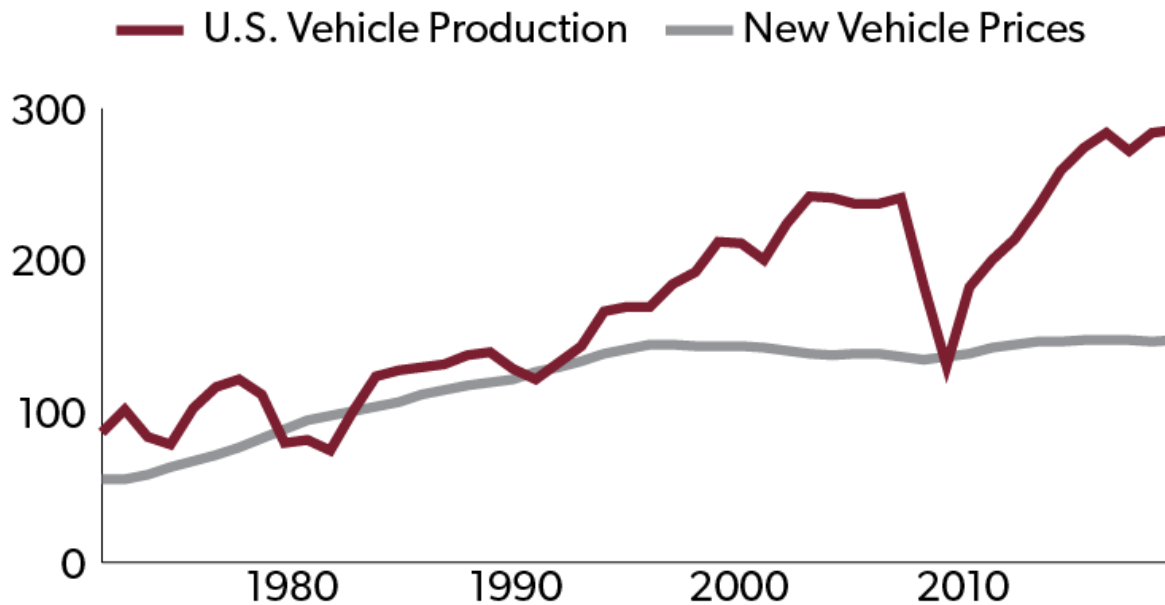
<sup>13</sup> “Initial Written Submission of Mexico.” United States – Automotive Rules of Origin (USA-MEX-2022-31-01), March 29, 2022. Retrieved from: <https://www.worldtradelaw.net/document.php?id=usmca/submissions/us-roo-usmca-mexico-submission.pdf&mode=download>.

<sup>14</sup> “Initial Written Submission of Canada.” United States – Automotive Rules of Origin (USA-MEX-2022-31-01), March 29, 2022. Retrieved from: <https://www.worldtradelaw.net/document.php?id=usmca/submissions/us-roo-usmca-canada-submission.pdf&mode=download>.

<sup>15</sup> “Opening Statement of the United States of America.” United States – Automotive Rules of Origin (USA-MEX-CDA-2022-31-01), August 2, 2022. Retrieved from: <https://ustr.gov/sites/default/files/enforcement/FTA/USMCA%2031/US.Autos.ROO.OS.8.2.22.pdf>.

<sup>16</sup> U.S.-Mexico-Canada Trade Agreement: Likely Impact on the U.S. Economy and Specific Industry Sectors.” U.S. International Trade Commission, April 2019. Retrieved from: <https://www.usitc.gov/publications/332/pub4889.pdf>.

<sup>17</sup> “Opening Statement of the United States of America.” United States – Automotive Rules of Origin (USA-MEX-CDA-2022-31-01), August 2, 2022. Retrieved from: <https://ustr.gov/sites/default/files/enforcement/FTA/USMCA%2031/US.Autos.ROO.OS.8.2.22.pdf>.



Note: [Real production](#) of automobiles and light duty motor vehicles data from Federal Reserve Bank, 1983=100. New [vehicle prices](#) for all urban consumers data from U.S. Bureau of Labor Statistics, 1982-1984=100.

Shockingly, the Biden administration did not deny that U.S. officials had previously made statements supporting the interpretation endorsed by Canada and Mexico. Instead, it asked the dispute resolution panel to [ignore](#) those statements.<sup>18</sup>

## USMCA Panel Decision

The USMCA panel sided with Canada and Mexico. According to the panel: “... prior to the entry into force of the Agreement, the United States held itself out as [sharing the interpretation](#) of the Agreement that Mexico and Canada have maintained in this dispute.”<sup>19</sup>

Unfortunately, the damage to the United States resulting from the Biden administration’s assertion that statements from U.S. government officials are not intended to be taken seriously will complicate efforts to negotiate agreements on trade, climate, taxes, or other issues.

## Biden’s USMCA Loss Is a Win for the United States

Maintaining excessively high and needlessly complex automobile rules of origin would have driven up car prices at a time of high inflation.

In addition to helping car buyers, the Biden administration’s loss will also benefit carmakers by reducing the administrative cost of complying with USMCA rules and confirming that the agreement will be implemented as expected. According to USTR: “In general, vehicle producer associations [agreed with Canada’s and Mexico’s interpretation](#) of the core parts requirement.”<sup>20</sup>

Of course, those benefits will vanish if the Biden administration rejects the USMCA decision. The Biden

<sup>18</sup> “Initial Written Submission of the United States of America.” United States – Automotive Rules of Origin (USA-MEX-CDA-2022-31-01), May 19, 2022. Retrieved from: [https://ustr.gov/sites/default/files/enforcement/FTA/USMCA%2031/USA%20Initial%20Written%20Submission%20Autos%20\(Public%20Version\).pdf](https://ustr.gov/sites/default/files/enforcement/FTA/USMCA%2031/USA%20Initial%20Written%20Submission%20Autos%20(Public%20Version).pdf).

<sup>19</sup> Rosselli, Elbio (Chair), Claussen, Kathleen, McRae, Donald, Miranda, Jorge, and Ryan Robertson, Ann. “The Arbitral Panel Established Pursuant to Article 31 of the Agreement Among the United States, Mexico, Canada Which Entered Into Force on July 1, 2020: Final Report.” December 14, 2022. Retrieved from: [https://www.worldtradelaw.net/document.php?id=usmca31/us-autoroo\(usmca\).pdf&mode=download#page=1](https://www.worldtradelaw.net/document.php?id=usmca31/us-autoroo(usmca).pdf&mode=download#page=1).

<sup>20</sup> “Report to Congress on the Operation of the United States-Mexico-Canada Agreement With Respect To Trade in Automotive Goods.” Office of the U.S. Trade Representative, July 1, 2022. Retrieved from: <https://ustr.gov/sites/default/files/2022%20USMCA%20Autos%20Report%20to%20Congress.pdf>.



administration has so far failed to comment on the panel ruling aside from a USTR [tweet](#) that it is “considering next steps” and that it plans to engage with Canada and Mexico on a resolution to the dispute.<sup>21</sup>

There should be nothing for the administration to consider or engage on. The USMCA announced its decision, and the Biden administration just needs to comply.

Alternatively, the Biden administration could ignore the panel decision, leading to retaliatory tariffs from Canada and Mexico.

The administration has also been [asked](#) to play the “essential security” trump card.<sup>22</sup> USMCA allows governments to [deviate](#) from its rules in order to protect their essential security interests.<sup>23</sup> The Biden administration could claim the USMCA decision would weaken the auto industry, and that the industry is essential to U.S. economic security. According to USTR, domestic restrictions imposed based on shaky national security grounds are [not subject to review](#) by trade dispute resolution panels.<sup>24</sup> Canada and Mexico would likely respond that their dairy, corn, and energy industries are a matter of essential security, exempting them from USMCA rules to the detriment of U.S. exporters and energy producers.

According to Autos Drive America, a trade association whose member companies account for nearly half of U.S. motor vehicle production, if the Biden administration [rejects](#) the USMCA panel decision the North American auto industry will be “less competitive” and “a less attractive investment target.”<sup>25</sup> As carmakers struggle to rebound from the COVID pandemic, the last thing they need is for the federal government to maintain vehicle production barriers that interfere with supply chains, violate U.S. trade commitments, and increase the cost of assembling vehicles in the United States.

The USMCA panel decision was a win for U.S. car buyers and manufacturers. If the Biden administration expects Canada and Mexico to play by the rules, it should promptly accept the decision.

## About the Author

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<sup>21</sup> Hodge, Adam. “Statement from USTR Spokesperson Adam Hodge,” January 11, 2023. Retrieved from: <https://twitter.com/USTRSpoX/status/1613279711135776770>.

<sup>22</sup> Benoit, Charles. “USMCA Auto Decision Is Major Setback for United States.” IndustryWeek, December 13, 2022. Retrieved from: <https://www.industryweek.com/the-economy/trade/article/21256381/usmca-auto-decision-is-major-setback-for-united-states>.

<sup>23</sup> U.S.-Mexico-Canada-Agreement, Chapter 32: Exceptions and General Provisions. Retrieved from: [https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/32\\_Exceptions\\_and\\_General\\_Provisions.pdf](https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/32_Exceptions_and_General_Provisions.pdf).

<sup>24</sup> Riley, Bryan. “Biden Administration Unleashes the Use of “Anything Under Sun” to Restrict Exports of American-Made Goods and Services.” National Taxpayers Union, January 6, 2023. Retrieved from: <https://www.ntu.org/publications/detail/biden-administration-unleashes-the-use-of-anything-under-sun-to-restrict-exports-of-american-made-goods-and-services>.

<sup>25</sup> Heslington, Rory. “Testimony of Rory Heslington, Vice President, Government Affairs, Autos Drive America, in the Hearing on the USMCA Automotive Rules of Origin: Economic Impact and Operation, 2023 Report (Investigation No. 332-592).” November 3, 2022. Retrieved from: <https://edis.usitc.gov/external/>.



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