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Updated December 6, 2024

USMCA: Automotive Rules of Origin

The United States-Mexico-Canada Agreement (USMCA; P.L. 116-113) entered into force on July 1, 2020, replacing the 1994 North American Free Trade Agreement (NAFTA). NAFTA was viewed as instrumental in creating a highly integrated North American motor vehicle industry. USMCA negotiations over new rules for North American automotive trade created tensions among and within the three trading partners. Some uncertainty remains over the implementation of the automotive trade rules and potential impacts on the North American motor vehicle industry. Numerous stakeholders have raised USMCA automotive trade rules as a potential topic during the scheduled 2026 joint review of USMCA, when the three countries are to discuss whether to renew the agreement. Congress has an oversight role in USMCA implementation and the joint review.

Automotive Rules of Origin

Most free trade agreements use rules of origin (ROO) to determine the national origin of a product. ROO provisions determine which goods traded between member countries are eligible for preferential treatment (reduced tariffs or duty-free trade). They generally seek to ensure that the benefits of the agreement are granted to goods primarily produced by a member country (and therefore subject to the entirety of its commitments) rather than to goods made wholly, or in large part, in other countries.

NAFTA phased out tariffs on automotive products traded among the three member countries as long as the products met the ROO, particularly regional value content (RVC) requirements (i.e., a certain percentage of North American content). USMCA maintains these tariff eliminations, but tightens the ROO, as shown in **Table 1**.

Table 1. NAFTA and USMCA Automotive ROOs

NAFTA	USMCA
62.5% RVC for passenger vehicles, light trucks, engines and transmissions	75% RVC for passenger vehicles, light trucks, core auto parts
60% RVC for other vehicles and auto parts	65%-70% RVC for other vehicles and auto parts
No labor value content rule (LVC) (no wage requirement)	LVC rule stating that 40%-45% of a vehicle's production by value be made by workers earning at least $16 per hour
No steel and aluminum requirement	70% of a vehicle manufacturer's steel and aluminum purchases by value must originate in North America

Source: CRS based on USMCA and NAFTA text.

During USMCA negotiations, motor vehicle and parts producers generally supported retaining NAFTA ROO. The Trump Administration and labor advocates sought to require higher wages and RVC thresholds, which they argued would incentivize auto manufacturing in the United States. Some economists contend that the higher RVC requirements in USMCA may have unintended consequences. For example, they state that it may be more cost efficient for manufacturers to pay the 2.5% U.S. most-favored-nation (MFN) tariff on passenger vehicles rather than meet the extensive ROO requirements. They argue that the new rules may raise North American auto production costs, resulting in higher vehicle prices, reduced demand for motor vehicles, and fewer auto exports, as well as incentivize more automation in automotive plants, thereby reducing demand for workers.

Entry into Force and Economic Impact

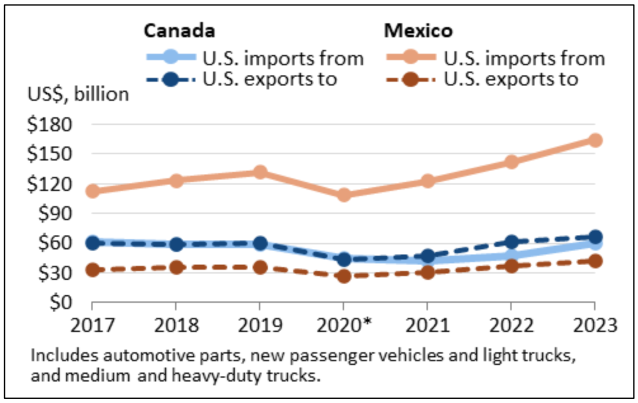
USMCA provided a three-year transition period for the new automotive ROO. It also allowed vehicle producers to request an alternative staging regime that would permit a longer transition period to implement the new ROO (up to five years after USMCA's entry into force, unless a request for a longer period is granted). The Office of the U.S. Trade Representative (USTR) approved alternative staging requests from 13 companies.

Since USMCA's entry into force, U.S. trade of motor vehicles and parts with Canada and Mexico has been relatively stable (**Figure 1**). USMCA implementing legislation (P.L. 116-113), requires the U.S. International Trade Commission (USITC) to publish biennial reports on the economic impacts of the USMCA automotive ROO through 2031. In its June 2023 report, the ITC estimated that through the end of 2022, the USMCA automotive ROO had marginal impacts on U.S. competitiveness, and the full impact of the USMCA automotive ROO may not be apparent until the full implementation of ROO in 2027. The ITC noted that other factors, such as supply chain disruptions during the COVID-19 pandemic, had a greater impact than the ROO during the analysis period (July 2020-December 2022). The ITC estimated that through the end of 2022, the USMCA automotive ROO contributed to an increase in U.S. aggregate employment of less than 0.01%. ITC also estimated that the ROO led to 487,048 fewer imports of core auto parts from non-USMCA countries and 1,464 more vehicles produced in the United States in 2022, which were lower than previously forecasted numbers. The ITC stated that although cost increases have not yet been significant, the ROO will likely lead to higher production costs and, potentially, higher vehicle prices over time. In November 2023, the ITC initiated the second report, scheduled to be reported to the President and Congress in July 2025.

Additionally, P.L. 116-113 requires USTR, in consultation with the Interagency Committee on Trade in Automotive

Goods, to submit a biennial report to Congress on motor vehicle trade. USTR published its second biennial report in July 2024. In the report, USTR noted an increase in the share of U.S. vehicle and parts imports from Canada and Mexico for which duties were paid (not entering duty-free under USMCA). CRS analysis of data from the U.S. International Trade Administration found that the value of U.S. vehicle and auto parts imports from Canada and Mexico that paid the 2.5% MFN tariff increased from about 4% in 2019 to 16% in 2023. Most dutiable auto imports came from Mexico. USTR noted that auto industry groups have expressed concerns about continued administrative burdens related to implementing the ROO and called for flexibility; labor groups have called for stricter ROO and for increasing the 2.5% MFN tariff to encourage greater ROO compliance.

Figure 1. U.S. Automotive Trade with Canada and Mexico, 2017-2023



Source: CRS analysis of data from U.S. International Trade Administration, accessed November 26, 2024.

Note: *USMCA entered into force.

Automotive ROO Dispute

In January 2022, Mexico and Canada established a USMCA dispute settlement panel to address a disagreement over the treatment of material in core motor vehicle parts (see **text box**). In December 2022, the panel ruled against the United States. USTR does not agree with the panel ruling and stated in the July 2024 report that the three countries are working towards a potential resolution. The USMCA panel decision cannot be appealed.

The Mexican and Canadian governments argued that if a core part qualifies for USMCA, 100% of its value should count towards the larger RVC calculation (referred to as "roll up"). USTR's interpretation was that the overall RVC calculation should exclude the value of materials in core parts that are not sourced from a USMCA country ("non-originating"). Mexico and Canada contended that all parties agreed to these flexibilities during the negotiations to help North American producers meet the RVC requirements.

Under USMCA rules, Canada and Mexico could have begun suspending certain benefits to the United States 45 days after the panel's final report was issued, but they have not done so to date. Some U.S. stakeholders, such as labor groups, expressed concerns that the ruling undermines efforts to boost the U.S. auto industry and undercuts workers' confidence in trade agreements. Some analysts have argued that the United States is undermining the USMCA dispute settlement process if it continues not to comply with the ruling.

Core Parts and Components for Determining Origin

Engine: Heads, blocks, crankshafts, crankcases, pistons, rods, head subassembly.

Transmission: Transmission cases, torque converters and housings, gears and gear blanks, clutches, valve body assembly.

Body and Chassis: Major body panels, secondary panels, structural panels, frames.

Axle: Axle shafts, axle housings, axle hubs, carriers, differentials.

Suspension System: Shock absorbers, struts, control arms, sway bars, knuckles, coil springs, leaf springs.

Steering System: Steering columns, steering gears/racks, control units.

Advanced Batteries: Cells, modules/arrays, assembled packs.

Source: Table A.2 in USMCA Chapter 4, Annex 4-B.

Considerations for Congress

As USMCA implementation continues, Congress may examine the impact of USMCA's automotive ROO on U.S. producers, particularly small- and medium-sized companies, and the North American auto industry. Additionally, the electric vehicle (EV) tax credit in P.L. 117-169, referred to as the Inflation Reduction Act (IRA), contains certain North American assembly requirements that may further change the North American automotive supply chain, if producers choose to qualify for the EV tax credit. U.S. trading partners have claimed that IRA requirements violate World Trade Organization rules. Some Members of Congress have stated that these requirements are important for lessening reliance on China and supporting U.S. jobs. Labor groups have raised concerns about ensuring that the EV transition does not negatively impact U.S. workers. Congress may examine the impacts of IRA EV tax credit requirements on the North American auto industry and USMCA utilization.

Other issues that Congress may consider addressing through legislation or conducting additional oversight over include

- Any ROO implementation and/or compliance issues.
- The implications of the January 2023 USMCA ROO panel decision and the lack of a resolution.
- Whether to raise the 2.5% passenger vehicle MFN tariff to encourage ROO compliance and the implications of such a tariff increase.
- Whether to address the automotive ROO dispute and other issues related to the North American auto sector, such as potential investments by China-based companies, as part of the 2026 USMCA joint review.

Liana Wong, Analyst in International Trade and Finance
Kyla H. Kitamura, Analyst in International Trade and Finance

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