American Iron and Steel Institute

Pre-Hearing Statement of Kevin M. Dempsey
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For the Hearing on Investigation No. 332-592
"USMCA Automotive Rules of Origin: Economic Impact and Operation, 2023 Report"
United States International Trade Commission
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In advance of the November 3, 2022, hearing at the U.S. International Trade Commission (ITC), the American Iron and Steel Institute (AISI) submits these comments on the economic impact and operation of the USMCA Automotive Rules of Origin on the U.S. steel industry. AISI serves as the voice of the American steel industry in the public policy arena and advances the case for steel in the marketplace as the preferred material of choice. AISI's membership is comprised of integrated and electric arc furnace steelmakers, and associate members who are suppliers to or customers of the steel industry.

The American steel industry serves as the backbone of the U.S. manufacturing sector and is essential to America's national defense, national economic security and homeland security. U.S. national defense requirements for military systems and U.S. national security requirements for critical infrastructure are both dependent on the availability of U.S.-produced steel products. The domestic steel industry is also proud to be the cleanest of the leading steel industries in the world, producing steel with lower carbon dioxide emissions intensity than major competing steel industries.

I. Introduction

The steel industry in the United States strongly supported the passage of the United States-Mexico-Canada Agreement (USMCA), which went into effect on July 1, 2020, following several years of negotiations between the three North American partners. Domestic steel producers greatly benefited from the predecessor trade pact, the North American Free Trade Agreement (NAFTA), but after more than 20 years, it needed to be modernized and strengthened to address recent trade challenges. The NAFTA resulted in strengthened manufacturing supply chains, particularly with key steel industry customer groups, such as the automotive industry, and facilitated significant increases in exports of U.S. steel mill products to Canada and Mexico. Our North American partners remain the two largest export markets for American-produced steel products,

accounting for 93 percent of all steel exports from the U.S. in 2021, up from approximately 75 percent in 1993, the year before the NAFTA went into effect. Throughout the USMCA negotiations, AISI and our partners worked to strengthen the rules of origin and regional value content (RVC) requirements that incentivize the consumption of North American steel in the manufacturing of steel-intensive goods in North America, including in the automotive sector. The prior NAFTA rules of origin for automotive goods did not provide clear incentives for North American automotive producers and parts producers to source steel products from U.S. and North American steelmakers, because imported steel did not count against the RVC requirements for these products. This was because the original NAFTA relied on tariff-shift rules for many steel-intensive products, allowing goods made from non-originating steel to be considered originating when substantially transformed in North America.

While it is too soon to see increases in steel shipments to the automotive sector solely because of the enhanced rules of origin, we expect demand for steel produced regionally to increase as a result of the USMCA, with U.S. steelmakers taking a substantial portion of the resulting consumption growth, since nearly three-quarters of steel production in North America takes place in the United States.

II. Context of USMCA Automotive Rules of Origin

The USMCA modernized the NAFTA by adopting new, strengthened rules of origin for automobiles and auto parts, which established enhanced RVC requirements for steel-intensive products and incentivize the use of North American steel by original equipment manufacturers (OEMs). Under the NAFTA, passenger vehicles and light trucks were required to have 62.5 percent RVC in order to be considered originating, and therefore receive duty-free treatment, and auto parts had to meet a 60 percent RVC threshold for origination. The NAFTA, though, did not contain a regional purchasing requirement for steel, nor was steel included on the tracing list for automobiles and light trucks. In addition, the NAFTA relied on tariff-shift rules for many steel-intensive products, allowing goods made from non-originating steel to be considered originating when substantially transformed in North America.

Thus, although the NAFTA's RVC requirements were the highest of any American free trade agreement, they did not provide sufficient incentives for North American OEMs and auto parts manufacturers to use North American steel since only traced products were considered in the RVC calculation. When steel was imported for incorporation into North American-produced vehicles, its value was not counted against the RVC requirement for automotive goods. For example, if the only input material in an automotive part was steel, such as a steel body stamping, because steel was not included in the NAFTA tracing, it allowed the manufacturer to import all its steel from non-NAFTA sources, without any adverse effect on the RVC calculation.

In an important change, the USMCA eliminated NAFTA's automotive tracing requirements. Instead, the USMCA sets forth specific, higher RVC requirements for various parts and components of an automobile. These parts and components are divided into three different categories, establishing a minimum RVC for each as follows:

1. Core parts and components, which include engines, axles, batteries, chassis, transmissions, and suspensions, among others, were required to reach a minimum RVC of 66 percent on the date of entry into force of the USMCA, increasing 3 percent each year, up to 75 percent;

2. Principal parts and components, which include brake systems, air conditioners, fuel systems, and exhausts, among others, were required to reach a minimum RVC of 62.5 percent on the date of entry into force of the USMCA, increasing 2.5 percent each year, up to 70 percent; and

3. Complementary parts and components, which include switches, valves, wire harnesses, lighting, and locks, among others, must reach a minimum of 62 percent RVC on the date of entry into force of the USMCA, increasing by 1 percent each year until reaching 65 percent.

The new RVC and automotive rules of origin under the USMCA are significantly stronger than the original NAFTA from a steel industry perspective. As a result, these new rules provide important new incentives for regional OEMs and auto parts manufacturers to use North American origin steel. Of particular value are the requirements that passenger vehicles and light trucks, as well as the "core parts" of these vehicles, must have at least 75 percent RVC using the net cost method upon the full phase-in of the RVC requirements. Furthermore, it is important to note that all "core parts" must meet the RVC requirements for the vehicle itself to be considered originating under the USMCA.

The largest impact of these new rules is expected to be in Mexico, where significant amounts of non-North American steel have traditionally been used to produce automobiles and auto parts. Indeed, during the USMCA negotiations, research from the Center for Automotive Research (CAR) reported that "most vehicles produced in the United States and Canada either already meet the new rules or are close to meeting the new rules, and … roughly 68 percent of current Mexican vehicle production is already conforming."[1] As a result, "the new rules mostly impact Mexican produced light vehicles and parts, as well as non-North American parts content used in the U.S.-, Canadian-, and Mexican-built vehicles."[2]

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[1] Center for Automotive Research, *Meet the New NAFTA* (October 16, 2018), *available at* https://www.cargroup.org/meet-the-new-nafta.

[2] *Id.*

In addition, another key provision of the USMCA automotive rules of origin is the separate requirement that 70 percent of each OEM's purchase of steel and aluminum must originate within North America for its vehicles to be considered originating. This requirement went into effect when the USMCA entered into force in July 2020, though alternative staging regimes agreed to between the USMCA governments and individual OEMs may allow for some flexibility. Eventually, by July 1, 2027, the USMCA will further require that for steel products to be considered originating and qualify under the automotive rules of origin, the steel must be "melted and poured" in North America, thus preventing semifinished steel imported from outside North America that is simply finished in the region from qualifying as North American steel.

III. Experience of Domestic Steelmakers with the Automotive Rules of Origin

It is difficult to quantify the impact of the USMCA automotive rules of origin at this point, or even to evaluate them separately from the many other trends underway in the automotive and steel industries in recent years. The USMCA has been in force for a little more than two years and, as noted above, automotive rules of origin provisions will continue to phase-in through 2023, with a regional "melted and poured" rule for steel content scheduled to take effect in 2027. Moreover, alternative staging regimes arrived at between the United States Trade Representative (USTR) and individual OEMs may extend the effective implementation date of some provisions until as late as 2025.

Relatedly, the period for which the USMCA has been in effect has been one of extraordinary volatility in the global economy, the automotive industry and the steel industry. The COVID-19 pandemic, related shutdowns of economies and industries, the brief but severe recession of 2020 and subsequent rapid recovery gave rise to disruptions to logistics networks, supply chains and global trade patterns that persist to some degree today.

Although a formal quantitative assessment of impacts therefore cannot be developed at this date, AISI has compiled insights on the operation of the rules of origin through conversations with executives of steel-producer member companies who deal regularly with automotive industry customers. They report the automotive rules of origin provisions in the USMCA have led to enhanced sales opportunities for their firms as a general matter. The minimum 70 percent regional steel purchase requirement allowing vehicle manufacturers to maintain duty-free access to the United States market has been cited as a particularly important factor driving customer inquiries.

AISI steel-producer members have conveyed that some Asian-based automakers with assembly facilities in Mexico have turned to domestic steelmakers to satisfy regional content requirements to maintain duty-free access of their finished vehicles to the large United States market. At the same time, some European-based automakers with

assembly facilities in the United States have similarly turned to domestic steelmakers as they look to satisfy reginal content requirements allowing the tariff-free import of their vehicles by Canada and Mexico.

AISI steel-producer members also report that the "melted and poured" rule scheduled to take effect in 2027 has stimulated sales inquiries. This rule will require that the finished steel products embodied in vehicles be manufactured regionally and themselves be made of raw steel produced within in the region. Although this requirement has not yet come into force, domestic steelmakers report they expect a positive impact on sales as this deadline draws closer.

The USMCA's automotive rules of origin are one of a number of critically important developments in the international trade arena in the last five years (including the Section 232 program of steel tariffs and quotas that took effect in 2018, successful anti-dumping and anti-subsidy cases and other measures), that have led to a wave of capital investments in the steel industry in the United States. With renewed confidence that their businesses would not be undermined by unfairly traded foreign steel, domestic steelmakers have announced investments of nearly $22 billion in new, expanded or restarted production since March 2018.

Finally, the USMCA's automotive regional content requirements have likely led to positive impacts on the broader economy. By operating to narrow the geographic scope of the supply footprint of the critical automotive industry, regional content requirements likely prevented even more severe logistics and supply disruptions to the North American automotive value chain than have been experienced since the onset of the pandemic, including those experienced by other industry sectors.

The full benefit of these provisions will not be realized, however, until these new requirements are completely phased in. Once the USMCA automotive rules of origin have fully entered into force, U.S. steelmakers are optimistic that U.S. economy will see significant additional benefits as current non-conforming automotive and auto parts manufacturing is adjusted to meet the USMCA RVC requirements for vehicles, auto parts and steel purchases. These changes will further strengthen regional supply chains for the automotive sector.

IV. Conclusion

From a steel perspective, the USMCA automotive rules of origin are a significant improvement over the prior NAFTA rules of origin for automotive goods, since the NAFTA rules did not provide clear incentives to source steel from U.S. and North American steelmakers. Automakers and auto parts manufacturers could utilize imported steel and it would not count against the RVC requirements for these products to receive duty-free treatment in the region. The new USMCA automotive rules of

origin set forth higher RVC requirements for auto parts and components, alongside a steel purchasing requirement for North American steel, and by 2027, a "melted and poured" standard, which will prevent semifinished steel imported from outside North America to qualify for originating treatment under the USMCA.

Even though too little time has passed to see documented increases in steel shipments to the automotive sector because of the enhanced USMCA automotive rules of origin, domestic steelmakers report that these new provisions have already led to enhanced sales opportunities for their respective companies. We expect demand for steel produced in North America to increases as a result of these new rules, since they provide important new incentives for regional OEMs and auto parts manufacturers to use steel produced in North America.