The Center for Automotive Research has issued a paper analyzing the proposed rule of origin changes in NAFTA. The paper is causing a stir for its pessimistic assessment of the rules recently under discussion and their potentially harmful effects on North American supply chains.

The paper's own analysis, however, raises some concerns. Although it enjoys a veneer of empiricism, a closer examination exposes assumptions, conclusory statements, and flawed analysis that call into question the utility of the findings.

1. The report moves inconsistently between focusing the United States and the North American region more generally. (*e.g.*, pp. 5, 7, 11). This approach is confusing: the United States and the NAFTA region are not coterminous. Moreover, it is of limited value in assessing the potential impact of a change in rules of origin, which affect trilateral trade flows.

   Interestingly, though, the paper's focus on the United States does highlight one salient point: 79% of vehicles assembled in the United States are sold in the United States. That fact would seem to undercut the relevance of the paper's argument elsewhere that stronger rules would adversely affect U.S. exports. (p. 9) Even if they do, U.S. exports seem, by the report's own description, to be small compared to domestic consumption. (p. 7)

2. The report distinguishes between final vehicles and parts, noting that U.S. imports of the former have a nearly 100% rate of claiming the preference, while U.S. imports of the latter "eschew the NAFTA . . . trading preferences." (p. 5) This assertion bears more discussion than the paper provides. Is there any distinction between parts on the tracing list, and those not on the tracing list? Parts not on the tracing list are "deemed originating," and thus the actual origin of the part is irrelevant for NAFTA content purposes. An importer might reasonably conclude that paying a 2.5% tariff on an inexpensive part is worth it, if that part can be counted toward the regional value content of the entire vehicle.

3. The report notes that "for many low-value and high labor content parts, there is currently little to no U.S. production capacity." (p. 7) Again, as noted above, the question with rules of origin is not whether these parts will be made in the United States, but rather in the NAFTA region. The report goes on to suggest – with no empirical support -- that there is not a "business case for production in the United States or the NAFTA region due to cost-competitiveness or issues of economies of scale." (p. 7)

   There is irony in the fact that loose rules of origin in U.S. trade agreements encouraged precisely this kind of sourcing in third parties. That, in turn, in why Ambassador Lighthizer is seeking to tighten them.

4. The report states that if "there is an RVC requirement for share (sic) of NAFTA steel and aluminum in core parts, production that relies heavily on imported specialty grades of these metals may also move offshore." (p. 7). There is no empirical analysis to support this assertion either, and it is not clear in any event that the conclusion drawn is a logical one. Offshored production won't count toward the revised NAFTA rules of origin.

5. The report asserts that of the vehicles produced in the NAFTA region, some alarming number would no longer qualify for NAFTA preferences if the proposed rules of origin were adopted. (p. 8). Well, yes. That assumes the producers would not alter their supply chains. The purpose of changing the rules is to change the sourcing incentives.

   The real question is whether they would do so, or whether they would simply pay the duties instead. Given that imports of vehicles from Canada and Mexico currently claim the preference almost 100% of the time, according to CAR itself, then it seems as though the incentive is to remain eligible for the preference. Moreover, a Scotiabank study from 2017 indicated that although the requirement under current rules is for 62.5% content, vehicles nevertheless seem to meet a 75% content threshold. If so, then there appears to be room for producers to adjust their supply chains.

6. The report projects an estimated loss of sales of 60,000 to 150,000 every year *if* producers paid duty on these vehicles and *assuming* the duty were passed on to consumers. (p. 9) As noted above, it is perfectly plausible that producers have room to alter their supply chains instead of paying the duty. Moreover, on what basis it is assumed that the duty will be passed on to consumers? The report relies on two tenuous hypotheticals to draw an alarmist conclusion. (Notably, the report does not disclose the methodology used to calculate the loss of sales.)

7. The report goes after the proposal's requirement that 70% of core parts use North American steel and aluminum. CAR states there is "some concern whether sufficient regional capacity exists – particularly for aluminum – to meet this requirement. In the United States, aluminum imports outstrip domestic production by a factor of 1.6." (p. 10). CAR does not define aluminum (primary? semi-finished? finished?), or provide citations for its assertions. However, it is worth noting that with respect to primary aluminum, the United States imports over 2 million tons a year from Canada, a figure that can be expected to rise with the Section 232 tariffs and Canada's exemption. CAR on the one hand questions the sufficiency of "regional" capacity, while on the other ignoring a NAFTA partner's status as one of the world's most significant aluminum exporters to the United States.

8. The report includes the labor value content requirement of 30% in its conclusory discussion of price increases for consumers. (pp. 8-9). However, CAR itself notes that at present the United States *by itself* contributes 20 to 30% of the content of vehicle imports from Mexico. (p. iv). If that's the case, then a requirement that 30% of the content of a vehicle comply with wage standards only met (at present) in Canada and

the United States seems easy enough to meet – indeed, it would seem to already be built into the cost structure.

9. Where was CAR's report on TPP? If CAR is really worried about threats to North American production, then presumably CAR would have analyzed the TPP rules to evaluate how they might affect sourcing patterns under NAFTA. Certainly the TPP rules, which were considerably weaker than the NAFTA rules, provided ample opportunity to lament the potential offshoring of North American jobs.