Overview of U.S. Work on Rules of Origin

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Types of Rules of Origin

- Preferential Rules of Origin
  - Provides access to preferential duty rates
  - Applied in U.S. free trade agreements and unilateral preference programs (GSP, African Growth and Opportunity Act, Caribbean Economic Recovery Act, Pacific Islands, and Nepal Preference Program)
- Non-preferential Rules of Origin
  - Applied for purposes **OTHER THAN** duty preference

Unilateral Preferential Rules of Origin

U.S. Trade Preference Programs

- Unlike most other WTO members, the United States has five preference programs
  - Former Trust Territory of the Pacific Islands (Northern Mariana Islands, Marshall Islands, Federated States of Micronesia, Palau), 1948
  - Generalized System of Preferences (GSP), 1976
  - Caribbean Basin Economic Recovery Act (CBERA), 1984
  - African Growth and Opportunity Act (AGOA), 2000
  - Trade Preferences for Nepal, 2016
- Note that some programs are based on a geographic area, but GSP is not
- Some countries are beneficiaries under more than one program (e.g., Caribbean + GSP, AGOA + GSP, Nepal + GSP)

U.S. Trade Preference Programs

- Each preference program has different product coverage
  - AGOA: 5,351 tariff lines
  - GSP: 5,138 tariff lines
  - Nepal: 77 tariff lines
  - CBERA (including CBTPA, Haiti HOPE) 5,674 tariff lines
- Rules of origin under U.S. preference programs are based on whether a good is a “product of” the beneficiary country and the regional value content (RVC) requirement, not tariff shift

U.S. Trade Preference Programs

- Caribbean Basin Economic Recovery Act (CBERA) has three parts
  - The base CBERA preference program is permanent
  - The Caribbean Basin Trade Partnership Act (CBTPA) preferences will expire on 30 September 2030
  - Haiti preferences will expire on 30 September 2025
- African Growth and Opportunity Act: Expires 30 September 2025
- Nepal Trade Preferences: Expires 31 December 2025
- GSP: Expired 31 December 2020 (GSP has expired several times - historically GSP renewal has allowed refunds for duties collected during the lapse)

Rules of Origin Under U.S. Preferences

- The United States applies a rule of origin based on whether good is a "product of" the beneficiary country and the amount of originating content in the good as a percentage of the good's value
- Generally speaking, non-textile products utilize the rule of origin that requires an regional value content (RVC) of 35 percent
- $(Cost\ of\ local\ materials + Direct\ cost\ of\ processing) \div Appraised\ value\ of\ Good\ \geq 35\ percent$
- Apparel products under AGOA and other programs are generally subject to a simple "cut-and-sew" (third-country fabric) rule
- Under some preference programs, cumulation with other beneficiaries in the geographic region or with the United States is permitted

Utilization of Trade Preferences: AGOA

Total U.S. Imports, 2023: USD 9.3 billion

- Mineral Fuels: USD 4.3 billion (46 percent)
- Textiles and Apparel: USD 1.1 billion (12 percent)
- Motor Vehicles: USD 1.8 billion (19 percent)
- Agriculture: USD 803 million (9 percent)

Utilization of Trade Preferences: CBERA

Total U.S. Imports, 2023: USD 2.0 billion

- Mineral Fuels: USD 729 million (37 percent)
- Textiles and Apparel: USD 66 million (33 percent)
- Agriculture and Food: USD 14 million (7 percent)

Effects of U.S. Trade Preferences

- The U.S. has identified numerous industries that have developed to take advantage of trade preferences.
  - Apparel, Sub-Saharan Africa: Provisions that allow the use of third-party fabrics have allowed Kenya, Lesotho, and Madagascar to take advantage of AGOA preferences
  - Apparel, Haiti: Haiti’s apparel exports have grown significantly under CBI preferences and reached 95 percent of total Haitian exports to the United States in 2020. Industry estimates that CBI is responsible for the creation of over 54,000 garment factory jobs in Haiti as of the end of 2020.
  - Travel goods, Southeast Asia: Travel goods were added to GSP for all GSP beneficiaries in 2018; currently the largest GSP import category.
  - Rum, Jamaica: Jamaica is currently the leading global supplier of rum to the United States.

Factors Affecting Utilization

- When costs of compliance exceed the duty rate
  - For example, U.S. MFN tariffs on crude petroleum are 5 or 11 cents per barrel and current spot price is USD 70 per barrel
  - In 2023, U.S. imports of crude from Guyana were USD 2.9 billion; USD 2.8 billion entered under MFN tariffs, only USD 79 million entered under CBERA
- Difficulty meeting the rule of origin
  - Tuna processed in a Sub-Saharan beneficiary country must be caught by a ship flying the flag of a beneficiary country
- Lack of awareness of preference program benefits
  - A study by the USITC indicated low awareness in certain AGOA beneficiaries
- Development of a national strategy
  - Beneficiaries with such a strategy have higher utilization rates

Utilization of Trade Preferences

- The base tariff rate may have an effect on utilization of preferences
- Vanadium oxide, 2825.30 (used in the production of strengthened steel): U.S. tariff rate is 5.5 percent
  - 2021 imports from AGOA beneficiaries: $20.4 million under AGOA (90% of total imports), $1 million under GSP, $1.2 million no program claimed
- Men's and boys' undergarments, other than cotton, 6107.99: U.S. MFN tariff rate 14.9 percent
  - 2021 imports from AGOA beneficiaries: $3.2 million under AGOA (99.9% of total imports), $836 no program claimed
- T-shirts, 6109.10: U.S. MFN tariff 16.5 percent
  - 2021 imports from AGOA beneficiaries: $43.4 million under AGOA (86.2% of total imports), $6.9 million no program claimed

To What Extent do Trade Preferences Affect Exports to the United States?

- 6107.99, total 2021 U.S. imports: $163 million
  - Top 5 exporting countries to the U.S. account for $149.7 million (91.7 percent). Only the exporter in fifth place ($3.5 million) receives preferences
  - <u>AGOA accounts for less than one percent of total U.S. imports</u>
- 6109.10, total 2021 U.S. imports: $6.2 billion
  - Top 15 exporting countries to the U.S. account for $5.2 (83 percent). Seven of the top 15 are U.S. FTA partners, first unilateral trade preference beneficiary is #14 (Haiti).
  - Five of top 10 exporters receive some sort of trade preference (e.g., FTA), ***but not the third country fabric allowance***
  - <u>Unilateral trade beneficiaries account for $260 million (4.2 percent) of U.S. imports</u>

Factors Affecting Utilization of Preferences

- Eligibility for preferences
- The presence of foreign direct investment (FDI) in the sector
- Consumer demand for the product in the United States
- Expanded production capabilities, and cost advantages in production.
- Foreign-domestic partnerships in certain industries

Rules of Origin in U.S. FTAs

Types of FTAs in U.S. FTAs

- Tariff Shift
- Regional Value Content
- Chemical Reaction
- Textile (yarn forward)
- Automobile (USMCA only)

Overview of USMCA Auto Rules

- The USMCA rules of origin for motor vehicles require a specific amount of North American content in the final vehicle in order to qualify for duty-free treatment. The USMCA raised regional value content (RVC) requirements to 75 percent for passenger vehicles and light trucks, compared to 62.5 percent under the NAFTA.
- In addition, certain "core parts" must also meet the higher RVC thresholds for the entire vehicle to qualify.
- The USMCA also requires that at least 70 percent of a vehicle producer's steel and aluminum purchases originate in North America.
- Finally, the USMCA introduced a new LVC rule that requires that a certain percentage of each producer's qualifying vehicles be produced by employees making an average of USD16 per hour. Collectively, these new requirements are intended to incentivize increased investment in autos and automotive parts production within the United States and North America.
- The USMCA eliminated the NAFTA "deeming" rule whereby any auto part that was not specifically identified on a list created at the time the NAFTA was negotiated (in the early 1990s) was "deemed" to be originating in North America, regardless of where it was actually produced.

Comparison of ROO for Autos: NAFTA/USMCA

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

USMCA Core Parts

- In addition to meeting the overall vehicle RVC requirement, the USMCA includes a new separate requirement that certain “core parts” of a vehicle must themselves be originating by satisfying separate RVC thresholds set out for those parts.
- The seven defined core parts – engine, transmission, body and chassis, axle, suspension system, steering system, and (where applicable) advanced battery – represent some of the most valuable parts of a vehicle. If these core parts are not themselves originating, the overall vehicle does not qualify for preferential tariff treatment under the USMCA.

Effect of USMCA Rules of Origin

- According to a USITC report, USMCA automotive ROOs resulted in decreased U.S. imports of motor vehicle engines and transmissions from non-USMCA countries in 2022, and increased U.S. employment, wages, capital expenditures, and revenue for U.S. producers of engines and transmissions.
- The USITC estimated that U.S. imports of engines and transmissions from non-USMCA countries decreased by 431,853 units and 55,195 units, respectively, in 2022. For U.S. engine and transmission producers, employment increased by 3,877 workers, wages increased by USD 239.1 million, capital expenditures increased by USD 60.2 million, and revenues increased by USD 1.6 billion.
- The USMCA automotive ROOs slightly increased employment, wages, capital expenditures, production, revenue, and profits for U.S. producers of light vehicles in 2022, as well as the average price of light vehicles in the United States, according to modeling estimates in the Commission’s 2023 report.
- In 2022, the USITC estimated that U.S. vehicle producers increased employment by 35 workers, wages by USD 2.7 million, capital expenditures by USD 1.2 million, production by 1,464 vehicles, revenue by USD 81.3 million, and profits by USD 25.0 million.

Effect of USMCA Rules of Origin on U.S. Imports

- The percentage of vehicles imported from Canada or Mexico for which duties were paid increased from 0.5 percent (a total value of USD 517 million) in 2019 to 8.2 percent (a total value of USD 8.9 billion) in 2023.
- However, the percentage of such imports appeared to level off in 2023, when the share was only 0.4 percentage points higher than 2022.
- Almost 90 percent (USD 7.9 billion) of U.S. imports from USMCA partner countries in 2023 that paid duties were vehicles of HS 8703.23 (vehicles for the transport of persons with a spark-ignition engine with a cylinder capacity greater than 1.5L but less than 3L) from Mexico.
- Negative effect on trade in used vehicles who could not demonstrate compliance with new rules of origin.

Promoting Supply Chain Resilience

- Strengthening supply chains is a critical component of our efforts to advance our worker-centered trade policy, create sustainable economic growth, ensure that our economy is more resilient in the face of supply shocks, and enhance U.S. economic security. The United States has felt first-hand the impacts of supply chain disruptions, which include volatile prices for critical consumer goods and medical products and widespread product shortages that contribute to inflationary dynamics.
- Further, global supply chains have been designed to maximize short-term efficiency and minimize costs, leading to greater vulnerability and unsustainable dependencies, and furthermore have promoted trade that may not reflect our core values, like labor standards and environmental protection.
- The Administration is undertaking a whole-of-government effort to proactively strengthen domestic manufacturing and to secure trusted supply chains through strategic arrangements with trusted partners and with regional partners. Enduring resilience will require new investments in infrastructure, new incentives to increase the supply of key inputs, and new forms of cooperation with allies and trading partners to prevent and withstand supply chain disruptions and mitigate risks of price spikes and volatility that could contribute to inflationary dynamics.
- To advance these policy priorities, USTR has been crafting a new approach to trade and investment policy that promotes supply chain resilience. Resilient supply chains provide a range of sources for critical inputs; adapt, rebound, and recover with agility when faced with economic shocks; uphold labor rights and environmental protections; and strengthen the domestic manufacturing base.

USTR *Federal Register* Notice seeking Comments, 7 March 2024

- Asked for comments that applied to specific economies sectors (e.g., aerospace, agriculture, autos, critical minerals, pharmaceuticals, semiconductors, textiles)
- "There is concern that preferential rules of origin in free trade agreements can operate as a 'backdoor' benefiting goods and/or firms from countries that are not party to the agreements and are not bound by labor and environmental commitments. What actions could be taken to mitigate these risks and maximize production in the parties? What policies could support strong rules of origin and adherence to rules of origin?"
- https://www.regulations.gov/document/USTR-2024-0002-0002

Comments Received

- USTR received 296 comments. All available online.
- Wide range of comments related to rules of origin. Some were general (e.g., “facilitate trade”), while others were related to specific industries (e.g., dairy, metals).

Comments Received

- Relationship of U.S. MFN tariff to FTA rules of origin
- Circumstances of production of specific goods
  - Where minerals were mined, nationality of mining firm
  - Origin of inputs into inputs (e.g., pharmaceuticals, metals)
- Costs of compliance
- Monitoring of forced labor

Modifying Rules of Origin

- Rules of origin under <u>U.S. preference programs</u> are defined in the legislation
- Rules of origin in <u>U.S. FTAs</u> can be modified with the agreement of the other party (except textiles)
  - Changes in the Harmonized System
  - Changes in sourcing
- Changes to U.S. FTA rules of origin can be made administratively, but require an analysis by the USITC, a formal agreement, and a presidential proclamation. Partners may have different procedures.

Difficulties to Modify FTA Rules of Origin

- Sensitivities that existed at the time the FTA was negotiated may not persist over time. Production patterns shift and companies go out of business.
- The connection to MFN tariffs is important. Higher MFN rates create a stronger incentive to meet a preferential rule of origin. However, low-cost producers may be able to overcome high duties.
- Changing FTA rules of origin can be difficult because the parties to the FTA may have different procedures to modify rules. Updating rules to reflect changes to the Harmonized System (i.e., non-substantive changes) is extremely time-consuming.

What Could the Future Hold?

- More work on specific products
- Relationship of MFN tariff to product identification
- Introduction of additional aspects to rules (e.g., labor value content)
- New FTAs only or existing ones, as well?
- The effect of technological change on rules of origin