

September 27, 2018

The Honorable Robert E. Lighthizer
United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508

Dear Ambassador Lighthizer:

In accordance with section 105(b)(4) of the Bipartisan Congressional Trade Priorities and Accountability Act of 2015, and section 135(e) of the Trade Act of 1974, as amended, I am pleased to transmit the report of the ITAC on Automotive Equipment and Capital Goods (ITAC-2) on the Trade Agreement with Mexico and Potentially Canada, reflecting the consensus and majority opinions and additional comments by one member on the proposed Agreement (see Attachment).

Sincerely,

A handwritten signature in cursive script, appearing to read "Charles D. Uthus".

Charles D. Uthus
Chair
ITAC on Automotive Equipment and Capital Goods (ITAC-2)

A Trade Agreement with Mexico and Potentially Canada

**Report of the
Industry Trade Advisory Committee on Automotive Equipment and Capital Goods**

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**Industry Trade Advisory Committee on Automotive Equipment and Capital Goods (ITAC-2)
Report to the President, the Congress, and the United States Trade Representative on the
Trade Agreement with Mexico and Potentially Canada**

Consensus and Majority Views

I. The Industry Trade Advisory Committee on Automotive Equipment and Capital Goods

The Industry Trade Advisory Committee on Automotive Equipment and Capital Goods (ITAC-2) was established by the Secretary of Commerce (the Secretary) and the United States Trade Representative (the USTR) pursuant to the authority of section 135 (c)(2) of the 1974 Trade Act (Public Law 93-618), as delegated by Executive Order 11846 of March 27, 1975. In establishing the Committee, the Secretary and the USTR consulted with interested private organizations and took into account the factors set forth in section 135 (c)(2)(B) of the Act

II. Purpose of Committee Report and Mandate

Section 105(b)(4) of the Bipartisan Congressional Trade Priorities and Accountability Act of 2015, and section 135(e)(1) of the Trade Act of 1974, as amended, require that advisory committees provide the President, the Congress, and the U.S. Trade Representative with reports not later than 30 days after the President notifies Congress of his intent to enter into an agreement.

The Committee shall perform such functions and duties and prepare such reports as may be required by section 135 of the Trade Act with respect to the industry trade advisory committees. The Committee advises the Secretary and the USTR concerning the trade matters referred to in section 135(a)(1) of the Trade Act and is consulted regarding the matters referred to in section 135(a)(2) of the Trade Act.

Under Section 135 (e) of the Trade Act of 1974, as amended, the report of this Advisory Committee must include:

- An advisory opinion as to whether and to what extent the agreement promotes the economic interests of the United States
- Achieves the applicable overall and principal negotiating objectives set forth in the Bipartisan Congressional Trade Priorities and Accountability Act of 2015.
- Whether the agreement provides for equity and reciprocity within the sectoral or functional area.

Pursuant to these requirements, the Industry Trade Advisory Committee on Automotive Equipment and Capital Goods (ITAC-2) hereby submits the following report. This Committee's specific responses to the mandated input can be found in the report's Conclusion.

III. Introduction

The members of the Industry Trade Advisory Committee on Automotive Equipment and Capital Goods (ITAC-2),¹ in accordance with the Trade Promotion Authority timeline, respectfully provide the following comments on the draft text of a trade agreement with Mexico and potentially Canada (Agreement) dated August 27, 2018, for review by cleared advisors.

It is important to note up front that several aspects of the Agreement are still not complete—most notably, a legal review of the text is still underway, Canada’s inclusion in the agreement is still unknown, and the text of important side letters to the agreement are not yet available for review. Nevertheless, The ITAC-2 is providing comments on the draft text that has been posted for cleared advisor’ review as well as the information made available to it through oral briefings provided by the U.S. negotiating team. These comments are, therefore, made subject to the opportunity to review a final draft agreement text and following a decision on whether Canada is included in the new agreement.

After nearly 25 years, The ITAC-2 fully recognizes the need to update NAFTA. Much has changed in the U.S. automotive and capital goods sectors, and the provisions of the agreement pertaining to these sectors clearly needed to be adjusted to account for the transformation that has taken place over the course of the last quarter-century.

The automotive and capital goods sectors are the cornerstone of the U.S. manufacturing sector and represent the largest segment of goods traded between the U.S., Canada and Mexico – estimated to be about 30% of total NAFTA goods trade. This volume of trade illustrates the deep and far-reaching regional integration of the automotive and capital goods sectors. As such, cautious and measured changes should be made to ensure that they do not result in unintended consequences that would harm – instead of strengthen – the U.S. manufacturing sector and the millions of American jobs that those sectors directly employ and indirectly support.

The ITAC-2 sincerely appreciates the efforts of the negotiators to work closely with the affected parties and stakeholders. Despite the short timeframe to negotiate an agreement, the U.S. team was generous with their time, fielding calls and meeting requests from the industries represented by the ITAC-2 throughout the process. Despite this access and the negotiators’ willingness to “take-on-board” much of industry’s advice, the ITAC-2 outlines below our assessment of the results, including areas where the majority of the Committee members believes improvements can be made.

IV. Executive Summary of the Committee Report

Listed immediately below and discussed in more detail in Section V, the ITAC-2 industry representatives are pleased with in some cases the entire chapter, and in other cases key provisions of the following Agreement Chapters:

- National Treatment and Market Access, with respect to Remanufactured Goods (Chapter 2)
- Rules of Origin Procedures (Chapter 5)
- Customs and Trade Facilitation (Chapter 7)
- Energy and Energy Performance Standards (EPS) (Chapter 8 and 8a)

¹ While “automotive” is in the title of the ITAC-2, please note in the context of our comments, we deem the term “automotive” to include the entire spectrum of light and heavy vehicles (passenger vehicles, light trucks, and heavy trucks) as well as the automotive parts and components used for those vehicles as new original equipment and aftermarket (auto parts).

- Technical Barriers to Trade (Chapter 11)
- Sectoral Annexes: U.S.-Mexico Bilateral Side Letter on Automotive Safety Standards (Chapter 12)
- Intellectual Property (Chapter 20)
- Small and Medium-Sized Enterprises (Chapter 25)
- Good Regulatory Practices (Chapter 28)
- Publication and Administration (Chapter 29)

There remain, however, some Chapters, and key provisions of Chapters, and related U.S. trade policy initiatives that the ITAC-2 industry representatives believe could and should be improved and addressed. The following subjects and chapters could include specific modifications that would improve the agreement, while not taking away from the Administration's overall goals:

- Section 232 Steel and Aluminum Tariffs (as applied to Canada and Mexico)
- Auto-related Side Letters (regarding Potential Section 232 on Automotive and Automotive Parts and an Automotive MFN tariff increase)
- National Treatment and Market Access, with respect to Duty Drawback (Chapter 2)
- Rules of Origin for Automotive Goods (Chapter 4)
- Rules of Origin for Capital Goods (Chapter 4)
- Product Specific Rules for "Steel-Intensive Products" (Non-Automotive (Chapter 4)
- Trade Remedies, with respect to AD/CVD Review (Chapter 10)
- Investor State Dispute Settlement (Chapter 14)
- Macro-economic and Exchange Rate Matters Currency (Chapter 33)
- Final Provisions, with respect to Performance Review and Termination (Chapter 34)

The ITAC-2 industry representatives believe it is particularly important to address and/or improve the following aspects of the draft agreement and related trade policy initiatives:

Canada's Inclusion in Agreement: Many of the agreement's chapters and provisions were drafted with the expectation that Canada would be included. Due to the high-level of integration of the U.S. and Canadian automotive and capital goods sectors, if Canada is not included in the agreement, the ITAC-2 would not be able to support the agreement without significant modification to account for the absence of Canada. Changes to rules of origin, discussed further below, are important examples.

Sec. 232 Steel and Aluminum: As of June 1, 2018, the U.S. has imposed tariffs of 25% on steel and 10% on aluminum imported from Canada and Mexico pursuant to Section 232². Maintaining these tariffs would be inconsistent with the spirit of a renewed free trade agreement, would lead to a net loss of U.S. jobs and economic growth, and, ultimately, would serve to harm—not help—the global competitiveness of the steel and aluminum consuming industries in the United States. The ITAC-2 industry representatives strongly recommend that Canada and Mexico be exempted from these import tariffs without any additional conditions, such as quotas.

Automotive Side letters (Sec. 232 and MFN tariffs): Although still unclear, the ITAC-2 industry representatives are deeply concerned with the possibility that the benefits of the agreement will effectively be undermined through the potential increase of tariffs stemming from the ongoing Section 232 automotive and automotive parts investigation (Autos 232), and a possible unilateral increase in the U.S. Most Favored Nation (MFN) tariff rate for passenger

² Section 232 of the Trade Expansion Act of 1962 (19 U.S.C. §1862)

vehicles and light trucks. It is our understanding that there are two side letters to the agreement still under development on these subjects. Although the ITAC-2 members have not seen the text for these letters, we understand that they attempt to:

- Limit the impact of the potential imposition of tariffs stemming from the Section 232 investigation currently being conducted by the U.S. Department of Commerce on the domestic auto industry; and,
- Mitigate the negative impact on trade of a potential unilateral increase in the U.S. MFN import tariff rate on passenger cars (currently 2.5%).

The ITAC-2 industry representatives strongly recommend that as part of the Agreement, that Canada and Mexico are exempted, without condition, from the imposition of any potential Autos 232 tariffs, and any potential unilateral raising of the U.S. Most Favored Nation (MFN) tariff rate for passenger vehicles and light trucks.

Rules of Origin for Automotive Goods: We recognize and appreciate the effort by the parties to craft new and updated automotive rules of origin for the Agreement. The ITAC-2 automotive industry representatives view the negotiated automotive rules of origin as workable and manageable. We look forward to ongoing engagement as the Administration continues to refine this part of the agreement. The draft rule of origin -- designed as an “Agreement in Principle” -- provided for our review does meet the purpose of preventing “free riders,” but does so at a cost to the automotive industry. The changes to the automotive rules of origin methodology and the increases in the Regional Value Content (RVC) levels present challenges. At the same time, we do recognize and appreciate that there were some helpful tools maintained in the automotive rules of origin that may temper some of those challenges. Overall, the rules of origin will add a higher degree of complexity, an administrative burden on industry’s supply chain, and a higher level of risk to ensure compliance.

Rules of Origin for Capital Goods: The scope of automotive parts encompasses not just light and heavy vehicle applications, but also non-automotive applications. Under the draft text, capital goods not covered by the automotive or heavy truck rules of origin will continue to follow the original NAFTA’s rules of origin, including the use of tracing. The ITAC-2 industry representatives are concerned that the list of core components and principal parts subject to more stringent automotive RVC requirements are the same parts and components used by a number of sectors outside the intended scope of passenger vehicle and light trucks. These changes will have a significant impact on manufacturers of capital goods. The ITAC-2 industry representatives recommend the new rules of origin apply only to those core components and principal parts that are destined for an end use in passenger vehicles and light trucks. Additionally, the ITAC-2 industry representatives recommend that the Agreement be modified to allow for the elimination or simplification of the “tracing list” procedures on the parts/components used by the non-automotive capital goods industry.

Need for Stability and Predictability: There are several issues that have resulted in a high-level of uncertainty for the U.S. automotive and capital goods sectors, including: Ongoing U.S. negotiations with Mexico and Canada—combined with the lack of clarity regarding the possible exclusion of Canada and Mexico from Section 232 steel and aluminum tariffs; the possible imposition of higher tariffs on passenger cars through an auto 232 investigation; and, a possible unilateral increase in the MFN tariff rate for passenger vehicles. The ITAC-2 industry representatives are also deeply concerned that other elements of the draft Agreement could also

further harm the stability and predictability of the business environment by omitting mechanisms found in the original NAFTA agreement, including the investor-state dispute settlement (ISDS), and the elimination of anti-dumping and countervailing duty (AD/CVD) reviews. The ITAC-2 industry representatives encourage the reconsideration of these important mechanisms found in the original NAFTA that have not been included in the proposed Agreement.

Performance Review and Termination: The ITAC-2 industry representatives are concerned that the preliminary agreement reached with Mexico introduces a new provision that could result in the termination of the agreement after 16 years. While the Committee welcomes the commitment by the Parties to review the agreement at the Commission level six years following entry into force, we emphasize this review should be directed toward and result in actions that support North American automotive and capital goods manufacturing and trade rather than actions that weaken the industries' and workers' global competitiveness by fostering greater uncertainty.

Business decisions are not tied to a 16-year cycle; instead they are based on market conditions that are underpinned by legal stability and predictability. The agreement's text on this matter will inject a significant source of instability into business decision-making by U.S. manufacturers. The ITAC-2 industry representatives strongly encourage the U.S. negotiators to reconsider and remove this termination provision from the agreement and replace it with a clear commitment by the Parties to regularly review and modernize the agreement.

Macro-economic and Exchange Rate Matters “Currency Manipulation”: The ITAC-2 vehicle manufacturer and worker representatives applaud the inclusion in the body of this agreement a provision that addresses this harmful distortion of trade, and they are encouraged that it is actionable (albeit on a significantly limited basis) under the agreement's dispute settlement provisions. The inclusion of these provisions is groundbreaking and very much appreciated. These representatives, however, are disappointed that many of the commitments in this section are restated language from agreements already made under the International Monetary Fund, and that the actionable provisions of the agreement are very limited – e.g., only with respect to transparency and reporting. Nonetheless, the auto manufacturer and worker representatives on ITAC-2 respectfully request that a commitment to coordinate action in opposition to currency manipulation by parties outside of the Agreement be added.

V. **Comments on Relevant Provisions and Related Trade Policy Initiatives**

1. **Section 232 Steel and Aluminum Tariffs**

The automotive and capital goods industries combined are the single largest consumers of all the steel and aluminum purchased in in the United States, and the vast majority of that steel and aluminum is produced in North America. The industry's expectation was that the announcement of a U.S.-Mexico agreement would include the resolution of the Sec. 232 steel and aluminum tariffs. We were therefore very disappointed to see that the tariffs were not eliminated. Whether part of the Agreement, in a side letter, or through a separate but parallel track, the ITAC-2 strongly recommends that the U.S. exempt Canada and Mexico from the currently imposed Sec. 232 steel and aluminum tariffs. Maintaining those tariffs is inconsistent with the spirit of a free trade agreement, will lead to a net loss of U.S. jobs and economic growth, and will only serve to harm the global competitiveness of the steel consuming industries in the United States. Moreover, given that the revised automotive rule of origin requires 70% steel and aluminum is

sourced in North America, as a necessary component to enjoy duty free treatment, a tariff or quota on top of that requirement is redundant and unnecessary.

2. Auto-related Side Letters

The ITAC-2 industry representatives strongly oppose the imposition of more tariffs on automotive products imported into the United States, whether through a potential Autos Sec. 232 remedy or through a unilateral increase in the MFN rate. Regarding the Agreement, we are very concerned with the adverse impact on the agreement's automotive provisions if U.S. auto tariffs are increased from the ongoing Autos 232 investigation. Similarly, we oppose the U.S. unilaterally increasing its passenger car MFN import tariffs. Although we have not seen text for these side letters, we understand that they are still being finalized, and will attempt to mitigate the impact of the potential imposition of possible higher tariffs from any findings related to the Autos 232 investigation, and the potential negative impact of a unilateral increase in the U.S. MFN tariff rate (2.5%) on passenger cars.

Regarding the provisions of the side letters, we understand that if auto tariffs are imposed because of the Autos 232 investigation, then a total cap on duty-free imports (vehicles and auto parts) would be imposed. However, questions remain on how that would be allocated, managed and implemented. Many aspects of vehicle and auto parts manufacturing are done in a "just-in-time" environment. A cap, particularly on automotive parts (the scope of which is beyond just light vehicle parts), adds a layer of significant uncertainty and makes it extremely difficult for planning and efficient manufacturing. Therefore, the ITAC-2 industry representatives strongly recommend that as part of the Agreement, that Canada and Mexico are exempted without condition from the imposition of any potential Autos 232 tariffs. We further recommend that, if a cap is put into place that the automotive parts value cap is indexed to accommodate for future changes. Additionally, we respectfully request that these side letters are beholden to any future review of the agreement.

3. National Treatment and Market Access for Goods (Chapter 2)

Remanufactured Goods: Facilitating trade in remanufactured goods advances the economic and environmental goals of the parties of the agreement. The agreement's strict definition of remanufactured parts, which require remanufactured goods to "meet all applicable technical requirements that apply to equivalent goods in new condition" helps ensure that these products are of the highest quality.

The ITAC-2 is pleased the current NAFTA draft maintains the disassembly rule to ensure that components recovered from goods disassembled in a NAFTA party jurisdiction are considered originating in that jurisdiction as a result of such disassembly. We are also pleased that the current proposal prohibits any party that maintains measures prohibiting or restricting the importation of used goods not apply those measures to remanufactured goods, and that remanufactured goods will move between the parties to the agreement duty-free.

Duty Drawback: The ITAC-2 members also note that the original NAFTA's restrictive duty drawback provisions have not been modified in the updated agreement. NAFTA's duty drawback provisions, the "lesser of two" rule, are unique in U.S. free trade agreements and undermine U.S. manufacturers in comparison to our North American competitors. Mexico and Canada have found ways to minimize these restrictions using regimes that target duty-rate reductions for inputs used in specific export industries, thus putting U.S. exporters at a

disadvantage. The ITAC-2 industry representatives recommend that the restrictive duty drawback provisions in the Agreement be modified consistent with most other U.S. trade agreements.

4. Rules of Origin for Automotive Goods (Chapter 4)

In the highly technical area of automotive rules of origin, where small details can have outsized impacts, as well as the fact that this chapter is marked “Agreement in Principle,” The ITAC-2 reserves our final assessment until after we have an opportunity to review the final text. With that in mind, we make the following comments and recommendations based upon the information available (as of Sept 27, 2018):

Recognizing that the general purposes of rules of origin are to prevent those that have not made adequate investments in the free trade region and/or those that have not provided concessions during negotiation of a free trade agreement (a.k.a. “free riders”) from benefiting from the agreement, while at the same time, providing those that have made adequate investments in the region a cost-effective means to enjoy the duty-free benefits of the agreement. A well-crafted rule of origin should strike the right balance between these two competing purposes.

Complexity and cost of compliance are also very important factors to consider when assessing rules of origin. The more streamlined the rule of origin is, the lower the administrative burden and, in turn, the larger the net benefit derived from the duty-free treatment of traded goods. On the other hand, if the rule of origin is too complex, the administrative burden of meeting the rule increases, adding to the cost of complying, thus limiting the ability for traders to avail themselves of the full benefits of the agreement. Higher levels of complexity also raise the risk that management must absorb to ensure that the product is in full compliance with the rules of origin. Like striking the right balance on the restrictiveness of the automotive rule of origin (noted above), a balance between administrative burden and economic benefit also needs to be established.

As such, the ITAC-2 automotive industry representatives understand the need to modernize and revise the rules. Although, overall, we view the negotiated automotive rules of origin as workable and manageable, we look forward to ongoing engagement as the Administration continues to refine this part of the agreement. The new rule prevents “free riders,” but presents challenges to industry, particularly, the RVC increases, which raise the level of difficulty to meet the automotive rules of origin requirements. These changes also add a higher level of complexity and administrative burden³ on industry, as well as a higher level of risk that management faces to ensure compliance.

Indeed, the ITAC-2 industry representatives are concerned with implementation of how many elements of the new rules would operate and impact trade and business decisions. Simultaneously, we do commend the negotiators for maintaining some helpful tools (such as averaging, and tariff shift), and, in some cases, adopting new requirements in a manner that minimizes administrative burdens, which is largely the result of the U.S. negotiators’ consultations with industry.

A good example of a new, but manageable, requirement is that automakers source 70% of their steel and aluminum from North America (see more details below). This condition is limited to

³ During the first five years, the administrative burden of meeting the rule is higher given the need to build new tracking and administrative systems but would be lower after the first five-year period.

the annual purchases of the motor vehicle manufacturers. Since this is a completely new requirement, it is, by definition, more difficult to meet and represents a higher level of administrative burden than the current NAFTA rule of origin. But, of the possible options available, this requirement is accomplished in a straightforward and minimally administratively burdensome manner.

Specific Auto Rule of Origin Provisions:

Passenger Car and Light-Truck RVC: An RVC requirement of 75% for passenger vehicles, not including diesel vehicles,⁴ is 12.5 percentage points higher than the original NAFTA. Although the differences in methodology makes a direct comparison difficult, the new higher RVC level will be more difficult to meet. This is illustrated by the fact that many vehicle models built in the NAFTA region that meet the current NAFTA automotive rules of origin will require significant changes to their supply chains to meet the new rule.

While this RVC level is workable, there is concern that some other automotive manufacturers may be driven to forgo the burden and cost of meeting the new automotive rules of origin, and simply pay the 2.5% U.S. MFN tariff rate on passenger vehicles. This, combined with Mexico's large number of free trade agreements, may induce and drive more investment in auto production in Mexico to serve the U.S. market (paying the 2.5% tariff) and exporting duty-free to many of the global markets with whom Mexico has free trade agreements.

Automotive Parts RVC: All three of the new categories of automotive parts (core parts at 75%, principal parts at 70%, and complementary parts at 65%) are more difficult to meet than the current NAFTA. Particularly the requirements for core and principal parts are significantly more complex and burdensome than the original NAFTA rules. At the same time, the industry representatives of ITAC-2 appreciate the inclusion of RVC tools that were maintained for principle and complementary parts (e.g. averaging and tariff shift) as a way to mitigate and temper some of the challenges faced. It is important to remember that this applies to all parts manufacturers, whether it is original equipment for new vehicles or as aftermarket parts for vehicle maintenance and repair. The revised RVC for automotive parts is a completely new paradigm and will require parts manufacturers to create new systems – adding administrative burdens – and adapt for compliance under a very short transition time.

Advanced Batteries: We appreciate the negotiators' recognition of the special challenges faced in meeting the core parts' rule of origin for advanced batteries and providing some additional flexibility in the in the phase-in and including the option to use a change in tariff classification to meet the requirement. One specific area of concern is scope of vehicles covered particularly with regards to transition assistance for PHEV light-trucks. The ITAC-2 recommends adding PHEV light-trucks to the scope of vehicles covered.

⁴ The initial NAFTA automotive rules of origin apply to passenger vehicles powered by diesel engines (compression-ignition engine).

Passenger Vehicle and Auto Parts Methodology: The new passenger vehicle and auto parts (core, principal and complementary) rules of origin applies the Net Cost/Roll-up methodology. This is significantly different from the original NAFTA rule that utilizes Net Cost with a “tracing list” and “deemed originating.” The welcomed removal of the “tracing list” makes complying somewhat easier, while the removal of most aspects of “deemed originating” makes it more difficult to meet.

The ITAC-2 was pleased to see the retention of a tariff shift option, which is an important methodology element for automotive parts manufacturers. But, again, there will be added administrative burdens to establish new compliance systems. Although there are positive and negative trade-offs, overall, the ITAC-2 industry representatives believe that, the new methodology represents a similar level of difficulty to meet, but with a higher level of administrative burden.

Steel and Aluminum: The condition that, on an annual basis, 70% of a vehicle producers’ steel and aluminum originates in North America, is a new requirement for meeting the automotive rule of origin. As such, this new condition is, by definition, more difficult to meet and more burdensome, however, as indicated above, we appreciate the negotiators applying this requirement in a minimally burdensome manner. We note that the details, such as whether the 70% steel and aluminum requirement is determined by weight or value is not yet defined.

Labor Value Content: The Agreement introduces a new automotive requirement into the automotive rule of origin, known as Labor Value Content (LVC), requiring a combination of high-wage (defined as US\$16 or more per hour) material or manufacturing costs (25% for passenger cars and 30% for light trucks), and high-wage technology or assembly expenditures (15% for both).

The requirement that: Passenger vehicles meet at least a 40% LVC (25% material/manufacturing cost + 15% technology/assembly), and; Light trucks meet a 45% LVC (35% material/manufacturing cost + 15% technology/assembly); adds a higher-level of difficulty to meet the new rule of origin, and a significant level of complexity, administrative burden, management risk and unintended consequences by burdening suppliers with compiling and passing that information on to the automakers. While ITAC 2 appreciates the objective of having a provision on LVC, we recommend that this requirement be streamlined to avoid the high cost of compliance, perhaps in a manner similar to the steel aluminum content requirements.

Transitions: The automotive rule of origin’s four stage phase-in (new rate on entry into force and a three-year linear transition) for most of the RVC increases and the new LVC is insufficient. Although importers may make a claim for preferential tariff treatment for passenger vehicles under an alternative staging regime—limited to 10% of each producer’s total North American passenger vehicle production (based on previous production patterns), but only for the first five years—the phase-ins are too aggressive. The ITAC-2 industry representatives, therefore, respectfully suggest an extension of the transition periods, while retaining the alternative staging regime.

Heavy-Duty Trucks: ITAC-2 industry representatives appreciate the less stringent requirements and longer phase-in periods that are applied to heavy-duty trucks under

the Agreement. The lower net-cost based auto RVC – 60% (upon entry into force of the agreement) over a seven-year transition, increased to 70% over a seven-year period – is reasonable and workable. Additionally, the core and principal parts 60% RVC requirement under the net cost methodology (compared to passenger cars and light trucks) is also welcomed. Complementary parts retain the same treatment under the original NAFTA. However, heavy duty trucks must, like cars and light trucks, also eventually meet the aforementioned new steel and aluminum conditions and the LVC provisions in order to enjoy duty-free treatment.

a. Automotive Rules of Origin without Canada

The automotive rules of origin were crafted with the understanding that Canadian content from North America (i.e., three parties – U.S., Mexico and Canada) would be included in meeting the North American RVC thresholds. The ITAC-2 has a strong preference that Canada be included in this new agreement. Due to the high-level of integration of the U.S. and Canadian automotive sectors, if Canadian content is not included in the agreement, the RVC required for passenger vehicles, light trucks, and automotive parts would preclude many North American built vehicle models and automotive parts from enjoying duty-free treatment.

In this situation, the ITAC-2 would not be able to support the agreement without either including Canada in the agreement, agreeing to allow the cumulation of Canadian content, or making a significant modification of the automotive rules of origin to account for the absence of Canada as a party to the agreement.

5. Rule of Origin for Capital Goods (Non-Automotive)

Capital Goods not covered by the automotive or heavy-duty rules of origin will continue to follow the initial NAFTA rules of origin, including the use of the “tracing list.” The ITAC-2 members are concerned that the list of “core components” and “principal parts” subject to more stringent content requirements under the automotive rules of origin are the same parts and components used by a number of sectors outside the intended scope of passenger vehicle and light trucks. These changes will have a significant impact on manufacturers of capital goods. For example, certain capital goods may also incorporate an engine, water pump, windshield or transmission classified under the same HTS code as those used in a passenger vehicle or light truck.

To ensure these rules of origin changes are focused on their intended sector, the ITAC-2 recommends that the new rule apply only to those core components and principal parts that are destined for an end use in passenger vehicles and light trucks. This can be achieved by allowing importers and exporters to self-certify end-use without the provision of a certificate or other documentation for each shipment. Importers and exporters could, however, be required to provide information that may be requested, and in such form, as is deemed necessary by the U.S. Customs and Border Protection to certify or further substantiate other end use.

Furthermore, the ITAC-2 members recommend that that ongoing modifications to NAFTA will allow for simplification of tracing procedures, up to and including its elimination. This will greatly reduce administrative burdens.

6. Product Specific Rules for “Steel-Intensive Products” (Non-Automotive Chapter 4)

Iron and steel structures and parts thereof: Recognizing the Parties’ interest in supporting the North American steel industry, it is unclear to the ITAC-2 members what practical achievements are intended with this rule change - given that the current U.S. MFN applied tariff rate is zero.

Electrical Transformers and Cores: Reiterating our recognition of the Parties’ interest in supporting steel manufacturing, the ITAC-2 members acknowledge the changes to the rule for this product area in the context of the five-year transition period specified.

7. Rules of Origin Procedures (Chapter 5)

Under the new rules of origin procedures, it appears that the Agreement aims to ease the burden on importers through the replacement of “shall” with “may”. This change, in concert with the elimination of a separate certificate of origin document and expressly permitting submission in electronic format only, has the potential to reduce significantly the administrative burden on importers. The expansion in Article 10 of options available to the Parties to conduct verification activities also strengthens the system.

8. Customs and Trade Facilitation (Chapter 7)

The Committee welcomes the myriad commitments in the Customs and Trade Facilitation Chapter, which breaks much new ground and converts many “endeavors” included in the current NAFTA and other trade agreements to “shalls”. Of significant interest to the Committee are provisions that improve transparency and predictability – such as online publication and advance rulings – and will enable Mexico to improve facilitation while also limiting, and hopefully eliminating corruption opportunities in this area. In the latter case, key provisions include the presumption of immediate release of goods upon arrival and the allowance for importers to complete their entry documents without mandatory involvement of a customs broker.

The ITAC-2 members believe this Chapter also sets a high standard for communication between the Parties’ customs authorities and “the trade,” translating to our North American partners the informed compliance and co-creation approach taken by the U.S. Customs and Border Protection with regard to facilitation of lawful trade in goods.

9. Energy and Energy Performance Standards (EPS) (Chapter 8)

The agreements of the Parties to “cooperate on Energy & Energy Performance Standards (EPS) and related test procedures to “facilitate trade among the Parties and advance energy efficiency, including cooperation using existing bilateral and trilateral fora” is an important achievement. The agreement to endeavor to harmonize existing EPS among the Parties, assuming support from industry and other private sector stakeholders in each Party, should result in, not only a common North American market for many energy-using products, but also consideration and adoption of the harmonized EPS standards by the Parties’ other free trade agreement partners in the Hemisphere. The ITAC-2 members also appreciate the recommendation that the Parties consider industry standards developed by accredited standards development organizations.

10. Technical Barriers to Trade (Chapter 11)

This Chapter breaks new ground and sets a high standard for this and future U.S. free trade agreements by going beyond the commitments negotiated in the Trans-Pacific Partnership. It provides greater support to the WTO definition of what is considered an international standard,

provides national treatment for conformity assessment bodies located in North America, and prohibits the Parties from refusing to accept conformity assessment results from an accredited body in another Party. These commitments, as well as others contained in the Chapter, should help reduce U.S. exporters' testing and certification costs, while increasing the prospects for development and use of harmonized technical standards among the Parties.

11. U.S.-Mexico Bilateral Side Letter on Automotive Safety Standards (Sectoral Annex Chapter 12)

The ITAC-2 strongly commends the ground-breaking side letter under Chapter 12 that commits Mexico to continue to allow the acceptance of U.S. FMVSS standards in Mexico and that it is enforceable under the agreement's dispute settlement provisions. This is a first for a U.S. free trade agreement (the EU has been including this kind of a commitment for decades), and it represents a very important precedent. While this approach works well for Mexico, a stronger and more assertive approach would be necessary with countries that use other approaches (i.e., countries that have their own regulatory approaches, use the EU approach, or have FTAs with the EU committing them to accept EU auto standards).

12. Intellectual Property (Chapter 20)

The ITAC-2 industry representatives especially welcome the following provisions:

- Trade secrets: It is a major achievement to include not only a commitment to “ensure that persons have the legal means to prevent trade secrets lawfully in their control from being disclosed to, acquired by, or used by others (including state-owned enterprises) without their consent in a manner contrary to honest commercial practices”, but also availability of civil and criminal courses of legal action in this regard;
- Protection of industrial designs: the inclusion in the agreement of protection of industrial designs;
- Treatment of digital goods: The equal treatment of digital and physical goods; and.
- Border enforcement: Strong border enforcement procedures and collaboration authorities, including ex officio authorities for regulators to act.

13. Small and Medium-Sized Enterprises (Chapter 25)

The ITAC-2 supports this Chapter, which contains commitments that, if implemented, should support the growth and development of small and medium-sized enterprises by enhancing their ability to participate in and benefit from the opportunities created by the broader agreement.

14. Good Regulatory Practices (Chapter 28)

The ITAC-2 industry representatives strongly support this Chapter, which is a model for future trade agreements.

15. Publication and Administration (Chapter 29)

Regarding Section B – Energy Regulatory Measures, the ITAC-2 recognizes the value of the new commitments for cross-border energy cooperation.

16. Macro-economic and Exchange Rate Matters Currency (Chapter 33)

The manipulation of currency values by U.S. trading partners has had a very serious deleterious impact on the competitiveness of the U.S. automotive manufacturing industry. This plays out in three ways. First, it makes U.S. goods more expensive in the country that has manipulated its currency (i.e., making it weaker than the market would otherwise determine). Second, it makes the manipulator's export product less expensive in the U.S. market. And, third, it makes the product exported by the manipulator to third markets more price competitive.

The automotive auto manufacturer and auto worker representatives on the ITAC-2 have been seeking strong and enforceable commitments from trade partners in all new or updated U.S. free trade agreements, under which these trade partners would agree not to engage in currency manipulation. These representatives are encouraged with the President's long held view (before and after he was elected) that some countries had kept their currencies artificially lower vis-à-vis the U.S. dollar to gain a competitive trade advantage. The auto manufacturer and auto worker representatives on ITAC-2 are pleased to see that this administration plans to put that commitment into action.

With regard to Chapter 33, the auto manufacturer and auto worker s representatives applaud the inclusion in the body of this agreement a provision that addresses this harmful distortion of trade, and they are encouraged that it is actionable (albeit on a significantly limited basis) under the agreement's dispute settlement provisions). The inclusion of this chapter is groundbreaking and very much appreciated.

However, the representatives of auto manufacturer and auto worker representatives on ITAC-2 are disappointed that many of the commitments in this section are restated language from agreements already made under the International Monetary Fund and that the actionable provisions of the agreement are very limited – e.g., only with respect to transparency and reporting. This disappointment is somewhat mitigated by the fact that this agreement is with trade partners that do not have a history of manipulating their currencies and are unlikely to do so in the future.

These representatives are hopeful that this type of strengthened currency manipulation provision will be included in all future U.S. free trade agreements. For any future U.S. free trade agreements with trade partners that have had a history of manipulating the foreign exchange rate markets to gain an unfair trade advantage, we would recommend strengthening the currency manipulation provisions and, in particular, broadening the scope of the provision well beyond limiting actions for lack of transparency and reporting.

The auto manufacturer and auto worker representatives also recognize the role that transparency plays, combined with the willingness of the U.S. to use its influence to highlight other finance ministries and central banks that engage in bad behavior. This has been effective in the past to keep some countries from directly intervening in the foreign exchange rate markets, however, as noted above, narrowly limiting this to reporting and transparency is insufficient, especially with regards to countries that have a history of intervening in foreign exchange rate markets.

The omission of a commitment to coordinate action in opposition to currency manipulation by parties outside of the agreement was unexpected. The representatives of the auto manufacturers and auto workers on the ITAC-2 respectfully request that such a commitment be added.

17. Provisions Governing Stability and Predictability (Chapters 14 and 34)

In addition to expanding market access, free trade agreements are a tool for ensuring stability and predictability in a trade and investment relationship. The ITAC-2 members are concerned that certain elements of the NAFTA 2.0 proposal may damage the stability and predictability provided through mechanisms in the original NAFTA agreement, including the erosion of investor-state dispute settlement, the elimination of AD/CVD reviews, and the introduction of a periodic performance review and termination provision.

a. Investor State Dispute Settlement (Chapter 14)

The ITAC-2 industry representatives appreciate the retention of critical investment protections, specifically those related to physical expropriation and violations of MFN treatment for foreign investors. However, the renegotiated NAFTA agreement does not maintain some investor protections in other respects. It also creates a lack of reciprocal protection for U.S. investors in Mexico compared to Mexican investors in the United States.

While Mexican investors in the U.S. will have access to protections through the Administrative Procedures Act, and the Due Process and Takings Clause of the U.S. Constitution, U.S. investors in Mexico will no longer have the same protections, including the “fair and equitable treatment” and “full protection and security” in the current NAFTA agreement. This may jeopardize the ability of individual investors to seek redress for possible discriminatory, arbitrary, and unfair actions pursued by the Mexican government. The ability to seek redress for indirect expropriation without compensation – such as through regulatory overreach, nationalization of operations, or restrictions on the investor’s ability to operate their business would largely be eliminated.

The elimination of protections against forced localization and technology transfer, and the ability to seek redress for limitations on the transfer of capital are also concerning for some industry representatives of ITAC-2. The original NAFTA included protections in these areas that are no longer available and may leave U.S. investors in Mexico vulnerable to measures that impair business operations and profitability.

Furthermore, the elimination of investment protections on a *pre-establishment* basis will allow Mexico to prevent new U.S. investments that are critical to expand U.S. sales in that country.

b. AD/CVD Review

The Agreement eliminates existing mechanisms to review anti-dumping and countervailing duty decisions made by another party to the agreement. Without these mechanisms in place, American exporters will be forced to use either foreign courts or a WTO process that can be lengthy and potentially unreliable. The ITAC-2 urges that the AD/CVD Review language (found under Chapter 19 of the original NAFTA agreement) be retained in the updated agreement.

c. Performance Review and Termination (Chapter 34)

Under “Term of the Agreement”, the notion is introduced that the Agreement will terminate 16 years from its Entry into Force unless each Party confirms, through its head of government, its wishes to extend the life of the Agreement for a new 16-year term. A business decision to serve customers, develop and strengthen supplier relationships, produce quality products and services, or deliver shareholder value are not tied to a 16-year-cycle. Rather, these business decisions should be based on market conditions that are underpinned by legal stability and predictability.

Whereas the original NAFTA and the United States’ other trade agreements provide for stability in the trading and investing environment, the new text around performance reviews and termination stands to inject a significant source of instability and uncertainty into business decision-making, which will negatively impact all stakeholders that engage with a North American business. The ITAC-2 industry representatives strongly recommend the reconsideration and removal of this termination provision from the Agreement.

VI. Conclusion

Since much has changed in the U.S. automotive and capital goods sectors since 1994, the ITAC-2 fully recognizes the need to update the parts of current NAFTA agreement related to these sectors. The volume of automotive and capital goods trade, estimated to be about 30% of all NAFTA goods trade, illustrates the deep and far-reaching regional integration of these important manufacturing sectors, and therefore the need to be cautious in making modifications to the current NAFTA in order to avoid unintended negative consequences.

The ITAC-2 members sincerely appreciate the efforts of the negotiators to work closely with the affected parties and stakeholders. As detailed above, the ITAC-2 is pleased with many changes made, including to sections of Chapters 2, 5, 7, 8, 11, 12, 20, 25, 28 and 29. However, we have concluded that several areas of the draft agreement could be improved in a manner that would not take away from the overall objectives of the agreement, and in the long-run, we believe would further boost economic growth, capital investment and job creation in the United States:

- Canada’s Inclusion in Agreement: Members of the ITAC-2 would not be able to support the agreement without significant modification to account for the absence of Canada. Rules of origin for automotive goods is an important example.
- Sec. 232 Steel and Aluminum tariffs: Industry representatives of ITAC-2 strongly recommend that Canada and Mexico be exempted from these import tariffs, without further conditions, like quotas.
- Automotive Side letters (Autos 232 and MFN tariffs): The ITAC-2 industry representatives strongly recommend that as part of the Agreement, that Canada and Mexico are exempted, without condition, from the imposition of any potential Autos 232 tariffs, and any potential unilateral raising of the U.S. Most Favored Nation (MFN) tariff rate for passenger vehicles and light trucks.
- Rules of Origin for Automotive Goods: The ITAC-2 automotive industry representatives view the final automotive rules of origin as workable and manageable, and we look forward to ongoing engagement as we continue to refine this part of the agreement.

- Rules of Origin for Capital Goods (Non-Automotive): Industry representatives of ITAC-2 recommend the new rule apply only to those core components and principal parts that are destined for an end use in passenger vehicles and light trucks. Additionally, ITAC-2 industry representatives recommend that NAFTA eliminate or simplify the “tracing list” procedures on the parts/components used by the non-automotive capital goods industry.
- Macro-economic and Exchange Rate Matters “Currency Manipulation”: The ITAC-2 automakers and automotive worker representatives respectfully request that a commitment to coordinate action in opposition to currency manipulation by non-NAFTA parties be added.
- Need for Stability and Predictability: The ITAC-2 industry representatives urge reconsideration of the eroded investor-state dispute settlement (ISDS) and the elimination of anti-dumping and countervailing duty (AD/CVD) reviews found in the original NAFTA.
- Performance Review and Termination: Industry representatives of ITAC-2 strongly encourage the U.S. negotiators to reconsider and remove this termination provision from the agreement and replace it with a clear commitment by the Parties to regularly review and modernize the agreement.

On June 28, 2017, ITAC-2 agreed with the Administration’s goals “to support higher paying jobs in the United States and to grow the U.S. economy by improving U.S. opportunities under NAFTA” and provided a set of three unanimous “basic principles” it recommended the Administration adhere to in its efforts to modernize and improve the operation of NAFTA. They were:

- “Create a model for future trade deals with other countries such as that the negotiated outcomes of each chapter should aim to advance stronger disciplines and outcomes that will enhance manufacturing success.
- “Avoid harming U.S. manufacturing success by adding unnecessary costs and red tape”; and,
- Negotiate an agreement including “the three North American countries”.

Also, as noted above, under Section 135 (e) of the Trade Act of 1974, as amended, the report of the Advisory Committees must include:

- An advisory opinion as to whether and to what extent the agreement promotes the economic interests of the United States
- Achieves the applicable overall and principal negotiating objectives set forth in the Bipartisan Congressional Trade Priorities and Accountability Act of 2015.
- Whether the agreement provides for equity and reciprocity within the sectoral or functional area.

The ITAC -2 believes it is premature to assess whether the agreement “promotes the economic interests of the United States,” and whether the agreement “provides for equity and reciprocity within the sectoral or functional area” until all the relevant details that are currently unavailable become accessible for review, including whether or not Canada joins the agreement makes it necessary to reserve judgment on this matter.

While the agreement attempts to achieve the applicable overall and principal negotiating objectives set forth in the Bipartisan Congressional Trade Priorities and Accountability Act of 2015, ITAC-2 industry representatives believe that, the Agreement, in its current form, falls short in several of the areas highlighted and discussed above.

ITAC-2 industry representatives also note that with regards to meeting the three basic principles ITAC-2 set forth for these talks (see above), the results are mixed. For some Chapters a good model for future U.S. trade agreements and stronger disciplines were established. However, the agreement fell short of meeting those principles in select Chapters (discussed above). With regards to meeting the principle of avoiding unnecessary costs and red tape, as noted above, there are Chapters where we believe this principle has also not been fully met. And, finally, at this point in time, with the status of Canada's inclusion in the agreement unknown, the third principle of having an agreement that includes all three of the North American countries is uncertain.

The ITAC-2 and all its members sincerely appreciates the opportunity to share our views and recommendations. As noted in the introduction, several aspects of the Agreement are still not complete, and therefore these comments are made subject to the opportunity to review a final draft agreement text and following a decision on whether Canada is included in the new agreement. We look forward to reviewing a more complete agreement text in the near future and working with the Administration to the Agreement.

Also see Attachment 1 for Additional Views

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VII. Membership of Committee

CHAIRMAN

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Vice President, International Policy
American Automotive Policy Council

Mr. Patrick T. Ameen
Vice President, Industry Relations
Amsted Rail Company, Inc.

Mr. Thomas M. Egan
Vice President, Industry Services
PMMI

Mr. Patrick W. McGibbon
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AMT - The Association for Manufacturing
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Mr. G. Mustafa Mohatarem, Ph.D.
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General Motors Corporation

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Affairs
Specialty Equipment Market Association

Ms. Lauren E. Wilk
Vice President, Policy and International Trade
The Aluminum Association

Additional Views of ITAC-2 United Auto Workers

NAFTA has been a bad agreement for working people. Millions of workers across economic sectors regard NAFTA as a failure because the agreement favors global employers over workers, weakening worker bargaining power, and encouraging de-industrialization of our economy. This is why we welcome renegotiation of NAFTA.

Manufacturing workers in all three countries have been left behind and have not adequately shared in NAFTA's economic gains. Since NAFTA's entry into force in 1993, the trade deficit with Mexico has skyrocketed. In 1993, the U.S. had an automotive trade deficit with Mexico of \$3.5 billion. By 2016, that trade deficit had grown to \$45.1 billion. In auto parts the U.S. trade deficit with Mexico over the same period grew from \$1 billion to \$23.8 billion—an increase of more than 2,300 percent.

During this same period, as the trade deficit in these sectors mushroomed, wages declined. Adjusted for inflation, auto parts production workers' average hourly wages declined by 23 percent in the last decade. Employment alone, between 2000 and 2014, among U.S. parts suppliers declined by 36 percent. While other factors certainly played a role in these trends – including technology changes and attacks on workers' rights—NAFTA was a major contributing factor.

Between 1994 and 2016, light vehicle final assembly facilities in the U.S. dropped by 10 percent and in Canada by 4 percent. Over that same period, Mexico added 8 vehicle assembly facilities. The U.S. share of NAFTA production over the period dropped from 77 percent to 67 percent while Mexico's share more than doubled from 8 percent to 19 percent.

Again, the outsourcing of production in these sectors to Mexico has resulted from a number of factors. Notably, repressive labor policies in Mexico, most particularly “protection” unions and contracts. Workers are generally kept from organizing in a meaningful way, suppressing wages and working conditions. At present time, it is unclear if NAFTA will lead to transforming labor standards in Mexico.

NAFTA 2018 includes provisions that will at least require a periodic review. NAFTA 2018 also significantly reduces (but does not eliminate) the investor-to-state dispute settlement mechanism, which privileges foreign investors over citizens in terms of access to justice while also promoting outsourcing. These are steps in the right direction.

In our view, the automotive rules of origin will make it harder for “free riders” who are not party to the agreement from benefiting and incentivize North American investments. The automotive rules of origin also include new concepts that link wages to commercial benefits. A change that is long overdue. It is unclear what long-term impact it will have. UAW agrees with fellow ITAC members that it is premature to make a final determination on the renegotiation of NAFTA at this time.

Thank you for considering our views.

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